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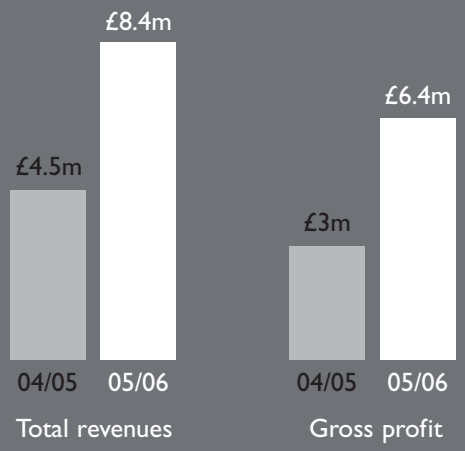
VECTURA

Financial highlights 2005/06

Total revenues up by 88% to £8.4 million (2004/05 £4.5 million)
Gross profit up by 114% to £6.4 million (2004/05 £3.0 million)
Loss after tax down to £6.5 million (2004/05 loss of £7.8 million)
Loss per share down 31% to 6.0p (2004/05 loss of 8.7p)
Net cash outflow from operating activities down to £1.6 million (2004/05 net cash outflow £5.0 million)



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Operating highlights 2005/06

NVA237 for chronic obstructive pulmonary disease (COPD)

- $375 million global licensing agreement with Novartis for NVA237 signed in April 2005
- Start of NVA237 Phase IIb clinical trial

VR315 for asthma

- European collaboration, development and license agreement signed in March 2006 with leading international pharmaceutical company
- In addition to attractive royalties, Vectura could receive up to €22.5 million in milestones and development funding, of which €5.6 million was received in April 2006

VR040 for Parkinson's disease

- Receipt of EU Orphan Medicinal Product designation
- Start of Phase IIa study

VR776 for premature ejaculation (PE)

- Successful completion of VR776 first clinical trial in man

VR496 for cystic fibrosis (CF)

- Receipt of EU Orphan Medicinal Product designation and US Orphan Drug designation

Developments since the year-end

- Signed a collaboration agreement in April 2006 with Boehringer Ingelheim International GmbH to develop a dry powder inhaler (DPI). Under the terms of the agreement, Vectura received an initial payment of €5 million and a €10 million equity investment
- In May 2006 announced the spin-out of PharmaKodex Limited a new speciality pharmaceutical company jointly established with Unilever Ventures Limited

Commenting on the results, Dr Chris Blackwell, Chief Executive of Vectura, said:

'This has been an extremely successful 12 months in which we have demonstrated our ability to deliver on the objectives set out at IPO by taking the key products in our pipeline to the next stages of development and establishing three major licensing deals with international pharmaceutical companies.

With the advancement of our product pipeline and the continued interest in our technologies from potential licensing partners, we look forward to the year ahead with confidence.'

What we do




Vectura is an emerging pharmaceutical company that is developing a range of inhaled drugs for the treatment of both lung diseases and other conditions where optimised delivery via the lungs can provide significant benefits. These benefits include a rapid onset of action, improved efficacy and improved tolerability compared with current therapies.

Vectura's strategy is to combine its proprietary, innovative, device and pulmonary formulation technologies (Aspirair®, GyroHaler® and PowderHale®) with existing, off-patent drugs either for use in new indications or to provide inhalation as an improved route of administration.

Chairman's and Chief Executive's review

Overview

This year has demonstrated the successful realisation of our evolving business strategy. We have continued to see positive progress on all fronts with solid advances in the product pipeline, progress on technology out-licensing, and an 88% increase in revenues to £8.4 million. The period started with our global licensing agreement with Novartis, which was signed on 12 April 2005, providing considerable validation for our strategy of applying innovative inhalation technologies (in this case PowderHale®) to established, off-patent products, creating valuable new products for development and subsequent out-licensing. The period concluded with our European licensing deal for VR315 which was signed on 31 March 2006 and incorporates delivery of VR315 using our GyroHaler® technology.

Importantly, we strengthened our product pipeline during 2005 by introducing three promising new candidates. The Novartis agreement provided QVA149, the combination of NVA237 and Novartis' QAB149, for the treatment of chronic obstructive pulmonary disease (COPD). VR040 for Parkinson's disease was added in early 2005, and finally VR315 for asthma.

John P (Jack) Cashman
Non-Executive Chairman

Dr Christopher P Blackwell
Chief Executive

Strategy

Vectura currently has ten products in the development pipeline, three of which are out-licensed. This portfolio focuses primarily on drugs for treating respiratory, neurological and sexual dysfunction disorders. We will be seeking licensing partners from early 2007 for our sexual dysfunction products following completion of their current Phase II clinical trial programmes. After this, we will concentrate our product development activity on therapies for respiratory and neurological disorders.

We will continue to license our technologies on a non-exclusive basis in order to continue to generate returns from a wide range of products.

Product Pipeline

	Product	Indication	Exploratory development	Pre-Clinical	Phase I	Phase II	Partner
Respiratory	NVA237	Chronic obstructive pulmonary disease					Novartis – Worldwide
	QVA149 (NVA237 + QAB149 combination)	COPD					Novartis – Worldwide
	VR315	Asthma					Major Pharma – Europe
	VR496	Cystic fibrosis / COPD					
	VR694	Asthma					
Neurology	VR040	Parkinson's					
	VR147	Migraine					
Sexual dysfunction	VR004*	Erectile dysfunction					
	VR776	Premature ejaculation					

* Inhaled apomorphine; this product is also available for licensing for female sexual dysfunction (VR400)

Both NVA237 & QAB149 have completed Phase II studies

Respiratory franchise

We are currently developing five products in our respiratory franchise.

Product	Description	Partner	Status	Indication
NVA237	Long-acting muscarinic antagonist (LAMA)	Novartis	Phase IIb	COPD
QVA149	Combination of NVA237 and a long-acting beta agonist (LABA) (QAB149)	Novartis	In preparation for Phase II*	COPD
VR315	Generic combination product	Undisclosed	In preparation for Phase III	Asthma
VR496	Mucolytic/anti-inflammatory	–	In preparation for Phase IIa	CF/COPD
VR694	Anti-inflammatory	–	Exploratory development	Asthma

* QAB149 the Novartis product to be used in combination with NVA237 is in preparation for Phase III studies.

NVA237 for COPD deal signed with Novartis and Phase IIb commenced

We announced in October 2005 that NVA237, a novel inhaled once-daily treatment for COPD, has entered a Phase IIb multiple dose-ranging clinical trial. NVA237 is being developed and commercialised by Novartis both as a monotherapy and in combination with their once-daily bronchodilator (QAB149).

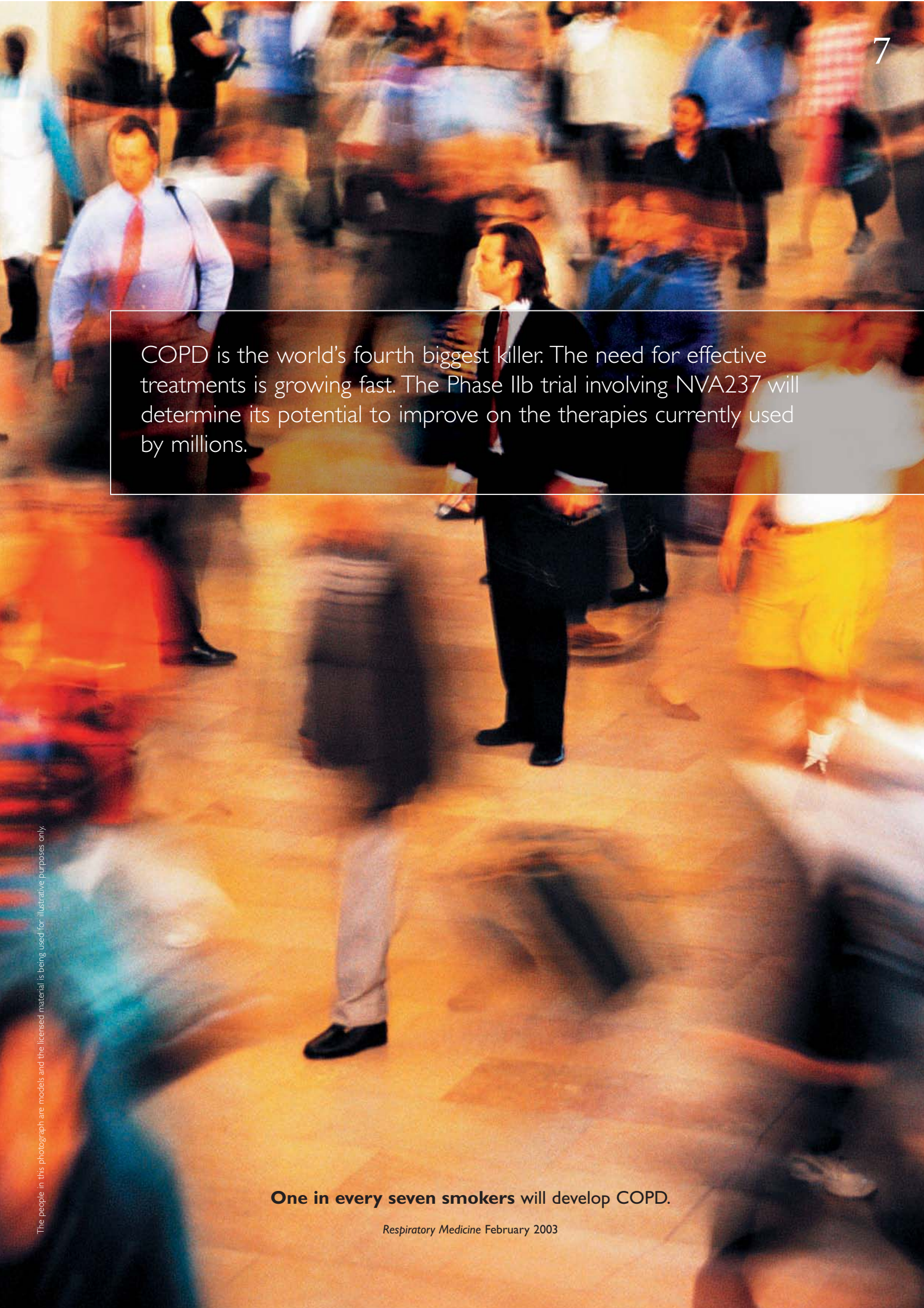
The study is a randomised, double-blind, multi-centre, placebo-controlled trial designed to evaluate the efficacy, safety and dose response of NVA237 in patients diagnosed with COPD over a four-week period and will report out in mid-2006.

COPD, the world's fourth largest cause of death, is a chronic obstruction of the airways which is caused primarily by smoking. It is estimated that COPD occurs in over 6% of the US population and that at least one in seven smokers suffers from it. The current market for COPD drug therapy is estimated to be worth $5 billion a year and is predicted to grow to $11 billion by 2011.

COPD is recognised as a common and costly disease with high unmet need. The commencement of the Phase IIb trial represents a further important step in validating the clinical profile of NVA237, which we believe to be a very promising product with the potential to improve upon existing therapies.

Novartis' commitment to NVA237, and the beneficial combination of NVA237 with QAB149, make Novartis, a world leader in the treatment of respiratory diseases, an ideal licensing partner for Vectura. Under the terms of the Novartis agreement, Vectura and Arakis Limited (part of Sosei Co. Ltd.), our development partner, each received an initial payment of $15 million (£7.9 million) in April 2005. Clinical, regulatory and commercialisation milestones will be payable upon the achievement of pre-agreed targets, which could reach $172.5 million for each company for both monotherapy and combination products. The initial payment and potential milestones therefore total up to $375 million.

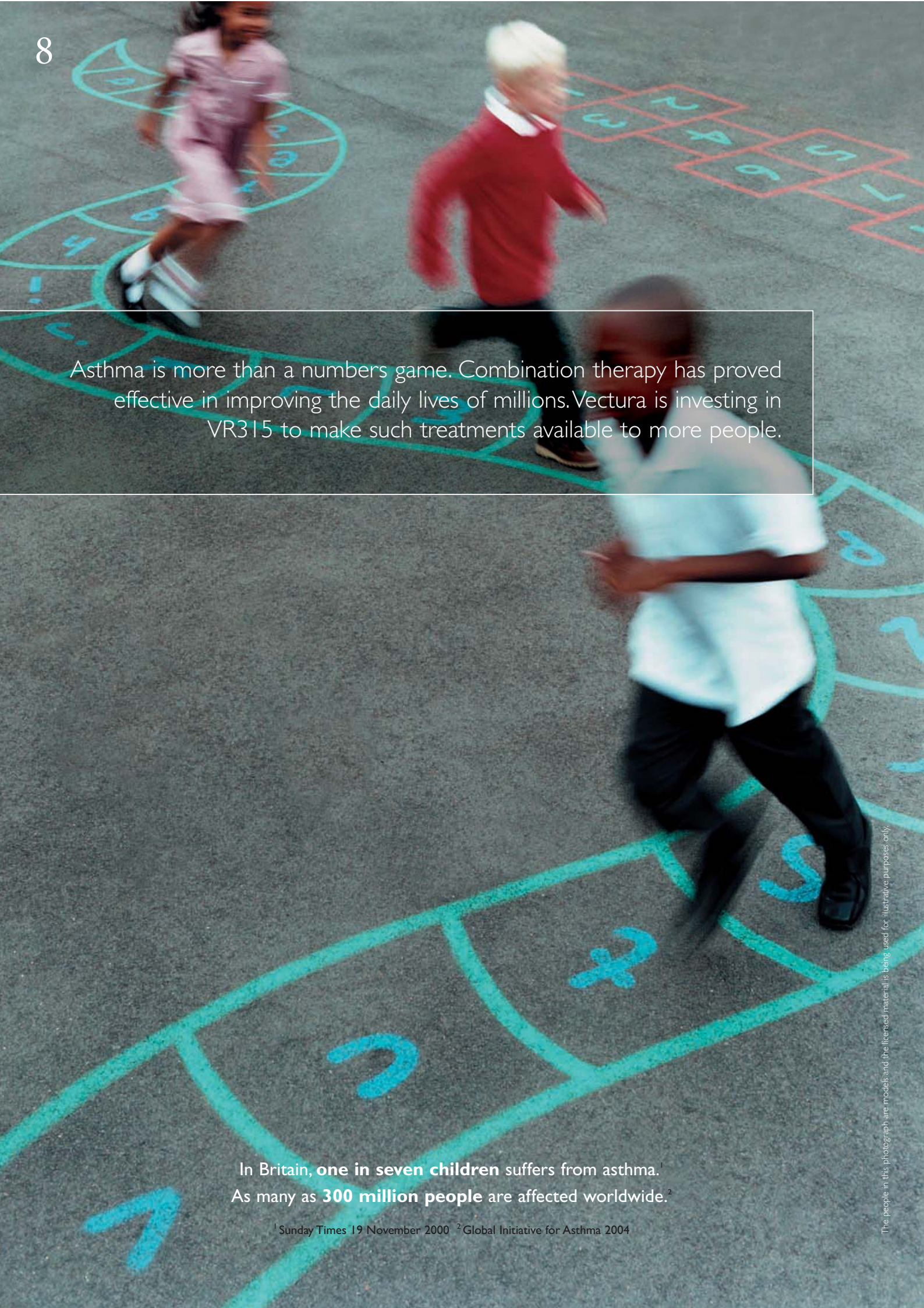
In addition, royalties on product sales will be paid for the monotherapy and the combination product. If a third combination product is developed by Novartis using NVA237, further milestones and royalties may be payable on that product. This is therefore one of the most significant European biotech licensing deals that the sector has seen for a single product, and provides a major endorsement of Vectura's business strategy.



COPD is the world's fourth biggest killer. The need for effective treatments is growing fast. The Phase IIb trial involving NVA237 will determine its potential to improve on the therapies currently used by millions.

One in every seven smokers will develop COPD.

Respiratory Medicine February 2003



Asthma is more than a numbers game. Combination therapy has proved effective in improving the daily lives of millions. Vectura is investing in VR315 to make such treatments available to more people.

In Britain, **one in seven children** suffers from asthma.[1]
As many as **300 million people** are affected worldwide.[2]

[1] Sunday Times 19 November 2000 [2] Global Initiative for Asthma 2004

VR315 for asthma successfully out-licensed for Europe

We signed a European collaboration, development and licence agreement with a leading international pharmaceutical company for VR315, our combination asthma therapy, in March 2006. VR315 will be developed as a generic combination product using our GyroHaler® dry powder inhaler.

We will be responsible for further formulation development of VR315 and for the supply of our GyroHaler® device. Our partner will be responsible for the clinical development, manufacture and European marketing of the product. We will have access to all clinical data, and our partner intends to provide, if required, US-compliant manufacturing facilities for the blister filling and assembly of VR315 for the US and other territories. The agreement covers Europe and certain other countries, with Vectura retaining the rights for the US, Japan, Canada, South America, Australia, New Zealand and some other territories.

Combination therapy for asthma is the biggest and fastest growing sector of the asthma market with annual sales currently exceeding $6 billion and European annual sales estimated at approximately $1.5 billion. With the validation of the European deal we believe we will be a very attractive partner for a large generics company with a presence in the US and other markets.

VR496 for cystic fibrosis (CF) receives Orphan Drug Status

VR496 was granted Orphan Drug Status by the European Committee for Orphan Drug Products and by the US Office of Orphan Products Development in 2005. This provides VR496 with regulatory approval advantages to speed its progress through the required CF trials which are expected to start in late 2006. VR496 for CF is a product that we now intend taking through Phase III clinical trials. VR496 also has potential use for COPD patients. We currently intend out-licensing the COPD indication following completion of our Phase II programme for this indication. We expect there will be advantages of working with a partner on the COPD indication while we progress the CF indication on our own.

VR694

VR694 is our exploratory development product targeted at asthma.

GyroHaler®

GyroHaler is a multi-dose, 'passive' DPI for effective local delivery of drugs into the lungs.

Neurology franchise

We are currently developing two products in our neurology franchise.

Product	Description	Partner	Status	Indication
VR040	Inhaled apomorphine	–	Phase IIa	Parkinson's disease
VR147	Inhaled neurovascular agent	–	Exploratory development	Migraine

VR040 for Parkinson's disease (PD) commences Phase IIa

Another new development programme this year is VR040 (inhaled apomorphine hydrochloride) for Parkinson's disease.

Apomorphine is an established, effective treatment for hypomobility, a disabling symptom of PD, and we believe that inhaled apomorphine delivery will address the two key clinically-unmet patient needs of rapid onset of symptom relief and non-invasive administration. Inhalation of apomorphine, we believe, will reduce the therapeutic dose required, thereby minimising unwanted side-effects when compared with other direct-acting dopaminergic drugs, including apomorphine delivered by injection. Our Phase IIa study using our proprietary formulation, delivered with our Aspirair® device, commenced in early 2006 and we plan to report results in H2 2006.

