Vectura Group plc Annual Report and Accounts

2004/5

Annual Report and Accounts for the year ended 31 March 2005

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Financial Highlights

AIM listing raised

£20.1m

before expenses

Total revenues increased by 57% to

£4.5m

(2003/04 £2.9m)

Gross profit more than doubled to

£3m

(2003/04 £1.4m)

Loss before tax reduced to

£8.8m

(2003/04 £9m)

33%

reduction in loss per share to 8.6p

(2003/04 - 12.8p)

Cash and liquid resources of

£18.4m

at 31 March 2005, with an additional £7.9m received from Novartis in April 2005

What we do

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

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

Operating Highlights

NVA237 (formerly AD 237) for Chronic Obstructive Pulmonary Disease (COPD)

- Global licensing agreement with Novartis. Successful completion of Phase IIa clinical trial
- Initial pharmacokinetic evaluations demonstrated low systemic exposure which could facilitate a beneficial side effect profile

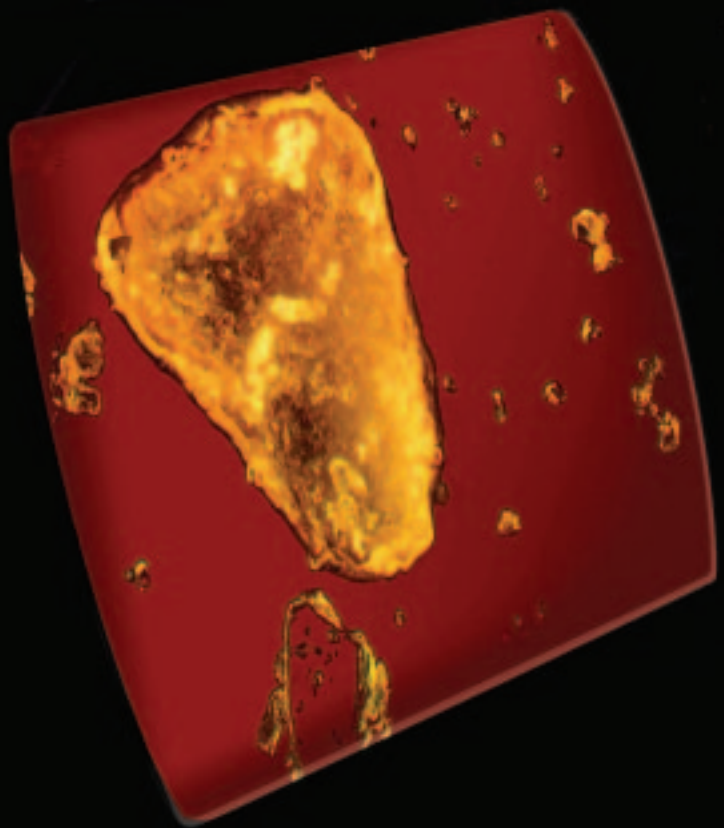
VR004 for Erectile Dysfunction (ED)

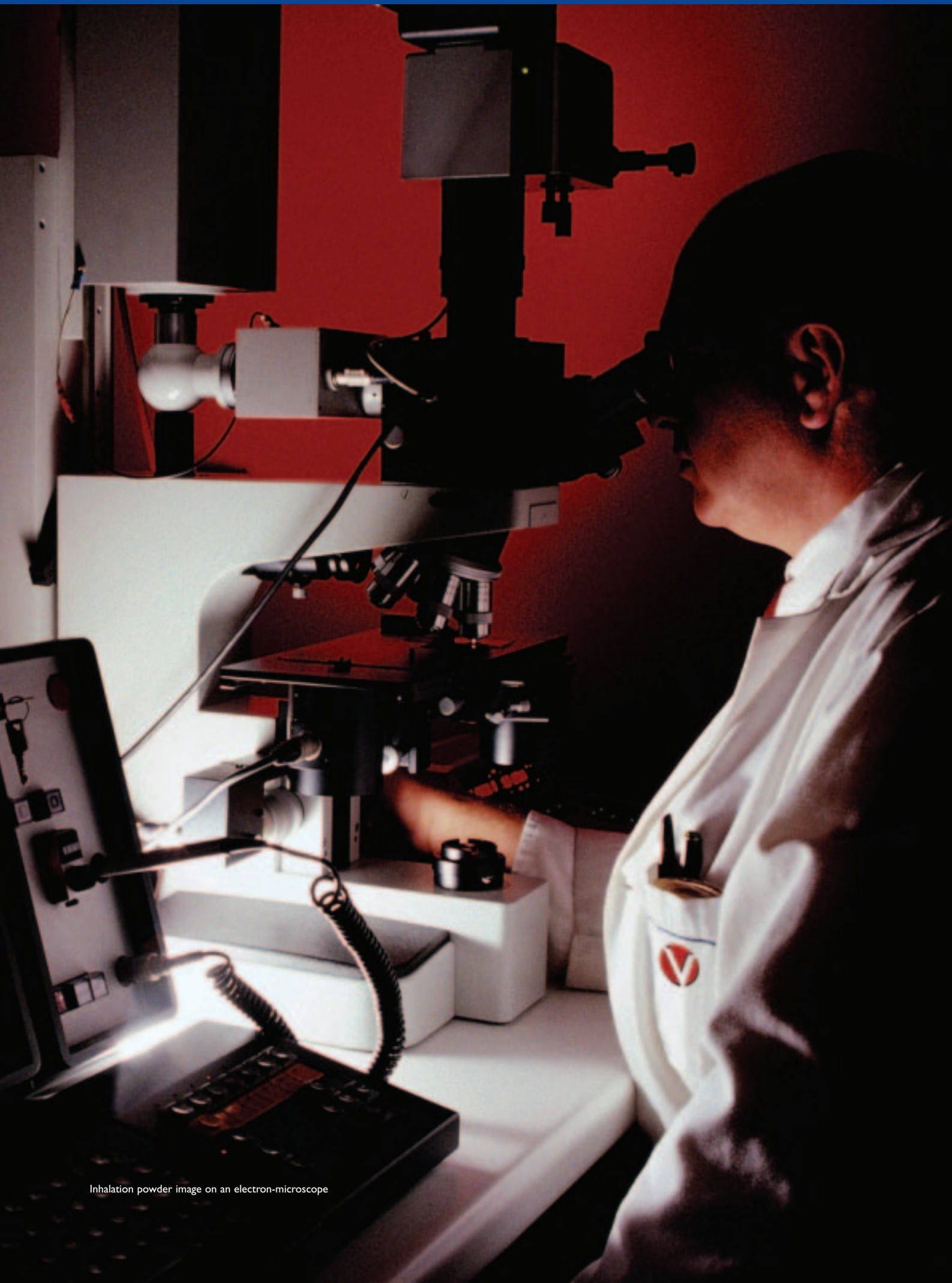
- Commencement of Phase IIb clinical trial and receipt of CTA and IND approvals
- Initial pharmacokinetic evaluations correlate with rapid onset of activity seen in previous Phase IIa study

Other

- Successful CTA and IND review of Aspirair inhalation device, permitting use of device in Phase II clinical studies
- Strategic alliance signed with SkyePharma for Aspirair
- Progression of formulation and device technology licensing discussions with third parties

We are also proud to announce our achievement in winning the techMARK Mediscience Award for Best Newcomer for the period to March 2005.





Inhalation powder image on an electron-microscope

Chairman's and Chief Executive's Review

Overview

Vectura has made very significant progress this year with a successful flotation on the Alternative Investment Market of the London Stock Exchange (AIM), solid advances in the product pipeline, further technology out-licensing, and a 57% increase in revenues. The year culminated in a series of licensing discussions on our lead product NVA237 (formerly AD 237). The resulting global licensing agreement with Novartis, which was signed on 12 April 2005, provides considerable validation for Vectura's strategy of applying our innovative inhalation technologies (in this case, PowderHale) to established, off-patent products, creating valuable new products for development and subsequent out-licensing.

The Novartis agreement also provides an additional product opportunity for an NVA237/QAB149 combination for COPD which, together with the introduction of VR040 for Parkinson's disease, brings our total number of products under development to nine, including products in pre-clinical development.

PRODUCT PIPELINE

Product	Indication	Late research	Pre-clinical	Phase I	Phase II	Partner
NVA237	COPD					Novartis
NVA237/QAB149	COPD					Novartis
VR004	ED					–
VR040	Parkinson's					–
VR400	FSD					–
VR776	PE					–
VR496	CF					–
	COPD					–
VR694	Asthma					–
VR147	Migraine					–

NVA237

NVA237 (formerly AD 237) and NVA237/QAB149 combination for COPD

The objective is for NVA237 to be launched as a differentiated, long-acting muscarinic antagonist (LAMA) for the treatment of chronic obstructive pulmonary disease (COPD), with improved benefits for patients compared with existing therapies.

NVA237 is a once-daily LAMA with a fast onset of action. The compound is in Phase II clinical trials and studies to date have demonstrated that it is well-tolerated and effective for at least 24 hours after a single dose. Vectura's unique PowderHale formulation technology facilitates optimised delivery of the active component of NVA237 to the lung (the site of the disease).

NVA237 has been developed through a joint venture with Arakis Limited. The co-development agreement with Arakis was signed in late 2000; all revenues are shared equally. NVA237 was licensed to Novartis on 12 April 2005.

Novartis' commitment to NVA237, and the beneficial combination of NVA237 with QAB149, make Novartis (a world leader in the treatment of respiratory disease) an ideal licensing partner for Vectura. Under the terms of the Novartis agreement, Vectura and Arakis 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 total up to $172.5 million for each company for both monotherapy and combination products. The initial payment and potential milestones therefore total up to $375 million.

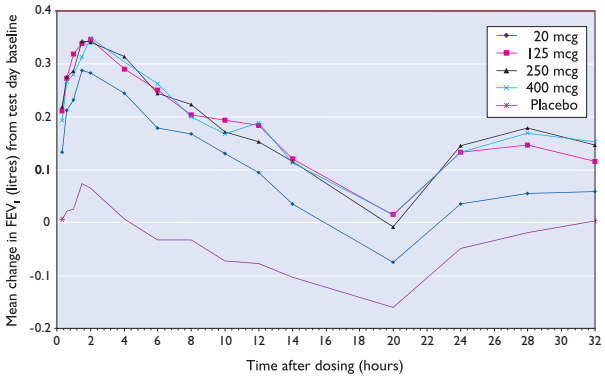
In addition, royalties on product sales will be paid for the monotherapy and the combination product. If a third combination product is developed by Novartis using NVA237, further milestones and royalties may be payable on that product. This is therefore one of the biggest European biotech licensing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

Vectura will be providing formulation and manufacturing services to Novartis for the next clinical (Phase IIb) study, and the turnover from these services will form part of Pharmaceutical Development Services revenues in 2005/06. The NVA237 Phase IIb study is expected to complete in 2006.

The second product under development with Novartis is the combination of NVA237 with Novartis' long-acting (once-daily) beta-agonist (LABA), QAB149 (in Phase III development), which is probably the most advanced LAMA/LABA combination in clinical development and could be the first such combination to reach the market for COPD. The combined activity of a cholinergic antagonist and an adrenergic agonist promises to be a potent bronchodilator and, with the convenience of once-daily dosing, is likely to address a large unmet need for COPD patients. We believe that NVA237 and NVA237/QAB149 will play a major role in the expansion of the COPD market, which is underserved today but set for dramatic growth over the coming decade. It is estimated that the COPD market, currently worth $4 billion, could be worth $10 billion by 2010.

During the financial year and prior to the licensing agreement with Novartis, two important NVA237 clinical studies were completed; a Phase IIa study which demonstrated excellent safety and efficacy in 45 COPD patients, and a pharmacokinetic study which showed low systemic exposure to the active component following inhalation compared with intravenous administration and could thus facilitate a beneficial side-effect profile.

