A therapeutic specialist for airways diseases

Vectura

Vectura Group plc Annual Report and Accounts 2013/14

Building a sustainable specialty pharmaceutical company.

Providing benefit to patients with airways diseases.

Highlights

Significant progress on respiratory programmes

- Seebri® Breezhaler® (glycopyrronium bromide, NVA237) approved in over 60 countries, including EU, Japan, Canada and Australia
  - Q1 2014 net sales of $30m; twelve months to 31 March 2014 of $82m (source: Novartis)
- Ultibro® Breezhaler® (indacaterol/glycopyrronium bromide QVA149) launched in seven countries to date and approved in over 30, including EU, Japan, Canada and Australia
  - Q1 2014 net sales of $14m; total of $20m since launch (source: Novartis)
- Approvals of GSK's BREO® ELLIPTA® and ANORO® ELLIPTA® signalled new royalty streams

Breakthrough for generic respiratory products

- AirFluSal® Forspiro® (VR315) approved in Denmark, Germany, Belgium, Sweden, Hungary, Romania, Norway, Bulgaria and South Korea; product now launched in most of these markets
- VR315 development in the US continues to make progress; additional milestone received
- FDA guidelines were a positive step for development of inhaled generics in the US

Strategic growth and pipeline augmentation

- Acquisition of Activaero GmbH strengthens development pipeline and enhances technology offering
- Initiated co-development deal with UCB for a novel molecule (VR942) currently at the pre-clinical stage
- The establishment of Kinnovata joint venture (JV) in China, extracting additional value from our mature assets. Kinnovata JV is still awaiting formal completion. Final local government approval expected later in 2014, upon which an exceptional non-cash gain will be recognised

Other highlights

- Placing completed 13 March 2014 and raised gross proceeds of £52m
- Two changes to the Board during the year:
  - Jack Cashman retired as Non-Executive Chairman of the Board and Bruno Angelici was appointed as Non-Executive Chairman in February 2014
  - July 2013, Anne Hyland stepped down as Chief Financial Officer and Company Secretary and Paul Oliver was appointed Chief Financial Officer and Company Secretary

Post-period event

- US launch of ANORO® ELLIPTA® triggered a £2m milestone associated with a licence agreement with GSK

Revenues

+20%

at £36.5m (2012/13: £30.5m)

Positive EBITDA[1]

£5.2m

compared to a loss in previous year (2012/13: loss of £3.4m)

Loss before tax decreased by

54%

to £4.8m (2012/13: £10.4m)

Balance sheet strength maintained with cash and cash equivalents of

£81.7m

(£70.1m at 31 March 2013)

1 Earnings before investment income, finance gains, tax, depreciation, amortisation, share-based compensation and adjusted for non-recurring expenditure.

Contents

Our business at a glance

"Vectura's vision is to address the unmet needs of people whose lives are impacted by airways diseases."

Our focus

Our therapeutic focus is to develop products for airways-related diseases. These include major diseases, such as asthma and chronic obstructive pulmonary disease (COPD), and is a market estimated to be worth in excess of US$46bn worldwide[1]. This segment of the market covers a wide range of other indications including cough, severe inflammation, cystic fibrosis, allergic rhinitis, and fibrotic diseases of the lung.

1 Pharmaview Commercial Landscape Series Respiratory Decision Resources 2013.

Global respiratory market estimated worth:

US$46bn

Read more about our markets on **pages 7 to 9**

How we work

We develop products in-house and in collaboration with pharmaceutical partners, leveraging investment in our intellectual property and, where possible, mitigating the risk of our business. Vectura has eight products marketed by partners and a portfolio of drugs in clinical development, a number of which have been licensed to major pharmaceutical companies. The Company's array of enabling devices and formulation technologies significantly amplifies the commercial potential of our products. These formulation and inhalation technologies are available to other pharmaceutical companies on an out-licensing basis where this complements Vectura's product development strategy.

Read more about our business model on **pages 10 to 15**

Current partnerships

Vectura has disclosed development collaborations, joint ventures and licence agreements with several pharmaceutical and biotechnology companies, including:

Ablynx	Grifols	sterna biologicals
Baxter	Kinnovata	Tianjin KingYork
GSK	Novartis	Ventaleon
	Sandoz	UCB

Our foundation

At Vectura we bring our values to reality through the way we operate.

We have a strong foundation of core company values. Everything we do stems from our five key values and these are reflected in the way we operate our business, both internally and externally, which ensures we express clearly our vision and values and the behaviours necessary to realise our strategic ambitions.

We have identified five core values that build on our strengths and highlight areas for transformation.

These values have a corresponding set of behaviours that describe what is required at the individual level to demonstrate them.

Achievement
We aim to deliver on the challenging goals we set ourselves

Enthusiasm
We give our best and enjoy what we're doing

Participation
Success comes from our culture, which fosters creativity and teamwork

Innovation
We think freely and creatively about our goals

Trust and respect
We value people and ideas on their merits

Work on biologics in the laboratory

Chairman's statement

"Vectura is transitioning into a leading specialty pharmaceutical company that focuses on developing innovative treatments for airways diseases."

Dear shareholder,

I am delighted to introduce Vectura's Annual Report for the financial year 2013/2014. This is my first Annual Report as Chairman and I hope to convey my sense of excitement as the Company executes its strategy and my deep commitment to building on the firm foundation left by my predecessor, Jack Cashman. In addition to improved performance, there is no doubt that under Jack's Chairmanship, the Board established a culture of good governance and high standard of business ethics. These have been adopted across the business. The management team I inherited is experienced, able and focused on operational excellence and the delivery of shareholder value.

The business model is balanced and through the recent acquisition of Activaero GmbH the Group is aiming to become the leading speciality pharmaceutical company in the treatment of airways disease. In considering how the Group can implement this stated strategy, I would like to highlight some of my thoughts as Chairman:

- Vectura Group is positioned within a unique segment of the healthcare market, aiming to develop therapies that benefit patients, physicians and payers through a specialised focus on airways disease. The Group has the mix of products, development pipeline assets and technologies to grow and develop as an independent organisation;
- the Group is fortunate to be led by seasoned, talented professionals and further supported by a skilled employee base;
- the Group's products are being recognised by our partners and end users for their quality, cutting edge technology and performance; and
- the Board comprises a diverse mix of experienced individuals who collectively support management when appropriate and challenge when necessary.

During my first year as Chairman, it is my intention to capitalise on these fundamentals through liaising with senior management and engaging with our shareholders. I am clear that in a rapidly changing world, we will face some challenges but I take up the new role with a sense of privilege in my appointment, respect for the organisation, enthusiasm for the task and confidence in the future.

We are grateful to our shareholders for their continued support as we continue to do everything we can to build the success and grow the value of the Group. I look forward to another exciting year for Vectura.

Reporting

This Annual Report has been produced in compliance with new narrative reporting regulations, the principal change being the requirement to produce a Strategic report that provides readers with a clear and focused explanation of a company's strategy, business model, key risks and performance. To date, Vectura Group has set high standards for the quality of its narrative reporting and I hope that you will find that this report fulfils the requirements and intentions of the new regulations, and continues to bring clarity and transparency to the Group's activities.

B. Angelici

Bruno Angelici
Chairman
20 May 2014

Chief Executive's statement

"Vectura has evolved into the product-focused company it is today. The recent acquisition provides important pipeline growth and diversification."

Delivering strong results

I am pleased to report on another year of significant progress for the Group, which saw a number of key drivers of future growth. We have reached the transformational point in Vectura's evolution, towards a specialty pharmaceutical company focused on airways-related diseases, and we are now embarking on the execution of that strategy.

Executing the strategy

The history of Vectura, since its formation in 1997, has been one of change, adapting to the needs of the industry in which we work. Vectura continues to evolve to maximise the value potential for our shareholders. This capability, to embrace and incorporate change, is key to our success.

Assets that are important for growth and value must:

- focus on airways disease;
- add balance to our development pipeline;
- increase the breadth of our product-enabling technology base; and
- have the potential to generate revenue in the short term and increase economics through partnering, co-development or focused, cost-effective self-commercialisation.

Assets must also leverage existing capabilities, such as our expertise in drug-device combinations and our nascent expertise in commercialisation.

Towards the end of this financial year, we announced a significant strategic acquisition of a private German company, Activaero GmbH, for €130m. This transaction aligned closely with our stated strategic intent and enhances our medium to long-term growth prospects. The acquisition brought us a proprietary smart nebuliser-based technology, FAVORITE, that facilitates targeting inhaled drugs into pre-selected areas of the lung. FAVORITE is incorporated into a range of products, with application to branded and generic drugs, for small molecules and for biologics. Our enhanced technology offering now spans both dry powder and liquid/aerosol forms of delivery to the lung.

The acquisition also brought us a balanced pipeline of partnered and unpartnered drug assets through seven clinical and several pre-clinical stage programmes.

A significant attribute of the deal was that it augmented our pipeline through a single transaction, not only providing a balance of drug assets across development phases, but doing so with limited use of human and financial capital when compared to the cash outlay that would be required to acquire a similar asset base through a series of individual transactions.

Organisational change

As a result of the enlarged organisation and the evolution from development to a product-focused organisation, we also made some changes to the way we manage the business – reconstituting the Executive Management Team (EMT: formerly known as the Leadership Team), responsible for the overall management of the Group's strategy and its execution. The changes include Gerhard Scheuch joining the EMT as Chief Scientific Officer. The role of CSO will be key to ensuring the appropriate scientific input and liaison for our technologies. Gerhard Scheuch will be an ambassador for our science, technology and products, both within and outside the business.

In preparation for laying out our strategy to derive future revenues from self-commercialisation of products, Roger Heerman has joined the EMT as Chief Commercial Officer. Roger Heerman brings significant experience of the commercialisation of respiratory products.

I look forward to working closely with Gerhard Scheuch and Roger Heerman on the EMT and am grateful that the Company has a strong, experienced and cohesive executive team to manage the next phase of growth for our Company.

Chief Executive's statement continued

"In the year ahead, we will increase our focus on the specialty area of airways diseases."

Making the most of our pipeline

Operational highlights include a number of commercial successes by the owners of our licensed products and intellectual property:

1. Novartis, with the approvals and launches of Ultibro® Breezhaler® in Japan and Europe;
2. Sandoz, with the launch of AirFluSal® Forspiro® (an achievement that bodes well for our high value respiratory generic portfolio in Europe and the rest of the world); and
3. GSK, with the launch of products that generate milestones and royalties for Vectura.

All signify the start of new, growing revenue streams that build on the success of another of our assets, the Novartis product, Seebri® Breezhaler®.

Other notable highlights included the establishment of Kinnovata, our joint venture in China, to maximise the potential value of assets that were no longer a focus for us in established, western markets, and the co-development partnership with UCB. The latter involves the development of a biologic molecule that will be delivered by inhalation to treat severe inflammatory diseases of the lung, an attribute that highlights Vectura's innovative capabilities.

Read more on the news section of our website
www.vectura.com

Business development activities during 2013/14

Vectura will seek to focus its business development activities on the acquisition and in-licensing of products and compounds which offer a good strategic fit and have the potential to deliver demonstrable value to all of the Company's stakeholders.

Evolution of the business and future growth

Vectura has increased its focus on developing and commercialising innovative specialty medicines to meet significant unmet patient needs in airways diseases. The past year has continued that evolution. The Board believes that Vectura is well placed to exploit future growth and value opportunities and in the year ahead, we will utilise our recently expanded proprietary technology base to target disease segments where we can lead the way in developing treatments of benefit to patients.

Our people

I would like to take this opportunity to thank everyone in Vectura for their tremendous contribution this year, which has been another demanding yet exciting year. Their hard work and drive to succeed has formed the bedrock of our continued growth. I would also like to welcome our new colleagues and thank them for their support during the integration process which, I am pleased to report, is progressing well and forms the foundation for future progression.

Dr Chris Blackwell
Chief Executive
20 May 2014

Our markets and opportunities

The asthma/COPD market is an attractive place to operate as the market need is growing.

Population growth, increasing longevity and rising wealth, particularly in developing economies, continue to expand the global market for pharmaceuticals. In addition there are a number of specific factors affecting the market, in particular downward pressure on healthcare costs, regulatory challenges, legally controlled pricing, the cost of developing and protecting intellectual property and intensifying competition from generic products.

Growth drivers

Expanding patient populations

The world population is expected to rise from its current level of some 7bn, to reach 9.6bn by 2050. In addition, the number of people who can access healthcare continues to increase, particularly among the elderly. Globally, it is estimated that between 2000 and 2050, the number of people aged 60 years and over will increase from 605m to over 2bn.

Unmet medical need

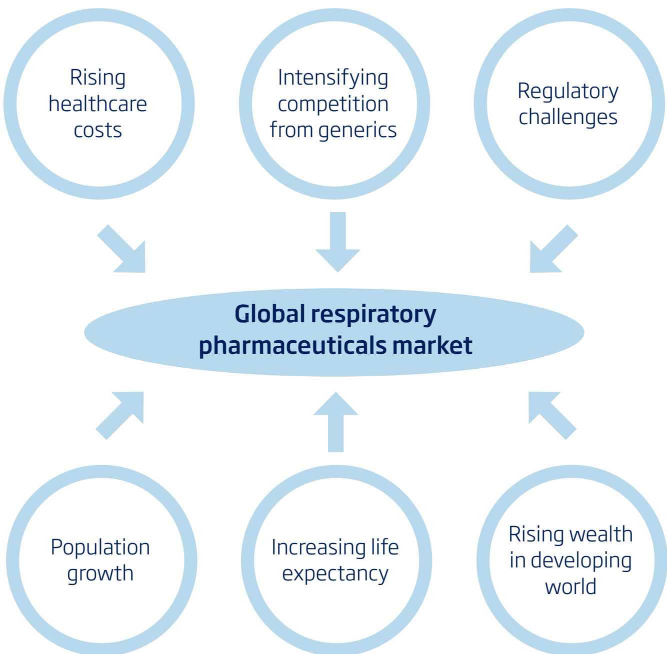
In most established markets, ageing populations and certain lifestyle choices such as smoking, poor diet and lack of exercise are increasing the incidence of non-communicable diseases, such as airway-related diseases, which require long-term management.

Advances in science and technology innovation are critical if we are to address unmet medical need. Existing drugs will continue to be important in meeting the growing demand for healthcare, particularly with the increasing use of generic medication. The use of large molecules, or biologics, has also become an important source of innovation, with biologics among the most commercially successful new products.

The respiratory market is dominated by a small number of companies. Inhalation products are complex dosage forms, which are challenging to develop within a strict global regulatory environment. Volume growth is expected to continue as demand in the developing world expands.

Vectura is one of only a few independent product development companies able to meet the challenges of the market for inhaled therapies to treat airways diseases. The Group has proven technologies and expertise in the development of inhalation products incorporating dry powder inhalers (both branded and generic) and smart inhalation systems utilising nebulisation.

Current market pressures and drivers



World population by 2050

9.6bn

Source: United Nations report: World Population Prospects, 2012 revision.

Our markets and opportunities continued

Our current addressable market falls into two main areas:

1

Asthma

Asthma is a chronic inflammatory disease of the airways leading to and from the lungs. Asthma itself is the result of genetic disposition and environmental factors.

People globally living with asthma

235m

Source: WHO, World Health Organisation.

2

COPD

Chronic obstructive pulmonary disease (COPD) is a chronic, slowly progressive disease, primarily associated with tobacco smoking, air pollution and occupational exposure.

People globally living with COPD

330m

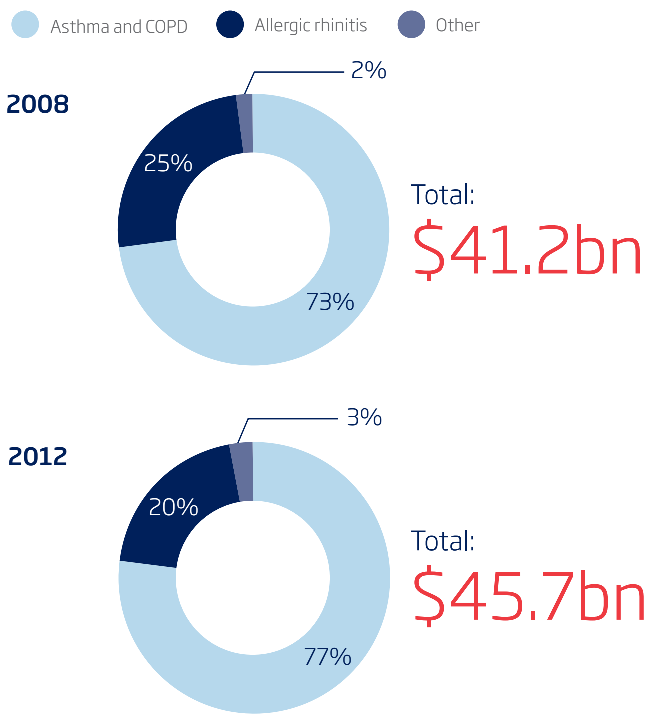
Source: The Lancet, Vol 380, 15 December 2012.

The body's respiratory system comprises the upper and lower airways, the lung tissue and associated blood vessels. The respiratory system is responsible for delivering oxygen to all parts of the body via the bloodstream and removing carbon dioxide. We breathe several thousand litres of air every day, a dynamic environment that is often polluted. Every day, hundreds of millions of people suffer from chronic airways diseases, including two of the most debilitating and life-threatening; asthma and chronic obstructive pulmonary disease (COPD).

Asthma and COPD make up the third-fastest growing market for therapeutic treatments, with the total market estimated to be worth more than $30bn in 2012, according to analyst reports. This figure will continue to grow as fixed-dose combination products are increasingly used and more effective therapies become available. Vectura's products for asthma and COPD target this ever-expanding global market.

For a pharmaceutical company, the asthma and COPD markets are important targets, as the market need is growing and patients, doctors and payors seek better, more cost-effective treatments. The incidence of COPD is increasing through the use of tobacco products and air pollution. Both asthma and COPD are global diseases, with a high prevalence in developed nations and those with high levels of pollution.

Respiratory: Leading drug groups



Source: Decision Resources 2013.

Asthma

Asthma is a chronic inflammatory disease of the airways leading to and from the lungs. Asthma is the result of genetic disposition and environmental factors. It is a reversible condition, resulting from temporary narrowing of the airways, often as a result of external stimuli such as stress, pollen, exercise or respiratory tract infection. Asthma symptoms, which are episodic and sometimes seasonal, include cough, wheezing and chest tightness, particularly at night and in the early morning. It would appear that the strongest risk factors for developing asthma are inhaled substances that cause an allergic reaction or irritate the airways (such as pollution).

According to the World Health Organization (WHO), around 235m people currently suffer from asthma worldwide. There is strong evidence that the prevalence of asthma increases as populations adopt an urban lifestyle and, with WHO forecasting that the world's urban population will increase from around 45% currently to around 59%, it also forecasts that there could be an additional 100m asthma sufferers by 2025. It is the most common chronic disease in children. In short, this is already a disease state of considerable, and growing, significance. Asthma is a public health problem across high and low income countries and, with mortality rates higher in developing countries, is likely to see increased spending in emerging economies.

COPD

Chronic obstructive pulmonary disease (COPD) is a chronic, slowly progressive, and only partly reversible airflow obstruction, primarily associated with tobacco smoking, air pollution and occupational exposure to lung irritants. COPD is characterised by chronic bronchitis (irreversible inflammation of the mucous membranes) and emphysema (destruction of the lung tissue). Symptoms include shortness of breath, cough, phlegm and activity limitation. Pharmacological treatments relieve symptoms and decrease exacerbations and hospitalisation, but are currently unable to reverse the underlying scarring of the lungs and loss of lung function.

There are approximately 330m people globally living with COPD and it is predicted to be the third leading cause of death by 2030. Currently the disease is largely hidden, with 50–75% of patients undiagnosed. 30m patients in the US suffer from COPD; only 6m receive treatment.

Our position

To optimise benefit to patients and maximise value from global opportunities, we are focusing on both the branded and generic respiratory product markets. These are very large markets, with dry powder inhalation (DPI) products currently generating sales in excess of $17bn a year in 2013 and growing. The Group's specialism and expertise in inhaled product development puts us in a good position to meet the regulatory requirements for successfully bringing to market branded and generic inhalation drugs. There are relatively few competitors working on complex, inhaled generic products, and new market opportunities are emerging that provide potential for growth.

DPI products currently generating annual sales of

$17bn

Source: BCC Research: Report – Pulmonary Drug Delivery Systems: Technologies and Global Markets, May 2014.

Inhalation dose testing

Our business model

The sustainable development of our business model is based on balancing unmet need with commercial attractiveness and financial discipline.

Vectura's strategy is to develop and commercialise products for the treatment of airways-related diseases (airways diseases), leading and enabling the development of innovative and efficacious medicines to address unmet medical and payer needs.

The development and commercialisation of therapies for airways diseases also represents a large market opportunity. Vectura is well placed to take advantage of this opportunity, through our technologies, our knowledge of the market, our products, our financial prudence and our people.

How we add value

WHAT WE DO

GOAL

To create value through the development of innovative products for airways diseases with high unmet need

Utilise partnerships to address unmet need treated by primary care physicians

Seek to adopt appropriate commercialisation of treatments in areas treated by specialist physicians

1. Innovative technologies that underpin our product value proposition
2. A balanced range of assets across development phases in our pipeline
3. Highly developed in-house development and commercial capabilities
4. A comprehensive portfolio of intellectual property

HOW WE GENERATE REVENUE

Milestones and royalties

Vectura licenses its assets and technologies to commercial partners. In return, Vectura receives milestone payments associated with development success and royalties from net sales.

Revenues, to date, comprised royalties from Baxter and milestone payments from our partners. In 2013, these revenue streams were augmented by the roll-out of Seebri® Breezhaler® and Ultibro® Breezhaler® by Novartis, and AirFluSal® Forspiro® by Sandoz.

How we add value in detail

Our business model continued

How we add value continued

1

Innovative technologies

We will continue to innovate with our proprietary formulation technologies, device design and development, and smart inhalation systems.

Inhalation devices are applicable to both small molecules and biologics and include a range of multi-dose dry powder inhalers based on GyroHaler. Following the acquisition of Activaero GmbH, we have a novel range of desktop and portable nebulisers. This differentiated technology has broad, multi-layered IP with coverage potentially up to 2033.

Spray dry technology

2

Developing our assets with focused investment

For programmes managed in-house, Vectura has an established project management framework.

The potential commercial opportunities for each project are assessed at the end of each stage of the project. Projects are assessed using widely accepted valuation metrics based upon discounted cash flows. An in-house review is supplemented by well-regarded disease area reports and, where appropriate, bespoke market research combined with the views of key opinion leaders in the disease area.

Under this framework, research and development programmes will only be approved when it can be shown that expected benefits outweigh the expected costs. All programmes are subject to a stage-gate approval process and in the event that this relationship changes, the Board would consider terminating or redefining the programme.

DPI assembly line

Our business model continued

How we add value continued

3

Strong in-house capabilities

Our talented team is committed to developing therapies that improve the quality of patients' lives.

We have many years of experience in areas such as corporate development, clinical development, pharmaceutical development, device development and global regulatory affairs.

The Group's specialism and expertise put us in a good position to manage the highly technical and regulated development and commercialisation of both branded and generic inhalation products. There are relatively few companies working in this area, particularly on the inhaled delivery of complex molecules. Our continued investment in our staff and facilities should enable us to continue at the forefront of innovation and development of products for airways diseases.

4

Maintaining our investment in intellectual property

Vectura maintains a substantial portfolio of more than 100 patent families* many of which comprise granted European and US patents.

* As at May 2014.

These provide comprehensive coverage for aspects of inhalation technologies. Vectura works closely with its legal advisors and obtains, where necessary, opinions on the intellectual property landscape relevant to the Group's product development programmes and manufacturing activities and processes. The Group ensures that patent applications are filed in a timely manner.

DPI mouthpiece component

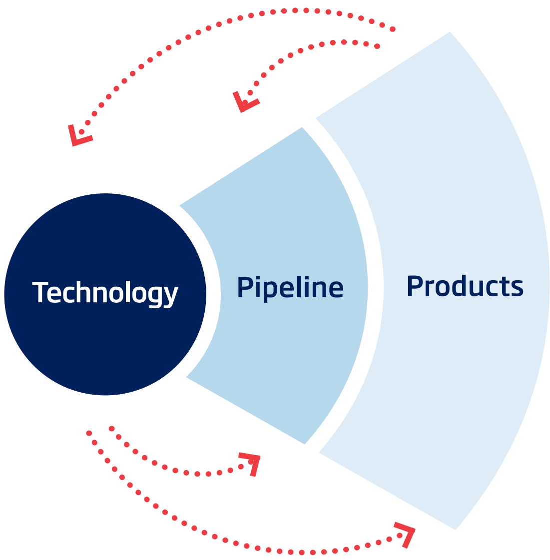
Our strategy

Creating the value cycle

As the Company's pipeline has matured, with key products receiving regulatory approvals, the next stage of the Company's strategy is to transform its business from a development stage company into a significant, profitable and self-sustaining specialty pharmaceutical company.

Vectura has sought to expand its development portfolio within airways diseases whilst attempting to mitigate specific product development and market risk, with appropriate deal making through in-licensing, co-development and acquisition whilst aiming to deliver superior returns for its shareholders.

We aim to build on our current position by delivering innovative inhaled and targeted therapies that address the evolving unmet medical needs of patients with airways diseases.



HOW IT WORKS

Our technologies underpin our products and pipeline focus. The cash flow from the commercialisation of our products will be invested in a balanced way to develop our pipeline and maintaining our technology leadership, thereby creating the Vectura value cycle.

Analytical scientist

What we're doing

Recognising that such a strategy requires careful investment, and that we cannot take on every opportunity open to us, we must continue to grow our revenue streams and manage our portfolio risk, prioritise investment into our pipeline assets and make appropriate commercialisation choices.

1 Leveraging our technology base

The creation and protection of our underlying intellectual property assets are essential elements of our business model. We will continue to leverage investment in our technology and device platforms, intellectual property and general know-how to allow us to develop more innovative products that address the needs of patients, physicians and payors. Our returns will arise from collaborations with other parties, where we earn milestone payments and royalties from development and commercialisation, or from self-commercialisation of carefully selected opportunities.

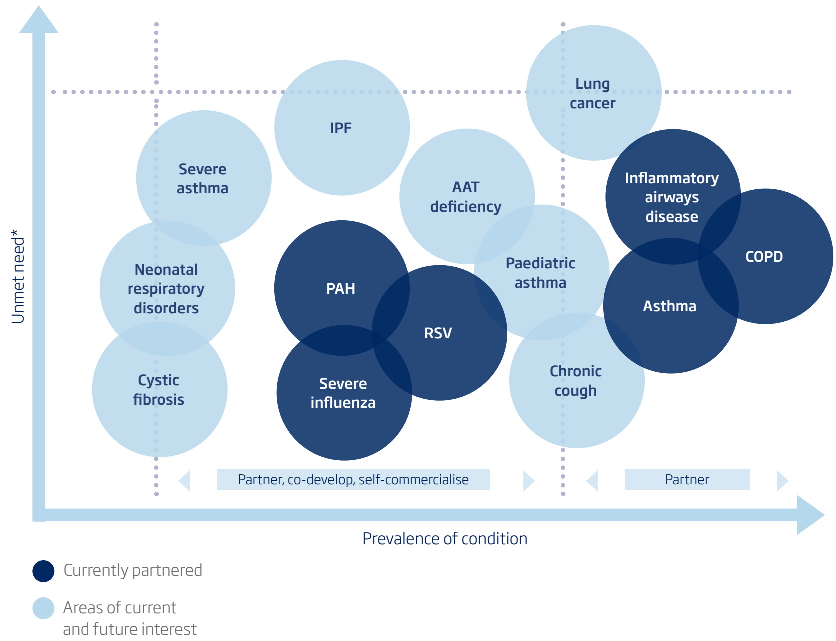
2 Progressing our pipeline

Our aim is to build a profitable cash-generative business through a specialist therapeutic focus and progressing our development portfolio within airways diseases. In the past year, our portfolio has been greatly enhanced by the acquisition of Activaero GmbH, which brought us a proprietary smart nebuliser-based technology that allows for targeting of drug into pre-selected areas of the lung via inhalation. This smart technology is incorporated into a range of devices, with applications for branded and generic drugs, including small molecules and biologics.

3 Making appropriate commercialisation choices

It is the Group's strategy to continue its existing partnering model to access those markets that require large general sales forces, such as COPD and asthma. For other markets, which can be addressed by a small specialist sales force, Vectura will consider a number of commercialisation alternatives: Partnering, to earn milestones and royalties; co-development, where Vectura undertakes development to achieve a greater share of the economics; and self-commercialisation, for specialty therapeutic targets that require a small, cost-effective and focused sales and marketing infrastructure. The means of commercialisation will be determined by an assessment of the product and market specific balance of risk and reward.

Identifying areas of potential interest



* Note: The vertical axis quantifying unmet need is based on scientific and clinical reviews of the disease area combined with the views of the Directors.

Abbreviations used: IPF; Idiopathic Pulmonary Fibrosis, AAT; Alpha Anti-Trypsin, PAH; Pulmonary Arterial Hypertension; RSV; Respiratory Syncytial Virus

Key Performance Indicators (KPIs)

Vectura's Board and management rigorously monitor the progress of our business, maintaining strict financial discipline, to facilitate achieving our key strategic objective, to become a profitable, self-sustaining and cash-generative business.

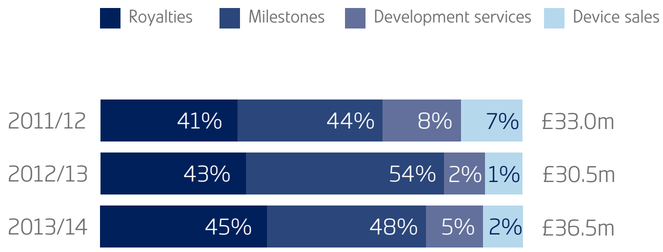
Vectura has three key financial KPIs: revenue growth, positive EBITDA progression and cash management.

Financial KPIs

Revenue growth

Vectura has five revenue streams: royalty revenue, product licensing revenue, technology licensing revenue, development services revenue and device sales revenue.

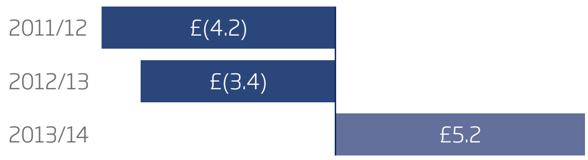
As shown on the right the percentage of overall revenue generated by royalties has increased each year since 2011/12. Growing and sustainable royalty revenues will provide stability and cash resources to fund Vectura's growth. For more information about Vectura's revenue streams, refer to pages 26 and 27.



Positive EBITDA progression

EBITDA is a measure of Vectura's underlying operational performance. A positive EBITDA progression shows Vectura's ability to generate returns on investment over time. As shown on the face of the consolidated income statement, EBITDA is calculated by adjusting Vectura's operating result for non-cash and non-recurring items.

EBITDA has moved from a negative in 2011/12 and 2012/13 to a positive in 2013/14. This increase has been driven by an increase in revenues and a reduction in research and development expenditure.



Cash management

Careful management of cash resources is vital to ensure that Vectura is able to develop and augment its pipeline assets. Free cash flow (FCF) is a measure of the cash investment required to support Vectura's operations and it is defined as the net cash outflow from operations, adjusted for net capital expenditure.

Non-financial KPIs

Progressing and commercialising our product pipeline

Successful product development and commercialisation is key to creating long-term value. A number of value creating events have occurred during 2013/14, namely:

- QVA149 was launched following approval by the European and Japanese regulatory authorities;
- VR315 was launched following approval in certain European territories;
- achieved a $3m US development milestone for progress of VR315 US;
- entered into a collaboration agreement with UCB to develop an innovative biologic immunomodulatory product in the area of severe inflammatory respiratory disease; and
- the acquisition of Activaero GmbH in March 2014 introduced seven clinical stage products and several pre-clinical stage products to the Vectura pipeline.

Our products

Our product portfolio comprises marketed products, which provide an important source of revenue; branded investigational drugs, at different stages of development with partners or by Vectura alone; and generic investigational drugs.

Recent progress in marketed products

Royalty income in 2013/14 was £16.3m; an increase of 25% from £13m in 2012/13. Royalty income was primarily from sales of Advate, with royalty growth driven primarily from sales of Seebri® Breezhaler®, Ultibro® Breezhaler® and AirfluSal® Forspiro®.

Ultibro® Breezhaler®

Clinical trials have shown that Ultibro® Breezhaler® offers statistically significant improvements in bronchodilation compared to treatments widely used as current standards of care, including salmeterol/fluticasone 500/50 mcg in patients with no history of moderate or severe exacerbations over the last year, and open-label tiotropium (18 mcg).

In Japan the product is approved as Ultibro® Inhalation Capsules.

Novartis plans to submit QVA149 for US filing in the fourth quarter of 2014 for an indication in COPD.

