

**Innovata Limited**

**Directors' Report and Financial Statements**

**Registered Number - 02148607**

**Year Ended 31 March 2011**

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## **Innovata Limited**

### **Contents**

|                                             |         |
|---------------------------------------------|---------|
| Officers and professional advisers          | 1       |
| Directors' report                           | 2 – 4   |
| Statement of Directors' responsibilities    | 5       |
| Independent auditors' report to the members | 6 - 7   |
| Statement of comprehensive income           | 8       |
| Balance sheet                               | 9       |
| Statement of changes in equity              | 10      |
| Cash flow statement                         | 11      |
| Notes to the financial statements           | 12 - 27 |

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Innovata Limited

**Officers and Professional advisers**

|                          |                                                                 |
|--------------------------|-----------------------------------------------------------------|
| <b>Registered Office</b> | One Prospect West<br>Chippenham<br>Wiltshire<br>SN14 6FH        |
| <b>Registered Number</b> | 02148607                                                        |
| <b>Directors</b>         | C P Blackwell<br>A P Hyland                                     |
| <b>Company Secretary</b> | P F Burrell                                                     |
| <b>Bankers</b>           | Barclays Bank Plc<br>28 Chesterton Road<br>Cambridge<br>CB4 3AZ |
| <b>Auditors</b>          | Deloitte LLP<br>126 – 130 Hills Road<br>Cambridge<br>CB2 1RY    |
| <b>Solicitors</b>        | Bristows<br>100 Victoria Embankment<br>London<br>EC4Y 0DH       |

# Innovata Limited

## Directors' report

The Directors presents their report and the audited financial statements for the year ended 31 March 2011

## 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 Directors are not aware, at the date of this report, of any likely changes in the Company's activity in the forthcoming year.

## Business review and future developments

Revenue includes fee income from technology licensing and pharmaceutical development fees. Revenue has increased by 60% to £14,812,000 (2010 - £9,257,000). Technology licensing revenue has increased to £5,000,000 (2010 - £nil) as a result of an upfront payment from GSK under a non-exclusive agreement to license certain of the Company's dry powder formulation patents. Development fees have also increased to £1,610,000 (2010 - £771,000).

Research & development expenditure has decreased by 54% to £950,000 (2010 - £2,087,000), partly due to a reduction in legal costs of defending the Company's intellectual property.

Profit before tax has increased by 113% to £13,366,000 (2010 - £6,277,000). The main reason for this increase is the increase in licensing revenues.

Cash and cash equivalents at the year end were £nil (2010 - £nil). All banking activities are under the control of another Group company. As a result, the directors expect the company to maintain a £nil cash and cash equivalents balance for the foreseeable future.

## 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
- Reliance on key customers
- 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.

**Directors' Report (continued)**

**Financial risk**

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 Directors, 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. Some of the Company's revenues are in either euros or US dollars. Where known liabilities arise in these currencies the revenues are retained on deposit in the appropriate currency in order to off-set the exchange risk on these liabilities.

**Credit risk**

The Company's principal financial assets are 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.

**Liquidity risk**

Another Group company controls the banking activities of the company and this ensures that there are sufficient funds available for ongoing operations and future developments.

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

**Risk management**

The Company's extensive risk management process seeks to identify material risks and to determine how best to manage them. Specific risk managing actions the Company has in place are set out against certain of the risks identified in this section.

**Results and dividends**

The profit on ordinary activities before taxation for the year amounted to £13,366,000 (2010 – £6,277,000). The profit after taxation for the year was £13,283,000 (2010 – £6,727,000).

The Directors do not recommend the payment of a dividend (2010 - £nil).

**Going Concern**

The company made a profit of £13,283,000 for the year ended 31 March 2011 (2010 – £6,727,000). The current economic slowdown and global recession has had limited impact on the Company as the ultimate parent company has sufficient resources to meet its ongoing liabilities as they fall due. The company continues to receive the support of its ultimate parent company to allow it to meet its liabilities as they fall due.

The Company's Directors have reviewed the group's detailed cash flow forecast for the period ending 30 November 2012, made relevant enquiries and considered reasonably possible changes in trading activities, to satisfy themselves that the ultimate parent company is able to provide the necessary support to enable the company to meet its liabilities as they fall due, despite the current uncertain economic outlook. A legally binding letter of support has been obtained from Vectura Group plc. After making these enquiries, the directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and accounts.