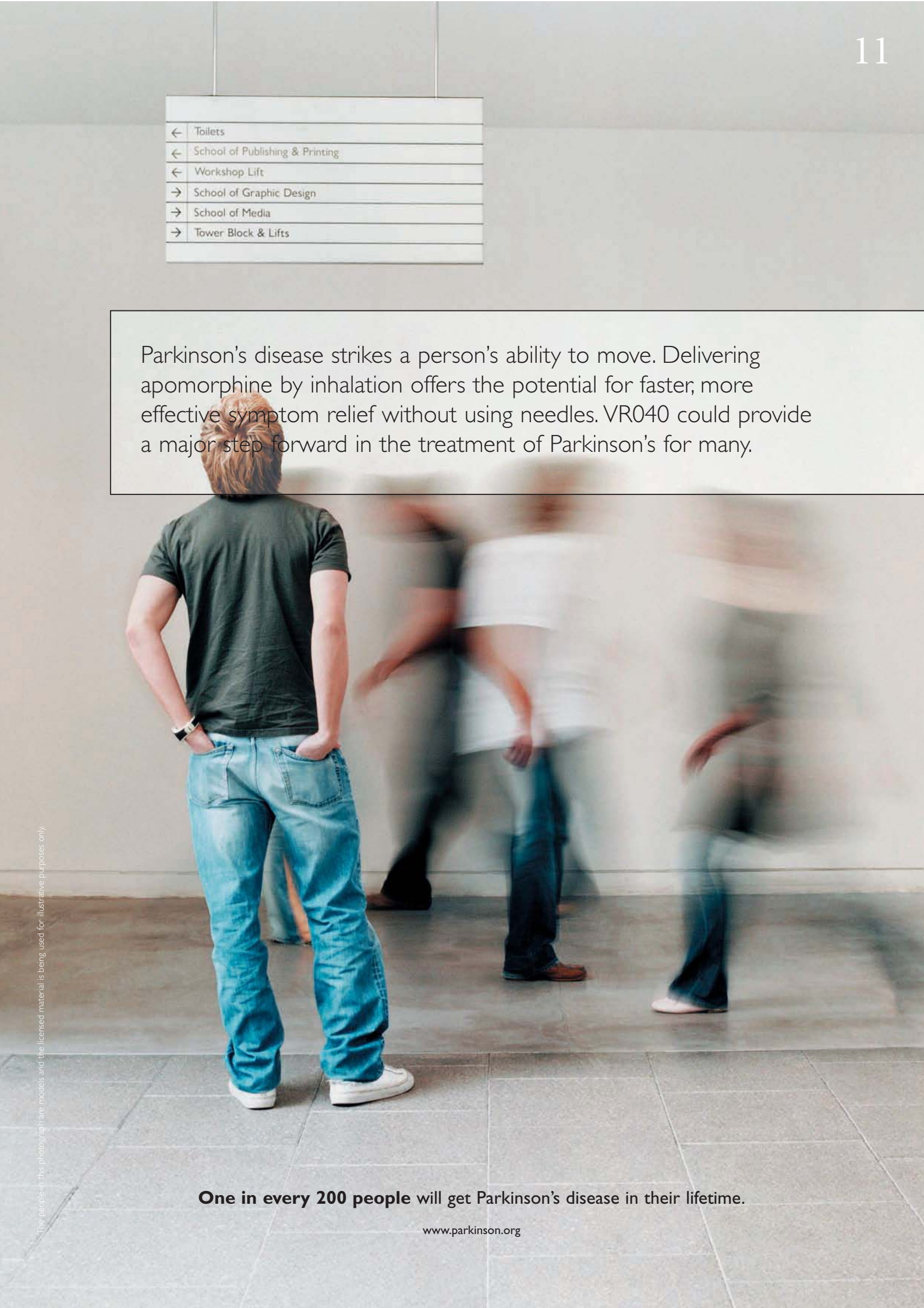
Aspirair DPI device in use

VR147 for migraine

We are considering a number of potential compounds for treating migraine. Although currently at an early stage, we anticipate this product could enter clinical development within the next 18 months. The rapid onset of action combined with the potential to reduce the amount of medication required makes inhalation an ideal route of administration for migraine therapies.

Aspirair®

Aspirair is an 'active' DPI for the demands of systemic and macromolecule delivery.



Parkinson's disease strikes a person's ability to move. Delivering apomorphine by inhalation offers the potential for faster, more effective symptom relief without using needles. VR040 could provide a major step forward in the treatment of Parkinson's for many.

One in every 200 people will get Parkinson's disease in their lifetime.

www.parkinson.org

Sexual dysfunction franchise

We are developing three products in our sexual dysfunction franchise for which we will be seeking licensing partners when the current Phase II trials are complete.

Product	Description	Partner	Status	Indication
VR004	Inhaled apomorphine	–	Phase IIb	Erectile dysfunction
VR776	Acts via 5HT- and noradrenergic-mediated pathways in the brain	–	Phase IIa	Premature ejaculation
VR400	Inhaled apomorphine	–	This is the same active as VR004 and will be out-licensed with VR400	Female sexual dysfunction

VR004 for erectile dysfunction (ED) continues Phase IIb

VR004 is a proprietary dry powder formulation of apomorphine hydrochloride, delivered using our Aspirair® delivery device. Apomorphine hydrochloride is also used in VR040, however VR004 utilises a lower dose range. The aim with VR004 is to provide an effective, well-tolerated and rapidly-acting treatment option for patients who suffer from ED.

VR004 is currently under investigation in two Phase IIb clinical studies. The objective of these double-blind, placebo-controlled trials, evaluating up to 150 patients on the first trial and approximately 250 patients on the second trial, is to identify the safe, effective dose to be used in a Phase III trial. Patients with mild, moderate or severe ED will receive treatment for a maximum of 12 weeks at home. Published clinical data from ED studies demonstrate that multiple dose "at home studies" normally demonstrate higher response rates than clinic-based ones.

In the first Phase IIb study, an independent safety review group noted transient falls in blood pressure following orthostatic challenge (standing and sitting manoeuvres to expose intolerance to vasodilation) in a small number of patients that had been given either of the two highest fine particle doses (250 µg and 300 µg) in the study. As a result, it was recommended that no further patients should be randomised to these two doses. Patients already randomised to these top doses that had not experienced these effects upon orthostatic challenge were allowed to continue their allocated treatment for the full 12-week period. Randomisation continued on placebo and the low dose (150 µg). Final un-blinded data from the study is expected in mid-2006.

The second dose-defining Phase IIb study is now underway to evaluate doses of 100 µg, 150 µg and 200 µg which are all lower than the top two doses used in the first study. This second study is due to report in H1 2007. We believe it should be possible to achieve target effectiveness at a dose with acceptable side-effects.

The market for ED is currently estimated to be worth $2.5 billion a year and is expected to be $4.4 billion a year by 2010. Through market research with doctors, patients and opinion leaders, we believe that there is a clear unmet need for products with a faster onset of action than current oral and buccal products. Studies to date have shown that VR004 is likely to offer distinct advantages in this area.

VR776 for premature ejaculation (PE) commenced Phase IIa

We are pleased to announce that recruitment has started for the Phase IIa study of VR776 in patients with premature ejaculation. This follows the successful completion of the Phase I study in early 2006. The utility of the active ingredient of VR776 for PE is described in the literature, but it is generally taken as an oral tablet 3 - 6 hours before intercourse. We believe the delivery of VR776 via the lungs will provide rapid delivery of this active component and therefore a rapid onset of action, offering significant clinical benefit. Currently, no product is licensed in the US or EU

specifically for the treatment of PE, although we are aware of a number of products in development. PE is estimated to affect between 27 and 34 percent of men across all age ranges, and thus may represent a bigger market opportunity than ED.

VR776 is formulated with our dry powder technology, PowderHale®, and delivered with our Aspirair® inhaler.

Generating value from our enabling technologies demonstrated by deal with Boehringer Ingelheim

Vectura's three dry powder inhaler (DPI) technologies, Aspirair, GyroHaler and PowderHale, are based on our in-depth knowledge of device engineering and particle science, which enable Vectura to re-formulate and patent a broad range of drugs for pulmonary delivery.

Vectura's strategy is to license rights to these technologies to other pharmaceutical companies where the resulting licence will complement the Group's overall business strategy and commercial returns.

There is a growing demand for dry powder inhalers, particularly those that can deliver high performance and consistent doses. We believe that our device and formulation technologies are well placed to capture a significant market share, as they can provide critical benefits which are needed by both patients and regulatory authorities.

In April 2006, we agreed a worldwide collaboration, development and licence agreement with Boehringer Ingelheim to develop a dry powder inhaler (DPI) as a tailored Boehringer Ingelheim device. It will deliver a range of their proprietary respiratory products, mainly for treating asthma and COPD.

Under the non-exclusive agreement, we will work with Boehringer Ingelheim on the continued development of the inhaler until the end of 2007, after which they will be responsible for any further development, manufacturing, clinical trial use with their proprietary compounds, and the commercialisation of these products.

Most treatments for asthma and COPD are delivered by inhalation. Global markets for these treatments are valued in excess of $17 billion today and are forecast to grow to over $28 billion by 2010. Dry powder inhalers are increasingly the first choice for patients with these diseases and it is expected that DPIs will be used to deliver the majority of the drugs sold in these markets by 2010.

People

Our most important resource is our staff and it is their expertise and hard work that have made possible the Group's successful progress over the past year. The Board recognises that our success is only being achieved as a result of their dedication, and we wish to record here our thanks for their commitment and ongoing contribution

Outlook

As Vectura carries out its strategy for growth, the key drivers for 2006/07 are the results from our development work on VR315 and the partnering of the product for the US, together with results from the NVA237 and VR004 Phase IIb and the VR040 and VR776 Phase IIa clinical trials. We will continue to advance the products in our pipeline and pursue appropriate licensing opportunities for both our products and our technologies in order to generate value for our shareholders.

Jack Cashman
Chairman

Chris Blackwell
Chief Executive

24 May 2006

Financial review

Revenue
In the 12 months to 31 March 2006, our revenues were £8.4 million, an increase over 2004/05 of 88%.

Our first product licensing revenues, £3.8 million, were generated during the period, all of which relate to our licensing agreement with Novartis for NVA237. We received an upfront access fee of £7.9 million in April 2005, which is non-refundable. This revenue is being recognised over a 24-month period.

Pharmaceutical Development Services revenues of £4.4 million were a 64% increase on the prior year (£2.7 million). These revenues include £1.1 million from Novartis in relation to our continued work on NVA237 and £1.1 million for re-imbursement of work undertaken during 2005/06 on VR315, the product we licensed on 31 March 2006. In addition to the Pharmaceutical Development Services revenue there was a VR315 access payment of £2.8 million and this revenue will be recognised over a four-year period.

Technology licensing revenues of £0.2 million (2005 - £1.8 million) were realised during the period. The majority of the 2004/05 income was generated from our licensing agreement with SkyePharma PLC signed in June 2004. Our agreement with SkyePharma on Aspirair has now lapsed.

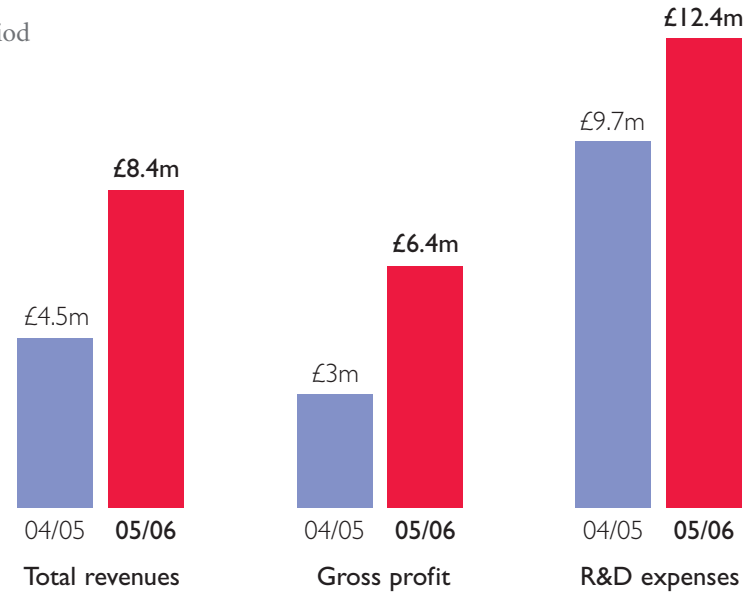
Gross profit
The gross profit in the year to 31 March 2006 was £6.4 million, a 114% improvement on the previous period (£3 million). The main reason for the increase was the increase in milestone licensing revenues.

Research and development expenses
Total investment in research and development was £12.4 million, a 28% increase on the prior year (£9.7 million), incurred primarily on the Phase IIb VR004 trials, the VR776 clinical trials and the VR040 Phase IIa trial.

Administrative expenses
Administrative expenses are £0.3 million lower at £2.5 million as the comparative costs include additional expenditure incurred at the time of the flotation.

Net interest receivable
Net interest receivable comprises primarily the interest income from cash invested in overnight deposits. In the year ended 31 March 2006, the Group had net interest receivable of £1 million (2005 - £0.6 million) on net cash deposits, reflecting the increased level of cash following the IPO in July 2004 and the £7.9 million licensing receipt in April 2005.

Taxation
R&D tax credits are recorded upon receipt. £1 million of R&D tax credits were received in the year (2005 - £1.2 million).



Capital expenditure

Capital expenditure in the period was £1.3 million (2005 - £0.5 million), incurred principally on the Group's new blister-filling line located in Chippenham, UK. This provides capability to manufacture Phase III material.

Operating cash flow

Net cash outflow from operating activities in the period was £1.6 million compared to £5 million in the prior period. As at 31 March 2006, Vectura had cash and short-term deposits of £16.8 million (2005 - £18.4 million). This excludes £14.0 million of cash receipts from the VR315 and Boehringer Ingleheim deals received after the period end.

Treasury

The Board has implemented an investment policy governing the investment of the Group's cash resources, under which the primary objective is to invest in low-risk cash or cash equivalent investments to safeguard the principal, ensuring that these resources remain available to fund the Company's operations while still seeking to maximise returns.

Loss per share

The net loss per share in 2006 was 6.0p, a 31% reduction on the prior year.

Headcount

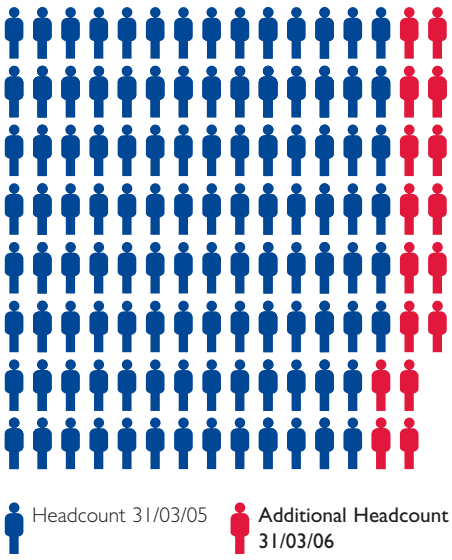
Headcount at 31 March 2006 was 126 (31 March 2005 - 110).

International Financial Reporting Standards

Up to 31 March 2005, we prepared our primary financial statements under UK Generally Accepted Accounting Practice (UK GAAP). The financial results presented here are presented in accordance with the Group's accounting policies based on IFRS. The comparative numbers for the 12 months ended 31 March 2005 have been restated under IFRS. All comparisons refer to the comparative results reported under IFRS.

Anne Hyland
Chief Financial Officer

24 May 2006



Board of Directors





John P (Jack) Cashman
Non-Executive Chairman

Jack Cashman, 65, joined Vectura as Non-Executive Chairman in April 2001. Mr Cashman is currently a Non-Executive Director of Bespak plc, the world's largest supplier of dry powder inhalers; Non-Executive Chairman of Interface Biologics Inc., a Canadian private therapeutic biomaterials company and Non-Executive Chairman of Insception Biosciences Inc., Canada's largest and most established cord blood bank. He is also a Non-Executive Director of Phoqus Group plc, a UK company specialising in oral drug delivery, a Non-Executive Director of Amtrol Inc. (USA), Amtrol-Alfa (Portugal) and Transat A.T. Inc. (Montreal). Mr Cashman is the former Chairman and joint-CEO of R.P. Scherer Corporation and participated in its leveraged buy-out and privatisation and subsequent successful public offering flotation on the New York Stock Exchange (R.P. Scherer was subsequently acquired by Cardinal Health Inc. (NYSE)). His early career was spent in the field of filtration and industrial mineral products. During that time, he took on successively more senior roles in marketing, operations and general management in the UK, Europe, Canada and USA. With this experience, he decided to pursue an entrepreneurial career in the industrial and healthcare sectors.

Dr Christopher P Blackwell BSc, PhD
Chief Executive

Dr Chris Blackwell, 44, was appointed Chief Executive of Vectura in February 2004 following a period of 17 months as Chief Operations Officer and Executive Director. Previously, Dr Blackwell worked at Scotia Pharmaceuticals Ltd, having been invited to join in 1998 as Director of Drug Development, becoming an Executive Director later that year. His primary role was to refocus the company's drug development capabilities from a research-led biotechnology company to a commercially-driven pharmaceutical development company. Dr Blackwell trained as a research scientist at the University of Bath, where in 1988 he completed his doctorate investigating free radicals and reperfusion-induced arrhythmias. Dr Blackwell joined Glaxo Research and Development as a Clinical Pharmacologist and progressed rapidly to a management role. Dr Blackwell moved to Hoffman La-Roche to specialise in project management and became UK Director, Global Project Management in 1996.

Anne P Hyland BBS, FCA, FITI
Chief Financial Officer and Company Secretary

Anne Hyland, 45, was appointed Chief Financial Officer, Company Secretary and Executive Director of Vectura in March 2002. Before this, she was a Director of Corporate Finance at Celltech Group plc. Other positions held at Celltech included Group Financial Controller and Finance Director for the Celltech/Medeva UK Division. Ms Hyland joined Celltech following the merger with Medeva plc where she was Finance Director for the UK Division. Previously, she was the Medeva Group Financial Controller where, through a period of rapid growth, she was responsible for managing treasury, tax, internal and external reporting, and acquisition and disposal activity. She joined Medeva from KPMG, London, where she was an audit manager and gained exposure to corporate finance, advisory and due diligence work. Ms Hyland has a Business Studies degree from Trinity College, Dublin, and is a Fellow of the Institute of Chartered Accountants in Ireland, and a Fellow of the Institute of Taxation in Ireland.