Seebri® Breezhaler®

Novartis plans to conduct a Phase III clinical trial programme to evaluate the efficacy, safety and tolerability of once-daily NVA237 (glycopyrronium bromide 50mcg) in patients with uncontrolled asthma. This programme aims to support registration of NVA237 as an add-on treatment for patients with asthma already on an inhaled corticosteroid and long-acting beta$_2$-agonist (ICS/LABA).

In Japan the product is approved as Seebri® Inhalation Capsules.

Novartis plans to submit NVA237 for US filing in the fourth quarter of 2014 for an indication in COPD.

AirFluSal® Forspiro®

Vectura initially developed the VR315 product and created the design of the innovative inhaler, before licensing the asset to Sandoz in 2006. It was subsequently developed in collaboration with Vectura as AirFluSal® Forspiro® by Aeropharm GmbH in Rudolstadt, Germany, Sandoz's global respiratory Center of Excellence. The innovative and intuitive to use design of the inhaler was awarded the Red Dot Product Design award in 2011, an internationally recognised quality seal awarded by the Design Zentrum Nordrhein Westfalen in Essen, Germany.

On 18 December 2013, Sandoz announced the first approval of AirFluSal® Forspiro® in Denmark, following a decentralised review process. The first wave of countries included in this process were Denmark, Germany, Hungary, Sweden, Norway, Belgium, Romania, Bulgaria and Luxembourg. The product has already been approved and launched in most of these countries and the first approval and launch (post-period) of the product in Asia (South Korea) was also announced.

Ultibro®, Seebri®, Breezhaler®, AirFluSal® and Forspiro® are registered trademarks of Novartis AG.

Manufacturing blister strips

Our products continued

Our marketed products at a glance

We have eight products marketed by partners. We receive royalty income from sales of these products.

Adept®

Adept® is a 4% icodextrin solution used during surgery to reduce post-surgical adhesions, a frequent and major complication after gynaecological and other abdominal surgery, where abnormal scarring causes the surfaces of internal structures to stick together. Whilst not necessarily dangerous in themselves, they can lead to future complications, often years later or if further abdominal surgery is required. It has been used in Europe since 2000, and since 2006 in the US. In December 2005, Vectura signed a licence deal with Baxter for the manufacture and distribution of Adept®.

Indication
Prevention of surgical adhesions

Partner
Baxter

Markets
Worldwide

Advate®

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

Indication
Haemophilia A

Partner
Baxter

Markets
Worldwide

Asmasal®

Asmasal® uses Vectura's proprietary reservoir DPI device, the Clickhaler®. Asmasal® contains salbutamol, a short-acting beta$_2$-agonist for the rapid relief of asthma symptoms.

Indication
Asthma

Partner
Recipharm

Markets
UK, France and Ireland

Extraneal®

Extraneal® is a peritoneal dialysis solution containing icodextrin, licensed to Baxter in 1996. Peritoneal dialysis is a form of treatment for kidney failure used to remove waste and excess water from the blood. Icodextrin 7.5% (Extraneal®) is a starch-derived glucose polymer which acts as an osmotic agent when administered intraperitoneally for continuous ambulatory peritoneal dialysis. Extraneal® works by removing water and waste products from the blood when kidney failure demands peritoneal dialysis or when glucose solution does not remove enough water. Vectura receives royalties on sales in the US and certain other territories.

Indication
Peritoneal dialysis

Partner
Baxter

Markets
Worldwide

AirFluSal® Forspiro® (VR315 – ex US)

AirFluSal® Forspiro® (VR315) is an inhaled combination therapy (salmeterol/fluticasone) for asthma and COPD, licensed to Sandoz for development and commercialisation in Europe and the rest of the world. Vectura initially developed the VR315 product and created the design of the innovative inhaler, before licensing the asset to Sandoz in 2006.

Indication
Asthma and COPD

Partner
Sandoz

Markets
AirFluSal® Forspiro® is currently launched in Denmark, Germany, Norway and South Korea

Asmabec®

Asmabec® uses Vectura's proprietary reservoir DPI device, the Clickhaler®. Asmabec® contains beclomethasone, an inhaled corticosteroid used as standard preventative therapy for asthma.

Indication
Asthma

Partner
Recipharm

Markets
UK, France and Ireland

Seebri® Breezhaler® (NVA237; glycopyrronium bromide)

Seebri® Breezhaler® is a novel, once-daily, inhaled long-acting muscarinic antagonist (LAMA) indicated as a maintenance bronchodilator treatment for the relief of symptoms in patients with COPD. In Japan, the product is approved as Seebri® Inhalation Capsules. Glycopyrronium bromide was exclusively licensed to Novartis in April 2005 by Vectura and our co-development partner Sosei Group Corporation.

Indication
COPD

Partner
Novartis

Markets
Seebri® Breezhaler® is currently approved in over 60 countries, including the EU, Japan, Canada and Australia

Ultibro® Breezhaler® (QVA149; indacaterol /glycopyrronium bromide)

Ultibro® Breezhaler® (indacaterol/glycopyrronium bromide) is a novel, once-daily, dual bronchodilator approved in the EU as a maintenance bronchodilator treatment for the relief of symptoms in adult patients with COPD. In Japan, the product is approved as Ultibro® Inhalation Capsules. Glycopyrronium bromide was exclusively licensed to Novartis in April 2005 by Vectura and our co-development partner Sosei Group Corporation.

Indication
COPD

Partner
Novartis

Markets
Ultibro® Breezhaler® is currently approved in over 30 countries, including the EU, Japan, Canada and Australia

Our products continued

Our product pipeline has developed significantly in the past year.

Our developing pipeline containing both branded and generic assets

Pre-clinical

- **VR588** Severe Inflammatory Airway Disease (Global)
- **VR611** Airways Inflammation and Chronic Cough (Global)
- **VR942 (UCB)** Inflammatory Airway Disease (Co-development global)

Phase 1

- **VR475** Severe Adult Asthma (US)
- **VR465 (Ablynx)** RSV Infection (Global)

Phase 2

- **VR647** Paediatric Asthma (Global)
- **VR179 (Grifols)** Cystic Fibrosis (Global)
- **VR736 (Ventaleon)** Severe Influenza (Global)
- **SB010 (sterna biologicals)** Asthma and other respiratory diseases (Global)

Phase 3

- **NVA237 (Novartis)** COPD (US)
- **QVA149 (Novartis)** COPD (US)
- **VR475** Severe Adult Asthma (EU)
- **VR876 (partnered, undisclosed)** Pulmonary Hypertension (Global)

Full development

Filed

Generic assets*

- **VR315 (partnered, undisclosed)** Asthma (US)
- **VR506** Asthma (US)
- **VR632 (Sandoz)** Asthma (EU)

* The phase of development of generic drugs (in red) is different from branded drugs and is not disclosed.

Branded investigational drugs

NVA237 COPD

Novartis plans to submit NVA237 for US filing in the fourth quarter of 2014 for an indication in COPD. Plans for regulatory filing of NVA237 (glycopyrronium bromide) for an indication in asthma will start in 2016.

QVA149 COPD

Novartis plans to submit QVA149 for US filing in the fourth quarter of 2014 for an indication in COPD.

VR475 using FAVORITE severe adult asthma (EU and US)

During the inhalation of a therapeutic drug, control of the flow and volume of the drug aerosol can improve the efficiency of delivery of drug. Vectura uses this principle in its FAVORITE technology, to enable a drug to be delivered to targeted areas of the lung, with high efficiency, where drug deposition may provide greater benefit to a patient.

VR475 is an investigational product that comprises the inhaled corticosteroid budesonide, delivered with Vectura's smart nebuliser system, the AKITA® Jet. With this system, FAVORITE technology is used to deliver budesonide more efficiently to uncontrolled, severe, oral corticosteroid (OCS) – dependent asthmatics such that their dose of OCS may be reduced or they may be weaned off OCS totally. OCS therapy is often associated with severe adverse reactions, and dose-reduction or weaning is a desirable end point for these patients, provided asthma control is maintained.

There are approximately 13.7m diagnosed asthmatic patients in the US and 17.9m in the EU5 (largest five EU markets)[1]. 19% (2.6m in the US and 3.4m in the EU5) are classified as severe, persistent asthmatics, which is the target population for VR475[2].

Vectura has completed a dependent on OCS, one multi-centre, double-blind, randomised, placebo controlled Phase IIb trial (AICS 01), which met its primary endpoint with supporting secondary endpoints demonstrating that patients could be weaned off their oral steroids. Vectura is planning a Phase III study to support filing an Marketing Authorisation Application (MAA) in Europe. A pharmacokinetic study to support initial development of VR475 in the US is being planned later this year.

1 Source: Decision Resources Patient Base Year 2012 (Accessed 18 February 2014).

2 Source: Real-world Evaluation of Asthma Control And Treatment (REACT), Peters et al JACI, June 2007.

VR876 Pulmonary hypertension

This is in clinical development stage and is being developed by an undisclosed partner as a nebulised version of a currently marketed drug for the treatment of pulmonary arterial hypertension (PAH) using FAVORITE technology.

VR647 Paediatric asthma

The Safe Corticosteroid Inhalation in Paediatrics (SCIPE) programme aims to provide additional benefit to persistent asthmatics under the age of twelve. The product investigated in the programme, VR647, aims to provide equivalent efficacy to the currently nebulised budesonide at lower doses. The time required for these children to use the nebuliser might be significantly reduced, and may provide further differentiation through improved compliance.

VR647 is the investigational product which delivers the corticosteroid budesonide using the FAVORITE technology through a smart card controlled jet nebuliser-based system.

In April 2013, results from a twelve-week Phase II trial conducted in Germany demonstrated that VR647 improved lung function when compared to standard nebuliser delivery of budesonide. Treatment times were in the region of two minutes, significantly faster than conventional nebulisation times.

In the US, there are 1.7m persistent asthmatics under the age of twelve (source: Decision Resources Patient Base Year 2012 – accessed 18 February 2014).

VR942 Inflammatory airway disease

VR942 has the potential to be the first inhaled, highly-differentiated biological therapy for severe airway disease. Vectura market research indicates an overwhelming US physician preference for inhaled rather than parenteral administration of such a product.

The VR942 programme is a co-development deal with UCB for a novel molecule currently at the pre-clinical stage.

VR179 Cystic fibrosis

VR179 is a nebulised α1-antitrypsin, under investigation for the treatment of cystic fibrosis. The programme is partnered with the Spanish company Grifols.

VR736 Severe influenza

VR736 is an inhaled treatment for hospitalised patients with severe influenza, being developed by Ventaleon, a joint venture between Vectura and an investment syndicate.

SB010 Asthma

SB010 is a first-in-class GATA-3 antagonist being developed by the German private biotech company, sterna biologics, for the treatment of allergic asthma.

In February 2014, sterna announced results from a Phase IIa trial in 39 patients with mild allergic asthma. SB010 provided a significant improvement in lung function in both the early and late-phase asthmatic response.

VR465 respiratory syncytial virus infection

The Belgian biotech company, Ablynx, is developing the anti-RSV Nanobody® ALX-0171 for the treatment of RSV infections in infants. The market for RSV is large. AstraZeneca's Synagis, which is approved for the prophylaxis of RSV in pre-term infants, achieved sales of $1.1bn in 2013. There are an estimated 310,000 children under the age of five hospitalised each year in the seven major markets due to RSV infections. Ablynx has demonstrated favourable tolerability and PK of ALX-0171 in three Phase I trials including either healthy subjects or subjects with hyper-reactive airways. Vectura is providing technology and expertise in delivery of the active product.

VR588 a small molecule JAK inhibitor

VR588 is a broad-based, potent and balanced kinase inhibitor of JAK 1/2/3 and tyrosine kinase. The pharmacology demonstrates a selective inhibition profile, minimising off-target effects, potentially suited to the management of various severe inflammatory and fibrotic airway diseases. Development activities have been initiated with the aim to enter the investigational product into the clinic next year.

VR611 airways inflammation and TRPV1 modulation

VR611 is designed to modulate the activity of channels located in airway neurons which are affected by various inflammatory stimuli. The TRPV1 receptor is involved in the control of the cough response. The treatment of chronic, persistent cough represents a significant unmet need. VR611 also has potential use in various other inflammatory airways indications. Non-clinical data indicate promising cough suppressing and anti-inflammatory properties. Pharmacological evaluation is planned to establish its use in cough through inhaled delivery.

Generic investigational drugs

VR315 US

In August 2011, Vectura signed a licence agreement for the development, manufacturing and commercialisation of VR315 in the US with the US division of a leading international pharmaceutical company. Vectura is eligible to receive development and regulatory milestones for VR315 and recorded a further development milestone under this agreement of $3m (£1.8m) in revenues during this year. Vectura is eligible to receive an additional $29m upon achievement of future, predetermined milestones. In addition, Vectura will receive a royalty from sales of VR315 in the US.

VR632 for asthma/COPD

VR632 is Vectura's second inhaled combination therapy for asthma and COPD. The European rights for VR632 were licensed to Sandoz in December 2007 in a deal worth up to €15.5m in milestones and development funding plus royalties on all products sold. Vectura retains the rights for the US and other territories.

VR506 for asthma

VR506 is an inhaled corticosteroid for the treatment of asthma, which entered clinical development in 2011. According to Decision Resources, inhaled corticosteroids for respiratory disease generated over US$4bn in global sales in 2012. Vectura has received licensing interest in VR506 for the US.

Our platform technologies and devices

Enabling the development and delivery of value-adding products.

Vectura has a wide range of patent-protected technology platforms, used to support the development and delivery of our own, value-adding products. We also offer licences to our technologies, generating significant revenues for Vectura in the process.

At our site in Chippenham, we have a state-of-the-art manufacturing facility, designed and run to standards of Good Manufacturing Practice (GMP) and used by us to manufacture inhaled products to supply clinical trials through to regulatory filing.

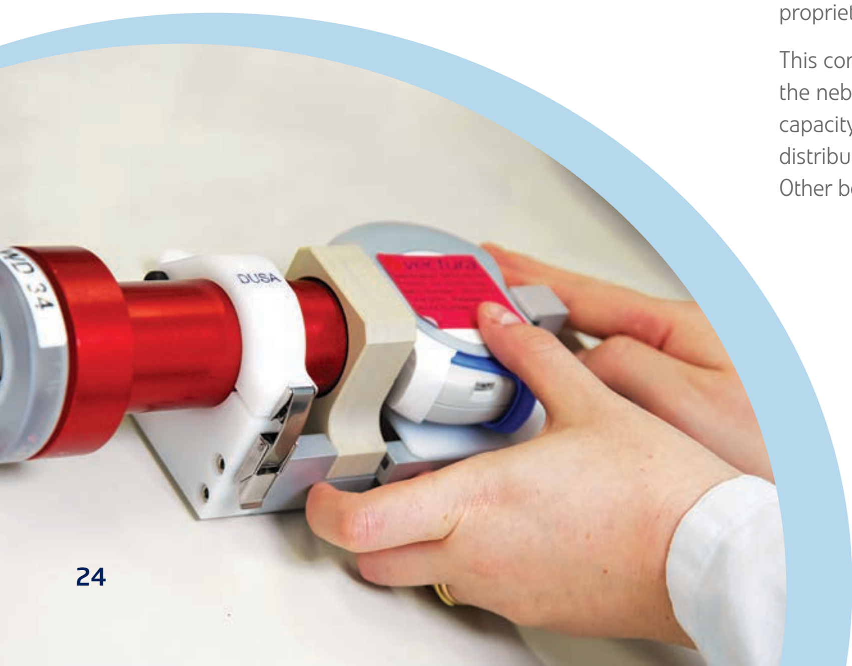
The development of drugs for inhalation is complex and requires specialist processes and know-how. Companies across the world are keen to harness our expertise and technology for their own inhalation programmes and we expect that this will lead to future collaborations and licensing deals.

Formulation technologies

With our formulation technologies, we seek to achieve state-of-the-art inhaled delivery of dry powders for our small molecule and biologic drugs. Our investment in dry powder formulation technology has delivered significant returns, having been used in many of our licensed products and as the subject of an intellectual property licence to GSK.

PowderHale®

Vectura's formulation technologies include PowderHale®, a patented formulation technology designed to significantly improve the performance of dry powder inhaler (DPI) products. DPI formulations incorporating PowderHale® technology give improved aerosolisation efficiency, delivered dose uniformity and enhanced product stability.



These improvements in performance are achieved via the combination of enhanced powder processing techniques and the incorporation of an additional excipient known as a Force Control Agent (FCA).

PowderMax

The Vectura PowderMax technology emanates from the expertise derived from applying the PowderHale® approach to a broad spectrum of drug substances. Advanced processing technologies are brought to bear to yield DPI formulations with yet further enhanced performance and stability.

ParticleMAX

Vectura has been active in the development of spray dried inhalation powders for many years and has consequently developed significant know-how and a portfolio of patents in this field. The ParticleMAX technology brings together existing excipients and processing knowledge with new excipients and novel processing to create a new generation of formulations. These are directed towards delivery of biomolecules with high aerosolisation efficiency and further enhanced room temperature stability. ParticleMAX has been developed with scale-up and transferability in mind, enabling laboratory gram-scale formulations to be manufactured in kilogram quantities.

Inhalation technologies

FAVORITE (Flow And VOlume Regulated Inhalation TEchnology)

A patient's breathing pattern can alter the efficiency of drug delivery to different parts of the lung. Control of the inspiratory flow rate, the inspiratory volume of aerosol and the timing during the inspiration when the drug aerosol is delivered can materially affect how much drug gets to central or peripheral parts of the lung. This is the basis of our proprietary, smart nebulisation-based technology known as FAVORITE.

This control is achieved through a modified nebuliser unit that delivers the nebulised airstream, tailored to the individual patient's breathing capacity. The increased efficiency of delivery means the drug is distributed more efficiently allowing targeted deposition in the lung. Other benefits for the patient may also be derived from this approach.

Testing devices

Device technologies

Dry powder inhalers

Vectura's range of pre-metered foil blister Dry Powder Inhalers (DPIs) has been developed to meet patients' needs in inhalation therapy. The devices are low cost and easy to use, yet they meet challenging technical and regulatory requirements, as demonstrated by recent approvals of Sandoz's AirFluSal® Forspiro®, which uses the GyroHaler® DPI device. This device has also gained a Red Dot design award. The core technology and IP used in GyroHaler® has also been incorporated in a family of devices aimed at meeting future product development and partnering opportunities. These include lever-operated and open-inhale-close devices.

Smart nebuliser delivery systems

Vectura's smart nebuliser delivery systems provide targeted inhalation therapy for specialist and niche disease areas. The nebuliser device guides the patient's inhalation manoeuvre, utilising the FAVORITE principle for precise delivery of drugs to the lung.

DPI devices

GyroHaler®

Lever-operated

Open-inhale-close

Smart nebuliser systems

AKITA® Jet

The AKITA® Jet nebuliser uses proportional valve-based technology to drive the positive ventilation and control volume tailored to the patient's breathing characteristics, following the principles of FAVORITE.

This system is used in conjunction with smart card technology that ensures full device exclusivity for a specific drug. The device is CE marked and 510(k) approved.

APIXNEB

The APIXNEB nebuliser is similar to the AKITA® device, but uses a mesh-based nebuliser handset instead of a jet nebuliser. The mesh provides the advantages of a much higher nebulisation efficiency than jet nebuliser, and can be used to nebulise molecules that cannot tolerate the higher shear forces of a jet nebuliser. The device is CE marked and 510(k) approved.

FOX

The FOX is a hand-held, self-contained, battery-powered, mesh nebuliser inhalation system that delivers nebulised drugs with high performance using a vibrating mesh technology. The mesh-based aerosolisation engine is proprietary to Vectura. The FOX inhalation system also makes use of a flow sensing/controlling valve system and is both re-chargeable and Bluetooth®-enabled. The latter feature allows remote firmware updates without cable connection or for the system to upload patient-use data for review by a healthcare professional.

Financial review

"It has been an important financial year for Vectura and we are pleased to report a positive EBITDA of £5.2m as well as a £6m increase in total revenues."

Summary

It has been an important financial year for Vectura. Total revenues of £36.5m have increased by £6m (20%) when compared to the prior year, principally due to the 25% (£3.3m) increase in royalty revenues. Total royalty revenue of £16.3m (2012/13: £13m) includes royalties earned from three newly marketed products, Ultibro® Breezhaler®, BREO® ELLIPTA® and AirFluSal® Forspiro®. In addition, royalty income earned from Seebri® Breezhaler® has increased as Vectura has earned royalty income for a full twelve months in the year ended 31 March 2014 and there has been a sustained increase in underlying sales of the product.

Significant milestone revenues were earned during the year, including £7.8m ($12.5m) following approval of Ultibro® Breezhaler® in Europe and Japan, a £1.8m ($3m) development milestone earned in relation to VR315 US, and £3.7m (€4.5m) following the approval of AirFluSal® Forspiro® in Germany, Romania and Belgium.

The Group continues to allocate its resources in an efficient manner and research and development (R&D) expenditure of £28m is down 9% (£2.9m) compared with last year (2012/13: £30.9m). Other administrative expenses of £3.4m are in line with the prior year (2012/13: £3.3m); however total administrative expenses include £2.5m of one-off costs associated with the acquisition of Activaero GmbH. Underlying non-cash items, such as share-based compensation and the amortisation charge associated with the pre-existing intangible assets, are consistent with the prior year, but overall amortisation is up by £0.6m, due mainly to the £0.5m amortisation charge recognised for the intangible assets acquired with Activaero GmbH.

The increase in revenues and reduction of R&D expenditure have improved the Group's loss before tax by £5.6m, to a loss of £4.8m (2012/13: £10.4m) and the Group has generated a positive EBITDA of £5.2m (2012/13: £3.4m loss).

In accordance with IFRS, the Group has consolidated the revenues and expenditure of Activaero GmbH in its financial results from the date of acquisition to the end of the financial year. The underlying revenues from the Activaero GmbH business constitute a mix of product and technology licensing revenues, as well as development services and device sales.

These underlying revenues are supplemented by milestone receipts from partnered projects, as and when certain milestone events occur. Following the acquisition of Activaero GmbH and the placing of additional shares to raise gross proceeds of £52m on 18 March 2014, the Group has maintained a strong balance sheet position with a cash balance at 31 March 2014 of £81.7m (2013: £70.1m).

Revenue

The Group has five revenue streams; royalty revenue, product licensing revenue, technology licensing revenue, development services revenue and device sales revenue.

Royalties

Total royalty revenue of £16.3m (2012/13: £13m) has increased by 25% compared to the prior year. This increase is driven primarily by royalty revenue from Novartis relating to sales of Seebri® Breezhaler®.

In addition, Vectura received its first royalties from Novartis for sales of Ultibro®Breezhaler®, from GlaxoSmithKline (GSK) for sales of BREO® ELIPTA™ , and from Sandoz for sales of AirFluSal® Forspiro®.

Other royalty income is mainly derived from the three products licensed to Baxter. ADVATE®, for haemophilia A, contributed royalties of £11.2m (2012/13: £11.1m). Extraneal®, for peritoneal dialysis, earned royalties of £1m (2012/13: £0.8m) and Adept®, for the prevention of surgical adhesions, earned royalties of £0.6m (2012/13: £0.6m). The Group does not expect to receive any future royalties from sales of Extraneal®.

Product licensing

Product licensing revenue earned in the year was £13.3m (2012/13: £12.8m), which includes milestone payments from Novartis of $10m (£6.2m) and $2.5m (£1.6m) relating to the respective European and Japanese approvals for QVA149.

In December 2013, Vectura's partner Sandoz announced it received marketing authorisation for AirFluSal® Forspiro® (formerly known as VR315 EU) in Denmark. Following the initial announcement, the product was approved in Germany, Hungary, Sweden, Norway, Belgium, Bulgaria, Romania and South Korea. The approvals in Germany, Romania and Belgium each triggered a milestone to Vectura of €1.5m, and therefore a total of €4.5m (£3.7m) has been recognised as revenue during the year ended 31 March 2014.

During the year, Vectura earned a milestone of £1.8m ($3m) in relation to progress with VR315 development in the US. Vectura is eligible to receive a further $29m upon achievement of future, predetermined development milestones. In addition, Vectura will receive a royalty from all VR315 US sales.

Technology licensing

Technology licensing revenue of £4.3m (2012/13: £3.7m) is higher than the previous year. £2m relates to milestones defined in a non-exclusive licence agreement with GSK. Under the terms of the agreement, Vectura has received a £10m upfront payment in 2010/11 and at 31 March 2014, a further £8m of a potential total of £10m, from development milestones.

In August 2013, a £2m change of control milestone was earned under a technology licensing agreement following the acquisition of ProFibrix BV by The Medicines Company.

Development services

Development services revenue has increased to £1.7m (2012/13: £0.6m). This was the result of higher demand for these services from our current licensing partners. Future revenues will depend on the number and nature of feasibility studies and new licensing deals. The development of inhalation products is a very specialised area, with partners frequently requiring Vectura's involvement for a period after licensing.

Device sales

Device sales of £0.9m were higher than the prior period (2012/13: £0.4m) due to the approval of AirFluSal® Forspiro® in a number of European countries. AirFluSal® Forspiro® uses Vectura's GyroHaler device.

Research and development expenses

Total investment in research and development was £28m, representing a 9% decrease on the previous year (2012/13: £30.9m). This decrease is partly due to the timing of certain development expenditure and partly due to an ongoing focus on cost control throughout the Group. Research and development expenses will increase during the 2014/15 financial year as we develop our newly acquired assets.

Taxation

During the year ended 31 March 2014, research and development tax credits totalling £4.7m were received in relation to the 2012/13 tax returns.

A receivable of £3.8m was included in the balance sheet as at 31 March 2013, resulting in a current year tax credit of £0.9m. Research and development tax credits of £3.3m have been recognised in respect of the 2013/14 financial year. As the Group's taxable losses reduce, research and development tax credit cash receipts will continue to decline.

A net deferred tax liability of £33.9m was recognised during the year, this includes a £34.7m (€42.0m) liability recognised in respect of the assets acquired with Activaero GmbH at an effective tax rate of 27%. The deferred tax liability resulting from the acquisition will be released to the income statement as the acquired intangible assets are amortised, and as the tax losses brought forward are utilised. £0.1m of this balance has been released to the income statement in the current year, relating to the £0.5m amortisation recognised in the year.

Total royalty revenue

£16.3m

(2012/13: £13m)

Positive EBITDA

£5.2m

(2012/13: loss of £3.4m)

Setting powder feed rate, prior to jet milling of drug substance

Financial review continued

Taxation continued
An additional liability of £1.8m has been charged to the income statement in respect of the intangible assets acquired from Innovata. The liability will reduce as the intangible assets are fully amortised over the next two years.

Intangible assets
Intangible assets of £138.9m include £10.7m relating to the Innovata acquisition and assets of £128.2m relating to the recent acquisition of Activaero GmbH.

The intangible assets of £10.7m (2013: £17.1m) relating to the Innovata acquisition have been amortised by £6.4m (2012/13: £6.3m) during the year. These assets will be fully written down over the next two years.

Intangible assets of €155.7m (£130.7m) were recognised on the acquisition of Activaero GmbH. These assets have been amortised by €0.6m (£0.5m) since acquisition and the remaining net book value of €155.1m has been translated at the prevailing exchange rate on the balance sheet date, giving a carrying value of £128.2m.

These acquired intangible assets relate to in-progress R&D programmes, which include FAVOLIR®, and they will continue to be amortised over their remaining expected useful life. In accordance with accounting standards and as set out in note 28, due to the proximity of the acquisition to Vectura's year end the initial accounting outlined above is deemed to be provisional pending finalisation of the fair value exercise. On that basis the assets, liabilities or items of consideration may be restated at any time up to the anniversary of the acquisition date in March 2015.

Translation reserve
The assets and liabilities acquired from Activaero GmbH are denominated in euros and therefore in accordance with accounting standards, the Group has recognised a net foreign exchange difference of £1.6m within reserves as a result of the movement in the exchange rate between 18 March 2014 and 31 March 2014. In future periods, the movement in this reserve will be dependent upon the £/€ exchange rate at the relevant balance sheet dates.

Property, plant and equipment
Vectura has invested £2.5m in its inhaled product manufacturing capabilities during the year (2012/13: £4m). In addition, the Group acquired property plant and equipment of £1.2m as part of the acquisition of Activaero GmbH.

Deferred income
Deferred income relates to milestones received in cash but not yet recognised as revenue. Of the £1.8m on the balance sheet at 31 March 2014 (2013: £1.4m), £0.1m will be recognised as revenue in 2014/15 and £1.7m, of which £1.3m relates to the VR315 RoW deal with Sandoz, will be recognised as revenue in later periods.

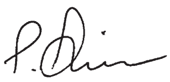
Deferred consideration
The deferred liability of £28.7m relates to the €35m payment in cash which is due to be paid to the former Activaero GmbH shareholders in August 2015 as part of the acquisition consideration.

Cash flow
Vectura continues to maintain a strong cash position with cash and cash equivalents at 31 March 2014 of £81.7m (2013: £70.1m). The increase in cash was driven largely by the placing of 33.6m new shares at a price of 155p per share, generating gross proceeds of £52m. This increase in cash was offset by a £37.8m (€45m) payment to the former shareholders of Activaero GmbH in consideration for the business and costs associated with the acquisition and placing of £4.5m.

Cash outflow from operating activities was £0.7m (2012/13: £2.8m outflow).

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

	2013/14	2012/13
Average rates:		
£/$	**1.59**	1.58
£/€	**1.19**	1.23
Period-end rates:		
£/$	**1.67**	1.52
£/€	**1.21**	1.18



Paul Oliver
Chief Financial Officer
20 May 2014

Corporate social responsibility statement

We are committed to the interests of every area of our company.

The Directors recognise the importance of corporate social responsibility and endeavour to take into account the interests of the Group's stakeholders, including its investors, employees, customers, suppliers and business partners when operating the business. The Group believes that having empowered and responsible employees who display sound judgement and awareness of the consequences of their decisions and actions, and who act in an ethical and responsible way, is key to the success of the business. The Group also endeavours to be honest and fair in its relationships with customers and suppliers and to be a good corporate citizen, respecting the laws of countries in which it operates.

The Group is a member of the FTSE4Good index, a leading investment index for businesses that meet globally recognised corporate social responsibility standards.

Our people

Diversity

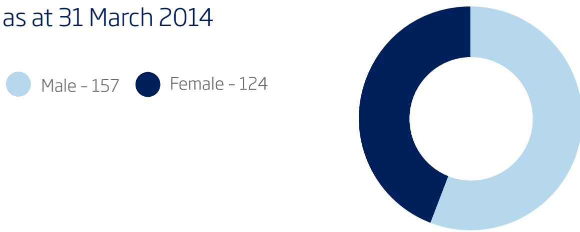
Our success continues to be driven by our diverse employee talent within the Group. The importance of diversity, equality and non-discrimination is highlighted in our employment practices, policies and procedures.

Vectura is an equal opportunity employer and we are committed to continuing to offer career opportunities without discrimination. Our equal opportunities policy covers all permanent and temporary employees including; Non-Executive Directors, all job applicants, agency staff, associates, consultants and contractors. Employees are valued highly and their rights and dignity are respected. The Group does not tolerate any harassment or discrimination.

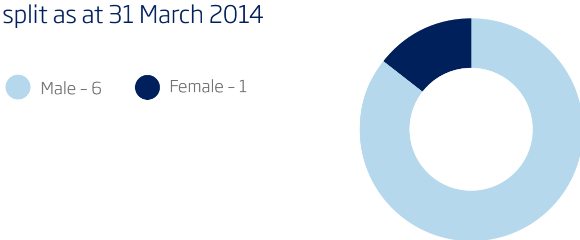
Whilst we do not have formal diversity targets or quotas, we recognise the importance of diversity, equality and non-discrimination and this is highlighted in our employment practices, policies and procedures. We focus on developing our core values within our staff, as we believe that this leads to an environment where they believe that what they are doing is making a difference. Refer to page 3 for more information about our core values.

Chris Blackwell is the Board member responsible for overseeing responsibility for human resources and non-discrimination issues.

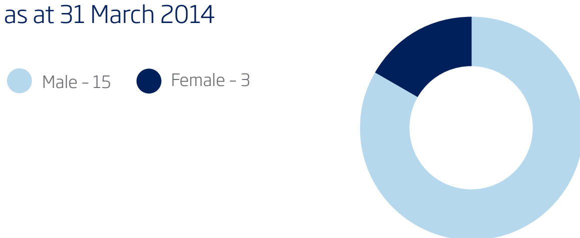
Overall gender breakdown as at 31 March 2014



Vectura Group plc's Directors gender split as at 31 March 2014



Vectura senior managers as at 31 March 2014



Release testing drug product

Corporate social responsibility statement continued

Green Committee

Vectura is committed to reducing its carbon footprint. During the year, our Green Action Team has continued to help us pursue this objective by supporting the implementation of a number of initiatives including:

- introduction of a policy whereby when existing light units require replacement they are replaced with LED lights. LED lights are up to four times more energy efficient than traditional units;
- introduction of a managed print solution to help control paper usage; and
- continued development of the Group's green policy in line with ISO14001.

