Vectura Group plc Annual Report and Accounts **2006/07**

vectura

A leader in inhaled pharmaceuticals

CAUTIONARY STATEMENT

This annual report has been prepared for, and only for, the members of the Company as a body and no other persons. The report contains certain forward-looking statements with respect to the operations, performance and financial condition of the Group and the markets in which it operates. By their nature, these statements involve uncertainty since future events and circumstances can cause results and developments to differ materially from those anticipated. The forward-looking statements reflect knowledge and information available at the date of preparation of this annual report and the Company undertakes no obligation to update these forward-looking statements. Nothing in this annual report should be construed as a profit forecast.

Contents

Highlights 06/07

Financial Highlights

Total revenues

up by 67%

to £14.1 million
(2006: £8.4 million)

Gross profit

up by 67%

to £10.8 million
(2006: £6.4 million)

Loss per share of 4.4p

27% improvement on the previous year
(2006 – 6.0p)

Cash of

£77.5 million

at 31 March 2007
(£16.8 million at 31 March 2006)

Developments since the year end

- Successful completion of a second Phase IIb study of VR004 announced in April 2007
- Successful completion of a Phase IIa study of VR776 for premature ejaculation announced in May 2007

Corporate Highlights

Acquisition of Innovata plc

concluded in January 2007 and successfully integrated

- £45 million fundraising in July 2006
- Oral and dermal assets spun-out to create **PharmaKodex Limited** in May 2006

Operating Highlights

NVA237 and QVA149 for COPD

- Positive results of **NVA237** Phase IIb clinical trial announced in June 2006
- Novartis announced expectation to file NDA submissions for both NVA237 and QVA149 in 2010

VR315 for asthma

- Major US generics collaboration announcement in December 2006

VR040 for Parkinson's disease

- Successful completion of proof-of-concept study announced in August 2006

VR004 for erectile dysfunction

- Successful completion of first Phase IIb study announced in June 2006

Major device deal signed with Boehringer Ingelheim, with €15 million upfront cash paid in May 2006 plus additional royalties and milestones

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This has been a successful twelve months in which we continued to demonstrate our ability to deliver major licensing deals with international pharmaceutical companies, as well as announcing positive clinical results on a number of our lead products. The **acquisition of Innovata**, completed at the beginning of this year, **has proved to be an excellent strategic fit**, with the two companies combining to give Vectura a significant revenue stream from marketed products, a deep drug development pipeline, a wide range of partners and financial strength. The next twelve months will see further advances in our product development as we continue to drive the value of our portfolio. We also look forward to our forthcoming move from AIM to the Main Exchange in London, where we believe we will see additional liquidity and a higher profile with investors.

Dr Chris Blackwell Chief Executive of Vectura

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Achievements during 2006/2007

Corporate

- Acquisition of Innovata plc
- Largest UK biotech public funding of £45 million

Operational

- Positive data from clinical studies
- Major US partnering deal on VR315 for asthma
- Major device deal signed with Boehringer Ingelheim

Financial

- Revenues increased by 67%
- Cash position £77.5 million

Vectura today

- A leader in inhaled pharmaceuticals
- Revenues from marketed products offsetting development costs
- Innovative development portfolio endorsed by credible partners
- Wide range of products leveraging value from large and fast-growing markets
- Strong financial position with mitigated risk strategy

Chairman's and Chief Executive's Report

Jack Cashman
Chairman

Chris Blackwell
Chief Executive

Overview

This year has been a year of positive achievement in our evolving business strategy, culminating in the acquisition of Innovata plc. Our goal of becoming a sustainable, self-funding principal player in the development of pulmonary pharmaceutical products has been further strengthened by this acquisition. We also benefit from continuing revenue streams on eight marketed products and future milestones on the Innovata licensing deals currently in place. The combination of the two companies has resulted in a leading pulmonary development company with the skills and resources to leverage a product pipeline of considerable potential, as well as a broader range of formulation and device capabilities. We believe that our shareholders, our employees and our collaborative partners will benefit from the enhanced strength and reputation of the enlarged Vectura Group.

The integration of Innovata has been successfully completed and we have combined the accomplishments of both Companies and created a solid foundation on which to build. The synergies from bringing together the complementary skill sets of inhaled product development and intellectual property into one group are already visible and we have also added to our expertise through the benefits of the Innovata clinical development and regulatory affairs departments; areas where we had previously relied solely on external consultants.

In addition to the acquisition, we have continued to make progress with solid advances in the product pipeline, progress on technology out-licensing, and a 67% increase in revenues to £14.1 million. The period started with our global licensing agreement with Boehringer Ingelheim, which was signed in April 2006, providing considerable validation for our device technologies and expertise. In December we concluded our US licensing deal for VR315, with the product now partnered in both the US and Europe.

Key performance indicators and risks

You will see that we have highlighted in this annual report some principal measures, or Key Performance Indicators (KPIs), that we use to assess the development, performance and position of the business. While these KPIs help illustrate the progress of our development pipeline and Vectura's financial strength, it is important to understand that precise forecasts of the outcome and impact of our business activities are difficult to determine due to the nature of our business and industry. We have also listed key risk factors that could cause our actual results to differ materially from forecast results.

Board, staff and shareholders

We were delighted to welcome our new Innovata colleagues to the Group in January. These included Dr Susan Foden who joined our Board in January 2007 and has been appointed as Chairman of our Remuneration Committee; Dr Colin Dalton who joined our Executive Committee as Director of Corporate Affairs and Intellectual Property, and Dr Terence Chadwick who joins us as Director of Medical Affairs. Our best wishes go to the outgoing Innovata Board and we thank them for their valuable contribution. We would also like to thank all our staff for their commitment and contribution, which has enabled the successful integration of the Companies and underpinned our progress over the last year, as well as our institutional shareholders who encouraged us to complete the Innovata acquisition and who overwhelmingly supported our July 2006 fundraising.

Outlook

Vectura has an innovative and broad clinical pipeline that combines valuable mid- and late-stage pharmaceutical products and earlier stage opportunities with high commercial potential. These are supported by a wide range of technologies and skills that allow us to address fast-growing market sectors. We expect to continue to invest in this broad product pipeline from a position of financial strength and plan on taking selected proprietary products through to registration, whilst maintaining a balanced risk/reward strategy of pursuing product and technology collaborations with large pharmaceutical partners where appropriate.

The key drivers over the coming year relate to the continued success of our development work on our respiratory programmes. The collaboration with Boehringer Ingelheim has advanced significantly, and we will continue to work closely with them to complete the first milestone around the turn of the year. In addition, we expect to announce data from a number of clinical programmes, including VR040 for Parkinson's disease and VR147 for migraine. We have some exciting opportunities for new licensing deals driven by the recent data from the successful Phase IIb programme for VR004 in erectile dysfunction and the Phase IIa data from the VR776 programme for premature ejaculation. We also expect to see advancement in the royalties earned on our licensed products, particularly ADVATE®.

It is our intention to migrate from AIM to the Official List, which we believe will provide further liquidity and a higher profile with investors and we anticipate that this will take place in July 2007.

With the strong progress we have achieved in 2006, we are making good progress on our long-term goal of becoming a sustainable, self-funding principal player in the development of pulmonary pharmaceutical products, providing valuable returns for shareholders.

22 May 2007

Business review

Vectura is a leader in the development of inhaled pharmaceuticals, using innovative technologies and expertise to create products to treat respiratory and neurological diseases. We are making excellent progress on our goal of becoming a sustainable, self-funding Company, which in return will provide valuable returns for our shareholders.

vectura

Business review – overview

Vectura Group plc is a pulmonary drug development company focused principally on the development of a range of inhaled therapies for the treatment of respiratory and neurological diseases. The Company targets opportunities where optimised delivery via the lungs can provide significant benefits, such as a rapid onset of action, improved efficacy and improved tolerability compared with current therapies.

Vectura has eight marketed products and a portfolio of drugs in clinical and pre-clinical development, some of which have been licensed to major pharmaceutical companies. The Company seeks to develop certain programmes further to more advanced development to optimise commercial value at that later stage. Vectura also offers its formulation and device technologies to other pharmaceutical companies on a licensing basis where this complements Vectura's business strategy.

Vectura has development collaborations with a broad range of pharmaceutical companies including Boehringer Ingelheim, Novartis, and Chiesi. The acquisition of Innovata in January 2007 brought established alliances with a number of additional companies, such as Baxter, GSK, Merck KGaA, UCB and Otsuka as well providing revenue streams, complementary products and critical mass.

Vectura is based in the UK with headquarters and development operations in Chippenham, Wiltshire, further laboratories in Nottingham and device development in Cambridge.

Business review – strategy

Vectura is targeting the treatment of respiratory and neurological diseases.

The Company has a broad clinical portfolio that combines valuable mid- and late-stage programmes with high-potential, earlier stage opportunities and has a wide range of device and formulation technologies addressing large and fast-growing market sectors.

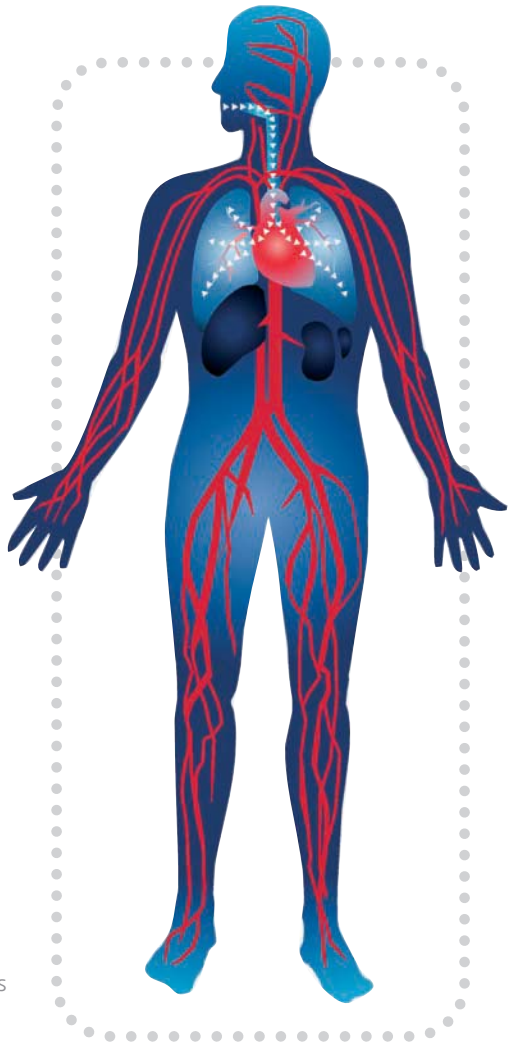
The respiratory development pipeline comprises inhaled formulations of both branded and generic products for the treatment of asthma, chronic obstructive pulmonary disease (COPD) and cystic fibrosis (CF).

In the neurological area, Vectura is exploiting its pulmonary delivery technology for indications such as Parkinson's disease and migraine, and is exploring additional opportunities for future development.

Vectura's goal is to be a cash generating business that creates value for its stakeholders. To achieve this goal, Vectura is:

- Developing pulmonary products using its proprietary device and formulation technologies, expertise and know-how, to advance programmes to clinical proof-of-concept, and
  - for selected products in respiratory and neurological illness, Vectura plans to further develop/co-develop in-house to regulatory approval in order to capture maximum value for the Company and its shareholders
  - for the products that address larger markets, Vectura will out-license the products to major pharmaceutical companies that have appropriate financial resources and existing sales and marketing infrastructures, with Vectura's return being mainly milestones and royalties
- Entering into a number of collaborations with pharmaceutical company partners to exploit both the generic and branded markets for the joint development of high-value pulmonary product opportunities, and
- Continuing to build the pulmonary franchise through internal innovation alongside the Company's strategy of exploring opportunities for the acquisition of products, technologies or businesses that support these goals.

Business review – markets



Inhalation market – why deliver drugs to the lungs?

The advantage of delivering drugs to the lungs for respiratory disease is that the drugs work at the site of action resulting in fewer systemic side effects. For other, non-respiratory conditions where the drug needs to gain access to the blood stream, pulmonary delivery leads to a more rapid onset of action compared to, say, tablets or subcutaneous injection.

Respiratory market

The majority of treatments for asthma and COPD are delivered by inhalation, with many patients taking more than one type of therapy. Drugs that are used to treat respiratory disease are designed to work predominantly in the lung itself, with relatively little active drug passing into the bloodstream. Asthma and COPD comprise the third fastest growing therapeutic targets (with 21 million people suffering from asthma in the US alone) and are forecast to continue to grow rapidly, potentially achieving sales in 2011 of US$20.9 billion for asthma and US$11 billion for COPD. This growth is being driven by two main trends: the use of fixed-dose combinations, and more targeted and effective therapies.

Inhaled fixed-dose combination asthma therapy is the use of two drugs in a fixed-dose combination in one inhaler to provide optimal clinical benefits; the combined mechanisms of the two drugs results in more effective treatment. An example is Seretide®/Advair® (salmeterol/fluticasone), marketed by GlaxoSmithKline (GSK), which is now the fourth biggest selling pharmaceutical product worldwide with sales of £3.3 billion (US$6.1 billion) in 2006. Fixed-dose combination therapy is likely to remain fundamental to the treatment of both asthma and COPD, and is seen as a major driver for growth.

Unlike asthma, for which the treatment options are extremely effective, COPD responds relatively poorly to the same medications. The COPD market is historically less well developed. It is estimated that up to 50% of Americans and 75% of Europeans with COPD are undiagnosed. Treatments recently introduced such as Boehringer Ingelheim's Spiriva® (tiotropium), with sales of over €1 billion in 2006, its first full year of launch, have made an important therapeutic contribution to this sector and are driving growth forecasts.

Neurology market

More recently attention has turned to delivery via the lung of drugs whose activity is directed at other sites in the body. For non-respiratory diseases, such as neurological diseases, pulmonary delivery can lead to a more rapid onset of action compared to tablet or injectable forms of certain drugs. Systemically acting drugs delivered by inhalation may offer some patients a needle-free and easier to use product and can also offer users a more immediate therapeutic benefit. Delivery of drugs by the inhaled route is often highly efficient, leading to greater bioavailability. This means that less active drug will be required for the same clinical effect; potentially reducing the side-effects associated with the higher dose of drug required using conventional delivery routes. Diseases in the neurological area where inhalation of the therapy can provide benefit include the following:

Parkinson's disease
Migraine
Pain
Panic
Anxiety

Other markets

Other markets that lend themselves to treatments delivered via the inhaled route include sexual dysfunction where the rapid onset of action that can be provided by inhaled medicine is important for patients. An example of such a condition is erectile dysfunction (ED) which affects more than 50 million men in the US and the EU. The market for drugs to treat ED is expected to increase to approximately $4.4 billion in 2010. Another market for inhaled medicine is the treatment of diabetes (21 million people suffer from this condition in the US) and the first inhaled insulin product, Exubera® was launched in 2006.

In the future, inhalation may be used to deliver a wide range of small molecules such as antibiotics and antivirals, as well as larger macromolecules such as antibodies and vaccines, and while Vectura does not plan to develop products in these areas it has the potential to exploit these expanding markets by licensing its intellectual property to third parties who work in these areas.

Business review – products

Product pipeline

Franchise	Product name	Indication	Pre-clinical	Phase I	Phase II	Phase III	Partner
Respiratory	Budesonide Clickhaler®	asthma					Japanese partner
	NVA237	COPD					Novartis
	QVA149	COPD					Novartis
	VR315	asthma					US and EU partners
	Duohaler® Project 1	asthma/COPD					EU partner
	Duohaler® Project 2	asthma/COPD					EU partner
	BI collaboration	respiratory products					Boehringer Ingelheim
	VR496	CF and COPD					
Neurology	VR040	Parkinson's disease					
	VR147	migraine					
Other	VR004	erectile dysfunction					
	VR776	premature ejaculation					
	QDose Insulin	diabetes					

Marketed products

Franchise	Product name	Indication	Market	Partner
Baxter collaboration	ADVATE®	haemophilia A		Baxter Worldwide
	Adept®	surgical adhesions		Baxter Worldwide
	Extraneal®	peritoneal dialysis		Baxter Worldwide
Respiratory	Asmabec®	asthma		UCB Europe
	Asmasal®	asthma		UCB Europe
	Budesonide Clickhaler®	asthma		Merck KGaA Europe
	Formoterol Clickhaler®	asthma		Merck KGaA Europe
	Meptin® Clickhaler®	asthma		Otsuka Japan

Business review – products (continued)

Product pipeline

Respiratory development products

Vectura has a strong respiratory franchise with six products in clinical development, as well as five marketed products from which it is generating revenues.

Product	Indication	Description	Status	Partner
NVA237	COPD	Long-acting muscarinic antagonist (LAMA)	Phase II	Novartis
QVA149	COPD	Combination of NVA237 and a long-acting beta agonist (LABA) (QAB149)	Phase II	Novartis
VR315	Asthma	Generic combination product	In preparation for Phase III	Undisclosed
Duohaler®	Asthma/COPD	Generic combination product	In preparation for Phase III	Undisclosed
Duohaler®	Asthma/COPD	Generic combination product	In preparation for Phase III	Undisclosed
BI collaboration	Various	DPI for respiratory products	Pre-clinical	Boehringer Ingelheim
VR496	CF/COPD	Mucolytic/anti-inflammatory	Pre-clinical	—
Budesonide Clickhaler®	Asthma	Budesonide delivered in Clickhaler®	Phase III	Japan, undisclosed

NVA237 for chronic obstructive pulmonary disease (COPD)

NVA237 is an inhaled, locally acting treatment for mild, moderate and severe COPD. It is being developed as a novel, proprietary dry powder inhaler (DPI) formulation of an existing off-patent compound, glycopyrronium bromide. Vectura developed NVA237 in collaboration with Sosei Co Ltd (Sosei), applying PowderHale®, its proprietary formulation technology, to improve delivery to the lungs. Vectura and Sosei licensed NVA237 to Novartis International Pharmaceuticals Limited (Novartis) in April 2005.

NVA237 is a once-daily, long-acting, rapid onset muscarinic antagonist (LAMA) that has recently concluded a Phase IIb trial. Novartis intends to launch NVA237 as a differentiated LAMA for treating COPD, with improved benefits for patients compared with existing therapies.

In June 2006, Vectura and Sosei announced the successful completion of a Phase IIb trial to evaluate the efficacy, safety and dose response of NVA237 in patients diagnosed with COPD over a four-week period. This study demonstrated the bronchodilatory efficacy and durability of NVA237.

COPD, the world's fourth largest cause of death, is a chronic obstruction of the airway that is caused primarily by tobacco smoke. It is estimated that COPD occurs in over 6% of the US population and that at least one in eight smokers suffers from the condition. 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.

Novartis has a reputation as a world leader in the treatment of respiratory diseases. With its commitment to NVA237, and the potentially beneficial combination of NVA237 with its bronchodilator QAB149 (see QVA149 on page 13), it is an ideal licensing partner for Vectura. Under the terms of the Novartis agreement, Vectura and Sosei 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 could total up to $375 million.

In addition, royalties on product sales will be paid for the monotherapy and the combination product.

Novartis has indicated that it expects to file an NDA submission for NVA237 and QVA149 in 2010.

