

DIAMEDICA INC.

MANAGEMENT'S DISCUSSION & ANALYSIS

FOR THE SIX MONTHS ENDED

JUNE 30, 2013 and 2012

The following management's discussion and analysis ("MD&A") is prepared as of August 26, 2013 for DiaMedica Inc. (the "Company" or "DiaMedica") for the six months ended June 30, 2013 and 2012, and should be read in conjunction with the unaudited condensed consolidated interim financial statements for the six months ended June 30, 2013 and the audited consolidated financial statements and accompanying notes for the year ended December 31, 2012 and 2011, which have been prepared by management in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). The Company's IFRS accounting policies are set out in note 3 of the consolidated financial statements for the year ended December 31, 2012. This MD&A should also be read in conjunction with the Company's Annual Information Form dated February 20, 2013. Additional information regarding the Company is available on SEDAR at http://www.sedar.com and on the Company's website at http://www.diamedica.com.

FORWARD-LOOKING STATEMENTS

All statements, other than statements of historical facts, included in this MD&A regarding the Company's strategy, future operations, financial position, future revenues, projected costs, prospects, plans and objectives of management are forward-looking statements. The words "believe", "anticipate", "estimate", "plan", "expect", "intend", "may", "project", "will", "would" and similar expressions and the negative of such expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. We cannot guarantee that we actually will achieve the plans, intentions or expectations disclosed in our forward-looking statements and you should not place undue reliance on our forward-looking statements.

The Company's statements of "belief" in respect of its drug candidates are based primarily upon results derived to date from its pre-clinical and clinical research and development and the Company's research and development program. The Company also uses the term "demonstrated" in this MD&A to describe certain findings that it makes arising from its research and development including any pre-clinical and clinical studies that the Company has conducted to date.

The Company believes that it has a reasonable scientific basis upon which it has made such statements of "belief" or arrived at such findings. It is not possible, however, to predict, based upon *in vitro* and/or animal studies, whether a new therapeutic agent or a second-generation compound will be proved to be safe and/or effective in humans and no conclusions should be drawn in that regard from what the Company states has been demonstrated by DiaMedica to date. The Company cannot assure the reader that the particular results expected by DiaMedica will occur.

There are a number of important factors that could cause the Company's actual results to differ materially from those indicated or implied by forward-looking statements or statements of "belief", including the factors discussed under "Risk Factors" and in other sections of this MD&A. These factors and the other cautionary statements made in this MD&A should be read as being applicable to all related forward-looking statements and statements of "belief" wherever they appear in this MD&A.

Any forward-looking statements and statements of "belief" represent the Company's estimates only as of the date of this MD&A and should not be relied upon as representing the Company's estimates as of any

subsequent date. Except as required by law, the Company does not assume any obligation to update any forward-looking statements or statements of "belief". The Company disclaims any intention or obligation to update or revise any forward-looking statements or statements of "belief", whether as a result of new information, future events or otherwise except as otherwise required by law. The forward-looking statements contained in this MD&A include, but are not limited to, statements regarding our:

- Intention to commercialize our products for the treatment of diabetes and potential additional indications;
- Intention to develop any of our drugs either on our own or in partnership with others;
- Intention to carry out trials on our products for the treatment of diabetes and potential additional indications, and intention to publish the results thereof;
- Intention to obtain regulatory approval for our products;
- Expectations with respect to the cost of the testing and commercialization of our products;
- Sales and marketing strategy;
- Expectations regarding any future financings;
- Anticipated sources of revenue;
- Ability to obtain the substantial capital required to fund research and operations;
- Intentions regarding the protection of our intellectual property;
- Business strategy; and
- Intention with respect to dividends.

Such forward-looking statements involve known and unknown risks and uncertainties, including those referred to in this MD&A or in any document incorporated by reference herein, which may cause the Company's actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. These risks include, but are not limited to:

- Our ability to successfully initiate or complete clinical studies on a timely basis;
- Our ability to obtain, on satisfactory terms or at all, the capital required for product development, operations and marketing;
- Our ability to attract patients to our clinical trials;
- General economic, business and market conditions;
- Product development delays and other uncertainties related to new product development;
- Our ability to attract and retain business partners and key personnel;
- Our inability to profitably commercialize our products;
- Operating losses and the extent of any future losses;
- Our ability to operate as a going concern;
- Our inability to establish or manage manufacturing, development or marketing collaborations;
- Delay of, or failure to obtain, necessary regulatory approvals and, ultimately, product launches;
- Dependence on third parties for successful commercialization of our products;
- Inability to obtain quantities of development product in sufficient quantity or at standards acceptable to complete studies;
- The risk of the termination or conversion to non-exclusive licenses or our inability to enforce our rights

under our licenses;

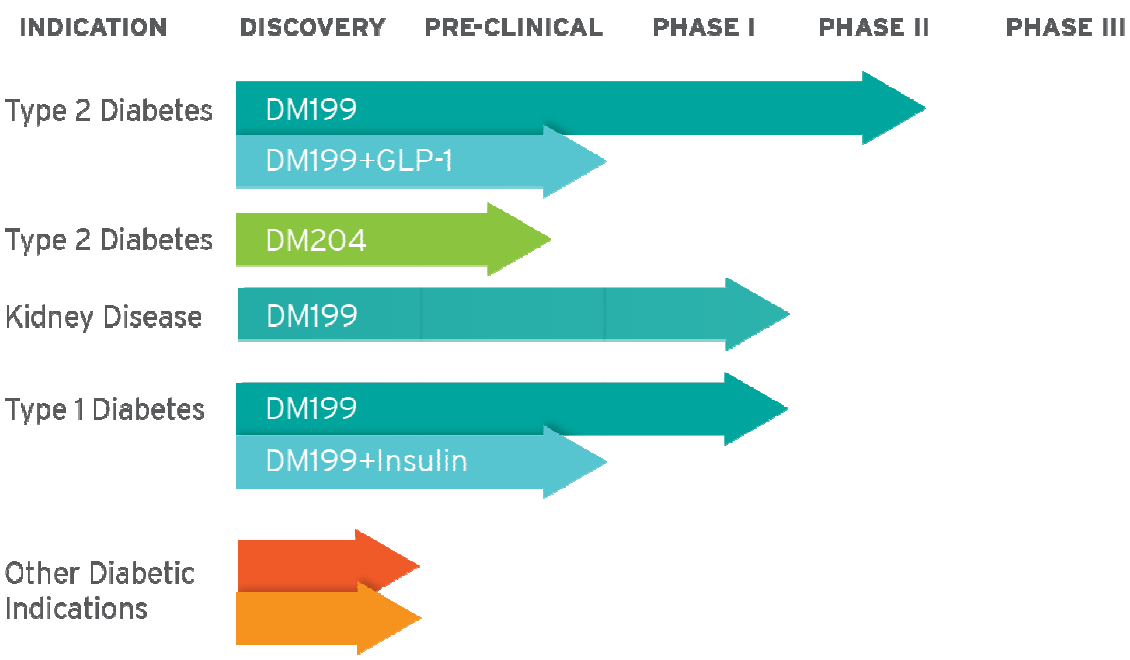
- Our ability to obtain patent protection and protect our intellectual property rights;
- Commercialization limitations imposed by intellectual property rights owned or controlled by third parties;
- Uncertainty related to intellectual property liability rights and liability claims asserted against us;
- Uncertainty of recovery of advances to subsidiaries;
- Impact of competitive products and pricing;
- Future levels of government funding; and
- Other factors discussed under “Risk Factors”.

The Company cautions you that the foregoing list of important factors and assumptions is not exhaustive. Events or circumstances could cause our actual results to differ materially from those estimated or projected and expressed in, or implied by, these forward-looking statements. You should also carefully consider the matters discussed under “Risk Factors” in this MD&A. Additional risk factors are described in our current annual information form. We undertake no obligation to update publicly or otherwise revise any forward-looking statements or the foregoing list of factors, whether as a result of new information or future events or otherwise, except as required by securities legislation.

OVERVIEW

DiaMedica is a clinical stage biotechnology company developing first-in-class treatments for the treatment of diabetes. DiaMedica's lead compound, DM199, is a recombinant human protein for the treatment of both Type 1 and Type 2 diabetes and their complications. DiaMedica has completed the acute escalating dosing of healthy volunteers in its Phase I/II clinical trial for DM199. The clinical trial is designed to evaluate the safety, tolerability, pharmacokinetics and efficacy of DM199 in healthy volunteers and in Type 2 diabetic patients. Data from this trial will support future DM199 clinical trial regulatory filings for Type 2 diabetes and potentially Type 1 diabetes and kidney disease. The Company is also developing a monoclonal antibody, DM204, for the treatment of Type 2 diabetes and cardiovascular disease. The Company plans to continue to generate additional preclinical data for both DM199 and DM204 in other indications in which these novel molecules have been shown to, or are expected to, demonstrate pharmacologic activity.

PRODUCT PIPELINE



During 2012 and 2013 and up to the date of this MD&A, the Company announced the following:

RECENT PROGRAM DEVELOPMENTS

DM199 Program

On August 20, 2013, DiaMedica announced that the final Type 2 diabetic patient has been enrolled in the single ascending dose ("SAD") portion of the DM199 Phase I/II clinical study. The randomized, placebo-controlled, double-blinded study is evaluating three dose levels in each Type 2 diabetic patient. The top line results from this study are expected in Q3 2013. The primary objective of the SAD portion of the ongoing Phase I/II clinical study is to evaluate acute safety, tolerability and pharmacokinetic properties for the first time in Type 2 diabetic patients, as well as the effect of DM199 on improving glucose control.

On June 24, 2013, DiaMedica provided an update on the ongoing clinical trial program for DM199. The Company successfully completed acute escalating dosing of DM199 at multiple levels in healthy volunteers and is now advancing the program to evaluate the acute effects of escalating doses of DM199 in patients with Type 2 diabetes. Preliminary results from the first part of the study in 18 healthy volunteers show that DM199 was well tolerated and demonstrated a favorable pharmacokinetic profile, supporting potential once weekly dosing. The randomized, placebo-controlled, double-blinded study has now enrolled Type 2 diabetic patients evaluating three well-tolerated dose levels based upon data from the first portion in healthy volunteers. This second portion of the study will evaluate acute safety, tolerability and pharmacokinetic properties for the first time in Type 2 diabetic patients, as well as the effect of DM199 on improving glucose control.

On June 20, 2013, The Sanford Project & DiaMedica announced that their abstract titled "Human Tissue

Kallikrein (DM199 Compound) Induces Diabetes-Protective Immunomodulation in non-obese diabetic ("NOD") Mouse Type 1 diabetes ("T1D") Model," was selected for a Late Breaking Poster Presentation at the American Diabetes Association's ("ADA") 73rd Scientific Sessions, held on June 21-25 in Chicago, Illinois. The poster presentation described DM199's mechanism of action in modulating immunological parameters associated with developing diabetes when administered to NOD mice.