Disabled employees

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

Family-friendly employment policies and employee welfare

The maternity and paternity leave and pay policies conform to statutory requirements. Flexible approaches to return to work after maternity leave and part-time or non-standard hours and work patterns are considered where viable.

Employee involvement

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

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

Training and development

The Group provides training and development appropriate to individual needs and offers remuneration packages (including pensions, private medical, permanent health and life insurance) and a working environment that are designed to be both fair and competitive with larger companies within the industry.

Vectura is positive about developing all employees for current and future roles. The Meakin Scholarship award is open to all employees and is awarded to employees who wish to study a "developmental course" in their own time. Any course that would significantly enhance an employee's skills whilst benefiting Vectura is considered. Vectura has supported a variety of programmes including the Pharmaceutical Industrial Advanced Training (PIAT) programme to MSc level, GCSE English and A level Chemistry.

Employee share ownership

Participation in the Group's share option schemes is extended to all of the Group's employees. More details are provided in the Report on remuneration.

Community investment

Vectura considers that its most important contribution to the communities within which it operates is to provide high-quality employment opportunities and to develop therapies to help patients with diseases. As the Group is currently loss-making it is not considered appropriate to make financial donations to charitable or community activities. However, it is the ethos of the Group to promote an environment of employee support and participation in initiatives that provide in-kind benefits where we believe we have a meaningful contribution to make. Where possible we aim to facilitate and support employee fund raising events, such as:

- we support the STEM (Science, Technology, Engineering and Mathematics) Initiative which is a major UK government initiative. Within this initiative our staff actively help local schoolchildren, being tomorrow's workforce, to gain the capabilities and skills to flourish in a scientific environment such as ours;
- an annual award of additional holiday is allocated to a small number of employees as a part of a staff initiative to volunteer for unpaid community or charitable services; and
- staff are encouraged to participate in nationwide charity campaigns, examples of which include Macmillan Coffee Mornings, Comic Relief and Movember. Where appropriate, Group facilities are made available to staff members organising such events.

Health and safety

The Group considers health and safety to be a priority in its workplaces. Vectura has a Health and Safety Committee to review health and safety standards within the Group. Trevor Phillips is the Board member to whom responsibility for health and safety issues has been delegated.

The Group provides specialist ongoing training to individuals who are responsible for health and safety, and general health and safety training is delivered to all staff via e-learning courses. The Group continuously monitors its health and safety practices to ensure that safety management procedures are robust and in line with industry best practice.

STEM Initiative

We support the STEM (Science, Technology, Engineering and Mathematics) Initiative which is a major UK government initiative. Within this initiative our staff actively help local schoolchildren, being tomorrow's workforce, to gain the capabilities and skills to flourish in a scientific environment such as ours.

Number of volunteers

27,000

Read more about STEM on its website:
www.stemnet.org.uk

The Group has an excellent safety record and there have been no major incidents or accidents reported to the Health and Safety Committee during the year (2012/13: none).

Environment

We are committed to minimising the impact of our activities on the environment and we believe that energy efficiency is the most important means of climate protection currently available to the Group. Vectura continues to report its environmental performance under the global Carbon Disclosure Project.

Greenhouse gas emission

There have been a number of important changes to legislation regarding disclosure of greenhouse gas (GHG) emissions. This section of our Annual Report includes our mandatory reporting of greenhouse gas emissions in accordance with the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 ("the Regulations"). The information presented below is included to provide a complete picture of Vectura's approach to corporate social responsibility.

Due to the nature of its activities, Vectura considers that it has a low environmental impact. However, we still actively seek to make energy savings in a way that is beneficial for the environment and cost effective for the business.

Greenhouse gas assessment parameters	
Baseline year	FY2013/14
Intensity ratio	GHG by gross building area

Emissions data is reported using a financial control approach to define our reporting boundary, which meets the requirements of the Regulations in respect of those emissions for which we are responsible. The information is presented for a twelve-month period. Emissions have been measured for all sites and the total emissions shown below include emissions for the newly acquired German sites for the period post-acquisition.

The amounts shown below for total Scope 1 and Scope 2 emissions are those required to be reported under the Regulations.

Greenhouse gas emission by source 2013/14	Tonnes of CO_2[1]
Scope 1	142
Scope 2	1,272
Total emissions (Scope 1 and 2)	1,414
Emissions reported (tonnes of CO_2 per sq ft)[2]	0.02

1 GHG emissions reported in metric tonnes of carbon dioxide equivalents. Emissions factors were sourced from the UK Defra database.

2 Gas and electricity usage information has been obtained from purchase invoices and verified by reference to meter readings. Vehicle fuel usage is based upon recorded mileage.

Intensity ratio

In order to express total annual emissions in relation to a quantifiable factor associated with Vectura's activities, gross building area has been used as an intensity ratio. Due to the nature of Vectura's business, a large amount of energy is consumed in maintaining air quality in the laboratories and therefore choosing gross building area as an intensity ratio gives the fairest reflection of performance.

Emissions reported (tonnes of CO_2 per sq ft)[2]

0.02

"We are committed to minimising the impact of our activities on the environment."

Corporate social responsibility statement continued

Environment continued

Carbon Disclosure Project

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

Our environmental footprint

Vectura's operational goals include objectives to reduce the Group's overall carbon footprint by controlling the use of key sources of energy and materials on a per capita basis. In order to support the Group in achieving these objectives, a Green Action Team meets regularly and has responsibility to pursue objectives for environmental sustainability and carbon reduction. Use is made of the Company intranet to communicate widely to all staff about environmental affairs and to receive their views and suggestions on green policy for consideration and discussion by the Green Action Team.

During the year, the Group has implemented a number of initiatives designed to control energy usage:

- when existing light units require replacement, they are replaced with LED lights. A large number of LED lights were installed at our Chippenham site during the year. The LED lights installed are up to four times more energy efficient than the traditional light units that they replaced;
- a managed print solution was implemented to help control paper usage;
- continued development of the Group's green policy in line with ISO14001 standards; and
- when existing desktop PCs require replacement, they are now replaced with virtual machines that use c.20% of the electricity of a standard desktop PC.

In addition, we report that since installing solar panels at the Chippenham site in FY2012/13, the panels have generated over 14,000 kWh of energy.

Paul Oliver is the Board member to whom responsibility for environmental issues has been delegated.

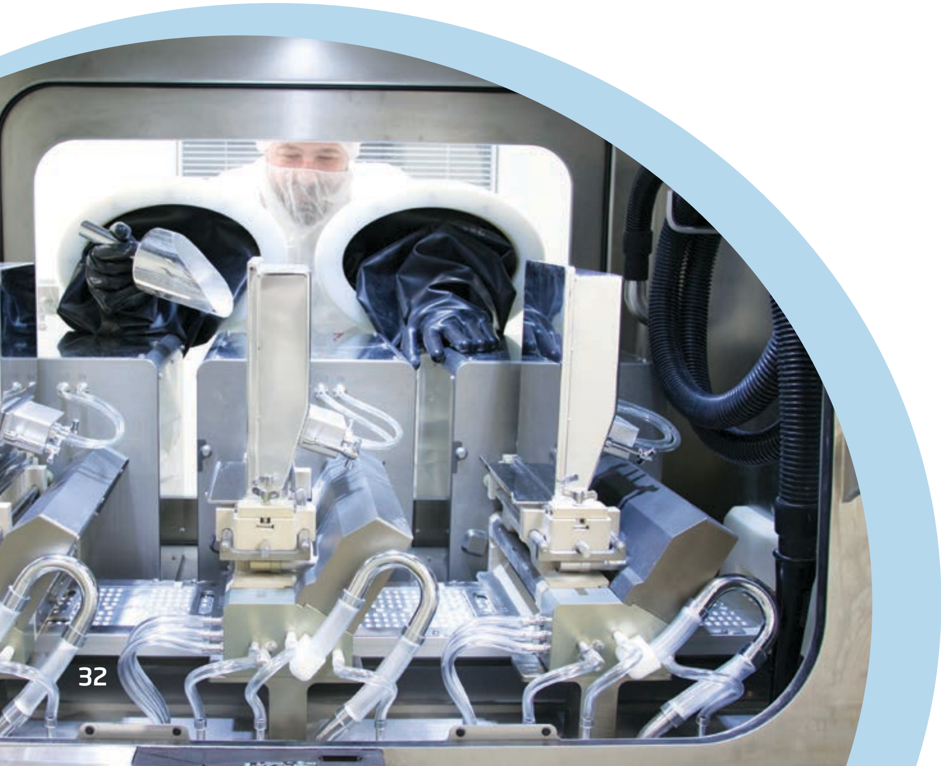
Waste management

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

Ethical and social policies

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

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



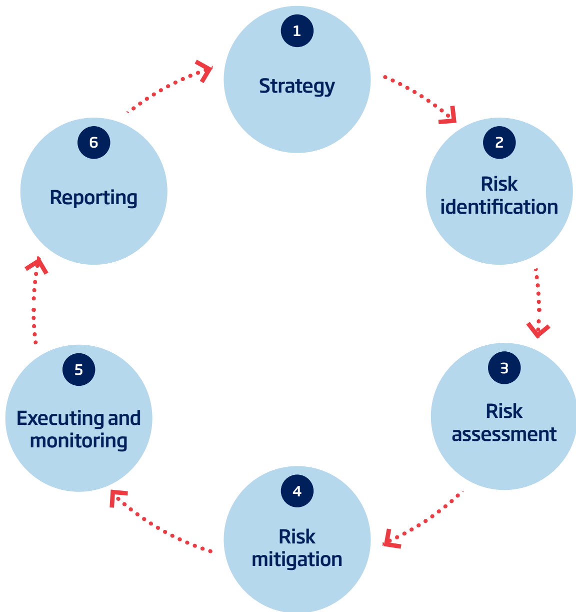
Powder dosing modules on high speed blister filling line

Risks and risk management

Our performance and prospects may be affected by a number of risks and uncertainties relating to our strategy, business model and operating environment. Our approach to risk management is to develop a risk management process that is aligned to our strategy, which will ensure that significant risks are identified, assessed and managed. Creating awareness of these risks throughout the organisation allows them to be limited, controlled and managed to ensure that business activities can be undertaken and opportunities can be maximised.

Objectives of the Vectura risk management process:

- to understand the business risks that Vectura faces in the execution of its strategy and the operation of its business model;
- to create and manage a register of these risks, documenting the decisions taken and judgements made;
- to ensure that the risk appetite of the Board is fully understood by those who are responsible for managing risk across the business;
- to ensure that mitigating actions and controls are aligned to the risk appetite of the Board;
- to ensure that risks are appropriately managed or mitigated and to ensure that where appropriate, risk is mitigated through insurance; and
- to control systematic risks within the organisation by maintaining and improving a system of internal controls to manage risks in decision making, legal contract management, quality and regulatory processes and the processing of financial transactions.



Such a system is designed to manage, rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.

Setting the tone	Designing the system	Completing the review
The Board	**Executive Management Team**	**Risk owners**
Responsible for maintaining and monitoring sound risk management and internal control systems	Responsible for ensuring that the risk management systems and internal control systems are appropriately designed	Responsible for bi-annual update of the Group's risk registers and reporting any significant issues up to the Executive Management Team
Responsible for conducting an annual review of the effectiveness of the Group's risk management and internal control systems. This review covers all material controls, including financial, operational and compliance controls. The scope of this review extends to a review of the Group's risk register	Responsible for ensuring that the risk appetite of the Board is appropriately understood by risk owners	Responsible for implementing and monitoring any mitigating actions and controls
Responsible for reporting to shareholders about the Group's risk management	Responsible for an annual review of the Group's risk register	Responsible for training and educating department and project team members about Vectura's risk management process
Review of process and outputs	Review of high risks	Risk registers

Risks and risk management continued

Identified risks

The principal risks specific to our business have been outlined below as well as an explanation of how we manage and mitigate them. Other risks are unknown or are deemed less material.

Some of these risk factors are specific to the Group and others are more generally applicable to the pharmaceutical industry or specific markets within which the Group operates. Our strategy is to become a speciality pharmaceutical company with a focus on airways-related diseases. In order to be successful, our business model involves the in-licensing of drug assets at various stages of their clinical development and developing those assets in an appropriate way and, partnering/co-developing or self-commercialising where appropriate.

The key risks highlighted below and on the following pages relate predominately to our stated strategy and current business model.

Strategic risks

Regulatory approvals

There can be no assurance that Vectura's, or a collaborator's, products will receive and maintain regulatory approvals. Even if Vectura's or a collaborator's products are approved, they may still face subsequent regulatory difficulties.

The international pharmaceutical industry is highly regulated by governmental authorities in the UK, the US and Europe and by regulatory agencies in other countries where the Group or a collaborator intends to test or market products they may develop. Regulatory authorities administer a wide range of laws and regulations governing the testing, approval, manufacturing, labelling and marketing of drugs and also review the quality, safety and effectiveness of pharmaceutical products. These regulatory requirements are a major factor in determining whether a substance can be developed into a marketable product and the amount of time and expense associated with such development.

As each regulatory authority may impose its own requirements, approval in one territory provides no guarantee that the product will receive subsequent regulatory approval in other territories. Even if regulatory approval to sell products is received, the FDA, the UK MHRA or comparable foreign regulatory agencies could require Vectura or a collaborator to conduct post-marketing trials or could prevent Vectura or a collaborator from using the labelling claims which Vectura or a collaborator would like to use to promote its products.

In addition, changes in applicable legislation or regulatory policies, or discovery of problems with the class of product, or its production process, site or manufacturer, may result in the imposition of restrictions on the product, its sale, manufacture or use, including withdrawal of the product from the market, or may otherwise have an adverse effect on Vectura's business.

Mitigating activities

The Group manages its regulatory risk by working closely with its expert regulatory advisors and, where appropriate, by seeking advice from regulatory authorities on the design of key development plans for its pre-clinical and clinical programmes.

The Group works closely with a number of blue-chip pharmaceutical partners such as Novartis, Sandoz, Baxter and GSK, who have significant regulatory expertise.

Unforeseen side effects

Unforeseen side effects may result from use of Vectura's or a collaborator's products or product candidates.

All drugs have a risk of adverse reactions and side effects. If any of Vectura's or its collaborators' products are found to cause adverse reactions and side effects other than those acceptable to regulators, Vectura or such collaborators may have to conduct additional clinical trials. This would cause delays and result in additional costs in the development of a product and in extreme circumstances a development programme may have to be terminated or suspended on the basis that participants are being exposed to unacceptable health risks.

Even after a pre-clinical or clinical trial is deemed successful or regulatory approval is received, a product may later be shown to be unsafe. In this circumstance, Vectura or its collaborator may be required to conduct additional trials or studies and regulatory approval may be suspended or withdrawn.

Mitigating activities

Vectura and its collaborators conduct extensive pre-clinical and clinical trials, designed to test for and identify any adverse side effects.

In addition, there is a significant amount of safety data available regarding existing marketing products to which our generic products relate.

However, clearly this is a risk inherent in the nature of Vectura's business and adverse side effects may be identified at any time, even after a product has been approved and sold commercially.

Competition

Vectura's business faces intense competition from a range of pharmaceutical and biotechnology companies. Technological changes could overtake the products being developed by Vectura or by its collaborators.

Vectura's competitors in the biotechnology and pharmaceutical industries may have superior research and development capabilities, products, manufacturing capability or sales and marketing expertise. Many of Vectura's competitors have significantly greater financial and human resources and may have more experience in research and development. As a result, Vectura's competitors may develop safer or more effective products, implement more effective sales and marketing programmes or be able to establish superior proprietary positions. In addition, Vectura anticipates that it will face increased competition in the future as new companies enter Vectura's markets and alternative products and technologies become available.

Mitigating activities

Vectura's current royalty generating products are expected to continue to provide royalties until patent expiry or until Vectura is no longer entitled to receive royalties in accordance with a license agreement.

For programmes managed in-house, Vectura has an established project management framework. The potential commercial opportunities for each project are assessed at the end of each stage of the project. Projects are assessed using widely accepted valuation metrics based upon discounted cash flows. These cash flows are discounted using a hurdle rate that is in line with industry standards and the expected return of each project is further risk adjusted by its phase of development. Vectura has experienced development and commercial teams who all contribute to this assessment. This in-house review is supplemented by well-regarded disease area reports and, where appropriate, bespoke market research.

Under this framework, research and development programmes will only be approved by the Board if it can be shown that the expected benefits outweigh the expected costs. All programmes are subject to a stage-gate approval process and in the event that it was no longer considered that the future revenues would be higher than the future costs, the Board would consider terminating or redefining the programme.

Vectura works closely with its advisors and obtains, where necessary, opinions on the intellectual property landscape relevant to the Group's product development programmes and manufacturing activities and processes. In addition, Vectura works with a number of key licensing partners who have significant expertise in the research, development and commercialisation of pharmaceuticals. These licensing partners have access to significant financial and human resources.

Partnerships

Vectura is dependent upon a number of key partners, the loss of any of which could have a material impact on the Group.

At present Vectura has several partnership and licensing agreements and may depend upon single or multiple key partners to assist in future commercialisation of its products. These partners may be unwilling or unable to meet Vectura's future needs. Vectura cannot guarantee that:

- existing collaborative arrangements or licence agreements or agreements with third-party contractors will be able to be maintained; or
- any collaborative arrangements or licence agreements or agreements with third-party contractors will prove successful.

Mitigating activities

All collaborations are performed under a suitable legal agreement which is assessed by Vectura and its external legal advisors.

Typically, for collaborations a Joint Steering Committee (JSC) will be established, which provides a mechanism by which Vectura can ensure that any joint project team activity is managed appropriately within standard project management processes.

An alliance manager is identified for all licensing partnerships or contract research organisation engagements.

Vectura has an established Business Development team which is responsible for negotiating terms with key partners. There is an agreed process for managing the process of entering agreements and this includes appropriate oversight and approval at Board level.

Risks and risk management continued

Strategic risks continued

Commercial success

The products that Vectura and its collaborators bring to market may not be commercially successful.

Vectura may not be able to sell its products profitably if reimbursement from third-party payors, including government and private health insurers, is unavailable or limited.

A significant portion of Vectura's future revenue is likely to depend on payments by third-party payors, including government health administration authorities and private health insurers. As such, Vectura may be adversely affected by third-party reimbursement and healthcare cost containment initiatives.

Vectura may not be able to sell its products profitably if reimbursement from these sources is unavailable or limited. Third-party payors are increasingly attempting to contain healthcare costs through measures that are likely to impact the products Vectura is developing, including:

- challenging the prices charged for healthcare products, limiting both coverage and the amount of reimbursement for new therapeutic products, and denying or limiting coverage for products that are approved by the regulatory agencies but are considered experimental by third-party payors; and
- refusing to provide coverage when an approved drug is used in a way that has not received regulatory marketing approval.

In addition, in many European countries, there has been an increasing trend towards reference pricing, where the amount of reimbursement is determined in light of reimbursement levels for comparable drugs in other European countries, which is likely to severely restrict the potential per unit price for many new drugs unless such drugs can be significantly differentiated from existing products. If products developed by Vectura or its partners are not covered by government or other third-party reimbursement schemes, are reimbursed at prices lower than those expected by Vectura, or become subject to legislation controlling treatments or pricing, Vectura and/or its partners may not be able to generate significant revenue or attain profitability for any product candidates which are approved for marketing.

Mitigating activities

Products may be out licensed to partners who have the expertise to commercialise products and negotiate pricing structures with third-party payors, especially in disease indications that require large sales forces. Should Vectura self-commercialise, this would be targeted commercialisation for niche products with significant unmet need, which require a small sales force to target specialist physicians.

Vectura's business model includes bringing highly innovative products to address unmet needs and the Company is also involved in a number of generics programmes which support government initiatives to reduce costs. This adds balance to our business model in an era of increasing cost containment.

Future acquisitions

Should the Group make further acquisitions, there is a risk that it will fail to identify appropriate investment opportunities or perform sound due diligence.

There is also a risk that any acquired business will not be successfully integrated into the Group.

Mitigating activities

The Board will continue to review all investment opportunities and oversee a rigorous due diligence process. Plans are in place to ensure structured post-acquisition integration is executed successfully.

Operational risks

Commercialisation

The successful development and commercialisation of medicines carries a high level of risk and the returns may be insufficient to cover the costs incurred.

Vectura's competitors in the biotechnology and pharmaceutical industries may have superior research and development capabilities, products, manufacturing capability or sales and marketing expertise. Many of Vectura's competitors have significantly greater financial and human resources and may have more experience in research and development. As a result, Vectura's competitors may develop safer or more effective products, implement more effective sales and marketing programmes or be able to establish superior proprietary positions. In addition, Vectura anticipates that it will face increased competition in the future as new companies enter Vectura's markets and alternative products and technologies become available.

Mitigating activities

The Group performs detailed reviews of the development process and progress of projects through trials.

Where appropriate, the Group looks to mitigate the development and commercial risk of its product pipeline by partnering drug candidates at an appropriate stage. The partnering event crystallises part of the programme's value, with the goal of retaining an attractive proportion of the commercial upside through future milestones and an ongoing royalty interest from commercial sales.

As explained above, programmes which are managed in-house are assessed using widely accepted valuation metrics based upon discounted cash flows. These cash flows are discounted using a hurdle rate that is in line with industry standards and the expected return of each project is further risk adjusted by its phase of development. Vectura has experienced development and commercial teams who all contribute to this assessment. This in-house review is supplemented by well-regarded disease area reports and, where appropriate, bespoke market research.

Product liability

In carrying out its activities Vectura will potentially face contractual and statutory claims, or other types of claim from customers, suppliers and/or investors.

Vectura is exposed to potential product liability risks that are inherent in the research, the pre-clinical and clinical evaluation, pre-clinical study, clinical trials, manufacturing, marketing and use of pharmaceutical products. Consumers, healthcare producers or persons selling products based on Vectura's and its collaborators' technology may be able to bring claims against Vectura based on the use of such products in clinical trials and the sale of products based on Vectura's technology.

Mitigating activities

Vectura maintains an appropriate level of product liability insurance and operates quality systems relating to the manufacture of products. Vectura has a pharmacovigilance system to monitor safety events arising with respects to products sold.

Vectura's insurance portfolio also includes other third-party liability insurances which would provide cover in the event of certain other contractual or statutory claims.

Intellectual property

The Group and its collaborators may be unable to successfully establish and protect intellectual property which is significant to the Group's competitive position.

Certain companies are developing medicines that may restrict the potential commercial success of Vectura's products or render them obsolete. Third-party companies may have intellectual property that restricts Vectura's or Vectura's partners' freedom to operate. Obtaining licences to intellectual property may not be possible or may be costly and may reduce net royalty income to Vectura. Vectura's intellectual property may become invalid or expire before its products are successfully commercialised.

Vectura's success depends in part on its ability to obtain and maintain protection for its inventions and proprietary information, so that it can prevent others from making, using or selling its inventions or proprietary rights.

There is a significant delay between the time of filing of a patent application and the time its contents are made public, and competitors may have filed patent applications for subject matter covered by the Group's pending patent applications without the Group being aware of those applications.

To develop and maintain its competitive position, the Group also relies upon unpatented trade secrets and improvements, unpatented know-how and continuing technological innovation.

Generic drug manufacturers, particularly in the US, may seek marketing approval for pharmaceutical products currently under patent protection by attacking the validity or enforceability of a patent. The more successful the product is commercially, the more likely the patent covering the product will be challenged by generic manufacturers. If such a challenge is successful the product could be exposed to generic competition before the expected expiration date of the patent. This could have a material effect on Vectura's revenues and results.

Mitigating activities

Vectura owns a portfolio of patents and patent applications and is the authorised licensee of other patents.

The Group works closely with its legal advisors and obtains, where necessary, opinions on the intellectual property landscape relevant to the Group's product development programmes and manufacturing activities and processes.

The Group ensures that patent applications are filed in a timely manner and are monitored closely to ensure that the result of any application is acted upon as soon as possible.

Reasonable security measures are adopted to protect this unpatented property, including confidentiality agreements with collaborators, consultants and employees.

Risks and risk management continued

Financial risks

Financial operations

Foreign exchange rate fluctuations may adversely affect Vectura's results of operations and financial condition.

Vectura records its transactions and prepares its financial statements in pounds sterling, but a substantial proportion of Vectura's income from collaborative agreements is received in euros and US dollars. Furthermore, Vectura incurs a proportion of its expenditure in euros, US dollars and other currencies.

Vectura's cash balances are predominantly held in pounds sterling. To the extent that Vectura's foreign currency assets and liabilities are not matched, fluctuations in exchange rates between pounds sterling, the US dollar and the euro may result in realised or unrealised exchange gains and losses on translation of the underlying currency into pounds sterling that may increase or decrease Vectura's results from operations and may adversely affect Vectura's financial condition, each as stated in pounds sterling. In addition, if the currencies in which the Group earns its revenues and/or holds its cash balances weaken against the currencies in which it incurs its expenses, this could adversely affect Vectura's profitability and liquidity.

Mitigating activities

Where known liabilities arise in these currencies the revenues are retained on deposit in the appropriate currency in order to offset the exchange risk on these liabilities. As at 31 March 2014, the Group had sufficient euro and US dollar reserves to cover its immediate and short-term liabilities in respect of these currencies.

Where a substantial net foreign currency liability exists, Vectura will consider hedging against it to minimise foreign currency expense. However, such hedging is based on estimates of liabilities and future revenues and will not fully eliminate future foreign currency exchange fluctuations.

Liquidity

The Group may be exposed to credit or liquidity risk.

The Group's credit and liquidity risk is primarily attributed to its cash and cash equivalents. With the current economic uncertainty, failure of an institution which the Group uses to hold cash deposits would have a material impact on the Group's ability to continue as a going concern.

Mitigating activities

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

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

The Strategic report, which comprises pages 7 to 38, has been approved and signed on behalf of the Board.

Dr Chris Blackwell
Chief Executive
20 May 2014

Corporate governance
Introduction from Chairman

Dear shareholder

On behalf of the Board, I am pleased to present the Governance report for the year ended 31 March 2014. I hope this report provides a clear and meaningful overview of how the Board and its sub-committees discharge their governance duties and apply the principles of good corporate governance as set out in the UK Corporate Governance Code ("the Code").

As a Board, we have a collective responsibility to set the governance framework for Vectura and to ensure that our strategy is aligned with the long-term interests of our shareholders. We believe that an effective governance framework is the foundation of a successful organisation and should be based upon an appropriate level of oversight, clear communication and transparency. In all this, our main focus is always the overall health and prosperity of the business. Throughout the financial year, Vectura has maintained its commitment to good corporate governance practices and I am pleased to report that throughout the year, and to the date of this report, the Group has fully complied with the principles and provisions set out in the Code.

There have been two changes to the membership of the Board during the year. In July 2013, Anne Hyland stepped down as Chief Financial Officer after eleven years of service. Paul Oliver was appointed as Anne Hyland's successor. In November 2013, Jack Cashman announced his intention to retire as Chairman of Board. Jack had served with distinction as Chairman since 2001 and he was integral to the successful development of Vectura since that time. The Board engaged the services of the executive search agency to assist in identifying potential suitable candidates to replace Jack. Following this external recruitment process, I was privileged to be appointed as Non-Executive Chairman effective 1 February 2014. I endeavour to make an enthusiastic contribution to your Board and to help support Vectura through the next stage in its development.

The annual Board performance evaluation was conducted internally during the year and, following this process, it was concluded that the individual members of the Board are effective in their roles and that they have the necessary skills and expertise to fulfil their duties. Details of the evaluation process and the outcome can be found on page 46 of this report.

Finally, I would like to take this opportunity to encourage all shareholders to attend our Annual General Meeting (AGM) on 19 September 2014. As usual, all of Vectura's Directors will be in attendance and will be available to meet investors.

B. Angelici

Bruno Angelici
Chairman
20 May 2014

Board of Directors

Bruno Angelici R N
MBA

Role
Non-Executive Chairman

Experience
Bruno Angelici, 66, was appointed to the Board of Vectura Group on 1 December 2013 and became Non-Executive Chairman on 1 February 2014. Bruno Angelici is a French national with an MBA (Kellogg School of Management) and business and law degrees from Reims.

Bruno Angelici's career includes senior management roles in pharmaceutical and medical device companies. Bruno Angelici retired from AstraZeneca in 2010 as Executive Vice President International after a 20-year career. He was responsible for Europe, Japan, Asia Pacific, Latin America, Middle East and Africa having originally joined as President of ICI Pharma France. Prior to this, he was at Baxter, a US-based global supplier of medical devices. He has extensive international experience, including in the US, and brings a deep understanding to the Company of the medical device and pharmaceutical industries.

Bruno Angelici is a Non-Executive Director of Smiths Group plc, a FTSE 100 technology group, and Novo Nordisk A/S, a global healthcare company and world leader in diabetes care. He is also a member of the Global Advisory Board of Takeda Pharmaceutical Company Ltd Japan, the largest pharmaceutical company in Asia, and a member of the Supervisory Board of Wolters Kluwer NV, a global information services and publishing company.

Chris Blackwell
BSc, PhD

Role
Chief Executive and Executive Director

Experience
Dr Chris Blackwell, 52, was appointed Chief Executive of Vectura in February 2004. He joined the Group in 2002 as Chief Operations Officer and Executive Director.

Having graduated with a first class honours degree in applied biology, Chris Blackwell received a PhD for his work at the University of Bath. Throughout both degrees, Chris Blackwell was sponsored by ICI Pharmaceuticals (now AstraZeneca), and worked in the fields of respiratory and cardiovascular diseases.

Prior to Vectura, Chris Blackwell was Executive Director of Drug Development at Scotia Pharmaceuticals Ltd. He was previously at Hoffmann-La Roche, where he was UK Director, Global Project Management, and before that, at Glaxo Group Research Ltd., in the Department of Clinical Pharmacology.

Paul Oliver
BA, FCCA

Role
Chief Financial Officer and Company Secretary

Experience
Paul Oliver, 36, was appointed Chief Financial Officer and Company Secretary of Vectura in July 2013. Paul Oliver joined Vectura in September 2006 and was appointed Group Financial Controller in 2007. In this role Paul Oliver was responsible for managing Vectura's finances and working closely with Vectura's Leadership Team and the Board on all aspects of operations and strategy development. Having worked on the successful acquisition of Innovata plc, he played a key part in its integration and subsequent restructuring.

Before joining Vectura, Paul Oliver worked in professional practice as an audit manager and he gained exposure to business advisory and corporate tax work. Paul Oliver has a degree in accounting and is a Fellow of the Association of Chartered Certified Accountants.

Trevor Phillips
BSc, PhD, MBA

Role
Chief Operations Officer and President of US Operations

Experience
Dr Trevor Phillips, 53, joined the Board of Vectura in June 2012. He was appointed Chief Operations Officer in July 2011, having joined the Company in January 2010 as President of US Operations.

Trevor Phillips has a BSc in microbiology from the University of Reading and a PhD in microbial biochemistry from the University of Wales. He was awarded an MBA from Henley Management College in 1997.

Prior to joining Vectura he gained extensive international experience in organisational leadership, management and pharmaceutical drug development in a number of senior roles, including positions as CEO and President of the US publicly held company, Critical Therapeutics Inc, following six years as the company's Chief Operating Officer. During his time at Critical Therapeutics, Trevor Phillips was involved in setting up commercial partnerships, product in-licensing and out-licensing, managing drug development and NDA filings, commercial product manufacturing and mergers and acquisitions. Between 1986 and 2002 Trevor Phillips held a number of management positions at Sepracor, Scotia Pharmaceuticals, Accenture, GlaxoWellcome Research and Development and Simbec Research Limited.

John Brown R N A
CBE, PhD, MBA, FRSE

Role
Non-Executive Director
and Senior Independent Director

Experience
Dr John Brown, 59, joined the Board of Vectura as Non-Executive Director and Senior Independent Director in 2004 and chairs the Nomination Committee as well as being a member of the Remuneration Committee. John Brown is Chairman of CXR Biosciences Ltd, Mode Diagnostics Ltd, The Cell Therapy Catapult and the Roslin Foundation. He also chairs the Life Science Advisory Board for the Scottish government. He was previously Chairman of BTG plc and Axis-Shield plc. Until late 2003, John Brown was Chief Executive of Acambis plc, a leading producer of vaccines to treat and prevent infectious disease. John Brown is an Honorary Professor of Edinburgh University and is a Fellow of the Royal Society of Edinburgh.

Susan Foden R N A
MA, DPhil

Role
Non-Executive Director

Experience
Dr Susan Foden, 61, joined the Board of Vectura as a Non-Executive Director in January 2007. She chairs the Remuneration Committee and is a member of the Audit and Nomination Committees. She holds a number of Non-Executive Directorships with both public and private companies in the biotech and healthcare field, including Source Bioscience plc, Cizzle Biotechnology Ltd, BerGenBio AS and Evgen Ltd. Prior to this Susan Foden held positions in venture capital and UK biotech companies. From 2000 to 2003 she was an Investor Director with the London-based venture capital firm Merlin Biosciences Limited, and was Chief Executive Officer of the technology transfer company Cancer Research Campaign Technology Ltd from 1987 to 2000. She studied biochemistry at the University of Oxford from where she obtained an MA and a DPhil.

