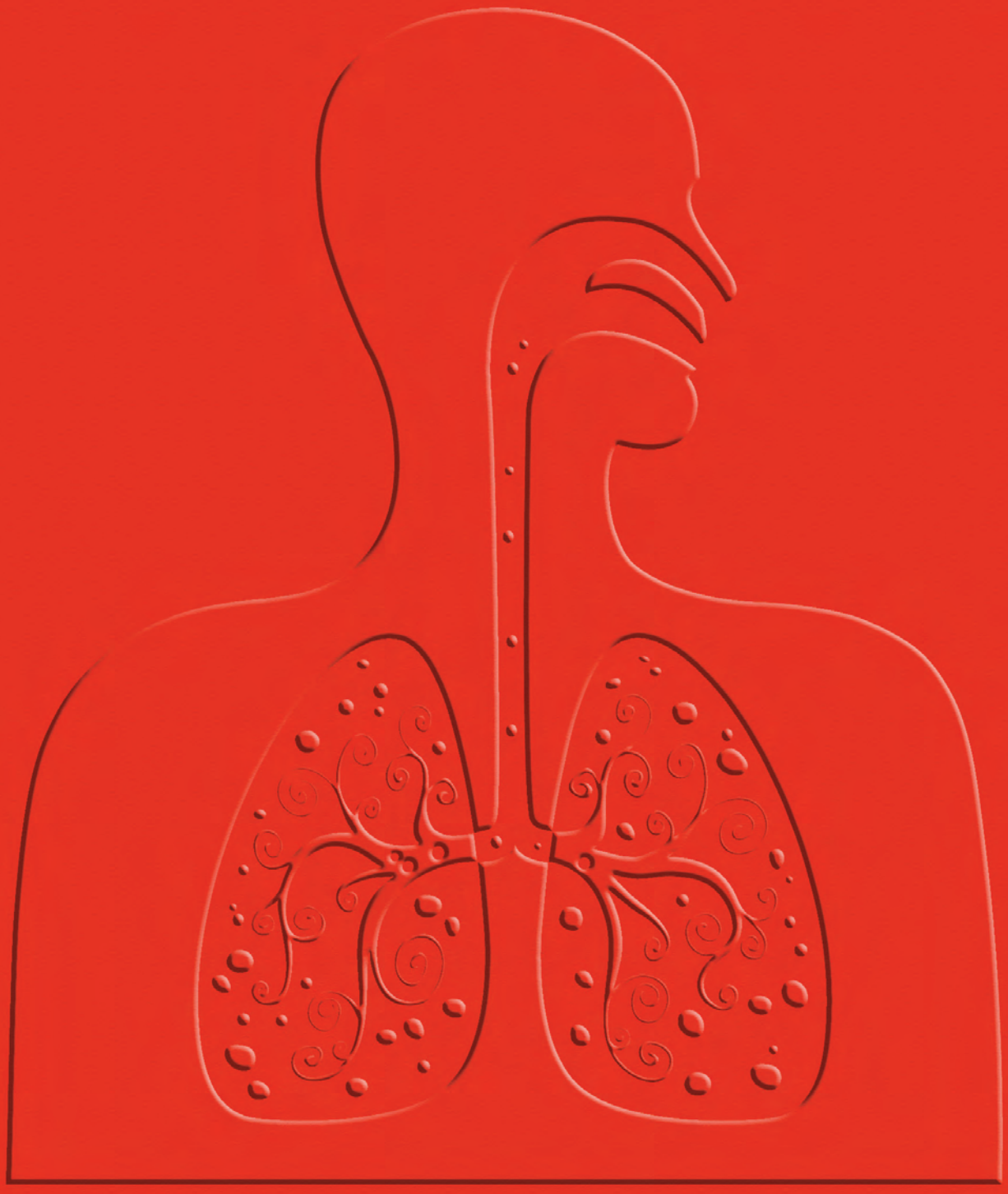
Vectura Group plc Annual Report and Accounts **2008/09**

vectura

A leader in inhaled pharmaceuticals



Contents

Vectura is a leader in the development of inhaled pharmaceuticals, creating products to treat respiratory and lung-related diseases using innovative technologies and expertise.

CAUTIONARY STATEMENT

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

Operational and product highlights

Strong rise in revenues with robust cash position

Good progress with portfolio and material clinical progress ahead

Achievement of €7.5m (£6.2m) milestone in October 2008 from ongoing collaboration with Boehringer Ingelheim to develop a new dry powder inhaler

Good progress being made with both generic asthma/chronic obstructive pulmonary disease products VR315 and VR632 partnered with Sandoz, the generics division of Novartis

Further development of NVA237 and QVA149 continues

- NVA237 to enter Phase III development in Q2 2009 with QVA149 expected to enter Phase III in Q4 2009
- Encouraging safety and efficacy data from Phase II NVA237 studies presented at the European Respiratory Society (ERS) meeting in Berlin in October 2008
- Safety and efficacy data from Phase II QVA149 studies expected to be presented by Novartis during 2009
- Filing of NDA submissions for both NVA237 and QVA149 anticipated in 2011

Start of Phase II studies in cystic fibrosis (CF) patients using VR496, which also has the potential for use in diseases such as asthma and COPD

Start of a Phase IIb "at-home" study with VR040 for Parkinson's disease

Vectura included in the FTSE 250 index from 23 March 2009

Financial highlights

+24%

Revenues increased by **24%** **to £31.2m** (2007/08: £25.2m)

+31%

Gross profit up by **31%** **to £27.3m** (2007/08: £20.8m)

+9%

Investment in research and development up by **9%** **to £32.3m** (2007/08: £29.7m)

£74m

Cash and cash equivalents of **£74m** at 31 March 2009 (31 March 2008: £78.8m)

Loss after tax reduced by **13%** to **£16.7m** (2007/08: £19.2m)

Loss per share reduced by **15%** to **5.2p** (2007/08: 6.1p)

Highlights after year end

Receipt of €2.5m (£2.2m) European milestone payment from Sandoz in relation to its generic combination asthma/COPD product VR315

Completion of a new 13,000 sq ft state of the art manufacturing facility, at Vectura's Chippenham headquarters

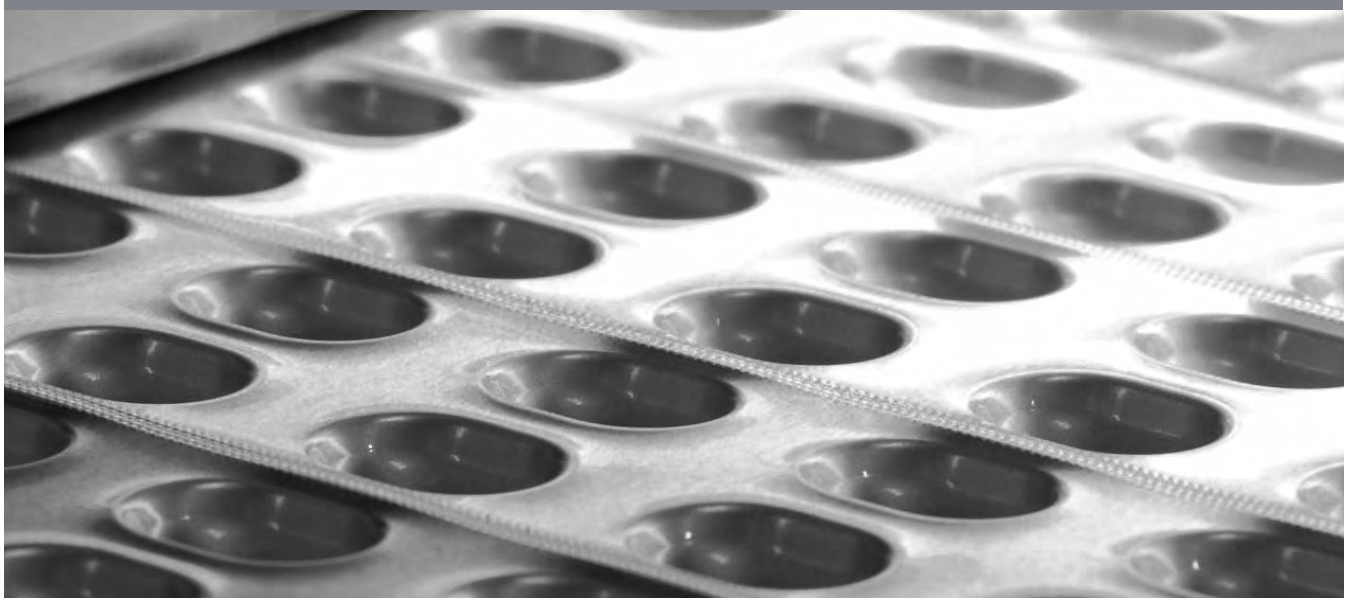
A positive approach brings positive results

“

It has been another strong year for Vectura from both a financial and product perspective. In the five years since Vectura listed on the Stock Exchange, we have seen a seven-fold increase in our revenues to £31.2m, which has contributed towards our healthy cash balance of £74m at 31 March 2009.

Over the course of the next twelve months we expect to see significant pipeline progress as our key programmes advance into registration trials. With our strong cash position, credible partners developing several products, and a diversified product development strategy, we remain confident of Vectura’s ability to generate long-term shareholder value. ”

Dr Chris Blackwell Chief Executive of Vectura



Revenues increased by 24% to £31.2m (2007/08:£25.2m)

Gross profit increased by 31% to £27.3m (2007/08: £20.8m)

Overview

In the current economic conditions, it is vital to maintain a strong financial position, as Vectura has, ending the financial year with £74m of cash and cash equivalents. Revenues increased by 24% to £31.2m (2007/08: £25.2m), gross profit increased 31% to £27.3m (2007/08: £20.8m) and, with a research and development investment of £32.3m (2007/08: £29.7m) we recorded a net cash outflow of £4.8m.

Vectura's strength lies in its specialism; the knowledge, experience and technical capabilities to develop inhaled pharmaceutical products. We have refined our focus to concentrate our efforts on developing our own range of inhaled products to treat lung diseases. Our late-stage pipeline is focused on the respiratory market, particularly the asthma and COPD segments, with an increasing emphasis on combination products. These markets are large, and growing, allowing several major products to generate very significant revenues.

Our late-stage projects have continued to progress over the course of the year with NVA237 due to enter a Phase III trial in COPD patients in the second quarter of 2009. We believe that NVA237 will be the second once-daily long-acting muscarinic antagonist (LAMA) on the market, and that QVA149 will be the first once-daily LAMA/LABA (long-acting beta-agonist) combination available to patients. Simplicity and ease-of-use improves compliance, which enhances the benefits patients get from their medicines.

Novartis plans to present data from QVA149 during 2009 and expects to start the Phase III trial in the fourth quarter of 2009. NDA submissions for both NVA237 and QVA149 are expected to be filed by Novartis in 2011.

Jack Cashman
Chairman

Chris Blackwell
Chief Executive

Our facilities

Vectura's headquarters and development operations are in Chippenham, Wiltshire, with further laboratories in Nottingham and a device development facility in Cambridge. At a time when other companies are closing down facilities, we were honoured in April to have the Economic and Business Minister responsible for bioscience and pharmaceuticals, Ian Pearson MP, and Dr Clive Dix, Chairman of the BioIndustry Association, officially open our new 13,000 sq ft, state-of-the-art facility in Chippenham. It is one of only a handful of facilities globally that has been specifically designed to manufacture inhaled products, enabling us to accelerate development projects. The facility will provide Vectura with additional space and the ability to produce later-stage clinical trial supplies, which will result in a more efficient business.

Our people

Our employees remain crucial to the success of Vectura and it is their skill and expertise that have enabled us to achieve our progress to date. We are committed to the development of a motivated and professional workforce in order to build a business that is constantly looking to innovate and evolve. On behalf of the Board, we thank all our staff for their hard work and continued support and commitment.

Our generic combination asthma/COPD products VR315 and VR632 are also progressing well. In April 2009, we received a €2.5m (£2.2m) European milestone payment from Sandoz, the generics division of Novartis, in relation to VR315. Increasing pressure on the regulatory authorities, particularly in the US, to approve cheaper generic drugs means that both programmes have significant revenue potential for Vectura. This is particularly true of VR315, for which Vectura has a profit-share agreement in the US market. Sandoz has made a significant investment in these programmes and has invested over $50m in manufacturing facilities for VR315 and VR632.

The €7.5m (£6.2m) milestone receipt from Boehringer Ingelheim in November 2008 endorses the strength of our technological capabilities, as Boehringer Ingelheim moves closer to development of its own proprietary products in the Vectura dry powder inhaler (DPI) device we have developed with them. Boehringer Ingelheim is one of the world's leading companies developing therapies to treat asthma and COPD, for which the majority of treatments are delivered by inhalation, with Spiriva® being the most prescribed COPD medicine worldwide. Milestones and equity payments received from Boehringer Ingelheim since April 2006 now total €37.5m (£31.2m) and additional milestones will be payable to Vectura for each product developed in the inhaler, as well as royalties on global sales.

In addition to the asthma/COPD market, there are a significant number of other areas where we expect local delivery of drug to the lung to be of benefit. Vectura has an active development group looking at new opportunities. We initiated a Phase II proof-of-concept study with VR496 in CF during the year and expect to be able to report the results of this trial in early 2010. We aim to advance this programme through clinical development towards commercialisation, allowing us the opportunity to retain a greater proportion of the value; something we increasingly seek to achieve in all of our licensing agreements and collaborations. It is our belief that the mucolytic and anti-inflammatory properties we expect to see with VR496 will also provide benefit to patients with airway diseases such as asthma and COPD. If the current study demonstrates these properties, we will look to partner VR496 for these significant markets while developing the CF indication ourselves.

Licensing activities for Vectura's non-respiratory assets continue. While still planning to out-license our Parkinson's disease programme, VR040, we have initiated a Phase IIb "at-home" study, which we expect to report early in 2010.

Jack Cashman
Chairman

Chris Blackwell
Chief Executive

18 May 2009

Outlook

Vectura has a broad and innovative development portfolio which combines mid and late-stage pharmaceutical products with earlier-stage opportunities addressing fast-growing market sectors.

Vectura benefits from a steady stream of revenues from products marketed by Baxter and a flexible development model. We are focused on our financial goal of becoming a sustainably cash-generative business following the receipt of the substantial milestone and royalty revenues from our partnered late-stage respiratory programmes. In the short-term we will continue with careful cash management and increase investment in our own proprietary development activities using both current revenue streams and our cash resources.

It is an important time in Vectura's development, with Novartis advancing both NVA237 and QVA149 into Phase III development in the coming months, and further good progress expected with our generic asthma/COPD programmes partnered with Sandoz.

In March 2009 we joined the FTSE 250 index of the London Stock Exchange, which we believe has helped to raise our profile within the investment community as well as increase our share trading volumes. We have a healthy pipeline of products in development and a number of innovative opportunities for future development and plan to continue to drive these forward diligently in order to grow shareholder value as we move towards becoming a specialty pharmaceutical company.

1 2 3

1 Ian Pearson MP opening Vectura's new state-of-the-art facility

2 Vectura's new facility enables us to accelerate development projects

3 Vectura's skilled staff have enabled us to achieve our progress to date

Financial review

Summary of results

The financial results for the year ended 31 March 2009 show total revenue of £31.2m (2007/08: £25.2m), a 24% increase on the previous year. The operating loss for the year was £20.9m (2007/08: £25.1m) after deduction of £12.1m (2007/08: £12.9m) of non cash amortisation and share option costs. The loss before tax was £19.6m (2007/08: £21.4m) and the loss after tax £16.7m (2007/08: £19.2m).

Revenue

In the 12 months to 31 March 2009, total revenue increased compared to the prior year by 24% to £31.2m. Revenue includes fee income from royalties, product licensing, technology licensing, development fees and device sales.

Royalties increased by 37% to £12.5m (2007/08: £9.1m) – 21% of this increase was due to increased product sales and the balance of 16% was due to favourable exchange movements. ADVATE® contributed 65% (£8.1m; 2007/08: £5.8m) of the royalties generated in the year. ADVATE® sales are continuing to grow and with current sales levels of approximately $1.5bn, Vectura is receiving a net royalty of just under 1% at these high levels of cumulative annual sales. Extraneal® contributed 27% or £3.4m (2007/08: £2.5m) of royalties in the year and benefited from £0.4m of one-off revenues in the period. The majority of the remaining royalties were generated from Adept® with contributions from products delivered in Clickhaler®.

Product licensing revenues in the period were £4.2m (2007/08: £2.8m), all of which was released from deferred income, with £1m generated from VR315, £2.3m from Duohaler® and £0.9m from Clickhaler®. A further £0.9m is expected to be released from deferred income in relation to VR315 in 2009/10. 2009/10 revenues will also benefit from the €2.5m (£2.2m) milestone receipt on VR315 EU. We also believe that two additional milestone payments of $7.5m each could be generated on the initiation of the NVA237 and QVA149 Phase III studies.

