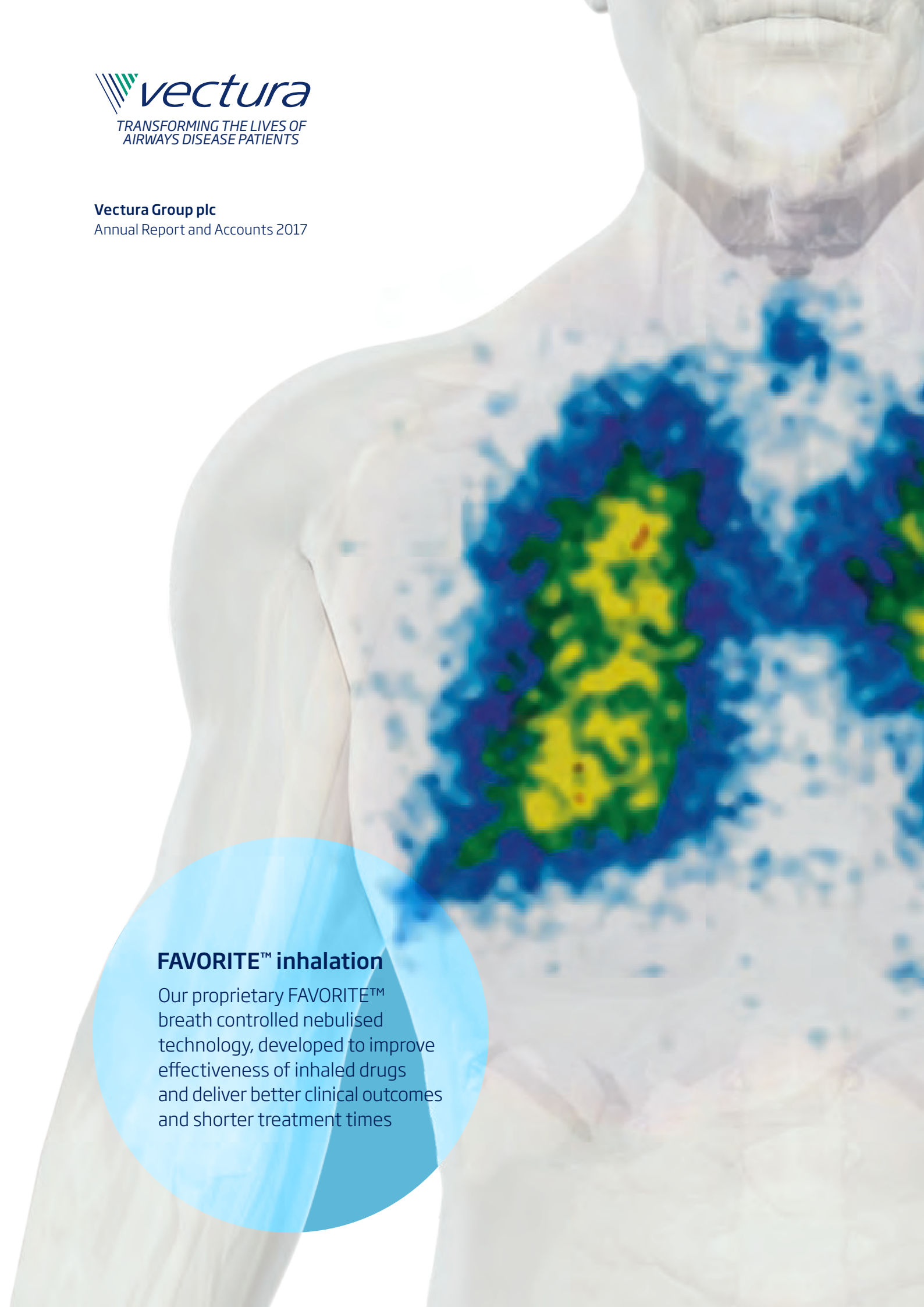
vectura

TRANSFORMING THE LIVES OF AIRWAYS DISEASE PATIENTS

Vectura Group plc
Annual Report and Accounts 2017



FAVORITE™ inhalation

Our proprietary FAVORITE™ breath controlled nebulised technology, developed to improve effectiveness of inhaled drugs and deliver better clinical outcomes and shorter treatment times

ASTHMA

Asthma is one of the most common non-communicable diseases.[1]

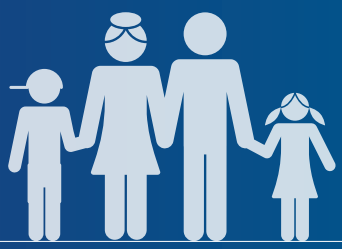
Asthma is a chronic, reversible disease that inflames and narrows airways in the lungs, causing wheezing, chest tightness and coughing.[2] Not all asthma is the same and severe asthma can have a number of underlying causes.[3]

Triggers[4]

- Dust mites
- Pets
- Sulphites in foods and drinks
- Infections, such as colds
- Physical activity, including exercise

Symptoms

- Recurring attacks of breathlessness and wheezing that vary in severity and frequency from person to person[5]
- Asthma attacks – a sudden worsening of symptoms, can be unpredictable
- During an asthma attack, the lining of the bronchial tubes swell, causing the airways to narrow and reducing the flow of air into and out of the lungs[6]



Prevalence

- Asthma is a significant health burden of considerable and growing significance with increasing urbanisation[7]
- Estimated 10m adults under the age of 45 affected in Europe[9] and 18.4m adults in the US[9]
- Prevalence continues to increase and it is estimated that by 2025 asthma will affect more than 400m people globally[10]
- Asthma affects people of all ages but most frequently begins in childhood[11]

14%

of the world's children experience asthma symptoms[12]

Impact

- Patients with uncontrolled asthma are significantly more likely to suffer from poor outcomes and medical emergencies
- Asthma caused 383,000 deaths in 2015[13]

40–50%

of patients are not well controlled[14]; poor adherence to treatment and device user errors contribute to lack of control [15]

By 2025 the total asthma market is expected to be worth over

$17bn[16]

1 Latest WHO estimates, released in December 2016, www.who.int/mediacentre/factsheets/fs307/en/ [Last accessed March 2018].
2 National Heart, Lung and Blood Institute. What is asthma? Available from www.nhlbi.nih.gov/health-topics/asthma [Last accessed March 2018].
3 Walford HH, Doherty TA. Diagnosis and management of eosinophilic asthma: a US perspective. J Asthma Allergy. 2014; 7; 53–65.
4 www.asthma.org.uk/advice/triggers/ [Last accessed March 2018].
5 Latest WHO estimates, released in December 2016, www.who.int/mediacentre/factsheets/fs307/en/ [Last accessed March 2018].
6 Latest WHO estimates, released in December 2016, www.who.int/mediacentre/factsheets/fs307/en/ [Last accessed March 2018].
7 www.globalasthmareport.org/burden/burden.php [Last accessed March 2018].
8 www.europeanlung.org/en/lung-disease-and-information/lung-diseases/adult-asthma [Last accessed March 2018].
9 2014; 12; 24: 14009; Centers for Disease, Control and Prevention (CDC). Respiratory & Allergies. Available from: www.cdc.gov/nchs/fastsats/asthma.htm [Last accessed March 2018].
10 WHO (2007) Global surveillance, prevention and control of chronic respiratory diseases: a comprehensive approach/Jean Bousquet and Nikolai Khaltaev.
11 National Heart, Lung and Blood Institute. What is asthma? Available from www.nhlbi.nih.gov/health-topics/asthma [Last accessed March 2018].
12 www.globalasthmareport.org/burden/burden.php [Last accessed March 2018].
13 Latest WHO estimates, released in December 2016, www.who.int/mediacentre/factsheets/fs307/en/ [Last accessed March 2018].
14 Adelphi DSP.
15 IMS, CRITIKAL publication 2017.
16 Decision Resources Pharmacor Asthma (March 2017).

COPD

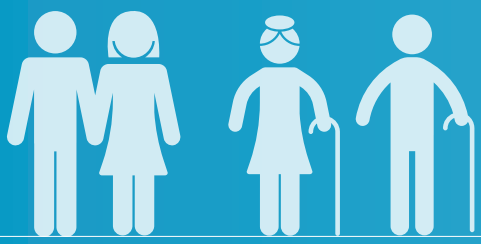
Chronic obstructive pulmonary disease (COPD) is a common, preventable and treatable disease that is characterised by persistent respiratory symptoms and airflow limitation that is due to airway and/or alveolar abnormalities usually caused by significant exposure to noxious particles or gases. COPD is not curable, but treatment can relieve symptoms, improve quality of life and reduce the risk of death.[1]

Risk factors[2]

- Smoking (no. 1)
- Second hand or passive exposure to smoke
- Exposure to indoor air pollution
- Occupational exposure to dusts and chemicals
- Frequent lower respiratory infections

Symptoms[3]

- Chronic and progressive shortness of breath
- Cough and mucus production
- Wheezing and chest tightness
- Infection-driven exacerbation of symptoms often speeds up decline of lung function
- Unexplained weight loss
- General fatigue



Prevalence

- COPD is currently the fourth leading cause of death in the US[4] and the World Health Organization (WHO) predicts that COPD will be the third leading cause of death worldwide by 2030[5]
- Currently the disease is largely hidden, with a large number of patients undiagnosed[6]

Approximately

330m

people globally living with COPD[7]

Impact[8]

- Significant impact on daily activities and quality of life
- Estimated one in five sufferers give up work due to their disease
- Six out of ten patients reported feeling concern about their future earning potential as a consequence of COPD

9 out of 10

patients reported an inability to maintain their lifestyle following the onset of COPD

By 2025 the total COPD market is expected to be worth over

$19bn[9]

1 World Health Organization, COPD factsheet, www.who.int/mediacentre/factsheets/fs315/en/ [Last accessed March 2018].
2 World Health Organization, COPD factsheet, www.who.int/mediacentre/factsheets/fs315/en/ [Last accessed March 2018].
3 COPD foundation, www.copdfoundation.org/What-is-COPD/Understanding-COPD/What-is-COPD [Last accessed March 2018].
4 Changing the burden of COPD mortality, David M Mannino and Victor A Kiri, International Journal of COPD 2006:1(3) 219–233.
5 World Health Organization, COPD, www.who.int/respiratory/copd/burden/en/ [Last accessed March 2018].
6 Changing the burden of COPD mortality, David M Mannino1 and Victor A Kiri, International Journal of COPD 2006:1(3) 219–233.
7 Vos T, et al. Lancet 2012;380:2163–96.
8 COPD Uncovered, www.copdfoundation.org/pdfs/COPD-Uncovered-Report-2011 [Last accessed March 2018].
9 Decision Resources Pharmacor COPD (October 2016).

An industry-leading inhaled airways disease-focused business with uniquely integrated formulation, device and development capabilities

For more information visit:
www.vectura.com

@vecturagroup

vectura

TRANSFORMING THE LIVES OF AIRWAYS DISEASE PATIENTS

Vectura develops products that help patients with airways diseases to live better lives

Airways diseases is an umbrella term covering diseases of the airways including asthma, chronic obstructive pulmonary disease (COPD), idiopathic pulmonary fibrosis, cystic fibrosis and respiratory syncytial virus

Every day hundreds of millions of people suffer from these conditions, severely impacting their quality of life

Every year, millions of people die from airways-related conditions

The number of people suffering from airways-related diseases is expected to grow by over 100m in the next six years alone

The airways diseases market is currently valued at $40bn and is expected to grow in value to $56bn by 2025

The complexity of developing inhaled products provides a significant opportunity for a limited number of companies with proven expertise

We aim to transform the lives of airways disease patients by enhancing the delivery and performance of inhaled products and through the development of high-quality generic alternatives to branded therapies.

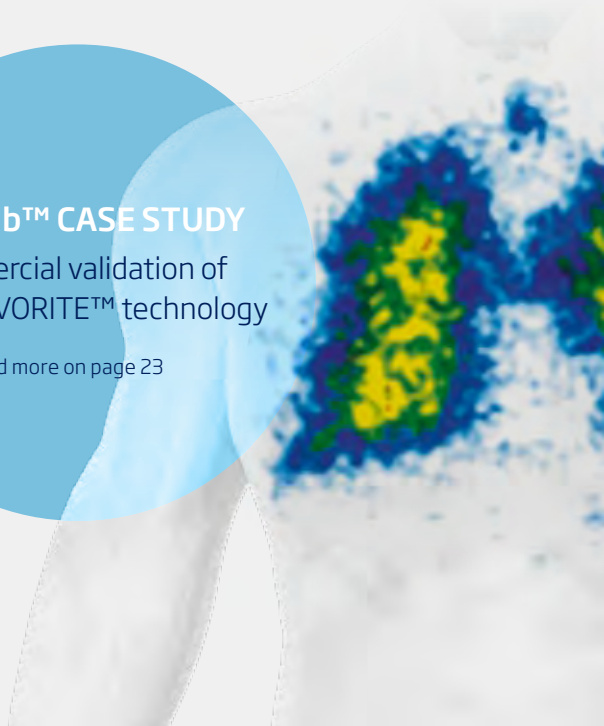
7m+

patients treated with Vectura technologies in 2017[1]

Breelib™ CASE STUDY

Commercial validation of our FAVORITE™ technology

Read more on page 23



1 Approximation based on 2017 IMS unit sales for marketed inhaled products, assuming 60% compliance.

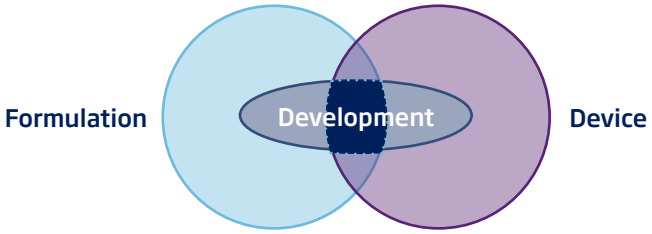
We develop products that help patients with airways diseases to live better lives

Our vision is clear... to be the industry-leading inhaled-drug device development specialist, transforming the lives of airways disease patients

Our differentiated capabilities are validated through our extensive collaboration and licensing arrangements and through our future pipeline

- 20 partnered on-market revenue-generating products
- Strong underlying revenue base – key growth drivers including *flutiform*® and Ultibro® Breezhaler®
- Established and long-lasting partnerships with some of the biggest names in the pharmaceutical industry
- Extensive pipeline in key Asthma and COPD growth classes, untapped generics and fast growing specialist segments
  - Exciting generics pipeline, including the three leading branded inhaled molecule opportunities in the US
  - Strong late-stage pipeline of nebulised programmes which aim to enhance the delivery of known molecules – including VR475 (EU) in Phase III due to complete in Q4 2018

Our uniquely integrated drug delivery platform allows us to navigate the complexities of combining formulation with devices to meet high regulatory requirements for approval



Proprietary IP and know-how

Formulation

Formulation expertise to develop the main dosage forms seen in inhaled medicine, including the following drug types:

Small molecules

Challenging and complex biomolecules

Development

In-house expertise in key areas to support the development process and allow seamless transition from early development to regulatory and commercialisation

Pharmaceutical and device development

Pre-clinical

Clinical

Scale-up + industrialisation

Manufacturing

Regulatory

Device

Range of devices to address all inhaled product types and patient and dosage requirements

Dry powder inhalers

Pressurised meter dose inhalers

Smart nebulisers

We have an agile and innovative organisation with a strong entrepreneurial culture and talent base...

Employees

c.450

Company established

1997

1 **Corporate office**
London, UK

4 **Inhalation development sites**
Chippenham and Cambridge, UK
Muttenz, Switzerland
Gauting, Germany

1 **Oral manufacturing site**
Lyon, France

...and a clear strategy for growth with focused priorities

Our strategy is to fully leverage our differentiated technology and skills, maximising value by enhancing the delivery and performance of inhaled products and through the development of high-quality generic alternatives to branded therapies.

Maximising pipeline value

- Leveraging rare product and device capabilities in lower-risk, high-return programmes

Focus on:

- Inhaled generics
- Vectura enhanced therapies

Operational Excellence

- Simplifying processes and procedures to drive operational efficiency and reduce costs
- Managing R&D investment in line with guidance

Maximising partnering value

- Seeking to partner existing programmes that no longer meet our investment criteria
- Partnering new generic and enhanced delivery development programmes

Strong financial discipline

- Leveraging strong and growing cash flows from inhaled market portfolio
- Continued commitment to capital allocation discipline

High performance culture

- Ensuring our culture and behaviour remain supportive of our strategic objectives

Read more in our strategic priorities on pages 24 to 32

Significant and meaningful progress

Operational highlights

Refocused pipeline investment with progression of key priority programmes

Inhaled generics

- Two major new generics programmes added to the pipeline (VR2081 and VR410) with potential for development of additional combination therapy (LAMA/LABA)
- Following FDA interactions, Vectura is progressing the development of its Open-Inhale-Close device which has the potential to be an AB-rated substitutable generic drug-device combination for the GSK Ellipta® portfolio. This is a significant opportunity, with analyst projections of global net sales for these products of approximately $6bn by 2023[1]. Pharmaceutical development has commenced, in parallel with partnering discussions
- Post-period update – Following the FDA rejection of CRL dispute process, Hikma confirmed the enrolment of the first patients in repeat clinical programme for VR315 (US) will take place in the coming weeks. Potential approval and launch during 2020

Vectura enhanced therapies utilising our proprietary smart nebulisation technology

- Lead programmes, VR475 (EU) Phase III and VR647 (US) Phase II programmes, progressing well with potential extension of portfolio under assessment following technology validation from Breelib™ EU approval and launch

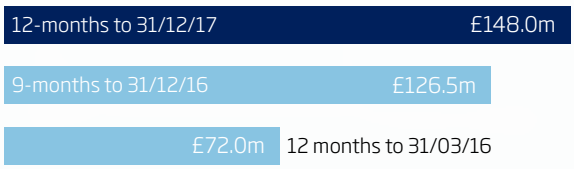
Tight financial management with R&D and capital allocation discipline

- Merger integration completed and on track to deliver £11m to £12m annual cost synergies by 2018. Majority of these annual synergy savings realised in 2017
- Effective prioritisation of R&D portfolio and Operational Excellence review to deliver cost savings and reduced pipeline risk whilst maintaining significant value potential
- Post-period update – £15m share buyback completed on 28 February 2018

1 Global Data, extracted Q4 2017.

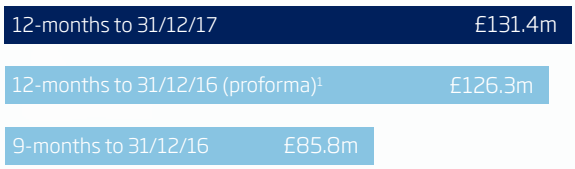
Reported revenue

£148.0m
+17.0%



Underlying revenue[2,3]

£131.4m
+4.0%



Reported operating loss

£96.2m
-116.2%

Adjusted underlying EBITDA[2,3]

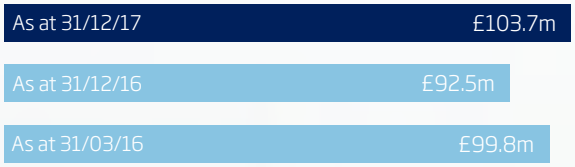
£10.0m
>+100%

Basic EPS

(12.6p) (loss)
>-100%

Cash and cash equivalents

£103.7m
+12.1%



1 The 2016 reported comparative results cover a shortened nine-month period and reflect the enlarged merged business for almost seven months. Therefore, in order to support a clear and effective assessment of the Group's performance in 2017, the Directors have provided additional unaudited proforma full-year financial information for 2016. A reconciliation of 2016 reported results to 2016 proforma full-year financial information is provided in the Financial review.

2 Certain measures in this annual report, including full year comparative financial information, proforma financial information, underlying financial information adjusted EBITDA, and adjusted operating profit, are not prepared in accordance with IFRS. Underlying measures are reconciled back to their most directly comparable IFRS measures in the Financial review.

3 Underlying revenues exclude the impact of licensing milestones and development services revenues which can vary materially from period to period and excludes material royalties that are not recurring as a result of patent expiry or legal dispute. Underlying measures of profitability are calculated using underlying revenues and are adjusted for non-cash charges such as amortisation and share-based compensation, and exceptional items. A full reconciliation of reported and full year results to underlying financial results is provided in the Financial review.

Read more in our Financial review on pages 56 to 63

Leveraging our uniquely integrated formulation, device and development capabilities to deliver value

By understanding our operating environment and focusing on our strategic priorities, we are able to deliver against our objectives

Market dynamics

Airways diseases market currently valued at $40bn with high barriers to entry

Ageing populations, alongside population growth and lifestyle changes, are increasing the disease burden

Rapid scientific and technological advances are changing treatment paradigms

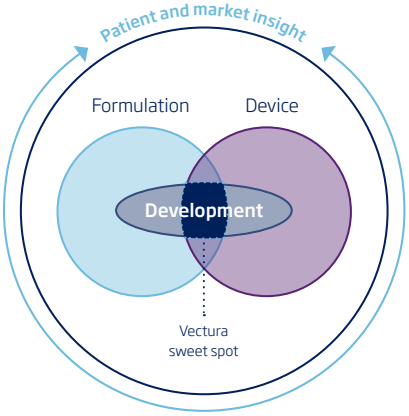
Changing attitudes towards globalisation and free trade have caused significant uncertainty

Downward pressure on healthcare costs increasing demand for generic therapies

Business model

Our resources

UNIQUELY INTEGRATED CAPABILITIES



PRODUCTS AND PIPELINE

IN-MARKET PRODUCTS

PIPELINE

- GENERIC PARTNERING
- VECTURA ENHANCED THERAPIES
- NOVEL MOLECULE PARTNERING

REVENUES

- In-market royalties
- Product supply and device sales
- Milestones
- Development services

Value we create for our stakeholders

Our purpose

Transforming the lives of patients with airways diseases

Our values

Patient focus • Innovation
Collaboration • Achievement

Strategic priorities

Read more on pages 13 to 15

Read more on pages 16 and 17

Clear strategic priorities	Measuring our progress	Managing our risks
Maximising pipeline value • Ensuring our pipeline focus leverages our core capabilities whilst managing overall pipeline risk and increasing speed to value realisation • Delivering our pipeline programmes on time and to budget	• Project milestones completed	• Failure or delay in partnering the product pipeline • Failure or delay in delivery and development of the product pipeline • Failure to launch VR315 (US) in a competitive timeframe • Partner failure • Failure to protect intellectual property
Operational Excellence • Simplifying processes to increase productive capacity • Maximising productivity to manage overall R&D investment over time	• No 2017 KPIs to report against • Operational Excellence KPIs have been established for 2018	• Supply chain disruption • Changes in regulatory, operating or pricing environment (excluding Brexit) • Brexit uncertainty
Maximising partnering value • Building and maintaining successful long-term partnerships	• Successful feasibility outcomes • Number of new alliances established **2018 KPIs:** • Number of valuable new business development deals signed • Partnering of generic programmes	• Partner failure • Failure to protect intellectual property
Strong financial discipline • Growth in adjusted operating profit and cash generation • Continued robust review of balance sheet and capital allocation	• Underlying revenues • Underlying adjusted EBITDA progression • Net cash	• Failure to deliver VR315 (US) in a competitive timeframe • Partner failure • Changes in regulatory, operating or pricing environment (excluding Brexit) • Brexit uncertainty • Failure to protect intellectual property
High performance culture • Ensuring our culture and behaviour are supportive of our overall strategic objectives • Attraction and retention of key talent	• Employee engagement	• Failure to attract or retain talent/key personnel
Read more on pages 24 to 33	Read more on pages 46 and 47	Read more on pages 48 to 54

We are uniquely positioned for future growth

Read more in our...

Governance report

See pages 76 to 78

Remuneration report

See pages 84 to 104

Viability statement

See page 55

Dear Shareholder

I am pleased to introduce Vectura's Annual Report for 2017.

The past year has been a mix of challenge and opportunity. Revenue growth was impacted by the delay in the approval of VR315 (US), the Group's US generic Advair® programme partnered with Hikma. Whilst this has had a significant impact on the share price, we should not let this overshadow the operational progress achieved by the Group during the year.

Operational performance and revenue growth

Underlying performance from our key in-market inhalation products was strong. The main growth drivers, *flutiform*® and Ultibro® Breezhaler®, continued to perform well in competitive markets, growing net sales at 11.8%[1] and 20.6%[1] respectively on a constant currency basis, when compared to calendar year 2016.

The Group has reported strong underlying financial performance, preserving a strong balance sheet through a combination of existing royalty streams and disciplined investment in R&D. The Group's 2017 IFRS operating loss of £96.2m was driven by a full year, non-cash, amortisation and impairment charge of £109.7m from prior acquisitions. Adjusted EBITDA[2] of £25.8m is underpinned by key products *flutiform*®, Ultibro® Breezhaler® and Seebri® Breezhaler®, which together delivered gross margin of £41.1m, up 18.8% on an underlying full year comparative basis, with *flutiform*® supply chain gross margin up 6.2 percentage points to 37.6%. Adjusted EBITDA also benefited from R&D expenditure of £60.3m being at the lower end of the guidance range and the delivery of merger synergy savings and ongoing R&D transformation initiatives.

Vectura continued to make operational progress across its proprietary partnered programmes. The Breelib™ device was approved and launched in Europe by our partner Bayer in April 2017 with positive patient feedback. This application of Vectura's FOX® smart nebuliser technology, from the Activaero acquisition, has enabled an almost one-hour reduction in the total daily treatment time for patients who are receiving treatment (iloprost) up to six times a day, a very meaningful improvement in patient quality of life. Whilst the financial benefit for Vectura from this product is modest, the validation of this important technology represents a significant milestone for the Group. The approval and subsequent commercialisation have opened up the possibility for multiple new valuable and relatively low-risk development programmes combining the device with known molecules, which are now under feasibility review.

Vectura's lead wholly owned programme in severe adult asthma patients, VR475 (EU), completed Phase III recruitment and the trial is due to complete in Q4 2018. The first patient in the Phase II trial for paediatric asthma, VR647 (US), was dosed in December 2017 and this trial is due to complete in Q3 2018.

Vectura is one of the few companies able to develop complex inhaled generics and overcome the strict regulatory barriers imposed by the FDA and EMA. During the year we announced a collaboration with Sandoz to develop VR2081, a pMDI generic for the US, and the licensing of technology from Pulmatrix, initially to support the development of VR410, a tiotropium DPI generic. As a result, the Group's pipeline now includes the current three largest US generic opportunities. In March 2018, Hikma confirmed that the dispute resolution process for VR315 (US) had concluded with the FDA upholding its original decision with a requirement that Hikma completes an additional Clinical Endpoint study. Hikma anticipates being able to submit a response to the FDA with new clinical data as early as possible in 2019, with a potential approval and launch during 2020.

An Operational Excellence review of the Vectura R&D function was performed during the year and a number of opportunities to significantly enhance productivity were identified. These will free up capacity to support future project development and achieve cost reductions. These activities are a priority for implementation in 2018.

In November 2017 the Board also approved a share buyback and cancellation programme to return up to £15m of capital to shareholders. This programme, which completed post period, is an efficient allocation of capital as part of our ongoing strong financial management discipline and demonstrates the Board's confidence in the cash generation of the business.

Merger integration and synergy realisation

The post-merger organisation structure was implemented early in 2017 and all priority integration initiatives have been completed. As announced in September 2017, we are on track to deliver £11m to £12m synergies by the end of 2018, with the majority of the savings being realised in 2017.

2018 business strategy

In the latter part of 2017 the Group completed a full review of its R&D investment strategy and this was communicated to the market on 4 January 2018. The following decisions were made:

- investment in relatively high-risk novel molecules at early stage will end and opportunities to partner remaining programmes will be sought;
- the Group will be more selective in identifying co-development programmes of novel molecules, focusing only on highly profitable and significant opportunities; and
- Vectura will seek to develop further high-potential generic medicines for the US market, in association with well-established partners.

This serves to increase the Group's focus on relatively lower-risk high-value development programmes, ultimately optimising the return on our R&D developments. In addition, it was decided that, in the absence of additional specialist marketed products being acquired, through M&A or licensing, the Group will initiate partnering discussions for VR475 (EU) and VR647 (US), following the completion of their respective current Phase III and Phase II activities.

1 In-market net sales are internal calculations using IMS Health (IMS) data based on sales to pharmacies and excluding certain minor countries which are not covered by IMS. In-market net sales are not the same as sales to wholesalers on which royalties are payable to the Group. All percentages quoted at constant currency rates.

2 Certain measures in this Annual Report, including underlying financial information, adjusted EBITDA, and adjusted operating profit, are not prepared in accordance with IFRS. Underlying financial measures are reconciled back to their most directly comparable IFRS measures in the Financial review.

Governance

As a Board, we are committed to the principles of good corporate governance and we have continued to comply with the provisions of the UK Corporate Governance Code ("the Code") throughout the year and to the date of this report. Through a robust internal framework of systems and controls, we strive to maintain the highest standards. Full details can be found in the Corporate governance report on pages 70 to 78.

Board changes

In December 2017, we welcomed Juliet Thompson as a new Independent Non-Executive Director. Upon appointment, Juliet also became a member of the Audit Committee and was appointed a member of the Remuneration Committee. Her extensive understanding of the healthcare industry and experience in corporate finance bring important insight to Board discussions, as well as supplementing and strengthening the existing skills and experience of the Board. Juliet's appointment also signals the Board's and Vectura's commitment to increased diversity up and down the organisation. Full details on succession planning can be found in the Nomination Committee report on page 79.

People and culture

The Group has a highly talented workforce with an invaluable diversity of proven capabilities, knowledge and experience. During the year, the Executive Leadership Team led a Company-wide project to identify and deliver a shared culture comprised of the values and behaviours which make our Company distinctive. This initiative is of paramount importance to the Board because it underpins Vectura's ability to deliver its product pipeline and to innovate.

On behalf of the Board, I would like to thank each one of our employees for their continued commitment and excellent contributions during the past year.

Shareholders

I would also like to thank our shareholders for their continued support following the delay with VR315 (US). The Board remains confident in the approvability of this product. With a newly renewed pipeline focus and commitment to Operational Excellence, our mission is clear: delivery, simplification and focus. We remain committed to growing an innovative and differentiated business which delivers shareholder value.

Outlook

The Board sees Vectura as being a highly competitive business with strong underlying revenues from our in-market products. The business is differentiated by its unique set of capabilities, as medicines in the respiratory space become more complicated. Vectura is one of the few companies globally with the expertise to formulate and deliver the most complex products for inhaled delivery.

I look forward with optimism as we work towards successful outcomes from developing our refocused pipeline and believe the Group is increasingly well positioned to achieve its ambition of becoming the industry-leading inhaled drug-device development specialist, delivering significant value for our shareholders.

Bruno Angelici
Chairman
20 March 2018

Delivering sustainable growth with risk-balanced investment

Our core values

- PATIENT FOCUS
- INNOVATION
- COLLABORATION
- ACHIEVEMENT

Read more on pages 64 to 69

It has been an important year of progress for Vectura. We have delivered a good set of financial results, in line with market expectations, and our key inhaled *flutiform*® and Ultibro® Breezhaler® products have continued to show strong in-market growth. We have progressed our enhanced therapy pipeline, extended our valuable generics portfolio and delivered our merger integration plans in terms of both financial synergies and the establishment of the "AsOne" Vectura Group culture and values. Despite these achievements, Vectura's performance in 2017 has been partly overshadowed by the delay in the approval of VR315 (US), our generic Advair® programme.

It was certainly disappointing to receive a complete response letter (CRL) in May but our confidence in the approvability of VR315 (US) has not changed. Only three companies have publicly stated that they have filed an Abbreviated New Drug Application (ANDA) for an AB-rated substitutable product and all three applicants had their submissions rejected. Although tough, the experience we have gained through the review process and feedback we have received in relation to the formulation and device elements of the programme give us even greater conviction that we are one of the very few companies which has the capability to meet the FDA's high standards to develop complex inhaled generic drug-device combinations. Our confidence in our drug formulation and device capability, the heart of what Vectura does, is reflected in our increased investment focus and our belief in the future valuation of our expanding generics portfolio.

Our belief in the value of our rare generic capabilities was further validated by Sandoz's decision in June 2017 to partner the VR2081 pMDI US generic development programme. This was after we had already received our VR315 CRL. Given that Sandoz has its own Advair® generic in development, its choice of Vectura for this new development was an important further validation of our capabilities.

Strategy

Vectura's strategy and vision remain unchanged.

Our goal is to be the industry-leading inhaled drug-device development specialist, enabling us to deliver on our purpose to transform the lives of airways disease patients. Our strategy is to fully leverage our differentiated technology and skills, maximising value through partnered generic drug-device combinations and enhancing the inhaled performance of existing molecules. We will do this by continuing to invest and grow our business alongside demonstrating strong financial and capital allocation discipline.

We aim to develop a strong portfolio, primarily partnered to share the risk and cost of development, and to progressively develop assets in niche specialist disease segments. Our current revenues result primarily from partnered sales in the largest respiratory disease segments of asthma and COPD. Over time, smaller niche disease areas will increasingly become an important revenue source and it is in this market segment that we would look to establish a successful specialist commercial product portfolio.

The plan is one of organic growth supplemented by the potential to acquire products with in-market revenues and specialist customer capabilities in the US.

Future self-commercialisation of our specialist assets remains an option open to us but only as part of a wider commercial portfolio.

Vectura has a well-established business with proven capabilities and a simple differentiated business model which can be described in three simple steps: firstly, inhaled drug formulation and licensing; secondly, inhaled device design, development and licensing; and thirdly, our "sweet spot", where we combine the drug formulation and device work together and license a combined development programme to partners. We hit this "sweet spot" when we maximise the integrated combined IP, technology and skills across our platforms and teams and it is at this point that we can create the highest value returns from our partners.

We have a well proven track record of value creation through this model with some of the world's biggest pharma companies. Typically, our formulation licensing expertise is seen in the revenues from novel patented molecules for inhaled delivery including Novartis' Ultibro® Breezhaler® and GSK's Ellipta® portfolio. Proprietary device licensing is a relatively small part of the business, again typically for novel patented molecules. Bayer's Breelib™ iloprost product and Ablynx's ALX-0171 novel inhaled Nanobody®, both of which use the FOX® device, are both examples of this approach. Our "sweet spot", where we combine our inhaled drug formulation, device and development expertise for the enhanced delivery of existing molecules or as generic developments, is demonstrated through in-market products such as *flutiform*® and AirFluSal® Forspiro®. In total, our partnered model, capabilities, reputation and track record are exemplified in the more than ten partnerships we have with leading pharmaceutical companies.

What we do is technically complex and the way we do it is different. Unlike most companies operating in this sector that work on elements of what we do, few have a proven successful track record of combining and integrating the three key elements of inhaled drug formulation, device and combined product development. Additionally, none have the range of skills and platforms that Vectura has developed ranging from small to large molecule and biologic formulation through to dry powder, pressurised metered dose and novel nebulised device design and development. In the complex and challenging world of inhaled drug-device development these proven capabilities are rare and difficult to replicate and provide the basis for our sustained and valuable differentiation.

In order to further accelerate the value leverage of our skills, we have taken the decision to adjust the focus of our investment with a deliberate shift towards projects with higher value and higher probability of success. Investment priority is being given to projects where Vectura has the highest probability of value creation with known medicines, either as partnered generics or as medicines with enhanced delivery mechanisms, using Vectura's advanced proprietary devices. Vectura will be more selective in identifying partnering and co-development opportunities for novel molecules, focusing only on highly profitable and significant opportunities. Existing early-stage novel programmes will be out-licensed where the cost, risk and likely returns do not meet our newly defined investment criteria.

Our strategy remains one where we are pursuing growth whilst, at the same time, maintaining and demonstrating strong financial management and capital allocation discipline.

Operational highlights

In-market portfolio

Our key inhaled growth drivers, *flutiform*® and Ultibro® Breezhaler®, have continued to perform strongly in market. *flutiform*® generated in-market sales of €206.2m, up 11.8% on a constant currency basis, contributing £68.5m to underlying revenues for Vectura (2016 underlying: £65.8m).

Mundipharma continues to focus on driving growth for *flutiform*® and is making steady market share gains in a highly competitive and mature European ICS/LABA market, reporting value growth of 5.0% on a constant currency basis. Outside of Europe, Mundipharma has continued to drive strong growth of 32.5% in 2017. As anticipated in our interim statements, Vectura's 2017 reported revenues were impacted by destocking which was driven by partner working capital management.

In Japan, which now contributes over 37.1% of total *flutiform*® sales, Kyorin continues to make good progress with in-market sales up 19.8%. This performance has given *flutiform*® a market share of 11.5% in the Japanese ICS/LABA market. With a strong respiratory commercial heritage in Japan and the relatively less mature nature of the Japanese ICS/LABA market, we believe that Kyorin has a solid basis for further strong growth in the future.

Ultibro® Breezhaler® grew in market by 20.6% on a constant currency basis with total reported sales of Ultibro® Breezhaler® and Seebri® Breezhaler® exceeding $550m. Ultibro® Breezhaler® continues to be the leading LAMA/LABA combination ex-US and is maintaining a strong growth profile despite heavy competition from Boehringer's Stiolto® combination. Following the initial rapid launch of Stiolto, its market share is now stabilising with Ultibro® Breezhaler® maintain its market-leading position and strong trajectory growth supported changes to the Global Initiative for Chronic Obstructive Lung Disease (GOLD) global COPD management strategy and a robust clinical data set. Reported sales for Ultibro® Breezhaler® were also affected by destocking as indicated by Novartis; however, they reported strong Q4 growth of 26% on a constant currency basis.

GSK's branded Ellipta® portfolio has also grown strongly with annual capped revenue of £9m achieved in Q3 2017.

Generics pipeline

A number of people have asked me why we would increase our focus on generics at a time when generics are under huge pressure in the US. To date there have been no approvals of complex inhaled substitutable drug-device combinations in the US and our own VR315 asset has been delayed following the receipt of a CRL. The answer is quite simple.

"

The team has demonstrated great tenacity and resilience and I would like to extend my heartfelt thanks for their contributions and support.

Operational highlights continued

Generics pipeline continued

We should not confuse the overall generics market, including the oral solids market, for example, which is relatively simple and commoditised, with the complex inhaled drug-device combination market, which remains untapped in the US today. The inhaled formulation market in 2017 in the US was valued at over $23bn, with less than 1% generic conversion in key inhaled classes. This compares to the oral solids market in the US, where over 91% of the prescriptions dispensed are for generic products. Vectura, with our partner Hikma, remains one of only three known companies with an inhaled drug-device combination application for a substitutable generic Advair® product (VR315 (US)). Our unique capabilities have been validated throughout the regulatory review process and the lessons we have learned on the VR315 (US) programme journey put us in a good position going for future development of complex generic programmes.