Neil Warner R N A
BA, FCA, MCT

Role
Non-Executive Director

Experience
Neil Warner, 61, joined the Board of Vectura as Non-Executive Director in February 2011 and is Chair of the Audit Committee. Neil Warner has significant financial and managerial experience in multi national businesses. Neil Warner is the Non-Executive Chairman of Enteq Upstream plc, a specialist reach and recovery products and technologies provider to the upstream oil and gas services market. He was Finance Director at Chloride Group plc, a position he held for 14 years until the company's acquisition by Emerson Electric. Prior to this, he spent six years at Exel plc (formerly Ocean Group plc and acquired by Deutsche Post in December 2005) where he held a number of senior posts in financial planning, treasury and control. He has also held senior positions in Balfour Beatty plc (formerly BICC Group plc), Alcoa and PricewaterhouseCoopers and was a Non-Executive Director of Dechra Pharmaceuticals plc where he was the Senior Independent Director and Chair of the Audit Committee. Neil Warner has an economics degree from the University of Leeds and is a Fellow of the Institute of Chartered Accountants.

Committee membership
- R Remuneration Committee
- N Nomination Committee
- A Audit Committee

Executive management

Karl Keegan
BSc, MPhil, PhD, MSc

Role
Chief Corporate Development Officer

Experience
Dr Karl Keegan, 47, joined Vectura in September 2012 and is an Irish national who has worked in the healthcare industry for over 20 years.

Karl Keegan has a BSc in pharmacology from University College Dublin, an MPhil and PhD in pharmacology from the University of Cambridge and a masters degree in finance from the London Business School. Following postdoctoral research work at Baylor College of Medicine, Houston, Texas, Karl Keegan joined SmithKline Beecham as a bench scientist and later moved to a strategic commercial role within the Neuroscience Strategic Product Development team.

Upon leaving the pharmaceutical industry, Karl Keegan became one of the leading financial analysts covering the biotechnology industry on a global basis. His most recent analyst role was at Canaccord Adams, as Managing Director, UK Head of Equity Research and Global Head of Life Sciences Research. Prior to joining Vectura in 2012, he was CFO of Minster Pharmaceuticals, a publicly listed UK company, and most recently CFO of Pharming Group, a Dutch biotech company listed on Euronext.

Roger Heerman
BS, MBA

Role
Chief Commercial Officer

Experience
Roger Heerman, 41, joined Vectura in 2010 and was appointed Senior Vice President, Commercial Strategy in 2013. Prior to joining Vectura, he gained extensive US and international commercialisation experience in a number of senior roles including VP Sales and Marketing of the US publicly held company Critical Therapeutics, Inc. and as VP, Director of Client Service at McK Healthcare.

At Critical Therapeutics, he was responsible for the build-out of the commercial infrastructure and the launch of ZYFLO CR in the United States. At McK Healthcare, Roger Heerman supported the launch and repositioning efforts of numerous US and global brands including UCB's Neupro® for Parkinson's disease and IROKO's Aggrastat® for acute coronary syndrome.

Roger Heerman began his career in the pharmaceutical industry as a sales representative in the respiratory division at GlaxoSmithKline. He received his BS from Babson College and his MBA from the F.W. Olin School of Business at Babson College.

Gerhard Scheuch
PhD

Role
Chief Scientific Officer

Experience
Dr. Gerhard Scheuch, 58, joined Vectura in March 2014 as part of the Activaero GmbH acquisition and was appointed to his new role of Chief Scientific Officer on 1 May 2014. Gerhard Scheuch completed his PhD in physics at the GSF National Research Center for Environment and Health with a thesis on "Dispersion, Deposition and Clearance of Aerosol Particles in the Human Airways". He then spent time at the Helmholtz Center for Health and Environment in Frankfurt and Munich where his main research interests were related to aerosol particle deposition and mucociliary clearance.

In 1998, Gerhard Scheuch founded Activaero GmbH as INAMED GmbH in Gauting. Gerhard Scheuch has held a number of society appointments (eg. President of ISAM from 2009 to 2011) and won several awards. He has published over 150 scientific articles on aerosol and lung research. He was appointed as a member of a committee at the EMA (European Medical Agency) to develop guidelines on orally inhaled products (OIP-Guideline) and he is a member of the expert panel of the EMA.

Corporate governance report

Compliance with the UK Corporate Governance Code

The UK Corporate Governance Code ("the Code") sets out the standards of good practice in relation to corporate governance to be applied by companies with a listing on the London Stock Exchange. A copy of the Code can be found on the Financial Reporting Council's website (www.frc.org.uk).

The principles and provisions of the Code cover five areas: leadership of the Company, effectiveness of the Board, accountability of the Board, remuneration and relations with shareholders. This report sets out how Vectura has applied the main principles of the Code.

The Board confirms that Vectura has fully complied with the principles and provisions set out in the Code throughout the year under review.

Leadership

The role of the Board

The Board is collectively responsible for the leadership, direction and long-term success of the Group. As part of the corporate governance framework, the Board has adopted a schedule of matters which are reserved for its review. Matters reserved for review by the Board include the approval of Group business and strategic plans, financial statements and budgets, significant acquisitions and disposals, significant capital expenditure, dividends and Board appointments.

At each meeting, the Board reviews strategy and progress of the Group towards its objectives, particularly in respect of research and development projects, and monitors financial progress against budget.

The Board delegates day-to-day responsibility for managing the Group to the Executive Management Team ("the EMT"), which normally has eight to ten formal meetings during the year. In addition, the EMT holds weekly update calls. The EMT is responsible for developing the strategy approved by the Board and, in particular, is responsible for ensuring that the Group's budget and forecasts are properly prepared, that targets are met and for managing and developing the business within the overall budget. Variations from the budget and changes in strategy require the approval of the Board.

The EMT is made up of the Chief Executive, the Chief Financial Officer, the Chief Operations Officer, the Chief Corporate Development Officer, the Chief Commercial Officer and the Chief Scientific Officer. Brief biographies of the EMT members are set out on pages 40 and 42. Other senior operational personnel also attend meetings of the EMT as appropriate.

Board composition

The Board is currently composed of seven Directors, three Executive Directors and four Non-Executive Directors. The biographies of the Directors are set out on pages 40 and 41. Particular attention is directed during the appointment process to ensuring that individual Directors have a wide range of experience within the industry and that the Board displays the necessary balance of skills necessary to deliver the Group's strategy.

Throughout the year ended 31 March 2014 and to the date of the publication of this report, at least half of the Board, excluding the Chairman, was comprised of Non-Executive Directors determined by the Board to be independent.

The roles of the Chairman and Chief Executive are separate, with a clear division of responsibilities between them. This division of responsibilities has been set out in writing and agreed by the Board.

Chairman

The Chairman, Bruno Angelici, is responsible for leadership of the Board and for ensuring its effectiveness in all aspects of its role, in particular creating the conditions for overall Board and individual effectiveness by:

- providing a sounding board to the Chief Executive;
- setting the agenda, style and tone of Board meetings;
- ensuring that the Board plays a full and constructive part in the development of corporate strategy;
- ensuring the highest standards of leadership and governance at Board level;
- ensuring that the performance of the Board, its committees and individual Directors are formally evaluated each year; and
- ensuring effective communications with shareholders.

The Chairman works closely with the Chief Executive to ensure that the strategies and actions agreed by the Board are implemented. Non-Executive Directors (NEDs) are encouraged to meet the Chairman without the presence of Executive Directors, as appropriate. Such meetings between the Chairman and the Non-Executive Directors took place during the year and included discussions relating to each Executive Director's performance.

Chief Executive

The Chief Executive, Chris Blackwell, is responsible for developing the Group's long-term strategic direction and commercial strategy for consideration and approval by the Board, and for implementing the agreed strategy. He is also responsible for fostering good relations with key stakeholders and ensuring effective communications with shareholders and analysts. His responsibilities extend to ensuring the effective day-to-day management of the Group. He is supported in his role by other members of the EMT.

Senior Independent Non-Executive Director

John Brown has been appointed as the Senior Independent Director. The Senior Independent Director is responsible for performing an annual review of the performance of the Chairman and he is available to act as an intermediary for Directors, if necessary. The Senior Independent Director is available to shareholders if they have concerns that cannot be resolved through the normal channels of Chairman, Chief Executive or Chief Financial Officer.

John Brown is the Chairman of the Nomination Committee and he is also a member of the Audit and Remuneration Committees.

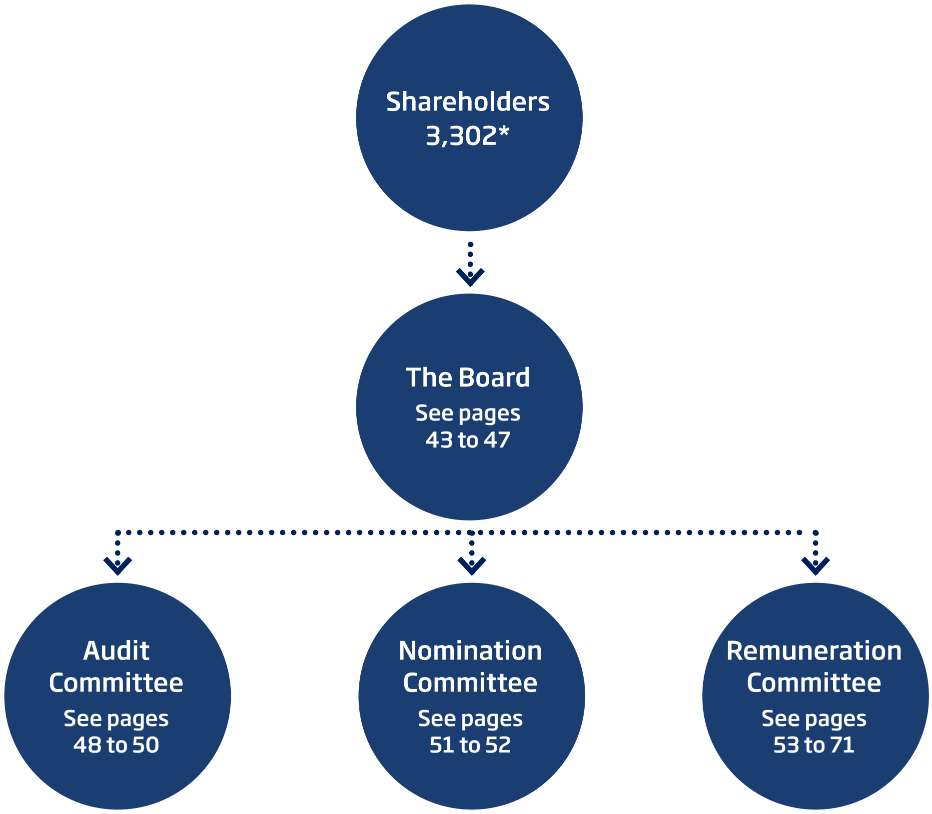
Non-Executive Directors

The role of the Non-Executive Directors is to bring independent judgement to Board deliberations and decisions. In addition, the Non-Executive Directors supervise the corporate governance arrangements of the Group. Vectura's Non-Executive Directors are all experienced and influential individuals and their skills and expertise facilitate the effective functioning of the Board, ensuring that all relevant matters are fully debated and that no one individual can dominate the Board's decision-making process.

Biographies of the Non-Executive Directors can be found on pages 40 to 41.

Corporate governance report continued
Compliance with the UK Corporate Governance Code continued

Leadership continued
Board committees
The Board has delegated some of its responsibilities to a number of Board committees, as shown in the governance framework diagram below:



* At 14 May 2014.

Each Committee has full terms of reference, which have been approved by the Board and which can be found on Vectura's website, www.vectura.com.

For details of the current constitution of each Committee, details of attendance and each member's tenure please refer to the individual Committee reports shown on the pages referenced above.

Board meetings
The Board plans formal meetings on a bi-monthly basis, with further meetings being called when circumstances or urgent business dictate. Additional meetings may be held via conference call.

The Board met twelve times during the year. Details of Directors' attendance at these meetings are set out below. In the event that a Director is unavailable to attend a Board meeting, or to attend by telephone link, he or she can communicate their views on any item to be raised at the meeting through the Chairman.

Bruno Angelici was unable to attend two of the Board meetings held whilst he was a Non-Executive Director. This was due to prior commitments, which were fully disclosed to the Board prior to his appointment.

	Meetings attended whilst the Director was a Board member	Meetings held whilst the Director was a Board member
Jack Cashman	9	9
Bruno Angelici (Chair)	4	6
Chris Blackwell	12	12
Trevor Phillips	12	12
Paul Oliver	10	10
Anne Hyland	0	2
John Brown	12	12
Neil Warner	12	12
Susan Foden	12	12

Bruno Angelici separately attended Vectura's Head Office on several occasions to hold meetings with management to ensure that he was fully informed about the matters discussed during the relevant meetings.

Anne Hyland was unable to attend the two Board meetings held whilst she was an Executive Director. This was due to commitments relating to the Chinese joint venture Kinnovata.

Board agenda

The Board is focused on driving our strategy, monitoring risk and the progress against previously agreed strategy by regular business, financial and departmental updates. The culture of the Board meetings is one of rigorous debate, where the Non-Executive Directors challenge management's performance in achieving previously agreed goals and objectives. In addition, the Board meets on an informal basis to provide the opportunity for more extended discussions on strategic issues.

The Board's main activities during the year are described below:

- appointment of Bruno Angelici as Non-Executive Director and Chairman Designate;
- appointment of Paul Oliver as Chief Financial Officer and Company Secretary;
- approval of the acquisition of Activaero GmbH;
- approval of further placing of Vectura Group plc shares to fund the enlarged pipeline of the Group;
- regular updates on business performance and market conditions;
- review of project and pipeline progress;
- approval of the budget for FY 14/15;
- review of progress against the approved budget for FY 13/14;
- internally facilitated review of Board effectiveness; and
- approval of the corporate goals.

Effectiveness

Independence

The Board has determined that at least half of the Board, excluding the Chairman, is comprised of independent Non-Executive Directors.

The holding of share options by Non-Executive Directors could be, amongst other things, relevant in determining whether a Non-Executive Director is independent. As explained in previous Annual Reports, prior to its listing on the Alternative Investment Market (AIM) on 2 July 2004, in addition to the payment of fees, the Group remunerated Non-Executive Directors with options to acquire shares in Vectura. At the time that the awards were granted, it was essential for an emerging pharmaceutical company such as Vectura to secure the recruitment and retention of Non-Executive Directors with the appropriate experience and international perspective in the context of the Group's then stage of development. No performance criteria were attached to these options and no share options have been granted to Non-Executive Directors since the Company's admission to AIM. As such, the Board considers that the historic granting of share options to Non-Executive Directors while the Company was a private company was appropriate.

Whilst the Code discourages the granting of share options to Non-Executive Directors, it nevertheless acknowledges that such grants may be appropriate in a particular company's circumstances. Of the Non-Executive Directors awarded share options only John Brown now holds outstanding options, as detailed in the Remuneration report on page 69. These options are now exercisable and thus similar to holding an equivalent number of shares. After detailed consideration, the Board has determined that it does not believe the holding of share options by John Brown impacts on his independence in character or judgement. There is no intention to award any further options to any Non-Executive Director.

Other factors that may reflect on the independence of a Non-Executive Director include any material business relationships with the Group. There were no such relationships during the year up until the date of this report, or in the prior year.

The Code indicates that serving more than nine years as a Non-Executive Director could be relevant to the determination of a Non-Executive Director's independence. Notwithstanding the fact that John Brown has been a Non-Executive Director for in excess of nine years, the Board, having rigorously evaluated his performance, considers that he continues to be fully independent in character and judgement when discharging his duties and responsibilities.

In accordance with the requirements of the UK Corporate Governance Code, the Committee confirms that Bruno Angelici was independent upon his appointment to the Board, and he continues to be independent.

Board appointments and succession

There are formal, rigorous and transparent procedures for the appointment of new Directors to the Board. Shortlisted candidates are interviewed by the Chairman of the Board and by the individual members of the Nomination Committee. Evaluations of appropriate candidates are then circulated to all members of the Nomination Committee for consideration, before a recommendation is made to the Board.

Diversity

The Board recognises the importance of diversity within all levels of the Group and it recognises that the Group, its shareholders and other stakeholders are best served by a Board which is diverse in skills, experience, and background, including gender. Diversity is considered when making appointments to the Board; however any appointments are ultimately made on merit against agreed selection criteria.

Induction and development

It is vital that Directors have a full understanding of the Group and its operations. Therefore, upon appointment each Director undergoes a formal induction programme, which includes briefing materials tailored to his or her particular Board responsibilities. New Directors meet with Board members and executive management as part of their induction process and tours of the Group's main facilities are scheduled to provide them with the opportunity to meet with operational management.

All Directors have access to the advice and services of the Company Secretary, who ensures that Directors take independent professional advice, at Vectura's expense, when it is judged necessary in order for them to discharge their responsibilities.

Corporate governance report continued
Compliance with the UK Corporate Governance Code continued

Board appointments and succession continued
Induction and development continued
Directors also receive regular updates on changes and developments within the business as well as information regarding legislative and regulatory changes. During the annual Board effectiveness review, all Directors are encouraged to identify any further training requirements which they feel would assist them in discharging their duties.

Information and support
To enable the Board to function effectively and to assist Directors in discharging their responsibilities, full and timely access is given to all relevant information. In the case of Board meetings, this consists of a formal agenda and a comprehensive set of papers including regular business progress reports. An established procedure is in place to ensure that such information is provided to Directors in a timely manner in advance of meetings.

In addition, the Executive Directors ensure regular informal contact is maintained with the Non-Executive Directors.

Performance evaluation and re-election
The Board has a process for evaluating its own performance and that of its committees and individual Directors, including the Chairman. These evaluations are carried out formally once a year, and informally on a regular basis throughout the year. The formal evaluation is through an appraisal process. In line with the practice of previous years, a consultant prepared and circulated a questionnaire for all Board members to answer and comment upon specific questions covering specific topics. These included the responsibilities and the roles of individual Directors and the Board as a whole, the conduct of Board meetings and Committees of the Board, the Board's role in monitoring the performance of the Group and corporate governance practices. A detailed, anonymised analysis of the replies to the questionnaire, together with conclusions drawn from such analysis, was prepared by the consultant and considered by the Board.

This evaluation took place during the year, and it was concluded that the Board remained effective and that individual members of the Board have the necessary skills and expertise to discharge their responsibilities. The evaluation also found that the Board's size supports close dialogue between Executive and Non-Executive Directors. It was noted that the Board has both formal and informal meetings, and this balance provides the dynamics for an effective Board.

All Directors have service agreements with indefinite terms, with twelve months' notice for Executive Directors, three months' notice for Non-Executive Directors and six months' notice in the case of the Chairman.

Directors are subject to election by shareholders at the first opportunity following their appointment, and to re-election at intervals of no more than three years thereafter. In accordance with the Code, Non-Executive Directors who have served more than nine years on the Board are subject to annual re-election by shareholders.

The performance of Bruno Angelici who is proposed for election and the performances of John Brown, Susan Foden and Trevor Phillips, who are being proposed for re-election, at the Annual General Meeting (AGM), have been evaluated and it has been determined that they continue to perform effectively and show full commitment to their roles on the Board.

Accountability
The Board is committed to providing a fair, balanced and understandable assessment of the Company's position and prospects. For information regarding the Directors' responsibility to prepare financial statements, please refer to the Statement of Directors' responsibilities on page 74. The Independent auditor's report includes a statement by the auditor on his reporting responsibilities.

The measures in place to ensure the auditor's independence are set out in the Audit Committee report on page 50.

The Board has overall responsibility for the Group's system of internal control and risk management and for reviewing its effectiveness. In discharging that responsibility, the Board confirms that it has established the procedures necessary to comply with the Code. Employees are required to follow clearly defined internal procedures and policies appropriate to the business and their position within the business. These procedures are regularly reviewed by the Board.

Risk management
Vectura adopts a robust risk management process, which is reviewed on a regular basis. This process is outlined on page 33 of this report. Such a process is designed to manage rather than eliminate the risk of failure to achieve business objectives and can provide only reasonable and not absolute assurance against material misstatement or loss. The concept of reasonable assurance recognises that the cost of a control procedure should not exceed the expected benefits. The significant risks identified are documented on pages 34 to 38 of this Annual Report.

Internal control
The Group's internal controls are regularly reviewed as part of the risk management process. The Audit Committee reviews the Group's internal financial control system on an annual basis and makes recommendations to the Board regarding any improvements that are required. The Board also carries out reviews of the non-financial control systems.

The Group's key systems of internal control include:

- Organisational structure: The Group's organisational structure has clearly established responsibilities and lines of accountability. The Group endeavours to appoint employees with appropriate skills, knowledge and experience for the roles they undertake.
- Documented policies and procedures:
  - The Group has documented quality procedures to ensure the maintenance of regulatory compliance. These are subject to periodic review to ensure current standards of quality compliance are maintained. A quality group monitors compliance with good laboratory practice, good clinical practice and good manufacturing practice through the implementation of a compliance programme for in-house and contracted-out activities.
  - The Group has a formal Health and Safety Committee comprising appropriate members of management and other employees to be responsible for these issues.
  - The Group has formal procedures to ensure appropriate security of documents and proprietary information.
  - The Group has a formal policy in place regarding share dealing in Vectura Group plc shares by employees and their connected persons.

- Budgeting process: The Group has a comprehensive financial planning and accounting framework which includes a robust budgeting and forecasting system. Detailed monthly management accounts are prepared and reports are provided to the Board showing actual results against budget and forecast results, highlighting and explaining significant variances. Variance reports are also provided to, and discussed with, the budget manager.
- Financial reporting processes: The Group has specific controls in place regarding the production of consolidated financial information. This includes operational procedures and validation and review of information.
- Authorisation of expenditure levels: The Group has clear requirements for the approval and control of expenditure. Material or strategic investment decisions are subject to formal approval by the Board. Day-to-day expenditure is controlled using predetermined authorisation limits which are approved by the EMT in accordance with tolerance limits agreed with the Board.
- Whistleblowing policy: the Group has a formalised whistleblowing policy which is available to all staff via the intranet. This policy provides a mechanism through which staff of the Group may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters.

There have been no significant internal control failings or weaknesses throughout the year ended 31 March 2014 and up to the date of publication of this report.

Remuneration

The Board has adopted remuneration policies that are considered sufficient to attract, retain and motivate Executive Directors of the quality required to manage the Company successfully. Remuneration packages are structured in such a way as to link rewards to corporate and individual performance. For further details, please refer to the Remuneration report set out on pages 53 to 71.

Relations with shareholders

Shareholder relations

The Board recognises the importance of regular dialogue with shareholders and regular meetings between institutional shareholders and Executive Directors are held throughout the year. The Chief Executive and the Chief Financial Officer give annual and half-yearly presentations to institutional investors, analysts and the media. The Group also arranges periodic site visits where appropriate.

Vectura's brokers collate anonymous feedback after investor presentations. This feedback is then circulated to the Board for its consideration. Through this programme of regular dialogue, the Executive Directors and the Board are able to develop an understanding of shareholder views and objectives and create a mutual understanding of the Company's strategy.

All meetings with shareholders are held in such a way as to protect price sensitive information that has not already been made generally available to the Company's shareholders and similar guidelines apply to communications between the Company and other parties, such as financial analysts, brokers and the media.

In addition, all NEDs have developed an understanding of the views of shareholders through corporate broker briefings and review of issued analyst notes. The Chairman seeks to meet with major shareholders on a regular basis and Non-Executive Directors meet with major shareholders as required. Bruno Angelici attended a number of institutional shareholder meetings during the year, and this provided an opportunity for a number of Vectura's major shareholders to meet with him prior to his appointment as Chairman on 1 February 2014.

Where material changes in respect of remuneration schemes or governance structures are proposed, the Board seeks to consult with its major shareholders before implementing such changes.

The Company views its website (www.vectura.com) as an important investor relations tool, particularly for private investors. In line with best practice, the website is regularly updated, ensuring that information relating to the Group and its activities is easily accessible. The website provides an overview of the business including its strategy, products and objectives.

All periodic reports and accounts are made available to shareholders on the website and paper copies are mailed to those shareholders who have elected to receive them. Separate announcements of all material events are made as necessary by press release. All such announcements are published on the website without delay along with webcasts of both the Interim and Annual Report presentations. The terms of reference of each of the Board's three committees and certain corporate governance documents are also published on the Group's website.

Private shareholders are encouraged to express their views and concerns either in person at the AGM or by e-mail using the links provided on the Group's website.

Constructive use of the AGM

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

Notice of the meeting is posted to shareholders not less than 20 working days prior to the date of the AGM. The information sent to shareholders includes a summary of the business to be covered at the AGM, where a separate resolution is prepared for each substantive matter. Results of voting at the AGM are posted on the Group's website as soon as they are available.

Audit Committee report

Dear shareholder

On behalf of the Board, I am pleased to present Vectura's Audit Committee report for the year ended 31 March 2014.

A number of updates have been made to the UK Corporate Governance Code ("the Code") and these changes came into effect for Vectura during the 2013/14 financial year. The Committee is very supportive of the latest revised Code, and we believe that it allows the Audit Committee to further strengthen its role as the key independent oversight Committee at Vectura and to add value to the Group and its operations. This report highlights how the Committee has discharged its responsibilities as set out in the Code.

I hope you will find this report helpful in understanding the work of the Committee.

Neil Warner
Chair of the Audit Committee
20 May 2014

Role and responsibilities

The Audit Committee ("the Committee") operates under written terms of reference, which are modelled on the Code and are available on the Company website, www.vectura.com. Following updates to the Code, the Board requested that the Committee advise it as to whether the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Group's performance, business model and strategy. The Committee's terms of reference were amended to reflect this requirement.

The Committee reviews the annual and half-year financial statements and interim management statements. In reviewing these reports, the Committee considers whether the accounting policies applied during the preparation of the information are consistent year on year and whether the disclosures made are appropriate, complete and in compliance with the relevant financial reporting standards, corporate governance standards and regulatory requirements. The Committee also considers the significant areas in which judgement has been applied in the preparation of the financial statements. In fulfilling this role, it supports the Board in discharging its responsibilities in relation to the Group's external financial reporting and similar announcements.

The Committee manages the relationship with the external auditor on behalf of the Board. During the year, the Committee reviews and monitors the independence of the external auditor and considers the effectiveness of the external audit process. In addition, the Committee is responsible for developing and implementing the Group's policy on non-audit services. The Committee makes recommendations to the Board regarding the appointment and, where appropriate, reappointment of the external auditor and it approves the external auditor's terms of engagement. On an annual basis, the Committee will consider the need for an internal audit function and will make recommendations to the Board accordingly.

The Committee is responsible for reviewing the effectiveness of the Group's financial risk management and internal control systems.

The Chairman of the Committee reports to the Board on all significant matters reviewed by the Committee.

The Committee has access to the external auditor, and if considered necessary, it is authorised to obtain external professional advice including, without limitation, legal and accounting advice to assist in the performance of its duties. No such advice has been sought during the year.

Membership and meetings

In accordance with the Code, the Audit Committee comprises three independent Non-Executive Directors, Neil Warner, John Brown and Susan Foden. All members have the necessary overview of the Group's business and financial dynamics and the risks facing the Group.

The Committee is chaired by Neil Warner, who is a Fellow of the Institute of Chartered Accountants with significant recent and relevant financial experience. Details of Neil Warner's financial experience are set out in his biography on page 41.

The Group Company Secretary acts as Secretary to the Committee. The Executive Directors also attend Committee meetings at the invitation of the Chairman. The Committee meets with the external auditor at least twice a year without management being present. The Committee Chairman keeps in touch, as required, with the key people involved in the Group's governance, including the Chairman of the Board, the Chief Executive, the Chief Financial Officer and the external audit lead partner.

The composition of the Committee is reviewed annually to ensure that it contains the appropriate balance of knowledge, skill and experience to support the business.

The Committee met three times during the year ended 31 March 2014, and all members were present at each meeting.

The key issues considered by the Committee during the year are outlined below.

Financial reporting

As explained above, the Committee is responsible for monitoring the integrity of the Group's financial statements and reviewing the significant judgements applied in the preparation of financial information. During the year and to the date of this report, the Committee reviewed the Group's interim management statements which were issued in August 2013 and February 2014, the interim report for the period ended 30 September 2013, and the preliminary announcement and Annual Report and Accounts for the year ended 31 March 2014.

Member	Date of appointment	Meetings attended (held)
N W Warner (Chair)	1 February 2011	3(3)
J R Brown	13 May 2004	3(3)
S E Foden	18 January 2011	3(3)

The significant issues considered and the conclusions reached by the Committee are outlined below.

Significant issues considered in relation to the financial statements

Acquisition accounting

On 13 March 2014, the Group announced that it had acquired 100% of the share capital of Activaero GmbH for a total consideration of €130m (£108m), comprising €45m (£38m) upfront cash consideration, €50m (£41m) in equity and a commitment to a deferred, non-contingent payment of €35m (£29m) payable on the first business day after 1 August 2015. The full details of the acquisition and the accounting treatment applied are set out in note 28 to the financial statements.

The Committee reviewed the accounting treatment applied in the FY2013/14 financial statements. The key areas of judgement relating to the acquisition are the identification of intangible assets and the subsequent determination of their fair value. Management provided a report to the Committee detailing how intangible assets had been identified, how their useful economic life had been derived and the key judgements, and assumptions made in determining likely returns and an appropriate discount rate. Each of these issues was discussed with management and the external auditor, who also provided detailed reporting to the Committee in respect of this matter.

Based upon the evidence reviewed and the discussions held, the Committee is satisfied that the identification and calculation of intangible assets is reasonable based upon the information currently available, and that the transaction has been appropriately presented in the financial statements. The Committee notes that in accordance with international financial reporting standards, the Group has twelve months to finalise the accounting for the acquisition and therefore the balances currently included in the financial statements may be restated within this period if pertinent information becomes available.

Revenue recognition

As disclosed on page 92 of this report, the Group has three principal revenue streams, being royalty income, product licensing milestone income and technology licensing milestone income. In FY2013/14, these three revenue streams comprised virtually all of the Group's overall revenue.

During the year, the Committee reviewed the judgements exercised by management in determining when to recognise key milestone events, particularly those milestones which were achieved around a period end. The Committee also discussed each significant milestone achieved during the year with the external auditor. Following discussions held and the review performed, the Committee is satisfied that the treatment adopted by management is reasonable and in compliance with IAS 18 and Vectura's accounting policies.

The recognition of royalty revenue involves accruing for an estimate of underlying product sales in the final quarter, and management has limited visibility over this information, save for where a licensing partner makes the information publicly available. This area was an increased focus during FY2013/14, as the Group has now begun to receive significant royalty streams from a number of new products and therefore management do not have significant historic evidence upon which to base the revenue accrual. The basis for each accrual was discussed with both management and the auditor, and the Committee is satisfied that appropriate assumptions have been made.

Goodwill impairment

During the year, particular attention was paid to the carrying value of goodwill. Goodwill associated with the acquisition of Innovata Plc, Vectura Delivery Devices Limited and Co-ordinated Drug Development Ltd (since renamed Vectura Limited) totals £49.6m and, as such, it represents one of the largest assets on the Group's balance sheet. For the purposes of impairment testing, management has determined that there is only one cash-generating unit (CGU) relating to these assets. This is considered appropriate in light of the fact that these entities have now fully integrated into the Group and future projects will use a mixture of Innovata Ltd, Vectura Delivery Devices Ltd and Vectura Ltd technologies and expertise.

The Committee reviewed the judgements and assumptions underlying the models used to support the carrying value of goodwill in the consolidated balance sheet. The primary judgement areas relate to the achievability of long-term business plans and the discount rate applied to the relevant cash flows. Management provided the Committee with a report, outlining the basis for the assumptions made. The Committee reviewed this document and challenged management assumptions where appropriate.

The carrying value of goodwill was also a key area of focus for the external audit team, and accordingly, Deloitte LLP ("Deloitte") provided a detailed report to the Committee regarding management's assumptions and conclusions. This report also included the results of sensitivity testing performed, which assessed whether a "reasonably possible" change in a key assumption could result in an impairment of the balance. The Committee noted that there were no disagreements between the conclusions of management and the conclusions drawn by the external auditor. Following a review of the evidence provided and discussions with both management and the audit team, the Committee is satisfied that no impairment charge should be recorded in FY2013/14 and that the disclosures made in the financial statements are appropriate.

Risk management and internal control

The Board as a whole, including the Audit Committee members, considers the nature and extent of Vectura's risk management framework and the risk profile that is acceptable to achieve the Group's strategic objectives. The Committee is responsible for reviewing the adequacy and effectiveness of the Group's risk management and internal control systems. In order to discharge this responsibility, the Committee receives reports from Vectura's management team and the external auditor as appropriate.

Each year, the Audit Committee considers the need for an internal audit function and has concluded that, given the size of the Group's operations at this time, it is not necessary. The Board accepted this recommendation.