Dr Andrew J M Richards BA, MA(Cantab), MSC, PhD, CChem
Non-Executive Director

Dr Andy Richards, 46, is currently a Non-Executive Director of Biowisdom, Babraham Bioscience Technology Ltd, Daniolabs, Cancer Research Technology Ltd (the commercial arm of Cancer Research UK) and Theradeas Ltd. He is a founder member of the "Cambridge Angels", a group of high net worth private investors, and a member of the Council of UEA. Originally a protein chemist, Dr Richards spent his early career with ICI (now AstraZeneca) and with PA Technology. He has broad experience of the UK biotechnology sector in research, drug development and building commercial relationships. In 1992, Dr Richards co-founded Chiroscience and was Business Development Director through to the merger in 1999 with Celltech. Dr Richards is an established biotechnology entrepreneur and business angel, focusing on founding, investing in, and assisting in the development of biotechnology and healthcare companies.

Dr John R Brown BSc, MBA, PhD
Non-Executive Director

Dr John Brown, 51, currently Chairs the Governing Council of the Roslin Institute in Edinburgh and is Chairman of Scottish Biomedical. Dr Brown is a Non-Executive Director of a number of private and public biotech companies including Ardana plc, Protherics plc and Cambridge Antibody Technology plc. He sits on the Advisory Board of the Life Sciences ITI in Scotland. Dr Brown is a member of the DTI Technology Strategy Board and the DTI Biotechnology Leadership Council. He is also Chairman of BIA Scotland. Until December 2003, Dr Brown was Chief Executive of the FTSE 250 biotech company Acambis plc, a leading producer of vaccines to treat and prevent infectious disease. Dr Brown joined Acambis as Finance Director in 1995 and was appointed CEO in 1997. Before this he worked in equity research as Head of Research at Sutherland and Partners. John also worked at PA Consulting, where he advised both biotech and pharmaceutical companies. Early in his career, he spent five years at Glaxo Group Research where he led a group developing neuropeptide antagonists. He holds an MBA and a PhD in neuropharmacology.

Senior management




Our management team have a wealth of commercial experience and practical knowledge of the pharmaceutical industry. This enables Vectura to meet the challenges of an increasingly competitive global market and address vital health issues which affect the lives of millions.

Dr Tim Wright BSc, PhD, MBA
Commercial Director

Dr Tim Wright, 45, joined Vectura as Commercial Director in March 2005. Prior to joining Vectura he gained a breadth of experience in business development and licensing in a number of senior roles at BTG plc, latterly as Vice President Business Development and Licensing, Oncology, and as Director of Business Development at DevCo Pharmaceuticals where he was successful in building a portfolio of neuroscience development candidates. Tim trained as a research scientist at London University, obtaining a PhD in neuroendocrinology in 1987, and an MBA from the London Business School Executive Programme in 1994. Between 1986 and 1999, he held a number of management positions at GlaxoWellcome Research and Development, both in Clinical Pharmacology and Medical Operations and in project management at Simbec Research Limited.

Dr Martin J Shott PhD, MRPharmS
Pharmaceutical Operations Director

Dr Martin Shott, 54, Director, Pharmaceutical Operations, joined Vectura in October 2002. Martin has wide-ranging experience in the pharmaceutical industry and is a member of the Royal Pharmaceutical Society of Great Britain. Prior to joining Vectura, Martin worked for four years at Innovata Biomed as Associate Director of Research and Development. His training as a research scientist included investigating the compression of pharmaceutical powders for a PhD at Nottingham University while continuing to work in the industry. This was completed in 1983. Martin has gained extensive experience in the UK and Europe working as a senior manager for companies including Lers-Synthelabo, and Ciba Geigy (later Novartis) where he managed the global DPI development unit based in the UK.

Dr Mark J Main BSc, PhD
Development Director

Dr Mark Main, 46, joined Vectura as Development Director in May 2004. Prior to joining Vectura, he was with Powderject Pharmaceuticals, where he joined in 2001 to lead multi-disciplinary development teams for both drug delivery and vaccine products involving all aspects of the drug/device development process. Mark trained as a research scientist at St. George's Hospital Medical School where he gained his doctorate investigating the prevention of ischaemia-induced damage of the mammalian myocardium. He joined Sterling Winthrop in 1986 and subsequently Parke-Davis, Ipsen International and Scotia Pharmaceuticals, gaining extensive experience of clinical development and project management in the areas of cardiovascular and oncological treatment.

Stephen W Eason BSc (Eng), ACGI
Director of Device Development

Stephen Eason, 48, joined Vectura as Director of Device Development in February 2002 when the Aspirair inhaler technology and staff were acquired from Cambridge Consultants Ltd. Stephen had initiated and led the Aspirair development programme within CCL, where he was an Associate Director. Stephen has also initiated and led the GyroHaler development programme for Vectura which commenced in 2003. In 1999, he set up CCL's Drug Delivery Devices Group. The team carried out significant product developments in the areas of inhalation, injection, and infusion products. Before specialising in drug delivery, Stephen created and managed CCL's Product Definition Group which carried out a number of healthcare, telecoms and consumer product developments for clients in Europe and the US. Prior to joining CCL, Stephen worked for seven years as a design and development engineer within the manufacturing industry, first with the TI Group and then with Baxter Healthcare. Stephen studied Mechanical Engineering at the Imperial College of Science and Technology, London.

Directors' report

The Directors present their Annual Report on the affairs of the Company and Group, together with the financial statements and Auditors' report for the year ended 31 March 2006. The Corporate Social Responsibility Statement is included in the Directors' Report.

Principal activity
The principal activity of the Group undertaken during the year was the ongoing research and development of novel therapeutic products and drug delivery systems for human use.

Review of business
Key events during the past year are referred to in the Chairman's and Chief Executive's Review and the Financial Review.

Results and dividends
The Group loss for the year, after taxation, amounted to £6,455,000 (2005 - £7,786,000). The Directors do not recommend the payment of a dividend (2005 - £nil).

Future developments
The Directors expect the level of investment in research and development expenditure to increase, which will give rise to further losses in the following year.

Directors
Membership of the Board (together with Directors' biographies) is shown in the section on Board of Directors and Senior Management. Details of Directors' remuneration and their interests in the share capital of the Company are given in the Directors' Remuneration Report. None of the Directors has any interest in any contract of significance to the financial statements.

Employees
Employees' remuneration
Vectura aims to provide remuneration packages that are competitive and designed to attract, retain and motivate employees. In addition to the payment of competitive salaries, Vectura also operates two discretionary bonus schemes. The first scheme, performance-related payments, is offered to all staff and Executive Directors. Performance-related payments may be made annually based on pre-determined individual and corporate performance objectives. Bonus award entitlements range between 10% and 50% (100% in the case of the Executive Directors) of salary depending on grade. The remuneration committee maintain the right to make one-off bonus awards for exceptional performance. The second scheme is an Employee Share Option Plan, under which option awards may be made to employees depending on their grade and length of service with the Company. All bonuses are provided for at the end of the financial year to which they relate. Further details of Directors' remuneration for the year are given in the Directors' Remuneration Report.

In addition, employees are given the opportunity to participate in the Group's Sharesave Scheme.

Employee involvement
During the year, Vectura continued its policy of providing employees with information about the Group through regular presentations by Directors, management and the Group's intranet. In addition, regular meetings are held between management and employees to allow for a free flow of information and ideas. A Staff Forum was formed in March 2005 to comply with the requirements of the Information and Consultation of Employees Regulations 2004, which implement the EC Directive. Vectura is not required to observe this legislation at present due to its current size. Nevertheless, the Board wishes to encourage constructive involvement.

Disabled employees
Applications for employment by disabled persons are always fully considered, bearing in mind the aptitudes of the applicant concerned. With regard to existing employees and those who may become disabled, Vectura's policy is to examine ways and means to provide continuing employment under its existing terms and conditions and to provide training and career development, including promotion, wherever appropriate.

Financial instruments
The policy and practice of the Group with regard to Financial Instruments is disclosed in note 17 of the financial statements.

Payment of creditors
The Group's policy in relation to its suppliers is to agree terms of payment when first contracting with a supplier, and to abide by those terms provided that it is satisfied that the supplier has provided the goods or services in accordance with such agreed terms and conditions. The Group operates a prompt payment policy in settling supplier invoices. The trade creditors carried in the balance sheet at 31 March 2006 represent 27 days of average purchases during the year for both the Group and Company (2005 - 30 days).

Political and charitable donations
Vectura encourages employee involvement in charitable causes. During the year, Vectura made contributions amounting to £350 (2005 - £350) to charitable organisations in the UK. This contribution was made in lieu of posting seasonal greetings to customers in December 2005. There were no political donations during the year (2005 - £nil).

Significant shareholdings
At 22 May 2006, the nearest practical date to the date of this report, the Company had a total of 559 ordinary shareholders and 115,269,681 ordinary shares in issue.

The Directors are aware of the following substantial holdings in the Company's share capital as at the close of business on 22 May 2006:

	Number of Shares '000	%
F&C Asset Management plc*	12,033	10.4%
Invesco Asset Management*	7,847	6.8%
Bluehone Investors LLP	6,338	5.5%
GAM UK Funds*	6,071	5.3%
Merlin Biosciences Funds*	5,856	5.1%
GLG Partners LP	4,995	4.3%
Boehringer Ingelheim International GmbH	4,940	4.3%
Aviva plc*	4,915	4.3%
Cambridge Consultants Limited	4,182	3.6%
J O Hambro Capital Management Limited	4,182	3.6%

*Includes all funds under management

Share price
The mid-market share price as derived from the London Stock Exchange Daily Official List was 104.5p on 31 March 2006. The mid-market share price ranged from 68p to 107.25p during the year to 31 March 2006. The average share price for the period was 86.3p.

Corporate social responsibility statement
The Directors recognise the increasing importance of corporate social responsibility and endeavour to take into account the interests of the Group's stakeholders, including its investors, employees, customers, suppliers and business partners when operating the business. The Group believes that having empowered and responsible employees who display sound judgement and awareness of the consequences of their decisions and actions, and who act in an ethical and responsible way, is key to the success of the business.

Equal opportunities policy
The Group is committed to achieving equality of opportunity in all its employment practices, policies and procedures. Employees are highly valued and their rights and dignity are respected. The Group does not tolerate any harassment or discrimination. The Group practises equal treatment of all employees or potential employees irrespective of their race, creed, colour, sexual orientation, nationality, ethnic origin, religion, disability, age, gender or marital status. The equal opportunities policy covers all permanent and temporary employees (including Non-Executive Directors), all job applicants, agency staff, associates, consultants and contractors. The Group also endeavours to be honest and fair in its relationships with customers and suppliers and to be a good corporate citizen, respecting the laws of countries in which it operates.

Family-friendly employment policies and careers
The maternity leave and maternity pay policy conforms with statutory requirements. Flexible approaches to return to work after maternity leave and part-time or non-standard hours and work patterns are considered where viable. The Group has adopted a paternity leave policy in line with recent legislative changes in the UK.

Environment
The Group is committed to complying with environmental legislation and minimising the impact of its activities on the environment. The Group considers that its activities have a low environmental impact. The Group is committed to minimising any adverse environmental impact of its Chippenham manufacturing facility and complies with UK environmental legislation.

Health and safety
Vectura has established a Health and Safety Committee to review health and safety standards within the Group on an ongoing basis. The Group considers health and safety to be a priority in its workplaces. The Group has an excellent safety record and there have been no major incidents or accidents to report to the Health and Safety Committee.

Going concern basis
Vectura is a research and development based emerging pharmaceutical company, which expects to incur further losses until revenues from royalty income and milestone receipts exceed expenditure on the product portfolio. The Directors have prepared projections which, by their nature, are inherently subject to some uncertainty, particularly in respect of revenues, but have reasonable expectations that the Group anticipates having sufficient cash resources to continue in operation for the foreseeable future. For this reason, the Board continues to adopt the going concern basis in preparing the financial statements.

Events since the balance sheet date
Details of post balance sheet events are disclosed in note 25 to the financial statements.

Annual General Meeting
The AGM of the Company will be held on 27 September 2006 at Olswang, 90 High Holborn, London WC1V 6XX. Details of the business to be transacted at the AGM can be found in the separate Circular to shareholders accompanying this report.

Auditors
A resolution to reappoint Ernst & Young LLP as auditors to the Group will be put to the members at the Annual General Meeting.

Directors' statement as to disclosure of information to auditors
The Directors who were members of the board at the time of approving the Directors' Report are listed on page 16. Having made enquiries of fellow directors and of the Company's auditors, each of these directors confirms that:

- to the best of each Director's knowledge and belief, there is no information relevant to the preparation of their report of which the Company's auditors are unaware; and
- each Director has taken all the steps a director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the Company's auditors are aware of that information.

By order of the Board

Anne Hyland
Company Secretary

24 May 2006

Corporate governance statement

Companies that have securities that trade on AIM are not required to comply with the disclosure requirements of the Combined Code. However, the Board is committed to practising good corporate governance as part of its aim to deliver shareholder value. In assessing the appropriate standards of corporate governance the Board takes into account the nature and size of the operation which comprised, at 31 March 2006, five directors and 124 staff operating from two sites in the UK. The Board is reporting here as a matter of best practice on its compliance with the new Combined Code on Corporate Governance (the "Code", published in July 2003).

Statement of compliance

The Company has been in compliance with the provisions set out in Section 1 of the Code throughout the year, other than in relation to Provision B.1.3 concerning the granting of share options to Non-Executive Directors (NEDs).

Whilst the Code discourages the granting of share options to NEDs, it nevertheless acknowledges that such grants may be appropriate in a particular company's circumstances. For the reason set out below and as stated in the Company's Listing Particulars dated 25 June 2004, the Board is of the view that the granting of share options to NEDs remains appropriate for the Company.

It is essential for an emerging pharmaceutical company like Vectura to secure the recruitment and retention of high calibre NEDs with the appropriate experience and international perspective in the context of the Company's stage of development. The Board is of the view that the ability to issue share options to NEDs enables this process.

The principles set out in the Combined Code cover four areas: the Board, Directors' remuneration, accountability and audit and shareholder relations. With the exception of Directors' remuneration (which is dealt with separately in the Directors' Remuneration Report), the following sets out how the Board has applied such principles.

The Board

The Code requires every company to be headed by an effective board, which is collectively responsible for the success of the Company. As part of its leadership and control of the Company, the Board has an agreed list of items that are specifically reserved for its consideration. These include strategy and management, financial reporting and controls, internal controls, major contracts, external communications with investors, Executive Committee appointments and remuneration, appropriate delegation of authority, corporate governance matters and appropriate policies for key areas including health and safety, corporate social responsibility and the environment. The Board considers that it has shown its commitment to leading and controlling the Company by meeting on a regular basis throughout the year and conducting strategy and budget reviews.

Division of responsibilities between Chairman and Chief Executive

The Board has shown its commitment to dividing responsibilities for running the Board and running the Company's business by: appointing Jack Cashman as Non-Executive Chairman; naming Dr John Brown as Senior Independent Director; establishing an executive management team (Vectura Executive Committee, the "VEC") under the leadership of the Chief Executive, Dr Chris Blackwell; and establishing a procedure whereby the VEC reports formally to the Board at each Board meeting.

Board balance

The Code requires a balance of Executive Directors and NEDs (and in particular independent NEDs) such that no individual or small group of individuals can dominate the Board's decision-taking. A smaller company, such as Vectura, must have at least two independent NEDs. Three of the five current Board members are NEDs. The NEDs come from diverse business backgrounds and each has specific expertise, materially enhancing the judgement and overall performance of the Board.

Independence of NEDs
As explained in the statement of compliance on page 21, in order to assist in securing the recruitment and retention of high calibre NEDs, the Company has remunerated NEDs in the form of options to acquire shares in the Company, in addition to fees. The Board has determined that all its NEDs are independent.

The holding of share options by NEDs could be, amongst other things, relevant in determining whether a NED is independent. After detailed consideration, the Board has determined that it does not believe that the holding of share options by its NEDs impacts on their independence in character and judgement. Options granted to NEDs are not subject to any performance conditions and the number of shares which may be acquired on the exercise of an option is solely dependent on the NED's period of service with the Company.

Other factors that may reflect on the independence of a NED include any material business relationships with the Company. Dr Richards provides advice to the Company on request on particular scientific and technical matters within his area of expertise. Dr Richard's consultancy fees for these services are paid to Croggan Limited, which totalled £5,000 in the year ended 31 March 2006. The Board considers that this arrangement does not in any way affect Dr Richards' independent judgement. Dr Richards is currently a Director and shareholder in PharmaKodex Limited, a company of which Vectura owns 49.99% of the issued share capital and Dr Richards 4.81%. At 31 March 2006 Vectura owned 100% of the issued share capital of PharmaKodex, the reduction in shareholding is a post balance sheet event and is recorded in note 25 of the financial statements. The Directors do not consider that this arrangement compromises his independence because his responsibilities include management of Vectura's investment in PharmaKodex.

The Board has established a Remuneration Committee, a Nomination Committee and an Audit Committee, whose make-up complies with the requirements of the Code. The terms of reference of each Committee can be downloaded from the Company's website. In accordance with the Smith Guidance on Board Committees, no one other than the Committee Chairman and committee members receive automatic invitations to the meetings. The NED members of the Board each serve on the three Board Committees, as described below. The Board has considered the composition of the Committees and concluded that the independence and objectivity of the individual NEDs is in no way impaired thereby.

The Remuneration Committee
The Code requires that, in the case of a smaller company, the Remuneration Committee consists of at least two independent NEDs. Dr Brown chairs the Remuneration Committee, its other members being Mr Cashman and Dr Richards. The Committee has responsibility for making recommendations to the Board on the Company's policy on the performance evaluation and remuneration of Directors and for determining, within agreed terms of reference, specific remuneration packages for each of the Directors and members of the Vectura Executive Committee, including pension rights, any compensation payments and the implementation of executive incentive schemes. The Committee met three times during the financial year ended 31 March 2006 and the Board can confirm full attendance by all member Directors. The Committee plans to meet at least twice a year in future.

The Nomination Committee
The Nomination Committee leads the process for Board appointments and makes recommendations to the Board. The Code recommends that a majority of members of the Nomination Committee are independent NEDs. Dr Brown chairs the Nomination Committee and its other members are Mr Cashman and Dr Richards. The Nomination Committee meets at least once a year, or more if necessary, and has responsibility for considering the size, structure and composition of the Board, retirements and appointments of additional and replacement Directors and making appropriate recommendations to the Board. The Committee met once during the financial year ended 31 March 2006 and the Board can confirm full attendance by all member Directors. The Committee plans to meet at least once a year in future.