On May 1, 2013 DiaMedica Inc. announced the commencement of its Phase I/II trial with first in human dosing of DM199. The study is designed to evaluate the safety, tolerability, pharmacokinetics and efficacy of DM199 in 36 healthy volunteers and in 40 Type 2 diabetic patients.

On April 8, 2013 the Company announced it had received regulatory approval to commence an anticipated 76 subject Phase I/II clinical trial for DM199. The clinical trial, to be conducted in the Netherlands, is designed to evaluate the safety, tolerability, pharmacokinetics and efficacy of DM199 in 36 healthy volunteers and in 40 Type 2 diabetes ("T2D") patients. Data from this trial will also support future DM199 clinical trial regulatory filings for Type 1 and 2 diabetes and in other potential indications. The Phase I stage, a randomized, controlled trial to evaluate the safety, tolerability and pharmacokinetics of DM199 in healthy volunteers, consists of both single ascending dose arms, and in multiple ascending dose for 14 days arms to assess the maximum tolerable dose. In addition in the Phase 1 stage, T2D patients will initially be assessed for acute safety and efficacy in single ascending dose study via a meal tolerance test. A Phase 2 Proof of Concept 28-day dosing double-blinded placebo-controlled will be conducted as the forth part of this study to assess the efficacy and safety of longer term DM199 use. Efficacy endpoints will include measuring HbA1c, post-meal blood glucose, average blood glucose and glucose regulatory peptides levels over the 28-day study period.

On January 29, 2013, the Company announced that it had successfully completed cGMP manufacturing of DM199 to be utilized in upcoming clinical trials. Additionally, the Company has successfully completed GLP toxicology studies in non-human primates and rat models, and has demonstrated DM199 to be safe and well-tolerated in repeated high dose administrations. The large-scale proprietary cGMP manufacturing process resulted in a high yield batch of DM199 to be used in upcoming clinical trials. The GLP preclinical toxicology studies demonstrate DM199 is safe and well tolerated at doses expected to cover the human therapeutic dose range over 28-days of repeat-dose study. The daily administration of DM199 was safe and well tolerated with no serious adverse events or any other tissue toxicity. Furthermore, DM199 showed no negative cardiovascular treatment-related effects, including heart rate or ECG intervals, which are important safety attributes for any Type 2 diabetes therapy.

In December 2012, the Company reported that treatment with DM199 in a three-week study of ZDF rats demonstrated expected improvement in glucose control. In addition, there was a positive control of blood pressure. Specifically, a low dose of DM199 therapy lead to a 1.6% improvement in HbA1c, and a 20 mm/Hg improved systolic blood pressure compared to untreated animal (controlled blood pressure). Ideally, next generation Type 2 diabetes therapeutics will provide glucose control plus additional benefits to control Type 2 diabetes complications and co-morbidities, termed "glucose-plus". DiaMedica believes DM199 potentially offers one of the most comprehensive "glucose-plus" profiles of any of the products currently on the market or in development. Animal studies to date show superior glucose control and a positive profile for blood pressure and heart rate.

In October 2012, DiaMedica reported that DM199 has demonstrated a statistically significant effect in

lowering daily insulin needs when co-administered with basal long-acting insulin (Lantus®) in a pre-clinical diabetes study. The study confirmed DM199 alone lowers fasting glucose values (p=0.000003) in a diabetic model. During an oral glucose tolerance test, DM199 co-administered with basal long-acting insulin significantly reduced the spike in glucose levels immediately and well after a meal to near normal levels (p=0.00002), as measured by area under the curve glucose, with no evidence of hypoglycemia. The results from this study suggest DM199 co-administered with basal long-acting insulin may reduce the need for short-acting insulin around meals while improving glucose control in diabetic patients.

In April 2012, DiaMedica successfully completed the manufacturing of a Master Cell Bank ("MCB"), under current Good Manufacturing Practice ("cGMP") regulations, required for larger scale manufacturing of clinical grade DM199.

In Q1 2012, DiaMedica submitted its pre-Investigational New Drug ("pre-IND") application with the U.S. Food and Drug Administration ("FDA") in preparation for an upcoming clinical trial with DM199. The Company has also recently filed additional patents on DM199 composition of matter and its uses and developed a proprietary, high-yield manufacturing process for the recombinant protein.

In December 2011, Dr. Alexi Savinov of The Sanford Project presented a poster based on its late-breaking abstract, detailing results of pre-clinical studies of DM199 for the treatment of Type 1 diabetes on behalf of DiaMedica.

On December 5, 2011 DiaMedica announced further compelling positive Type 1 diabetes data using DM199 therapy. An in vivo study with the chronic administration of DM199 significantly delayed the autoimmune attack, preserved beta cell mass and demonstrated a 12-fold increase in circulating C-peptide levels in the NOD animal model. Additionally, the increase in C-peptide levels correlated with preserved beta cell mass, reduced insulitis (inflammation of islets) and increased regulatory T cell populations, which is believed to suppress the autoimmune response associated with type 1 diabetes. Furthermore, insulin-producing beta cells in the pancreas were still functional as good glucose control was observed. Treatment with DM199 was well tolerated throughout the study (18 weeks). DM199 treatment increased expression of indoleamine 2,3-dioxygenase ("IDO") mRNA in a dose-dependent manner in both total splenocytes and purified CD11c+ splenic dendritic cells. IDO is an enzyme with potent tolerogenic properties due to its ability to metabolize and consume all the local tryptophan, leaving the autoreactive T cells starving of this most limiting and essential amino acid. Induction of IDO expression has been shown to block local T cell proliferation, and ultimately result in abrogation of diabetogenic autoimmunity (Ueno et al. 2007. Diabetes; (56): 1686-1693). Thus, it is believed that induction of IDO expression is one possible mechanism of anti-diabetic immunomodulatory action of DM199.

DM204 Program

DM204 is a novel monoclonal antibody ("mAb") for the treatment of Type 2 diabetes and other diseases. DiaMedica is initially focused on the treatment of diabetes and some of the associated major complications including blood pressure and cholesterol.

In June 2012, the Company was selected for a Late Breaking Poster Presentation at the American Diabetes Association's 72nd Scientific Sessions in Philadelphia, PA. The poster was presented covering results of pre-clinical studies of DM204 for the treatment of Type 2 diabetes. The poster presentation outlined the performance of DM204 chronically administered in a pre-clinical in vivo model of Type 2 diabetes. Treatment with DM204 resulted in superior glucose control (e.g. decreased HbA1c and lower fasting blood glucose levels) over the length of the three-week study compared to approved anti-diabetic drugs included as controls. In addition, DM204 treated animals demonstrated statistically significant positive effects on blood pressure, cholesterol, and heart rate when compared to control.

On December 19, 2011, the Company announced the successful humanization of its monoclonal antibody ("mAb"), DM204, for Type 2 diabetes and diabetic related complications of hypertension (high blood pressure) and cholesterol. The humanized DM204 mAb demonstrated improved binding affinity of up to two orders of magnitude compared to the recently announced first-generation parental murine (mouse) antibody. The increased binding affinity demonstrated by DM204 has resulted in a significant improvement in glucose utilization over the first-generation antibody as measured by an *in vivo* Type 2 diabetes oral glucose tolerance test ("OGTT").

On December 1, 2011, the Company released results of head-to-head pre-clinical studies against two marketed Type 2 diabetes drugs. In pre-clinical *in vivo* animal studies, DM204 significantly ameliorated diabetes and associated complications compared to control:

- Glucose control - 2.6% improvement in HbA1c (measure of blood glucose levels)
- High blood pressure - 25 mm/Hg improvement
- High cholesterol - 24% improvement

Administration of DM204 was well tolerated and significantly outperformed marketed Type 2 diabetes drugs sitagliptin (Januvia®) and exenatide (Byetta®) in the study.

The Company presented DM204 Type 2 diabetes pre-clinical data at the IDF 21st biennial World Diabetes Congress in Dubai, United Arab Emirates on December 5, 2011.

The Company anticipates commencing cGMP manufacturing of DM204 in preparation for future clinical trials subject to funding.

CORPORATE DEVELOPMENTS

On March 22, 2013, the Company announced the completion of a short form prospectus offering under which it issued a total of 5,111,175 units at a price of $0.90 per unit for aggregate gross proceeds of approximately $4.6 million. Each unit was comprised of one common share in the capital stock of the Company and one half of one common share purchase warrant with each whole warrant entitling the holder thereof to acquire an additional common share until March 22, 2016 at a price of $1.10 per share. Please see "Liquidity and Capital Resources" in this MD&A for further details.

On February 22, 2013 the Company announced the resignation of David Allan from the board of directors.

On January 9, 2013, DiaMedica announced that Mark Robbins, Ph.D., J.D., joined as Vice President, Clinical and Regulatory Affairs to oversee DiaMedica's clinical programs. Dr. Robbins has over 30 years of experience in biopharmaceutical drug development with broad therapeutic experience in endocrine/metabolic, cardiology, neurology, dermatology, and oncology. Dr. Robbins has developed and successfully implemented regulatory/clinical strategies leading to 11 successful NDA/BLA approvals.

In November 2012, DiaMedica established its U.S. headquarters by opening an office in Minneapolis, Minnesota through its wholly owned subsidiary DiaMedica USA Inc. in order to take advantage of, among other things, the strong life sciences community and talented workforce in Minneapolis.

On September 11, 2012, the Company announced that it has received gross proceeds of $1,706,325 pursuant to the completion of the early exercise warrant incentive program as previously announced on August 3, 2012, and the full exercise of associated outstanding broker warrants. The early exercise program resulted in the exercise of 878,800 July 2011 warrants at $1.50 per share for $1,318,200, representing 88% of the outstanding July 2011 warrants, and 100% of the 310,500 July 2011 broker warrants for $388,125.

On September 11, 2012, the Company announced that it received gross proceeds of $1,318,200 from the exercise of 878,800 $1.50 warrants and an additional $388,125 from the exercise of 310,500 $1.25 broker warrants.

On August 28, 2012 the Company announced that it has retained Cooley LLP ("Cooley") and Bill Christiansen, Ph.D., a Partner in the Cooley Patent Counseling & Prosecution practice group as its primary legal counsel for intellectual property and legal advisor for partnering. Cooley is working closely with DiaMedica to expand the Company's patent portfolio, including recent freedom to operate and patentability analysis. They will also provide corporate representation to DiaMedica with regards to the company's ongoing partnership discussions.