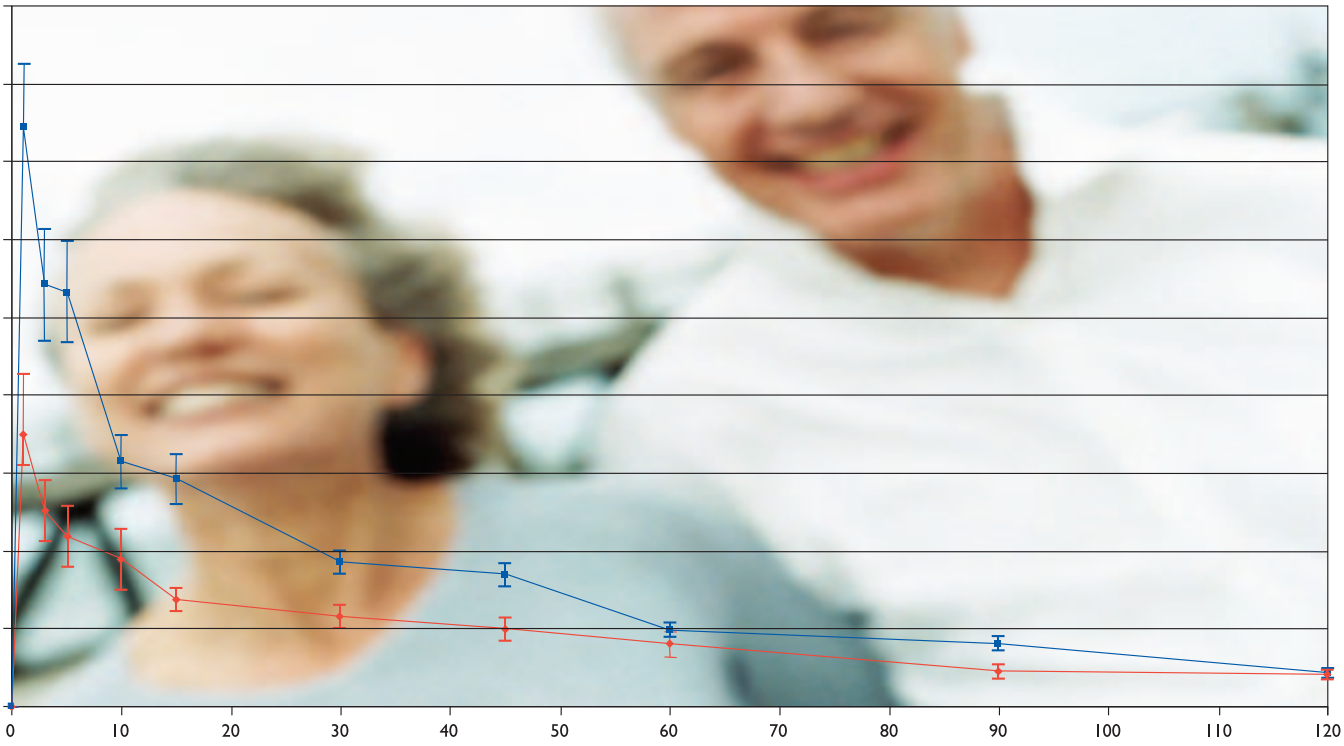
NVA237 – Lung function profile consistent with once-daily dosing



VR004 – When 'Fast' Isn't Quick Enough

A major aim of the VR004 product development is to provide a rapid and effectively durable action through non-injection systemic delivery.

VR004 Plasma Concentration Profiles from two inhaled doses – Mean Plasma Concentration +/- SEM



VR004 for ED commences Phase IIb

VR004 is a proprietary dry powder formulation of apomorphine hydrochloride, delivered using our Aspirair delivery device. The aim with VR004 is to provide an effective and well-tolerated spontaneous treatment option for patients who suffer from erectile dysfunction (ED).

In a previous Phase IIa study in ED patients using a non-optimised delivery system, an improvement in erectile performance was achieved with a median onset time of 8 minutes, with some subjects responding just 1 minute after completion of dosing.

In May 2004, a pharmacokinetic study was completed that validated the concept of rapid lung absorption and elimination when VR004 is delivered by inhalation. Maximum plasma concentrations were observed 1 to 3 minutes after dosing. Elimination of drug from plasma was relatively rapid, with a terminal half-life of approximately 60 minutes.

The Phase IIb programme commenced in March 2005 with a home-based, randomised, double-blind, placebo-controlled study in patients with mild, moderate and severe ED, which aims to identify the optimal doses of inhaled VR004 for Phase III trials. The study is being undertaken under EU regulatory authorisation.

The primary end point is erectile performance, assessed as the number of successful attempts at intercourse over a 12-week treatment period. As a result of the optimisation of the VR004 formulation and device delivery system, it was anticipated there might be an increased systemic exposure to apomorphine for any given dose. Since lowering of blood pressure is a recognised effect of apomorphine, the study was designed to assess the effects of the first dose in the clinic following orthostatic challenge, prior to allowing patients to take subsequent treatments at home. A blinded review of safety and tolerability was also

included to determine which doses should continue throughout the study. As a result of this review, a recommendation was made to restrict treatment at the top two doses on the grounds that a small number of patients experienced transient falls in blood pressure after their first dose. Patients already randomised to these top doses will continue their allocated treatment for the full 12-week period. Randomisation will continue with the placebo and the low doses. Full data from the study are expected in early 2006.

The study exemplifies the high efficiency of the VR004 delivery system and we believe we will achieve the target efficacy at a dose range below the top doses used in the ongoing study. These findings assist in the identification of the optimal dose range. However, in parallel with the ongoing study, a second, dose-defining study will be undertaken to evaluate lower doses that will report results by 2H06. Together, we believe these studies will provide key information on the optimal doses to progress to Phase III trials.

VR040 for PD to commence Phase IIa

Our product pipeline has been further strengthened by the introduction of a new product, VR040 (inhaled apomorphine hydrochloride) for Parkinson's Disease.

Apomorphine has a beneficial effect in the treatment of Parkinson's Disease (PD). PD is a debilitating, progressive neurological condition affecting movements such as walking, talking and writing. In spite of advances in therapeutic approaches, around 10% of PD patients develop hypomobility, or so-called "off" episodes of virtual paralysis, within 3-5 years of commencing standard treatments.

Apomorphine is already used to treat PD, but current modes of administration such as injection may be sub-optimal from the perspective of patient acceptability, ease of administration, poor bioavailability and speed of onset.

We believe that inhaled apomorphine will be an effective treatment for hypomobility, and will address the clinically unmet patient needs of rapid onset of action and non-invasive administration, which can be achieved with inhaled delivery. Inhaled apomorphine may also provide an improved side-effect profile compared with direct-acting dopaminergic drugs, and our inhaled product, VR040, may provide the means to reduce the therapeutic dose and so minimise unwanted side-effects. We will be starting clinical development of our proprietary formulation, delivered with our Aspirair device, in early 2006.

VR776 completes pre-clinical development for PE

VR776 is being developed for premature ejaculation (PE), an indication believed to be some three times more prevalent than ED, and still with no approved therapy.

The active component of VR776 is approved as an oral tablet for the treatment of a different indication, but is believed to be used successfully "off label" in the treatment of PE. The onset of action using a tablet is likely to be slow, so a rapidly-acting inhaled product will, we believe, find an important niche in the treatment of PE.

VR776 has successfully completed pre-clinical trials, the data from which is currently being evaluated, and is scheduled to enter Phase I clinical development later this year.

VR496 heading for Phase I

VR496 is targeted, in the first instance, as a mucolytic for the treatment of cystic fibrosis (CF).

Pre-clinical studies have confirmed mucolytic activity. Vectura is seeking EU Orphan Medicinal Product designation and US Orphan Drug designation for the CF indication. Clinical development is expected to commence around the middle of 2006.

Upon demonstration of clinical proof-of-concept, it is Vectura's intention to consider the development of VR496 also for COPD.

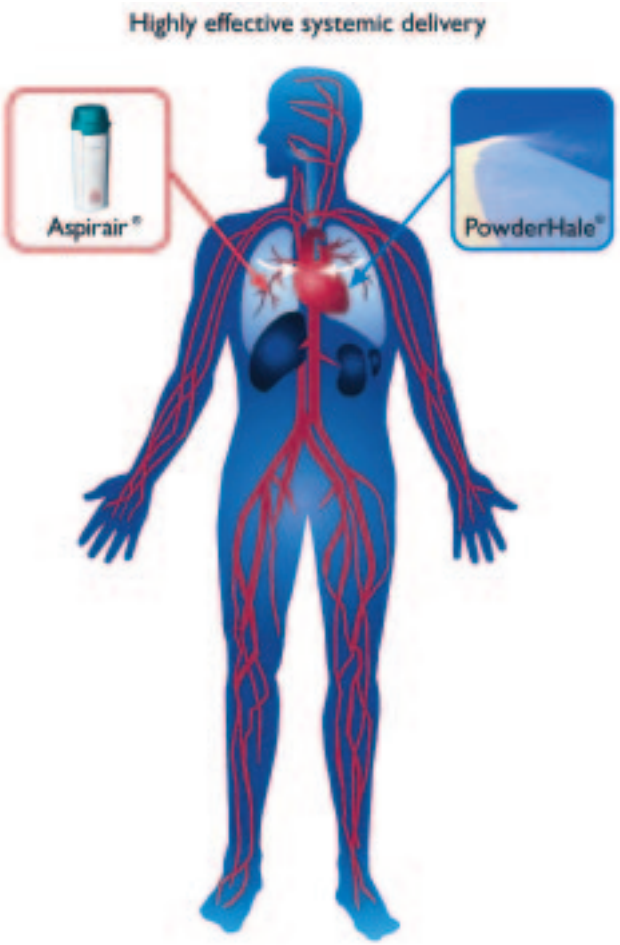
Other pipeline products

In addition to our lead products, our pipeline comprises product candidates targeting female sexual dysfunction, migraine and asthma.

Generating value from our enabling technologies

Our three pulmonary technologies are based on our in-depth knowledge of particle science and device engineering and they enable us to re-formulate and patent a broad range of drugs for pulmonary delivery.

Our two device technologies are the dry powder inhalers (DPIs) **Aspirair®** and **GyroHaler®** and these are complemented by our formulation technology **PowderHale®**.



Our formulation technology, PowderHale, is the subject of collaborations with several companies, including GlaxoSmithKline (GSK). PowderHale facilitates deep-lung penetration of inhaled dry powders with low dose variability. Typical dry powder inhaled formulations have a limited penetration to the lungs. PowderHale technology provides the capability to deliver a consistent fine-particle or deep-lung dose of drug, close to the nominal delivered dose. PowderHale also provides a higher degree of dose uniformity, which is an increasingly important consideration for regulators in approving inhaled products.

Aspirair is a highly efficient DPI that will be used for the delivery of inhalation products for systemic availability and for the delivery of macromolecules. Aspirair is now being used in our VR004 Phase IIb "at home" programme for which the device has been reviewed by both the MHRA and the FDA.

GyroHaler is aimed at the respiratory diseases market, where there is a significant opportunity for DPI devices that combine multiple single-unit dosing, foil protection, convenience for patients and low production costs.

Our strategy is to license rights to these technologies to other pharmaceutical companies where we believe that the resulting licenses will compliment our overall business strategy and commercial returns.

We announced in June 2004 our first device deal, which was with SkyePharma PLC. SkyePharma acquired non-exclusive rights to evaluate the high-performance capabilities of Aspirair to deliver certain macromolecules.

Advanced licensing discussions for GyroHaler are in progress following the successful completion of its first development phase. The current DPI market for respiratory diseases is estimated to be worth in excess of US$5 billion and GyroHaler therefore presents a significant licensing opportunity for Vectura.

Vectura's purpose built facility in Chippenham, Wiltshire, UK

Facilities

In May 2004, our clinical trials manufacturing facility in Chippenham, UK, received a Manufacturers' Authorisation for Investigational Medicinal Products from the Medicines and Healthcare products Regulatory Agency (MHRA). This authorisation allows Vectura to manufacture and release investigational products in compliance with the new Clinical Trials Directive that came into force in May 2004.

Flotation

Our flotation, in July 2004, raised £20.1m before expenses through the placing of 35.8m shares with a group of leading UK and European institutions at a price of 56p per share. Our ability to complete this placing in the challenging market conditions of June 2004 is testament to the strength of our business model and a reflection of Vectura's strong growth potential. The funds raised place us in a strong position to take our products through to the point where we can out-license them to development and marketing partners. The increased profile and status of Vectura as a listed company also assists us in pursuing licensing partners.

techMARK Mediscience Award

On 9 June 2005 we were delighted to receive the techMARK mediscience best newcomer award. Twenty six companies were eligible for the award, which was for companies that had gone public in the year ended 31 March 2005 and who had demonstrated that they possessed exceptional investment and growth qualities.

Board and management

Commensurate with Vectura's public listing, the following Board changes were implemented:

In May 2004, we were delighted to welcome to the Board Dr John Brown, former Chief Executive of Acambis plc. John brings invaluable industry experience and is a great asset to Vectura as we grow.

Following John's appointment, and at the time of the IPO, Mr Mark Clement, Professor David Davies, Mr Adam Holloway and Dr Brian Moon resigned from the Board. The Company is indebted to all of them for their invaluable advice and enthusiastic support.

Also at the time of the IPO, Professor John Staniforth resigned from the Board. John remains deeply involved with the business as Chief Scientific Officer and as a member of the Vectura Executive Committee (VEC).

During the year, we announced the appointments of Dr Tim Wright as Commercial Director and Dr Mark Main as Development Director. Tim and Mark join the VEC bringing with them a wealth of development and licensing experience. Mr Peter Virley retired from the Group during the year. Peter, formerly a CEO of Vectura, was an important contributor to the Company's progress in its formative years and the Board thanks him for his valuable contribution.

We would also like to thank all of our staff for their consistent commitment and contribution, which has underpinned the Group's successful progress over the last 12 months.

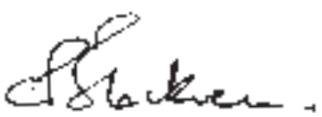
Outlook

As Vectura carries out its strategy for growth, the priorities for 2005/06 are the successful progression of our VR004 Phase IIb clinical trials, continued progress of the licensed products, NVA237 and the NVA237/QAB149 combination, and the extension and growth of our product pipeline. Vectura will continue to advance the products in the pipeline and pursue appropriate licensing opportunities both for its products and its technologies to generate value for shareholders.

Finally, on behalf of the Board, we wish to express our sincere gratitude to all our investors. Thank you for your continued support.

Jack Cashman
Chairman

21 June 2005



Chris Blackwell
Chief Executive

21 June 2005

Naturally Inspired Treatments

Vectura has developed pulmonary delivery technology systems which mimic elements and structures found in nature

Clinical Indications – Addressing Unmet Patient Needs

Chronic Obstructive Pulmonary Disease (COPD)

COPD comprises a set of mostly smoking-related diseases such as emphysema and chronic bronchitis. While there is no cure for the underlying disease, current drug treatment for COPD usually involves a stepped regimen, starting with inhaled bronchodilator (anti-muscarinics and/or beta-agonists) before adding an inhaled steroid, and frequently using oral antibiotics to control commonly occurring infections. It is recognised generally that COPD is poorly treated, partly because of the problems of airflow obstruction and mucous production associated with the disease. It is believed that patients would benefit from bronchodilation, which improves airflow by relaxing the airways, that is provided in a once-daily presentation.