**Directors' Report (continued)**

**Directors**

The directors who held office during the year and to the date of this report were

C C Dalton – Executive Director (resigned 5 July 2011)

C P Blackwell – Executive Director (Appointed 11 November 2010)

A P Hyland - Executive Director (Appointed 11 November 2010)

**Creditor payment policy**

The Company's policy and practice in relation to the payment of its creditors is to make payments in accordance with relevant payment terms for each business transaction

**Directors' indemnities**

The parent 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

**Auditors**

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

The Directors at the date of approval of this report confirm that

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

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

Approved by the Board and signed on its behalf by,



A P Hyland

Director

8 November 2011

## **Innovata Limited**

### **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 have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the Directors must not approve the financial statements 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.

**INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF INNOVATA LIMITED**

We have audited the financial statements of Innovata Limited for the year ended 31 March 2011, which comprise the Statement of comprehensive income, the Balance sheet, the Cash flow statement, the Statement of changes in equity and the related notes 1 to 18. 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.

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 auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

**Respective responsibilities of Directors and auditors**

As 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 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 Company's affairs as at 31 March 2011 and of its profit for the year then ended,
- have been properly prepared in accordance with IFRSs as adopted by the European Union, and
- have been prepared in accordance with the requirements of the Companies Act 2006.

**Opinion on other matters prescribed by the Companies Act 2006**

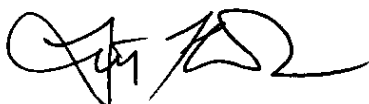
In our opinion the information given in the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.

## **Innovata Limited**

### **Matters on which we are required to report by exception**

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us, or
- the financial statements 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



**Stuart Henderson (Senior Statutory Auditor)**

for and on behalf of Deloitte LLP

Chartered Accountants and Statutory Auditor

Cambridge, United Kingdom

8 November 2011

# Innovata Limited

## Statement of comprehensive income For the year ended 31 March 2011

|                                                                   | Notes | 2011<br>£'000 | 2010<br>£'000  |
|-------------------------------------------------------------------|-------|---------------|----------------|
| Revenue                                                           | 2     | 14,812        | 9 257          |
| Gross profit                                                      |       | <u>14,812</u> | <u>9,257</u>   |
| Research and development expenditure                              |       | <u>(950)</u>  | <u>(2,087)</u> |
| Share-based compensation                                          |       | (357)         | (308)          |
| Other administrative expenses                                     |       | <u>(174)</u>  | <u>(485)</u>   |
| Administrative expenses                                           |       | <u>(531)</u>  | <u>(793)</u>   |
| Operating profit                                                  | 6     | <u>13,331</u> | <u>6,377</u>   |
| Finance gains/(losses)                                            | 4     | 35            | (100)          |
| Profit for the year before taxation                               |       | <u>13,366</u> | <u>6,277</u>   |
| Taxation                                                          | 5     | <u>(83)</u>   | <u>450</u>     |
| Profit for the year after taxation and total comprehensive income |       | <u>13,283</u> | <u>6,727</u>   |

All results are derived from continuing activities

# Innovata Limited

## Balance sheet

At 31 March 2011

|                               | Notes | 2011<br>£'000  | 2010<br>£'000  |
|-------------------------------|-------|----------------|----------------|
| <b>ASSETS</b>                 |       |                |                |
| Non-current assets            |       |                |                |
| Property, plant and equipment | 8     | -              | 106            |
| Investments                   | 9     | 55,425         | 55,675         |
|                               |       | <u>55,425</u>  | <u>55,781</u>  |
| Current assets                |       |                |                |
| Trade and other receivables   | 10    | 47,826         | 40,146         |
| Total assets                  |       | <u>103,251</u> | <u>95,927</u>  |
| <b>LIABILITIES</b>            |       |                |                |
| Current liabilities           |       |                |                |
| Trade and other payables      | 11    | (1,781)        | (7,740)        |
| Total liabilities             |       | <u>(1,781)</u> | <u>(7,740)</u> |
| Net assets                    |       | <u>101,470</u> | <u>88,187</u>  |
| <b>SHAREHOLDER'S EQUITY</b>   |       |                |                |
| Called-up share capital       | 12    | 5,032          | 5,032          |
| Share premium account         |       | 73,326         | 73,326         |
| Merger reserve                |       | 36,984         | 36,984         |
| Special reserve               |       | 4,049          | 4,049          |
| Other reserve                 |       | 1,884          | 1,884          |
| Retained deficit              |       | (19,805)       | (33,088)       |
| Total shareholder's equity    |       | <u>101,470</u> | <u>88,187</u>  |

