Vectura Group plc
Annual Report and Accounts
2011/12

vectura

A leader in inhaled pharmaceuticals

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Financial highlights

- Revenues ahead of expectations at £33m (2010/11: £42.9m)
- Loss before tax in line with previous year at £13.2m (2010/11: £13.3m)
- Loss after tax reduced by 50% to £4.4m (2010/11: £8.8m)
- Cash and cash equivalents increased by £1.1m with cash of £75.5m at 31 March 2012

Operational Highlights

NVA237 (COPD)

First launch anticipated in 2012

- European Marketing Authorisation Application (MAA) filed in September 2011, triggering a $5m milestone receipt from Novartis
- EU decision on NVA237 expected from mid-2012
- New Drug Application (NDA) for Japan filed in November 2011
- Phase III data presented in September 2011 at the European Respiratory Symposium (ERS) demonstrated improvements compared with placebo
  - Additional Phase III data expected in H1 2012
- US NDA filing expected early in 2014

QVA149 (COPD)

On track for European filing in 2012 and launch in 2013

- Novartis reported headline Phase III data from the first four studies in April 2012, which showed that QVA149 met all primary endpoints:
  - ILLUMINATE – superior lung function (measured by FEV_1 $AUC_{0\text{-}12h}$ with a p value <0.001) of once-daily QVA149 compared with twice-daily Seretide® (fluticasone 500mcg/salmeterol 50mcg) in patients with moderate to severe COPD
  - SHINE – superiority in trough FEV_1 ($p<0.001$) compared with once-daily indacaterol or once-daily NVA237. In addition, QVA149 showed superiority in trough FEV_1 ($p<0.001$) compared with placebo and open-label tiotropium (18mcg)
  - BRIGHT – patients experienced significantly better exercise endurance versus placebo (p=0.006)
  - ENLIGHTEN – QVA149 was well tolerated with a safety and tolerability profile similar to placebo
- Additional Phase III data to be published at a conference in H2 2012
- US NDA filing is expected at the end of 2014

VR315 (asthma/COPD)

Progress continues in all territories with two new partnerships secured

- Agreement signed with Sandoz in August 2011 for Rest of World (RoW) development; €2.5m received
- Development progresses in both EU and RoW with Sandoz
- Agreement signed with the US division of an international pharmaceutical company for development and commercialisation in the US; $10m generated in August 2011
- A further $2m received in March 2012 from our US partner relating to development progress

VR632 (asthma/COPD)

Development progresses in Europe with Sandoz

- €0.4m milestone received in March 2012

Chairman and Chief Executive's report

Jack Cashman Chairman

Chris Blackwell Chief Executive

'Vectura has delivered another set of robust results, preserving a strong balance sheet through a combination of existing royalty streams and disciplined investment in R&D. During the year we delivered two new deals around VR315; securing a new US partner and extending our existing relationship with Sandoz (our European partner) to cover Rest of World territories. We also announced positive Phase III data from the combination product, QVA149 in April of this year and anticipate a number of major catalysts in 2012, including the EU filing of this product as well as the expected launch of NVA237 in Europe. As these programmes mature, we anticipate the resultant milestones and royalties will transform our revenue streams, making Vectura a self-sustainable, cash-generative Company, setting the stage for the next chapter in the Company's growth.'

Overview

Vectura is a developer of inhaled pharmaceuticals with a range of proprietary lung delivery technologies, including formulation and device capabilities. Our focus is principally on developing treatments for respiratory diseases. We have a broad and largely late-stage pipeline of products spanning both the branded and generics space. The collaborations and licence agreements we have struck around these products with major players in the $25bn asthma/chronic obstructive pulmonary disease (COPD) market are testament to the strength of our respiratory franchise.

Our most advanced pipeline products are:

- NVA237, a long-acting muscarinic antagonist (LAMA), which is being developed for the treatment of COPD both as a monotherapy and as part of a novel, fixed-dose combination with the once-daily, long acting beta-agonist (LABA) Indacaterol (QVA149)
- QVA149, the fixed-dose combination of NVA237 with the once-daily, long acting beta-agonist (LABA), Onbrez® Breezhaler® (indacaterol maleate) developed and marketed by Novartis. Onbrez® Breezhaler® is now approved in more than 80 countries, including the US, where it is approved under the name Arcapta™ Neohaler™, and Japan under the name Onbrez® Inhalation Capsules
- VR315, a generic version of an established blockbuster for asthma and COPD

Novartis, the worldwide licensee for NVA237, has made progress this year in commercialising its COPD products in a number of territories. The publication of positive pivotal Phase III data for NVA237 in August 2011 coincided with the European regulatory filing for the drug. Marketing Authorisation is being sought with the European Medicines Agency (EMA) for NVA237, under the brand name Seebri® Breezhaler®. For this, Vectura received a $5m milestone. An EU decision on NVA237 is expected mid-year with the first launch expected later in 2012. In the US, Novartis has agreed Phase III for NVA237 with the FDA and expect to file the product at the beginning of 2014.

We believe that QVA149 could be the first once-daily LABA/LAMA combination therapy to market for COPD. With the dual activity of a beta-adrenergic agonist and a muscarinic antagonist offering the potential for potent bronchodilation, it has an opportunity to address a large and unmet medical need for COPD sufferers. This year should see a number of important milestones for QVA149. We recently announced positive pivotal Phase III data and expect Novartis to present additional data in H2 2012, which should support initial regulatory submissions in Europe and other countries, including Japan, later this year.

Our licensing deal with Novartis for NVA237 and QVA149 is a good example of our disciplined approach to R&D; it also demonstrates the high return possible on our drug discovery platform. To date, we have made a four times return on our investment in NVA237, with the prospect of transformational royalties and milestones pointing towards further significant near-term upside.

Our key generic programme, VR315, also continues to progress worldwide. During the financial year, we secured two prestigious partners. In the US, our new partner is the US division of a leading international pharmaceutical company, while we have extended our existing relationship with Sandoz, our licensee for Europe, to cover RoW (ex-US). In March 2012 we received $2m from our new US partner indicating further development progress during the year.

As detailed below, we continue to see progress on our other programmes including VR632, a second combination product for asthma and COPD, where we received a €0.4m milestone from Sandoz in relation to European development progress.

Summary and outlook

Vectura has made significant progress this year on both its branded and generic programmes as they move closer to market. At the same time, the Company has maintained its financial discipline in preserving a strong balance sheet whilst investing in future growth. The low risk development model we have adopted, together with strict development criteria, optimises the likely returns we have seen and will continue to see from our R&D investment.

We look forward to a number of significant catalysts in this coming year from our programmes while we continue to look to exploit other significant opportunities within the markets in which we operate.

Jack Cashman
Chairman

Chris Blackwell
Chief Executive

25 April 2012

Financial review

Summary

This was another cash generative year for Vectura with a £1.1m increase in cash to £75.5m (2011: £74.4m). Revenues of £33.0m (2010/11: £42.9m) were ahead of expectations, although £9.9m lower than the previous year, due to a higher level of one-off milestone receipts in the previous year. However, Vectura managed this decrease in revenue through active reduction in expenses resulting in £0.1m reduction in the loss before tax to £13.2m (2010/11: £13.3m).

Revenue
Revenue includes fee income from royalties, product licensing, technology licensing, development fees and device sales.

Royalties were in line with the previous year at £13.5m (2010/11: £13.6m). ADVATE® royalties increased by 4% in the period to £10.6m (2010/11: £10.2m) and contributed 79% of the royalties generated in the year. ADVATE® sales are continuing to grow, approaching $1.9bn in 2011, compared with sales of $1.8bn in 2010. Underlying ADVATE® royalties increased by 6% in the period with the effect of foreign exchange rates reducing the net increase to 4%. Vectura receives a net royalty of under 1% at these high levels of cumulative annual sales. Extraneal® royalties were £1.7m (2010/11: £2.4m), which included exceptional royalties of £1.1m relating to prior year sales. Extraneal® royalties are expected to be approximately £0.6m in the next financial year as Vectura patents relating to this product expire. The majority of the remaining royalties were generated from Adept®, £0.9m (2010/11: £0.8m).

Product licensing revenues in the period were £12.1m (2010/11: £10.6m), which includes the final £2.4m of the £5.1m ($7.5m) QVA149 Phase III clinical trial milestone received from Novartis in 2010 and the final £1.4m of the £6.2m ($9.5m) milestone received from Sandoz for VR315 US. We announced two new licensing deals in August 2011, both relating to VR315, of which £3.9m ($6.3m) relates to the upfront milestone received for the licence of VR315 to an undisclosed partner in the US and £0.9m relates to the upfront milestone received for the licence of VR315 to Sandoz for the RoW territories. A further £3.2m ($5m) relates to the NVA237 EU filing milestone received from Novartis in September 2011 and £0.3m relating to a development milestone from Sandoz for VR632 received in March 2012.

Technology licensing revenues of £2.3m (2010/11: £12.9m) are lower than the previous year. In 2010/11 we received a £10m upfront payment from GSK under a non-exclusive licence agreement. In addition to the upfront payment we are due to receive a further £10m by the time the products are launched, £4m of which was received by 31 March 2012.

Pharmaceutical development services (PDS) revenues decreased to £2.8m (2010/11: £4.2m) as work on some of our partnered programmes has been successfully completed. Future PDS revenues will depend on the extent and nature of feasibility studies and new licensing deals as the development of inhalation products is a very specialist area, with partners frequently requiring Vectura's involvement in the continuing development of a product. We expect these revenues to decrease further in the next financial year.

The significant increase in device sales to £2.3m (2010/11: £1.6m) was mainly due to sales of the GyroHaler® device.

Gross profit
The gross profit in the year to 31 March 2012 was £30.8m (2011: £40.2m). Gross profit represents 93% of revenue (2010/11: 94%).

Research and development expenses
Total investment in research and development was £32.8m, a 13% decrease on the previous year (2010/11: £37.7m). Research and development expenditure in 2010/11 includes £2.5m that relates to the costs of restructuring our development operations, encompassing closure of the Nottingham facility and a reduction in the number of research and development employees.

Taxation
The tax credit for the year was £8.8m (2010/11: £4.5m). Research and development tax credits of £4.6m were received in cash during the year (2010/11: £8.2m) of which £2.5m was included in other receivables as at 31 March 2011, resulting in current year tax income of £2.1m. An estimated research and development tax credit of £4.0m relating to the 2011/12 financial year has been recorded and this is expected to be received during 2012/13. A release of £2.8m from a deferred tax liability has also been credited to the income statement for the 2011/12 financial year due to the utilisation of tax losses carried forward. As the Group's losses reduce, research and development tax receipts will decline significantly.

Intangible assets
Intangible assets of £23.4m (2011: £30.9m) have been amortised by £7.5m (2010/11: £10.7m) during the year. These intangible assets relate to the Innovata acquisition and they will continue to be amortised over their expected useful life. The reduction in the amortisation charge is in line with the reduction in royalty streams as Extraneal® comes off patent in certain territories.

Property, plant and equipment
Property, plant and equipment increased by £3.1m (2011: decline of £0.1m) in the year as a result of the Group's investment in its inhaled product manufacturing capabilities.

Deferred income
Deferred income relates to milestones received in cash but not yet recognised as revenue. Of the £4.8m on the balance sheet at 31 March 2012 (2010: £5.5m), £3.5m will be recognised as revenue in 2012/13; £0.6m relates to ADVATE® royalties, £1.6m to technology licensing and £1.3m relates to the VR315 US $2m receipt. £1.3m will be recognised as revenue in later periods relating to the VR315 RoW deal with Sandoz.

Business review: overview

Equity
A shareholder resolution was approved at the Company's AGM, held on 22 July 2011, to reduce the Company's share premium account by £78.6m. An application to reduce the Company's share premium account was subsequently made to the High Court of Justice and approval was received on 25 January 2012. In the balance sheet, the share premium account has been reduced by £78.6m and the retained loss of the Company has been reduced from £25.9m to £nil. The remaining balance of £52.7m has created a retained profit in the Company balance sheet and will enable the Company to pay dividends in future periods. The Board does not currently intend to pay dividends.

The Company balance sheet is not included in these preliminary results.

Cash flow
Cash increased by £1.1m in the period (2010/11: £10.3m). The net cash flows from operating activities are once again positive at £2.1m (2010/11: £10.8m). At 31 March 2012, Vectura had cash and cash equivalents of £75.5m (2011: £74.4m), which was equivalent to 23p per share in issue.

Foreign exchange rates
The following foreign exchange rates were used during the year:

	2011/12	2010/11
Average rates:		
£/$	1.60	1.56
£/€	1.16	1.18
Period end rates:		
£/$	1.60	1.60
£/€	1.20	1.13

Anne Hyland
Chief Financial Officer

25 April 2012

Vectura Group plc and its subsidiaries ('Vectura' or the 'Group') 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 in excess of $25 billion.

Vectura has six products marketed by its partners and a portfolio of drugs in clinical and pre-clinical development, a number of which have been licensed to major pharmaceutical companies. Vectura has development collaborations and licence agreements with several pharmaceutical companies, including Novartis, Sandoz (the generics arm of Novartis), Baxter and GlaxoSmithKline (GSK).

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.

Business review: core purpose, values and strategy

Our people

We have a talented team of people at Vectura and we are committed to developing therapies that improve the quality of patients' lives. The respiratory market is a large and growing market and we are confident we will succeed in creating value for our shareholders.

Our main values

Everything we do stems from our five key values:

Achievement – we deliver on the challenging goals we set ourselves.

Enthusiasm – we give our best and enjoy what we're doing.

Participation – success comes from working together. By being flexible and informal, we encourage each other as well as innovation.