The Audit Committee
The Code recommends that the Board should establish an Audit Committee of at least three independent NEDs, one of whom has recent and relevant financial experience. The Company complies with these recommendations. Dr Brown is Chairman of the Committee the other members being Mr Cashman and Dr Richards. The Audit Committee met three times during the year and intends to meet not less than three times a year in future years. The Board can confirm full attendance by all member Directors. The Audit Committee is responsible for making recommendations to the Board on the appointment, reappointment and removal of the external Auditors and assesses annually the qualification, expertise, resources, remuneration and independence of the Auditors, as well as the effectiveness of the audit process.

Any non-audit services that are to be provided by the external auditors are reviewed in order to safeguard Auditor objectivity and independence. The Board can confirm that there have been no significant non-audit services that are considered to have impaired the objectivity and independence of the external Auditors. A full breakdown of payments made to the external Auditors during the financial year is disclosed in note 5 to the financial statements.

The Code requires that this Annual Report separately describes the work of the Audit Committee and how it discharges its responsibilities. The Audit Committee focuses particularly on compliance with legal requirements, accounting standards and the Code, and on ensuring that an effective system of internal financial controls is maintained. The ultimate responsibility for reviewing and approving the financial statements in the Interim and Annual Reports remains with the Board. Written terms of reference are modelled on the Code provisions and set out the main roles and responsibilities of the Audit Committee. The Audit Committee reports to the Board, identifying any need for action or improvement on any of these terms of reference and making recommendations as to the steps to be taken. The Board reviews the effectiveness of the Audit Committee.

The Audit Committee meets with the external Auditors at least once a year without management present and its Chairman keeps in touch, as required, with the key people involved in the Company's governance, including the Board Chairman, the Chief Executive, the Chief Financial Officer and the external audit lead partner. All Audit Committee members understand the role of the Audit Committee, its terms of reference, their expected time commitments and have the necessary overview of the Company's business, financial dynamics and risk.

The Audit Committee reviews the financial integrity of the Group's financial statements, including relevant corporate governance statements prior to Board submission.

Timeliness and quality of Board information
The Board has sought to ensure that Directors are properly briefed on issues arising at Board meetings by establishing procedures for distributing Board papers in a timely manner in advance of meetings. The Board met formally seven times during the financial year ended 31 March 2006 and these meetings were augmented with regular Board conference calls. The Board can confirm full attendance by all Directors during the year.

Board performance evaluation
Directors are subject to election by shareholders at the first opportunity after their appointment, and to re-election thereafter at intervals of no more than three years. The Board has a process for evaluation of its own performance and that of its committees and individual Directors, including the Chairman. These evaluations are carried out on a regular basis throughout the year. The performance of Mr Jack Cashman and Ms Anne Hyland, who are being proposed for re-election at the AGM, has been so evaluated and it has been determined that they continue to perform effectively and show full commitment to their roles on the Board.

Accountability and audit
The Board is responsible for the preparation of an Annual Report that presents a balanced and understandable assessment of the Group's financial position and prospects. This responsibility is administered primarily by the Audit Committee. In addition, reference should be made to the Statement of Directors' Responsibilities in relation to the financial statements set out on page 35. The independent Auditors' report includes a statement by the Auditors about their reporting responsibilities.

Maintenance of a sound system of internal control
The Board has overall responsibility for the Group's system of internal control and for reviewing its effectiveness. The Group's internal controls are regularly reviewed as part of the risk management process. Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss. The concept of reasonable assurance recognises that the cost of a control procedure should not exceed the expected benefits.

Risk assessment review
An ongoing process for identifying, evaluating and managing the significant risks faced by the Group is in place. The effectiveness of the Group's internal control system has been reviewed by the Board during the year. The Audit Committee's terms of reference include the review of the Group's internal financial control systems and it recommends to the Board any improvements required. The Audit Committee considers the need for an internal audit function annually and has concluded that, given the size of the Group's operations at this time, it is not necessary. The Board carries out reviews of the non-financial control systems.

Key internal controls
The Group's organisational structure has clearly established responsibilities and lines of accountability. Employees are required to follow clearly laid-out internal procedures and policies appropriate to the business and their position within the business.

The Group endeavours to appoint employees with appropriate skills, knowledge and experience for the roles they undertake.

The Board has shown its commitment to formal and transparent arrangements for internal control by, amongst other things, reviewing the Group's arrangements for its employees to raise concerns, in confidence, about possible wrongdoing (formalised in a "grievance procedure" policy circulated to all employees).

Documented quality procedures are in place to ensure the maintenance of regulatory compliance. These are subject to periodic review to ensure current standards of quality compliance are maintained. A quality group monitors compliance with Good Laboratory Practice (GLP), Good Clinical Practice (GCP) and Good Manufacturing Practice (GMP) through the implementation of a compliance programme for in-house and contracted-out activities

The Group has set up a formal Health & Safety Committee, comprising appropriate members of management and other employees, to be responsible for these issues.

The Group has formal procedures to ensure appropriate security of documents and proprietary information.

The Group has reviewed its portfolio of insurance policies with its insurance broker to ensure that the policies are appropriate to the Group's activities, size and exposures.

A comprehensive budgeting system allows managers to submit detailed budgets which are reviewed and amended by Executive Directors prior to submission to the Board for approval. At the end of each quarter a forecast is prepared in the same level of detail as the budget. Reports of actual results against budget and forecast, highlighting variances, are prepared for managers and the Board.

Shareholder relations

The Company reports formally to shareholders twice a year by way of the Interim and Annual Reports. Separate announcements of all material events are made as necessary by press releases that are posted on the Company's website and automatically sent to all shareholders who are Vectura registered website users. These are the main mechanisms by which the Board seeks to present a balanced and understandable assessment of the Company's position and prospects. All periodic reports and accounts are mailed to shareholders. The Vectura website (www.vectura.com) provides additional information about the Company and allows access to reports and accounts, press releases and other materials issued by the Company.

Regular communications are maintained with institutional shareholders and, in particular, presentations are given to shareholders when the half- and full-year financial results are announced.

Dr Brown, as Senior Independent Director, is contactable by shareholders through a link on the Company website. In addition, all NEDs have developed an understanding of the views of shareholders through corporate broker briefings and review of issued analyst notes.

Constructive use of the AGM

The Board seeks to use the AGM (together with other forums) to communicate with investors and encourage their participation by arranging business presentations and inviting shareholder questions. The Chairman of the Audit, Nomination and Remuneration Committees is present at the AGM to answer questions, through the Chairman of the Board.

Anne Hyland
Company Secretary

24 May 2006

Directors' remuneration report

Introduction

Companies that have securities that trade on AIM are not required to comply with the disclosure requirements of Directors' Remuneration Report Regulations 2002 (the "Regulations") or to comply with the UKLA Listing Rules and the disclosure provisions under Schedule 7A of the Companies Act 1985. However, the Remuneration Committee is committed to following best practice and thus this report has been prepared in accordance with these provisions and a resolution to approve the report will be proposed at the Company's AGM in September. Details of the resolution can be found in the Circular accompanying this report. The vote will be advisory and will be considered carefully by the members of the Remuneration Committee in the formulation and approval of the Company's future remuneration policies.

The Regulations require the Auditors to companies on the main list to report to the Group's members on the "auditable part" of the Directors' Remuneration Report and state whether in their opinion that part of the report has been properly prepared in accordance with the Companies Act 1985 (as amended by the Regulations). The report has therefore been divided into separate sections for unaudited and audited information. Whilst there is no requirement for the auditors to report on the "auditable part" for Vectura Group plc, they have done so at our request, again as a matter of best practice.

Unaudited information

Remuneration Committee

The Remuneration Committee consists entirely of Non-Executive Directors (NEDs) and is constituted in accordance with the recommendations of the Combined Code. Its members for the year were Mr J Cashman, Dr A J M Richards and Dr J R Brown (Chairman). The Committee met three times during year ended 31 March 2006 and seeks independent advice, where appropriate, for the purpose of determining all aspects of the remuneration of each Executive Director. The remuneration of each Executive Director is determined by the Committee (including the award of annual bonuses and share options), as are the terms of their service agreements. If appropriate, the Committee will commission reports from expert remuneration consultants. The Committee also recommends to the Board the fees paid to the Chairman. The fees of the Non-Executive Directors are determined by the Board on the joint recommendation of the Chairman and the Chief Executive.

None of the Committee's members has any personal financial interest (other than as shareholder) or conflicts of interests arising from cross-directorships or day-to-day involvement in running the business (see note 24 to the financial statements). No Director plays a part in any discussion about his own remuneration.

In determining the Directors' remuneration for the year, the Committee reviewed executive compensation packages in the UK pharmaceutical sector. It also referred to a number of specialist studies on executive remuneration.

Remuneration policy

Policy on remuneration of Executive Directors

In determining the Group's policy, and in constructing the remuneration arrangements of each Executive Director, the Board, advised by the Remuneration Committee, aims to provide remuneration packages that are competitive and designed to attract, retain and motivate Executive Directors of the highest calibre. To achieve this objective, the Committee takes account of information from both internal and independent sources.

The total remuneration of each individual Executive Director is benchmarked against the relevant sector. Vectura's policy is to provide remuneration generally at levels that are broadly aligned with the mid-points for equivalent roles in comparable companies in Europe and the US.

The Group's ongoing policy is that a substantial proportion of the remuneration of Executive Directors should be performance-related. Performance measures are balanced between internal measures and sector comparative measures to achieve maximum alignment between executive and shareholder objectives. Base salaries can be supplemented by performance-related bonuses. Performance objectives are set at the start of each year.

Components of the remuneration package
The principal components of Executive Directors' remuneration packages are base salary, short-term incentives, medium- and long-term incentives, and pension benefits. The policy in relation to each of these components, and key terms of the various incentive and benefit programmes, is explained further below.

Basic salary
Basic salaries are reviewed annually taking into account recommendations on individual performance and salary levels in comparable companies.

In formulating its decision, the Committee takes into account appropriate benchmarks. For the financial year ended 31 March 2006, the Committee chose the UK pharmaceutical sector.

Each Executive Director's base salary was broadly aligned with the mid-points of the chosen UK pharmaceutical sector comparator group and adjusted to reflect company size and complexity. Basic salaries aligned with these mid-points, combined with cash and bonus incentives, continue to provide competitive compensation packages, in which performance-related components represent a substantial element.

Performance-related bonuses
Executive Directors are eligible for an annual discretionary bonus, whereby performance objectives are established at the beginning of the financial year by reference to suitably challenging corporate achievements. Performance-related payments may be paid annually, dependent upon achievements measured against objectives. Executive Directors are entitled to bonuses in the form of cash. Cash bonuses are limited to a maximum of 100% of basic salary for each Director, however the Remuneration Committee maintains the right to make one-off bonus awards for exceptional performance.

Bonus awards may be made over shares having a value equal to the Director's annual cash bonus, which, as stated above, is itself based on corporate performance objectives being met and is not therefore subject to any further performance conditions. Awards vest in three equal tranches, on the first, second and third anniversaries of the date on which the award is made and, on vesting, the award converts to a share option with a grant price of current market value which is exercisable over 10 years. Participation is at the discretion of the Committee. Vectura operates the Plan in order to provide additional incentives to its key senior executives, recognising that the retention and recruitment of such employees is critical to the Company's long-term success.

Share options
The limit on the market value of shares which may be placed under option annually for each Executive Director is set by the Committee.

Executive Directors hold options under the Unapproved Share Option Plan, the Enterprise Management Incentive arrangements (the EMI Plan), and the Sharesave Share Option Scheme.

The exercise price of the options granted under the above schemes is equal to the market value of the Company's shares at the time when the options are granted. The Company's policy is to grant options annually to Executive Directors at the discretion of the Remuneration Committee, taking into account individual performance. The Company received approval at the Annual General Meeting held on 12 September 2005 for a new Long-Term Incentive Plan (LTIP), under which participating Executives are granted an annual award under the LTIP. At the end of a 3-year performance period shares are released to the Executive depending on the achievement of set Performance Conditions. It is the Company's policy to phase the granting of share options, rather than to award a single large block to any individual.

The Company also operates a Sharesave Share Option Scheme for employees and Executive Directors. Under this Scheme all eligible employees and Directors are invited to subscribe for options, which may be granted at a discount of up to 20% of market value. The Sharesave Share Option Scheme is an all-employee plan to which performance conditions do not apply.

The Company's current policy is to grant NEDs share options (in addition to fees) as part of their remuneration package. This is considered to be essential to secure the recruitment and retention of high calibre NEDs with the appropriate experience and international perspective in the context of the Company's stage of development.

Options will become exercisable to the extent vested, which is dependent only on the NED remaining with the Company. Options granted following the IPO will vest as to one third annually on the first, second and third anniversary of grant. The Board considers that the terms of the options will not in any way affect the independent judgement of Mr Cashman, Dr Brown or Dr Richards, or any additional independent Director to be appointed in the future.

Full details of Directors' interests in ordinary shares of the Company together with options granted and exercised in the financial year ended 31 March 2006 are set out on pages 30 and 31 respectively.

Long-Term Incentive Plan

At the AGM on 12 September 2005 approval was received for the Long-Term Incentive Plan ("LTIP"). The LTIP provides for the award of whole shares, subject to performance conditions based on the relative performance of the Group's shares compared to other similar companies over time. Under the LTIP each participating Executive is granted an annual award of shares, which are held over a performance period of three years. At the end of the performance period a percentage of the shares is released to the Executive dependent upon the Group's comparative Total Shareholder Return (TSR) performance compared to a comparator group of quoted UK pharmaceutical and biotechnology companies. Awards will be released in accordance with the following table:

Level of comparative TSR performance over performance period	Percentage of the LTIP award released
Below median	0%
At or above median	30%*
Upper quartile	100%*

* Straight line vesting between points

In addition, the Remuneration Committee is required to ensure that the underlying financial performance of the Group is consistent with its TSR performance, by considering the Group's performance against a range of objective financial measures. If the Committee believes that the underlying corporate financial performance is not consistent with its TSR performance, then no LTIP Awards will be released.

The Comparator Group of companies to which the performance of Vectura Group plc is compared is as follows:

Acambis plc
Alizyme plc
Allergy Therapeutics plc
Antisoma plc
Ark Therapeutics plc
Axis-Shield plc
CAT Group plc
CeNeS Pharma plc
Futura Medical plc
GW Pharmaceutical plc
Innovata plc
NeuTec Pharma plc
Oxford BioMedica plc
Proteome Sciences plc
Protherics plc
Sinclair Pharma plc
SkyePharma plc
Vernalis Group plc

During the year ended 31 March 2006 grants of shares were made to Dr Blackwell and Ms Hyland under the LTIP scheme. The market price of the shares on the date of grant of the LTIP awards was 83p.

Pension arrangements

All employees, including Executive Directors, are invited to participate in the Group Personal Pension Plan, which is money-purchase in nature. The only pensionable element of remuneration is basic salary. During the year, the Group contributed 10% of basic salary to the Group Personal Pension Plan in the name of the Executive Directors.

Performance graph

The following graph shows the Company's performance, measured by Total Shareholder Return compared with the performance of the Comparator Group of companies in the sector as described on the previous page, measured by total shareholder return since the Company's initial listing.

Directors' service contracts

It is the Company's policy that Executive Directors should have contracts with an indefinite term providing for a maximum of one year's notice. This applies to the contracts of Dr Blackwell and Ms Hyland, which were effective from 25 June 2004. All Executive Directors are subject to re-election at an AGM at intervals of no more than three years.

Non-Executive Directors

All NEDs have specific terms of engagement with an indefinite term (terminable on three months' notice by either party) and their remuneration is determined by the Board within the limits set by the Articles of Association and based on a review of fees paid to NEDs of similar companies. NEDs are not eligible to join the Group's pension scheme. All NEDs are subject to re-election at an AGM at intervals of no more than three years.

The dates of appointment of each of the NEDs serving at 31 March 2006 are summarised in the table below:

Name of director	Date of appointment
J R Brown	13 May 2004
J Cashman	27 March 2001
A J M Richards	21 January 2000

Directors' interests

The Directors who held office at 31 March 2006 and their interests in the share capital of the company at 31 March 2005 and 31 March 2006 were as follows:

	31 March 2006 ordinary shares of 0.025p each	31 March 2005 ordinary shares of 0.025p each
C P Blackwell	51,948	51,948
J R Brown[1]	20,457	20,457
J Cashman	434,749	434,749
A P Hyland	58,180	58,180
A J M Richards	84,998	72,728

[1] The holding of J R Brown includes 8,929 ordinary shares of 0.025p each which are held through nominees.

There was no change in the Directors' interests between 31 March 2006 and 24 May 2006, the date of this report.

Audited information

Directors' remuneration

The total amounts for Directors' remuneration were as follows:

	2006 £'000	2005 £'000
Emoluments	908	724
Money-purchase pension contributions	39	33
	947	757

The remuneration of the individual Directors who served during the year was as follows:

	Basic salary and fees £'000	Bonuses £'000	Benefits[2] £'000	Total emoluments 2006 £'000	Total emoluments 2005 £'000
Executive Directors:					
C P Blackwell	228	249	1	478	361
A P Hyland	162	177	1	340	243
J N Staniforth (resigned 9 June 2004)	-	-	-	-	27
Non-Executive Directors:					
J R Brown	25	-	-	25	22
J Cashman	40	-	-	40	37
A J M Richards [1]	25	-	-	25	24
M R Clement [3] (resigned 9 June 2004)	-	-	-	-	3
D J G Davies (resigned 9 June 2004)	-	-	-	-	3
A Holloway [3] (resigned 9 June 2004)	-	-	-	-	4
B R Moon (resigned 9 June 2004)	-	-	-	-	-
	480	426	2	908	724

[1] In addition to the above, fees for consultancy services of £5,000 (2005 - £10,000) were paid to Dr A J M Richards, who is a leading scientist, for specialist scientific advice not connected with his services as a Director. The fees received were paid through a consultancy company, Croggan Limited.

[2] Benefits represent payments for medical insurance.

[3] Fees for services as Non-Executive Director were paid to a third party.