On August 3, 2012 the Company announced that in accordance with the terms of the warrant indenture for the $1.50 warrants issued on July 22, 2011, the Company will provide the required written notice to holders of such warrants that the expiry date has been accelerated to the close of business September 7, 2012. Under the terms of the warrant indenture, if the 10-day volume weighted average trading price of the common shares of DiaMedica on the TSX Venture Exchange exceeds $2.00, then the expiry date of the warrant may be accelerated. Any warrants not exercised prior to the accelerated expiry date and time will expire without any further action being taken.

On May 8, 2012, the Company reported that it had received gross proceeds of $3,166,800 pursuant to the early exercise warrant incentive program (as defined below).

In April 2012, the Company received conditional approval from the TSX Venture Exchange for an incentive program (the "Early Warrant Exercise Incentive Program") to encourage the early exercise of the 3,105,000 warrants, with an exercise price of $1.50 per common share, that were previously issued in connection with DiaMedica's short form prospectus offering on July 22nd, 2011 (the "Original Warrants"). Any proceeds received as a result of the Incentive Program will be used for substantially the same purposes as set out in the final short form prospectus of DiaMedica dated July 7, 2011.

In February 2012, DiaMedica was named as one of the TSX Venture Top 50 ® companies for 2012, an annual ranking of Canada's emerging publicly traded companies. TSX Venture 50 companies were

chosen, with equal weighting assigned to each of the following criteria: share price appreciation, trading volume, market capitalization growth and analyst coverage.

On October 27, 2011, the Company announced the appointment of Dr. Paul Burn to DiaMedica's Scientific Advisory Board. Dr. Burn currently serves as the Broin Chair and Director for The Sanford Project, an emerging translational research center focused on identifying and delivering a cure for Type 1 diabetes. He also holds an appointment as Professor of Pediatrics at the Sanford School of Medicine of The University of South Dakota. Dr. Burn is a highly regarded key opinion leader having previously served in senior positions at the Juvenile Diabetes Research Foundation, Bayer Health Care, Eli Lilly, Monsanto/Pharmacia, and at Hoffman-La Roche. Dr. Burn's business expertise includes establishing and leading alliances with strategic partners, licensing of compounds and facilitating over 50 clinical trials.

In October 2011, the Company's products under development for the treatment of diabetes, DM199 and DM204, were selected by Windhover Information as one of the 2011 Top 10 Most Interesting Cardiovascular/Metabolic Projects to Watch for strategic partnerships. An independent committee assembled by Windhover Information, a division of Elsevier Business Intelligence, was responsible for selecting both programs into the Top 10 Most Interesting Cardiovascular/Metabolic Projects to Watch.

Also in October 2011, the Company received the 2011 Emerging Company of the Year Award from the Life Science Association of Manitoba. The Emerging Life Science Company of the Year award celebrates a company based in Manitoba that is recognized for their growth potential and will have distinguished themselves from their peers with demonstrated technology innovation and achievement of milestones.

On August 3, 2011, the Company announced the appointment of John M. Amatruda, M.D. to the Company's Scientific Advisory Board. Dr. Amatruda is a world leader in diabetes drug development and was the former Senior Vice President and Franchise Head for Diabetes and Obesity at Merck Research Laboratories where he lead the development and regulatory approvals of Januvia™ and Janumet™ – the first compounds in the DPP-IV inhibitor class for Type 2 diabetes.

On July 22, 2011, the Company completed a prospectus offering of 3,105,000 units at a price of $1.25 per unit, for aggregate gross proceeds to the Company of $3,881,250. See Liquidity and Capital Resources below for more information.

On September 22, 2011 at the annual general meeting, the shareholders approved a shareholder rights plan. The plan is designed to provide adequate time for the board of directors and the shareholders to assess an unsolicited takeover bid for DiaMedica. The additional time allows the board of directors the opportunity to explore and develop alternatives for maximizing shareholder value if a takeover bid is made, and to provide shareholders with an equal opportunity to participate in a takeover bid and receive full and fair value for their common shares. The Company did not adopt the plan in response to any specific proposal to acquire control of the Company, nor was it aware of any such effort. The plan will expire at the close of the Company's annual meeting of shareholders in 2014. The shareholders also approved amendments to the Company's stock option plan and approved a deferred share unit plan.

Diabetes and Insulin Market

Diabetes Overview

Diabetes is a disease in which the body does not produce or properly use insulin. Insulin is a hormone released from beta cells located in islets of the pancreas that is needed to help control blood sugar levels, and determines which energy source (carbohydrates or fats) are used to fuel daily life. There are primarily two forms of diabetes; Type 1 diabetes and Type 2 diabetes.

Type 1 diabetes develops when the body's own immune system destroys beta cells, which are the only cells in the body that produce insulin, a hormone that regulates the body's blood sugar. To survive, people with Type 1 diabetes must have insulin delivered by injection or pump in order to lower their blood glucose levels. Type 1 diabetes accounts for 5-10% of all diagnosed cases of diabetes.

Type 2 diabetes begins as insulin resistance, a disorder in which the body's cells do not respond to insulin properly. As the need for insulin increases, the pancreas can become exhausted and gradually loses its ability to produce insulin. Current treatments for Type 2 diabetes include lifestyle changes, anti-diabetic medications, and insulin therapy.

The International Diabetes Foundation estimates that the number of people with diabetes in 2012 reached a staggering 371 million globally, 4.8 million deaths a year are due to diabetes and health care spending on diabetes reached 471 billion USD. In 2010, the United Health Group estimated more than half of Americans will have diabetes or pre-diabetes over the next 10 years, costing the US healthcare system $3.35 trillion. In a 2011 fact sheet issued by the U.S. Center for Disease Control ("CDC"), it was reported that 8.3% of the total US population currently has Type 2 diabetes, and over 25% of those aged 65 and over have the disease.

In 2009, the global annual sales of insulin and anti-diabetic medications were approximately $25 billion (Visiongain, 2009) and forecasted to reach $55 billion by 2016 (Report Linker, 2011).

The poor control of blood glucose levels leads to diabetes and has been shown to result in severe long-term complications. According to the U.S. CDC, complications associated with diabetes include:

- Heart disease and stroke;
- High blood pressure;
- Blindness due to retinopathy, a condition manifested by damage to the retina;
- Nephropathy (kidney disease);
- Neuropathy, a condition where there is damage to the nervous system;
- Amputations due to peripheral vascular disease; and
- Periodontal disease.

Products in Development

DM199

DiaMedica's lead product, DM199, is a recombinant human tissue kallikrein protein., DM199 increased whole body glucose utilization in animals using a hyperinsulemic euglycemic clamp model. Having completed cGMP manufacturing and IND-enabling toxicology studies for DM199 in early Q1-2013, the Company initiated a Phase I/Phase II clinical trial in Q2-2013 to evaluate the safety, tolerability, pharmacokinetics and efficacy of DM199 in 36 healthy volunteers and in 40 patients with Type 2 diabetes.

Type 2 Diabetes

Type 2 diabetes is primarily a result of insulin resistance, in which the body's cells do not respond properly to insulin to promote glucose uptake from the blood. As a result, Type 2 diabetics struggle with glucose control and hyperglycemia as measured by Hb1Ac (an indicator of how well blood glucose levels have been controlled over several months). The ability of DM199 to restore and improve blood glucose control may improve a patient's quality of life by decreasing glucose fluctuations resulting in reduced risk of long-term complications of diabetes.

DM199 was shown to improve whole body glucose uptake in a hyperinsulinemic euglycemic clamp model, the gold-standard method for characterizing the body's response to insulin. Animals treated with a single dose of DM199 had a 160% increase in maximal glucose infusion rate. This enabled animals to process 77% more total glucose compared to untreated animals. Additionally, treatment with DM199 in a three-week study of ZDF rats demonstrated expected improvement in glucose control. In addition, there was a positive control of blood pressure. Specifically, a low dose of DM199 therapy lead to a 1.6% improvement in HbA1c, and a 20 mm/Hg improved mean systolic blood pressure compared to untreated animals.

DM199 is currently being studied in a Phase I/II clinical trial being conducted in the Netherlands. The DM199 Phase I/Phase II clinical trial in diabetes began in Q2-2013. The clinical trial is designed to evaluate the safety, tolerability, pharmacokinetics and efficacy of DM199 in 36 healthy volunteers and in 40 T2D patients. Data from this trial will also support future DM199 clinical trial regulatory filings for Type 1 and 2 diabetes and in other potential indications. The Phase I stage, a randomized, double-blinded, placebo-controlled trial to evaluate the safety, tolerability and pharmacokinetics of DM199 in healthy volunteers, consists of both single ascending dose arms, and in multiple ascending dose for 16 days arms to assess the maximum tolerable dose. In addition in the Phase 1 stage, T2D patients will initially be assessed for acute safety and efficacy in single ascending dose study via a meal tolerance test. A Phase 2, 28-day dosing double-blinded placebo-controlled to assess the efficacy and safety of longer term DM199 use will be conducted as the forth part of this study. Efficacy endpoints will include measuring HbA1c, post-meal blood glucose, average blood glucose and glucose regulatory peptides levels over the 28-day study period.

Type 1 Diabetes

DiaMedica believes that its DM199 program represents a novel approach in the treatment of Type 1 diabetes potentially targeting major aspects of the disease via: improved glucose control and immune therapy. DM199's disease targeting therapy may therefore reduce the amount of exogenous insulin needed to control blood glucose and the long-term disease associated complications of Type 1 diabetes.

Glucose control: restoring and improving blood glucose control will improve a patient's quality of life by decreasing glucose fluctuation levels throughout the day resulting in reduced risk of long-term complications of diabetes:

Results - DM199 has demonstrated a statistically significant effect in lowering daily insulin needs when co-administered with basal long-acting insulin (Lantus®) in a pre-clinical diabetes study. The study confirmed DM199 alone lowers fasting glucose values (p=0.000003) in a diabetic model. During an oral glucose tolerance test, DM199 co-administered with basal long-acting insulin significantly reduced the spike in glucose levels immediately and well after a meal to near normal levels (p=0.00002), as measured by area under the curve glucose, with no evidence of hypoglycemia. The results from this study suggest DM199 co-administered with basal long-acting insulin may reduce the need for short-acting insulin around meals while improving glucose control in diabetic patients.