Following the announcement of the partnering of VR2081, and the in-licensing of an advanced tiotropium from Pulmatrix, our generics pipeline now includes the three largest current inhaled branded opportunities in the US.

In addition, following a series of interactions with the FDA, we are looking forward to the partnering and development of what we believe is the leading industry drug-device combination for the Ellipta® portfolio. This portfolio includes, potentially, five separate project opportunities with analyst projections of net sales of approximately $6bn in 2023.

Enhanced delivery pipeline

One of the highlights for me during the year was participating in a symposium about Breelib™ at the European Respiratory Society (ERS) meeting in Milan. Breelib™, which uses our novel FOX® handheld nebuliser, is the new iloprost product device combination sold by our partner Bayer. This was the first time that Breelib™ and the FOX® device were being showcased at such an event since the product was launched. The compelling data presented at the meeting showed a decrease in the average inhalation time of approximately 48 minutes per patient per day and is quite remarkable for these very sick pulmonary arterial hypertension patients. It provides us with both an enormous source of pride in terms of patient impact as well as important validation of the technical value of these novel devices.

In addition to Breelib™ we have made very good progress with our two leading AKITA® budesonide clinical programmes. The Phase III EU adult asthma programme is now fully recruited and we look forward to the completion of this important and challenging project before the end of 2018. The US paediatric programme has also progressed well, with the first Phase II patients dosed in Q4 2017, with completion expected in Q3 2018.

Based on the increased conviction in both the differentiation and validation of our devices seen with Breelib™, we are now initiating the development of a series of known compounds where, through formulation and enhanced delivery, we believe that efficacy and convenience of delivery for the patient can be significantly improved. We look forward to sharing details of these projects around the time of our interim results.

Novel drug-device partnering pipeline

During the year we have made good progress with continued support for the ongoing Ablynx ALX-0171 neonatal RSV Nanobody® development utilising an adapted variant of the FOX® handheld nebuliser device. Ablynx is expected to report Phase IIb results in Q4 2018.

In December 2017, Mundipharma informed the Group of its decision to stop the development of the pMDI triple therapy for asthma and COPD (VR2076), which was at an early formulation phase.

Aligned to our refocused investment strategy, we will now take an increasingly selective approach to future novel partnered development programmes, with each programme having to achieve a higher hurdle rate in terms of potential financial returns.

Organisation

Following the successful completion of the merger with Skyepharma in June 2016, we made huge progress in the integration across the business in 2017 and we are tracking above the targeted plan of £10m annual savings in cost synergies. We now expect financial synergies to total between £11m and £12m by the end of 2018.

A key component of the integration has been the alignment of a new "AsOne" culture. Our target culture is supported by a clear set of values and expected behaviours. These elements were articulated with the engagement of all Vectura employees and have been incorporated into all the key management frameworks and systems being used across the business.

Alongside the merger integration activities, I was pleased to welcome Gonzalo De Miguel and Tony Fitzpatrick to the Executive Leadership Team. Both Gonzalo and Tony bring a wealth of experience to the clinical development and manufacturing operations settings respectively and have quickly settled into their new roles making positive contributions to, and beyond, their functions.

Summary

2017 was a challenging year for Vectura. Despite this we remained highly focused and we have delivered well against our key objectives. The team demonstrated great tenacity and resilience and I would like to extend my heartfelt thanks for their contributions and support.

With strong in-market product performance and validation of our team's skills, capabilities and technology during 2017, we enter 2018 with a clear, refocused investment strategy and increased conviction in our ability to create and deliver shareholder value.

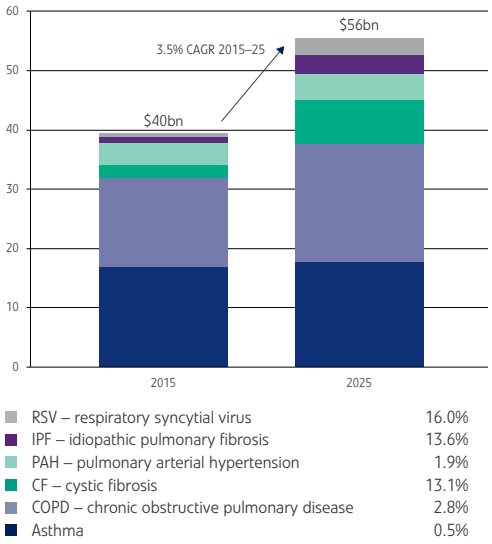
James Ward-Lilley
Chief Executive Officer
20 March 2018

Our markets

Well placed to succeed in a dynamic and growing airways disease market

The airways disease market is currently estimated to be worth in excess of $40bn[1] worldwide; population growth and lifestyle changes, coupled with increasing longevity and wealth, particularly in developing economies, are increasing the disease burden for airways diseases. As a whole, this market is expected to grow in value by 3.5% annually to $56bn by 2025[1].

Respiratory is a large, attractive market with significant growth in asthma, COPD and specialist disease areas



1 Source: Global Data Reports, Internal Projections (where Global Data not available at 2025), Decision Resources.

After many years of status quo, the dynamics within this market are beginning to change with new treatment classes emerging, offering society and patients new ways to treat and control airways-related diseases.

Asthma and COPD

Asthma and COPD are expected to remain the largest and most competitive segments with new classes of treatment emerging and new phenotyping leading to more personalised medicine. Given the size and scale of these markets, these disease areas are best served by Vectura partnering with pharmaceutical companies which have the expertise and infrastructure to sell and market these products globally.

Vectura's existing portfolio and existing pipeline are well placed to benefit from changing market dynamics in the asthma and COPD market

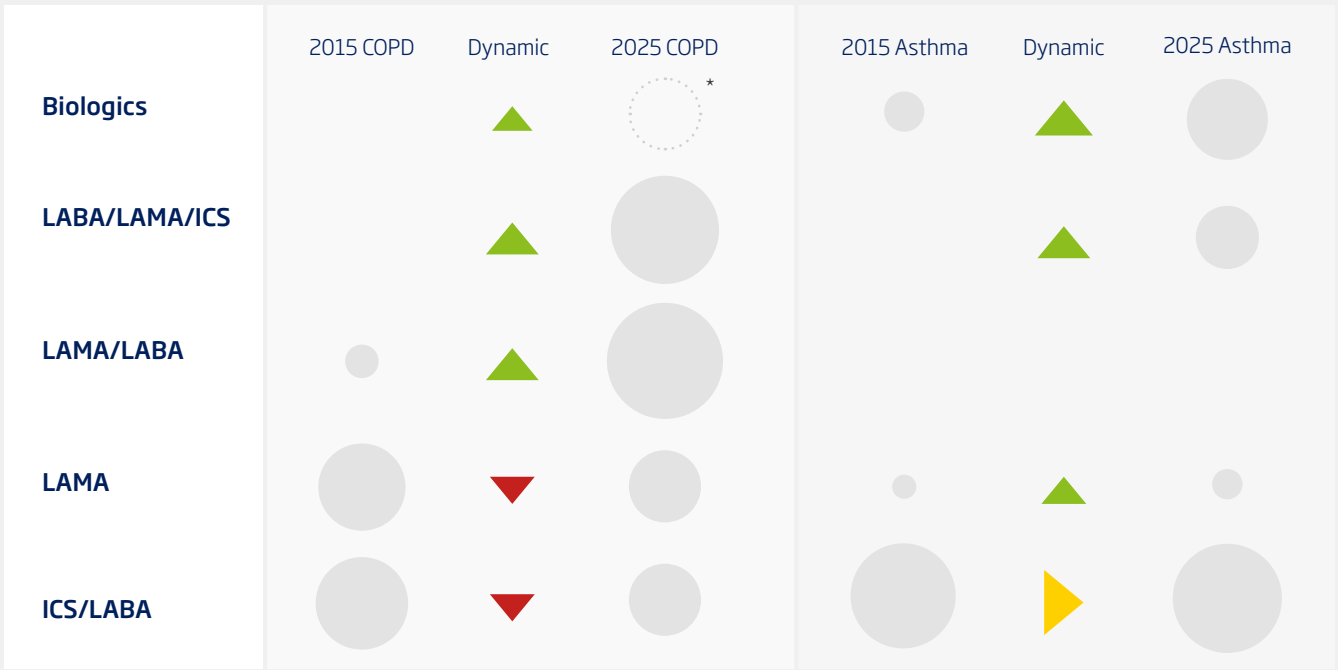
The COPD market as a whole is expected to grow from $15bn to in excess of $19bn[2], with the growth being driven from continued uptake of dual bronchodilators such as Breezhaler® (LAMA/LABA, partnered with Novartis) and Anoro® Ellipta® (LAMA/LABA, IP licence with GSK) and the emergence of closed triple therapies.

The asthma market as a whole is expected to grow from $17bn to nearly $18bn[3], with growth being driven by the emergence of closed triple therapies such as QVM149 (ICS/LAMA/LABA, partnered with Novartis) and biologic therapies expected to grow strongly from a small base offsetting genericisation of the ICS/LABA class (VR942, co-developed with UCB, now available for license).

2 Decision Resources Pharmacor COPD (October 2016).

3 Decision Resources Pharmacor Asthma (March 2017).

Growth drivers: LAMA/LABA and fixed-dose combinations (FDC) triples in COPD and biologics and FDC triples in asthma



* Too early to forecast based on limited information.

Vectura's existing portfolio and existing pipeline are well placed to benefit from changing market dynamics in the asthma and COPD market continued

With diagnosis and treatment rates improving, particularly in emerging markets, we expect to see volume growth in the ICS/LABA class to continue to treat asthma.

Vectura's generic ICS/LABA assets for the treatment of asthma

On-market assets	Pipeline assets
flutiform® (EU and RoW, excluding Japan, partnered with Mundipharma)	VR315 – generic Advair® (US, partnered with Hikma)
flutiform® (Japan, partnered with Kyorin)	
AirFluSal® Forspiro® (EU and RoW, partnered with Sandoz)	

Asthma and COPD generics – inhaled generics class still in its infancy, set to expand rapidly

Generic penetration is increasing in the EU; however, there is currently very little generic penetration in the US. Globally, the use of generic medicines is growing. In the US, the inhalants market was estimated to be worth some $23bn[5] in 2017, with less than 1% generic conversion in key inhaled maintenance classes[6]. This trend is set to change as a number of inhaled products reach patent expiry in the US, with generic entrants expected over the coming years.

Generic erosion is expected to have the most impact in ICS, ICS/LABA and LAMA classes[7].

Significant growth in these classes is likely as substitutable products are approved; however, the large volumes and value opportunities are made up of a limited number of large individual opportunities, e.g. Seretide/Advair®, Symbicort®, Spiriva® and QVAR®. Technology barriers remain, making inhaled generics a specialist area.

The ICS/LABA class is expected to remain the largest and at present Advair® and Symbicort® remain the largest brands within this class in the US. Vectura's pipeline asset VR315 (US) is one of only three known AB-rated generic Advair® applications that has been submitted to the FDA for review.

Globally, the LAMA class is expected to be worth $2.7bn by 2025[8], with $1.2bn of this value being in the US[9] and Spiriva® remaining the dominant branded product in this segment. Vectura's pipeline includes VR410 (US), a branded alternative to Spiriva® HandiHaler® in the US.

Globally, the ICS class is expected to be worth $3.4bn by 2025, with $3.0bn of this value being in the asthma segment[10]. Of the total ICS asthma market, $1.4bn of this value is expected to be in the US[11]. Vectura's pipeline includes VR506 (US), which targets this growing market.

Read more about our generics pipeline on pages 40 and 41

Airways disease market growth drivers

Expanding patient populations

The world population is expected to rise from its current level of some 7bn to 8.5bn by 2030 according to the United Nations[13] and, alongside this population increase, life expectancy is also expected to increase significantly. Globally, over the same time period, the number of people aged 60 years and over will increase from 901m to over 1.4bn[14]. Alongside these changing demographics, the number of people who can access healthcare continues to increase.

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.

Rapid scientific and technological advances

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 amongst the most commercially successful new products.

It is expected that generics will take an increasingly larger share of global medicine spend increasing from

27% in 2012

36% by 2017[16]

Specialist markets

Alongside the expected growth in asthma and COPD markets, specialist markets are also expected to grow significantly with high unmet medical need and increasing scientific understanding driving development of new therapies. Patient populations are smaller, but significant commercial potential exists and this specialist market has less competitive intensity than the larger asthma and COPD markets.

The growing specialist disease segment is well suited to nebuliser therapy and provides an opportunity for future Vectura enhanced delivery programmes to enhance patient benefit using our smart nebuliser technology. The nebuliser device market is currently worth c.$630m, and France, Germany, the UK and the US account for 65% of this value[12].

5 Q4 2017 IMS SMART data for inhaled classes in Asthma and COPD.

6 Q4 2017 IMS SMART data – defined as pMDI and DPI ICS, ICS/LABA, LAMAs and LAMA/LABAs and LABAs and newly launched triple formulations.

7 G7, Decision Resources Pharmacor Asthma (March 2017) and COPD (October 2016). G7: The United States, Japan, Germany, the United Kingdom, France, Italy and Canada.

8 Internal projections based on IMS data.

9 Internal projections based on IMS data.

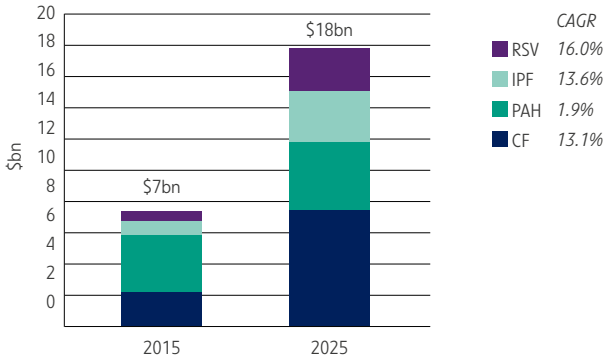
10 Internal projections based on IMS data.

11 Internal projections based on IMS data.

12 Markets and Markets – global forecast to 2020.

Read more about our Vectura enhanced therapies pipeline on pages 44 and 45

Specialist diseases with high unmet need are expected to show significant growth as therapies become available



No commercial forecast estimates available for ARDS, lung cancer (inhaled therapies), lung infections (outside of RSV) or cough.

Note: diseases shown limited by availability of data rather than specific selections.

Abbreviations: PAH – pulmonary arterial hypertension; IPF – idiopathic pulmonary fibrosis; CF – cystic fibrosis; RSV – respiratory syncytial virus.

Changing political landscape

Over the past few years, changing attitudes towards globalisation and free trade, coupled with concerns over inflation and wages and, for many, concerns about inequality, have caused significant volatility and uncertainty in western markets. In 2016, these uncertainties were exemplified by the UK vote to leave the European Union and the result of the US presidential election. These trends have continued during 2017 as the "Brexit" negotiations have commenced and further national elections have been held in the UK, France and Germany.

See risks and uncertainties section for further details on pages 50 to 54

Downward pressure on healthcare costs and regulatory challenges

Expanding patient populations and growing unmet medical need are contributing to higher demand for healthcare services and leading to increased cost pressure within global healthcare systems. The world's major regions are expected to see healthcare spending increases ranging between 2.4% and 7.5% between 2015 and 2020[15]. This background of steadily rising healthcare costs has also led to increased scrutiny on drug pricing by governments, the media and consumers, particularly in the US.

Increasingly, government agencies and insurers are looking for ways to manage increasing costs and, in some cases, are restricting access to treatment, slowing the uptake of innovative new medicines. With continued focus on cost management, it is expected that generics will take an increasingly larger share of global medicine spend, increasing from 27% in 2012 to 36% by 2017[16].

13 United Nations – Sustainable Development Goals.

14 United Nations – World Population Ageing 2015 Highlights.

15 Deloitte – Global Healthcare Outlook 2017.

16 Deloitte – Global Life Sciences Outlook 2016.

A simple integrated and focused business model with proven success

Our business model leverages core formulation, device and development capabilities and balances risk and returns

Our resources

Our talented people

Over 450 employees working internationally across five different sites with expertise throughout the development and regulatory processes

Our shared culture

Our shared values foster a strong culture which is a definitive expression of "how we do things" at Vectura

Our intellectual property

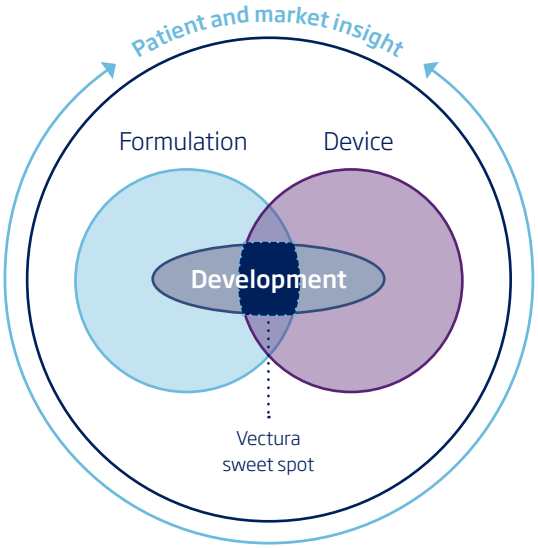
We have a broad IP base covering our technologies and capabilities managed by our experienced in-house team

Our strong partnerships

10+ active partnerships with leading pharmaceutical and biotech companies

Our business

UNIQUELY INTEGRATED CAPABILITIES



Read more on page 18

We leverage our differentiated capabilities to develop valuable pipeline programmes for partnered development. Our "sweet spot" is where our licensed programmes utilise our device technology and formulation expertise and require our specialist development capabilities. These programmes generate the most value for Vectura.

Our purpose

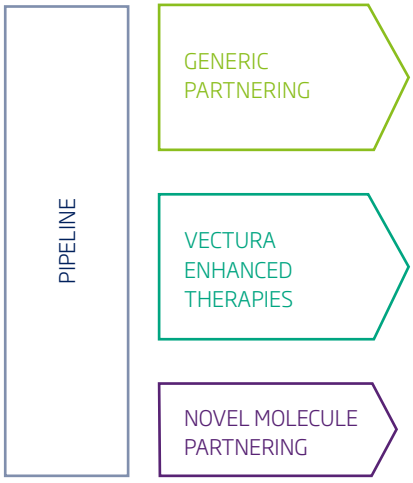
Transforming the lives of patients with airways diseases

Our purpose underpins everything we do and it gives us a reason to come to work every day

Our strategic priorities

Read more on pages 24 and 25

PRODUCTS AND PIPELINE



Read more on pages 34 to 45

REVENUES

Read more on pages 57 to 59

Our current revenues arise primarily from in-market products sold by partners in the largest respiratory segments of Asthma and COPD. Smaller niche disease areas will increasingly become an important revenue source where we aim to establish a successful specialist commercial portfolio for new Vectura-enhanced therapy programmes.

Our values

Patient focus • Innovation • Collaboration • Achievement

Value we create for our stakeholders

Our patients

– Developing products to improve patients' lives

– Promoting affordable quality products with our generics pipeline and supporting patient access through development of innovative technologies and solutions to address major areas of unmet medical need

Our shareholders

Maintaining a strong balance sheet by ensuring R&D investment focused and pipeline delivery to target long-term growth

Our people

Creating a dynamic and rewarding place to work with clear development opportunities

Our partners

Scientific and Operational Excellence and a broad range of technologies and capabilities to support the development of medicines to treat airways diseases

Our environment and local communities

Offering good quality employment opportunities and the potential for healthier communities

Read more in our Corporate responsibility report on page 64

Uniquely integrated inhaled drug delivery platform

We effectively integrate all technologies and disciplines required to deliver an inhaled product

1 "GMP" – Good Manufacturing Practice.

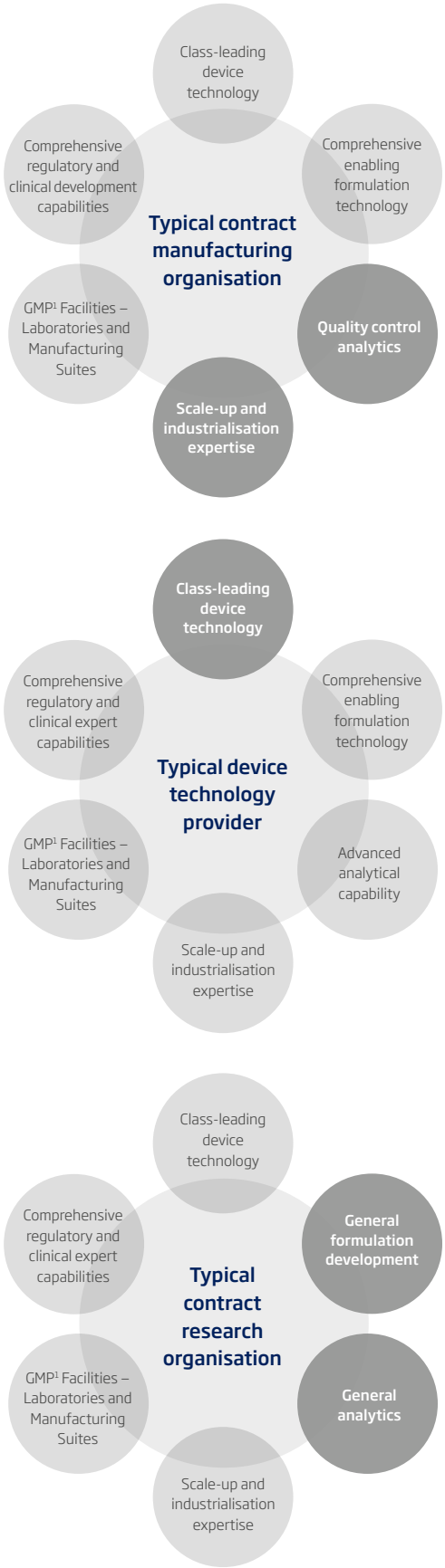
Our uniquely integrated formulation, device and development capabilities

As the respiratory disease space becomes more sophisticated and challenging, Vectura is one of the few companies globally with the expertise to design, develop, industrialise and deliver the most complex products.

Vectura's breadth of capabilities enable products utilising engineered particles, dry powders, aqueous formulations for nebulisation, and pressurised propellant-based solutions or suspensions delivered via inhalers developed internally by our device design team. We have more than 140 expert pharmaceutical scientists and device engineers focused on the development of inhaled products. With vertically integrated capabilities and deep experience, Vectura can provide nimble solutions by delivering unique and differentiated medicines to fulfil both patient and partner needs.

Read more overleaf for detail of our development capabilities

Differentiated from our competitors



Class-leading device technology

Vectura has expertise applied to its approved devices and across its innovative pipeline, spanning the complete range of inhalation delivery types. These include cost-effective DPI and pMDI devices, through to smart nebulisers optimised for targeted lung delivery of a wide range of dose levels. In particular, Vectura's differentiated smart nebuliser technology has the potential to demonstrate significant improvement in efficacy and/or reduction in treatment time over conventional nebulisers.

Vectura's dry powder inhalers build on commercially validated platform

- Robust and low cost
- Simple and intuitive user interface
- Builds on proven DPI platform
- Enabled via add-on or integrated connectivity
- Consistent performance across range of products
- Broad and long dated patent coverage

GyroHaler®

Lever-operated

Open-Inhale-Close

Multi-use single unit dose

Vectura's pressurised metered dose inhalers are familiar and universally acceptable

- Portable and robust
- Synchronisation improved when combined with spacers
- Breath actuation in partnership with Mundipharma
- Active dispersion enables low inspiration flow rates
- Front-facing dose indicator
- Low cost
- Designed for high volume manufacture

Dose indicating pMDI actuator

Vectura's differentiated nebulised devices provide opportunity for enhanced outcomes and shorter treatment times

- Breath actuation
- Faster delivery
- Potential to increase efficiency and reduce drug dosage
- Low inspiration flow rate
- Controlled inhalation volume
- Potential for use with large molecules including biologics

AKITA® JET

FOX®

Comprehensive enabling formulation technology

Our range of device and formulation capabilities provides us with a competitive advantage for developing generics for Asthma and COPD, as well as products aimed at the enhanced delivery of known molecules to the lungs in specialist disease areas. This includes inhaled reformulations of medicines normally delivered by the oral or injectable route, including biologics.

Our in-house capability to design and engineer our own formulations and adapt their aerodynamic properties by altering size, shape, surface roughness and surface chemistry to optimise them for their particular purpose.

For example, we can engineer a particle to make it less "sticky", so that it flows and aerosolises better and has the potential to be delivered with higher efficiency to effect an increased efficacy.

The versatility and ability to alter drug formulations according to dosing regimens is key when delivering complex biologics and is increasingly demanded by regulators and physicians. Our wide range of delivery devices also allows us to easily combine different molecules together in combination products.

We are an attractive partner for pharma companies, working closely with them to select the right technology for the intended patient and disease before the formulation or device becomes fixed in the later stages of development.

Advanced analytical capability

Vectura's advanced in-house analytical capability further cements the Company's ability to support all phases of inhalation product development. Vectura has extensive state-of-the-art analytical testing facilities and equipment, and an expert analytical workforce able to fully develop and validate all of the methods required to characterise complex inhalation products not just for small molecules and combinations thereof but also for complex biologic inhalation products. The pharmaceutical development of inhalation products requires many decisions to be made along the way. Most decisions are based on the analytical data generated, making Vectura's advanced analytical capability a key strength of the organisation.

Scale-up and industrialisation expertise

Vectura has the expertise to develop product manufacturing processes, ranging in scale from small laboratory, all the way through to commercially relevant scale, offering a seamless transition and transfer out to commercial product manufacturing sites.

The Group has a proven ability to advance products from early development stages all the way through to commercial production. Vectura also has strong clinical and regulatory capabilities to complement its technical formulation, device, analytical and manufacturing expertise.

GMP[1] Facilities – Laboratories and Manufacturing Suites

We have the expertise to develop manufacturing processes ranging in scale from laboratory testing all the way through to commercially relevant scale-up, including the manufacture of clinical supplies for large scale clinical studies. This enables us to offer a seamless transfer out to commercial manufacturing sites.

Comprehensive regulatory and clinical expert capabilities

Vectura has a strong team of experienced professionals in all development-related disciplines required for taking drugs and drug-device combinations from pre-clinical development right through to regulatory submission (MAA – Marketing Authorisation Application or NDA – New Drug Application) and post-approval. The Clinical/Regulatory Development team is composed of more than 40 scientists with experienced background and positive track record in the respiratory field emanating from different biotech, medtech, pharma-industries and also academia.

Outside of the big pharma organisations active in the field of inhalation product development it is really only Vectura that is able to bring together all of the disciplines required to seamlessly work together to create a successful product. It is Vectura's ability to successfully combine all of the required technologies and capabilities that makes the Company a global leader in the field of inhalation product development.

40+

experienced scientists in our clinical and regulatory teams

1 "GMP" — Good Manufacturing Practice.

CASE STUDY: Breelib™ meets iloprost – a modern nebuliser for an established drug

What is Breelib™ ?

Breelib™ is a small handheld, battery-powered, breath activated, vibrating mesh technology inhalation system utilising the FOX®'s unique flow rate and volume control technology. It is a smart nebuliser device designed to provide patients with both an easier to use device and improved delivery of Ventavis® (iloprost), a well-established inhaled treatment for patients with pulmonary arterial hypertension.

Drug product is available at 10 microgram/ml (1ml ampule) and 20 microgram/ml nebuliser solution through the technology. Patients can initiate on Ventavis® (iloprost) with this device or switch from an alternative device.

History

In October 2012, Vectura established a collaboration with Bayer to develop Breelib™, a smart hand-held nebuliser device designed to provide patients with both an easier to use device and improved delivery of Bayer's Ventavis® (iloprost), a well-established inhaled treatment for patients with PAH.

Class-leading device technology

Together with Bayer, Vectura used its in-house respiratory expertise to customise its proprietary FOX® platform to design a patient-focused drug-specific nebuliser system to match the high-performance profile of the existing device.

The Bluetooth® enabled device incorporates a patient feedback mechanism, which helps to guide a patient's breathing during the inhalation process. To improve inhalation technique, the Breelib™ mouthpiece will glow green if the patient is breathing with the right speed and force and red for sub-optimal breathing. Vectura also supported the development of the BreeConnect app solutions, which helps patients to monitor the number of inhalations they have taken a day, reminds them when to inhale and shares the data with their doctor, providing an enhanced patient experience. In 2014, the FOX® device won the Red Dot Award for product design.

Now approved in Poland, Germany, Austria, Portugal and the UK with further roll-out underway. The adapted FOX® handheld smart nebuliser, which utilises Vectura's unique FAVORITE™ inhalation technology, is able to significantly reduce each treatment time from eleven minutes to three minutes, whilst maintaining efficacy. This reduction in treatment time, along with an improved cleaning regime, saves a typical patient over one hour per day.

Comprehensive regulatory support

Leveraging our strong clinical and regulatory capabilities throughout the development of Breelib™, Vectura supported the planning of the required clinical studies with drug delivery, device and PAH experts providing support for the dosing strategy and patient-specific device parameters, and undertaking device validation and device vigilance.

Scale-up, industrialisation and GMP manufacturing

Vectura handled all aspects of industrialisation and supply of the Breelib™ inhalation device, and were responsible for the GMP manufacturing of the device from clinical trials through to commercial launch. Vectura supported Bayer by enabling a seamless transition and transfer of the Breelib™ design to commercial manufacturing sites to support the scale-up and industrialisation of the device.

Market launch

Working closely with Bayer, Vectura was part of the market launch team, performing device workshops and training for the Bayer commercial team and healthcare professionals.

Spotlighting our capabilities

Breelib™ highlights our integrated development capabilities which enable us to support the development of complex inhaled products throughout the development lifecycle, from initial partner interaction, right down to product launch support and digital solution development.

Breelib™ is an alternative delivery mechanism for Bayer's Ventavis® (iloprost) to treat pulmonary arterial hypertension (PAH) patients. Vectura's simple and easy to use proprietary hand-held FOX® nebuliser enhances the delivery of this known product, significantly reducing treatment times for patients.

The commercialisation of Breelib™ validates the potential opportunity for multiple further developments, leveraging our device technology to enhance the delivery of existing approved medicines.

> Faster delivery and an improved cleaning regime save the typical patient over one hour a day.

reddot design award winner

Proprietary flow rate management with valve and colour changes reinforcing optimum inhalation technique

Clear strategic priorities

We are resolutely pursuing our vision to be the industry-leading inhaled drug-device development specialist.

At our Capital Markets Day in June 2017, the management team presented a comprehensive overview of Vectura's differentiated formulation and device development capabilities. The team identified the growing market segments where Vectura is best placed to succeed and also outlined the investment required to drive development programmes and launch and commercialise our pipeline assets.

As part of our annual strategy review process, during the second half of 2017, we reviewed our investment priorities to ensure that we remain focused on delivering against our vision for the Group alongside building shareholder value.

The outputs of this review reaffirmed our conviction in the strength of our core capabilities. The review determined that these capabilities are best deployed across relatively lower-risk, higher-value development opportunities, particularly in well-known on-market medicines. We are therefore refocusing our pipeline and adjusting the mix of R&D investment during 2018. In making these adjustments, we are reducing the level of overall R&D investment, optimising the risk profile of the business and creating headroom to introduce new development programmes leveraging our proven capabilities. We believe that by focusing our resources in this manner we will increase the probability of valuable returns from our investments and we look forward to the future with confidence.

Read more about our pipeline on page 29

Read more about our differentiated formulation and device development capabilities on pages 18 to 22

Our strategy is to fully leverage our differentiated technology and skills, maximising value by enhancing the delivery and performance of inhaled products for specialty diseases and through the development of high-quality generic alternatives to branded therapies.

Our priorities against which we will measure our progress are clearly defined:

Achieving our strategic priorities involves risks and uncertainties, which are detailed on pages 50 to 54

Strategy at a glance

Strategic priority	Progress in 2017
Maximising pipeline value 	• VR475 (EU) Phase III trial progressing well and patient recruitment now completed • VR647 (US) Phase I successfully completed and Phase II now underway • Breelib™ launched in the EU providing commercial validation of our proprietary FOX® nebuliser technology • Utibron™ and Seebri™ Neohaler® launched in the US
Operational Excellence 	• Synergy delivery above plan and delivered ahead of communicated timeline • Completed an Operational Excellence review of activities within the R&D function which highlighted opportunities to significantly improve productivity • Delivered improved *flutiform*® gross margins of 37.6% (2016 proforma underlying: 31.4%), (Underlying nine-months 2016: 31.3%)
Maximising partnering value 	• Generics pipeline extended: new development deal signed with Sandoz (VR2081) and Pulmatrix licensing deal, which has accelerated development of our tiotropium DPI programme (VR410) for COPD by up to two years • Signed Dynavax partnership, extending use of our smart nebuliser technology into lung cancer (VR347) • Ongoing business development discussions and interest
Strong financial discipline 	• Strong closing cash position £103.7m • £7.3m reduction in total operating costs as a result of early synergy delivery and R&D operational productivity initiatives • £15m share buyback and cancellation commenced; completed post period in February 2018
High performance culture 	• Delivered roll-out of new culture and values at Company-wide "AsOne" event • Launched a Recognition Scheme and Performance Management system that is fully aligned to, and supportive of, our newly articulated culture and values • Launched career development path across the organisation • Developed and delivered a new Leadership Development Programme

Key challenges in 2017	Key priorities in 2018	KPIs
• Receipt of major CRL for our generic Advair® programme partnered with Hikma (VR315 (US)) • Delayed launch of Utibron™ Neohaler® in the US	• Completion of VR647 (US) Phase II activities • Completion of VR475 (EU) Phase III activities • Progression of extended generic portfolio • Development of new enhanced therapy portfolio	• Project milestones completed
• Merger interpretation and transformation • Implementing effective supply chain including partner destocking • Increasing industrialisation and manufacturing of nebulised devices • Initialising R&D transformation initiative	• Delivery of procurement savings using category management principles • Implementing continuous improvement programmes with suppliers and contract manufacturing organisations	• No 2017 KPIs to report against. Operational Excellence KPIs have been established for 2018
• Effective conclusion of new BD deals: Sandoz, Dynavax, Pulmatrix • Management of effective alliance management • Mundipharma's announcement of intention to cease development of pMDI triple programme (VR2076)	• Extension of generics pipeline • Initiation of partnering discussions for VR475 (EU) and VR647 (US) • Seeking partners for VR942 (Global) and VR588 (Global)	• Number of valuable new BD deals signed • Partnering of generic programmes
• Partner destocking within the *flutiform*® supply chain resulting in one-off revenue impact for 2017 • Highly competitive ICS/LABA class in EU limiting *flutiform*® growth • Destocking within Ultibro® supply chain impacting headline growth rates for 2017 • Major CRL for generic Advair® programme delayed launch with milestone and royalty impact for 2017	• Deliver financial results in line with Board expectations • Deliver Operational Excellence savings	• Underlying revenues • Underlying adjusted EBITDA progression • Net cash
• Ongoing effective integration • Development and roll-out of new culture and values • Maintained focus with pipeline/portfolio initiatives	• Continued focus on effective talent development and retention and succession planning	• Continued progress against employee engagement metrics

Strategy in action

Maximising pipeline value

Vectura's pipeline has historically focused on three key areas – generic partnering (device and formulation), Vectura-led development of programmes for enhanced delivery of known medicines (device and formulation) and novel molecule partnering (device or formulation). Each of these types of programme carries a different level of risk for Vectura; they have different probability of success rates and have different development requirements, meaning that certain programmes will cost more and/or take longer to get to market than others. The objective of our 2017 investment review was to ensure that our pipeline contained an optimal mix of these programmes, thus giving Vectura the best chance of achieving valuable returns for its stakeholders over the short, medium and long term.

Refocused approach to R&D investment, increasing returns and lowering risk

GENERIC PARTNERING
Device AND formulation

Future spend from 2019[1]

Previous typical % of R&D

10%-20%

Pipeline asset examples

VR315 (Hikma)
VR730 (Hikma)
VR506 (Hikma)
VR632 (Sandoz)
VR2081 (Sandoz)
VR410 (Potential to partner)

Strategic evolution

Increased leverage of rare formulation, device and development capability

Typical risk and economics

- US development risk related to substitutability of device and formulation
- £ Development service revenue and mid-teen royalties
- £ Upfront technology access and development milestones

VECTURA ENHANCED THERAPIES
Device AND formulation

Future spend from 2019[1]

Previous typical % of R&D

45%-50%

Pipeline asset examples

VR475 (Vectura)
VR647 (Vectura)

Strategic evolution

Increased future leverage of proven proprietary technology

Typical risk and economics

- Development risk associated with proof of enhanced delivery (speed/efficiency/tolerability)
- £ Attractive upfront milestones reflecting access to technology and Vectura clinical development
- £ Development milestones and attractive royalty stream

NOVEL MOLECULE PARTNERING
Device OR formulation

Future spend from 2019[1]

Previous typical % of R&D

35%-40%

Pipeline asset examples

VR465 (Ablynx)[2]
VR347 (Dynavax)

Strategic evolution

Decreased focus given high risk and low upfront revenues

Typical risk and economics

- High development risk with novel molecule and low probability of success
- £ Low upfront technology access and development milestones
- £ Development service revenue plus low single-digit royalties

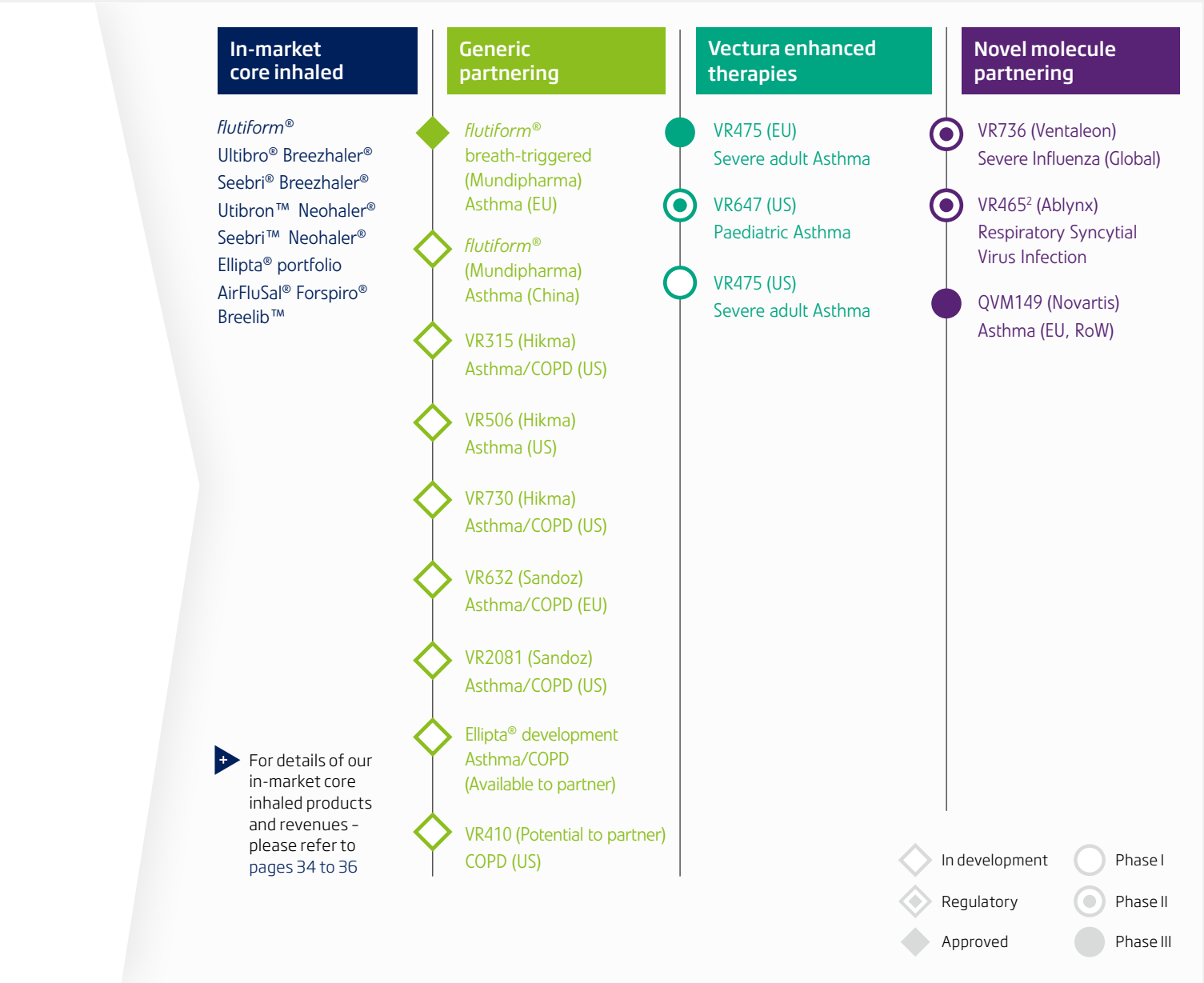
1 Assuming VR647 (US) is licensed prior to commencement of Phase III activities.