Whistleblowing

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

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

Audit Committee report continued

Risk management and internal control continued

UK Bribery Act

The Group has continued to operate its anti-bribery policy, introduced in 2010, in response to the UK Bribery Act 2010. This has included the conduct of due diligence on new key business partners who may act on behalf of the Group in higher risk areas of business.

External audit

The external auditor, Deloitte, is engaged to express an opinion on the Group's and the Company's financial statements.

The Audit Committee is responsible for making recommendations to the Board on the appointment, reappointment and removal of the external auditor. When considering reappointment, the Committee considers the independence of the audit firm and the effectiveness of the overall external audit process.

Audit engagement partner rotation

Deloitte adheres to a rotation policy which is in accordance with the ethical standards of the Audit Practices Board ("the APB") and the Group engagement partner is rotated every five years. David Hedditch, the current engagement partner, was appointed during the 2012/13 year and therefore the next rotation is scheduled to take place in 2017/18.

Independence and non-audit work performed by the external auditor

The Committee is responsible for monitoring and reviewing the independence and objectivity of the external auditor. On an annual basis, the auditor confirms their policies for ensuring auditor independence and provides the Committee with a confirmation that they continue to be independent in respect of the forthcoming audit engagement.

Vectura's policy on the provision of non-audit services is a key mechanism which safeguards the independence of the external auditor. The provision of non-audit services by the auditor is governed by a "non-audit services policy", which is reviewed by the Committee on an annual basis. The policy sets out the circumstances in which the external auditor may be permitted to undertake non-audit services and the overriding purpose of the policy is to ensure that the auditor does not provide a service that:

- creates a mutuality of interest;
- places the auditor in a position of auditing its own work;
- results in the auditor acting as a Vectura manager or employee; or
- places the auditor in a position to advocate for Vectura.

Vectura does not impose an automatic restriction on the provision of non-audit services by the external auditor. The external auditor is eligible for selection to provide non-audit services that are not, and are not perceived to be, in conflict with auditor independence, provided that the auditor has the skill, competence and integrity to carry out the work in the best interest of the Group. Where appropriate, services are tendered prior to awarding work to the external auditor.

During the year, Deloitte undertook non-audit services, and the relevant fees are disclosed in note 5 to the financial statements. These services were provided in compliance with the policy outlined above and no actual conflicts of interest were found to exist between the audit work and the non-audit work performed, which mainly related to tax advisory and financial due diligence work to support the acquisition of Activaero GmbH. The Committee considered that it was appropriate for the auditor to undertake these services given the nature of the work to be performed. During meetings held in February and May 2014, the external auditor confirmed to the Audit Committee that it had met its statutory requirements with regard to independence.

Accordingly, the Audit Committee confirms that the Group continues to receive an independent audit service. On this basis, the Committee has recommended to the Board that Deloitte be reappointed as the Group's auditor for a further year. This recommendation has been accepted by the Board.

Effectiveness

The Committee places great importance on ensuring that there are high standards of audit quality and effectiveness in the external audit process. The effectiveness of the external audit process is reviewed on an annual basis, and this includes consideration of the qualification, expertise, resources, remuneration and independence of the auditor. Where appropriate, actions are agreed in respect of any issues identified and these are monitored for progress.

At the conclusion of the FY2013/14 audit, the Committee performed a formal evaluation of the performance of the external auditor. In performing this evaluation, the Committee worked with the external auditor, Executive Directors and relevant senior management. In addition to this, the Committee performs its own ongoing evaluation of audit quality and effectiveness, taking into account such matters as the quality of reporting to the Committee by the external auditor and the level and quality of the interactions between the Committee and the audit partner.

Tendering

Deloitte has been Vectura's auditor since 2007 following Vectura's full listing on the London Stock Exchange. During that time, the audit has not been formally tendered and, whilst this is not currently a formal requirement for Vectura under the Code, the Committee will keep the need to tender the audit under review. There are no contractual restrictions in place which would restrict the choice of the external auditor.

Committee effectiveness review

During the year, the Committee reviewed its own effectiveness as part of the overall Board evaluation process. The Committee considered that it acted transparently and, given the number of Committee and Board meetings scheduled throughout the financial year, maintained a thorough understanding of the Group and its business. The results of the review were advised to the Board.

Neil Warner
Chairman of the Audit Committee
20 May 2014

Nomination Committee report

Dear shareholder

On behalf of the Board, I am pleased to present Vectura's Nomination Committee report for the year ended 31 March 2014.

During the year, the Committee considered and made recommendations to the Board regarding the appointment of Paul Oliver as our new Chief Financial Officer and Bruno Angelici as Non-Executive Director and Chairman of the Board.

I hope you find this report useful in understanding the work of the Committee.

Dr John Brown
Chair of the Nomination Committee
20 May 2014

Role and responsibilities

The Nomination Committee ("the Committee") operates under written terms of reference, which are modelled on the UK Corporate Governance Code ("the Code") and are available on the Company website www.vectura.com. The Committee reviews these terms on an annual basis. No material changes were made to the terms of reference during the year.

The Committee is responsible for reviewing the structure of the Board and the Committees and evaluating the balance of skills, experience, independence and knowledge of the Board as a whole. On the basis of this evaluation, the Committee makes recommendations to the Board regarding Board appointments. Where the need for a new Executive or Non-Executive Director is identified, the Committee is responsible for preparing a description of the role and the capabilities required for a particular appointment and for identifying and nominating potential candidates to fill the vacancy.

Membership and meetings

The Committee comprises four independent Non-Executive Directors, John Brown, Neil Warner, Susan Foden and the Chairman of the Board, Bruno Angelici. In accordance with the requirements of the Code, the Board has confirmed that Bruno Angelici was independent upon his appointment to the Board, and that he continues to be independent.

The Committee is chaired by John Brown, the Senior Independent Director. Details of John Brown's experience are set out in his biography on page 41.

The Group Company Secretary acts as Secretary to the Committee. The Executive Directors, other members of Executive Management and external advisors may also attend Committee meetings as required, at the invitation of the Chairman.

The Committee is authorised to obtain external professional advice including, without limitation, legal and other professional advice to assist in the performance of its duties. During the year, the Committee has utilised the services of Odgers Berndtson as outlined below.

The Committee met twice during the year ended 31 March 2014, and all members were present at each meeting. Additionally, the Committee held a number of informal meetings and discussions during the year.

The key issues considered by the Committee during the year are outlined below.

Appointment of Directors

The Committee's primary focus for the year ended 31 March 2014 was the continued development of the Board.

In May 2013, Anne Hyland announced her intention to stand down as Chief Financial Officer and Company Secretary. The Committee recommended to the Board that Paul Oliver be appointed as her successor. Paul Oliver joined Vectura in 2006, and he was appointed as the Group's Financial Controller in 2007. During this time, Paul Oliver worked closely with Anne Hyland and other members of Vectura's Executive Management Team and Board on all aspects of Vectura's operations, strategic development and financial discipline. As such, Paul Oliver was well placed to succeed Anne Hyland as the Group's Chief Financial Officer and the Board was unanimous in accepting the recommendation of the Committee to appoint him as an Executive Director and Company Secretary.

In September 2013, Vectura announced that Jack Cashman had given notice that he intended to retire as Non-Executive Director and Chairman of the Board. Following this announcement, the Committee undertook an external search to find a suitable candidate to succeed Jack as Non-Executive Director and Chairman of the Board. Bruno Angelici was appointed to the Board on 1 December 2013 and he became Chairman of the Board on 1 February 2014.

Bruno Angelici brings exceptional knowledge, independence and extensive international experience to the Board and the Board believes that Bruno Angelici will be a significant addition to the Company as it enters the next stage in its evolution. Full biographical details can be found on page 40.

Member	Date of appointment	Meetings attended (held)
John Brown (Chair)	13 May 2004	2(2)
Jack Cashman	27 March 2001	2(2)
Bruno Angelici	1 December 2013	0(0)
Neil Warner	1 February 2011	2(2)
Susan Foden	18 January 2011	2(2)

Nomination Committee report continued

Appointments process

There is a formal, rigorous and transparent procedure for the appointment of new Directors to the Board under which the Committee interviews suitable candidates who are proposed either by existing Board members or by an external search firm. The Committee gives careful consideration to the appointment of any proposed appointee, to ensure that the candidate has sufficient time available to devote to the role as well as the required level of skill and knowledge to ensure that the balance of skills, experience and knowledge on the Board is maintained.

During the process of recruiting for a Non-Executive Director and Chairman, the Committee appointed Odgers Berndtson, an external search agency, to assist with the identification of suitable candidates for the role. Odgers Berndtson has no other connection to the Company. The Committee worked with Odgers Berndtson who drew up a list of candidates from a range of industries and backgrounds for initial appraisal by the Committee. From this list, a shortlist of suitable candidates who met the search and selection criteria was prepared and these candidates were interviewed by members of the Nomination Committee.

Following this process, the Nomination Committee recommended the appointment of Bruno Angelici to the Board. Bruno Angelici disclosed his significant commitments to the Board prior to his appointment and the Board as a whole were satisfied that he had sufficient time to devote to this role.

Bruno Angelici has been appointed for an initial term of three years, subject to election by shareholders at the Annual General Meeting on 19 September 2014. The appointment may be terminated earlier than three years at the discretion of either party upon six months' notice.

Advisors

As explained above, during the year the Committee engaged Odgers Berndtson to act as advisors to the Committee.

The Executive Directors provide advice to the Committee, where required, to help it make informed decisions.

Diversity

The Board's policy on diversity is set out on page 45.

The search for Board candidates is conducted, and appointments made, on merit against objective selection criteria and having due regard, amongst other things, to the benefits of diversity on the Board, including the inclusion of women. Diversity is considered by the Nomination Committee in considering Board composition and in the process of making Board appointments.

Committee effectiveness review

During the year, the Committee reviewed its own effectiveness as part of the overall Board evaluation process. The Committee considered that it acted transparently and, given the number of Committee and Board meetings scheduled throughout the financial year, maintained a thorough understanding of the Group and its business. The results of the review were advised to the Board.

John R. Brown.

Dr John Brown
Chairman of the Nomination Committee
20 May 2014

Remuneration Committee report

Letter from the Chair of the Remuneration Committee

Dear shareholder

On behalf of the Board, I am pleased to present Vectura's Remuneration Committee report for the year ended 31 March 2014. I hope that you find this report of the Committee's work understandable and comprehensive.

This has been another year of excellent progress for Vectura, marked by a number of development achievements which are linked to significant revenue streams to Vectura over the coming years. In particular, Novartis announced the approval of Ultibro® Breezhaler® (formerly QVA149) in Europe and Ultibro® Inhalation Capsules in Japan and GSK announced that BREO® ELLIPTA® was available for sale in the US during October 2013. This was followed in December 2013 by the announcement that ANORO® ELLIPTA® had been approved by the US Food and Drug Administration.

In December 2013, our partner Sandoz announced that it had received Danish marketing authorisation for AirFluSal® Forspiro® (formerly known as VR315). To date, marketing authorisations have been received in Denmark, Germany, Belgium, Sweden, Hungary, Romania, Norway, Bulgaria and South Korea and the product has now been launched in most of these countries.

These milestone events for Vectura represent a de-risking of the Group's pipeline, and the Group has begun to execute the next stage of its strategy: to transform its business from a development stage company into a significant, profitable and self-sustaining specialty pharmaceutical company.

On 13 March 2014, Vectura announced that it had acquired Activaero GmbH, a privately owned German pharmaceutical company focused on the development of products for respiratory diseases. As discussed on page 5 of this Annual Report, this acquisition fulfilled a number of Vectura's strategic priorities, and the enlarged Group will be a specialist in the therapeutic area of airways diseases.

Against this background, the Remuneration Committee ("the Committee") has sought to ensure that the remuneration policy of the Group is sufficient to attract, retain and motivate Executives of the highest calibre who are capable of delivering the Group's strategy. When considering the remuneration packages for each of the Executive Directors, the Committee has recognised the need to ensure continuity of the Executive Team at this vital stage in the development and evolution of the enlarged Group.

During 2013, the Committee approved an LTIP award to Trevor Phillips equal to 200% of his salary. This was appropriate in light of the expansion of Trevor Phillips' role following his appointment to the Board. Trevor Phillips was appointed to the Board in 2012 and the Committee recognised the need to ensure that, as a new Director, his remuneration package was appropriately designed to align his interests with the interests of shareholders. It is not envisaged that any further exceptional awards will be made to Trevor Phillips.

In light of the changes to the Group's structure and profile, the Committee has approved adjustments in the base salary of the Executive Directors for the forthcoming financial year. Details of each Executive Director's base salary are set out on page 71 to this report.

When considering the base salary levels for each Director, the Committee has considered pay and conditions across the Group and has also undertaken a review of the remuneration packages of each Executive Director. This review has, inter alia, taken into account a number of parameters including personal performance during the year, Company growth and complexity and alignment of salaries with our policy statements with regard to mid-market levels. The Committee has proposed bonus payments to each of the Executive Directors, as detailed on page 64 of this report. These bonus payments reflect the significant progress made towards delivering the Group's strategy during the year. As part of the formulation of the remuneration policy, the Committee has introduced a provision to claw back cash bonuses in the event of material misstatement of financial results or environmental, social or corporate governance issues.

There have been a number of changes to the composition of the Board during the financial year. On 21 May 2013, it was announced that Anne Hyland had stepped down as Chief Financial Officer and Company Secretary. Paul Oliver was appointed as her successor. In determining Paul Oliver's remuneration package, the Committee gave full and due regard to the policy for remuneration of new appointments, as set out on page 60. Additionally, Bruno Angelici was appointed to the Board as a Non-Executive Director on 1 December 2013. Jack Cashman stepped down from his position as Chairman of the Board and member of Board sub-committees, on 1 February 2014 and he was succeeded by Bruno Angelici. In determining the fee level for Bruno Angelici, the Committee considered market conditions, as well as Board committee responsibilities and ongoing time commitments required to fulfil his role. The annual fees payable to Bruno Angelici are disclosed on page 71.

The Value Realisation Plan (VRP), which was approved by shareholders in 2008, expired during the year. This scheme was designed to provide participants with a share of a predetermined percentage of the total consideration paid for the Group in the event of a change in control. There are no plans to reinstate such a scheme. In addition, the Committee reports that the LTIP awards that were due to vest in June 2013 did not vest as performance conditions were not met.

This year, shareholders will be asked to vote separately on our Directors' remuneration policy and our Annual report on remuneration. I hope that you will join with me in supporting the two resolutions in respect of this year's Remuneration Committee report at the Company's Annual General Meeting on 19 September 2014.

Yours sincerely

Dr Susan Foden
Chair of the Remuneration Committee
20 May 2014

Remuneration report

Introduction

The report that follows has been prepared in accordance with the provisions of the Companies Act 2006 ("the Act"), the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 ("the Regulations") and the relevant provisions of the Listing Rules of the Financial Conduct Authority. In this report, we also describe how the principles of good governance relating to directors' remuneration, as set out in the Corporate Governance Code ("the Code"), are applied in practice. The Committee confirms that the Group has complied with these governance rules throughout the year ended 31 March 2014.

The report is presented in two separate sections:

- Directors' remuneration policy – set out on pages 54 to 61; and
- Annual report on remuneration – set out on pages 61 to 71.

The Directors' remuneration policy section sets out Vectura's remuneration policy ("the Policy") for Executive and Non-Executive Directors. This policy will be subject to a binding vote of the shareholders at the forthcoming AGM on 19 September 2014. If approved, the policy will become effective from this date for a period of three years.

The Annual report on remuneration provides details of how the current remuneration policy has been implemented during the year and it provides details of the Directors' emoluments, shareholdings, long-term incentive awards and pensions for the year ended 31 March 2014. The elements of the Annual report on remuneration which are subject to audit have been clearly identified. The Annual report on remuneration continues to be subject to an advisory vote by shareholders at the Annual General Meeting ("the AGM").

Unaudited information
Directors' remuneration policy

In formulating the remuneration policy, the Committee has given full consideration to the principles set out in the Code. Vectura aims to provide a remuneration package that is sufficient to attract, retain and motivate high-calibre Executive Directors who can deliver the business strategy. The Committee recognises that remuneration packages should be appropriately structured, including both fixed and variable pay elements and a mixture of short, medium and long-term incentives. Appropriately structured remuneration packages serve to align the actions and interests of our Executive Directors with those of our shareholders.

How shareholders' views are taken into account

Shareholders' views are key inputs when shaping remuneration policy. The Committee considers shareholder feedback received in relation to the AGM each year and guidance from shareholder representative bodies more generally. The Committee will seek to engage directly with major shareholders and their representative bodies should any material changes to the Policy be proposed.

Consideration of employment conditions elsewhere in the Group

Although the Committee does not consult directly with employees regarding the Policy, the Committee considers the general basic salary increase for the broader employee population when determining the annual salary increases and remuneration packages for the Executive Directors. Accordingly, the Committee confirms that the remuneration policy outlined below has been designed with due regard to the policy for remuneration of employees across the Group.

The remuneration of senior executives below Board level is reviewed by the Committee on an annual basis. The remuneration packages of these executives are consistent with the policy outlined below, save that lower bonus percentages and lower LTIP opportunities are applicable. Variable pay elements for senior executives are driven principally by market comparatives and the overall impact of the role the individual holds at Vectura. Long-term incentives are provided to those individuals identified as having significant potential to influence Group performance.

All employees are rewarded with a market-competitive remuneration package that includes certain key benefits such as life assurance, permanent health insurance, private medical insurance, access to the pension scheme, participation in Vectura's all-employee share schemes and eligibility to receive a bonus. The bonus scheme for Directors and employees is designed to reward performance, and all individuals are required to set challenging personal goals.

Summary remuneration policy

The following table and accompanying notes set out the main principles of reward for the Executive Directors of Vectura Group plc. The policy outlined below will be effective for a period of three years from 19 September 2014, following our AGM. For the avoidance of doubt, any commitments entered into by the Company prior to the approval and implementation of the policy outlined opposite may be honoured, even if they are not consistent with the policy prevailing at the time the commitment is fulfilled.

Executive Directors

Purpose and link to strategy	Operation	Maximum opportunity	Performance metrics
Base salary			
To recruit and retain executives of the highest calibre who are capable of delivering the Group's strategic objectives, reflecting the individual's experience and role within the Group. Base salary is designed to provide an appropriate level of fixed income to avoid an over-reliance on variable pay elements that could encourage excessive risk taking.	The Committee aims to provide base salary at levels that are broadly aligned with the mid-points for equivalent roles in comparable companies in the UK, adjusted to reflect company size and complexity. Salaries are normally reviewed annually and changes are generally effective from 1 April. The annual salary review of Executive Directors takes a number of factors into consideration, including: • business performance; • salary increases awarded to the overall employee population; • skills and experience of the individual over time; • scope of the individual's responsibilities; • changes in the size and complexity of the Group; • market competitiveness; and • the underlying rate of inflation.	Base salary increases are awarded at the discretion of the Committee; however, salary increases will normally be no greater than the inflationary pay rises awarded to the wider workforce. Where peer review data indicates that a role is under-remunerated, or where there has been a change in responsibilities, the Committee retains the discretion to award more significant base salary increases.	No formal metrics although increases will take account of Group performance.
Benefits			
Benefits in kind offered to Executive Directors are provided on a market-competitive basis, to assist with the retention and recruitment of staff.	The Company aims to offer benefits that are in line with market practice. The main benefits currently provided are life assurance, permanent health insurance and private medical and dental insurance. Under certain circumstances the Group will offer relocation allowances to employees.	The value of each benefit is not predetermined and is based upon the cost to the Group.	Not performance related.
Pensions			
The Group aims to provide market-competitive retirement benefits, to reward sustained contribution.	The Group operates a money purchase scheme and all employees, including Executive Directors, are invited to participate. For executives who are affected by the HMRC lifetime or annual allowances, the Company may provide cash supplements in respect of benefits above the allowance.	Up to 20% of basic salary contribution to the Group Personal Pension Plan or equivalent cash allowance.	Not performance related.

Remuneration report continued

Executive Directors continued

Purpose and link to strategy	Operation	Maximum opportunity	Performance metrics
Annual performance bonus			
An annual cash bonus rewards the achievement of stretching objectives that support the Group's corporate goals and delivery of the business strategy together with goals in relation to personal performance.	Objectives are agreed with the Committee, and the Board as a whole, at the start of each financial year. Different performance measures and weightings may be used each year, as agreed with the Committee, to take into account changes in the business strategy. Bonuses are paid at the discretion of the Remuneration Committee. The Committee takes into account overall corporate performance and individual performance when determining the final bonus amount to be awarded. Bonuses are paid in cash, typically in June. During the 2013/14 financial year, the Committee introduced a provision to claw back up to 100% of the bonus awarded in the event of material misstatement of the Company's financial results, an error in assessing the performance conditions to which an award is subject or for any other matter which it deems relevant.	Bonuses are limited to a maximum of 100% of base salary for each Executive Director.	Corporate goals typically include revenue generation, development of pipeline progress, partnering successes and control of cash expenditure, although the Committee has discretion to set other targets. Goals set are specific, measurable and are linked to the Group's longer-term strategy. 0% of the maximum is payable at threshold performance.

Purpose and link to strategy	Operation	Maximum opportunity	Performance metrics
Long-Term Incentive Plan (LTIP)			
The Remuneration Committee believes that a key component of the overall remuneration package is the provision of equity awards to senior executives through the LTIP which is designed to develop a culture which encourages strong corporate performance on an absolute and relative basis.	Awards are made on an annual basis, at the discretion of the Remuneration Committee. Awards consist of shares that vest according to performance conditions. Typically, awards are granted following the release of full-year or interim financial results. Awards are discretionary and do not vest until the date on which the performance conditions are determined. If employment ceases during a three-year performance period, awards will typically lapse, save in certain good leaver situations. The Committee may decide that an award will be subject to claw back where there has been a misstatement of the Company's financial results, an error in assessing the performance conditions to which an award is subject or for any other matter which it deems relevant.	Awards of up to 200% may be granted; however, Executive Directors would normally receive grants worth up to 100% of salary.	Awards are subject to challenging performance measures. Current awards are based on relative total shareholder return (TSR) measured over a three-year period against two peer groups each determining the vesting of 50% of the awards. The Committee retains the discretion to vary the peer groups, weighting between them and introduce new metrics for awards in future years providing they are not materially less challenging in the circumstances. The Committee would normally consult with its major shareholders before making significant changes to the performance conditions. Awards are subject to an underpin based on the Committee's assessment of the Group's underlying performance against a range of factors, including the Company's underlying financial performance, absolute shareholder returns and progress against milestones over the three-year performance period. Any exercise of discretion will be fully disclosed to shareholders. Furthermore, the Company will consult with its major shareholders before exercising its discretion to increase the percentage that vests. The performance conditions for previous long-term incentive awards are described in the Annual report on remuneration section. For the current TSR performance conditions 25% of the award vests at median against the peer group, increasing on a straight-line basis so that 100% vests for performance at or above the upper quartile.

Remuneration report continued

Executive Directors continued

Purpose and link to strategy	Operation	Maximum opportunity	Performance metrics
All-employee share schemes			
All employees, including Executive Directors, are encouraged to become shareholders of Vectura Group plc through participation in our all-employee share schemes. The Group currently offers employees the opportunity to participate in the Vectura Sharesave scheme and the Vectura Share Incentive Plan (SIP).	Both of the schemes offered are HMRC approved schemes and operate on standard terms.	Participation limits are set by the relevant tax authorities from time to time.	Not performance related and no performance conditions apply.
Share ownership guidelines			
Share ownership guidelines for Executive Directors and senior employees are designed to align the interests of senior management to those of Vectura's shareholders.	In accordance with best practice, Executive Directors are required to retain at least half of any share awards vesting as shares (after paying any tax due) until they have reached the required level of holding.	Executive Directors are required to build and retain a holding of Vectura Group plc shares equivalent to at least 100% of their base salary.	Not performance related.

Chairman and Non-Executive Directors

Purpose and link to strategy	Operation	Maximum opportunity	Performance metrics
Fees			
Set at a level that is sufficient to attract and retain high-calibre Non-Executives.	The Chairman and the Non-Executive Directors receive fees paid in cash, with additional fees received for chairing committees of the Board or fulfilling the role of Senior Independent Director. Fees are paid monthly and reviewed annually. The Chairman and the Non-Executive Directors do not participate in any performance-related incentive schemes, nor do they receive any benefits.	When reviewing fee levels, account is taken of market movements in the fees of Non-Executive Directors, Board committee responsibilities and ongoing time commitments.	Not performance related.

Notes to the policy table

Performance conditions

The Committee selected the performance conditions outlined above because they are central to the Group's overall strategy and they are the key metrics used by the Executive Directors to oversee the operations of the business. The Committee considers that the performance targets for the LTIP and the bonus represent an appropriate balance between the long-term and short-term performance of the Group, as well as an appropriate balance between external and internal assessments of performance.

The targets for the bonus scheme for the forthcoming year will be set out in general terms, subject to limitations with regards to commercial sensitivity. The full details of the targets will be disclosed when they are in the public domain, usually following the end of the relevant financial year in the Annual report on remuneration.

Committee discretion

The Committee operates under the powers it has been delegated by the Board. In addition, it complies with rules that have either been approved by shareholders (Long-Term Incentive Plan) or by the Board (annual performance bonus scheme). These rules provide the Committee with certain discretions which serve to ensure that the implementation of the remuneration policy is fair, both to the individual Director and to the shareholders. The Committee also has discretions to set components of remuneration within a range, from time to time. The extent of such discretions is set out in the relevant rules, the maximum opportunity or the performance metrics section of the policy table above.

To ensure the efficient administration of the variable incentive plans outlined above, the Committee will apply certain operational discretions. These include the following:

- selecting the participants in the plans on an annual basis;
- determining the timing of grants of awards and/or payments;
- determining the quantum of awards and/or payments (within the limits set out in the policy table above);
- determining the extent of vesting based on the assessment of performance;
- making the appropriate adjustments required in certain circumstances, for instance for changes in capital structure;
- determining "good leaver" status for incentive plan purposes and applying the appropriate treatment; and
- undertaking the annual review of weighting of performance measures and setting targets for the annual bonus plan and other incentive schemes, where applicable, from year to year.

If an event occurs which results in the annual bonus plan or LTIP performance conditions and/or targets being deemed no longer appropriate (e.g. material acquisition or divestment), the Committee will have the ability to adjust appropriately the measures and/or targets and alter weightings, provided that the revised conditions are not materially less challenging that the original conditions.

Remuneration scenarios for Executive Directors

The charts below show hypothetical values of the remuneration package for each Executive Director under three assumed performance scenarios and these scenarios are based upon the remuneration policy set out below. The information presented below uses the level of salary, benefits and pension entitlements for each of the Directors as at 1 April 2014. Refer to page 71 of this report for details of base salary levels set for the coming year.

Below target remuneration receivable – this scenario assumes that there is no annual bonus payment and no awards under the LTIP award vest.

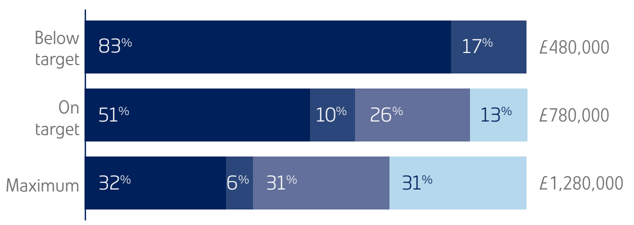
On-target performance – this scenario assumes that the Directors receive a 50% bonus pay-out. It is assumed that a face value limit of 100% base salary applies to the LTIP award and that 25% of the LTIP granted would ultimately vest.

Above target remuneration receivable – this scenario assumes that the Directors receive a maximum bonus pay-out of 100% of their salary. It is assumed that a face value limit of 100% base salary applies to the LTIP award and that 100% of the LTIP award granted would ultimately vest.

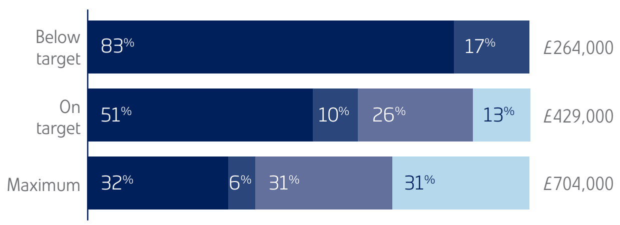
The actual amounts earned by Executive Directors under these three scenarios will depend on share price performance over the vesting period. For the purpose of these illustrations, any share price appreciation has been ignored. For simplicity, the value of participating in the Company's all employee share schemes has also been ignored.

Remuneration scenarios for Executive Directors

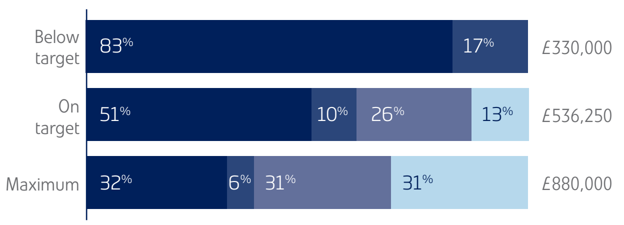
Chris Blackwell

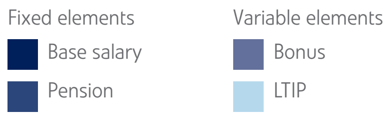


Paul Oliver



Trevor Phillips





Remuneration report continued

Other remuneration policies

Termination and loss of office payments

The Group's policy on remuneration for Executive Directors who leave the Group is consistent with general market practice and it is set out below. The Committee will exercise its discretion when determining amounts that should be paid to leavers, taking into account the facts and circumstances of each case. When calculating termination payments, the Committee will take into account a variety of factors, including individual and Company performance, the length of service of the Executive Director in question and, where appropriate, the obligation for the Executive Director to mitigate loss.

In the case of a "good leaver", the following policy will normally apply:

- notice period of twelve months and pension and contractual benefits, or payment in lieu of notice;
- statutory redundancy payments will be made, as appropriate;
- executives have no entitlement to a bonus payment in the event that they cease to be employed by the Group; however, they may be considered for a pro-rated award by the Committee in good leaver circumstances;
- the rules of the 2012 LTIP plan contain provisions setting out the treatment of awards where a participant ceases to be employed by the Vectura Group. Other than in good leaver circumstances, awards will normally lapse. In the event of a participant's death, retirement, ill health, injury, disability, redundancy, the sale of his employing company or business out of the Vectura Group or for any other reason at the discretion of the Remuneration Committee, awards will not be forfeited but will instead vest on the normal vesting date. Vesting in these circumstances will be subject to the satisfaction of the relevant performance conditions measured at that time and time pro-rating. In exceptional circumstances, the Remuneration Committee may allow the awards to vest on cessation of the participant's employment, subject to the satisfaction of the performance conditions measured at that time and time pro-rating. In either case, the Remuneration Committee can decide to dis-apply time pro-rating if it thinks it is appropriate to do so in the particular circumstances;
- any other share-based entitlements granted to an Executive Director under the Company's share and share option plans will be determined based upon the relevant plan rules; and
- the Committee may also provide for the leaver to be reimbursed for a reasonable level of legal fees in connection with a settlement agreement.

In circumstances in which a leaving Director may be entitled to pursue a legal claim, the Company may negotiate settlement terms if it considers this to be in the best interests of the Company and, with the approval of the Committee on the remuneration elements therein, to enter into a settlement agreement.

Executive Directors' service contracts

It is the Group's policy that Executive Directors should have contracts with an indefinite term and which provide for a maximum period of twelve months' notice. This will continue as part of the Policy.

This applies to the contract of Chris Blackwell which was effective from 24 June 2004, Trevor Phillips' contract, which was amended with effect from 16 July 2012 and to Paul Oliver's contract, which took effect from 1 July 2013. Executive Directors are subject to re-election at an AGM at intervals of no more than three years.

The Executive Directors may accept outside appointments, with prior Board approval, provided that these opportunities do not negatively impact on their ability to fulfil their duties to the Group. Whether any related fees are retained by the individual or are remitted to the Group will be considered on a case by case basis.

Non-Executive Directors' terms of engagement

All Non-Executive Directors have specific terms of engagement which are terminable on not less than three months' notice by either party and six months' notice in the case of the Chairman. The remuneration of Non-Executive Directors is determined by the Board within the limits set by the Articles of Association and based on a review of fees paid to Non-Executive Directors of similar companies. All Non-Executive Directors are subject to re-election at an AGM at intervals of no more than three years.

The dates of appointment of each of the Non-Executive Directors serving at 31 March 2014 are summarised in the table below.

A Board evaluation has been performed and the results of this exercise confirmed that all Non-Executive Directors were independent, including John Brown who has service greater than nine years. John Brown's independence is considered valid due to the major change in the operating activities of the Group during the term of his appointment.

Remuneration for new appointments

Where it is necessary to recruit or replace an Executive Director, the Committee has determined that the new Executive Director will receive a compensation package in accordance with the provisions of the Policy.