NVA237 and QAB149 are both once-daily bronchodilators with QAB149 acting on the beta-2 adrenergic receptors in the smooth muscle lining encouraging muscle relaxation and airways opening. NVA237 blocks the receptors (M_3-muscarinic receptors) again allowing these muscles to relax leading to airways opening. As both products are tackling different receptors their combination will provide additional patient benefit.

Erectile Dysfunction (ED)

ED is defined as the consistent inability to achieve and/or maintain an erection adequate for satisfactory sexual function. The condition is correlated with increasing age, cardiovascular disease, hypertension, diabetes, obesity, hyperlipidemia and smoking. In addition, neurogenic risk factors resulting from radical prostatectomy, spinal cord injury and multiple sclerosis as well as certain prescription drugs and psychogenic issues may contribute to ED.

Erections result from increased blood flow to the penis, caused by relaxation of smooth muscle in the corpus cavernosum. In response to an erotic stimulus, VR004 activates a dopamine pathway cascade in the brain, leading to a nervous system reflex that mediates the local actions of nitric oxide in the penis. This leads to smooth muscle relaxation in the corpus cavernosum allowing the pelvic arteries to dilate, resulting in increased blood flow to the penis, and corporal engorgement, which supports an erection.

The mechanism of action is different to that of the PDE-5 inhibitors such as Viagra®, which act locally on the blood vessels which supply blood to the penis, rather than via a central nervous system reflex. The current PDE-5 inhibitors are all contraindicated for use with nitrate-based drugs for cardiovascular disease, which prevents their use by a number of potential ED patients. It is possible that VR004 will not be contraindicated for these drugs because it operates through a different mechanism of action.

Premature Ejaculation (PE)

PE is the inability to delay ejaculation long enough to have a satisfactory sexual experience. It is the most common form of sexual dysfunction in men, affecting nearly 30% at some time in their lives. Most often it is due to nervousness or anxiety. PE is currently treated by counselling and/or the use of desensitising products. Recent studies have shown that centrally acting oral anti-depressants can be effective, but the onset of action is slow. In spite of this some are known to be used "off-label" for the treatment of PE.

The active constituent of VR776 is hypothesised to act in PE via modulation of neurotransmitter pathways in the brain. These neurotransmitters are involved in the central control of ejaculation through the activation and inhibition of neurotransmitter receptors.

Cystic Fibrosis (CF)

In healthy individuals, mucous is secreted in the lungs in limited quantities to help clear the lungs of foreign matter. In certain diseases, such as CF and COPD, the lungs' natural process of mucous secretion is dysfunctional, and the lungs are unable to effectively clear the thick mucous produced. This results in blockages of the airways and increased susceptibility to infection and ultimately may reduce life expectancy.

Mucolytic agents, such as the active ingredient in VR496, act to break down this thick mucous so that it is more easily cleared from the lungs, alleviating the blockages, and reducing the chance of infection.

Naturally Inspired Technologies

Vectura's technologies make it easier for patients to inhale powders that otherwise could not be delivered to the lungs

Inspired Enabling Technologies

Three novel technology platforms for optimal product performance:

Aspirair®

'Active' DPI for the demands of systemic and macromolecule delivery

- High delivery efficiency
- Low variability of delivered dose
- High payload capability for small and large molecules
- Convenient size; simple to use

Aspirair DPI delivery for systemic drugs

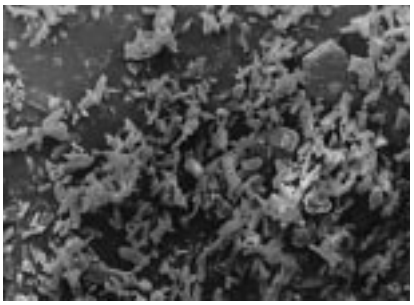
Aspirair DPI device in use

PowderHale®

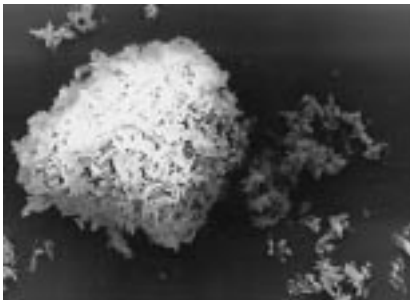
Formulation technology for dry powder inhalers (DPI)

- Increases fine-particle fraction of delivered dose
- Raises deep-lung drug penetration
- Lowers delivered-dose variability

DPI particle-surface modification



A Process Intensified PowderHale



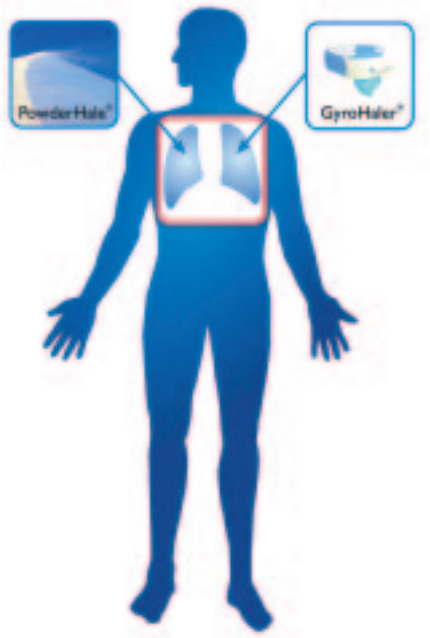
B Conventional Formulation

GyroHaler®

'Passive' DPI for effective local delivery

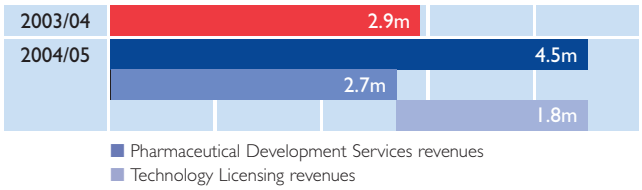
- Multi-dose
- Moisture protection
- High-dose reproducibility
- Economical
- Easy to use

Delivering drugs to treat lung diseases



Financial Review

Turnover



In the 12 months to 31 March 2005, Vectura's revenues realised from technology licensing and Pharmaceutical Development Services were £4.5m, an increase over 2003/04 of 57%.

Technology licensing revenues of £1.8m were realised during the period (2003/04 - £0.3m). Revenues of £0.3m (2003/04 - £0.1m) were generated from feasibility studies and £1.5m (2003/04 - £0.2m) from milestone payments. The majority of the milestones were generated from our agreement with SkyePharma PLC. Also included in milestones was a final payment from Zambon Group SpA. The agreement with Zambon has now concluded and total revenues generated by the contract prior to cessation were £0.6m.

Pharmaceutical Development Services revenues of £2.7m (H1 £1.5m, H2 £1.2m) were a 2% improvement on prior year. 2005/06 revenues will include our Contract Development Agreement with Novartis. This contract will replace contracts completed in 2004/05, allowing us to continue to generate single-digit % increases in this area of the business.

Gross profit

Gross profit in the 12 months to 31 March 2005 was £3m, a £1.6m improvement on the prior year (2003/04 - £1.4m). The main reason for the increase was £1.5m of milestone payments.

Research and development expenses

Total investment in research and development was £10.2m, a 17% increase on the prior year. Expenditure was incurred primarily on the Phase IIa NVA237 trial, VR004 and NVA237 pharmacokinetic studies and for the initial pre-clinical studies for VR776 and VR496. The initial payments on the VR004 Phase IIb trial, which commenced in March 2005, are also included.

Administrative expenses

Administrative expenses of £2.2m (2003/04 - £1.6m) included £0.4m of additional costs associated with the IPO.

Net interest receivable

Net interest receivable comprises primarily the interest income from cash invested in overnight deposits. In the year ended 31 March 2005 the Group had net interest receivable of £0.6m (2003/04 - £nil) on net cash deposits, reflecting the increased level of cash following the IPO.

Taxation

The R&D tax credits recoverable are only recorded when we receive confirmation of our claim. £1.2m of R&D tax credits were received in October 2004 in relation to the year ended 31 March 2004 and these have been recorded in the year (2003/04 - £0.8m).

Capital expenditure

Capital expenditure in the period was 0.5m (2003/04 - £0.5m), incurred principally on the Group's laboratory facility in Chippenham, UK. Capital expenditure in 2005/06 will include the acquisition of a new blister filling line which will provide Phase III blister manufacturing capabilities for both our Aspirair and GyroHaler DPIs. The estimated cost of this new production line will be £1.2m. This equipment will also provide capability to manufacture Phase III material for our licensing partners.

Operating cash flow

Net cash outflow before financing in the 12 months of £4.9m has decreased 10% from the prior year (2003/4 - £5.4m) principally due to the increase in turnover, interest receivable and R&D tax credits off-setting the increased investment in research and development.

Financing

The IPO generated £20.1m before expenses through the placing of 35.8m shares. Prior to this we raised £1.5m in April 2004 by means of a convertible loan facility, which converted into shares at flotation, and in June 2004 a further £2m was raised by means of an equity investment by SkyePharma PLC at the equivalent of £0.625 per share. Thus, total funds raised in the period were £23.6m before expenses. Following our flotation, we repaid in full a loan facility bringing total loan repayments in the period to £1.3m.

Treasury

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

As at 31 March 2005 Vectura had cash and short-term deposits of £18.4m. An additional £7.9m was received from Novartis in April 2005. Cash resources at 31 May 2005 were £24.8m.

Loss per share

The net loss per share was 8.6p, a 33% reduction on the prior year (2004 - 12.8p).

Headcount

Headcount at 31 March 2005 was 108 (31 March 2004 - 100).

International Accounting Standards

We are adopting International Financial Reporting Standards and International Accounting Standards for the financial year ending 31 March 2006. The most significant impact for Vectura will be the adoption of IFRS 2 Share Based Payment, which requires the fair value of equity-based compensation to be recognised in the Group's profit and loss account. We believe that we will be fully prepared to adopt IFRS for the year ending 31 March 2006.

Post balance sheet event

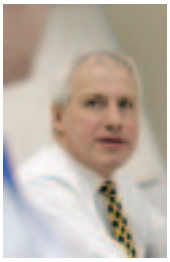
On 12 April 2005 we signed our licensing agreement for NVA237 with Novartis. The upfront access fee of £7.9m was received in April 2005 and is non-refundable. This fee will be recognised over 24 months in line with the period of the Contract Development Agreement, whereby Vectura will provide development expertise that will include the manufacturing of the Phase IIb clinical trial material for Novartis. The financial statements to 31 March 2006 will include the appropriate amount of this revenue.

Anne Hyland
Chief Financial Officer

21 June 2005

Directors




John (Jack) P Cashman
Non-Executive Chairman

Jack Cashman, aged 64, joined Vectura as Non-Executive Chairman in April 2001. Jack is currently a Non-Executive Director of Bespak plc, the world's largest supplier of dry powder inhalers; Chairman of Advanced Surgical Concepts, an Irish-based medical devices company; a Non-Executive Director of Phoqus Limited, a UK company specialising in oral drug delivery and a Non-Executive Director of Amtrol Inc. (USA), Amtrol-Alfa (Portugal) and Transat.A.T. Inc (Montreal). Jack is the former Chairman and joint-CEO of R.P. Scherer Corporation and participated in its leveraged buyout and privatisation and its subsequent successful public-offering flotation on the New York Stock Exchange (R.P. Scherer was subsequently acquired by Cardinal Health Inc. (NYSE)). His early career was spent in the field of filtration and industrial mineral products. During that time, he took on successively more senior roles in marketing, operations and general management in the UK, Europe, Canada and USA. With this experience, he decided to pursue an entrepreneurial career in the industrial and healthcare sectors.

Dr Christopher P Blackwell BSc PhD
Chief Executive

Dr Chris Blackwell, aged 43, was appointed Chief Executive of Vectura in February 2004 following a period of 17 months as Chief Operations Officer and Executive Director. Previously, Chris worked at Scotia Pharmaceuticals Ltd, having been invited to join in 1998 as Director of Drug Development, becoming an Executive Director later that year. His primary role was to refocus the Company's drug development capabilities from a research-led biotechnology company to a commercially-driven pharmaceutical development company. 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. Chris joined Glaxo Group Research Ltd as a Clinical Pharmacologist and progressed rapidly to a management role. Chris moved to Hoffman La-Roche to specialise in project management and became UK Director, Global Project Management in 1996.

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

Anne Hyland, aged 44, 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. Anne joined Celltech following the merger with Medeva plc where she was Finance Director for the UK Division. Previously, she was the Medeva Group Financial Controller where, through a period of rapid growth, she was responsible for managing treasury, tax, internal and external reporting, and acquisition and disposal activity. She joined Medeva from KPMG, London, where she was an audit manager and gained exposure to corporate finance, advisory and due diligence work. Anne 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 J M Richards
BA MA(Cantab) MSc PhD CChem
Non-Executive Director

Dr Andy Richards, aged 45, is currently a Non-Executive Director of Arakis (of which he was a founder and former CEO), Biowisdom, Babraham Bioscience Technology Ltd, Daniolabs, Cancer Research Technology Ltd (the commercial arm of Cancer Research UK) and Theradeas Ltd. He is a founder member of the Cambridge Angels and a member of the Council of UEA. Originally a protein chemist, Andy spent his early career with ICI (now AstraZeneca) and with PA Technology. He has broad experience of the UK biotechnology sector in research, drug development and in building commercial relationships. In 1992, Andy co-founded Chiroscience and was Business Development Director through to the merger in 1999 with Celltech. Andy is an established biotechnology entrepreneur and business angel, focusing on founding, investing in and assisting in the development of biotechnology and healthcare companies.