Directors' pension entitlements

The money-purchase pension contributions paid by the Company for Executive Directors were as follows:

	2006 £'000	2005 £'000
C P Blackwell	23	18
A P Hyland	16	13
J N Staniforth	-	2
	39	33

The following Directors who held office at 31 March 2006 had options outstanding over ordinary shares of 0.025p as follows:

Director	Plan	Options held at 1 April 2005	Options granted during year	Options held at 31 March 2006	Exercise price (p)	Date from which first exercisable	Expiry date
J Cashman	Unapproved	166,232	-	166,232	48.125	18/04/04	18/04/11
	Unapproved	680,000	-	680,000	36.000	29/04/04	29/04/14
	Unapproved	238,989	-	238,989	56.000	02/07/05	02/07/14 [1]
		1,085,221	-	1,085,221			
C P Blackwell	EMI	277,776	-	277,776	48.125	05/11/05	03/11/12
	Unapproved	122,224	-	122,224	48.125	01/10/05	01/10/12
	Unapproved	23,376	-	23,376	48.125	11/04/06	11/04/13
	Unapproved	1,162,704	-	1,162,704	36.000	29/04/07	29/04/14
	Unapproved	716,966	-	716,966	56.000	02/07/05	02/07/14 [1]
	SAYE Scheme	18,651	-	18,651	50.800	01/04/08	30/09/08
	Unapproved	-	132,424	132,424	82.500	03/08/06	03/08/15 [1]
		2,321,697	132,424	2,454,121			
J R Brown	Unapproved	222,224	-	222,224	36.000	29/04/04	29/04/14
	Unapproved	238,989	-	238,989	56.000	02/07/05	02/07/14 [1]
		461,213	-	461,213			
A P Hyland	EMI	243,900	-	243,900	48.125	19/03/05	17/03/12
	Unapproved	196,100	-	196,100	48.125	18/03/05	18/03/12
	Unapproved	33,896	-	33,896	48.125	11/04/06	11/04/13
	Unapproved	595,684	-	595,684	36.000	29/04/07	29/04/14
	Unapproved	358,483	-	358,483	56.000	02/07/05	02/07/14 [1]
	SAYE Scheme	18,651	-	18,651	50.800	01/04/08	30/09/08
	Unapproved	-	94,090	94,090	82.500	03/08/06	03/08/15 [1]
		1,446,714	94,090	1,540,804			
A J M Richards	Unapproved	500,000	-	500,000	36.000	29/04/04	29/04/14
	Unapproved	238,989	-	238,989	56.000	02/07/05	02/07/14 [1]
		738,989	-	738,989			

[1] Exercisable over three equal annual instalments from date first exercisable.

All options were granted for nil consideration. No options were exercised by Directors during the year.

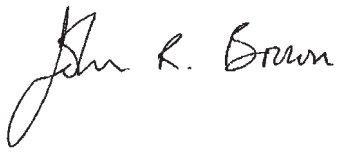
LTIP awards

Under the new LTIP scheme the grants made to Directors during the year ended 31 March 2006 were as follows. The number of shares released to the executives at the end of the 3-year performance period is dependent upon the performance of the Company during that period.

	Value of shares conditionally awarded during the year	% of salary	No. of shares conditionally awarded during the year	Date of the end of the holding period when shares may be released
C P Blackwell	£285,000	125	361,741	12/09/2008
A P Hyland	£202,500	125	261,290	12/09/2008

The market value of the ordinary shares at close of business on 31 March 2006 was 104.5 pence and the range during the year was 68 pence to 107.25 pence.

On behalf of the Board



John Brown
Chairman of the Remuneration Committee

24 May 2006

Financial statements

Financial table of contents

Statement of Directors' responsibilities

in relation to the financial statements

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable United Kingdom law and those International Financial Reporting Standards as adopted by the European Union.

The Directors are required to prepare financial statements for each financial year which present fairly the financial position of the Company and of the Group and the financial performance and cash flows of the Company and of the Group for that period. In preparing those financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information; and
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- state that the Company has complied with IFRSs, subject to any material departures disclosed and explained in the financial statements.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and of the group and enable them to ensure that the financial statements comply with the Companies Act 1985 and Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

On behalf of the Board

Anne Hyland
Company Secretary

24 May 2006

Independent auditors' report

to the shareholders of Vectura Group plc

We have audited the Group and parent company financial statements (the financial statements) of Vectura Group plc for the year ended 31 March 2006 which comprise the Consolidated Income Statement, Consolidated Balance Sheet, Consolidated Cash Flow Statement, Consolidated Statement of Changes in Equity, Company Balance Sheet, Company Cash Flow Statement, Company Statement of Changes in Equity and the related notes 1 to 26. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

This report is made solely to the company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company's members as a body, for our audit work, for this report or for the opinions we have formed.

Respective responsibilities of directors and auditors
The directors' are responsible for preparing the Annual Report, the Directors' Remuneration Report and the financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRSs) as adopted by the European Union as set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements, International Standards on Auditing (UK and Ireland) and Listing Rules of the Financial Services Authority.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration Report to be audited are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises only the Highlights, Chairman's and Chief Executive's Review, Financial Review, Corporate Governance Statement, unaudited part of the Directors' Remuneration Report, Directors' Report. We consider the implications for our report if we become aware of any apparent misstatement or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Directors' Remuneration Report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Directors' Remuneration Report to be audited.

Opinion
In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 March 2006 and of its loss for the year then ended;
- the parent company financial statements give a true and fair view, in accordance with IFRSs adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent company's affairs as at 31 March 2006; and
- the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985.

Separate opinion in relation to IFRSs
As explained in Note 1 to the Group financial statements, the Group, in addition to complying with its legal obligation to comply with those IFRSs as adopted by the European Union, has also complied with IFRSs as issued by the International Accounting Standards Board.

In our opinion the Group financial statements give a true and fair view, in accordance with IFRSs, of the state of the Group's affairs as at 31 March 2006 and of its loss for the year then ended.

Ernst & Young LLP
Registered Auditors
Bristol

24 May 2006

Consolidated income statement

for the year ended 31 March 2006

	Notes	31 March 2006 £'000	31 March 2005 £'000
Revenue	2	8,411	4,484
Cost of sales		(1,965)	(1,472)
Gross profit		6,446	3,012
Research and development expenses		(12,397)	(9,719)
Other administrative expenses		(1,783)	(2,239)
Share-based compensation		(741)	(621)
Administrative expenses		(2,524)	(2,860)
Operating loss	5	(8,475)	(9,567)
Interest income	4	1,042	755
Finance costs	4	(6)	(155)
Loss before taxation		(7,439)	(8,967)
Taxation	7	984	1,181
Loss after taxation attributable to equity holders of the Company		(6,455)	(7,786)
Loss per ordinary share basic and diluted	8	(6.0p)	(8.7p)

All results are derived from continuing activities.

Consolidated balance sheet

at 31 March 2006

	Notes	31 March 2006 £'000	31 March 2005 £'000
Assets			
Goodwill and intangible assets	9	2,012	2,012
Property, plant and equipment	10	4,071	3,102
Other receivables	12	428	428
Non-current assets		6,511	5,542
Trade and other receivables	13	4,689	850
Cash and cash equivalents		16,828	18,388
Current assets		21,517	19,238
Total assets		28,028	24,780
Liabilities			
Loans and obligations under finance leases	15	-	14
Deferred income	16	2,258	-
Non-current liabilities		2,258	14
Trade and other payables	14	4,489	2,784
Deferred income	16	4,666	-
Current liabilities		9,155	2,784
Total liabilities		11,413	2,798
Net assets		16,615	21,982
Equity			
Share capital	18a	62	61
Share premium	18b	22,869	22,523
Shares to be issued	18c	918	918
Special reserve	18d	8,245	8,245
Merger reserve	18e	3,211	3,211
Share-based compensation reserve	18f	1,403	662
Retained loss		(20,093)	(13,638)
Total equity		16,615	21,982

The Financial Statements on pages 38 to 71 were approved by the Board of Directors on 24 May 2006 and were signed on its behalf by:

Dr C P Blackwell
Director

A P Hyland
Director

Consolidated cash flow statement

for the year ended 31 March 2006

	Notes	31 March 2006 £'000	31 March 2005 £'000
Net cash flows from operating activities	20	(1,560)	(4,982)
Cash flows from investing activities			
Interest received		1,042	755
Purchase of property, plant and equipment		(1,295)	(492)
Net cash flows from investing activities		(253)	263
Cash flows from financing activities			
Proceeds from issue of redeemable preference shares		-	34
Proceeds from issue of ordinary shares		347	23,651
Share issue costs		-	(1,117)
Payment of finance lease liabilities		(84)	(141)
Repayment of loans		(4)	(1,272)
Interest element of payments under finance leases		(5)	(16)
Interest on loans		(1)	(139)
Net cash flows from financing activities		253	21,000
(Decrease)/increase in cash and cash equivalents		(1,560)	16,281
Cash and cash equivalents at beginning of period		18,388	2,107
Cash and cash equivalents at end of period		16,828	18,388

Consolidated statement of changes in equity

for the year ended 31 March 2006

	Share capital £'000	Share premium £'000	Shares to be issued £'000	Special reserve £'000	Merger reserve £'000	Share-based compensation reserve £'000	Retained loss £'000	Total equity £'000
Note	18a	18b	18c	18d	18e	18f		
At 1 April 2004	16	20,781	867	-	3,020	41	(18,388)	6,337
Loss for the year	-	-	-	-	-	-	(7,786)	(7,786)
Total recognised income and expense for the year	-	-	-	-	-	-	(7,786)	(7,786)
Cancellation of share premium account	-	(20,781)	-	20,781	-	-	-	-
Transfer of parent company retained loss to special reserve	-	-	-	(11,399)	-	-	11,399	-
Issue of redeemable preference shares	34	-	-	-	-	-	-	34
Conversion of Loan Note to ordinary shares	1	1,519	-	-	-	-	-	1,520
Issue of ordinary shares	10	22,121	-	-	-	-	-	22,131
Share issue costs	-	(1,117)	-	-	-	-	-	(1,117)
Shares issued	-	-	(145)	-	191	-	-	46
Shares cancelled	-	-	(72)	-	-	-	-	(72)
Uplift in market value for shares to be issued	-	-	268	-	-	-	-	268
Transfer of parent company deficit on profit and loss account at 22 June 2004 to special reserve	-	-	-	(1,137)	-	-	1,137	-
Share-based compensation	-	-	-	-	-	621	-	621
At 1 April 2005	61	22,523	918	8,245	3,211	662	(13,638)	21,982
Loss for the year	-	-	-	-	-	-	(6,455)	(6,455)
Total recognised income and expense for the year	-	-	-	-	-	-	(6,455)	(6,455)
Share-based compensation	-	-	-	-	-	741	-	741
Exercise of warrants and options	1	346	-	-	-	-	-	347
At 31 March 2006	62	22,869	918	8,245	3,211	1,403	(20,093)	16,615

Company balance sheet

at 31 March 2006

	Notes	31 March 2006 £'000	31 March 2005 £'000
Assets			
Goodwill and intangible assets	9	783	783
Property, plant and equipment	10	2,225	704
Investments	11	10,496	10,070
Other receivables	12	428	428
Non-current assets		13,932	11,985
Trade and other receivables	13	4,675	850
Cash and cash equivalents		16,763	18,388
Current assets		21,438	19,238
Total assets		35,370	31,223
Liabilities			
Loans and obligations under finance leases	15	-	14
Deferred income	16	584	-
Non-current liabilities		584	14
Trade and other payables	14	4,625	2,971
Deferred income	16	4,107	-
Current liabilities		8,732	2,971
Total liabilities		9,316	2,985
Net assets		26,054	28,238
Equity			
Share capital	18a	62	61
Share premium	18b	22,869	22,523
Shares to be issued	18c	1	1
Special reserve	18d	8,245	8,245
Share-based compensation reserve	18f	1,403	662
Retained loss		(6,526)	(3,254)
Total equity		26,054	28,238

Company cash flow statement

for the year ended 31 March 2006

	Notes	31 March 2006 £'000	31 March 2005 £'000
Net cash flows from operating activities	20	(1,199)	(3,217)
Cash flows from investing activities			
Increase in investment in subsidiaries		(426)	(1,862)
Interest received		1,042	755
Purchase of property, plant and equipment		(1,295)	(395)
Net cash flows from investing activities		(679)	(1,502)
Cash flows from financing activities			
Proceeds from issue of redeemable preference shares		-	34
Proceeds from issue of ordinary shares		347	23,651
Share issue costs		-	(1,117)
Payment of finance lease liabilities		(84)	(141)
Repayment of loans		(4)	(1,272)
Interest element of payments under finance leases		(5)	(16)
Interest on loans		(1)	(139)
Net cash flows from financing activities		253	21,000
(Decrease)/increase in cash and cash equivalents		(1,625)	16,281
Cash and cash equivalents at beginning of period		18,388	2,107
Cash and cash equivalents at end of period		16,763	18,388

Company statement of changes in equity

for the year ended 31 March 2006

	Share capital £'000	Share premium £'000	Shares to be issued £'000	Special reserve £'000	Share-based compensation reserve £'000	Retained loss £'000	Total equity £'000
Note	18a	18b	18c	18d	18f		
At 1 April 2004	16	20,781	1	-	41	(11,487)	9,352
Loss for the year	-	-	-	-	-	(4,303)	(4,303)
Total recognised income and expense for the year	-	-	-	-	-	(4,303)	(4,303)
Cancellation of share premium account	-	(20,781)	-	20,781	-	-	-
Transfer of parent company retained loss to special reserve	-	-	-	(11,399)	-	11,399	-
Issue of redeemable preference shares	34	-	-	-	-	-	34
Conversion of Loan Note to ordinary shares	1	1,519	-	-	-	-	1,520
Issue of ordinary shares	10	22,121	-	-	-	-	22,131
Share issue costs	-	(1,117)	-	-	-	-	(1,117)
Transfer of parent company deficit on profit and loss account at 22 June 2004 to special reserve	-	-	-	(1,137)	-	1,137	-
Share-based compensation	-	-	-	-	621	-	621
At 1 April 2005	61	22,523	1	8,245	662	(3,254)	28,238
Loss for the year	-	-	-	-	-	(3,272)	(3,272)
Total recognised income and expense for the year	-	-	-	-	-	(3,272)	(3,272)
Share-based compensation	-	-	-	-	741	-	741
Exercise of warrants and options	1	346	-	-	-	-	347
At 31 March 2006	62	22,869	1	8,245	1,403	(6,526)	26,054

Notes to the financial statements

at 31 March 2006

1 Accounting policies

General information

Vectura Group plc is a public limited company incorporated in the United Kingdom under the Companies Act 1985. The address of the registered office and principal place of business is given on page 73. The Company's ordinary shares are traded on the Alternative Investment Market ("AIM").

Basis of preparation

The financial statements of the Group have been prepared for the first time in accordance with International Financial Reporting Standards ("IFRS") as adopted by the EU as they apply to the financial statements of the Group for the year ended 31 March 2006. The Group's financial statements are also consistent with International Financial Reporting Standards as issued by IASB. The required disclosures concerning the transition from UK Generally Accepted Accounting Practice (UK GAAP) to IFRS are given in note 26.

The separate financial statements of the Company are presented as required by the Companies Act 1985 and have been prepared in accordance with IFRS. The Company is taking advantage of the exemption in s230 of the Companies Act 1985 not to present its individual income statement and the related notes that form a part of these approved financial statements. The consolidated income statement includes a loss of £3,272,000 (2005 – £4,303,000) for the parent company.

The financial statements have been prepared on the historical cost basis, revised for use of fair values where required by applicable IFRS. The consolidated financial statements are presented in sterling and all values are rounded to the nearest thousand (£'000), except where otherwise indicated. The principal accounting policies adopted are set out below.

Basis of consolidation

The consolidated annual financial statements comprise the financial statements of Vectura Group plc and its subsidiaries as at 31 March each year. The financial statements of subsidiaries are prepared for the same reporting year as the parent company, using consistent accounting policies. Adjustments are made to bring into line any dissimilar accounting policies that may exist.

All inter-company balances and transactions, including unrealised profits arising from intra-group transactions, have been eliminated in full.

Subsidiaries are consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group. Where there is a loss of control of a subsidiary, the consolidated financial statements include the results for the part of the reporting year during which Vectura Group plc has control.

Revenue recognition

Revenue represents the amount receivable for goods and services provided and royalties earned, net of trade discounts, VAT and other sales-related taxes. Revenue is recognised as follows:

Technology and product licensing

Technology and product licensing income represents amounts earned for licences provided under licensing agreements, including up-front payments, milestone payments and technology access fees. Revenues are recognised where they are non-refundable, the Group's obligations related to the revenues have been discharged and their collection is reasonably assured. Refundable licensing revenue is treated as deferred until such time that it is no longer refundable. In general, up-front payments are deferred and amortised on a systematic basis in line with the period of development. Milestone payments related to scientific or technical achievements are recognised as income when the milestone is accomplished.

Royalty income

Royalty income is recognised on an accruals basis and represents income earned as a percentage of product sales in accordance with the substance of the relevant agreement.

Pharmaceutical development services

Pharmaceutical development services revenues principally comprise contract product development and contract clinical trial manufacturing fees invoiced to third parties. Revenues are recognised upon the transfer to the customer of significant risks and rewards or upon the completion of agreed tasks or numbers of man days.

Interest income

Interest income is recognised on a time-proportion basis using the effective interest method.

1 **Accounting policies** (continued)

Intangible assets

Goodwill

Goodwill recognised under UK GAAP prior to 1 April 2004 is stated at net book value at that date. Goodwill arising on the acquisition of subsidiary or associate undertakings and businesses subsequent to 1 April 2004, representing any excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired, is capitalised. After initial recognition, goodwill is stated at cost less any accumulated impairment losses, with the carrying value being reviewed for impairment, at least annually and whenever events or changes in circumstances indicate that the carrying value may be impaired. For the purpose of impairment testing, goodwill is allocated to the related cash-generating units monitored by management,

Intellectual property

Intellectual property comprises acquired patents, trade marks, know-how and other similarly identified rights. Intangible assets acquired separately from a business are carried initially at cost. An intangible asset acquired as part of a business combination is recognised outside goodwill if the asset is separable or arises from contractual or other legal rights and its fair value can be measured reliably. Intangible assets are amortised on a straight line basis over their estimated useful economic lives from the time they are available for use.

The period over which the Group expects to derive economic benefits does not exceed 20 years. Such assets are amortised on a straight line basis and charged to research and development expenses in the income statement.

Research and development expenditure

Research expenditure is charged to the income statement in the period in which it is incurred. Development expenditure is capitalised when the criteria for recognition as an asset are met – when the Group can demonstrate the technical feasibility of completing the project so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete, and that costs attributable to the asset in its development can be measured reliably. Regulatory and other uncertainties generally mean that such criteria are not met. When development costs are capitalised they are amortised over their useful economic lives from product launch. Prior to product launch, the expenditure so capitalised is tested for impairment annually.

Computer software

The Group writes off software costs as incurred, except for purchases from third parties in respect of major systems. In such cases these are capitalised and written off over a period of three years from the date of purchase.