	Date of appointment
J R Brown	13 May 2004
S E Foden	18 January 2007
N W Warner	1 February 2011
B F J Angelici	1 December 2013

In setting base salary for new Executive Directors, the Committee will consider the existing salary package of the new Director, and the individual's level of experience. In setting the annual performance bonus, the Committee may wish to set different performance metrics (to those of other Executive Directors) in the first year of appointment. Where it is appropriate to offer a below median salary on initial appointment, the Committee will have the discretion to allow phased salary increases over a period of time for a newly appointed Director, even though this may involve increases in excess of inflation and the increases awarded to the wider workforce.

The Committee wishes to retain the ability to make buy-out awards to a new Executive Director, to facilitate the recruitment process. The amount of any such award would not exceed the expected value being forfeited and, to the extent possible, would mirror the form of payment, timing and degree of conditionality etc. Where awards are granted subject to performance conditions these would be relevant to Vectura Group plc. Any such award would only be made in exceptional circumstances and shareholders would be informed of any such payments at the time of appointment. Share-based awards would be made using the existing share plans where possible although the Committee may also use the flexibility provided under the Listing Rules to make awards without prior shareholder approval.

In respect of internal appointments, any commitments entered into in respect of a prior role, including variable pay elements, may be allowed to pay out according to its prior terms.

For external and internal appointments, the Committee may consider it appropriate to pay reasonable relocation or incidental expenses, including payment of reasonable legal expenses. Tax equalisation may be considered if an Executive Director is adversely affected by taxation due to their employment with the Company.

The terms of appointment for a Non-Executive Director would be in accordance with the policy for remuneration of Non-Executive Directors as set out in the policy table.

Unaudited information

Annual report on remuneration

Remuneration Committee ("the Committee")

The Committee consists entirely of independent Non-Executive Directors. The Committee is chaired by Susan Foden, and during the year ended 31 March 2014, its members were Bruno Angelici, Jack Cashman, John Brown and Neil Warner. Jack Cashman stepped down from his position as Chairman of the Board and member of Board sub-committees on 1 February 2014 and he was succeeded by Bruno Angelici. In accordance with the requirements of the UK Corporate Governance Code, the Board has confirmed that Bruno Angelici was independent upon his appointment to the Board, and he continues to be independent. Jack Cashman was considered to be independent upon his appointment to the Board and he remained independent for the whole of his appointment.

No conflicts of interest have arisen during the year and none of the members of the Committee has any personal financial interest in the matters discussed, other than as shareholders. The fees of the Non-Executive Directors are determined by the Board on the joint recommendation of the Chairman and the Chief Executive.

In determining the Group's current policy, and in constructing the remuneration arrangements of each Executive Director and senior employees, the Board, advised by the Committee, aims to provide remuneration packages that are competitive and designed to attract, retain and motivate Executive Directors and senior employees of the highest calibre.

To achieve this objective, the Committee takes account of information from both internal and independent sources, including New Bridge Street (a brand of Aon Hewitt Ltd, part of Aon plc) and PricewaterhouseCoopers LLP. During 2013/14, Vectura incurred fees of £22,000 from New Bridge Street and £17,000 from PricewaterhouseCoopers in relation to advice on executive remuneration. Both New Bridge Street's and PricewaterhouseCoopers' fees are based upon hourly charged rates and both companies are signatories to the Remuneration Consultants' Group Code of Conduct, which sets out the role of executive remuneration consultants and the professional standards by which they advise their clients. The Committee reviews the performance and independence of its advisors on an annual basis.

The Group's Director of Human Resources provides updates to the Committee, as required, to ensure that the Committee is fully informed about pay and performance issues throughout the Group. The Committee takes these factors into account when determining the remuneration of the Executive Directors and senior executives.

No Executive Director or employee is allowed to participate in any discussion directly relating to their conditions of service or remuneration.

The Committee is formally constituted with written terms of reference and its main responsibilities are detailed below.

The Committee is responsible for:

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

Remuneration report continued

Unaudited information continued

Annual report on remuneration continued

Meetings

The Committee met formally three times during the year ended 31 March 2014.

A summary of the key decisions made by the Committee during the year is summarised below:

- approval of overall pay levels for 2013/14 for the Group as a whole;
- approval of base salary increases for Executive Directors and other members of the Executive Management Team, ensuring these are aligned appropriately both internally and externally;
- recommending to the Board an increase in the Chairman's fee, to bring arrangements in line with market rates;
- recommending the fee level for the new Chairman of the Board;
- approval of remuneration package for the new Chief Financial Officer, following his appointment to the Board;
- approval of the percentage of the bonus pool to be paid out across the Group;
- review of the performance conditions for the 2010 Long-Term Incentive Plan (LTIP), including lapse, without any payment, of the options due to vest in 2013 due to failure to meet performance conditions; and
- approval of awards under the 2012 LTIP scheme.

Audited information

Directors' remuneration – year ended 31 March 2014

The total remuneration of the individual Directors who served during the year is shown below. Total remuneration is the sum of emoluments plus Company pension contributions and the value of long-term incentive awards vesting by reference to performance in the year 2014: £117,000 (2013: £nil).

	Basic salary[a] £000	Benefits[b] £000	Bonus[c] £000	LTIP[d] £000	Pension entitlements[e] £000	Other[f] £000	SIP awards[g] £000	**Total remuneration £000**
Executive Directors								
C P Blackwell	337	2	337	—	67	—	5	**748**
A P Hyland[(1)]	55	1	—	117	11	178	3	**365**
T M Phillips[(2)(3)(4)]	241	15	241	—	48	91	5	**641**
P S Oliver[(5)]	150	2	150	—	30	—	2	**334**
Non-Executive Directors								
B F J Angelici[(6)]	40	—	—	—	—	—	—	**40**
J P Cashman[(7)]	83	—	—	—	—	—	—	**83**
J R Brown*	45	—	—	—	—	—	—	**45**
S E Foden*	45	—	—	—	—	—	—	**45**
N W Warner*	45	—	—	—	—	—	—	**45**
	1,041	20	728	117	156	269	15	**2,346**

(1) A P Hyland stepped down as Chief Financial Officer and Company Secretary, effective from 1 July 2013. Details of payments, including "other" made to A P Hyland, are outlined on page 67 of this report.

(2) T M Phillips was paid in US $; the amount shown above is converted at the annual average exchange rate of $1.59/£1.

(3) T M Phillips receives benefits of £13,000 (US $21,357 at an average annual exchange rate) relating to US medical and dental insurance. T M Phillips also makes employee contributions towards this plan.

(4) T M Phillips received a one-off relocation allowance of £90,909 during the year; this is shown within "other" remuneration in the single figure above.

(5) P S Oliver was appointed to the Board on 1 July 2013.

(6) B F J Angelici was appointed to the Board on 1 December 2013.

(7) J P Cashman stepped down as the Chairman of the Board on 1 February 2014.

* Included within the Non-Executive Directors' fees are the fees for chairing committees. J R Brown received £5,000 for chairing the Nomination Committee and £10,000 for his role as Senior Independent Director. S E Foden received £15,000 for chairing the Remuneration Committee and N W Warner received £15,000 for chairing the Audit Committee.

Directors' remuneration – year ended 31 March 2013

The total remuneration of the individual Directors who served during the year is shown below. Total remuneration is the sum of emoluments plus Company pension contributions and the value of long-term incentive awards vesting by reference to performance in the year 2013: £nil.

	Basic salary[a] £000	Benefits[b] £000	Bonus[c] £000	LTIP[d] £000	Pension entitlements[e] £000	Other[f] £000	SIP awards[g] £000	Total remuneration £000
Executive Directors								
C P Blackwell	328	2	193	—	66	—	5	594
A P Hyland	218	1	129	—	44	—	5	397
T M Phillips[(1)(2)(3)]	189	11	115	—	37	—	1	353
Non-Executive Directors								
J P Cashman	80	—	—	—	—	—	—	80
J R Brown*	45	—	—	—	—	—	—	45
S E Foden*	40	—	—	—	—	—	—	40
N W Warner*	40	—	—	—	—	—	—	40
	940	14	437	—	147	—	11	1,549

(1) T M Phillips was appointed to the Board on 1 June 2012.

(2) T M Phillips was paid in US $; the amount shown above is converted at the annual average exchange rate.

(3) T M Phillips receives benefits relating to US medical and dental insurance. T M Phillips also makes employee contributions towards this plan.

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

Notes to the remuneration table

(a) This is the amount earned in respect of the financial year.

(b) This is the taxable value of benefits paid in respect of the financial year. These benefits typically relate to death, disability and medical insurance. As disclosed in note footnote (3) above, T M Phillips also receives benefits in relation to US medical and dental insurance.

(c) This is the total bonus earned under the annual bonus scheme in respect of the financial year.

(d) The amount shown relates to the market value of LTIP awards that vested during the year. The awards that vested during the year relate to an agreement entered into with A P Hyland; refer to page 67 for further details. No other LTIP awards vested during the year.

(e) UK tax legislation imposes penalty taxes on annual pension contributions where prescribed maximum amounts are exceeded. The Committee has previously determined that impacted Executive Directors would receive pension benefits limited by the prescribed maximum amounts and an additional taxable supplementary cash payment equal to the cost to the Company of the pension benefit foregone. The amount of the allowance awarded to any Executive Director so impacted has been set by the Committee so that there is no additional cost to the Company resulting from this arrangement.

(f) Other payments in 2013/14 relate to one-off remuneration agreements with individual directors. Amounts payable to T M Phillips are explained in footnote (4) to the single figure remuneration table for FY2013/14. Amounts payable to A P Hyland are explained on page 67 of this report.

(g) This relates to SIP awards granted during the year, calculated as the number of shares awarded multiplied by the share price on the date of the award.

Remuneration report continued

Additional requirements in respect of the single total figure table (audited information)

Performance-related pay earned in the year

Annual performance bonus

All employees are eligible for an annual discretionary cash bonus, whereby performance objectives are established at the beginning of the financial year by reference to suitably challenging corporate goals. The scheme is offered to all staff below Board level and maximum bonus opportunities range from 10% and 75% of salary, depending on grade. Bonus payments are not pensionable.

The Committee has consistently set stretching corporate goals, including goals around revenue generation, development pipeline progress, partnering successes and control of cash expenditure, which are weighted towards goals with the highest corporate significance.

In addition, a significant percentage of the bonus potential is set against challenging personal objectives which are linked to the overall business strategy. Bonuses are limited to a maximum of 100% of basic salary for each Executive Director.

For the year ended 31 March 2014 the performance objectives against which bonus payments were calculated are set out in the table below.

The Committee assessed that a bonus of 100% (2012/13: 59% and 61%) of salary was appropriate when judged by the achievement of the below metrics and that this was confirmed when looking at a broader picture of the Group's corporate performance over the period.

As Vectura has formal share ownership guidelines, the Remuneration Committee has not required any of the bonus payment for this year to be deferred into shares.

Performance metric	Weighting as % of maximum bonus potential	Level of bonus awarded as % of metric (% of full bonus)	Commentary (full disclosure has been restricted due to commercial sensitivity)
Create strategic growth opportunities	48%	48% (48%)	• Announced co-development deal with UCB for the development of an innovative biologic product • Successful in-licensing of VR588, an asset with pharmacological properties suited to the management of various severe inflammatory and fibrotic airways diseases • Successful in-licensing of VR611, an asset which may be used in various inflammatory airways indications • Acquisition of Activaero GmbH • Significant progress made towards licensing unlicensed pipeline asset
Secure existing pipeline value	16%	16% (16%)	• Development milestone earned from VR315 US • Patents filed in relation to new technologies
Achieve financial growth	16%	16% (16%)	• Revenue growth of £6.0m was achieved • Positive EBITDA growth, FY2013/14 positive EBITDA of £5.2m compared to FY2012/13 negative EBITDA of £3.4m • Significant growth in share price during the year following positive news flow • R&D expenditure in line with budget, demonstrating continued discipline on expenditure
Personal objectives	20%	20% (20%)	• Challenging personal objectives were set for all Executive Directors
Total bonus payment as a % of salary	100%	100%	

LTIP awards

In 2010, an award of LTIP options was made to the Executive Directors who were in office at this time. The award was made in two tranches and for the first tranche performance was assessed over a performance period of three years. For the second tranche performance was assessed over a performance period of four years.

During the year, the Committee assessed whether the first half of the award made under the 2010 LTIP scheme had vested. Vesting of this LTIP award was dependent upon the Group's relative total shareholder return (TSR) measured over a performance period of three years. Awards were due to vest in accordance with the following table:

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

* Linear vesting between points.

In determining whether awards would vest, the Company's performance was measured against the FTSE Small Cap Index rather than a comparator group of companies. The scheme rules included an additional performance criterion whereby the awards would not vest if the average share price over the three-month period before the date of vesting is less than 100p. The average share price over this period was 87.83p and consequently the first half of the award made in 2010 did not vest.

Scheme interests awarded during the year

LTIP

On 7 June 2013, the following awards were granted to the Executive Directors under the 2012 LTIP scheme:

Director	Number of options awarded	Value of award	Share price used to determine level of award p	Face value £	Exercise price p	% that vests at threshold	Vesting date
C P Blackwell	458,110	110%	81.0	371,069	0.025	25%	07/06/2016
T M Phillips	611,246	200%	81.0	495,109	0.025	25%	07/06/2016
P S Oliver	185,185	100%	81.0	150,000	0.025	25%	07/06/2016
Total	**1,254,541**			**1,016,178**			

Award levels were calculated based on the closing share price of 81p on the trading day immediately preceding the date of grant. The face value of each award shown above is based upon this share price. For the purposes of calculating the award, Trevor Phillips' salary was translated at an exchange rate of $1.55/£1.

When determining the award for Trevor Phillips, the Committee exercised its discretion and made an exceptional award of 200% of base salary. This was appropriate in light of the expansion of Trevor Phillips' role following his appointment to the Board which took place during 2013. It is not envisaged that any further exceptional awards will be made to Trevor Phillips.

An award of 110% was made to Chris Blackwell. In determining the level of Chris Blackwell's award, the Committee took account of his performance during 2012/13, in particular continuing to develop the Executive Management Team and developing and executing Vectura's strategy.

The awards granted under the 2012 LTIP scheme on 7 June 2013, are subject to relative TSR measured over a three-year period against two comparator groups (each representing 50% of the total award), as set out in the table on page 66.

Remuneration report continued

Scheme interests awarded during the year continued

LTIP continued

	TSR performance vs. FTSE Small Cap over three years (% of award vesting)	TSR performance vs. Euro Stoxx Pharmaceuticals and Biotechnology Index over three years (% of award vesting)
Below median	0%	0%
Median	12.5%	12.5%
Between median and upper quartile	Between 12.5% and 50% on a straight-line basis	Between 12.5% and 50% on a straight-line basis
Upper quartile or above	50%	50%

Performance against the conditions will be measured by the Committee's independent advisors.

Vesting of awards is also subject to an "underpin" enabling the Committee to decrease or increase the percentage of the award which vests based on its assessment of the Group's underlying performance over the period against a range of factors including the Group's underlying financial performance, absolute shareholder returns and progress against milestones. Any exercise of this discretion by the Committee will be fully disclosed to shareholders with an explanation of the Committee's reasoning in the Report on remuneration for the relevant year. Furthermore, the Committee will consult with its major shareholders before exercising its discretion to increase the percentage of any award that vests.

To the extent that the performance conditions are not met in full at the end of the three-year performance period, awards lapse.

Consistent with current best practice, the Committee has the power to claw back all or part of the awards/payments for one year following vesting in the event of a material misstatement, error in the calculation of performance against the performance conditions of the plan or any other matter which it deems relevant to this provision.

Free share awards

An award of free shares was made to all employees on 24 June 2013, under Vectura's Share Incentive Plan (SIP). The awards are subject to a three-year holding period and no performance conditions are attached. The awards made to Directors who held office on 24 June 2013 are shown on the table below.

Director	Number of shares awarded	Closing share price on date of grant p	Face value £	% that vests at threshold	Vesting date
C P Blackwell	3,703	81.0	3,000	—	24/06/2016
T M Phillips	3,703	81.0	3,000	—	24/06/2016
A P Hyland	3,703	81.0	3,000	—	24/06/2016
Total	**11,109**		**9,000**		

Matching share awards

On 3 July 2013, the Directors listed below purchased shares through the SIP. For every one share purchased, Vectura awarded a free matching share pursuant to the scheme rules. The value of the matching shares is shown below. The awards are subject to a three-year holding period and no performance conditions are attached.

Director	Number of shares awarded	Closing share price on date of grant p	Face value £	% that vests at threshold	Vesting date
C P Blackwell	1,875	80.0	1,500	—	03/07/2016
T M Phillips	1,875	80.0	1,500	—	03/07/2016
P S Oliver	1,875	80.0	1,500	—	03/07/2016
Total	**5,625**		**4,500**		

Total pension entitlements

As stated in the notes to the single figure table, UK tax legislation imposes penalty taxes on annual pension contributions where prescribed maximum amounts are exceeded. Impacted Executive Directors receive an additional taxable supplementary cash payment in lieu of pension contributions in excess of any limits.

	Paid into pension fund £000	Received in cash £000	Total pension £000
Executive Directors			
C P Blackwell	50	17	67
A P Hyland	11	—	11
T M Phillips(1)	48	—	48
P S Oliver	30	—	30
	139	**17**	**156**

(1) At an average exchange rate of 1.59 $/1.

Payments made for loss of office and payments to past Directors

After eleven years of service at Vectura, Anne Hyland stepped down as Chief Financial Officer and Company Secretary, effective from 1 July 2013. During her time at Vectura, Anne Hyland was responsible for Vectura's listing on the Alternative Investment Market and the subsequent listing on the Main Market. Anne Hyland was closely involved in the acquisition of Innovata plc and, more recently, she was instrumental in establishing Vectura's Chinese joint venture, Kinnovata.

The Company entered into an agreement with Anne Hyland. Pursuant to this agreement, Anne Hyland received a payment of £178,000 as settlement of her legal entitlement. This included £136,000 as payment in lieu of salary and benefits during the balance of her twelve-month contractual notice period and in respect of her accrued holiday entitlement. In addition, the Company continued to provide Anne Hyland with private medical insurance and life assurance during this period.

The amounts paid to Anne Hyland under this agreement relate to her service as a Director and therefore they have been included in the "other" amount disclosed in the total remuneration table.

In accordance with the remuneration policy outlined in the remuneration policy section of this report, Anne Hyland was treated as a good leaver under the various share schemes that the Group operates. Awards that may vest under the 2012 LTIP scheme will vest at the normal vesting date and be pro-rated, according to length of service. Awards made under the Group's Share Incentive Plan and Sharesave Scheme will vest in accordance with the rules of those schemes.

With regard to the award made under the 2010 scheme, it was agreed that the following options were deemed to have vested:

Early vesting of LTIP awards

Share option awards			£
2010 award (option over 574,632 shares)	25% vesting; 44/48 time pro-rated	Option over 131,226 shares	116,791

* Share price at vesting: £0.89.

** The Committee considered the performance against the performance conditions up to the termination date and determined that 25% of this award should vest.

Remuneration report continued

Statement of Directors' shareholding and share interests (audited information)

As a direct link between executive remuneration and the interests of shareholders, the Committee has implemented shareholding guidelines for Executive Directors and key senior employees. The guidelines require that Executive Directors build up and maintain an interest in the ordinary shares of the Company that is equal in value to their annual base salary. In assessing compliance with this requirement, the value of the shareholding shown below is assessed using the higher of the share price on 31 March 2014, being 153.25p, and the acquisition price of the shares. The value as a percentage of salary has been calculated using base salary as at 31 March 2014, as shown in the single figure remuneration table.

Until this level of shareholding has been attained, Executive Directors are required to retain at least half of any share awards vesting as shares (after paying any tax due) until they have a holding equivalent to at least 100% of their base salary.

The Directors who have held office during the year ended 31 March 2014 and their interests (in respect of which transactions are notifiable to the Company under the Financial Conduct Authority's Transparency Rules) in the share capital of Vectura Group plc at 31 March 2014 are shown in the table opposite.

There was no change in the Directors' interests between 31 March 2014 and 20 May 2014, the date of this report.

	Shares owned	
	31 March 2014 Ordinary shares of 0.025p each	Value of owned shares as a % of salary
Executive Directors		
C P Blackwell(1)	692,949	315%
T M Phillips(2)	27,479	18%
P S Oliver(3)	65,116	50%
A P Hyland	642,496	—
Non-Executive Directors		
B F J Angelici	12,903	—
J P Cashman	946,647	—
J R Brown(4)	242,681	—
S E Foden	11,000	—
N W Warner	30,477	—

(1) The holding of C P Blackwell includes 59,130 ordinary shares of 0.025p each, which are held in the Vectura Group plc Employee Benefit Trust (Share Incentive Plan).

(2) The holding of T M Phillips includes 16,027 ordinary shares of 0.025p each, which are held in the Vectura Group plc Employee Benefit Trust (Share Incentive Plan).

(3) P S Oliver was appointed to the Board on 1 July 2013. The holding of P S Oliver includes 58,664 ordinary shares of 0.025p each which are held in the Vectura Group plc Employee Benefit Trust (Share Incentive Plan).

(4) The holding of J R Brown includes 20,457 ordinary shares of 0.025p each, which are held through nominees.

(5) Vested LTIP awards relate to outstanding awards granted between 2005 and 2008.

Gain on exercise of share options

	Number of options exercised	Exercise price p	Market value at date of exercise p	Gain on exercise of share options £
Executive Directors				
C P Blackwell	23,376	48.125	97.250	11,483
C P Blackwell	122,224	48.125	97.250	60,043
Aggregate gain on exercise of share options				71,526

The gain shown above is the notional gain on exercise of unapproved options exercised during the year. In total, Chris Blackwell exercised 145,600 options and of this total he sold 112,500 shares solely to cover the cost of the exercise including related tax liabilities. Chris Blackwell retained the balance of 33,100 shares.

Approved and Unapproved Share Option Plans and the EMI Plan

Executive Directors hold options under the Approved and Unapproved Share Option Plans as detailed above. Historically, no performance conditions have been attached to the options granted under the above schemes. The exercise price is equal to the market value of Vectura Group plc's shares at the time the options are granted.

In the Corporate governance section of this Annual Report, it is noted that the Group granted certain of its Non-Executive Directors share options as part of their remuneration. The policy of granting share options to Non-Executive Directors has not applied since the Group was publicly listed in 2004, and no further share option have been made or will be made. The options held by the John Brown have vested and are exercisable at any time. The facts and circumstances of this arrangement are set out on page 45, and following a rigorous Board evaluation, the Board has determined that John Brown continues to be independent.

LTIP awards subject to performance conditions				Share option awards not subject to performance conditions					
Unvested			Vested[5]	Unvested			Vested		
2010 award	2012 award	2013 award		Unapproved scheme	Approved scheme	Sharesave	Unapproved scheme	Approved scheme	Sharesave
878,684	401,889	458,110	1,271,149	—	—	18,987	2,646,926	37,383	—
242,664	410,659	611,246	—	—	—	11,718	212,010	—	—
—	34,785	185,185	—	—	—	18,987	119,063	35,460	—
131,226	121,941	—	860,853	—	—	—	618,830	—	—
—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	918,989	—	—
—	—	—	—	—	—	—	238,989	—	—
—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—

Unaudited information

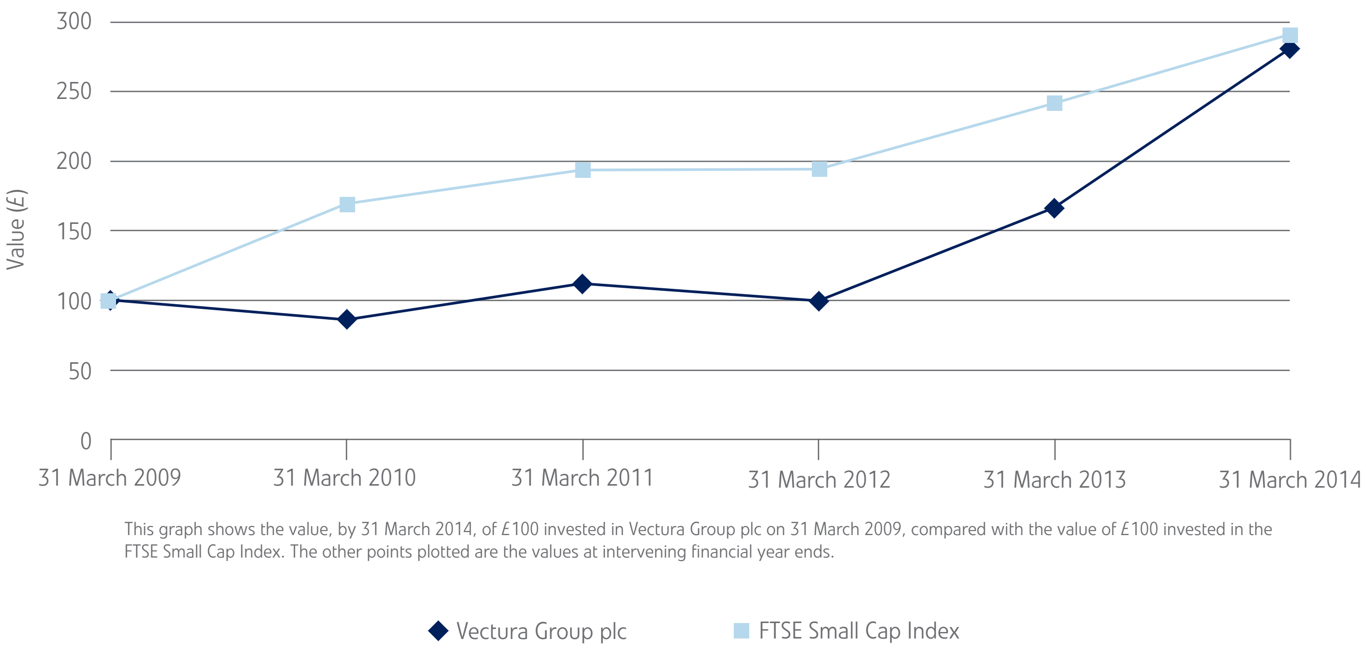
Performance graph and table

The following graph shows the Vectura Group plc's cumulative total shareholder return (TSR) over the last five financial years relative to the FTSE Small Cap Index. This index was chosen as Vectura is one of the constituent companies and the Committee feels that it is one of the most appropriate against which to measure performance.

TSR is defined as the return on investment obtained from holding a company's shares over a period. It includes dividends paid, the change in the capital value of the shares and any other payments made to or by shareholders within the period.

Total shareholder return

Source: Thomson Reuters



This graph shows the value, by 31 March 2014, of £100 invested in Vectura Group plc on 31 March 2009, compared with the value of £100 invested in the FTSE Small Cap Index. The other points plotted are the values at intervening financial year ends.

Remuneration report continued

Aligning pay with performance

Chief Executive remuneration compared with annual growth in TSR:

	2009/10 £000	2010/11 £000	2011/12 £000	2012/13 £000	**2013/14 £000**
Annual growth in TSR (%)	(13.8)	29.8	(11.1)	67.3	**68.9**
Salary, pensions and benefits	384	383	396	401	**411**
Annual performance bonus	150	196	174	193	**337**
Long-term incentive plans vesting	177	90	401	—	**—**
Chief Executive total remuneration	711	669	971	594	**748**
Actual bonus as a % of the maximum	47%	62%	53%	59%	**100%**
Actual share award vesting as a % of the maximum(1)	83.3%	62.9%	100%	0%	**0%**

(1) No LTIP awards vested during FY 2012/13.

Percentage change in remuneration of the Chief Executive

Set out below is the change over the prior period in base salary, benefits, pension, annual performance bonus of the Chief Executive and the Group's employees:

	2013/14 £000	Chief Executive Percentage change (FY2012/13 v FY2013/14)	All employees Percentage change (FY2012/13 v FY2013/14)
Salary	337	+2.7%	+2.8%
Benefits	2	0%	0%
Bonus	337	+75%	+77%

Relative importance of Executive Director remuneration

	FY2013/14 £m	FY2012/13 £m	Change £m
Total employee remuneration	13.4	12.2	1.2
Revenue	36.5	30.5	6.0
Research and development expenditure	28.0	30.9	(2.9)
(Loss)/profit before tax	(4.8)	(10.4)	5.6
Distributions to shareholders	—	—	—

Statement of shareholder voting at 2013 AGM

At last year's AGM held on 23 September 2013, approval of the Remuneration report received the following votes from shareholders:

	For (including discretionary votes)	Against	Total votes cast (excluding votes withheld)	Votes withheld(1)	Total votes cast (including withheld votes)
To approve the Remuneration report	271,054,029	3,097,220	274,151,249	2,446,473	276,597,722
% of votes cast	98.87	1.13	100		

(1) A vote that is withheld does not constitute a vote in law and has not therefore been included in the totals above.

Statement of implementation of remuneration policy in the following financial year

Base salaries

The Committee has, in conjunction with its executive pay consultants, conducted a detailed review of the remuneration of the Executive Directors. This is the first significant review of base salary levels that has taken place for seven years. The review indicated that the salaries for each of the Executive Directors were significantly below the Committee's assessment of mid-market levels for the roles. This was in line with the Committee's expectations given the significant growth and change in the profile of the Company since this time.

The Committee concluded that it would be appropriate to increase the salary of the Chief Executive with effect from 1 April 2014 by 18.7% from £337,000 to £400,000. Whilst the Committee recognises that this is a significant increase, it was of the view that, as well as excellent personal performance, the increase fairly reflected the following factors:

(i) Company growth. Over the last few years the size and complexity of the business has increased significantly. Further success requires a Chief Executive who is properly motivated and incentivised to deliver.

(ii) Policy. Our remuneration policy is clear in stating that 'we aim to provide salaries that are broadly aligned with the mid points of equivalent roles in comparable companies in the UK, adjusted to reflect company size and complexity'. The increase awarded is, in effect, enacting this policy and seeks to align the Chief Executive's salary with mid-market levels.

(iii) Past awards. The Committee has historically acted with restraint, preferring to await significant performance and delivery rather than award year on year increments. Thus in three of the years since 2008, the Chief Executive received no salary increase and in the other years, increases were close to inflation. Averaged out over this period, the present increase equates to 3.66% pa.

For similar reasons, the Chief Operations Officer's salary has been increased with effect from 1 April 2014 by 14% from £241,000 (at an average exchange rate of US$1.59/£1) to £275,000.

It is anticipated that following this re-alignment, future increases for Trevor Phillips will be in line with those of the general workforce.

The Committee will review the level of Chris Blackwell's salary again in 2015 having due regard to the criteria presented above.

The Chief Financial Officer's base salary was set at £200,000 upon his appointment to the Board in July 2013. This was set below the Committee's assessment of a mid-market rate for the role, with a view to increasing his salary toward a mid-market level over time subject to his performance and development in the role, in line with Vectura's policy for new appointments. Having reviewed Paul Oliver's development within his role, the Committee has determined that a 10% base salary increase is appropriate, increasing his salary to £220,000 with effect from 1 April 2014. This base salary remains below the Committee's assessment of the mid-market rate for this role, and subject to continuing performance and development in the role, a further above inflation increase may be considered in 2015.

Overall, the Committee believes that these changes were commercially necessary to ensure retention of Executive Directors of the calibre required to deliver the Group's strategic objectives.

Non-Executive Directors' fees

Non-Executive Directors' fees have been increased from £45,000 to £52,000 per annum, which is inclusive of fees for chairing committees and undertaking the role of Senior Independent Director. The increase reflects the increased demands and time required to fulfil these roles. The Chairman's fee was re-positioned following his appointment to the Board in December 2013; as such, his fee remains at £120,000.

Bonus

The performance targets set for the performance bonus for future years will be disclosed in accordance with the policy set out on pages 55 to 61 of this report.

Performance measures will include targets relating to creating strategic growth opportunities, securing existing pipeline value and achieving financial growth.

On behalf of the Board

Dr Susan Foden
Chair of the Remuneration Committee
20 May 2014

Additional statutory information

The following matters are reported by the Directors in accordance with the Companies Act 2006 requirements in force and the date of this Annual Report and Accounts.

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

Review of business
The consolidated income statement for the year ended 31 March 2014 is set out on page 80. Key events during the past year are described in the Strategic report; highlights of 2013/14 are shown on page 1 and are referred to in more detail in the Chairman's statement, the Chief Executive's statement and the Financial review. These reports, together with the Chairman's introduction, the Corporate governance statement, the Audit Committee report, the Nomination Committee report and the Remuneration Committee report, are incorporated into this report by reference and should be read as part of this report.

The Group's risk management process and the Board's assessment of the key risks and uncertainties facing the business are set out on pages 33 to 38. During the year, the Board has reviewed the risk management policies in place, as summarised in the Corporate governance statement on pages 46 to 47. Key performance indicators are set out on page 18.

Group's result and dividend
The consolidated loss after tax for the year was £2.3m (2012/13: loss of £5.9m). The Directors do not recommend the payment of a dividend (2012/13: £nil).

Financial instruments
The policy and practice of the Group with regard to financial instruments is disclosed in note 20 of the financial statements.