Innovation – we think freely and creatively about our goals.

Trust and respect – we value people and ideas on their merits. Everyone has a part to play, and everyone's contribution is recognised.

Our strategy

Treating respiratory diseases
Our broad clinical portfolio has a range of mid and late-stage programmes with high potential, as well as earlier-stage opportunities that are addressing fast-growing markets. We have innovative device and formulation technologies and our respiratory development pipeline includes branded and generic products to treat asthma and chronic obstructive pulmonary disease.

Seeking value
We have also developed therapies for conditions such as Parkinson's disease and cystic fibrosis, from which we seek to derive value by actively seeking licencees.

Financial stability and a self-sustaining business
We are creating value for our shareholders in three key ways:

Intellectual property and expertise – we are out-licensing products and technologies to major pharmaceutical companies in return for revenues from milestones and royalties. We are also developing specialty products. Our current strategy is to take these products to Phase II clinical development and then look for licensing partners.

Collaborations with partners – we are looking to optimise the value of our branded and generic/branded generic products in the growing respiratory market by working with other leading pharmaceutical companies.

Building our franchise – we continue to build the Company through internal innovation as well as exploring opportunities with products, technologies or businesses that support these goals.

Business review: market potential

Hundreds of millions of people every day suffer from chronic respiratory diseases including asthma and chronic obstructive pulmonary disease (COPD). COPD is predicted to be the third leading cause of death by 2030, while the World Health Organization Director-General has stated that *'asthma is on the rise everywhere'*.

Asthma and COPD make up the third-fastest growing marketplace for therapeutic treatments, with the total market estimated to be worth more than $25 billion in the US alone. The increase in fixed-dose combinations, and ongoing advances in effective therapies mean this figure will continue to grow. Our products for asthma and COPD target over half of this ever-expanding global market.

A carefully developed strategy for growth

To generate as much value as possible from our global opportunities, we are focusing on both the branded and generic/branded generic respiratory markets. It is a very large market with dry powder inhalation (DPI) products currently generating sales in excess of $11 billion a year and the market is still growing. This market poses a number of regulatory challenges, which require a specialism and expertise in product development for which Vectura is known. There are relatively few competitors working on complex generic/branded generic respiratory products, and new market opportunities are emerging that provide huge potential for growth.

Asthma is a chronic disease that is characterised by recurring attacks of breathlessness and wheezing. An asthma sufferer may experience symptoms several times a day, and they may become worse during physical activity or at night.

COPD is a progressive, life-threatening disease that is often associated with tobacco smoking, air pollution or occupational exposure. The condition obstructs airflow in the lungs, leading to debilitating and often distressing bouts of breathlessness. COPD cannot be cured, and anyone suffering from the condition will need treatment to reduce the symptoms and exacerbations indefinitely.

Business review: products

Product pipeline

Product	Indication	Pre-clinical	Phase I	Phase II	Phase III	Filed
Respiratory						
NVA237*	COPD					EU & Japan
QVA149*	COPD					

*Partnered with Novartis

Licensing opportunities						
VR496	Cystic fibrosis					
VR040	Parkinson's disease					

Generic/branded generics

Product	Indication	Partner
VR315 EU & RoW	Asthma/COPD	**Sandoz**
VR315 US	Asthma/COPD	**Undisclosed**
VR632 EU	Asthma/COPD	**Sandoz**
VR632 US & RoW	Asthma/COPD	
VR506	Asthma	

Partnered proprietary products and technologies

In the asthma and COPD markets, we offer licensing opportunities for our products and also offer technologies to other pharmaceutical companies, where our expertise enables a more effective delivery of products.

NVA237 and QVA149 for chronic obstructive pulmonary disease (COPD)
NVA237 is a dry powder formulation for inhalation of glycopyrronium bromide, a LAMA with a rapid onset of activity at first dose, being investigated for the treatment of COPD.

NVA237 was licensed to Novartis in April 2005 by Vectura and our co-development partner, Sosei Group Corporation. It is anticipated that Novartis will launch NVA237 in certain territories as a once-daily monotherapy for COPD in 2012 and as a combination (QVA149) with its once-daily LABA, indacaterol, in some territories in 2013.

In September 2011, Novartis filed NVA237 for marketing authorisation with the EMA under the brand name Seebri® Breezhaler®, triggering a $5m milestone payment to Vectura.

That same month, Novartis presented new NVA237 Phase III data at the ERS congress. The GLOW1 and GLOW3 studies in COPD patients showed that NVA237 significantly increased patients' lung function compared with placebo, with a fast onset of action at first dose, as well as improving exercise endurance.

The GLOW1 study met its primary endpoint by showing that NVA237 50mcg once-daily produced a significant improvement of 108 mL in trough FEV_1 (forced expiratory volume of breath in one second) after 12 weeks in patients with moderate-to-severe COPD compared with placebo ($p<0.001$). Moreover, NVA237 had a rapid onset of action at first dose, with a 93 mL improvement in FEV_1 compared with placebo at five minutes after the first dose ($p<0.001$).

NVA237 significantly prolonged the time to first moderate/severe COPD exacerbation compared with placebo, and reduced the percentage of hospitalisations. Significant improvement in breathlessness was seen at 26 weeks compared with placebo, accompanied by a significant improvement in health-related quality of life and reduction in the use of rescue medication.

The GLOW3 study investigated the effects of NVA237 50mcg once-daily on exercise endurance in moderate-to-severe COPD patients. The study met its primary endpoint by showing a significant 21% improvement in exercise endurance relative to placebo at the end of the study (i.e. day 21), with a significant 10% increase from day one (both $p<0.001$).

Both studies showed that NVA237 was well-tolerated, with a similar incidence of adverse events for patients treated with NVA237 and placebo. Novartis expect to announce additional Phase III data from the GLOW2 study in H1 2012.

After discussions with the Food and Drug Administration (FDA), in April 2012 Novartis announced that in the US, they have agreed on Phase III for NVA237 and they expect to file the product at the beginning of 2014.

The FDA's requirement for additional clinical data for NVA237 has also impacted the timing of the NDA submission for QVA149 in the US, which is now expected at the end of 2014. We believe that QVA149 could be the first once-daily LABA/LAMA combination therapy on the market for COPD. The dual activity of a beta-adrenergic agonist ($beta_2$-agonist) and a muscarinic antagonist could result in a potent bronchodilator that would address a large and unmet need for COPD sufferers.

Novartis commenced Phase III studies with QVA149 in May 2010, triggering a $7.5m milestone payment to Vectura. In April 2012, Novartis announced headline data from four of these studies. The studies ILLUMINATE, SHINE, BRIGHT and ENLIGHTEN, have all met their respective primary endpoints and demonstrate the potential of QVA149 in the treatment of COPD.

The ILLUMINATE study in more than 500 patients demonstrated that superior lung function (measured by FEV_1 $AUC_{0\text{-}12h}$ with a p value <0.001) was achieved with once-daily QVA149 compared with twice-daily Seretide® (fluticasone 500mcg/salmeterol 50mcg) in patients with moderate to severe COPD.

The results of SHINE, with an enrolment of more than 2,100 patients, met the primary endpoint, demonstrating the superiority in trough FEV_1 ($p<0.001$) of once-daily QVA149 compared with once-daily indacaterol or once-daily NVA237 in patients with moderate to severe COPD. In addition, QVA149 showed superiority in trough FEV_1 ($p<0.001$) compared with placebo and open-label tiotropium (18mcg).

The results of BRIGHT showed that patients experienced significantly better exercise endurance versus placebo (p=0.006). ENLIGHTEN demonstrated that QVA149 was well tolerated with a safety and tolerability profile similar to placebo.

Novartis expects to present additional Phase III data at a conference in H2 2012 and to file the product in Europe and other countries, including Japan, in 2012. The first product launch is expected in 2013.

To date, Vectura has received $35m from Novartis and, under the terms of the licence, could receive up to an additional $152.5m for achievement of regulatory and commercialisation targets for both the monotherapy and combination product. Vectura has no cost obligations for these products and royalties will be received on product sales following successful product launches. The COPD market is forecast to grow to $24bn in 2019 and these products are expected to play an important role in this market.

Generic/branded generic products

Branded, combination, dry powder inhaler (DPI) therapy constitutes the largest sector of the respiratory market, with annual sales of over $11bn. With an ever-growing need for effective and affordable medicines, these products have excellent potential to generate value as generics or branded generics. With extensive formulation and device expertise, both of which are needed to create DPI products, we are ideally placed to take advantage of this opportunity.

VR315 for asthma/COPD
VR315 is an inhaled combination therapy for asthma and COPD, delivered with Vectura's GyroHaler® DPI device in Europe, where it is licensed to Sandoz AG for development and commercialisation. The deal is worth up to €22.5m in milestones and development funding, plus royalties on all products sold. Vectura has received all development funding with €7.5m in milestones to be received.

Vectura signed a US licence agreement with a division of a leading international pharmaceutical company in August 2011. Under the terms of this agreement, Vectura's partner will be responsible for the commercialisation and manufacture of the product together with clinical development. Vectura is providing support for the US development of VR315 and received an initial payment of $10m with a further $2m payment received in March 2012. Vectura is eligible to receive a further $33m upon achievement of pre-determined development milestones and, in addition, will receive a royalty from all VR315 US sales.

Also in August, we extended our collaboration with Sandoz for RoW rights to VR315. Sandoz is responsible for any development work required and for obtaining marketing authorisations throughout the RoW territory, which includes Japan, Canada, South America and Australia. Under the terms of the agreement, Vectura will receive a royalty on net sales and a margin on the commercial manufacture and supply of the GyroHaler® device used to deliver VR315, and is also eligible for milestones and advance pre-launch royalties worth up to €8m.

VR632 for asthma/COPD
VR632 is our second inhaled combination therapy for asthma and COPD, which also uses our GyroHaler® technology. The European rights for VR632 were licensed to Sandoz in December 2007 in a deal worth up to €15.5m in milestones and development funding plus royalties on all products sold. We retain the rights for the US and other territories. Development progress continues on the product and we received €0.4m from Sandoz in March 2012.

VR506 for asthma
VR506 is an inhaled corticosteroid (ICS) for the treatment of asthma that entered clinical development in early 2011. ICS's are the mainstay of prophylactic therapy for asthma. As one of the recommended 'preventer' drugs for adults and children, they are often prescribed alongside $beta_2$-agonist bronchodilators.

Business review: marketed products

Six products are being marketed and are generating revenue for Vectura, with ADVATE® being the main value driver.

ADVATE® for haemophilia A
In 2000, we granted worldwide rights to Baxter to use our stabilisation patents in its serum-free recombinant Factor VIII, ADVATE®. This is indicated for the treatment of haemophilia A and is marketed worldwide by Baxter, from which Vectura earns royalties from sales.

Extraneal® for peritoneal dialysis
Extraneal® is a peritoneal dialysis solution containing icodextrin, licensed to Baxter in 1996 and marketed by Baxter worldwide. Vectura receives royalties on sales in the US and certain other territories.

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 after gynaecological and other abdominal surgery. It has been used in Europe since 2000 and since 2006 in the US. In December 2005, we signed a licence deal with Baxter for the manufacture and distribution of Adept®.

Products delivered in Clickhaler® for asthma
Five products have gained regulatory approvals for the treatment of asthma that are delivered using Clickhaler®, our proprietary reservoir DPI device.

Asmasal® and Asmabec® are marketed by Recipharm in the UK, France and Ireland. Asmasal® contains salbutamol, a short-acting $beta_2$-agonist for the rapid relief of asthma symptoms. Asmabec® contains beclometasone, an inhaled steroid used as standard preventative therapy for asthma. Meptin® (procaterol) is a short-acting $beta_2$-agonist for the rapid relief of mild, intermittent asthma symptoms, marketed by Otsuka Pharmaceutical in Japan.

Regulatory approvals have also been received for Clickhaler® budesonide in Germany, the Netherlands and New Zealand, with approvals for Clickhaler® formoterol received in Denmark, the Netherlands, South Africa and New Zealand. Neither of these products is marketed at present; we are actively exploring new territories for marketing them as well as other Clickhaler® products. One of the countries we are considering is China, where an estimated 5% of the population suffers from asthma or COPD.

enabling technology platforms

We have a wide range of important drug delivery technology platforms that are patent-protected, which we use to support our own product development. We also offer technologies for licence to other pharmaceutical companies, a strategy that has already generated significant revenue for Vectura.

Vectura has a state-of-the-art Good Manufacturing Practice (GMP) facility that has been designed specifically to manufacture inhaled products to support clinical trials through to regulatory filing.

The development 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. Companies across the world are keen to harness our expertise and technology for their own inhalation programmes and we expect that this will lead to future collaborations and licensing deals.

Formulation technologies – including PowderHale®
Our formulation technologies include PowderHale®, a patented DPI formulation technology designed to allow aerosolised drug particles to achieve high lung deposition with low-dose variability. This is achieved by incorporating an additional pharmacologically inactive excipient known as a Force Control Agent (FCA). We also possess expertise in micronisation, blending and spray drying, all of which are used in the development of our own and third-party products.

An example of the type of formulation technology licensing deal possible is the non-exclusive licensing agreement signed in August 2010 with GSK which enables them to use some of our dry powder drug formulation patents for two late-stage development compounds in their respiratory product pipeline. Under the agreement, Vectura will receive £20m by the time the compounds are launched, as well as earning royalties on sales of these products, generating up to £13m per year.

