Innovata Limited

Director's Report and Financial Statements

Registered Number - 02148607

18 Months Ended 31 March 2008

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Officers and Professional advisers

Registered Office	1 Mere Way Ruddington Nottingham NG11 6JS
Registered Number	02148607
Director	C C Dalton
Company Secretary	A Dickinson
Bankers	Barclays Bank Plc Barclays Business Centre Manchester City Office P.O. Box 357 51 Mosley Street Manchester M60 2AU
Auditors	Deloitte LLP Chartered Accountants and Registered Auditors Cambridge
Solicitors	Bristows 100 Victoria Embankment London EC4Y 0DH

Director's report

The Director presents his report and the audited financial statements for the 18 months ended 31 March 2008.

Business Review and Principal activity

The Company's principal activity is the research, development and commercialisation of pharmaceutical products and technologies. There have not been any significant changes in the Company's principal activity in the period under review. The Director is not aware, at the date of this report, of any likely changes in the Company's activity in the forthcoming year.

As shown in the Company's income statement on page 10, revenue has decreased by 64% as compared to the prior year to £5.7m and by 76% on a like-for-like basis. This is due to large decreases in licensing fees and royalties.

The operating loss for the period was £0.6m compared with a profit of £8.9m for the prior year.

The balance sheet on page 11 shows the Company's financial position at the period-end is consistent with that of the prior year. An increase in trade receivables was offset by a reduction in cash and provisions.

Principal risks and uncertainties

The Company's business involves exposure to a number of risks, many of which are inherent in pharmaceutical product development. Particular risks include:

- The partial dependence of financial performance on milestone receipts.
- The risk of competition to both projects under development by the Company and licensees' sales from which the Company derives income.
- Reliance on key collaborators and suppliers.
- Product and development failure.
- Regulatory failure.
- Failure to attract collaboration partners for projects.
- Potential threats to intellectual property rights and the cost of protecting intellectual property.
- Product liability beyond reasonable commercial insurance.
- The exposure of significant revenues to currency fluctuations and, in particular, the fact that certain royalties are calculated and/or paid in US dollars.

Given that risk is a necessary and unavoidable part of its operations, the Company is aware of the need to achieve a balance of risk and potential reward and operates procedures for identifying and managing significant business risks. These involve regular reviews of strategic risks and opportunities undertaken by the Board and detailed reviews of operational issues and risks at weekly meetings of the Executive Management team. Each member of the team has operational responsibilities for identifying and managing the relevant risks.

Director's Report (continued)

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

Cash flow risk
The Company's activities expose it to the financial risks of changes in foreign currency exchange rates.

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

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

The Company's credit risk is concentrated on the one principal bank which hold its bank balances and cash and on its collaboration partners and licensees from who it receives licensing fees, development fees, royalties and proceeds of product sales.

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

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

Results and dividends
The loss on ordinary activities before taxation for the period amounted to £2,633,000 (year ended September 2006 - profit of £4,467,000). The loss after taxation for the period was £2,717,000 (year ended September 2006 – profit of £4,261,000).

The Director does not recommend the payment of a dividend.

The loss for the period is stated after charging research and development expenditure of £2,420,000 (year ended September 2006 - £2,644,000). The Director expects the general level of activity to continue next year.

Director's Report (continued)

Going Concern

The current economic slowdown and global recession has had limited impact on the company as the ultimate parent company has sufficient cash resources to meet its ongoing liabilities as they fall due. Therefore, the director has prepared these financial statements on the going concern basis.

The company has cash and cash equivalents of £20.3m at 31 March 2008 and incurred a loss of £2.7m for the 18 months then ended. The Company's Directors have prepared a detailed cash flow forecast for the period ending 30 April 2010 which include a number of significant assumptions regarding income, expenditure and future funding through the Company's parent, Vectura Group plc, from which a legally binding letter of support has been obtained.

After making enquiries, the director has a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future and will be able to meet its obligations as they fall due, for a period of at least 12 months from the date of approval of this report. Accordingly, they continue to adopt the going concern basis in preparing these financial statements.

Directors
The Directors who held office during the period were:

K P Murphy - Chief Executive Officer (Resigned 18 January 2007)
Dr T S Chadwick - Executive Director (Resigned 18 January 2007)
Dr C C Dalton - Executive Director
P J Shennan - Executive Director (Resigned 18 January 2007)

Creditor payment policy
The Company's policy and practice in relation to the payment of its creditors is to make payments in accordance with appropriate payment terms for each business transaction. At 31 March 2008 trade creditors for the Company represented 21 days of amounts invoiced by suppliers (30 September 2006 - 9 days).