NVA237 and QVA149 for COPD

Positive results of NVA237 Phase IIb clinical trial announced in June 2006

Novartis indicated expectation to file NDA submissions for both NVA237 and QVA149 in 2010

Respiratory disease affects an increasing number of people of all ages. **Asthma** and **chronic obstructive pulmonary disease** are two of the largest and fastest growing areas in a respiratory market that is projected to be worth around $32 billion within four years.

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VR315 for asthma

Major US generics collaboration announcement in December 2006

BI collaboration

Major device deal signed with **Boehringer Ingelheim**, with €15 million upfront cash paid in May 2006 plus additional royalties and milestones

The person in this photograph is a model and the licensed image is being used for illustrative purposes only.

Business review – products (continued)

Budesonide Clickhaler® in use

QVA149 for COPD

QVA149 comprises the combination of NVA237 with Novartis' long-acting [once-daily] beta-agonist (LABA), indacaterol (or QAB149), which is currently in Phase III development. QVA149 is one of the most advanced once daily LAMA/LABA combinations in development and could be the first such combination to come to market for COPD. Indacaterol has been shown to have a similar rapid onset to NVA237 and to benefit lung function for a 24-hour period. The dual activity of a muscarinic antagonist and an adrenergic agonist promises to be a potent bronchodilator and, with convenient once-daily dosing, would have the potential to address a large unmet need for COPD patients.

Novartis has indicated that it expects to file an NDA submission for QVA149 in 2010.

VR315 for asthma

VR315 is an inhaled combination asthma therapy that is being developed as a generic product using GyroHaler® as the delivery device. Vectura licensed the European rights for VR315 to an undisclosed leading international pharmaceutical company in March 2006. The US rights were licensed to an undisclosed leading international pharmaceutical company in December 2006.

Combination therapy for asthma is the biggest and fastest growing sector of the asthma market, with annual sales currently exceeding $8 billion.

Duohaler®

Vectura has two exclusive agreements with a leading European pharmaceutical company for the marketing and distribution in Europe and other specified countries (excluding the US and Japan) of two Duohaler® products, each of which combines established respiratory drugs.

Boehringer Ingelheim collaboration

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

In April 2006, Vectura agreed a worldwide collaboration, development and licence agreement with Boehringer Ingelheim to develop a DPI as a tailored Boehringer Ingelheim device. It will potentially deliver a range of their proprietary respiratory products, mainly for treating asthma and COPD. Under the non-exclusive agreement, Vectura will work with Boehringer Ingelheim on the continued development of the inhaler until around the end of the year. After this, Boehringer Ingelheim will be responsible for any further development, manufacturing and clinical trial use with their proprietary compounds, and the commercialisation of these products. Vectura will receive milestones and royalties on sales of the products commercialised using the device.

VR496 treatment for Cystic Fibrosis (CF) and COPD

VR496 is being developed as an inhaled, locally acting treatment for CF, with the potential to be developed as a therapy for COPD. VR496 is formulated using PowderHale® and is expected to be delivered with GyroHaler®. The active component of VR496 is an off-patent drug that has been approved worldwide as a parenteral treatment for other indications. A significant literature database describes the multi-modal and complementary pharmacological properties of the active molecule that is relevant to the treatment of CF and COPD, with mucolytic, anti-inflammatory, bronchodilatory and anti-infective activity being particularly relevant.

Based on this, Vectura believes VR496 may satisfy the need for a safe and effective treatment for CF and COPD.

The European Medicines Agency (EMEA) and US Food Drug Administration (FDA) have designated VR496 an orphan drug for CF. The EMEA Scientific Advice procedure for orphan drugs will facilitate design of the first VR496 clinical study and development thereafter. Vectura anticipates beginning the trial at the turn of the year.

Vectura has developed an inhalable dry powder formulation of VR496 using PowderHale® and in-vitro studies have confirmed the mucolytic and anti-inflammatory properties of VR496.

VR496 for CF is a product that Vectura plans to take through Phase III clinical trials unpartnered. VR496 also has potential use for COPD patients and the Company currently intends partnering the COPD indication following completion of our Phase II programme. Vectura expects there will be advantages of working with a partner on the COPD indication while progressing the CF indication independently.

Clickhaler® with budesonide for Japan

Vectura has an exclusive agreement with an undisclosed Japanese pharmaceutical company for the marketing rights to the Clickhaler® for use with budesonide in Japan. Under the agreement, Vectura supplies devices on commercial terms and could receive milestone payments based on its successful clinical and regulatory development and royalty payments on future sales. The Japanese pharmaceutical company is undertaking the clinical development of the Clickhaler® with budesonide for which Phase III trials have been undertaken.

Business review – products (continued)

Neurological development products

Vectura currently has two products in full development in its neurology franchise.

Product	Indication	Description	Status	Partner
VR040	Parkinson's disease	Inhaled apomorphine	Phase II	—
VR147	Migraine	Inhaled neurovascular agent	Pre-clinical	—

VR040 treatment for Parkinson's disease (PD)

VR040 is an inhaled, systemically acting product for treating "off" episodes associated with advanced PD that do not respond to oral treatment. The active ingredient in VR040, apomorphine hydrochloride, has previously been approved in Europe (APO-go®) and more recently in 2004 in the US (Apokyn®) for treating "off" episodes. Both products are available as solutions for subcutaneous injection and, in Europe, for subcutaneous infusion. VR040 uses a Vectura proprietary DPI formulation, which is delivered by oral inhalation using Vectura's Aspirair® device.

EMEA has designated VR040 an orphan drug. Vectura will be using the EMEA Scientific Advice procedure to progress the VR040 development programme.

The clinical and pre-clinical studies conducted in support of VR004 (Vectura's inhaled apomorphine product in development for erectile dysfunction) are highly relevant to the VR040 development programme as the two products have the same active ingredient although administered in different dose ranges. In particular, the successfully completed VR004 28-day inhalation toxicology study allowed the immediate progression of VR040 into Phase II clinical evaluation.

The successful results of the Phase IIa proof-of-concept clinical study for VR040 were reported in August 2006. This was a single centre, randomised, double blind, ascending dose, placebo-controlled, parallel group study evaluating VR040 in 24 PD patients. Vectura is currently carrying out a second Phase II clinical study to establish optimal doses. Vectura retains the opportunity to take VR040 to registration and/or to out-license development and commercialisation rights for VR040 in major territories.

VR147 for migraine

Vectura is considering a number of compounds with potential to treat migraine via inhaled delivery. The first product will enter clinical development in 2007. The advantage of an inhaled route of delivery, particularly the rapid onset of action, is expected to provide key benefits to migraine patients.

Aspirair® single unit-dose inhaler device

VR040 for Parkinson's disease

Successful completion of proof-of-concept study announced in August 2006

Neurological disorders constitute a large and increasing share of the global burden of disease. These debilitating disorders include degenerative conditions such as **Parkinson's disease** as well as **migraine** and **pain**; areas in which Vectura has a significant interest.

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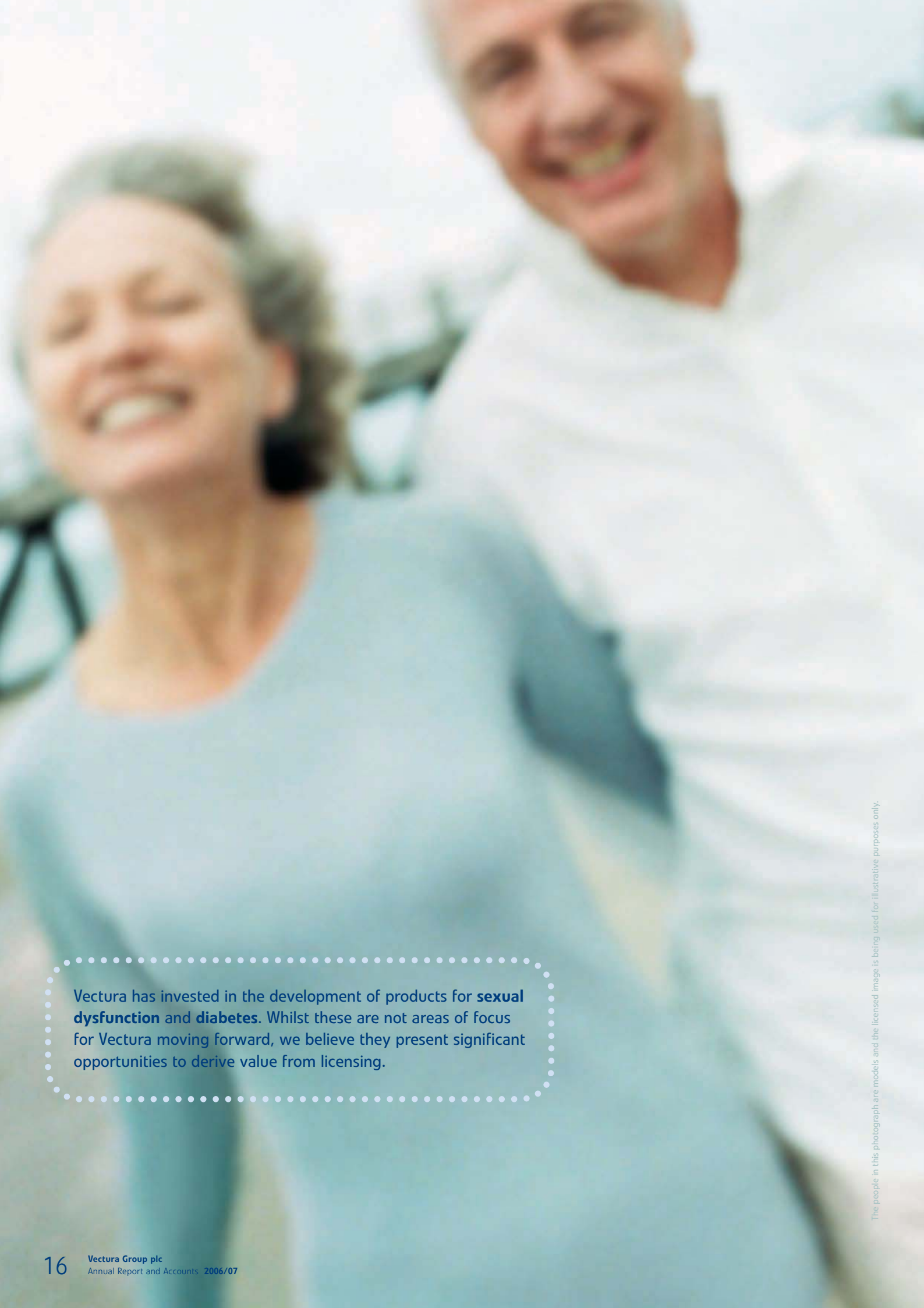


Vectura has invested in the development of products for **sexual dysfunction** and **diabetes**. Whilst these are not areas of focus for Vectura moving forward, we believe they present significant opportunities to derive value from licensing.

The people in this photograph are models and the licensed image is being used for illustrative purposes only.

Business review – products (continued)

Other development products

Vectura is developing products for sexual dysfunction and has an inhaled insulin product for diabetes. The Company anticipates that any future development with these products will be undertaken in conjunction with partners.

Product	Indication	Description	Status	Partner
VR004	Erectile dysfunction	Inhaled apomorphine	Phase IIb completed	—
VR776	Premature ejaculation	Inhaled product that acts via 5HT- and noradrenergic-mediated pathways in the brain	Phase IIa	—
VR400	Female sexual dysfunction	Inhaled apomorphine	This is the same active ingredient as in VR004. To be out-licensed with VR004	—
Inhaled insulin	Diabetes	Rapidly acting inhaled insulin	Phase I	—

VR004 for the treatment of erectile dysfunction (ED)

VR004 is an inhaled, systemic product for treating mild, moderate and severe ED. As with VR040, the active ingredient is apomorphine hydrochloride, previously approved in Europe for treating ED as a sublingual tablet by TAP. VR004 is formulated in a proprietary Vectura formulation and delivered using Vectura's Aspirair® device.

VR004 has completed a Phase IIa clinical study that demonstrated efficacy and a rapid onset of action in ED patients at doses that produced no serious adverse events. Two Phase IIb clinical trials were completed during the last 12 months, assessing VR004 in a larger population in the "at home" setting. The trials have identified an effective dose range associated with an acceptable side-effect profile and Vectura is now seeking licensing partners for the product.

VR776 for the treatment of premature ejaculation (PE)

VR776 is a Vectura proprietary inhaled, systemic treatment for PE in which the active ingredient is an off patent neuro-active drug approved worldwide for treating other indications. VR776 is formulated using PowderHale® and delivered with Aspirair®.

The utility of the active ingredient of VR776 for PE is described in published data, but is generally taken as an oral tablet 3–6 hours before intercourse. The delivery of VR776 via the lungs provides rapid delivery of VR776 into the blood stream with the expectation of a rapid onset of clinical effect, offering significant clinical benefit. Currently, no product is licensed in the US or the EU specifically for the treatment of PE, although a number of products are in development.

Vectura has completed pre-clinical toxicology studies, and a first-time-in-man study. A successful Phase IIa proof-of-concept study was announced in May 2007.

Inhaled insulin

Vectura is developing an inhaled insulin product in a joint venture (QDose) with MicroDose Technologies Inc. The Company will be seeking licensing partners for this product when the current Phase I trial is complete.

Other interests in non-pulmonary products

Vectura has a broad-based patent licence with GSK that permits GSK to use certain Vectura formulation and delivery patents for vaccines delivered onto, into and across the skin. Vectura has also granted a licence to Profibrix BV to use its patents for the development of Fibrocaps®, a novel dry powder haemostatic agent that stops acute and severe bleeding after trauma injury or elective surgery.

Business review – products (continued)

Marketed products

Vectura has three marketed products licensed to Baxter as well as five marketed products in its respiratory franchise.

Product	Indication	Description	Status	Partner
ADVATE®	Haemophilia A	Serum-free recombinant factor VIII	Marketed – worldwide	Baxter
Adept®	Surgical adhesions	4% icodextrin solution	Marketed – US and Europe	Baxter
Extraneal®	Peritoneal dialysis	Solution containing icodextrin	Marketed – worldwide	Baxter
Asmasal®	Asthma	Salbutamol delivered in Clickhaler®	Marketed in UK, France and Ireland	UCB SA
Asmabec®	Asthma	Beclomethasone delivered in Clickhaler®	Marketed in UK, France and Ireland	UCB SA
Budesonide Clickhaler®	Asthma	Budesonide delivered in Clickhaler®	Marketed in certain European countries	Merck Respiratory
Formoterol Clickhaler®	Asthma	Formoterol delivered in Clickhaler®	Marketed in certain European countries	Merck Respiratory
Meptin® Clickhaler®	Asthma	Meptin® delivered in Clickhaler®	Marketed in Japan	Otsuka Pharmaceutical Co

ADVATE®

In 2000, Baxter was granted exclusive and non-exclusive worldwide rights to use Vectura's stabilisation patents and has utilised the technology in its serum-free recombinant Factor VIII, ADVATE®. ADVATE® is indicated for the treatment of haemophilia A and is marketed by Baxter worldwide. Vectura receives royalties on sales of ADVATE®. Sales have increased to over $850 million in 2006, compared to 2005 sales of $600 million. Projected sales for 2007 are in excess of $1.1 billion.

Adept®

Adept® is a 4% icodextrin solution used during surgery to prevent post-surgical adhesions, a frequent complication following gynaecological and other abdominal surgery and a major surgical problem. It has been used for this purpose in Europe since 2000. Vectura signed a global licence deal with Baxter for the manufacturing and distribution of Adept® in December 2005.

On 1 August 2006, Baxter announced that the FDA had approved Adept® adhesion reduction solution for intraperitoneal use as an adjunct to good surgical technique for the reduction of post-surgical adhesions in patients undergoing gynaecological laparoscopic adhesiolysis. Adept® was launched by Baxter in the US in October 2006.

Extraneal®

Extraneal® is a peritoneal dialysis solution containing icodextrin, licensed to Baxter in 1996 and which Baxter now markets worldwide. The product has been launched in over 45 countries worldwide including, in 2003, the major markets of the US and Japan. From September 2006, Vectura no longer receives royalties on the sales of Extraneal® in Europe, but continues to receive royalties on sales in the US, Japan and the rest of the world.

Asmasal® and Asmabec®

The Clickhaler® is a multi-dose, single reservoir dry powder inhaler (DPI) using proven technology. Two Clickhaler® products for the treatment of asthma, Asmasal® containing salbutamol and Asmabec® containing beclomethasone, are marketed by UCB SA in the UK, France and Ireland.

Budesonide Clickhaler® and Formoterol Clickhaler®

Two further Clickhaler® products for the treatment of asthma, the Budesonide Clickhaler® and the Formoterol Clickhaler®, are marketed by Merck Respiratory (the respiratory unit of Merck KGaA) in certain European countries.

Meptin® Clickhaler®

Meptin® Clickhaler®, is marketed in Japan by Otsuka Pharmaceutical Co Ltd (Otsuka) and is for the delivery of its asthma treatment, procaterol.

Vectura receives royalties and/or product margin on these Clickhaler® products and continues to explore licensing opportunities for Clickhaler® products in other countries. Vectura also supplies the Clickhaler® devices to these licensees and earns a margin on the device sales.

Business review – enabling technologies

Vectura has several important, patent-protected pulmonary technology platforms. In addition to using these technologies to support its own product development programmes, the Company's strategy is to seek to out-license to other pharmaceutical companies non-exclusive rights to the technologies for certain areas where it believes that the resulting licence will not impact Vectura's product development opportunities. Such agreements can generate revenues from licensees while allowing Vectura to retain its focus on developing its own inhaled pharmaceutical products.

Dry Powder Inhaled formulation technology – including PowderHale®

The formulation of drugs for inhalation is more complex than for oral delivery and different approaches may be required for locally acting or systemic products. For example, with systemic delivery the dose needs to be formulated and produced such that the particles are less than five microns in size. Vectura's know-how, expertise and patents enable the Company to develop patent-protected systemic and respiratory products.

Vectura's formulation technologies include PowderHale®, micronisation, blending, spray drying, polyol stabilisation and pulmonary controlled release. For example, PowderHale® is a patented technology, designed to allow aerosolised drug particles to achieve high lung penetration with low dose variability. This is achieved by the addition of a pharmacologically inactive excipient, known as a Force Control Agent (FCA), to the active drug component.

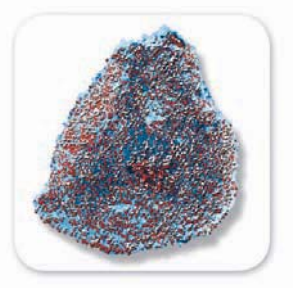
Typical DPI formulations have a limited penetration to the lungs. PowderHale® technology provides the capability to deliver a consistent fine particle dose of drug to the lung, close to the nominal delivered dose. This is achieved by modifying the interactive forces holding together the active drug particles and carrier particles. In this way, benefits can be achieved in deaggregation and aerosolisation, as well as in bulk powder handling and metering of the formulation. In addition, PowderHale® technology provides a higher degree of intra-dose uniformity – an increasingly important consideration for regulators in approving inhaled pharmaceutical products in general.