Dr John R Brown BSc MBA PhD
Non-Executive Director

Dr John Brown, aged 50, is currently a Non-Executive Director of Ardana plc, Pharmagene plc and Protherics plc and Chairman of the Roslin Institute in Edinburgh. He was, until early 2004, CEO of Acambis plc, the FTSE 250 biotech company which specialises in the development of vaccines. He joined Acambis as Finance Director in 1995, leading the Company through a successful flotation, and was appointed CEO in 1997. During John's time with Acambis the Company grew from 29 to 325 employees and achieved profitability in 2002. Prior to this he worked in equity research as Head of Research at Sutherland and Partners. John also worked at PA Consulting, where he advised both biotech and pharmaceutical companies. Early in his career, he spent five years at Glaxo Group Research where he led a group developing neuropeptide antagonists. He holds an MBA and a PhD in neuropharmacology.

Senior Management

Dr Tim Wright BSc PhD MBA
Commercial Director

Dr Tim Wright, aged 44, joined Vectura as Commercial Director in March 2005. Prior to joining Vectura he gained a breadth of experience in business development and licensing in a number of senior roles at BTG plc, latterly as Vice President Business Development and Licensing, Oncology, and as Director of Business Development at DevCo Pharmaceuticals where he was successful in building a portfolio of neuroscience development candidates. Tim trained as a research scientist at London University, obtaining a PhD in neuroendocrinology in 1987, and an MBA from London Business School Executive Program in 1994. Between 1986 and 1999, he held a number of management positions at GlaxoWellcome Research and Development, both in Clinical Pharmacology and Medical Operations and in project management at Simbec Research Limited.

Professor John N Staniforth
BSc PhD MRPharmS FZS CChem FRSC
Chief Scientific Officer

Professor John Staniforth, aged 51, was seconded from the University of Bath in August 1999, and joined Vectura on a full-time basis in April 2001. He has extensive research experience in the field of pharmaceutical technology, and is the author of over 100 research articles in the field of particle engineering and drug technology. John has been awarded numerous scientific awards, including the Churchill Fellowship, the Pfizer Prize, and more recently, the 2003 Academy of Pharmaceutical Sciences' AstraZeneca Award for Industrial Achievement. He has served as consultant to several international pharmaceutical companies and is the inventor or co-inventor of several drug-delivery technologies.

Dr Martin J Shott PhD MRPharmS
Pharmaceutical Operations Director

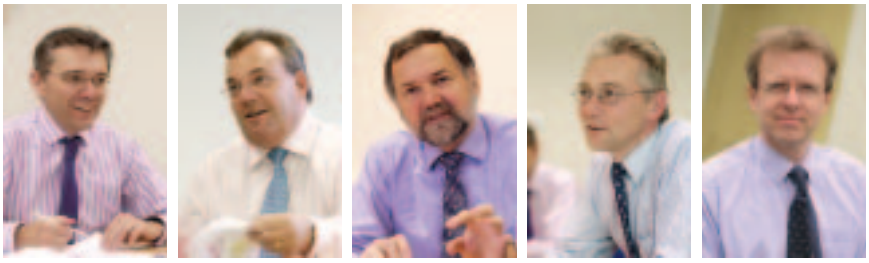
Dr Martin Shott, aged 53, joined Vectura as Pharmaceutical Operations Director in October 2002. Martin has wide-ranging experience in the pharmaceutical industry and is a member of the Royal Pharmaceutical Society of Great Britain. Prior to joining Vectura, Martin worked for four years at Innovata Biomed as Associate Director of Research and Development. His training as a research scientist included investigating the compression of pharmaceutical powders for a PhD at Nottingham University while continuing to work in the industry. This was completed in 1983. Martin has gained extensive experience in the UK and Europe working as a senior manager for companies including Lers-Synthelabo, and Ciba Geigy (later Novartis) where he managed the global DPI development unit based in the UK.

Dr Mark J Main BSc PhD
Development Director

Dr Mark Main, aged 45, joined Vectura as Development Director in May 2004. Prior to joining Vectura, he was with Powderject Pharmaceuticals, where he joined in 2001 to lead multi-disciplinary development teams for both drug delivery and vaccine products involving all aspects of the drug/device development process. Mark trained as a research scientist at St. George's Hospital Medical School where he gained his doctorate investigating the prevention of ischaemia-induced damage of the mammalian myocardium. He joined Sterling Winthrop in 1986 and subsequently Parke-Davis, Ipsen International, and Scotia Pharmaceuticals gaining extensive experience of clinical development and project management in the areas of cardiovascular and oncological treatment.

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

Stephen Eason, aged 47, joined Vectura as Director of Device Development in February 2002 when the Aspirair inhaler technology and staff were acquired from Cambridge Consultants Ltd. Stephen had initiated and led the Aspirair development programme within CCL, where he was an Associate Director. Stephen has also initiated and led the GyroHaler development programme for Vectura which commenced in 2003. In 1999, he set up CCL's Drug Delivery Devices Group. The team carried out significant product developments in the areas of inhalation, injection and infusion products. Before specialising in drug delivery, Stephen created and managed CCL's Product Definition Group which carried out a number of healthcare, telecoms and consumer-product developments for clients in Europe and the US. Prior to joining CCL, Stephen worked for seven years as a design and development engineer within the manufacturing industry, first with the TI Group and then with Baxter Healthcare. Stephen studied Mechanical Engineering at the Imperial College of Science and Technology, London.



Directors' Report

The Directors present their Annual Report on the affairs of the Company and Group, together with the financial statements and Auditors' report for the year ended 31 March 2005. The Remuneration Report and the Corporate Governance Report are included separately. The Corporate Social Responsibility Statement is included in the Directors' Report.

Principal activity

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

Review of business

Key events during the past year are referred to in the Chairman's and Chief Executive's Review and the Financial Review. These announcements include the following:

May 2004: successful completion of Phase IIa clinical trial in COPD patients using AD 237.

May 2004: appointment of Dr John Brown as a Non-Executive Director.

May 2004: successful completion of pharmacokinetic and maximum-tolerated-dose study for VR004 for erectile dysfunction.

June 2004: Group entered into a strategic alliance with SkyePharma PLC whereby they acquired certain rights to use Aspirair, our dry powder inhaler (DPI) device, for certain macromolecules on a non-exclusive basis. As part of the alliance, SkyePharma made a £2 million equity investment.

June 2004: successfully raised £20.1m and listed on the Alternative Investment Market (AIM) of the London Stock Exchange (LSE).

September 2004: successful completion of pharmacokinetic study for NVA237 for COPD.

October 2004: successful completion of first development phase for GyroHaler.

Results and dividends

The Group loss for the year, after taxation, amounted to £7,655,000 (2004 - £8,131,000). The Directors do not recommend the payment of a dividend (2004 - £nil).

Future developments

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

Directors

Membership of the Board (together with Directors' biographies) is shown in the section on Board of Directors and Senior Management. Details of Directors' remuneration and their interests in the share capital of the Company are given in the Remuneration Report. There have been no changes to Directors' interests from 31 March 2005 to the date of this document. Dr John Brown was appointed to the Board on 13 May 2004. On 9 June 2004, Mr Mark Clement, Mr Adam Holloway, Professor David Davies and Professor John Staniforth retired from the Board. Dr Chris Blackwell and Dr Andy Richards will be seeking re-election at this year's AGM.

None of the Directors has any interest in any contract of significance to the financial statements.

Employees

Employees' remuneration

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

length of service with the Company. All bonuses are provided for at the end of the financial year to which they relate. Further details of Directors' remuneration for the year are given in the Remuneration Report.

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

Employee involvement

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

Disabled employees

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

Payment of creditors

The Group's policy, in relation to all of its suppliers, is to agree terms of payment when first contracting with a supplier and to abide by those terms provided that it is satisfied that the supplier has provided the goods or services in accordance with such agreed terms and conditions. The Group operates a prompt payment policy in settling supplier invoices. The trade creditors carried in the balance sheet at 31 March 2005 represent 30 days of average purchases during the year for both Group and Company (2004 - 21 days).

Political and charitable donations

Vectura encourages employee involvement in charitable causes. During the year, Vectura made contributions amounting to £350 (2004 - £nil) to charitable organisations in the UK. This contribution was made in lieu of posting seasonal greetings to customers in December 2004. There were no political donations during the year (2004 - £nil).

Significant shareholdings

At 10 June 2005, the nearest practical date to the date of this Report, the Company had a total of 361 ordinary shareholders and 108,008,733 ordinary shares in issue.

The Directors are aware of the following substantial holdings in the Company's share capital as at the close of business on 10 June 2005:

	Number of shares '000	%
F&C Asset Management plc*	20,612	19.1%
Merlin Biosciences Funds**	18,602	17.2%
University of Bath	6,487	6.0%
Lehman Brothers*	5,095	4.7%
Aviva plc*	5,000	4.6%
UBS AG*	4,359	4.0%
Cambridge Consultants Limited	4,182	3.9%
Merrill Lynch Investment Managers*	4,076	3.8%
GAM UK Funds*	3,971	3.7%

* Includes all funds under management

** Includes 1.9m shares held by Merlin Equity Limited

Comparative share price performance for Vectura Group plc for the period to 21 June 2005

Share price

The mid-market share price as derived from the London Stock Exchange Daily Official List was 68p on 31 March 2005. The mid-market share price ranged from 47.5p to 74.5p during the period from the date of the Company's flotation on 2 July 2004 to 31 March 2005. The average share price for the period was 61p.

Corporate social responsibility statement

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

Equal opportunities policy

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

Family-friendly employment policies and careers

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

Environment

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

Health and safety

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

Going concern basis

Vectura is a research- and development-based emerging pharmaceutical company, which expects to incur further losses until revenues from royalty income and milestone receipts exceed expenditure on the product portfolio. The Directors have prepared projections which, by their nature, are inherently subject to some uncertainty, particularly in respect of revenues, but have reasonable expectations that the Group will have 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 11.45 am on 12 September 2005 at Olswang, 90 High Holborn, London WC1V 6XX. Details of the business to be transacted at the AGM can be found in the separate Circular to shareholders accompanying this report.

Auditors

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

By order of the Board

Anne Hyland
Company Secretary

21 June 2005

Corporate Governance

Companies which have securities that trade on AIM are not required to comply with the disclosure requirements of the Combined Code. However, the Board is committed to practising good corporate governance as part of its aim to deliver shareholder value. In assessing the appropriate standards of corporate governance, the Board takes into account the nature and size of the operation which comprised, at 31 March 2005, five Directors and 106 staff operating from two sites in the UK. The Board is reporting here as a matter of best practice on its compliance with the new Combined Code on Corporate Governance (the Code, published in July 2003).

Statement of compliance

From 2 July 2004, being the date on which the Company listed on the AIM, to 31 March 2005, the Company has been in compliance with the provisions set out in Section 1 of the Code, other than in relation to Provision B.1.3 concerning the granting of share options to Non-Executive Directors (NEDs).

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

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

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

The Board

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

Division of responsibilities between Chairman and Chief Executive

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

Board balance

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

Independence of NEDs

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

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

Other factors that may reflect on the independence of a NED include any material business relationships with the Company. Dr Andy Richards was until recently a Strategic Advisor to the Merlin Biosciences Fund (a shareholder of the Company) and is currently a Director and shareholder in Arakis Limited, the company with which Vectura co-developed NVA237. The Directors do not consider these arrangements compromise his independence because they do not relate to his role for the Company and he has not at any time represented Merlin or Arakis on the Board. The Board considers that neither the terms of the consultancy or the Directorship, nor the fees payable thereunder, in any way affects Dr Richards' independent judgement. Dr Richards provides advice to the Company on request on particular scientific and technical matters that are within his area of expertise. Dr Richards' consultancy fees are paid to Croggan Limited for these services, which totalled £10,000 in the year ended 31 March 2005. Again, the Board considers that this arrangement does not in any way affect Dr Richards' independent judgement.

The Board Committees

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 Remuneration Committee

The Code requires that, in the case of a smaller company, the Remuneration Committee consists of at least two independent NEDs. The Company complies with this requirement. Mr Jack Cashman chairs the Remuneration Committee, its other members being Dr Andy Richards and Dr John Brown. The Committee has responsibility for making recommendations to the Board on the Company's policy on the performance evaluation and remuneration of Directors and for determining, within agreed terms of reference, specific remuneration packages for each of the Directors and members of the Vectura Executive Committee, including pension rights, any compensation payments and the implementation of executive incentive schemes. The Committee met three times during the financial year ended 31 March 2005 and the Board can confirm full attendance by all member Directors. The Committee plans to meet at least twice a year in future.

The Nomination Committee

The Nomination Committee leads the process for Board appointments and makes recommendations to the Board. The Code recommends that a majority of members of the Nomination Committee are independent NEDs. The Company complies with this recommendation. Dr Brown chairs the Nomination Committee and its other members are Mr Cashman and Dr Richards. The Nomination Committee meets at least once a year, or more if necessary, and has responsibility for considering the size, structure and composition of the Board, retirements and appointments of additional and replacement Directors and making appropriate recommendations to the Board. The Committee met once during the financial year ended 31 March 2005 and the Board can confirm full attendance by all member Directors. The Committee plans to meet at least once a year in future.