Auditors
The Director at the date of approval of this report confirms that:

(1) so far as the Director is aware, there is no relevant audit information of which the company's auditors are unaware; and

(2) the Director has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

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

Deloitte LLP (Deloitte & Touche LLP changed its legal name to Deloitte LLP on 1 December 2008) have expressed their willingness to continue in office as auditors and a resolution to reappoint them will be proposed at the forthcoming Annual General Meeting.

Director's report (continued)

Statement of Director's responsibilities

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

Company law requires the Director to prepare financial statements for each financial year. Under that law, the Director has elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. The financial statements are required by law to be properly prepared in accordance with IFRSs as adopted by the European Union and the Companies Act 1985.

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

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

The Director is responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and enable him to ensure that the financial statements comply with the Companies Act 1985. The Director is 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 Director is 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.

Approved by the Board and signed on its behalf by,

Colin Dalton

C C Dalton
Director
28 April 2009

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF INNOVATA LIMITED

We have audited the financial statements of Innovata Limited for the 18 months ended 31 March 2008, which comprise the Income Statement, the Balance Sheet, the Statement of Changes in Equity, the Cash Flow Statement and the related notes 1 to 20 These financial statements have been prepared under the accounting policies set out therein.

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

Respective responsibilities of the Director and auditors

The Director's responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Director's Responsibilities.

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

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Director's Report is consistent with the financial statements.

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

We read the other information contained in the Annual Report as described in the contents section and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any further information outside the Annual Report.

Basis of audit opinion

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

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

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Company's affairs as at 31 March 2008 and of its loss for the 18 months then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Director's Report is consistent with the financial statements.

Deloitte LLP

Deloitte LLP
Chartered Accountants and Registered Auditors
Cambridge, United Kingdom

30 April 2009

Income statement
For the 18 months ended 31 March 2008

	Notes	18 months ended 31 March 2008 £'000	12 months ended 30 September 2006 £'000
Revenue	**2**	**5,701**	**15,949**
Cost of sales		(268)	(877)
Gross profit		**5,433**	**15,072**
Research and development expenditure		(2,420)	(2,644)
Selling, marketing and distribution costs		-	(438)
Share-based compensation		(840)	(690)
Other administrative expenses		(5,728)	(2,400)
Administrative expenses		(6,568)	(3,090)
Other income		3,000	-
Operating (loss) / profit		**(555)**	**8,900**
Investment income	3	1,954	379
Financing costs	3	(4,032)	(4,812)
(Loss) / profit before taxation		**(2,633)**	**4,467**
Taxation	5	(84)	(206)
(Loss) / profit for the period	**4,15**	**(2,717)**	**4,261**

All results are derived from continuing activities.

Balance sheet
As at 31 March 2008

	Notes	31 March 2008 £'000	30 September 2006 £'000
ASSETS			
Non-current assets:			
Property, plant and equipment	7	229	110
Investments	8	55,675	55,675
		55,904	55,785
Current assets:			
Inventories	9	-	17
Trade and other receivables	10	16,963	8,901
Short term investments		-	500
Cash and cash equivalents		20,268	35,589
		37,231	45,007
Total assets		93,135	100,792
LIABILITIES			
Non current liabilities:			
Trade and other payables	11	-	(194)
Provisions	12	(7,896)	(7,978)
		(7,896)	(8,172)
Current liabilities:			
Trade and other payables	11	(944)	(3,337)
Provisions	12	(860)	(3,358)
		(1,804)	(6,695)
Total liabilities		(9,700)	(14,867)
Net assets		83,435	85,925
SHAREHOLDER'S EQUITY			
Called-up share capital	13	5,032	5,032
Share premium account	14	73,326	73,314
Merger reserve	14	36,984	36,984
Special reserve	14	4,049	4,049
Other reserve	14	1,884	1,669
Retained deficit	14	(37,840)	(35,123)
Total shareholder's equity	15	83,435	85,925

The financial statements were approved by the Director and authorised for issue on 29 April 2009 and signed by:

C C Dalton
Director

Statement of changes in equity

For the 18 months ended 31 March 2008

	Called-up share capital £'000	Share premium account £'000	Merger reserve £'000	Special reserve £'000	Other reserve £'000	Retained deficit £'000	Total shareholders' equity £'000
At 30 September 2005	5,026	73,230	36,984	4,049	979	(39,384)	80,884
Loss for the year	-	-	-	-	-	4,261	4,261
Exercise of share options	6	84	-	-	-	-	90
Share-based payments	-	-	-	-	690	-	690
At 30 September 2006	5,032	73,314	36,984	4,049	1,669	(35,123)	85,925
Loss for the period	-	-	-	-	-	(2,717)	(2,717)
Share-based compensation	-	-	-	-	215	-	215
Exercise of share options	-	12	-	-	-	-	12
At 31 March 2008	5,032	73,326	36,984	4,049	1,884	(37,840)	83,435