Technology licensing revenues of £6.1m (2007/08: £2.9m) comprises £1.1m generated from a 2003 licence on Innovata technology, and £5m released from deferred income in relation to the Boehringer Ingelheim milestones of €10m (£7.2m) received in December 2007 and €7.5m (£6.2m) received in November 2008. A further £5.5m is expected to be released from deferred income in relation to these milestones in 2009/10, with the final £1.8m expected to be released in the year ending 31 March 2011.

Pharmaceutical Development Services (PDS) revenues were £6.6m, a 26% reduction from the £8.9m received in 2007/08. These revenues principally represent contractual development fees charged to licensing partners for work carried out during the period on Vectura's generic programmes. As previously reported, we expect these revenues to continue to decline as we complete our work on these generic programmes. The level of PDS revenues in the future will depend on new licensing deals. The development of inhalation products is a very specialist area. When a partner licenses one of our products, they frequently require Vectura's involvement in the continuing development of that product and Vectura continues to charge for these services as part of the licensing agreement.

Device sales revenue of £1.8m (2007/08: £1.5m) was derived from the sale of devices to licensees.

Gross profit

The gross profit in the period to 31 March 2009 was £27.3m, a £6.5m improvement on the prior year (£20.8m). Gross margin in the year to 31 March 2009 represents 88% of revenue (2007/08: 83%) with the improvement arising from the increased proportion of royalties and milestones earned during the year.

Research and development

Total investment in research and development was £32.3m, a 9% increase on the prior year (£29.7m). Research and development costs include primarily clinical trial costs, salary costs for scientists and scientific support staff, intellectual property costs, laboratory running costs and depreciation. We expect our investment in this area to increase significantly as some of our key products and devices move to late-stage development, with 2009/10 investment likely to be approximately 25% in excess of the current year.

Other administrative expenses

Other administrative expenses for the period were £3.2m, in line with the previous year.

Investment income

Investment income of £3.6m (2007/08: £4.5m) for the period is expected to reduce significantly in 2009/10 due to the fall in interest rates. The Board operates an investment policy, under which the primary objective is to invest in a diverse portfolio of low risk cash or cash equivalent investments to safeguard the principal. These investments do not offer above-market rates of interest.

Loss after taxation and loss per share

The loss for the period after taxation was £16.7m (2007/08: £19.2m) giving a loss per ordinary share of 5.2p (2007/08: 6.1p).

Non-current assets

Non-current assets were £106.1m, compared with £117m on 31 March 2008, including goodwill (£49.6m), intangible assets (£52.2m), and property, plant and equipment (£3.5m).

Financial liability

Financial liabilities total £6.6m ($9.4m), which represents a liability to Royalty Securitization Trust in respect of a loan secured against US dollar denominated royalty streams. $9m was paid to Royalty Securitization Trust during the year ended 31 March 2009. The exchange loss recorded in the year on this liability is due to the depreciation of sterling against the US dollar. Vectura's exchange loss on this US dollar liability is naturally offset by royalty streams being received in US dollars. This loss is offset by the gains made on these income streams, the majority of which flow directly into the revenue line.

Deferred income

Deferred income relates to milestones received in cash but not yet recognised as revenue. The £10.4m to be recognised as part of revenue in later periods includes £0.9m for VR315, £7.3m relating to Boehringer Ingelheim and £2.2m relating to other licensing deals.

Cash flow

The net cash outflow from operating activities in the year was £0.7m compared to a net cash outflow of £1.5m in 2007/08. After investing and financing activities, the net cash outflow was £4.8m compared to a net inflow of £1.3m in 2007/08. At 31 March 2009, Vectura had cash and cash equivalents of £74m (31 March 2008: £78.8m).

Capital expenditure

Capital expenditure in the period was £1.6m (2007/08: £0.7m) and includes the expansion of our manufacturing facilities at Chippenham. These new facilities were completed on time and below the £2m originally budgeted as no contingencies were required.

Foreign exchange rates

The following foreign exchange rate was used on 31 March 2009:

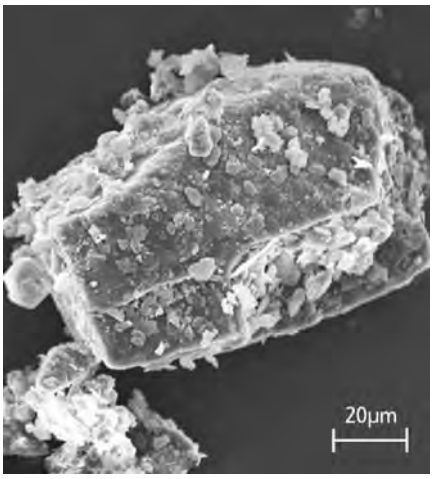
£/$1.43 (31 March 2008: £/$1.99)

The following foreign exchange rate was the average for the year ended 31 March 2009:

£/$1.72 (31 March 2008: £/$2.01)

Anne Hyland
Chief Financial Officer

18 May 2009



1 2

1 Surface coating of lactose and API particles with magnesium stearate

2 Vectura's GyroHaler® device in use

Vectura Group plc and its subsidiaries ("Vectura" or the "Group") is a product-focused Group that develops inhaled therapies principally for the treatment of respiratory diseases. Vectura's main products target diseases such as asthma and chronic obstructive pulmonary disease (COPD); a growing market that is currently estimated to be worth $20bn. Vectura also develops products for other lung pathologies and non-respiratory diseases.

Vectura has eight products marketed by its partners and a portfolio of drugs in clinical and pre-clinical development, some of which have been licensed to major pharmaceutical companies. Vectura seeks to develop certain programmes itself where this will optimise value. Vectura's formulation and inhalation technologies are available to other pharmaceutical companies on an out-licensing basis where this complements Vectura's business strategy.

Vectura has development collaborations with several pharmaceutical companies, including Boehringer Ingelheim, Novartis, Sandoz (the generics arm of Novartis), Baxter, GlaxoSmithKline (GSK), Mylan, UCB and Otsuka. Vectura has been included in the FTSE 250 index since 23 March 2009.

We set ourselves challenging goals

Vectura's core purpose

To establish a world-class speciality pharmaceuticals company that improves the quality of patients' lives and is driven by the enthusiasm and commitment of our staff.

We will create value for ourselves and our shareholders centred on the innovative development of products targeting the lungs.

Vectura's strategy is to target the treatment of diseases associated with the lungs

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

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

Vectura seeks value from its other pipeline products through out-licensing
Vectura has developed therapies for indications such as Parkinson's disease and migraine, which it is actively seeking to out-license.

Vectura's goal is to be a cash-generative business that creates value for its shareholders through:

- its intellectual property and expertise in inhaled product development, which allows Vectura to:
  - out-license products to major pharmaceutical companies in return for revenues from milestones and royalties
  - develop or co-develop specialty products to regulatory approval or beyond, to capture maximum value from licensing at a later stage of development or from sales revenues
- entering into technology collaborations with pharmaceutical company partners to exploit both the generic and branded markets for the joint development of high-value inhaled product opportunities, and
- continuing to build its franchise through internal innovation as well as exploring opportunities for the acquisition of products, technologies or businesses that support these goals.

Vectura's main values

Achievement
Our success depends on satisfying the needs of our customers. We set ourselves challenging goals and we are proud of delivering on our commitments.

Enthusiasm
We welcome enthusiastic people who give their best and encourage others to do the same. We take our work seriously and value what we do, but we also want to enjoy what we are doing.

Participation
We can be successful only by working together. We want everyone to share in that success, so we support and encourage our colleagues. We are also keen to protect the flexibility and informality of the Group as we grow.

Innovation
We want people to think freely and creatively about what we are trying to achieve.

Trust and respect
We want to work in an atmosphere of mutual trust and respect where people and ideas are valued on their merits, and where we recognise the contribution and achievements of everyone in the business.

Inhalation market – why deliver drugs to the lungs?

Delivering drugs directly to their site of action in the lungs often results in fewer systemic side-effects and generally requires lower doses.

Respiratory market

The majority of treatments for asthma and COPD are delivered by inhalation, with many sufferers taking more than one type of therapy. Most drugs that are used to treat respiratory disease are designed to work in the lung, with relatively little active drug passing into the bloodstream.

The asthma and COPD markets comprise the third-fastest growing therapeutic targets (with 21 million people suffering from asthma in the USA alone) and are forecast to continue to grow rapidly, achieving sales in 2011 of $21bn and $11bn respectively. This growth is being driven by two main trends: the use of fixed-dose combinations, and more targeted and effective therapies.

Inhaled fixed-dose combination therapy requires the combination (usually) of two drugs at fixed doses with the aim of providing optimal clinical benefits for the patient. An example is Seretide®/Advair® (salmeterol/fluticasone), marketed by GlaxoSmithKline (GSK), which is now the fourth-biggest selling pharmaceutical product worldwide with sales of $7.7bn in 2008. Fixed-dose combination therapy is likely to remain fundamental to the treatment of both asthma and COPD, and sales of such products is seen as a major driver for growth in the respiratory market.

The COPD market is less well developed than that for asthma. It is estimated that up to 50% of Americans and 75% of Europeans with COPD are undiagnosed. Treatments for COPD, such as Spiriva® (tiotropium), have made an important therapeutic contribution and are driving growth forecasts. Spiriva® sales for 2008 were in excess of $3bn.

Product pipeline

Respiratory development products

Product	Indication	Description	Partner
NVA237	COPD	Long-acting muscarinic antagonist	Novartis
QVA149	COPD	Combination of NVA237 and a long-acting beta agonist (QAB149)	Novartis
VR315	Asthma/COPD	Generic combination product	Sandoz US & Europe
VR632	Asthma/COPD	Generic combination product	Sandoz Europe
Duohaler®	Asthma/COPD	Generic dual-drug product	–
BI collaboration	Various	DPI for respiratory products	Boehringer Ingelheim
VR496	CF/COPD	Mucolytic/anti-inflammatory	–

Marketed products

Product	Indication	Description	Partner
ADVATE®	Haemophilia A	Serum-free recombinant factor VIII	Baxter Worldwide
Adept®	Prevention of surgical adhesions	4% icodextrin solution	Baxter Worldwide
Extraneal®	Peritoneal dialysis	Solution containing icodextrin	Baxter Worldwide
Asmasal®	Asthma	Salbutamol delivered in Clickhaler®	UCB Europe
Asmabec®	Asthma	Beclometasone delivered in Clickhaler®	UCB Europe
Budesonide Clickhaler®	Asthma	Budesonide delivered in Clickhaler®	Merck Generics Europe
Formoterol Clickhaler®	Asthma	Formoterol delivered in Clickhaler®	Merck Generics Europe
Meptin Clickhaler®	Asthma	Procaterol delivered in Clickhaler®	Otsuka Japan

1

2

1 Vectura has the complete range of device and formulation expertise to take an active pharmaceutical ingredient and deliver a finished inhaled pharmaceutical product

2 GyroHaler® is suitable for the delivery of a wide range of pharmaceuticals

Respiratory development products

NVA237 and QVA149 for chronic obstructive pulmonary disease (COPD)
NVA237 is a dry powder formulation for oral inhalation of glycopyrronium bromide, a long-acting muscarinic antagonist (LAMA) with a rapid onset of activity.

NVA237 was licensed to Novartis in April 2005 by Vectura and its co-development partner, Sosei Group Corporation (Sosei). Novartis intends to launch NVA237 as a once-daily monotherapy for COPD and as a combination with Novartis's once-daily, long-acting beta-agonist (LABA), indacaterol, which was filed for approval with the regulatory authorities as a monotherapy treatment for COPD at the end of 2008. The combination of NVA237 and indacaterol is known as QVA149.

COPD is a chronic obstruction of the airways that affects 210 million people worldwide and is projected to be the third leading cause of death by 2030. It is a progressive lung disease with symptoms including chronic bronchitis and/or emphysema, which slowly progresses and eventually leads to a largely irreversible loss of lung function. While there is no cure, bronchodilators such as LAMAs make breathing easier by enlarging the patient's airways, and are recognised in international guidelines as an integral part of the treatment for COPD.

To date, Vectura has received $15m and, under the terms of the agreement with Novartis, could receive up to $172.5m for achieving clinical, regulatory and commercialisation targets for both the monotherapy and combination product. In addition, royalties on product sales will be received for both products. If additional combination products are developed by Novartis using NVA237, then further milestones and royalties will be receivable.

QVA149 is one of the most advanced once-daily LAMA/LABA combinations in development and Vectura believes that it could be the first such combination to come to market for COPD. The dual activity of a muscarinic antagonist and a beta-adrenergic agonist promises to be a potent bronchodilator and, with convenient once-daily dosing, has the potential to improve compliance and address a large and unmet need for COPD sufferers.

Novartis has made substantial progress in the development of NVA237 and QVA149, with both due to start Phase III clinical trials in 2009. We also expect Novartis to present the Phase II QVA149 data during 2009.

Data from the Phase II NVA237 trial were presented at the annual congress of the European Respiratory Society (ERS) in Berlin in October 2008. The data demonstrate that NVA237 provides sustained 24-hour bronchodilation in patients with moderate-to-severe COPD and showed similar efficacy and duration of action to Spiriva® with the potential for a more rapid onset of action. In addition, studies lasting up to 28 days showed that NVA237 was safe and well-tolerated, with no clinically relevant adverse events.

Another important outcome from the ERS meeting in October 2008 was the publication of the tiotropium (Spiriva®) safety database from approximately 20,000 patients. This meta-analysis, which included the prospectively designed UPLIFT study (Understanding Potential Long-term Impacts on Function with Tiotropium), demonstrated the cardiovascular safety of tiotropium and, in our view, allays any concerns over cardiovascular safety for this class of drug.

NDA submissions are expected to be filed for both NVA237 and QVA149 in 2011.

VR315 for asthma/COPD
Combination therapy for asthma is the biggest and fastest-growing sector of the asthma market, with annual sales of approximately $10bn.

VR315 is an inhaled combination therapy for asthma and COPD that is being jointly developed with Sandoz, the generics division of Novartis, using Vectura's GyroHaler® Dry Powder Inhaler ("DPI") device. Vectura licensed the European rights for VR315 to Sandoz in March 2006, in a deal worth up to €22.5m in milestones and development funding, together with royalties on all products sold. Rights in the US were licensed to Sandoz in December 2006 in a profit-sharing agreement, which includes the

Respiratory disease affects an increasing number of people of all ages. Asthma and COPD (chronic obstructive pulmonary disease) markets are forecast to grow rapidly, achieving sales in 2011 of

$21bn and **$11bn** respectively

payment of up to $63m in milestones to Vectura. Sandoz has since invested over $50m in manufacturing facilities for VR315 and VR632.

With more key respiratory drugs coming off patent over the coming years and with increasing pressure on the regulatory authorities to approve lower cost drugs, both programmes have significant financial upside for Vectura. Vectura received a €2.5m (£2.2m) milestone payment from Sandoz in April 2009 and expects to receive a further €7.5m in milestones from its EU collaboration, and up to $30m from its US collaboration prior to the launch of VR315 in these regions. Revenues will also be earned on all product sales in the EU and from a profit share in the US. Vectura will also earn a margin on the commercial manufacture and supply of GyroHaler® and retains rights for un-licensed territories.

VR632 for asthma/COPD

VR632 is a second inhaled combination therapy for asthma and COPD that is being jointly developed with Sandoz, and is delivered using GyroHaler®. Vectura licensed the European rights for VR632 to Sandoz in December 2007 in a deal worth up to €15.5m in milestones and development funding, together with royalties on all products sold. Vectura will also earn a margin on the commercial manufacture and supply of GyroHaler® devices. Vectura retains rights for the US and other un-licensed territories.

Boehringer Ingelheim collaboration on a DPI

Most treatments for asthma and COPD are delivered by inhalation. DPIs are increasingly the preferred choice for patients with these conditions and it is expected that DPIs will be used to deliver the majority of the drugs sold in these markets by 2011. Vectura believes that its device and formulation technologies are well placed to capture a significant market share.

In April 2006, Vectura agreed a non-exclusive, worldwide collaboration, development and licence agreement with Boehringer Ingelheim to develop a fully integrated, multi-dose DPI. The device will be available to Boehringer Ingelheim for the development and marketing of its proprietary respiratory medicines for the treatment of respiratory diseases such as asthma and COPD.

Boehringer Ingelheim is one of the world's leading companies developing therapies to treat asthma and COPD. Its COPD therapy Spiriva® is the most prescribed COPD medicine worldwide, with sales in excess of $3bn in 2008.

Vectura has received a total of €37.5m (£31.2m) in equity investment and milestone payments from Boehringer Ingelheim to date, the latest receipt being €7.5m (£6.2m) in November 2008. Boehringer Ingelheim will be responsible for further development, manufacturing and clinical trial use of the DPI with its proprietary compounds, as well as the commercialisation of these products. Vectura will receive development milestones and royalties on sales of each product marketed in the device. Our collaboration with Boehringer Ingelheim has added significantly to our intellectual property portfolio and provided Vectura with an excellent DPI platform to deliver further value from its inhaled therapy technologies through other collaborations.