Directors
The Directors listed on pages 40 to 41 served throughout the year with the exception of Paul Oliver and Bruno Angelici. Paul Oliver was appointed as Chief Financial Officer and Company Secretary on 1 July 2013 and Bruno Angelici was appointed as a Non-Executive Director on 1 December 2013 and became Chairman of the Board on 1 February 2014.

In addition, Jack Cashman served as a Non-Executive Director and Chairman of the Board for the period 1 April 2013 to 1 February 2014.

Brief biographical details of each Director are set on pages 40 to 41.

Details of Directors' remuneration and their interests in the share capital of the Company are given in the Remuneration report. None of the Directors has any interest in any contract of significance to the financial statements.

With regard to the appointment and replacement of Directors, the Company is governed by its Articles of Association, the UK Corporate Governance Code, the Companies Act 2006 and related legislation. The Articles of Association themselves may be amended by special resolution of the shareholders. The powers of Directors are described in the Board's terms of reference, copies of which are available on request, and the Corporate governance report on pages 43 to 47.

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

Other than the indemnity provisions described above, none of the Directors had a material interest in any contract of significance to which the Company or any of its subsidiary undertakings was a party during the year ended 31 March 2014 and up to the date of the publication of this report.

Shares
Share capital
At 14 May 2014, the nearest practical date to the date of this report, the Company had a total of 3,302 ordinary shareholders and 399,889,916 ordinary shares in issue.

Rights and obligations
The rights and obligations attaching to the ordinary shares are set out in the Company's Articles of Association ("the Articles"). The Articles may only be amended by special resolution of the members of the Company. A copy of the Articles is available upon request.

Significant shareholdings
The Directors had been notified of the following substantial holdings in the Company's share capital as at the close of business on 14 May 2014:

	Number of shares	
	'000	%
Invesco Asset Management Limited	50,063	12.52
Legal & General Investment Management Limited	38,454	9.62
Franklin Resources, Inc.	27,629	6.91
Aberforth Partners LLP	20,730	5.19
Aviva plc	16,663	4.17
Baillie Gifford & Co	15,886	3.97
AXA SA	14,347	3.59

Share price

The mid-market share price as shown by the London Stock Exchange Daily Official List on 31 March 2014 was 153.25p. The mid-market share price ranged from 77p to 170p during the year to 31 March 2014. The average share price for the period was 113.4p.

Capital structure

Details of the authorised and issued share capital, together with details of the movements in the Company's issued share capital during the year, are shown in note 21. The Company has one class of ordinary shares which carry no right to fixed income. Each share carries the right to one vote at general meetings of the Company. The redeemable preference shares carry no interest, nor do they carry voting rights. The percentage of the issued nominal value of the ordinary shares is 74.6% of the total issued nominal value of all share capital.

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

Details of employee share schemes are set out in note 22. Shares held by the Vectura Group plc Employee Benefit Trust abstain from voting.

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

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

Employee engagement

The Group's policies on the environment, health and safety, ethical and social issues and its employees are disclosed in the Strategic review; refer to pages 29 to 32.

Political and charitable donations

Vectura encourages employee involvement in charitable causes, but does not contribute itself because it is loss-making. There were no political donations during the year (2012/13: £nil).

Going concern

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

The Group made a loss of £2.3m for the financial year ended 31 March 2014 (2012/13: £5.9m) but had £81.7m of cash and cash equivalents as at 31 March 2014 (2013: £70.1m). The Board operates an investment policy under which the primary objective is to invest in low-risk cash or cash equivalent investments to safeguard the principal. The Group's forecasts, taking into account likely revenue streams, show that the Group has sufficient funds to operate for the foreseeable future.

After reviewing the Group's forecasts and assessing the uncertain nature of some of the Group's forecast revenues, the Directors believe that the Group is adequately placed to manage its business and financing risks successfully despite the current uncertain economic outlook. Accordingly, they continue to adopt the going concern basis in preparing the Annual Report and Accounts.

Annual General Meeting

The Annual General Meeting will be held at the offices of Olswang, 90 High Holborn, London WC1V 6XX on 19 September 2014 at 12.00 noon. Details of the business to be transacted at the forthcoming AGM will be given in a separate circular to shareholders.

Auditor

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

The Directors who were members of the Board at the time of approving the Directors' report are listed on pages 40 and 41. Having made enquiries of fellow Directors and of the Company's auditor, each of these Directors confirms that:

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

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

Directors' report

The Directors' report comprises pages 72 to 73 of this Annual Report and Accounts.

By order of the Board

Paul Oliver
Company Secretary
20 May 2014

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

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

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

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

Directors' responsibility statement

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with International Financial Reporting Standards as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole;
- the Strategic report includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties which they face; and,
- the Annual Report and financial statements, taken as whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Company's performance, business model and strategy.

Paul Oliver
Director
20 May 2014

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

Opinion on financial statements of Vectura Group plc

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 March 2014 and of the Group's loss for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

The financial statements comprise the consolidated income statement, consolidated statement of comprehensive income, the balance sheet, the cash flow statement, the statement of changes in equity and the related notes 1 to 28. The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Separate opinion in relation to IFRSs as issued by the IASB

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

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

Going concern

As required by the Listing Rules we have reviewed the Directors' statement contained on page 73 that the Group is a going concern. We confirm that:

- we have concluded that the Directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate; and
- we have not identified any material uncertainties that may cast significant doubt on the Group's ability to continue as a going concern.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's ability to continue as a going concern.

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

Our assessment of risks of material misstatement

The assessed risks of material misstatement described below are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team:

Risk	How the scope of our audit responded to the risk
Acquisition accounting	
The Group acquired Activaero GmbH on 18 March 2014 for a total consideration of €130m. Management exercised judgement in determining its provisional valuation of the intangible assets and associated deferred tax liability, underlying net assets and resultant goodwill associated with the acquisition. See Note 28 to the financial statements where the key assumptions around the acquisition accounting have been disclosed.	We focused our audit work on the key judgements taken by management around the recognition and valuation of intangible assets and associated deferred tax liability. This included critically assessing the underlying cash flow forecasts and using our firm's valuation experts in auditing key assumptions such as independently recalculating and benchmarking the discount rate applied and evaluating whether the valuation technique was appropriate in the circumstances. We also worked with our tax experts in challenging and testing the key assumptions applied around the recognition of deferred tax. We have performed audit work on the underlying net assets acquired, including adjustments made to those amounts by management. This included, but was not limited to, testing a sample of current assets and liabilities to supporting audit evidence, verifying the valuation and existence of tangible assets and performing tests for unrecorded liabilities.
Goodwill impairment	
The carrying value of goodwill relies on assumptions and judgements made by management concerning the estimated future cash flows from a combination of early and late-stage research and development programmes, associated discount rates, regulatory milestones, clinical and commercial risk and market growth rates.	We assessed management's assumptions used in its impairment model for goodwill, described in Note 9 to the financial statements, including: • the cash flow projections (by discussing with senior operational management and considering the consistency of the forecasts with clinical and licensing partner data and contractual agreements); • discount rates (by engaging our valuation specialists to independently recalculate the Group's WACC and then performing an assessment of the risk adjustments applied by management); and • sensitivity analysis of management's forecasts including assessing the impact of applying further sensitivities.

Risk	How the scope of our audit responded to the risk
Revenue recognition The Group's two principal revenue streams are licence milestones and royalty income: • recognition of revenue on licence milestones can be subjective and management exercises judgement in determining whether the Group has fulfilled all of its performance obligations under that contract and therefore the relevant period over which to recognise revenue. This is a material judgement that impacts the financial statements; and • royalty income needs to be accrued for at year end based on management's estimate of the licence partners' global sales in the final quarter, over which there is no direct visibility. This requires management to exercise judgement in estimating the amount to recognise as revenue in the year, which has a material impact on the financial statements.	We reviewed the key contracts for the Group and management's calculations for each milestone to assess consistency with the Group's accounting policies and compliance with IAS 18 'Revenue'. We challenged management's assumptions through discussions with the development team and review of supporting documentation and regulatory announcements to assess whether the period of recognition for each milestone was appropriate. Our audit work focused on the royalty income accrued in the final quarter of the year and we used evidence from a range of sources, such as previous royalty statements and post year end correspondence with the licensing partners to challenge management's estimates around the amount accrued.

The Audit Committee's consideration of these risks is set out on page 49.

Our audit procedures relating to these matters were designed in the context of our audit of the financial statements as a whole, and not to express an opinion on individual accounts or disclosures. Our opinion on the financial statements is not modified with respect to any of the risks described above, and we do not express an opinion on these individual matters.

Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

We determined materiality for the Group to be £2m, which is approximately 1% of equity. Equity has been used as the basis for determining materiality as it represents the most stable aspect of the business, with year on year fluctuations seen in revenues and loss before tax as the Group progresses its R&D programmes; equity also reflects the Group's focus on cash generation and cash management.

We agreed with the Audit Committee that we would report to the Committee all misstatements identified in excess of £40,000, as well as misstatements below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

Our Group audit was scoped by obtaining an understanding of the Group and its environment, including Group-wide controls, and assessing the risks of material misstatement at the Group level.

Based on that assessment, we focused our Group audit scope on the UK businesses which are managed from Chippenham, UK. These were subject to a full scope audit by the Group audit team using component materialities which were lower than Group materiality. The UK businesses account for 99% of the Group's net assets, 99% of the Group's revenue and 85% of the Group's loss before tax.

Specified audit procedures were performed by the Group audit team in respect of the recently acquired German business using a component materiality which is lower than Group materiality. Including goodwill and intangible assets this business accounts for 1% of the Group's net assets, 1% of the Group's revenues and 15% of the Group's loss before tax for the period between acquisition and the year end.

At the parent entity level we also tested the consolidation process and performed analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to audit or audit of specified account balances.

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

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

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

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

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

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of Directors' remuneration have not been made or the part of the Directors' Remuneration report to be audited is not in agreement with the accounting records and returns. We have nothing to report arising from these matters.

Corporate Governance Statement

Under the Listing Rules we are also required to review the part of the Corporate Governance Statement relating to the Company's compliance with nine provisions of the UK Corporate Governance Code. We have nothing to report arising from our review.

Our duty to read other information in the Annual Report

Under International Standards on Auditing (UK and Ireland), we are required to report to you if, in our opinion, information in the Annual Report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or
- otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the directors' statement that they consider the Annual Report is fair, balanced and understandable and whether the Annual Report appropriately discloses those matters that we communicated to the Audit Committee which we consider should have been disclosed. We confirm that we have not identified any such inconsistencies or misleading statements.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities statement, 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. We also comply with International Standard on Quality Control 1 (UK and Ireland). Our audit methodology and tools aim to ensure that our quality control procedures are effective, understood and applied. Our quality controls and systems include our dedicated professional standards review team, strategically focused second partner reviews and independent partner reviews.

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

Matters on which we are required to report by exception continued

Scope of the audit of the financial statements

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

David Hedditch

David Hedditch (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
Bristol, United Kingdom
20 May 2014

Consolidated income statement
for the year ended 31 March 2014

	Note	2014 £m	2013 £m
Revenue	2	36.5	30.5
Cost of sales		(1.0)	(0.7)
Gross profit		35.5	29.8
Research and development expenses		(28.0)	(30.9)
Other administrative expenses		(3.4)	(3.3)
Non-recurring acquisition costs		(2.5)	—
Amortisation		(6.9)	(6.3)
Share-based compensation		(0.9)	(0.9)
Total administrative expenses		(13.7)	(10.5)
Operating loss	5	(6.2)	(11.6)
Presented as:			
EBITDA[1]		5.2	(3.4)
Non-recurring acquisition costs		(2.5)	—
Amortisation		(6.9)	(6.3)
Depreciation of assets		(1.1)	(1.0)
Share-based compensation		(0.9)	(0.9)
Operating loss		(6.2)	(11.6)
Investment income	4	1.6	0.5
Finance (costs)/gains	4	(0.2)	0.7
Loss before taxation		(4.8)	(10.4)
Taxation	7	2.5	4.5
Loss after taxation attributable to equity holders of the Company		(2.3)	(5.9)
Loss per share: basic and diluted	8	(0.7p)	(1.8p)

(1) Earnings before investment income, finance (costs)/gains, tax, depreciation, amortisation, share-based compensation, adjusted for non-recurring items.

All results are derived from continuing activities.

Consolidated statement of comprehensive income
for the year ended 31 March 2014

	Note	2014 £m	2013 £m
Loss after taxation attributable to equity holders of the Company		**(2.3)**	(5.9)
Other comprehensive loss:			
Items that may be subsequently reclassified through the income statement			
Foreign currency translation differences for foreign operations	28	**(1.6)**	—
Other comprehensive expense		**(1.6)**	—
Total comprehensive loss attributable to equity holders of the Company		**(3.9)**	(5.9)

Balance sheet
at 31 March 2014

		Group		Company	
	Note	2014 £m	2013 £m	2014 £m	2013 £m
Assets					
Goodwill	9	57.3	49.6	2.0	2.0
Intangible assets	10	138.9	17.1	—	—
Property, plant and equipment	11	11.6	9.0	—	—
Investments in subsidiary undertakings	12	—	—	233.8	125.6
Investments in joint venture	13	3.4	—	—	—
Other receivables	14	0.4	0.4	—	—
Non-current assets		211.6	76.1	235.8	127.6
Inventories	15	1.0	0.8	—	—
Trade and other receivables	16	13.7	9.2	—	—
Amounts due from subsidiary undertakings	17	—	—	86.7	72.9
Cash and cash equivalents	20	81.7	70.1	—	—
Current assets		96.4	80.1	86.7	72.9
Total assets		308.0	156.2	322.5	200.5
Liabilities					
Trade and other payables	18	(16.9)	(19.7)	—	—
Deferred income	19	(0.1)	(0.1)	—	—
Current liabilities		(17.0)	(19.8)	—	—
Deferred income	19	(1.7)	(1.3)	—	—
Deferred consideration	28	(28.7)	—	(28.7)	—
Deferred tax liabilities	7	(33.9)	—	—	—
Non-current liabilities		(64.3)	(1.3)	(28.7)	—
Total liabilities		(81.3)	(21.1)	(28.7)	—
Net assets		226.7	135.1	293.8	200.5
Equity					
Share capital	21a	0.1	0.1	0.1	0.1
Share premium	21b	97.4	2.8	97.4	2.8
Special reserve	21c	8.2	8.2	8.2	8.2
Other reserve	21d	124.9	124.9	123.7	123.7
Share-based compensation reserve	21e	13.8	12.9	13.8	12.9
Translation reserve	21f	(1.6)	—	—	—
Retained (loss)/profit	21g	(16.1)	(13.8)	50.6	52.8
Total equity		226.7	135.1	293.8	200.5

The financial statements of Vectura Group plc, registered number 03418970, were approved and authorised for issue by the Board of Directors on 20 May 2014 and were signed on its behalf by:

Dr C P Blackwell
Director

P S Oliver
Director

Cash flow statement
for the year ended 31 March 2014

	Group		Company	
	2014 £m	2013 £m	2014 £m	2013 £m
Operating loss	(6.2)	(11.6)	(2.6)	—
Depreciation and amortisation	8.0	7.3	—	—
Share-based compensation	0.9	0.9	—	—
Decrease/(increase) in inventories	0.2	(0.1)	—	—
Increase in trade and other receivables	(3.9)	—	—	—
Increase in inter-company receivables	—	—	(9.6)	—
Decrease in payables	(4.6)	(1.0)	—	—
Increase/(decrease) in deferred income	0.4	(3.4)	—	—
Exchange movements	(0.2)	0.7	—	—
Net cash outflow from operations	(5.4)	(7.2)	(12.2)	—
Research and development tax credits received	4.7	4.4	—	—
Net cash outflow from operating activities	(0.7)	(2.8)	(12.2)	—
Cash flows from investing activities				
Interest received	0.4	0.6	—	—
Purchase of property, plant and equipment	(2.3)	(4.0)	—	—
Receipts from sale of property, plant and equipment	—	0.2	—	—
Disposal of investments	1.2	—	—	—
Acquisition of Activaero GmbH	(37.8)	—	(37.8)	—
Non-recurring acquisition costs	(2.5)	—	—	—
Net cash outflow from investing activities	(41.0)	(3.2)	(37.8)	—
Net cash outflow before financing activities	(41.7)	(6.0)	(50.0)	—
Cash flows from financing activities				
Proceeds from issue of ordinary shares	55.3	0.6	52.0	—
Costs of raising equity	(2.0)	—	(2.0)	—
Net cash inflow from financing activities	53.3	0.6	50.0	—
Increase/(decrease) in cash and cash equivalents	11.6	(5.4)	—	—
Cash and cash equivalents at beginning of period	70.1	75.5	—	—
Cash and cash equivalents at end of period	81.7	70.1	—	—

Statement of changes in equity
for the year ended 31 March 2014

Group	Share capital £m	Share premium £m	Special reserve £m	Other reserve £m	Share-based compensation £m	Translation reserve £m	Retained loss £m	Total equity £m
At 1 April 2012	0.1	2.2	8.2	124.9	12.0	—	(7.9)	**139.5**
Loss for the year	—	—	—	—	—	—	(5.9)	**(5.9)**
Share-based compensation	—	—	—	—	0.9	—	—	**0.9**
Exercise of share options	—	0.6	—	—	—	—	—	**0.6**
At 31 March 2013	0.1	2.8	8.2	124.9	12.9	—	(13.8)	**135.1**
Loss for the year	—	—	—	—	—	—	(2.3)	**(2.3)**
Other comprehensive loss	—	—	—	—	—	(1.6)	—	**(1.6)**
Total comprehensive loss	—	—	—	—	—	(1.6)	(2.3)	**(3.9)**
Share-based compensation	—	—	—	—	0.9	—	—	**0.9**
Shares issued on acquisition	—	41.3	—	—	—	—	—	**41.3**
On placement of new shares	—	52.0	—	—	—	—	—	**52.0**
Cost of raising equity	—	(2.0)	—	—	—	—	—	**(2.0)**
Exercise of share options	—	3.3	—	—	—	—	—	**3.3**
At 31 March 2014	**0.1**	**97.4**	**8.2**	**124.9**	**13.8**	**(1.6)**	**(16.1)**	**226.7**

Company	Share capital £m	Share premium £m	Special reserve £m	Other reserve £m	Share-based compensation £m	Translation reserve £m	Retained profit £m	Total equity £m
At 1 April 2012	0.1	2.2	8.2	123.7	12.0	—	52.7	**198.9**
Profit for the year	—	—	—	—	—	—	0.1	**0.1**
Share-based compensation	—	—	—	—	0.9	—	—	**0.9**
Exercise of share options	—	0.6	—	—	—	—	—	**0.6**
At 31 March 2013	0.1	2.8	8.2	123.7	12.9	—	52.8	**200.5**
Loss for the year	—	—	—	—	—	—	(2.2)	**(2.2)**
Share-based compensation	—	—	—	—	0.9	—	—	**0.9**
Shares issued on acquisition	—	41.3	—	—	—	—	—	**41.3**
On placement of new shares	—	52.0	—	—	—	—	—	**52.0**
Cost of raising equity	—	(2.0)	—	—	—	—	—	**(2.0)**
Exercise of share options	—	3.3	—	—	—	—	—	**3.3**
At 31 March 2014	**0.1**	**97.4**	**8.2**	**123.7**	**13.8**	**—**	**50.6**	**293.8**

Notes to the financial statements
for the year ended 31 March 2014

1. Significant accounting policies

General information

Vectura Group plc is a public limited company incorporated in the United Kingdom under the Companies Act 2006. The address of the registered office and principal place of business is given on the final page of the report. The nature of the Group's operations and its principal activities are set out in Strategic report on pages 7 to 38.

The Company's ordinary shares are traded on the London Stock Exchange (LSE) under the ticker VEC.

Basis of preparation

The financial statements have been prepared in accordance with the Companies Act 2006 and IFRSs and related interpretations as adopted by the European Union and, therefore, the Group financial statements comply with Article 4 of the EU International Accounting Standard (IAS) Regulation. The Group and Company financial statements are also consistent with International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board (IASB).

The separate financial statements of the Company are presented as required by the Companies Act 2006 and have been prepared in accordance with IFRSs as adopted by the European Union. The Company is taking advantage of the exemption in section 408 of the Companies Act 2006 not to present its individual statement of comprehensive income and the related notes that form a part of these approved financial statements. The parent company loss for the year ended 31 March 2014 is £2.2m (2012/13: £0.1m profit).

The financial statements have been prepared on the historical cost basis, revised for use of fair values where required by applicable IFRS. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the Group takes into account the characteristics of the asset or liability if a market participant would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value measurements and/or disclosures purposes in these consolidated financial statements is determined on such basis, except for share-based payment transactions that are within the scope of IFRS 2, leasing transactions that are within the scope of IAS 17, and measurements that have some similarities to fair value but are not fair value, such as net realisable value in IAS 2 or value in use in IAS 36.

The presentational and functional currency of Vectura Group plc is sterling since that is the currency of the primary economic environment in which the Group operates. Foreign operations are included in accordance with the policies set out in this note to the financial statements. The consolidated financial statements are presented in sterling and all values are rounded to the nearest one hundred thousand (£0.1m), except where otherwise indicated. The principal accounting policies adopted are set out below.

Going concern

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

The Group made a loss of £2.3m for the financial year ended 31 March 2014 (2012/13: £5.9m) but had £81.7m of cash and cash equivalents as at 31 March 2014 (2013: £70.1m). The Board operates an investment policy under which the primary objective is to invest in low-risk cash or cash equivalent investments to safeguard the principal. The Group's forecasts, taking into account likely revenue streams, show that the Group has sufficient funds to operate for the foreseeable future.

After reviewing the Group's forecasts and assessing the uncertain nature of some of the Group's forecast revenues, the Directors believe that the Group is adequately placed to manage its business and financing risks successfully despite the current uncertain economic outlook. Accordingly, they continue to adopt the going concern basis in preparing the Annual Report and Accounts.

Basis of consolidation

The consolidated annual financial statements comprise the financial statements of Vectura Group plc and entities controlled by the Company (its subsidiaries) as at 31 March each year. Control is achieved when the Company:

- has power over the investee;
- is exposed to, or has rights, to variable return from its involvement with the investee; and
- has the ability to use its power to affect its returns.

The Company reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

Notes to the financial statements continued
for the year ended 31 March 2014

1. Significant accounting policies continued

Basis of consolidation continued

Subsidiaries are consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group. Where there is a loss of control of a subsidiary, the consolidated financial statements include the results for the part of the reporting year during which the Group had control.

The financial statements of subsidiaries are prepared for the same reporting year as the parent Company, using consistent accounting policies. Adjustments are made to bring into line any dissimilar accounting policies that may exist.

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

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 estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

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 determination of the fair value of acquired intangible assets, the measurement and review for impairment of definite and indefinite-life intangible assets (goodwill), revenue recognition and the treatment of research and development expenditure in line with the relevant accounting policy.

Estimation uncertainty – Intangible assets

The measurement of intangible assets other than goodwill on a business combination involves estimation of future cash flows and the selection of a suitable discount rate. In determining the fair value of acquired intangibles, the Group uses market-observable data to the extent that is available. To the extent that such inputs are not available, the Group works closely with external valuation experts to establish the appropriate valuation techniques and inputs to the model. Information about the valuation techniques and inputs used to determine the fair value of acquired intangible assets are disclosed in notes 28.

Estimation uncertainty – Impairment of goodwill

The Group determines on an annual basis whether goodwill is impaired and this requires the estimation of the value in use of the cash-generating units to which goodwill is allocated. The value in use calculation requires the entity to estimate the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate the present value. Details of goodwill are set out in note 9.

Critical accounting judgements – Revenue recognition

The recognition of milestone revenue income requires an assessment of the Group's future obligations under a given contract, which determines the period over which the revenue is recognised.

Estimation uncertainty – Share-based payments

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.

Critical accounting judgements – Research and development costs.

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

Revenue recognition

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

Technology and product licensing

Technology and product licensing income represents amounts earned for licences provided under licensing agreements, including up front payments, milestone payments and technology access fees. Revenues are recognised where they are non-refundable; the Group's obligations related to the revenues have been discharged and their collection is reasonably assured. Refundable licensing revenue is treated as deferred until such time that the above criteria have been met. 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.

1. Significant accounting policies continued

Revenue recognition continued

Royalty income

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

Pharmaceutical Development Services

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

Device sales

Device sales are recognised when goods are delivered to customers.

Interest income

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

Business combinations

The acquisition of subsidiaries is accounted for using the acquisition method. The cost of the acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree. Acquisition-related costs are recognised in the statement of comprehensive income as they are incurred. In accordance with IFRS 3 – Business Combinations, the Group has a twelve-month period in which to finalise the fair values allocated to assets and liabilities determined provisionally on acquisition.

Goodwill

Goodwill recognised under UK Generally Accepted Accounting Principles (GAAP) prior to 1 April 2004 is stated at net book value at that date. Goodwill arising on the acquisition of subsidiary or associate undertakings and businesses subsequent to 1 April 2004, representing any excess of the fair value of the consideration given over the fair value of the identifiable assets, liabilities and contingent liabilities acquired, is capitalised. After initial recognition, goodwill is stated at cost less any accumulated impairment losses, with the carrying value being reviewed for impairment at least annually and whenever events or changes in circumstances indicate that the carrying value may be impaired. For the purpose of impairment testing, goodwill is allocated to the related cash-generating units monitored by management. Where the recoverable amount of the cash-generating unit is less than its carrying amount, including goodwill, an impairment loss is recognised in the statement of comprehensive income. An impairment loss recognised for goodwill is not reversed in a subsequent period.

On disposal of a subsidiary, associate or jointly controlled entity, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Intangible assets

Intangible assets acquired separately from a business combination are carried initially at fair value. An intangible asset acquired as part of a business combination is recognised outside goodwill if the asset is separable or arises from contractual or other legal rights and its fair value can be measured reliably.

Development expenditure on internally developed intangible assets is taken to the statement of comprehensive income in the year in which it is incurred, except where expenditure relating to clearly defined and identifiable development projects meets the following criteria, in which case development expenditure will be recognised as an intangible asset:

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

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

Patents, trademarks and licence agreements – between three and ten years.

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

Notes to the financial statements continued
for the year ended 31 March 2014

1. Significant accounting policies continued

Property, plant and equipment

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

Buildings – 20 years

Laboratory equipment – three to seven years

Office and IT equipment – three years

Freehold land is not depreciated.

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

Impairment of assets

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

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

Investments in subsidiaries

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

Investments in associates and joint ventures

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

Financial assets

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

Inventories

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

1. Significant accounting policies continued

Trade and other receivables

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

Cash and cash equivalents

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

Leasing

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

Foreign currencies

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

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

For the purposes of presenting consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated at the exchange rate prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates for the period. Exchange differences arising, if any, are recognised in other comprehensive income and accumulated in equity.

Interest-bearing loans and borrowings

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

Financial liabilities

Financial liabilities are initially measured at fair value and, if material, are subsequently measured at amortised cost using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments throughout the expected life of the financial liability.

Provisions

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

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

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

Restructuring

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

Notes to the financial statements continued
for the year ended 31 March 2014

1. Significant accounting policies continued

Taxation

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

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

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

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

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

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

Research and development tax credits are recognised on an accruals basis.

Post-retirement benefits

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

Borrowing costs

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

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

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

Share-based payments

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

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

1. Significant accounting policies continued

New accounting standards and interpretations

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

- Amendments to IAS 1 – Presentation of Items of Other Comprehensive Income
  The amendment requires separate presentation of items that may be reclassified to profit or loss in the future from those that would never be reclassified.

- Amendments to IFRS 1 – Government Loans
  The amendment adds an exception to the retrospective application of IFRSs to require that first time adopters apply the requirements of IFRS 9 – Financial Instruments and IFRS 20 – Accounting for Government Grants and disclosure of Government Assistance prospectively to government loans existing at the date of transition to IFRS.

- Amendments to IFRS 7 – Financial Instruments: Disclosure on Offsetting Financial Assets and Financial Liabilities
  The amendment enhances current disclosures on offsetting financial assets and financial liabilities.

- IFRS 10 – Consolidated Financial Statements
  This standard replaces all of the guidance on control and consolidation in IAS 27 and SIC 12. IFRS 10 changes the definition of control so that the same criteria are applied to all entities to determine control. The core principle that a consolidated entity presents a parent and its subsidiaries as if they are a single entity remains unchanged, as do the mechanics of consolidation.

- IFRS 11 – Joint Arrangements and IAS 28 (revised 2011) – Investments in Associates and Joint Ventures
  The amendments eliminate the existing accounting policy choice of proportionate consolidation for jointly controlled entities and makes equity accounting mandatory for participants in joint ventures. Changes in definitions also mean that types of joint arrangements have been reduced from three to two, joint operations and joint ventures. IFRS 11 also made a number of consequential amendments to IAS 28 – Investments in Associates and Joint Ventures.

- IFRS 12 – Disclosure of Interest in Other Entities
  This standard sets out the required disclosures for entities reporting under IFRS 10 and IFRS 11. IFRS 12 requires entities to disclose information about the nature, risks and financial effects associated with the entities interest in subsidiaries, associates and joint arrangements and unconsolidated structured entities.

- IFRS 13 – Fair Value Measurement
  This standard explains how to measure fair value and enhances fair value disclosures. IFRS 13 established a single source of guidance for fair value measurements and disclosures about fair value measurements. The scope of IFRS 13 is broad; the fair value measurement requirements of IFRS 13 apply to both financial instruments and non-financial instrument items for which other IFRSs require or permit fair value measurements and disclosures about fair value measurements, except for share-based payment transactions that are within the scope of IFRS 2 – Share-based payment, leasing transactions that are within the scope of IAS 17 – Leases, and measurements that have some similarities to fair value but are not fair value (e.g. net realisable value for the purposes of measuring inventories or value in use for impairment assessment purposes).

  IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under the current market conditions. Fair value under IFRS 13 is an exit price, regardless of whether that price is directly observable or estimated using another valuation technique. IFRS 13 also includes extensive disclosure requirements.

- IAS 19 – Employee Benefits
  This standard makes significant changes to the recognition and measurement of defined benefit pension expense and termination benefits and significantly increases the volume of disclosures. The Group does not operate any defined benefit pension schemes.

- IAS 27 (revised 2011) – Separate Financial Statements
  This standard deals solely with separate financial statements.

- IAS 28 – Investments in Associates and Joint Ventures
  This standard outlines how to apply, with certain limited exceptions, the equity method to investments in associates and joint ventures. The standard also defines an associate by reference to the concept of "significant influence", which requires power to participate in financial and operating policy decisions of an investee (but not joint control or control of those polices).

Notes to the financial statements continued
for the year ended 31 March 2014

1. Significant accounting policies continued

New accounting standards and interpretations continued

- Amendments to IAS 36 – Recoverable amount disclosures for non-financial assets
  The amendment reduces the circumstances in which the recoverable amount of assets or cash-generating units is required to be disclosed, clarifies the disclosures required and introduces an explicit requirement to disclose the discount rate used in determining impairment where recoverable amount is determined using a present value technique.

  The Group has early adopted the amendments of IAS 36 (effective from 1 January 2014) and therefore the recoverable amounts of the Group's CGUs have not been disclosed.

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

FRS 10, IFRS 12 and IAS 27 (amended)	Investment Entities
IAS 32 (amended)	Offsetting Financial Assets and Financial Liabilities
IAS 39 (amended)	Novation of Derivatives and Continuation of Hedge Accounting
IFRIC 21	Levies

The Directors do not expect that the adoption of the standards listed above will have a material impact on the financial statements of the Group in future periods.

2. Revenue

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

Revenue by category	2014 £m	2013 £m
Royalties	**16.3**	13.0
Product licensing	**13.3**	12.8
Technology licensing	**4.3**	3.7
Development services	**1.7**	0.6
Device sales	**0.9**	0.4
	36.5	30.5
Investment income:		
Total investment income (note 4)	**1.6**	0.5
Total revenue per IAS 18	**38.1**	31.0

Revenue by customer location	2014 £m	2013 £m
United Kingdom	**2.8**	3.9
Rest of Europe	**17.4**	11.4
United States of America	**16.2**	15.2
Rest of world	**0.1**	—
	36.5	30.5

Information about major customers

Revenue earned from the Group's major customers was as follows: Customer A – £14.9m (2012/13: £12.7m), Customer B – £12.9m (2012/13: £12.7m), and Customer C – £2.5m (2012/13: £3.5m).

3. Segmental information

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

All revenue and losses before taxation originate in the United Kingdom and Germany. Revenues from external customers in the United Kingdom were £36.2m and non-current assets originating in the United Kingdom were £179.3m.