Multi-unit dose DPI devices
Our cost-effective, multi-unit dose DPI technologies, designed to deliver locally-acting drugs to the lungs, include devices such as GyroHaler® and OmniHaler®. Compact and easy to use, our devices consist of just a few moulded parts, which reduces manufacturing costs. Each device delivers up to 60 doses and is disposable after use. They have aerosolisation characteristics that are competitive in the marketplace and provide excellent drug protection from moisture and light using sealed, foil blisters. GyroHaler® is used to deliver some of our generic products and is scaled up for commercial launch. Other devices are in late-stage development.

We continue to invest in our device platform and have tailored our device technologies for the US respiratory generics market and have received recent validation from both partners and other external parties. All our multi-unit dose DPI technologies are available for licensing where such a partnership would add value to our business.

Duohaler® device and combination products for asthma/COPD
In addition to our multi-unit dose devices we also have the two reservoir DPIs Clickhaler® and Duohaler®. Duohaler® provides advantages over a number of other multi-dose DPIs. Two separate drug reservoirs feed two individual drug formulations into two separate metering chambers, and the drugs are then delivered to the user in the same inhalation. This process obviates the need to co-formulate combination drugs and provides a means of delivering simultaneously a combination formulation from one reservoir and an individual drug from the second. Both Clickhaler® and Duohaler® are available for licensing.

Business review: capabilities

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 some of those developed by our partners. Key functions include liaison 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 the conduct of clinical trials.

Regulatory affairs
Vectura has experience in global pharmaceutical product registration and inhaled product development. Vectura has regulatory support for its own programmes and for those of its partners, thus ensuring that it has the data requirements to ensure timely approvals. Vectura prepares and maintains Clinical Trial Authorisations (CTAs) and prepares regulatory 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 development environment ensures that the clinical supplies produced and the data intended to support regulatory submissions are generated in compliance with Good Pharmaceutical Manufacturing Practice (GMP), the principles of Good Laboratory Practice (GLP) and Good Clinical Practice (GCP), collectively referred to as GxP.

Vectura has a Manufacturer's Authorisation for Investigational Medicinal Products at its Chippenham facility – MIA(IMP)33496 – 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, certification and release of clinical trial supplies by the Group's Qualified Person.

Vectura is also certified under ISO 13485:2003 for the design and manufacture of inhaler products. In order to achieve the ISO 13485 certification, Vectura's device engineering and Quality Management System 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.

Manufacturing operations
The Manufacturing Operations team is responsible for the late-stage manufacturing of Vectura's technologies and 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 portfolio of intellectual property is a valuable asset that is fundamental to success, and the Group aims to secure registered protection for all aspects of its products, processes and technology platforms.

Vectura's extensive patent portfolio consists of patent families relating to various pharmaceutical technologies, including inventions made by the Group's researchers as well as inventions the Group has acquired or licensed from third parties. The Group actively protects, maintains and defends this patent estate. Vectura also maintains additional intellectual property rights including trademarks, design rights and know-how.

Value continues to be obtained from Vectura's intellectual property portfolio from licensing IP rights for the development of inhalation and non-pulmonary products.

Facilities
Vectura operates from two facilities in the UK. There are approximately 64,000 square-feet of laboratory, office, warehouse and manufacturing facilities in Chippenham, Wiltshire. These facilities are approved for GMP manufacturing of Investigational Medicinal Products for clinical trials. On the Cambridge Science Park, Vectura occupies a 4,200 square-foot laboratory and device engineering unit.

Business review: key performance indicators

Loss reduction and revenue generation
Loss after taxation over the last three years has reduced year on year as follows:

Year ended	Loss £m	Decrease £m
31 March 2012	**4.4**	**4.4**
31 March 2011	8.8	1.4
31 March 2010	10.2	6.5

Revenues generated over the last three years are as follows:

Year ended	Loss £m	(Decrease)/increase %
31 March 2012	**33.0**	**(23)**
31 March 2011	42.9	7
31 March 2010	40.1	29

Cash management
This involves the management of the funding received and the cash resources available. The operational cash 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 2012 are as follows:

Year ended	Increase/(decrease) in cash £m	Cash inflow/(outflow) from financing £m
31 March 2012	**1.1**	**2.5**
31 March 2011	10.3	0.2
31 March 2010	(9.9)	(5.7)

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 VR632 EU (€0.4m received March 2012) and NVA237 ($5m EU filing milestone received).

Progress with the un-partnered product pipeline
During the year rights to VR315 were licensed for territories outside Europe. In August 2011 an undisclosed US division of a major international pharmaceutical company licensed the rights for the US market and in the same month Sandoz licensed the rights to VR315 for the remaining territories.

Identification of new product pipeline
Vectura continues to evaluate new product opportunities. Vectura 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 and filings.

Business review: risk management

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 Agency (EMA) in Europe and the Food and Drug Administration (FDA) in the US. The Group may be unable to attract, by itself or from partners, the funding necessary to meet the high cost of developing its products through to successful commercialisation.

Clinical and regulatory risk
Drug substances may not be stable or economic to produce. Unacceptable toxicities or insufficient efficacy in the chosen indication may cause the medicine to fail or limit its applicability. Lack of performance by third-party clinical research organisations or an inability to recruit patients 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 conditions unacceptable for 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. The Group manages its regulatory risk by working closely with its expert regulatory advisers and, where appropriate, by seeking advice from regulatory authorities on the design of key development plans for its pre-clinical and clinical programmes.

Counterparty risk
The Group relies on third party organisations to conduct its clinical trials and to manufacture certain of its products. If the relationship with or performance of any of these partners is adversely affected, the Group's operations may be adversely impacted. As part of the Group's routine vendor assessment, detailed due diligence is performed on all third party organisations to establish that such organisations have the required capability, expertise and financial stability to perform the relevant services for the Group. Where possible, alternative third party suppliers are identified to take over the performance of such services in the event difficulties are experienced with the original vendor.

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 party companies may have intellectual property that restricts the Group's or the Group's partners' freedom to operate. Obtaining licences to intellectual property may not be possible 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. The Group works closely with its legal advisers and obtains where necessary opinions on the intellectual property landscape relevant to the Group's product development programmes and manufacturing activities and processes.

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

Cash flow risk
The Group's activities expose it to the financial risks of changes in foreign currency exchange rates. The majority of the Group's revenues are in euros or US dollars. Where known liabilities arise in these currencies the revenues are retained on deposit in the appropriate currency in order to offset the exchange risk on these liabilities. As at 31 March 2012, the Group had sufficient euro and US dollar reserves to cover its immediate and short-term liabilities in respect of these currencies.

Credit risk
The Group's credit risk is primarily attributed to its cash and cash equivalents. This risk is limited because the counterparties are banks with high credit ratings assigned by international credit-rating agencies. Deposits are made in accordance with the Group's Treasury Policy approved by the Board, which contains strict criteria on minimum credit ratings and maximum deposit size. However, the recent global credit problems could result in the failure of even high credit-rated banks where funds are deposited.

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, working closely with its legal advisers on negotiations that are of significant importance to the Group.

Risk management
The Group's extensive risk management process is detailed in the corporate governance statement section of the business review. The process seeks to identify material risks and to determine how best to manage them. Specific risk managing actions the Group has in place are set out against certain of the risks identified in this section.

Business review: 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 2012 six Directors and over 200 staff operating from two sites in the UK and one office in the US. 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 code of best practice set out in the UK Corporate Governance Code (the 'Code'), a copy of which is available on the Financial Reporting Council's website at www.frc.org.uk.

Statement of compliance with the UK Corporate Governance 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 2012.

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 matters 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. Discussions took place on two occasions during the year and included discussions on each Executive Director's performance.

Vectura is committed to working towards achieving meaningful shareholdings in the Group for executive directors in order to align their interests to those of the shareholders. The Executive Directors acquired shares in both the years ended 31 March 2012 and 2011.

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 Leadership Team (LT) under the leadership of Chief Executive Dr Chris Blackwell; and by establishing a procedure whereby the LT 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. 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.

Throughout the year ended 31 March 2012 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.

Independence of NEDs
As explained in previous annual reports, in order to assist in securing the recruitment and retention of high-calibre NEDs, in the past the Group has, 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. No share options have been granted to NEDs since 2 July 2004, when the Company was admitted to the Alternative Investment Market (AIM).

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 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 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; however, there were no such relationships during the year or prior year.

Serving more than nine years could be relevant to the determination of a NED's independence. Notwithstanding the fact that Jack Cashman has been a NED of the parent company of the Group for 11 years, the Board has rigorously evaluated his performance and considers that he is fully independent of the Company.

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 receives automatic invitations to the meetings. 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 not 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 Mr Warner, all of which are considered to be independent. 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 Executive Committee, including pension rights, any compensation payments and the implementation of executive incentive schemes. The Committee met formally four times during the financial year ended 31 March 2012 and the Board confirms full attendance by all members at those meetings. No Directors are involved in determining their own remuneration.

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 Mr Warner. The Nomination Committee meets at least once a year, or more if necessary, and has responsibility for considering the size, structure and composition of the Board, retirements and appointments of additional and replacement Directors and making appropriate recommendations to the Board. The Committee met twice during the financial year ended 31 March 2012 and the Board confirms full attendance by all members at those meetings.

The Audit Committee

The Code recommends that the Board should establish an Audit Committee of at least three independent NEDs, and the Group complies with these recommendations. Mr Warner is the NED with relevant financial experience and who chairs the Audit Committee; its other members are Dr Foden and Dr Brown. The Audit Committee met twice during the year ended 31 March 2012. 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 auditor and assesses annually the qualification, expertise, resources, remuneration and independence of the auditor, as well as the effectiveness of the audit process.

Any non-audit services that are to be provided by the external auditor are reviewed and approved in advance 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 auditor. Non-audit fees are disclosed in note 6 to the financial statements within this Annual Report.

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 auditor 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.

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.

Business review: corporate governance statement

continued

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 plans formal meetings on a bi-monthly basis, with additional meetings either in person or by conference call when circumstances and urgent business dictate. In the financial year under review, seven regular meetings of the full Board were held.

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 all members 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 at intervals of no more than three years thereafter. The Board has a process for evaluation of its own performance and that of its committees and individual Directors, including the Chairman. These evaluations are carried out formally once a year and informally on a regular basis throughout the year. The formal evaluation is through an appraisal process. In line with the practice of previous years, the Assistant Company Secretary prepared and circulated a questionnaire for all Board members to answer and comment upon specific questions covering specific topics. These included the responsibilities and the roles of individual directors and the Board as a whole; the conduct of Board meetings and Committees of the Board; the Board's role in monitoring the performance of the Group and corporate governance practices. A detailed anonymised analysis of the replies to the questionnaire, together with conclusions drawn from such analysis, was prepared by the Assistant Company Secretary and considered by the Board.

The performances of Mr Cashman, Dr Brown and Dr Foden 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 auditor's report includes a statement by the auditor on its reporting responsibilities.

Measures to ensure auditor's independence include:
- approving engagements with independent audit firms and fees for audit, audit-related and non-audit services,
- external auditor conducting the audit part of the financial statements not being permitted to perform certain other services without full consideration being given to alternative suppliers of the services,
- disclosing the extent and nature of non-audit services in the notes to the financial statements.

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.

There have been no significant internal control failings or weaknesses throughout the year ended 31 March 2012 and up to the date of publication of this report.

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 the grievance procedure and the whistle-blowing policy circulated to all employees). In addition, the Group operates certain controls specifically relating to the production of consolidated financial information, covering operational procedures, validation and review.

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 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. Lean techniques addressing laboratory and office inefficiencies have also been adopted.

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 that 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. Each year, the Audit Committee considers the need for an internal audit function 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 four times a year by way of the Interim and Annual Reports and 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. Separate announcements of all material events are made as necessary by press releases. The Group's website (www.vectura.com) provides an overview of the business including its strategy, products and objectives. All Group announcements are published on the website without delay together with webcasts of both the Interim and Annual results presentations. The terms of reference of each of the Board's three Committees and certain corporate governance documents are also published on the Group's website. These are the main mechanisms by which the Board seeks to present a balanced and understandable assessment of the Group's position and prospects.

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. The Chairman seeks to meet with major shareholders on a regular basis. Certain Non-Executive Directors meet with major shareholders as required. Private shareholders are encouraged to express their views and concern either in person at the AGM or by e-mail.

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

25 April 2012

Board of Directors

John Patrick (Jack) Cashman
Non-Executive Chairman

Jack Cashman, aged 71, joined the Board of Vectura as Non-Executive Chairman in 2001 and is a member of both the Nomination and Remuneration Committees. Jack 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. He is currently a Director of Telesat Holdings 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, 50, was appointed Chief Executive of Vectura in February 2004. He joined the Group in 2002 as Chief Operations Officer and Executive Director. He trained as a scientist. Having achieved a first class honours degree in Applied Biology, Chris pursued a PhD at the University of Bath, where in 1988 he completed his doctorate investigating free radicals and reperfusion-induced arrhythmias in heart disease. Throughout both degrees, Chris was sponsored by ICI Pharmaceuticals (now Astra Zeneca), and worked in the fields of respiratory and cardiovascular diseases. 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, where he was UK Director, Global Project Management, and before that, at Glaxo in the department of Clinical Pharmacology.

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

Anne Hyland, 51, 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 and is also a member of the Primary Markets Group of the London Stock Exchange. She is also a Trustee of Sustrans, the charity that has created the National Cycle Network.

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

Dr John Brown, 57, joined the Board of Vectura as Non-Executive Director and Senior Independent Director in 2004 and chairs the Nomination Committee as well as being a member of the Remuneration Committee. John is Chairman of CXR Biosciences Ltd and the Roslin Foundation and is a Non-Executive Director of the UK Technology Strategy Board. He also Chairs the Life Science Advisory Board for the Scottish Government. 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. In June 2011 John received a CBE (Commander of the British Empire).