Aspirair® – 'Active' DPI device technology

Aspirair® is Vectura's high performance, patent-protected inhaler technology, designed to allow delivery with high lung penetration and low variability, essential for drugs intended for systemic use. The device is conveniently sized, simple to use, and economical compared to other 'active' inhalers and has received CE mark certification.

Experiments to date indicate that Aspirair® is capable of delivering DPI formulations of both large and small molecules, even of active drug concentrations up to 98%. In laboratory tests, Aspirair® has been shown consistently to deliver both fine and ultra-fine particles successfully in tests designed to measure projected delivery to the deep lung regions. Aspirair® generates an aerosol plume, triggered by a patient's inhalation, which is significantly slower than most spray type active inhalers currently available. This reduces the amount of drug that is unintentionally deposited in the mouth and throat and subsequently swallowed rather than inhaled into the lungs. Aspirair® has been used in patient studies in the clinic and at home by more than 600 subjects.

The Aspirair® technology, alone or in conjunction with appropriate formulation technologies, can be used to deliver systemic products efficiently and effectively. Aspirair® can also be used to deliver proteins and macromolecules.



Structured lactose with force control agent ○ and active particles ●

Excellent powder flow

Aspirair® unit-dose inhaler

Business review – enabling technologies (continued)

GyroHaler® multi-dose "passive" DPI with sealed foil blisters

Clickhaler® multi-dose reservoir DPI

Duohaler® fixed combination therapy multi-dose reservoir DPI

S2 unit-dose DPI

GyroHaler® – "Passive" DPI device technology

The GyroHaler® device is a novel, cost-effective, multi-unit dose DPI device designed to deliver locally-acting drugs to the lung. It is compact and easy to use with a small number of moulded parts, facilitating short device development times and competitive manufacturing costs. The device contains up to 60 doses and is disposable after use. It is designed to have competitive aerosolisation characteristics and to provide excellent drug protection from moisture and light using sealed foil blisters.

The GyroHaler® technology has the potential to deliver respiratory products in an efficient and patient-friendly manner. Further variants of the GyroHaler® technology are also in development.

Clickhaler® – multi-dose reservoir DPI

Clickhaler® is a multi-dose "passive" reservoir DPI using proven technology. It is approved for use and marketed to treat asthma and COPD with a number of different drugs (salbutamol, beclometasone, formoterol, budesonide and procaterol) in a number of European countries as well as Japan.

Clickhaler® is inexpensive to produce and fill. Production is fully automated.

Duohaler® – fixed combination therapy multi-dose reservoir DPI

The Duohaler® is a fixed combination therapy, multi-dose DPI. It has two separate drug reservoirs which feed two separate drugs to two separate metering chambers from which the drugs are delivered to the patient in the same breath, which circumvents potential co-formulation issues.

Vectura has two exclusive agreements with a leading European pharmaceutical company for the marketing and distribution in Europe and other specified countries (excluding the US and Japan) and for the development of two Duohaler® products combining established respiratory drugs for combination therapy.

S2 unit dose DPI

The S2 Unit Dose device may be embodied as a re-useable or disposable single-dose DPI. It has an innovative dispersion mechanism enabling highly efficient drug delivery deep into the lungs with minimal patient inspiratory effort, a feature of particular benefit to systemic drug delivery. It is designed to be easy to use and inexpensive to manufacture and may be suitable for a wide range of conditions requiring a rapid onset of effect, such as migraine, nausea/vomiting and analgesia, or which require a short duration of therapy or occasional use.

Pre-clinical experiments revealed that the S2 can generate high fine particle fractions suggesting high lung deposition would be achieved. Initial human tests using scintigraphy (labelling drug particles with radioactive isotopes and then imaging the lungs following inhalation) confirmed highly efficient drug delivery to the deep lung.

Business review – capabilities

Pharmaceutical development services

Vectura's product development activities are augmented and supported by an established, profitable Pharmaceutical Development Services business. This business generates revenues by providing specialist product development services to other pharmaceutical companies, primarily licensing partners. Vectura applies its in-house expertise to solving technical challenges in drug development. Historically the emphasis was on helping customers develop their own product candidates and in this way Vectura has gained experience by working on numerous inhaled products that have now received regulatory approval. The emphasis now is on working with licensing partners to continue the development of products or technologies licensed from Vectura until complete transfer has been achieved.

Commercial and business development

Vectura has a strong in-house commercial and business development group that maintains good relationship with international pharmaceutical companies, both licensees and non licensees, and undertakes market analysis for all products under development. In addition, the group provides the market analysis and competitor information that is required to identify valuable new product opportunities. The major licensing deals that Vectura has concluded to date demonstrate the strength of the commercial and business development skills available.

Clinical development

Vectura has an in-house clinical development team, which has demonstrated its ability to develop products through stages of pre-clinical and clinical development. The team supports the development of Vectura's own products as well as those developed on behalf of other companies. Key functions include liaising with thought-leaders, clinical investigators and experts in the design of clinical trials (and associated pre-clinical development programmes), and the selection and management of specialist respiratory and other Clinical Research Organisations (CROs) responsible for conducting clinical trials.

Regulatory affairs

Vectura has an in-house regulatory team that is experienced in global pharmaceutical product registration and pulmonary product development. The regulatory group provides the regulatory support for Vectura's own and its partners' programmes and works closely with all functions within the Group, advising on regulatory strategy and data requirements to ensure timely approvals. The group is responsible for the preparation and maintenance of clinical trial authorisations (CTAs) and marketing authorisations (MAs) and preparation of responses to questions on a worldwide basis, as required. Responsibility for submission of dossiers and liaison with individual regulatory authorities is also undertaken as appropriate.

Quality assurance

Quality assurance (QA) in a pharmaceutical product development environment ensures that data intended to support regulatory submissions are generated in compliance with Good Manufacturing Practice (GMP), Good Laboratory Practice (GLP) and Good Clinical Practice (GCP), collectively referred to as GxP.

One of the many achievements of the QA team during the year was the support provided for CE mark certification for Aspirair®. This certificate confirms that the Aspirair® inhaler meets all regulatory requirements for a class IIb medical device within Europe. Aspirair® will now be labelled with the CE mark of an approved device.

Vectura has a Manufacturer's Authorisation (MA) (Investigational Medicinal Products) (IMP) Licence from the Medicines and Healthcare products Regulatory Agency (MHRA). An MA (IMP) Licence is a requirement of the EU Clinical Trials Directive and allows the manufacture and release of clinical trial supplies by the company's Qualified Person.

Vectura is also accredited to ISO 13485:2003 Medical Devices. Achieving ISO 13485 accreditation means that Vectura had its device engineering and contract manufacturing processes inspected by an authorised quality standards organisation (Lloyds Register Quality Organisation), which found it to be of sufficiently high quality to allow Vectura to self-certify its inhaler devices as being fit for market use in Europe.

Manufacturing operations

The manufacturing operations group is responsible for the late-stage development of Vectura's respiratory products, ensuring that such products can be successfully validated and commercialised in client or contract manufacturing facilities. The group is responsible for global supply chain operations as Vectura's products are distributed worldwide.

Vectura's strategy is to produce clinical trials supplies up to pilot-plant scale. The Company then uses contract manufacturing organisations for larger scale manufacturing for late-stage development and commercial supply, as well as for some smaller scale manufacturing where it is more economical to do so.

Business review – capabilities (continued)

Intellectual property

Vectura's intellectual property is a valuable asset that underpins its past, present and future success. The Group aims to secure multi-layered registered protection for its products, processes and technology platforms, which has the potential to provide highly effective protection.

Vectura has built up a substantial portfolio of patents and patent applications comprising approximately 135 patent families containing 781 granted cases globally, with patents in the key territories of the US, Japan and the main European Member states. In addition, it has 39 granted designs, 39 pending designs and 474 pending patents.

Additional value continues to be obtained from Vectura's intellectual property estate from licensing its rights for the development of non-pulmonary products. For example, Baxter is licensed to use certain of Vectura's patents for ADVATE®, Adept® and Extraneal® products, which are sold on the market.

Facilities

Vectura currently operates from three leased facilities in the UK. The first of these is an approximately 50,000 square feet laboratory, office and manufacturing facility in Chippenham, Wiltshire. This facility is approved for GMP manufacturing of IMPs for clinical trials. Vectura's second facility is an approximately 30,000 square feet laboratory and office facility in Ruddington, Nottingham. The third facility a 4,200 square feet laboratory and device engineering unit on the Cambridge Science Park.

Vectura Chippenham (Head Office)

Vectura Nottingham

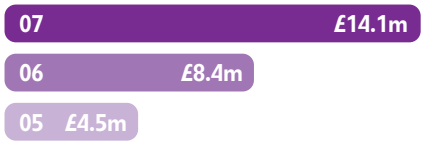
Vectura Cambridge

Business review – key performance indicators

Revenue growth

Revenues over the last three years have increased as follows:

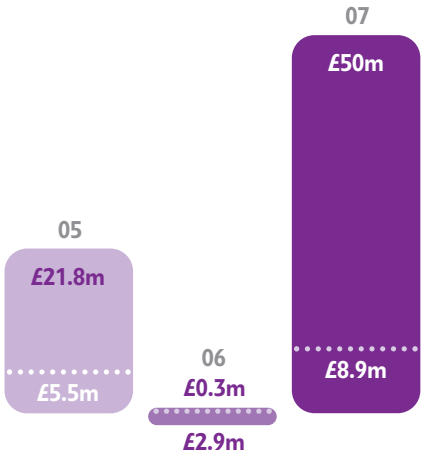
Year ended	Revenue £m	Increase %
31 March 2007	**14.1**	**67**
31 March 2006	8.4	87
31 March 2005	4.5	55



Cash management

This involves the management of the cash consumed/generated in the business and funding received. The operational cash consumed is defined by reference to the cash flow statements as being the addition of the net cash outflow from operations and the cash purchase of tangible and intangible assets. These KPIs for the three years to 31 March 2007 are as follows:

Year ended	Operational cash consumed £m	Funding received £m
31 March 2007	**(8.9)**	**50.0**
31 March 2006	(2.9)	0.3
31 March 2005	(5.5)	21.8



Progress with collaborative partners and licensees for the development and commercialisation of products

During the year Vectura entered into two significant new licensing deals, both of which are collaborative in nature. The first was with Boehringer Ingelheim for a dry powder inhaler device and the second was with an unnamed company for the US rights to VR315. Vectura continued to progress the development and commercialisation of existing partnered programmes including VR315, Duohaler® and Clickhaler® and the collaboration with Boehringer Ingelheim. The Company is actively seeking partners for its sexual dysfunction products, which have successfully completed clinical trials in H1 2007.

Progress with the unpartnered product pipeline

During the year Vectura reported proof-of-concept results on VR040, the product for Parkinson's disease, which successfully completed clinical trials in the first half of 2007. This is the first product that Vectura currently intends to take through to registration in certain territories without a partner.

Identification of new product pipeline

Vectura continues to drive evaluation of new product opportunities through a New Opportunities Committee. During the year Vectura entered into an agreement with Theradeas Limited to explore three potential new products.

Maintaining and strengthening the Vectura intellectual property portfolio

Vectura has been successful during the year in oral opposition proceedings and has achieved numerous patent grants.

Major device deal signed with Boehringer Ingelheim, with €15 million upfront cash paid in May 2006 plus additional royalties and milestones

Business review – risk management

The Group's business involves exposure to a number of risks, many of which are inherent in pharmaceutical product development. Particular risks includes the following:

Industry risk

The nature of pharmaceutical development is such that drug candidates may not be successful due to an inability to demonstrate in a timely manner the necessary safety and efficacy in a clinical setting to the satisfaction of appropriate regulatory bodies, such as the European Medicines Agency (EMEA) in Europe and the Food and Drug Administration (FDA) in the US. The Group may be unable to attract, by itself or from partners, the funding necessary to meet the high cost of developing its products through to successful commercialisation.

Clinical and regulatory risk

Drug substances may not be stable or economic to produce. Unacceptable toxicities or insufficient efficacy in the chosen indication may cause the medicine to fail or limit its applicability. Lack of performance by third party Clinical Research Organisations or an inability to recruit patients may cause undue delays in clinical trials. Clinical and regulatory issues may arise or changes to the regulatory environment may occur that lead to delays, further costs, reduction in the commercial potential of a product in development or the cessation of programmes. Ethical, regulatory or marketing approvals may be delayed or withheld or, if awarded, may carry unacceptable conditions to further development or commercial success. The Group's manufacturing facilities and those of its third party manufacturers are subject to regulatory requirements and licensing and there can be no assurance that such facilities will continue to comply with such regulatory requirements. Given the cutting-edge nature of the technology, alternative manufacturing facilities may not be available.

Competition and intellectual property risk

Certain companies are developing medicines that may restrict the potential commercial success of the Group's products or render them obsolete. Third parties may have intellectual property that may restrict the Company's freedom to operate or that of the Company's partners. Licences may not be available or may be costly and may reduce net royalty income to the Company. The Group's intellectual property may become invalid or expire before its products are successfully commercialised.

Economic risk

The successful development and commercialisation of medicines carry a high level of risk and the returns may be insufficient to cover the costs incurred. Restrictions on health budgets worldwide or on the prices that may be charged for new medicines through competitive or other pressures may limit a medicine's sales potential. The Group may not be able to attract partners on favourable terms or recruit the appropriate calibre of staff to help develop or commercialise its products. Any such partners may fail to perform or commit the resources necessary to commercialise the Group's products successfully.

Financial risk management objectives and policies

The Group's activities expose it to a number of financial risks including cash flow risk, credit risk, liquidity risk and price risk. In accordance with policies approved by the Board of Directors, the Group does not use financial derivatives to manage these risks. In addition, the Group does not use financial instruments for speculative purposes.

Cash flow risk

The Group's activities expose it to the financial risks of changes in foreign currency exchange rates. The majority of the Group's revenues are in Euros and US Dollars. Where known liabilities arise in these currencies the revenues are retained on deposit in these currencies in order to off set the exchange risk on these liabilities.

Credit risk

The Group's principal financial assets are bank balances and cash, trade and other receivables and investments. The Group's credit risk is primarily attributable to its trade receivables. An allowance for impairment is made where there is an identified loss event which, based on previous experience, is evidence of a reduction in the recoverability of the cash flows.

The credit risk on liquid funds is limited because the counterparties are banks with high credit ratings assigned by international credit-rating agencies.

The Group's credit risk is concentrated on the two principal banks that hold its bank balances and cash, and on its collaboration partners and licensees from whom it receives licensing fees, development fees, royalties and proceeds from device sales.

Liquidity risk

In order to maintain liquidity to ensure that sufficient funds are available for ongoing operations and future developments, the Group closely monitors the cash available to it, which is invested in a mixture of current accounts and short-term deposit accounts.

Price risk

The Group is exposed to pricing risk in respect of its income and expenditure. The Group manages its exposure to price risk through commercial negotiations with customers and suppliers.

Risk management

The Group's risk management processes are detailed in the Corporate Governance report.

Financial review

Summary of results

The results for the year ended 31 March 2007 show total revenue of £14.1 million (2006 – £8.4 million), a 67% increase on the previous year. The operating loss for the year was £11.3 million (2006 – £8.5 million). The loss before tax was £8.7 million (2006 – £7.4 million) and the loss after tax was £6.8 million (2006 – £6.5 million).

Innovata acquisition

Comparison of the results with the previous year is affected by the acquisition of Innovata in January 2007. The income statement separately identifies the results relating to the Innovata business for the two and a half months post acquisition and this financial review provides further information on the potential financial impact of the acquisition for the 12 months to 31 March 2008 and Innovata's actual results for the 12 months to 31 March 2007. It is Vectura's intention to maintain Innovata as a cash-generating business. In addition, the combination of the two businesses is expected to provide approximately £3 million per annum in research and development and administration cost savings, which would not have been possible had the two companies remained independent.

Revenue

Revenue includes fee income from product licensing, technology licensing, development fees, royalties and Clickhaler® device sales. In the 12 months to 31 March 2007, total revenue increased compared to the prior year by 67% to £14.1 million, and included a contribution of £3.0 million from Innovata in the period post acquisition. The underlying revenue for the existing Vectura Group increased by 31%, from £8.4 million to £11.0 million.

Product and technology licensing revenues are non-recurring and are typically triggered by the signing of new licence agreements or by regulatory or commercial events, and as such tend to be irregular in timing and subject to variation from one period to another. Total product licensing revenues in the period were £4.6 million, and included £4.0 million recognised from the upfront NVA237/QVA149 access fee of £7.9 million, which was received in April 2005, and £0.6 million of the VR315 access payment from an undisclosed licensee, which is being recognised over a four-year period from 31 March 2006.

Technology licensing revenues of £1.7 million were realised during the period. This was the access fee from Boehringer Ingelheim, which is being recognised over two years.

Pharmaceutical Development Services (PDS) revenues for Vectura of £4.7 million showed a 9% increase on the prior year (£4.4 million); £1.8 million of these revenues was generated in the six months to 31 March 2007. The Innovata PDS revenues were £1.1 million for the 2.5 months to 31 March 2007 and £6.3 million for the 12 months to 31 March 2007. These revenues represent principally contractual development fees charged to licensing partners for work carried out during the year.

Total royalties for the period were £1.4 million and relate to products in the portfolio acquired from Innovata. The principal royalty income streams were from ADVATE® and Extraneal®, with smaller contributions from Adept® and products delivered in Clickhaler®. If the Innovata acquisition had closed on 1 April 2006 and royalties had been received at this level for the 12 months to 31 March 2007, total royalties for the year would be £6.9 million. Sales of the products that underlie these royalty streams are expected to grow during the 12 months to 31 March 2008.

Product sales revenue of £0.5 million was derived from the sale of Clickhaler® devices to licensees.

Gross profit

The gross profit in the period to 31 March 2007 was £10.8 million, a 67% improvement on the prior year (£6.4 million). Gross profit in the year to 31 March 2007 represents 77% of revenue (2006 – 77%).

Research and development expenses

Total investment in research and development was £17 million, a 37% increase on the prior year (£12.4 million). These costs include primarily clinical trial costs, salary costs for scientists and scientific support staff, intellectual property costs, laboratory running costs and depreciation. We expect our investment in this area to almost double in the year to 31 March 2008 as some of our key products move to late-stage development and we consolidate 12 months of Innovata's investment in this area. The research and development expenses for the 12 months to 31 March 2008 will include savings in the region of £1 million arising as a result of the acquisition of Innovata. The savings arise from a reduction in regulatory, clinical development and intellectual property costs as the Group benefits from the in-house expertise in these areas acquired with the Innovata business.

Financial review (continued)

Administrative expenses

Administrative expenses for the year to 31 March 2007 were £2.6 million, a £0.8 million increase on the prior period. This expenditure is expected to increase in the year to 31 March 2008 as the business grows and will include the one-off costs of the Company's move to the Main Exchange of the London Stock Exchange. However, combined administration expenses will benefit significantly from the acquisition of the Innovata business with savings of approximately £2 million being achieved. These savings arise from the consolidation to one Board of Directors and the elimination of the duplicate costs of running two listed companies.

Amortisation expenses

Vectura acquired £74.5 million of intangible assets with Innovata. These assets are being amortised over a period of up to 10 years. The amortisation charge in the earlier years will be higher than that in the later years. A charge in the region of £10 million is expected for the year ended 31 March 2008. These charges have no cash impact. In accordance with accounting practice, the calculation of the fair value of the assets acquired with the Innovata business is provisional and may be adjusted at any time up to the anniversary of the acquisition in January 2008.