The financial statements of Innovata Limited, registered number 02148607 were approved by the Directors and authorised for issue on 8 November 2011 and signed by



A P Hyland  
Director

# Innovata Limited

## Statement of changes in equity

For the year ended 31 March 2011

|                     | Called-up<br>share<br>capital<br>£'000 | Share<br>premium<br>account<br>£'000 | Merger<br>reserve<br>£'000 | Special<br>reserve<br>£'000 | Other<br>reserve<br>£'000 | Retained<br>deficit<br>£'000 | Total<br>shareholders'<br>equity<br>£'000 |
|---------------------|----------------------------------------|--------------------------------------|----------------------------|-----------------------------|---------------------------|------------------------------|-------------------------------------------|
| At 31 March 2009    | 5,032                                  | 73,326                               | 36,984                     | 4,049                       | 1,884                     | (39,815)                     | 81,460                                    |
| Profit for the year | -                                      | -                                    | -                          | -                           | -                         | 6,727                        | 6,727                                     |
| At 31 March 2010    | 5,032                                  | 73,326                               | 36,984                     | 4,049                       | 1,884                     | (33,088)                     | 88,187                                    |
| Profit for the year | -                                      | -                                    | -                          | -                           | -                         | 13,283                       | 13,283                                    |
| At 31 March 2011    | 5,032                                  | 73,326                               | 36,984                     | 4,049                       | 1,884                     | (19,805)                     | 101,470                                   |

**Cash flow statement**

For the year ended 31 March 2011

|                                                        | 2011<br>£'000 | 2010<br>£'000 |
|--------------------------------------------------------|---------------|---------------|
| Operating profit                                       | 13,331        | 6,377         |
| Depreciation                                           | 48            | 62            |
| Increase in trade and other receivables                | (7,628)       | (18,118)      |
| (Decrease)/increase in trade and other payables        | (5,959)       | 3,012         |
| Withholding tax                                        | (83)          | (242)         |
| R&D tax credit received                                | 198           | 493           |
| Loss on disposal of property plant and equipment       | 58            | -             |
| Exchange movements                                     | 35            | (74)          |
| Net cash outflow from operating activities             | -             | (8,490)       |
| Financing activities                                   |               |               |
| Decrease in provisions                                 | -             | (6,277)       |
| Interest paid                                          | -             | (313)         |
| Net cash outflow from financing activities             | -             | (6,590)       |
| Decrease in cash and cash equivalents                  | -             | (15,080)      |
| Cash and cash equivalents at the beginning of the year | -             | 15,080        |
| Cash and cash equivalents at the end of the year       | -             | -             |

## 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 2006. The address of the registered office and principal place of business is One Prospect West, Chippenham, Wiltshire SN14 6FH.

#### Basis of preparation

The financial statements have been prepared in accordance with the Companies Act 2006 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 Company is a wholly-owned subsidiary of another company incorporated in the EEC. In accordance with section 400 of the Companies Act 2006, the Company is not required to produce and has not published consolidated accounts.

#### New accounting Standards and Interpretations

In the current financial year, the Company has adopted the following Standards and Interpretations issued by the IASB and the International Financial Reporting Interpretations Committee:

- Improvements to IFRSs 2009 (April 2009)
- IFRS 1 (Amendment) (November 2008) – First time adoption of International Reporting Standards – revised
- IFRS 2 (Amendment) (June 2009) – Group cash-settled share-based payments transactions
- IFRS 3 (Amendment) (December 2008) – Comprehensive revision on applying the acquisition method
- IAS 27 (Amendment) (January 2008) – Consolidated and Separate Financial Statements
- IAS 32 (Amendment) (October 2009) – Relating to classification of rights issues
- IAS 39 (Amendment) (July 2008) – Eligible Hedged Items
- IFRIC 17 – Distribution of non-cash assets to owners
- IFRIC 19 – Extinguishing financial liabilities with equity instruments

Adoption of these Standards and Interpretations did not have any effect on the financial statements of the Company, or result in changes in accounting policy or additional disclosure.