The Audit Committee

The Code recommends that the Board should establish an Audit Committee of at least three independent NEDs, one of whom has recent and relevant financial experience. The Company complies with these recommendations. Dr Brown was appointed Chairman of the Committee on 10 June 2004, the other members being Mr Cashman and Dr Richards. The Audit Committee has met twice during the year and intends to meet not less than three times a year in future years. The Board can confirm full attendance by all member Directors. The Audit committee is responsible for making recommendations to the Board on the appointment, reappointment and removal of the external Auditors and assesses annually the qualification, expertise, resources, remuneration and independence of the Auditors, as well as the effectiveness of the audit process.

Any non-audit services that are to be provided by the external Auditors are reviewed in order to safeguard Auditor objectivity and independence. The Board can confirm that, since the IPO, there have been no significant non-audit services that are considered to have impaired the objectivity and independence of the external Auditors. A full breakdown of payments made to the external Auditors during the financial year is disclosed in note 3 to the financial statements.

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

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

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

Timeliness and quality of Board information

The Board has sought to ensure that Directors are properly briefed on issues arising at Board meetings by establishing procedures for distributing Board papers in a timely manner in advance of meetings. The Board met formally seven times during the financial year ended 31 March 2005 and these meetings were augmented with regular Board conference calls. The Board can confirm full attendance by all Directors in the period from Listing until the financial year-end.

Board performance evaluation

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

Accountability and audit

The Board is responsible for the preparation of an Annual Report that presents a balanced and understandable assessment of the Group's financial position and prospects. This responsibility is administered primarily by the Audit Committee. In addition, reference should be made to the Statement of Directors' Responsibilities in respect of the financial statements set out on page 34. The independent Auditors' Report includes a statement by the Auditors about their reporting responsibilities.

Maintenance of a sound system of internal control

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

Risk assessment review

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

Key internal controls

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

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

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

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

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

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

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

A comprehensive budgeting system allows managers to submit detailed budgets, which are reviewed and amended by Executive Directors prior to submission to the Board for approval. At the end of each quarter a forecast is prepared in the same level of detail as the budget. 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 Annual and Interim Reports. Separate announcements of all material events are made as necessary by press releases that are posted on the Company's website and automatically sent to all shareholders who are Vectura registered website users. These are the main mechanisms by which the Board seeks to present a balanced and understandable assessment of the Company's position and prospects. All periodic reports and accounts are mailed to shareholders. The Vectura website (www.vectura.com) provides additional information about the Company and allows access to reports and accounts, press releases and other materials issued by the Company.

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

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

Constructive use of the AGM

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

Approved by the Board

Anne Hyland
Chief Financial Officer

21 June 2005

Remuneration Report

Introduction

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

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

Unaudited information

Remuneration Committee

The Remuneration Committee consists entirely of Non-Executive Directors (NEDs) and is constituted in accordance with the recommendations of the Combined Code. Its members for the first quarter of the year were Mr M R Clement (Chairman), Mr A Holloway and Mr J Cashman. Following the Company's IPO, Mr Cashman was appointed Chairman of the Committee and Dr A J M Richards and Dr J R Brown were appointed to the Committee. The Committee met three times during year ended 31 March 2005 and seeks independent advice, where appropriate, for the purpose of determining all aspects of the remuneration of each Executive Director.

The remuneration of each Executive Director is determined by the Committee (including the award of annual bonuses and share options), as are the terms of their service agreements. If appropriate, the Committee will commission reports from expert remuneration consultants. The Committee also recommends to the Board the fees paid to the Chairman. The fees of the Non-Executive Directors are determined by the Board on the joint recommendation of the Chairman and the Chief Executive.

None of the Committee's members has any personal financial interest (other than as shareholder) or conflicts of interests arising from cross-directorships or day-to-day involvement in running the business (see Independence of NEDs on page 23). No Director plays a part in any discussion about his own remuneration.

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

Policy on remuneration of Executive Directors

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

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

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

Components of the remuneration package

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

Basic salary

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

In formulating its decision, the Committee takes into account appropriate benchmarks. For the financial year ended 31 March 2005, the Committee chose the UK pharmaceutical sector.

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

Performance-related bonuses

Executive Directors are eligible for an annual discretionary bonus, whereby performance objectives are established at the beginning of the financial year by reference to suitably challenging corporate achievements. Performance-related payments may be paid annually, dependent upon achievements measured against objectives. Executive Directors are entitled to bonuses in the form of cash.

Cash bonuses are limited to a maximum of 100% of basic salary for each Director, however the Remuneration Committee maintain the right to make one-off bonus awards for exceptional performance.

Deferred bonus awards may be made over shares having a value of up to 100% of the Director's annual cash bonus, which, as stated above, is itself based on corporate performance objectives being met and is not therefore subject to any further performance conditions. Awards vest in three equal tranches, on the first, second and third anniversaries of the date on which the award is made and, on vesting, the award converts to a share option which is exercisable over 10 years. Participation is at the discretion of the Committee. Vectura operates the Plan in order to provide additional incentives to its key senior executives, recognising that the retention and recruitment of such employees is critical to the Company's long-term success.

Share options

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

Executive Directors hold options under the Unapproved Share Option Plan and 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 when the options are granted. The Company's policy is to grant options annually to Executive Directors at the discretion of the Remuneration Committee, taking into account individual performance, up to a maximum of two times salary in any one year. If the Long-Term Incentive Plan (LTIP) arrangements referred to below are approved at the forthcoming AGM, this policy will be modified so that awards under option schemes and the LTIP combined shall not exceed two times salary. It is the Company's policy to phase the granting of share options, rather than to award a single large block to any individual.

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

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

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

Full details of Directors' interests in ordinary shares of the Company, together with options granted in the financial year ended 31 March 2005, are set out on pages 30 and 32 respectively.

Long-term incentive plan

The Company is seeking shareholder approval at the AGM for a new Long-Term Incentive Plan (LTIP) to be introduced. The LTIP will provide 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, and is described in more detail in the separate Circular enclosed with this Annual Report. It will ensure that Vectura has available to it the full range of equity incentives, given the significant developments which have recently taken place, particularly in relation to tax and accounting standards, which influence the structure of these awards.

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.

Directors' service contracts

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

Non-Executive Directors

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

The dates of appointment of each of the NEDs serving at 31 March 2005 are summarised in the table below:

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

Directors' interests

The Directors who held office at 31 March 2005 and their interests in the share capital of the Company at 31 March 2004 and 31 March 2005 were as follows:

	31 March 2005 ordinary shares of 0.025p each	31 March 2004 ordinary shares of 0.025p each (1)
C P Blackwell	**51,948**	51,948
J Cashman (2)	**434,749**	332,464
J R Brown (3)	**20,457**	-
A P Hyland	**58,180**	58,180
A J M Richards	**72,728**	72,728

(1) The positions at 31 March 2004 have been adjusted to reflect the change in the nominal value of the ordinary shares in accordance with a special resolution of the shareholders of 22 June 2004 (see note 17 to the financial statements).
(2) The holding of J Cashman was held through a trust at 31 March 2004. On 20 April 2004, J Cashman acquired these shares from the trust.
(3) The holding of J R Brown includes 8,929 ordinary shares of 0.025p each which are held through nominees.

There was no change in the Directors' interests between 31 March 2005 and the date of this report.

Audited Information

Directors' remuneration and pension entitlements	2005 £000	2004 £000
The total amounts for Directors' remuneration were as follows:		
Emoluments	**729**	686
Money-purchase pension contributions	**33**	48
	762	734

In addition to the emoluments and pension contributions disclosed above, the following fees were paid to third parties in respect of the services of Non-Executive Directors (see note 21 to the financial statements):

	2005 £000	2004 £000
M R Clement (2004 – P Keen and M R Clement)	**3**	15
A Holloway	**4**	15
	7	30

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

	Basic salary and fees £000	Bonuses £000	Benefits (4) £000	Consultancy £000	**Total emoluments 2005 £000**	Total emoluments 2004 £000
Executive Directors:						
C P Blackwell (1)	180	180	1	-	**361**	177
A P Hyland (2)	129	113	1	-	**243**	119
J N Staniforth (resigned 9 June 2004)	24	3	-	-	**27**	153
P Virley (resigned 9 March 2004)	-	-	-	-	**-**	164
Non-Executive Directors:						
J R Brown	22	-	-	-	**22**	-
J Cashman	37	-	-	-	**37**	25
M R Clement (resigned 9 June 2004)	-	-	-	-	**-**	-
D J G Davies (3) (resigned 9 June 2004)	3	-	-	2	**5**	27
A Holloway (resigned 9 June 2004)	-	-	-	-	**-**	-
B R Moon (resigned 9 June 2004)	-	-	-	-	**-**	-
A J M Richards (3)	24	-	-	10	**34**	21
	419	296	2	12	**729**	686

(1) £71,575 of C P Blackwell's bonus payments was awarded as a result of the successful IPO.
(2) £35,286 of A P Hyland's bonus payments was awarded as a result of the successful IPO.
(3) The fees for consultancy services paid to Prof D J G Davies and Dr A J M Richards, who are both leading scientists, were for specialist scientific advice not connected with their services as Directors. The fees received by Dr A J M Richards were paid through a consultancy company, Croggan Limited.
(4) Benefits represent payments for medical insurance.

Directors' pension entitlements

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

	2005 £000	2004 £000
C P Blackwell	**18**	12
A P Hyland	**13**	10
J N Staniforth	**2**	13
P Virley	**-**	13
	33	48

The following Directors who served during the year had options outstanding over ordinary shares of 0.025p each at 31 March 2005:

Director	Plan	Options held at 1 April 2004 (1)	Options granted (lapsed) during year	**Options held at 31 March 2005**	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	166,232	(166,232)	**-**	48.125	-	-	
	Unapproved	120,000	(120,000)	**-**	48.125	-	-	
	Unapproved	-	680,000	**680,000**	36.000	29/04/07	29/04/14	
	Unapproved	-	238,989	**238,989**	56.000	02/07/05	02/07/14	(2)
		452,464	632,757	**1,085,221**				
C P Blackwell	EMI	277,776		**277,776**	48.125	5/11/05	3/11/12	
	Unapproved	122,224	-	**122,224**	48.125	1/10/05	1/10/12	
	Unapproved	23,376	-	**23,376**	48.125	11/04/06	11/04/13	
	Unapproved	120,000	(120,000)	**-**	48.125	-	-	
	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	(2)
	Sharesave Scheme	-	18,651	**18,651**	50.800	01/04/08	30/09/08	
		543,376	1,778,321	**2,321,697**				
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	(2)
		-	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	120,000	(120,000)	**-**	48.125	-	-	
	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	(2)
	Sharesave Scheme	-	18,651	**18,651**	50.800	01/04/08	30/09/08	
		593,896	852,818	**1,446,714**				
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	(2)
		-	738,989	**738,989**				

(1) The opening positions at 1 April 2004 have been adjusted to reflect the change in the nominal value of the ordinary shares, as noted above.
(2) Exercisable over three equal annual instalments from 2 July 2005.

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

The market value of the ordinary shares at close of business on 31 March 2005 was 68 pence and the range between the date of flotation on 2 July 2004 and the year-end was 47.5 pence to 74.5 pence.

Approved by the Board

Jack Cashman
Chairman of the Remuneration Committee

21 June 2005

Statement of Directors' Responsibilities

The following statement, which should be read in conjunction with the Auditors' Statement of their Responsibilities set out on page 35, is made with a view to distinguish for shareholders the respective responsibilities of the Directors and of the Auditors in relation to the financial statements.

Company law requires the Directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the Company and of the Group and of the profit or loss 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;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

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

By order of the Board

Anne Hyland
Company Secretary

21 June 2005

Independent Auditors' Report

to the members of Vectura Group plc

We have audited the financial statements of Vectura Group plc for the year ended 31 March 2005, which comprise the Group Profit and Loss Account, Group Statement of Total Recognised Gains and Losses, Group Balance Sheet, Company Balance Sheet, Group Cash Flow Statement, the audited part of the Directors' Remuneration Report and the related notes 1 to 22. These financial statements have been prepared on the basis of the accounting policies set out therein.

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

As described in the Statement of Directors' Responsibilities the Company's Directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. The Directors are also responsible for preparing the Directors' Remuneration Report.

Our responsibility is to audit the financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards and Listing Rules of the Financial Services Authority.

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

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises the Highlights, the Chairman's and Chief Executive's Review, Financial Review, Board of Directors and Senior Management, Directors' Report, Corporate Governance, and the unaudited part of the Director's Remuneration Report. 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 United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

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

Opinion

In our opinion, the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 March 2005, and of the loss of the Group for the year then ended, and the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985.

Ernst & Young LLP
Registered Auditor
Bristol

21 June 2005

Group Profit and Loss Account

for the year ended 31 March 2005

	Notes	**2005 £000**	2004 £000
Turnover	2	**4,484**	2,863
Cost of sales		**(1,472)**	(1,436)
Gross profit		**3,012**	1,427
Research and development		**(10,209)**	(8,730)
Administrative expenses		**(2,239)**	(1,620)
Total administrative expenses		**(12,448)**	(10,350)
Group operating loss	3	**(9,436)**	(8,923)
Interest receivable and similar income		**755**	213
Interest payable and similar charges	5	**(155)**	(260)
Loss on ordinary activities before taxation		**(8,836)**	(8,970)
Tax on loss on ordinary activities	6	**1,181**	839
Loss on ordinary activities after taxation attributable to members of the parent undertaking	18	**(7,655)**	(8,131)
Loss per share – basic and diluted	7	**(8.6p)**	(12.8p)

The Group's results are all derived from continuing activities.