Other income

Other income of £1.4 million relates to the profit realised on the disposal of the oral and dermal technologies to PharmaKodex Limited. Vectura maintains a 20% shareholding in this company. The £0.2 million share of the losses of PharmaKodex Limited represent the percentage of losses equated to the Vectura shareholding. There are no cash implications attached to this share of losses or the profit realised. There are no obligations on Vectura to provide funding for this company. Vectura will continue to consolidate a share of the profits or losses of this entity.

Interest receivable

Interest receivable relates primarily to the interest income from cash invested in overnight and other short-term deposits. In the year ended 31 March 2007, the Group had net interest receivable of £2.8 million (2006 – £1.0 million) on net cash deposits, reflecting the increased level of cash following the Placing in July 2006 and the acquisition of Innovata in January 2007.

Taxation

R&D tax credits are recorded upon receipt. £1.4 million of R&D tax credits were received in the year (2006 – £1.0 million) for the Vectura business. The tax credit of £0.4 million relating to the Innovata business includes a £0.6 million release of a deferred tax liability which equates to 30% of the amortisation charge in the period. The total deferred tax liability of £21.8 million at 31 March 2007 equates to 30% of the total carrying value of the Innovata intangible assets at that date (£72.5 million). This liability will be released through the Income Statement in line with the amortisation charge on these assets.

The Innovata business is expected to be profitable; however, it is not expected to pay corporation tax in the immediate future due to the availability of an estimated £88 million of tax losses acquired with the business. A tax asset of £1.9 million has been recognised that relates to the estimated tax that would be payable on the Innovata profits for the year ending 31 March 2008 had these losses not been available.

Loss after taxation and loss per share

The loss for the year after taxation was £6.8 million (2005 – £6.5 million) giving a loss per Ordinary Share of 4.4p (2006 – 6.0p).

Assets

Non-current assets were £156.2 million, compared with £6.5 million at 31 March 2006, reflecting the goodwill, intangible assets, deferred tax asset and property, plant and equipment acquired with Innovata. Current assets were £86.0 million (2006 – £21.5 million), which reflected an increase in prepayments and accrued income in relation to the royalty streams receivable and a £60.7 million increase in the cash balance resulting mainly from the Placing in July 2006 and the acquisition of Innovata.

Goodwill

Innovata was acquired for a total consideration of £123.6 million, which consists of £2.8 million of cash costs and the issue of 143.8 million ordinary shares at 84p each. Goodwill on the acquisition was £72.3 million.

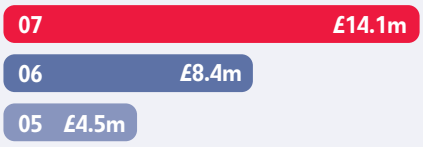
Liabilities

Total liabilities of £59.9 million include £8.1 million of trade and other payables, a £3.6 million increase from the previous year (2006 – £4.5 million), reflecting the increase in activities of the enlarged Group. Liabilities also include £21.8 million of deferred tax discussed above, £11.3 million of deferred income, £0.4 million of finance lease liabilities and a financial liability of £18.4 million.

Financial liability

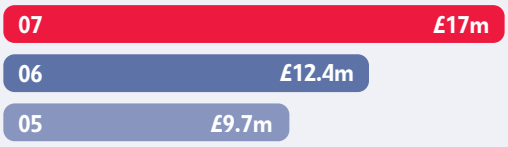
Current liabilities include £3.2 million of the total £18.4 million financial liability, which represents an Innovata liability to a third party in respect of Adept® and Extraneal® royalty streams. The total liability equates to an estimated £19.6 million due to the third party based on agreed minimum and maximum payments shown in note 21 to the Financial Statements; the total includes an assumed interest charge of £1.2 million. £0.8 million of this assumed interest charge is expected to be expensed in the year ending 31 March 2008.

Total revenue



Gross profit

R&D development expenses



Deferred Income

Deferred income relates to milestones received but not yet recognised as revenue. Included in the £4.4 million deferred income expected to be recognised in the year ending 31 March 2008 is £1.7 million relating to Boehringer Ingelheim; £1 million relating to VR315; £0.8 million relating to Clickhaler®, £0.2m relating to NVA237 with the majority of the balance relating to Innovata's vaccine delivery deal. The £6.9 million to be recognised as revenue in latter years includes £2 million for VR315, £2.6 million for Clickhaler® and £2.4 million for Duohaler®.

Shareholders' equity

Shareholders' equity at 31 March 2007 was £182.3 million (2006 – £16.6 million), a net increase of £165.6 million. This increase comprises the shares issued in the year including the fundraising and the acquisition of Innovata, and a share-based payments charge, less the recognised loss for the year.

Capital expenditure

Capital expenditure in the period was £2.4 million (2006 – £1.3 million), incurred principally on laboratory equipment and a blister filling machine for the VR315 programme. Capital expenditure is expected to be slightly in excess of this in the year ended 31 March 2008.

Operating cash flow

Net cash outflow from operating activities in the period was £6.5 million compared to £1.6 million in the prior year. At 31 March 2007, Vectura had cash and short-term deposits of £77.5 million (2006 – £16.8 million).

Treasury

The primary objective of the Group's investment policy is to invest in low-risk cash or cash equivalent investments to safeguard the principal, seeking both to maximise returns and to ensure that the resources remain available to fund the Group's operations.

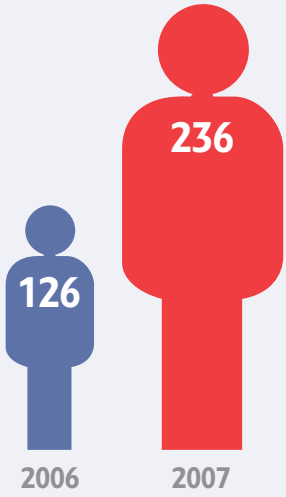
Financing activities

The main financing activities that occurred during the year were as follows:

- the issue of 4.9 million ordinary shares to Boehringer Ingelheim in May 2006 at a price of £1.40 per share generating £6.9 million
- the issue of 52.9 million shares in July 2006 at a price of £0.85 per share generating £45 million before expenses of £2.1 million.

Headcount

Headcount at 31 March 2007 was 236 (31 March 2006 – 126).



Anne Hyland
Chief Financial Officer

22 May 2007

Board of Directors

John Patrick (Jack) Cashman Non-Executive Chairman

Jack Cashman, aged 66, joined the Board of Vectura as Non-Executive Chairman in 2001. He is currently Non-Executive Chairman of Interface Biologics Inc, a private Canadian therapeutic biomaterials company, and 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, and a Non-Executive Director of Amtrol Inc (USA), Amtrol-Alfa (Portugal) and Transat AT Inc (Montreal). Jack is the former Chairman and joint-Chief Executive Officer of RP Scherer Corporation and participated in its leveraged buyout and privatisation and its subsequent successful public offering flotation on the New York Stock Exchange. (RP Scherer was later acquired by Cardinal Health Inc.) 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 Paul Blackwell BSc PhD Chief Executive

Dr Chris Blackwell, aged 45, was appointed Chief Executive of Vectura in February 2004. He joined the company in 2002 as Chief Operations Officer and Executive Director. Prior to Vectura he was Director of Drug Development and an Executive Director at Scotia Pharmaceuticals Ltd, which he joined in 1998. He was previously at Hoffman-La Roche specialising in project management, where he became UK Director, Global Project Management in 1996, and Glaxo Research and Development as a Clinical Pharmacologist. Chris trained as a research scientist at the University of Bath, where in 1988 he completed his doctorate investigating free radicals and reperfusion-induced arrhythmias. In July 2006, Chris was appointed Non-Executive Director of AGI Therapeutics plc, a speciality pharmaceutical company focused on gastrointestinal drug products.

Anne Philomena Hyland BBS FCA FITI Chief Financial Officer and Company Secretary

Anne Hyland, aged 46, was appointed Chief Financial Officer, Company Secretary and Executive Director of Vectura in March 2002. Prior to 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. She 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. Anne joined Medeva from KPMG, London, where she was an audit manager and gained exposure to corporate finance, advisory and due diligence work. She has a Business Studies degree from Trinity College, Dublin, and is a Fellow of the Institute of Chartered Accountants, Ireland and a Fellow of the Institute of Taxation, Ireland.

Dr Andrew John McGlashan Richards BA MA(Cantab) MSc PhD CChem Non-Executive Director

Dr Andy Richards, aged 47, joined the Board of Vectura as a Non-Executive Director in 2000. He is an established biotechnology entrepreneur and business angel, focusing on founding, investing in, and growing biotechnology and healthcare companies. He has broad experience of the UK biotechnology sector in research, drug development and in building commercial relationships. He is Chairman of Geneservice Ltd, PharmaKodex Ltd and Altacor Ltd and a Non-Executive Director of Aitua Ltd, Biowisdom Ltd, Babraham Bioscience Technology Ltd, Cancer Research Technology Ltd (the commercial arm of Cancer Research UK), Theradeas Ltd and VASTox plc. He is also a founder member of the "Cambridge Angels", and a director of the BIA (BioIndustry Association). In 1992, he co-founded Chiroscience and was Business Development Director through to its merger in 1999 with Celltech. Originally a protein chemist, Andy spent his early career with ICI (now AstraZeneca) and with PA Technology.

Dr John Robert Brown BSc PhD MBA FRSE Non-Executive Director

Dr John Brown, aged 52, joined the Board of Vectura as Non-Executive Director and Senior Independent Director in 2004. He currently chairs the Governing Council of the Roslin Institute in Edinburgh and is Chairman of Scottish Biomedical. He is a Non-Executive Director of a number of private and public biotech companies including Ardana plc and Protherics plc. He sits on the Advisory Board of the Life Sciences ITI in Scotland and is a member of the DTI Technology Strategy Board. He is also Chairman of BIA Scotland. Until December 2003, John was Chief Executive of the FTSE 250 biotech company Acambis plc, a leading producer of vaccines to treat and prevent infectious disease. He joined Acambis as Finance Director in 1995 and was appointed CEO in 1997. Prior to Acambis 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. He previously spent five years at Glaxo Group Research where he led a group developing neuropeptide antagonists. John holds an MBA and a PhD in neuropharmacology.

Dr Susan Elizabeth Foden MA DPhil Non-Executive Director

Dr Susan Foden, aged 54, joined the Board of Vectura as a Non-Executive Director in January 2007 having previously served on the Board of Innovata plc. She holds a number of Non-Executive Directorships with both public and private companies and public funding bodies in the biotech and healthcare field including Medical Solutions plc, PIramed Ltd, and Cell Centric Ltd, and is a Trustee of The Institute of Cancer Research. Prior to this Susan held positions in venture capitalism, technology transfer and UK biotech. From 2000 to 2003, she was an Investor Director with the London-based venture capital firm Merlin Biosciences Limited and was Chief Executive Officer of the technology transfer company Cancer Research Campaign Technology Limited from 1997 to 2000. From 1983 to 1987 Susan headed up the academic liaison function at what was then Celltech Limited, dealing with some of the earliest tech transfer deals in the UK, which set industry precedents. She studied biochemistry at the University of Oxford from where she obtained an MA and DPhil.

Senior management

Dr Tim Wright BSc PhD MBA Commercial Director

Dr Tim Wright, 46, 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. Between 1986 and 1999, Tim 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. Tim trained as a research scientist at London University, obtaining a PhD in neuroendocrinology in 1987 and an MBA from London Business School Executive Programme in 1994.

Dr Martin J. Shott PhD MRPharmS Pharmaceutical Operations Director

Dr Martin Shott, 55, joined Vectura as Director Pharmaceutical Operations in October 2002 with a wide-range of experience from within the pharmaceutical industry. Prior to joining Vectura, he worked for four years at Innovata Biomed as Associate Director of Research and Development. Martin has gained extensive experience in the UK and Europe working as a senior manager at several companies, including Lers-Synthelabo and Ciba-Geigy (later Novartis), where he managed the global DPI development unit based in the UK. He trained as a research scientist during which time he investigated the compression of pharmaceutical powders for a PhD at Nottingham University, while continuing to work in the industry. He is a member of the Royal Pharmaceutical Society of Great Britain.

Dr Mark J. Main BSc PhD Development Director

Dr Mark Main, 47, joined Vectura as Development Director in May 2004. Prior to joining Vectura, he was with Powderject Pharmaceuticals, which 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. He was previously with 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. 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.

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

Stephen Eason, 49, joined Vectura as Director of Device Development in February 2002 when the Aspirair® inhaler technology and staff were acquired from Cambridge Consultants Ltd, where he was an associate director. He had previously initiated and led the Aspirair® development programme at CCL and has subsequently initiated and led the GyroHaler development programme for Vectura. While at CCL Stephen carried out significant product developments in the areas of inhalation, injection, and infusion products. 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.

Colin C. Dalton BTech (Hons) PhD Director of Corporate Development and Intellectual Property

Dr Colin Dalton, 57, joined Vectura as Director of IP and Corporate Affairs in January 2007 when Innovata plc was acquired. He was previously Corporate Development Director with Innovata and Quadrant, a formulation company acquired by Innovata. For five years prior to Quadrant, he was Director of Business Development at GSK Biologicals where he managed a group responsible for licensing new products and technologies, collaborations and alliances. He previously worked in business development at Quadrant Healthcare plc and British Sugar plc and was a senior consultant in the biotechnology practice at PA Consulting. He started his career as a fermentation scientist at BP Co Ltd. He trained as an applied biologist at Brunel University and obtained a PhD in 1977 at Leicester University.

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.

Environment

Vectura is committed to complying with environmental legislation and minimising the impact of its activities on the environment. Vectura considers that its activities have a low environmental impact. The Group is committed to minimising any adverse environmental impact of its manufacturing and laboratory facilities 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. The Group has provided training to individuals who are responsible for health and safety.

The Group continues to keep environment and health and safety practices under review.

Ethical and social policies

The Group's principal activities are undertaken within the pharmaceutical industry, which is subject to a highly regulated ethical framework with which the Group complies. In addition, the Group seeks to conduct its activities generally in accordance with good business ethics.

The Group does not consider it appropriate at its current stage of development to make significant financial donations to charitable, community or social activities, but considers that its most important contribution to the communities within which it operates is to provide high-quality employment opportunities and to develop therapies for diseases.

Employees

The Group recognises that in an industry based on innovation, research and development, its employees are one of its biggest assets and seeks to communicate and, where appropriate, consult with them on matters affecting them as employees, in the most appropriate manner.

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.

The Group provides training and development appropriate to individual needs and offers remuneration packages, including pensions, private medical, permanent health and life insurances and a working environment, all of which are designed to be both fair and competitive with larger companies within the industry. Participation in the Group's share option schemes is extended to all of the Group's employees. More details are provided in the Remuneration Report.

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. Staff forums have been formed to comply with the requirements of Information and Consultation of Employees Regulations 2004, which implement the EC Directive.

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.

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 UK legislation.

Corporate governance statement

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 2007 six directors and 234 staff operating from three sites in the UK. The Board recognises that it is accountable to shareholders for the Group's standard of governance and is reporting here as a matter of best practice on its compliance with the Combined Code on Corporate Governance (the "Code", published in July 2003).

Statement of compliance

The Group 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) in a prior year.

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 was appropriate for the Company.

It was 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 Group was also in a position of non-compliance until 18 January 2007 resulting from the fact that the Chairman, Mr J Cashman, was a member of the Audit Committee until the appointment of Dr S E Foden on that date. The Group is also in a position of non-compliance as a result of Mr Cashman being a member of the Remuneration Committee. Mr Cashman has remained on the Remuneration Committee in view of the impending rule change that permits a Chairman to be a member of a Remuneration Committee, which will mean that the Group will become compliant.

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 Report on Directors' remuneration), 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 its success. 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 business strategy, financing arrangements, material acquisitions and divestments, approval of the annual budget, major capital expenditure projects, risk management, treasury policies and establishing and monitoring internal controls. At each meeting, the Board reviews strategy and progress of the Group towards its objectives, particularly in respect of research and development projects, and monitors financial progress against budget.

NEDs are encouraged to meet without the presence of Executive Directors as appropriate.

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; by naming Dr John Brown as Senior Independent Director; by establishing an executive management team (Vectura Executive Committee, the "VEC") under the leadership of the Chief Executive, Dr Chris Blackwell; and by 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. Four of the six 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. Dr J R Brown is the Non-Executive Director with relevant financial experience.

Independence of NEDs

As explained in the statement of compliance above, in order to assist in securing the recruitment and retention of high-calibre NEDs, the Company has historically 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 were not subject to any performance conditions and are now exercisable.

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 are paid to Croggan Limited for these services, which totalled £2,000 in the year ended 31 March 2007 (2006 - £5,000). 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 20.4% of the issued share capital, and Dr Richards owns 1.84%. 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 the Remuneration Committee consists of at least two independent NEDs. Dr Foden has chaired the Remuneration Committee since 18 January 2007, its other members being Dr Brown (Chair up to and including 17 January 2007), 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 formally four times during the financial year ended 31 March 2007 and the Board can confirm full attendance by all current at the time of the meeting. The Committee plans to meet at least three times a year.

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, Dr Foden 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 twice during the financial year ended 31 March 2007 and the Board can confirm full attendance by all members current at the time of the meeting.

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 Dr Foden and Dr Richards.

In compliance with the Code's recommendation that the Chairman should not sit on the Audit Committee, Mr Cashman resigned from the Committee on the appointment of Dr Foden on 18 January 2007. The Audit Committee has 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 members current at the time of the meeting. 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.

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 twice a year

Corporate governance statement (continued)

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 arrangements by which staff of the Company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The Audit Committee's objective is to ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action.

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 to help them make an effective contribution at the meetings by establishing procedures for distributing Board agendas and papers in a timely manner in advance of meetings. The Board has at least six scheduled formal meetings per year (approximately every two months), with additional meetings when circumstances and urgent business dictate. In the financial period under review, seven regular meetings of the full Board were held. The Board can confirm full attendance by all Directors during the year, except for Dr Foden, who attended all meetings in the period post joining the Board.

In addition, the Executive Directors ensure regular informal contact is maintained with Non-Executive Directors. The Board makes full use of appropriate technology as a means of updating and informing all its members.

Transparency of Board appointments

There are formal, rigorous and transparent procedures for the appointment of new Directors to the Board. Short-listed candidates are interviewed by the Chairman of the Board and at least one other member of the Nomination Committee and evaluations of all appropriate candidates are circulated to all members of the Nomination Committee for consideration and approval prior to candidate recommendation to the Board.

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 performances of Dr Foden, Dr Brown and Dr Richards, who are being proposed for re-election at the Annual General Meeting, have been so evaluated and it has been determined that they continue to perform effectively and show full commitment to their roles on the Board. All Directors have service agreements with indefinite terms.

Accountability and audit

The Board is required by the Code to present a balanced and understandable assessment of the Group's position and prospects. In relation to this requirement reference is made to the Statement of Directors' Responsibilities for preparing financial statements. 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 provide only 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" and "whistle-blowing" 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 and 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. 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 that 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 Chairmen of the Audit, Nomination and Remuneration Committees are present at the AGM to answer questions through the Chairman of the Board.