Susan Elizabeth Foden MA DPhil
Non-Executive Director

Dr Susan Foden, 59, 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 in the biotech and healthcare field, including Source Bioscience plc, Cizzle Biotechnology Ltd, BerGenBio AS and Evgen Ltd. 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.

Neil William Warner BA FCA MCT
Non-Executive Director

Neil Warner, 59, joined the Board of Vectura as Non-Executive Director in February 2011 and is Chair of the Audit Committee. Neil has significant financial and managerial experience in multi-national businesses and is a Non-Executive Director of Dechra Pharmaceuticals plc where he is the Senior Independent Director. He is also Non-Executive Chairman of Enteq Upstream plc, a specialist reach and recovery products and technologies provider to the upstream oil and gas services market. He was Finance Director at Chloride Group plc, a position he held for 14 years until its acquisition by Emerson Electric. Prior to this, he spent six years at Exel plc (formerly Ocean Group plc and acquired by Deutsche Post in December 2005) where he held a number of senior posts in financial planning, treasury and control. He has also held senior positions in Balfour Beatty plc (formerly BICC Group plc), Alcoa and PricewaterhouseCoopers. Neil has an Economics degree from the University of Leeds and is a Fellow of the Institute of Chartered Accountants.

Executive management

Timothy Wright BSc PhD MBA
Commercial Director

Dr Tim Wright, 51, 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.

Stephen William Eason BSc (Eng)
Director of Device Development

Stephen Eason, 54, joined Vectura in 2002 as Director of Device Development. He has overall responsibility for the development of Vectura's inhaler technologies and leads a team of device engineers and designers based in Cambridge. He is also responsible for Vectura's Intellectual Property Group. Stephen joined Vectura from Cambridge Consultants Limited (CCL), where in 1999 he had set up and led CCL's Drug Delivery Devices Group. The team carried out significant product developments in the areas of inhalation, injection and infusion products. Before specialising in drug delivery, Stephen managed a number of healthcare, telecoms and consumer product developments for clients in Europe and the US. Prior to joining CCL, Stephen worked in design and development for Baxter Healthcare. He studied Mechanical Engineering at the Imperial College of Science and Technology, London.

Trevor Phillips BSc PhD MBA
Chief Operations Officer & President of US Operations

Dr Trevor Phillips, 51, was appointed Chief Operations Officer in July 2011, having joined Vectura in January 2010 as President of US operations. Prior to joining Vectura he gained extensive international experience in organisational leadership, management and pharmaceutical drug development in a number of senior roles, including positions as CEO and President of the US publicly held company, Critical Therapeutics Inc, following six years as the Company's Chief Operating Officer. During his time at Critical Therapeutics, Trevor was involved in setting up commercial partnerships, product in-licensing and out-licensing, managing drug development and NDA filings, commercial product manufacturing, and mergers and acquisitions. Between 1986 and 2002 Trevor held a number of management positions at Sepracor, Scotia Pharmaceuticals, Accenture, GlaxoWellcome Research and Development and Simbec Research Limited. Trevor trained as a microbiologist at University of Reading, obtaining a PhD in microbial biochemistry from the University of Wales in 1986. He was awarded an MBA from Henley Management College in 1997.

Corporate social responsibility statement

The Directors recognise the 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.

Our people

Employees

The key to our success is to develop core values within all of our staff which lead to an environment where they believe that what they are doing is making a difference. The core values with which we operate are participation, achievement, trust and respect, innovation and enthusiasm.

During the period under review the rate at which we gained and lost employees has been low and absence levels have been below sector norms.

The Group recognises that in an industry based on innovation and 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 valued highly 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, inter alia, 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 are established 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 and paternity leave and pay policies conform to 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.

Ms Hyland is the board member responsible for overseeing responsibility for Human Resources and non-discrimination issues.

Community investment

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 to help patients with diseases.

Whilst the Group does not consider it appropriate while it is loss making to make financial donations to charitable or community activities it does encourage and support initiatives that provide in-kind benefits where we believe we have a meaningful contribution to make. Examples include:

- We support the STEM (Science, Technology, Engineering and Mathematics) Initiative which is a major UK Government initiative. Within this initiative our staff are actively helping

Corporate social responsibility statement continued

local schoolchildren, being tomorrow's workforce, to gain the capabilities and skills to flourish in a scientific environment such as ours.
- Quarterly visits to the Chippenham site (where approximately 90% of the employees are based) by the Blood Transfusion Services are facilitated and employees are encouraged to take the time to donate.
- An annual award of additional holiday is allocated to a small number of employees as part of a staff initiative to volunteer for unpaid community or charitable services.
- Staff are encouraged to participate in nationwide charity campaigns such as the Macmillan Coffee Mornings and Movember.

Health and safety

Vectura has a Health and Safety Committee to review health and safety standards within the Group. The Group considers health and safety to be a priority in its workplaces and a senior person is responsible for overseeing appropriate management. 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 health and safety practices under review.

The Group has an excellent safety record and there have been no major incidents or accidents to report to the Health and Safety Committee.

Environment

We are committed to minimising the impact of our activities on the environment and energy efficiency is the most important means of climate protection currently available to the Group. Due to the nature of its activities, Vectura considers that it has a low environmental impact.

Vectura has adopted an environmental policy, which can be found on our website. The policy sets out a commitment to reducing gas and electricity consumption and greenhouse gas emissions per employee from quantified levels. Quantifiable targets are established and we monitor performance against these targets. Vectura's current target is to reduce energy consumption and greenhouse gas emissions per employee by 3% per annum and this has been achieved for gas and electricity-based emissions of the Group in 2011/12.

A programme of capital investment for information technology has been undertaken to provide a virtual IT operating environment. This investment will significantly reduce the physical IT equipment we operate and is expected to lead to significantly reduced carbon emissions and make a significant financial return.

Vectura continues to adopt the principles of environmental management systems to ISO14001 standards. A Green Action Team meets regularly and has responsibility to pursue objectives for environmental sustainability and carbon reduction. Vectura's forthcoming operational goals include a quantified target for reducing our carbon footprint. Use is made of the Company intranet to communicate widely to all staff on environmental affairs and to receive their views and suggestions on green policy for consideration and discussion within the Green Action Team.

Vectura is committed to undertaking an environmental impact review of new product developments, site development and of merger and acquisitions.

Vectura has begun reporting its environmental performance under the Carbon Disclosure Project (CDP). CDP plays a vital role in communicating information about greenhouse gas emissions and related activities reported by the UK's largest companies, enabling investors and the public to take informed action against climate change. There have been no contentious issues or other matters having economic, legal, reputational or environmental consequences that have arisen in the year under review.

Ms Hyland is the board member to whom responsibility for environmental issues has been delegated. She is also a Trustee of Sustrans, a leading UK charity enabling people to travel by foot, bicycle or public transport for more of their journeys.

Waste management

Initiatives to effectively manage and reduce waste have been implemented throughout the Group, including recycling of all paper waste, aluminium cans, printer toners/cartridges and redundant mobile telephone handsets. Induction procedures for all newly recruited staff include sufficient information to ensure a high level of compliance with our standards. We aim to comply with all legislation in this area, including using registered waste disposal contractors.

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.

Vectura has adopted a clear anti-bribery policy and communicated it to all employees so they can recognise and avoid the use of bribery and report any suspicion for rigorous investigation. Political donations are prohibited and advance approval from management is required before management and staff may accept or solicit a gift of any kind.

Through the use of a risk register the Group has identified specific company-wide risks that include those in the key activities of intellectual property, medical and regulatory affairs, clinical development, pharmaceutical operations and device development.

Conclusion

Corporate social responsibility matters are considered as part of the risk assessments of the Group and are part of the considerations when setting remuneration targets.

Report on remuneration

Introduction

This report has been prepared in accordance with the Accounting Regulations of the Companies Act 2006 (the 'Act') and complies with the UK Corporate Governance Code. 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 auditor 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 2006. The report has, therefore, been divided into separate sections for unaudited and audited information.

Unaudited information

Remuneration Committee

The Remuneration Committee (the 'Committee') consists entirely of NEDs and is constituted in accordance with the recommendations of the UK Corporate Governance Code. The Committee is formally constituted with written terms of reference and its main responsibilities are detailed below. Its members for the year ended 31 March 2012 were Dr Foden (Chair), Dr Brown, Mr Cashman and Mr Warner.

The Committee is responsible for:

- setting a remuneration strategy that ensures that talented executives are recruited, retained and motivated to deliver results;
- ensuring that the remuneration for the Executive Directors and other senior executives reflects both their individual performance and their contribution to the overall Company results;
- determining the terms of employment and remuneration for the Executive Directors and senior executives including recruitment and retention terms;
- approving the design and targets for any annual incentive schemes that include the Executive Directors and senior executives;
- agreeing the design and targets, where applicable, of all share incentive plans requiring shareholder approval;
- assessing the appropriateness and subsequent achievement of the performance targets related to any share incentive plans;
- recommending to the Board the fees paid to the Chairman. The Chairman is excluded from this process; and
- the selection and appointment of the external advisers to the Committee to provide independent remuneration advice where necessary.

The Committee members have no personal financial interests other than as shareholders in matters to be decided, no potential conflicts of interests arising from cross directorships and no day-to-day involvement in running the business. No Director plays a part in any discussion about his or her own remuneration.

The fees of the Non-Executive Directors are determined by the Board on the joint recommendation of the Chairman and the Chief Executive.

The Committee met formally four times during the year ended 31 March 2012.

A summary of the matters considered at each of those meetings is set out in the following panel.

Current approach to remuneration policy

When determining the structure and level of the Executive Directors' remuneration, the Committee has regard to compensation packages in the UK pharmaceutical and biotech sectors.

In determining the Group's current policy, and in constructing the remuneration arrangements of each Executive Director and senior employee, the Board, advised by the 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 and appointed New Bridge Street (a brand of Aon Hewitt Ltd, part of Aon plc) to advise it during the year. Aon Hewitt Ltd does not provide any other services to the Group.

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.

Report on remuneration continued

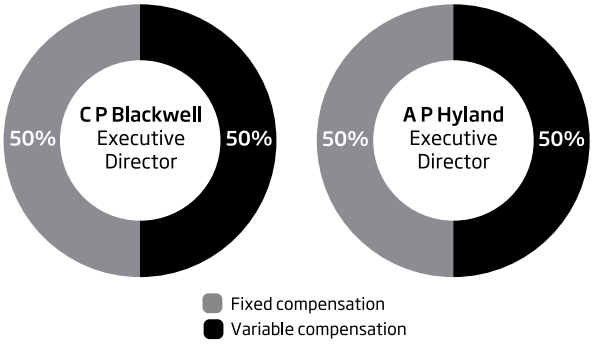
Meeting	Standing agenda items	Other agenda items
April 2011	• Review the market competitiveness of the remuneration policy and the remuneration arrangements for the Executive Directors and other members of the Leadership Team, ensuring these are in line with current investor guidelines and also taking account of the level of remuneration elsewhere in the Group • Review current status of Long-Term Incentive Plans ('LTIPs') and share option schemes for all employees • Approve overall pay levels for 2011/12 for the Group as a whole • Review the salary levels for the Executive Directors and other members of the	• Update on governance and regulatory developments
July 2011	• Review current status of share option schemes	• Review of the COO remuneration package
December 2011	• Review current status of share option schemes	
February 2012	• Review of responsibilities and executive compensation packages for senior employees • Review of LTIPs and share option schemes for all employees	

The Group's 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.

In line with the Association of British Insurers' Guidelines on Responsible Investment Disclosure, the Committee will ensure that the incentive structure for executive directors and senior management will not raise environmental, social or governance ("ESG") risks by inadvertently motivating irresponsible behaviour. More generally, the Committee will ensure that the overall remuneration policy does not encourage inappropriate operational risk-taking.

The diagram below shows the components of the remuneration package as a percentage of total remuneration. 50% of the Executive Directors' total remuneration is performance-related.

Balance between fixed & performance based compensation (Variable compensation)



Components of the current remuneration package

The principal components of remuneration packages are base salary, short 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 inter alia: individual and corporate performance against objectives; levels of responsibility; salary levels in comparable companies; and pay and conditions throughout the Company.

The Committee aims to set each Executive Director's base salary, taking account of the factors above, so that it is broadly aligned with the mid-points of the chosen UK pharmaceutical sector comparator group (see next page) and adjusted to reflect company size and complexity.

For the year ending 31 March 2013 the Committee decided that the salaries of Dr Blackwell and Ms Hyland should remain unchanged (2011/12: 3%).

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, partnering successes and control of cash expenditure, and are weighted towards goals with the highest corporate significance. Performance-related payments may be paid annually, dependent upon achievements measured against corporate goals. Bonus payments are not pensionable. The scheme is offered to all staff below board level with bonus award entitlements ranging between 10% and 50% of salary depending on grade. Cash bonuses are limited to a maximum of 100% of basic salary for each Executive Director.

For the year ended 31 March 2012 the performance objectives against which bonus payments were calculated were as follows:

Performance metric	Weighting as % of maximum bonus potential	Level of bonus awarded as % of metric (% of full bonus)	Commentary (full disclosure has been restricted due to commercial sensitivity)
Revenue generation	25%	0% (0%)	Revenues in the year ended 31 March 2012 were £33m. This was below the target set by the Board thus no bonus was payable in respect of this matrix
Development & technology pipeline progress	35%	46% (16%)	New formulation and device patents were filed and new device designs were developed. Significant progress was made on the development of VR506 with three clinical studies initiated in the period
Generation of new partnerships and progress with current partnerships	40%	93% (37%)	During the year significant new partnerships with Sandoz and a US company were announced. Development progress was made on VR315 and VR632
Total bonus payment as a % of salary		53%	

The Committee also assessed that a bonus in the order of 53% (2010/11: 62%) of salary was appropriate when judged by the achievement of the above metrics and when looking at a broader picture of the Company's corporate performance over the period.