Group statement of total recognised gains and losses

for the year ended 31 March 2005

There were no recognised gains or losses attributable to the shareholders other than as stated above.

Group Balance Sheet

at 31 March 2005

	Notes	2005 £000	2004 £000
Fixed assets			
Intangible assets	9	**1,636**	2,813
Tangible assets	10	**3,102**	3,616
Investments	11	**428**	428
		5,166	6,857
Current assets			
Debtors	12	**850**	683
Cash at bank and in hand	19(b)	**18,388**	2,107
		19,238	2,790
Creditors: amounts falling due within one year	13	**(2,735)**	(2,581)
Net current assets		**16,503**	209
Total assets less current liabilities		**21,669**	7,066
Creditors: amounts falling due after more than one year	14	**(14)**	(682)
		21,655	6,384
Capital and reserves			
Called up share capital	17	**61**	16
Shares to be issued	18	**918**	867
Share premium account	18	**22,523**	20,781
Special reserve	18	**8,245**	-
Merger reserve	18	**3,211**	3,020
Profit and loss account	18	**(13,303)**	(18,300)
Shareholders' funds		**21,655**	6,384
Shareholders' funds			
Equity		**21,621**	6,384
Non-equity	17	**34**	-
		21,655	6,384

Approved by the Board

Dr C P Blackwell
Director

A P Hyland
Director

21 June 2005

Company Balance Sheet

at 31 March 2005

	Notes	2005 £000	2004 £000
Fixed assets			
Intangible assets	9	**636**	783
Tangible assets	10	**704**	640
Investments	11	**10,600**	8,538
		11,940	9,961
Current assets			
Debtors	12	**850**	683
Cash at bank and in hand		**18,388**	2,107
		19,238	2,790
Creditors: amounts falling due within one year	13	**(2,922)**	(2,670)
Net current assets		**16,316**	120
Total assets less current liabilities		**28,256**	10,081
Creditors: amounts falling due after more than one year	14	**(14)**	(682)
		28,242	9,399
Capital and reserves			
Called up share capital	17	**61**	16
Shares to be issued	18	**1**	1
Share premium account	18	**22,523**	20,781
Special reserve	18	**8,245**	-
Profit and loss account	18	**(2,588)**	(11,399)
Shareholders' funds		**28,242**	9,399
Shareholders' funds			
Equity		**28,208**	9,399
Non-equity	17	**34**	-
		28,242	9,399

Approved by the Board

Dr C P Blackwell
Director

A P Hyland
Director

21 June 2005

Group Cash Flow Statement

for the year ended 31 March 2005

	Notes	2005 £000	2004 £000
Net cash outflow from operating activities	19(a)	**(6,163)**	(5,724)
Returns on investment and servicing of finance			
Interest paid on loans		**(139)**	(225)
Interest element of repayments under finance leases and hire purchase contracts		**(16)**	(35)
Interest received		**755**	212
Net cash inflow/(outflow) from returns on investments and servicing of finance		**600**	(48)
Taxation			
Taxation received		**1,181**	839
Capital expenditure and financial investment			
Purchase of tangible fixed assets		**(492)**	(510)
Net cash outflow from capital expenditure and financial investment		**(492)**	(510)
Net cash outflow before financing		**(4,874)**	(5,443)
Financing			
Issue of redeemable preference shares		**34**	-
Issue of ordinary share capital		**23,651**	1
Share issue costs		**(1,117)**	-
Capital element of repayments under finance leases and hire purchase contracts		**(141)**	(252)
Repayment of loans		**(1,272)**	(603)
Net cash inflow/(outflow) from financing		**21,155**	(854)
Increase/(decrease) in cash	19(b)	**16,281**	(6,297)

Group Cash Flow Statement

for the year ended 31 March 2005

	Notes	2005 £000	2004 £000
Reconciliation of net cash flow to movement in net funds			
Increase/(decrease) in cash		**16,281**	(6,297)
New finance leases and hire purchase contracts		**-**	(155)
Capital element of repayments under finance leases and hire purchase contracts		**141**	252
Repayment of loans		**1,272**	603
Movement in net funds		**17,694**	(5,597)
Net funds at 1 April		**592**	6,189
Net funds at 31 March	19(b)	**18,286**	592

Notes to the Financial Statements

at 31 March 2005

1 Accounting policies

Basis of preparation

The financial information has been prepared under the historical cost convention and in accordance with applicable accounting standards.

Fundamental accounting concept

The Group has received significant levels of funding during the year. The receipt of these funds has led the Directors to conclude that it is appropriate to prepare these financial statements on the going concern basis.

Basis of consolidation

The Group financial statements consolidate the financial statements of Vectura Group plc and its subsidiary undertakings drawn up to 31 March each year. No profit and loss account is presented for Vectura Group plc as permitted under Section 230 of the Companies Act 1985.

The subsidiary undertakings have been included in the Group financial information using the acquisition method of accounting. Accordingly, the Group profit and loss account and cash flow statement will include the results and cash flows of the subsidiary undertakings for the period from their acquisition. The purchase consideration is allocated to assets and liabilities on the basis of fair value at the date of acquisition.

Turnover

Turnover represents the amount receivable for goods and services and royalties earned, net of trade discounts, VAT and other sales-related taxes. Amounts received or receivable in respect of licence fees or milestone payments are recognised as turnover when the licence rights are granted or the specific conditions stipulated in the licence agreement have been satisfied.

Goodwill

Goodwill arising on the acquisition of subsidiary undertakings and businesses, representing any excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired, is capitalised and written off on a straight-line basis over its useful economic life, which is considered to be 5 to 10 years. It is reviewed for impairment at the end of the first full financial year following the acquisition and in other periods if events or changes in circumstances indicate that the carrying value may not be recoverable.

Goodwill is adjusted to reflect the fair value of deferred equity consideration at the time that related deferred shares are issued.

If a subsidiary, associate or business is subsequently sold or closed any goodwill arising on acquisition that has not been amortised through the profit and loss account is taken into account in determining the profit or loss on sale or closure.

Intangible assets

Intangible assets acquired separately from a business are capitalised at cost. Intangible assets acquired as part of an acquisition of a business are capitalised separately from goodwill if the fair value can be measured reliably on initial recognition, subject to the constraint that, unless the asset has a readily ascertainable market value, the fair value is limited to an amount that does not create or increase any negative goodwill arising on the acquisition. Intangible assets created within the Group are not capitalised and expenditure is charged against profits in the year in which it is incurred.

Intangible assets are amortised on a straight-line basis over their estimated useful lives up to a maximum of 20 years. The carrying value of intangible assets is reviewed for impairment at the end of the first full year following acquisition and in other periods if events or changes in circumstances indicate the carrying value may not be recoverable.

1 Accounting policies (continued)

Research and development
Research and development expenditure is written off as incurred.

Tangible fixed assets
Tangible fixed assets are stated at cost, net of depreciation and any provision for impairment. Depreciation is provided on all tangible fixed assets, at rates calculated to write off the cost, less estimated residual value, of each asset on a straight-line basis over its expected useful life as follows:

Laboratory equipment	– 3 - 7 years
Office and IT equipment	– 3 years
Leasehold improvements	– over the shorter of 3 years or the period of the lease

The carrying values of tangible fixed assets are reviewed for impairment when events or circumstances indicate the carrying values may not be recoverable.

Investments
Fixed asset investments are shown at cost less provision for impairment.

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 rates subsequent to the date of the transaction is included as an exchange gain or loss in the profit and loss account.

Leasing and hire purchase contracts
Assets held under finance leases and hire purchase contracts, which confer risks and rewards similar to those attached to owned assets, are capitalised as tangible fixed assets and are depreciated over the shorter of the lease terms and their useful lives. The capital elements of future lease obligations are recorded as liabilities, while the interest elements are charged to the profit and loss account over the period of the leases to produce a constant rate of charge on the basis of capital repayments outstanding.

Rentals under operating leases are charged on a straight-line basis over the lease term, even if the payments are not made on such a basis.

Taxation
UK corporation tax is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax
Deferred taxation is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events have occurred at that date that will result in an obligation to pay more, or the right to pay less or to receive more tax.

Provision is made for tax on gains arising from the revaluation (and similar fair value adjustments) of fixed assets, or gains on disposal of fixed assets that have been rolled over into replacement assets, only to the extent that, at the balance sheet date, there is a binding agreement to dispose of the assets concerned. However, no provision is made where, on the basis of all available evidence at the balance sheet date, it is more likely than not that the taxable gain will be rolled over into replacement assets and charged to tax only where the replacement assets are sold.

Deferred tax assets are recognised only to the extent that the Directors consider that it is more likely than not that there will be suitable taxable profits from which the underlying timing differences can be deducted.

Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

Pension costs

The Group contributes a set proportion of employees' gross salary to a defined contribution scheme. The amount charged to the profit and loss 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 as either prepayments or creditors in the balance sheet.

Employee share option schemes

In accordance with Urgent Issues Task Force Abstract 17, "Employee share schemes", the cost to the Group of awards to employees that take the form of shares or rights to shares is recognised as a charge to the profit and loss account. The cost, which is the difference between the fair value at the date of grant and any exercise price, is charged to the profit and loss account over the period until the shares vest, with a corresponding credit to reserves.

2 Turnover

The principal activity of the Group is the development of pharmaceutical products for use in the treatment of human diseases, which comprises the Group's only class of business.

The Group's strategy is to find licensing partners for these products for late-stage clinical development and commercialisation. The Group's intellectual property rights include a number of enabling technologies from which the product portfolio is derived. The Group from time to time licenses these technologies to third parties and the turnover relating to this additional licensing activity is disclosed in the table below. In addition, the Group offers product development and clinical trial manufacturing services to third parties on a fee-for-service basis through its Pharmaceutical Development Services activities. The turnover relating to these activities is also disclosed below.

Turnover	**2005 £000**	2004 £000
Pharmaceutical Development Services	**2,662**	2,601
Technology licensing	**1,822**	262
	4,484	2,863

Sales are made into four geographical markets:	**2005 £000**	2004 £000
United Kingdom	**2,527**	2,622
Rest of Europe	**1,876**	227
USA	**41**	14
Rest of world	**40**	-
	4,484	2,863

All turnover and losses before taxation originate in the United Kingdom. All assets and liabilities are held in the United Kingdom.

3 Group operating loss

The group operating loss is stated after charging:	2005 £000	2004 £000
Depreciation of tangible fixed assets:		
– owned	**750**	621
– held under finance leases and hire purchase contracts	**159**	331
Amortisation of intangible fixed assets	**1,419**	1,545
Share-based compensation	**116**	143
Operating lease rentals:		
– land and buildings	**251**	251
– plant and machinery	**92**	150
Auditors' remuneration:		
– for audit services	**39**	24
– for non-audit services	**151**	8

Non-audit services in 2005 relate to financial due diligence at the time of the Company's flotation on AIM.

4 Directors and employees

	2005 £000	2004 £000
Directors' remuneration		
Fees	**105**	103
Salary and benefits	**335**	517
Bonuses	**296**	96
Pension contributions	**33**	48
	769	764

Fees include £12,000 (2004 - £18,000) paid to two Non-Executive Directors for consultancy services and £7,000 (2004 - £30,000) paid to third parties in respect of the services of Non-Executive Directors (note 21).

Bonuses include a one-off bonus paid to the Executive Directors in relation to the IPO in July 2004.

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

Employees

The average monthly number of employees (including Executive Directors) during the year was as follows:	2005 No.	2004 No.
Pharmaceutical Development Services	**23**	28
Research and development	**71**	65
Business development and administration	**8**	8
	102	101

4 Directors and employees (continued)

Employees (continued)

The aggregate remuneration comprised:	2005 £000	2004 £000
Wages and salaries	**4,142**	3,449
Social security costs	**481**	391
Other pension costs	**256**	240
	4,879	4,080

5 Interest payable and similar charges

	2005 £000	2004 £000
Loans	**139**	225
Finance charges payable under finance leases	**16**	35
	155	260

6 Tax on loss on ordinary activities

a) Tax on loss on ordinary activities:	2005 £000	2004 £000
R&D tax credit not recognised in previous year	**1,181**	839

b) Factors affecting the current year tax charge:

The tax assessed for the year is lower than the standard rate of tax in the UK.
The differences are explained below:

Loss on ordinary activities before tax	**(8,836)**	(8,970)
Loss on ordinary activities multiplied by standard rate of tax in the UK of 30%	**(2,651)**	(2,691)
Effects of:		
Expenses not deductible for tax purposes	**166**	115
Depreciation in advance of capital allowances	**583**	632
Losses carried forward	**1,902**	1,944
Credit not provided in previous year relating to research and development tax credit	**(1,181)**	(839)
Total current tax	**(1,181)**	(839)

c) Factors that may affect future tax charges:

Cumulative tax losses of approximately £11,979,000 (2004 - £5,636,000) (subject to agreement by the Inland Revenue) are available within the Group to carry forward against future taxable profits or surrender in return for research and development tax credit. There is an unrecognised deferred tax asset of £3,594,000 (2004 - £1,691,000), which relates to the above tax losses, and a deferred tax asset of £466,000 (2004 - liability of £117,000) arising as a result of unclaimed capital allowances. The total deferred tax asset of £4,060,000 has not been recognised since it is uncertain that there will be suitable future taxable profits against which the deferred tax asset can be offset.