2 Ablynx ALX-0171.

We believe that our refined pipeline achieves our investment objectives and is well placed to accelerate shareholder value

The objective of our 2017 investment review was to ensure that our pipeline maximises the opportunity to leverage our capabilities and the value of our "sweet spot".

Unique capabilities validated through extensive collaboration, licensing arrangements and future pipeline



For details of our in-market core inhaled products and revenues – please refer to pages 34 to 36

Maximising pipeline value continued

Our 2018 refocused investment priorities explained:

EXTENDING GENERICS

Extending our partnered development of high-potential generic medicines for the US market

As we are seeking to balance the mix of our overall investment, we will therefore increase our focus on expanding our generics pipeline. We believe that we are uniquely positioned to be one of few winners with inhaled mono and combination generic products. The global generics market is large and is growing in value and volume terms and the inhaled respiratory generics segment is largely untapped.

Development of inhaled generics requires specialised capabilities which are scarce in the industry but are core competencies of Vectura.

Our current pipeline includes development programmes covering the three leading generic molecule opportunities in the US and combined US net sales of the branded reference products in 2017 were in excess of $4.9bn[1]. VR315 (US) is partnered with Hikma, VR2081 (US) is partnered with Sandoz and VR410 (US) is, as yet, unpartnered. We, and our partner Hikma, remain confident that our generic Advair® programme (VR315 (US)) will be approved and launched in due course.

Beyond our existing pipeline, we believe that there are a number of additional valuable opportunities within the generics space and we look forward to confirming development and licensing of further programmes in due course.

1 Evaluate Pharma 2017.

Read more about our generics pages 38 to 41

EXTENDING DEVELOPMENT OF VECTURA ENHANCED THERAPIES

Enhancing delivery of existing inhaled treatments or repurposing non-inhaled treatments for inhaled delivery

Following the commercial validation of our FOX® technology with the approval of Bayer's Breelib™ product, we are now progressing initial development for further enhanced delivery programmes.

A pipeline progress update will be provided in Q3 2018.

Read more about our enhanced therapies on pages 42 to 45

SELECTIVE NOVEL PARTNERING

Increasingly selective approach to novel molecule partnering

We will take an increasingly selective approach to further novel partnering. Development of novel molecules is a higher risk activity which typically has a long and expensive development cycle and carries a lower probability of success. Whilst we do receive significant interest from a number of biotech companies who want to use our technology to pursue novel development programmes, the near-term financial returns of such projects are typically low and therefore we believe that such programmes do not represent the optimal type of investment for the Group.

Future novel partnering arrangements will need to meet strict, pre-defined investment hurdles.

STOPPING EARLY-STAGE NOVEL INVESTMENT

Stopping Vectura investment in early-stage novel molecule clinical development

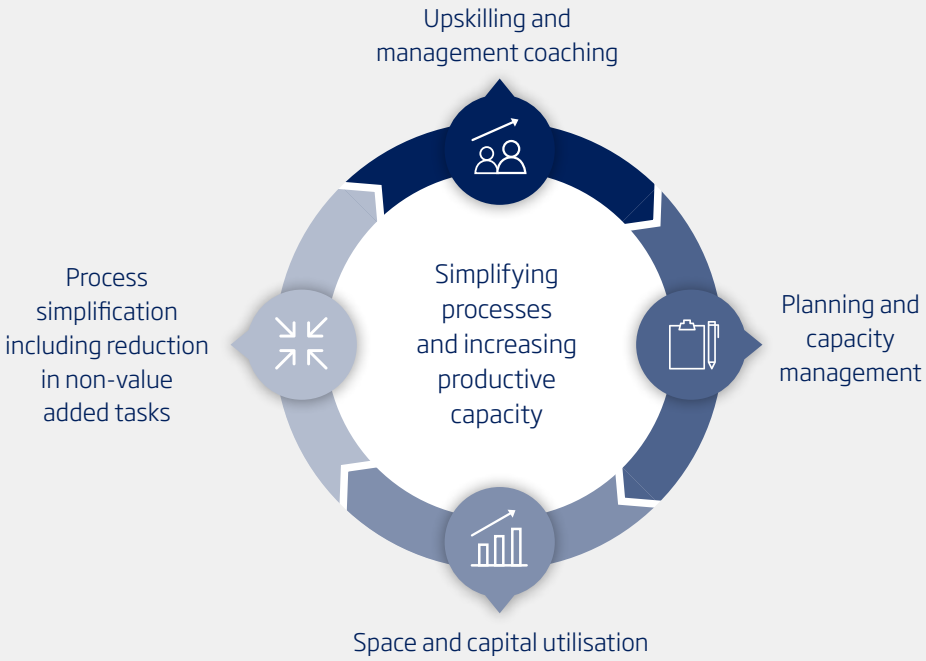
During 2018 we will seek to partner and out-license VR588, a wholly owned kinase inhibitor, and, along with our co-collaborator UCB, we will also seek to partner VR942, a dry powder inhaled biologic that successfully completed Phase I during 2017.

In January 2018, we confirmed that our partner Mundipharma had informed us of its decision to stop the development of the pMDI triple therapy for Asthma and COPD (VR2076), which was in an early formulation phase. Given the early stage of this asset, we do not expect this change to have a material impact on the Group's revenues in 2018.

Operational Excellence

During 2017, we completed an Operational Excellence review of activities within the R&D function. This review validated that Vectura has a highly skilled and stable workforce and it highlighted a number of areas where we have opportunities to significantly enhance productivity.

By delivering against these activities during 2018, we will free up capacity to support future new development programmes and achieve cost savings through a lower internal programme expenditure.



Maximising partnering value

Vectura currently has two leading Vectura enhanced delivery assets which target niche patient populations; we believe these assets represent a transformational opportunity for nebulised therapy. The VR647 (US) Phase II trial has now initiated with the first patient dosed in December 2017 and activities are expected to complete in Q3 2018. We remain on track to complete the current VR475 (EU) Phase III trial in Q4 2018.

As part of the investment review, we have considered the commercialisation options for these two assets. We have decided that, in the absence of additional specialist marketed products being acquired through M&A or in-licensing, the Group will initiate partnering discussions for these assets. This approach reflects the high cost, low financial leverage and opportunity cost associated with the commercialisation of single assets in a given territory.

In 2018 we will focus on continued and successful execution of current clinical activities and the initiation of partnering discussions. We would expect the conclusion of these partnering discussions to be in 2019, following read-out from the ongoing clinical trials.

VR647 (US) – nebulised budesonide for paediatric Asthma (Phase II)

US nebulised budesonide market is currently worth

c.$770m[1]

VR475 (EU) – nebulised budesonide for severe adult Asthma (Phase III)

Analyst indicative peak sales range[2]

$150m–$300m

1 2017 FY IMS MIDAS Q4 2017.

2 Peak sales based upon consensus of these analysts who have published product level forecasts. Provided for inductive purposes only and not necessarily representing the views of management.

Strong financial discipline

We remain committed to exercising strong financial discipline over our business and demonstrating excellence in stewardship of our capital.

Our refocused pipeline and commitment to Operational Excellence have allowed us to optimise our R&D investment in 2018 and beyond.

As a result of stopping development of VR942 and VR588 and savings identified through our Operational Excellence initiatives, 2018 R&D guidance has been reduced to £55m–£65m. We have the potential to further reduce this investment level to between £45m and £55m from 2019 assuming that VR647 (US) is partnered in 2019 prior to the start of Phase III activities. These are substantial reductions in investment which can be achieved whilst simultaneously reducing the risk profile of the business and accelerating the pipeline value proposition.

Our £15m share buy-back and cancellation programme, which commenced on 14 November 2017, was completed post period on 28 February 2018. As at the end of December 2017, approximately £1.4m had been spent in respect of this scheme and the balance of cash outflows was incurred in 2018. The Group maintains a disciplined approach to capital allocation and capital expenditure is expected to be in a normal annual range of £10m to £15m during 2018 as the majority of capacity expansion initiatives having been completed in previous years.

As a result of stopping development of VR942 and VR588 and savings identified through our Operational Excellence initiatives, 2018 R&D guidance has been reduced to

£55m–£65m

High performance culture

Our high performance culture enables us to achieve significant and lasting performance that strengthens our competitive advantage.

We facilitate a high performance culture by ensuring our people have the autonomy, skills and confidence they need to excel in their roles and that they feel connected with our purpose and values.

Throughout 2017 we, collectively as an organisation, have undertaken an exercise to clearly articulate our culture and values. Our culture and values are now embedded across our business and within our business processes.

During 2018, we will continue our focus on effective talent retention and development for succession planning, as we seek to increase the depth, breadth and diversity of our employees.

Our core values

- PATIENT FOCUS
- INNOVATION
- COLLABORATION
- ACHIEVEMENT

Guidance and outlook

The Board maintains its expectations for strong growth in total 2018 revenues, driven by the established performance from in-market inhaled products, particularly *flutiform*® and Ultibro®/Seebri® Breezhaler®.

As previously guided, until the expiry of certain patents, the earliest of which will expire in September 2018, Vectura will continue to receive a 3% share of Pacira's cash receipts from net sales of EXPAREL®. The Group remains entitled to a non-patent-dependent milestone of $32m, receipt of which is subject to cumulative twelve-month sales of the product reaching $500m which may occur in the medium term.

Revenues in 2018 may also be supplemented by further business development activity, including potential milestone and development services revenues from further partnering deals signed during the year.

The Board also reaffirms its 2018 R&D guidance at the reduced level of £55m to £65m. This guidance reflects merger synergy delivery of £11m to £12m per annum from 2018, ahead of the original £10m annual target together with focused pipeline investment and ongoing R&D Operational Excellence initiatives. As announced on 4 January 2018, the costs to deliver the Operational Excellence initiative are estimated at approximately £0.5m within exceptional items in 2018, in addition to the £0.9m reported in exceptional items in 2017.

Vectura anticipates important data from its lead enhanced therapy programmes, with the VR647 (US) Phase II study in children with asthma, and the VR475 (EU) Phase III trial in severe adult asthma, both expected to complete in the second half of the year. The Group intends to partner both programmes after these important data points. Were VR647 to be partnered before the commencement of Phase III activities, total R&D spend in 2019 is expected to reduce to between £45m and £55m.

Expected news flow 2018

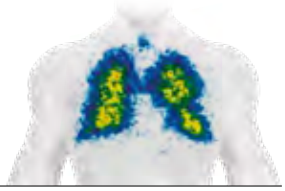
FY2017 results
AGM 17 May 2018

Enhanced delivery portfolio update - Q3

VR647 (US)
Phase II completion - Q3

VR465[1] (Global)
Phase IIb top line results - Q4
1 ALX-0171.

VR475 (EU)
Phase III completion - Q4



GSK UK patent litigation outcome expected - Q4

In-market products – Inhaled

Our key inhaled assets drive our base of recurring revenues

flutiform®

Well-established EU performance and continued strong growth in Japan

Underlying revenue

£68.5m

Gross profit margin

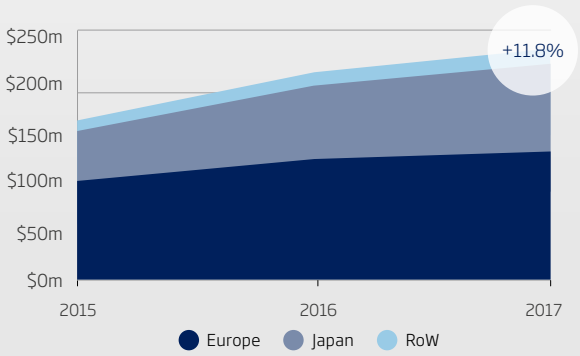
37.6%

Sweet spot

Kyorin

mundipharma

***flutiform*® sales by region[1]**



1 IMS MIDAS Q42017; *Units calculation equals to packs; Value at ex-manufacturer prices in LCUS$, CER Q42017.

flutiform®

flutiform® (fluticasone/formoterol) is a fixed dose combination of an inhaled anti-inflammatory (ICS) and a bronchodilator (LABA) in a pressurised meter dose inhaler (pMDI) device. Vectura earns revenue from product supply and royalties from in-market net sales, and is eligible to receive up to €30.0m in future sales milestones from Mundipharma. The product is now launched in 39 countries, and approved in a further nine.

flutiform® continued to perform strongly and in-market net sales for the twelve-month period ended 31 December 2017 grew by 11.8% (CER) to €206.2m[1], generating total underlying product supply and royalty revenue for the Group of £68.5m (2016 proforma underlying: £65.8m). Revenues earned by the Group grew at a rate below the rate of in-market sales growth, impacted by the previously reported destocking in the supply chain during H2 2017 driven by partner working capital demand which is independent of in-market sales growth.

flutiform® is marketed in the Europe and RoW (excluding North America and Japan) by our partner Mundipharma and in Japan by our partner Kyorin. The product is not available in the US. In October 2017, Mundipharma received a successful outcome of the European Decentralised Procedure (DCP) for the k-haler® breath-triggered version of the product, a natural extension of the *flutiform*® franchise.

flutiform® (Mundipharma, Europe and RoW (excluding North America and Japan))

flutiform® continued to perform well, growing 5.0% (CER) in value[1] terms in a challenging and competitive European ICS/LABA market which declined by 3.2%, and achieved a slight increase in market value share to 3.6%.[2]

Net sales in RoW territories were €15.3m, up 32.5%, and now contribute over 7% of total *flutiform*® net sales[1].

During 2017, roll-out into Asia Pacific and Latin America has continued and Mundipharma confirmed the first enrolment into a Phase III asthma study in China with recruitment ongoing. In addition, data was presented at the European Respiratory Society International Congress (ERS) from the largest ever *flutiform*® study which confirmed the effectiveness and tolerability of the product in real-world clinical practice (*AffIRM* study).

flutiform® (Kyorin, Japan)

Japanese sales of *flutiform*® now account for 37.1% of total in-market *flutiform*® net sales and Kyorin continues to drive success in a dynamic market, delivering a 19.8% increase in value year on year[1] and an increased value market share from 9.9% to 11.5%[2]. Overall, the ICS/LABA market in Japan continued to grow in value terms, up 1.2% in year on year.[2]

During 2017, Kyorin commenced a paediatric Phase III clinical trial to expand the indication of *flutiform*®. Kyorin has estimated that there are 2.6m children between the ages of five and 14 who suffer from asthma in Japan.[3]

flutiform® breath-triggered (Mundipharma)

An inhaled anti-inflammatory (ICS) and bronchodilator (LABA) combination therapy for the treatment of asthma in adults and adolescents (aged twelve years and older). Mundipharma's *k-haler*® is an aerosol device with a breath-triggered mechanism, activated with a low inspiratory force, which is designed to make it easier for patients to use correctly.

In October 2017, Mundipharma received a successful outcome of the DCP for the *flutiform*® breath-triggered product. The UK's Medicines and Healthcare products Regulatory Agency (MHRA) acted as the Reference Member State for the DCP, which covers 18 countries across Europe. This positive DCP outcome marked an important step in the regulatory process and Mundipharma has now begun to apply for national approvals and reimbursement in the European countries covered by this procedure. The launch of the enhanced *flutiform*® *k-haler*® device, in due course, will represent a helpful life cycle management for an already successful product and supports our confidence in the further evolution of *flutiform*® revenues.

Ultibro® Breezhaler® (Novartis, EU and RoW (excluding US))

A first-in-class once-daily fixed dose inhaled dual bronchodilator (LAMA/LABA) indicated as a maintenance bronchodilator treatment to relieve the symptoms of adult patients with COPD.

The product is now approved in over 100 countries including Japan, the EU and China (approved December 2017). In-market net sales grew by 12.0% (CER) on an annual basis.[4] This growth rate was impacted by destocking in certain territories. Novartis reported Q4 net sales growth of 26.0% (CER).[4] IMS data shows strong regional growth in Europe of 18.6% (CER) which accounts for 76.0% of total IMS reported in-market sales[1].

This growth was fuelled by positive results from the FLAME[5] study and GOLD[6] changes, which recommend LAMA/LABA as a treatment option in the majority of symptomatic patients regardless of their exacerbation risk. This was further reinforced by new data published by Novartis from the FLASH[7] study, which demonstrated significantly improved lung function in COPD patients after a direct switch from Seretide®.

In February 2018, data from Novartis' CLAIM study was published in the Lancet Respiratory Medicine, which showed Ultibro® Breezhaler® provided significant improvements in cardiac and lung function in COPD patients with lung hyperinflation, compared to placebo. Many people living with COPD are at increased risk of death and disability due to comorbid cardiovascular disease.[8] Lung hyperinflation is common in people with COPD[9], and has been linked to impaired cardiac function and a worsening of COPD symptoms, especially breathlessness.[10,11,12] CLAIM is the first study to investigate the effects of dual bronchodilation on cardiac function and lung hyperinflation.

The CLAIM study met its primary endpoint demonstrating that treatment with Ultibro® Breezhaler® led to decreased lung hyperinflation and improvements in cardiac function[13] after 14 days of treatment[14]. This translated into clinically relevant patient benefits of improved health status and breathlessness (dyspnea), studied as exploratory endpoints.[14]

1 In-market net sales are internal calculations using IQVIA Health (IMS) data based on sales to pharmacies and excluding certain minor countries which are not covered by IQVIA. In-market net sales are not the same as sales to wholesalers on which royalties are payable to the Group. All percentages quoted at constant currency rates.

2 IMS Q4 2017 SMART/MIDAS data base.

3 As reported by Kyorin.

4 As reported by Novartis on 24 January 2018.

5 Wedzicha JA, Banerji D, Chapman KR, et al. Indacaterol/Glycopyrronium Versus Salmeterol/Fluticasone for COPD Exacerbations. New England Journal of Medicine. 2016. Available at: www.nejm.org/doi/full/10.1056/NEJMoa1516385 (link is external).

6 Global Initiative for Chronic Obstructive Lung Disease (GOLD). Global Strategy for the Diagnosis, Management and Prevention of COPD, 2017. Available at: http://goldcopd.org (link is external).

7 Frith P, Ashmawi S, Krishnamurthy S, et al. Assessing direct switch to indacaterol/glycopyrronium from salmeterol/fluticasone in moderate to severe symptomatic COPD patients: the FLASH study. [APSR 2017 abstract].

8 Chen W, Thomas J, Sadatsafavi M. Risk of cardiovascular comorbidity in patients with chronic obstructive pulmonary disease: a systematic review and meta-analysis. Lancet Respir Med 2015;3:631–39.

9 Mayo Clinic. Hyperinflated lungs. What does it mean? Available at: https://www.mayoclinic.org/diseases-conditions/emphysema/expert-answers/hyperinflated-lungs/faq-20058169 [Accessed December 2017].

10 Barr RG et al. Percent Emphysema, Airflow Obstruction, and Impaired Left Ventricular Filling. New Engl J Med. 2010;362:217–227.

11 Watz H et al. Decreasing Cardiac Chamber Sizes and Associated Heart Dysfunction in COPD. Chest. 2010;138:32–38.

12 Rossi, A., Aisanov, Z., Avdeev, S., Di Maria, G., Donner, C.F., Izquierdo, J.L., Roche, N., Similowski, T., Watz, H., Worth, H., et al. (2015). Mechanisms, assessment and therapeutic implications of lung hyperinflation in COPD. Respir. Med. 109, 785–802.

13 As measured by left ventricular end-diastolic volume (LV-EDV).

14 Hohlfeld JM, Vogel-Claussen J, Biller H et al. Effect of lung deflation with indacaterol plus glycopyrronium on ventricular filling in patients with hyperinflation and COPD (CLAIM): a double-blind, randomised, crossover, placebo-controlled, single-centre trial. Lancet Respir Med 2018. Published online February 21, 2018. http://www.thelancet.com/journals/lanres/article/PIIS2213-2600(18)30054-7/fulltext?elsca1=tlxpr.

Ultibro® Breezhaler®

In-market performance driving strong recurring revenue growth for Vectura

Formulation

Underlying revenue

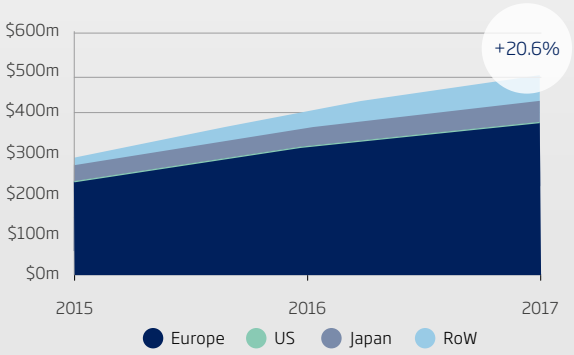
£12.7m

Gross profit margin

100%

NOVARTIS

Ultibro® Breezhaler® sales by region[1]



1 IMS MIDAS Q42017; *Units calculation equals to packs; Value at ex-manufacturer prices in LCUS$, CER Q42017.

In-market products – Inhaled continued

NOVEL IP LICENSING

Seebri® Breezhaler®
(EU and RoW – launched 2012)

Seebri™ Neohaler®
(US – launched late 2017)

NOVARTIS

Formulation

COPD

Easy to use DPI device and effective bronchodilator (LAMA).

GENERIC PARTNERING

AirFluSal® Forspiro®
(EU and RoW, ex. US – launched 2014)

SANDOZ A Novartis Division

Sweet spot

Asthma and COPD

Anti-inflammatory and bronchodilator (ICS/LABA) delivered using Vectura's proprietary Gyrohaler® DPI device is a cost-effective alternative to Seretide® and/or other ICS/LABA treatments.

VECTURA ENHANCED DELIVERY

Breelib™
(EU and ROW, ex. US – launched in 2017)

BAYER

Device and development

Pulmonary arterial hypertension

Vectura's proprietary handheld FOX® nebuliser used to deliver Bayer's iloprost solution – delivery technology reduces mean inhalation time to three minutes per treatment meaning that a typical patient's inhalation time is reduced by 48 minutes.

NOVEL IP LICENSING

Relvar® Ellipta®/Breo® Ellipta®
(Global)

Launched 2013 (US and RoW)

Launched 2014 (EU)

gsk

Formulation only

Asthma/COPD

Once-daily anti-inflammatory and bronchodilator (ICS/LABA) which utilises Vectura's formulation IP.

Incruse® Ellipta®
(Global)

Launched 2014 (RoW)

Launched 2015 (US and EU)

gsk

Formulation only

COPD

Once-daily bronchodilator (LAMA) which utilises Vectura's formulation IP.

Anoro® Ellipta®
(Global)

Launched 2014 (US, EU and RoW)

gsk

Formulation only

COPD

Once-daily dual bronchodilator (LAMA/LABA) which utilises Vectura's formulation IP.

Royalties earned on sales of the Ellipta® products are capped at £9m p.a.

Oral and non-inhaled

In addition to our core focus in airways diseases, Vectura has a number of legacy oral and non-inhaled products that generate revenue

Oral products

Vectura has significant oral technology and manufacturing expertise and capabilities. Our manufacturing facility in Lyon, France, has cGMP status with approvals from the European Medicines Agency, the FDA, ANVISA (Brazil) and KFDA (South Korea), amongst others. The site currently manufactures seven oral products for partners.

Focusing on maximising the value of the facility, Vectura continues to leverage the undercapacity of this high-quality manufacturing site with increasing business development volumes being achieved. Whilst Vectura's investment in the site continues to be modest, we believe that over time the site will become a well-utilised, fully integrated development, manufacturing and packaging contract organisation.

Five of the products manufactured use the Geomatrix™ family of technologies: Diclofenacratiopharm Uno®, Coruno®, ZYFLO CR®, Madopar® DR®/Prolopa® and Sular®, whilst LODOTRA®/RAYOS® uses the Geoclock™ chronotechnology. The facility also manufactures Triglide®, which utilises the Group's solubilisation technology.

Total underlying revenue for 2017 from oral and non-inhaled

£24.3m

(2016: £23.7m)

Lyon facility:

Focused to maximise value of facility and leverage contract multilayer tableting, oral technology and high-quality manufacturing capacity.

Non-inhaled products

EXPAREL® (Pacira, US) is an injectable product for single-dose administration into the surgical site to produce post-surgical analgesia. Vectura recognised £6.6m within other revenue during 2017 (2016 proforma underlying: £5.8m) which equates to a 3% share of Pacira's cash receipts from net sales of EXPAREL®. Vectura is also eligible to receive a further sales milestone of $32m when worldwide annual net sales of the product reach $500m (on a cash-received basis); the receipt of this milestone is not patent dependent.

ADVATE® (Baxter, Global) is an antihaemophilic factor (recombinant) for the treatment of haemophilia A and marketed worldwide by Baxter. Vectura's ADVATE® patent expired at the end of January 2016; however, due to higher than anticipated production of ADVATE® inventory by Baxter prior to this expiry, Vectura has continued to receive royalties from sales of this product totalling £1.0m for 2017 (2016 proforma: £13.7m). Vectura does not anticipate further material royalties from sales of this product.

Solaraze® (Sandoz US and Almirall EU) is a non-steroidal anti-inflammatory drug (NSAID) treating actinic keratosis, a precancerous skin growth usually caused by sun exposure. Solaraze® royalties were £2.9m for 2017 (2016 proforma underlying: £6.7m).

Adept® (Baxter, Global) is a 4% icodextrin solution used during surgery to reduce post-surgical adhesions, a frequent and major complication after gynaecological and other abdominal surgery. Adept® continues to make a minor contribution to royalty revenue.

EXPAREL®

Solaraze®

Generic programmes

A large and untapped US market with few new entrants into this complex space

What is a generic?

A generic drug is a medication that has exactly the same active ingredient as its equivalent brand-name drug and yields the same therapeutic effect. It has the same dose, safety, efficacy and quality.

Developing products for the generic respiratory market has additional complexities as it involves interactions between the drug, the formulation and the delivery device.

Pricing pressures in global healthcare systems

Expanding patient populations and growing unmet medical need are contributing to higher demand for healthcare services and are leading to increased cost pressure within global healthcare systems. Steadily rising healthcare costs have also led to increased scrutiny on drug pricing by governments, the media and consumers. In this context, it is understandable that extending the use of generics is considered an important element in most prescribing strategies to achieve substantial savings without impacting patient care. Switching from branded inhaled drugs to lower-cost generic inhaled drugs represents an opportunity to reduce the cost of drug treatments in asthma and COPD.

The market for inhaled generics

One of the most significant changes the airways diseases market is facing is the increase in the number of generic equivalents, both substitutable and therapeutic equivalents, of major blockbuster products. Of the major inhaled products facing genericisation in the US, Advair®/Seretide®, Symbicort® and Spiriva® are the largest in terms of volumes and value, collectively generating US net sales in excess of $4.9bn in 2017[1].

Globally, the use of generic medicines is growing. In the US, the inhalants market was estimated to be worth some $23bn[2] in 2017, with less than 1% generic conversion in key inhaled maintenance classes[3] meaning that the inhaled generics market for major airways diseases products in the US remains largely untapped. This is in contrast to the oral solids market, where generic products account for 18.3% of the market value and 90.8% of all prescriptions[4].

Whilst pricing is a key challenge for the wider generics market, the relatively low level of competition within the inhaled generics space underpins our belief that this area continues to be a valuable opportunity that Vectura is well placed to exploit. As we refocus our investment and pipeline, we will seek to bring more partnered generic programmes into our strong existing generics pipeline.

Data suggests

<1%

generic conversion in key inhaled maintenance classes

US inhalants market estimated to be worth

c.$23bn

in 2017

1 Evaluate Pharma 2017.

2 IMS SMART Q4 2017 data.

3 Q2 2017 IMS data – defined as ICS, ICS/LABA. LAMAs and LAMA/LABAs and LABAs and newly launched triples.

4 Global Generic and Biosimilars Trends and Insights, IQVIA, February 2018.

A complex development process with multiple variables and challenges

Given the inherent complexity associated with developing inhaled generics, we believe that there are only a handful of companies which have the necessary capabilities to successfully develop these programmes.

Technical challenges

Copying an oral small molecule drug or an injectable is simple and many hundreds of generics companies are able to do it. Copying an inhaled therapy is more challenging. Sourcing the drug is similar to simpler dosage forms. However, from this point in development the complexity of inhaled product development rapidly increases due to the need for the product to be formulated, combined with a specific delivery device and manufactured at a commercial scale, all requiring specialist capabilities, IP and know-how.

Legal/IP challenges

The approval of a generic is litigious, particularly for inhaled therapies where multiple overlapping patents are typical. Even after all the patents expire, a generic cannot infringe design copyright or trademarks relating to the device.

Development of non-inhaled or injectable generics typically does not pose the same IP challenge; as an example of a modern tablet product facing generic competition in the US, rosuvastatin calcium (CRESTOR®) tablets have four patents listed in the Orange Book, whereas GSK's inhaled product Breo® Ellipta® (ICS/LABA) has 14 patents listed[5].

Formulation challenges

The formulation of inhaled generics has many variables, all of which need to be understood and managed. The way in which these variables interact can change over the lifecycle of the product meaning that product performance changes throughout shelf life or as a result of shipping or seasonal factors. This variability of the originator product must be successfully matched to demonstrate bioequivalence.

Regulatory challenges

Once the technical legal and formulation challenges are overcome, regulators must then be convinced that the generic is an accurate copy by proving "bioequivalence". This is relatively straightforward for simple oral generics, but is significantly more challenging for inhaled therapies. For example the US FDA requires clinical evidence of equivalence for inhaled products, not just reliance on single-dose pharmacokinetic studies.

5 Orange Book – accessed 22 February 2018.

Generic programmes continued

Developing generics in Europe and the US

Europe and the US have different guidelines on developing respiratory generics. Broadly, there are two routes to follow:

US direct substitution route ("ANDA" or "505j"): this requires the generic to prove bioequivalence to the branded drug, and is the preferred route to market as it gives the generic an "AB rating" that allows pharmacists to directly substitute a cheaper generic instead of a branded version, increasing sales and decreasing distribution costs.

It is more difficult to copy a respiratory drug unless the same or a very similar device is used as the reference product. This is often not possible because of layers of patent protection around devices.

US branded generic route ("505b2"): this is used where it is difficult to prove bioequivalence or where devices are different. Under this route, the generic is not directly substitutable and needs to be actively marketed. This type of development often requires significant investment in the development of the product.

EU Hybrid MAA route: unlike the US, the EU only has one development route known as a "Hybrid MAA"; this allows differences in device design and drug delivery compared with a reference product, resulting in more market entrants compared with the US. The "generic" products are usually non-substitutable at the pharmacy and require some level of promotion to support the sales of the product; this leads to lower rates of conversion to the generic product relative to a substitutable product.

Our current generics pipeline

Our partnering model allows us to access high-volume generic opportunities whilst managing the significant costs associated with their development. Typically our involvement will include both device and formulation development and, as a result, Vectura earns development services revenues as well as milestones and mid-teen royalties on net sales of the final marketed products. This type of programme sits squarely within our "sweet spot" of capabilities and potential returns.

US	505(j) ANDA AB rated	Device requires same operating steps	Allows substitutability at the pharmacy
US	505(b) (2) NDA	Different device design with previously approved drugs	Allows improvements in drug delivery and novel combinations (not substitutable)
EU	"Hybrid" MAA	Focused on equivalent PK/PD product performance	Provides flexibility of device design (not substitutable)

Generic partnering pipeline

- ***flutiform®*** breath-triggered (Mundipharma) Asthma (EU)
- ***flutiform®*** (Mundipharma) Asthma (China)
- **VR506 (Hikma)** Asthma/COPD (US)
- **VR315 (Hikma)** Asthma (US)
- **VR730 (Hikma)** Asthma/COPD (US)

We currently have nine generic products in development, including VR315 (US), a generic version of Advair® Diskus®, partnered with Hikma, for the treatment of asthma and COPD in adolescents and adults, and programmes targeting the Symbicort® and Spiriva® opportunities in the US market.

Only three companies have publicly stated that they have submitted an ANDA filing for an AB-rated substitutable generic Advair® in the US and all three companies have had their initial submissions rejected. Of the companies which have made an ANDA filing, only Vectura has developed the device and formulation capabilities in house rather than via acquisition or in-licensing.

In May 2017, we announced that the US FDA had issued a Complete Response Letter (CRL) in relation to our partner Hikma's ANDA for a generic version of GlaxoSmithKline's Advair® Diskus®. Throughout 2017, Vectura supported Hikma in a constructive dialogue with the FDA and a number of the questions raised were clarified and resolved. However, one issue remained outstanding regarding the Clinical Endpoint (CEP) study and Hikma, supported by Vectura, progressed a dispute resolution process.

Post period, on 12 March 2018, Hikma confirmed that the dispute resolution process had concluded with the FDA upholding its original decision with a requirement that Hikma completes an additional Clinical Endpoint study. In anticipation of this as one of the potential outcomes, Hikma had already finalised the planning of a new clinical study and expects to start patient enrolment in the coming weeks. Hikma has confirmed that it anticipates being able to submit a response to the FDA with new clinical data as early as possible in 2019. This decision will have no impact on Vectura's revenue or R&D expectations for 2018.

Both Vectura and Hikma remain confident in the approvability of the product and are committed to bringing this cost-effective alternative to Advair® Diskus® to the market as quickly as possible. Assuming the successful execution of the new study and a standard regulatory review, we now expect a potential approval and launch during 2020.

Throughout the process, we have gained significant insight into the FDA approval process for complex inhaled generic programmes, which we believe has strengthened our likelihood of success for VR315. Whilst the regulatory bar remains high, the ongoing dialogue with the FDA leaves us well placed to react to any new requirements or challenges that lie ahead. These learnings support our confidence that we have the capabilities to achieve US regulatory approval for our extensive inhaled generic pipeline, which includes generic versions of the three current largest US inhaled brands.

Significant patient need for accessible lower priced medicines remains and, in 2017, US sales of Advair® were $2.1bn[1]. This remains a significant market opportunity and we do not believe that there will be a large number of new entrants into this space; therefore, those who can successfully cross the regulatory line stand to win significant and valuable future market share.

Future opportunities

Following FDA interactions, Vectura is progressing further development of its Open-Inhale-Close device which has the potential to be an AB-rated substitutable generic drug-device combination for the GSK Ellipta® portfolio. This programme offers a very significant opportunity for Vectura, with analyst projections for the branded revenue opportunity of these products at approximately $6bn by 2023[2]. Pharmaceutical development has commenced, in parallel with partnering discussions.

1 Evaluate Pharma 2017.

2 Global Data, extracted Q4 2017.

VR632 (Sandoz)
Asthma/COPD (EU)

VR2081 (Sandoz)
Asthma/COPD (US)

VR410
(Potential to partner)
COPD (US)

Ellipta® programmes
(Potential to partner)

In development · Regulatory · Approved

Vectura enhanced delivery programmes

A core pillar of our R&D strategy is focused on developing known molecules and optimising their safety and efficacy profiles by delivering them right to the site of action using our advanced device technology and inhaled formulation capabilities. Our next wave of development programmes focuses on specialist disease areas affecting the lungs and on very specific patient groups with high unmet medical need which require targeted treatments into the airways.