Cash flow statement

For the 18 months ended 31 March 2008

	Notes	18 months ended 31 March 2008 £'000	12 months ended 30 September 2006 £'000
Operating activities:			
Cash generated from operations	17	1,029	6,633
Withholding tax		(265)	(206)
R&D tax credit received		181	-
Net cash generated from operating activities		945	6,427
Investing activities:			
Purchases of property, plant and equipment		(286)	(74)
Sale of property, plant and equipment		-	62
Net cash used in investing activities		(286)	(12)
Financing activities:			
Exercise of share options		12	90
Repayment of finance lease capital		-	(199)
(Decrease) / increase in amount owing to Paul Capital		(2,580)	409
(Increase) / decrease in net amount due from Group undertakings		(11,334)	2,126
Interest received		1,954	379
Interest paid		(4,032)	(4,812)
Net cash used in financing activities		(15,980)	(2,007)
(Decrease) / increase in cash and cash equivalents		(15,321)	4,408
Cash and cash equivalents at the beginning of the period		35,589	31,181
Cash and cash equivalents at the end of the period		20,268	35,589

Notes to the financial statements

1) Accounting policies and basis of preparation

General Information
Innovata Limited is a limited company incorporated in the United Kingdom under the Companies Act 1985. The address of the registered office and principal place of business is 1 Mere Way, Ruddington, Nottingham, NG11 6JS.

Basis of preparation
The financial statements have been prepared in accordance with the Companies Act 1985 and International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretations Committee interpretations as adopted by the European Union.

The financial statements have been prepared on the historical cost basis, revised for use of fair values where required by applicable IFRS.

The accounts have been prepared under the going concern basis for the reasons set out in the Directors' Report.

The Company is a wholly-owned subsidiary of another company incorporated in the EEC. In accordance with section 228 of the Companies Act 1985, the Company is not required to produce and has not published consolidated accounts.

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:

IFRS 1 (revised)	First Time Adoption of IFRS
Amendments to IFRS 2	Vesting conditions and cancellations
IFRS 3 (revised)	Business Combinations
IFRS 8	Operating segments
IFRIC 11 IFRS2	Group and Treasury Share Transactions
IFRIC 12	Service Concession Arrangements*
IFRIC 13	Customer Loyalty Programmes
IFRIC 14 - IAS 19	The Limit of a Defined Benefit Asset, Minimum Funding Requirements and their Interaction
IFRIC 15	Agreements for the Construction of Real Estate
IFRIC 16	Hedges of a Net Investment in a Foreign Operation
IFRIC 17	Distributions of Non-cash Assets to Owners
IFRIC 18	Transfers of Assets from Customers
IAS 1 (revised)	Presentation of Financial Instruments
IAS 23 (revised)	Borrowing Costs
Amendments to IAS 27	Consolidated and Separate Financial Statements
IAS 32 (amended)/IAS 1 (amended)	Puttable Financial Instruments and Obligations Arising on Liquidation
Amendments to IAS 39	Financial Instruments: Recognition and Measurement: Eligible Hedged Items
Amendments to IAS 39	Reclassification of Financial Assets: Effective Date and Transition

* IFRIC 12 is not yet endorsed, and therefore cannot be effective.

Notes to the financial statements

1) Accounting policies and basis of preparation (continued)

Basis of Preparation (continued)

The Director anticipates that the adoption of these Standards and Interpretations in future periods will have no material impact on the Company's financial statements.

In the current year, the Company has chosen to adopt early IFRS 7 – Financial Instruments: Disclosures, which is effective for annual reporting periods beginning on or after 1 January 2007. The impact of the adoption of IFRS 7 has been to expand the disclosures provided in these financial statements regarding the Group's financial instruments and management of capital (see note 21).

A summary of significant accounting policies is presented below.

Revenue
Revenue, which excludes value added tax, comprises:

- Licensing and evaluation fees, which are recognised once it can be determined with reasonable certainty that such amounts will be received and that they are non-refundable. These fees are taken to revenue when the associated conditions are satisfied and/or substantive obligations met, pending which they are treated as deferred revenue. License fees which are refundable if contractually specified conditions are not met are recognised as liabilities until such conditions are fully satisfied.