Property, plant and equipment

Property, plant and equipment is stated at cost, net of depreciation and provision for impairment. Depreciation is provided on all property, plant and equipment at rates calculated to write off the cost of each asset, less its estimated residual value, on a straight line basis over its expected useful life, as follows:

Laboratory equipment – 3-7 years
Office and IT equipment – 3 years

The carrying values of property, plant and equipment are reviewed for impairment when events or circumstances indicate the carrying values may not be recoverable. Useful life and residual value are reviewed annually.

Impairment of assets

Goodwill which has an indefinite life is not subject to amortisation and is tested annually for impairment. Assets that are subject to amortisation or depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying value exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value, less costs to sell and its value in use. Any impairment loss is charged to the income statement in the year concerned. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are identifiable cash in-flows (cash-generating units).

The expected cash flows generated by the assets are discounted using asset-specific discount rates which reflect the risks associated with the group of assets. These risks vary with the nature and location of the cash-generating units.

Leases and hire purchase contracts

Assets held under finance leases and hire purchase contracts, which confer risks and rewards similar to those attaching to owned assets, are capitalised as property, plant and equipment and are depreciated over the shorter of the lease terms and their useful lives. The capital elements of future lease obligations are recorded as liabilities, while the interest elements are charged through the income statement over the period of the lease to produce a constant rate of charge on

the capital repayments outstanding. Rentals under operating leases are charged over the period of the lease on a straight line basis in accordance with the terms of the lease agreements.

Investments
Investments in subsidiaries are eliminated upon consolidation. In the company accounts investments are carried at historic cost.

Trade and other receivables
Trade receivables are recognised and carried at the lower of their original invoiced value and recoverable amount. Provision is made when there is objective evidence that the Group will not be able to recover balances in full. Balances are written off when the probability of recovery is assessed as being remote.

Cash and cash equivalents
Cash and short-term deposits in the balance sheet comprise cash at banks and in hand and short-term deposits with an original maturity of three months or less. For the purpose of the consolidated cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

Foreign currencies
Transactions in foreign currencies are recorded at the rate of exchange at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are reported at the rates of exchange prevailing at that date. Any gain or loss arising from a change in exchange rate subsequent to the date of the transaction is included as an exchange gain or loss in the income statement.

Interest-bearing loans and borrowings
All loans and borrowings are initially recognised at fair value less directly attributable transaction costs. After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses arising on the repurchase, settlement or cancellation of liabilities are recognised respectively in interest income and finance costs.

Income taxes
Current tax assets and liabilities are measured at the amount expected to be recovered from or paid to the taxation authorities, based on tax rates and laws that are enacted or substantively enacted by the balance sheet date.

Deferred income tax is recognised on all temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements, with the following exceptions:

- where the temporary difference arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss;
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future; and
- deferred income tax assets are recognised only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, carried forward tax credits or tax losses can be utilised.

Deferred income tax assets and liabilities are measured on an undiscounted basis at the tax rates that are expected to apply when the related asset is realised or liability is settled, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

Income tax is charged or credited directly to equity if it relates to items that are credited or charged to equity. Otherwise income tax is recognised in the income statement.

Post-retirement benefits
The Group contributes a set proportion of employees' gross salary to a defined contribution personal pension plan. The amount charged to the income statement in respect of pension costs is the contribution payable in the year. Differences between contributions payable in the year and contributions actually paid are shown either as prepayments or payables in the balance sheet.

Share-based payments
The Group operates a number of executive and employee share option schemes, including a Long-Term Incentive Plan ("LTIP") under which shares may be granted to staff members. The level of grant to members of staff under the LTIP is dependent upon the total shareholder return of Vectura compared to a peer group of UK pharmaceutical and biotechnology companies. In accordance with IFRS 2, for all grants of share options and awards, the cost of equity-settled transactions is measured by reference to their fair value at the date at which they are granted, with fair value determined using the Hull-White trinomial model.

1 Accounting policies (continued)

The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the period until the award vests. No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied. At each reporting date, the cumulative expense recognised for equity-based transactions reflects the extent to which the vesting period has expired and the number of awards that, in the opinion of the Directors at that date, will ultimately vest. The Group has taken advantage of the exemptions afforded by IFRS 1 in respect of equity-settled awards and has applied IFRS 2 only to equity-settled awards granted after 7 November 2002 and not vested at 1 January 2005.

New standards and interpretations not applied

During the year, the IASB and IFRIC have issued a number of standards and interpretations with an effective date after the date of these financial statements. The Directors do not anticipate that the adoption of any of these standards or interpretations will have a material impact on the Group's financial statements in the period of initial application.

2 Revenue

Revenue represents amounts invoiced to third parties, derived from the provision of licenses and services which fall within the Group's sole ordinary activity, the development of pharmaceutical products. All of the following relate to the rendering of services.

	2006 £'000	2005 £'000
Revenue by category:		
Product Licensing	3,803	-
Technology Licensing	238	1,822
Pharmaceutical Development Services	4,370	2,662
	8,411	4,484
Finance revenue:		
Interest income (note 4)	1,042	755
Total revenue	9,453	5,239

	31 March 2006 £'000	31 March 2005 £'000
Revenue by customer location:		
United Kingdom	2,928	2,527
Rest of Europe	5,477	1,876
United States of America	6	41
Rest of world	-	40
	8,411	4,484

All revenue and losses before taxation originate in the United Kingdom.

3 Segmental information

For management purposes the Group is currently organised into one business segment, which is the development of pharmaceutical products. Since this is the only primary reporting segment no further information has been shown. All of the Group's operations are located in the UK.

4 Interest income and finance costs

	2006 £'000	2005 £'000
Interest income:		
Interest receivable on bank deposits and similar income	1,042	755
Finance costs:		
Loans	(1)	(139)
Finance charges payable under finance leases	(5)	(16)
	(6)	(155)

5 Operating loss

Operating loss is the result for the business before interest and tax.

	2006 £'000	2005 £'000
Operating loss is after charging:		
Amortisation of intangible assets	-	1,043
Depreciation of property plant and equipment		
– owned	767	750
– held under finance leases and hire purchase contracts	49	159
Auditors' remuneration		
– audit	70	39
– fees receivable by the auditors in respect of other services	6	151
Share-based compensation	741	621
Operating lease rentals		
– land and buildings	309	251
– plant and machinery	97	92
Net foreign exchange loss	17	3

Non-audit services in 2005 relate to financial due diligence at the time of the Company's flotation on AIM. The Company audit fee included in the table above was £62k (2005 – £33k).

6 Directors and employees

Group:
Directors' remuneration

	2006 £'000	2005 £'000
The aggregate remuneration comprises:		
Fees	90	93
Salaries and benefits	392	335
Bonuses	426	296
Pension contributions	39	33
	947	757

Fees include £nil (2005 – £7,000) paid to third parties in respect of the services of Non-Executive Directors (see note 24). Two Directors (2005 – 2) receive company contributions to a defined contribution personal pension plan. None of the Directors made any gains on share options in the year.

The remuneration of the Executive Directors is decided by the Remuneration Committee. Full details of Directors' remuneration and options are contained in the Directors' Remuneration Report on pages 26 to 32.

Employees
The average monthly number of employees (including Executive Directors) employed by the Group during the year was as follows:

	2006 No.	2005 No.
Pharmaceutical Development Services	24	23
Research and development	88	71
Business development and administration	8	8
	120	102

	2006 £'000	2005 £'000
The aggregate remuneration comprises:		
Wages and salaries	4,878	4,142
Social security costs	627	481
Other pension costs	303	256
Share-based compensation charge	741	621
	6,549	5,500

7 Taxation

	2006 £'000	2005 £'000
Group:		
Research and development tax credits	984	1,181

The taxation recorded in the income statement relates to research and development tax credits, which are recorded upon receipt from HMRC. There is therefore no current tax or deferred tax recognised in respect of the current period.

7 **Taxation** (continued)

The credit for the year can be reconciled to the loss per the income statement as follows:

	2006 £'000	2005 £'000
Loss on ordinary activities before tax	(7,439)	(8,967)
Loss on ordinary activities multiplied by standard rate of tax in the UK of 30%	(2,232)	(2,690)
Effects of:		
Permanent differences – expenses not deductible for tax purposes	224	205
Capital allowances in advance of depreciation	(69)	583
Other differences	(16)	-
Losses carried forward	2,093	1,902
Credit not recognised in previous years relating to research and development tax credit	(984)	(1,181)
Total tax credit for the year	(984)	(1,181)

Factors that may affect future tax charges:

Cumulative tax losses of approximately £15,800,000 (2005 – £11,979,000) (subject to agreement by HMRC) are available within the group to carry forward against future taxable profits or surrender in return for research and development tax credit. There is an unrecognised deferred tax asset of £4,740,000 (2005 – £3,594,000), which relates to the above tax losses, and a deferred tax asset of £242,000 (2005 – £466,000) arising as a result of unclaimed capital allowances. The net deferred tax asset with regard to capital allowances consists of a deferred tax asset of £293,000 (2005 – £466,000) and a deferred tax liability of £51,000 (2005 – £nil). The total deferred tax asset of £4,982,000 has not been recognised since it is uncertain that there will be suitable future taxable profits against which the deferred tax asset can be offset. The losses and deferred tax assets have no formal expiry date

8 Loss per ordinary share

The calculation of loss per share is based on the following losses and number of shares:

	2006	2005
Retained loss for the year (£'000)	(6,455)	(7,786)
Weighted average number of ordinary shares (No. '000)	108,298	89,193
Loss per ordinary share	(6.0p)	(8.7p)

The loss per share is based on the weighted average number of shares in issue during the period. IAS 33, "Earnings per Share", requires presentation of diluted earnings per share when a company could be called upon to issue shares that would decrease net profit or increase net loss per share. No adjustment has been made to the basic loss per share, as the exercise of share options and warrants would have the effect of reducing the loss per ordinary share and is therefore not dilutive.

9 Goodwill and intangible assets

Group:	Patents and trademarks 2006 £'000	Goodwill 2006 £'000	Total 2006 £'000	Patents and trademarks 2005 £'000	Goodwill 2005 £'000	Total 2005 £'000
Cost:						
At 1 April	3,490	3,489	6,979	3,490	3,247	6,737
Additions	-	-	-	-	314	314
Disposals and eliminations	-	-	-	-	(72)	(72)
At 31 March	3,490	3,489	6,979	3,490	3,489	6,979
Amortisation:						
At 1 April	3,490	1,477	4,967	2,447	1,477	3,924
Charge for the year	-	-	-	1,043	-	1,043
At 31 March	3,490	1,477	4,967	3,490	1,477	4,967
Net book value:						
At 31 March	-	2,012	2,012	-	2,012	2,012
At 1 April 2004	-	-	-	1,043	1,770	2,813

Goodwill arose on the acquisition of Vectura Limited and Vectura Delivery Devices Limited. The Group tests goodwill annually for impairment, or more frequently if there are indications that goodwill might be impaired. At 31 March 2006, there was no accumulated impairment loss.

The recoverable amount of the cash-generating unit is determined from value-in-use calculations. The key assumptions for the value-in-use calculations are those regarding the discount rates, growth rates and expected changes to contribution during the period. The calculation has been based on the most recent cash flow forecasts that have been prepared by management.

Company:	Goodwill £'000
Cost:	
At 1 April 2004, 31 March 2005 and 31 March 2006	1,467
Carrying amount:	
At 1 April 2004, 31 March 2005 and 31 March 2006	783

The Company tests goodwill on the same basis as for the Group.

Goodwill has been allocated for impairment testing purposes to two cash-generating units as follows:

- Pharmaceutical Development Services
- Vectura Delivery Devices Limited

These represent the lowest level within the group at which goodwill is monitored for internal management purposes.

Pharmaceutical Development Services (PDS) cash-generating unit
The recoverable amount of the Pharmaceutical Development Services unit has been determined based on a value-in-use calculation using cash flow projections based upon the pipeline of work predicted by management and the associated costs related to undertaking this work covering a 5-year period. An appropriate discount factor has been used to discount the cash flows to generate a net present value. The discount factor selected is based upon the risk profile of the unit.

Vectura Delivery Devices Limited (VDD) cash-generating unit
The recoverable amount of the Vectura Delivery Devices Limited unit is also determined on a value-in-use basis using cash flow projections based on the product pipeline and the associated development costs which management expect to be incurred. This is incorporated within the financial budgets covering a 5-year period that have been developed by management. An appropriate discount rate is applied to the cash flow projections which reflect the risk profile of the unit.

9 Goodwill and intangible assets (continued)

The carrying value of the goodwill allocated to the cash-generating units is as follows:

	2006 £'000	2005 £'000
PDS unit	1,476	1,476
VDD unit	536	536
	2,012	2,012

All of the goodwill arises on consolidation except for £783,000, which is a constituent of the PDS goodwill and is held on the Vectura Group plc books. This goodwill arose upon the acquisition of the Centre for Drug Formulation Studies, an unincorporated entity.

10 Property, plant and equipment

Group:	Laboratory equipment 2006 £'000	Office & IT equipment 2006 £'000	Total 2006 £'000	Laboratory equipment 2005 £'000	Office & IT equipment 2005 £'000	Total 2005 £'000
Cost:						
At 1 April	5,703	131	5,834	5,309	130	5,439
Additions	1,745	40	1,785	394	1	395
At 31 March	7,448	171	7,619	5,703	131	5,834
Depreciation:						
At 1 April	2,618	114	2,732	1,732	91	1,823
Charge for the year	790	26	816	886	23	909
At 31 March	3,408	140	3,548	2,618	114	2,732
Net book value:						
At 31 March	4,040	31	4,071	3,085	17	3,102
At 1 April 2004	-	-	-	3,577	39	3,616

Company:	Laboratory equipment 2006 £'000	Office & IT equipment 2006 £'000	Total 2006 £'000	Laboratory equipment 2005 £'000	Office & IT equipment 2005 £'000	Total 2005 £'000
Cost:						
At 1 April	2,018	62	2,080	1,624	61	1,685
Additions	1,745	40	1,785	394	1	395
At 31 March	3,763	102	3,865	2,018	62	2,080
Depreciation:						
At 1 April	1,315	61	1,376	985	60	1,045
Charge for the year	253	11	264	330	1	331
At 31 March	1,568	72	1,640	1,315	61	1,376
Net book value:						
At 31 March	2,195	30	2,225	703	1	704
At 1 April 2004	-	-	-	639	1	640

10 Property, plant and equipment (continued)

The net book value of the assets includes the following assets held under hire purchase agreements and finance leases:

Group and Company:	Laboratory equipment £'000	Office and IT equipment £'000	Total £'000
At 31 March 2006	14	-	14
At 31 March 2005	63	-	63

11 Investments

Company:	Shares in subsidiary undertakings 2006 £'000	Loans to subsidiary undertakings 2006 £'000	Total 2006 £'000	Shares in subsidiary undertakings 2005 £'000	Loans to subsidiary undertakings 2005 £'000	Total 2005 £'000
Cost:						
At 1 April	478	9,662	10,140	478	7,702	8,180
Additions	-	426	426	-	1,960	1,960
At 31 March	478	10,088	10,566	478	9,662	10,140
Amounts written off:						
At 1 April	70	-	70	70	-	70
At 31 March	70	-	70	70	-	70
Net book value:						
At 31 March	408	10,088	10,496	408	9,662	10,070
At 1 April 2004	-	-	-	408	7,702	8,110

The company has taken advantage of Section 131 of Companies Act 1985 and recorded the shares in subsidiary undertakings at the par value of the shares issued and not at their fair value.

Details of the investments in subsidiary undertakings are as follows:

Name of undertaking	Country of Incorporation	Holding	Proportion held	Nature of business
Vectura Limited	England	Ordinary	100%	Dormant
Vectura Delivery Devices Limited	England	Ordinary	100%	Pharmaceutical development
PharmaKodex Limited	England	Ordinary	100%	Pharmaceutical development

Subsequent to the year-end Vectura Group plc entered into a shareholders' agreement in relation to PharmaKodex Limited. The details of this are recorded in note 25.

12 Other receivables

Group and Company:
Other receivables represent an investment bond in respect of a rental deposit paid under the terms of a lease agreement for the premises at Chippenham. The deposit is for a fixed period of one year and is renewed annually. Under the terms of the lease agreement the deposit must be maintained until the Group has made three years of consecutive profits. The interest rate is fixed annually and was 3.75% for the year ended 31 March 2006. Interest is recognised using the effective interest method.

13 Trade and other receivables

	Group		Company	
	2006 £'000	2005 £'000	2006 £'000	2005 £'000
Trade receivables	4,156	668	4,156	668
Other receivables	36	23	36	23
Prepayments and accrued income	278	66	278	66
VAT recoverable	219	93	205	93
	4,689	850	4,675	850

Included within trade receivables is £2.8 million due from a leading pharmaceutical company under the terms of a development agreement signed on 31 March 2006. This amount was received on 28 April 2006 and has been deferred as described in note 16.

Credit risk:
The Group's credit risk is primarily attributable to its trade receivables. The amounts presented in the balance sheet are net of allowances for doubtful receivables. The Group has no significant concentration of credit risk.

Debtor days at the year end were 180 days (2005 – 54 days). This is however not representative due to the payments due under the contract signed on 31 March 2006, as noted above. No interest was charged on receivables. The Directors consider that the carrying value of trade and other receivables approximates to their fair value.

14 Trade and other payables

	Group		Company	
	2006 £'000	2005 £'000	2006 £'000	2005 £'000
Loans	-	4	-	4
Trade payables	698	880	667	880
Owed to group undertakings	-	-	187	187
Obligations under finance leases	14	84	14	84
Other taxes and social security costs	144	128	144	128
Other payables	-	1	-	1
Accruals	3,633	1,687	3,613	1,687
	4,489	2,784	4,625	2,971

Trade payables principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken for trade purchases is 27 days (2005 – 30 days).