1 2

1 Duohaler® fixed combination therapy multi-dose reservoir DPI

2 Vectura's new 'Cleanroom', opened in April 2009

VR496 for cystic fibrosis (CF) (with potential for asthma and/or COPD)
VR496 is being developed as an inhaled, locally acting treatment for CF, and has the potential to be developed as a therapy for patients with other airway diseases such as asthma and COPD. The active component of VR496 is heparin, a drug that has been approved worldwide as an injected or infused treatment for other indications.

Vectura has initiated a Phase II clinical study with VR496 in CF patients. If the data prove to be positive in CF, Vectura intends to progress the product for this indication. A significant literature database describes the multi-modal and complementary pharmacological properties of inhaled heparin that are relevant to the treatment of CF, asthma and COPD, with mucolytic, anti-inflammatory, bronchodilatory and anti-infective activity being particularly relevant. Vectura will look to find a partner for the larger indications.

The European Medicines Evaluation Agency (EMEA) and US Food and Drug Administration (FDA) have granted VR496 orphan drug status.

Duohaler® for asthma/COPD
An undisclosed pharmaceutical company that had an exclusive agreement for the development, marketing and distribution in Europe of two Duohaler® products, has reviewed its portfolio of products following a recent acquisition. As a result of this review, the company is working to find a new partner for these projects and will continue to assist in the funding of the lead programme so that the development can proceed on schedule. The second Duohaler® project is currently on hold and will be reinitiated if interest is received from new partners.

£2.3m of milestone income generated from both of these projects, which was potentially repayable under certain circumstances, is no longer repayable and has been released from deferred income to revenue in the year.

The Duohaler® device provides advantages over some multi-dose DPIs. It has two separate drug reservoirs that feed two individual drug formulations to two separate metering chambers from which the drugs are delivered to the user in a single inhalation, avoiding co-formulation issues.

We believe that the Duohaler® lead product in development has the ability to capture an attractive share of the European and other generic markets and we look forward to the licensing discussions progressing.

Budesonide Clickhaler® for asthma in Japan
An undisclosed Japanese pharmaceutical company that had an exclusive licence to the Clickhaler® for use with budesonide in Japan has decided to no longer sell products in the respiratory market. The company has therefore returned all rights to Vectura, including access to the Phase III data generated to date. This product is now available for licensing to other third parties.

Other development products

VR040 for Parkinson's disease (PD)
VR040 is an inhaled, systemically acting product for the treatment of "off" episodes associated with advanced PD. The active ingredient in VR040, apomorphine hydrochloride, has been approved previously as an injectable formulation in Europe, and more recently in the US, for treating "off" episodes. VR040 is Vectura's formulation of apomorphine, delivered by inhalation using Vectura's proprietary DPI technology.

The EMEA has granted VR040 orphan drug status. Vectura is using the EMEA Scientific Advice procedure to progress the development of the product.

The successful results of a Phase IIa proof-of-concept clinical study for VR040 were reported in August 2006. In October 2007, Vectura announced successful completion of a second Phase II clinical study of VR040 in patients with PD. The study demonstrated that VR040 is safe and well-tolerated. Following treatment with VR040, patients successfully and rapidly recover from an induced "off" episode; this effect was also durable. Vectura believes that delivery of apomorphine by inhalation will allow patients to experience benefits beyond those offered by current products.

Vectura initiated a Phase II "at-home" study at the end of 2008 and intends to out-license VR040 before the start of Phase III trials.

VR147 for migraine
VR147 is an orally inhaled DPI formulation of a triptan that offers the potential to provide a rapid onset of action, and so provide early symptomatic relief for migraine sufferers. In April 2008, Vectura announced the successful completion of an early proof-of-concept study. The data demonstrated that VR147 is safe and well tolerated. Vectura is exploring out-licensing opportunities for VR147.

VR004 for erectile dysfunction (ED) and VR776 for premature ejaculation (PE)
Vectura is seeking licensing partners for these products. There is no expenditure in relation to these projects in the year to 31 March 2009 and no future expenditure will be incurred.

Marketed products

ADVATE® for haemophilia A
In 2000, Baxter was granted worldwide rights to use Vectura's stabilisation patents and has utilised the technology in its serum-free recombinant Factor VIII, ADVATE®. ADVATE® is indicated for the treatment of haemophilia A and is marketed worldwide by Baxter. Vectura receives royalties on sales of ADVATE®, which have increased to over US$1.5bn in 2008, compared to US$1.2bn in 2007.

There is strong demand for ADVATE®, and Baxter continues to differentiate the product with various dosage forms, making it easier for patients to administer higher doses from fewer vials and to reduce the total infusion time. Growth of ADVATE® sales has continued to exceed our expectations as patients switch from plasma-based and other competing products in Europe and the US. Baxter recently announced that it has established the leadership position in Japan for recombinant Factor VIII. We expect to see further growth from increased compliance, establishing prophylaxis as the standard of care and the global penetration of the therapy.

Extraneal® for peritoneal dialysis
Extraneal® is a peritoneal dialysis solution containing icodextrin, licensed to Baxter in 1996 and marketed by Baxter worldwide. The product has been launched in over 45 countries including, in 2003, the US and Japanese markets. Vectura receives royalties on the sales of Extraneal® in the US, Japan and the rest of the world.

Adept® for prevention of surgical adhesions
Adept® is a 4% icodextrin solution used during surgery to reduce post-surgical adhesions, a frequent and major complication following gynaecological and other abdominal surgery. It has been used for this purpose in Europe since 2000 and in the US since October 2006. Vectura signed a global licence deal with Baxter in December 2005 for the manufacture and distribution of Adept®.

Asmasal® and Asmabec® for asthma
Asmasal® and Asmabec® are Clickhaler® based products. Asmasal® contains salbutamol, a short-acting beta-2 agonist for the quick relief of asthma symptoms. Asmabec® contains beclomethasone, an inhaled steroid used as standard preventative therapy for asthma. Asmasal® and Asmabec® are marketed by UCB SA in the UK, France and Ireland. Clickhaler® is Vectura's proprietary reservoir DPI device.

Budesonide Clickhaler® and Formoterol Clickhaler® for asthma
These are Clickhaler® based products containing budesonide and formoterol respectively. Budesonide is a steroid used as standard preventative therapy for asthma. Formoterol is a long-acting beta-2 agonist with a fast onset of action and longer duration than salbutamol, benefiting sufferers with more severe symptoms. Mylan Inc, our licensing partner for these products, has received regulatory approvals for budesonide in Germany, The Netherlands and New Zealand; with regulatory approvals for formoterol received in Denmark, The Netherlands, South Africa and New Zealand. No further approvals are expected for these products in the near future. £0.9m of milestone revenue was released from deferred income in relation to these products during 2008/09.

Meptin Clickhaler® for asthma
Otsuka Pharmaceuticals, in Japan, has licensed the Clickhaler® technology from Vectura to deliver its short-acting beta-2 agonist Meptin® (procaterol) for the quick relief of mild, intermittent asthma symptoms.

Other Clickhaler® opportunities
Vectura continues to explore licensing opportunities for Clickhaler® products in other countries. Vectura supplies the Clickhaler® devices to licensees and earns a margin on these device sales.

Vectura has several important, patent-protected, enabling technology platforms. In addition to using these technologies to support its own product development programmes, Vectura's strategy is to out-license rights to the technologies to other pharmaceutical companies where the resulting licence will generate significant value and will not impact Vectura's own product development opportunities. Such agreements have already generated revenues from licensees whilst allowing Vectura to retain its focus on its own product development strategy.

Dry Powder Inhaled (DPI) formulation technology – including PowderHale®

The formulation of drugs for inhalation is more complex than for oral delivery and different approaches are required depending on the characteristics of the drug being delivered to the lung. Vectura's know-how, expertise and patents enable the development of patent-protected inhaled products.

Vectura's formulation technologies include PowderHale®, micronisation, blending and spray drying. PowderHale® is a patented DPI formulation technology, designed to allow aerosolised drug particles to achieve high lung deposition with low dose variability. This is achieved by the incorporation of an additional pharmacologically inactive excipient, known as a Force Control Agent (FCA), to the drug formulation.

GyroHaler® and OmniHaler® – "Passive" DPI devices

The GyroHaler® and OmniHaler® are novel, cost-effective, multi-unit dose DPI devices designed to deliver locally acting drugs to the lung. They are compact and easy to use with a small number of moulded parts, facilitating short device development times and competitive manufacturing costs. The devices may contain up to 60 doses and are disposable after use. They are designed to have competitive aerosolisation characteristics and to provide excellent drug protection from moisture and light using sealed foil blisters. Automated form/fill/seal machinery for producing the blister strips is available in Vectura's Chippenham facility.

GyroHaler® and OmniHaler® have the potential to deliver respiratory products in an efficient and patient-friendly manner.

Clickhaler® – multi-dose reservoir DPI

The Clickhaler® is a multi-dose, reservoir DPI. It is approved for use and marketed to treat asthma and COPD with a number of different drugs (salbutamol, beclometasone, formoterol, budesonide and procaterol) in a number of countries in Europe and in Japan.

Clickhaler® is inexpensive to produce and fill, and production is fully automated.

Duohaler® – fixed dual-therapy multi-dose reservoir DPI

The Duohaler® is a fixed dual-therapy, passive, multi-dose DPI. It has two separate drug reservoirs that feed two individual drug formulations to two separate metering chambers from which the drugs are delivered to the user in the same breath, avoiding co-formulation issues.

Aspirair® – "Active" DPI device technology

Aspirair® is a high-performance device, designed to deliver dry powdered drugs with high lung penetration and low dose variability. The device is conveniently sized, simple to use, and economical compared to other "active" inhalers. It is a multiple-use device using individual foil blisters.

Aspirair®, alone or in conjunction with appropriate formulation technologies, can be used to deliver to the deep lung efficiently and effectively. Aspirair® has the potential to deliver proteins and macromolecules.

Unit dose DPIs

Unit dose devices are being developed as re-useable or disposable single-dose dry powder inhalers. They are designed to be easy to use and inexpensive to manufacture and may be suitable for a wide range of conditions that require a rapid onset of effect or that are for occasional use.

Pharmaceutical development services

Vectura's pharmaceutical development services revenues are generated by providing specialist product development services to other pharmaceutical companies, primarily licensing partners, to continue the development of products or technologies licensed from Vectura until complete transfer has been achieved.

Commercial and business development

Vectura's Commercial team, responsible for business development and licensing, maintains good relationships with international pharmaceutical companies and undertakes market analysis for all products under development. In addition, the team provides the market analysis and competitor information that is required to identify valuable new product opportunities. The major licensing deals Vectura has concluded to date demonstrate the strength of the Group's commercial and business development skills.

Development

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

Regulatory affairs

The Regulatory team at Vectura is experienced in global pharmaceutical product registration and inhaled product development. The Regulatory team provides regulatory support for Vectura's own programmes and for those of its partners, and works closely with all functions within Vectura, advising on regulatory strategy and data requirements to ensure timely approvals. The team is responsible for the preparation and maintenance of Clinical Trial Authorisations (CTAs) and Marketing Authorisations (MAs) and preparation of responses to questions on a worldwide basis as required. Submission of dossiers and liaison with individual regulatory authorities is also undertaken as appropriate.

Quality

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

Vectura has a Manufacturer's Authorisation for Investigational Medicinal Products, MIA(IMP) 20066 from the Medicines and Healthcare products Regulatory Agency (MHRA). An MIA(IMP) is a requirement of the EU Clinical Trials Directive, now embodied in national legislation, and allows for manufacture, assembly and release of clinical trial supplies by the Group's Qualified Person.

Vectura is also certified under ISO 13485:2003 Medical devices. In order to achieve the ISO 13485 certification, Vectura's device engineering and contract manufacturing processes were inspected by an authorised quality standards organisation (Lloyds Register Quality Assurance), which found the quality system to be of sufficiently high standard to allow Vectura to self-certify its inhaler devices as being fit for market use in Europe.

1 2 3

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

2 Vectura's blister-filling machine in operation

3 Vectura adheres to GxP at all times

Manufacturing operations

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

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

Intellectual property

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

Vectura's patent portfolio includes in excess of 100 families of patents and patent applications, covering inventions made by the Group's researchers as well as inventions the Group has acquired or licensed from third parties. The Group actively protects and maintains this patent estate.

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

Facilities

Vectura currently operates from three leased facilities in the UK. The first of these is an approximately 50,000 square-foot laboratory, office and manufacturing facility in Chippenham, Wiltshire. This facility is approved for GMP manufacturing of Investigational Medicinal Products for clinical trials. Vectura's Nottingham facility comprises approximately 30,000 square feet of laboratories and offices. On the Cambridge Science Park, Vectura occupies a 4,200 square-foot laboratory and device engineering unit.

1 2 3 4

1 Vectura's strength lies in its specialism; the knowledge, experience and technical capabilities to develop inhaled pharmaceutical products

2 Vectura's committed and motivated workforce is constantly looking to innovate and evolve

3 The active pharmaceutical (API) needs to be formulated so it can be inhaled to reach the targeted area of the lung

4 Vectura has one of only a handful of facilities globally that has been specifically designed to manufacture inhaled products

Revenue growth

Revenues over the last three years have increased year on year as follows:

Year ended	Revenue £m	Increase %
31 March 2009	31.2	24
31 March 2008	25.2	79
31 March 2007	14.1	67

Cash management

This involves the management of the cash generated/(consumed) in the business, the funding received and the cash resources available. The operational cash generated/(consumed) is defined by reference to the cash flow statements as being the addition of the net cash outflow from operations and the cash inflows from investing activities excluding cash inflow/outflow on acquisitions. These key performance indicators (KPIs) for the three years to 31 March 2009 are as follows:

Year ended	Operational cash generated/ (consumed) £m	Financing activities £m
31 March 2009	1.3	(6.1)
31 March 2008	3.6	(2.3)
31 March 2007	(6.3)	67.0

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

Vectura continued to progress the development and commercialisation of programmes partnered in earlier years including VR315 ($2.5m received April 2009), and the collaboration with Boehringer Ingelheim (€7.5m received November 2008). In 2007/08 milestones were also received on VR315 and Boehringer Ingelheim.

Progress with the un-partnered product pipeline

During the year Vectura entered Phase II trials on VR496 for the treatment of CF, and VR040 entered a Phase IIb "at-home" study for the treatment of Parkinson's disease. Vectura is actively seeking partners for its non-respiratory products, including VR147 for the treatment of migraine, which successfully completed clinical trials in 2008.

Identification of new product pipeline

Vectura evaluates new product opportunities through a New Opportunities Committee. The Committee seeks and considers opportunities arising from internal development activities as well as potential in-licensing and co-development opportunities.

Maintaining and strengthening our intellectual property portfolio

Vectura has been successful during the year in oral opposition proceedings and has also achieved a number of patent grants.

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

Industry risk

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

Clinical and regulatory risk

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

Competition and intellectual property risk

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

Economic risk

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

Financial risk management objectives and policies

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

Cash flow risk
The Group's activities expose it to the financial risks of changes in foreign currency exchange rates. The majority of the Group's revenues are in either euros or US dollars. Where known liabilities arise in these currencies the revenues are retained on deposit in the appropriate currency in order to off-set the exchange risk on these liabilities.

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

The credit risk on liquid funds is limited because the counterparties are banks with high credit ratings assigned by international credit-rating agencies. However, the recent global credit problems could result in the failure of even high credit-rated banks where funds are deposited.

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

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

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

Risk management

The Group's risk management processes are detailed in the Corporate governance statement.

Corporate governance statement

The Board is committed to practising good corporate governance as part of its aim to deliver shareholder value. In assessing the appropriate standards of corporate governance the Board takes into account the nature and size of the operation, which comprised at 31 March 2009 six Directors and nearly 250 staff operating from three sites in the UK. The Board recognises that it is accountable to shareholders for the Group's standard of governance and is reporting here on its compliance with the Combined Code on Corporate Governance published in July 2003 and revised in June 2006 (the "Code").

Statement of compliance with the Combined Code

The Group has, in the Directors' opinion, complied with the provisions set out in Section 1 of the Code throughout the year ended 31 March 2009.

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

The Board

The Code requires every company to be headed by an effective board, which is collectively responsible for its success. As part of its leadership and control of the Group, the Board has an agreed list of items that are specifically reserved for its consideration. These include business strategy, financing arrangements, material acquisitions and divestments, approval of the annual budget, major capital expenditure projects, risk management, treasury policies and establishing and monitoring internal controls. At each meeting, the Board reviews strategy and progress of the Group towards its objectives, particularly in respect of research and development projects, and monitors financial progress against budget.

Non-executive Directors (NEDs) are encouraged to meet without the presence of Executive Directors as appropriate.

Division of responsibilities between Chairman and Chief Executive

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

Board balance

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

Independence of NEDs

As explained in previous annual reports, in order to assist in securing the recruitment and retention of high-calibre NEDs, the Group has historically, in addition to fees, remunerated NEDs in the form of options to acquire shares in Vectura.

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. The Board is of the view that the historic granting of share options to NEDs when Vectura Group plc was a private company was appropriate and no share options have been granted to NEDs since 2 July 2004.

It was essential for an emerging pharmaceutical company like Vectura to secure the recruitment and retention of NEDs with the appropriate experience and international perspective in the context of the Group's then stage of development. There are no performance criteria attaching to these options, and these options are now exercisable. No options have been granted to NEDs since Vectura Group plc was listed, and there is no intention to award any further options to NEDs.