- Development fees, which are recognised in the period in which the development is undertaken for third party licensees under the terms of license agreements.

- Expenditure incurred in relation to development fees is treated as a cost of sale.

- Royalties, which are recognised in the period in which the sales by third parties that give rise to the royalties take place.

- Product sales, which are recognised when the goods are delivered to customers.

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

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

Property, Plant and Equipment
Property, plant and equipment is carried at cost, less accumulated depreciation and accumulated impairment losses.

Depreciation is provided on a straight-line basis over the anticipated useful economic lives of the assets. The following rates applied for the Company:

- Plant and machinery	20% - 33%
- Computer and office equipment	33%
- Motor vehicles	33%

Notes to the financial statements

1) Accounting policies and basis of preparation (continued)

Inventories
Inventories comprise goods held for resale and are stated at the lower of cost and net realisable value. Costs include the direct costs and an attributable proportion of distribution overheads incurred in bringing stocks 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.

Leases
Finance leases, which transfer to the company substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Plant and machinery, and computer and office equipment which are the subject of finance leases are dealt with in the financial statements as property, plant and equipment, with a corresponding liability being recognised for the fair value of the leased asset or, if lower, the present value of the minimum lease payments. Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term.

Financial instruments
Financial assets and financial liabilities are recognised on the Company's balance sheet when the Company becomes a party to the contractual provision of the instrument.

Trade and other receivables
Trade receivables do not carry interest and are stated at their nominal value as reduced by appropriate allowances for estimated irrecoverable amounts. The carrying value of these assets approximates their fair value.

Cash and cash equivalents
Cash and cash equivalents in the balance sheet comprise cash at bank and in hand and short-term deposits with an original maturity of three months or less. The carrying amount of these assets approximates their fair value.

Trade and other payables
Trade payables are not interest bearing and are stated at their nominal value.

Financial liabilities and equity
A provision is recognised when the Company has a legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. Financial liabilities are initially measured at fair value and, if material, are subsequently measured at amortised cost using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments throughout the expected life of the financial liability. Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Company after deducting all of its liabilities.

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

Notes to the financial statements

1) Accounting policies and basis of preparation (continued)

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

- where the temporary difference arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss;
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future; and

- deferred tax assets are recognised only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, carried forward tax credits or tax losses can be utilised.

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

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

Retirement benefit costs
Payments to defined-contribution retirement benefit schemes are charged as an expense as they fall due.

Share-based payments
The ultimate parent company, Vectura Group plc, operates a number of executive and employee share option schemes, as well as a Long-Term Incentive Plan (LTIP) under which Executive Directors and certain senior staff members may be granted nil-cost options under certain conditions. The level of grant 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 as at the date on which they are granted. The Black-Scholes model is used to determine fair value for options, and the Monte Carlo binomial model for LTIP awards.

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

Foreign currencies
Transactions in currencies other than pounds sterling are recorded at the rate of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary assets and liabilities carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Gains and losses arising on re-translation are included in net profit or loss for the period, except for exchange differences arising on non-monetary assets and liabilities where the changes in fair value are recognised directly in equity.

Notes to the financial statements

1) Accounting policies and basis of preparation (continued)

Operating lease agreements
All leases are treated as operating leases. Their annual rentals are charged to the income statement on a straight-line basis over the term of the lease.

Critical accounting judgements
The key sources of estimation uncertainty that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year are the estimation of share-based payment costs and the treatment of R&D expenditure in line with the relevant accounting policy.

The estimation of share based-payment costs requires the selection of an appropriate valuation model, consideration as to the inputs necessary for the valuation model chosen and the estimation of the number of awards that will ultimately vest, inputs for which arise from judgements relating to the probability of meeting non-market conditions and the continuing participation of employees. The treatment of R&D expenditure requires an assessment of the expenditure in order to determine whether or not it is appropriate to capitalise onto the balance sheet in accordance with IAS 38.

2) Segmental analysis

Segmental analysis of revenue:

	18 months ended 31 March 2008 £'000	12 months ended 30 September 2006 £'000
Licensing and evaluation fees	571	8,060
Development fees	923	411
Royalties	4,207	7,266
Product sales	-	212
Total	5,701	15,949

Geographical analysis of revenue by customer location:

	18 months ended 31 March 2008 £'000	12 months ended 30 September 2006 £'000
United Kingdom	923	1,713
Rest of Europe	-	6,093
North America	4,778	7,249
Rest of world	-	894
Total	5,701	15,949