## Notes to the financial statements

### 1) Accounting policies and basis of preparation (continued)

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

- IFRS 1 (Amendment) (December 2010) – Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters
- IFRS 1 (Amendment) (December 2010) – Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters
- IFRS 7 (Amendment) (October 2010) – Disclosures – Transfers of Financial Assets
- IFRS 9 – Financial Instruments (November 2009)
- IFRS 10 – Consolidated Financial Statements (May 2011)
- IFRS 11 – Joint Arrangements (May 2011)
- IFRS 12 – Disclosure of Interests in Other Entities (May 2011)
- IFRS 13 – Fair Value Measurements (May 2011)
- Improvements to IFRSs 2010 (May 2010)
- IAS 1 (Amendment) (June 2011) – Revise the way other comprehensive income is presented
- IAS 12 (Amendment) (December 2010) – Deferred Tax Recovery of Underlying Assets
- IAS 19 (Amendment) (June 2011) – Amended standard resulting from the Post-Employment Benefits and Termination Benefits projects
- IAS 24 (Amendment) (November 2009) – Related Party Disclosures
- IAS 27 (Amendment) (May 2011) – Separate Financial Statements
- IAS 28 (Amendment) (May 2011) – Investments in Associates and Joint Ventures
- IFRIC 14 (Amendment) (November 2009) – Prepayments of a minimum funding requirement

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

### Going Concern

The accounts have been prepared under the going concern basis.

The company made a profit of £13,283,000 for the year ended 31 March 2011 (2010: £6,722,000). The current economic slowdown and global recession has had limited impact on the Company as the ultimate parent company has sufficient resources to meet its ongoing liabilities as they fall due. The company continues to receive the support of its ultimate parent company to allow it to meet its liabilities as they fall due.

The Company's Directors have reviewed the Company's detailed cash flow forecast for the period ending 30 November 2012, made relevant enquiries and considered reasonably possible changes in trading activities, to satisfy themselves that the ultimate parent company is able to provide the necessary support to enable the company to meet its liabilities as they fall due, despite the current uncertain economic outlook. A legally binding letter of support has been obtained from Vectura Group plc. After making these enquiries, the directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and accounts.

## Notes to the financial statements

### 1) Accounting policies and basis of preparation (continued)

#### Revenue recognition

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

##### *Technology and product licensing*

Technology and product licensing income represents amounts earned for licences provided under licensing agreements, including up-front payments, milestone payments and technology access fees. Revenues are recognised where they are non-refundable, the Company'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.

#### Research and development

Expenditure on internally developed intangible assets, including development costs, is taken to the statement of comprehensive income 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 are applied for the Company:

- |                                 |           |
|---------------------------------|-----------|
| - Plant and machinery           | 20% - 33% |
| - Computer and office equipment | 33%       |

## Notes to the financial statements

### 1) Accounting policies and basis of preparation (continued)

#### 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.

#### *Trade and other payables*

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

#### *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. 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.

#### Provisions

Provisions are recognised when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that the Company 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.

## Notes to the financial statements

### 1) Accounting policies and basis of preparation (continued)

#### 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

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 statement of comprehensive income

#### 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 parent company has applied IFRS 2 only to equity-settled awards granted after 7 November 2002 and not vested at 1 January 2005.

## Notes to the financial statements

### 1) Accounting policies and basis of preparation (continued)

#### 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.

#### 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.

#### 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 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 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.