The Board has determined that all 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 now exercisable and thus are similar to holding the equivalent amount of shares.

Other factors that may reflect on the independence of a NED include any material business relationships with the Group.

Dr Foden provides specific advice to the Group on intellectual property within her area of expertise. During the year ended 31 March 2009, £7,000 was paid to Dr Foden (2008: £4,000) in respect of these services. The Board considers that this assists the Board in providing further understanding of certain key scientific aspects of the business and, as the amount involved is not material, does not in any way affect Dr Foden's independent judgement.

Throughout the year ended 31 March 2009 and up to the date of publication of this report, more than half the Board, excluding the Chairman, comprised NEDs determined by the Board to be independent.

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 Group'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. All of the NEDs serve on the three board committees, as described below. The Board has considered the composition of the committees and concluded that the independence and objectivity of the individual NEDs is in no way impaired by sitting on these committees.

The Remuneration Committee

The Code requires that the Remuneration Committee consists of at least two independent NEDs. Dr Foden chairs the Remuneration Committee, its other members being Dr Brown, Mr Cashman and Dr Richards. The Committee has responsibility for making recommendations to the Board on the Group'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 VEC, including pension rights, any compensation payments and the implementation of executive incentive schemes. The Committee met formally three times during the financial year ended 31 March 2009 and the Board confirms full attendance by all members during the year.

The Nomination Committee

The Nomination Committee leads the process for Board appointments and makes recommendations to the Board. The Code recommends that a majority of members of the Nomination Committee are independent NEDs. Dr Brown chairs the Nomination Committee and its other members are Mr Cashman, Dr Foden and Dr Richards. The Nomination Committee meets at least once a year, or more if necessary, and has responsibility for considering the size, structure and composition of the Board, retirements and appointments of additional and replacement Directors and making appropriate recommendations to the Board. The Committee met once during the financial year ended 31 March 2009 and the Board confirms full attendance by all members at that meeting.

The Audit Committee

The Code recommends that the Board should establish an Audit Committee of at least three independent NEDs, one of whom has recent and relevant financial experience. The Group complies with these recommendations. Dr Brown is Chairman of the Committee, the other members being Dr Foden and Dr Richards.

The Audit Committee met three times during the year ended 31 March 2009. The Board confirms full attendance by all members during the year. 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 confirms that there have been no non-audit services that are considered to have impaired the objectivity and independence of the external auditors.

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

The Audit Committee meets with the external Auditors at least twice a year without management present and its Chairman keeps in touch, as required, with the key people involved in the Group'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 and their expected time commitments, and have the necessary overview of the Group's business, financial dynamics and risk.

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

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

The Group has a formal whistle blowing policy, which is available to all staff via the Group's intranet.

Timeliness and quality of Board information

The Board has sought to ensure that Directors are properly briefed to help them make an effective contribution at the meetings by establishing procedures for distributing Board agendas and papers in a timely manner in advance of meetings. The Board has at least six scheduled formal meetings per year, with additional meetings when circumstances and urgent business dictate. In the financial year under review, seven regular meetings of the full Board were held. The Board confirms full attendance by all Directors during the year.

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

Transparency of Board appointments

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

Board performance evaluation

Directors are subject to election by shareholders at the first opportunity after their appointment, and to re-election thereafter at intervals of no more than three years. The Board has a process for evaluation of its own performance and that of its committees and individual Directors, including the Chairman. These evaluations are once a year formally and are carried out on a regular basis informally throughout the year. The formal evaluation is through an appraisal process. The Company Secretary reports the results of the reviews back to the Board with identified areas for future action. The performance of Dr Blackwell and Dr Richards, who are being proposed for re-election at the Annual General Meeting (AGM), have been so evaluated and it has been determined that they continue to perform effectively and show full commitment to their roles on the Board. All Directors have service agreements with indefinite terms, with 12 months' notice for Executive Directors and three months' notice for Non-Executive Directors.

Accountability and audit

The Board is required by the Code to present a balanced and understandable assessment of the Group's position and prospects. In relation to this requirement reference is made to the Statement of Directors' responsibilities for preparing financial statements. The independent auditors' report includes a statement by the auditors about their reporting responsibilities.

Maintenance of a sound system of internal control

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

The Group's organisational structure has clearly established responsibilities and lines of accountability. Employees are required to follow clearly defined 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 grievance procedure and whistle blowing policies 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, Good Clinical Practice and Good Manufacturing Practice through the implementation of a compliance programme for in-house and contracted-out activities. The Group has set up a formal Health and Safety Committee, comprising appropriate members of management and other employees, to be responsible for these issues. The Group has formal procedures to ensure appropriate security of documents and proprietary information.

The Group regularly reviews 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.

Risk assessment review

An ongoing process for identifying, evaluating and managing the significant risks which are detailed in the risk factors section of this report 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 also carries out reviews of the non-financial control systems.

Shareholder relations

The Group reports formally to shareholders twice a year by way of the Interim and Annual Reports, and also issues two interim management statements, providing a quarterly communication with shareholders. All periodic reports and accounts are made available to shareholders on the Group's website, or are mailed to shareholders who have elected to receive hard copies. Those shareholders who are Vectura registered website users receive all these press releases by e-mail. Separate announcements of all material events are made as necessary by press releases that are posted on the Group'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 Group's position and prospects. The Vectura website provides additional information about the Group and allows access to reports and accounts, press releases and other materials issued by the Group.

Regular communications are maintained with major institutional shareholders and, in particular, presentations are made when half-year and full-year financial results are announced. Dr Brown, as Senior Independent Director, is contactable by shareholders through a link on the Group's 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 Chairs of the Remuneration, Nomination and Audit Committees are present at the AGM to answer questions through the Chairman of the Board.

Anne Hyland
Company Secretary

18 May 2009

Board of Directors






John Patrick (Jack) Cashman
Non-Executive Chairman

Jack Cashman, aged 68, joined the Board of Ventura as Non-Executive Chairman in 2001 and is a member of both the Nomination and Remuneration Committees. Mr Cashman brings significant experience to the Board of Vectura, having held a variety of senior executive-level roles in business and having been a Board member for several companies in both North America and Europe. Jack is currently a Director of Transat AT Inc. (Canada) and a Director of Telesat Inc. (Canada). He is the former Chairman and joint-Chief Executive Officer of RP Scherer Corporation and participated in its leveraged buyout and privatisation and its subsequent successful flotation on the New York Stock Exchange. (RP Scherer was later acquired by Cardinal Health Inc.) His early career was spent in the field of filtration and industrial mineral products. During that time, he took on successively more senior roles in marketing, operations and general management in the UK, Europe, Canada and USA. With this experience, he decided to pursue an entrepreneurial career in the industrial and healthcare sectors.

Christopher Paul Blackwell **BSc PhD**
Chief Executive

Dr Chris Blackwell, 47, was appointed Chief Executive of Vectura in February 2004. He joined the Group in 2002 as Chief Operations Officer and Executive Director. Prior to Vectura he was Director of Drug Development and an Executive Director at Scotia Pharmaceuticals Ltd, which he joined in 1998. He was previously at Hoffmann-La Roche specialising in project management and becoming UK Director, Global Project Management, and Glaxo Research and Development as a Clinical Pharmacologist. Chris trained as a research scientist at the University of Bath, where in 1988 he completed his doctorate investigating free radicals and reperfusion-induced arrhythmias. In July 2006, Chris was appointed Non-Executive Director of AGI Therapeutics plc, a speciality pharmaceutical company focused on gastrointestinal drug products.

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

Anne Hyland, 48, was appointed Chief Financial Officer, Company Secretary and Executive Director of Vectura in March 2002. Prior to this she was a Director of Corporate Finance at Celltech Group plc. Other positions held at Celltech included Group Financial Controller and Finance Director for the Celltech/Medeva UK Division. She joined Celltech following the merger with Medeva plc, where she was Finance Director for the UK Division. Previously she was the Medeva Group Financial Controller where, through a period of rapid growth, she was responsible for managing treasury, tax, internal and external reporting, and acquisition and disposal activity. Anne joined Medeva from KPMG, London, where she was an audit manager and gained exposure to corporate finance, advisory and due diligence work. She has a Business Studies degree from Trinity College, Dublin, and is a Fellow of the Institute of Chartered Accountants, Ireland and a Fellow of the Institute of Taxation, Ireland.

John Robert Brown **BSc PhD MBA FRSE**
Non-Executive Director
and Senior Independent Director

Dr John Brown, 54, joined the Board of Vectura as Non-Executive Director and Senior Independent Director in 2004 and chairs the Audit and Nomination Committees as well as being a member of the Remuneration Committee. He is Chairman of BTG plc and CXR Biosciences Ltd and is a Non-Executive Director of Axis-Shield plc. From 1999 until May 2008 John was Chairman of the Governing Council of the Roslin Institute in Edinburgh and is now Chairman of the Roslin Foundation. He is Chairman of BIA Scotland, a member of the UK Technology Strategy Board, and an advisor to several private equity and venture capital funds. Until late 2003, John was Chief Executive of Acambis plc, a leading producer of vaccines to treat and prevent infectious disease. John is an Honorary Professor of Edinburgh University and is a Fellow of the Royal Society of Edinburgh.

Susan Elizabeth Foden **MA DPhil**
Non-Executive Director

Dr Susan Foden, 56, joined the Board of Vectura as a Non-Executive Director in January 2007. She chairs the Remuneration Committee and is a member of the Audit and Nomination Committees. She holds a number of Non-Executive Directorships with both public and private companies and public funding bodies in the biotech and healthcare field, including Source Bioscience plc, Cell Centric Ltd, Cizzle Ltd, Rainbow Seed Fund Cascade Ltd, Oxford Ancestors Ltd, and is a Trustee of The Institute of Cancer Research. Prior to this Susan held positions in venture capital and UK biotech companies. From 2000 to 2003 she was an Investor Director with the London-based venture capital firm Merlin Biosciences Limited, and was Chief Executive Officer of the technology transfer company Cancer Research Campaign Technology Ltd from 1987 to 2000. She studied biochemistry at the University of Oxford from where she obtained an MA and a DPhil.

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

Dr Andy Richards, 49, joined the Board of Vectura as a Non-Executive Director in 2000 and is a member of the Audit, Nomination and Remuneration Committees. He is an established biotechnology entrepreneur and business angel, focusing on founding, investing in and growing biotechnology and healthcare companies. He has broad experience of the UK biotechnology sector in research, drug development and in building commercial relationships. He is Chairman of Altacor Ltd and a Non-Executive Director of Aitua Ltd, Arecor Ltd, Biowisdom Ltd, Babraham Bioscience Technology Ltd, Cancer Research Technology Ltd (the commercial arm of Cancer Research UK), Theradeas Ltd and Summit Corporation plc. He is also a founder member of the Cambridge Angels, a director of the BIA (BioIndustry Association), a member of BBSRC Council and member of the UKTI Lifesciences strategy implementation board. In 1992, he co-founded Chiroscience and was Business Development Director through to its merger in 1999 with Celltech. Originally a protein chemist, Andy spent his early career with ICI (now AstraZeneca) and with PA Technology. Andy has a PhD in Chemistry.

Executive management

Timothy Wright **BSc PhD MBA**
Commercial Director

Dr Tim Wright, 48, joined Vectura as Commercial Director in March 2005. Prior to joining Vectura he gained a breadth of experience in business development and licensing in a number of senior roles at BTG plc, latterly as Vice President Business Development and Licensing, Oncology, and as Director of Business Development at DevCo Pharmaceuticals, where he was successful in building a portfolio of neuroscience development candidates. Between 1986 and 1999 Tim held a number of management positions at GlaxoWellcome Research and Development, both in Clinical Pharmacology and Medical Operations, and in project management at Simbec Research Limited. Tim trained as a research scientist at London University, obtaining a PhD in neuroendocrinology in 1987. He was awarded an MBA from London Business School's Executive Programme in 1994.

Martin John Shott **PhD MRPharmS**
Pharmaceutical Operations Director

Dr Martin Shott, 57, joined Vectura as Pharmaceutical Operations Director in October 2002 with a wide range of experience from within the pharmaceutical industry. Prior to joining Vectura he worked for four years at Innovata Biomed as Associate Director of Research and Development. Martin has gained extensive experience in the UK and Europe working as a senior manager at several companies, including Lers-Synthelabo and Ciba-Geigy (later Novartis), where he managed the global DPI development unit based in the UK. He trained as a research scientist, during which time he investigated the compression of pharmaceutical powders for a PhD at Nottingham University, while continuing to work in the industry. He is a member of the Royal Pharmaceutical Society of Great Britain.

Mark Jonathan Main **BSc PhD**
Development Director

Dr Mark Main, 49, joined Vectura as Development Director in May 2004. Prior to joining Vectura he was with Powderject Pharmaceuticals, which he joined in 2001 to lead multi-disciplinary development teams for both drug delivery and vaccine products involving all aspects of the drug/device development process. He was previously with Sterling Winthrop in 1986 and subsequently Parke-Davis, Ipsen International, and Scotia Pharmaceuticals, gaining extensive experience of clinical development and project management in the areas of cardiovascular and oncological treatment. Mark trained as a research scientist at St George's Hospital Medical School, where he gained his doctorate investigating the prevention of ischaemia-induced damage of the mammalian myocardium.

Stephen William Eason **BSc (Eng)**
Director of Device Development

Stephen Eason, 51, joined Vectura as Director of Device Development in February 2002 when the Aspirair® inhaler technology and staff were acquired from Cambridge Consultants Ltd (CCL), where he was an associate director. He had previously initiated and led the Aspirair® development programme at CCL and has subsequently initiated and led the GyroHaler® development programme for Vectura. While at CCL Stephen carried out significant product developments in the areas of inhalation, injection and infusion products. Prior to joining CCL, Stephen worked for seven years as a design and development engineer within the manufacturing industry, first with the TI Group and then with Baxter Healthcare. Stephen studied Mechanical Engineering at the Imperial College of Science and Technology, London.

Colin Clive Dalton **BTech PhD**
Director of Intellectual Property and Corporate Affairs

Dr Colin Dalton, 59, joined Vectura as Director of IP and Corporate Affairs in January 2007 when Innovata plc was acquired. He was previously Corporate Development Director with Innovata and Quadrant Healthcare Limited, a formulation company acquired by Innovata. For five years prior to joining Quadrant he was Director of Business Development at GSK Biologicals where he managed a group responsible for licensing new products and technologies, collaborations and alliances. He previously worked in business development at Quadrant and British Sugar plc and was a senior consultant in the biotechnology practice at PA Consulting. He started his career as a fermentation scientist at BP Co Ltd. He trained as an applied biologist at Brunel University and obtained a PhD in 1977 at Leicester University.

Corporate social responsibility statement

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

Environment

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

Waste management

Various waste management initiatives were implemented through the Group in 2007, including recycling of all paper waste, aluminium cans, printer toners/cartridges and redundant mobile telephone handsets. The Group's employees are actively encouraged to reduce power usage in the office environment, and telephone conferencing facilities are used wherever possible in order to reduce unnecessary travel.

Health and safety

Vectura has established a Health and Safety Committee to review health and safety standards within the Group on an ongoing basis. The Group considers health and safety to be a priority in its workplaces. The Group has an excellent safety record and there have been no major incidents or accidents to report to the Health and Safety Committee. The Group has provided specialist training to individuals who are responsible for health and safety, and general health and safety training to all staff.

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

Ethical and social policies

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

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

Employees

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

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

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

Employee involvement

During the year, Vectura continued its policy of providing employees with information about the Group through regular presentations by Directors, management and the Group's intranet. In addition, regular meetings are held between management and employees to allow for a free flow of information and ideas. Staff forums have been formed to comply with the requirements of Information and Consultation of Employees Regulations 2004. The forums ensure implementation of the EC Directive.

Disabled employees

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

Family-friendly employment policies and employee welfare

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

Introduction

This report has been prepared in accordance with Schedule 7A of the Companies Act 1985 (the "Act") and complies with the Combined Code on Corporate Governance. The report also meets the relevant requirements of the Listing Rules of the Financial Services Authority and describes how the Board has applied the principles relating to Directors' remuneration under the Directors' Remuneration Report Regulations 2002. As required by the Act, a resolution to approve this report will be proposed at the Annual General Meeting of the Group at which the financial statements will be approved.

The Act requires the auditors to report to the Group's members on certain parts of the Report on remuneration and state whether in their opinion those parts of the report have been properly prepared in accordance with the Companies Act 1985 (as amended by the Regulations). The report has, therefore, been divided into separate sections for unaudited and audited information.

Unaudited information

Remuneration Committee
The Remuneration Committee consists entirely of NEDs and is constituted in accordance with the recommendations of the Combined Code. Its members for the year ended 31 March 2009 were Dr Foden (Chair), Dr Brown, Mr Cashman and Dr Richards. The Committee met formally three times during year ended 31 March 2009. It seeks independent advice, where appropriate, for the purpose of determining the remuneration policy for the Group. The remuneration of each Executive Director and senior employees is determined by the Committee (including the award of annual bonuses, share options and LTIP awards), 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 Chairman is excluded from this process. 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 a shareholder) or conflicts of interests arising from cross-directorships or day-to-day involvement in running the business. No Director plays a part in any discussion about his or her own remuneration.