7 Loss per ordinary share

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

	2005	2004
Retained loss for the year (£000)	**7,655**	8,131
Weighted average number of ordinary shares (No. 000)	**89,193**	63,544
Loss per ordinary share	**8.6p**	12.8p

The loss per share is based on the weighted average number of shares adjusted to reflect the subdivision and restructuring of the share capital of the Company and is presented as if the share restructuring had happened at the beginning of the period under review.

The loss and weighted average number of ordinary shares for the purpose of calculating the diluted earnings per ordinary share are identical to those used for the basic earnings per ordinary share, as the exercise of share options would have the effect of reducing the loss per ordinary share and is therefore not dilutive.

8 Loss for the financial year attributable to members of Vectura Group plc

The loss for the financial year dealt with in the financial statements of the parent company, Vectura Group plc, was £3,841,000 (2004 - £4,533,000). As permitted by Section 230 of the Companies Act 1985, no separate profit and loss account is presented in respect of the parent undertaking.

9 Intangible fixed assets

Group	Patents and trademarks £000	Goodwill £000	Total £000
Cost:			
At 1 April 2004	3,490	3,247	6,737
Uplift in goodwill for 300,000 deferred shares issued in respect of the acquisition of a subsidiary (note 18)	-	46	46
Elimination of goodwill for 150,000 deferred shares cancelled in respect of the acquisition of a subsidiary (note 18)	-	(72)	(72)
Uplift in goodwill to market value of shares to be issued in respect of the acquisition of a subsidiary (note 18)	-	268	268
At 31 March 2005	**3,490**	**3,489**	**6,979**
Amortisation:			
At 1 April 2004	2,447	1,477	3,924
Charge for the year	1,043	376	1,419
At 31 March 2005	**3,490**	**1,853**	**5,343**
Net book value:			
At 31 March 2005	**-**	**1,636**	**1,636**
At 1 April 2004	1,043	1,770	2,813

Company	Goodwill £000
Cost:	
At 1 April 2004 and 31 March 2005	**1,467**
Amortisation:	
At 1 April 2004	684
Charge for the year	147
At 31 March 2005	**831**
Net book value:	
At 31 March 2005	**636**
At 1 April 2004	783

10 Tangible fixed assets

Group	Laboratory equipment £000	Office and IT equipment £000	Total £000
Cost:			
At 1 April 2004	5,309	130	5,439
Additions	394	1	395
At 31 March 2005	**5,703**	**131**	**5,834**
Depreciation:			
At 1 April 2004	1,732	91	1,823
Charge for the year	886	23	909
At 31 March 2005	**2,618**	**114**	**2,732**
Net book value:			
At 31 March 2005	**3,085**	**17**	**3,102**
At 1 April 2004	3,577	39	3,616

Company	Laboratory equipment £000	Office and IT equipment £000	Total £000
Cost:			
At 1 April 2004	1,624	61	1,685
Additions	394	1	395
At 31 March 2005	**2,018**	**62**	**2,080**
Depreciation:			
At 1 April 2004	985	60	1,045
Charge for the year	330	1	331
At 31 March 2005	**1,315**	**61**	**1,376**
Net book value:			
At 31 March 2005	**703**	**1**	**704**
At 1 April 2004	639	1	640

10 Tangible fixed assets (continued)

The net book value of these assets (Group and Company) includes the following assets held under hire purchase agreements and finance leases:	Laboratory equipment £000	Office and IT equipment £000	Total £000
At 31 March 2005	**63**	**-**	**63**
At 1 April 2004	188	-	188

11 Investments

Group	Corporate bond £000	Total £000
Cost:		
At 1 April 2004 and 31 March 2005	**428**	**428**
Amounts written off:		
At 1 April 2004 and 31 March 2005	**-**	**-**
Net book value:		
At 1 April 2004 and 31 March 2005	**428**	**428**

In accordance with the lease dated 26 July 2002 by which Vectura Group plc leased premises at 1 Prospect West, Chippenham, Wiltshire, SN14 6FH, a sum of £428,000 was deposited in a separate interest-earning account in the joint names of the Landlord and Vectura Group plc. Interest on the deposit of £428,000 accumulates in the bank account and is payable to Vectura Group plc at the end of each annual deposit term. See also notes 16 and 20.

Company	Shares in subsidiary undertakings £000	Loans to subsidiary undertakings £000	Corporate bond £000	Total £000
Cost:				
At 1 April 2004	478	7,702	428	8,608
Additions	-	2,062	-	2,062
At 31 March 2005	**478**	**9,764**	**428**	**10,670**
Amounts written off:				
At 1 April 2004 and 31 March 2005	**70**	**-**	**-**	**70**
Net book value:				
At 31 March 2005	**408**	**9,764**	**428**	**10,600**
At 1 April 2004	408	7,702	428	8,538

11 Investments (continued)

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

Details of the investments in subsidiary undertakings are as follows:

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

12 Debtors

	Group		Company	
	2005 £000	2004 £000	**2005 £000**	2004 £000
Amounts falling due within one year:				
Trade debtors	**668**	566	**668**	566
Other debtors	**23**	41	**23**	41
Prepayments and accrued income	**66**	31	**66**	31
VAT recoverable	**93**	45	**93**	45
	850	683	**850**	683

13 Creditors: amounts falling due within one year

	Group		Company	
	2005 £000	2004 £000	**2005 £000**	2004 £000
Loans (note 14)	**4**	692	**4**	692
Trade creditors	**880**	725	**880**	725
Amounts owed to Group undertaking	**-**	-	**187**	187
Obligations under finance leases and hire purchase contracts (note 15)	**84**	141	**84**	141
Other taxation and social security costs	**128**	111	**128**	111
Other creditors	**1**	2	**1**	2
Accruals	**1,638**	910	**1,638**	812
	2,735	2,581	**2,922**	2,670

14 Creditors: amounts falling due after more than one year

Group and Company	2005 £000	2004 £000
Loans (see below)	-	584
Obligations under finance leases and hire purchase contracts (note 15)	14	98
	14	682

The maturity of the loans is as follows:	2005 £000	2004 £000
Amounts payable:		
– Within one year	4	826
– In more than one year but not more than two years	-	617
	4	1,443
Less: interest charges allocated to future periods	-	(167)
	4	1,276

Loans are analysed as follows:	2005 £000	2004 £000
Current obligations (note 13)	4	692
Non-current obligations	-	584
	4	1,276

The amounts outstanding at 31 March 2005 represent the balance of two loan accounts at market rates of interest with a supplier for the acquisition of software.

Loans at 31 March 2004 included a loan from ETV Capital S.A. in the amount of £1,266,143, which was repaid in full during the year.

15 Obligations under finance leases and hire purchase contracts

The maturity of these amounts is as follows:

Group and Company	2005 £000	2004 £000
Amounts payable:		
– Within one year	**88**	156
– In two to five years	**15**	103
	103	259
Less: finance charges allocated to future periods	**(5)**	(20)
	98	239

	2005 £000	2004 £000
Finance leases and hire purchase contracts are analysed as follows:		
Current obligations (note 13)	**84**	141
Non-current obligations (note 14)	**14**	98
	98	239

	2005 £000	2004 £000
Details of the movements in finance leases and hire purchase contracts in the year are as follows:		
At 1 April	**239**	336
New leases	**-**	155
Repayments made	**(141)**	(252)
At 31 March	**98**	239

16 Financial instruments

The Group's principal financial instruments comprise borrowings, cash and liquid resources, 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 2005 and 2004 are not 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.

Short-term debtors and creditors have been excluded from the following disclosures, other than currency risk disclosures, as permitted by FRS 13 "Derivatives and other financial instruments".

Interest rate risk and liquidity risk of the Group's financial assets

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

Interest rate profile of the Group's financial assets

Financial assets comprise overnight cash deposits (2005 - £18,388,000, 2004 - £2,107,000) and an investment bond (2005 - £428,000, 2004 - £428,000).

Interest on overnight cash deposits is calculated on the basis of a floating rate set at 12.5 basis points below 7-day sterling LIBID. The interest rate on the investment bond is fixed annually and is 3.75% in the year ending 29 July 2005 (2004 - 3.025%). The investment is for a fixed period of one year and is renewable annually.

Interest rate risk profile of the Group's financial liabilities

The Group's liabilities were all in sterling at fixed rates of interest and consist of loans and finance leases. Details of the loans are set out in note 14. Details of the finance leases are set out in note 15. The weighted average period for which the rates are fixed, which is also the weighted average period to maturity, is 11 months (2004 - 20 months). In the year ended 31 March 2005, these liabilities bore a weighted average interest rate of 7.5% (2004 - 12.2%).

Currency risk profile

The Group had no significant commitments to foreign currencies throughout the period.

Borrowing facilities

The Group had no borrowing facilities at 31 March 2005 (2004 - £nil).

Fair values

The Directors consider there to be no material difference between the fair value and carrying values of the financial instruments at the balance sheet dates.

Market-price risk

The principal market-price risk comprises interest rate exposure. Group funds are invested in money-market cash deposits with the objective of maintaining a balance between accessibility of funds and competitive rates of return.

17 Called up share capital

	2005		2004	
	£000	No. 000	£000	No. 000
Authorised:				
Ordinary shares of 0.1p each			16	15,505
Preferred A ordinary shares of 0.1p each			4	4,045
Ordinary shares of 0.025p each	45	181,200		
Redeemable preference shares of £1 each	34	34		
Allotted, called up and fully paid:				
Ordinary shares of 0.1p each			13	12,527
Preferred A ordinary shares of 0.1p each			3	3,414
Ordinary shares of 0.025p each	27	107,899		
Redeemable preference shares of £1 each	34	34		

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

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

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

By an ordinary resolution passed by the shareholders on 8 June 2004, the authorised share capital was increased from £24,550 to £58,550 by the creation of 34,000 redeemable preference shares of £1 each. The rights attaching to these redeemable preference shares are summarised as follows:

a) the shares do not confer any right to dividend or other distributions; b) on a return of capital on liquidation or otherwise, the assets of the Company available for distribution among the members are to be applied first in repaying to the holders of the redeemable preference shares the amounts paid up or credited as paid up in respect of such shares; c) holders of redeemable preference shares have the right to receive notice of and attend general meetings, but have no right to vote thereat; d) the price per share at which redeemable preference shares are transferred may not exceed the amount paid or credited as being paid up, and e) the Company may specify

by notice in writing the date upon which it intends to redeem all (but not some only) of the shares. The price per share payable by the Company to the holders of the redeemable preference shares on their redemption shall be the amount paid up or credited as paid up on each such share.

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

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

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

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

Warrants

Pictet Private Equity Investors S.A. has a Warrant Instrument conferring on them the right to subscribe for up to 748,052 ordinary shares at a subscription price of 48.125p.

GATX European Venture Finance Limited has a Warrant Instrument conferring on them the right to subscribe for up to 83,116 ordinary shares at a subscription price of 48.125p.

All warrants expire on 20 November 2012.

Deferred share consideration

Under a share purchase agreement dated 5 February 2002 between Vectura Group plc and Cambridge Consultants Limited (CCL), whereby Vectura acquired the entire share capital of Vectura Delivery Devices Limited, CCL are due deferred consideration in the form of ordinary shares of 0.025p each. The outstanding balance of deferred consideration is to be issued by the satisfaction of certain patent and revenue milestones, or by 29 December 2006, if earlier. In accordance with a Deed of Variation dated 9 November 2004, CCL agreed to remove their right to appoint a Director to the Vectura Group plc Board and agreed to the cancellation of 150,000 deferred shares and Vectura agreed to include the date of 29 December 2006 as the date by which all the deferred shares will be issued. On 12 November 2004, 300,000 ordinary shares were issued to CCL to satisfy a revenue milestone. As at 31 March 2005, 1,350,000 ordinary shares (2004 - 1,800,000 ordinary shares) remained to be issued under these arrangements.

17 Called up share capital (continued)

Options

The Company's Directors, officers and employees (and a former Director) hold options under the Vectura Unapproved Share Option Plan (the "Unapproved Plan"), Enterprise Management Incentive arrangements (the "EMI Plan") and the Vectura Group plc Save as You Earn Share Option Scheme (the "Sharesave Scheme") to subscribe for ordinary shares in the Company, as shown below. The Directors' interests in these options are detailed in the Directors' Remuneration Report.

	Unapproved Plan	EMI Plan	Sharesave Scheme	Total Options
Shares under option at 1 April 2004	5,136,204	4,345,096	-	9,481,300
Options granted	5,793,275	516,428	579,661	6,889,364
Options exercised	(1,432,000)	-	-	(1,432,000)
Options lapsed	(1,325,632)	(81,616)	-	(1,407,248)
Shares under option at 31 March 2005	**8,171,847**	**4,779,908**	**579,661**	**13,531,416**
Option price per share	0.025p – 68p	0.025p – 48.125p	50.8p	
Weighted average option price per share	39.98p	29.06p	50.8p	

The opening options positions at 1 April 2004 have been adjusted to reflect the change in the nominal value of the ordinary shares, as noted above.