## Notes to the financial statements

### 2) Revenue

|                                                              |               |               |
|--------------------------------------------------------------|---------------|---------------|
| <i>Segmental analysis of revenue</i>                         | 2011<br>£'000 | 2010<br>£'000 |
| Licensing and evaluation fees                                | 5,000         | 5             |
| Development fees                                             | 1,610         | 771           |
| Royalties                                                    | 8,202         | 8,481         |
| Total                                                        | <u>14,812</u> | <u>9,257</u>  |
| <i>Geographical analysis of revenue by customer location</i> | 2011<br>£'000 | 2010<br>£'000 |
| United Kingdom                                               | 6,610         | 771           |
| North America                                                | 8,202         | 8,481         |
| Rest of World                                                | -             | 5             |
| Total                                                        | <u>14,812</u> | <u>9,257</u>  |

#### Information about major customers

Revenue earned from the Company's major customers is as follows, Customer A - £8,202,000 (2010 £8,481,000), Customer B - £5,000,000 (2010 nil) and Customer C £1,610,000 (2010 £771,000)

### 3) Segmental Information

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

### 4) Investment income and finance costs

|                                        |               |               |
|----------------------------------------|---------------|---------------|
|                                        | 2011<br>£'000 | 2010<br>£'000 |
| Finance gains/(losses)                 |               |               |
| Foreign exchange gains                 | 35            | 213           |
| Finance charges on financial liability | -             | (313)         |
|                                        | <u>35</u>     | <u>(100)</u>  |

## Notes to the financial statements

### 5) Taxation

The tax charge for the year ended 31 March 2011 of £83,000 represents withholding taxes on royalty receipts, less R&D tax credits received (2010 £450,000 credit) The charge can be reconciled to the loss per the statement of comprehensive income as follows

|                                                                                                   | 2011<br>£000 | 2010<br>£000 |
|---------------------------------------------------------------------------------------------------|--------------|--------------|
| Profit on ordinary activities before tax                                                          | 13,366       | 6,277        |
| Profit on ordinary activities multiplied by standard rate of tax<br>in the UK of 28% (2010 - 28%) | 3,743        | 1,758        |
| Effects of                                                                                        |              |              |
| Permanent differences - expenses not deductible for tax purposes                                  | 111          | 121          |
| Uplift for R&D expenditure                                                                        | (162)        | (136)        |
| Utilisation of tax losses brought forward                                                         | (3,692)      | (1,742)      |
| Withholding taxes on royalties                                                                    | 83           | 242          |
| Research and development tax credits                                                              | -            | (691)        |
| Total current tax                                                                                 | 83           | (450)        |

Cumulative tax losses of approximately £27,976,000 (subject to agreement by HMRC) are available to carry forward against future taxable profits, or surrender in return for research and development tax credits (2010 - £40,006,000) There is an unrecognised deferred tax asset of £7,274,000 (2010 - £11,202,000) relating to the above tax losses, and a deferred tax asset of £78,000 arising as a result of unclaimed capital allowances (2010 - £119,000) The total deferred tax asset of £7,352,000 (2010 - £11,321,000) 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 2011, the UK Government announced a further reduction in the standard rate of UK corporation tax to 26% effective from 1 April 2011 and to 25% effective 1 April 2012 These further rate reductions became substantively enacted in March 2011 and July 2011, respectively

The UK Government also proposed changes to further reduce the standard rate of the UK corporation tax by 1% per annum to 23% by 1 April 2014, but these changes have not yet been substantively enacted

The effect of these tax rate reductions on the deferred tax balance will be accounted for in the period in which the tax rate reductions are substantively enacted

### 6) Operating profit

Operating profit for the year is stated after charging

|                                             | 2011<br>£'000 | 2010<br>£'000 |
|---------------------------------------------|---------------|---------------|
| Depreciation on owned tangible fixed assets | 48            | 62            |
| Staff costs (see note 7)                    | 769           | 910           |

Audit fees for the audit of the Company's annual accounts, amounting to £7,500 (2010 £7,500), were borne by a Group company

**Notes to the financial statements**

**7) Directors and employees**

|                                                                                                   | 2011<br>Number | 2010<br>Number |
|---------------------------------------------------------------------------------------------------|----------------|----------------|
| Average weekly number of persons (including Directors)<br>employed by the Company during the year | 12             | 12             |
|                                                                                                   | £'000          | £'000          |
| Wages and salaries                                                                                | 675            | 784            |
| Social security costs                                                                             | 66             | 91             |
| Other pension costs (see note 15)                                                                 | 28             | 35             |
|                                                                                                   | 769            | 910            |