In determining the Directors' remuneration for the year, the Committee reviewed executive compensation packages in the UK pharmaceutical and biotech sectors; it also referred to a number of specialist studies on executive remuneration.

Remuneration policy

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

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

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

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

Basic salary
Basic salaries are reviewed annually, taking into account recommendations on individual performance and salary levels in comparable companies. In formulating its decision, the Committee takes into account appropriate benchmarks. As in the prior year, for the financial year ended 31 March 2009 the Committee chose the UK pharmaceutical sector.

Each Executive Director's base salary was broadly aligned with the mid-points of the chosen UK pharmaceutical sector comparator group (see below) and adjusted to reflect company size and complexity. Basic salaries aligned with these mid-points, combined with bonus incentives, continue to provide competitive compensation packages, in which performance-related components represent a substantial element. For the year ending 31 March 2010 the Remuneration Committee determined that no base salary increases would be paid to the Executive Directors (2008/09: 6%).

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

Long-Term Incentive Plan

Annually, Executive Directors and certain senior executives are granted an award in the form of nil-cost options under the Vectura Group plc 2005 Long-Term Incentive Plan ("the LTIP"). Under the LTIP, each participating executive is granted an annual award of shares, dependent on the achievement of a rigorous, pre-determined set of performance conditions. At the end of a three-year performance period, a percentage of the shares so awarded is made available to the participating executives, dependent upon the Group's Total Shareholder Return ("TSR") as compared to those of a comparator group of similar, quoted UK pharmaceutical and biotechnology companies. Awards are released in accordance with the following table:

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

* Linear vesting between points

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

For grants made up to 31 March 2009, the comparator group of companies to which the performance of Vectura Group plc is compared is as follows:

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

During the year ended 31 March 2009, grants of shares were made to Dr Blackwell and Ms Hyland under the LTIP scheme, as further detailed in this report, below. The market price of the shares on the date of grant of the LTIP awards was 53.50p.

For grants issued after 31 March 2009, the comparator group of companies will be as follows:

Allergy Therapeutics plc
Antisoma plc
Ark Therapeutics plc
Axis-Shield plc
Biocompatables International plc
BTG plc
GW Pharmaceutical plc
Oxford BioMedica plc
ProStrakan Group plc
Sinclair Pharma plc
SkyePharma plc
Vernalis Group plc

Value Realisation Plan

On 31 October 2008, the shareholders approved the Vectura Group plc Value Realisation Plan ("the VRP"). The VRP runs in parallel to the LTIP and provides participants with a share of a pre-determined percentage of the total consideration paid for the Group in the event of a change in control. In this event, under the VRP members of the Executive Committee of the Group will be granted a one-off entitlement in the form of units, which convert into ordinary shares in Vectura Group plc, the actual number of shares that convert being linked to the offer price per share achieved. The VRP is triggered upon achievement of a minimum bid price of £1.27 per share, with a maximum number of shares available to participants if the bid price reaches or exceeds £1.77 per share.

Share Incentive Plan

The Vectura Group plc Share Incentive Plan ("SIP") is available to all employees, including Executive Directors, for the purpose of encouraging employees to become shareholders of the Group and to retain their shares over the medium to long term. It introduces share ownership to the employee in three ways: free shares, partnership shares, and matching shares. Vectura Group plc may award free shares annually, employees may buy partnership shares out of pre-tax salary, and Vectura Group plc may match any partnership shares purchased in a year with the award of additional matching shares on a one-for-one basis. The SIP is an HMRC approved scheme through which benefits are provided in a tax efficient manner.

Sharesave Share Option Scheme
Vectura Group plc also operates a Sharesave ("SAYE") Share Option Scheme for both employees and Executive Directors. Under this Scheme all eligible employees and Executive Directors are invited to subscribe for options, which may be granted at a discount of up to 20% of market value. The Sharesave Share Option Scheme is an all-employee plan where shares must be held for a minimum of three years, and to which performance conditions do not apply.

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

Historically, before it was listed, Vectura Group plc did grant NEDs share options as part of their remuneration package. At the early stage of the Group's development this was considered to be essential to secure the recruitment and retention of high-calibre NEDs with the appropriate experience. This policy of granting share options to NEDs has not applied since the Group was publicly listed, and no further share option awards will be made to NEDs. In this connection, reference should also be made to the Corporate governance statement. The options held by the NEDs have vested and are exercisable at any time. The Board does not believe that the retention of these fully vested options in any way compromises the independence of the NEDs concerned.

Historically, no performance conditions were attached to the options granted under the above schemes. The exercise price is equal to the market value of Vectura Group plc's shares at the time the options are granted.

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 20% of basic salary to the Group Personal Pension Plan in the name of the Executive Directors.

Performance graph
The following graph shows Vectura Group plc's performance since its initial listing in July 2004, measured by TSR, compared with the performance of the current comparator group of companies in the sector, as described above.

Directors' service contracts
It is the Group's policy that Executive Directors should have contracts with an indefinite term and providing for 12 months' 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.

Dr Blackwell is also a Non-Executive Director of AGI Therapeutics plc for which he receives a fee of €30,000 per annum.

Non-Executive Directors
All NEDs have specific terms of engagement which are 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, nor do they receive other benefits. 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 2009 are summarised in the table below:

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

All of the NEDs are considered independent including those with service greater than nine years. This is due to the major change in the operating activities of the Group that occurred with effect from July 2004 when the Company completed its Initial Public Offering.

Directors' interests

The Directors that held office at 31 March 2009 and their interests in the share capital of Vectura Group plc at 31 March 2008 and 31 March 2009 were as follows:

	31 March 2009 ordinary shares of 0.025p each	31 March 2008 ordinary shares of 0.025p each
C P Blackwell [1]	143,873	106,526
J R Brown [2]	70,457	70,457
J P Cashman	434,749	434,749
A P Hyland [1]	150,105	112,758
A J M Richards	134,998	134,998
S E Foden	11,000	11,000

[1] The holdings of C P Blackwell and A P Hyland include 16,925 ordinary shares of 0.025p each, which are held in the Vectura Group plc Employee Benefit Trust (Share Incentive Plan).

[2] 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 2009 and 18 May 2009, the date of this report.

Audited information

Directors' remuneration

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

	Basic salary and fees £000	Bonuses £000	Benefits £000	2009 Total emoluments £000	2008 Total emoluments £000
Executive Directors:					
C P Blackwell	318	175	1	494	451
A P Hyland	212	117	1	330	301
Non-Executive Directors:					
J R Brown*	45	–	–	45	45
J Cashman	60	–	–	60	60
S E Foden*	45	–	–	45	38
A J M Richards	30	–	–	30	30
	710	292	2	1,004	925

* Included within the NEDs' fees are the fees for chairing committees. Dr Brown received £15,000 for chairing the Audit and Nomination Committees. Dr Foden received £7,500 for chairing the Remuneration Committee.

Also included in the above are fees for consultancy services of £7,000 (2008: £4,000) paid to Dr Foden, for the provision of specialist advice in intellectual property matters.

Benefits represent payments for medical insurance.

Directors' pension entitlements

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

	2009 £000	2008 £000
C P Blackwell	64	60
A P Hyland	42	40
	106	100

Directors holding office at 31 March 2009 with options outstanding over ordinary shares of 0.025p are as follows:

Plan	Options held at 1 April 2008	Options granted/ (exercised) during year	Options held at 31 March 2009	Exercise price (p)	Date from which first exercisable	Expiry date
J Cashman						
Unapproved	166,232	–	166,232	48.125	18/04/04	18/04/11
Unapproved	680,000	–	680,000	36.000	29/04/04	29/04/14
Unapproved	238,989	–	238,989	56.000	02/07/05	02/07/14 [1]
	1,085,221	–	1,085,221			
C P Blackwell						
EMI	277,776	–	277,776	48.125	05/11/05	03/11/12
Unapproved	122,224	–	122,224	48.125	01/10/05	01/10/12
Unapproved	23,376	–	23,376	48.125	11/04/06	11/04/13
Unapproved [2]	1,112,704	(6,349)	1,106,355	36.000	29/04/07	29/04/14
Unapproved	716,966	–	716,966	56.000	02/07/05	02/07/14 [1]
Unapproved	132,424	–	132,424	82.500	03/08/06	03/08/15 [1]
Unapproved	265,493	–	265,493	93.750	09/08/07	09/08/16 [1]
SAYE Scheme	18,651	(18,651)	–	–	–	–
Unapproved	271,304	–	271,304	86.250	25/05/08	25/05/17 [1]
SAYE Scheme	26,666	–	26,666	36.000	01/04/11	01/10/11
Unapproved	–	237,384	237,384	53.500	23/05/09	23/05/18 [1]
Approved	–	37,383	37,383	53.500	23/05/09	23/05/18 [1]
	2,967,584	249,767	3,217,351			
J R Brown						
Unapproved	172,224	–	172,224	36.000	29/04/04	29/04/14
Unapproved	238,989	–	238,989	56.000	02/07/05	02/07/14 [1]
	411,213	–	411,213			
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 [2]	545,684	(6,349)	539,335	36.000	29/04/07	29/04/14
Unapproved	358,483	–	358,483	56.000	02/07/05	02/07/14 [1]
Unapproved	94,090	–	94,090	82.500	03/08/06	03/08/15 [1]
Unapproved	188,640	–	188,640	93.750	09/08/07	09/08/16 [1]
SAYE Scheme	18,651	(18,651)	–	–	–	–
Unapproved	192,174	–	192,174	86.250	25/05/08	25/05/17 [1]
SAYE Scheme	26,666	–	26,666	36.000	01/04/11	01/10/11
Unapproved	–	143,926	143,926	53.500	23/05/09	23/05/18 [1]
Approved	–	37,383	37,383	53.500	23/05/09	23/05/18 [1]
	1,898,284	156,309	2,054,593			

Options

Plan	Options held at 1 April 2008	Options granted/ (exercised) during year	Options held at 31 March 2009	Exercise price (p)	Date from which first exercisable	Expiry date
A J M Richards						
Unapproved	450,000	–	450,000	36.000	29/04/04	29/04/14
Unapproved	238,989	–	238,989	56.000	02/07/05	02/07/14 [1]
	688,989	–	688,989			

All options were granted for nil consideration.

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

[2] On 23 May 2008, C P Blackwell and A P Hyland each acquired a total of 25,000 ordinary shares through the exercise of options. Of this total, 6,349 shares were acquired at a share price of 36p through the exercise of Unapproved options granted on 29 April 2004, and 18,851 shares were acquired at a share price of 50.8p through the exercise of options granted under Vectura Group plc's SAYE Scheme that vested on 1 April 2008. On the date of exercise the share price was 53.75p per share. The total cost of this exercise was £12,308.95 per Director, including taxation. No gains were realised by the Directors on this exercise. The nominal gain was £1,683.05.

Directors' LTIP awards

Under the LTIP scheme, the grants made to Directors at 31 March 2009 were as shown in the table below:

Director	1 April 2008 £	Awards during year £	31 March 2009 £	% of salary %	Share price on date of grant pence	Date of release of shares
C P Blackwell	361,741	–	361,741	125	77.50	12/09/08 [1]
	258,064	–	258,064	100	93.00	22/11/09
	347,826	–	347,826	100	86.25	25/05/10
	–	594,392	594,392	100	53.50	23/05/11
Total	967,631	594,392	1,562,023			
A P Hyland	261,290	–	261,290	125	77.50	12/09/08 [1]
	182,795	–	182,795	100	93.00	22/11/09
	231,884	–	231,884	100	86.25	25/05/10
	–	396,261	396,261	100	53.50	23/05/11
Total	675,969	396,261	1,072,230			

[1] The award made on 12 September 2005 reached the end of its holding period on 12 September 2008. The TSR of the Group during this period compared with that of the comparator group was in the upper quartile. Accordingly, 100% of the shares awarded were released. The nil–cost options relating to this award lapse on 11 September 2015.

The number of shares released to the Directors at the end of the three–year performance period is dependent upon the performance TSR of the Group during that period in comparison to that of a comparator group of companies as described in the LTIP section of this Report on remuneration.

On behalf of the Board

Dr S E Foden
Chair of the Remuneration Committee

18 May 2009

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 2009.

Principal activity

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

Review of business

Key events during the past year are referred to in the Highlights, Chairman and Chief Executive's report, the Business review and the Financial review. During the year, the Board has considered the key risks and uncertainties of the business, which are summarised on page 21. The Board has reviewed the risk management policies in place as summarised in the Corporate governance statement.

Results and dividends

The group loss for the year, after taxation, amounted to £16.7m (2008: £19.2m). The Directors do not recommend the payment of a dividend (2008: £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 sections on Board of Directors and Executive Management. Details of remuneration and their interests in the share capital of the Company are given in the Report on remuneration. None of the Directors has any interest in any contract of significance to the financial statements.

Employees

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

Financial instruments

The policy and practice of the Group with regard to financial instruments is disclosed in note 22 of the financial statements.

Payment of creditors

The Group's policy is to agree payment terms with the suppliers at the start of business relationships and to abide by them. The typical terms are 30 days (2008: 30 days).

Political and charitable donations

Vectura encourages employee involvement in charitable causes. During the year, Vectura made contributions amounting to £350 (2008: £350) to local charitable organisations in the UK. These contributions were made in lieu of posting seasonal greetings to customers. There were no political donations during the year (2008: £nil).

Directors' indemnities

The Company has granted an indemnity to its Directors against liability in respect of proceedings brought by third parties, which remains in force as at the date of approving the Directors' report.

Significant shareholdings

At 13 May 2009, the nearest practical date to the date of this Report, the Company had a total of 3,878 ordinary shareholders and 321,046,532 ordinary shares in issue.

The Directors had been notified of the following substantial holdings in the Company's share capital as at the close of business on 13 May 2009:

	Number of shares '000	%
Fidelity Institutional Group	32,848	10.23%
Aviva Investors Global Services	31,745	9.89%
Invesco Institutional Group	27,552	8.58%
Aberforth Partners	21,742	6.77%
Legal & General Investment Management	20,610	6.42%
AXA Framlington Institutional Group	15,176	4.73%
F&C Asset Management	11,440	3.56%

Share price

The mid-market share price as shown by the London Stock Exchange Daily Official List was 54.5p on 31 March 2009. The mid-market share price ranged from 38p to 64.85p during the year to 31 March 2009. The average share price for the period was 51p.

Corporate social responsibility statement

The Group's policies on the environment, health and safety, ethical and social issues and its employees are described in the statement on page 28.

Going concern

Although the current economic conditions may place pressures on customers and suppliers which may face liquidity issues, the Group's product diversity and customer and supplier base substantially mitigate these risks. In addition, the Group operates in the relatively defensive pharmaceutical industry which we expect to be less affected compared to other industries.

The Group has £74m of cash and cash equivalents as at 31 March 2009. The Board operates an investment policy, under which the primary objective is to invest in low-risk cash or cash equivalent investments to safeguard the principal. The Group's forecasts, taking into account likely revenue streams, show that the Group has sufficient funds to operate for the foreseeable future.

After making enquiries, the directors believe that the Group is adequately placed to manage its business and financing risks successfully despite the current uncertain economic outlook. Accordingly they continue to adopt the going concern basis in preparing the annual report and accounts.

Annual General Meeting

The Annual General Meeting will be held at the offices of Olswang, 90 High Holborn, London WC1V 6XX on 23 September 2009 at 11.00 a.m. Details of the business to be transacted at the forthcoming AGM will be sent to shareholders in a circular.

Auditors

Deloitte LLP have expressed their willingness to continue in office as auditors and a resolution to re-appoint them will be put to the members at the forthcoming Annual General Meeting.

The Directors that were members of the Board at the time of approving the Directors' report are listed on page 26. Having made enquiries of fellow Directors and of the Company's auditors, each of these Directors confirms that:

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

This confirmation is given and should be interpreted in accordance with the provisions of s234ZA of the Companies Act 1985.

By order of the Board

Anne Hyland
Company Secretary

18 May 2009

Financial table of contents

Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and the financial statements. The Directors are required to prepare financial statements for the Group in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU. Company law requires the Directors to prepare such financial statements in accordance with IFRSs, the Companies Act 1985 and Article 4 of the IAS Regulation.

International Accounting Standard 1 requires that financial statements present fairly for each financial year the Group's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the Preparation and Presentation of Financial Statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable IFRSs. Directors are also required to:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information; and
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group, for safeguarding the assets, for taking reasonable steps for the prevention and detection of fraud and other irregularities and for the preparation of a directors' report and a report on remuneration which comply with the requirements of the Companies Act 1985.

The Directors are responsible for the maintenance and integrity of the Group website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements differs from legislation in other jurisdictions.

Directors' responsibility statement

We confirm to the best of our knowledge:

- the financial statements, prepared in accordance with International Financial Reporting Standards as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
- the management report, which is incorporated into the Directors' report, includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties they face.