Given the number of shares acquired for cash by the Executive Directors during the year ended 31 March 2012, the Remuneration Committee has not required any of the bonus payment for this year to be deferred into shares.

Long-Term Incentive Plan

Historically, Executive Directors and certain senior executives have been granted an annual award in the form of nil-cost options under the Vectura Group plc 2005 Long-Term Incentive Plan ("LTIP"). These awards are dependent on the achievement of a rigorous, pre-determined set of performance conditions which for recent awards are based on relative TSR. PricewaterhouseCoopers report to the Committee annually on the Company's TSR performance. The scheme expired in September 2010 and no awards have been made in the year ended 31 March 2012. Subject to the outcome of a consultation with the Company's major shareholders, the Committee intends to introduce a new LTIP at the 2012 AGM.

The Committee also intends to make the following changes to the remuneration of the Executive Directors:

- The Company intends to introduce a shareholding requirement for the Executive Directors under which they will be required to build and maintain a holding of Company shares with a market value on acquisition equivalent to 100% of salary.
- The Company also intends to introduce a share trading plan for its Directors and Persons Discharging Managerial Responsibilities ('PDMRs') that will enable them to sell shares from their holdings in a way that is transparent for shareholders.

Report on remuneration continued

Performance conditions under LTIP schemes
Vesting of existing LTIP awards is dependent upon the Group's relative Total Shareholder Return ("TSR") measured over a performance period of three or four years. Awards vest in accordance with the following table:

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

* Linear vesting between points

In addition, the 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. These measures include revenue and cash generation. If the Committee believes that the underlying corporate financial performance is not consistent with its TSR performance, then no LTIP awards will be released.

The comparator group of companies used for the awards made in 2009 is as follows:

Allergy Therapeutics plc	GW Pharmaceutical plc	SkyePharma plc
Antisoma plc	Oxford BioMedica plc	Vernalis Group plc
Ark Therapeutics plc	ProStrakan Group plc	
BTG plc	Sinclair Pharma plc	

In 2010/11 the Remuneration Committee introduced additional criteria whereby the 2009 awards would not vest if the average share price over the three-month period to 21 May 2012 was less than £1. This would ensure that even if the TSR measures had been achieved, the LTIP would pay out only if the share price performance were strong. The average share price for the two months to 21 April 2012 was 59p.

The awards granted to Dr Blackwell and Ms Hyland under the LTIP scheme on 8 June 2010 are subject to the following conditions:

- the Company's performance will be measured against the FTSE SmallCap Index rather than a comparator group of companies;
- the first 50% of the award is subject to a three-year performance period. In addition, this part of the award will not vest if the average price of the Company's shares for a three-month period before the date of vesting is less than £1.00. The second 50% of the award is subject to a four-year performance period and will not vest if the average price of the Company's shares for the three-month period before the date of vesting is less than £1.27.

Value Realisation Plan
On 31 October 2008, the shareholders approved the Vectura Group plc Value Realisation Plan ('VRP'). The VRP runs in parallel to the LTIP and provides participants with a share of a predetermined 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 Leadership Team 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. The VRP operates over a five-year period to 31 October 2013.

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 and which vest after three years. The Sharesave Share Option Scheme is an all-employee plan to which performance conditions do not apply.

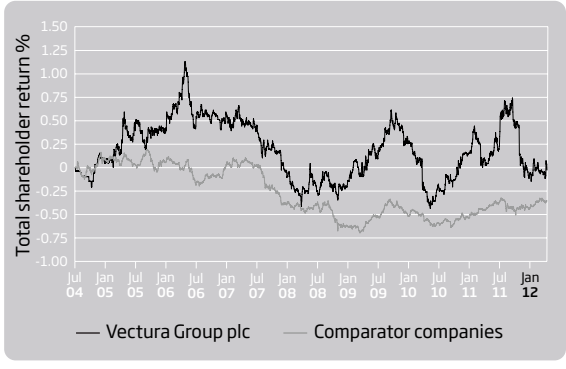
Approved and Unapproved Share Option Plans and the EMI Plan
Executive Directors hold options under the Approved and Unapproved Share Option Plans and under Enterprise Management Incentive arrangements (the 'EMI Plan').

Historically, before it was listed, Vectura Group plc granted 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 in 2004, and no further share option awards will be made to them. 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.

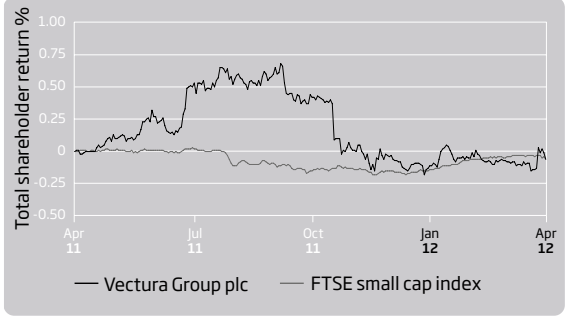
Historically, no performance conditions have been attached to the options granted under the above schemes. The exercise price is equal to the market value of Vectura Group plc's shares at the time the options are granted.

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.



The following graph shows Vectura Group plc's performance since 1 April 2011, measured by TSR, compared with the performance of the FTSE Small Cap, as described above. This index was chosen as Vectura is one of the constituent companies and the Committee feels that it is the most appropriate one against which to measure performance.



Report on remuneration continued

Other information

Directors' service contracts

It is the Group's policy that Executive Directors should have contracts with an indefinite term and which provide for a maximum period of 12 months' notice. This applies to the contracts of Dr Blackwell and Ms Hyland, which were effective from 25 June 2004. Executive Directors are subject to re-election at an AGM at intervals of no more than three years.

Awards made under the Company's Long-Term Incentive Plan that have not been released at the date the Executive's employment ceases lapse, unless the Remuneration Committee in its absolute discretion determines otherwise. Executives have no entitlement to a bonus payment in the event that they cease to be employed by the Company. In addition, in the event of early termination the Committee would seek to ensure that the principle of mitigation applies.

Dr Blackwell resigned his position as a Non-Executive Director of AGI Therapeutics plc on 3 February 2012. He received no salary in the year to 31 March 2012 (2011: nil).

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 2012 are summarised in the table below:

Name of Director	Date of appointment
J R Brown	13 May 2004
J P Cashman	27 March 2001
S E Foden	18 January 2007
N W Warner	1 February 2011

All of the NEDs are considered independent, including Mr Cashman, who has 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 who held office at 31 March 2012 and their interests in the share capital of Vectura Group plc at 31 March 2012 and 31 March 2011 were as follows:

	31 March 2012 ordinary shares of 0.025p each	31 March 2011 ordinary shares of 0.025p each
C P Blackwell [1]	374,717	344,930
J R Brown [2]	242,681	242,681
J P Cashman	946,647	780,415
A P Hyland [1]	624,849	351,162
S E Foden	11,000	11,000
N W Warner	20,800	Nil

[1] The holdings of C P Blackwell and A P Hyland include 43,103 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 2012 and 25 April 2012, 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	2012 Total emoluments £000	2011 Total emoluments £000
Executive Directors					
C P Blackwell	328	174	2	504	515
A P Hyland	218	116	1	335	344
Non-Executive Directors					
J R Brown*	45	–	–	45	45
J Cashman	80	–	–	80	60
S E Foden*	40	–	–	40	40
A J M Richards	10	–	–	10	30
N W Warner	40	–	–	40	6
	761	290	3	1,054	1,040

* Included within the NEDs' fees are the fees for chairing committees. Dr Brown received £5,000 for chairing the Nomination Committee and £10,000 for his role as Senior Independent Director. Dr Foden received £10,000 for chairing the Remuneration Committee and Mr Warner received £10,000 for chairing the Audit Committee.

Benefits represent payments for medical insurance.

In addition to the above, nominal gains of £137,558 arose during the year following the exercise of share options by a number of Directors.

Directors' pension entitlements

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

	2012 £000	2011 £000
C P Blackwell	66	64
A P Hyland	44	42
	110	106

Report on remuneration continued

Options

Directors holding office at 31 March 2012 with options outstanding over ordinary shares of 0.025p were as follows:

Plan	Options held at 1 April 2011	Options granted (exercised or cancelled) during year	Options held at 31 March 2012	Exercise price (p)	Date from which first exercisable	Expiry date
J Cashman						
Unapproved	166,232	(166,232)	–	48.125	18/04/04	31/03/12 [2]
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]
Total	1,085,221	(166,232)	918,989			
C P Blackwell						
EMI	277,776	–	277,776	48.125	05/11/05	03/11/13
Unapproved	122,224	–	122,224	48.125	01/10/05	01/10/13
Unapproved	23,376	–	23,376	48.125	11/04/06	11/04/13
Unapproved	1,023,355	–	1,023,355	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]
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 [3]
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]
SAYE Scheme	13,761	(13,761)	–	65.400	01/04/14	01/10/14 [4]
SAYE Scheme	–	18,987	18,987	47.400	01/04/15	01/10/15 [4]
Total	3,148,112	(21,440)	3,126,672			
J R Brown						
Unapproved	238,989	–	238,989	56.000	02/07/05	02/07/14 [1]
Total	238,989	–	238,989			
A P Hyland						
EMI	243,900	(243,900)	–	48.125	19/03/05	17/03/12 [5]
Unapproved	196,100	–	196,100	48.125	18/03/05	29/05/13
Unapproved	33,896	–	33,896	48.125	11/04/06	11/04/13
Unapproved	456,335	–	456,335	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]
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 [3]
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]
SAYE Scheme	13,761	–	13,761	65.400	01/04/14	01/10/14
Total	1,985,354	(270,566)	1,714,788			

All options were granted for nil consideration.

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

[2] On 9 August 2011, J Cashman exercised 166,232 Unapproved options at a grant price of 48.125p per share. On the date of exercise, the market value of the Company's shares was 95.75p. The total cost for the exercise was £117,377, including taxation, and the nominal gain was £79,168.

[3] On 9 August 2011, C P Blackwell and A P Hyland each exercised 26,666 SAYE options at a grant price of 36p per share. On the date of exercise, the market value of the Company's shares was 95.75p. The total cost for each exercise was £9,600 and the total nominal gain was £15,933 in each case.

[4] On 19 February 2012, C P Blackwell cancelled his 2011 Sharesave Scheme and began contributing to the 2012 Sharesave Scheme.

[5] On 9 February 2012, A P Hyland exercised 243,900 EMI options at a grant price of 48.125p per share. On the date of exercise, the market value of the Company's shares was 59p. The total cost for the exercise was £117,377 and the total nominal gain was £26,524.

Directors' LTIP awards

Under the LTIP scheme, the grants made to Directors at 31 March 2012 were as follows:

Director	Date of award	1 April 2011 £	Awarded/ (exercised) during year £	31 March 2012 £	Share price on date of grant p	Date of release of shares
C P Blackwell	12/09/05	272,741	–	272,741	77.50	12/09/08 [1]
	22/11/06	215,011	–	215,011	93.00	22/11/09 [2]
	25/05/07	219,005	–	219,005	86.25	25/05/10 [3]
	23/05/08	594,392	–	594,392	53.50	23/05/11 [4]
	21/05/09	928,467	–	928,467	68.50	21/05/12
	08/06/10	878,684	–	878,684	38.00	08/06/13
	08/06/10	878,684	–	878,684	38.00	08/06/14
Total		3,986,984	–	3,986,984		
A P Hyland	12/09/05	166,290	–	166,290	77.50	12/09/08 [1]
	22/11/06	152,299	–	152,299	93.00	22/11/09 [2]
	25/05/07	146,003	–	146,003	86.25	25/05/10 [3]
	23/05/08	396,261	–	396,261	53.50	23/05/11 [4]
	21/05/09	618,978	–	618,978	68.50	21/05/12
	08/06/10	574,632	–	574,632	38.00	08/06/13
	08/06/10	574,632	–	574,632	38.00	08/06/14
Total		2,629,095	–	2,629,095		

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.

[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.

[2] The award made on 22 November 2006 reached the end of its holding period on 22 November 2009. The TSR of the Group during this period compared with that of the comparator group equated to 83.32% of the shares awarded being released. The nil-cost options relating to this award lapse on 21 November 2016.

[3] The award made on 25 May 2007 reached the end of its holding period on 25 May 2010. The TSR of the Group during this period compared with that of the comparator group equated to 62.964% of the shares awarded being released. The nil-cost options relating to this award lapse on 25 May 2017.

[4] The award made on 23 May 2008 reached the end of its holding period on 23 May 2011. 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 23 May 2018.

On behalf of the Board

Dr S E Foden
Chair of the Remuneration Committee

25 April 2012

Directors' report

The Directors present their Annual Report on the affairs of the Company and Group, together with the financial statements and Auditor's report for the year ended 31 March 2012.

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 Financial review and the Business review. During the year, the Board has considered the key risks and uncertainties of the business, which are summarised on page 13. 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 £4.4m (2010/11: £8.8m). The Directors do not recommend the payment of a dividend (2010/11: £nil).

Balance sheet strength
The net current assets position of the Group was further strengthened in the year with cash and cash equivalents increasing to £75.5m (31 March 2011: £74.4m).