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

Notes to the financial statements

3) Financing income and expense

	18 months ended 31 March 2008 £'000	12 months ended 30 September 2006 £'000
Financing income:		
Bank interest receivable	1,954	379
Financing costs:		
Bank interest payable	(20)	-
Interest payable on finance leases	(42)	(14)
Finance charges on PRF liability	(3,970)	(4,798)
	(4,032)	(4,812)

4) (Loss) / profit for the period

The (loss) / profit for the period is stated after charging / (crediting):

	18 months ended 31 March 2008 £'000	12 months ended 30 September 2006 £'000
Depreciation on owned tangible fixed assets	76	36
Depreciation on tangible fixed assets held under finance leases	33	66
Amortisation of intangible fixed assets	-	2,300
Payments made to auditors (see below)	543	334
Operating lease costs on:		
- Rental of premises	-	18
- Hire of plant and machinery	9	10
Staff costs (see note 6)	2,058	3,880
Loss / (profit) on disposal of property, plant and equipment	58	(53)

A more detailed analysis of auditors' remuneration is provided below:

	18 months ended 31 March 2008 £'000	12 months ended 30 September 2006 £'000
Fees payable to the company's auditors for the audit of the company's annual accounts	10	58
Total audit fees	10	58
Corporate finance services	376	30
Tax services	-	37
Other services	-	209
Total non-audit fees	376	276

Notes to the financial statements

5) Taxation

The tax charge for the 18 months to 31 March 2008 represents withholding taxes on royalty receipts, less R&D tax credits received. The charge can be reconciled to the loss per the income statement as follows:

	31 March 2008 £000	30 September 2006 £000
(Loss) / profit on ordinary activities before tax	(2,633)	4,467
(Loss) / profit on ordinary activities multiplied by standard rate of tax in the UK of 30%	(789)	1,340
Effects of:		
Permanent differences - expenses not deductible for tax purposes	253	-
Utilisation of tax losses brought forward	-	(1,286)
Group relief surrendered	55	(54)
Unrecognised tax losses carried forward	481	-
Withholding taxes on royalties	(265)	(206)
Credit not recognised in previous year relating to research and development tax credit	181	-
Total current tax	84	(206)

Cumulative tax losses of approximately £48,542,000 (subject to agreement by HMRC) are available to carry forward against future taxable profits, or surrender in return for research and development tax credits (30 September 2006 - £46,523,000). There is an unrecognised deferred tax asset of £13,592,000 (30 September 2006 - £13,026,000) relating to the above tax losses, and a deferred tax asset of £199,000 arising as a result of unclaimed capital allowances (30 September 2006 - £308,000). The total deferred tax asset of £13,791,000 (30 September 2006 - £13,334,000) has not been recognised since it is uncertain that there will be suitable future taxable profits against which the deferred tax asset can be offset.

In March 2007, the UK government announced that they would reduce the corporation tax rate to 28% with effect from 1 April 2008. This legislation was substantively enacted in June 2007. As a consequence, the effective tax rate for the year ending 31 March 2009 is expected to reduce accordingly.

6) Directors and employees

	31 March 2008 Number	30 September 2006 Number
Average weekly number of persons (including Directors) employed by the Company during the period:		
Research and development	12	18
Administration and marketing	17	18
	29	36
	£'000	£'000
Wages and salaries	1,809	3,409
Social security costs	126	277
Other pension costs (see note 18)	123	194
	2,058	3,880

Notes to the financial statements

7) Property, Plant and Equipment

	Plant and machinery	Computer and office equipment	Motor vehicles	Total
	£'000	£'000	£'000	£'000
Cost:				
At 1 October 2005	-	111	293	404
Additions	29	-	-	29
Transfer to parent company	-	-	18	18
Disposals	-	(3)	(134)	(137)
At 30 September 2006	29	108	177	314
Additions	230	56	-	286
Disposals	-	-	(177)	(177)
At 31 March 2008	259	164	-	423
Depreciation:				
At 1 October 2005	-	49	163	212
Charge for year	2	34	66	102
Transfer to parent company	-	-	18	18
Disposals	-	-	(128)	(128)
At 30 September 2006	2	83	119	204
Charge for period	48	61	-	109
Disposals	-	-	(119)	(119)
At 31 March 2008	50	144	-	194
Net book value:				
At 31 March 2008	209	20	-	229
At 30 September 2006	27	25	58	110
At 30 September 2005	-	62	130	192

The net book value of tangible fixed assets includes £nil (2006 - £1,518,000) in respect of assets held under finance leases.