Anne Hyland
Company Secretary

22 May 2007

Report on Directors' remuneration

Introduction

The Company is currently not required to prepare a remuneration report nor to comply with the UKLA Listing Rules and the disclosure provisions under Schedule 7A of the Companies Act 1985 (the "Act") as it is not on the Official List of the UK Stock Exchange. However, in view of its intention to list during 2007 and the fact that the Remuneration Committee is committed to following best practice, 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 to be held in October. The report meets the relevant requirements of the Listing Rules of the Financial Services Authority and describes how the Board has applied the principles relating to Directors' remuneration. Details of the resolution can be found in the Circular accompanying this report.

The Regulations require the Auditors to companies on the Official List of the UK Stock Exchange to report to the Group's members on the "auditable part" of the Report on Directors' remuneration 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.

Unaudited information

Remuneration Committee

The Remuneration Committee consists entirely of NEDs and is constituted in accordance with the recommendations of the Combined Code. Its members for the year were Dr Foden (Chairman) from 18 January 2007, Dr Brown (Chairman up to and including 17 January 2007), Mr Cashman and Dr Richards. The Committee met formally four times during year ended 31 March 2007 and seeks independent advice, where appropriate, for the purpose of determining the remuneration policy for the Group. The remuneration of each Executive Director and senior employees 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. No Director plays a part in any discussion about his or her own remuneration.

In determining the Directors' remuneration for the year, the Committee reviewed executive compensation packages in the UK pharmaceutical and biotech sectors. It also referred to a number of specialist studies on executive remuneration, including the survey carried out by Halliwell Consulting on the pharmaceutical sector.

Remuneration policy

Policy on remuneration of Executive Directors and senior employees

In determining the Group's policy, and in constructing the remuneration arrangements of each Executive Director and senior employee, the Board, advised by the Remuneration Committee, aims to provide remuneration packages that are competitive and designed to attract, retain and motivate Executive Directors and senior employees 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 and senior employee 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 the UK.

The Group's ongoing policy is that a substantial proportion of the remuneration of Executive Directors and senior employees 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 corporate goals bonuses. Corporate goals are set at the start of each year.

Components of the remuneration package

The principal components of 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. As in the prior year, for the financial year ended 31 March 2007, 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 cash bonuses

All employees are eligible for an annual discretionary cash bonus, whereby performance objectives are established at the beginning of the financial year by reference to suitably challenging corporate goals. Performance-related payments may be paid annually, dependent upon achievements measured against corporate objectives. The scheme is offered to all staff and Executive Directors. Bonus award entitlements range between 10% and 50% (100% in the case of the Executive Directors) of salary depending on grade. Cash bonuses are limited to a maximum of 100% of basic salary for each Executive Director; however, the Remuneration Committee maintains the right to make one-off bonus awards for exceptional performance.

Performance-related share option awards

Share option awards are also made over shares for Executive Directors and senior employees, normally having a value equivalent to the annual cash bonus, which, as stated above, is itself based on corporate performance objectives being met. The share option awards are therefore not 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 an exercise price of current market value on the date of grant which expires 10 years from the date of grant. 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.

Unapproved Share Option Plan and the EMI Plan

NEDs and Executive Directors hold options under the Unapproved Share Option Plan. The Executive Directors hold options under the Enterprise Management Incentive arrangements (the "EMI Plan").

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 the options are granted.

Sharesave Share Option Scheme

The Company also operates a Sharesave Share Option Scheme for both employees and Executive Directors. Under this Scheme all eligible employees and Executive 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.

Option scheme for NEDs

Historically, the Company's policy was to grant NEDs share options (in addition to fees) as part of their remuneration package. At the early stage of the Company's development this was considered to be essential to secure the recruitment and retention of high-calibre NEDs with the appropriate experience. This policy of granting share options to NEDs no longer applies. In this connection, reference should also be made to the report on Corporate Governance.

Long Term Incentive Plan

The Company received approval at the Annual General Meeting held on 12 September 2005 for the Vectura Group plc 2005 Long Term Incentive Plan (the LTIP), under which participating Executives are granted an annual award under the LTIP.

At the end of a three-year period shares are released to the Executive depending on the achievement of set performance conditions. The Company's policy is that awards under option schemes and the LTIP combined shall not exceed two times salary in any one year. 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 period of three years. At the end of the 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 performance over performance period	Percentage TSR of the LTIP Award released %
Below median	–
At or above median	30*
Upper quartile	100*

* Linear 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.

Report on Directors' remuneration (continued)

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
CeNeS Pharma plc
Futura Medical plc
GW Pharmaceutical plc
Oxford BioMedica plc
Proteome Sciences plc
Protherics plc
Sinclair Pharma plc
SkyePharma plc
Vernalis Group plc

During the year ended 31 March 2007 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 93p.

Share Incentive Plan

During the year ended 31 March 2007, the Company introduced the Vectura Group plc Share Incentive Plan (SIP) following approval by the shareholders on 27 September 2006. This plan is available to all employees, including Executive Directors, the purpose being to encourage employees to become shareholders of the Company and retain their shares over the medium to long term. It introduces share ownership to the employee in three ways: free shares, partnership shares and matching shares. The Company may award free shares annually; the employee may buy partnership shares with pre-tax salary; and the Company may match any partnership shares purchased in one year with additional matching shares on a one-for-one basis. The SIP is an Inland Revenue approved scheme through which benefits are provided in a tax efficient manner.

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 since its initial listing, measured by Total Shareholder Return, compared with the performance of the Comparator Group of companies in the sector, as described left.

Directors' service contracts

It is the Company's policy that Executive Directors should have contracts with an indefinite term and 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.

During the year, the Board approved the appointment of Dr Blackwell as a non-executive director of AGI Therapeutics plc. His remuneration for this position is €30,000 per annum and he retains such earnings.

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 2007 are summarised in the following table:

Name of Director	Date of appointment
J R Brown	13 May 2004
J P Cashman	27 March 2001
A J M Richards	21 January 2000
S E Foden	18 January 2007

Directors' interests

The Directors that held office at 31 March 2007 and their interests in the share capital of the company at 31 March 2006 and 31 March 2007 are as follows:

	31 March 2007 ordinary shares of 0.025p each	31 March 2006 ordinary shares of 0.025p each
C P Blackwell [2]	53,138	51,948
J R Brown [1]	20,457	20,457
J P Cashman	434,749	434,749
A P Hyland [2]	59,370	58,180
A J M Richards	84,998	84,998
S E Foden	11,000	–

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

[2] The holdings of C P Blackwell and A P Hyland include 1,190 ordinary shares of 0.025p each that are held in the Vectura Group plc Employee Benefit Trust (Share Incentive Plan).

There was no change in the Directors' interests between 31 March 2007 and 22 May 2007, the date of this report.

Audited information

Directors' remuneration

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

	Basic salary and fees £000	Bonuses £000	Benefits £000	2007 Total emoluments £000	2006 Total emoluments £000
Executive Directors:					
C P Blackwell*	240	234	1	475	478
A P Hyland*	170	166	1	337	340
Non-Executive Directors:					
J R Brown**	45	–	–	45	25
J P Cashman	60	–	–	60	40
S E Foden**	8	–	–	8	–
A J M Richards***	30	–	–	30	25
	553	**400**	**2**	**955**	**908**

*Included within bonuses for the year ended 31 March 2007 are bonuses relating to the £45m Placing completed in July 2006 and the acquisition of Innovata plc in January 2007.

**Included within the NED's fees are the fees for Chairmanship of Committees, Dr Brown received £15,000 for his Chairmanship of the Audit Committee, the Nomination Committee and the Remuneration Committee until 18 January 2007. Dr Foden received £2,000 for her Chairmanship of the Remuneration Committee from 18 January to 31 March 2007.

***In addition to the above, fees for consultancy services of £2,000 (2006 – £5,000) were paid to Dr 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.

Benefits represent payments for medical insurance.

Directors' pension entitlements

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

	2007 £000	2006 £000
C P Blackwell	24	23
A P Hyland	17	16
	41	39

Report on Directors' remuneration (continued)

Directors holding office at 31 March 2007 with options outstanding over ordinary shares of 0.025p are as follows:

Plan	Options held at 1 April 2006	Options granted during year	Options held at 31 March 2007	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]
Unapproved	132,424	–	132,424	82.500	03/08/06	03/08/15 [1]
Unapproved	–	265,493	265,493	93.750	09/08/07	09/08/16 [1]
SAYE Scheme	18,651	–	18,651	50.800	01/04/08	30/09/08
	2,454,121	**265,493**	**2,719,614**			
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]
Unapproved	94,090	–	94,090	82.500	03/08/06	03/08/15 [1]
Unapproved	–	188,640	188,640	93.750	09/08/07	09/08/16 [1]
SAYE Scheme	18,651	–	18,651	50.800	01/04/08	30/09/08
	1,540,804	**188,640**	**1,729,444**			
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**			

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

[1] Vesting in three equal annual instalments from date first exercisable.

Directors' LTIP awards

Under the LTIP scheme, the grants made to Directors at 31 March 2007 were as shown in the table below:

Director	1 April 2006 £	Awards during year £	31 March 2007 £	% of salary %	Share price on date of grant pence	Date of release of shares
C P Blackwell	361,741	–	361,741	125	77.5	12/09/08
	–	258,064	258,064	100	93.0	22/11/09
	361,741	**258,064**	**619,805**			
A P Hyland	261,290	–	261,290	125	77.5	12/09/08
	–	182,795	182,795	100	93.0	22/11/09
	261,290	**182,795**	**444,085**			

The number of shares released to the Directors at the end of the three-year performance period is dependent upon the performance of the Company during that period as compared to that of the comparator group of companies as described in the LTIP section of this Report on Directors' remuneration.

The mid-market share price as derived from the London Stock Exchange Daily Official List was 87.75p on 31 March 2007. The mid-market share price ranged from 83p to 127.5p during the year to 31 March 2007. The average share price for the period was 95.3p.

On behalf of the Board

Suan Foden
Chairman of the Remuneration Committee

22 May 2007

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 2007.

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 Highlights, Chairman's and Chief Executive's report, the Business Review and the Financial Review. The Board have considered the key risks and uncertainties of the business and have detailed the risk management policies in place.

Results and dividends

The Group loss for the year, after taxation, amounted to £6,827,000 (2006 – £6,455,000). The Directors do not recommend the payment of a dividend (2006 – £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. Details of Directors' remuneration and their interests in the share capital of the Company are given in the Report on Directors' remuneration. None of the Directors has any interest in any contract of significance to the financial statements.

Employees

Details on the involvement of employees are disclosed in the Corporate social responsibility statement.

Financial instruments

The policy and practice of the Group with regard to financial instruments is disclosed in note 24 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 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 average credit period taken by the Group for trade purchases is 32 days (2006 – 27 days). The average credit period taken by the Company for trade purchases is 30 days (2006 – 27 days).

Political and charitable donations

Vectura encourages employee involvement in charitable causes. During the year, Vectura made contributions amounting to £350 (2006 – £350) to charitable organisations in the UK. This contribution was made in lieu of posting seasonal greetings to customers in December 2006. There were no political donations during the year (2006 – £nil).

Directors' liabilities

The Company has granted an indemnity to its Directors against liability in respect of proceedings brought by third parties, subject to the conditions set out in the Companies Act 1985. Such qualifying third party indemnity provision remains in force as at the date of approving the Directors' report.

Significant shareholdings

At 18 May 2007, the nearest practical date to the date of this Report, the Company had a total of 4,021 ordinary shareholders and 314,854,096 ordinary shares in issue.

The Directors had been notified of the following substantial holdings in the Company's share capital as at the close of business on 18 May 2007:

	Number of shares	
	'000	%
Aviva Group	30,092	9.56%
Invesco Asset Management	22,059	7.01%
AXA Framlington	21,510	6.83%
Bluecrest Capital Management	21,120	6.71%
F&C Asset Management	16,639	5.29%
Aberforth Partners	13,043	4.14%
UBS	12,540	3.98%
Lehman Brothers	11,502	3.65%
J O Hambro Capital Management	10,299	3.27%

Share price

The mid-market share price as derived from the London Stock Exchange Daily Official List was 87.75p on 31 March 2007. The mid-market share price ranged from 83p to 127.5p during the year to 31 March 2007. The average share price for the period was 94.2p.

Corporate social responsibility statement

The Group's policies on the environment, health and safety, ethical and social issues and its employees are described in the statement on page 31.

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.

Annual General Meeting

The AGM of the Company will be held at 9 am on 3 October 2007 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.

Olswang's offices, London

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 that were members of the Board at the time of approving the Directors' report are listed on pages 28 and 29. 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

22 May 2007

Financial statements

Financial table of contents

Statement of Directors' responsibilities

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 (IFRS) as adopted by the European Union.

The Directors are required to prepare financial statements for each financial year that 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 that 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. 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.

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 2007, which comprise the Consolidated Income Statement, the Consolidated and Company Balance Sheets, the Consolidated and Company Cash Flow Statements, the Consolidated and Company Statement of Changes in Equity and the related notes 1 to 32. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Report on Directors' Remuneration 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 auditors' 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 and 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' responsibilities for preparing the Annual Report, the Report on Directors' Remuneration and the financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

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

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 Report on Directors' Remuneration to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the directors' report is consistent with the financial statements. The information given in the Directors' Report includes that specific information presented in the Operating and Financial Review that is cross-referenced from the Review of Business section of the Directors' Report.

In addition we report to you if, in our opinion, 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 are not disclosed.

We review whether the Corporate Governance and Social Responsibility Statement reflects the Company's compliance with the nine provisions of the 2003 Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. 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. The other information comprises only the Directors' Report, the unaudited part of the Report on Directors' Remuneration, the Chairman and Chief Executive's Report, the Financial Review, the Business Review, the Directors' biographies, and the Corporate Governance and Social Responsibility Statement. We consider the implications for our report if we become aware of any apparent misstatements 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 Report on Directors' Remuneration 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 the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations that we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Report on Directors' Remuneration 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 Report on Directors' Remuneration 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 2007 and of its loss for the year then ended;
- The parent company financial statements give a true and fair view, in accordance with IFRSs as 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 2007;
- The financial statements and the part of the Report on Director's remuneration to be audited have been properly prepared in accordance with the Companies Act 1985; and
- The information given in the Directors' report is consistent with the financial statements.

Ernst & Young LLP
Registered Auditors
Bristol

22 May 2007

Consolidated income statement

for the year ended 31 March 2007

	Notes	2007 Continuing £000	2007 Total acquisition £000	2007 Total continuing £000	2006 £000
Revenue	3	**11,046**	**3,005**	**14,051**	8,411
Cost of sales		(2,352)	(943)	(3,295)	(1,965)
Gross profit		**8,694**	**2,062**	**10,756**	6,446
Research and development expenses		(15,427)	(1,567)	(16,994)	(12,397)
Administrative expenses		(2,376)	(239)	(2,615)	(1,783)
Amortisation		–	(1,995)	(1,995)	–
Share-based compensation		(1,633)	–	(1,633)	(741)
Total administrative expenses		(4,009)	(2,234)	(6,243)	(2,524)
Share of loss of associate	14	(208)	–	(208)	–
Other income	14	1,423	–	1,423	–
Operating loss	6	**(9,527)**	**(1,739)**	**(11,266)**	(8,475)
Finance revenue	5	2,633	183	2,816	1,042
Finance costs	5	(3)	(239)	(242)	(6)
Loss before taxation		**(6,897)**	**(1,795)**	**(8,692)**	(7,439)
Taxation	8	1,437	428	1,865	984
Loss after taxation attributable to equity holders of the Company		**(5,460)**	**(1,367)**	**(6,827)**	(6,455)
Loss per ordinary share basic and diluted	9			(4.4p)	(6.0p)

Consolidated balance sheet

at 31 March 2007

	Notes	2007 £000	2006 £000
Assets			
Goodwill	10	74,279	2,012
Intangible assets	11	72,505	–
Property, plant and equipment	12	5,635	4,071
Investments in associates and joint ventures	14	1,228	–
Trade investment	15	250	–
Deferred tax asset	8	1,871	–
Other receivables	16	428	428
Non-current assets		**156,196**	6,511
Inventories	17	202	–
Trade and other receivables	18	8,230	4,689
Short-term investments	24	500	–
Cash at bank and in hand	24	77,029	16,828
Current assets		**85,961**	21,517
Total assets		**242,157**	28,028
Liabilities			
Deferred income	20	(6,888)	(2,258)
Financial liabilities	21	(15,163)	–
Deferred tax	8	(21,752)	–
Non-current liabilities		**(43,803)**	(2,258)
Trade and other payables	22	(8,060)	(4,475)
Obligations under finance leases	23	(410)	(14)
Deferred income	20	(4,400)	(4,666)
Financial liabilities	21	(3,216)	–
Current liabilities		**(16,086)**	(9,155)
Total liabilities		**(59,889)**	(11,413)
Net assets		**182,268**	16,615
Equity			
Share capital	25a	113	62
Share premium	25b	72,889	22,869
Shares to be issued	25c	–	918
Special reserve	25d	8,245	8,245
Merger reserve	25e	124,905	3,211
Share-based compensation reserve	25f	3,036	1,403
Retained loss		(26,920)	(20,093)
Total equity		**182,268**	16,615

These financial statements were approved by the Board of Directors on 22 May 2007 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 2007

	Notes	2007 £000	2006 £000
Net cash flows from operating activities	27	**(6,510)**	(1,560)
Cash flows from investment activities:			
Cash acquired as part of Innovata		19,882	–
Costs in association with acquisition of Innovata		(2,830)	–
Interest received		2,816	1,042
Investment in associate		(160)	–
Purchase of property, plant and equipment		(2,438)	(1,295)
Receipts from sale of property, plant and equipment		22	–
Net cash flows from investment activities		**17,292**	(253)
Cash flows from financing activities:			
Proceeds from issue of ordinary shares		52,143	347
Share issue costs		(2,072)	–
Payment of finance lease liabilities		(139)	(84)
Repayment of loans		–	(4)
Interest element of payments under finance leases		(10)	(5)
Interest paid on bank loans and overdrafts		(3)	(1)
Net cash flows from financing activities		**49,919**	253
Increase/(decrease) in cash and cash equivalents		60,701	(1,560)
Cash and cash equivalents at beginning of period		16,828	18,388
Cash and cash equivalents at end of period		**77,529**	16,828

Consolidated statement of changes in equity

for the year ended 31 March 2007

	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	25a	25b	25c	25d	25e	25f		
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
Loss for the year	–	–	–	–	–	–	(6,827)	(6,827)
Total recognised income and expense for the year	–	–	–	–	–	–	(6,827)	(6,827)
Share-based compensation	–	–	–	–	–	1,633	–	1,633
Exercise of options	–	203	–	–	–	–	–	203
Shares issued	51	51,889	(918)	–	121,694	–	–	172,716
Share issue costs	–	(2,072)	–	–	–	–	–	(2,072)
At 31 March 2007	113	72,889	–	8,245	124,905	3,036	(26,920)	182,268