The strategic case for investment in Vectura enhanced therapies

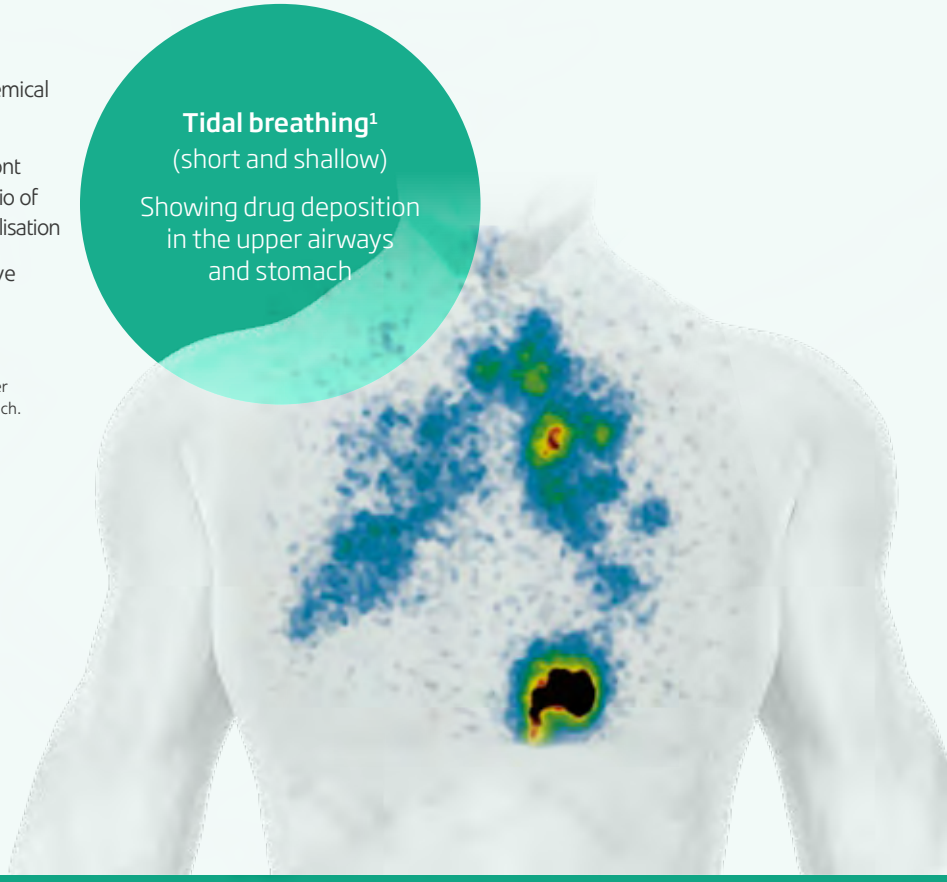
- Ability to target niche patient population and speciality disease areas with high unmet medical needs
- Low development risk associated with proof of enhanced delivery for molecules with a known safety profile
- Strong rationale of an improved efficacy profile with enhanced and targeted pulmonary delivery
- Simpler development programmes with lower development costs than those involving novel chemical entities or mass market inhaled generics
- Opportunity to partner and achieve attractive upfront milestones and royalties and/or to build out portfolio of specialist assets for potential future self-commercialisation
- Focus on areas that are less competitive yet have the potential for premium prices

1 Meyer et al. 2001: Deposition von therapeutischen Aerosolen in der Lungenperipherie. Aerosole in der inhalationstherapie, ed. a Scheuch. Vol. 5. 2001, Dusti-verlag Dr Karl Feistle: München 99–100.

More than just a conventional nebuliser

Our AKITA® JET nebuliser incorporates our proprietary flow and volume regulated inhalation technology (FAVORITE™) inhalation technology.

The AKITA® JET is CE marked and has FDA 510(k) clearance.



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 and the stage at which drug aerosol is delivered during the inspiration can materially affect how much drug gets to central or peripheral parts of the lungs, influencing the efficacy of the drug administered. When using a conventional nebuliser, the normal "tidal" breathing pattern (short and shallow) leads to a lot of the delivered drug either being stuck at the back of the throat and swallowed, or mainly being delivered to the central part of the lungs, where many molecules cannot fully exert their action. To overcome oral absorption and therefore increase lung deposition, patients would need to inhale high amounts of drug to achieve the desired clinical effect, with the consequent safety risks that the orally absorbed dose may cause.

Our FAVORITE™ technology optimises the amount of drug delivered to the lung by guiding the patient to inhale slowly and deeply during inhalation. This technology is breath activated, delivering the drug only once the patient starts inhaling so that no drug is wasted during exhalation, as is the case with conventional jet nebulisers. Finally, the duration of each breath can be adjusted to promote an ideal breathing pattern which remains comfortable for an individual patient. This efficient drug administration allows for either faster drug delivery, reducing treatment times, or a higher drug deposition in the lungs, with the potential for greater efficacy.

The device emits lower sound when it is activated during inhalation, and stops when the patient exhales. This indicates to patients and carers when the treatment is effectively administered to improve compliance.

The device has a smart card which serves a dual purpose; it instructs the device on how to deliver the drug according to the patient's specific profile and it provides a locking mechanism to prevent a generic drug being used off-label in the device.

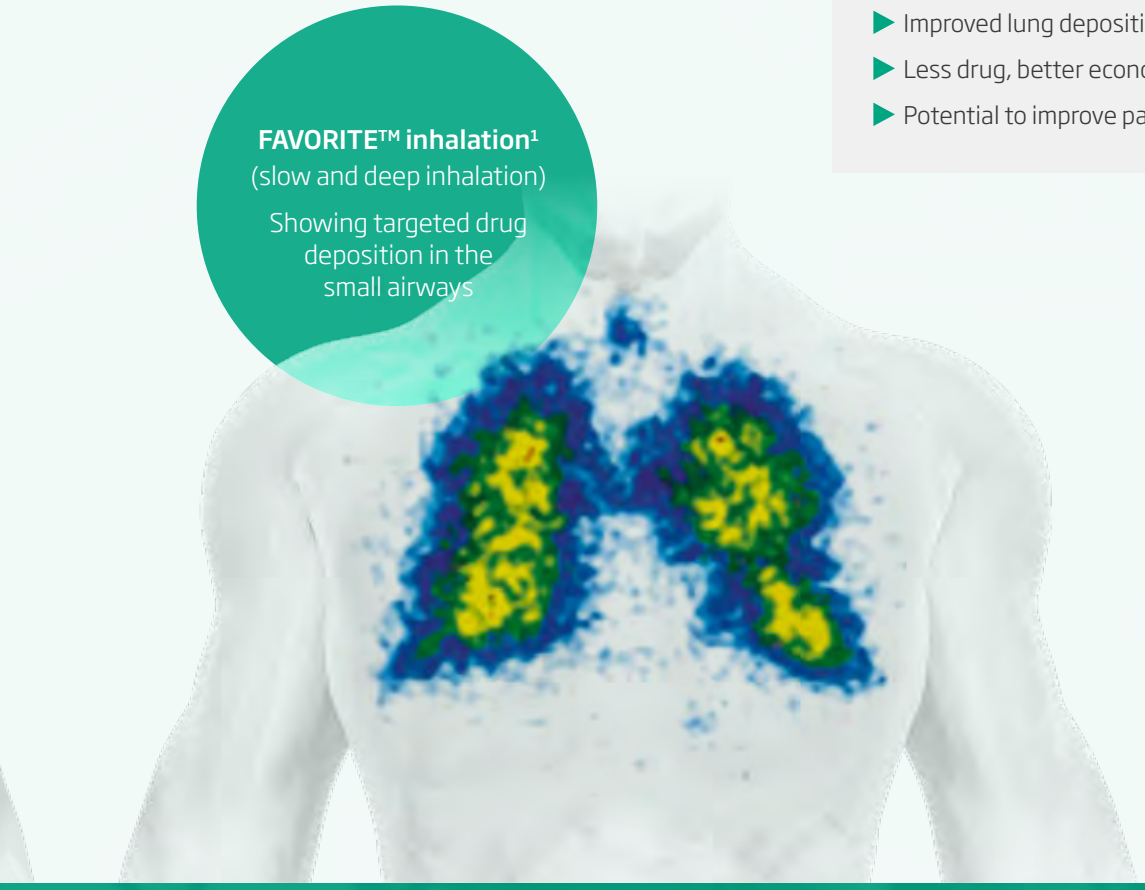
Other opportunities to use our innovative technology to enhance delivery of known molecules

We see further significant nebulised product opportunities where efficacy/safety ratios could be improved by utilising our unique technology across multiple potential indications. We are currently evaluating potential application of this technology and we look forward to providing a pipeline progress update in Q3 2018.

Differentiated technology

FAVORITE™ improves the effectiveness of inhaled drug delivery with the potential for improved outcomes and shorter treatment times:

- Faster delivery
- Improved lung deposition
- Less drug, better economics
- Potential to improve patient outcomes



Vectura enhanced delivery programmes continued

Current pipeline assets. Our two most advanced enhanced delivery programmes are VR475 (EU) for severe, uncontrolled asthma in adults, and VR647 (US) for paediatric asthma. Both these programmes use our AKITA® smart nebuliser, improving the delivery of budesonide to achieve differentiated outcomes for asthma patients.

VR475 (EU) – "A significant opportunity based on delivery of challenging reduction in exacerbation primary endpoint"

Phase III – nebulised budesonide for severe, uncontrolled adult asthma

The GINA guidelines provide the evidence-based management strategies for asthma and advocate a stepwise approach to control asthma symptoms and reduce risk (learn more at *www.ginaasthma.com*). At each treatment step in asthma management, different medication options are presented. Treatment steps are graded 1–5, with severe asthmatics defined as those asthmatics that are inadequately controlled at treatment step 4.

Inhaled corticosteroids are the mainstay of current asthma treatment. Patients whose asthma is uncontrolled while on short-term reliever therapies commence a low dose of inhaled corticosteroids (treatment step 2), with the dose of inhaled corticosteroids increasing in a stepwise fashion until their asthma symptoms are controlled. Patients at treatment step 4 are treated with medium-high doses of inhaled steroids but experience shows that for severe uncontrolled patients, the inflammation in the lungs becomes unresponsive to inhaled steroids or, in other words, inhaled steroids reach a flat dose-response level beyond which higher doses of standard inhaled steroids will not improve asthma control any further. Therefore in step 5 asthmatics, asthma guidelines recommend adding either oral corticosteroids, which provide more efficacy but have very undesirable side effects, or biologic treatments, which are currently very expensive.

The cost of biologic treatments in the EU5 countries (UK, Germany, France, Spain and Italy) range from £10,000–£20,000 per annum and only target a subset of the severe asthma population that have certain characteristics that make them suitable for biologic therapy.

Cost of biologic treatments ranges from

£10,000–£20,000

per annum in EU5 countries[2]

VR475 (EU) targets patients who are uncontrolled at treatment step 4 and are about to move up to treatment step 5, with the proposition that using the FAVORITE™ technology a higher lung deposition of budesonide into the small airways will be achieved, thus optimising and shifting up budesonide's dose responsiveness, providing a clinically relevant additional efficacy. Consequently, a large proportion of this patient population could be controlled using inhaled steroids without having to resort to unpleasant and unwanted oral corticosteroids or expensive biologic treatments. This has a clear patient benefit but also a significant benefit for healthcare systems and payors.

Key dates

- Estimated Phase III study completion date Q4 2018
- Initial planned submission in 2019
- Anticipated conclusion of partnering discussions 2019
- Targeting approval in 2020

Side effects of oral corticosteroids[1]:

- Depression
- Sleep disruption
- Weight gain
- Skin conditions
- Osteoporosis and vertebral and hip fractures

Asthma control is suboptimal:

45%

of all asthmatic patients in EU are uncontrolled[3]

Severe uncontrolled asthmatics account for

>50%

of the asthma-related healthcare costs[4]

By 2020 the number of severe persistent asthmatics, uncontrolled on high dose ICS/LABA5 (+/- LAMA) in EU5[5], is estimated to be

1.2m

Analyst indicative sales range

$150m–$300m[6]

VR647 (US) – "A significant opportunity for reduced nebulisation time in a well-established paediatric budesonide market"

Phase II – nebulised budesonide for paediatric asthma

In North America, the use of home nebulisation in young children is standard of care and the market for nebulised budesonide is valued at approximately $770m[7]. Nebulised budesonide (ICS) is approved by the FDA for "the maintenance treatment of asthma and as a prophylactic treatment in children of twelve months to eight years of age".

The treatment of paediatric asthma requires specific solutions to achieve optimum treatment outcomes. The VR647 (US) product uses a smart nebuliser device, which is specifically optimised for use with children. This produces much shorter treatment times and much better control of the delivery of inhaled corticosteroids than conventional treatments, an important advantage for children and their caregivers.

Recent Phase I data in adults has demonstrated the potential of VR647 to reduce treatment time. Compared with standard doses of budesonide administered using a convention nebuliser, delivery of the same amount of budesonide to the lungs with VR647 reduced the treatment times from twelve to fifteen minutes in a non-clinical setting down to one to four minutes in a clinical setting. It also has the potential to reduce exposure to corticosteroids within the body, potentially reducing the risk of steroid-related adverse effects in children. These promising patient benefits offer the opportunity to capture a sizable market share at brand-level prices.

Key dates

- Estimated Phase II study completion date Q3 2018
- Anticipated conclusion of partnering discussions 2019

US market for nebulised budesonide is valued at approximately

$770m

VR647 reduced the treatment times from 12–15 minutes down to

1–4 minutes

Our FAVORITE™ technology is also used in our FOX® handheld nebuliser device, which is now clinically and commercially validated and used in Bayer's on-market Breelib™ product.

Read case study on page 23

Proprietary flow rate management with valve and colour changes reinforcing optimum inhalation technique

1 Hyland ME, Whalley B, Jones RC, et al. A qualitative study of the impact of severe asthma and its treatment showing that treatment burden is neglected in existing asthma assessment scales. Quality of Life Research. 2015: 24 (3) 631–619.

2 HRW Physician Research 2015/Adelphi Payer Research 2016.

3 D. Price et al, PCRM (2014): 24.

4 DH. Smith et al. AJRCC (1997): 156.

5 Decision Resources Group – Asthma Epidemiology – Mature Markets. All Populations – Full Details DR Mar 2017; Adelphi Priority DSP analysis for Vectura 4.6.17.

6 Peak sales bases upon consensus of those analysts who have published product-level forecasts. Provided for indicative purposes and not necessarily representing the view of management.

7 2017 FY1 QVIA MIDAS Q4 2017.

Measuring our progress

We measure our success by tracking key performance indicators that reflect our strategic priorities and growth drivers. Success against these KPIs forms a component of the Executive Directors' and senior management's remuneration

Changes to our KPIs this year

As explained in the Financial review, during the year, Vectura has reviewed its financial reporting framework to ensure that it remains current with both the latest regulatory requirements and developing best practice within the pharmaceutical industry. Following this review, Vectura has determined that "underlying revenue growth" and "underlying EBITDA progression" are more appropriate KPIs than "recurring revenue growth" and "EBITDA progression" since the underlying metrics reflect the ongoing business and are consistent with how management reviews the business for the purposes of making long-term operating decisions. Accordingly, the prior year KPIs of "recurring revenue growth", "other revenues" and "adjusted EBITDA progression" have been replaced with two new KPIs "underlying revenue growth" and "underlying adjusted EBITDA progression".

Refer to the financial review for the reconciliation of prior year comparatives to previously reported KPIs.

Changes to our KPIs for 2018 onwards

During the year, in line with the Group's focus on Operational Excellence, Vectura has established a number of Operational Excellence KPIs. As the KPIs were established during the year, 2017 performance against these KPIs is not reported; however, performance against these KPIs will be reported on from 2018 onwards.

On 4 January 2018, Vectura announced a refocused R&D investment strategy which will increase the Group's focus on generic and enhanced therapy programmes and decrease focus on novel molecule development. To reflect this refocus, from 2018 the KPI "number of successful feasibility outcomes" will be replaced with "number of valuable new BD deals signed" and "partnering of generic programmes".

Financial KPIs

Underlying revenue growth

£131.4m

2017 **£131.4m**

2016 (12-months proforma) £126.3m

2016 (9-months to 31/12/16) £85.8m

Link to strategy

Why is it a KPI? Underlying revenues are those revenues which the Group earns from royalties earned on sales of approved in-market products and on supply of products to partners. Underlying revenues represent those revenues which recur in both the current reporting period and the prior year reporting period and therefore they provide a key measure of Vectura's growth and sustainability.

How is it measured? Reported revenue adjusted for revenue from non-recurring sources comprising royalties and share of sales which have discontinued in either period (due to patent expiry or GSK dispute), milestones and development services revenue.

Refer to pages 57 and 62 for a reconciliation of underlying revenue to reported revenue.

2017 performance Underlying revenues have grown by 4.0% compared to 2016. This headline growth rate was impacted by previously reported destocking in the *flutiform*® supply chain during H2 2017. The destocking was driven by partner working capital demand and is independent of in-market performance of *flutiform*® which grew by 11.8% on a constant currency basis compared to the prior year.

In addition, the GSK Ellipta® royalties reached their £9m annual cap in 2016 and 2017.

Underlying adjusted EBITDA progression

£10.0m

2017 **£10.0m**

2016 (12-months proforma) (£2.6m)

2016 (9-months to 31/12/16) (£6.6m)

Link to strategy

Why is it a KPI? Underlying adjusted EBITDA is an important non-GAAP measure used by the Board, the Executive Leadership Team and managers to monitor and assess Vectura's performance. It provides useful information about the underlying profitability and cash generation of the Group.

How is it measured? Underlying adjusted EBITDA is calculated by taking adjusted operating profit based only on underlying revenues, and adding back charges for share-based compensation, amortisation and deprecation.

Refer to pages 57 and 62 for a reconciliation of underlying adjusted EBITDA to statutory operating loss.

2017 performance Underlying adjusted EBITDA has increased to a profit of £10m, compared to a prior year loss of £2.6m, as the result of effective cost management, including early delivery of synergy savings and ongoing R&D transformation initiatives.

Net cash

£99.6m

2017 **£99.6m**

2016 £88.0m

Link to strategy

Why is it a KPI? Availability of sufficient liquidity is important in funding the Vectura's strategy and R&D investment.

How is it measured? Cash and cash equivalents less drawn short and long-term debt.

2017 performance The increase in net cash compared to 2016 is the result of a 41.6% increase in cash inflows from operations, reported after £60.3m of R&D investment.

Non-financial KPIs

Pipeline progression performance measures – successful product development is key to creating long-term value. Our development pipeline encompasses a broad range of assets across various stages of development. Each year we set ourselves stringent targets relating to completion of key milestones across our development pipeline.

Project milestones completed

12

12-months to 31/12/17: 12

9-months to 31/12/16: 8

12-months to 31/03/16: 13

Link to strategy

Clinical studies completed

1

12-months to 31/12/17: 1

9-months to 31/12/16: 2

12-months to 31/03/16: 0

Link to strategy

- Maximising pipeline value
- Operational Excellence
- Maximising partnering value
- Strong financial discipline
- High performance culture

Business development and alliance performance measures – we operate a partnered business model and building new partnerships and alliances ensures that we are able to pursue development of pipeline programmes in line with our strategic investment objectives.

Number of successful feasibility outcomes

5

12-months to 31/12/17: 5

9-months to 31/12/16: 4

12-months to 31/03/16: 5

Link to strategy

Number of alliances established

4

12-months to 31/12/17: 4

9-months to 31/12/16: 4

12-months to 31/03/16: 1

Link to strategy

Continued progress against employee engagement metrics

Link to strategy

Why is it a KPI? Having empowered and engaged people is fundamental to our success. We monitor our employee engagement to ensure that adverse trends or issues can be addressed in a timely manner.

2017 performance We conducted an annual employee engagement survey in March 2017 to find out how employees feel about working for Vectura and identify areas where we can do more to improve engagement.

84% of employees participated in the survey, which was administered by an independent third party enabling us to compare our results with external benchmarks.

The areas that received the highest engagement scores ahead of the benchmarks included:

- value/culture and link with strategy;
- diversity;
- team collaboration;
- pride in the organisation;
- employees encouraged to share ideas and views; and
- manager communication and feedback.

Risk management and internal control

We operate within a complex regulatory environment, which is subject to change, and the nature of pharmaceutical development exposes us to a number of risks and uncertainties

Our ability to meet our goals and objectives may be impacted by a number of these risks, which could impact our strategy, our business model and our operating environment.

We have developed and implemented a risk management process which is designed to ensure that existing or emerging significant risks are identified, assessed, managed and reported to relevant stakeholders in a timely manner to inform and support decision making. Our risk management process aims to mitigate the significant risks that Vectura faces in accordance with our risk appetite. The Group's risk appetite has been reduced following the refocused investment strategy announced in January 2018 and described in this report.

It is recognised, however, that no risk management process can provide absolute assurance against loss.

This section provides an overview of our risk management process, the key risks faced by the business and the actions that we have taken to mitigate them. Not all the risks identified as part of our risk management processes are detailed in this section; instead this report focuses on those risks that the Directors believe to be the most important and which could cause Vectura's results to differ materially from expected and historical results and significantly impact our strategy. Not all of these risks are within the control of the Group and other factors besides those listed may affect the Group's performance. As with all business operating in a dynamic environment, some risks may not yet be known whilst other low-level risks could become material in the future.

Objectives of our risk management process:

- to ensure that the risk appetite of the Board is embedded throughout the organisation and fully understood by those who are responsible for managing risk and making key decisions across the business;
- to identify and assess the likelihood and potential impact of the risks that Vectura faces in the execution of its strategy and the operation of its business model, and ensure that appropriate mitigating actions and controls are in place such that the residual risk is aligned to the risk appetite of the Board;
- 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; and
- to ensure that identified risks are reported to relevant stakeholders in a timely manner to facilitate effective decision making.

The Audit Committee reviews the effectiveness of Vectura's risk management and internal control at least annually, on behalf of the Board. This review has been undertaken during the year and, with direct support from the Audit Committee, the Board believes that it has taken all reasonable steps to satisfy itself that the risk management process is effective and fit for purpose. No material control weaknesses or deficiencies were identified as part of this review.

Our approach to assessing risk

Risk is assessed net of the application of current control activities using a standard matrix which considers the potential likelihood of a risk event occurring and the potential impact on the business were such an event to occur. The output of this matrix allows the business to prioritise risks and mitigating actions. Risks are considered within the timeframe of at least three years, which is the same period that has been used in the Viability statement.

How our principal risks have evolved during 2017

One of the principal risks described in the 2016 Report and Accounts, "Disruption to the launch of the Group's US generic Advair® programme (VR315 (US))", was realised during 2017. Accordingly, this principal risk has been updated to "Failure to launch VR315 (US) in a competitive timeframe".

During the year, the Board undertook a review of the Group's investment strategy and as a result of this review has determined that it will seek to partner VR475 (EU) and VR647 (US). Accordingly, the prior year risk of "Failure to successfully launch and self-commercialise Vectura's wholly owned pipeline products" is no longer considered a key risk and is replaced by the risk of "Failure or delay in partnering VR647 (US) and VR475 (EU)". For further details of the Group's investment review and impact on overall pipeline risk, see pages 28 to 30.

The Brexit deadline on 29 March 2019 is now closer with only the first phase of negotiations concluded. Uncertainty from Brexit is now considered to be a principal risk in its own right whereas previously it was absorbed into the risk of "Changes to the regulatory, operating or pricing environment for the pharmaceutical industry".

All other principal risks have remained broadly unchanged in the year.

Principal risks

Risks specific to Vectura's business model

Supply chain disruption

Risk movement: Stable

Strategic priorities impact:

OPERATIONAL RISK

What is the risk?

Vectura manages the supply chain for certain commercial products (*flutiform*®, AirFluSal® Forspiro® and Breelib™), and also relies on suppliers for the provision of quality compliant materials for R&D.

What would the impact be?

Major disruption to, or failure of, these supply chains, particularly for *flutiform*®, could result in lost revenues and business opportunities, stock shortages, liabilities and significant damage to profitability and prospects for Vectura. Such disruption could be either quality or capacity related.

What could cause the risk to be realised?

- Supply chain disruption involving single point of failure for which Vectura has high dependency and limited resilience.
- Supplier loss of licence or regulatory action impacting Vectura.
- Termination of the manufacturing agreement with Sanofi for *flutiform*®. The agreement continues to 2020 and will be automatically renewed biannually unless terminated by either party within 24 months' notice.

How do we manage the risk?

Vectura has strong working relationships with its suppliers; we have established due diligence processes to ensure that our stringent quality standards are maintained and we have put in place appropriate systems that will provide an early warning of potential issues.

A dedicated Commercial Quality Director has oversight of release of commercial product and ensures appropriate management of quality for commercial products.

Monthly meetings are held to discuss customer demand forecasts and to review Vectura's ability to meet these forecasts. Vectura has established contingency arrangements to ensure that production capacities exceed forecast demand so that it would be possible to catch up on any shortfall in production or meet unexpected demand. Appropriate levels of safety stock are maintained.

Supply chain mapping has been undertaken, and is regularly reviewed, to identify potential points of failure and mitigating actions. Where economically feasible, additional sources of supply are established and contracts negotiated to include appropriate provisions for replacement of defective goods.

The Group also has appropriate insurance, but it is not possible to insure against all risks and not all insurable risks can be fully insured on an economically feasible basis.

Change since last report

No changes.

Failure or delay in partnering VR647 (US) and VR475 (EU)

Risk movement: Increasing

Strategic priorities impact:

STRATEGIC RISK

What is the risk?

In the absence of M&A, the Group plans to balance risk and value generation by partnering its specialist nebulised assets. The partnering of VR475 (EU) and VR647 (US) is anticipated in 2019 subject to the successful completion of the current clinical trial activity.

Vectura could be unable to find a partner with suitable commercial strength and respiratory heritage for these assets in a timely manner.

What would the impact be?

Failure to partner these assets with a suitable partner in a timely manner or at all could materially impact future revenues, profitability and prospects of Vectura.

Failure to partner the assets may lead to an increase in Vectura's future R&D investment.

What could cause the risk to be realised?

- Phase III (VR475 (EU)) or Phase II (VR647 (US)) clinical trials could be unsuccessful.
- Inability to identify a suitable partner.
- Inability to negotiate a deal with commercially attractive terms.

How do we manage the risk?

Vectura has acquired, developed and progressed these two specialist pipeline assets based on its experience and knowledge of the respiratory market. As such the Group believes these products are well placed to capture value in an attractive niche market where relatively few competitors have relevant assets.

Vectura has dedicated, experienced personnel responsible for marketing assets to, and negotiating with, potential partners. In addition to its existing partner relationships, which have the potential to be extended to new projects, the Group also attends industry conferences and events where its programmes and technologies are marketed to new potential partners.

Change since last report

Increasing risk following the decision, in the absence of M&A, not to self-commercialise VR475 (EU) and VR647 (US).

Maximising pipeline value | Operational Excellence | Maximising partnering value | Strong financial discipline | High performance culture

Failure to launch VR315 (US) in a competitive timeframe

Risk movement: Decreasing

Strategic priorities impact:

OPERATIONAL RISK

What is the risk?

On 10 May 2017, our partner Hikma Pharmaceuticals PLC ("Hikma") received a complete response letter (CRL) from the US FDA in relation to its abbreviated new drug application for its generic version of GSK's Advair® Diskus®. This CRL has been categorised as "Major".

Hikma and Vectura have had constructive dialogue with the FDA to resolve the observations made in the CRL and the majority of questions raised have been addressed and clarified. Hikma, supported by Vectura, decided to progress a dispute resolution process regarding the remaining outstanding issue, namely the different interpretation of the results from the Clinical Endpoint Study (CEP). The dispute resolution process concluded in March 2018 and the FDA has upheld its original decision and included a requirement that Hikma completes an additional CEP study.

What would the impact be?

Failure to complete the Clinical Endpoint study in a timely manner could result in the product being launched later than those of competitors resulting in loss of potential future revenues and funds for investment.

What could cause the risk to be realised?

- Competitor products are approved and launched while the additional CEP study is completed.

How do we manage the risk?

The Group is unable to take direct action to mitigate this risk.

In anticipation of an unfavourable outcome from the dispute resolution process, Hikma has already finalised the planning of a new clinical study and expects to start patient enrolment in the coming weeks. Hikma anticipates being able to submit a response to the FDA with new clinical data as early as possible in 2019. A joint clinical team is in place to oversee the conduct of the study.

In addition, the Group has responded to the delay alongside other factors by reviewing its R&D investment strategy and, as a result, the Group plans to reduce its pipeline risk as detailed above.

Change since last report

Decreasing risk following receipt of the CRL during 2017 and the unfavourable outcome of the dispute resolution process in March 2018.

Partner failure

Risk movement: Stable

Strategic priorities impact:

OPERATIONAL RISK

What is the risk?

Vectura operates a partnering business model and therefore is reliant on partners for development and commercialisation of pipeline assets.

In addition, Vectura earns revenues from a number of partnered on-market assets and is dependent upon those partners for maintaining regulatory approvals and for marketing of the products.

What would the impact be?

Failure by a strategic partner to deliver on its obligations during the development phase could result in a delay or cessation of development; this in turn could cause a delay in the product reaching the market which could undermine the product's commercial potential and result in lower returns on investment for Vectura.

The marketing and commercialisation strategy taken by partners for existing on-market products could materially impact the level of royalties and sales milestones earned by Vectura.

What could cause the risk to be realised?

- Change in partner strategy or priorities.
- Partner trading issues/insolvency.
- Failure by a partner to market the product successfully.
- Partner failure to obtain appropriate pricing and reimbursement.

How do we manage the risk?

Vectura has a broad range of disclosed and undisclosed partners.

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

Typically, for collaborations, a joint steering committee (JSC) is established involving both Vectura and partner personnel. This provides Vectura with a mechanism to ensure that any joint project activity is managed appropriately. Where the Group supplies product, regular operational meetings take place to review demand forecasts.

The Group also has a commercial and business development department which maintains regular dialogue with existing and potential new partners.

Change since last report

No change.

Maximising pipeline value | Operational Excellence | Maximising partnering value | Strong financial discipline | High performance culture

Principal risks continued

Industry-related risks

Failure or delay in achieving development milestones required to advance the product pipeline

Risk movement: Decreasing

Strategic priorities impact:

OPERATIONAL RISK

What is the risk?

Vectura increases the value potential of its research and development by successfully advancing its pipeline projects through the development cycle.

Failure or delay in achieving development milestones for the Group's late-stage product development pipeline (e.g. VR475 (EU) and VR647 (US)), generic programmes and other new development opportunities would impact the potential value of these programmes.

What would the impact be?

Pipeline failures or delays could materially impact the future revenues, profitability and prospects of Vectura.

What could cause the risk to be realised?

- Phase III (VR475 (EU)) or Phase II (VR647 (US)) clinical trials could be unsuccessful.
- Manufacturing issues associated with a particular device or product for clinical trials.
- Ineffective design and execution of clinical programmes and protocols.
- Failure of outsourced provider of clinical trials.
- Constraints in R&D capacity and investment.

How do we manage the risk?

Vectura has an established governance process to oversee the conduct and delivery of all development programmes and to ensure that any potential changes to the development plan or budget are identified and discussed in a timely manner such that mitigating activities or actions can be put in place as required.

Vectura works closely with expert regulatory advisors and, when appropriate, seeks advice from regulatory authorities on the design of key development plans for pre-clinical and clinical programmes.

Clinical trials are conducted in accordance with prevailing practice and statutory/regulatory requirements.

Individuals with the necessary skills and experience have been recruited to lead and oversee the development of our late-stage assets. Vectura continues to work with a network of experienced consultants and contractors which provide additional support and expertise as required.

Operational Excellence initiatives within the R&D function have been established to increase productive capacity.

Change since last report

Risk decreasing as a result of Vectura's revised investment strategy which seeks to reduce overall pipeline delivery risk with increased focus on enhanced delivery of existing medicines and extending our inhaled generics portfolio.

Changes in the regulatory, operating or pricing environment (excluding Brexit)

Risk movement: Stable

Strategic priorities impact:

OPERATIONAL RISK

What is the risk?

Vectura operates in the highly regulated international pharmaceutical industry, which is subject to change.

What would the impact be?

Changes in the pharmaceutical regulatory landscape, operational restrictions and downward pricing pressure could impact whether a development product can be developed into a viable marketable product and the amount of time and expenses associated with such development.

Even if products are approved, they may still face subsequent difficulties resulting in financial loss and reputational damage.

What could cause the risk to be realised?

- Political change.
- Competitor pricing strategies.
- Regulatory action on pricing.

How do we manage the risk?

Regulatory changes tend to be slow due to lengthy consultations and discussions between regulators and the pharmaceutical industry. We work closely with expert regulatory advisors and, when appropriate, seek advice from regulatory authorities on the design of key development plans for pre-clinical and clinical programmes.

We work with a number of blue-chip pharmaceutical partners which have significant regulatory expertise.

Our business strategy includes investment in generic products which support government initiatives to reduce cost.

Change since last report

No change.

Maximising pipeline value | Operational Excellence | Maximising partnering value | Strong financial discipline | High performance culture

Failure to attract or retain talent/key personnel

Risk movement: Stable

Strategic priorities impact:

STRATEGIC AND OPERATIONAL RISK

What is the risk?

Vectura relies upon a number of key qualified management, scientific, technical, marketing and support personnel. Competition for such personnel is intense and there can be no assurance that the Group will be able to continue to attract and retain such personnel.

What would the impact be?

The loss of talent or key personnel could adversely impact the effectiveness of the Group's operations.

What could cause the risk to be realised?

- Inadequate succession planning/talent management.
- Organisational disruption and/or change.
- Failure to attract the correct calibre of candidates.

How do we manage the risk?

Vectura seeks to develop employees for current and future roles and our career development and talent management programmes remain a key area of focus for the Executive Leadership Team. We continue to invest in ongoing training and development. New leadership development training has been developed in 2017 and is currently being rolled out, starting with the Executive and Business Leadership Teams.

Succession plans for key roles have been developed to ensure a talent pool is identified, developed and ready for implementation. These plans include the identification of "emergency successors" in the case of unanticipated and immediate absence.

Vectura offers market-competitive reward packages and a clear career development framework.

Our multiple locations provide flexibility for potential employees and an ability to target talent pools across a wide geography.

Change since last report

No change.

Principal risks continued

Risks not specific to the industry or Vectura

Failure to protect intellectual property

Risk movement: Stable

Strategic priorities impact:

OPERATIONAL RISK

What is the risk?

Patent infringement by a competitor organisation or failure to obtain patents for Vectura-related development could impact on Vectura's ability to deliver its product pipeline or impact on-market products.

What would the impact be?

Such infringement or failure could result in Vectura or a partner having to take a licence to third-party IP in order to develop a product, or even being unable to commercialise a product, materially impacting Vectura's future revenues, profitability and prospects.

What could cause the risk to be realised?

- Competitor successful in challenging Vectura or partner patent.
- Critical information missing from filed patent.

How do we manage the risk?

Dedicated internal resource, supplemented with external expertise, files for and prosecutes patents and other forms of intellectual property.

In conjunction with our partners, where relevant, Vectura takes steps to enforce these rights.

Third-party rights that may be of interest to and/or have adverse effects on Vectura's activities are also monitored so that action can be initiated where appropriate.

Change since last report

No change.

Brexit uncertainty

Risk movement: Increasing

Strategic priorities impact:

STRATEGIC AND OPERATIONAL RISK

What is the risk?

While the impact of the UK's decision to leave the European Union (EU) in March 2019 is still uncertain, Brexit may result in an increase in cost of operations of the Group and disruption to the Group and partner supply chains, particularly *flutiform*®, where most raw materials are imported from the EU into the UK by Vectura and finished product is exported from the UK into the EU by a partner.

What would the impact be?

Disruption to or additional cost associated with managing an intra-EU supply chain.

Delays may also arise in progressing the R&D pipeline due to potential skills shortages and changes in the regulatory landscape for the UK pharmaceutical industry.

Further volatility in exchange rates, particularly in the euro and US dollar versus sterling could materially impact the Group's reported financial results.

What could cause the risk to be realised?

- Failure by the UK to negotiate an adequate transition period to prepare for exit from the EU.
- Tariffs introduced on flow of goods between the UK and EU.
- Inability to perform quality assurance release testing for products supplied by the Group into the EU.
- Reduced labour pool and increased competition for labour from EU citizens not wishing or able to work in the UK.
- Partner failure to mitigate risks from Brexit (see risk #5 above).

How do we manage the risk?

A team comprising senior representatives from relevant functions is in place responsible for monitoring and mitigating the risks from Brexit. The Group and individuals on the team are members of various professional bodies and trade organisations. Guidance and intelligence from these organisations is monitored and actions are taken accordingly.

Process mapping is taking place in the supply chain to identify all potential points where Brexit could impact the Group's ability to meet its product supply obligations.

The Group is raising the risk from Brexit with its partners and suppliers, providing support where required.

Change since last report

Increasing risk as negotiations between the UK and EU are ongoing and the deadline of 29 March 2019 is now closer, but an approach to the exit and a transition plan are still to be established.

Maximising pipeline value | Operational Excellence | Maximising partnering value | Strong financial discipline | High performance culture

In accordance with the provisions in the UK Corporate Governance Code (C.2.2 of the 2014 revision), the Directors have assessed the viability of the Group over a three-year period. The Directors' assessment has been made with reference to the Group's current strategy, the strong balance sheet including the availability of the £50m revolving credit facility and the Group's principal risks as described in this Strategic report.

Whilst the Directors have no reason to believe the Group will not be viable over a longer period, a three-year period is considered appropriate as it is possible that one or more of the principal risks could reasonably be realised in the period which could materially impact the viability of the Group. In addition, this period is more than double that used for the going concern assessment and is within the term of the Group's revolving credit facility. This period therefore provides the Board with an appropriate degree of confidence while still providing a suitable longer-term outlook.

The process adopted to assess viability this year followed that undertaken in 2016 and involved collaborative input from a range of business functions to model a series of theoretical "stress test" scenarios linked to the Group's principal risks. These scenarios included both significant adverse financial outcomes and operational failures. Consideration was given to the impact of mitigations as well as their interdependencies. The Audit Committee reviewed the process before the viability evaluation was provided to the Board to assist in its assessment.

In making their assessment, the Directors have undertaken a sensitivity analysis of its forecast cash flows and liquidity. The key assumptions underpinning the assessment during the period are as follows:

- changes to *flutiform*® net in-market sales prices, growth of product supply volumes and the related supply margin;
- manufacturing and assembly of *flutiform*® by Sanofi continues in line with contractual obligations;
- the rate of growth of net sales of Seebri® Breezhaler®/Ultibro® Breezhaler® in EU/RoW; and
- the timing and forecast cash flows from partnering the product pipeline, particularly VR475 (EU) and VR647 (US).

The principal plausible stress tests in accordance with the Group's principal risks and uncertainties are:

- a significant reduction in product supply inflows for *flutiform*® from either a reduction in demand or an inability to supply;
- lower in-market sales prices of *flutiform*® due to competition, technological change or regulatory body action;
- slower than expected sales growth in Seebri® Breezhaler®/ Ultibro® Breezhaler® in EU/RoW and lower than expected royalties from the Group's other on-market products;
- significant delays in contracting with new or existing partners;
- unsuccessful outcome from the VR475 (EU) Phase III clinical trial with no return on R&D investment;
- unsuccessful outcome from the VR647 (US) Phase II clinical study with no return on R&D investment;
- VR315 (US) is not launched in the viability period; and
- lower *flutiform*® margins from tariffs on raw materials imported from the EU and a reduction in supply prices due to tariffs on export of finished product from the UK to the EU.

As a worst case scenario, the combined impact of these downside scenarios was assessed in combination against the Group's liquidity.

Based on the assessment and stress testing, the Directors have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over a three-year period.

Going concern

At the time of approving the financial statements the Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis of accounting in preparing the 2017 Annual Report and Accounts.

Delivering consistent financial results

Summary

- Reported revenue of £148.0m, in line with expectations; underlying revenues grew 4.0% driven by the Group's key inhaled products.
- Adjusted EBITDA of £25.8m underpinned by key products *flutiform*®, Ultibro® and Seebri® Breezhaler®, which together delivered gross margin of £41.1m, +18.8%.
- Strong closing cash of £103.7m driven by strong operating cash inflows and a continued focus on cash and working capital management.