Immune therapy: to stop and/or slow the immune system response that attacks the insulin producing beta cells that causes diabetes. This attack needs to be a halted so that beta cell therapy can produce new insulin-producing beta cells:

Results – DiaMedica and the Sanford Project (a non-profit research group whose research goal is to cure Type 1 diabetes) announced the successful completion of a study involving DM199 treatment in preventing the onset of Type 1 diabetes in the non-obese diabetic ("NOD") mouse model. DM199 administration to NOD mice appeared to prevent the autoimmune attack and thereby the destruction of insulin-producing beta cells in the pancreas which causes Type 1 diabetes. DM199 showed a significant dose-dependent and dose-frequency-dependent delay in the onset of Type 1 diabetes over the 18-week course of treatment (beginning at 6 weeks of age) leading to a 12x increase in C-peptide (a primary clinical endpoint) to 5-6 nM. Treatment with DM199 also resulted in increased regulatory T cell ("Tregs") levels that appeared to correlate with delay in Type 1 diabetes. DM199 treatment induced expression of IDO mRNA in a dose-dependent manner in both total splenocytes and purified CD11c+ splenic Dendritic Cells. IDO is an enzyme with potent immunodulatory properties due to its ability to metabolize and consume all the local tryptophan, leaving the autoreactive T cells starving of this most limiting and essential amino acid.

DiaMedica is considering a plan to move forward with the clinical development of DM199 for Type 1 Diabetes with current clinical development remains focused on the Type 2 Diabetes market.

DM204

DM204 is a unique antibody targeted to the human receptor cell line. The Company is continuing to optimize the antibody selection and further define the pharmacological properties of DM204.

Type 2 Diabetes

The Company's DM204 program is initially focused on Type 2 diabetes. DiaMedica believes that a monoclonal antibody with potent dual capabilities to reduce blood glucose and improve blood pressure control offers an attractive drug candidate for drug development. In a 3-week pre-clinical ZDF diabetic rat study, DM204 has significantly ameliorated diabetes and associated complications over control including a 2.6% 2.6% improvement in glucose control as measured by HbA1c, a 25 mm/Hg improvement in blood pressure and a 24% improvement in total cholesterol.

Administration of DM204 was well tolerated over 3-weeks and significantly outperformed marketed Type 2 diabetes drugs sitagliptin (Januvia®) and exenatide (Byetta®) in the study.

In another pre-clinical study, DM204's activity was measured using a hyperinsulinemic euglycemic clamp model. Rats treated with a single dose of DM204 demonstrated a 291% increase in maximal glucose infusion rate ($p<0.0035$). This significant increase in glucose disposal was associated with a 160% overall average increase ($p<0.0066$) in the glucose infusion rate compared to control in order to maintain euglycemia. DM204 also showed positive results in two other Type 2 diabetes models.

Hypertension

In a pre-clinical study, DM204 significantly reduced the systolic blood pressure in treated animals by an average of 15 mm Hg ($p<0.05$) over the duration of the study. High blood pressure (hypertension) is the primary risk associated with Type 2 diabetes, with 70% of Type 2 diabetics at increased risk of stroke and cardiovascular disease as a result of having high blood pressure.

DiaMedica believes that a monoclonal antibody with potent dual capabilities to normalize blood glucose and blood pressure could replace currently used combination therapies of diabetic and anti-hypertensive drugs resulting in the potential for DM204 to fundamentally change the current treatment regimen for Type 2 diabetics.

Other indications

DiaMedica is primarily focused on developing its two lead programs, DM199 and DM204, for the treatment of diabetes and associated disease complications in the near term.

OUTLOOK

In 2013, DiaMedica will continue to advance the development of its DM199 and DM204 programs. The Company is planning to complete a Phase I/Phase II clinical trial in healthy volunteers and in patients with Type 2 diabetes with DM199 and perform additional development studies to expand the potential diabetes-related indications for the drug. Subject to available resources, the Company anticipates entering a Phase 2 clinical trial in 2014 for kidney disease and it will continue its research and development efforts on DM204 by identifying a humanized clone for development and moving into development of a stable cell line for the DM204 program in 2014, followed by completing its preclinical development, and initiating cGMP manufacturing of the antibody in preparation for future clinical trials.

DiaMedica intends to expand the diseases targeted for both DM199, while its primary focus remains on the development of DM199 and DM204 in the near-term. The Company may decide to accelerate, terminate or reduce its focus in certain research areas, or commence research in new areas as a result of the Company's research progress and the availability of financial resources. These decisions are made with the goals of managing the Company's cash resources and optimizing the Company's opportunities. Management is not at present aware of any factors that would change its strategy over the next year.

DiaMedica plans to advance discussions with potential partners for its programs in 2013 while continuing to move the development programs forward. As the Company advances its development programs, DiaMedica expects to continue incurring operating losses.

Competition

Current treatment for Type 1 diabetes today is almost exclusively limited to insulin therapy to treat the symptoms of the disease, not the underlying cause or long-term complications. Global sales of insulin, the only Food and Drug Administration ("FDA") approved treatment for Type 1 diabetes, have grown by over 400% in the last 10 years and are expected to reach $15 billion in revenue in 2011 (IMS Health, 2010). Insulin treatment is not a cure and people with Type 1 diabetes generally have their life expectancy reduced by up to 15 years. The abnormal high blood glucose levels wreak havoc on the body over time resulting in long-term medical problems such as nephropathy, retinopathy, neuropathy, and cardiovascular diseases.

There are several classes of drugs that are currently approved by the FDA to treat Type 2 diabetes. The current standard of care includes treatment such as Metformin, thiazolidinediones ("TZDs"), Glucagon-like-peptide ("GLP-1") agonists and dipeptidyl peptidase-4 ("DPP4") inhibitors, often in combination. These treatments either improve the body's sensitivity to insulin or increase insulin secretion from beta cells to help lower blood glucose. In addition, it appears that a large portion of the Type 2 diabetes population (approximately 2/3) eventually fail to control their diabetes with these drugs (as determined by Hb1Ac > 7%). Hb1Ac is an indicator of how well blood glucose levels have been controlled over several months. Furthermore, patients with Type 2 diabetes can progress to a point where they are no longer able to produce insulin thus requiring insulin injections to lower blood sugar, similar to treatment for Type 1 diabetes. As such, there is an ongoing need to develop new, safe drug treatments to complement or even replace those currently available. Long-term complications from Type 2 diabetes, after years of uncontrolled blood glucose (hyperglycemia), include nephropathy (kidney damage), retinopathy (eye

damage), neuropathy (nerve damage), cardiovascular disease and dementia.

See the Competition section under “risks related to our business and our industry” for further information.

TREND INFORMATION

Historical patterns of expenditures cannot be taken as an indication of future expenditures. The amount and timing of expenditures and therefore liquidity and capital resources vary substantially from period to period depending on the timing of manufacturing, and the initiation and completion of pre-clinical and clinical studies being undertaken at any one time and the availability of funding from investors and prospective commercial partners.

Other than as discussed above, the Company is not aware of any material trends related to the Company’s business of product development, patents and licensing.

RISKS AND UNCERTAINTY

The Company operates in a highly competitive environment that involves significant risks and uncertainties, some of which are outside of the Company's control. The Company is subject to risks inherent in the biotechnology industry, including:

Risks Related to our Business and our Industry

Uncertainties Related to Clinical Trials and Product Development

Before obtaining regulatory clearance for the commercial sale of any of our products under development, we must demonstrate through pre-clinical studies and clinical trials that the potential product is safe and efficacious for use in humans for each target indication. The results from pre-clinical studies and early clinical trials may not be predictive of results that will be obtained in large clinical trials, and there can be no assurance that our clinical trials will demonstrate sufficient safety and efficacy necessary to obtain the requisite regulatory approvals or will result in marketable products. A number of companies in the pharmaceutical industry, including biotechnology companies, have suffered significant setbacks in advanced clinical trials, even after promising results in earlier trials. The failure to adequately demonstrate the safety and efficacy of a product under development could delay or prevent regulatory clearance of the potential product and would have a material adverse effect on our success. Any drug is likely to produce some toxicity or undesirable side effects in animals and in humans when administered at sufficiently high doses and/or for sufficiently long periods of time. There can be no assurance that unacceptable toxicity or side effects will not occur at any dose level at any time in the course of human clinical trials of our potential products. The appearance of any such unacceptable toxicity or side effects in clinical trials could cause us or regulatory authorities to interrupt, limit, delay or abort the development of any of our product candidates and could ultimately prevent their clearance by the therapeutic products directorate the FDA or other regulatory authorities, for any or all targeted indications. Even after being cleared by the Therapeutic Products Directorate (“TPD”) in Canada, the FDA or other regulatory authorities, a product

may later be shown to be unsafe or not to have its purported effect, thereby preventing its widespread use or requiring withdrawal from the market. There can be no assurance that any of our products or product candidates will be safe when administered to patients.

The rate of completion of our clinical trials will be dependent upon, among other factors, the rate of patient enrolment. Patient enrolment is a function of many factors, including the size of the patient population, the nature of the protocol, the proximity of parties to clinical sites and the eligibility criteria for the study. Delays in planned patient enrolment may result in increased costs, delays or termination of clinical trials, which could have a material adverse effect on our success.

In addition, our staff has limited clinical experience and, as a result, will rely on third parties to assist us in overseeing and monitoring the clinical trials, which may result in delays in completing clinical trials, or the trials not being completed at all, if such third parties fail to perform under their agreements with us or fail to meet regulatory standards in the performance of their obligations under such agreements. There can be no assurance that we will be able to submit a new drug application as scheduled if clinical trials are completed or that any such applications will be reviewed and cleared by the TPD or FDA in a timely manner or at all.

Risks Related to Regulatory Matters

Potential investors should be aware of the risks, problems, delays, expenses and difficulties which we may encounter in light of the extensive regulatory environment within which our business is carried out. Numerous statutes and regulations govern the manufacture and sale of non-therapeutic and human therapeutic products in Canada, the United States and other countries that are the intended markets for our products and product candidates. Such legislation and regulation governs the approval of manufacturing facilities, the testing procedures and controlled research that must be carried out and the pre-clinical and clinical data that must be collected prior to marketing approval. Our research and development efforts, as well as any future clinical trials, and the manufacturing and marketing of any products we may develop, will be subject to and restricted by such extensive regulation.

The process of obtaining necessary regulatory approvals is lengthy, expensive and uncertain. We or our collaborators may fail to obtain the necessary approvals to commence or continue clinical testing or to manufacture or market our potential products in reasonable time frames, if at all. In addition, governmental authorities in Canada, the United States, or other countries may enact regulatory reforms or restrictions on the development of new therapies that could adversely affect the regulatory environment in which we operate or the development of any products we may develop.

Completing clinical testing and obtaining required approvals is expected to take several years and to require the expenditure of substantial resources. There can be no assurance that clinical trials will be completed successfully within any specified period of time, if at all. Furthermore, clinical trials may be delayed or suspended at any time by us or by the TPD or FDA if it is determined at any time that the subjects or patients are being exposed to unacceptable risks.