Company balance sheet

at 31 March 2007

	Notes	2007 £000	2006 £000
Assets			
Goodwill	10	2,022	2,022
Property, plant and equipment	12	3,552	2,225
Investments in subsidiary undertakings	13	135,164	12,131
Investments in associates	14	1,228	–
Other receivables	16	428	428
Non-current assets		142,394	16,806
Trade and other receivables	18	896	4,675
Cash and cash equivalents		76,370	16,763
Current assets		77,266	21,438
Total assets		**219,660**	38,244
Liabilities			
Amounts owed to subsidiary undertakings	19	16,895	187
Deferred income	20	646	584
Non-current liabilities		17,541	771
Trade and other payables	22	4,156	4,438
Deferred income	20	864	4,107
Current liabilities		5,020	8,545
Total liabilities		**22,561**	9,316
Net assets		**197,099**	28,928
Equity			
Share capital	25a	113	62
Share premium	25b	72,889	22,869
Shares to be issued	25c	–	1
Special reserve	25d	8,245	8,245
Merger reserve	25e	123,651	2,874
Share-based compensation reserve	25f	3,036	1,403
Retained loss		(10,835)	(6,526)
Total equity		**197,099**	28,928

These financial statements were approved by the Board of Directors on 22 May 2007 and were signed on its behalf by:

Dr C P Blackwell
Director

A P Hyland
Director

Company cash flow statement

for the year ended 31 March 2007

	Notes	2007 £000	2006 £000
Net cash flows from operating activities	27	**12,229**	(1,199)
Cash flows from investing activities:			
Increase in investment in subsidiaries		–	(426)
Costs in association with acquisition of Innovata		(2,830)	–
Interest received		2,633	1,042
Investment in associate		(160)	–
Purchase of property, plant and equipment		(2,319)	(1,295)
Net cash flows from investing activities		**(2,676)**	(679)
Cash flows from financing activities:			
Proceeds from issue of ordinary shares		52,143	347
Share issue costs		(2,072)	–
Payment of finance lease liabilities		(14)	(84)
Repayment of loans		–	(4)
Interest element of payments under finance leases		–	(5)
Interest on bank loans and overdrafts		(3)	(1)
Net cash flows from financing activities		**50,054**	253
Increase/(decrease) in cash and cash equivalents		**59,607**	(1,625)
Cash and cash equivalents at beginning of period		16,763	18,388
Cash and cash equivalents at end of period		**76,370**	16,763

Company statement of changes in equity

for the year ended 31 March 2007

	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	25a	25b	25c	25d	25e	25f		
At 1 April 2005	61	22,523	1	8,245	2,874	662	(3,254)	31,112
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	2,874	1,403	(6,526)	28,928
Loss for the year	–	–	–	–	–	–	(4,309)	(4,309)
Total recognised income and expense for the year	–	–	–	–	–	–	(4,309)	(4,309)
Share-based compensation	–	–	–	–	–	1,633	–	1,633
Exercise of options	–	203	–	–	–	–	–	203
Shares issued	51	51,889	(1)	–	120,777	–	–	172,716
Share issue costs	–	(2,072)	–	–	–	–	–	(2,072)
At 31 March 2007	113	72,889	–	8,245	123,651	3,036	(10,835)	197,099

Notes to the financial statements

at 31 March 2007

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 86. The Company's ordinary shares are traded on the Alternative Investment Market (AIM).

Basis of preparation

The financial statements have been prepared in accordance with the Companies Act 1985 and International Financial Reporting Standards (IFRS) and related interpretations as adopted by the European Union. The Group and Company financial statements are also consistent with International Financial Reporting Standards as issued by International Accounting Standards Board.

The separate financial statements of the Company are presented as required by the Companies Act 1985 and have been prepared in accordance with IFRS as adopted by the European Union. 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 parent company loss for the year ended 31 March 2007 is £4,309,000 (2006 – £3,272,000).

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.

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. Control comprises the power to govern the financial and operational policies of the investee so as to obtain benefit from its activities and is achieved through direct or indirect ownership of voting rights, or by way of contractual agreement. 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.

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.

Key sources of estimation uncertainty

The key sources of estimation uncertainty that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year are the measurement and impairment of indefinite-life intangible assets (including goodwill), the measurement of provisions, the estimation of share-based payment costs and the treatment of R&D expenditure in line with the relevant accounting policy.

The measurement of intangible assets other than goodwill on a business combination involves estimation of future cash flows and the selection of a suitable discount rate. The Group determines whether indefinite-life intangible assets are impaired on an annual basis and this requires the estimation of the value-in-use of the cash-generating units to which the intangible assets are allocated. This involves estimation of future cash flows and choosing a suitable discount rate.

The measurement of provisions involves estimation of future cash flows and the associated level of liabilities expected to arise as a result of these cash flows.

The estimation of share-based payment costs requires the selection of an appropriate valuation model, consideration as to the inputs necessary for the valuation model chosen and the estimation of the number of awards that will ultimately vest, inputs for which arise from judgements relating to the probability of meeting non-market conditions and the continuing participation of employees.

The treatment of R&D expenditure requires an assessment of the expenditure in order to determine whether or not it is appropriate to capitalise onto the balance sheet in accordance with IAS 38.

1 Accounting policies (continued)

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 relating 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 completion of agreed tasks or numbers of man days.

Product sales

Product sales are recognised when goods are delivered to customers.

Interest income

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

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, liabilities, and contingent 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. Where the recoverable amount of the cash-generating unit is less than its carrying amount, including goodwill, an impairment loss is recognised in the income statement.

Intangible assets

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. Expenditure on internally developed intangible assets, including development costs, is taken to the income statement in the year in which it is incurred. Expenditure relating to clearly defined and identifiable development projects is recognised as an intangible asset only after the following criteria are met:

- The project's technical feasibility and commercial viability can be demonstrated;
- The availability of adequate technical and financial resources and an intention to complete the project have been confirmed; and
- The correlation between development costs and future revenues has been established.

Following initial recognition, the historic cost model is applied, with intangible assets being carried at cost less accumulated amortisation and accumulated impairment losses. Intangible assets with a finite life have no residual value and are amortised on a straight-line basis over their expected useful lives with charges included in administrative expenses as follows:

Patents, trademarks and licence agreements – over the useful life of the asset.
Computer software – 3 years.

The carrying value of intangible assets is reviewed for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable.

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 to 7 years
Office and IT equipment – 3 years
Motor vehicles – 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

The Group assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value-in-use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value-in-use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses on continuing operations are recognised in the income statement in those categories consistent with the function of the impaired asset.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in profit or loss unless the asset is carried at a re-valued amount, in which case the reversal is treated as a revaluation increase. After such a reversal, the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

Investments in subsidiaries

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

Investments in associates and joint ventures

The Group's interests in its associates, being those entities over which it has significant influence and which are neither subsidiaries nor joint ventures, are accounted for using the equity method of accounting. The Group's interests in its joint ventures are also accounted for using the equity method of accounting. Under the equity method, the investment is carried in the balance sheet at cost plus post-acquisition changes in the Group's share of net assets of the entity, less distributions received and less any impairment in the value of individual investments. The Group's income statement reflects the Group's share of any income and expense recognised by the associate or joint venture outside profit and loss. The Group does not recognise losses in excess of the value of its investments.

Financial assets

Financial assets are recognised when the Group becomes party to the contracts that give rise to them and are classified as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or as available-for-sale financial assets, as appropriate. The Group determines the classification of its financial assets at initial recognition and re-evaluates this designation at each financial year end. When financial assets are recognised, initially they are measured at fair value, being the transaction price plus, in the case of financial assets not at fair value through profit or loss, directly attributable transaction costs.

Inventories

Inventories comprise goods held for resale and are stated at the lower of cost and net realisable value. Costs include the direct costs and an attributable proportion of distribution overheads incurred in bringing inventories to their current location and condition. Cost is determined on a first-in, first-out basis. Net realisable value is based on estimated selling price, less any further costs expected to be incurred to completion and disposal.

Trade and other receivables

Trade and other 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 purposes of the consolidated cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

Notes to the financial statements (continued)

at 31 March 2007

1 Accounting policies (continued)

Leases and hire purchase contracts

Assets held under finance leases and hire purchase contracts, which confer risks and rewards to the Group 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 and shown as obligations under finance leases, 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. All other leases are operating leases and the annual rentals are charged to the income statement on a straight-line basis over the period of the lease in accordance with the terms of the lease agreements.

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.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

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 as interest income or finance costs.

Financial liabilities

A provision is recognised when the Group has a legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation.

If the effect is material, expected future cash flows are discounted using a rate that reflects, where appropriate, the risks specific to the liability.

Income taxes

Current tax assets and liabilities are measured as the amounts 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, which 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.

Research and development tax credits are recognised on a cash basis.

Post-retirement benefits

The Group contributes a set proportion of employees' gross salary to defined contribution personal pension plans. 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 (a market condition) 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. The Black-Scholes model is used to determine fair value for options and the Monte Carlo binomial model for LTIP awards.

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

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 new standards and interpretations issued include the following:

- IFRS 7 – Financial Instruments: Disclosures
- IFRS 8 – Operating Segments
- IAS 1 (Amendment) – Presentation of Financial Statements: Capital Disclosures
- IFRIC 7 – Applying the Restatement Approach under IAS 29: Financial Reporting in Hyperinflationary Economies
- IFRIC 8 – Scope of IFRS 2
- IFRIC 9 – Reassessment of Embedded Derivatives
- IFRIC 10 – Interim Financial Reporting and Impairment
- IFRIC 11 – IFRS 2 Group and Treasury Share Transactions
- IFRIC 12 – Service Concession Arrangements

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 Acquisition

On 18 January 2007, the Company acquired Innovata plc and its subsidiaries (together "the Innovata Group") for a consideration of £123.6 million, including acquisition costs of £2.8 million. This was satisfied by the issue of 143,824,813 new Ordinary shares in Vectura Group plc ("Vectura" or "the Company") by means of a Scheme of Arrangement under Section 425 of the Companies Act 1985, whereby Innovata's share capital was acquired by Vectura and Innovata shareholders were allotted new shares in Vectura and these new shares were admitted to trading on the AIM market of the London Stock Exchange.

Innovata earned revenues of £23.1 million in the year to 31 March 2007, and achieved an operating profit of £4.7 million before exceptional costs of £4.1 million relating to the acquisition by Vectura. Retained loss for the 12-month period was £5.5 million, after further non-cash exceptional charges of £6.1 million relating to an increase in financial liabilities (see note 21).

The purchase of Innovata has been accounted for using acquisition accounting, after taking into account the fair value of the shares issued by Vectura Group plc based on the market value at the close of business on 17 January 2007 of 84 pence per share. On this basis, the net assets acquired and the goodwill arising in respect of the acquisition of Innovata were as follows:

Fair value of net assets of Innovata:	Book value £000	Fair value £000
Goodwill	38,873	–
Intangible assets	11,816	74,500
Property, plant and equipment	3,758	700
Investments	250	250
Inventories	228	228
Debtors	8,009	8,009
Deferred tax asset	–	2,000
Cash	19,882	19,882
Creditors	(9,912)	(9,912)
Deferred income	(1,700)	(3,274)
Financial liability	(12,428)	(18,657)
Deferred tax liability	(3,545)	(22,350)
	55,231	
Net assets acquired		51,376
Goodwill		72,267
		123,643
Consideration discharged by:		
Fair value of shares issued		120,813
Costs associated with the acquisition		2,830
Total consideration		123,643

The adjustments made to book values in arriving at the fair value of the net assets of Innovata comprise adjustments arising from the application of the accounting policies of Vectura Group plc where they differ from those of the Innovata Group, and adjustments arising from a provisional assessment of the fair values of the assets and liabilities of the Innovata Group. These include:

- The identification of separately identifiable intangible assets acquired, consisting of licence agreements and supply agreements held by Innovata. The recognition of a deferred tax liability in relation to these intangible assets has also been included.
- Accounting policy adjustments to the deferred income on the balance sheet.
- Fair value adjustments to write down the value of research and development fixed assets held, to recognise a deferred tax asset and to recognise a financial liability as detailed in note 21.

Goodwill comprises the value held in assets that are not separately identifiable and include value from patents and the know-how and skill base contained within the motivated workforce.

3 Revenue

Revenue represents amounts invoiced to third parties, derived from the provision of licences and services that fall within the Group's sole ordinary activity, the development of pharmaceutical products.

Group revenue by category:	2007 £000	2006 £000
Product licensing	4,592	3,803
Technology licensing	1,713	238
Pharmaceutical development services	5,838	4,370
Royalties	1,443	–
Product sales	465	–
	14,051	8,411
Finance revenue:		
Interest income (note 5)	2,816	1,042
Total revenue	16,867	9,453

Acquired revenue by category:	2007 £000	2006 £000
Product licensing	30	–
Technology licensing	–	–
Pharmaceutical development services	1,076	–
Royalties	1,434	–
Product sales	465	–
	3,005	–
Finance revenue:		
Interest income	183	–
Total revenue	3,188	–

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

4 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 Group operations are located in the UK.

5 Interest income and finance costs

	2007 £000	2006 £000
Interest income:		
Interest receivable on bank deposits and similar income	2,816	1,042
Finance costs:		
Bank loans and overdrafts	(3)	(1)
Finance charges payable under finance leases	(10)	(5)
Interest charge on financial liabilities	(229)	–
	(242)	(6)

6 Operating loss

Operating loss is the result for the business before interest and taxation, and is stated after charging:

	2007 £000	2006 £000
Amortisation of intangible assets	1,995	–
Depreciation of property plant and equipment:		
– owned	1,242	767
– held under finance leases and hire purchase contracts	23	49
Share-based compensation	1,633	741
Share of loss of associate (after taxation)	(208)	–
Auditors' remuneration:		
– audit	71	40
– fees receivable by the auditors in respect of other services	120	26
Minimum operating lease rentals:		
– land and buildings	456	309
– plant and machinery	86	97
Net foreign exchange loss	32	17

Non-audit services included fees relating to reviews of working capital projections and financial information included in documents sent to shareholders during the year and amounted to £110,000 (2006 – IFRS review £20,000). The fees for non-audit services also included fees of £10,000 (2006 – £6,000) for the audit of subsidiary companies. The Company audit fee included in the table above was £41,000 (2006 – £30,000).

Notes to the financial statements (continued)

at 31 March 2007

7 Directors and employees

Directors' remuneration

The aggregate remuneration comprised:

	2007 £000	2006 £000
Fees	143	90
Salaries and benefits	412	392
Bonuses	400	426
	955	908
Pension contributions	41	39
	996	947

Two Directors (2006 – 2) receive company contributions to defined-contribution personal pension plans. 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 Report on Directors' remuneration contained within this Annual Report.

Employees

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

	2007 No.	2006 No.
Research and development	153	112
Business development and administration	10	8
	163	120

The aggregate remuneration comprised:

	2007 £000	2006 £000
Wages and salaries	7,018	4,878
Social security costs	860	627
Other pension costs	407	303
Share-based compensation charge	1,633	741
	9,918	6,549

8 Taxation

The major components of the income tax charge for the years ended 31 March 2007 and 2006 are as follows:

	2007 £000	2006 £000
Current income tax:		
Current income tax charge	(41)	–
Research and development tax credits	1,437	984
	1,396	984
Deferred income tax:		
Deferred tax relating to the reversal of temporary differences	469	–
	1,865	984

Research and development tax credits are recorded upon receipt from HMRC. The credit for 2007 relates to relief calculated at 16% of the Vectura qualifying research and development expenditure incurred in the year ended 31 March 2006.

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

	2007 £000	2006 £000
Loss on ordinary activities before tax	(8,692)	(7,439)
Loss on ordinary activities multiplied by standard rate of tax in the UK of 30%	(2,608)	(2,232)
Effects of:		
Permanent differences – expenses not deductible for tax purposes	210	224
Capital allowances in advance of depreciation	(245)	(69)
Foreign withholding taxes withheld	41	–
Other differences	(36)	(16)
Research and development expenditure enhancement	(1,228)	–
Losses carried forward	3,438	2,093
Credit not recognised in previous years relating to research and development tax credit	(1,437)	(984)
Total tax credit for the year	(1,865)	(984)

Factors that may affect future tax charges:

Cumulative tax losses of approximately £110,511,000 (2006 – £15,800,000) (subject to agreement by HMRC) are available within the Group to carry forward against future taxable profits. There is an unrecognised deferred tax asset of £33,153,000 (2006 – £4,740,000), which relates to the above tax losses. In addition, there is a net deferred tax asset of £744,000 (2006 – £242,000) arising as a result of unclaimed capital allowances, which consists of a deferred tax asset of £974,000 (2006 – £293,000) and a deferred tax liability of £230,000 (2006 – £51,000). Of the total deferred tax asset of £33,897,000, £1,871,000 has been recognised as a deferred tax asset as at 31 March 2007; the balance has not been recognised since it is uncertain that there will be suitable future taxable profits against which the losses can be offset. The losses and deferred tax assets have no formal expiry date.

Announcements were made before the balance sheet date to changes in tax laws and rates that will have an affect on the deferred tax assets and liabilities of the Group. These tax rates and laws have not yet been substantively enacted and therefore the Group has not quantified any impact of the changes at this stage. The main changes that will affect the Group are the reduction in the rate of UK Corporation tax (from 30% to an estimated 28%), a change in the rate of capital allowances on plant and machinery and an increase in enhanced tax deductions on qualifying R&D expenditure for large companies.

Deferred tax:	**2007 £000**	2006 £000
Deferred tax asset:		
Losses available for offset against future taxable income	1,871	–
Deferred tax liability:		
In respect of intangible assets	21,752	–

9 Loss per ordinary share

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

	2007	2006
Loss for the year (£000)	(6,827)	(6,455)
Weighted average number of ordinary shares (No. '000)	155,205	108,298
Loss per ordinary share	(4.4p)	(6.0p)

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.

10 Goodwill

Group	**2007 £000**	2006 £000
Cost:		
At 1 April	2,012	2,012
Additions	72,267	–
At 31 March	74,279	2,012
Net book value:		
At 31 March	74,279	2,012
At 1 April	2,012	2,012

Goodwill existing at 1 April 2006 and 2005 arose on the acquisition of Vectura Limited and Vectura Delivery Devices Limited.

10 Goodwill (continued)

The addition to goodwill added during the year ended 31 March 2007 arose on the acquisition of Innovata plc, and results from assets that cannot be recognised separately and measured reliably, including early-stage pipeline products and a highly skilled workforce.

The Group tests goodwill annually for impairment, or more frequently if there are indications that goodwill might be impaired. At 31 March 2007, 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 prepared by management, which consist of detailed product-by-product analyses based on individual forecasts for development timings, royalty and growth rates. The discount rate used in the forecasts is 13%.

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

- Pharmaceutical Development Services
- Vectura Delivery Devices Limited
- Innovata 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 five-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 that management expect to be incurred. This is incorporated within the financial budgets covering a five-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.

Innovata Limited (IOV) cash-generating unit

The recoverable amount of the Innovata 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 that management expect to be incurred. This is incorporated within the financial budgets covering a ten-year period that have been developed by management. A ten-year forecast is used due to the length of the development cycle for the products within the cash-generating unit. An appropriate discount rate is applied to the cash flow projections that reflects the risk profile of the unit.