Directors
Membership of the Board (together with Directors' biographies) is shown in the section on Board of Directors. Details of Directors' remuneration and their interests in the share capital of the Company are given in the Report on 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 20 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 (2010/11: 30 days).

Political and charitable donations
Vectura encourages employee involvement in charitable causes, but does not contribute itself because it is loss-making. There were no political donations during the year (2011: £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 23 April 2012, the nearest practical date to the date of this Report, the Company had a total of 3,526 ordinary shareholders and 331,685,931 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 20 April 2012:

	Number of shares '000	%
Legal & General Investment Management Limited	33,815	10.20
Aviva plc	30,845	9.30
Aberforth Partners LLP	26,508	7.99
Franklin Resources, Inc	24,444	7.37
Invesco Asset Management Limited	23,995	7.23
BlackRock, Inc	13,442	4.05
J P Morgan Chase	13,020	3.93
AXA SA	10,505	3.17

Share price
The mid-market share price as shown by the London Stock Exchange Daily Official List on 31 March 2012 was 54.25p. The mid-market share price ranged from 50p to 107p during the year to 31 March 2012. The average share price for the period was 72.4p.

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 pages 21 and 22.

Going concern
The accounts have been prepared on the going concern basis. 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 made a loss of £4.4m for the financial year ended 31 March 2012 (2011: £8.8m) but had £75.5m of cash and cash equivalents as at 31 March 2012 (2011: £74.4m). 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 reviewing the Group's forecasts and assessing the uncertain nature of some of the Group's forecast revenues, 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 18 September 2012 at 12.00 noon. Details of the business to be transacted at the forthcoming AGM will be given in a separate circular to shareholders.

Capital structure
Details of the authorised and issued share capital, together with details of the movements in the Company's issued share capital during the year are shown in note 21. The Company has one class of ordinary shares which carry no right to fixed income. Each share carries the right to one vote at general meetings of the Company. The redeemable preference shares carry no interest, nor do they carry voting rights. The percentage of the issued nominal value of the ordinary shares is 71% of the total issued nominal value of all share capital.

There are no specific restrictions on the size of a holding nor on the transfer of shares, which are both governed by the general provisions of the Articles of Association and prevailing legislation. The Directors are not aware of any agreements between holders of the Company's shares that may result in restrictions on the transfer of securities or on voting rights.

Details of employee share schemes are set out in note 22.

Shares held by the Vectura Group plc Employee Benefit Trust abstain from voting.

No person has any special rights of control over the Company's share capital and all issued shares are fully paid.

With regard to the appointment and replacement of Directors, the Company is governed by its Articles of Association, the UK Corporate Governance Code, the Companies Act 2006 and related legislation. The Articles of Association themselves may be amended by special resolution of the shareholders. The powers of Directors are described in the Board's Terms of Reference, copies of which are available on request, and the Corporate governance statement on pages 14 to 17.

Under its Articles of Association, the Company has authority to issue 441.2m ordinary shares.

Equity
A shareholder resolution was approved at the Company's AGM, held on 22 July 2011, to reduce the Company's share premium account by £78.6m, being the value of the share premium account as at 14 June 2011. A subsequent application to reduce the Company's share premium account was approved by the High Court of Justice on 25 January 2012. As part of this share premium reduction, the retained loss value of £25.9m in the Company balance sheet as at 14 June 2011 was cancelled and the remaining balance of £52.7m has created a retained profit in the Company balance sheet.

Auditor
Deloitte LLP has expressed a willingness to continue in office as auditor 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 pages 18 and 19. Having made enquiries of fellow Directors and of the Company's auditor, 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 auditor is 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 auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of s418 of the Companies Act 2006.

By order of the Board

Anne Hyland
Company Secretary

25 April 2012

Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors are required to prepare the Group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and Article 4 of the IAS Regulation and have also chosen to prepare the parent Company financial statements under IFRSs as adopted by the EU. Under company law the Directors must not approve the accounts unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, International Accounting Standard 1 requires that directors:

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

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company, and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Responsibility statement

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with International Financial Reporting Standards, 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 that they face.

By order of the Board

Anne Hyland
Director

25 April 2012

Independent auditor's report to the members of Vectura Group plc

We have audited the financial statements of Vectura Group plc for the year ended 31 March 2012, which comprise the Consolidated statement of comprehensive income, the Balance sheet, the Cash flow statement, the Statement of changes in equity and the related notes 1 to 27. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and as regards the parent Company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company 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 auditor

As explained more fully in the Statement of Directors' responsibilities, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent Company's affairs as at 31 March 2012 and of the Group's loss for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Separate opinion in relation to IFRSs as issued by the IASB

As explained in note 1 to the Group financial statements, the Group in addition to complying with its legal obligation to apply IFRSs as adopted by the European Union, has also applied IFRSs as issued by the International Accounting Standards Board (IASB).

In our opinion the Group financial statements comply with IFRSs as issued by the IASB.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Report on remuneration to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent Company financial statements and the part of the Report on remuneration to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the Directors' statement contained within the Directors' report in relation to going concern;
- the part of the Corporate governance statement relating to the Company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review; and
- certain elements of the report to shareholders by the Board on Directors' remuneration.

Stuart Henderson (ACA) (Senior statutory auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
Cambridge, United Kingdom

25 April 2012

Consolidated statement of comprehensive income

for the year ended 31 March 2012

	Note	2012 £m	2011 £m
Revenue	2	33.0	42.9
Cost of sales		(2.2)	(2.7)
Gross profit		30.8	40.2
Research and development expenses	4	(32.8)	(37.7)
Other administrative expenses		(3.3)	(3.3)
Amortisation		(7.5)	(10.7)
Share-based compensation		(1.1)	(1.8)
Total administrative expenses		(11.9)	(15.8)
Operating loss	6	(13.9)	(13.3)
Investment income	5	0.7	0.8
Finance costs	5	–	(0.8)
Loss before taxation		(13.2)	(13.3)
Taxation	8	8.8	4.5
Loss after taxation attributable to equity holders of the Company and total comprehensive income		(4.4)	(8.8)
Loss per ordinary share: basic and diluted	9	(1.3p)	(2.7p)

All results are derived from continuing activities.

Balance sheet

at 31 March 2012

	Note	Group 2012 £m	Group 2011 £m	Company 2012 £m	Company 2011 £m
Assets					
Goodwill	10	49.6	49.6	2.0	2.0
Intangible assets	11	23.4	30.9	–	–
Property, plant and equipment	12	6.0	2.9	–	–
Investments in subsidiary undertakings	13	–	–	125.6	125.6
Other receivables	14	0.4	0.4	–	–
Non-current assets		79.4	83.8	127.6	127.6
Inventories	15	0.7	0.2	–	–
Trade and other receivables	16	9.7	9.2	0.1	0.1
Amounts due from subsidiary undertakings	17	–	–	71.2	86.1
Cash and cash equivalents	20	75.5	74.4	–	–
Current assets		85.9	83.8	71.3	86.2
Total assets		165.3	167.6	198.9	213.8
Liabilities					
Trade and other payables	18	(20.7)	(18.7)	–	–
Deferred income	19	(3.5)	(5.5)	–	–
Current liabilities		(24.2)	(24.2)	–	–
Deferred income	19	(1.3)	–	–	–
Amounts owed to subsidiary undertakings	17	–	–	–	(18.5)
Deferred tax liabilities	8	(0.3)	(3.1)	–	–
Non-current liabilities		(1.6)	(3.1)	–	(18.5)
Total liabilities		(25.8)	(27.3)	–	(18.5)
Net assets		139.5	140.3	198.9	195.3
Equity					
Share capital	21a	0.1	0.1	0.1	0.1
Share premium	21b	2.2	78.3	2.2	78.3
Special reserve	21c	8.2	8.2	8.2	8.2
Other reserve	21d	124.9	124.9	123.7	123.7
Share-based compensation reserve	21e	12.0	10.9	12.0	10.9
Retained (loss)/profit	21f	(7.9)	(82.1)	52.7	(25.9)
Total equity		139.5	140.3	198.9	195.3

The financial statements of Vectura Group plc, registered number 03418970, were approved and authorised for issue by the Board of Directors on 25 April 2012 and were signed on its behalf by:

Dr C P Blackwell
Director

A P Hyland
Director

Cash flow statement

for the year ended 31 March 2012

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Operating loss	(13.9)	(13.3)	–	–
Depreciation and amortisation	8.6	12.0	–	–
Share-based compensation	1.1	1.8	–	–
Increase in inventories	(0.5)	(0.2)	–	–
Decrease in receivables	0.9	0.9	–	–
Increase/(decrease) in payables	2.0	(0.5)	–	–
(Decrease)/increase in deferred income	(0.7)	2.8	–	–
Exchange movements	–	(0.8)	–	–
Net cash (outflow)/inflow from operations	(2.5)	2.7	–	–
Taxation paid	–	(0.1)	–	–
Research and development tax credits received	4.6	8.2	–	–
Net cash inflow from operating activities	2.1	10.8	–	–
Cash flows from investing activities				
Interest received	0.7	0.7	–	–
Purchase of property, plant and equipment	(4.2)	(1.5)	–	–
Receipts from sale of property, plant and equipment	–	0.1	–	–
Net cash outflow from investing activities	(3.5)	(0.7)	–	–
Net cash (outflow)/inflow before financing activities	(1.4)	10.1	–	–
Cash flows from financing activities				
Proceeds from issue of ordinary shares	2.5	0.2	–	–
Net cash inflow from financing activities	2.5	0.2	–	–
Increase in cash and cash equivalents	1.1	10.3	–	–
Cash and cash equivalents at beginning of period	74.4	64.1	–	–
Cash and cash equivalents at end of period	75.5	74.4	–	–

Statement of changes in equity

for the year ended 31 March 2012

Group	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 2010	0.1	78.1	8.2	124.9	9.1	(73.3)	147.1
Loss for the year	–	–	–	–	–	(8.8)	(8.8)
Share-based compensation	–	–	–	–	1.8	–	1.8
Exercise of share options	–	0.2	–	–	–	–	0.2
At 31 March 2011	0.1	78.3	8.2	124.9	10.9	(82.1)	140.3
Loss for the year	–	–	–	–	–	(4.4)	(4.4)
Conversion of share premium into retained (loss)/profit	–	(78.6)	–	–	–	78.6	–
Share-based compensation	–	–	–	–	1.1	–	1.1
Exercise of share options	–	2.5	–	–	–	–	2.5
At 31 March 2012	0.1	2.2	8.2	124.9	12.0	(7.9)	139.5

Company	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 2010	0.1	78.1	8.2	123.7	9.1	(25.9)	193.3
Share-based compensation	–	–	–	–	1.8	–	1.8
Exercise of share options	–	0.2	–	–	–	–	0.2
At 31 March 2011	0.1	78.3	8.2	123.7	10.9	(25.9)	195.3
Conversion of share premium into retained (loss)/profit	–	(78.6)	–	–	–	78.6	–
Share-based compensation	–	–	–	–	1.1	–	1.1
Exercise of share options	–	2.5	–	–	–	–	2.5
At 31 March 2012	0.1	2.2	8.2	123.7	12.0	52.7	198.9

Notes to the financial statements

1 Accounting policies

General information
Vectura Group plc is a public limited company incorporated in the United Kingdom under the Companies Act 2006. The address of the registered office and principal place of business is given on page 62. 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 2006 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 2006 and have been prepared in accordance with IFRSs as adopted by the European Union. The Company is taking advantage of the exemption in section 408 of the Companies Act 2006 not to present its individual statement of comprehensive income and the related notes that form a part of these approved financial statements. The parent Company loss for the year ended 31 March 2012 is £nil (2011: £nil).

The financial statements have been prepared on the historical cost basis, revised for use of fair values where required by applicable IFRS. The presentational and functional currency of Vectura Group plc is sterling since that is the currency of the primary economic environment in which the Group operates. Therefore, the consolidated financial statements are presented in sterling and all values are rounded to the nearest one hundred thousand (£0.1m), 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. 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 made a loss of £4.4m for the financial year ended 31 March 2012 (2011: £8.8m) but had £75.5m of cash and cash equivalents as at 31 March 2012 (2011: £74.4m). 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 reviewing the Group's forecasts and assessing the uncertain nature of some of the Group's forecast revenues, 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.

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 review for impairment of definite and indefinite-life intangible assets (goodwill), the review for impairment of investments, the measurement of provisions, the estimation of share-based payment costs, revenue recognition 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.

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 acquisition 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. Acquisition related costs are recognised in the statement of comprehensive income as they are incurred. 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 cash-generating units monitored by management. Where the recoverable amount of the cash-generating unit is less than its carrying amount, including goodwill, an impairment loss is recognised in the statement of comprehensive income. 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.

Intangible assets
Intangible assets acquired separately from a business combination 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 statement of comprehensive income in the year in which it is incurred, except where expenditure relating to clearly defined and identifiable development projects meets the following criteria, in which case development expenditure will be recognised as an intangible asset:

- 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, trademarks 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.

Notes to the financial statements continued

1 Accounting policies continued

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:

- Buildings – 20 years
- Laboratory equipment – 3–7 years
- Office and IT equipment – 3 years
- Freehold land is not depreciated.

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 statement of comprehensive income 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 statement of comprehensive income 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.

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 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 statement of comprehensive income 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 statement of comprehensive income.

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
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.

Provisions
Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group will be required to settle that obligation and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the balance sheet date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using cash flows estimated to settle the present obligation, its carrying amount is the value of those cash flows.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognised as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

Restructuring
A restructuring provision is recognised when the Group has developed a detailed formal plan for the restructuring and has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement the plan or announcing its main features to those affected by it. The measurement of a restructuring provision includes only the direct expenditures arising from the restructuring, which are those amounts that are both necessarily entailed by the restructuring and not associated with the ongoing activities of the entity.