The Directors' remuneration was borne by other Group companies for their services during the year and for the preceding year

**8) Property, Plant and Equipment**

|                           | Plant and<br>machinery<br>£'000 | Computer<br>and office<br>equipment<br>£'000 | Total<br>£'000 |
|---------------------------|---------------------------------|----------------------------------------------|----------------|
| Cost                      |                                 |                                              |                |
| At 31 March 2009 and 2010 | 259                             | 166                                          | 425            |
| Disposals                 | (259)                           | (143)                                        | (402)          |
| At 31 March 2011          | -                               | 23                                           | 23             |
| Depreciation              |                                 |                                              |                |
| At 31 March 2009          | 104                             | 153                                          | 257            |
| Charge for year           | 53                              | 9                                            | 62             |
| At 31 March 2010          | 157                             | 162                                          | 319            |
| Charge for year           | 48                              | -                                            | 48             |
| Disposals                 | (205)                           | (139)                                        | (344)          |
| At 31 March 2011          | -                               | 23                                           | 23             |
| Net book value            |                                 |                                              |                |
| At 31 March 2011          | -                               | -                                            | -              |
| At 31 March 2010          | 102                             | 4                                            | 106            |
| At 31 March 2009          | 155                             | 13                                           | 168            |

**Notes to the financial statements**

**9) Fixed asset investments**

|                         | <i>Investment</i><br>£'000 | <i>Subsidiaries</i><br>£'000 | <i>Total</i><br>£'000 |
|-------------------------|----------------------------|------------------------------|-----------------------|
| Cost and carrying value |                            |                              |                       |
| At 31 March 2010        | 250                        | 55,425                       | 55,675                |
| Disposals               | (250)                      | -                            | (250)                 |
| At 31 March 2011        | -                          | 55,425                       | 55,425                |

| <i>Principal subsidiary companies</i> | <i>% held</i> | <i>Country of incorporation</i> | <i>Description of shares</i>   | <i>Nature of business</i> |
|---------------------------------------|---------------|---------------------------------|--------------------------------|---------------------------|
| Innovata Biomed Limited               | 100           | Scotland                        | Ordinary and Preference Shares | (2)                       |
| Quadrant Technologies Limited         | 100           | England                         | Ordinary Shares                | (2)                       |
| Quadrant Drug Delivery Limited (1)    | 100           | England                         | Ordinary Shares                | (2)                       |
| Quadrant Healthcare Limited (1)       | 100           | England                         | Ordinary Shares                | (2)                       |
| <i>Joint venture</i>                  |               |                                 |                                |                           |
| QDose (1)                             | 50            | England                         | Ordinary shares                | (2)                       |

(1) held through Quadrant Technologies Limited

(2) Research, development and commercialisation of pharmaceutical products and technologies

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

**10) Trade and other receivables**

|                                     | 2011<br>£'000 | 2010<br>£'000 |
|-------------------------------------|---------------|---------------|
| Amounts due within one year         |               |               |
| Other receivables                   | 97            | -             |
| Prepayments and accrued income      | 344           | 1,248         |
| Amounts due from Group undertakings | 47,385        | 38,898        |
|                                     | <u>47,826</u> | <u>40,146</u> |

The Directors consider that the carrying amount of trade and other receivables approximates their fair value

**11) Trade and other payables**

|                                    | 2011<br>£'000 | 2010<br>£'000 |
|------------------------------------|---------------|---------------|
| Amounts due within one year        |               |               |
| Other creditors                    | 999           | 584           |
| Accruals                           | 782           | 903           |
| Amounts owed to Group undertakings | -             | 6,253         |
|                                    | <u>1,781</u>  | <u>7,740</u>  |

The Directors consider that the carrying amount of trade and other payables approximates their fair value

## Notes to the financial statements

### 12) Called-up share capital

|                                                                                | 2011<br>£'000 | 2010<br>£'000 |
|--------------------------------------------------------------------------------|---------------|---------------|
| Authorised<br>670,000,000 Ordinary Shares of 1p each                           | 6,700         | 6,700         |
| Allotted, called-up and fully paid,<br>503,158,305 Ordinary Shares of £1p each | 5,032         | 5,032         |

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

The below disclosures have been taken from the Vectura Group plc accounts for the year ended 31 March 2011. They have been included here on the basis that part of the Group share-based compensation charge has been recharged to this company.