17 Called up share capital (continued)

The outstanding options at 31 March 2005 were granted as follows:

Grant Date	Exercise price per share (p)	Number	Date from which first exercisable	Expiry date
August 1999	0.025	688,000	02/07/04	04/08/09
January 2000	23.150	428,000	01/12/03	31/01/07
December 2000	23.150	1,024,000	22/12/03	21/12/10
March 2001	23.150	236,000	28/03/04	26/03/11
April 2001	0.025	488,000	13/04/04	11/04/11
April 2001	48.125	171,200	18/04/04	18/04/08
April 2001	48.125	166,232	11/04/04	11/04/11
June 2001	48.125	36,592	09/06/04	07/06/11
August 2001	48.125	96,000	08/08/04	08/08/11
October 2001	48.125	8,000	16/10/04	16/10/11
February 2002	0.025	800,000	23/02/05	21/02/12
March 2002	48.125	440,000	18/03/05	18/03/12
May 2002	48.125	332,116	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	180,000	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	465,516	11/04/06	28/04/13
November 2003	48.125	42,000	19/11/06	17/11/13
December 2003	48.125	212,432	03/12/06	30/11/13
April 2004	36.000	1,402,224	29/04/04	29/04/14
April 2004	36.000	1,976,484	29/04/07	29/04/14
April 2004	36.000	277,644	30/04/07	28/04/14
May 2004	48.125	200,000	05/05/07	03/05/14
July 2004	56.000	180,000	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	604,472	02/07/07	02/07/14
July 2004	57.500	2,000	06/07/07	06/07/14
August 2004	57.500	20,000	01/08/07	01/08/14
October 2004	50.500	21,000	01/10/07	01/10/14
November 2004	63.000	20,000	11/11/07	11/11/14
January 2005	63.500	62,000	04/01/08	04/01/15
February 2005 (1)	50.800	579,661	01/04/08	30/09/08
March 2005	68.000	340,559	31/03/08	31/03/15
Total options outstanding		**13,531,416**		

(1) Sharesave Scheme

18 Reconciliation of shareholders' funds and movement on reserves

Group	Share capital £000	Shares to be issued £000	Share premium £000	Special reserve £000	Merger reserve £000	Profit and loss account £000	Share-holders' funds £000
At 1 April 2003	16	1,059	20,780	-	2,828	(10,312)	14,371
Issue of ordinary shares	-	-	1	-	-	-	1
Deferred shares issued	-	(192)	-	-	192	-	-
Loss for the year	-	-	-	-	-	(8,131)	(8,131)
Charge for share options issued at less than fair value	-	-	-	-	-	143	143
At 1 April 2004	16	867	20,781	-	3,020	(18,300)	6,384
Cancellation of share premium account	-	-	(20,781)	20,781	-	-	-
Transfer of parent company profit and loss deficit to special reserve	-	-	-	(11,399)	-	11,399	-
Issue of redeemable preference shares	34	-	-	-	-	-	34
Conversion of Loan Note to ordinary shares	1	-	1,519	-	-	-	1,520
Issue of ordinary shares	10	-	22,121	-	-	-	22,131
Share issue costs	-	-	(1,117)	-	-	-	(1,117)
Shares issued (note 9)	-	(145)	-	-	191	-	46
Shares cancelled (note 9)	-	(72)	-	-	-	-	(72)
Uplift in market value for shares to be issued (note 9)	-	268	-	-	-	-	268
Loss for the year	-	-	-	-	-	(7,655)	(7,655)
Charge for share options issued at less than fair value	-	-	-	-	-	116	116
Transfer of parent company deficit on profit and loss account at 22 June 2004 to special reserve	-	-	-	(1,137)	-	1,137	-
At 31 March 2005	**61**	**918**	**22,523**	**8,245**	**3,211**	**(13,303)**	**21,655**

18 Reconciliation of shareholders' funds and movement on reserves (continued)

Company	Share capital £000	Shares to be issued £000	Share premium £000	Special reserve £000	Profit and loss account £000	Share-holders' funds £000
At 1 April 2003	16	1	20,780	-	(7,009)	13,788
Issue of ordinary shares	-	-	1	-	-	1
Loss for the year	-	-	-	-	(4,533)	(4,533)
Charge for share options issued at less than fair value	-	-	-	-	143	143
At 1 April 2004	16	1	20,781	-	(11,399)	9,399
Cancellation of share premium account	-	-	(20,781)	20,781	-	-
Transfer of parent company profit and loss deficit to special reserve	-	-	-	(11,399)	11,399	-
Issue of redeemable preference shares	34	-	-	-	-	34
Conversion of Loan Note to ordinary shares	1	-	1,519	-	-	1,520
Issue of ordinary shares	10	-	22,121	-	-	22,131
Share issue costs	-		(1,117)	-	-	(1,117)
Loss for the year	-	-	-	-	(3,841)	(3,841)
Charge for share options issued at less than fair value	-	-	-	-	116	116
Transfer of parent company deficit on profit and loss account at 22 June 2004 to special reserve	-	-	-	(1,137)	1,137	-
At 31 March 2005	**61**	**1**	**22,523**	**8,245**	**(2,588)**	**28,242**

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

19 Notes to the group cash flow statement

a) Reconciliation of group operating loss to net cash flow from operating activities:	2005 £000	2004 £000
Group operating loss	**(9,436)**	(8,923)
Depreciation of tangible fixed assets	**909**	952
Amortisation of intangible fixed assets	**1,419**	1,545
Share-based compensation	**116**	143
Increase in debtors	**(167)**	(33)
Increase in creditors	**996**	592
Net cash outflow from operating activities	**(6,163)**	(5,724)

b) Analysis of net funds:	At 1 April 2004 £000	Cash flow £000	At 31 March 2005 £000
Cash at bank and in hand	2,107	16,281	**18,388**
Finance leases and hire purchase contracts	(239)	141	**(98)**
Loans	(1,276)	1,272	**(4)**
	592	17,694	**18,286**

c) Major non-cash transactions:

During the year the Group signed further finance leases with an initial value of £nil (2004 - £155,000).

20 Financial commitments

	Group		Company	
	2005 £000	2004 £000	2005 £000	2004 £000
Capital commitments:				
Contracted but not provided for	**960**	-	**960**	-

Pension commitments:

The Company operates a defined contribution pension scheme for all Executive Directors and employees. The assets of the scheme are held separately from those of the Company in an independently administered fund. The unpaid contributions at the year-end, included in 'Other creditors' (note 13), were £1,000 (2004 - £nil).

20 Financial commitments (continued)

	Land and buildings		Other	
Group and Company	**2005 £000**	2004 £000	**2005 £000**	2004 £000
Annual commitments under non-cancellable operating leases:				
Expiry date:				
– Within one year	**-**	-	**57**	-
– In two to five years	**-**	-	**83**	86
– In over five years	**251**	251	**-**	-
	251	251	**140**	86

On 26 July 2002 the Group and the Company entered into a 25-year lease agreement in respect of the lease of premises at 1 Prospect West, Chippenham, Wiltshire, SN14 6FH. The annual commitment in respect of this lease is £251,000, which is included in the table above. The lease has a break clause in July 2017.

21 Related party transactions

The following transactions with related parties took place during the year at arm's length:	**Amount £000**	**Due at 31 March 2005 £000**	Amount £000	Due at 31 March 2004 £000
Merlin Biosciences Limited:				
Directors' fees for M R Clement	**3**	**-**	15	4
Monitoring fee	**1**	**-**	7	2
Room hire	**2**	**1**	-	-
Cambridge Consultants Limited:				
Rent and facilities	**82**	**7**	74	-
Laboratory support and other supplies	**3**	**-**	2	-
ISIS Equity Partners Limited:				
Directors' fees for A Holloway	**4**	**-**	15	1
Monitoring fee	**1**	**-**	7	1
University of Bath:				
Laboratory purchases and other services	**219**	**3**	221	-

The Directors' fees disclosed above, paid in respect of the services of M R Clement and A Holloway, are included in the Directors' remuneration as detailed in note 4. Full details of fees paid to Directors are included in the Remuneration Report.

Merlin Equity Limited, Merlin General Partner Limited as general partner of The Merlin Fund L.P. and Merlin General Partner II Limited as general partner of the Merlin Biosciences Fund L.P. and as managing partner of the Merlin Biosciences Fund GbR are significant shareholders in Vectura Group plc. Merlin Biosciences Limited are advisors to these shareholders. In addition to the above, Merlin Biosciences Limited received £60,000 during the year ended 31 March 2005 (2004 - £nil) for providing strategic advice to Vectura Group plc.

ISIS Equity Partners Limited is part of F&C Asset Management plc. The following shareholders in Vectura Group plc are funds which are managed by companies within F&C Asset Management plc: The Aim VCT plc, The Aim VCT 2 plc, Baronsmead VCT plc, Baronsmead VCT 2 plc, Baronsmead VCT 3 plc, Baronsmead VCT 4 plc, Active Capital Trust plc, FIS Nominee Limited as nominees for ISIS II 2001 L.P. and as nominees for ISIS II 2001 GmbH & Co KG, Discovery Trust, ISIS Smaller Companies Trust and UK Smaller Companies Unit Trust.

Cambridge Consultants Limited and the University of Bath are both shareholders in the Company.

On 28 November 2000, the Company signed a collaboration agreement with Arakis Limited to develop a novel inhaled treatment for chronic obstructive pulmonary disease. The Merlin Biosciences Fund L.P., a venture fund advised by Merlin Biosciences Limited, is a shareholder of Arakis. Furthermore, Dr A J M Richards is a shareholder and director of Arakis. During the year, the Company charged expenses to Arakis totalling £74,000 (net of amounts charged by Arakis) (2004 - £201,000 net charged by Arakis) of which £46,000 (2004 - £120,000 due to Arakis) was outstanding at 31 March 2005.

In addition to the above, £10,000 was paid to Croggan Limited for consultancy services. Dr A J M Richards is a director of Croggan Limited.

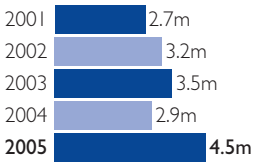
22 Post balance sheet event

On 12 April 2005, Vectura Group plc signed a licensing agreement with Novartis Pharma AG for NVA237. The upfront access fee of £7.9m was received in April 2005 and is non-refundable. This revenue is being recognised over 24 months in line with the period of the Contract Development Agreement, whereby Vectura will provide development expertise which will include the manufacturing of the Phase IIb clinical trial material for Novartis.

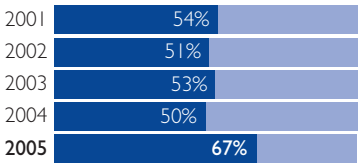
Five-year Summary

Trading results

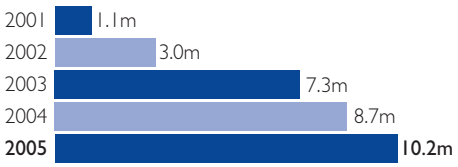
Turnover



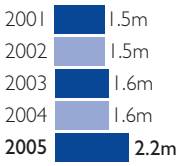
% gross profit to sales



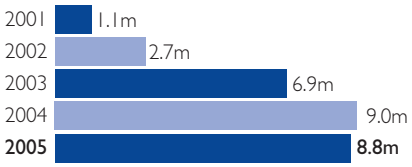
Research and development



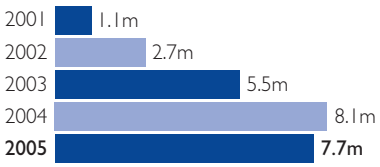
Administrative expenses



Loss before tax

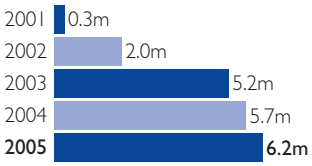


Loss after tax

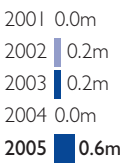


Cash flows

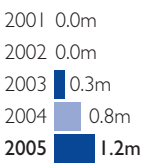
Net cash outflow from operations



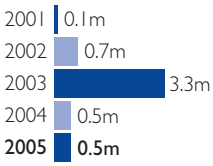
Interest



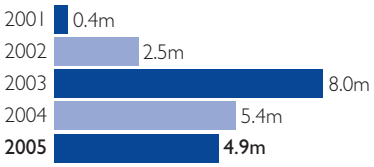
Taxation credits



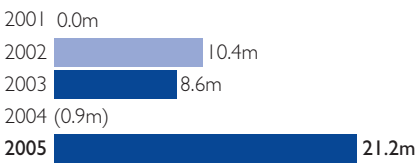
Capital expenditure/acquisitions



Net cash outflow before financing

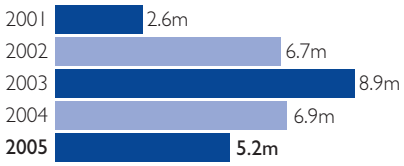


Financing

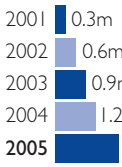


Balance sheet

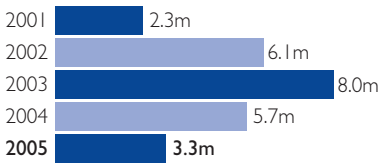
Fixed assets



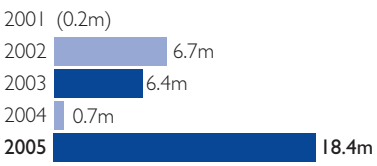
Net current operating liabilities



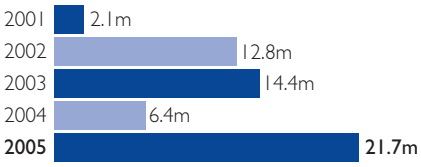
Net operating assets



Net cash (borrowings)



Shareholders' funds



All amounts are shown in £millions.

Shareholder Information

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

Secretary
A P Hyland

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A glossary of terms used in this report is available on our website **www.vectura.com**

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