Any failure or delay in obtaining regulatory approvals would adversely affect our ability to utilize our technology and would therefore adversely affect our operations. Furthermore, no assurance can be given

that our product candidates will prove to be safe and effective in clinical trials or that they will receive the requisite regulatory approval. Moreover, any regulatory approval of a drug which is eventually obtained may be granted with specific limitations on the indicated uses for which that drug may be marketed. Furthermore, product approvals may be withdrawn if problems occur following initial marketing or if compliance with regulatory standards is not maintained. Similar restrictions are imposed in markets other than Canada and the United States.

In addition, we rely to some extent on the availability of certain agents that are currently marketed by other firms. Such agents may become unavailable as a result of failing to meet regulatory requirements.

Additional Financing Requirements and Access to Capital

We require significant additional funds for further research and development, planned clinical trials, and the regulatory approval process. We may raise additional funds for the aforementioned purposes through public or private equity or debt financing which may be dilutive, or through collaborations with other biotechnology companies, or financing from other sources may be undertaken. It is possible that financing will not be available or, if available, may not be on favourable terms. The availability of financing will be affected by the results of scientific and clinical research, the ability to attain regulatory approvals, market acceptance of the Company's products, the state of the capital markets generally with particular reference to pharmaceutical, biotechnology and medical companies, the status of strategic alliance agreements, and other relevant commercial considerations – see Liquidity and Capital Resources section below. If adequate funding is not available, we may be required to delay, reduce, or eliminate one or more of our product development programs or obtain funds through corporate partners or others who may require us to relinquish significant rights to product candidates or obtain funds on less favourable terms than we would otherwise accept.

Rapid Technological Change

The industry in which we operate is characterized by rapid and substantial technological change. There can be no assurance that developments by others will not render our products or technologies non-competitive or that we will be able to keep pace with technological developments. Our competitors may have developed or may be developing technologies which could become the basis for competitive products. Some of these products may prove to be more effective and less costly than our products.

Partnerships for Development and Commercialization of Technology

We may need, but be unable, to obtain partners to support our development efforts and to commercialize our technology. Equity and/or debt financings alone may not be sufficient to fund the cost of developing our products, and we may need to rely on our ability to reach partnering arrangements to provide financial support for our discovery and development efforts.

In addition, in order to successfully develop and commercialize our technology, we may need to enter into a wide variety of arrangements with corporate sponsors, pharmaceutical companies, universities, research groups and others. While we have had previous research contracts, we may enter into additional arrangements with other contract research organizations. We may fail to obtain any such agreements on

terms acceptable to us or at all. Even if we enter into these arrangements, we may not be able to satisfy our obligations under them or renew or replace them after their original terms expire. Furthermore, arrangements of this nature may require us to grant certain rights to third parties, including exclusive marketing rights to one or more products, may require us to issue securities to our collaborators or may contain other terms that are burdensome to us. If any of our collaborators terminates its relationship with us or fails to perform its obligations in a timely manner, the development or commercialization of our technology and potential products may be adversely affected.

Uncertainties Related to Forecasts

Our expectations regarding the success of our product candidates and our business are based on forecasts which may include the commencement and completion of clinical trials and anticipated regulatory approval which may not be realized. The actual timing of these events can vary dramatically due to factors such as delays or failures in our clinical trials, the uncertainties inherent in the regulatory approval process and delays in achieving manufacturing capacity and marketing infrastructure sufficient to commercialize our biopharmaceutical products. There can be no assurance that clinical trials involving our products will be successfully completed, that we will make regulatory submissions or receive regulatory approvals as forecasted or that we will be able to adhere to our current schedule. The failure to do so could have a material adverse effect on us.

Competition

Technological competition is intense in the industry in which we operate, and in particular in the market for therapeutic products to treat and diagnose Type 1 and Type 2 diabetes. Competition comes from pharmaceutical companies, biotechnology companies and universities as well as companies that participate in each of the non-pharmaceuticals markets we may attempt to address with our products. Many of our competitors have substantially greater financial and technical resources, more extensive research and development capabilities and greater marketing, distribution, production and human resources than we do. Moreover, competitors may develop products more quickly than us and may obtain regulatory approval for such products more rapidly than we do. Products and processes which are more effective than those that we intend to develop may be developed by our competitors. Research and development by others may render our technology products or processes non-competitive or obsolete.

Competitive products on the market and/or in development include the following:

- Sulfonylureas;
- Metformin;
- Insulins (injectable and inhaled versions);
- TZDs and other PPAR or non-PPAR insulin sensitizers;
- Glinides;
- DPP-IV inhibitors;
- Incretin mimetics/GLP-1 receptor agonists;
- Alpha-glucosidase inhibitors; and
- Sodium-glucose transporter-2 (SGLT-2) inhibitors.

Unproven Market

Notwithstanding the estimated market potential for our products and product candidates, no assurance can be given that our projections and assumptions will prove to be correct owing to, in particular, competition from existing or new products and the yet to be established clinical viability of our identified drug candidates.

Management of Growth

Engagement of a clinical trial and future pipeline development has placed, and is expected to continue to place, a significant strain on our managerial, operational and technical resources. We expect operating expenses and staffing levels to increase in the future. To manage our growth, we must expand our operational and technical capabilities and our employee base while effectively administering multiple relationships with various third parties. There can be no assurance that we will be able to manage our expanding operations effectively. Any failure to implement cohesive management and operating systems, add resources on a cost effective basis or properly manage our expansion could have a material adverse effect on our business and results of operations.

Dependence on Key Personnel

We depend on our management personnel. The loss of services of one or more of such persons could adversely affect our operations. It is necessary for us to continue to implement and improve our management systems and to continue to recruit and train new employees in order to manage our growth effectively. While we have been able to attract and retain skilled and experienced personnel in the past, no assurance can be given that we will be able to do so in the future.

Supply of Raw Materials

The Company has selected manufacturers that it believes comply with Good Manufacturing Practices, or cGMP and other applicable regulatory standards. Although the manufacturers are experienced, no assurance can be given that sufficient quantities for on-going studies and for future clinical trials will be produced, or produced on terms that are acceptable to the Company.

Systems Failures

Despite the implementation of security measures, our internal computer systems are vulnerable to damage from computer viruses, unauthorized access, natural disasters, terrorism, war and telecommunication and electrical failure. Any system failure, accident or security breach that causes interruptions in our operations could result in a material disruption of our drug discovery programs. To the extent that any disruption or security breach results in a loss or damage to our data or applications, or inappropriate disclosure of confidential or proprietary information, we may incur liability as a result, our drug discovery programs may be adversely affected and the further development of our product candidates may be delayed. In addition, we may incur additional costs to remedy the damages caused by these disruptions or security breaches.

Effect of Insurers' Willingness to Pay for Products on Our Ability to Become Profitable

Since health care insurers and other organizations may not pay for any products that we may develop or may impose limits on reimbursements, our ability to become profitable could be reduced. In both domestic and foreign markets, sales of potential products are likely to depend in part upon the availability and amounts of reimbursement from third party health care payor organizations, including government agencies, private health care insurers and other health care payors, such as health maintenance organizations and self-insured employee plans. There is considerable pressure to reduce the cost of therapeutic products, and government and other third party payors are increasingly attempting to contain health care costs by limiting both coverage and the level of reimbursement for new therapeutic products and by refusing, in some cases, to provide any coverage for uses of approved products for disease indications for which marketing approval has not been granted. Significant uncertainty exists as to the reimbursement status of newly approved health care products or novel therapies. We can give no assurance that reimbursement will be provided by such payors at all or without substantial delay or, if such reimbursement is provided, that the approved reimbursement amounts will be sufficient to enable us to sell products we may develop on a profitable basis. Changes in reimbursement policies could also adversely affect the willingness of pharmaceutical companies to collaborate with us on the development of our product candidates. In certain markets, pricing or profitability of prescription pharmaceuticals is subject to government control.

Potential Product Liability

A risk of product liability claims and related negative publicity is inherent in the development of human therapeutics and other products. Product liability insurance is expensive, its availability is limited, and it may not be offered on terms acceptable to us, if at all. The commercialization of our potential products could be inhibited or prevented by an inability to maintain sufficient insurance coverage on reasonable terms or to otherwise protect against potential product liability claims. A product liability claim against us or the withdrawal of a product from the market could have a material adverse effect upon the Company and its financial condition.

Foreign Currency Risk

A portion of our expenditures are in US dollars and, therefore, we are subject to foreign currency fluctuations which may, from time to time, impact our financial position and results of operations.

Risks Related to Intellectual Property

Patents and Proprietary Rights

We believe that patents and other proprietary rights are important to our business. Our policy is to file patent applications to protect technology, inventions and improvements that may be important to the development of our business. We also rely upon trade secrets, know-how, continuing technological innovations and licensing opportunities to develop and maintain our competitive position. We plan to enforce our issued patents and our rights to proprietary information and technology. We review third-party patents and patent applications, both to refine our own patent strategy and to identify useful licensing opportunities.

We have a number of patents, patent applications and rights to patents related to our compounds, products and technology, but we cannot be certain that they will be enforceable or provide adequate protection or that pending patent applications will result in issued patents.

Our success depends, in part, on our ability to secure and protect our intellectual property rights and to operate without infringing on the proprietary rights of others or having third parties circumvent the rights owned or licensed by us. Applications for patents on key technologies, composition of matter and therapeutic uses of DM199 and DM204 have been filed or will be filed in the United States, Europe and other jurisdictions, and have been exclusively assigned to DiaMedica. Such patent applications are being actively pursued and include the use of DM199 for treatment of diabetes, rheumatoid arthritis, and neurological disorders. DiaMedica's DM199 patent applications include composition of matter and use patents, if all issued as patents, will expire between 2022 and 2032. Patent applications for DM204 include composition of matter and use patents. DiaMedica's DM204 patent applications, if issued as patents, will expire in 2031. We have also secured patent rights to issued and pending patents pursuant to a license agreement with Mount Sinai Hospital and a license agreement and intellectual property rights agreement with the University of Manitoba. The Company's DM71 program is covered by these issued and pending patent applications. Once granted, each patent will expire at different times, the first of which expires December 1, 2014, which may undermine our ability to protect our intellectual property rights in DM71.

To the extent that development, manufacturing and testing of our products is performed by third party contractors, such work is performed pursuant to fee for service contracts. Under the contracts, all intellectual property, technology know-how and trade secrets arising under such agreements are the exclusive property of the Company, and must be kept confidential by the contractors. It is not possible for us to be certain that we have obtained from the contractors all necessary rights to such technologies. Disputes may arise as to the scope of the contract, or possible breach of contract. No assurance can be given that our contracts would be enforceable or would be upheld by a court.