Comparative financial information

The comparison of the financial results for the twelve-months ended 31 December 2017 with those of the previously reported period is distorted by a number of factors: the Skyepharma merger which took place part-way through 2016; the subsequent change of the accounting reference date which had the effect of shortening the prior period to nine-months; and, as expected, significantly lower revenues from non-recurring sources (milestones, development services and certain royalties) earned in 2017 compared to 2016.

Accordingly, to assist full understanding of the Group's 2017 results, this review includes financial information taken directly from the audited financial statements, prepared in accordance with International Financial Reporting Standards ("IFRS") and the Group's accounting policies, as well as financial information presented on an underlying basis as explained below. The Directors believe that this additional information is important to fully assess the financial performance of the Group on a comparable year-on-year basis.

Underlying financial information

In order to provide a comparative basis from which to calculate underlying financial performance, certain 2016 income statement measures have been prepared on a proforma full year calendar basis for Vectura and Skyepharma. This information has been extracted from the Group's management accounts for the twelve-months ended 31 December 2016 and is prepared in accordance with Vectura's relevant accounting policies. This proforma financial information presents performance for the business for the twelve-months ended 31 December 2016 as though Vectura and Skyepharma had always been merged, excluding the impact of the acquisition accounting adjustments required by IFRS 3 Business Combinations. A reconciliation of 2016 reported results for the nine-month period to 2016 proforma results is included in an appendix to this report.

However, comparison of the 2017 reported results to the 2016 proforma twelve-month financial information is also impacted by significantly lower revenues from non-recurring sources, largely relating to: licensing milestones, which, by their nature, can vary materially year to year; R&D development services revenues; and lower royalties in 2017 due to the expiry of the ADVATE® patent in 2016 and GSK's decision to cease paying royalties in respect of the Ellipta® products under a legacy Vectura agreement with effect from August 2016, which is now subject to a legal dispute process. The impact of these items can distort comparison of financial results from period to period and therefore can obscure trends in the underlying, recurring base of the business.

Accordingly, certain underlying financial information is included in this report. Underlying financial information is calculated using the 2017 reported results and proforma 2016 twelve-month financial information, excluding certain non-underlying items: (i) revenue from non-recurring sources comprising royalties and share of sales which have discontinued in either period (for example, due to patent expiry or legal dispute), milestones and development services

Financial highlights

	2017 reported	Adjusting items	2017 underlying	2016 proforma underlying	% movement
Revenue	**£148.0m**	**(£16.6m)**	**£131.4m**	£126.3m	4.0%
Cost of sales	**(£57.2m)**	**£0.8m**	**(£56.4m)**	(£55.1m)	(2.4%)
Gross margin	**£90.8m**	**(£15.8m)**	**£75.0m**	£71.2m	5.3%
R&D expenditure	**(£60.3m)**	**—**	**(£60.3m)**	(£65.1m)	7.4%
Other operating expenditure and income	**(£12.5m)**	**£2.1m**	**(£10.4m)**	(£12.9m)	19.4%
Amortisation of intangible assets	**(£109.7m)**	**£109.7m**	**—**	—	—
Exceptional items	**(£4.5m)**	**£4.5m**	**—**	—	—
Operating (loss)/profit	**(£96.2m)**	**£100.5m**	**£4.3m**	(£6.8m)	>100.0%
Adjusted EBITDA	**£25.8m**	**(£15.8m)**	**£10.0m**	(£2.6m)	>100.0%

Underlying revenues by revenue stream

	2017 reported	Revenue from non-recurring sources	2017 underlying	2016 proforma underlying	% movement
Royalties	**£52.6m**	**(£2.5m)**	**£50.1m**	£47.9m	4.6%
Product supply and device sales	**£74.7m**	**—**	**£74.7m**	£72.6m	2.9%
Signing and milestone payments	**£5.1m**	**(£5.1m)**	**—**	—	—
Development services	**£9.0m**	**(£9.0m)**	**—**	—	—
Other revenue	**£6.6m**	**—**	**£6.6m**	£5.8m	13.8%
Revenue	**£148.0m**	**(£16.6m)**	**£131.4m**	£126.3m	4.0%

revenue; (ii) non-cash share-based payment and amortisation of intangible assets charges; and (iii) exceptional items. The underlying financial information therefore reflects the ongoing business in both periods and is consistent with how management reviews the business for the purpose of making long-term operating decisions.

A reconciliation of 2016 reported results for the nine-month period to 2016 underlying proforma results is also included in an appendix to this report. The appendix also includes a reconciliation of underlying proforma measures to the previously reported non-IFRS financial measures of recurring revenues and adjusted EBITDA based upon recurring revenues.

Metrics presented on both reported and underlying bases include revenue, operating profit/(loss) and adjusted EBITDA. A summary reconciliation between the 2017 IFRS-reported metrics and the relevant underlying financial metrics is presented in the table above and further detail on the specific reconciling items is presented within the relevant line item commentary in the following sections of this report.

The focus of the narrative below is on the underlying results; however, key aspects of reported year-on-year performance are also presented.

Revenue

Vectura has five revenue streams: royalties earned from sales of in-market partnered products, product supply and device sales revenues, signing and milestone payments, development services and other revenue.

In line with expectations, 2017 reported revenue was £148.0m, an increase of 17.0% compared to the prior nine-month period (reported nine-month 2016: £126.5m), with headline growth being impacted by the lack of comparability between the two periods as highlighted above.

Underlying revenues, which are those revenues recurring in both comparable twelve-month periods, increased by 4.0%, reflecting strong in-market performance of key products *flutiform*® and Ultibro®/Seebri® Breezhaler® where combined revenues grew 5.4% to £85.8m (2016 proforma underlying: £81.4m). Growth in underlying revenues was moderated below the rate of in-market sales growth of these products due to 2017 supply chain stocking factors, as previously announced, which has not impacted the in-market performance of the products. AirFluSal® Forspiro® revenues were slightly below the prior period with lower sales of the GyroHaler® device to Sandoz.

Revenue continued

Overall growth of underlying revenues also benefited from increased income from oral products and EXPAREL®, which more than offset £3.8m lower royalties from the topical product Solaraze®, which benefited from temporary market factors in the prior period, as previously reported and in line with expectations for that product.

Underlying revenues by product

Product	2017 underlying revenue (12 months)	2016 proforma underlying revenue (12 months)	% movement
flutiform®	**£68.5m**	£65.8m	4.1%
Ultibro® and Seebri® Breezhaler®	**£17.3m**	£15.6m	10.9%
GSK Ellipta® portfolio	**£9.0m**	£9.0m	—
AirFluSal® Forspiro®	**£3.8m**	£4.9m	(22.4%)
Seven key inhaled products	**£98.6m**	£95.3m	3.5%
% of total underlying revenue	**75.0%**	75.5%	(0.5 ppts)
Solaraze®	**£2.9m**	£6.7m	(56.7%)
Other products	**£29.9m**	£24.3m	23.0%
Total underlying revenue	**£131.4m**	£126.3m	4.0%

Royalties

Vectura earns royalties from the sale of 20 marketed partnered products, seven of which were launched in the last six years (twelve-months to 31 December 2016: 21 marketed partnered products, seven launched in the last five years).

Royalty stream	2017 royalty (12 months)	2016 proforma royalty (12 months)	% movement
Ultibro® and Seebri® Breezhaler®	**£17.3m**	£15.6m	10.9%
Ellipta® portfolio	**£9.0m**	£9.0m	—
flutiform®	**£5.1m**	£5.0m	2.0%
AirFluSal® Forspiro®	**£2.3m**	£1.8m	27.8%
Solaraze®	**£2.9m**	£6.7m	(56.7%)
Other royalties	**£13.5m**	£9.8m	37.8%
Total underlying royalties	**£50.1m**	£47.9m	4.6%
ADVATE® royalties (patent expired January 2016)	**£1.0m**	£13.7m	(92.7%)
Ellipta® portfolio (legacy Vectura agreement, legal dispute in process)	—	£12.9m	(>100%)
IFRS 3 fair value adjustment – *flutiform*® royalties	**£1.5m**	—	>100%
Total royalties	**£52.6m**	£74.5m	(29.4%)

Despite Vectura's ADVATE® patent expiring in January 2016, due to higher than anticipated run-off sales of inventory manufactured by Baxter prior to patent expiry, the Group continued to receive substantial royalties during 2016. In addition, royalties that Vectura had previously earned on sales of the Ellipta® products under a legacy agreement with GSK ceased at the end of July 2016 and became the subject of an ongoing legal dispute. These two royalty streams are excluded from underlying revenues in order to present a clear trend of the Group's ongoing royalty and overall revenue performance. A fair value credit of £1.5m in respect of the IFRS 3 acquisition accounting for the Skyepharma merger, which relates to Mundipharma's clawback of certain development costs from *flutiform*® royalties, has also been excluded from 2017 underlying revenues, as underlying revenues exclude acquisition accounting adjustments.

Overall underlying royalties increased by 4.6% in 2017, with growth across inhaled and non-inhaled products partly offset by lower sales as expected of the topical product Solaraze®, which benefited from temporary market upside in 2016, as noted above.

Total royalties recognised in respect of Ultibro® and Seebri® Breezhaler® were £17.3m (2016 proforma underlying: £15.6m). Novartis reported Ultibro® Breezhaler® net sales of $411m for 2017, an increase of 12% on a constant currency basis compared to the full year 2016[1]. Novartis has reported that this annual growth rate was impacted by short-term normalisation of stocking effects in certain territories. Novartis reported strong year-on-year growth in Q4 2017 of 26% on a constant currency basis[1]. As expected, reported Seebri® Breezhaler® net sales of $151m were in line with those reported for the 2016 full year.

During 2017, Novartis' sub-licence partner Sunovion launched both Utibron™ Neohaler® and Seebri™ Neohaler® in the US and roll-out of these products is now underway. In the future, US sales will generate a further contribution to Vectura's royalty base and underlying revenues.

GSK has continued to report strong performance of its Ellipta® franchise (Breo®/Relvar® Ellipta®, Anoro® Ellipta®, Incruse® Ellipta®). Under the terms of a legacy Skyepharma agreement with GSK, Vectura royalties earned on the sales of these products are capped at £9.0m per annum and this cap was reached in 2016 and 2017 (2016 proforma underlying: £9.0m).

Royalties on net sales of *flutiform*®, which continues to benefit from strong and growing demand, particularly in Japan, contributed £5.1m to 2017 underlying royalties (2016 proforma underlying: £5.0m). Total in-market net sales of *flutiform*® were €206.2m in 2017, 11.8% higher than 2016 on a constant currency basis[2].

The underlying growth in total royalties recognised for *flutiform*® was impacted by a cap in the agreement with Mundipharma, which limits the aggregate amount of revenues that can be earned by Vectura for royalties and the cost of product sales to 35% of Mundipharma's net sales in the same period. Accordingly, the 2017 effective royalty rate received from Mundipharma is a low single-digit percentage (2016 underlying: low-single-digit percentage). However, when combined with the gross margin generated by *flutiform*® supply to Mundipharma, the Group in effect receives a double-digit to low-teens percentage of in-market sales, depending on the sales mix of countries, at the gross margin level. Royalties received from our partner Kyorin were impacted by the effect of currency, and grew by 18% on a constant currency basis, in line with in-market net sales growth in Japan.

1 As reported by Novartis on 24 January 2018.

2 In-market net sales are internal calculations using IQVIA Health (IMS) data based on sales to pharmacies and excluding certain minor countries which are not covered by IQVIA. In-market net sales are not the same as sales to wholesalers on which royalties are payable to the Group. All percentages quoted at constant currency rates.

AirFluSal® Forspiro® continued to make a modest but growing contribution to underlying royalties, and Vectura recognised £2.3m of royalties in respect of 2017 sales of the product (2016 proforma underlying: £1.8m).

Underlying royalties from net sales of Solaraze® were £2.9m, a reduction, as expected, compared to the prior period which benefited from short-term market factors (2016 proforma underlying: £6.7m).

Other underlying royalties primarily relate to the legacy Skyepharma oral portfolio. Certain non-inhaled legacy products from Vectura continue to contribute an immaterial amount to other like-for-like royalties.

Product supply and device sales

Product supply and device sales of £74.7m form an important component of underlying revenues (2016 proforma underlying: £72.6m).

Revenue earned from the supply of *flutiform*® to Mundipharma and Kyorin was up 4.3% to £63.4m in 2017 (2016 proforma underlying: £60.8m). As previously communicated, product supply revenue was impacted by customer supply chain destocking in the second half of 2017. Therefore, this relatively modest underlying growth is not reflective of the in-market net sales performance of this product, which, as noted above, grew by 11.8% on an annual constant currency basis during 2017[2].

In addition to *flutiform*® product supply revenues, Vectura recognised £8.6m for the supply of certain oral products from Lyon to the Group's partners, up 21.1% (2016 proforma underlying: £7.1m). Vectura also received £1.5m device sales revenue for the supply of its GyroHaler® device to Sandoz to support the continued roll-out and growth of AirFluSal® Forspiro® in a number of European and Rest of the World territories (2016 proforma underlying: £3.1m). As previously noted, relatively minor destocking was noted in the AirFluSal® Forspiro® supply chain during 2017.

Signing and milestone payments

Whilst signing and milestone payments represent an integral part of our partner-based business model and are an important source of income they are, by their nature, irregular and may vary materially from one year to the next. Milestones are therefore excluded from our definition of underlying revenues.

Vectura recognised signing and milestone payments of £5.1m in 2017; this relates primarily to a €5.0m (£4.2m) milestone received from Bayer following the first European launch of Breelib™ , the new nebuliser for Ventavis® (iloprost) based on the FOX® handheld smart nebuliser. Vectura is eligible to receive contingent annual milestones on the anniversary of this first launch on a decreasing scale, over six years, to the total value of €5.75m. Vectura also receives small product supply revenues for the supply of the FOX® device to Bayer but does not receive royalties on commercial sales of this product.

In the twelve-month proforma to 31 December 2016, Vectura recognised £22.4m in signing and milestone payments. The major milestones recognised included $10.0m (£7.1m) following acceptance by the FDA of Hikma's ANDA filing for VR315 (US); €1.5m (£1.1m) from Ablynx after it exercised its commercial licence option in May 2016 to use the Group's FOX® handheld smart nebuliser technology to progress its ALX-0171 infant RSV programme; an $8.0m (£6.1m) sales milestone was recorded following Pacira's confirmation that worldwide annual net sales of EXPAREL® (on a cash-received basis) to 30 June 2016 had reached $250m; and a $5.0m (£4.1m) sales milestone achieved as 2016 sales of Seebri® and Ultibro® Breezhaler® exceeded $0.5bn.

Development services

As with signing and milestone payments, development services revenues are irregular and dependent upon the level of specialist development services required by Vectura's partners and as such may vary materially from one year to the next. Development services revenues are therefore excluded from our definition of underlying revenues.

Development services revenues were £9.0m during 2017 (proforma 2016: £7.5m) and mainly relate to the ongoing development of the breath-triggered version of *flutiform*® and the VR2076 triple programme, both with Mundipharma, and the VR2081 US generic programme, partnered with Sandoz.

As announced in January 2018, Mundipharma has decided to terminate the development VR2076, which was in an early formulation phase. Given the early stage of this asset, this is not expected to have a material impact on the Group's revenues in 2018. As an acquired programme from the Skyepharma merger, VR2076 was held as an intangible asset net of its associated deferred tax liability and had a value as at 31 December 2017 of £7.6m. This asset was fully impaired in the 2017 financial statements.

Other revenue

In 2017, other revenue of £6.6m solely comprised the Group's 3% share of Pacira's cash receipts from net sales of EXPAREL® (2016 proforma: £5.8m). Pacira reported 2017 net sales of EXPAREL® of $282.9m, a 6.4% increase compared to 2016. Vectura expects to receive share of sales revenues until the expiry of certain patents, the earliest of which expire in September 2018. The Group is also eligible to receive a $32m sales milestone when twelve-month net sales of EXPAREL® reach $500m (on a cash received basis). This milestone is not patent dependent.

Other revenue in the twelve-month proforma to 31 December 2016 also included £0.8m as the final portion of the annual rental income from Aenova of its lease of the Lyon facility for the period 1 January –30 June 2016. This element of other revenues is non-recurring and has been excluded from underlying revenues.

Implementation of IFRS 15 – Revenue from Contracts with Customers

The impact of IFRS 15 – Revenue from Contracts with Customers is subject to final assessment and audit, but is not currently expected to have a material impact on total revenues for 2018. Refer to note 2 in the financial statements for further information.

Cost of sales

Cost of sales increased by £2.1m to £57.2m (twelve-months proforma 2016: £55.1m). This increase is in line with increased product supply and device sales revenue. Underlying gross profit from *flutiform*® product supply, excluding a £0.8m charge associated with a fair value adjustment, was £23.8m, which equates to a gross margin of 37.6% (2016 proforma underlying: gross profit of £19.0m, 31.4% gross margin). The 6.2 percentage point increase in gross margin reflects increasing benefits of scale, cost reductions and a one-off cost initiative that accounts for approximately half of the improvement.

Inventories for the *flutiform*® supply chain were £21.5m at 31 December 2017 (31 December 2016: £17.6m).

Research and development (R&D) expenses

The Group maintains a disciplined approach to capital allocation in managing its R&D portfolio. R&D expenses of £60.3m were at the lower end of the 2017 guidance range, and were £4.8m lower than 2016 underlying as the result of pipeline prioritisation, early delivery of synergy savings and R&D productivity initiatives.

Expenditure recorded during the period comprised £34.2m on the Group's enhanced delivery assets (2016 proforma underlying: £27.5m) related to the ongoing Phase III trial for VR475 (EU) and costs associated with continued development of VR647 (US); £14.3m on novel-patented molecule partnering projects (2016 proforma underlying: £24.8m) reducing compared to prior year as a result of the decision to partner both VR942 and VR588; £9.5m on generic partnering projects (2016 proforma underlying: £10.9m); and £2.3m on oral projects (2016 proforma underlying: £1.9m).

Other operating expenditure and income

Underlying other operating expenditure and income, which excludes the impact of a £2.1m non-cash charge for share-based compensation, has decreased by 19.4% to £10.4m. This reduction is mainly due to merger synergy cost savings.

Other operating expenditure and income includes a £1.7m R&D expenditure credit (2016 proforma underlying: £1.4m). As this is effectively a taxable grant, it is booked within Vectura's operating loss and is subject to taxation in the normal manner. Following the Skyepharma merger, Vectura is no longer eligible to receive cash tax credits under the small and medium enterprises R&D tax credit scheme.

Amortisation and impairment of intangible assets

The 2017 reported amortisation charge of £109.7m includes an £8.7m charge for impairment relating to the VR2076 intangible asset following Mundipharma's decision to terminate this development programme. As expected, the 2017 charge is significantly higher than the prior nine-month period which only included approximately six and half months of amortisation for the Skyepharma intangibles (£64.0m). Intangible assets recognised from the Skyepharma and Activaero combinations will continue to be amortised over their remaining useful lives. As underlying financial information excludes acquisition accounting adjustments, there is no amortisation charge included in either the 2017 or 2016 underlying financials.

Exceptional items

Adjusted EBITDA and underlying adjusted EBITDA are stated before exceptional items.

A total net exceptional charge of £4.5m was recognised in the 2017 reported financial results (nine-months ended 31 December 2016: £9.4m charge).

Exceptional costs recognised during 2017 comprise £4.5m of post-merger integration costs, £1.8m for the progression of legal proceedings against GSK to enforce Vectura's patents in respect of the Ellipta® products and £0.8m of restructuring costs at the Group's oral manufacturing facility in France. These costs are partly offset by a £0.2m credit relating to curtailments of the Swiss pension scheme, a £0.2m credit relating to the movement in an onerous lease provision in Switzerland and a £2.2m release of research and development accruals.

As part of the merger integration and alignment, management has performed a detailed review of research and development accruals during 2017, including historical accruals. This activity identified a number of individually immaterial historical accruals originally established based upon specific programme knowledge obtained from members of staff who have now left the business. It is no longer considered probable that these accruals will result in future cash outflows. The accruals, totalling £2.2m, have been released in the 2017 Consolidated income statement and are presented within exceptional items to enable users to understand the impact of the credit on current year performance. Management has determined that there is no material impact of the accruals on any comparative income statement, balance sheet or cash flow statement.

Post-merger integration costs comprise mainly spend on projects required to combine the two businesses including the cost of a third party consultancy to harmonise ways of working and enhance productivity in the R&D function. In addition, these costs also include a share-based payment charge of £1.8m in respect of retention awards granted to key members of management considered critical to the integration process.

To date, the Group has recognised exceptional post-merger integration costs totalling £8.4m net of Swiss pension curtailment gains. The remaining balance of the total £9m merger integration costs are expected to be largely incurred in 2018.

As announced in January 2018, the Group will recognise further exceptional costs in 2018 of approximately £0.5m related to the delivery of operational excellence initiatives.

Adjusted EBITDA and underlying adjusted EBITDA

Adjusted EBITDA and underlying adjusted EBITDA are non-IFRS measures which management uses to assess the performance of the business.

Adjusted EBITDA of £25.8m has decreased compared to reported adjusted EBITDA of £34.1m for the nine-month period ended 31 December 2016. This reduction in EBITDA is the result of increased R&D expenditure for the twelve-month period compared to the previously reported nine-month period and a change in revenue mix with the prior year 2016 reported numbers including £22.4m of non-recurring milestones and material non-recurring royalties from sales of Ellipta® products and ADVATE®, which achieve a 100% margin.

Adjusted underlying EBITDA, which excludes the impact of material non-recurring revenue streams, has increased from a loss of £2.6m in 2016 to a profit of £10.0m. This improvement demonstrates both the increased underlying revenue and the significant reduction in the fixed cost base of the business that has been achieved through the delivery of merger synergies and Operational Excellence initiatives.

As shown in note 8 to the financial statements, adjusted EBITDA is calculated by adjusting statutory reported operating profit for non-cash items such as depreciation, amortisation and share-based compensation and for items that are exceptional in nature and do not represent the underlying trends of business performance. Underlying adjusted EBITDA is calculated in the same way but based on operating profit from underlying revenues.

Share of movements in associates

The charge of £3.4m recognised in 2017 (nine-months ended 31 December 2016: income of £0.4m) includes £1.7m for the Group's share of losses of its German associate (Ventaleon GmbH) and £1.6m relating to the contributions necessary to finalise the valuation process for approval by the Chinese State authorities of the Group's 37.84% share in Tianjin Kinnovata Pharmaceutical Company Limited.

Net finance expenses/income

Net finance costs of £2.6m (nine-months ended 31 December 2016: net £4.0m income) in 2017 mainly comprise foreign exchange losses of £1.4m (nine-months ended 31 December 2016: £4.2m gain).

Loss before tax

As expected, the Group's statutory loss before tax of £102.2m has increased significantly compared to the prior nine-month statutory reporting period (nine-months ended 31 December 2016: £40.1m loss). This is due to the discontinued royalty revenues and significant non-recurring milestones recognised in 2016, increased amortisation charges and the change in accounting reference date, as noted above.

Taxation

The Group's effective tax rate (ETR) for the year ended 31 December 2017 is a 16.2% credit (nine-months ended 31 December 2016: 20.0% credit). The ETR is driven by tax charges on profits in Switzerland (8.5% charge) and the US (inclusive of prior year adjustments) (42.9% charge), and a small credit in the UK on losses and R&D incentives. The ETR is significantly impacted by deferred tax credits on the amortisation of acquired intangible assets (17.6% credit). The expectation of the long-term trend for the ETR is a high-teens credit percentage rate.

Loss after tax

Loss after tax was £85.7m (nine-months ended 31 December 2016: £32.1m loss).

Loss per share

Basic loss per share has increased to 12.6p, reflecting the reduction in non-recurring revenues and increased R&D and amortisation charges, as noted above (nine-months ended 31 December 2016: 5.3p loss per share).

Balance sheet

Goodwill

Goodwill of £161.4m at 31 December 2017 (31 December 2016: £162.8m) arises from historical acquisitions. The balance is not amortised but subject to annual impairment testing. The movement in the goodwill balance compared to the prior period relates to foreign exchange losses recognised.

Intangible assets

The carrying value of intangible assets at 31 December 2017 of £335.4m (31 December 2016: £456.8m) has decreased by £121.4m during the period. This is due to amortisation of £101.0m, an £8.7m impairment charge for the acquired pMDI triple therapy development programme (VR2076) and £11.9m of foreign exchange losses.

Property, plant and equipment

During 2017, Vectura has invested £11.7m of capital expenditure (nine-months ended 31 December 2016: £3.1m). This consists mainly of £3.8m of equipment to support the manufacture of *flutiform*® actuators still under construction at 31 December 2017 and a £3.4m investment in manufacturing equipment at the Group's oral manufacturing facility, of which £2.5m is under construction at 31 December 2017. Construction of the actuator equipment is expected to complete in H2 2018 and the construction of the oral manufacturing equipment is expected to complete in Q1 2018. Once completed, both assets will become operational and will be reclassified to property, plant and equipment and depreciated from this point.

In January 2017, the Group's £8.8m investment in expanding capacity of *flutiform*® at the Sanofi manufacturing facility in Holmes Chapel, previously classified as an asset under construction, became fully operational.

Translation reserve

In accordance with IAS 21 – Effects of Changes In Foreign Exchange Rates, the Group has recognised a net foreign exchange loss of £15.1m (nine-months ended 31 December 2016: £49.0m gain) within reserves as a result of translating overseas operations denominated in local currencies to the presentational currency of the Group.

Cash position and liquidity

Vectura continues to maintain strong liquidity with cash and cash equivalents at 31 December 2017 of £103.7m (31 December 2016: £92.5m).

The Group generated a £26.9m cash inflow from operations (restated nine-months ended 31 December 2016: £19.0m inflow). Excluding cash flows relating to exceptional items of £5.9m (nine-months ended 31 December 2016: £11.9m), cash generated from operations was £32.8m (restated nine-months ended 31 December 2016: £30.9m). This is higher than adjusted EBITDA of £25.8m due to £6.5m of working capital movements, plus £0.5m of non-cash items.

The Group made scheduled corporation tax payments relating to prior years for its US and Swiss operations of £2.9m (nine-months ended 31 December 2016: £2.6m). These payments were almost offset by cash inflows from research and development tax credits received of £2.1m (nine-months ended 31 December 2016: £2.4m).

Cash outflows from investing activities were £9.5m lower mainly due to the merger-related outflows in the six-months ended 30 September 2016, partially offset by higher capital expenditure outflows.

On 14 November 2017 the Group commenced a £15.0m share buyback and cancellation programme. As at 31 December 2017, total cash outflows relating to this programme were £1.4m. The programme was completed post-period on 28 February 2018.

On 22 August 2017, HSBC Bank Plc, one of the Group's existing relationship banks, was added as a lender to the £50m multicurrency revolving credit facility with Barclays Bank PLC. This facility expires in August 2021 and remains undrawn.

By order of the Board

Andrew Derodra
Chief Financial Officer
20 March 2018

Appendix to the Financial review

Reconciliation of 2016 underlying financial information to previously reported financial information for the nine-month period ended 31 December 2016

	2016 reported (9 months)	Adjustment 1	2016 reported proforma	Adjustment 2	2016 proforma (12 months)	Adjustment 3	Adjustment 4	2016 proforma underlying (12 months)
Revenue								
Royalties	£47.5m	£24.9m	£72.4m	£2.1m	**£74.5m**	(£26.6m)	—	**£47.9m**
Product supply and device sales	£50.3m	£22.3m	£72.6m	—	**£72.6m**	—	—	**£72.6m**
Signing and milestone payments	£20.5m	£1.9m	£22.4m	—	**£22.4m**	—	(£22.4m)	**—**
Development services	£4.5m	£3.0m	£7.5m	—	**£7.5m**	—	(£7.5m)	**—**
Other revenues	£3.7m	£2.9m	£6.6m	—	**£6.6m**	—	(£0.8m)	**£5.8m**
Total revenue	£126.5m	£55.0m	£181.5m	£2.1m	**£183.6m**	(£26.6m)	(£30.7m)	**£126.3m**
Cost of sales	(£41.9m)	(£13.2m)	(£55.1m)	—	**(£55.1m)**	—	—	**(£55.1m)**
Gross profit	£84.6m	£41.8m	£126.4m	£2.1m	**£128.5m**	(£26.6m)	(£30.7m)	**£71.2m**
Expenses								
Selling and marketing	(£2.8m)	(£0.7m)	(£3.5m)	—	**(£3.5m)**	—	—	**(£3.5m)**
Research and development	(£45.6m)	(£19.5m)	(£65.1m)	—	**(£65.1m)**	—	—	**(£65.1m)**
Corporate and other administrative	(£7.0m)	(£4.0m)	(£11.0m)	—	**(£11.0m)**	—	—	**(£11.0m)**
Other								
Other income	£1.5m	£0.1m	£1.6m	—	**£1.6m**	—	—	**£1.6m**
Add back depreciation	£3.4m	£0.8m	£4.2m	—	**£4.2m**	—	—	**£4.2m**
Adjusted EBITDA	£34.1m	£18.5m	£52.6m	£2.1m	**£54.7m**	(£26.6m)	(£30.7m)	**(£2.6m)**

Adjustment 1: Adjustment to present nine-month financial information on a proforma full-year calendar basis by adding in actual performance reported on a management accounts basis under IFRS from 1 January 2016 as if the merger had occurred on that date. This excludes acquisition accounting adjustments required by IFRS 3 – Business Combinations.

Adjustment 2: In the December 2015 management accounts, certain royalties were over accrued by £2.1m with no implication on the twelve-month March 2016 reported IFRS results. The adjusting entry has been posted in Q1 calendar year 2016 reducing royalty revenues accordingly. 2016 reported proforma revenues are therefore adjusted to exclude this understatement.

Adjustment 3: Adjustment to remove non-recurring royalties from ADVATE® and GSK Ellipta® from proforma underlying revenues which materially ceased in 2016.

Adjustment 4: Adjustment to remove milestone payments, development services revenues and non-recurring other revenues from proforma underlying revenues.

Reconciliation of 2016 underlying financial information to previously reported alternative performance measures

Reconciliation of recurring revenues to underlying revenues

	2016 reported (9 months)	2016 reported proforma (12 months)	**2016 proforma (12 months)**
Royalties	£47.5m	£72.4m	**£74.5m**
Product supply and device sales	£50.3m	£72.6m	**£72.6m**
Signing and milestone payments	£20.5m	£22.4m	**£22.4m**
Development services	£4.5m	£7.5m	**£7.5m**
Other revenues	£3.7m	£6.6m	**£6.6m**
Total revenue	£126.5m	£181.5m	**£183.6m**
Less:			
Signing and milestone payments	(£20.5m)	(£22.4m)	**(£22.4m)**
Development services	(£4.5m)	(£7.5m)	**(£7.5m)**
Revenue from recurring sources	£101.5m	£151.6m	**£153.7m**
Less:			
Annual rental income from Aenova	(£0.2m)	(£0.8m)	**(£0.8m)**
Recurring revenue	£101.3m	£150.8m	**£152.9m**
Less:			
ADVATE® royalties (patent expired January 2016)	(£8.2m)	(£13.7m)	**(£13.7m)**
Ellipta® portfolio (legacy Vectura agreement, legal dispute in process)	(£7.3m)	(£12.9m)	**(£12.9m)**
Underlying revenues	£85.8m	£124.2m	**£126.3m**

The change in presentation to underlying results has impacted the comparability of current year alternative performance measures with those disclosed in previous years. The table above reconciles "recurring revenues" disclosed in 2016 to "underlying revenues" disclosed in the current year financial review. Underlying revenues exclude material royalties received in 2016 from ADVATE® and the Ellipta® portfolio that did not recur to a material extent in 2017. The impact of these items distorts comparison of financial results from period to period and therefore can obscure trends in the underlying, recurring base of the business. The Directors consider that reporting performance on an underlying basis provides a more meaningful reflection of the ongoing business in both periods and is consistent with how management reviews the business for the purpose of making long-term operating decisions.

Sustainability

We transform the lives of patients with airways diseases. This shared purpose drives our strategy and our behaviours set a framework for how we deliver our goals and measure our successes. Ultimately, we believe that how we achieve success is every bit as important as what we achieve.

We assess our performance across four key areas: our patients, our people, our partners, and our local communities and our environment. By operating responsibly we will build a business that is durable in the long term, maximise our commercial success and deliver long-term value for our shareholders and society.

Jo Hombal
Executive Vice President, Human Resources

OUR PATIENTS

More than 300m people living with Asthma and COPD respectively and significant unmet need remains.

"Commercial success will follow if we are genuinely delivering solutions to match patient need. "

Frazer Morgan – Vice President, Programme Development

The future of our business depends upon our ability to meet the needs of our patients and our ability to respond to changing dynamics in the highly complex airways disease market.

Our areas of focus

Our patient focus drives what we do and how we do it; we are passionate about transforming the lives of patients with airways-related diseases.

How we engage

We seek to understand the needs of our patients by maintaining an in-depth appreciation of the continuous clinical innovation in the way that Asthma and COPD patients are being treated. This enables us to match our future pipeline to the emerging treatment paradigm, thus addressing unmet medical need.

We ensure that our employees understand the science behind the diagnosis and treatment of airways disease patients by hosting educational seminars with charity advocates, internal experts, industry experts, practitioners and patient guest speakers.

Our development teams actively consider the needs of our patients throughout the development process striving to develop relevant products and easy-to-use device platforms to help improve patient compliance.

Promoting affordable quality products

Our diverse pipeline includes a number of generics programmes. Vectura is a responsible partner to major pharmaceutical companies such as Hikma which strive to reliably supply affordable, high-quality generic medicines to meet today's diverse healthcare needs.

Promoting access

Vectura currently licenses its products, technologies and know-how to partner companies. We play an important role in improving access to healthcare through the development of innovative technologies and solutions that address major areas of unmet medical need; the need to improve patient compliance and outcomes; and reduce overall costs of healthcare. We utilise our development and regulatory expertise to support our partners in bringing the benefits of these innovative products to as many markets as possible, including developing economies.

Patient safety

Although our business does not include direct marketing and sales to patients, patient safety is our number one priority in the development, testing, manufacturing and ultimate use of our products. All medicines have potential risks as well as benefits. Our robust policies and governance framework are designed to help us and our partners detect and act on any side effects that may be associated with our medicines. We always put patient safety first in the design and conduct of our clinical trials.

Clinical trials

Vectura has an established set of standard operating procedures (SOPs) and policies which govern the conduct of clinical trials which it sponsors. These SOPs and policies ensure that Vectura-sponsored clinical trials are compliant with internationally recognised and adopted standards and with national and international legislation in the relevant territories. Compliance with our SOPs and policies is monitored and inspected on an ongoing basis by our internal quality assurance department.

We do not conduct animal testing in house and we have no plans to do so. We outsource toxicology studies which are required by law before human clinical trials of novel therapeutics can be conducted. There are a limited number of companies with the expertise to conduct regulatory-standard, inhalation toxicology studies, which are our area of focus.

Our progress in 2017

During the year we:

- hosted a live patient interview event for all staff, giving a patient and their physician the opportunity to explain the impact of severe Asthma on their lifestyle including a discussion of the issues and side effects of current treatments and hopes for future treatment options;
- hosted an internal education event for all staff focusing on Vectura's pipeline, including guest key opinion leader speaker to discuss the treatment burden and challenges in treating Asthma and COPD;
- held a V2V charity cycle ride where employees cycled from our Gauting site to Muttenz to raise money for Asthma UK, a charity for which Vectura is an ambassador; and
- offered two employees the opportunity to take paid leave to volunteer as part of the support crew for this year's Antonia's Friends' "Race Across America" (RAAM) event, in support of Asthma UK.

OUR PEOPLE

More than 450 talented and diverse employees working internationally across five sites.

"Everything we all do has a positive impact on transforming the lives of airways disease patients – not only does it make me want to come to work each day, it makes me want to go the extra mile in everything that I do."

Liza Hemmings – Director, HR Operations

Our ability to deliver upon our valuable product pipeline and to innovate for the future is dependent upon the skills and expertise of our workforce. It is vital that our people are motivated to achieve our common goals in order to drive Vectura forwards. Each of our employees contributes to and shares in Vectura's success.

Our areas of focus

We strive to create a stimulating and rewarding place to work and ensure that our culture and values are a definitive expression of "how we do things" at Vectura.

How we engage

Communication is part of our day-to-day operating model. Engaging our colleagues is a priority and it is embedded in everything we do. We have a number of communication channels to ensure that the views and needs of our employees are understood and considered by the Executive Leadership Team and the Board. Connecting our different sites through communications channels, both electronic and face to face, improves collaboration and integration and embraces diversity as well as helping to speed up internal processes.

Our values:

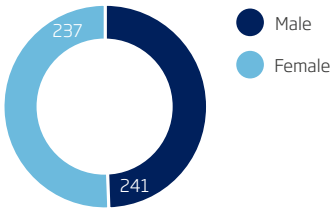
PATIENT FOCUS – our patient focus drives what we do and how we do it; we are passionate about improving the lives of airways disease patients

INNOVATION – we look to innovate every day. Each one of us is inspired and enabled to improve what we do and how we do it. We keep learning so that we can push the boundaries of what is possible

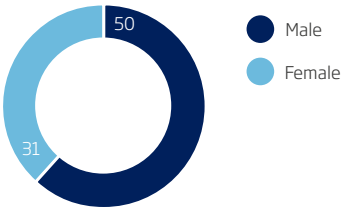
COLLABORATION – we seek to understand each other's needs consistently, and use our combined knowledge and expertise to enable mutual success in every collaboration

ACHIEVEMENT – we enjoy working together to achieve what needs to be done. It is our individual drive to apply our learning and be accountable to others that makes our collaboration so successful

Overall gender breakdown of all employees at 31 December 2017



Senior managers (Directors and above) at 31 December 2017



Our employment practices

Our commitment to diversity

The diverse perspectives and experiences of our global workforce strengthen our business and help us meet the needs of our patients and other stakeholders. Vectura promotes a culture of opportunity for all – decisions about employment, development, promotion, pay and benefits are based upon ability, qualifications and performance.

We believe in diversity in its widest sense and we have not set any formal diversity quotas or targets; all appointments, both internal and external, are ultimately made on the basis of merit. Our policies support the differing needs and commitments of our employees, with around 16% of our employees benefiting from some kind of flexible working practice. James Ward-Lilley, our Chief Executive Officer, is the Board member responsible for overseeing human resources and non-discrimination issues.

We are a global organisation and want our leaders to represent the varied markets we serve. Four nationalities are currently represented on our Board of Directors.