Carrying amount of goodwill allocated to cash-generating units:

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

	2007 £000	2006 £000
PDS cash-generating unit	1,476	1,476
VDD cash-generating unit	536	536
IOV cash-generating unit	72,267	–
	74,279	2,012

Company	£000
Carrying amount:	
At 31 March 2006 and 31 March 2007	2,022

The goodwill in the Company arose on the acquisition of the Centre for Drug Formulation Studies, an unincorporated entity, in 1999. Amortisation of £684,000 was applied prior to 1 April 2004. Goodwill in the Company is tested for impairment on the same basis as for the Group, within the PDS cash-generating unit.

11 Intangible assets

Group	VDD Patents and trademarks 2007 £000	Innovata licences 2007 £000	Total 2007 £000	VDD Patents and trademarks 2006 £000	Innovata licences 2006 £000	Total 2006 £000
Cost:						
At 1 April	3,490	–	3,490	3,490	–	3,490
Additions	–	74,500	74,500	–	–	–
At 31 March	3,490	74,500	77,990	3,490	–	3,490
Amortisation:						
At 1 April	(3,490)	–	(3,490)	(3,490)	–	(3,490)
Charge for the year	–	(1,995)	(1,995)	–	–	–
At 31 March	(3,490)	(1,995)	(5,485)	(3,490)	–	(3,490)
Net book value:						
At 31 March	–	72,505	72,505	–	–	–
At 1 April 2005	–	–	–	–	–	–

Intangible assets recognised upon the acquisition of Innovata are being amortised on a straight-line basis over the expected life of each separate asset.

12 Property, plant and equipment

Group	Laboratory equipment £000	Office and IT equipment £000	Motor vehicles £000	Total £000
Cost:				
At 1 April 2005	5,703	131	–	5,834
Additions	1,745	40	–	1,785
At 1 April 2006	7,448	171	–	7,619
Additions	2,083	113	–	2,196
Acquisition	188	449	63	700
Disposals	(65)	–	(2)	(67)
At 31 March 2007	9,654	733	61	10,448
Depreciation:				
At 1 April 2005	(2,618)	(114)	–	(2,732)
Charge for the year	(790)	(26)	–	(816)
At 1 April 2006	(3,408)	(140)	–	(3,548)
Charge for the year	(1,187)	(66)	(12)	(1,265)
Disposals	–	–	–	–
At 31 March 2007	(4,595)	(206)	(12)	(4,813)
Net book value:				
At 31 March 2007	5,059	527	49	5,635
At 31 March 2006	4,040	31	–	4,071
At 31 March 2005	3,085	17	–	3,102

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

Group	Laboratory equipment £000	Office and IT equipment £000	Motor vehicles £000	Total £000
At 31 March 2007	–	–	49	49
At 31 March 2006	14	–	–	14

Company	Laboratory equipment £000	Office and IT equipment £000	Total £000
Cost:			
At 1 April 2005	2,018	62	2,080
Additions	1,745	40	1,785
Disposals	–	–	–
At 1 April 2006	3,763	102	3,865
Additions	1,969	105	2,074
Disposals	(65)	–	(65)
At 31 March 2007	5,667	207	5,874
Depreciation:			
At 1 April 2005	(1,315)	(61)	(1,376)
Charge for the year	(253)	(11)	(264)
At 1 April 2006	(1,568)	(72)	(1,640)
Charge for the year	(658)	(24)	(682)
At 31 March 2007	(2,226)	(96)	(2,322)
Net book value:			
At 31 March 2007	3,441	111	3,552
At 31 March 2006	2,195	30	2,225
At 31 March 2005	703	1	704

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

Company	Laboratory equipment £000	Office and IT equipment £000	Total £000
At 31 March 2007	–	–	–
At 31 March 2006	14	–	14

13 Investments in subsidiary undertakings

Company	Shares in subsidiary undertakings £000	Loans to subsidiary undertakings £000	Total £000
Cost:			
At 1 April 2005	2,113	9,662	11,775
Additions	–	426	426
At 1 April 2006	2,113	10,088	12,201
Additions	123,643	–	123,643
Reduction	–	(610)	(610)
At 31 March 2007	125,756	9,478	135,234
Amounts written off:			
At 1 April 2005, 1 April 2006 and 31 March 2007	(70)	–	(70)
Net book value:			
At 31 March 2007	125,686	9,478	135,164
At 31 March 2006	2,043	10,088	12,131
At 31 March 2005	2,043	9,662	11,705

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
Innovata Limited	England	Ordinary	100%	Pharmaceutical development
Innovata Biomed Limited [1]	Scotland	Ordinary	100%	Pharmaceutical development
Quadrant Technologies Limited [1]	England	Ordinary	100%	Pharmaceutical development
Quadrant Healthcare Limited [2]	England	Ordinary	100%	Pharmaceutical development
Quadrant Drug Delivery Limited [2]	England	Ordinary	100%	Pharmaceutical development

[1] a subsidiary of Innovata Limited

[2] a subsidiary of Quadrant Technologies Limited

In addition, the Group has a number of subsidiaries that are dormant or whose residual activities are not material to the Group.

14 Investments in associates and joint ventures

Group	2007 Total £000	2006 Total £000
Balance at 1 April 2006	–	–
Value at 12 May 2006	61	–
Share of loss	(61)	–
	–	–
Value at 17 November 2006	1,375	–
Share of loss	(147)	–
Balance at 31 March 2007	1,228	–

PharmaKodex Ltd

PharmaKodex Limited ("PharmaKodex") was a 100%-owned subsidiary until 12 May 2006. From this date, the Group held a 49.99% interest until 17 November 2006, when the holding was diluted to 20.40%. PharmaKodex has been accounted for as an associate under the equity method in accordance with IAS 28, "Investments in Associates".

The investment in PharmaKodex on 12 May 2006 was valued at £61,000 and consisted of £10,000 cash and equity of £51,000. The profit on this disposal was £199,000. The value of the investment was written down to nil as the Group recognised its post-investment share of the losses of PharmaKodex, of £61,000.

On 17 November 2006, the investment was valued at £1,375,000 and consisted of £151,000 cash and equity of £1,224,000, following its disposal of a 29.59% shareholding. The profit on disposal was £1,224,000. The value of this investment has been written down to £1,228,000 as the Group has recognised its post-investment share of the losses of PharmaKodex.

Total profits on disposal for the year amounted to £1,423,000 being £199,000 on disposal in May 2006 and a further £1,224,000 on disposal in November 2006.

Aggregated unaudited amounts relating to the associate for the year ended 31 March 2007, which is unlisted, are shown below:

	2007 £000	2006 £000
Assets	6,375	–
Liabilities	(357)	–
Net assets	6,018	–
Turnover	145	–
Loss after taxation	(1,402)	–

QDose Limited

The Group also has a 50% investment in a joint venture with Microdose Technologies Limited. This investment is carried at nil as the joint venture has net liabilities. The Group does not continue to recognise losses in excess of the value of its investment.

15 Trade investment

The Group has an investment in an unquoted company, representing 12% of the share capital of that company. The value in the balance sheet is stated at fair value.

16 Other receivables

Group and Company

Other receivables represent an investment bond of £428,000 in respect of a rental deposit paid under the terms of a lease agreement for the Company's 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 3.5% for the year ended 31 March 2007. Interest is recognised using the effective interest method.

Notes to the financial statements (continued)

at 31 March 2007

17 Inventories

	Group		Company	
	2007 £000	2006 £000	2007 £000	2006 £000
Raw materials and consumables	202	–	–	–

18 Trade and other receivables

	Group		Company	
	2007 £000	2006 £000	2007 £000	2006 £000
Trade receivables	2,099	4,156	421	4,156
Other receivables	14	36	6	36
Prepayments and accrued income	5,538	278	4	278
VAT recoverable	579	219	465	205
	8,230	4,689	896	4,675

Credit risk

The Group's credit risk is primarily attributable to its trade receivables. The Group has no significant concentration of credit risk.

Debtor days at the year end were 54 days (2006 – 180 days). No interest was charged on receivables. The Directors consider that the carrying value of trade and other receivables approximates to their fair value.

19 Amounts owed to subsidiary undertakings

	Group		Company	
	2007 £000	2006 £000	2007 £000	2006 £000
Amounts falling due after more than one year:				
Owed to subsidiary undertakings	–	–	16,895	187

20 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, and deferred income is as follows:

	Group		Company	
	2007 £000	2006 £000	2007 £000	2006 £000
Amounts due in more than one year	6,888	2,258	646	584
Amounts due within one year	4,400	4,666	864	4,107
At 31 March	11,288	6,924	1,510	4,691

21 Financial liabilities

Group	£000
At 1 April 2006	–
Acquired as part of Innovata	18,657
Utilised	(507)
Interest	229
At 31 March 2007	18,379
Provisions due in more than one year	15,163
Provisions due within one year	3,216
	18,379

A revenue management agreement was entered into on 28 June 2001 between Innovata and Paul Capital Royalty Acquisition Fund L.P. (PRF or "Paul Capital"), which was subsequently amended and restated ("the PRF Agreement"), pursuant to which Paul Capital provided funding totalling £22.5 million in return for which Paul Capital would receive a share of the revenues earned by Innovata from the commercialisation of Extraneal® and Adept® in the period from commencement of these arrangements up to 30 September 2010. Under the terms of the PRF Agreement, Paul Capital was granted a right (the "Put Option") in certain circumstances (including on change of control), to require that Innovata re-purchases Paul Capital's interests in the royalty streams from Extraneal® and Adept® for a consideration calculated to give Paul Capital an agreed minimum rate of return under the royalty-sharing arrangements. Since these arrangements were entered into, the interests of Paul Capital have been assigned to Royalty Securitization Trust I (RST).

A deed of waiver and amendment ("the RST Deed") was entered into between Innovata and RST on 18 January 2007, the date of the acquisition of Innovata by Vectura, pursuant to which RST agreed to waive its right to exercise the Put Option (see above). Vectura made a payment to PRF for $2 million on signing of the RST Deed, and RST and Innovata also agreed to amend the terms of the Paul Capital Agreement in that future receipts by RST under the agreement will be subject to guaranteed minimum and maximum annual payments as follows:

Fiscal Year (1 October to 30 September)	Minimum payment	Maximum payment
2006–2007	USD $5,000,000	USD $11,000,000
2007–2008	USD $8,000,000	USD $12,000,000
2008–2009	USD $9,000,000	USD $13,000,000
2009–2010	USD $10,000,000	USD $14,000,000

The provision as at 31 March 2007 of £18.4 million is based on the estimated payments due excluding an imputed interest charge of £1.2 million.

Further, the terms on which the Put Option becomes exercisable in the future (for example, on a change of control of Vectura) were also amended, such that, dependent upon when the Put Option is exercised, there will be a fixed price at which Innovata would have the obligation to re-purchase RST's interests in the royalty streams from Extraneal® and Adept®. These fixed prices (subject to certain adjustments to reflect payments made and royalty sharing entitlements earned during the relevant year) would be as follows:

Exercise date	Put option price
On or prior to 30 September 2007	USD $50,000,000
Between 1 October 2007 and 30 September 2008	USD $40,000,000
Between 1 October 2008 and 30 September 2010	USD $25,000,000

Innovata will also have a right to buy out the interests of RST on the same fixed payment basis as that described above. Vectura has agreed to guarantee the performance by Innovata of its obligations under the PRF Agreement, as amended by the RST Deed.

22 Trade and other payables

	Group 2007 £000	2006 £000	Company 2007 £000	2006 £000
Amounts falling due within one year:				
Trade payables	1,063	698	757	667
Other taxes and social security costs	416	144	192	144
Other payables	438	–	47	14
Accruals	6,143	3,633	3,160	3,613
	8,060	4,475	4,156	4,438

Trade payables principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken by the Group for trade purchases is 32 days (2006 – 27 days). The average credit period taken by the Company for trade purchases is 30 days (2006 – 27 days).

23 Obligations under finance leases

The maturity of these amounts is as follows:

Group	2007 £000	2006 £000
Amounts payable:		
Within one year	410	15
	410	15
Less: finance charges allocated to future periods	–	(1)
	410	14

There are no finance leases held in the Company at 31 March 2007 (2006 – £14,000).

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

	2007 £000	2006 £000
At 1 April	14	98
Acquired as part of Innovata	535	–
Repayments made	(139)	(84)
At 31 March	410	14

24 Financial instruments

The Group's 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 2007 and 2006 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.

The Group is funded principally with equity and invests its funds in short-term bank deposits. The Group has access to the majority of 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 exchange transactions, the balances are exchanged for sterling at spot rate.

No interest is charged on balances with other Group companies or associates.

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

Group	2007 £000	2006 £000
Cash and cash equivalents (held at floating rates):		
Sterling	76,700	17,329
US Dollar	190	8
Euro	139	(509)
	77,029	16,828
Short-term investments:	4.75%	–
Amounts on deposit for a period of more than 3 months (fixed rate)	500	–
	500	–
Other receivables:	3.50%	3.75%
Investment bond (fixed rate)	428	428
	428	428
Finance leases:	5.20%	6.60%
Finance leases (fixed rate)	(410)	(14)
	(410)	(14)

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 fair value of the financial instruments is as per the book values disclosed above. The fair value of the investment bond and finance leases is identical to the book values as disclosed in notes 16 and 23.

24 Financial instruments (continued)

Company	2007 £000	2006 £000
Cash and cash equivalents (held at floating rates):		
Sterling	76,176	17,264
US Dollar	55	8
Euro	139	(509)
	76,370	16,763
Other receivables:	3.50%	3.75%
Investment bond (fixed rate)	428	428
	428	428

25 Equity

(a) Share capital

	31 March 2007		31 March 2006	
	£000	No.'000	£000	No.'000
Authorised:				
Ordinary shares of 0.025p each	110	441,200	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	28	110,330	27	107,899
Issued to investors	15	57,881	–	–
Issued on acquisition of Innovata	36	143,825	–	–
Issued to Share Investment Plan	–	300	–	–
Issued in satisfaction of deferred consideration	–	1,350	–	–
Issued on exercise of share options	–	832	1	2,105
Issued on exercise of warrants	–	–	–	326
At 31 March	79	314,518	28	110,330
Redeemable preference shares of £1 each:				
At 1 April and 31 March	34	34	34	34

The rights attaching to the 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.

On 10 May 2006, Boehringer Ingelheim International GmbH ("Boehringer") subscribed for 4,939,536 ordinary shares of 0.025p each at a price of £1.3975 per share, representing a subscription price of €10,000,000 (£6,903,100). The subscription price per share was equal to the average of the middle-market quotation for an ordinary share in the capital of the Company as reported by the London Stock Exchange for the 30 dealing days up to and including the fourth business day prior to the effective date of a Licence Agreement signed with Boehringer on 16 April 2006, plus a premium of 35%.

Under the above licensing agreement, Boehringer has an option to subscribe for ordinary shares in the Company for a consideration of €5,000,000 based on the average share price of Vectura Group plc's ordinary shares calculated over a 30-day period ending three business days prior to the date of the decision to exercise the option, plus a premium.

On 25 July 2006, the Company issued 52,941,177 ordinary shares of 0.025p each by way of an open offer and private placing at a price of 85 pence per share, representing a total consideration of £45 million.

On 18 January 2007, by way of a Scheme of Arrangement under Section 425 of the Companies Act 1985 the Company issued 143,824,813 shares of 0.025p each to the shareholders of Innovata plc on the basis of 0.2858 Vectura Group plc ordinary shares for each Innovata plc share held (note 2).

On 18 January 2007, the Company issued 300,000 shares to the Vectura Group plc Employee Benefit Trust in satisfaction of an issue of Free Shares to employees.

Between 1 April 2006 and 31 March 2007 the Company issued 832,327 (2006 – 2,105,556) ordinary shares of 0.025p each on exercise of employee share options at an average exercise price of 24.4p per share (2006 – 16.5p).

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

(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).

(c) Shares to be issued

The shares to be issued reserve at 31 March 2006 related to a total of 2,200,000 ordinary shares of 0.025p each to be issued to Cambridge Consultants Limited (CCL) as deferred consideration in connection with the acquisition of Vectura Delivery Devices Limited under a purchase agreement dated 5 February 2002. In accordance with this agreement, 400,000 ordinary shares were issued on 21 August 2003 and a further 300,000 ordinary shares were issued on 12 November 2004, both to satisfy revenue milestones. In accordance with a Deed of Variance dated 9 November 2004, CCL agreed to the cancellation of 150,000 deferred shares. The balance of 1,350,000 deferred shares outstanding was issued to CCL on 3 January 2007.

(d) Special reserve

The special reserve was created on 19 May 2004 as part of the process prior to the Company's IPO on 2 July 2004, 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) in 1999 and also relates to the acquisition of Vectura Delivery Devices Limited in 2002 (see above). In compliance with IAS 27, at 1 April 2006 this reserve was recorded in the books of the Company, thus reflecting the transition requirements of IFRS.

During the year ended 31 March 2007, the merger reserve was increased by £120,776,886 following the acquisition of Innovata plc on 17 January 2007, as described above.

(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.

26 Share options and Long Term Incentive Plan

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.

On 18 January 2007, the date of completion of the acquisition of Innovata plc in accordance with a Scheme of Arrangement (see note 2), options over Innovata shares issued and outstanding at that date under the ML Laboratories PLC 1989 Executive Option Scheme and the ML Laboratories PLC 1999 Executive Option Scheme were exchanged for options over Vectura shares in accordance with the rules of the relevant Innovata Option Scheme. The exchange was on the basis that the option holders received new options over 0.2858 Vectura shares for every one Innovata share, equating to an aggregate market value similar to that of the Innovata shares released and at a similar aggregate exercise price, save that, to the extent such Innovata options would not have vested but for the Scheme becoming effective, the new options are subject to the vesting periods that would otherwise have applied. No performance conditions (to the extent that they applied under the Innovata Option Schemes) apply to the new options over Vectura shares. The numbers of Innovata shares outstanding at 18 January 2007 and the equivalent number of Vectura shares are shown in the tables below.

ML Laboratories PLC 1989 Executive Option Scheme (the "1989 Scheme"):

Grant date	Innovata grant price Pence	Innovata shares exchanged No.	Exchange rate %	Vectura grant price Pence	Equivalent Vectura shares No.
09/02/98	124	826,614	0.2858	433.870	236,246
18/03/98	119	56,554	0.2858	416.375	16,163
06/07/98	88	109,383	0.2858	307.908	31,262
08/03/99	106	177,261	0.2858	370.889	50,661
		1,169,812			334,332

ML Laboratories PLC 1999 Executive Option Scheme (the "1999 Scheme"):

Grant date	Innovata grant price Pence	Innovata shares exchanged No.	Exchange rate %	Vectura grant price Pence	Equivalent Vectura shares No.
20/08/99	138.21	273,925	0.2858	483.590	78,288
10/11/00	139.69	127,778	0.2858	488.768	36,519
02/11/01	36.52	2,525,174	0.2858	127.782	721,695
17/04/03	14.56	5,784,244	0.2858	50.945	1,653,137
19/04/04	18.75	5,347,866	0.2858	65.605	1,528,420
03/03/05	21.25	3,000,000	0.2858	74.353	857,400
14/07/05	21.72	3,000,000	0.2858	75.997	857,400
15/07/05	22.00	4,000,000	0.2858	76.977	1,143,200
14/09/05	25.50	7,800,000	0.2858	89.223	2,229,240
10/10/05	25.50	200,000	0.2858	89.223	57,160
		32,058,987			9,162,459

26 Share options and Long Term Incentive Plan (continued)

Share Investment Plan

During the year ended 31 March 2007, the Company introduced the Vectura Group plc Share Incentive Plan (SIP) following approval by the shareholders on 27 September 2006. This plan is available to all employees, including Executive Directors, the purpose being to encourage employees to become shareholders of the Company and retain their shares over the medium to long term. Under this plan, the Company may award free shares with a three-year vesting period; the employee may buy partnership shares with pre-tax salary; and the Company may match any partnership shares purchased in one year with additional matching shares. On 18 January 2007, the Company issued 279,650 free shares to employees. The fair value of these free shares, calculated using the Black-Scholes model (see below), was £271,271 for the entire vesting period, with £11,407 charged to the income statement of the current year.