4. Investment income and finance gains

	2014 £m	2013 £m
Investment income:		
Income from sale of investments	**1.2**	—
Interest receivable on bank deposits and similar income	**0.4**	0.5
Total investment income	**1.6**	0.5
Finance (costs)/gains:		
Foreign exchange (losses)/gains	**(0.2)**	0.7

5. Operating loss

Operating loss is the result for the Group before investment income, finance (costs)/gains and taxation, and is stated after charging/(crediting):

	2014 £m	2013 £m
Amortisation of intangible assets	**6.9**	6.3
Depreciation of property, plant and equipment	**1.1**	1.0
Share-based compensation	**0.9**	0.9
Cost of inventories recognised as expense	**0.3**	0.2
Staff costs (note 6)	**13.4**	12.2
Non-recurring acquisition costs	**2.5**	—
Operating lease rentals:		
– land and buildings	**0.5**	0.5

The analysis of auditor's remuneration is as follows:

	2014 £000	2013 £000
Fees payable to the Company's auditor for the audit of the Company's annual accounts	**20**	20
Fees payable to the Company's auditor and its associates for other services to the Group:		
– the audit of the Company's subsidiaries	**63**	63
Total audit fees	**83**	83
Audit-related assurance services	**15**	15
Taxation compliance services	**4**	4
Other taxation advisory services	**20**	2
Other services	**315**	23
Total non-audit fees	**354**	44
Total fees	**437**	127

Notes to the financial statements continued
for the year ended 31 March 2014

5. Operating loss continued

Details of the Group's policy on the use of the auditor for non-audit services, the reasons why the auditor was used rather than another supplier and how the auditor's independence and objectivity was safeguarded are set out in the Audit Committee report on page 50. No services were provided pursuant to contingent fee arrangements.

Other services fees this year relate to tax advisory services and financial due diligence work to support the acquisition of Activaero GmbH.

6. Employees

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

	2014 Number	2013 Number
Research and development	199	201
Business development and administration	16	15
	215	216

The aggregate remuneration comprised:

	2014 £m	2013 £m
Wages and salaries	11.5	10.4
Social security costs	1.3	1.2
Other pension costs	0.6	0.6
	13.4	12.2

In addition to the wages and salaries analysis above are the effects of the charge for share-based compensation under IFRS 2 during the year of £0.9m (2012/13: £0.9m).

The Company had no employees during the years ended 31 March 2014 and 31 March 2013.

7. Taxation

The major components of the income tax credit for the years ended 31 March 2014 and 31 March 2013 were as follows:

	2014 £m	2013 £m
Research and development tax credits:		
– current year	3.3	3.8
– receipt in respect of prior year	0.9	0.4
Net (increase)/decrease in deferred tax liability	(1.7)	0.3
Total	2.5	4.5

Research and development tax credits are accrued based on the estimated receipt from Her Majesty's Revenue and Customs (HMRC).

7. Taxation continued

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

	2014 £m	2013 £m
Loss on ordinary activities before tax	**(4.8)**	(10.4)
Loss on ordinary activities multiplied by standard rate of UK corporation tax of 23% (2012/13: 24%)	**(1.1)**	(2.5)
Effects of:		
Expenses not deductible for tax purposes	**0.2**	0.2
Unrecognised tax losses carried forward	**0.9**	2.3
Net increase/(decrease) in deferred tax liability	**1.7**	(0.3)
Research and development tax credits		
– current year	**(3.3)**	(3.8)
– receipt in respect of prior year	**(0.9)**	(0.4)
Total tax credit for the year	**(2.5)**	(4.5)

In March 2013 the UK government announced the main rate of UK corporation tax would reduce to 21% with effect from 1 April 2014 and reduce to 20% with effect from 1 April 2015. These changes have 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.

Factors that may affect future tax charges are shown below.

Deferred tax asset

Cumulative tax losses of approximately £66.9m (2013: £79.7m), subject to agreement by HMRC, are available within the Group to carry forward against future taxable profits. Following the acquisition of Activaero GmbH, the Group acquired corporation tax losses brought forward of approximately €11.6m and trade tax losses of approximately €11.4m.

The Group has a total deferred tax asset of £16.7m. There is a deferred tax asset of £13.2m (2013: £19.6m) in relation to the UK tax losses, calculated at the standard tax rate of 20% (2013: 23%), of which £1.1m has been recognised. A further deferred tax asset of €3.1m (£2.6m) has been recognised in relation to the tax losses acquired from Activaero GmbH (see note 28).

	2014 £m	2013 £m
On UK cumulative tax losses – unrecognised	**12.1**	14.4
On UK cumulative tax losses – recognised	**1.1**	4.4
On German cumulative tax losses – recognised	**2.6**	—
On unclaimed capital allowances – unrecognised	**0.3**	—
On unexercised share options – unrecognised	**0.6**	0.8
	16.7	19.6

Notes to the financial statements continued
for the year ended 31 March 2014

7. Taxation continued
Deferred tax liability
A total deferred tax liability of £37.6m exists at 31 March 2014. This balance is broken down as follows:

	2014 £m	2013 £m
Arising on Innovata intangible assets	1.8	3.4
Excess of capital allowances over depreciation	1.2	1.0
Arising on acquisition of Activaero GmbH (see note 28)	34.6	—
	37.6	4.4

The deferred tax liability arising upon the acquisition of Activaero GmbH of £35.3m (€42m) is equal to 27% of the acquired intangible assets acquired.

A net deferred tax liability of £33.9m has been recognised on the balance sheet.

	2014 £m	2013 £m
Asset		
On UK cumulative tax losses – recognised	1.1	4.4
On German cumulative tax losses – recognised	2.6	—
	3.7	4.4
Liability		
Arising on Innovata intangible assets	(1.8)	(3.4)
Excess of capital allowances over depreciation	(1.2)	(1.0)
Arising on acquisition of Activaero GmbH (see note 28)	(34.6)	—
	(37.6)	(4.4)
	(33.9)	—

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

	2014	2013
Loss for the year (£m)	(2.3)	(5.9)
Weighted average number of ordinary shares (number m)	337.8	332.9
Loss per ordinary share	(0.7p)	(1.8p)

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

9. Goodwill

Group	2014 £m	2013 £m
Cost:		
At 1 April	**49.6**	49.6
Recognised on acquisition of a subsidiary (note 28)	**7.8**	—
Effect of movement in foreign exchange	**(0.1)**	—
At 31 March	**57.3**	49.6
Net book value:		
At 1 April	**49.6**	49.6
At 31 March	**57.3**	49.6

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

Group	2014 £m	2013 £m
Co-ordinated Drug Development Limited (since renamed Vectura Limited)	**1.5**	1.5
Vectura Delivery Devices Limited	**0.5**	0.5
Innovata Limited	**47.6**	47.6
Activaero GmbH	**7.7**	—
	57.3	49.6

Goodwill is allocated to cash-generating units (CGUs), which are tested for impairment on an annual basis, or more frequently if there are indications that goodwill might be impaired. The recoverable amounts of the cash-generating units are assessed using a value-in-use model. An impairment provision is recognised only if the goodwill carrying value exceeds this value in use.

The key assumptions for the value-in-use calculations are those regarding the discount rates, growth rates and expected changes to contribution during the period. The model has been based on the most recent pre-tax cash flow forecasts prepared by management, which consist of detailed probability weighted product-by-product analyses. These forecasts are based on development timings and specific projections for sales volumes over the likely period in which cash flows could be expected. No terminal values have been included in the cash flow forecasts. No general growth rates are assumed. The discount rates used in the forecasts range from 8% to 13.5%.

Following the acquisition of Activaero GmbH in March 2014, and for the purpose of impairment testing of goodwill, the Group is split into two cash-generating units (CGUs), being the Vectura CGU and the Activaero CGU.

In previous periods the Group was split into two cash-generating units, being the Vectura CGU, which includes Vectura Limited and Vectura Delivery Devices Limited, and the Innovata CGU, being the group of companies acquired in January 2007. These two CGUs have been combined into the Vectura CGU in the current period. This change was considered necessary as the Company no longer has separate Vectura and Innovata projects, the projects use a combination of technology and expertise from both businesses and are monitored as such internally. No impairment loss was recognised as a result of this reallocation.

Notes to the financial statements continued
for the year ended 31 March 2014

9. Goodwill continued

Goodwill has been allocated to the following cash-generating units:

	2014 £m	2013 £m
Vectura CGU	**49.6**	49.6
Activaero CGU	**7.7**	—
	57.3	49.6

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

Company	£m
Carrying amount:	
At 31 March 2013 and **31 March 2014**	**2.0**

The goodwill in the Company arose on the acquisition of the Centre for Drug Formulation Studies, an unincorporated entity, in 1999. Amortisation of £0.7m was applied prior to 1 April 2004. Goodwill in the Company is tested for impairment using the same discount rates and on the same basis as for the Group.

10. Intangible assets

Group	Patents and trademarks £m	Licences £m	Total £m
Cost:			
At 1 April 2012 and 31 March 2013	3.5	74.6	78.1
Acquired on acquisition of subsidiary (note 28)	104.5	26.2	130.7
Effects of movements in foreign exchange	(1.6)	(0.4)	(2.0)
At 31 March 2014	**106.4**	**100.4**	**206.8**
Amortisation:			
At 1 April 2012	(3.5)	(51.2)	(54.7)
Charge for the year	—	(6.3)	(6.3)
At 31 March 2013	(3.5)	(57.5)	(61.0)
Charge for the year	(0.4)	(6.5)	(6.9)
At 31 March 2014	**(3.9)**	**(64.0)**	**(67.9)**
Net book value:			
At 31 March 2013	—	17.1	17.1
At 31 March 2014	**102.5**	**36.4**	**138.9**

Intangible assets are being amortised on a straight-line basis over a period of ten years. The Company had no intangible assets at 31 March 2014 and 31 March 2013.

11. Property, plant and equipment

Group	Assets in the course of construction £m	Freehold land and buildings £m	Laboratory equipment £m	Office and IT equipment £m	Total £m
Cost:					
At 1 April 2012	2.5	0.8	11.5	0.5	15.3
Additions	2.3	0.1	1.6	—	4.0
Disposals	—	—	(0.1)	—	(0.1)
At 31 March 2013	4.8	0.9	13.0	0.5	19.2
Additions	1.6	—	0.9	—	2.5
Acquired on acquisition of Activaero GmbH (note 28)	—	0.3	0.9	—	1.2
At 31 March 2014	**6.4**	**1.2**	**14.8**	**0.5**	**22.9**
Depreciation:					
At 1 April 2012	—	—	(8.9)	(0.4)	(9.3)
Charge for the year	—	—	(1.0)	—	(1.0)
Disposals	—	—	0.1	—	0.1
At 31 March 2013	—	—	(9.8)	(0.4)	(10.2)
Charge for the year	—	—	(1.1)	—	(1.1)
At 31 March 2014	**—**	**—**	**(10.9)**	**(0.4)**	**(11.3)**
Net book value:					
At 31 March 2013	4.8	0.9	3.2	0.1	9.0
At 31 March 2014	**6.4**	**1.2**	**3.9**	**0.1**	**11.6**

The Company had no property, plant and equipment at 31 March 2014 and 31 March 2013.

12. Investments in subsidiary undertakings

Company	Shares in subsidiary undertakings £m
Cost:	
At 1 April 2012 and 31 March 2013	125.7
Additions (note 28)	108.2
At 31 March 2014	**233.9**
Amounts written off:	
At 1 April 2012, 31 March 2013 and **31 March 2014**	**(0.1)**
Net book value:	
At 31 March 2013	125.6
At 31 March 2014	**233.8**

Notes to the financial statements continued
for the year ended 31 March 2014

12. Investments in subsidiary undertakings continued

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

Name of undertaking	Country of incorporation	Holding	Proportion held	Nature of business
Vectura Group Investments Limited	England	Ordinary	100%	Pharmaceuticals
Vectura Limited(1)	England	Ordinary	100%	Pharmaceuticals
Vectura Delivery Devices Limited(1)	England	Ordinary	100%	Pharmaceuticals
Vectura Inc.	USA	Ordinary	100%	Pharmaceuticals
Innovata Limited(1)	England	Ordinary	100%	Pharmaceuticals
Innovata Biomed Limited(2)	Scotland	Ordinary	100%	Pharmaceuticals
Vectura GmbH (formerly Activaero GmbH)	Germany	Ordinary	100%	Pharmaceuticals

(1) A subsidiary of Vectura Group Investments Limited.

(2) A subsidiary of Innovata Limited.

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

13. Investments in joint ventures

The investment balance shown below relates to the Group's investment in Ventaleon GmbH, whose principal activity is the research and development of pharmaceuticals. Ventaleon is incorporated in Germany and its principal place of business is also Germany. The Group holds a 48% share in the Company.

Group	£m
Cost:	
At 1 April 2012 and 31 March 2013	—
Additions (note 28)	3.5
Effects of movements in foreign exchange	(0.1)
At 31 March 2014	**3.4**
Net book value:	
At 31 March 2013	—
At 31 March 2014	**3.4**

14. Other receivables

Group

Other receivables represent an investment bond of £0.4m (2013: £0.4m) in respect of a rental deposit paid under the terms of a lease agreement for the Company's premises at Chippenham. The deposit is for a fixed period of one year and is renewed annually. Under the terms of the lease agreement the deposit must be maintained until the Group has made three years of consecutive profits. The interest rate is 1% below the Royal Bank of Scotland base rate and was 0% for the year ended 31 March 2014. Interest is recognised using the effective interest method.

15. Inventories

	Group 2014 £m	Group 2013 £m	Company 2014 £m	Company 2013 £m
Finished goods	**1.0**	0.8	**—**	—

16. Trade and other receivables

	Group 2014 £m	Group 2013 £m	Company 2014 £m	Company 2013 £m
Trade receivables	**4.4**	0.1	**—**	—
Other receivables[1]	**3.4**	4.0	**—**	—
Prepayments and accrued income	**5.0**	4.2	**—**	—
VAT recoverable	**0.9**	0.9	**—**	—
	13.7	9.2	**—**	—

(1) Includes research and development tax credits of £3.3m (2013: £3.8m).

The average credit period taken by customers is 30 days (2013: 30 days). The Directors consider that the carrying value of trade and other receivables approximates to their fair value.

17. Amounts due from and owed to subsidiary undertakings

	Group 2014 £m	Group 2013 £m	Company 2014 £m	Company 2013 £m
Amounts falling due within one year:				
Due from subsidiary undertakings	**—**	—	**86.7**	72.9
	—	—	**86.7**	72.9

18. Trade and other payables

	Group 2014 £m	Group 2013 £m	Company 2014 £m	Company 2013 £m
Amounts falling due within one year:				
Trade payables	**2.3**	3.8	**—**	—
Other payables	**0.5**	0.3	**—**	—
Accruals	**14.1**	15.6	**—**	—
	16.9	19.7	**—**	—

Trade payables principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken by the Group for trade purchases is 31 days (2013: 31 days).

Notes to the financial statements continued
for the year ended 31 March 2014

19. Deferred income

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

	Group		Company	
	2014 £m	2013 £m	**2014 £m**	2013 £m
Amounts due within one year	**0.1**	0.1	**—**	—
Amounts due in more than one year	**1.7**	1.3	**—**	—
	1.8	1.4	**—**	—

20. Financial instruments

Categories of financial instruments

Unless stated otherwise, all disclosures relate to the Group.

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

	2014 £m	2013 £m
Cash and cash equivalents	**81.7**	70.1
Loans and receivables	**13.7**	8.8
	95.4	78.9

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

There were no provisions against impaired assets at 31 March 2014 (31 March 2013: £nil). There are no amounts past due but not impaired (2013: £nil).

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

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

	2014 £m	2013 £m
Other	**(16.9)**	(19.7)

All financial liabilities fall due within one year.

Fair value of financial assets and liabilities

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

Capital risk management

The Group manages its capital to ensure that entities in the Group will be able to continue as going concerns while maximising the return to stakeholders. The capital structure of the Group consists of cash and cash equivalents and equity attributable to equity holders of Vectura Group plc, comprising issued share capital (note 21a), reserves and retained earnings as disclosed in the statement of changes in equity.

Externally imposed capital requirement

The Group is not subject to externally imposed capital requirements.

20. Financial instruments continued

Significant accounting policies

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

Financial risk management

The Group's objective in using financial instruments is to maximise the returns on funds held on deposit, to minimise exchange rate risk where appropriate, and to generate additional cash resources through the issue of shares when appropriate. Balance sheets at 31 March 2014 and 31 March 2013 are not necessarily representative of the positions throughout the year, as cash and short-term investments fluctuate considerably depending on when share issues have occurred.

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

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

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

Foreign currency risk management

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

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

	Group		Company	
	2014 £m	2013 £m	**2014 £m**	2013 £m
Cash and cash equivalents:				
Euro	**5.7**	2.6	**—**	—
US dollar	**2.5**	8.2	**—**	—
	8.2	10.8	**—**	—

Foreign currency sensitivity analysis

The following table details the Group's sensitivity to a 10% increase and decrease in sterling against the euro and US dollar; 10% represents management's assessment of a reasonably possible change in foreign exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated items and adjusts their translation at the period end for a 10% change in foreign currency rates. A positive number below indicates an increase in profit and other equity where sterling weakens against the relevant currency. For a 10% strengthening of sterling against the euro and the US dollar there would be an equal and opposite impact on the loss and other equity and the balances below would be negative (2012/13: negative).

	2014 £m	2013 £m
Euro currency impact – gain	**0.5**	0.3
US dollar currency impact – gain	**0.2**	0.8

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

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

Notes to the financial statements continued
for the year ended 31 March 2014

20. Financial instruments continued

Interest rate risk management

The Group has no external borrowings and is not exposed to interest rate risk through borrowings. Cash and cash equivalents earned £0.4m of finance income during the year (2012/13: £0.5m). If interest rates had been 0.5% higher/lower and all other variables were constant, the Group's loss for the year ended 31 March 2014 would decrease/increase by £0.3m (2012/13: £0.4m).

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

Liquidity risk management

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

Credit risk management

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

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

Market risk management

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

21. Equity

(a) Share capital

	2014 £m	No. '000	2013 £m	No. '000
Authorised:				
Ordinary shares of 0.025p each	0.1	441,200	0.1	441,200
Redeemable preference shares of £1 each	—	34	—	34
Allotted, called up and fully paid:				
Ordinary shares of 0.025p each:				
At 1 April	0.1	334,456	0.1	331,686
Issued to Share Investment Plan	—	—	—	1,000
Issued on exercise of share options	—	5,174	—	1,062
Issued on exercise of Sharesave options	—	172	—	226
Issued on exercise of LTIP options	—	646	—	482
Issued on placement of shares	—	33,565	—	—
Issued on acquisition of subsidiary (note 28)	—	25,641	—	—
At 31 March	0.1	399,654	0.1	334,456
Redeemable preference shares of £1 each:				
At 1 April and 31 March	—	34	—	34

21. Equity continued

(a) Share capital continued

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

Between 1 April 2013 and 31 March 2014 the Company did not issue any ordinary shares to the Vectura Group plc Employee Benefit Trust (2012/13: 1,000,000).

Between 1 April 2013 and 31 March 2014 the Company issued 5,173,784 (2012/13: 1,061,980) ordinary shares of 0.025p each on the exercise of employee share options at a weighted average exercise price of 61.19p per share (2012/13: 48.52p).

Between 1 April 2013 and 31 March 2014 the Company issued 171,736 (2012/13: 225,634) ordinary shares of 0.025p each on the exercise of Sharesave options at a weighted average exercise price of 55.5p (2012/13: 48.18p) per share.

Between 1 April 2013 and 31 March 2014 the Company issued 646,484 (2012/13: 482,121) ordinary shares of 0.025p each on the exercise of LTIP nil-cost options.

On 18 March 2014 the Company placed 33,565,280 new shares at a price of £1.55 per share.

On 18 March 2014 the Company issued 25,641,398 to the shareholders of Activaero GmbH as part of the purchase consideration for 100% of its ordinary share capital. The ordinary shares issued have the same rights as the other shares in issue. The fair value of the shares issued amounted to £41m (£1.609 per share).

(b) Share premium

The share premium account consists of the proceeds from the issue of shares in excess of their par value (which is included in the share capital account) less amounts transferred to distributable reserves through capital conversion. Certain costs relating to share issues have also been charged to the share premium account.

(c) Special reserve

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

(d) Other reserve

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

(e) Share-based compensation reserve

The share-based compensation reserve represents the credit arising on the charge for share options, also matching and free shares awarded under the Vectura Group plc Share Incentive Plan, calculated in accordance with IFRS 2.

(f) Translation reserve

Exchange differences relating to the translation of the net assets of the Group's foreign operations, which relate to subsidiaries only, from their functional currency into the parent's functional currency, being sterling, are recognised directly in the translation reserve

(g) Retained (loss)/profit

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

Notes to the financial statements continued
for the year ended 31 March 2014

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

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

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

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

The Company also operates a Long-Term Incentive Plan (LTIP) under which Executive Directors and certain senior managers are granted conditional rights in the form of nil-cost options to receive a maximum number of shares at the beginning of a three-year period, a proportion of which they will be entitled to receive at the end of that period, depending on the extent to which the challenging performance conditions set by the Remuneration Committee at the time the allocation was made are satisfied. The nil-cost option entitlement is exercisable from the beginning of the fourth year to the end of the tenth year following the date of grant. Further information on the performance conditions of the LTIP is detailed in the Remuneration report. At 31 March 2014, 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	482,035
22 November 2009	409,864
2 March 2010	104,758
25 May 2010	446,636
23 May 2011	1,348,100
7 June 2014[(1)]	1,982,311
18 September 2015[(1)]	1,564,438
7 June 2016[(1)]	2,004,878

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

On 31 October 2008, the shareholders approved a Value Realisation Plan (VRP). The VRP runs in parallel to the LTIP and provides participants with a share of a predetermined percentage of the total consideration paid for the Company in the event of a change in control within five years of the date of approval of the Plan. In this event, under the VRP members of the Executive Committee of the Company will be granted a one-off entitlement in the form of units, which convert into ordinary shares in the Company, the actual number of shares that convert being linked to the offer price per share achieved. The VRP is triggered upon achievement of a minimum bid price of £1.27 per share, with a maximum number of shares available to participants if the bid price reaches £1.77 per share or greater. This scheme expired in October 2013.

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

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 2014 there were no options outstanding that were granted before this date (2012/13: 318,324).

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

Year of grant	2014	2013
The assumptions input into the Black-Scholes model were as follows:		
Weighted average share price of grants during the year	163.0p	72.03p
Weighted average exercise price of grants during the year	130.4p	80.41p
Expected volatility(1)	41%–45%	45%–49%
Expected life(2)	3–5 years	3–5 years
Expected dividends	Nil	Nil
Risk-free interest rate(3)	0.3%–1.2%	0.3%–0.5%
The assumptions input into the Monte Carlo model were as follows:		
Weighted average share price of grants during the year	81.0p	81.5p
Weighted average exercise price of grants during the year	0.025p	0.025p
Expected volatility(1)	43%	49%
Expected life(2)	3 years	3 years
Expected dividends	Nil	Nil
Risk-free interest rate(3)	0.6%	0.4%

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

(2) The expected life used in the models is based on management's best estimate of behavioural consideration based on historic exercise patterns.

(3) 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 share-based compensation charge for the year ended 31 March 2014, including the LTIP, was £890,000 (2012/13: £918,000).

The aggregate of the estimated fair value of options granted under share option schemes and Share Incentive Plan during the year ended 31 March 2014 was £493,000 (2012/13: £336,000) and under the SAYE Scheme £59,000 (2012/13: £53,000). The estimated fair value of LTIP awards during the year ended 31 March 2014 was £780,000 (2012/13: £790,000).

Notes to the financial statements continued
for the year ended 31 March 2014

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

Fair value calculations continued

	Share option schemes		SAYE Scheme		LTIP	
Options outstanding	Number of options	WAEP*	Number of options	WAEP*	Number of options	WAEP*
At 1 April 2012	13,735,473	79.91	1,656,518	50.43	10,905,510	0.025
Options granted	153,833	66.75	170,367	76.80	1,710,423	0.025
Options exercised	(1,061,980)	48.52	(225,634)	51.32	(482,121)	0.025
Options cancelled	(137,887)	80.81	(41,583)	58.32	(2,134,079)	0.025
At 31 March 2013	12,689,439	60.64	1,559,668	53.50	9,999,733	0.025
Options granted	—	—	115,930	130.40	2,004,878	0.025
Options exercised	(5,167,784)	61.19	(171,736)	55.50	(646,484)	0.025
Options cancelled	—	—	(37,539)	47.95	(3,015,107)	0.025
At 31 March 2014	**7,521,655**	**61.67**	**1,466,323**	**59.41**	**8,343,020**	**0.025**
Range of exercise prices		0.025p–104p		47.4p–130.4p		0.025p
Weighted average remaining contractual life (years)		2.19 (2013: 2.43)		1.67 (2013: 2.30)		6.05 (2013: 6.37)
Options vested						
At 31 March 2013	11,915,629	60.64	—	—	3,266,926	0.025
At 31 March 2014	**6,986,739**	**59.75**	**—**	**—**	**2,791,393**	**0.025**
Weighted average remaining contractual life (years)		1.80 (2013: 2.08)	—	—		2.82 (2013: 3.81)

* = Weighted average exercise price (p).

23. Analysis of net funds

Group	1 April 2013 £m	Cash flow £m	**31 March 2014 £m**
Cash and cash equivalents	70.1	11.6	**81.7**

The Company had no net funds at 31 March 2014 and 31 March 2013.

24. Retirement benefits plans

The Group operates a number of defined contribution personal pension plans for all qualifying employees. The assets of the schemes are held separately from those of the Group and are independently administered. The total cost charged in the statement of comprehensive income is detailed in note 6.

25. Operating lease arrangements

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

Group	Land and buildings 2014 £m	Land and buildings 2013 £m	Other 2014 £m	Other 2013 £m
Expiry date:				
Within one year	**0.5**	0.5	**—**	—
In the second to fifth years inclusive	**0.8**	1.1	**0.1**	—
	1.3	1.6	**0.1**	—

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

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

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

On 18 March 2014, the Group acquired, as part of the Activaero GmbH acquisition, an agreement in respect of premises at Gauting, Germany. The Group has the right to break the lease with a maximum of nine months' notice.

The Company had no other operating lease arrangements at 31 March 2014 and 31 March 2013.

26. Capital and other commitments

At 31 March 2014 the Group had capital commitments contracted, but not provided for, of £0.3m (2013: £1.7m). The Company had no capital and other commitments at 31 March 2014 and 31 March 2013.

27. Related party transactions

Group

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

Remuneration of key management personnel

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

	2014 £m	2013 £m
Short-term employee benefits	**2.3**	1.5
Post-employment benefits	**0.2**	0.1
Share-based payments	**0.3**	0.3
	2.8	1.9

Please refer to page 62 of the Remuneration report for the single figure of remuneration for each Director.

Notes to the financial statements continued
for the year ended 31 March 2014

27. Related party transactions continued

Company

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

Related party	Recharge from related parties £m	Recharge to related parties £m	Amounts owed by related parties £m	Amounts owed to related parties £m
Subsidiaries:				
2013	—	0.9	72.9	—
2014	**—**	**0.9**	**86.7**	**—**

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

28. Business combinations

On 18 March 2014, the Group acquired 100% of the issued share capital and obtained control of Activaero GmbH (Activaero), a company focused on the development of products for the treatment of respiratory diseases. The acquisition of Activaero fulfils a number of strategic priorities in a single transaction, creating a therapeutic area specialist for airways diseases. The combined entity will benefit from:

- diversified income streams with long-term value-creation for Vectura's shareholders;
- a balanced pipeline of late-stage and early-stage assets across a spectrum of indications;
- access to revenue generating, proprietary, smart nebuliser-based technology that enables targeting of inhaled drugs into pre-selected areas of the lung;
- the opportunity to develop a wide range of molecular entities, ranging from small molecules to biologics; and
- a broader partnership base.

The following table summarises the provisional amounts recognised in respect of the identifiable assets acquired and liabilities assumed on the acquisition of Activaero.

	£m
Identifiable intangible assets (note 10)	130.7
Property, plant and equipment (note 11)	1.2
Investment in joint venture (note 13)	3.5
Inventories	0.4
Trade and other payables	(2.7)
Deferred tax liability	(32.7)
Total identifiable assets	100.4
Goodwill	7.8
Total consideration	**108.2**

28. Business combinations continued

Satisfied by:

	£m
Cash	37.8
Equity instruments (25,641,398 ordinary shares)	41.3
Deferred cash consideration payable in August 2015	29.1
Total consideration	**108.2**
Net cash outflow arising on acquisition	
Cash consideration	37.8
	37.8

The above transaction contains certain translations of euros into amounts in pounds sterling based on the exchange rate of £1.00 = €1.1913, being the published exchange rate by the Financial Times at the close of business on 18 March 2014, being the date of acquisition.

The fair value of the 25,641,398 ordinary shares issued as part of the consideration paid for Activaero was calculated using a two-week VWAP (volume weighted average price) share price calculated on 10 March 2014 as 160.9p per share.

The goodwill of £7.8m arising from the acquisition is attributable to the future development opportunities arising from the acquisition of proprietary, smart nebuliser-based technology and certain cost synergies.

In the period since 18 March 2014, Vectura GmbH (formerly Activaero GmbH) contributed £0.3m revenue to the Group and this is recognised in the consolidated statement of income. Over the same period, the subsidiary incurred underlying costs of £0.3m.

Had Activaero been consolidated from 1 April 2013, Group revenues would have been £39.9m and the Group loss after tax would have been £2.1m.

The deferred cash consideration is non-contingent. The undiscounted amount that Vectura Group plc is due to pay is €35m. The deferred cash consideration of €35m has been discounted to a present value of €34.7m by applying a discount rate of 0.5%.

Acquisition-related costs of £2.5m have been included in other administrative expenses.

Further costs of £2.0m were incurred following the placing of new shares, and these costs have been recognised in share premium.

Due to the proximity of the acquisition to Vectura's year end, in accordance with IFRS 3, the initial accounting outlined above is deemed to be provisional pending finalisation of the fair value exercise. On that basis the assets, liabilities or items of consideration may be restated at any time up to the anniversary of the acquisition date in March 2015.

Five-year summary
year ended 31 March

Unaudited Year ended 31 March	2010 £m	2011 £m	2012 £m	2013 £m	2014 £m
Consolidated statement of comprehensive income					
Revenue	40.1	42.9	33.0	30.5	**36.5**
Gross profit	36.6	40.2	30.8	29.8	**35.5**
Gross profit margin	91%	94%	93%	98%	**97%**
Research and development expenses	(34.8)	(36.4)	(31.7)	(29.9)	**(26.9)**
Other administrative expenses	(3.4)	(3.3)	(3.3)	(3.3)	**(3.4)**
EBITDA	(1.6)	0.5	(4.2)	(3.4)	**5.2**
Depreciation	(1.6)	(1.3)	(1.1)	(1.0)	**(1.1)**
Amortisation	(10.6)	(10.7)	(7.5)	(6.3)	**(6.9)**
Non-recurring acquisition costs	—	—	—	—	**(2.5)**
Share-based compensation	(1.5)	(1.8)	(1.1)	(0.9)	**(0.9)**
Operating loss	(15.3)	(13.3)	(13.9)	(11.6)	**(6.2)**
Investment income	0.6	0.8	0.7	0.5	**1.6**
Finance gains/(costs)	0.9	(0.8)	—	0.7	**(0.2)**
Loss before taxation	(13.8)	(13.3)	(13.2)	(10.4)	**(4.8)**
Taxation	3.6	4.5	8.8	4.5	**2.5**
Loss after taxation	(10.2)	(8.8)	(4.4)	(5.9)	**(2.3)**
Loss per ordinary share	(3.2p)	(2.7p)	(1.3p)	(1.8p)	**(0.7p)**
Cash flow statement					
Operating loss	(15.3)	(13.3)	(13.9)	(11.6)	**(6.2)**
Depreciation and amortisation	12.2	12.0	8.6	7.3	**8.0**
Share-based compensation	1.5	1.8	1.1	0.9	**0.9**
Decrease/(increase) in working capital	4.1	0.2	2.4	(1.1)	**(8.3)**
(Decrease)/increase in deferred income	(7.7)	2.8	(0.7)	(3.4)	**0.4**
Exchange movements	0.9	(0.8)	—	0.7	**(0.2)**
Taxation paid	(0.2)	(0.1)	—	—	**—**
Research and development tax credits received	0.7	8.2	4.6	4.4	**4.7**
Net cash (outflow)/inflow from operations	(3.8)	10.8	2.1	(2.8)	**(0.7)**
Net capital expenditure	(1.0)	(1.4)	(4.2)	(3.8)	**(2.3)**
Free cash flow (outflow)/inflow	(4.8)	9.4	(2.1)	(6.6)	**(3.0)**
Balance sheet					
Cash and cash equivalents	64.1	74.4	75.5	70.1	**81.7**
Shareholders' equity	147.1	140.3	139.5	135.1	**226.7**
Net current assets	56.2	59.6	61.7	60.3	**79.4**

Shareholder information

Directors
Bruno F J Angelici
(Non-Executive Chairman)

Dr Christopher P Blackwell
(Chief Executive)

Paul S Oliver
(Chief Financial Officer)

Dr Trevor M Phillips
(Chief Operations Officer and President of US Operations)

Dr John R Brown
(Non-Executive and Senior Independent Director)

Dr Susan E Foden
(Non-Executive)

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