Notes to the financial statements

8) Fixed asset investments

	Investment £'000	*Subsidiaries £'000*	*Total £'000*
Carrying value:			
At 30 September 2006 and 31 March 2008	250	55,425	55,675

Principal subsidiary companies:	*% held*	*Country of incorporation*	*Description of Shares*	*Nature of business*
Innovata Biomed Limited	100	Scotland	Ordinary and Preference Shares	Research, development and commercialisation of respiratory drug delivery technologies
Quadrant Technologies Limited	100	England	Ordinary Shares	Research, development of drug formulation and delivery systems
Quadrant Drug Delivery Limited	100	England	Ordinary Shares	Research, development of drug formulation and delivery systems
Quadrant Healthcare Limited	100	England	Ordinary Shares	Research, development of drug formulation and delivery systems together with the provision of management services to other Group companies
Joint venture:				
QDose	50	England	Ordinary shares	Research, development of drug formulation and delivery systems

9) Inventories

	31 March 2008 £'000	30 September 2006 £'000
Raw materials and consumables	-	17

10) Trade and other receivables

	31 March 2008 £'000	30 September 2006 £'000
Amounts due within one year:		
Trade debtors	2	50
R&D tax credit	-	400
VAT	22	-
Amounts due from Group undertakings	16,095	4,955
Other debtors	-	5
Prepayments and accrued income	844	3,491
Total trade and other receivables	16,963	8,901

The Director considers that the carrying amount of trade and other receivables approximates their fair value.

Notes to the financial statements

11) Trade and other payables

	31 March 2008 £'000	30 September 2006 £'000
Amounts due within one year:		
Trade creditors	73	901
Tax and social security	36	67
Other creditors	35	-
Accruals	800	2,369
	944	3,337
Amounts due after one year:		
Amounts owed to parent undertaking	-	194
Total trade and other payables	944	3,531

The Director considers that the carrying amount of trade and other payables approximates their fair value.

12) Provisions

	PRF Royalty Fund £'000
1 October 2006	11,336
Payments	(6,550)
Interest charge	3,970
Total provisions	8,756
31 March 2008	
Provisions due within one year	860
Provisions due after one year	7,896
	8,756
30 September 2006	
Provisions due within one year	3,358
Provisions due after one year	7,978
	11,336

13) Called-up share capital

	31 March 2008 £'000	30 September 2006 £'000
Authorised:		
670,000,000 Ordinary Shares of £1 each	6,700	6,700
Allotted, called-up and fully paid;		
503,158,305 Ordinary Shares of £1 each	5,032	5,032

Notes to the financial statements

14) Reserves

	Share premium account	Merger reserve	Special reserve	Other reserve	Retained deficit
	£'000	£'000	£'000	£'000	£'000
At 30 September 2006	73,314	36,984	4,049	1,669	(35,123)
Share-based payments	-	-	-	215	-
Exercise of share options	12	-	-	-	-
Retained loss for the period	-	-	-	-	(2,717)
At 31 March 2008	73,326	36,984	4,049	1,884	(37,840)

15) Reconciliation of movements in shareholders' equity

	18 months ended 31 March 2008	12 months ended 30 September 2006
	£'000	£'000
(Loss) / profit for the financial period	(2,717)	4,261
Share-based compensation	215	690
Exercise of share options	12	90
Opening shareholders' equity funds	85,925	80,884
Closing shareholders' equity funds	83,435	85,925

16) Equity-settled share option schemes and Long-Term Incentive Plan

The Company's Director, officers and employees hold options granted under various option plans operated by its ultimate parent company, Vectura Group plc. 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.

The parent company also operates a Save as You Earn (SAYE) Share Option Scheme in which all employees and Executive Directors of the Group are invited to participate, and to subscribe for options to acquire shares in Vectura Group plc. Options may be granted at a discount of up to 20% of the market value on the offer date which vest after three years and are exercisable during a period of six months following the vesting date.

Vectura Group plc also operates a Long-Term Incentive Plan (LTIP) under which Executive Directors and certain senior managers are granted conditional rights to receive nil-cost options over 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 fair value of awards under these schemes has been calculated in compliance with International Financial Reporting Standard (IFRS) 2. The Company has applied IFRS 2 only to options granted after 7 November 2002, and not vested at 1 January 2005. With the exception of the LTIP awards, the fair value of the options was determined using the Black-Scholes pricing model. The fair value of the LTIP awards was 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.