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 from 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 statement of comprehensive income.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

Research and development tax credits are recognised on an accruals 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 statement of comprehensive income 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 as payables in the balance sheet.

Notes to the financial statements continued

1 Accounting policies continued

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
The following new and revised Standards and Interpretations have been adopted in the current year. Their adoption has not had any significant impact on the amounts reported in these financial statements, but with the exception of the amendment to IFRS 1, may impact the accounting for future transactions and arrangements.

- **Amendment to IFRS 1**
  Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters
  The amendment provides a limited exemption for first-time adopters from providing comparative fair-value hierarchy disclosures under IFRS 7.
- **IAS 24 (2009)**
  Related Party Disclosures
  The revised Standard has a new, clearer definition of a related party, with inconsistencies under the previous definition having been removed.
- **Amendment to IAS 32**
  Classification of Rights Issues
  Under the amendment, rights issues of instruments issued to acquire a fixed number of an entity's own non-derivative equity instruments for a fixed amount in any currency and which otherwise meet the definition of equity are classified as equity.
- **Amendments to IFRIC 14**
  Prepayments of a Minimum Funding Requirements
  The amendments now enable recognition of an asset in the form of prepaid minimum funding contributions.
- **Improvements to IFRSs 2010**
  Aside from those items already identified above, the amendments made to standards under the 2010 improvements to IFRSs have had no impact on the Group.

At the date of authorisation of these financial statements, the following Standards and Interpretations which have not been applied in these financial statements were in issue but not yet effective (and in some cases had not yet been adopted by the EU):

- IFRS 1 (amended): Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters
- IFRS 7 (amended): Disclosures – Transfers of Financial Assets
- IFRS 9: Financial Instruments
- IFRS 10: Consolidated Financial Statements
- IFRS 11: Joint Arrangements
- IFRS 12: Disclosure of Interests in other Entities
- IFRS 13: Fair Value Measurement
- IAS 1 (amended): Presentation of Items of Other Comprehensive Income
- IAS 12 (amended): Deferred Tax: Recovery of Underlying Assets
- IAS 19 (revised): Employee Benefits
- IAS 27 (revised): Separate Financial Statements
- IAS 28 (revised): Investments in Associates and Joint Ventures
- IAS 32 (amended): Offsetting Financial Assets and Financial Liabilities
- IFRIC 20: Stripping Costs in the Production Phase of a Surface Mine

The adoption of IFRS 9 which the Group plans to adopt for the year beginning on 1 April 2013 will impact both the measurement and disclosures of Financial Instruments. The Directors do not expect that the adoption of the other standards listed above will have a material impact on the financial statements of the Group in future periods.

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.

Revenue by category	2012 £m	2011 £m
Royalties	13.5	13.6
Product licensing	12.1	10.6
Technology licensing	2.3	12.9
Pharmaceutical development services	2.8	4.2
Device sales	2.3	1.6
	33.0	42.9
Investment income:		
Interest income (note 5)	0.7	0.8
Total income	33.7	43.7

Revenue by customer location	2012 £m	2011 £m
United Kingdom	2.5	11.6
Rest of Europe	9.4	15.1
United States of America	21.0	13.5
Rest of World	0.1	2.7
	33.0	42.9

Information about major customers

Revenue earned from the Group's major customers was as follows: Customer A – £13.4m (2011: £13.5m), Customer B – £10.6m (2011: £14.4m) and Customer C – £6.2m (2011: £nil).

3 Segmental information

The Group is engaged in a single business activity of pharmaceuticals and the Group does not have multiple operating segments. The Group's pharmaceutical business consists of the research, development and commercialisation of pharmaceutical products. The Leadership Team is the Group's chief operating decision-making body, as defined by IFRS 8, and all significant operating decisions are taken by the Leadership Team. In assessing performance, the Leadership Team reviews financial information on an integrated basis for the Group as a whole, substantially in the form of, and on the same basis as, the Group's IFRS financial statements. Resources are allocated between activities and products on a Group-wide basis on merit.

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

4 Research and development expenses

Included in research and development expenses for 2010/2011 was a £2.5m restructuring charge relating to the restructuring of development operations, with the closure of the Nottingham facility and a reduction in the number of R&D employees. This action was taken in order to reduce the ongoing cost base. There was no impairment of the intangible assets or goodwill following this restructuring.

5 Investment income and finance costs

	2012 £m	2011 £m
Interest income:		
Interest receivable on bank deposits and similar income	0.7	0.8
Finance costs:		
Foreign exchange losses	–	(0.8)

Notes to the financial statements continued

6 Operating loss

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

	2012 £m	2011 £m
Amortisation of intangible assets	7.5	10.7
Depreciation of property plant and equipment	1.1	1.3
Share-based compensation	1.1	1.8
Cost of inventories recognised as expense	1.1	1.4
Net foreign exchange losses	–	0.8
Staff costs (note 7)	12.0	14.0
Operating lease rentals:		
– land and buildings	0.5	1.2
– plant and machinery	0.1	0.1

The analysis of auditor's remuneration is as follows:

	2012 £000	2011 £000
Fees payable to the Company's auditor for the audit of the Company's annual accounts	20	20
Fees payable to the Company's auditor and their associates for other services to the Group:		
– The audit of the Company's subsidiaries	63	63
Total audit fees	83	83
Audit related assurance services	15	15
Taxation compliance services	7	–
Other taxation advisory services	16	5
Other services	10	–
Total non-audit fees	48	20
Total fees	131	103

7 Directors and employees

Directors' remuneration

The aggregate remuneration comprised:

	2012 £m	2011 £m
Fees	0.2	0.2
Salaries and benefits	0.5	0.5
Bonuses	0.3	0.3
	1.0	1.0
Pension contributions	0.1	0.1
	1.1	1.1

Two Directors (2011: two) receive company contributions to defined contribution personal pension plans. Three Directors exercised share options in the year and increased their combined shareholding in the Company by 463,464 Ordinary shares 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:

	2012 No.	2011 No.
Research and development	194	240
Business development and administration	15	16
	209	256

The aggregate remuneration comprised:

	2012 £m	2011 £m
Wages and salaries	10.2	12.0
Social security costs	1.2	1.3
Other pension costs	0.6	0.7
	12.0	14.0

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 £1.1m (2011: £1.8m).

The Company had no employees during the years ended 31 March 2012 and 31 March 2011.

8 Taxation

The major components of the income tax credit for the years ended 31 March 2012 and 31 March 2011 were as follows:

	2012 £m	2011 £m
Foreign withholding tax charge on royalties	(0.1)	(0.1)
Research and development tax credits:		
– current year	4.0	2.5
– receipt in respect of prior year	2.1	1.1
Reduction in deferred tax liability	2.8	1.0
Total	8.8	4.5

With effect from 1 April 2009, research and development tax credits are accrued based on the estimated receipt from Her Majesty's Revenue and Customs (HMRC).

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

	2012 £m	2011 £m
Loss on ordinary activities before tax	(13.2)	(13.3)
Loss on ordinary activities multiplied by standard rate of UK Corporation Tax of 26% (2011: 28%)	(3.4)	(3.7)
Effects of:		
Expenses not deductible for tax purposes	0.2	0.5
Unrecognised tax losses carried forward	3.2	3.2
Reduction in deferred tax liability	(2.8)	(1.0)
Foreign withholding taxes	0.1	0.1
Research and development tax credits		
– current year	(4.0)	(2.5)
– receipt in respect of prior year	(2.1)	(1.1)
Total tax credit for the year	(8.8)	(4.5)

In March 2011, the UK Government announced a reduction in the standard rate of UK corporation tax to 26% effective 1 April 2011. This rate reduction was substantively enacted in March 2011.

In March 2012, the UK Government announced the main rate of UK corporation tax would reduce to 24% with effect from 1 April 2012, with subsequent 1% reductions annually to 22% by April 2014. These changes were substantively enacted on 26 March 2012.

The effect of these tax rate reductions on the deferred tax balance has been accounted for in the period in which the tax rate reductions are substantively enacted.

Factors that may affect future tax charges are:

Cumulative tax losses of approximately £89m (2011: £100m), subject to agreement by HMRC, are available within the Group to carry forward against future taxable profits. There is a deferred tax asset of £21.9m (2011: £26.7m), including these tax losses, calculated at the standard rate of tax of 24% (2011: 26%), as follows:

	2012 £m	2011 £m
On cumulative tax losses – unrecognised	15.8	21.0
On cumulative tax losses – recognised	5.6	4.9
On unclaimed capital allowances	0.3	0.4
On unexercised share options	0.2	0.4
	21.9	26.7

As described above, of the total deferred tax asset, £5.6m has been recognised as a deferred tax asset as at 31 March 2012 (2011: £4.9m), 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 £5.6m relating to these losses has been recognised as at 31 March 2012 (2011: £4.9m). To the extent permitted by IAS 12 – Income Taxes, this deferred tax asset has been offset against the deferred tax liability arising on the intangible assets.

Deferred tax liability

A deferred tax liability of £5.9m exists at 31 March 2012 (2011: £8.0m). This relates to 24% of the intangible asset value at that date (2011: 26%). A deferred tax liability of £5.6m is offset by a deferred tax asset as described above. A deferred tax liability of £0.3m is provided for at 31 March 2012 (2011: £3.1m).

9 Loss per ordinary share

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

	2012	2011
Loss for the year (£m)	(4.4)	(8.8)
Weighted average number of ordinary shares (No. m)	329.3	325.3
Loss per ordinary share	(1.3p)	(2.7p)

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

Notes to the financial statements continued

10 Goodwill

Group	2012 £m	2011 £m
Cost:		
At 1 April	49.6	49.6
At 31 March	49.6	49.6
Net book value:		
At 1 April	49.6	49.6
At 31 March	49.6	49.6

Goodwill is allocated to future cash-generating units (CGUs), 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. An impairment provision is recognised only if the goodwill carrying value exceeds this value-in-use.

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 pre-tax cash flow forecasts prepared by management, which consist of detailed probability weighted product-by-product analyses. These forecasts are based on development timings and specific projections for sales volumes over a ten-year period, being the period in which the expected useful economic life of each asset has been substantially completed. No terminal values have been included in the cash flow forecasts. No general growth rates are assumed. The discount rates used in the forecasts range from 8% to 13%.

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

Group	2012 £m	2011 £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 2011 and 31 March 2012	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. These CGUs are part of the Group's only operating segment.

The Group has conducted a sensitivity analysis on the impairment test of each CGU's carrying value. In each case the valuations indicate sufficient headroom such that a reasonably possible change to key assumptions is unlikely to result in an impairment of the related goodwill.

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 using the same discount rates and on the same basis as for the Group.

11 Intangible assets

Group	Patents and trademarks £m	Licences £m	Total £m
Cost:			
At 1 April 2010, 31 March 2011 and 31 March 2012	3.5	74.6	78.1
Amortisation:			
At 1 April 2010	(3.5)	(33.0)	(36.5)
Charge for the year	–	(10.7)	(10.7)
At 31 March 2011	(3.5)	(43.7)	(47.2)
Charge for the year	–	(7.5)	(7.5)
At 31 March 2012	(3.5)	(51.2)	(54.7)
Net book value:			
At 31 March 2011	–	30.9	30.9
At 31 March 2012	–	23.4	23.4

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.

12 Property, plant and equipment

Group	Assets in the course of construction £m	Freehold land and buildings £m	Laboratory equipment £m	Office and IT equipment £m	Total £m
Cost:					
At 1 April 2010	–	–	11.3	1.0	12.3
Additions	–	–	1.3	–	1.3
Disposals	–	–	(1.7)	(0.4)	(2.1)
At 31 March 2011	–	–	10.9	0.6	11.5
Additions	2.5	0.8	0.9	–	4.2
Disposals	–	–	(0.3)	(0.1)	(0.4)
At 31 March 2012	2.5	0.8	11.5	0.5	15.3
Depreciation:					
At 1 April 2010	–	–	(8.7)	(0.6)	(9.3)
Charge for the year	–	–	(1.2)	(0.1)	(1.3)
Disposals	–	–	1.7	0.3	2.0
At 31 March 2011	–	–	(8.2)	(0.4)	(8.6)
Charge for the year	–	–	(1.0)	(0.1)	(1.1)
Disposals	–	–	0.3	0.1	0.4
At 31 March 2012	–	–	(8.9)	(0.4)	(9.3)
Net book value:					
At 31 March 2011	–	–	2.7	0.2	2.9
At 31 March 2012	2.5	0.8	2.6	0.1	6.0

The Company had no property, plant and equipment at 31 March 2012 and 31 March 2011.

Notes to the financial statements continued

13 Investments in subsidiary undertakings

Company	Shares in subsidiary undertakings £m
Cost:	
At 1 April 2010, 31 March 2011 and 31 March 2012	125.7
Amounts written off:	
At 1 April 2010, 31 March 2011 and 31 March 2012	(0.1)
Net book value:	
At 31 March 2011	125.6
At 31 March 2012	125.6

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

Name of undertaking	Country of incorporation	Holding	Proportion held	Nature of business
Vectura Group Investments Limited	England	Ordinary	100%	Pharmaceuticals
Vectura Limited [1]	England	Ordinary	100%	Pharmaceuticals
Vectura Delivery Devices Limited [1]	England	Ordinary	100%	Pharmaceuticals
Vectura Inc	USA	Ordinary	100%	Pharmaceuticals
Innovata Limited [1]	England	Ordinary	100%	Pharmaceuticals
Innovata Biomed Limited [2]	Scotland	Ordinary	100%	Pharmaceuticals

[1] A subsidiary of Vectura Group Investments Limited.
[2] A subsidiary of Innovata Limited.