The patent positions of pharmaceutical and biotechnology firms, ourselves included, are uncertain and involve complex questions of law and fact for which important legal issues remain unresolved. Therefore, it is not clear whether our pending patent applications will result in the issuance of patents or whether we will develop additional proprietary products which are patentable. Part of our strategy is based on our ability to secure a patent position to protect our technology. There is no assurance that we will be

successful in this approach and failure to secure patent protection may have a material adverse effect upon the Company and its financial condition. Also, we may fail in our attempt to commercialize products using currently patented or licensed technology without having to license additional patents. Moreover, it is not clear whether the patents issued or to be issued will provide us with any competitive advantages or if any such patents will be the target of challenges by third parties, whether the patents of others will interfere with our ability to market our products or whether third parties will circumvent our patents by means of alternate processes. Furthermore, it is possible for others to develop products which have the same effect as our products or technologies on an independent basis or to design around technologies patented by us. Patent applications relating to or affecting our business may have been filed by pharmaceutical or biotechnology companies or academic institutions. DiaMedica has not detected any third party patents that could interfere with its current projects. Such applications may conflict with our technologies or patent applications and such conflict could reduce the scope of patent protection which we could otherwise obtain or even lead to the rejection of our patent applications. There is no assurance that we can enter into licensing arrangements on reasonable commercial terms, or develop or obtain alternative technology in respect of patents issued to third parties that incidentally cover our products or production technologies. Any inability to secure licenses or alternative technology could result in delays in the introduction of some of our products or even lead to us being prevented from pursuing the development, manufacture or sale of certain products. Moreover, we could potentially incur substantial legal costs in defending legal actions which allege patent infringement, or by initiating patent infringement suits against others. It is not possible for us to be certain that we are the creator of inventions covered by pending patent applications or that we were the first to invent or file patent applications for any such inventions. While we have used commercially reasonable efforts to obtain assignments of intellectual property from all individuals who may have created materials on our behalf (including with respect to inventions covered by our patent and pending patent applications), it is not possible for us to be certain that we have obtained all necessary rights to such materials. No assurance can be given that our patents, if issued, would be upheld by a court, or that a competitor’s technology or product would be found to infringe on our patents. Moreover, much of our technology know-how that is not patentable may constitute trade secrets. Therefore, we require our employees, consultants, advisors and collaborators to enter into confidentiality agreements either as stand-alone agreements or as part of their consulting contracts. However, no assurance can be given that such agreements will provide meaningful protection of our trade secrets, know-how or other proprietary information in the event of any unauthorized use or disclosure of confidential information. Also, while we have used commercially reasonable efforts to obtain executed copies of such agreements from all employees, consultants, advisors and collaborators, no assurance can be given that executed copies of all such agreements have been obtained.

Costs Stemming from Defence Against Third-Party Intellectual Property Infringement Claims

Third parties may claim that we are using their proprietary information without authorization. Third parties may also have or obtain patents and may claim that technologies licensed to or used by us infringe their patents. If we are required to defend patent infringement actions brought by third parties, or if we sue to protect our own patent rights or otherwise to protect our proprietary information and to prevent its disclosure, we may be required to pay substantial litigation costs and managerial attention may be diverted from business operations even if the outcome is in our favour. In addition, any legal action that seeks damages or an injunction to stop us from carrying on our commercial activities relating to the affected technologies could subject us to monetary liability and require us or any third party licensors to

obtain a license to continue to use the affected technologies. We cannot predict whether we would prevail in any of these types of actions or that any required license would be available on commercially acceptable terms or at all. Some of our competitors may be able to sustain the costs of complex patent litigation more effectively than we can because they have substantially greater resources.

Risks Related to the Early Stage of our Products and our Company

Stage of Development

The Company has compounds in various stages of development. Prior to commercialization of any potential product, significant additional investments will be necessary to complete the development of any of our products. Pre-clinical and clinical trial work must be completed before some of our other products could be ready for use within the market that we have identified. We may fail to develop any products, to obtain regulatory approvals, to enter clinical trials, or to commercialize any products. Competitors may develop alternative products and methodologies to treat and diagnose Type 1 and Type 2 diabetes and this could reduce our competitive advantages. We do not know whether any of our potential product development efforts will prove to be effective, meet applicable regulatory standards, obtain the requisite regulatory approvals, be capable of being manufactured at a reasonable cost or successfully marketed. The products or processes we are currently developing are not expected to be commercially viable for several years and we may encounter unforeseen difficulties or delays in commercializing our products. In addition, our products may cause undesirable side effects. Results of early pre-clinical research may not be indicative of the results that will be obtained in later stages of pre-clinical or clinical research. If regulatory authorities do not approve our products or if we fail to maintain regulatory compliance, we would have limited ability to commercialize our products, and our business and results of operations would be harmed. If we do succeed in developing products, we will face many potential obstacles such as the need to develop or obtain manufacturing, marketing and distribution capabilities.

Lack of Product Revenues; History of Operating Losses

As at the date of this MD&A, we have not recorded any revenues from the sale of products. We have an accumulated deficit, based on our consolidated financial statements, since our inception through June 30, 2013 of over $36 million. Losses are expected to increase in the near term as we continue our product development efforts, enter clinical trials and seek regulatory approval for the sale of our products. Operating losses are expected to be incurred until such time as product sales and royalty payments are sufficient to generate revenues to fund our continuing operations. We are unable to predict the extent of any future losses or when we will become profitable, if ever. Even if we do achieve profitability, we may not be able to sustain or increase profitability on an ongoing basis.

Risks and Uncertainties of Current Economic Conditions

To date, we have primarily relied on equity financing to fund our working capital requirements and drug development activities. A substantial amount of additional capital is needed to develop our products to a point where they may be commercially sold. The Company’s future operations are dependent upon its ability to generate product sales, negotiate collaboration or license agreements, obtain research grant

funding, defer expenditures, or other strategic alternatives, and/or secure additional funds. While the Company is striving to achieve these plans, there is no assurance these and other strategies will be achieved or that such sources of funds will be available or obtained on favourable terms or obtained at all. The Company's ability to continue as a going concern is dependent on its ability to continue obtaining sufficient funds to conduct its research and development, and to successfully commercialize its products. There is substantial doubt about the appropriateness of the use of the going concern assumption because the Company has experienced operating losses and cash outflows from operations since incorporation, its cash resources are not sufficient for the next 12 months of planned operations, and has not reached successful commercialization of its products. See Liquidity and Capital Resources section below.

Risks Related to the Company's Common Shares

Share Price Volatility

A number of factors could influence the volatility in the trading price of our common shares, including changes in the economy or in the financial markets, industry related developments, and the impact of changes in our operations. Our quarterly losses may vary because of expenses we incur related to future research including the timing of costs for manufacturing and initiating and completing pre-clinical and clinical trials. Each of these factors could lead to increased volatility in the market price of our common shares. In addition, the market prices of the securities of our competitors may also lead to fluctuations in the trading price of our common shares.

Dividends

We have not declared or paid any cash dividends on our common shares to date. The payment of dividends in the future will be dependent on our earnings and financial condition and on such other factors as our board of directors considers appropriate. Unless and until we pay dividends, shareholders may not receive a return on their shares. There is no present intention by our board of directors to pay dividends on our common shares.

Dilution

You may experience future dilution due to additional future equity financing events by the Company. If outstanding options, warrants or deferred share units of the Company are exercised into common shares, you will experience additional dilution.

RESULTS OF OPERATIONS

For the three and six months ended June 30, 2013 and 2012

Since inception, the Company has incurred losses while advancing the research and development of its therapeutic products. Net loss for the three months ended June 30, 2013 was $2,276,394 compared to a loss of $2,595,329 for the three months ended June 30, 2012. The decrease in net loss for the three months ended June 30, 2013 over the comparable period of the prior year was due mainly to lower advisory costs related to patent management, capital markets strategy, investor relations and business development, and lower non-cash expenses for share-based compensation. Net loss for the six months ended June 30, 2013 was $5,049,870 compared to a loss of $4,421,489 for the six months ended June 30, 2012. The increase in net loss for the six months ended June 30, 2013 over the comparable period of the prior year was due mainly to higher DM199 program costs for drug manufacturing and the Phase I/II clinical trial.

Research and Development

Components of research and development expenses for the three months ended June 30 were as follows:

	2013	2012
	$	$
Research and development programs	**946,413**	1,094,003
Salaries, fees and short-term benefits	**388,232**	102,792
Share-based compensation	**88,575**	262,631
Depreciation of property and equipment	**1,170**	768
Amortization of intangible assets	**587,208**	587,208
Government assistance	**(20,638)**	-
Total	**1,990,160**	2,047,402

Components of research and development expenses for the six months ended June 30 were as follows:

	2013	2012
	$	$
Research and development programs	**2,442,229**	1,829,485
Salaries, fees and short-term benefits	**651,067**	292,090
Share-based compensation	**201,985**	430,379
Depreciation of property and equipment	**2,518**	1,454
Amortization of intangible assets	**1,174,416**	1,174,416
Government assistance	**(20,638)**	(16,456)
Total	**4,451,577**	3,711,368

Research and development program expenditures include direct and indirect costs associated with the Company's research and development programs, including personnel costs, manufacturing, pre-clinical and clinical research costs, business development, intellectual property costs, and consulting.

The decrease in research and development expenses for the three months ended June 30, 2013 was due mainly to lower spending on DM199 of $75,796 primarily for the Phase I/II clinical trial in healthy volunteers and in patients with Type 2 diabetes compared to higher costs of pre-clinical studies and manufacturing scale-up in the prior year's comparative period. DM204 costs were higher in the second quarter of 2013 by $54,428 reflecting higher pre-clinical study costs compared to the manufacturing costs incurred in the comparable period. Salary and benefits costs are higher in part reflecting the addition of senior staff to manage clinical and regulatory operations and in part due to the reversal of $80,640 of expenses in the second quarter of 2012 where bonuses were reversed from salaries expense and recorded as share-based compensation expenses on the issue of DSU units. Non-cash expenses for share-based compensation were also lower by $174,056 in the second quarter of 2013 compared to the prior year period.

The increase in research and development expenses for the six months ended June 30, 2013 was due mainly to higher research spending on DM199 of $785,874 primarily for the Phase I/II clinical trial compared to lower costs of pre-clinical studies and manufacturing scale-up in the prior year's comparative period. DM204 costs were lower in the first half 2013 by $45,860 reflecting lower manufacturing costs in 2013, partially offset by higher pre-clinical costs. Salary and benefits costs are higher in part reflecting the addition of senior staff to manage clinical and regulatory operations and in part due to the reversal of expenses in the second quarter of 2012 where bonuses were reversed from salaries expense and recorded as share-based compensation expenses on the issue of DSU units. Non-cash expenses for share-based compensation were also lower by $228,394 in the first half of 2013 compared to the prior year period.