Employee engagement

Communication is part of our day-to-day operating model. Engaging our colleagues is a priority and it is embedded in everything we do. In an industry based upon innovation and research and development, our employees are our biggest asset and it is therefore critical that we forge strong connections through timely and meaningful communication; we aim to achieve this through:

- our Group-wide intranet and video information terminals, which we are evolving every year. Working with our employees, we continually strive to improve the design and effectiveness of communications channels across the Group;
- our Manager Forum, which enables all people managers to meet on a monthly basis to discuss topical items, share learnings, communicate updates, provide feedback on corporate initiatives and benefit from upskilling;
- our Employee Representative Forum of elected representatives, which provides a mechanism by which employees can raise issues that matter to them for discussion, enables employee feedback and facilitates the communication and dissemination of key information throughout the organisation;
- our all-employee quarterly business updates, hosted by members of the Executive Leadership Team, are used to share strategy, programme, people and business performance updates through the use of a balanced scorecard and facilitate two-way dialogue through Q&A;
- our business leaders' briefing packs, which are issued post the Quarterly Leadership Team meetings to facilitate ongoing engagement via team cascade sessions, to ensure that all employees understand how their work contributes to the overall progress of Vectura; and
- our annual employee engagement survey: the 2017 annual survey was conducted in March 2017; 84% of employees responded and we received feedback indicating we are ahead of the comparator benchmarks (including the top 10% of participating companies) in the following areas:
  - employees are encouraged to share their thoughts and views with their managers and senior leaders at my organisation;
  - my manager communicates well with me, giving me clear feedback on my work and performance; and
  - my organisation's values have been clearly articulated.

We use the feedback obtained from the processes and activities outlined above to determine key priority areas for improvement going forward and we regularly communicate our progress. We monitor our employee turnover on a monthly basis to identify any possible employee relations or motivational issues and to assist in our recruitment and resource planning.

During 2018, we will continue to review employee communication channels to identify opportunities for continuous improvement.

Developing our people

Attracting and retaining skilled people with values aligned to our ethos is critical for the long-term sustainability of our business and we aim to develop and maintain a motivated and professional workforce. We recognise the importance of investing in our people, ensuring that they are equipped to deliver in their current and future roles within the business.

In addition to investment in general training and development, Vectura offers all employees the opportunity to apply for scholarship funding. The Vocational Qualification Award provides substantial financial assistance to those who wish to pursue further self-development, largely in their own time. Any course that would significantly enhance an employee's skills whilst benefiting Vectura is considered. During 2017, we have supported employees through MSc studies in clinical development, A Levels in chemistry and EMBAs.

Talent management is another key component in the attraction and retention of motivated and highly skilled employees. On an annual basis, the Executive Leadership Team reviews the succession plan, identifying the "high potential" employees who are the future leaders of our business, and ensures appropriate retention, support and personal development planning is in place.

Rewarding our people

Remuneration plays an important role in retaining and motivating our people. We seek to provide well-constructed and fair reward systems designed to incentivise superior performance and align the interests of our employees with those of our shareholders and other stakeholders. The annual bonus allows us to reward employees for achieving and exceeding challenging corporate and individual objectives. In addition to our remuneration packages, which include a pension entitlement, permanent health insurance, life assurance and private medical care, all employees are given the opportunity to participate in our all-employee share plans.

For more details of our all-employee share plans, please refer to the Remuneration Report. In addition to standard remuneration packages, our recognition policy acknowledges the impact and value of a sincere "thank you" and a series of thank you cards are available for employees to provide sincere appreciation to colleagues, and managers are also encouraged to provide low monetary value awards to those who go the extra mile to achieve a great outcome.

Our commitment to health and safety

We consider health and safety to be a priority in our workplaces. We have an established Health and Safety Committee that reviews health and safety standards within the organisation. The Committee continually monitors and reviews health and safety practices to ensure that health and safety management procedures are robust and in line with industry best practice. Annual updates are provided to the Board for review and additional update reports are provided as required. Each ELT member also receives a quarterly HSE report, enabling them to reinforce the importance of a strong safety culture. James Ward-Lilley is the Board member to whom responsibility for health and safety issues has been delegated.

Specialist ongoing training is provided to those individuals who are responsible for health and safety across the organisation. General health and safety training is delivered to all staff via in-house training sessions provided by our Health and Safety Manager and by e-learning courses.

Vectura has an excellent safety record and there have been no major incidents or accidents to report to the Health and Safety Executive in the United Kingdom or to the equivalent bodies in Germany, Switzerland or France during the period (2016: none).

Policies and practices

Our Code of Conduct

Our Code of Conduct documents our behavioural standards and ways of working. The Code of Conduct is provided in all of the principal languages spoken by our people, and it describes the principles, policies and procedures that ensure our business continues to operate in accordance with the requirements of our highly regulated industry. The Code of Conduct is applicable to all permanent and temporary employees and contractors and third parties we work with are expected to adhere to the same standards.

Our Code of Conduct sets out Vectura's zero tolerance attitude to bullying and harassment and bribery and corruption and details our whistleblowing policy and procedure. The Code of Conduct is available to all employees via our Group-wide intranet.

Anti-bribery and corruption

We have adopted a clear anti-bribery policy, which has been communicated 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.

We do not believe that human rights issues present a significant issue for Vectura, but we are committed to protecting the human rights of our employees and the people who come into contact with our business.

Sales and marketing ethics

Vectura does not currently market pharmaceutical products directly to patients; however, we are committed to employing ethical marketing and sales practices. We follow the Code of Practice of the Association of the British Pharmaceutical Industry (ABPI), which governs the promotion of medicines to health professionals.

Working with suppliers

Our ethical standards are integral to our procurement and partnering activities and we continuously monitor compliance through assessments and improvement programmes. We have a highly regulated vendor selection process, which includes evaluating prospective suppliers' technical capability and a full audit of their quality systems to ensure compliance with appropriate quality and safety standards.

Manufacturing compliance

Vectura manufacturing and laboratory facilities are subject to regular inspection by relevant regulatory authorities. These inspections have not revealed any major instances of non-compliance at any of our sites.

Our progress in 2017

Vectura has a talented workforce with an invaluable diversity of skills, knowledge and experience. Following the 2016 merger with Skyepharma, we undertook a Group-wide project to identify, articulate and deliver our shared cultures and value.

During the year we:

- worked across the Group to develop and articulate our shared culture, with high levels of participation and feedback from our employees achieved through surveys, workshops and an online digital discussion forum;
- hosted a Group-wide "AsOne" event to launch new culture and values with subsequent roll-out of materials and supporting tools across all sites to support consistency of understanding and behaviour;
- launched a new reward framework across all sites which includes career development paths so that all our employees can understand how their role fits into the wider organisation and clearly see their opportunities for development;
- launched a Recognition Scheme and Performance Management system that is fully aligned and supportive of our newly articulated values and culture; and
- developed and delivered a new Leadership Development Programme which equips leaders at all levels within our organisation with the skills and knowledge to lead their teams effectively and in accordance with our defined culture.

OUR PARTNERS

Over ten active partnerships and 20 revenue-generating in-market assets.

"We build collaborations and alliances every day and everywhere. It makes us strong when we use the knowledge and experience of all our team members… it has helped us find solutions for difficult challenges."

Vectura has developed and maintains a partnering model for its generic development programmes and certain Vectura enhanced delivery programmes. In order for this model to continue to be successful, Vectura needs to meet the changing scientific and operational needs of its wide partnership base, enabling the best outcomes for programmes and patients.

Our areas of focus

We strive for a culture of scientific and Operational Excellence and invest in our intellectual property portfolio and our device, development and formulation capabilities.

How we engage

We routinely establish industry standard management and governance process for our partnerships and then maintain close working relationships with our partners, ensuring regular feedback and dialogue to enable us to continue to deliver against our partners' needs and expectations. We continue to invest in our people, our IP and our core capabilities and technologies to maintain our broad integrated drug delivery platform offering, leaving Vectura uniquely placed as a key partner within the industry.

Our progress in 2017

Our partnerships continue to make significant contributions to our business. To support systematic and continuous improvement in the performance of our partnerships during 2017 we designed and undertook a health check survey for use with partners. This scheme was piloted with a major partnership; we engaged with all key personnel across the partnership to assess how important behaviours are to supporting progress of the relationship. The analysis of the survey allowed us to jointly understand areas that are working well and where improvement should be targeted. Joint workshops allowed us to share the results with the team and to identify specific actions to progress the partnership more effectively. This process will be repeated at appropriate intervals and we intend to roll this approach out across other selected partnerships and alliances during 2018.

On an ongoing basis we also use a "scorecard" where key attributes of the partnership – Strategic, Financial/Resources, Operational and Relational – are summarised, scored and tracked. This allows the governance teams (project teams and Joint Steering Committees) to easily track and measure progress of the project and partnership performance.

OUR COMMUNITIES AND OUR ENVIRONMENT

As a responsible business, we are committed to having a long-term positive impact within our local communities and to minimising our long-term impact on the environment.

Our areas of focus

We maintain close relationships with our local universities, support our employees in local and national charity endeavours and monitor the carbon footprint of our organisation.

How we engage

Vectura has always sought to foster close working relationships with universities close to our R&D sites. We believe that bringing placement students into our premises is an essential mechanism via which we can give students direct exposure to the world of work and, in so doing, we are contributing to developing the next generation of pharmaceutical scientists, creating potential future permanent employees and helping to support the local academic community. In addition to this, Vectura also supports a number of academic collaborations with universities developing novel drug delivery technologies of interest in the field of pulmonary delivery.

We support the communities within which we operate by providing high-quality employment opportunities, supporting charitable social engagement and local volunteering. Our employees, particularly those on our Green Action Team, are committed to reviewing Vectura's impact on the environment over the long term and proposing energy reduction initiatives where appropriate. We offer our UK employees the opportunity to participate in a cycle to work scheme and encourage car sharing where possible.

Our progress in 2017

One of the most significant impacts that we can have within our local communities is to continue to provide high-quality employment opportunities and to develop therapies to help patients with airways-related diseases.

We are proud to have a highly creative and active Social Committee which initiates a calendar of social and charitable events each year. With a dedicated budget, this team is empowered to organise engaging and rewarding activities to raise money for local charities, as well as facilitating our support of nationwide charity campaigns such as Comic Relief, the BBC Children in Need appeal and Macmillan as well as local charities nominated by our employees. Wherever possible, Group facilities are made available for these events. For the second year running, Vectura supported a bike ride with 40 employees participating in a Gauting to Muttenz charity bike ride. This raised over £20,000 for Asthma UK, as well as forging strong relationships built on mutual trust and support, having fun and sharing a great achievement. The team raised a further £6,500 for national asthma charities in Germany and Switzerland.

Our carbon footprint

The Group is committed to protecting the environment in all areas of our operations, including undertaking initiatives to effectively manage and reduce waste throughout the organisation.

We aim to foster a positive attitude towards the environment among employees and to raise employee awareness of responsible environmental practices at all sites operated by the Group. The Group endeavours to ensure compliance with all relevant legislation and regulatory requirements as a minimum. Andrew Derodra, Chief Financial Officer, has responsibility for reporting on relevant environmental matters to the Board. There have been no reportable incidents in 2017 at any of the Group's sites.

Due to the nature of our activities, Vectura considers that it has a low environmental impact. However, we remain committed to minimising the impact of our activities on the environment and actively seek to make energy savings in a way that is beneficial for the environment and cost effective for the business. Vectura has a Green Action Team which has responsibility to pursue initiatives for environmental sustainability and carbon reduction.

Our environmental initiatives

Vectura has adopted and maintains a number of specific environmental initiatives.

Energy efficiency

- It is our policy that when an existing light unit requires replacement it is replaced with an LED light. The LED lights installed are up to four times more energy efficient than the traditional light units that they replace. The majority of the lighting at our Chippenham site is now LED.
- Passive infrared light sensors are installed in many general work areas. This ensures that lighting is not left on in work areas that are not currently in use.

Greenhouse gas emissions

Vectura reports greenhouse gas emissions in accordance with the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 ("the Regulations").

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 except for our office in London as it is considered to be negligible for these purposes. The amounts shown below for Scope 1 and Scope 2 emissions are those required to be reported under the Regulations.

Greenhouse gas emission by source[1]	Year ended 31 December 2017	9 months ended 31 December 2016	Year ended 31 March 2016
Scope 1	**2,312**	465	431
Scope 2	**1,522**	1,163	1,426
Total emissions (Scope 1 and 2)	**3,834**	1,628	1,857
Emissions reported (tonnes of CO_2 per sq ft)[2]	**0.01**	0.01	0.03

The significant increase in Scope 1 emissions relates to the inclusion of Skyepharma sites for the full twelve-month period and the gas consumption at our Lyon manufacturing site that accounts for 70% of the total. However, the emissions reported per sq ft is in line with last year.

1 GHG emissions reported in metric tonnes of carbon dioxide equivalent. 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.

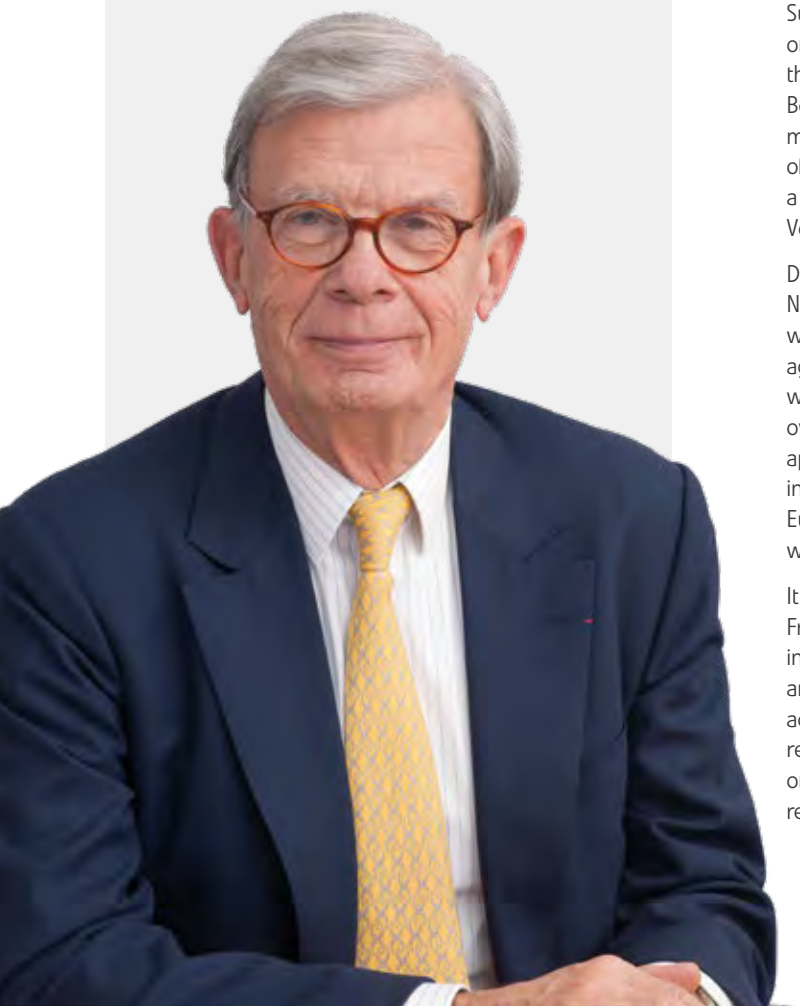
The Strategic Report has been approved by the Board and is signed by order of the Board.

Andrew Derodra
Chief Financial Officer
20 March 2018

Introduction from the Chairman

> During the year the Group has continued to develop Vectura's strategy by strengthening senior management, so that the core values of the Board are communicated throughout the Company, and by management being rewarded on the basis of achieving its objectives aligned to this strategy.

Bruno Angelici
Chairman



Dear Shareholder
The Board continues to focus on enhancing the corporate culture of the enlarged Group and is committed to maintaining high standards of corporate governance, which we believe are integral to the long-term success of Vectura and its purpose of transforming the lives of airways disease patients. During the year the Group has continued to develop Vectura's strategy by strengthening senior management, so that the core values of the Board are communicated throughout the Company, and by management being rewarded on the basis of achieving its objectives aligned to this strategy. Maintaining the development of good governance throughout the Group is a high priority and the Company continues to take advice from leading governance advisors. Details of our Executives' remuneration is provided in the Directors' remuneration report and the following report explains more about how Vectura's corporate governance is embedded in the Company.

UK Corporate Governance Code

In relation to compliance with the UK Corporate Governance Code, the Board considers that it has complied in full with the applicable version (2016). Further information on areas that the Board discussed as part of its determination are set out below.

Board composition and evaluation

The Board acknowledges that some shareholders have raised issues regarding the independence of Frank Condella (Vice Chairman) and Susan Foden (Chair of the Remuneration Committee and SID), based on their respective lengths of service, which in Frank's case was on the Boards of Skyepharma and Vectura and in Susan's case on the Board of Vectura. Frank has been a Non-Executive Director since the merger with Skyepharma in 2016 and, prior to that, he was chairman of Skyepharma and including his service at Skyepharma, he has been a Director since 2006. Sue has been a Non-Executive Director of Vectura since January 2007.

Dr. Thomas Werner also joined the Board as an Independent Non-Executive Director in June 2016 as a result of the merger with Skyepharma and will have completed nine years' service in aggregate in May 2018. Dr. Werner has not served concurrently with any Executive Director for more than six years. Thomas has over 30 years of Pharmaceutical business experience gained from appointments in a wide range of pharmaceutical companies and investment funds. The skills and experience, particularly of the European respiratory markets and investment environment, which Thomas brings are of great benefit to the Board.

It continues to be the belief of the other Board members that Frank, Sue and Thomas are fully independent in thought and action in terms of their participation in Board and Committee meetings, and they have the full support of the other Board members in the activities they undertake. The Company is aware that the proposed revised Corporate Governance Code reflects a more specific view on the maximum nine-year term and this will be taken into account in respect of the Board's composition. It is, however, difficult with a

smaller Board to find candidates of suitable expertise to provide for effective succession planning and the Board feels that more flexibility in this respect is in the best interests of the shareholders. Following a search in 2017, an additional independent Non-Executive Director, Juliet Thompson, was appointed in December to supplement the skill and experience of the Board and to work towards ensuring successful succession planning for the future.

We can confirm that Frank stood down from the Audit Committee following the 2017 AGM and Dr Thomas Werner was appointed to the Nomination Committee to satisfy the requirement for a majority of independent NEDs on that Committee. In addition, following her appointment to the Board, Juliet was appointed as a member of both the Audit and Remuneration Committees in December 2017.

In accordance with the UK Corporate Governance Code and as advised in last year's report, an externally facilitated evaluation was carried out in 2017 by Independent Audit Limited (IAL), a company which has no other connection with Vectura. This year a review of effectiveness was carried out internally using IAL's online governance assessment service and questionnaires were completed by all Directors. The results were based on self-assessment and, although collated by IAL, were not verified by them.

Board diversity

Juliet Thompson's appointment has taken the Board closer to its diversity targets under the Hampton-Alexander Review. In addition, her appointment supplements the skills and experience of the existing Board. We are continuing to focus on Board composition and succession matters and the Board has retained an external consultancy, which is actively recruiting a further independent Non-Executive Director to join the Board during the course of the 2018. The parameters of the search include Board diversity and expertise in the US marketplace as two major items. This individual will replace Frank Condella, the only Board member currently with this critical in-market US expertise, in due course and following a suitable handover period. On the assumption that this search is successful in finding the appropriate candidate, there will then be a total of ten Board members, three of which will be women. Even prior to Frank stepping down, this will enable us to meet the Hampton-Alexander requirements at Board level.

In terms of the next level of management, our Executive Leadership Team, excluding Executive Directors, totalled seven, of which there were two female members and we therefore met the Hampton-Alexander objective. At the business leadership level, the total number was 41, of which 18 were female. As highlighted in the Hampton-Alexander Review in November 2017, the Group has already achieved the target female representation at Leadership Team level of 41.9%, resulting in the Group being highlighted in the review as being in the top ten best performers.

As a Board, our strategy will be to maintain and improve these levels so that the objectives of the Hampton-Alexander Review continue to be met and maintained by 2019.

Vectura believes in a diverse and gender-balanced workforce and is committed to creating a rewarding and stimulating place to work and one which embraces diversity throughout all levels of the organisation. At this time the Company is not required to report on gender pay but a copy of the Group's policy will be available on the website in future.

Internal control and external audit tender

In relation to the appropriateness of the Company's systems of internal control, the Board, as part of its deliberations, again considered whether there should be a separate internal audit function. The Board considered that, at this time, the financial controls and management oversight provided are appropriate for a company of Vectura's size and complexity. This will continue to be reviewed annually.

As recommended by the Audit Committee last year it was considered appropriate to tender the provision of the external audit as the existing incumbent had been in the post for ten years. This process resulted in KPMG LLP being appointed and this appointment was approved by shareholders at the 2017 Annual General Meeting. A resolution to reappoint KPMG as auditor will be put to the 2018 Annual General Meeting for approval.

The Board spent time considering the Group's strategy going forward, its development pipeline, projects, markets and technological developments. In terms of governance, it also reviewed matters reserved to the Board, Market Abuse Regulation and anti-slavery requirements in order to ensure that the Company is compliant and also that the governance framework is appropriate.

Statement of compliance with the Code

The following sections contain an explanation of how good governance has been embedded into the larger Vectura Group including the Group's reporting disclosures on corporate governance required by the Companies Act 2006, the UK Corporate Governance Code (available on the FRC website, www.frc.org.uk), including how the main principles and supporting principles have been applied, and the UKLA's Disclosure and Transparency Rule 7, including the required statement of compliance.

I am pleased to confirm that the Board considers that it has been in compliance with the Code throughout the period ended 31 December 2017. It further considers that the Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's position and performance, business model and strategy.

Bruno Angelici
Chairman
20 March 2018

Bruno Angelici
Non-Executive Chairman

N R

Appointment to the Board
Bruno Angelici was appointed to the Vectura Board on 1 December 2013 and became Non-Executive Chairman in February 2014. Following the merger with Skyepharma in June 2016, Bruno became Chairman of the enlarged Vectura Group plc.

Experience and expertise
Bruno has an MBA (Kellogg School of Management) and business and law degrees from Reims.

Bruno's career includes senior management roles in pharmaceutical and medical device companies. Bruno 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, the Middle East and Africa, having originally joined as president of ICI Pharmaceuticals France. He was a non-executive director of Novo Nordisk A/S, a global healthcare company and world leader in diabetes care. Prior to this, he was at Baxter, a US-based global supplier of medical devices. He has extensive international business leadership experience, including in the US, and brings a deep understanding to the Company of the medical device and pharmaceutical industries.

Current external appointments
Bruno is a non-executive director of Smiths Group plc, a technology group. He was a member of the global advisory board of Takeda Pharmaceutical Company Ltd, Japan, the largest pharmaceutical company in Asia until the end of 2017, and a member of the supervisory board of Wolters Kluwer NV, a global information services and publishing company.

James Ward-Lilley
Chief Executive Officer

Appointment to the Board
James Ward-Lilley was appointed Chief Executive Officer of Vectura in September 2015 and became CEO of the enlarged Group following the merger with Skyepharma in June 2016.

Experience and expertise
James holds an Institute of Marketing Diploma, a BA (Hons) degree and an MBA.

Prior to joining Vectura, James was a senior executive at AstraZeneca, being vice president respiratory, inflammation & autoimmunity, global product and portfolio strategy (GPPS). In this role James had responsibility for the development of AstraZeneca's respiratory, inflammation and autoimmunity (RIA) strategy which included the acquisitions of Almirall's respiratory business and Pearl Therapeutics. Prior to this, James led the AstraZeneca investor relations team from 2011 to 2012. His extensive international management career at AstraZeneca spanned 28 years across a variety of commercially focused roles. James progressed from sales and marketing roles in the UK through to country head of Belgium and Luxembourg. He then led AstraZeneca's business in China to become the number one pharmaceutical company in that market. James went on to become regional vice president for Central Eastern Europe and the Middle East, where the business enjoyed strong growth.

Current external appointments
James does not currently hold any other directorships.

Andrew Derodra
Chief Financial Officer

Appointment to the Board
Andrew Derodra was appointed Chief Financial Officer (CFO) on 10 June 2016 having previously been appointed CFO of Skyepharma in November 2013.

Experience and expertise
He is a Fellow of the Chartered Institute of Management Accountants and holds a BA (Hons) in mathematics from Oxford University.

Andrew brings to the role over 25 years' experience in senior finance and commercial roles in multinational FTSE 100 companies. Prior to Skyepharma he was with Tate & Lyle, where he was group vice president finance & control from 2011. Previously, at SABMiller, he held a succession of commercial and strategic roles culminating in business transformation director – Europe. He held senior finance roles in several industries and sectors with Diageo, British Airways and Reed Elsevier.

Current external appointments
Andrew does not currently hold any other directorships.

Frank Condella
Non-Executive Vice Chairman

N

Appointment to the Board
Frank Condella was appointed as non-executive chairman of Skyepharma on 1 January 2010, having originally joined that company's board as chief executive officer in March 2006. Following the merger with Vectura, he was appointed to the Board on 10 June 2016 as Non-Executive Vice Chairman.

Experience and expertise
He holds a BS in pharmacy and an MBA from Northeastern University, US.

Frank brings over 30 years' experience in the pharmaceutical industry to the Board. He is a non-executive director of Palladio Biosciences Inc. Previously, he was president and CEO of Juniper Pharmaceuticals, has served as a non-executive director of Fulcrum Pharma Ltd, Prosonix Ltd and Juniper Pharmaceuticals Inc. and was president of European operations at IVAX, chief executive officer of Faulding Pharmaceuticals, vice president of the specialty care products business at Roche and vice president and general manager of the Lederle unit of American Home Products (Pfizer).

Current external appointments
Frank is a non-executive director of Palladio Biosciences Inc. and a former director of Juniper Pharmaceuticals Inc.

Susan Foden
Non-Executive Director

N R

Appointment to the Board
Dr Susan Foden joined the Vectura Board in January 2007.

Experience and expertise
She holds an MA and a DPhil in biochemistry from Oxford University.

Susan brings significant experience in venture capital, UK biotech and healthcare companies to the Board. Prior to undertaking a plural career, 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.

Current external appointments
Susan holds a number of non-executive directorships with both public and private companies in the biotech and healthcare field, including BTG plc, BerGenBio ASA, the Cell and Gene Therapy Catapult, Evgen Pharma plc and Oxford Ancestors Limited.

Per-Olof Andersson
Non-Executive Director

A N

Appointment to the Board
Dr Per-Olof Andersson joined the Vectura Board in April 2015.

Experience and expertise
He holds a degree in medicine from Lund University, Sweden.

Per-Olof is an expert in international research and development within the pharmaceuticals, biopharmaceuticals and speciality pharmaceutical industry and has considerable experience in respiratory therapeutic development. In 2011, Per-Olof retired from Almirall, where he was executive director for R&D and a member of the board of directors. Prior to joining Almirall in 2006, Per-Olof had a distinguished international career at Pharmacia and Pfizer over a period of nearly 20 years. Since 2011, Per-Olof has been an independent consultant advising biotech and pharma companies.

Current external appointments
Per-Olof does not currently hold any other directorships.

Neil Warner
Non-Executive Director

R A

Appointment to the Board
Neil Warner was appointed to the Board of Vectura as a Non-Executive Director in February 2011.

Experience and expertise
Neil holds an economics degree from the University of Leeds and is a Fellow of the Institute of Chartered Accountants.

Neil brings significant financial and leadership experience in multinational listed companies. 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, Neil spent six years at Exel plc (formerly Ocean Group plc and acquired by DHL/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 was formerly 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.

Current external appointments
Neil is senior independent director and audit committee chair of Trifast plc, a global leader in design, technology and manufacturing of industrial fasteners for the automotive and technology sectors. He is also a non-executive director, chair of the audit committee and member of the remuneration committee of Directa Plus plc, which floated on AIM in May 2016. Directa Plus is one of the world's largest producers of graphene-based materials – marketed under its "Graphene Plus" (G+) brand, which can be used by third parties in a wide variety of industrial and commercial applications.

Committee membership:

R Remuneration Committee N Nomination Committee A Audit Committee Committee Chairman

Thomas Werner
Non-Executive Director

R A N

Appointment to the Board
Thomas Werner was appointed to the Board of Skyepharma as a non-executive director in May 2009 and joined the Board of Vectura following the merger in June 2016.

Experience and expertise
He holds a degree in chemistry from the University of Göttingen.

Thomas Werner has over 30 years of experience in the pharmaceutical industry, previously as senior vice president of GlaxoSmithKline, where he was managing director for Germany and also co-ordinated its European oncology business. Prior to that, he was responsible for Glaxo Wellcome Germany and Central Europe, Bristol-Myers Squibb Germany and ConvaTec Germany/Central Europe. He has held various non-executive positions including Riemser Pharma GmbH and New Oncology AG. Beside his business responsibilities he has previously served for many years on the board of trustees of the Paul Ehrlich Foundation and the Robert Koch Foundation and was a director of the American Chamber of Commerce in Germany representing healthcare companies.

Current external appointments
Thomas is chairman of Fertin Pharma, a Danish medicated chewing gum company, and sits on the boards of Basilea Pharmaceutica Ltd. He is chairman of the investment advisory committee of the Seventure (France) Health for Life capital investment fund. He stood down as a director of BSN Medical following the sale of the company in April 2017.

EXECUTIVE LEADERSHIP TEAM

John Murphy
General Counsel and Company Secretary

Appointment
John Murphy joined Skyepharma as general counsel in March 2006 and was appointed as General Counsel and Company Secretary of Vectura in June 2016 following the merger.

Experience and expertise
John is a lawyer with extensive experience in legal and company secretarial roles in listed pharmaceutical and biotechnology companies including Medeva PLC, Celltech Group PLC and Pharmagene PLC. He is chairman of the BIA Intellectual Property Advisory Committee and a member of the EuropaBio Intellectual Property Working Group. He holds a BSc in aeronautical engineering from Bristol University and is a qualified solicitor.

Geraldine Venthoye
Executive Vice President – Pharmaceutical Development

Appointment
Dr Geraldine Venthoye joined Vectura in June 2016 upon completion of the merger with Skyepharma PLC, where she had been executive vice president pharmaceutical development since 2013, having joined Skyepharma as head of inhalation business unit in September 2003.

Experience and expertise
Geraldine is a UK registered pharmacist and holds a doctorate degree in pharmaceutics from the University of London.

Geraldine held senior CMC leadership and scientific roles in Inhale/Nektar Therapeutics, San Carlos, California, US, and, prior to this in the UK, held scientific positions in inhalation drug delivery at Vandsons Research and Norton Healthcare.

Roger Heerman
Executive Vice President – Commercial and Business Development

Appointment
Roger Heerman joined Vectura in 2010 and was appointed to the Executive Leadership Team in 2013.

Experience and expertise
Prior to joining Vectura, Roger gained extensive US and international commercialisation experience in a number of senior roles, including vice president sales and marketing of the US publicly held company Critical Therapeutics, Inc. and vice president, 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 US. At McK Healthcare, Roger 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 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.

Juliet Thompson
Non-Executive Director

R A

Appointment to the Board
Juliet Thompson was appointed to the Vectura Board as a Non-Executive Director in December 2017.

Experience and expertise
Juliet has a BSc in economics and is a chartered accountant.

She has spent over 20 years actively involved in the life sciences sector working as an investment banker and strategic advisor to healthcare companies in Europe. She headed up the European healthcare team at Stifel (formerly Oriel) and prior to this was a founding partner of Code Securities, a healthcare investment banking boutique which was acquired by Nomura, later forming Nomura Code.

Current external appointments
Juliet sits on the boards of Nexstim plc, a Nasdaq-listed Finnish medical technology company, Novacyt S.A., a France-based company whose shares are admitted to trade on AIM, and GI Dynamics, Inc., a US-headquartered, Australian Stock Exchange-listed company. She chairs the audit committee of each of these three companies. Juliet stepped down as non-executive chairman and director of the Board of Premier Veterinary Group plc with effect from 28 February 2018.

Committee membership:

R Remuneration Committee N Nomination Committee A Audit Committee Committee Chairman

Gonzalo De Miquel
Chief Medical Officer and Executive Vice President Development

Appointment
Gonzalo De Miquel joined Vectura in February 2017.

Experience and expertise
Gonzalo has highly relevant medical and product development experience ranging from pharmacovigilance and regulatory through to early and late-stage clinical development and medical affairs. Prior to joining Vectura, Gonzalo was vice president of clinical development at AstraZeneca with responsibility for the overall strategy, organisation, resource assignment and project prioritisation across AstraZeneca's respiratory portfolio.

Gonzalo trained in internal medicine and rheumatology practising for six years in Barcelona before moving into the pharmaceutical industry. Gonzalo has held senior positions including global clinical lead for respiratory autoimmunity at Boehringer, working in early clinical development as well as the late-stage and launch of Spiriva in Spain and with Almirall as Global Director of Clinical Development, successfully leading its aclidinium franchise development through to FDA and EMA approvals in 2012 and previously as its Head of Global Medical Affairs. Gonzalo was appointed a non-executive Director of ALK-Abello with effect from March 2018.

David Lescuyer
Executive Vice President – Oral Business

Appointment
David Lescuyer joined Vectura in June 2016 upon completion of the merger with Skyepharma PLC, where he had been executive vice president – oral business since April 2016.

Experience and expertise
David, a French national, holds a BSc in mechanical engineering and an MBA from HEC Paris.

David joined Skyepharma from Patheon Pharmaceuticals, where he was executive director and general manager, Patheon France, and more recently global VP, operational excellence. Prior to Patheon, David's career included experience with Fareva, Cenexi and Catalent in senior operational and general management roles.

Joanne Hombal
Executive Vice President – Human Resources

Appointment
Joanne Hombal joined Vectura in January 2015.

Experience and expertise
Joanne has a BSc in psychology from the University of Birmingham and a postgraduate diploma in human resource management from the University of Glamorgan and is a Chartered Member of the Institute of Personnel and Development.

Before joining Vectura, Joanne was vice president HR at Invensys Rail, with responsibility for setting and leading the people strategy for Northern Europe. She has also held senior HR roles in the financial services and ICT industries and led a number of organisational development and transformation initiatives.

Anthony Fitzpatrick
Executive Vice President Operations

Appointment
Anthony Fitzpatrick joined Vectura in July 2017.

Experience and expertise
Anthony has a first class BSc in aeronautical engineering from the University of Manchester and an MSc in numerical computation from the University of Manchester Institute of Science and Technology.

Anthony joined Vectura from Baxter, where he had worked since 1999, having been responsible for global supply chain and most recently VP manufacturing and supply chain for EMEA. This role included operations with 24 manufacturing sites, production values worth over $1.5bn, 9,000 employees and capex of over $100m. His Baxter experience includes operating in both a pharma product environment and in product device and pure medical device operations. Prior to working at Baxter he worked in various manufacturing and logistics roles for Ingram Micro (IT technology), Exel Logistics, Coopers and Lybrand and Mobil Oil.

Leadership

The Board and its processes

Board membership

The Board currently comprises two Executive and seven Non-Executive Directors. Juliet Thompson joined the Board as a Non-Executive Director on 1 December 2017.

The Board is supported in its role by the Audit, Nomination and Remuneration Committees, details of which are set out below.

The Directors' roles and membership of the Committees are set out in the preceding pages of the Directors' biographies.

In accordance with the Code, Juliet Thompson will put herself forward for election and all other Directors will put themselves forward for re-election at the Annual General Meeting.

Board balance and independence

The Board considers that the balance achieved between Executive and Non-Executive Directors during the period was appropriate and effective for the business.

The Board considers that all of its Non-Executive Directors are independent in character and judgement, and their knowledge, diversity of experience and business interests continue to enable them to contribute significantly to the work of the Board including developing strategy and challenging the Executive Management appropriately and constructively.

The role of the Board

The Board is collectively responsible for the long-term success of the Company, its governance and internal controls and is accountable for its activities. The Board reviews the operational performance of the Group on a regular basis and also exercises a number of reserved powers. The matters reserved for the Board, which were reviewed and updated in the period to ensure that they are appropriate for the enlarged Company, are available via the Company's website, www.vectura.com.

Board meetings

The Board meets ordinarily between six and eight times a year and ad hoc as required. In the twelve-months to 31 December 2017, in addition to seven scheduled formal Board meetings which were held, there were six ad hoc meetings held by telephone to discuss specific topics.

Attendance at formal pre-scheduled Board and Committee meetings is set out in the table below.

Board and Committee meetings

	Board meetings	Audit Committee meetings	Nomination Committee meetings	Remuneration Committee meetings
Bruno Angelici (Non-Executive Chairman)	7/7	—	5/5	5/5
Frank Condella	7/7	—	5/5	—
Andrew Derodra	7/7	—	—	—
Trevor Phillips (left the Board on 31 May 2017)	3/3	—	—	—
James Ward-Lilley	7/7	—	—	—
Per-Olof Andersson	7/7	5/5	5/5	—
Susan Foden	7/7	—	5/5	5/5
Neil Warner	7/7	5/5	—	5/5
Thomas Werner	7/7	5/5	5/5	5/5
Juliet Thompson	1/1	—	—	—

Attendance above is in relation to members of the Board/Committees. Other Directors and Senior Executives may attend by invitation but their attendance is not recorded in the table.

At each formal meeting the Board considers reports on the key activities of the Group and reports from the Chairs of the Audit, Nomination and Remuneration Committees as appropriate. It also received information on important forthcoming events and received reports on investor relations, legal affairs and environment and health and safety matters. The Board regularly receives papers and presentations from senior management, which gives the Board the opportunity to meet Executives below Board level. In addition, there was a two-day Board meeting to focus on strategic development, looking at the Group's longer-term horizon.

The Non-Executive Directors held meetings without management present after each Board meeting and, in addition, met in early 2018 for a routine meeting led by the Senior Independent Director to review the performance of the Chairman during the year, including the leadership of the Board and ensuring its effectiveness. The Chairman, with assistance from the General Counsel and Company Secretary, is responsible for the governance arrangements including meeting agendas, timely information flows and dialogue between Executive and Non-Executive Directors encouraging an open and supportive culture.

Executive Leadership Team

The Board delegates day-to-day management of the Group to the Chief Executive and his team. The Executive Leadership Team (ELT) supports the Chief Executive and is accountable for delivery of the strategy adopted by the Board. The ELT consisted during the period of the Executive Directors, the General Counsel and Company Secretary, the Executive Vice President – Pharmaceutical Development, the Chief Medical Officer and Executive Vice President – Development, the Executive Vice President – Oral Business, the Executive Vice President – Commercial and Business Development, and Executive Vice President – Operations and the Executive Vice President – Human Resources. Two of the members were women. In July 2017 Anthony Fitzpatrick joined the ELT.