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

14 Other receivables

Group
Other receivables represent an investment bond of £0.4m (2011: £0.4m) 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 2012. Interest is recognised using the effective interest method.

15 Inventories

	Group		Company	
	2012 £m	**2011 £m**	**2012 £m**	**2011 £m**
Finished goods	0.7	0.2	–	–

16 Trade and other receivables

	Group		Company	
	2012 £m	**2011 £m**	**2012 £m**	**2011 £m**
Trade receivables	0.8	2.0	–	–
Other receivables [1]	4.4	2.7	0.1	0.1
Prepayments and accrued income	3.5	3.5	–	–
VAT recoverable	1.0	1.0	–	–
	9.7	9.2	0.1	0.1

[1] Includes research and development tax credits of £4.0m (2011: £2.5m).

The average credit period taken by customers is 30 days (2011: 30 days). The Directors consider that the carrying value of trade and other receivables approximates to their fair value.

17 Amounts due from and owed to subsidiary undertakings

	Group		Company	
	2012 £m	**2011 £m**	**2012 £m**	**2011 £m**
Amounts falling due within one year:				
Due from subsidiary undertakings	–	–	71.2	86.1
Amounts falling due after more than one year:				
Owed to subsidiary undertakings	–	–	–	18.5

18 Trade and other payables

	Group		Company	
	2012 £m	**2011 £m**	**2012 £m**	**2011 £m**
Amounts falling due within one year:				
Trade payables	2.5	2.9	–	–
Other payables	1.1	1.0	–	–
Accruals	17.1	14.8	–	–
	20.7	18.7	–	–

Trade payables principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken by the Group for trade purchases is 32 days (2011: 33 days).

Notes to the financial statements continued

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		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Amounts due within one year	3.5	5.5	–	–
Amounts due in more than one year	1.3	–	–	–
	4.8	5.5	–	–

20 Financial instruments

Categories of financial instruments
Unless stated otherwise, all disclosures relate to the Group.

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

	2012 £m	2011 £m
Cash and cash equivalents	75.5	74.4
Loans and receivables	9.1	9.4
	84.6	83.8

All financial assets fall due within the first quarter of the year, with the exception of the investment bond which is included within loans and receivables in the table above, the repayment of which is determined by the Group's results (see note 14).

There were no provisions against impaired assets at 31 March 2012 (2011: £nil). There are no amounts past due but not impaired (2011: £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 (at amortised cost) have been identified:

	2012 £m	2011 £m
Other	(20.7)	(18.7)

All financial liabilities fall due within one year.

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 21a), reserves and retained earnings as disclosed in the 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 2012 and 31 March 2011 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.

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

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Cash and cash equivalents:				
Euro	1.1	1.6	–	–
US Dollar	5.1	11.5	–	–
	6.2	13.1	–	–

Notes to the financial statements continued

20 Financial instruments continued

Foreign currency sensitivity analysis

The following table details the Group's sensitivity to a 10% increase and decrease in sterling against the Euro and US Dollar; 10% represents management's assessment of a reasonably possible change in foreign exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated items and adjusts their translation at the period end for a 10% change in foreign currency rates. A positive number below indicates an increase in profit and other equity where sterling weakens against the relevant currency. For a 10% strengthening of sterling against the Euro and the US Dollar there would be an equal and opposite impact on the loss and other equity and the balances below would be negative (2011: negative).

	2012 £m	2011 £m
Euro currency impact – gain	0.1	0.2
US Dollar currency impact – gain	0.5	1.2

The Company did not hold any balances denominated in foreign currencies at year end and therefore is not exposed to any risk from fluctuations in foreign currencies.

The Group and Company have a legal right of offset between all foreign currency bank accounts and all sterling bank accounts.

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 £0.7m of finance income during the year (2011: £0.8m). 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 2012 would increase/decrease by £0.4m (2011: £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.

21 Equity

(a) Share capital

	2012		2011	
	£m	No. '000	£m	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	326,659	0.1	323,949
Issued to Share Investment Plan	–	–	–	1,500
Issued on exercise of share options	–	3,475	–	789
Issued on exercise of Sharesave options	–	1,466	–	–
Issued on exercise of LTIP options	–	86	–	421
At 31 March	0.1	331,686	0.1	326,659
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 2011 and 31 March 2012 the Company issued no ordinary shares to the Vectura Group plc Employee Benefit Trust (in the year ended 31 March 2011 1,500,000 ordinary shares of 0.025p each were issued 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 2011 and 31 March 2012 the Company issued 3,475,463 (2011: 789,175) ordinary shares of 0.025p each on the exercise of employee share options at a weighted average exercise price of 57.04p per share (2011: 31.45p).

Between 1 April 2011 and 31 March 2012 the Company issued 1,465,608 (2011: nil) ordinary shares of 0.025p each on the exercise of Sharesave options at a weighted average exercise price of 36.14p per share.

Between 1 April 2011 and 31 March 2012 the Company issued 86,209 (2011: 421,153) ordinary shares of 0.025p each on the exercise of LTIP nil-cost options.

(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. It is a non-distributable reserve.

Notes to the financial statements continued

21 Equity continued

(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.

(f) Retained (loss)/profit
A shareholder resolution was approved at the Company's AGM, held on 22 July 2011, to reduce the Company's share premium account by £78.6m, being the value of the share premium account as at 14 June 2011. A subsequent application to reduce the Company's share premium account was approved by the High Court of Justice on 25 January 2012. As part of this share premium reduction, the retained loss value of £25.9m in the Company balance sheet as at 14 June 2011 was cancelled and the remaining balance of £52.7m has created a retained profit in the Company balance sheet.

22 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 and 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 a Long-Term Incentive Plan (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 2012, Executive Directors and eligible senior managers hold rights to ordinary shares awarded under the LTIP, as follows:

Date of vesting	Ordinary shares vesting
12 September 2008	584,615
22 November 2009	501,242
2 March 2010	314,274
25 May 2010	446,636
23 May 2011 [1]	1,630,705
21 May 2012 [1]	2,405,654
7 June 2013 [1]	2,511,192
7 June 2014 [1]	2,511,192

[1] Maximum number of shares, subject to performance conditions,

On 31 October 2008, the shareholders approved a Value Realisation Plan (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 within five years of the date of approval of the Plan. 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 2012 there were 2,255,995 options outstanding that were granted before this date (2011: 2,255,995).

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.

Year of grant	2012	2011
The assumptions input into the Black-Scholes model were as follows:		
Weighted average share price of grants during the year	69.22p	59.53p
Weighted average exercise price of grants during the year	60.61p	56.88p
Expected volatility [1]	46%–49%	46%–48%
Expected life	3–5 years	3–5 years
Expected dividends	Nil	Nil
Risk-free interest rate [2]	0.5%–1.0%	1.4%–2.7%
The assumptions input into the Monte Carlo model were as follows:		
Weighted average share price of grants during the year	–	38p
Weighted average exercise price of grants during the year	–	0.025p
Expected volatility [1]	–	46%
Expected life	–	3 years
Expected dividends.	–	Nil
Risk-free interest rate [2]	–	1.4%

[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 statement of comprehensive income.

[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 described above, and after adjusting for the likelihood of cancellation of options when employees leave.

Notes to the financial statements continued

22 Equity-settled share option schemes and Long-Term Incentive Plan continued

The share-based compensation charge for the year ended 31 March 2012, including the LTIP, was £1,040,000 (2011: £1,785,000).

The aggregate of the estimated fair value of options granted under share option schemes and Share Incentive Plan during the year ended 31 March 2012 was £426,000 (2011: £492,000) and under the SAYE Scheme £232,000 (2011: £143,000). There were no awards under the LTIP during the year ended 31 March 2012 (the estimated fair value of LTIP awards during the year ended 31 March 2011 was £444,000).

Options outstanding	Share Option Schemes Number of options	WAEP*	SAYE Scheme Number of options	WAEP*	LTIP Number of options	WAEP*
At 1 April 2010	19,028,332	60.50	2,115,313	41.20	6,560,356	0.025
Options granted	314,696	43.60	490,430	65.40	5,681,638	0.025
Options exercised	(777,323)	31.45	(11,852)	48.40	(421,153)	0.025
Options cancelled	(311,305)	112.41	(227,298)	55.21	–	–
At 31 March 2011	18,254,400	62.37	2,366,593	44.83	11,820,841	0.025
Options granted	414,375	95.75	1,101,966	47.40	–	–
Options exercised	(3,474,463)	57.04	(1,465,608)	36.14	(86,209)	0.025
Options cancelled	(1,458,839)	100.48	(346,433)	62.75	(829,122)	0.025
At 31 March 2012	13,735,473	79.91	1,656,518	50.43	10,905,510	0.025
Range of exercise prices		36p–104p		47.4p–65.4p		0.025p
Weighted average remaining contractual life (years)		3.42 (2011: 3.76)		2.82 (2011: 1.37)		7.02 (2011: 7.57)
Options vested						
At 31 March 2011	16,628,383	63.64	–	–	1,932,976	0.025
At 31 March 2012	12,950,364	59.87	–	–	3,477,472	0.025
Weighted average remaining contractual life (years)		3.11 (2011: 3.37)	–	–		5.24 (2011: 5.47)

* = Weighted average exercise price (p)

23 Analysis of net funds

Group	1 April 2011 £m	Cash flow £m	31 March 2012 £m
Cash and cash equivalents	74.4	1.1	75.5

The Company had no net funds at 31 March 2012 and 31 March 2011.

24 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 statement of comprehensive income is detailed in note 7.

25 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		Other	
	2012 £m	2011 £m	2012 £m	2011 £m
Expiry date:				
Within one year	0.5	0.7	–	0.1
In the second to fifth years inclusive	1.5	1.5	–	–
After five years	0.1	0.4	–	–
	2.1	2.6	–	0.1

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. The Group has the right to break the lease in July 2017.

On 29 September 2011, the Group entered into an agreement in respect of the lease of premises at Five Prospect West, Chippenham, Wiltshire. The Group has the right to break the lease in September 2015.

On 13 June 2005, the Group entered into an agreement in respect of premises at Cambridge Science Park, Milton Road, Cambridge and on 27 October 2006, the Group entered into a lease agreement on an adjacent property at Cambridge Science Park; both these leases expire on 24 December 2014.

The Company had no operating lease arrangements at 31 March 2012 and 31 March 2011.

Notes to the financial statements continued

26 Capital and other commitments

At 31 March 2012, the Group had capital commitments contracted, but not provided for, of £4.1m (2011: £0.3m).

The Company had no capital and other commitments at 31 March 2012 and 31 March 2011.

27 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.

Remuneration of key management personnel
The remuneration of the Directors, who are the key management personnel of the Group, is set out below.

	2012 £m	2011 £m
Short-term employee benefits	1.2	1.1
Post-employment benefits	0.1	0.1
Share-based payments	0.4	0.5
	1.7	1.7

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:				
2011	–	1.8	86.1	18.5
2012	–	1.1	71.2	–

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

Five year summary

year ended 31 March

Unaudited Year ended 31 March	2008 £m	2009 £m	2010 £m	2011 £m	2012 £m
Consolidated statement of comprehensive income					
Revenue	25.2	31.2	40.1	42.9	33.0
Gross profit	20.8	27.3	36.6	40.2	30.8
Gross profit margin	83%	88%	91%	94%	93%
Research and development expenses	(28.1)	(30.7)	(34.8)	(36.4)	(31.7)
Other administrative expenses	(3.0)	(3.2)	(3.4)	(3.3)	(3.3)
EBITDA	(10.3)	(6.6)	(1.6)	0.5	(4.2)
Depreciation	(1.6)	(1.6)	(1.6)	(1.3)	(1.1)
Amortisation	(10.2)	(10.2)	(10.6)	(10.7)	(7.5)
Share-based compensation	(2.7)	(1.9)	(1.5)	(1.8)	(1.1)
Share of loss of associate	(0.3)	(0.6)	–	–	–
Operating loss	(25.1)	(20.9)	(15.3)	(13.3)	(13.9)
Investment income	4.5	3.6	0.6	0.8	0.7
Finance (costs)/income	(0.8)	(2.3)	0.9	(0.8)	–
Pre-tax loss	(21.4)	(19.6)	(13.8)	(13.3)	(13.2)
Taxation	2.2	2.9	3.6	4.5	8.8
Loss after taxation	(19.2)	(16.7)	(10.2)	(8.8)	(4.4)
Loss per ordinary share	(6.1p)	(5.2p)	(3.2p)	(2.7p)	(1.3p)
Cash flow statement					
Net cash (outflow)/inflow from operations	(3.7)	(3.6)	(4.3)	2.7	(2.5)
Net taxes received	2.2	2.9	0.5	8.1	4.6
Interest received	4.5	3.6	0.6	0.7	0.7
Net capital expenditure	0.6	(1.6)	(1.0)	(1.4)	(4.2)
Net cash inflow/(outflow) before financing	3.6	1.3	(4.2)	10.1	(1.4)
Balance sheet					
Cash and cash equivalents	78.8	74.0	64.1	74.4	75.5
Shareholders' equity	169.5	154.9	147.1	140.3	139.5
Net current assets	68.6	56.0	56.2	59.6	61.7

Shareholder information

Directors

John (Jack) P Cashman
(Non-Executive Chairman)

Dr Christopher P Blackwell
(Chief Executive)

Anne P Hyland
(Chief Financial Officer)

Dr John R Brown
(Non-Executive)

Dr Susan E Foden
(Non-Executive)

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