Notes to the financial statements

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

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

	Year of grant	
	2008	*2007*
Weighted average share price of grants during the year	68.31p	92.27p
Expected volatility[1]	33% - 48%	47% - 59%
Expected life	5 years	5 years
Expected dividends	Nil	Nil
Risk-free interest rate[2]	3.9% - 5.6%	4.9% - 5.4%

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

	2008	*2007*
Weighted average share price of grants during the year	88.65p	92.34p
Expected volatility[1]	48%	48%
Expected life	3 years	3 years
Expected dividends	Nil	Nil
Risk-free interest rate[2]	5.7%	5.0 -5.3%

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

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

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

The aggregate of the estimated fair value of options granted under share option schemes during the period ended 31 March 2008 was £576,000 (2007 - £435,000) and under the SAYE Scheme £226,000 (2007 - £178,000). The estimated fair value of the LTIP awards during the period ended 31 March 2008 was £510,000 (2007 - £555,000).

Previous to the acquisition of the Company by Vectura Group plc on 18 January 2007, the Company had operated its own Executive Share Option Scheme. On 18 January 2007, the date of completion of the acquisition of Innovata plc in accordance with a scheme of arrangement, options over Innovata shares issued and outstanding at that date under the ML Laboratories PLC 1989 Executive Option Scheme and the ML Laboratories PLC 1999 Executive Option Scheme were exchanged for options over Vectura shares in accordance with the rules of the relevant Innovata Option Scheme. The exchange was on the basis that the option holders received new options over .2858 Vectura shares for every one Innovata share, equating to an aggregate market value similar to that of the Innovata shares released and at a similar aggregate exercise price, save that, to the extent such Innovata options would not have vested but for the Scheme becoming effective, the new options are subject to the vesting periods that would otherwise have applied. No performance conditions (to the extent that they applied under the Innovata Option Schemes) apply to the new options over Vectura shares.

In respect of the period from 1 October 2006 to 31 March 2007, an amount of £215,000 was charged in the income statement of the Company relative to the option awards made under the Innovata Executive Share Option Schemes, prior to their absorption into the Vectura Group plc option scheme.

The total share-based compensation charge in the Group for awards under all schemes for the year ended 31 March 2008 was £2,702,000 (2007 - £1,633,000). Of this amount, £625,000 has been recognised by the Company and charged in the income statement, resulting in a total share-based compensation charge in the Company for the eighteen months ended 31 March 2008 of £840,000 (year ended 30 September 2006 - £690,000).

Notes to the financial statements

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

Details of the options outstanding and vested at 31 March 2008 under all schemes, including awards made to employees of the company, are as follows:

Options outstanding

	Share Option Schemes		*SAYE Scheme*		*LTIP*	
	Number of options	*WAEP**	*Number of options*	*WAEP**	*Number of options*	*WAEP**
At 1 April 2006	11,306,556	41.72	701,660	55.86	1,032,611	77.50
Options acquired from Innovata plc	9,496,791	93.83	-	-	-	-
Options granted	1,045,462	92.27	439,003	71.20	998,484	92.34
Options exercised	(832,327)	24.43	-	-	-	
Options cancelled	(42,900)	70.75	(19,397)	50.80	(82,835)	77.50
At 31 March 2007	20,973,582	68.45	1,121,266	61.95	1,948,260	85.11
Options granted	1,915,831	68.31	1,656,476	36.00	842,269	88.65
Options exercised	(1,241,972)	49.38	-	-	-	-
Options cancelled	(791,701)	206.64	(380,792)	70.70	-	-
At 31 March 2008	20,855,740	63.85	2,396,950	42.63	2,790,529	86.18
Range of exercise prices		0.025p - 489p		36p - 72p		
Weighted average of remaining contractual life	6.01 years		2.75 years		8.43 years	

Options vested

	Share Option Schemes		*SAYE Scheme*		*LTIP*	
	Number of options	*WAEP**	*Number of options*	*WAEP**	*Number of options*	*WAEP**
At 31 March 2007	10,387,229	67.82	-	-	-	-
At 31 March 2008	15,002,506	58.26	-	-	-	-
Weighted average of remaining contractual life	5.15 years		N/A		N/A	

* = Weighted average exercise price (p)

Notes to the financial statements

17) Cash (used in) / generated from operations

	18 months ended 31 March 2008 £'000	12 months ended 30 September 2006 £'000
Operating (loss) / profit	(555)	8,900
Adjustments for:		
Depreciation	109	102
Investment write-off	-	200
Share-based compensation	840	690
Loss / (profit) on sale of fixed assets	58	(53)
Operating cash flows before movements in working capital	452	9,839
Changes in working capital		
Decrease / (increase) in inventories	17	(17)
Decrease / (increase) in trade and other receivables	3,078	(2,885)
Decrease in trade and other payables	(2,518)	(304)
Cash generated from operations	1,029	6,633

18) Pensions

The Company participates in certain defined contribution pension schemes. The assets of the schemes are held separately from those of the Company and are independently administered. The pension cost charge represents contributions payable by the Company under the schemes and amounted to £123,000 (year to 30 September 2006 - £194,000). Contributions totalling £nil (30 September 2006 - £nil) were payable at the period-end.