Risk

The Board is responsible for the Group's risk management process. Responsibility for its implementation is delegated to the Chief Executive and ELT members. The Board outlines the general level of risk which is acceptable and has a considered approach

to evaluating risk and reward, promoting a risk-aware culture throughout the business.

The Board has carried out a robust assessment of the principal risks facing the Group and has also conducted an annual review of the effectiveness of the systems of internal control during the period. Risk management and internal control is a continuous process and has been considered by the Board on a regular basis, noting that it currently does not consider that a separate internal audit function is required for the business.

The Board's considerations include identifying and evaluating principal risks and the control strategies developed to mitigate these. The Board promotes the development of a strong control culture within the business and the Audit Committee regularly reviews the financial and operational controls, including in relation to the financial reporting process, reporting to the Board as appropriate.

Further information on the principal risks and the Group's system of risk management is contained in the Strategic report on pages 48 to 54.

Induction and development and information flows

New Directors receive formal induction training, including site visits and meetings with the Company's advisors, brokers, auditor and major shareholders, and ongoing training is encouraged and provided upon request and as appropriate. This training is customised for each Director and varies depending upon their skills, experience and background.

Directors also received regular updates on changes and developments in the business, legislative and regulatory environments. During the period, the Board received updates on the Market Abuse Regulation and its impact on the Company and requirements for Directors; the anti-bribery and anti-slavery policies were reviewed by the Board during the period. Each board pack contains a copy of the Directors' statutory duties. Directors are encouraged to discuss with the Chairman any further training requirements which they feel are needed. This is included in the discussions held during the annual performance evaluation.

Good information flows between the Board and management are essential for effective governance together with senior management to ensure: that the agendas are appropriate for the business and are forward looking as well as providing historical and current results data; that papers are of an appropriate length and content for the Non-Executive Directors in particular to be able to understand and review; and that sufficient time is given for Directors to read and review the papers prior to meetings. To give time for such review, papers are typically sent out, usually electronically, one week before the meeting to give an opportunity to clarify any points before the meeting and to prepare questions and observations of the matter at the meeting.

Board evaluation

In accordance with the Code requirements and following last year's external evaluation carried out in conjunction with Independent Audit Limited (IAL), the Board has this year undertaken a review of effectiveness with the assistance of IAL, using their online governance assessment service to review the role of the Board and its Committees. In addition, Sue Foden, in her capacity as SID, has conducted a review of the Chairman's role by interviewing and discussing his position with the Non-Executive members of the Board.

The Chairman and the Board discussed the results of the review at the March 2018 Board meeting. The resulting summary provided suggestions for improving the effectiveness of the Board and these are being reviewed. These included, for example: providing exposure to a wider range of Senior Executives and management outside Board meetings to create enhanced interaction between the Board and management, a better understanding of how technology drives strategy and improvements to response planning.

The Board as stated will also spend further time on succession planning and diversity of Non-Executive Directors.

The Board looks forward to developing plans and taking action to implement and expand on recommendations made by this review and will further report on developments in the future.

Register of conflicts and time commitments

The Board formally considers any potential conflicts between a Director and the Company. Any situational conflicts must be notified to the Board for authorisation as and when they arise, notwithstanding a Director's general duty to avoid such conflicts. Transactional conflicts must be notified to the Board in person or in writing at the next meeting, where the Board can decide, in the absence of the Director concerned, whether or not to authorise such conflict. If such conflict is approved, depending on the matter, action would be taken; for example, the Director concerned may not receive related Board papers, be present in the Board meeting for any related discussion or participate in any vote on the matters concerned. At no time during the period did any Director hold a material interest in any contract of significance with the Company or any of its subsidiaries, other than service contracts and insurance and indemnification arrangements.

Prior to finalising an appointment, a new Director is required to confirm his existing appointments and discuss the time commitment required to deal appropriately with the affairs of the Group. At each Board meeting, Directors are requested to inform the Board if there are any changes in their commitments or other appointments. Significant changes in a Director's outside commitments are discussed with the Board prior to a Director accepting further appointments.

No transactional conflicts arose in the period and no further actions were required following changes in Board members' commitments.

Policy on other appointments

The Board believes that Directors should be able to accept other appointments where no significant actual or potential conflicts of interest arise and provided that the Director is able to maintain their time commitments to the Company. These other appointments enable Directors to develop further skills and experience from which the Company benefits, provided that such commitments do not impinge on their duties to the Company.

Details of any appointments held by each Director are listed under their biographies on pages 72 to 75. There are no significant actual or potential conflicts of interest arising from any appointments held by Directors. Their commitments were reviewed at each Board meeting. Although no Executive Director held an external non-executive position, this would be considered as part of their future development.

Board Committees

There are three main Committees, all of which operate within written terms of reference. The terms of reference are available on the Company website (www.vectura.com). Details of attendance at Board and Committee meetings in 2017 can be found in the table on page 76.

Remuneration Committee

The following were members of the Committee: Susan Foden (Chair), Bruno Angelici, Neil Warner and Thomas Werner. Juliet Thompson joined the Committee on 20 December 2017. The Chief Executive Officer and Chief Financial Officer may be invited to attend Committee meetings, other than when their own remuneration is discussed. No Director is involved in deciding his own remuneration. The General Counsel and Company Secretary acted as Secretary of the Committee.

The Remuneration Committee's full report appears on pages 84 to 104.

Audit Committee

The following were members of the Audit Committee: Neil Warner (Chair), Per-Olof Andersson and Thomas Werner. Juliet Thompson joined the Committee on 1 December 2017.

The Committee continued to meet the UK Corporate Governance Code's requirements that at least one member should have recent and relevant financial experience and that, as a body, the Committee has sufficient experience relevant to the pharmaceutical business sector. Mr Warner is considered as having recent and relevant financial experience being a chartered accountant and a current and past chairman of other listed company audit committees and has previously been finance director of a listed company.

In order to facilitate good information flows and provide challenge where appropriate, the Committee invited the Chief Executive Officer, the Chief Financial Officer, the General Counsel and Company Secretary, the Group Financial Controller and senior representatives of the external auditor to attend. The Committee held regular discussions with the external auditor independently of Group management. The General Counsel and Company Secretary acted as Secretary to the Committee.

The Audit Committee's report including a review of its activities in the period is on pages 80 to 83.

Nomination Committee

The following were members of the Committee: Bruno Angelici (Chair), Per-Olof Andersson, Frank Condella, Susan Foden and Thomas Werner. The General Counsel and Company Secretary acted as Secretary to the Committee.

Its work and activities are further described in its report on page 79.

Relations with shareholders

Executive Management runs an extensive programme of roadshows and ad hoc meetings with both existing and potential new shareholders. In 2017, meetings were held in London and France as well as calls with potential investors in other countries. Executive Management also presented regularly at investor and industry conferences. Both the Chairman and Senior Independent Director have held meetings with shareholders independently of Executive Directors during the year and are regularly available for such meetings if requested.

The Company holds regular Capital Markets Days with analysts and institutional investors and holds updates post-results. These provide a detailed review of the Group's development pipeline as well as an update of the progress of the Group's key growth drivers and strategy. The Board also receives regular updates from its brokers on the views of shareholders about the Company and its market to ensure that the Non-Executive Directors in particular gain an understanding of the views of major shareholders about the Company.

The Company welcomes dialogue with investors, including retail investors, for which the AGM is an opportunity to meet with the Directors and put questions to the Board.

Going concern and viability assessment

Vectura's business activities, together with the factors likely to affect its future development, performance and position, are provided in the Strategic report. The Strategic report also describes the Group's financial position, cash flows and borrowing facilities, with further information provided in the financial statements. The Directors consider that, having reviewed current performance and forecasts for the Group, they have a reasonable expectation that the Group has adequate resources to continue its operations for the foreseeable future. Accordingly Vectura continues to adopt the going concern basis in preparing the financial statements.

In relation to the Company's viability, the Directors have examined the prospects of the Company and the Group and consider that, in accordance with the Code, a three-year assessment period is appropriate being significantly longer than twelve-months but providing some certainty. In considering the appropriate time period, the Audit Committee and Board took into account the risks facing the Group, its forecasting period and business plans.

Further information and the Company's full Statement of viability and going concern is contained on page 55.

Focused on the positive evaluation of our Board

> The Nomination Committee has continued to work throughout the year on the search for new Non-Executive Directors to supplement the skill and experience of the Board and to ensure that the appropriate succession planning in respect of the longest serving Non-Executive Board Directors was in place.
>
> **Bruno Angelici**

The Nomination Committee during the period consisted of Bruno Angelici (Chair), Per-Olof Andersson, Frank Condella, Susan Foden and Thomas Werner. A copy of the Committee's terms of reference are available on the Company's website.

Review of the period

The Nomination Committee has continued to work throughout the year on the search for new Non-Executive Directors to supplement the skill and experience of the Board and to ensure that the appropriate succession planning in respect of the longest serving Non-Executive Board Directors was in place. The search, which included consideration of diversity, Board composition and succession planning, was carried out with the assistance of external search consultancy Odgers Berndtson, a company which has no other connection with the Group and resulted in the appointment of Juliet Thompson in December 2017, which took the Board closer to the diversity targets under the Hampton-Alexander Review.

A further search is being undertaken in 2018 with external assistance and, if an appropriate candidate can be identified, a further additional female appointment will be made. At that point, the Board representation percentage of at least 33% female membership will have been achieved. It is anticipated that, subject to a suitable handover period, Frank Condella will step down from the Board in due course.

As highlighted in the Hampton-Alexander Review in November 2017, the Group has already achieved the target female representation at the Leadership Team level of 41.9% and the Company was highlighted in the review report to be in the top ten best performers for this measure.

The Committee recommends the election of Juliet Thompson and the re-election of all Directors standing for re-election at the 2018 AGM.

Bruno Angelici
Nomination Committee Chairman
20 March 2018

Carefully monitoring reporting and transition

> The Committee's focus this year has been on ensuring that the Group's half year and annual financial statements for 2017 are fair, balanced and understandable, the impact of new accounting standards as well as the audit tender process and ensuring a successful and smooth transition to KPMG LLP.
>
> **Neil Warner**

Changes to the composition of the Audit Committee are set out in the Corporate governance report.

Main activities of the Committee

During the period, and through to the finalisation of the report and accounts for the year to 31 December 2017, the main activities and principal issues considered by the Audit Committee were as follows:

FRC review of the Vectura's Report and Accounts to 31 December 2016

In October 2017, Vectura received a query from the UK Financial Reporting Council (FRC) concerning the following matters arising from the FRC's review of the December 2016 Report and Accounts (R&A):

1. Presentation of the IFRS loss within the Strategic report and compliance surrounding the usage of non-GAAP alternative performance measures (APMs) with the European Securities and Markets Authority (ESMA) guidelines.
2. Accounting for merger-related transaction costs and cash flows, specifically the recognition of stamp duty payable on the share for share exchange within equity and the presentation of acquisition-related costs as investing activities in the cash flow.

The Committee reviewed all correspondence between Vectura and the FRC.

In respect of item (1), Vectura clarified that as a result of the scale and mid-year timing of the Skyepharma merger and shortened nine-month accounting period in 2016, explaining the performance of the Group through the usual comparison of reported GAAP numbers did not provide sufficient, meaningful information to a user of the accounts. This item has been closed with Vectura committed to (a) providing an explanation of the IFRS loss earlier in the strategic report and (b) continuing to monitor and improve disclosures on APMs against emerging best practice.

In respect of item (2), the FRC agreed with the undertaking to restate the Consolidated cash flow statement for the nine-month period ended 31 December 2016. The adjustments are explained in note 30 to the Consolidated Financial Statements.

Regarding the stamp duty recorded in equity, The FRC agreed not to take further action in view of the fact that the amount is not material.

In their communication with the Group, the FRC also highlighted key themes for 2017/2018 reporting and made specific observations where the Group should consider improvements to its future reporting. The Committee reviewed and agreed with the proposed changes in respect of these themes and observations.

The FRC's enquiries regarding the above matters are now complete.

The FRC's review is limited to the published 2016 Annual Report and Accounts; it does not benefit from a detailed understanding of underlying transactions and provides no assurance that the report and accounts are correct in all material respects.

Review of critical areas of accounting judgement and estimates
The Committee reviewed the following matters of judgement and estimates considered critical to the reported amounts of assets, liabilities, revenues and expenses. These included but were not limited to:

- Critical estimate – intangibles impairment: the Committee reviewed management's assessment of the indicators of impairment for the Group's intangible assets. Where impairment indicators had been identified, the Committee concurred that the key assumptions used to assess their recoverable amounts were appropriate. The impairment of the VR2076 intangible asset resulting from the decision by Mundipharma to cease development was noted as well as the acceleration of amortisation of the VR876 intangible to fully write down the asset following receipt of the launch milestone in April 2017. The Committee also reviewed the sensitivity analyses to the impairment tests and the associated disclosures provided in note 16, noting that the carrying value of the *flutiform*® intangible was particularly sensitive to impairment.
- Critical judgement – revenue recognition: significant judgement can be required to determine the appropriate period in which to recognise milestone revenues. In the current period, the recognition of milestone revenues was not considered contentious and the Committee concurred that revenue recognised in the period is appropriate. The Committee noted that accrued royalty income at the balance sheet date had been adjusted for material differences to partner royalty statements received post 31 December. No matters were brought to the attention of the Committee relating to the completeness of *flutiform*® product supply sales in 2017.
- Critical estimate – useful economic lives of intangible assets: the Committee considered the useful economic lives of the Group's on-market intangible assets and concurred with the assessment of average patent lives in the applicable territories for each intangible. The Committee also reviewed the useful economic lives of the smart nebuliser based technology assets following the recent change in the Group strategy and agreed with the assessments made.
- Critical estimate – measurement of deferred tax liabilities: the Committee noted that the balances are particularly sensitive to any future tax reform noting that as this has not yet been enacted, the current rates are reasonable and consistent.
- Critical judgement – uncertain tax position: the Committee considered external professional advice and management's judgement in respect of uncertainty from utilisation of tax losses claimed in an overseas jurisdiction. The Committee concurred with the position taken in the tax filings to date and the level of the provision held in the Consolidated balance sheet.
- Critical estimate – actuarial assumptions on Swiss pension benefits: the Committee reviewed and agreed with the actuarial assumptions used by management having received advice from a local pension expert.
- Critical estimate – impairment of parent company's investments in subsidiary undertakings: the assets of the parent company include the investments in Germany (from the Activaero acquisition in 2014) and Switzerland and the US (from the Skyepharma merger in 2016). As these investments are not amortised, their carrying values are at risk of impairment. Although no impairment has been identified, the Committee noted that any significant diminution in expected value from these recent investments would result in impairment. In particular, the Committee observed that the carrying value of the investment in Germany is sensitive to the outcome of the VR475 (FAVOLIR®) Phase III study and VR647 (SCIPE) Phase II study scheduled for completion in the second half of 2018.

Review of goodwill for impairment
The key assumptions used to support the carrying value of goodwill for each of the Group's cash generating units (CGUs) was challenged by the Committee noting that headroom had decreased for all cash generating units versus the prior year. The reason for this reduction in headroom for the UK CGU was largely the result of the delay in approval for VR315 US for the single CGU for the UK and Germany and headroom for the Swiss CGU was impacted by the decision by Mundipharma to cease development of VR2076 and lower a forecast contribution from *flutiform*®. The Committee agreed with the conclusion that no impairment was required.

New accounting standards
The Committee reviewed management's assessment of the impact of IFRS 9 – Financial Instruments and approved the recommendation to early adopt the standard for the Group's 2017 financial statements.

The project to assess the impact of IFRS 15 – Revenue from Contracts with Customers on the Group's contractual arrangements with its customers has been substantial and complex. The Committee received regular updates on this project and concurred with the judgements and preliminary conclusions.

In light of the improvement areas highlighted in the FRC Summary of key developments for 2017/2018 annual reports, the Committee considered the disclosures concerning the adoption of IFRS 15, IFRS 9 and IFRS 16 and concluded that sufficient information is provided to users.

Fair, balanced and understandable assessment
The Committee noted the challenge in providing an understandable assessment of performance in 2017 due to the distortions in the comparative 2016 period comprising the merger, the change in accounting reference date plus two material royalty streams ceasing in 2016. This was added to by the matter raised by the FRC above and the need to improve compliance with the ESMA guidelines. Alongside input from the Group's brokers, the Committee agreed with the need to provide proforma information for 2016 as well as other APMs to assist users in understanding 2017 performance.

In addition to the annual reporting being understandable, the Committee considered the annual report to be fair and balanced. The report acknowledges the challenges from the delay in approval of VR315 (US) amongst others as well as the strengths and opportunities of the Group.

Going concern and viability
The Audit Committee reviewed management's assessment of going concern and viability provided in the Risk management and internal control section of this report. Specifically, the Committee considered that the three-year viability period and stress tests applied to assessing viability was appropriate.

Audit tender
As highlighted in the Corporate Governance report, an audit tender process was initiated by the Committee at the start of 2017. The process was mandatory due to the incumbent reaching the ten year limit. This was a significant undertaking for the Committee, supported by management, and concluded with the appointment of KPMG LLP.

A number of firms were approached to tender for the audit including some firms outside the Big Four. The criteria for the firms approached was based upon their experience, pharmaceutical expertise, their ability to perform the audit to a high standard and any pre-existing business relationships that might affect their independence. Six firms were approached and three were shortlisted. Each was given access to Directors and Management, including meetings with the Executive Directors, relevant members of the Executive Leadership and Finance Teams, before presenting to the Audit Committee, Chief Financial Officer and Group Financial Controller. Two firms were recommended by the Committee to the Board for consideration with KPMG LLP proposed as the preferred firm based on the results of the tender. The Board and subsequently shareholders at the May 2017 AGM, approved the appointment of KPMG LLP.

Following their appointment, the Committee has monitored the progress of KPMG against their transition plan and reviewed their proposed audit strategy and approach including their identification of significant risks and their determination of materiality.

Independence and non-audit services performed by the external auditor
For the audit of the twelve-month period, the non-audit services performed by KPMG related to the review of the Group's Interim Financial Report and the provision of liquidation services for a number of dormant entities as part of a project to streamline the Group's corporate structure post the Skyepharma merger. The Committee assessed the threats to KPMG's independence from providing these services and the safeguards applied to mitigate or eliminate these threats.

KPMG's fees for non-audit services equated to 20% of the fees earned in respect of its audit work in 2017. The Committee has considered the level of non-audit service fees and concurred with KPMG that they did not impact independence.

At both the half year and the full year, KPMG confirmed that its independence and objectivity have been maintained.

Committee evaluation
Following last year's evaluation carried out by an external party, Independent Audit Limited (IAL), an internal review of the Board and its Committees has been carried out in 2017 using questionnaires. The results from this exercise demonstrate that the Committee is working well.

Neil Warner
Audit Committee Chairman
20 March 2018

Establishment and terms of reference
Under its terms of reference, the Audit Committee is constituted by at least three independent Non-Executive Directors. Its role and responsibilities are contained in the terms of reference, which are available on the Vectura website, www.vectura.com.

Membership, skills, experience and training
Members of the Committee are determined by the Board, on the recommendation of the Nomination Committee, in consultation with the Audit Committee Chairman. When determining membership, the individual's financial skills and experience and knowledge of the sector are of importance. The individual must bring independent thought and abilities to the role. As such, their previous roles and qualifications will have a bearing on their appointment to the Committee, together with the existing members, so that at least one member has recent and relevant financial experience and that, as a whole, the Committee has sufficient competence in the pharmaceutical sector that the Group operates in. Sufficient information to enable the Committee to discharge its responsibilities is made available from management and the Committee has access to the Company Secretary and to employees more widely if there are any matters for which the Committee requires further information. Committee members are provided with a tailored induction and receive updates on emerging financial and audit-related issues.

Meetings
Meetings are held around the primary financial reporting periods and during the course of the year. Papers are provided typically one week before the meeting to Committee members. The Chairman of the Committee may hold pre-meetings to discuss matters with management and the external auditor as appropriate. Where possible there is sufficient time between the Audit Committee meeting and the Board meeting in order for matters to be considered and any further work carried out. The Committee has authority from the Board to seek independent advice if it wishes.

Relationship with the Board
The Committee Chairman provides a verbal update to the Board following the Committee meetings. Any recommendations or further work required on major issues is reported in order to keep the Board apprised of matters within the Committee's remit. If there is a disagreement between the Committee and the Board, the Committee can report that to shareholders in this Audit Committee report.

Annual Reports and periodic reports
The Committee reviews and reports to the Board on significant financial reporting issues and judgements made in connection with the preparation of the financial statements, Interim Reports preliminary announcements and related formal statements. The Committee considers significant accounting policies and any changes to them and whether the Group has adopted appropriate accounting policies and, where necessary, the Group has made appropriate estimates and judgements.

The Committee reviews the Report and Accounts and the related information presented with the financial statements including the Strategic report and Corporate governance statement relating to the audit and risk management. It advises the Board on whether it considers that the Report and Accounts, taken as a whole, is fair, balanced and understandable and that the non-financial information provided is consistent with the financial statements. The Committee also reviews and recommends to the Board the disclosures in the Report and Accounts relating to internal control, risk management, going concern and viability statements. The Committee would also review, where practicable, information required for other statements where financial information is provided, such as a release of price sensitive information, prior to Board review.

Internal control and risk management systems
Whilst overall responsibility for risk management and internal controls systems resides with the Board, the Committee reviews the Group's principal risks and internal financial controls, including the systems for identifying, assessing, managing and monitoring financial risks. Management retains responsibility for day-to-day oversight of the risk management and internal controls and provides the Committee with reports on the effectiveness of the systems.

Internal audit
Considering the Group's scale, diversity, complexity, risk profile and controls within the Finance function, the Committee and Board do not believe that a separate internal audit function is required at this time. This remains under review and the Committee will report on this again to shareholders in the next Annual Report.

External audit
The Committee has primary responsibility for the appointment, reappointment or removal of the external auditor. This includes determining the fee and scope of the audit and leading the tender process. The Committee reviews and assesses the auditor annually including its effectiveness when proposing to the Board whether shareholders should be requested to reappoint it.

The terms of engagement and fees of the external auditor determined by the Committee are reviewed and agreed prior to the start of the audit process. The scope and fee levels are considered, so that an appropriate, effective audit can be carried out at the fee level proposed. The Committee reviews the plans in place for the annual audit including the work plan and resources including seniority and expertise of the audit team. The effectiveness of the annual audit is assessed by the Committee including the quality of the audit, taking into account, for example, its quality control and the contribution of the auditor in relation to key judgements.

Independence, including non-audit services
The independence and objectivity of the auditor is reviewed by the Committee, taking into consideration relevant laws and standards. Any threats to independence, and appropriateness of safeguards, is considered with the auditor. The level of non-audit fees compared to audit fees is kept under review. The Committee agrees with the Board the Group's policy in relation to the provision of non-audit services by the auditor, taking into account the relevant standard and legal requirements and keeping such policy under review.

The Committee is responsible for approving non-audit services with the objective that the provision of such services does not impair the auditor's independence or objectivity. In doing so it considers various factors relating to whether it is appropriate for the auditor to provide such service, including that the auditor's skills and experience make it the most suitable supplier.

Communication with shareholders
The Committee is keen to provide shareholders with the information required for them to understand the process that the Committee has been through to achieve effective oversight of the financial reporting and internal controls for the Group. It is intended that the Chair of the Committee will attend the AGM in order to meet with and answer questions from shareholders relating to the Committee's activities and matters within the Committee's remit.

Making considered and responsible decisions for the business

> The Remuneration Committee is grateful for the level of shareholder support for the new Remuneration Policy which was put to a binding vote at the last AGM and received 96.56% support.
>
> **Susan Foden**

Dear Shareholder

On behalf of the Board, I am pleased to present Vectura's Remuneration Committee report for the year ended 31 December 2017. The Remuneration Committee is grateful for the level of shareholder support for the new remuneration policy, which was put to a binding vote at the last AGM and received 96.56% support.

2017 represents our first full year since the closing of the all-share merger with Skyepharma and is the first year of operation of the policy approved by shareholders at the 2017 AGM.

During the year, Long Term Incentive Plan ("LTIP") awards of 185% of base salary were granted to the Executive Directors, with vesting subject to achievement of two performance measures, each of which is measured over a three-year period and subject to a two-year holding period following vesting. Half of the award is subject to relative TSR performance against the FTSE 250 Index (excluding financial services and real estate sector companies). The remainder is subject to stretching growth in cumulative adjusted EBITDA target. Given the lack of clarity concerning the timing of regulatory approval of VR315, the Committee postponed the setting of the EBITDA targets and set a deadline in this regard of the final quarter 2017. Accordingly the targets were agreed and set in December 2017. In order to ensure that there was no benefit to participants based on any knowledge of the performance of the business in 2017, up to the point at which the targets were agreed, the targets were set based on the April 2017 management accounts and reviewed by the Board, updated only in respect of the Board's expectations for the approval of VR315. The market was further updated of the regulatory status of VR315 at the start of 2018 and in line with our commitment to publish targets once this had occurred, we now disclose the relevant details in this report, which can be found on page 99.

As announced at last year's AGM, Trevor Phillips stood down from the Board in May. In accordance with the regulations, his termination package is shown on page 101. These arrangements are in line with the remuneration policy.

Outturns for the period under review

As reported in the Financial review set out on pages 56 to 63, the Group has performed strongly in delivering on the synergies resulting from the merger and, given the delay in obtaining approval for VR315, has undertaken a number of initiatives to manage the business more efficiently. This has resulted in strong underlying EBITDA figures for the business excluding VR315. We have also delivered significant milestone achievements, including Fox capacity development and VR475 and VR647 clinical trials progress.

Against this backdrop the Committee considers that the remuneration paid to the Executive Directors, who have worked with determination and commitment in the face of the challenges that the Group has had to address, fairly reflects their performance during the year. The annual bonus payments to Executive Directors for the financial period to 31 December 2017, of between 74% and 81% of base salary, recognise a year of significant performance against a challenging backdrop.

A detailed breakdown of the targets set and the payments awarded under the annual bonus scheme and the LTIP are set out on pages 98 and 99.

LTIP awards granted in 2014 were eligible to vest during the year. Half of the award was subject to relative TSR performance measured against the FTSE SmallCap Index and half was subject to relative TSR performance against selected constituents of the Euro Stoxx Pharmaceuticals and Biotechnology Index over the three years to 30 June 2017. TSR growth over the period did not achieve the median for either element and therefore none of the award vested. The performance period of the first tranche of the 2015 LTIP award ended on 31 December 2017. This tranche, which represents 40% of the award, was subject to three-year relative TSR performance against FTSE 250 companies (excluding financial services and real estate) and selected European pharmaceutical peers. TSR growth over the period did not achieve the median for either element and therefore none of this tranche will vest on the vesting date in September 2018. The second and third tranches are subject to a five-year performance period that will end on 31 December 2019. Vectura's TSR is currently below median against both comparator groups. Further details of LTIP vesting against targets are set out on pages 98 and 99 of our report.

Remuneration for 2018 and beyond

The salaries of the Executive Directors were reviewed early in December 2017 with effect from 1 January 2018. The salaries of James Ward-Lilley and Andrew Derodra were increased in line with the general workforce increase in the UK of 2.7% to £515,811 and £357,211 respectively.

AGM

Our Annual report on remuneration will be subject to an advisory vote at our forthcoming Annual General Meeting. I very much hope that you will join me in supporting the resolution at the AGM.

Yours sincerely

Dr Susan Foden
Chair of the Remuneration Committee
20 March 2018

The following section sets out the remuneration policy which was approved by shareholders in a binding vote at the 2017 AGM held on 25 May 2017. The text has been updated to reflect the passage of time and the fact that the policy has now been approved by shareholders.

This policy report can also be found in full on the Company website (www.vectura.com); it has been prepared in accordance with the provisions of the Companies Act 2006 ("the Act") and the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 ("the Regulations"). It also meets the requirements of the UK Listing Authority's Rules and the Disclosure and Transparency Rules.

Directors' remuneration policy

Vectura's remuneration policy is driven by the Company's strategy and business model and has been designed to reflect the Committee's remuneration philosophy, as summarised below.

Philosophy	Support value creation for shareholders over the longer term and create alignment with shareholders					
	Fixed remuneration			Variable remuneration		
Element	Base salary	Benefits	Pension	Annual bonus	LTIP	Share ownership guidelines and holding periods
How it is influenced by the remuneration philosophy	Broadly mid-market.			Set no higher than mid-market and is the least significant variable element. Has stretching corporate and personal targets that support Vectura's annual goals and its overall strategy. Deferral of a proportion in shares increases alignment with shareholders.	The most significant element of the package. Has stretching targets that are clearly aligned with shareholder value. Performance measured over three years and subsequent holding requirements for a further two years align with the long-term interests of the Company.	Significant personal holdings must be acquired and maintained and vested shares must be retained for a period.

Whilst the Committee does not consult directly with employees regarding its policy for Directors, the Committee has regard to the policy for remuneration of employees across the Group. It does so in a number of respects:

- Employees are rewarded with a remuneration package that includes certain key benefits such as life assurance, permanent health insurance, private medical insurance, access to the pension scheme and participation in Vectura's all-employee share schemes and many employees are eligible to receive a bonus.
- The bonus scheme for Directors and employees is designed to reward corporate and personal performance, and all individuals work towards challenging personal goals related to their roles. When determining the annual salary increases and remuneration packages for the Executive Directors, the Committee considers the general base salary increase for the broader employee population.

The remuneration of Senior Executives below Board level is reviewed by the Committee on an annual basis. The remuneration packages of these Executives are broadly consistent with the policy outlined above, with the overall impact of the role and the individual being considered as well as relevant market comparative data, save that lower bonus percentages and lower long-term incentive opportunities are applicable.

- The following table and accompanying notes set out the main principles of reward for the Executive Directors of the Group as set out in the current remuneration policy.

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 set 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 January. 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 considered in relation to the average pay rises awarded to the wider workforce. Where a higher level of increase is appropriate given the performance and contribution of the incumbent, 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. Any reasonable business-related expenses (including tax thereon) can be reimbursed if determined to be a taxable benefit. Executive Directors are eligible for other benefits which are introduced for the wider workforce on broadly similar terms.	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.

Directors' remuneration policy continued

Executive Directors continued

Purpose and link to strategy	Operation	Maximum opportunity	Performance metrics
Annual performance bonus (awards made from 2017)			
An annual 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. Delivery of a proportion in shares provides alignment with shareholders and facilitates the operation of clawback.	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 Committee. The Committee takes into account overall corporate performance and individual performance when determining the final bonus amount to be awarded. Bonuses are typically paid in March. Bonuses up to 100% of base salary are payable in cash, with any bonus in excess of 100% of base salary normally compulsorily deferred into shares for two years. Participants may also be entitled to receive dividend equivalents on vested shares. Under the rules of the scheme, the Committee can 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 135% of base salary for the CEO and 125% of base salary for the CFO.	Corporate goals typically include revenue generation, development of pipeline progress, partnering successes and control of cash expenditure, although the Committee has the discretion to set other targets. Goals set are specific, measurable and linked to the Group's longer-term strategy. Up to 20% of the maximum is payable at threshold performance against each measure.
Long-Term Incentive Plan (LTIP) (awards made from 2017)			
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 incentivise growth in the longer term and align them with shareholders' interests.	Discretionary annual award of nil or nominal cost options that vest according to performance conditions normally measured over three financial years. Participants may also be entitled to receive dividend equivalents on vested shares. Awards granted from 2017 onwards are subject to an additional two-year post-vesting holding requirement on the net of tax value of shares vesting. Awards will be subject to clawback 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 the Committee deems relevant. Awards are subject to the discretions contained in the relevant plan rules.	Annual awards of up to 185% of salary may be granted.	Awards normally based on key measures linked to achievement of Vectura's strategy such as relative total shareholder return (TSR) and/or financial metrics measured over three years. The Committee retains the discretion to vary the chosen relative TSR peer group or the weighting between the metrics and/or introduce new metrics aligned to the Group's strategy 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. 15% of the maximum award vests at the threshold/median performance level, rising to 100% vesting at maximum/upper quartile. Awards are also 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 performance period. Any exercise of discretion will be fully disclosed to shareholders. The performance conditions for previous long-term incentive awards are described in the Annual report on remuneration.

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 UK employees the opportunity to participate in the Vectura Sharesave (SAYE) scheme and the Vectura Share Incentive Plan (SIP). Where possible, similar plans will operate for overseas employees.	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 strengthen the alignment between the interests of senior management with those of Vectura's shareholders.	In accordance with best practice, Executive Directors are required to retain at least half of any LTIP 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 200% 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 who have a broad range of skills and experience to oversee the implementation of the Company's strategy.	The Chairman and the Non-Executive Directors receive fees paid in cash, with additional fees received for chairing Committees of the Board, for fulfilling the role of Senior Independent Director or for transatlantic travel. Additional fees may also be paid in the event that a Director's normal annual time commitment is significantly exceeded in any year. Fees are normally 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, other than limited travel and hospitality-related benefits, in connection with their roles.	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

For the avoidance of doubt, any commitments entered into by the Company prior to the approval and implementation of the policy outlined above may be honoured, even if they are not consistent with the policy prevailing at the time the commitment is fulfilled.

In operating its policy, the Committee may exercise discretion set out below and in accordance with the relevant sections of the various plan rules:

Performance conditions

The Committee selected the performance conditions outlined in the remuneration policy because they are aligned with 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 Directors' remuneration report.

Directors' remuneration policy continued

Notes to the policy table continued

Performance conditions continued

Relative TSR has been chosen as a performance metric for 50% of the 2017 and 2018 LTIP awards as it is aligned with our shareholders' expectations and it reflects the returns that we generate for our shareholders relative to the returns of the general market. The FTSE 250 Index (excluding financial services and real estate companies) has been chosen as it is a published index, is transparent for shareholders, and provides a robust comparator group of similarly sized companies.

The Committee believes that the introduction of a financial metric for the remaining 50% of the LTIP awards reflects our growth ambitions and the increasing maturity of our business. Over the life of the policy, the choice of financial metric and basis of measurement may be varied to reflect the Company's development and strategic priorities. For awards granted in 2017 and 2018, cumulative adjusted EBITDA has been selected as the financial metric; however, the Committee intends to keep the choice of metric under review for future awards.

The proposed performance conditions for the LTIP awards to be granted in 2018 are outlined on page 104 of the Directors' annual remuneration report.

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 and Deferred Share Bonus 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 Directors and to the shareholders. The Committee also has discretion to set components of remuneration within a range, from time to time. The extent of such discretions is set out in the relevant rules and the maximum opportunity or the performance metrics sections 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);
- reviewing performance against LTI performance metric;
- 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 than the original conditions.

Remuneration scenarios for Executive Directors

The charts below show hypothetical values of the 2018 remuneration package for each Executive Director under three assumed performance scenarios and these scenarios are based upon the remuneration policy set out above. The information presented below uses the level of salary, benefits and pension entitlements for each of the Directors as at 1 January 2018.

Base salaries for 2018: CEO – £515,811 and CFO – £357,211. Benefits of £24,000 and £9,000 respectively, and a pension allowance of 20% of salary have been assumed.

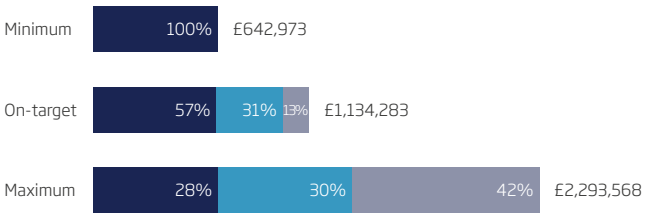
Below target remuneration receivable – this scenario assumes that there is no annual bonus payment and no awards under the LTIP vest.

On-target performance remuneration receivable – this scenario assumes that the Directors receive a bonus payout of 67.5% (CEO) or 62.5% (CFO) of salary and that LTIP awards worth 27.75% of salary at grant would ultimately vest.

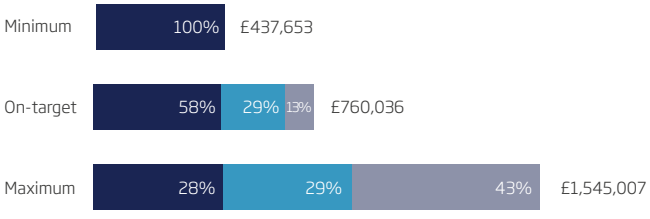
Stretch remuneration receivable – this scenario assumes that the Directors receive a maximum bonus payout of 135%/125% (CEO/CFO) of their salary and that a maximum LTIP award of 185% of salary would ultimately vest.

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.

James Ward-Lilley



Andrew Derodra



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 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 cash award by the Committee in good leaver circumstances;
- the rules of the LTIP and Deferred Share Bonus Plan (DSBP) 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 or 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 normally vest on the original 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 the case of LTIP awards. DSBP awards will normally vest in full at the original vesting date. 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 the case of LTIP awards. In either case, the Remuneration Committee can decide to disapply 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 and may make a contribution towards outplacement costs.

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, 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. 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. Neither of the Executive Directors currently hold any outside directorships.

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 not less than 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. In accordance with the Code, as applicable to a FTSE 250 company, all Non-Executive Directors are subject to annual re-election at each AGM.

The dates of appointment of each of the Directors serving at 31 December 2017 are summarised in the table below.

	Date of contract or date of appointment
Executive Directors	
J Ward-Lilley	24 September 2015
A Derodra	10 June 2016
Non-Executive Directors	
S E Foden	18 January 2007
N W Warner	1 February 2011
B F J Angelici	1 December 2013
P-O Andersson	1 April 2015
F Condella	10 June 2016
T Werner	10 June 2016
J Thompson	1 December 2017

An external independent Board evaluation was performed in January – February 2017 and the Board confirmed that all Non-Executive Directors were regarded as independent, including Susan Foden, who has service greater than nine years, and Frank Condella, who was previously an executive director then non-executive director of Skyepharma. Notwithstanding her length of service Susan is considered by the Board to be independent in both character and judgement and there has been significant Board refreshment during her tenure. Further details of the evaluation are contained in the Corporate governance report on page 70.

Directors' remuneration policy continued

Other remuneration policies continued

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.

In setting base salaries 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 buyout 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 will be in accordance with the remuneration policy for Non-Executive Directors as set out in the policy table. This was the case with the appointment of Juliet Thompson in December 2017.

Consideration of employment conditions elsewhere in the Group

Whilst the Committee does not consult directly with employees regarding the policy, the Committee considers the general base 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 above 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 above, 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 and participation in Vectura's all-employee share schemes and many have eligibility to receive a bonus. The bonus scheme for Directors and employees is designed to reward performance, and all individuals are required to achieve challenging personal goals.