By order of the Board

Anne Hyland
Director

18 May 2009

Independent auditors' report
to the members of Vectura Group plc

We have audited the Group and parent Company financial statements (the "financial statements") of Vectura Group plc for the year ended 31 March 2009, which comprise the Consolidated income statement, the Consolidated and Company balance sheets, the Consolidated and Company cash flow statements, the Consolidated and Company statements of changes in equity, and the related notes 1 to 30. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Report on remuneration that is described as having been audited.

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

Respective responsibilities of Directors and auditors
The Directors' responsibilities for preparing the Annual Report, the Report on remuneration and the financial statements in accordance with applicable law and IFRSs as adopted by the European Union are set out in the Statement of Directors' responsibilities.

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

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Report on remuneration to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' report is consistent with the financial statements. The information given in the Directors' report includes that specific information presented in the Financial review and Business review that is cross referred from the Business review section of the Directors' report.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We review whether the Corporate governance statement reflects the Company's compliance with the nine provisions of the 2006 Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report as described in the contents section and consider whether it is consistent with the audited financial statements. The other information comprises only the Directors' report, the unaudited part of the Report on remuneration, the Chairman and Chief Executive's report, the Financial review, the Business review and the Corporate governance statement. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any further information outside the Annual Report.

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

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

Opinion
In our opinion:

the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 March 2009 and of its loss for the year then ended;

the parent Company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent Company's affairs as at 31 March 2009;

the financial statements and the part of the Report on remuneration to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation; and the information given in the Directors' report is consistent with the financial statements.

Deloitte LLP
Chartered Accountants and Registered Auditors
Cambridge, United Kingdom

18 May 2009

Consolidated income statement
for the year ended 31 March 2009

	Note	2009 £m	2008 £m
Revenue	2	31.2	25.2
Cost of sales		(3.9)	(4.4)
Gross profit		27.3	20.8
Research and development expenses		(32.3)	(29.7)
Other administrative expenses		(3.2)	(3.0)
Amortisation		(10.2)	(10.2)
Share-based compensation		(1.9)	(2.7)
Total administrative expenses		(15.3)	(15.9)
Share of loss of associate	13	(0.6)	(0.3)
Operating loss	5	(20.9)	(25.1)
Investment income	4	3.6	4.5
Finance costs	4	(2.3)	(0.8)
Loss before taxation		(19.6)	(21.4)
Taxation	7	2.9	2.2
Loss after taxation attributable to equity holders of the Company		(16.7)	(19.2)
Loss per ordinary share basic and diluted	8	(5.2p)	(6.1p)

All results are derived from continuing activities.

Consolidated balance sheet
at 31 March 2009

	Note	2009 £m	2008 £m
Assets			
Goodwill	9	49.6	49.6
Intangible assets	10	52.2	62.4
Property, plant and equipment	11	3.5	3.4
Investments in associates and joint ventures	13	–	0.9
Trade investments	14	0.4	0.3
Other receivables	15	0.4	0.4
Non-current assets		106.1	117.0
Inventories	16	0.1	0.2
Trade and other receivables	17	6.4	6.0
Cash and cash equivalents	22	74.0	78.8
Current assets		80.5	85.0
Total assets		186.6	202.0
Liabilities			
Trade and other payables	21	(14.7)	(10.0)
Deferred income	19	(8.6)	(5.5)
Financial liabilities	20	(1.2)	(0.9)
Current liabilities		(24.5)	(16.4)
Deferred income	19	(1.8)	(8.2)
Financial liabilities	20	(5.4)	(7.9)
Non-current liabilities		(7.2)	(16.1)
Total liabilities		(31.7)	(32.5)
Net assets		154.9	169.5
Equity			
Share capital	23a	0.1	0.1
Share premium	23b	77.2	77.0
Special reserve	23c	8.2	8.2
Other reserve	23d	124.9	124.9
Share-based compensation reserve	23e	7.6	5.7
Retained loss		(63.1)	(46.4)
Total equity		154.9	169.5

These financial statements were approved and authorised for issue by the Board of Directors on 18 May 2009 and were signed on its behalf by:

Dr C P Blackwell
Director

A P Hyland
Director

Consolidated cash flow statement
for the year ended 31 March 2009

	2009 £m	2008 £m
Operating loss	(20.9)	(25.1)
Depreciation and amortisation	11.8	11.8
Share-based compensation	1.9	2.7
Decrease in inventories	0.1	–
(Increase)/decrease in receivables	(0.2)	2.2
Increase in payables	4.6	1.9
(Decrease)/increase in deferred income	(3.3)	2.4
Exchange movements	1.8	–
Other non-cash movements	0.6	0.4
Net cash outflow from operations	(3.6)	(3.7)
Taxation paid	(0.4)	(0.1)
Research and development tax credits received	3.3	2.3
Net cash outflow from operating activities	(0.7)	(1.5)
Cash flows from investing activities		
Interest received	3.6	4.5
Purchase of property, plant and equipment	(1.6)	(0.7)
Receipts from sale of property, plant and equipment	–	1.3
Net cash inflow from investing activities	2.0	5.1
Net cash inflow before financing activities	1.3	3.6
Cash flows from financing activities		
Proceeds from issue of ordinary shares	0.2	4.1
Payment of financial liabilities	(5.9)	(5.2)
Payment of finance lease liabilities	–	(0.4)
Interest paid on loans and financial liabilities	(0.4)	(0.8)
Net cash outflow from financing activities	(6.1)	(2.3)
(Decrease)/increase in cash and cash equivalents	(4.8)	1.3
Cash and cash equivalents at beginning of period	78.8	77.5
Cash and cash equivalents at end of period	74.0	78.8

Consolidated statement of changes in equity
for the year ended 31 March 2009

	Share capital £m	Share premium £m	Special reserve £m	Other reserve £m	Share-based compensation reserve £m	Retained loss £m	Total equity £m
At 1 April 2007	0.1	72.9	8.2	124.9	3.0	(27.2)	181.9
Loss for the year	–	–	–	–	–	(19.2)	(19.2)
Share-based compensation	–	–	–	–	2.7	–	2.7
Exercise of share options	–	0.6	–	–	–	–	0.6
Shares issued	–	3.5	–	–	–	–	3.5
At 31 March 2008	0.1	77.0	8.2	124.9	5.7	(46.4)	169.5
Loss for the year	–	–	–	–	–	(16.7)	(16.7)
Share-based compensation	–	–	–	–	1.9	–	1.9
Exercise of share options	–	0.2	–	–	–	–	0.2
At 31 March 2009	0.1	77.2	8.2	124.9	7.6	(63.1)	154.9

Company balance sheet
at 31 March 2009

	Notes	2009 £m	2008 £m
Assets			
Goodwill	9	2.0	2.0
Property, plant and equipment	11	–	1.8
Investments in subsidiary undertakings	12	133.9	133.9
Investments in associates	13	–	0.9
Trade investments	14	0.1	–
Other receivables	15	–	0.5
Non-current assets		136.0	139.1
Trade and other receivables	17	0.2	0.9
Amounts due from subsidiary undertakings	18	75.1	–
Cash and cash equivalents	22	–	76.9
Current assets		75.3	77.8
Total assets		211.3	216.9
Liabilities			
Trade and other payables	21	–	(6.0)
Deferred income	19	–	(0.5)
Current liabilities		–	(6.5)
Amounts owed to subsidiary undertakings	18	(20.2)	(20.4)
Deferred income	19	–	(0.4)
Non-current liabilities		(20.2)	(20.8)
Total liabilities		(20.2)	(27.3)
Net assets		191.1	189.6
Equity			
Share capital	23a	0.1	0.1
Share premium	23b	77.2	77.0
Special reserve	23c	8.2	8.2
Other reserve	23d	123.7	123.7
Share-based compensation reserve	23e	7.6	5.7
Retained loss		(25.7)	(25.1)
Total equity		191.1	189.6

These financial statements were approved and authorised for issue by the Board of Directors on 18 May 2009 and were signed on its behalf by:

Dr C P Blackwell
Director

A P Hyland
Director

Company cash flow statement
for the year ended 31 March 2009

	2009 £m	2008 £m
Operating loss	(0.6)	(19.0)
Depreciation and amortisation	–	0.8
Share-based compensation	–	0.3
Increase in receivables	(70.0)	–
(Decrease)/increase in payables	(6.0)	7.4
Decrease in deferred income	(0.9)	(0.6)
Other non-cash movements	0.6	0.3
Net cash outflow from operations	(76.9)	(10.8)
Research and development tax credits received	–	1.9
Net cash outflow from operating activities	(76.9)	(8.9)
Cash flows from investing activities		
Interest received	–	4.4
Purchase of property, plant and equipment	–	(0.4)
Receipts from sale of property, plant and equipment	–	1.3
Net cash inflow from investing activities	–	5.3
Net cash outflow before financing activities	(76.9)	(3.6)
Cash flows from financing activities		
Proceeds from issue of ordinary shares	–	4.1
Net cash inflow from financing activities	–	4.1
(Decrease)/increase in cash and cash equivalents	(76.9)	0.5
Cash and cash equivalents at beginning of period	76.9	76.4
Cash and cash equivalents at end of period	–	76.9

Company statement of changes in equity
for the year ended 31 March 2009

	Share capital £m	Share premium £m	Special reserve £m	Other reserve £m	Share-based compensation reserve £m	Retained loss £m	Total equity £m
At 1 April 2007	0.1	72.9	8.2	123.7	3.0	(10.8)	197.1
Loss for the year	–	–	–	–	–	(14.3)	(14.3)
Share-based compensation	–	–	–	–	2.7	–	2.7
Exercise of share options	–	0.6	–	–	–	–	0.6
Shares issued	–	3.5	–	–	–	–	3.5
At 31 March 2008	0.1	77.0	8.2	123.7	5.7	(25.1)	189.6
Loss for the year	–	–	–	–	–	(0.6)	(0.6)
Share-based compensation	–	–	–	–	1.9	–	1.9
Exercise of share options	–	0.2	–	–	–	–	0.2
At 31 March 2009	0.1	77.2	8.2	123.7	7.6	(25.7)	191.1

1 Accounting policies

General information
Vectura Group plc is a public limited company incorporated in the United Kingdom under the Companies Act 1985. The address of the registered office and principal place of business is given on page 76. The Company's ordinary shares are traded on the London Stock Exchange (LSE) under the ticker VEC.

Basis of preparation
The financial statements have been prepared in accordance with the Companies Act 1985 and IFRSs and related interpretations as adopted by the European Union and, therefore, the Group financial statements comply with Article 4 of the EU International Accounting Standard (IAS) Regulation. The Group and Company financial statements are also consistent with IFRSs as issued by the International Accounting Standards Board (IASB).

The separate financial statements of the Company are presented as required by the Companies Act 1985 and have been prepared in accordance with IFRSs as adopted by the European Union. The Company is taking advantage of the exemption in section 230 of the Companies Act 1985 not to present its individual income statement and the related notes that form a part of these approved financial statements. The parent company loss for the year ended 31 March 2009 is £0.6m (2008: £14.3m).

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

Going concern
The accounts have been prepared on the going concern basis, for the reasons set out in the Directors' report on page 37.

Basis of consolidation
The consolidated annual financial statements comprise the financial statements of Vectura Group plc and its subsidiaries as at 31 March each year.

Subsidiaries are consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group. Control comprises the power to govern the financial and operational policies of the investee so as to obtain benefit from its activities and is achieved through direct or indirect ownership of voting rights, or by way of contractual agreement. The financial statements of subsidiaries are prepared for the same reporting year as the parent company, using consistent accounting policies. Adjustments are made to bring into line any dissimilar accounting policies that may exist.

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

Where there is a loss of control of a subsidiary, the consolidated financial statements include the results for the part of the reporting year during which the Group had control.

Critical accounting judgements and key sources of estimation uncertainty
In preparing the financial statements, management is required to make estimates and assumptions, in accordance with IFRS, that affect the amounts of assets, liabilities, revenues and expenses reported in the financial statements. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual amounts and results could differ from those estimates.

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

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

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

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

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

1 Accounting policies (continued)

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

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

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

Pharmaceutical Development Services
Pharmaceutical Development Services revenues principally comprise contract product development and contract clinical trial manufacturing fees invoiced to third parties. Revenues are recognised upon the completion of agreed tasks or numbers of person days and in the period to which they relate.

Device sales
Device sales are recognised when goods are delivered to customers.

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

Business combinations
The acquisition of subsidiaries is accounted for using the purchase method. The cost of the acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree, plus any costs directly attributable to the business combination. In accordance with IFRS 3 – Business Combinations, the Group has a twelve-month period in which to finalise the fair values allocated to assets and liabilities determined provisionally on acquisition.

Goodwill
Goodwill recognised under UK Generally Accepted Accounting Principles (GAAP) prior to 1 April 2004 is stated at net book value at that date. Goodwill arising on the acquisition of subsidiary or associate undertakings and businesses subsequent to 1 April 2004, representing any excess of the fair value of the consideration given over the fair value of the identifiable assets, liabilities and contingent liabilities acquired, is capitalised. After initial recognition, goodwill is stated at cost less any accumulated impairment losses, with the carrying value being reviewed for impairment at least annually and whenever events or changes in circumstances indicate that the carrying value may be impaired. For the purpose of impairment testing, goodwill is allocated to the related future cash-generating units monitored by management. Where the recoverable amount of the future cash-generating unit is less than its carrying amount, including goodwill, an impairment loss is recognised in the income statement. On disposal of a subsidiary, associate or jointly controlled entity, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Other intangible assets
Intangible assets acquired separately from a business are carried initially at cost. An intangible asset acquired as part of a business combination is recognised outside goodwill if the asset is separable or arises from contractual or other legal rights and its fair value can be measured reliably. Development expenditure on internally developed intangible assets, is taken to the income statement in the year in which it is incurred. Expenditure relating to clearly defined and identifiable development projects is recognised as an intangible asset only after the following criteria are met:

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

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

Patents, trade marks and licence agreements – between 3 and 10 years

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

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

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

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

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

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

Investments in subsidiaries
Investments in subsidiaries are eliminated upon consolidation. In the Company accounts investments are carried at historic cost, less provision for impairment.

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

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

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

1 Accounting policies (continued)

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

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

Leasing
Operating leases and the annual rentals are charged to the income statement on a straight-line basis over the period of the lease in accordance with the terms of the lease agreements.

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

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

Interest-bearing loans and borrowings
All loans and borrowings are initially recognised at fair value, less directly attributable transaction costs. After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses arising on the repurchase, settlement or cancellation of liabilities are recognised respectively as finance income or finance costs. The effective interest rate is the rate that exactly discounts estimated future cash payments (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial liability, or, where appropriate, a shorter period.

Financial liabilities
A provision is recognised when the Group has a legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. Financial liabilities are initially measured at fair value and, if material, are subsequently measured at amortised cost using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments throughout the expected life of the financial liability.

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

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

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

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

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

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

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

Borrowing costs
Borrowing costs directly attributed to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to prepare for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

All other borrowing costs are recognised in profit or loss in the period in which they are incurred.

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

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

New accounting Standards and Interpretations
Two Interpretations issued by the International Financial Reporting Interpretations Committee are effective for the current period. These are:

- IFRIC 12 – Service Concession Arrangements
- IFRIC 14 – IAS 19: The Limit on a Defined Benefit Asset Minimum Funding Requirements and their Interaction.

The adoption of these Interpretations has not led to any changes in the Group's accounting policies.

During the year, the IASB and IFRIC have issued a number of Standards and Interpretations with an effective date after the date of these financial statements. The new Standards and Interpretations issued include the following:

- IFRS 2 (Amendment) – Share Based Payments
- IFRS 3 (Amendment) – Business Combinations
- IFRS 7 (Amendment) – Financial Instruments (Disclosure)
- IFRS 8 – Operating Segments
- IAS 1 (Amendment) – Presentation of Financial Statements
- IAS 23 (Amendment) – Borrowing Costs
- IAS 27 (Amendment) – Consolidated and Separate Financial Statements
- IAS 28 (Amendment) – Investments in Associates
- IAS 31 (Amendment) – Interests in Joint Ventures
- IAS 32 (Amendment) – Financial Instruments: Presentation
- IAS 39 (Amendment) – Financial Instruments: Recognition and Measurement
- IFRIC 13 – Customer Loyalty Programmes
- Improvements to IFRSs (May 2008)

The Directors anticipate that the adoption of these Standards and Interpretations in future periods will have no material impact on the Group's financial statements.

2 Revenue

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

Group revenue by category:	2009 £m	2008 £m
Royalties	12.5	9.1
Product licensing	4.2	2.8
Technology licensing	6.1	2.9
Pharmaceutical development services	6.6	8.9
Device sales	1.8	1.5
	31.2	25.2
Investment income:		
Interest income (note 4)	3.6	4.5
Total revenue	34.8	29.7

Revenue by customer location:	2009 £m	2008 £m
United Kingdom	8.0	7.8
Rest of Europe	10.8	8.4
United States of America	12.4	8.9
Rest of world	–	0.1
	31.2	25.2

3 Segmental information

For management purposes the Group is currently organised into one business segment, which is the development and commercialisation of pharmaceutical products. Since this is the only primary reporting segment, no further information has been shown.