General and Administrative

Components of general and administrative expenses for the three months ended June 30 were as follows:

	2013	2012
	$	$
General and administrative	**112,391**	374,918
Salaries, fees and short-term benefits	**32,948**	35,340
Share-based compensation	**167,211**	125,183
Total	**312,550**	535,441

Components of general and administrative expenses for the six months ended June 30 were as follows:

	2013	2012
	$	$
General and administrative	**327,479**	454,172
Salaries, fees and short-term benefits	**86,093**	92,990
Share-based compensation	**200,051**	160,841
Total	**613,623**	708,003

General and administration expenses include costs not directly related to research activities. This includes expenses for professional fees such as legal and audit, fees related to maintaining a public stock exchange listing, shareholder relations' activities and insurance.

General and administration expenses for the three months ended June 30, 2013 decreased over the comparable period due mainly to lower advisory costs related to capital markets and investor relations of $248,441. Salaries, fees and short-term benefits costs were comparable between the periods while non-cash share-based compensation expenses were lower by $42,028.

General and administration expenses for the six months ended June 30, 2013 decreased over the comparable period due mainly to lower advisory costs related to capital markets and investor relations of $133,644. Salaries, fees and short-term benefits costs were comparable between the periods while non-cash share-based compensation expenses were lower by $39,210.

Finance income and finance costs

Investment income for the six months ended June 30, 2013 was lower than the comparable period due mainly to higher average cash balances last year and higher interest rates on Canadian denominated funds. Finance income was affected positively by net foreign exchange gains in 2013 while finance costs included a net foreign exchange loss in the comparable periods.

LIQUIDITY AND CAPITAL RESOURCES

Since inception, the Company has financed its operations from public and private sales of equity, the exercise of warrants and stock options, interest income on funds available for investment and government grants and tax credits. As at June 30, 2013, the Company had cash and cash equivalents totaling $2,188,191 compared to $2,327,650 at December 31, 2012.

Common shares issued – for the six months ended June 30, 2013

On March 22, 2013, the Company completed a prospectus offering of 5,111,175 units at a price of $0.90 per unit, for aggregate gross proceeds to the Company of $4,600,058 ($3,949,127 net of issuance costs). Each unit consisted of one common share and one half of one common share purchase warrant. Each whole warrant entitles the holder to purchase one common share at a price of $1.10 at any time prior to expiry on March 22, 2016. The warrant expiry date can be accelerated at the option of the Company, in the event that the volume-weighted average trading price of the Company's common shares exceeds $1.60 per common share for any 10 consecutive trading days. In connection with the financing, the Company issued 357,782 compensation warrants. Each compensation warrant entitles the holder to acquire one common share at an exercise price of $0.90 prior to expiry on March 22, 2014.

The $0.90 unit issue price was allocated to common shares in the amount of $0.79 per common share and the unit warrants were allocated a price of $0.11 per half-warrant. The costs of the issue were allocated on a pro rata basis to the common shares and unit warrants. Accordingly, $3,466,456 was allocated to common shares and $482,671 to the unit warrants, net of issue costs. Assumptions used to determine the value of the unit warrants were: dividend yield 0%; risk-free interest rate 1.1%; expected volatility 69%; and average expected life of 36 months. Assumptions used to determine the value of the compensation warrants were: dividend yield 0%; risk-free interest rate 1.0%; expected volatility 63%, respectively; and

average expected life of 12 months.

During the first half of 2013, 71,042 common shares were issued on the exercise of stock options for gross proceeds of $46,250.

The Company applied to the TSX Venture Exchange ("TSXV") to amend the exercise price of the warrants that were issued in May 2012 in connection with an earlier exercise incentive program from an exercise price of $2.50 to an exercise price of $1.60. Subsequent to the end of the quarter, the amendment became effective with TSXV approval.

Common shares issued – for the six months ended June 30, 2012

On May 8, 2012, the Company completed an incentive program to encourage the early exercise of the $1.50 warrants that were previously issued in connection with DiaMedica's short form prospectus offering in July 2011 (the "Original Warrants"). DiaMedica amended the terms of the Original Warrants to enable the holders thereof to receive a Unit in lieu of a common share of DiaMedica on the exercise of their Original Warrants prior to the May 8, 2012 expiry date. Each Unit consisted of one common share in the capital stock of DiaMedica and one-half of one warrant (each whole warrant, a "New Warrant"). Each New Warrant entitles the holder thereof to acquire a common share in DiaMedica at a price of $2.50 per share for 24 months following the date of issue of the Unit. On May 8, 2012, 2,111,200 common shares were issued on the exercise of $1.50 warrants for gross proceeds of $3,166,800 ($3,150,781 net of cash issue costs) under the incentive program, and accordingly, 1,055,600 New Warrants, with a total grant date fair value of $277,000, were issued with an exercise price of $2.50. Assumptions used in an option pricing model to determine the value of the New Warrants were: dividend yield 0%; risk-free interest rate 1.2%; expected volatility 74%; and expected life of 2 years. In July 2013, the exercise price of the New Warrants was amended to $1.60.

In the event the volume-weighted average trading price of DiaMedica's common shares exceeds $3.00 per share for a period of 10 consecutive trading days, DiaMedica may, at its option, accelerate the New Warrant Expiry Date by delivery of notice to the holders of New Warrants and issuing a press release announcing such acceleration and, in such case, the New Warrant Expiry Date shall be deemed to be the 30th day following the later of: (i) the date on which the Warrant Acceleration Notice is sent to Warrant holders; and (ii) the date of issuance of the Warrant Acceleration Press Release.

Subsequent to the quarter-end on August 3, 2012, the ten-day volume-weighted average trading price of DiaMedica common shares exceeded $2.00 per common share and the Company provided notice to the remaining $1.50 warrant holders that the expiry date of these warrants had been accelerated to September 7, 2012.

During the first half of 2012, 273,000 common shares were issued on the exercise of stock options for gross proceeds of $281,400.

Common Shares

The continuity of the number of issued and outstanding common shares of the Company for the six months ended June 30, 2013 and to the date of this MD&A is presented below:

Balance December 31, 2012	50,534,443
Shares issued under prospectus	5,111,175
Shares issued on exercise of stock options	71,042
Balance as at June 30, 2013 and at the date of this MD&A	55,716,660

Stock Options

The Company has a stock option plan which is administered by the Board of Directors of the Company with stock options granted to directors, management, employees and consultants as a form of compensation. 7,000,000 common shares were reserved for issuance under the plan. Options granted vest at various rates and have terms of up to 10 years.

The following table reflects the activity under the Company's stock option plan for the six months ended June 30, 2013:

	Number of Options	Weighted Average Exercise Price
Balance, December 31, 2012	4,327,500	$ 1.01
Granted	848,000	1.07
Exercised	(71,042)	0.65
Forfeited	(111,458)	1.40
Expired/ Cancelled	(50,000)	1.00
Balance, June 30, 2013	4,943,000	$ 1.02

Warrants

The following tables reflect the activity of the warrants for the six months ended June 30, 2013 and as at the date of this MD&A, and the closing balance reflects the potential cash proceeds from the outstanding warrants if they were to be exercised:

	Unit Warrants		Unit Warrants		Compensation Warrants	
Exercise price	$1.60 (note 1)		$1.10		$0.90	
Expiry Date	May 8, 2014		March 22, 2016		March 22, 2014	
	#	$	#	$	#	$
Balance December 31, 2012	1,055,600	1,688,960	-	-	-	-
Exercised	-	-	-	-	-	-
Issued	-	-	2,555,587	2,811,146	357,782	322,004
Expired	-	-	-	-	-	-
Balance June 30, 2013 and the date of this MD&A	1,055,600	1,688,960	2,555,587	2,811,146	357,782	322,004

Note 1:

The Company applied to the TSX Venture Exchange ("TSXV") to amend the exercise price of the warrants that were issued in May 2012 in connection with an earlier exercise incentive program from

an exercise price of $2.50 to an exercise price of $1.60. Subsequent to the end of the quarter, the amendment became effective with TSXV approval.

The Company believes it has sufficient resources available to support the Company's activities into the first quarter of 2014. The Company's management will seek to raise additional funds for operations from current stockholders and other potential investors. This disclosure is not an offer to sell, nor a solicitation of an offer to buy the Company's securities. While the Company may pursue such financing, there is no assurance that funding will be available or obtained on favourable terms.

These consolidated financial statements have been prepared using IFRS that are applicable to a going concern, which contemplates the realization of assets and settlement of liabilities in the normal course of business as they come due. There is substantial doubt about the appropriateness of the use of the going concern assumption because the Company has experienced operating losses and cash outflows from operations since incorporation, the Company will require ongoing funding in order to continue its research and development activities, and it has not reached successful commercialization of its products.

The Company's future operations are dependent upon its ability to generate product revenues, negotiate license agreements with partners, and secure additional funds. There can be no assurance that the Company will be successful in commercializing its products, entering into strategic agreements with partners, or raising additional capital on favourable terms or at all. There is also no certainty that these and other strategies will be sufficient to permit the Company to continue as a going concern.

These consolidated financial statements do not reflect adjustments in the carrying values of the Company's assets and liabilities, expenses, and the balance sheet classification used, which would be necessary if the going concern assumption was not appropriate. Such adjustments could be material.

Shareholder rights plan

The shareholders of the Company approved the adoption of a shareholder rights plan agreement (the "Plan") on September 22, 2011. The Plan is designed to provide adequate time for the Board of Directors and the shareholders to assess an unsolicited takeover bid for DiaMedica, to provide the Board of Directors with sufficient time to explore and develop alternatives for maximizing shareholder value if a takeover bid is made, and to provide shareholders with an equal opportunity to participate in a takeover bid and receive full and fair value for their Common Shares. The Plan will expire at the close of the Company's annual meeting of shareholders in 2014.

The rights issued under the Plan will initially attach to and trade with the Common Shares and no separate certificates will be issued unless an event triggering these rights occurs. The rights will become exercisable only when a person, including any party related to it, acquires or attempts to acquire 20 percent or more of the outstanding Common Shares without complying with the "Permitted Bid" provisions of the Plan or without approval of the Board of Directors. Should such an acquisition occur or be announced, each right would, upon exercise, entitle a rights holder, other than the acquiring person and related persons, to purchase Common Shares at a 50 percent discount to the market price at the time.

Under the Plan, a Permitted Bid is a bid made to all holders of the Common Shares and which is open for acceptance for not less than 60 days. If at the end of 60 days at least 50 percent of the outstanding Common Shares, other than those owned by the offeror and certain related parties have been tendered, the offeror may take up and pay for the Common Shares but must extend the bid for a further 10 days to

allow other shareholders to tender. The issuance of Common Shares upon the exercise of the rights is subject to receipt of certain regulatory approvals.