19) Related party transactions

Details of trading with other Group companies during the period are disclosed in accordance with IAS 24:

	Recharge from related parties for services	Recharge to related parties for services	Amounts owed to related parties	Amounts owed by related parties
	£'000	£'000	£'000	£'000
Vectura Group plc				
2008	-	3,018	-	4,828
2006	-	-	-	-
Innovata Biomed Limited				
2008	48	512	-	6,624
2006	-	713	-	3,590
Quadrant Drug Delivery Limited				
2008	1	84	-	1,193
2006	140	731	140	1,452

The amounts outstanding are unsecured and will be settled in cash. No guarantees have been given or received. No provisions have been made for doubtful debts in respect of the amounts owed by related parties.

Notes to the financial statements

19) Related party transactions (continued)

Remuneration of key management personnel

	2008 £000	2006 £000
Short-term employee benefits	817	741
Post-employment benefits	21	65
	838	806

20) Ultimate parent company

The Company's immediate and ultimate parent undertaking and ultimate controlling party is Vectura Group plc, a company incorporated in England and Wales. This represents the smallest and largest group into which the results of the Company are consolidated. The consolidated financial statements are available from Vectura Group plc, One Prospect West, Chippenham, Wiltshire, SN14 6FH.

21) Financial Instruments

Capital risk management

The Company manages its capital to ensure that it is able to continue as a going concern while maximising the return to stakeholders. The capital structure of the Company consists of cash and cash equivalents, amounts due from, and to, other Vectura Group plc companies and equity attributable to equity holders of the Company, comprising issued share capital, reserves and retained earnings as disclosed in the statement of changes in equity.

Externally imposed capital requirement

The Company is not subject to externally imposed capital requirements.

Financial risk management

The Company follows Vectura Group plc policies on interest rate risk, credit risk and the investment of excess liquidity. The Company's objective in using financial instruments is to maximise the returns on funds held on deposit and to minimise exchange rate risk where appropriate.

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

The Company is funded principally with equity and invests its funds in short-term bank deposits. The Company has access to the majority of these deposits at a maximum of 24 hours' notice. The Company'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 7-day sterling London Inter-Bank Offer Rate (LIBOR).

Foreign currency risk management

The Company had no significant commitments to foreign currencies throughout the period. When foreign currencies are received the business aims to match these with payments in foreign currency. Where there are no imminent foreign exchange transactions, the balances are exchanged for sterling at spot rate.

Notes to the financial statements

21) Financial Instruments (continued)

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

	31 March 2008 £'000	30 September 2006 £'000
Cash and cash equivalents		
Sterling	20,235	35,589
US Dollar	35	-
Euro	(2)	-
	20,268	35,589

The amounts disclosed reflect the book value and fair value of the Company's financial instruments. Cash and cash equivalents comprise current accounts held by the Company with immediate access and short-term bank deposits with a maturity value of three months or less. The fair value of the financial instruments is as per the book values disclosed above.

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

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

	31 March 2008 £'000	30 September 2006 £'000
Amounts receivable from revenues	24	50
Short term investments	-	500
Cash and cash equivalents	20,268	35,589
	20,292	36,139

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

	31 March 2008 £'000	30 September 2006 £'000
Trade creditors and accruals	(944)	(3,531)
Financial Liabilities	(8,756)	(11,336)
	(9,700)	(14,867)

Foreign currency sensitivity analysis
The Company's principal functional currency is sterling. However, the Company had expenditure in US dollars and Euros during 2008 and 2007. The Company's policy is to maintain natural hedges, where possible, by matching foreign currency revenues with matching foreign currency expenditure. The Company considers foreign currency risk to be immaterial due to natural hedges and to the low amounts of foreign currency held.

Notes to the financial statements

21) Financial Instruments (continued)

Interest rate risk management

The Company has no external borrowings and is not exposed to interest rate risk through borrowings. Cash and cash equivalents earned £1,954,000 of finance income during the year (2007 - £379,000). 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 2008 would increase/decrease by £0.2 million.

Liquidity risk management

The Company 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 Company's credit risk is primarily attributed to its cash and cash equivalents. The risk is limited because the Company primarily deposits its cash with banks that have an AAA rating with S&P, Moody's and Fitch.

Market risk management

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