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

Vectura schemes	Unapproved Plan	EMI Plan	Sharesave Scheme	Total
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 1 April 2006	7,274,120	4,032,436	701,660	12,008,216
Options granted	1,045,462	–	439,003	1,484,465
Options exercised	(161,111)	(668,444)	–	(829,555)
Options forfeited	(42,900)	–	(19,397)	(62,297)
Options outstanding at 31 March 2007	8,115,571	3,363,992	1,121,266	12,600,829
Options vested at 31 March 2007	2,792,634	3,244,976	–	6,037,610
Range of exercise prices	0.025p to 104.0p	0.025p to 48.125p	50.8p to 72.0p	

Schemes acquired from Innovata:	1998 Scheme	1999 Scheme	Total
Options outstanding at 18 January 2007	334,332	9,162,459	9,496,791
Options granted	–	–	–
Options exercised	–	(2,772)	(2,772)
Options forfeited	–	–	–
Options outstanding at 31 March 2007	334,332	9,159,687	9,494,019
Options vested at 31 March 2007	334,332	4,015,286	4,349,668
Range of exercise prices	308p to 434p	51p to 489p	

The options exercised during the year ended 31 March 2007 yielded proceeds of £203,321 (2006 – £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 in the following disclosure.

The weighted average exercise price across all schemes for outstanding options at the beginning of the period was 68.1p (2006 – 35.5p). The weighted average exercise price of options exercised in the year was 24.4p (2006 – 16.5p) and these options had a weighted average market price at exercise of 91.0p (2006 – 90.5p). Options with a weighted average exercise price of 64.5p (2006 – 49.6p) were cancelled in the year and options with a weighted average exercise price of 92.3p (2006 – 82.7p) were granted during the year. The weighted average exercise price of all share options outstanding at the year end was 68.1p (2006 – 42.6p). The weighted average remaining contractual life of the outstanding share options at the year end was 6.4 years (2006 – 7.0 years). The aggregate of the estimated fair values of the options granted during the year (excluding the LTIP) was £430,000 (2006 – £692,000).

The outstanding options at 31 March 2007, including the Innovata options rolled over on 18 January 2007, were granted as follows:

Grant date	Exercise price per share (p)	Number	Date from which first exercisable	Expiry date
February 1998	433.870	236,246	09/02/01	09/02/08
March 1998	416.375	16,163	18/03/01	18/03/08
July 1998	307.908	31,262	06/07/01	06/07/08
March 1999	370.889	50,661	08/03/02	08/03/09
August 1999	483.590	54,896	20/08/02	20/08/09
August 1999	483.590	23,392	20/08/04	20/08/09
November 2000	488.768	36,519	10/11/03	10/11/10
December 2000	23.150	368,000	22/12/03	21/12/10
March 2001	23.150	196,000	28/03/04	26/03/11
April 2001	48.125	171,200	18/04/04	18/04/08
April 2001	48.125	166,232	11/04/04	11/04/11
August 2001	48.125	96,000	08/08/04	08/08/11
October 2001	48.125	8,000	16/10/04	16/10/11
November 2001	127.782	721,695	02/11/04	02/11/11
February 2002	0.025	760,000	23/02/05	21/02/12
March 2002	48.125	440,000	18/03/05	18/03/12
May 2002	48.125	107,844	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	389,792	11/04/06	28/04/13
April 2003	50.945	1,651,823	17/04/06	17/04/13
November 2003	48.125	42,000	19/11/06	17/11/13
December 2003	48.125	161,000	03/12/06	30/11/13
April 2004	65.605	1,526,962	19/04/07	19/04/14
April 2004	36.000	1,402,224	29/04/04	29/04/14
April 2004	36.000	1,935,164	29/04/07	29/04/14
April 2004	36.000	209,764	30/04/07	28/04/14

Notes to the financial statements (continued)

at 31 March 2007

26 Share options and Long Term Incentive Plan (continued)

Grant date	Exercise price per share (p)	Number	Date from which first exercisable	Expiry date
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
January 2005	63.500	62,000	04/01/08	04/01/15
February 2005[1]	50.800	514,757	01/04/08	30/09/08
March 2005	74.353	857,400	03/03/08	03/03/15
March 2005	68.000	300,050	31/03/08	31/03/15
June 2005	89.500	4,000	30/06/08	30/06/15
July 2005	75.997	857,400	17/01/07	31/01/09
July 2005	76.977	1,143,200	15/07/08	15/07/15
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	89.223	2,229,240	14/09/08	14/09/15
September 2005	82.500	131,366	30/09/08	30/09/15
October 2005	89.223	57,160	10/10/08	10/10/15
January 2006	83.000	169,000	02/01/09	02/01/16
February 2006[1]	72.000	167,506	01/04/09	30/09/09
May 2006	104.000	75,000	22/05/06	22/05/16
June 2006	89.500	408,524	28/06/07	28/06/16
August 2006	93.750	454,133	09/08/07	09/08/16
September 2006	88.500	71,000	29/09/09	29/09/16
March 2007[1]	71.200	439,003	01/04/10	30/09/10
March 2007	87.750	30,000	30/03/10	30/03/17
		22,094,848		

[1] Sharesave scheme

Long Term Incentive Plan (LTIP)

Under the rules of this plan, Executive Directors and certain senior managers are granted 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 LTIP are detailed in the Report of the Board on remuneration. At 31 March 2007, Executive Directors and eligible senior managers hold rights which may result in the issue of 1,032,611 ordinary shares on 12 September 2008, 668,814 ordinary shares on 22 November 2009 and 329,670 ordinary shares on 1 March 2010. The fair value of this scheme has been estimated using the Monte Carlo model, and using the same assumptions for volatility, option life, expected dividend yield and risk-free rate of return detailed below. For the purposes of calculating the fair value of the LTIP, it was considered equally probable 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 Report on Directors' remuneration. The fair value charge for the LTIP, which is included with the share option charge, has been calculated as £180,000 (2006 – £49,000).

Fair value calculation

The Group has taken advantage of the exemption in IFRS 1 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 4,460,450 options outstanding that were granted before this date (2006 – 4,042,644).

The fair value of the options was determined using the Black-Scholes pricing model. The share-based compensation charge for the year ended 31 March 2007, including the LTIP, is £1,633,000 (2006 – £741,000).

The assumptions input into the Black-Scholes model were as follows:

	Year of grant 2007	2006
Weighted average share price of grants during the year	92.27p	82.71p
Expected volatility[1]	47–59%	30–50%
Option life	10 years	10 years
Expected dividends	Nil	Nil
Risk-free interest rate[2]	4.87–5.43%	4.21– 4.61%

The assumptions input into the Monte Carlo model were as follows:

	Year of grant 2007	2006
Weighted average share price of grants during the year	92.00p	77.5p
Expected volatility[1]	47.97–58.69%	30–50%
Option life	3 years	3 years
Expected dividends	Nil	Nil
Risk-free interest rate[2]	4.99–5.28%	4.21–4.61%

[1] Expected volatility has been calculated by reference to the Company's historic share price since the IPO in July 2004, considered alongside the volatility of similar companies.

[2] The risk-free interest rate is the UK Gilt Rate at the date of grant.

The charge is spread over the expected vesting period, utilising the fair value calculated by using the two models above, and after adjusting for the likelihood of cancellation of options as employees leave.

In the prior year, the fair value of options was determined using the Hull-White pricing model.

Notes to the financial statements (continued)

at 31 March 2007

27 Reconciliation of net cash flows from operating activities

Group	2007 £000	2006 £000
Operating loss	(11,266)	(8,475)
Depreciation of property plant and equipment	1,265	816
Amortisation of intangible assets	1,995	–
Profit on sale of assets	(20)	–
Profit on disposal of investments	(1,215)	–
Decrease in inventories	24	–
Decrease/(increase) in receivables	4,469	(3,839)
(Decrease)/increase in payables	(2,555)	1,289
(Decrease)/increase in deferred income	(2,236)	6,924
Share-based compensation	1,633	741
Net cash outflow from operations	(7,906)	(2,544)
Research and development tax credits received	1,396	984
Net cash outflow from operating activities	(6,510)	(1,560)

Company	2007 £000	2006 £000
Operating loss	(8,303)	(5,119)
Depreciation of property plant and equipment	682	264
Profit on disposal of investments	(1,067)	–
Decrease/(increase) in receivables	3,929	(3,825)
Increase in payables	17,320	1,238
(Decrease)/increase in deferred income	(3,181)	4,691
Share-based compensation	1,633	741
Net cash outflow from operations	11,013	(2,010)
Research and development tax credit received	1,216	811
Net cash inflow/(outflow) from operating activities	12,229	(1,199)

28 Analysis of net funds

	1 April 2006 £000	Cash flow £000	Non-cash movements £000	31 March 2007 £000
Cash and cash equivalents	16,828	60,701	–	77,529
Financial liabilities	–	507	(18,886)	(18,379)
Finance leases	(14)	139	(535)	(410)
	16,814			58,740

29 Retirement benefits plans

The Group operates a number of defined contribution personal pension plans for all qualifying employees. The assets of the schemes are held separately from those of the Group and are independently administered. The total cost charged in the income statement is detailed in note 6. At 31 March 2007, contributions of £47,593 (2006 – £1,416), due in respect of the current reporting period, had not been paid over to the scheme. This amount is included in other payables (note 22).

30 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		Total	
Group	2007 £000	2006 £000	2007 £000	2006 £000	2007 £000	2006 £000
Expiry date:						
Within one year	672	329	108	68	780	397
In the second to fifth years inclusive	1,316	1,102	71	62	1,387	1,164
After five years	1,332	1,318	–	–	1,332	1,318
	3,320	2,749	179	130	3,499	2,879

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, which has a break clause in July 2017, is £251,000.

On 13 June 2005, Vectura Delivery Devices Limited entered into a five-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. There is a break clause in June 2008.

On 27 October 2006, Vectura Delivery Devices Limited entered into a lease agreement in respect of additional premises at Cambridge Science Park, expiring on 13 June 2010. The annual commitment in respect of this lease is £38,535.

On 23 February 1996, Quadrant Technologies Limited entered into a lease in respect of the premises at Ruddington, expiring on 27 July 2017. The annual commitment in respect of this lease is £327,000. There is a break clause on 31 July 2007.

All items in the above table also relate to the Company, with the exception of the Cambridge and the Quadrant Technologies Limited leases described above.

31 Capital and other commitments

At the year end the Group had capital commitments contracted, but not provided for of £29,000 (2006 – £940,000). The Company had capital commitments of £27,000 (2006 – £867,000).

At the year end the Group also had a potential commitment to pay future milestones in relation to an agreement with Theradeas Limited based on successful clinical development of three potential products. There are no royalties due to Theradeas Limited if these products are successfully launched.

32 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, over the Theradeas patents and know-how, to develop, manufacture and commercialise inhaled products resulting from their patents. In accordance with this agreement, payments of £25,000 and £100,000 were made to Theradeas in May and August 2006 respectively. 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 Report of the Board on remuneration, during the year £2,000 (2006 – £5,000) was paid to Croggan Limited for consultancy services. Dr A J M Richards is a director of Croggan Limited.

Dr Richards is a Non-Executive Director and has a holding of 1.84% in PharmaKodex Limited, an associated company (note 14).

Company

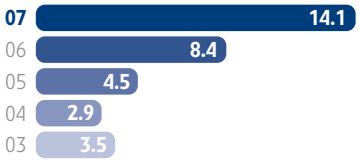
Details of the Company related party transactions with parties outside of the Group are noted above. In addition, the following details of trading within the Group are disclosed in accordance with IAS 24.

Related party	Recharge from related parties £000	Recharge to related parties £000	Amounts owed by related parties £000	Amounts owed to related parties £000
Subsidiaries:				
2007	619	3,202	9,580	16,895
2006	–	2,682	10,088	187

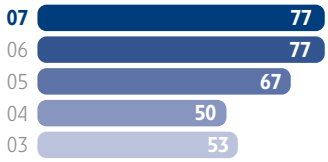
Five-year summary

Trading results (All amounts are shown in £ millions)

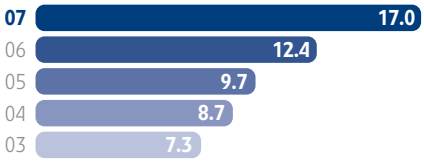
Turnover



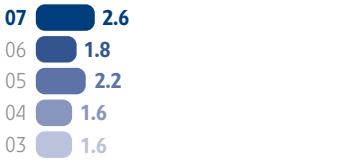
% gross profit to sales



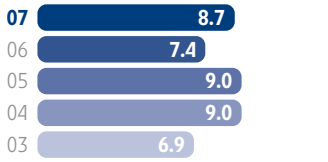
Research and development



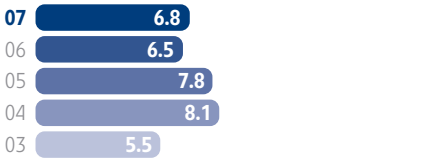
Administrative expenses



Loss before tax

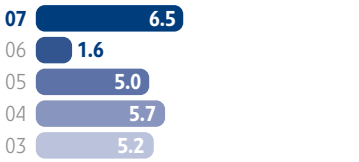


Loss after tax



Cash flows (All amounts are shown in £ millions)

Net cash outflow from operations

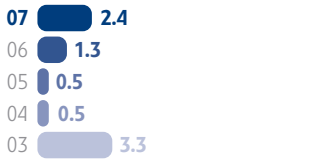


Interest

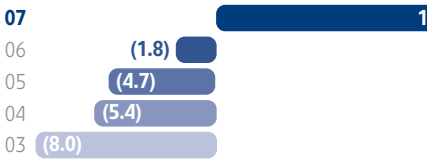
Taxation credits

Acquired

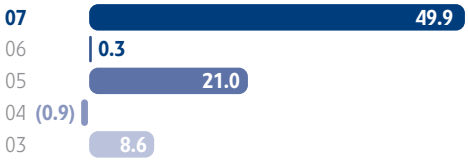
Capital expenditure/acquisitions



Net cash (outflow)/inflow before financing



Financing



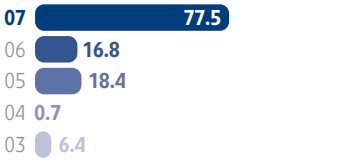
Balance sheet (All amounts are shown in £ millions)

Non-current assets

Net current operating liabilities

Net operating assets

Net cash and cash equivalents



Shareholder funds

Note: 2005 figures have been adjusted to reflect the impact of the IFRS restatement made in 2006.

Shareholder information

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

Secretary
A P Hyland

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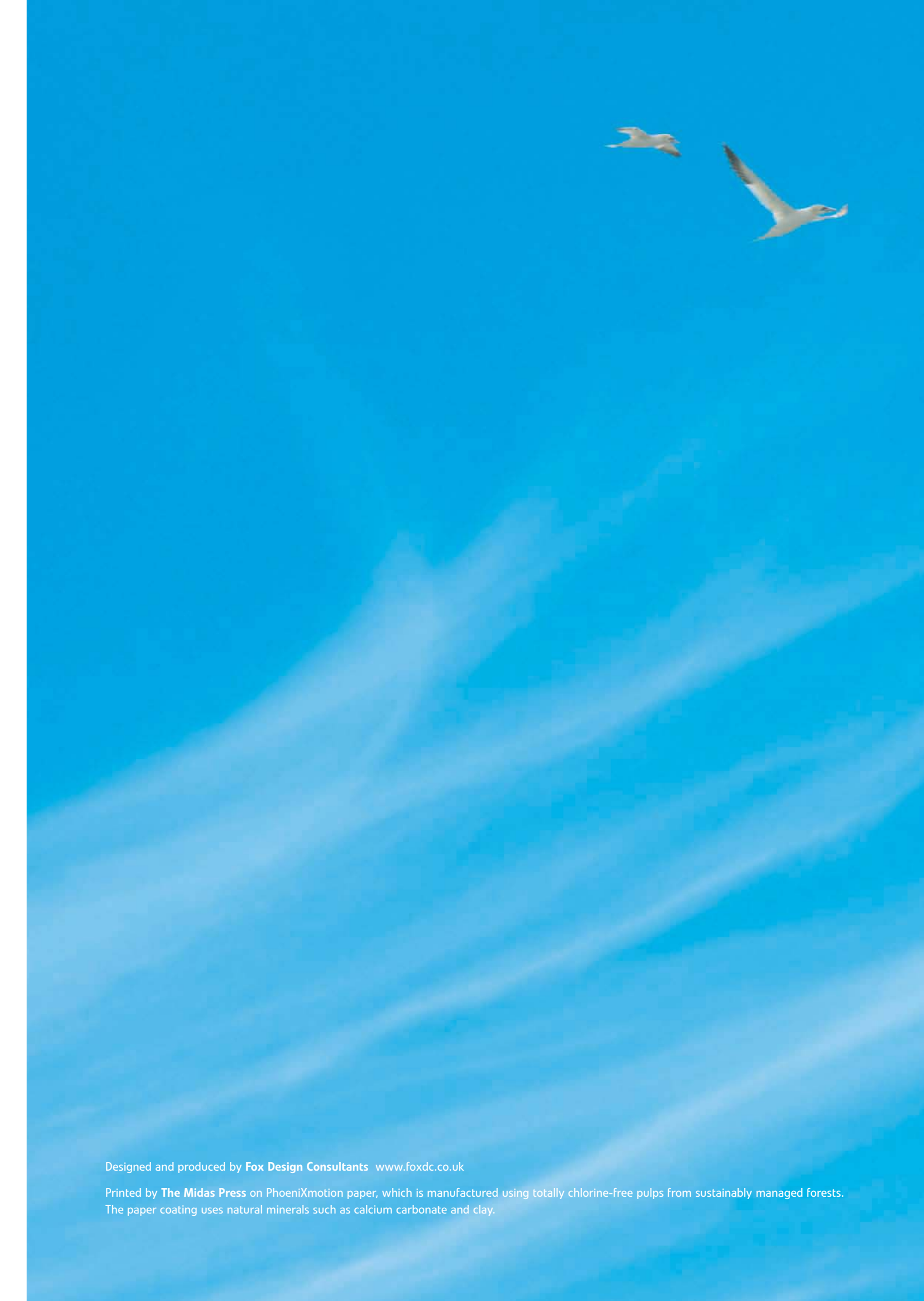

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