Deferred Share Units Plan

The shareholders of the Company approved the adoption of a deferred share units plan (the "DSU Plan") on September 22, 2011 reserving for issuance up to 2,000,000 common shares under the DSU Plan. The purpose of the DSU Plan is to provide an alternative form of compensation to satisfy annual and special bonuses payable to senior officers and directors and to satisfy fees that may be payable to directors for acting as directors of the Corporation. There have been 74,556 DSU units issued to June 30, 2013.

COMMITMENTS

As at June 30, 2013 and in the normal course of business, the Company had obligations to make future payments, representing research and development contracts and other commitments that are known and committed in the amount of $2,360,000 over the next 12 months, $94,000 from 12 to 24 months, $43,000 from 24-36 months and $20,000 each year thereafter. The Company's largest commitment is a contract in the amount of approximately $2.5 million for the Phase I/II clinical trial of which $750,000 has been expensed to date.

The Company enters into research, development and license agreements in the ordinary course of business where the Company receives research services and rights to proprietary technologies. Milestone and royalty payments that may become due under various agreements are dependent on, among other factors, clinical trials, regulatory approvals and ultimately the successful development of a new drug, the outcome and timing of which is uncertain.

The Company periodically enters into research and license agreements with third parties that include indemnification provisions customary in the industry. These guarantees generally require the Company to compensate the other party for certain damages and costs incurred as a result of claims arising from research and development activities undertaken by or on behalf of the Company. In some cases, the maximum potential amount of future payments that could be required under these indemnification provisions could be unlimited. These indemnification provisions generally survive termination of the underlying agreement. The nature of the indemnification obligations prevents the Company from making a reasonable estimate of the maximum potential amount it could be required to pay. Historically, the Company has not made any indemnification payments under such agreements and no amount has been accrued in the accompanying consolidated financial statements with respect to these indemnification obligations.

RELATED PARTY TRANSACTIONS

The key management personnel of the Company are the Directors, the President and Chief Executive Officer and the Vice Presidents.

Compensation for key management personnel of the Company for the three months ended June 30 were as follows:

	2013	2012
	$	$
Salaries, fees and short-term benefits	**247,373**	141,717
Share-based compensation	**123,519**	215,463
Total personnel expenses	**370,892**	357,180

Compensation for key management personnel of the Company for the six months ended June 30 were as follows:

	2013	2012
	$	$
Salaries, fees and short-term benefits	**487,997**	313,969
Share-based compensation	**251,264**	398,369
Total personnel expenses	**739,261**	712,338

Executive officers and directors participate in the stock option plan and certain officers participate in the Company's health plan. Directors receive annual and meeting fees for their services. As at June 30, 2013, the key management personnel control approximately 2% of the voting shares of the Company.

Amounts due to related parties, including amounts due to key management personnel, at the year-end are unsecured, interest free and settlement occurs in cash. There have been no guarantees provided or received for any related party receivables or payables.

OFF-BALANCE SHEET ARRANGEMENTS

Other than as described above, the Company does not have any off-balance sheet arrangements.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

As a result of the Company's limited administrative staffing levels, internal controls which rely on segregation of duties in many cases are not possible. Due to resource constraints and the present stage of the Company's development, the Company does not have sufficient size and scale to warrant the hiring of additional staff to address this potential weakness at this time. To help mitigate the impact of this, the Company is highly reliant on the performance of compensating procedures and senior management's

review and approval. During the six months ended June 30, 2013, the Company made no material changes to its system of internal controls over financial reporting.

As a venture issuer, the Company is not required to certify the design and evaluation of the Company's disclosure controls and procedures ("DC&P") and internal controls over financial reporting ("ICFR"), and as such has not completed such an evaluation.

Investors should be aware that inherent limitations on the ability of certifying officers of a venture issuer to design and implement on a cost effective basis DC&P and ICFR as defined in NI 52-109 may result in additional risks to the quality, reliability, transparency and timeliness of interim and annual filings and other reports provided under securities legislation.

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in conformity with IFRS requires the Company to select from possible alternative accounting principles and to make estimates and assumptions that determine the reported amounts of assets and liabilities at the balance sheet date, and reported costs and expenditures during the reporting period. Management believes that the estimates and assumptions upon which the Company relies are reasonable based upon information available at the time these estimates and assumptions are made. Estimates and assumptions may be revised as new information is acquired, and are subject to change. A summary of the Company's significant accounting policies and estimates under IFRS is found in Note 3 of the Company's consolidated financial statements for the year ended December 31, 2012.

In addition to the going concern assumptions described above, management believes that its most critical accounting policies and estimates relate to the following areas:

Research and development costs

Research expenditures are expensed as incurred. Development expenditures are capitalized only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and the Company intends to and has sufficient resources to complete development and to use or sell the asset. Government assistance and investment tax credits relating to research and development are recorded as a reduction of expenses when the related expenditures are incurred.

Intangible assets

Other intangible assets that are acquired separately and have finite useful lives are measured at cost less accumulated amortization and accumulated impairment losses. Subsequent expenditures are capitalized only when they increase the future economic benefits embodied in the specific asset to which it relates. All other expenditures are recognized in profit or loss as incurred.

Amortization is recognized in profit or loss on a straight-line basis over the estimated useful lives of intangible assets from the date they are available for use in the manner intended by management. The period that the technology acquired in the June 30, 2010 Sanomune Inc. acquisition is available for use is estimated at three years which reflects management's intent about commercializing the assets.

Share-based payments

The Company uses the Black-Scholes option-pricing model to value warrants and stock options. The use of this pricing model requires management to make assumptions regarding the expected life of the options and warrants, estimated forfeitures, the price volatility of the Company's stock over a relevant timeframe, the determination of a relevant risk-free interest rate and an assumption regarding the Company's dividend policy in the future.

Income taxes

The Company has a net tax benefit resulting from non-capital losses carried forward, and pools of scientific research and development expenditures and investment tax credits. The Company recognized no income taxes in the statements of loss and comprehensive loss, as it has been incurring losses since inception, and it is not probable that future taxable profits will be available against which the accumulated tax losses can be utilized.

CHANGES IN ACCOUNTING POLICIES

The Company's principal accounting policies were outlined in the Company's annual audited consolidated financial statements for the year ended December 31, 2012 and have been applied consistently to all periods presented in these consolidated financial statements. These statements should be read in conjunction with the annual audited consolidated financial statements for the year ended December 31, 2012.

New standards and interpretations adopted

IFRS 10 *Consolidated Financial Statements*

This amendment provides a single model to be applied in the control analysis for all investees. The amendments issued in June 2012 simplify the process of adopting IFRS 10 and provide additional relief from certain disclosures. The Company adopted IFRS 10, including the amendments issued in June 2012, in its financial statements for the annual period beginning on January 1, 2013. The adoption did not have a material impact on the financial statements.

IFRS 13 *Fair Value Measurement*

In May 2011, the IASB published IFRS 13 *Fair Value Measurement*, which is effective prospectively for annual periods beginning on or after January 1, 2013. The disclosure requirements of IFRS 13 need not be applied in comparative information for periods before initial application. IFRS 13 replaces the fair value measurement guidance contained in individual IFRSs with a single source of fair value measurement guidance. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, i.e. an exit price. The standard also establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements to provide information that enables financial statement users to assess the methods and inputs used to develop fair value measurements and, for recurring fair value measurements that use significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income. IFRS 13 explains 'how' to measure fair value when it is required or permitted by other IFRSs. The Company adopted IFRS 13 prospectively in its financial statements for the annual period beginning on January 1, 2013. The adoption did not have a material impact on the

financial statements.

Annual Improvements to IFRSs 2009-2011 Cycle – various standards

In May 2012, the IASB published Annual Improvements to IFRSs – 2009-2011 Cycle as part of its annual improvements process to make non-urgent but necessary amendments to IFRS. These amendments are effective for annual periods beginning on or after January 1, 2013 with retrospective application. The Company adopted the amendments to the standards in its financial statements for the annual period beginning on January 1, 2013. The adoption did not have a material impact on the financial statements.

New standards and interpretations not yet effective

IFRS 9 *Financial Instruments: Classification and Measurement*

IFRS 9 (2010) reflects the first phase of the IASBs work on the replacement of IAS 39, Financial instruments: Recognition and Measurement and deals with the classification and measurement of financial assets and financial liabilities. This standard establishes two primary measurement categories for financial assets, amortized cost and fair value, and eliminates the existing categories of held to maturity, available for sale, and loans and receivables. The new classification will depend 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 intends to adopt IFRS 9 (2010) in its financial statements for the annual period beginning on January 1, 2015. The Company does not currently expect IFRS 9 (2010) to have a material impact on the financial statements. The classification and measurement of the Company's financial assets is not expected to change under IFRS 9 (2010) because of the nature of the Company's operations and the types of financial assets that it currently holds.

SELECTED QUARTERLY FINANCIAL INFORMATION

The selected financial information provided below is derived from the Company's unaudited condensed consolidated interim financial statements for each of the last eight quarters.

	Q2-2013	Q1-2013	Q4-2012	Q3-2012	Q2-2012	Q1-2012	Q4-2011	Q3-2011
Interest income	$ 7,707	$ 1,522	$ 5,262	$ 12,611	$ 11,895	$ 11,052	$ 15,564	$ 16,363
Net loss for the period	$ 2,276,394	$ 2,773,476	$ 3,040,469	$ 2,537,682	$ 2,595,329	$ 1,826,160	$ 1,880,052	$ 1,827,052
Loss per share	$ 0.04	$ 0.05	$ 0.06	$ 0.05	$ 0.05	$ 0.04	$ 0.04	$ 0.04
Cash and cash equivalents	$ 2,188,191	$ 4,413,276	$ 2,327,650	$ 3,824,109	$ 3,984,159	$ 2,069,855	$ 2,707,663	$ 3,997,195

It is important to note that historical patterns of expenditures cannot be taken as an indication of future expenditures. The amount and timing of expenditures, and therefore liquidity and capital resources, may vary substantially from period to period depending on the business and research activities being undertaken at any one time and the availability of funding from investors and prospective commercial partners.

The increase in quarterly losses beginning in Q2 2012 is due mainly to higher costs for DM199 development including pre-clinical studies, manufacturing scale-up and production and clinical trial costs. The Company's quarterly losses include non-cash expenses of $587,208 each quarter related to the amortization of the acquired technology intangible asset from the acquisition of Sanomune on June 30, 2010.

Additional Information

Additional information relating to the Company, including its Annual Information Form can be found on SEDAR at www.sedar.com.