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

4 Investment income and finance costs

	2009 £m	2008 £m
Interest income:		
Interest receivable on bank deposits and similar income	3.6	4.5
Finance costs:		
Imputed interest charge on financial liabilities	(0.4)	(0.8)
Exchange rate loss on financial liability	(3.7)	–
Foreign exchange gains	1.8	–
	(2.3)	(0.8)

5 Operating loss

Operating loss is the result for the Group before interest and taxation, and is stated after charging (crediting):

	2009 £m	2008 £m
Amortisation of intangible assets	10.2	10.2
Depreciation of property plant and equipment:	1.6	1.6
Share-based compensation	1.9	2.7
Share of loss of associate (after taxation)	0.6	0.3
Staff costs (note 6)	13.4	13.5
Operating lease rentals:		
– land and buildings	0.9	0.8
– plant and machinery	0.2	0.2

The analysis of auditors' remuneration is as follows:

	2009 £000	2008 £000
Fees payable to Deloitte LLP for the audit of the parent company and consolidated financial statements	20	55

	2009 £000	2008 £000
Fees payable to Ernst & Young LLP and its associates for other services:		
Corporate finance services	–	43

	2009 £000	2008 £000
Fees payable to Deloitte LLP and its associates for other services:		
Audit of the Company's subsidiaries pursuant to legislation	78	43
Corporate finance services	–	30
	78	73

6 Directors and employees

Directors' remuneration

The aggregate remuneration comprised:

	2009 £m	2008 £m
Fees	0.2	0.2
Salaries and benefits	0.5	0.5
Bonuses	0.3	0.2
	1.0	0.9
Pension contributions	0.1	0.1
	1.1	1.0

Two Directors (2008: two) receive company contributions to defined contribution personal pension plans. Two Directors exercised share options in the year and increased their shareholding in the Company by 25,000 Ordinary shares each as a result of this exercise. No Director disposed of any shares during the year.

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

Employees

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

	2009 No.	2008 No.
Research and development	226	231
Business development and administration	12	12
	238	243

The aggregate remuneration comprised:

	2009 £m	2008 £m
Wages and salaries	11.5	11.6
Social security costs	1.2	1.3
Other pension costs	0.7	0.6
	13.4	13.5

In addition to the wages and salaries analysis above are the effects of the charge for share-based compensation under IFRS 2 during the year of £1.9m (2008: £2.7m).

7 Taxation

The major components of the income tax credit for the years ended 31 March 2009 and 31 March 2008 are as follows:

	2009 £m	2008 £m
Foreign withholding tax charge on royalties	(0.4)	(0.1)
Research and development tax credits	3.3	2.3
Total	2.9	2.2

Research and development tax credits are recorded upon receipt from Her Majesty's Revenue and Customs (HMRC).

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

	2009 £m	2008 £m
Loss on ordinary activities before tax	(19.6)	(21.4)
Loss on ordinary activities multiplied by standard rate of tax in the UK of 28% (2008/09: 30%)	(5.5)	(6.4)
Effects of:		
Permanent differences – expenses not deductible for tax purposes	0.7	0.1
Utilisation of Innovata tax losses	–	(3.7)
Unrecognised tax losses carried forward	4.8	10.0
Foreign withholding taxes	(0.4)	(0.1)
Research and development tax credits relating to prior years	3.3	2.3
Total tax credit for the year	2.9	2.2

Factors that may affect future tax charges:

Cumulative tax losses of approximately £128m (2008: £133m), subject to agreement by HMRC, are available within the Group to carry forward against future taxable profits. There is a deferred tax asset of £37m (2008: £38m), including these tax losses, of which £14.6m are recognised (2008: £17m) and calculated at the standard rate of tax of 28%, as follows:

	2009 £m	2008 £m
On cumulative tax losses – unrecognised	21.2	19.8
On cumulative tax losses – recognised	14.6	17.5
On unclaimed capital allowances	0.9	0.9
On unexercised share options	0.4	0.1
	37.1	38.3

As described above, of the total deferred tax asset, £14.6m has been recognised as a deferred tax asset as at 31 March 2009, which offsets a deferred tax liability in the same amount (see below). The losses and deferred tax assets have no formal expiry date.

Deferred tax asset
On the acquisition of Innovata, that business had accumulated losses of approximately £108m. A deferred tax asset of £14.6m relating to these losses has been recognised as at 31 March 2009. In accordance with IAS 12 – Income Taxes, this deferred tax asset has been offset against the deferred tax liability arising on the intangible assets, as described below.

Deferred tax liability
A deferred tax liability of £14.6m exists at 31 March 2009. This relates to 28% of the intangible asset value at that date. This deferred tax liability will result in no cash tax charge as it is offset by an equal and opposite deferred tax asset, as described above.

8 Loss per ordinary share

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

	2009	2008
Loss for the year (£m)	(16.7)	(19.2)
Weighted average number of ordinary shares (No. 000)	320,566	315,793
Loss per ordinary share	(5.2p)	(6.1p)

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

9 Goodwill

Group	2009 £m	2008 £m
Cost:		
At 1 April	49.6	49.6
At 31 March	49.6	49.6
Net book value:		
At 31 March	49.6	49.6
At 1 April	49.6	49.6

Goodwill is allocated to future cash-generating units, which are tested for impairment on an annual basis, or more frequently if there are indications that goodwill might be impaired. The recoverable amounts of the future cash-generating units are assessed using a value-in-use model. The key assumptions for the value-in-use calculations are those regarding the discount rates, growth rates and expected changes to contribution during the period. The model has been based on the most recent cash flow forecasts prepared by management, which consist of detailed product-by-product analyses based on individual forecasts for development timings, royalty and growth rates. The discount rates used in the forecasts range from 13% to 16%.

The carrying value of goodwill is made up of balances arising on acquisition of the following companies:

	2009 £m	2008 £m
Co-ordinated Drug Development Limited (since re-named Vectura Limited)	1.5	1.5
Vectura Delivery Devices Limited	0.5	0.5
Innovata Limited	47.6	47.6
	49.6	49.6

Company	£m
Carrying amount:	
At 31 March 2008 and 31 March 2009	2.0

For the purposes of goodwill impairment testing, the Group recognises two distinct cash generating units being the Vectura CGU, which includes Vectura Limited and Vectura Delivery Devices Limited and the Innovata CGU, being the group of companies acquired in January 2007.

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

10 Intangible assets

Group	Patents and trade marks 2009 £m	Licences 2009 £m	Total 2009 £m	Patents and trade marks 2008 £m	Licences 2008 £m	Total 2008 £m
Cost:						
At 1 April and at 31 March	3.5	74.6	78.1	3.5	74.6	78.1
Amortisation:						
At 1 April	(3.5)	(12.2)	(15.7)	(3.5)	(2.0)	(5.5)
Charge for the year	–	(10.2)	(10.2)	–	(10.2)	(10.2)
At 31 March	(3.5)	(22.4)	(25.9)	(3.5)	(12.2)	(15.7)
Net book value:						
At 31 March	–	52.2	52.2	–	62.4	62.4
At 1 April	–	62.4	62.4	–	–	–

Intangible assets are being amortised on a straight-line basis over the expected life of each separate asset. The expected life of these intangible assets is between three and ten years.

11 Property, plant and equipment

Group	Laboratory equipment £m	Office and IT equipment £m	Motor vehicles £m	Total £m
Cost:				
At 1 April 2007	9.7	0.7	0.1	10.5
Additions	0.6	0.1	–	0.7
Disposals	(1.3)	–	(0.1)	(1.4)
At 31 March 2008	9.0	0.8	–	9.8
Additions	1.5	0.2	–	1.7
Disposals	(0.1)	–	–	(0.1)
At 31 March 2009	10.4	1.0	–	11.4
Depreciation:				
At 1 April 2007	(4.6)	(0.2)	–	(4.8)
Charge for the year	(1.5)	(0.1)	–	(1.6)
Disposals	–	–	–	–
At 31 March 2008	(6.1)	(0.3)	–	(6.4)
Charge for the year	(1.5)	(0.1)	–	(1.6)
Disposals	0.1	–	–	0.1
At 31 March 2009	(7.5)	(0.4)	–	(7.9)
Net book value:				
At 31 March 2009	2.9	0.6	–	3.5
At 31 March 2008	2.9	0.5	–	3.4

11 Property, plant and equipment (continued)

Company	Laboratory equipment £m	Office and IT equipment £m	Total £m
Cost:			
At 1 April 2007	5.7	0.2	5.9
Additions	0.3	0.1	0.4
Disposals	(1.3)	–	(1.3)
At 31 March 2008	4.7	0.3	5.0
Transfer of assets to Vectura Limited	(4.7)	(0.3)	(5.0)
At 31 March 2009	–	–	–
Depreciation:			
At 1 April 2007	(2.2)	(0.1)	(2.3)
Charge for the year	(0.8)	(0.1)	(0.9)
At 31 March 2008	(3.0)	(0.2)	(3.2)
Transfer of depreciation to Vectura Limited	3.0	0.2	3.2
At 31 March 2009	–	–	–
Net book value:			
At 31 March 2009	–	–	–
At 31 March 2008	1.7	0.1	1.8

12 Investments in subsidiary undertakings

Company	Shares in subsidiary undertakings £m	Loans to subsidiary undertakings £m	Total £m
Cost:			
At 1 April 2007	125.7	9.5	135.2
Reduction	–	(1.2)	(1.2)
At 31 March 2008	125.7	8.3	134.0
At 31 March 2009	125.7	8.3	134.0
Amounts written off:			
At 1 April 2007, 1 April 2008 and 31 March 2009	(0.1)	–	(0.1)
Net book value:			
At 31 March 2009	125.6	8.3	133.9
At 31 March 2008	125.6	8.3	133.9

Details of the Company's significant subsidiary undertakings are as follows:

Name of undertaking	Country of incorporation	Holding	Proportion held	Nature of business
Vectura Limited	England	Ordinary	100%	Pharmaceuticals
Vectura Delivery Devices Limited	England	Ordinary	100%	Pharmaceuticals
Innovata Limited	England	Ordinary	100%	Pharmaceuticals
Innovata Biomed Limited [1]	Scotland	Ordinary	100%	Pharmaceuticals
Quadrant Technologies Limited [1]	England	Ordinary	100%	Pharmaceuticals
Quadrant Drug Delivery Limited [2]	England	Ordinary	100%	Pharmaceuticals
Quadrant Healthcare Limited [3]	England	Ordinary	100%	Pharmaceuticals

[1] a subsidiary of Innovata Limited

[2] a subsidiary of Quadrant Technologies Limited

[3] a subsidiary of Quadrant Drug Delivery Limited

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

13 Investments in associates

Group and Company	2009 £m	2008 £m
Balance at 1 April	0.9	1.2
Share of loss	(0.6)	(0.3)
Transfer to trade investments	(0.1)	–
Transfer of sales proceeds to other receivables	(0.2)	–
Balance at 31 March	–	0.9

PharmaKodex Limited
PharmaKodex Limited was a 20.4% associated company until February 2009. Losses of the company have been consolidated until that date. PharmaKodex Limited was sold to Orexo AB in February 2009.

14 Trade investments

Group
The Group holds two investments with a value of £0.4m (2007/08: £0.3m). One investment held by the Group is in Orexo AB, a Swedish listed company, which mainly relates to a holding of Orexo AB ordinary shares. This investment is as a result of the disposal of Vectura's shareholding in PharmaKodex Limited in February 2009. PharmaKodex Limited was equity accounted as an associate for the period to February 2009 and Vectura's share of the losses for that period was £0.6m. The carrying value of PharmaKodex Limited was £0.9m at 31 March 2008 and after consolidation of the losses was reduced to £0.3m at the date of disposal. Vectura is entitled to deferred and contingent consideration from Orexo AB. The group's second investment is in an unquoted company.

Company
The Company holds the investment in Orexo AB at 31 March 2009 (2008: £nil).

15 Other receivables

Group
Other receivables represent an investment bond of £428,000 in respect of a rental deposit paid under the terms of a lease agreement for the Company's premises at Chippenham. The deposit is for a fixed period of one year and is renewed annually. Under the terms of the lease agreement the deposit must be maintained until the Group has made three years of consecutive profits. The interest rate is 1% below the Royal Bank of Scotland base rate and was 0% for the year ended 31 March 2009. Interest is recognised using the effective interest method.

Company
Other receivables were transferred to Vectura Limited, a wholly owned subsidiary undertaking, during the year. Other receivables held at 31 March 2008 represent the investment bond of £428,000 in respect of a rental deposit paid.

16 Inventories

	Group 2009 £m	2008 £m	Company 2009 £m	2008 £m
Finished goods	0.1	0.2	–	–

17 Trade and other receivables

	Group 2009 £m	2008 £m	Company 2009 £m	2008 £m
Trade receivables	1.4	2.9	–	0.7
Other receivables	0.3	–	0.2	–
Prepayments and accrued income	4.0	2.8	–	–
VAT recoverable	0.7	0.3	–	0.2
	6.4	6.0	0.2	0.9

The average credit period taken by customers is 30 days. The Directors consider that the carrying value of trade and other receivables approximates to their fair value.

18 Amounts due from and owed to subsidiary undertakings

	Group 2009 £m	2008 £m	Company 2009 £m	2008 £m
Amounts falling due within one year:				
Due from subsidiary undertakings	–	–	75.1	–
Amounts falling due after more than one year:				
Owed to subsidiary undertakings	–	–	20.2	20.4

19 Deferred income

Deferred income relates to amounts received under product licensing agreements. Vectura continues to provide services to these licensing partners over a period of time. Milestone payments under these licensing agreements are therefore spread, and income is deferred as follows:

	Group 2009 £m	2008 £m	Company 2009 £m	2008 £m
Amounts due within one year	8.6	5.5	–	0.5
Amounts due in more than one year	1.8	8.2	–	0.4
	10.4	13.7	–	0.9

20 Financial liabilities

	2009 £m	2008 £m
At 1 April	8.8	14.0
Utilised	(5.9)	(5.2)
Exchange rate adjustment	3.7	–
At 31 March	6.6	8.8

	2009 £m	2008 £m
Amounts due within one year	1.2	0.9
Amounts due in more than one year	5.4	7.9
At 31 March	6.6	8.8

A revenue management agreement was entered into on 28 June 2001 between Innovata and Paul Capital Royalty Acquisition Fund L.P. ("PRF" or "Paul Capital"), which was subsequently amended and restated ("the PRF Agreement"), pursuant to which Paul Capital provided funding totalling £22.5m in return for a share of the revenues earned by Innovata from the commercialisation of Extraneal® and Adept®. Since these arrangements were entered into, the interests of Paul Capital have been assigned to Royalty Securitization Trust I (RST).

A deed of waiver and amendment ("the RST Deed") was entered into between Innovata and RST on 17 January 2007, the date of the acquisition of Innovata by Vectura. Payments by Vectura to RST under the agreement will be subject to guaranteed minimum and maximum annual payments as follows:

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

The provision as at 31 March 2009 of £6.6m is based on the total future discounted minimum payments due excluding an imputed interest charge of £0.4m.

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

Exercise date	Put option price
Between 1 October 2008 and 30 September 2010	US$25,000,000

Innovata has a Call Option under which it has the right to buy out the interests of RST on the same fixed payment basis as that described above. Vectura has agreed to guarantee the performance by Innovata of its obligations under the RST Deed.

21 Trade and other payables

	Group 2009 £m	2008 £m	Company 2009 £m	2008 £m
Amounts falling due within one year:				
Trade payables	3.2	1.9	–	1.0
Other taxes and social security costs	–	0.4	–	0.2
Other payables	1.6	0.4	–	–
Accruals	9.9	7.3	–	4.8
	14.7	10.0	–	6.0

Trade payables principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken by the Group for trade purchases is 35 days (2008: 29 days).

22 Financial instruments

Categories of financial instruments

Under IFRS 7, and for the purposes of risk management, the following classes of financial assets and their carrying values have been identified:

	2009 £m	2008 £m
Amounts receivable from revenues	1.4	2.9
Other receivables	5.4	0.4
Cash and cash equivalents	74.0	78.8
	80.8	82.1

All financial assets fall due within the first quarter of the year, with the exception of the investment bond, the repayment of which is determined by the Group's results (see note 15).

There were no provisions against impaired assets at 31 March 2009 (2008: £nil). There are no amounts past due but not impaired (2008: £nil).

Cash and cash equivalents comprise current accounts held by the Group with immediate access and short-term bank deposits with a maturity value of three months or less.

Under IFRS 7, and for the purposes of risk management, the following classes of financial liabilities and their carrying values have been identified:

	2009 £m	2008 £m
Trade payables and accruals	(13.1)	(9.2)
Financial liabilities	(6.6)	(8.7)
	(23.0)	(17.9)

All financial liabilities fall due within the first half of the year, except for £5.4m relating to financial liabilities which is due before July 2010.

22 Financial instruments (continued)

Fair value of financial assets and liabilities
The Directors consider there to be no material difference between the book value and the fair value of the Group's financial assets and liabilities at the balance sheet date.