15 Obligations under finance leases

The maturity of these amounts is as follows:

Group and company:	2006 £'000	2005 £'000
Amounts payable:		
– Within one year	15	88
– In two to five years	-	15
	15	103
Less: finance charges allocated to future periods	(1)	(5)
	14	98

	2006 £'000	2005 £'000
Finance leases and hire purchase contracts are analysed as follows:		
Current liabilities (see note 14)	14	84
Non-current liabilities	-	14
	14	98

15 Obligations under finance leases (continued)

Details of the movements in finance leases and hire purchase contracts in the year are as follows:

	2006 £'000	2005 £'000
At 1 April	98	239
Repayments made	(84)	(141)
At 31 March	14	98

16 Deferred income

Deferred income relates to amounts received under product licensing agreements. Vectura Group plc continues to provide services to these licensing partners over a period of time. Milestone payments under these licensing agreements are therefore spread. The total deferred income as at 31 March 2006 relates to two contracts. The first was signed on 7 April 2005 with Novartis International Pharmaceutical Limited for NVA237, giving rise to £4.1 million of deferred income. This revenue is being recognised over a 24-month period. A second contract was signed on 31 March 2006 with a leading pharmaceutical company for VR315, giving rise to £2.8 million of deferred income. The £2.8 million is also included within receivables as disclosed in note 13. The revenue associated with this contract is being released over 4 years. £2 million included within amounts due in more than 1 year is potentially repayable if there is an early termination of the agreement. In relation to this agreement, 80% of the income relates to a subsidiary company, Vectura Delivery Devices Limited, and 20% to Vectura Group plc

Deferred income is as follows:

	Group		Company	
	2006 £'000	2005 £'000	2006 £'000	2005 £'000
Amounts due within 1 year	4,666	-	4,107	-
Amounts due in more than 1 year	2,258	-	584	-
At 31 March	6,924	-	4,691	-

17 Financial instruments

The Group's principal financial instruments principally comprise cash and short-term deposits, and these are used to finance the Group's operations. The Group's objective in using financial instruments is to maximise the returns on funds held on deposit, to minimise exchange rate risk where appropriate, and to generate additional cash resources through the issue of shares when appropriate. Balance sheets at 31 March 2006 and 2005 are not necessarily representative of the positions throughout the year as cash and short-term investments fluctuate considerably depending on when share issues have occurred.

It is, and has been throughout the year, the Group's policy that no speculative trading in financial instruments is undertaken.

17 **Financial instruments** (continued)

The Group is principally funded with equity and invests its funds in short-term bank deposits. The Group has access to these deposits at a maximum of 24 hours notice. The Group's policy throughout the period has been to minimise the risk by placing funds in low-risk cash deposits, but also to maximise the return on funds placed on deposit.

Interest on overnight cash deposits is calculated on the basis of a floating rate set at 12.5 basis points below 7-day sterling London Inter-Bank Bid Rate ("LIBID").

The Group had no significant commitments to foreign currencies throughout the period. When foreign currencies are received the business aims to match these with payments in foreign currency. Where there are no imminent foreign transactions, the balances are exchanged for sterling at spot rate. At the year-end, the business had a Euro overdraft. However, a legal right of set-off existed against a sterling current account, such that the Euro overdraft was maintained and settled against an amount of €4 million (£2.8 million) due at 31 March 2006 from a leading pharmaceutical company (see also note 16).

Interest rate and currency profile of financial instruments at the year-end:

	2006 £'000	2005 £'000
Cash and cash equivalents:	Floating rate	Floating rate
Sterling	17,329	18,386
US Dollar	8	-
Euro	(509)	2
	16,828	18,388
Other receivables:	3.75%	3.75%
Investment bond	428	428
	428	428
Finance leases:	6.60%	6.60%
Finance leases	(14)	(98)
	(14)	(98)

The amounts disclosed reflect the book value and fair value of the Group's financial instruments. All cash and cash equivalents are deposited in bank accounts to which the Group has same-day access. The Euro account is a bank overdraft. The fair value of the financial instruments is as per the book value disclosed. The fair value of the investment bond and finance leases is identical to the book values as disclosed within notes 12 and 15.

18 Equity

a) Share capital

	31 March 2006		31 March 2005	
	£'000	No.'000	£'000	No.'000
Authorised:				
Ordinary shares of 0.025p each	45	181,200	45	181,200
Redeemable preference shares of £1 each	34	34	34	34
Allotted, called up and fully paid:				
Ordinary shares of 0.025p each –				
At 1 April	27	107,899	-	-
Converted from ordinary shares of 0.1p [1]	-	-	16	69,698
Issued to investors	-	-	11	36,322
Issued on exercise of share options	1	2,105	-	1,432
Issued as part of milestone payment	-	-	-	300
Issued on exercise of warrants	-	326	-	147
At 31 March	28	110,330	27	107,899
Redeemable preference shares of £1 each –				
At 1 April	34	34	-	-
Issued during the year	-	-	34	34
At 31 March	34	34	34	34

[1] At 31 March 2004 the authorised share capital was as follows:

	31 March 2004	
	£'000	No.'000
Authorised:		
Ordinary shares of 0.1p each	16	15,505
Preferred A ordinary shares of 0.1p each	4	4,045
Allotted, called up and fully paid:		
Ordinary shares of 0.1p each	13	12,527
Preferred A ordinary shares of 0.1p each	3	3,414

On 23 April 2004, by an ordinary resolution passed by the shareholders at an Extraordinary General Meeting, the authorised share capital of the Company was increased from £19,550 to £24,550 by the creation of 2,000,000 ordinary shares of 0.1p each and the creation of 3,000,000 preferred B ordinary shares of 0.1p each having the rights and subject to the restrictions set out in the articles of association.

18 **Equity** (continued)

On 30 April 2004, the Group entered into an Unsecured Convertible Loan Note Instrument. The subscribers to the Loan Note included all the institutional shareholders as at 31 March 2004. The Loan Note was drawn down by £1.5 million. Interest accrued on the drawdown at the rate of 8% per annum. In connection with the subscription, a total of 5,058 ordinary shares of 0.1p each were issued to three subscribers to the Loan Note. The principal amount of the Loan Note (plus interest accrued of £20,000) was converted into 678,581 B ordinary shares of 0.1p each. In lieu of an arrangement fee each Loan Note holder was entitled to a free issue of shares at the flotation price of 56p per share, the 472,864 free shares of 0.025p each so issued being equivalent to 17.65% of the amount of the Loan Note drawn down at that time. In addition, each Loan Note holder received a warrant to subscribe for shares at nominal value at the flotation. The number of ordinary shares was equal to 10% of the value of the Loan Note holder's commitment that was not drawn down, divided by the flotation price. In total, 147,364 shares were issued under these warrants at the nominal value of 0.025p per share.

On 1 June 2004, SkyePharma PLC agreed to subscribe for 800,000 ordinary shares of 0.1p each at a price of £2.50 per share.

By an ordinary resolution passed by the shareholders on 8 June 2004 the authorised share capital was increased from £24,550 to £58,550 by the creation of 34,000 redeemable preference shares of £1 each. The rights attaching to these redeemable preference shares are summarised as follows: a) the shares do not confer any right to dividend or other distributions; b) on a return of capital on liquidation or otherwise, the assets of the Company available for distribution among the members are to be applied first in repaying to the holders of the redeemable preference shares the amounts paid up or credited as paid up in respect of such shares; c) holders of redeemable preference shares have the right to receive notice of and attend general meetings, but have no right to vote thereat; d) the price per share at which redeemable preference shares are transferred may not exceed the amount paid or credited as being paid up, and e) the Company may specify by notice in writing the date upon which it intends to redeem all (but not some only) of the shares. The price per share payable by the Company to the holders of the redeemable preference shares on their redemption shall be the amount paid up or credited as paid up on each such share.

By special resolutions passed on 22 June 2004, simultaneously upon Listing on 2 July 2004 each ordinary and each preferred A ordinary share of 0.1p each and B ordinary share of 0.1p each (see above) in issue at that time was converted into four ordinary shares of 0.025p each and the authorised share capital of the Company was increased to £79,300 by the creation of 83,000,000 ordinary shares of 0.025p each.

On 23 June 2004, Vectura Limited was re-registered as a public company under the name of Vectura Group plc.

On 2 and 5 July, 35,848,301 ordinary shares with a nominal value of 0.025p per share were issued in connection with the Company's flotation on AIM at a price of 56p per share.

Relevant costs associated with these share issues have been set off against the share premium account as permitted under the Companies Act 1985.

Warrants
On 30 August 2005, Pictet Private Equity Investors S.A. exercised the right conferred on them under a Warrant Instrument dated 20 November 2002 and subscribed £73.32 for 293,271 ordinary shares of 0.025p each.

On 30 August 2005, GATX European Venture Finance Limited exercised the right conferred on them under a Warrant Instrument dated 20 November 2002 and subscribed £8.15 for 32,585 ordinary shares of 0.025p each.

b) Share premium account
The share premium account consists of the proceeds from the issue of shares in excess of their par value (which is included in the share capital account).

On 23 April 2004, by a special resolution passed by shareholders, the total of £20.8 million standing to the credit of the share premium account was ordered to be cancelled. On 19 May 2004, the High Court approved the utilisation of the cancelled share premium to offset £11.4 million of losses incurred by the parent company to 31 March 2004 and the transfer of £9.4 million to a newly-established special reserve. Under the Order of the High Court, the Company was also entitled to reduce the special reserve by transferring to the profit and loss account of the Company a sum necessary to ensure that it did not have a deficit on its profit and loss account as at the date of drawing up any accounts necessary to enable re-registration as a public company. An amount of £1.1 million was transferred in accordance with this entitlement.

18 **Equity** (continued)

c) Shares to be issued
The shares to be issued reserve relates to shares to be issued to Cambridge Consultants Limited ("CCL") as part of the deferred consideration for the acquisition of Vectura Delivery Devices Limited under the purchase agreement dated 5 February 2002. These deferred shares are included at cost in the company balance sheet and fair value in the consolidated balance sheet.

In accordance with a Deed of Variance dated 9 November 2004, CCL agreed to the cancellation of 150,000 of the deferred shares and Vectura agreed to include the date of 29 December 2006 as the date by which all deferred shares will be issued. This resulted in a debit of £72,000 to the Group reserve (Company – £nil), being the elimination of goodwill for the 150,000 shares. On 12 November 2004, 300,000 ordinary shares were issued to CCL to satisfy a revenue milestone. Accordingly, £145,000 was debited to the group reserve (Company – £nil), being the value in the reserve of the shares issued. £268,000 (Company – £nil) was credited to the reserve at 31 March 2005 being the uplift to market value for shares remaining to be issued. As at 31 March 2006, 1,350,000 ordinary shares (2005 – 1,350,000 ordinary shares) remained to be issued under these arrangements.

d) Special reserve
The special reserve was created on 19 May 2004 as part of pre-IPO process, to enable re-registration as a public company. It is a non-distributable reserve.

e) Merger reserve
The merger reserve was created on the merger of the Company and Co-ordinated Drug Development Limited (since renamed Vectura Limited) and also relates to the acquisition of Vectura Delivery Devices Limited. On 12 November 2004, 300,000 ordinary shares were issued to Cambridge Consultants Limited to satisfy a revenue milestone.

f) Share-based compensation reserve
The share-based compensation reserve represents the credit arising on the charge for share options calculated in accordance with IFRS 2.

19 Long-Term Incentive Plan and share options

Long-Term Incentive Plan (LTIP)
Under the rules of this plan, set up in accordance with an ordinary resolution of the shareholders at the Annual General Meeting held on 12 September 2005, Executive Directors and certain senior managers received conditional rights to receive a maximum number of shares at the beginning of a three-year period, a proportion of which they will be entitled to receive at the end of that period, depending on the extent to which the challenging performance conditions set by the Remuneration Committee at the time the allocation was made, are satisfied. Further information on the performance conditions of the Long-Term Incentive Plan are detailed in the Directors' Remuneration Report. At 31 March 2006, eligible employees hold rights which may result in the issue of 1,032,611 ordinary shares on 12 September 2008. The fair value of this scheme has been estimated using the Hull-White model, in the same way as for the other option schemes described below, and using the same assumptions for volatility, option life, expected dividend yield and risk-free rate of return. For the purposes of calculating the fair value of the LTIP it was considered equally probably that the Company's performance would be such that it would perform in each of the quartiles established under the LTIP scheme as described in the Directors' Remuneration Report. The fair value charge for the LTIP, which is included with the share option charge, has been calculated as £49,000.

Share options
The Company's Directors, officers and employees hold options under the Vectura Unapproved Share Option Plan (the "Unapproved Plan") and Enterprise Management Incentive arrangements (the "EMI Plan"), whereby options are granted to acquire shares at the market price ruling on the date of grant. In general, options vest after three years and are exercisable during a period ending ten years after the date of grant.

The Company also operates a Save as You Earn Share Option Scheme (the "Sharesave Scheme"). All employees and Directors are invited to subscribe for options to acquire shares in the Company, which may be granted at a discount of up to 20% of the market value on the offer date. The options granted vest after three years and are exercisable during a period of six months following the vesting date.

19 Long-Term Incentive Plan and share options (continued)

A summary of the outstanding options in these schemes is shown below.

	Unapproved Plan	EMI Plan	Sharesave Scheme	Total Scheme
Options outstanding at 1 April 2005	8,171,847	4,779,908	579,661	13,531,416
Options granted	538,886	-	167,506	706,392
Options exercised	(1,422,000)	(683,556)	-	(2,105,556)
Options forfeited	(14,613)	(63,916)	(45,507)	(124,036)
Options outstanding at 31 March 2006	7,274,120	4,032,436	701,660	12,008,216
Options vested at 31 March 2006	2,949,820	3,092,520	-	6,042,340
Range of exercise prices	0.025p to	0.025p to	50.8p to	
	89.5p	48.125p	72.0p	
Weighted average exercise price per share	47.61p	31.10p	55.86p	

The options exercised during the year ended 31 March 2006 yielded proceeds of £346,536.

The Directors do not believe that presenting further separate information on each scheme is a meaningful method of presenting information on the schemes. Therefore, the schemes have been aggregated together for the following disclosure.

The weighted average exercise price across all schemes for outstanding options at the beginning of the period was 35.5p. The weighted average exercise price of options exercised in the year was 16.5p and these options had a weighted average market price at exercise of 90.5p. Options with a weighted average exercise price of 49.6p were cancelled in the year and options with a weighted average exercise price of 82.7p were granted during the year. The weighted average exercise price of share options exercisable at the year-end was 30.7p. The weighted average remaining contractual life of the outstanding share options at the year-end was 7 years. The aggregate of the estimated fair values of the options granted during 2006 (excluding the LTIP) is £692,000 (2005 – £621,000).

19 Long-Term Incentive Plan and share options (continued)

The outstanding options at 31 March 2006 were granted as follows:

Grant Date	Exercise price per share (p)	Number	Date from which first exercisable	Expiry date
December 2000	23.150	688,000	22/12/03	21/12/10
March 2001	23.150	196,000	28/03/04	26/03/11
April 2001	0.025	208,000	13/04/04	11/04/11
April 2001	48.125	171,200	18/04/04	18/04/08
April 2001	48.125	166,232	11/04/04	11/04/11
June 2001	48.125	36,592	09/06/04	07/06/11
August 2001	48.125	96,000	08/08/04	08/08/11
October 2001	48.125	8,000	16/10/04	16/10/11
February 2002	0.025	800,000	23/02/05	21/02/12
March 2002	48.125	440,000	18/03/05	18/03/12
May 2002	48.125	256,280	13/05/05	27/05/12
June 2002	48.125	116,340	16/06/05	14/06/12
July 2002	48.125	80,000	15/07/05	28/07/12
August 2002	48.125	140,000	06/08/05	07/08/12
October 2002	48.125	322,224	02/10/05	27/10/12
November 2002	48.125	317,776	01/11/05	04/11/12
April 2003	48.125	401,564	11/04/06	28/04/13
November 2003	48.125	42,000	19/11/06	17/11/13
December 2003	48.125	182,000	03/12/06	30/11/13
April 2004	36.000	1,402,224	29/04/04	29/04/14
April 2004	36.000	1,957,112	29/04/07	29/04/14
April 2004	36.000	209,764	30/04/07	28/04/14
May 2004	48.125	200,000	05/05/07	03/05/14
July 2004	56.000	80,000	02/07/04	02/07/14
July 2004	56.000	597,472	02/07/05	02/07/14
July 2004	56.000	597,472	02/07/06	02/07/14
July 2004	56.000	600,472	02/07/07	02/07/14
July 2004	57.500	2,000	06/07/07	06/07/14
August 2004	57.500	20,000	01/08/07	01/08/14
October 2004	50.500	21,000	01/10/07	01/10/14
November 2004	63,000	20,000	11/11/07	11/11/14
January 2005	63.500	62,000	04/01/08	04/01/15
February 2005 [1]	50.800	534,154	01/04/08	30/09/08
March 2005	68.000	329,946	31/03/08	31/03/15
June 2005	89.500	4,000	30/06/08	30/06/15
August 2005	82.500	75,506	03/08/06	03/08/15
August 2005	82.500	75,504	03/08/07	03/08/15
August 2005	82.500	75,504	03/08/08	03/08/15
September 2005	82.500	138,366	30/09/08	30/09/15
January 2006	83.000	170,006	02/01/09	02/01/16
February 2006 [1]	72.000	167,506	01/04/09	30/09/09
Total outstanding options		12,008,216		

[1] Sharesave scheme

19 Long-Term Incentive Plan and share options (continued)

The Group has taken advantage of the exemption in IFRS and has only applied IFRS 2 to options granted after 7 November 2002 and not vested at 1 January 2005. At the year-end there were 4,042,644 options outstanding that were granted before this date.

The fair value of the options was determined using the Hull-White pricing model. The share-based compensation charge for the year ended 31 March 2006, including the LTIP, is £741,000 (2005 – £621,000).

Unapproved and EMI Plans:	2006	2005	Year of grant 2004
Weighted average share price of grants during the year	82.71p	44.54p	48.13p
Expected volatility	30 – 50%	30 – 50%	30 – 50%
Option life	10 years	10 years	10 years
Expected dividends	Nil	Nil	Nil
Risk-free interest rate	4.21 – 4.61%	4.21 – 5.09%	4.21 – 5.04%

Sharesave Scheme:	2006	Year of grant 2005
Weighted average share price of grants during the year	72.00p	50.08p
Expected volatility	30 – 50%	30 – 50%
Option life	3.7 years	3.7 years
Expected dividends	Nil	Nil
Risk-free interest rate	4.21 – 4.61%	4.21 – 4.61%

Expected volatility has been calculated by reference to the Company's historic share price since the IPO in July 2004. The risk-free interest rate is calculated by reference to UK government bonds. Expectation of the cancellation of options has been considered in determining the fair value expense charged in the income statement.

20 Reconciliation of net cash flows from operating activities

Group:	Year ended 31 March 2006 £'000	Year ended 31 March 2005 £'000
Operating loss	(8,475)	(9,567)
Amortisation of intangible assets	-	1,043
Depreciation of property plant and equipment	816	909
Increase in receivables	(3,839)	(167)
Increase in payables	1,289	998
Deferred income	6,924	-
Share-based compensation	741	621
Net cash outflow from operations	(2,544)	(6,163)
Research and development tax credit received	984	1,181
Net cash outflow from operating activities	(1,560)	(4,982)

Company:	Year ended 31 March 2006 £'000	Year ended 31 March 2005 £'000
Operating loss	(5,119)	(5,947)
Depreciation of property plant and equipment	264	331
Increase in receivables	(3,825)	(167)
Increase in payables	1,238	902
Deferred income	4,691	-
Share-based compensation	741	621
Net cash outflow from operations	(2,010)	(4,260)
Research and development tax credit received	811	1,043
Net cash outflow from operating activities	(1,199)	(3,217)

21 Retirement benefits plan

The Group operates a defined contribution personal pension plan for all qualifying employees. The total cost charged in the income statement is detailed in note 6. At 31 March 2006, contributions of £1,416 (2005 – £852), due in respect of the current reporting period, had not been paid over to the scheme.