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 in Vectura Group plc 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 parent company operates a Sharesave Scheme. All employees and Executive Directors are invited to subscribe for options to acquire shares in the parent 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 parent 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. At 31 March 2011, 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       | 532,845                 |
| 23 May 2011 (1)   | 1,630,705               |
| 21 May 2012 (1)   | 2,575,522               |
| 7 June 2013 (1)   | 2,840,819               |
| 7 June 2014 (1)   | 2,840,819               |

(1) Maximum number of shares, subject to performance conditions.

## Notes to the financial statements

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

On 31 October 2008, the shareholders of Vectura Group plc 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 parent company will be granted a one-off entitlement in the form of units, which convert into ordinary shares in the parent 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 2011 there were 2,255,995 options outstanding that were granted before this date (2010: 2,770,113).

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.

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

| Year of grant                                             | 2011        | 2010        |
|-----------------------------------------------------------|-------------|-------------|
| Weighted average share price of grants during the year    | 59.53p      | 69.25p      |
| Weighted average exercise price of grants during the year | 56.88p      | 60.85p      |
| Expected volatility <sup>(1)</sup>                        | 46%–48%     | 35%–36%     |
| Expected life                                             | 3–5 years   | 5 years     |
| Expected dividends                                        | Nil         | Nil         |
| Risk-free interest rate <sup>(2)</sup>                    | 1.4% – 2.7% | 1.8% – 2.7% |

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

|                                                           |         |         |
|-----------------------------------------------------------|---------|---------|
| Weighted average share price of grants during the year    | 38p     | 68.50p  |
| Weighted average exercise price of grants during the year | 0.025p  | 0.025p  |
| Expected volatility <sup>(1)</sup>                        | 46%     | 39%     |
| Expected life                                             | 3 years | 3 years |
| Expected dividends                                        | Nil     | Nil     |
| Risk-free interest rate <sup>(2)</sup>                    | 1.4%    | 1.9%    |

<sup>(1)</sup> 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.

<sup>(2)</sup> 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.

The Group share-based compensation charge for the year ended 31 March 2011, including the LTIP, was £1,785,000 (2010: £1,539,000), of which £357,000 (2010: £308,000) has been charged to the company.

## **Innovata Limited**

The aggregate of the estimated fair value of options granted under share option schemes and Share Incentive Plan during the year ended 31 March 2011 was £492,000 (2010 £450,000) and under the SAYE Scheme £143,000 (2010 £55,000) The estimated fair value of the LTIP awards during the year ended 31 March 2011 was £444,000 (2010 £1,270,000)

Notes to the financial statements

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

| Share Option Schemes                                | SAYE Scheme | LTIP             |           |                  |            |         |
|-----------------------------------------------------|-------------|------------------|-----------|------------------|------------|---------|
| Number of                                           | Number of   | Number of        |           |                  |            |         |
| Options outstanding                                 | options     | options          | options   | options          | options    | options |
| At 1 April 2009                                     | 21,017,442  | 61 36            | 2,129,753 | 41 22            | 4,425,234  | 0 025   |
| Options granted                                     | 167,861     | 68 50            | 254,664   | 55 80            | 2,575,522  | 0 025   |
| Options exercised                                   | (1,861,788) | 46 61            | (53,947)  | 67 37            | -          | -       |
| Options cancelled                                   | (295,183)   | 191 50           | (215,157) | 52 14            | (440,400)  | 0 025   |
| At 31 March 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   |
| Range of exercise prices                            |             |                  |           |                  |            |         |
| 0 025p - 127 78p                                    |             | 36 00p - 65 4p   |           | 0 025p           |            |         |
| Weighted average remaining contractual life (years) |             |                  |           |                  |            |         |
| 3 76 (2010 4 72)                                    |             | 1 37 (2010 1 43) |           | 7 57 (2010 7 85) |            |         |
| Options vested                                      |             |                  |           |                  |            |         |
| At 31 March 2010                                    | 14,800,342  | 60 34            | -         | -                | 1,821,284  | 0 025   |
| At 31 March 2011                                    | 16,628,383  | 63 64            | -         | -                | 1,932,976  | 0 025   |
| Weighted average remaining contractual life (years) |             |                  |           |                  |            |         |
| 3 37 (2010 3 93)                                    |             | -                |           | 5 47 (2010 6 07) |            |         |
| * = Weighted average exercise price (p)             |             |                  |           |                  |            |         |