Capital risk management
The Group manages its capital to ensure that entities in the Group will be able to continue as going concerns while maximising the return to stakeholders. The capital structure of the Group consists of cash and cash equivalents and equity attributable to equity holders of Vectura Group plc, comprising issued share capital (note 23a), reserves and retained earnings as disclosed in the consolidated statement of changes in equity.

Externally imposed capital requirement
The Group is not subject to externally imposed capital requirements.

Significant Accounting Policies
Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each class of financial asset, financial liability and equity instrument are disclosed in note 1 to the financial statements.

Financial risk management
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 2009 and 31 March 2008 are not necessarily representative of the positions throughout the year, as cash and short-term investments fluctuate considerably depending on when share issues have occurred.

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

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

Interest on overnight cash deposits is calculated on the basis of a floating rate set at between 5 and 10 basis points below seven-day sterling London Inter-Bank Offer Rate (LIBOR).

Foreign currency risk management
The Group's principal functional currency is sterling. However, the Group undertakes certain transactions denominated in foreign currencies. The Group's policy is to offset its currency exposure by matching foreign currency revenues with expenditure in the same foreign currency. Where there are no imminent foreign exchange transactions, the balances are exchanged for sterling at spot rate.

As the timing and amount of US dollar denominated income is uncertain, it is not possible to estimate the impact of a change in the foreign exchange rates on the Group.

All assets and liabilities are denominated in sterling other than those shown below:

Group	2009 £m	2008 £m
Cash and cash equivalents:		
US Dollar	–	(0.1)
Euro	0.3	(0.1)
	0.3	(0.2)
Financial Liabilities:		
US Dollar	(9.1)	(9.5)
Euro	(1.3)	–
	(10.4)	(9.5)

Company	2009 £m	2008 £m
Cash and cash equivalents:		
US Dollar	–	(0.2)
Financial Liabilities:		
US Dollar	–	(0.3)

Interest rate risk management
The Group has no external borrowings and is not exposed to interest rate risk through borrowings. Cash and cash equivalents earned £3.6m of finance income during the year (2008: £4.5m). If interest rates had been 0.5% higher/lower and all other variables were constant, the Group's profit for the year ended 31 March 2009 would increase/decrease by £0.5m (2008: £0.4m).

All the Group's monetary assets and liabilities are held at floating rates.

Liquidity risk management
The Group manages liquidity risk by maintaining adequate reserves and by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities.

Credit risk management
The Group's credit risk is primarily attributed to its cash and cash equivalents. The Board operates an investment policy, under which the primary objective is to invest in a diverse portfolio of low risk cash or cash equivalent investments to safeguard the principal.

The Group's credit risk on trade and other receivables is low as the amounts are owed by large, multinational, pharmaceutical companies. For the same reason, the directors assess the quality of these assets as high.

Market risk management
The Group's exposure to market risk primarily comprises interest rate exposure. Group funds are invested in cash deposits with the objective of maintaining a balance between accessibility of funds and competitive rates of return.

23 Equity

(a) Share capital

	2009 £m	2009 No. '000	2008 £m	2008 No. '000
Authorised:				
Ordinary shares of 0.025p each	0.1	441,200	0.1	441,200
Redeemable preference shares of £1 each	–	34	–	34
Allotted, called up and fully paid:				
Ordinary shares of 0.025p each:				
At 1 April	0.1	319,511	0.1	314,518
Issued to investors	–	–	–	3,628
Issued to Share Investment Plan	–	919	–	123
Issued on exercise of share options	–	600	–	1,242
At 31 March	0.1	321,030	0.1	319,511
Redeemable preference shares of £1 each:				
At 1 April and 31 March	–	34	–	34

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

Between 1 April 2008 and 31 March 2009 the Company issued 919,315 (2008: 122,579) ordinary shares of 0.025p each to the Vectura Group plc Employee Benefit Trust in satisfaction of the issue of matching and free shares due to employees in accordance with the rules of the Vectura Group plc Share Incentive Plan (SIP).

Between 1 April 2008 and 31 March 2009 the Company issued 599,796 (2008: 1,241,972) ordinary shares of 0.025p each on the exercise of employee share options at a weighted average exercise price of 35.8 pence per share (2008: 49.4 pence).

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

(c) Special reserve
The special reserve was created on 19 May 2004 as part of the process prior to the Company's Initial Public Offering on 2 July 2004, to enable re-registration as a public company. It is a non-distributable reserve.

(d) Other reserve
The other reserve was created on the acquisition by the Company of Co-ordinated Drug Development Limited (since renamed Vectura Limited) in August 1999, of Vectura Delivery Devices Limited in February 2002 and of Innovata plc in January 2007.

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

24 Equity-settled share option schemes and Long-Term Incentive Plan

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

On 18 January 2007, upon the acquisition of Innovata plc in accordance with a scheme of arrangement, options over Innovata shares issued and outstanding at that date under the ML Laboratories plc 1989 Executive Option Scheme and the ML Laboratories plc 1999 Executive Option Scheme were exchanged for options over Vectura shares in accordance with the rules of the relevant Innovata Option Scheme. The exchange was on the basis that the option holders received new options representing 0.2858 Vectura shares for every one Innovata share.

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

The Company also operates an LTIP under which Executive Directors and certain senior managers are granted conditional rights in the form of nil-cost options to receive a maximum number of shares at the beginning of a three-year period, a proportion of which they will be entitled to receive at the end of that period, depending on the extent to which the challenging performance conditions set by the Remuneration Committee at the time the allocation was made, are satisfied. The nil-cost option entitlement is exercisable from the beginning of the fourth year to the end of the tenth year following the date of grant. Further information on the performance conditions of the LTIP are detailed in the Report on remuneration. At 31 March 2009, Executive Directors and eligible senior managers hold rights to 949,776 ordinary shares that vested on 12 September 2008, and further rights that may result in the issue of 668,814 ordinary shares on 22 November 2009, 329,670 ordinary shares on 2 March 2010, 842,269 ordinary shares on 25 May 2010 and 1,630,705 ordinary shares on 23 May 2011.

On 31 October 2008, the shareholders approved the VRP. The VRP runs in parallel to the LTIP and provides participants with a share of a pre-determined percentage of the total consideration paid for the Company in the event of a change in control. In this event, under the VRP members of the Executive Committee of the Company will be granted a one-off entitlement in the form of units, which convert into ordinary shares in the Company, the actual number of shares that convert being linked to the offer price per share achieved. The VRP is triggered upon achievement of a minimum bid price of £1.27 per share, with a maximum number of shares available to participants if the bid price reaches £1.77 per share, or greater.

Fair value calculations

The Group has taken advantage of the exemption in IFRS 1 and has applied IFRS 2 only to options granted after 7 November 2002 and not vested at 1 January 2005. At 31 March 2009, there were 3,579,113 options outstanding that were granted before this date (2008: 3,968,221).

With the exception of the LTIP awards and the potential awards under the VRP, the fair value of the options was determined using the Black–Scholes pricing model. The fair value of the LTIP and VRP awards have been estimated using the Monte Carlo model, using the same basis for the assumptions for volatility, option life, expected dividend yield and risk-free rate of return as used for the Black–Scholes model. For the purposes of calculating the fair value of the LTIP, it was considered equally probable that the Company's performance would be such that it would perform in each of the quartiles established under the LTIP scheme, as described in the Report on remuneration.

24 Equity-settled share option schemes and Long-Term Incentive Plan (continued)

The assumptions input into the Black–Scholes model were as follows:	Year of grant 2009	2008
Weighted average share price of grants during the year	51.89p	68.31p
Weighted average exercise price of grants during the year	49.18p	53.33p
Expected volatility [1]	33–37%	33–48%
Expected life	5 years	5 years
Expected dividends	Nil	Nil
Risk-free interest rate [2]	1.9–5.4%	3.9–5.6%

The assumptions input into the Monte Carlo model were as follows:		
Weighted average share price of grants during the year	43.98p	88.65p
Weighted average exercise price of grants during the year	0.025p	0.025p
Expected volatility [1]	34%	48%
Expected life	3 years	3 years
Expected dividends	Nil	Nil
Risk-free interest rate [2]	5.0%	5.7%

[1] Expected volatility has been calculated by reference to the Company's historic share price since the IPO in July 2004, considered alongside the volatility of similar companies. The expectation of the cancellation of options has been considered in determining the fair value expense charged in the income statement.

[2] The risk-free interest rate is the UK Gilt Rate at the date of grant, commensurate with the expected term.

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

The share-based compensation charge for the year ended 31 March 2009, including the LTIP, is £1,898,000 (2008: £2,702,000).

The aggregate of the estimated fair value of options granted under share option schemes and Share Incentive Plan during the year ended 31 March 2009 was £585,000 (2008: £576,000) and under the SAYE Scheme £64,000 (2008: £226,000). The estimated fair value of the LTIP awards and under the VRP during the year ended 31 March 2009 was £1,096,000 (2008: £510,000).

Options outstanding

	Share Option Schemes Number of options	WAEP*	SAYE Scheme Number of options	WAEP*	LTIP Number of options	WAEP*
At 1 April 2007	20,973,582	68.45	1,121,266	61.95	1,948,260	0.025
Options granted	1,915,831	68.31	1,656,476	36.00	842,269	0.025
Options exercised	(1,241,972)	49.38	–	–	–	–
Options cancelled	(791,701)	206.64	(380,792)	70.70	–	–
At 31 March 2008	20,855,740	63.85	2,396,950	42.63	2,790,529	0.025
Options granted	1,155,554	49.29	333,100	48.80	1,634,705	0.025
Options exercised	(381,210)	27.12	(218,586)	50.80	–	–
Options cancelled	(612,642)	118.10	(381,711)	51.21	–	–
At 31 March 2009	21,017,442	61.36	2,129,753	41.22	4,425,234	0.025
Range of exercise prices		0.025p–489p		36p–72p		0.025p
Weighted average remaining contractual life		5.71 years		2.55 years		8.06 years

Options vested

	Share Option Schemes Number of options	WAEP*	SAYE Scheme Number of options	WAEP*	LTIP Number of options	WAEP*
At 31 March 2008	15,002,506	58.26	–	–	–	–
At 31 March 2009	16,943,935	61.10	–	–	949,776	0.025
Weighted average remaining contractual life		4.22 years		N/A		6.45 years

* = Weighted average exercise price (p)

25 Analysis of net funds

Group	1 April 2008 £m	Cash flow £m	Non-cash movements £m	31 March 2009 £m
Cash and cash equivalents	78.8	(4.8)	–	74.0
Financial liabilities	(8.8)	6.3	(4.1)	(6.6)
	70.0	1.5	(4.1)	67.4

26 Retirement benefits plans

The Group operates a number of defined contribution personal pension plans for all qualifying employees. The assets of the schemes are held separately from those of the Group and are independently administered. The total cost charged in the income statement is detailed in note 6. At 31 March 2009, contributions of £nil (2008: £58,902), due in respect of the current reporting period, had not been paid over to the scheme. This amount was included in other payables (note 21).

27 Operating lease arrangements

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

Group	Land and buildings 2009 £m	2008 £m	Other 2009 £m	2008 £m
Expiry date:				
Within one year	0.9	0.8	0.1	0.1
In the second to fifth years inclusive	2.9	3.0	–	0.1
After five years	2.3	3.0	–	–
	6.1	6.8	0.1	0.2

On 26 July 2002, the Group entered into a 25-year lease agreement in respect of the lease of premises at One Prospect West, Chippenham, Wiltshire. There is a break clause in July 2017.

On 5 February 2007, the Group entered into an agreement in respect of the lease of premises at Five Prospect West, Chippenham, Wiltshire. The lease expires on 28 September 2011.

On 13 June 2005, the Group entered into a 5-year lease agreement in respect of premises at Cambridge Science Park, Milton Road, Cambridge.

On 27 October 2006, the Group entered into a lease agreement in respect of additional premises at Cambridge Science Park, expiring on 13 June 2010.

On 23 February 1996, the Group entered into a lease in respect of the premises at Ruddington, expiring on 27 July 2017.

Company	Land and buildings 2009 £m	2008 £m	Other 2009 £m	2008 £m
Expiry date:				
Within one year	–	0.4	–	0.1
In the second to fifth years inclusive	–	1.4	–	0.1
After five years	–	1.2	–	–
	–	3.0	–	0.2

All leases have been moved to Vectura Limited, following the transfer of trade and assets during the year.

28 Capital and other commitments

At the year end the Group and Company had capital commitments contracted, but not provided for, of £0.2m (2008: £0.1m).

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

29 Related party transactions

Group

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

As noted in the Board's Report on remuneration, during the year £7,000 (2008: £4,000) was paid to Dr S Foden for consultancy services.

Remuneration of key management personnel

	2009 £m	2008 £m
Short-term employee benefits	1.1	1.0
Post-employment benefits	0.1	0.1
Share-based payments	0.5	0.7
	1.7	1.8

29 Related party transactions (continued)

Company

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

Related party	Recharge from related parties £m	Recharge to related parties £m	Amounts owed by related parties £m	Amounts owed to related parties £m
Subsidiaries:				
2009	–	1.9	83.4	20.2
2008	2.8	6.8	8.3	20.4

Amounts outstanding are unsecured. No provisions have been made for doubtful debts owed by related parties.

30 Transfer of trade from Vectura Group plc to Vectura Limited

With effect from 1 April 2008, the trading activity and all related assets and liabilities of Vectura Group plc were transferred to Vectura Limited at their net book value of £73.2m.

Five-year summary
year ended 31 March

Year ended 31 March	2005 £m	2006 £m	2007 £m	2008 £m	2009 £m
Consolidated income statement					
Revenue	4.5	8.4	14.1	25.2	31.2
% gross profit to sales	67%	77%	77%	83%	88%
Research and development expenses	(8.7)	(12.4)	(17.0)	(29.7)	(32.3)
Other administrative expenses	(2.2)	(1.8)	(2.6)	(3.0)	(3.2)
Amortisation	(1.0)	–	(2.0)	(10.2)	(10.2)
Share-based compensation	(0.6)	(0.7)	(1.6)	(2.7)	(1.9)
Share of loss of associate	–	–	(0.2)	(0.3)	(0.6)
Other income	–	–	1.4	–	–
Operating loss	(9.6)	(8.5)	(11.2)	(25.1)	(20.9)
Investment income	0.8	1.0	2.8	4.5	3.6
Finance costs	(0.2)	–	(0.1)	(0.8)	(2.3)
Taxation	1.2	1.0	1.4	2.2	2.9
Loss after taxation	(7.8)	(6.5)	(7.1)	(19.2)	(16.7)
Loss per ordinary share	(8.7p)	(6.0p)	(4.6p)	(6.1p)	(5.2p)

Year ended 31 March	2005 £m	2006 £m	2007 £m	2008 £m	2009 £m
Consolidated cash flow statement					
Net cash outflow from operations	(6.2)	(2.5)	(7.9)	(3.7)	(3.6)
Net taxes received	1.2	1.0	1.4	2.2	2.9
Interest received	0.8	1.0	2.8	4.5	3.6
Net capital expenditure	(0.5)	(1.3)	(2.4)	0.6	(1.6)
Net cash acquired with Innovata acquisition	–	–	17.1	–	–
Investment in associates	–	–	(0.2)	–	–
Net cash (outflow)/inflow before financing	(4.7)	(1.8)	10.8	3.6	1.3

Year ended 31 March	2005 £m	2006 £m	2007 £m	2008 £m	2009 £m
Consolidated balance sheet					
Cash and cash equivalents	18.4	16.8	77.0	78.8	74.0
Shareholders' equity	22.0	16.6	182.0	169.5	154.9
Net current assets	16.5	12.4	70.4	68.6	56.0

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

Shareholder information

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

Secretary
Anne P Hyland

Corporate broker
Piper Jaffray Limited
One South Place
London
EC2M 2RB, UK

Registrars
Computershare Investor Services plc
PO Box 82
The Pavilions
Bridgwater Road
Bristol
BS99 7NH, UK

Public relations
Financial Dynamics Limited
26 Southampton Buildings
London
WC2A 1PB, UK

Auditors
Deloitte LLP
126–130 Hills Road
Cambridge
CB2 1RY, UK

Bankers
Barclays Bank plc
28 Chesterton Road
Cambridge
CB4 3UT, UK

Legal advisers
Olswang
90 High Holborn
London
WC1V 6XX, UK

Vectura Group plc
One Prospect West
Chippenham
Wiltshire
SN14 6FH, UK

vectura

A leader in inhaled pharmaceuticals

Vectura Group plc

One Prospect West
Chippenham
Wiltshire SN14 6FH
United Kingdom

T +44 (0)1249 667700
F +44 (0)1249 667701
E investorqueries@vectura.com

www.vectura.com

Registered in England and Wales
Number: 3418970

This Report has been printed on Colorplan and Think Bright. Both papers have been independently certified according to the rules of the FSC (Forest Stewardship Council). Think Bright is manufactured from 50% post-consumer recycled fibre within an ISO 14001 & ISO 9001 accredited mill. Colorplan is 100% ECF virgin fibre.

Designed and produced by **Fox Design Consultants**
Printed by **The Midas Press**