22 Operating lease arrangements

At the balance sheet date, the Group has aggregate outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	Land and buildings		Other	
	2006	2005	2006	2005
Group:	£'000	£'000	£'000	£'000
Expiry date:				
– Within one year	329	251	68	56
– In the second to fifth years inclusive	1,102	1,004	62	83
– After five years	1,318	1,569	-	5
	2,749	2,824	130	144

On 26 July 2002, the Company entered into a 25-year lease agreement in respect of the lease of premises at One Prospect West, Chippenham, Wiltshire. The annual commitment in respect of this lease is £251,000, which is included in the table above. The lease has a break clause in July 2017.

On 13 June 2005, Vectura Delivery Devices Limited entered into a 5-year lease agreement in respect of premises at Cambridge Science Park, Milton Road, Cambridge. The annual commitment in respect of this lease is £77,700, which is included in the table above. The lease has a break clause in June 2008.

All items in the above table also relate to the Company, with the exception of £175,000 in respect of the Cambridge lease described above.

23 Capital Commitments

At the year-end the Group had capital commitments contracted for but not provided for of £940,000 (2005 – £960,000). The Company had commitments of £867,000 (2005 – £nil).

24 Related party transactions

Group:
Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation. Except as disclosed below, no Group company entered into a transaction with a related party that is not a member of the Group.

On 6 April 2006, the Company entered into an agreement with Theradeas Limited in relation to an initial evaluation of three inhaled therapy concepts that are the subject of Theradeas's patent applications. The broad concept is that Vectura and Theradeas would, following successful completion of Vectura's initial evaluation, enter into a collaboration that would be funded by Vectura. Under the collaboration, Theradeas would grant Vectura an exclusive licence, with rights to sub-license, under the Theradeas patents and know how, to develop, manufacture and commercialise inhaled products resulting from their patents. A payment of £25,000 was made to Theradeas in May 2006. Dr A J M Richards, a Non-Executive Director of Vectura Group plc, is also a Non-Executive Director and shareholder of Theradeas Limited.

As noted in the Directors' Remuneration Report, during the year £5,000 (2005 – £10,000) was paid to Croggan Limited for consultancy services. Dr A J M Richards is a director of Croggan Limited.

Dr Richards' Non-Executive Directorship and shareholding in PharmaKodex Limited are disclosed in note 25.

Apart from the above, the Group had no other related party transactions at 31 March 2006. At 31 March 2005, Merlin Biosciences Limited was considered to be a related party of the Group since it held more than 10% of the issued shares. At 31 March 2005, the Group owed Merlin £1,000 in respect of room hire. Total transactions, all at arm's length, amounted to £6,000 for the year ended 31 March 2005.

Remuneration of key management personnel:
The aggregate remuneration of the Directors of the Group is set out in the following table. Further information about the remuneration of individual directors is provided in the audited part of the Directors' Remuneration Report.

24 Related party transactions (continued)

	2006 £'000	2005 £'000
Short-term employee benefits	908	724
Post-employment benefits	39	33
Share-based compensation (IFRS2)	536	511
	1,483	1,268

Company:
Details of the Company related party transactions with parties outside of the Group are noted above. In additional, the following details of trading within the Group are disclosed in accordance with IAS 24.

Related party	Recharge to related party £'000	Amounts owed by related party £'000	Amounts owed to related party £'000
Subsidiaries:			
– 2006	2,682	10,088	187
– 2005	2,027	9,662	187

25 Post balance sheet events

Agreement with Boehringer Ingelheim International GmbH
On 13 April 2006, the Company signed a worldwide collaboration, development and licence agreement with the leading pharmaceutical company, Boehringer Ingelheim International GmbH ("Boehringer Ingelheim"). The aim of the collaboration is to develop a dry powder inhaler ("DPI"), as a Boehringer Ingelheim branded device, to deliver a range of proprietary respiratory products of Boehringer Ingelheim, mainly for the treatment of asthma and chronic obstructive pulmonary disease (COPD). Under the terms of the agreement, the Company received an initial payment of £3.5 million and a £6.9 million equity investment. These payments are not reflected in the accounts for the year ended 31 March 2006. As a result of the equity investment 4,939,536 ordinary shares of 0.0025p each were issued to Boehringer Ingelheim on 10 May 2006.

PharmaKodex Limited
On 12 May 2006, Vectura Group plc entered into a shareholders' agreement in relation to the investment in PharmaKodex Limited ("PharmaKodex") with Unilever Ventures Limited, Dr A J M Richards and others. Up to this date Vectura Group plc retained a 100% investment in PharmaKodex. As a result of the investments made by these parties Vectura Group plc's shareholding in PharmKodex was reduced to 49.99% with effect from this date and Dr Richards acquired 4.81% of the shares in issue at an arm's length valuation. Dr Richards was appointed a Non-Executive Director of PharmaKodex on 12 May 2006 and will represent Vectura's interest on the board of that company.

26 Transition to IFRS

This is the first year that the Group and company have presented their financial statements under IFRS. The following disclosures are required in the year of transition. The last financial statements under UK GAAP were for the year ended 31 March 2005; the date of transition to IFRS was therefore 1 April 2004.

The standards giving rise to changes in the Group and Company results on transition from UK GAAP to IFRS and their financial impact are as follows:

Share-based payment
IFRS 2, "Share-based Payment", requires the fair value of all share-based payments to be charged in the income statement over their respective vesting periods. Share-based payments include executive and employee share option schemes. Fair value is determined at the date of grant and is calculated using an appropriate option pricing model. Under UK GAAP, an expense was recorded in respect of share option grants where the grant price was below the fair value of the shares at the date of grant. In restating the financial results of the Company under IFRS, expenses previously so recorded under UK GAAP have been reversed and an expense has been recorded based upon the fair value of share option grants. The Group has taken advantage of the exemption afforded by IFRS 1, "First-time Adoption of International Financial Reporting Standards", in respect of equity-settled awards and has applied IFRS 2 only to equity-settled awards granted after 7 November 2002 and not vested at 1 January 2005.

Business combinations
Under IFRS 1, the Group may elect not to apply IFRS 3, "Business Combinations", retrospectively to transactions occurring prior to the date of transition to IFRS and management has elected to take advantage of this exemption. The carrying amount of goodwill in the opening IFRS balance sheet is that recorded under UK GAAP at the date of transition. As from the date of transition, goodwill is not amortised, but subject to annual tests of impairment.

26 Transition to IFRS (continued)

Holiday pay
Under IAS 19, "Employee Benefits", a provision for holidays to which employees are entitled, but have not taken, is required. This charge was not required under UK GAAP.

Financial instruments
As provided by IFRS 1 the Group has taken advantage of the fact that a first-time adopter need not restate the comparative information. IAS 32, "Financial Instruments: Disclosure and Presentation", and IAS 39, "Financial Instruments: Recognition and Measurement", have been applied with effect from 1 April 2005. The restatement to IFRS at 1 April 2005 of the financial instruments in place at 31 March 2005 has no impact.

Reconciliation of the consolidated balance sheet

at 1 April 2004	As previously reported under UK GAAP £'000	IFRS 2 share-based payment £'000	IFRS 3 business combinations £'000	Holiday pay £'000	Restated under IFRS £'000
Assets					
Goodwill and intangible assets	2,813	-	-	-	2,813
Property, plant and equipment	3,616	-	-	-	3,616
Other receivables	428	-	-	-	428
Non-current assets	6,857	-	-	-	6,857
Trade and other receivables	683	-	-	-	683
Cash and cash equivalents	2,107	-	-	-	2,107
Current assets	2,790	-	-	-	2,790
Total assets	9,647	-	-	-	9,647
Liabilities					
Loans and obligations under finance leases	(682)	-	-	-	(682)
Non-current liabilities	(682)	-	-	-	(682)
Trade and other payables	(2,581)	-	-	(47)	(2,628)
Current liabilities	(2,581)	-	-	(47)	(2,628)
Total liabilities	(3,263)	-	-	(47)	(3,310)
Net assets	6,384	-	-	(47)	6,337
Equity					
Share capital	16	-	-	-	16
Share premium	20,781	-	-	-	20,781
Shares to be issued	867	-	-	-	867
Merger reserve	3,020	-	-	-	3,020
Share-based compensation reserve	-	41	-	-	41
Retained loss	(18,300)	(41)	-	(47)	(18,388)
Total equity	6,384	-	-	(47)	6,337

Reconciliation of the consolidated income statement

for the year ended 31 March 2005	Previously reported under UK GAAP £'000	IFRS 2 share-based payment £'000	IFRS 3 business combinations £'000	Holiday pay £'000	Restated under IFRS £'000
Revenue	4,484	-	-	-	4,484
Cost of sales	(1,472)	-	-	-	(1,472)
Gross profit	3,012	-	-	-	3,012
Research and development expenses	(10,209)	116	376	(2)	(9,719)
Other administrative expenses	(2,239)	-	-	-	(2,239)
Share-based compensation	-	(621)	-	-	(621)
Administrative expenses	(2,239)	(621)	-	-	(2,860)
Operating loss	(9,436)	(505)	376	(2)	(9,567)
Interest income	755	-	-	-	755
Finance costs	(155)	-	-	-	(155)
Loss before taxation	(8,836)	(505)	376	(2)	(8,967)
Taxation	1,181	-	-	-	1,181
Loss after taxation attributable to equity holders of the Company	(7,655)	(505)	376	(2)	(7,786)
Loss per share basic and diluted	(8.6p)				(8.7p)

Reconciliation of the consolidated balance sheet

at 31 March 2005	Previously reported under UK GAAP £'000	IFRS 2 share-based payment £'000	IFRS 3 business combinations £'000	Holiday pay £'000	Restated under IFRS £'000
Assets					
Goodwill and intangible assets	1,636	-	376	-	2,012
Property, plant and equipment	3,102	-	-	-	3,102
Other receivables	428	-	-	-	428
Non-current assets	5,166	-	376	-	5,542
Trade and other receivables	850	-	-	-	850
Cash and cash equivalents	18,388	-	-	-	18,388
Current assets	19,238	-	-	-	19,238
Total assets	24,404	-	376	-	24,780
Liabilities					
Loans and obligations under finance leases	(14)	-	-	-	(14)
Non-current liabilities	(14)	-	-	-	(14)
Trade and other payables	(2,735)	-	-	(49)	(2,784)
Current liabilities	(2,735)	-	-	(49)	(2,784)
Total liabilities	(2,749)	-	-	(49)	(2,798)
Net assets	21,655	-	376	(49)	21,982
Equity					
Share capital	61	-	-	-	61
Share premium	22,523	-	-	-	22,523
Shares to be issued	918	-	-	-	918
Special reserve	8,245	-	-	-	8,245
Merger reserve	3,211	-	-	-	3,211
Share-based compensation reserve	-	662	-	-	662
Retained loss	(13,303)	(662)	376	(49)	(13,638)
Total equity	21,655	-	376	(49)	21,982

Reconciliation of the Company balance sheet

at 1 April 2004	As previously reported under UK GAAP £'000	IFRS 2 share-based payment £'000	IFRS 3 business combinations £'000	Holiday pay £'000	Restated under IFRS £'000
Assets					
Goodwill and intangible assets	783	-	-	-	783
Property, plant and equipment	640	-	-	-	640
Investments	8,110	-	-	-	8,110
Other receivables	428	-	-	-	428
Non-current assets	9,961	-	-	-	9,961
Trade and other receivables	683	-	-	-	683
Cash and cash equivalents	2,107	-	-	-	2,107
Current assets	2,790	-	-	-	2,790
Total assets	12,751	-	-	-	12,751
Liabilities					
Loans and obligations under finance leases	(682)	-	-	-	(682)
Non-current liabilities	(682)	-	-	-	(682)
Trade and other payables	(2,670)	-	-	(47)	(2,717)
Current liabilities	(2,670)	-	-	(47)	(2,717)
Total liabilities	(3,352)	-	-	(47)	(3,399)
Net assets	9,399	-	-	(47)	9,352
Equity					
Share capital	16	-	-	-	16
Share premium	20,781	-	-	-	20,781
Shares to be issued	1	-	-	-	1
Share-based compensation reserve	-	41	-	-	41
Retained loss	(11,399)	(41)	-	(47)	(11,487)
Total equity	9,399	-	-	(47)	9,352

Reconciliation of the Company income statement

for the year ended 31 March 2005	Previously reported under UK GAAP £'000	IFRS 2 share-based payment £'000	IFRS 3 business combinations £'000	Holiday pay £'000	Restated under IFRS £'000
Revenue	4,484	-	-	-	4,484
Cost of sales	(1,472)	-	-	-	(1,472)
Gross profit	3,012	-	-	-	3,012
Research and development expenses	(6,676)	-	147	(2)	(6,531)
Other administrative expenses	(1,821)	-	-	-	(1,821)
Share-based compensation	-	(607)	-	-	(607)
Administrative expenses	(1,821)	(607)	-	-	(2,428)
Operating loss	(5,485)	(607)	147	(2)	(5,947)
Interest income	755	-	-	-	755
Finance costs	(154)	-	-	-	(154)
Loss before taxation	(4,884)	(607)	147	(2)	(5,346)
Taxation	1,043	-	-	-	1,043
Loss after taxation attributable to equity holders of the Company	(3,841)	(607)	147	(2)	(4,303)

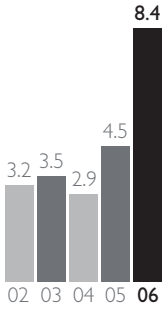
Reconciliation of the Company balance sheet

at 31 March 2005	Previously reported under UK GAAP £'000	IFRS 2 share-based payment £'000	IFRS 3 business combinations £'000	Holiday pay £'000	Restated under IFRS £'000
Assets					
Goodwill and intangible assets	636	-	147	-	783
Property, plant and equipment	704	-	-	-	704
Investments	10,172	(102)	-	-	10,070
Other receivables	428	-	-	-	428
Non-current assets	11,940	(102)	147	-	11,985
Trade and other receivables	850	-	-	-	850
Cash and cash equivalents	18,388	-	-	-	18,388
Current assets	19,238	-	-	-	19,238
Total assets	31,178	(102)	147	-	31,223
Liabilities					
Loans and obligations under finance leases	(14)	-	-	-	(14)
Non-current liabilities	(14)	-	-	-	(14)
Trade and other payables	(2,922)	-	-	(49)	(2,971)
Current liabilities	(2,922)	-	-	(49)	(2,971)
Total liabilities	(2,936)	-	-	(49)	(2,985)
Net assets	28,242	(102)	147	(49)	28,238
Equity					
Share capital	61	-	-	-	61
Share premium	22,523	-	-	-	22,523
Shares to be issued	1	-	-	-	1
Special reserve (1)	8,245	-	-	-	8,245
Share-based compensation reserve	-	662	-	-	662
Retained loss	(2,588)	(764)	147	(49)	(3,254)
Total equity	28,242	(102)	147	(49)	28,238

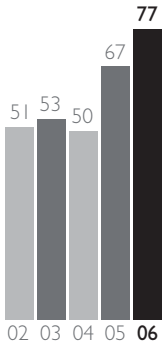
Five-year summary

Trading results

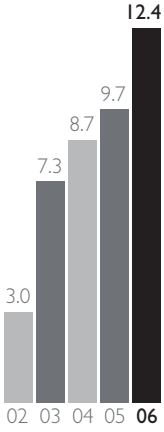
All amounts are shown in £ millions.



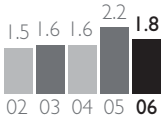
Turnover



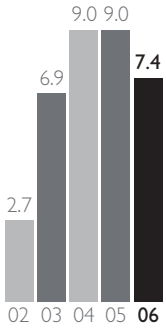
% gross profit to sales



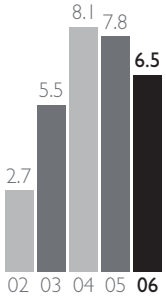
Research and development



Administrative expenses

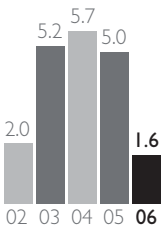


Loss before tax



Loss after tax

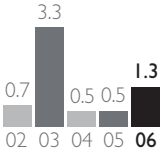
Cash flows



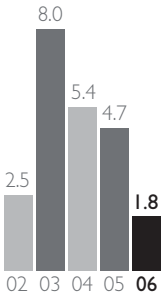
Net cash outflow from operations

Interest

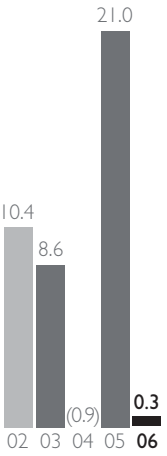
Taxation credits



Capital expenditure /acquisitions

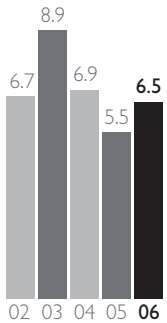


Net cash outflow before financing

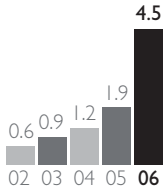


Financing

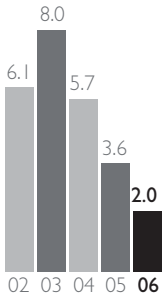
Balance sheet



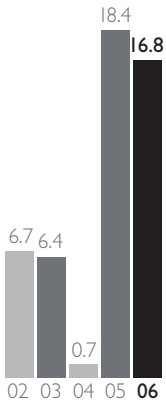
Fixed assets



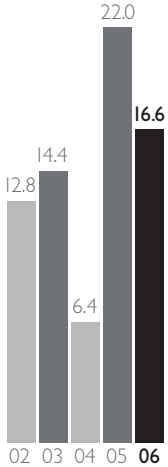
Net current operating liabilities



Net operating assets



Net cash



Shareholders' funds

Note: 2005 figures have been adjusted to reflect the impact of the IFRS restatement.

Shareholder information

Directors
John (Jack) P Cashman (Non-Executive Chairman)
Dr Christopher P Blackwell (Chief Executive)
Dr John R Brown (Non-Executive)
Anne P Hyland (Chief Financial Officer)
Dr Andrew J M Richards (Non-Executive)

Secretary
Anne P Hyland

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Financial Dynamics Limited
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Solicitors
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Patent Attorneys
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A glossary of terms used in this report is available on our website **www.vectura.com**

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