\* = Weighted average exercise price (p)

15) Pensions

The Company participates in a defined contribution pension scheme. The assets of the scheme are held separately from those of the Company and are independently administered. The pension cost charge represents contributions payable by the Company under the scheme and amounted to £28,000 (2010 - £35,000). Contributions totalling £nil (2010 - £nil) were payable at the year-end.

## Notes to the financial statements

### 16) Related party transactions

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

|                                       | Recharge from<br>related parties<br>for services | Recharge to<br>related parties<br>for services | Amounts due<br>to related<br>parties | Amounts due<br>from related<br>parties |
|---------------------------------------|--------------------------------------------------|------------------------------------------------|--------------------------------------|----------------------------------------|
|                                       | £'000                                            | £'000                                          | £'000                                | £'000                                  |
| <b>Vectura Group plc</b>              |                                                  |                                                |                                      |                                        |
| 2011                                  | 474                                              | -                                              | -                                    | 3,456                                  |
| 2010                                  | 409                                              | -                                              | -                                    | 3,931                                  |
| <b>Vectura Limited</b>                |                                                  |                                                |                                      |                                        |
| 2011                                  | -                                                | 918                                            | -                                    | 3,166                                  |
| 2010                                  | -                                                | 385                                            | 6,253                                | -                                      |
| <b>Vectura Delivery Devices Ltd</b>   |                                                  |                                                |                                      |                                        |
| 2011                                  | -                                                | 113                                            | -                                    | 210                                    |
| 2010                                  | -                                                | 96                                             | -                                    | 96                                     |
| <b>Innovata Biomed Limited</b>        |                                                  |                                                |                                      |                                        |
| 2011                                  | -                                                | 467                                            | -                                    | 25,706                                 |
| 2010                                  | 74                                               | 193                                            | -                                    | 25,239                                 |
| <b>Quadrant Drug Delivery Limited</b> |                                                  |                                                |                                      |                                        |
| 2011                                  | -                                                | 111                                            | -                                    | 11,397                                 |
| 2010                                  | -                                                | 96                                             | -                                    | 6,182                                  |
| <b>Quadrant Technologies Limited</b>  |                                                  |                                                |                                      |                                        |
| 2011                                  | -                                                | -                                              | -                                    | 2,828                                  |
| 2010                                  | -                                                | -                                              | -                                    | 2,828                                  |
| <b>Quadrant Healthcare Limited</b>    |                                                  |                                                |                                      |                                        |
| 2011                                  | -                                                | -                                              | -                                    | 622                                    |
| 2010                                  | -                                                | -                                              | -                                    | 622                                    |

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 due from related parties.

### 17) Ultimate parent company and controlling party

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.

## Notes to the financial statements

### 18) Financial instruments

#### Categories of financial instruments

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

|                       | 2011<br>£'000 | 2010<br>£'000 |
|-----------------------|---------------|---------------|
| Loans and receivables | 47,826        | 40,146        |

All financial assets fall due within one year, with the exception of the investment bond, the repayment of which is determined by the Company's results (see note 9)

There were no provisions against impaired assets at 31 March 2011 (2010 £nil) There are no amounts past due but not impaired (2010 £nil)

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

|       | 2011<br>£'000 | 2010<br>£'000 |
|-------|---------------|---------------|
| Other | 1,781         | 7,740         |

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 Company's financial assets and liabilities at the balance sheet date

#### 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 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

#### 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 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

## Notes to the financial statements

### 18) Financial instruments (continued)

#### Foreign currency risk management

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

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

#### Interest rate risk management

The Company has no external borrowings and is not exposed to interest rate risk through borrowings.

#### 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. Another Group company controls the banking activities of the company and the risk is limited because the Group primarily deposits its cash with banks that have strong credit ratings.

#### 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.