How shareholders' views are taken into account

The Committee takes an active interest in shareholders' views and voting on the Remuneration report. In developing the current policy, the Committee engaged directly with major shareholders and their representative bodies regarding the changes to salaries awarded following completion of the merger and also to the policy going forward.

This has informed a number of the key revisions to the proposed policy:

- the scaling back of the proposed salary increases post-merger;
- the introduction of a two-year post-vesting holding period for awards made in 2017 and subsequently under the LTIP;
- the introduction of a financial performance metric for awards made in 2017 and subsequently under the LTIP; and
- bonus deferral into shares under the annual bonus for awards in excess of 100% of salary.

The Committee will continue to engage directly with major shareholders and their representative bodies should any material changes to the policy be proposed.

Annual report on remuneration

Remuneration Committee ("the Committee")

Governance

The Committee consists entirely of independent Non-Executive Directors. The Committee is chaired by Susan Foden and, during the year ended 31 December 2017, its members were Bruno Angelici, Thomas Werner, Neil Warner, and with effect from 20 December 2017, Juliet Thompson.

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. No conflicts of interest have arisen during the period and none of the members of the Committee have 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 Officer.

The Committee's principal function is to support Vectura's strategy by ensuring that those individuals responsible for delivering the strategy are appropriately incentivised and rewarded through the operation of Vectura's remuneration policy. In determining the Group's policy, and in constructing the remuneration arrangements for Executive Directors 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.

The Committee is responsible for and considered during the period:

- setting a remuneration policy that is designed to promote the long-term success of the Company;
- 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 of 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;
- rigorously assessing the appropriateness and subsequent achievement of the performance targets related to any share incentive plans;
- recommending to the Board the fees to be 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.

The Committee is formally constituted and operates on written terms of reference, which are modelled on the Code and are available on Vectura's website, www.vectura.com.

Advice to the Committee

The Committee takes account of information from both internal and independent sources, including New Bridge Street (NBS) (Aon plc's executive remuneration consultancy), which acts as the Committee's principal, and only material, advisor. NBS advises on all aspects of Vectura's remuneration policy and reviews Vectura's remuneration structures against corporate governance best practice.

NBS is a founder member of the Remuneration Consultants Group and complies with its Code of Conduct, which sets out guidelines to ensure that its advice is independent and free of undue influence. The Committee reviews the performance and independence of its advisors on an annual basis. During the period, Vectura incurred fees of £223,596 from NBS.

The Group's Executive Vice President – 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. The CEO and CFO also attend at the Committee's request but are not present in discussions directly regarding their own remuneration.

During 2017, we reviewed our reward strategy below Board level to harmonise our terms and conditions to the fullest extent possible within local legislative parameters. Harmonisation took place in 2017 and the Committee ensured it is aligned to our newly defined values and behaviours to ensure that our reward practices will both reinforce and embed our target culture. No Executive Director or employee is allowed to participate in any discussion directly relating to their own personal conditions of service or remuneration.

Key decisions during the period

The Committee met seven times during the year ended 31 December 2017.

The key decisions made by the Committee during the period are summarised below:

- determination of the leaver arrangements for Trevor Phillips;
- approval of 2018 base salary increases for Executive Directors and other members of the Executive Leadership Team, ensuring that, where appropriate, these are aligned both internally and externally;
- review of achievement against the 2017 corporate goals and approval of the percentage of the bonus pool to be paid out across the Group, and a review of achievement against personal goals for Executive Directors;
- determination of performance against the TSR conditions for awards under the Long-Term Incentive Plan (LTIP), resulting in the approval of zero vesting of the awards granted in 2014;
- approval of the grant of the 2017 LTIP awards and performance conditions;
- review of the Company's gender pay gap data; and
- review of remuneration packages for the appointment of new Senior Executives and, where appropriate, confirming approval.

Audited information

Directors' remuneration – twelve-months ended 31 December 2017

The total remuneration of the individual Directors who served during the period 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 twelve-months to 31 December 2017, being £nil.

	Basic salary[a] £000	Benefits[b] £000	Bonus[c] £000	LTIP[d] £000	Pension entitlements[e] £000	Other[f] £000	SIP/SAYE awards[g] £000	**Total remuneration £000**
Executive Directors								
J Ward-Lilley	502	28	407	—	100	—	4	**1,041**
A Derodra	348	4	257	—	70	—	4	**683**
T M Phillips[1]	127	15	74	—	51	225	—	**492**
Non-Executive Directors								
B F J Angelici	150	—	—	—	—	—	—	**150**
F Condella[2]	75	—	—	—	—	14	—	**89**
S E Foden	60	—	—	—	—	—	—	**60**
N W Warner	58	—	—	—	—	—	—	**58**
P-O Andersson[2]	50	—	—	—	—	10	—	**60**
T Werner	50	—	—	—	—	—	—	**50**
J Thompson[3]	4	—	—	—	—	—	—	**4**
	1,424	47	738	—	221	249	8	**2,687**

1 T M Phillips stepped down from the Board on 25 May 2017. He received payment in lieu of notice of £150,528 in the period and £65,824 by way of compensation and settlement. Prior to stepping down he received annual benefits of approximately £8,750 relating to US medical and dental insurance. T M Phillips also made employee contributions towards this plan. Benefits include a payment of £13,582 for outstanding holiday accrued prior to stepping down from the Board.

2 P-O Andersson and F Condella receive a £2,000 allowance for each Board meeting that requires transatlantic travel and these amounts are shown as "Other" in the table above. P-O Andersson received £22,000 for travel allowance in 2017, of which £2,000 relates to travel in the year ended 31 March 2016, £6,000 to travel in nine-month period ended 31 December 2016 and £4,000 to travel in January 2018.

3 J Thompson joined the Board on 1 December 2017.

Directors' remuneration – nine-months ended 31 December 2016

The total remuneration of the individual Directors who served during the period 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 nine-months to 31 December 2016.

	Basic salary[a] £000	Benefits[b] £000	Bonus[c] £000	LTIP[d] £000	Pension entitlements[e] £000	Other[f] £000	SIP/SAYE awards[g] £000	Total remuneration £000
Executive Directors								
J Ward-Lilley[1]	357	23	355	—	71	600	3	1,409
A Derodra[2]	190	—	189	—	38	—	4	421
T M Phillips[3]	223	12	219	425	45	—	4	928
A J Oakley[4]	56	2	43	—	66	260	—	427
Non-Executive Directors								
B F J Angelici	107	—	—	—	—	—	—	107
J R Brown[5]	23	—	—	—	—	—	—	23
F Condella[6]	44	—	—	—	—	6	—	50
S E Foden	43	—	—	—	—	—	—	43
N W Warner	42	—	—	—	—	—	—	42
P-O Andersson[6]	36	—	—	—	—	6	—	42
T Werner	28	—	—	—	—	—	—	28
	1,149	37	806	425	220	872	11	3,520

1 The value of awards made under LR 9.4.2(2) to J Ward-Lilley vesting on 24 September 2016 and 7 June 2016 are shown in the table under "Other".

2 A Derodra was appointed as Chief Financial Officer upon completion of the merger with Skyepharma on 10 June 2016.

3 T M Phillips received annual benefits of approximately £15,000 relating to US medical and dental insurance. T M Phillips also made employee contributions towards this plan.

4 A J Oakley stepped down as Chief Financial Officer upon completion of the merger with Skyepharma on 10 June 2016. He received payment in lieu of notice of £141,882 in the period and £96,376 by way of compensation and settlement and up to £30,000 towards outplacement fees. A further payment of £141,882 in lieu of notice was made six-months later as he had not materially breached any of the terms of the settlement agreement or commenced employment which is equivalent to his twelve-month notice entitlement.

5 J Brown retired from the Board on 11 July 2016.

6 P-O Andersson and F Condella receive a £2,000 allowance for each Board meeting that requires transatlantic travel and these amounts are shown as "Other" in the table above.

Notes to the remuneration tables

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

(b) This is the taxable value of benefits paid or payable in respect of the financial period. These benefits typically relate to death, disability and medical insurance. T M Phillips also received benefits in relation to US medical and dental insurance and A J Oakley received worldwide medical and dental insurance and was provided with a relocation allowance.

(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 whose performance period ended during the year. Refer to page 99 for details of LTIP awards.

(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 2017 relate to travel allowances for F Condella and P-O Andersson and payments made under agreement with T M Phillips; amounts paid to T M Phillips are described later in this report on page 101.

(g) This relates to matching and free share SIP awards granted during the year and SAYE awards which have vested during the year. The benefit of the SIP awards is calculated as the number of shares awarded multiplied by the share price on the date of the award. The benefit of the SAYE award is calculated as the number of options awarded multiplied by the discount to the market share price on the date the option was awarded.

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

Performance-related pay earned in the year to 31 December 2017

Annual performance bonus

Employees are eligible for an annual discretionary cash bonus, whereby performance objectives are established at the beginning of the financial period by reference to suitably challenging corporate goals. The scheme is offered to many staff below Board level and maximum bonus opportunities range from 10% to 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 were limited to a maximum of 135% of basic salary for the CEO and 125% for the CFO.

The performance objectives against which bonus payments were calculated are set out in the table below. Full disclosure of some objectives has been restricted due to commercial sensitivity; however, full disclosure will be provided as and when the objectives cease to be commercially sensitive. It is anticipated that disclosure will be made in the following year, in line with best practice.

The Committee assessed that a bonus of 74%–81% (2016: 77%–99.5%) of salary was appropriate for the Executive Directors when judged by the achievement of the metrics set out in the tables below.

		Threshold						Maximum	Actual
Revenue	Target	£172.7m	£172.8m	£183.0m	£193.1m	£203.3m	£213.5m	£223.6m	£233.8m	£148.0m
	% of bonus	0%	5%	7.5%	10.0%	12.5%	15.0%	17.5%	20%	0%
Adjusted EBITDA	Target	Adjusted EBITDA £49.0m or synergies >£10m	£49.1m	£52.0m	£54.9m	£57.8m	£60.7m	£63.6m	£66.47m	Adjusted EBITDA £25.8m Synergies of £12m
	% of bonus	0–5%	5%	7.5%	10.0%	12.5%	15.0%	17.5%	20%	4%
Total		0%	10.0%	15.0%	20.0%	25.0%	30.0%	35.0%	40.0%	4%

Given the importance of delivering the synergies announced to the market as part of the merger, threshold for the Adjusted EBITDA performance target required synergies of at least £10m, for which up to 5% of this element could be paid or Adjusted EBITDA of at least £49.1m, for which 5% would be paid. The Committee determined that 4% for this element would be paid for expected Synergies of £12m expected to be delivered by the end of 2018.

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

Performance-related pay earned in the year to 31 December 2017 continued

Annual performance bonus continued

Performance measure	Weighting	Targets	Level of bonus awarded as a % of metric (% of full bonus)	Commentary
Pipeline and technology progression	20%	VR475 and VR647 Phase III and Phase II study progression to key milestones. VR942 Phase I completion, communication and clear Phase II development strategy. Key new generic/partner programme progression. Key supply chain improvements for *flutiform*® and nebulizer manufacturing and industrialisation.	18%	VR475 Phase III recruitment completed ahead of plan. VR647 US P2 study first patient dosed. Positive Phase I study presented at American Thoracic Society meeting. Aligned with UCB on out-licensing of asset for future development. Licensing of VR2081 with Sandoz and in-licensing of advanced tiotropium formulation from Pulmatrix (VR410). VR2076 Triple programme development terminated by Mundipharma Q4. Good *flutiform*® supply chain progress and roadmap for AKITA and FOX nebulizer capacity development in place alongside short-term yield increases achieved.
Execution of valuable new business development	20%	Completion of new deals with NPV in line with corporate strategy.	20%	Target fully met with valuable new deals being completed with Sandoz, Dynavax and Pulmatrix.
Efficient, effective working environment	10%	Implementation of new culture, values and behaviours programme. Integration systems and simplification delivery. Implementation of workspace and site development plans.	10%	Fully implemented across all sites and aligned within all management frameworks, e.g. performance management and leadership development. Systematic delivery including in HR, Finance, Legal, Quality and IT in 2017 and completing as planned in 2018. Significant workspace improvements made in Chippenham and Cambridge. Initial site roadmap reviewed with Board Q4.
Individual objectives	10%	Corporate and functional and team target.	6–8%	
Total	**60%**		**54–56%**	

The personal objectives set in respect of the 2017 bonus plan are set out below:

	Personal objectives	Key aspects of performance against individual objectives	Performance
J Ward-Lilley	Corporate strategy reviewed and endorsed by the Board.	Full market, competition, capabilities and financial outlook review completed with strategy and refocused investment plan endorsed by Board and communicated to market.	Met
	Enhanced investor communication including effective Capital Markets meeting.	Significant improvement in clarity of messaging and focus on increasing US holding of Vectura stock but work still ongoing to simplify and clarify communication. Successful completion of Capital Markets Day with explanation of product opportunity and development plans for VR475 and VR647.	Partially met
	Enhanced efficiency and effectiveness of corporate governance and Board interactions.	Improved preparations for governance and Board interactions reflected in 2017 Board evaluation including updates provided between scheduled activities.	Met
A Derodra	Proactively support delivery of financial targets.	Tight financial control including cash management. Proactive management of VR315 risk mitigation including R&D cost and project prioritisation. Effective finance support for BD licensing, supply chain and capital projects.	Met
	Delivery of integration targets.	Effective tracking of synergy delivery ahead and above plan. Integrated Group finance reporting tools and systems harmonization ongoing as planned for full implementation in 2018. Significant progress made in simplification of Group structure, freeing of trapped cash and ensuring distributable reserves in Vectura Group plc.	Met
	Enhanced investor communication including effective investor relations activities.	Significant effort made to improve breadth and quality of analyst coverage. Ongoing focus on clarifying and simplifying Vectura's investor proposition and key messaging. Successful completion of Capital Markets Day with explanation of product opportunity and development plans for VR475 and VR647.	Partially met
	Corporate strategy fully reviewed and endorsed by the Board.	Fully supported review of market, competition, capabilities and financial outlook with strategy and refocused investment plan endorsed by Board and communicated to market.	Met
T M Phillips	Delivery of integration targets.	Leadership of integration programme office. Synergy targets on track to be delivered earlier and above goal.	Met
	Full implementation of post-merger organisation structure and systems for operations teams.	New team structures delivering synergies, enhancing accountability, and effective cross-functional working developed. Full systems integration delivery ongoing.	Partially met
	Effective supply chain delivery for *flutiform*® and existing nebulised devices.	Sustained delivery and maintenance of supply chain for *flutiform*® and delivery of commercial Breelib stocks and Ablynx Phase II supplies.	Met
	Enhanced leverage of *flutiform*® supply chain with third parties.	Improved contracting reflecting Vectura investment in productivity improvements ongoing.	Partially met

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

Performance-related pay earned in the year to 31 December 2017 continued

Annual performance bonus continued

The resulting annual bonus awards were as follows:

	Actual % of maximum	Maximum opportunity % salary	Actual % of salary	Total awarded '000
J Ward-Lilley	60%	135%	81.00%	£406,823
A Derodra	59%	125%	73.75%	£256,517
T M Phillips*	58%	100%	58.00%	£73,677

* Bonus award pro-rated for the period worked from 1 January 2017 to 31 May 2017.

Under the policy approved in 2017, any bonus up to 100% of salary is payable in cash, with the remainder deferred into shares for two years. As a result of the above outcomes, bonuses are paid entirely in cash.

LTIP scheme

Scheme interests vested during the period

On 1 July 2014, an award of LTIP options was made to the Executive Directors who were in office at this time. As disclosed in the 2016 report, James Ward-Lilley also has an award subject to the same conditions granted as part of his buyout arrangements.

Vesting of these awards was calculated in the period by our consultants, New Bridge Street, as follows:

Measure	Performance target		Actual performance
TSR against constituents of the FTSE SmallCap Index (50% of award)	The vesting outcome for each comparator group is calculated as follows:		Vectura's TSR of -3.0% was below the constituents of the FTSE SmallCap Index over the measurement period. Consequently, none of this element of the awards was eligible to vest.
	Level of comparative performance during the performance period	Percentage of LTIP award released	
	Below median	—	
TSR against Euro Stoxx comparator group (50% of award)[2]	At or above median	25[1]	Vectura's TSR of -3.0% was below the median of the peer group over the measurement period. Consequently, none of this element of the awards was eligible to vest.
	Upper quartile	100[1]	

1 Linear vesting between points.

2 The full European pharmaceutical comparator group used for these awards is Ablynx, Active Biotech, ALK-Abelló, BB Biotech, BTG, Faes Farma, Galapagos, Genmab, Hikma, Ipsen, Medivir, Pharma Mar, Recordati, Stada Arzneimittel, Swedish Orphan Biovitrum, ThromboGenics, Tubize and Virbac.

On 24 September 2015, an award of LTIP options was made to the Executive Directors who were in office at this time. The awards are subject to relative TSR, measured over three tranches over three or five years against two comparator groups (each representing 50% of the total award). 40% of the award vests on 24 September 2018 (with performance measured up to 31 December 2017) and the remaining 60% of the award (40% for the standard five-year award and 20% for the "kicker" award) vests on 24 September 2020.

Vesting of the first tranche of these awards was calculated in the period by New Bridge Street, as follows:

Measure	Performance target		Actual performance
TSR against constituents of the FTSE 250 companies (excluding real estate and financial services) (50% of award)	The vesting outcome for each comparator group is calculated as follows:		Vectura's TSR of -31.6% was below the constituents of the FTSE 250 companies (excluding real estate and financial services) over the measurement period. Consequently, none of this element of the awards was eligible to vest.
	Level of comparative performance during the performance period	Percentage of LTIP award released	
	Below median	—	
TSR against selected European pharmaceutical companies (50% of award)[2]	At or above median	15[1]	Vectura's TSR of -31.6% was below the median of the peer group over the measurement period. Consequently, none of this element of the awards were eligible to vest.
	Upper quartile	100[1]	

1 Linear vesting between points.

2 The full European pharmaceutical comparator group used for these awards is AB Science, Ablynx, Actelion, ALK-Abelló, Almirall, Basilea, Bavarian Nordic, Biotest, Boiron, BTG, Celyad, CHR Hansen, Circassia, Consort Medical, Cosmo, Dechra, Evotec, Faes Farma, Galapagos, Genfit, Genmab, Genus, Grifols, Guerbet, Hikma, Innate Pharma, Ipsen, KRKA, Lonza, Lundbeck, Meda, Medivir, Merck KGaA, MorphoSys, Novozymes, Orion, Pharma Mar, Qiagen, Recordati, Richter Gedeon, ROVI, Shire, Siegfried, SOBI, Sopharma, Stada Arzneimittel, Stallergenes, ThromboGenics, Transgene, UCB, Valneva, Vétoquinol, Virbac and Zealand Pharma.

As a result, the LTIP options awarded to current Executive Directors have lapsed as follows:

Director	Type of award	Vesting date	Number of options awarded	Percentage of award vested	Exercise price p	Value of LTIP awards vesting £
J Ward-Lilley	Buyout of AZ 2014 LTIP	1 July 2017	273,635	0%	nil	—
J Ward-Lilley	2015 LTIP – tranche one	24 September 2018	252,100	0%	nil	—
Total			**525,735**			—

In accordance with the rules of Vectura's LTIP scheme, the Committee determined that Chris Blackwell, who retired as CEO on 30 June 2015, Andrew Oakley, who retired as CFO on 10 June 2016, and Trevor Phillips, who stepped down from the Board on 25 May 2017, should be treated as good leavers. During the period 300,751 awards made to Chris Blackwell, 165,413 awards made to Andrew Oakley and 206,766 awards made to Trevor Phillips were due to vest in respect of their 2014 awards. Vesting of awards was subject to pro-rating to their dates of departure. However, as a result of the outcome of the performance conditions, all awards lapsed. In respect of their 2015 awards, 157,913 awards made to both Trevor Phillips and Andrew Oakley respectively will lapse on 24 September 2018, based on the outcome of the above performance conditions.

Scheme interests awarded during the period (audited)

Long-Term Incentive Plan (LTIP)

The following awards of nominal cost options were granted to the Executive Directors under the 2015 LTIP scheme on 25 May 2017:

Director	Date of grant	Number of options awarded	Value of award	Share price used to determine level of award[2] p	Face value £	Exercise price p	% that vests at threshold	End of performance period[1]
J Ward-Lilley	25 May 2017	776,242	185%	119.7	929,162	0.025	15%	31 December 2019
A Derodra	25 May 2017	537,566	185%	119.7	643,467	0.025	15%	31 December 2019
Total		**1,313,808**			**1,572,629**			

1 Details of the relevant performance conditions are set out overleaf.

2 The share price used for awards made on 25 May was the closing mid-market price on the date prior to the award.

Long-Term Incentive Plan (LTIP) (audited)

The awards granted under the 2015 LTIP scheme on 25 May 2017 are subject to relative TSR and cumulative growth in adjusted EBITDA, measured over three years (each representing 50% of the total award), as set out in the following table:

Proportion of total award	Performance period	Measure	Performance required for vesting
50%	Three years	Relative TSR against FTSE 250 companies (excluding real estate and financial services)	Median (15%) to upper quartile (100%)
50%	Three years	Cumulative adjusted growth in adjusted EBITDA	Threshold (15%): £86.7m Maximum (100%): £120.6m

Given the lack of clarity concerning the timing of regulatory approval of VR315, the Committee postponed the setting of the EBITDA targets and set a deadline in this regard of the final quarter 2017. Accordingly the targets were agreed and set in December 2017. The market was further updated of the regulatory status of VR315 at the start of 2018 and in line with our commitment to publish targets once this had occurred, we now disclose the relevant details in this report.

As a business with a significant annual investment in research and development the Committee is highly conscious of the need to ensure that the performance against the EBITDA targets is consistent with a disciplined approach to research and development expenditure. The targets have therefore been set on the basis of planned levels of research and development spend. In order to ensure that participants are not inappropriately rewarded for changes in research and development expenditure, the Committee will have discretion to take account of changes in planned levels of research and development spend when determining performance against the performance conditions. Any such adjustments will be fully disclosed to shareholders at the point of vesting,

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

Irrespective of the extent to which the conditions have been met, the Committee may decrease the percentage vesting based on a range of factors, including the Group's 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 Remuneration report for the relevant year.

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

The Committee has the power to claw back and/or apply a malus mechanism in respect of 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.

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

Scheme interests awarded during the period (audited) continued

SIP – free share awards

An award of free shares was made to all employees on 28 December 2017 under Vectura's Share Incentive Plan (SIP). The awards are subject to a three-year holding period and no performance conditions are attached, except for continued employment. The awards made to Directors who held office on 28 December 2017 are shown in the table below:

Director	Number of shares awarded	Closing share price on day before grant p	Face value £	% that vests at threshold	Vesting date
J Ward-Lilley	3,157	114	3,598	100	29 December 2020
A Derodra	3,157	114	3,598	100	29 December 2020
Total	**6,314**		**7,196**		

Sharesave

Vectura Group plc also operates a Sharesave (SAYE) Share Option Scheme for employees and Executive Directors. Under this scheme all eligible employees and Executive Directors are invited to subscribe for options, which may be granted at a discount of up to 20% of market value and which vest after three or five years. The SAYE is an HMRC-approved all-employee plan to which performance conditions do not apply. No Sharesave options vested for Executive Directors during the year.

Total pension entitlements

As stated in the notes to the single figure remuneration 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.

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

As a direct link between Executive remuneration and the interests of shareholders, the Committee has 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 200% of their annual base salary. In assessing compliance with this requirement, the value of the shareholding shown below is assessed using the share price on 29 December 2017, being 118p. The value as a percentage of salary has been calculated using the base salary as at 29 December 2017, 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 200% of their base salary.

	Shares owned		LTIP awards subject to performance conditions*				
			Unvested				Vested
	31 December 2017 ordinary shares of 0.025p each	Value of owned shares as a % of salary	2015 award[1]	2016 award[1]	Awards granted under LR 9.4.2(2)[3]	2017 award[2]	Awards granted under LR 9.4.2(2) and LTIP schemes
Executive Directors							
J Ward-Lilley	**461,860**	109	378,152	780,838	—	776,242	—
A Derodra	**415,146**	141	—	532,147	—	537,566	—
T M Phillips*	**484,917**	186	236,869	489,108	—	—	—
Non-Executive Directors							
B F J Angelici	**162,903**	—	—	—	—	—	—
F Condella	**169,946**	—	—	—	—	—	—
S E Foden	**17,500**	—	—	—	—	—	—
P-O Andersson	**—**	—	—	—	—	—	—
N W Warner	**30,477**	—	—	—	—	—	—
T Werner	**124,341**	—	—	—	—	—	—
J Thompson	**—**	—	—	—	—	—	—

* As at date of stepping down from the Board, being 25 May 2017.

	Received in cash £000
Executive Directors	
J Ward-Lilley	100
A Derodra	70
T M Phillips[1]	17
Total	**187**

1 Trevor Phillips stood down from the Board on 25 May 2017.

Payments made for loss of office and payments to past Directors (audited information)

Trevor Phillips stepped down from the Board as Chief Operations Officer and President of US Operations at the AGM last year on 25 May 2017 and left the Company on 31 May 2017. He received normal pay and benefits up to this date and received his bonus in respect of 2016. Under the terms of his settlement agreement, Trevor Phillips received a sum of £216,352, which was comprised of £65,824 in lieu of any statutory or redundancy entitlements and £150,528 (equivalent to approximately six-months' salary) by way of payment in lieu of notice. The Company paid the sum of £8,750 in lieu of healthcare benefits for the balance of the contractual notice period. He received a monthly cash payment in lieu of pension contributions up to 31 December 2017. The Company also agreed to provide £2,500 plus VAT towards reasonable legal fees in connection with the termination of employment.

As disclosed on page 98 he also received a pro-rata bonus payment of £73,677 for the period worked from 1 January 2017 to 31 May 2017 based on the Company and individual performance.

He was treated as a good leaver under the LTIP. Outstanding awards will vest on their normal vesting dates, subject to the satisfaction of any relevant performance conditions, pro-rated based on the period from the date of grant of the awards to 31 May 2017. He was automatically treated as a good leaver under the Share Incentive Plan and, as a result, all free shares, partnership shares and matching shares held by him under the SIP on the date of cessation were released.

The Directors who have held office during the period ended 31 December 2017 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 December 2017 are shown in the following table below.

There was no change in the Directors' interests between 31 December 2017 and 20 March 2018, the date of this report.

	Share option awards not subject to performance conditions					
	Unvested			Vested		
	Unapproved scheme	Approved scheme[4]	Sharesave	Unapproved scheme	Approved scheme	Sharesave
	—	3,157	—	—	—	—
	—	3,157	—	—	—	—
	—	—	—	—	—	—
	—	—	—	—	—	—
	—	—	—	—	—	—
	—	—	—	—	—	—
	—	—	—	—	—	—
	—	—	—	—	—	—
	—	—	—	—	—	—

1 The 2015 and 2016 awards consist of a three-year tranche, a five-year tranche and a five-year "kicker". In accordance with the outcome of the performance conditions for the three-year tranche, 40% of the 2015 LTIP award lapsed. The above unvested awards reflect the remaining five-year tranche and five-year "kicker".

2 In accordance with the outcome of the performance conditions as outlined on page 99, 273,635 of unvested options have lapsed.

3 The 2017 awards are subject to performance conditions measures over three years from 1 January 2017. Vesting of 50% of the awards is dependent on relative TSR performance against FTSE 250 (excluding financial services and real estate sector companies) and the remaining 50% based on cumulative three-year growth in EBITDA.

4 Share Incentive Plan awards granted on 28 December 2016. The awards are subject to a three-year holding period with no performance conditions.

Unaudited information

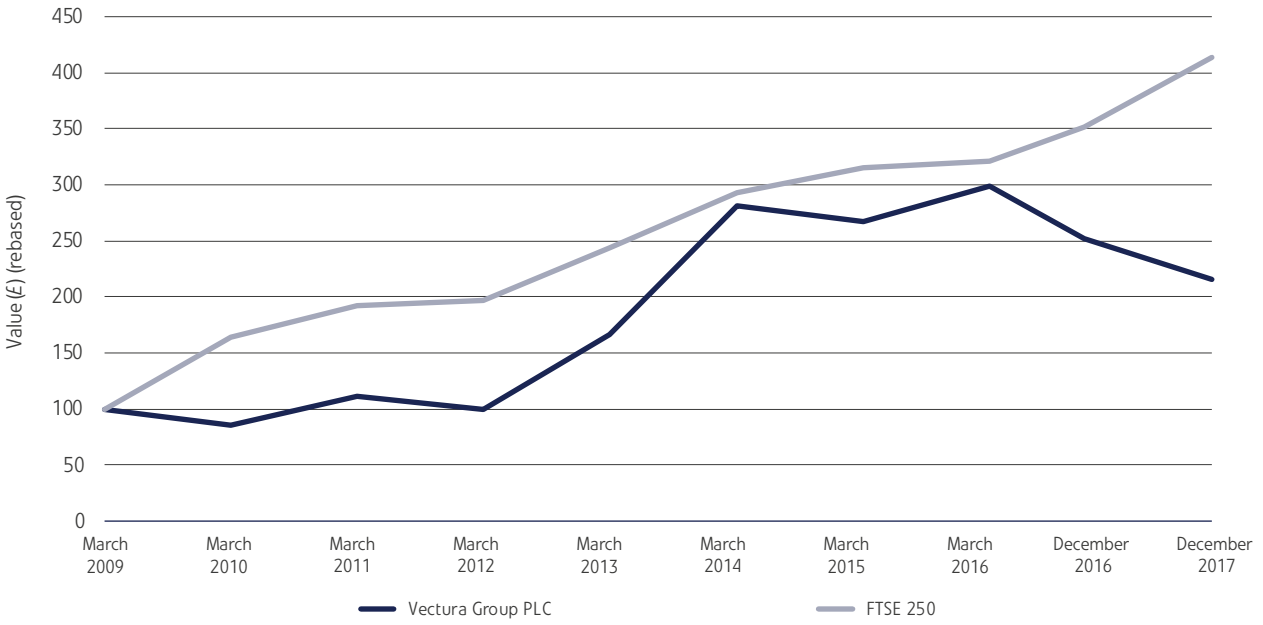
Performance graph and table

The following graph shows Vectura Group plc's cumulative total shareholder return (TSR) over the last nine financial years relative to the FTSE 250 Index. This index was chosen as Vectura is one of the constituent companies and the Committee feels that it is 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: Datastream (Thomson Reuters)



This graph shows the value, by 31 December 2017, of £100 invested in Vectura Group PLC on 31 March 2009, compared with the value of £100 invested in the FTSE 250 Index on the same date.

The other points plotted are the values at intervening financial year ends.

Aligning pay with performance

Chief Executive Officer remuneration compared with annual growth in TSR:

	2009/10 £000	2010/11 £000	2011/12 £000	2012/13 £000	2013/14 £000	2014/15 £000	Chris Blackwell 2015/16 £000	James Ward-Lilley 2015/16 £000	2016[1] £000	**2017 £000**
Chief Executive Officer total remuneration	711	669	971	594	748	1,951	1,110	1,178	1,409	**932**
Actual bonus as a % of the maximum	47	62	53	59	100	80	—	92	99.5	**81**
Actual share award vesting as a % of the maximum[2,3]	83.3	62.9	100	—	—	100	50	100	75	—

1 Nine-month period.

2 No LTIP awards vested during FY 2012/13, FY 2013/14 or FY 2017.

3 Upon appointment, James Ward-Lilley received nil-cost options, certain of which vested immediately and certain vested on the first anniversary of appointment subject to performance conditions. Refer to page 98 for further details.

Percentage change in remuneration of the Chief Executive Officer

Set out below is the change over the prior period in base salary, benefits, pension and annual performance bonus of the Chief Executive Officer and the Group's employees. To aid comparison the percentage change has been calculated using a full year equivalent number for the nine-month 2016 financial period:

James Ward-Lilley

	2017 £000	Chief Executive Officer Percentage change (12 months 2016 vs. FY 2017)	All employees[1] Percentage change
Salary	502	4.5%	2.1%
Benefits	28	(8.7%)	—
Bonus	407	(14.1%)	(34.7%)

1 % figures based on annualised change.

Relative importance of Executive Director remuneration

Total revenue, research and development expenditure and adjusted EBITDA have been selected as comparators for the employee costs as these three financial measures are strong indicators of the activity within the Group and of its performance. To aid comparison with 2017, 2016 twelve-month proforma figures have been used.

	12 months* 2016 £m	FY 2017 £m	Change £m
Total employee remuneration	42.1	42.1	—
Employee headcount as at 31 December	453	478	25
Revenue	183.6	148.0	(35.6)
Research and development expenditure	(65.1)	(60.3)	4.8
Adjusted EBITDA	54.7	25.8	(28.9)
Distributions to shareholders	—	—	—

* Twelve-month proforma figures used, as per the Financial review on page 56.

Statement of shareholder voting at 2017 AGM

At last year's AGM held on 25 May 2017, votes cast by proxy and at the meeting in respect of the Directors' remuneration were as follows:

	For (including discretionary votes)	Against	Total votes cast (excluding votes withheld)	Votes withheld[1]	Total votes cast (including votes withheld)
To approve the Directors' remuneration policy	518,828,772	18,505,659	537,334,431	16,469,480	553,803,911
% of votes cast	96.56%	3.44%			
To approve the Remuneration report	522,296,809	23,001,558	545,298,367	8,505,545	553,803,912
% of votes cast	95.78%	4.22%			

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

Unaudited information continued

Statement of implementation of remuneration policy in the following financial year

Base salaries

	Salary from 1 January 2018 or date of appointment	Increase
J Ward-Lilley	£515,811	2.7%
A Derodra	£357,211	2.7%

Bonus

The annual bonus maximum is 135% of salary for the CEO and 125% of salary for the CFO. Up to 100% of salary is payable in cash, with any excess compulsorily deferred into shares for two years.

Performance measures for Executive Directors will include targets relating to creating strategic growth opportunities, securing existing pipeline value and achieving financial growth, with the following weightings:

- financial goals, revenue and EBITDA: 40%;
- corporate objectives, including strategy, partnering deals, pipeline and organisation development: 50%; and
- personal objectives: 10%.

The performance targets set for the above measures will be disclosed in Vectura's 2018 Annual Report and Accounts in accordance with the policy set out on pages 86 to 89 of this report.

LTIP

Awards granted in 2018 will consist of:

- A grant of performance shares with a face value of 185% of salary.
- Performance will be measured over three financial years, commencing with 2018, based against the two following performance conditions:
  - 50% against relative TSR ranking vs. FTSE 250 Index companies (excluding financial services and real estate sector companies); and
  - 50% against growth in cumulative adjusted EBITDA. Threshold will be set at £120m and stretch (maximum) at £155m, with linear vesting between these points.
- 15% of the total award vesting at threshold/median performance, increasing to 100% vesting at stretch/upper quartile performance.
- Following vesting, a further two-year holding period will apply.
- Recovery and withholding conditions continue to apply.

Non-Executive Directors' fees

Non-Executive Director and Chairman fees will be unchanged from the current fees which were effective from 1 July 2016:

	Fee
Chairman	£150,000
Vice Chairman	£75,000
Committee Chairs/SID[1]	£58,000
Other NEDs	£50,000

1 In the event that an individual holds a Committee chairmanship and holds the position of Senior Independent Director they will receive an additional fee of £2,000 bringing the total maximum fee level to £60,000.

In addition, where a Non-Executive Director is required to undertake transatlantic travel to attend a Board meeting, an allowance of £2,000 is provided per trip.

On behalf of the Board

Dr Susan Foden
Chair of the Remuneration Committee
20 March 2018

The Directors' report comprises pages 105 to 107 of this report, together with the sections of the Annual Report incorporated by reference.

The Directors present their report and the audited financial statements of the Group for the period ended 31 December 2017. The following additional disclosures are made in compliance with the Companies Act 2006, the Disclosure and Transparency Rules and the UK Corporate Governance Code (September 2014).

Description of operations, principal activities and review of business

The strategic report of the business of the Company and its subsidiaries is given on pages 2 to 55. Certain information required for disclosure in this report in accordance with the Listing Rules is provided in other appropriate sections of this Annual Report. These include the:

- Corporate governance report on pages 70 to 78;
- Directors' remuneration report on pages 84 to 107, including Directors' interests in shares;
- Operating reviews on pages 26 to 45 in respect of the Group's activities in the fields of research and development (where the outlook section covers likely future developments in the business of the Company and its subsidiaries);
- Financial review on pages 56 to 63;
- disclosures on the Group's greenhouse gas emissions, Director and employee gender and human rights which are included in the Corporate responsibility report on pages 64 to 69; and
- disclosures on financial instruments and capitalised interest in note 26 "Financial instruments".

These disclosures are, accordingly, incorporated into this report by reference.

Compliance with the UK Corporate Governance Code

The statements of compliance with the principles of the Code as published by the Financial Reporting Council in September 2014 are set out on page 71.

Results and dividends

The Group made a loss after tax for the twelve-months to 31 December 2017 of £85.7m (nine-months to 31 December 2016: loss £32.1m). The Directors do not recommend payment of a dividend.

Political donations

The Company made no political donations during the period. The Group has a policy of not making donations to any EU political party and will continue to adhere to this policy.

Employees

Further information on our employees including the learning, health and safety, communication and equal opportunities, and the employment of disabled persons is contained in our Corporate responsibility report on pages 66 to 67.

Human rights

While Vectura does not have a Human Rights policy, a copy of the Anti-Slavery policy is available on the Company's website, www.vectura.com and sets out the steps we have taken to ensure that slavery and human trafficking is not present in our supply chains or business and the Board has adopted.

Capital structure

In November 2017, the Group announced a share buyback programme to return up to a maximum of £15m of capital to shareholders and entered into an agreement with Numis Securities Limited to enable Numis to purchase shares on the Group's behalf. This authority expires on 11 May 2018 and all shares purchased by the Company have been cancelled.

Details of the share capital, together with details of the movements in the Company's issued share capital during the year, are shown in note 28 "Ordinary share capital".

The Company has two classes of shares. Ordinary shares of 0.025p each are referred to as "Ordinary Shares". These carry no right to fixed income. Each Ordinary Share carries the right to one vote at general meetings of the Company. Ordinary Shares are listed on the London Stock Exchange.

The Company also has redeemable preference shares of £1.00 each. These shares are not listed on any exchange and carry no rights to dividend or other distribution. Holders have the right to receive notice of meetings and to attend, but not to vote at the same.

Pursuant to the general provisions of the Articles of Association and prevailing legislation, there are no specific restrictions on the size of a holding. The Directors are not aware of any restrictions on the transfer of Ordinary Shares in the Company other than certain restrictions which may from time to time be imposed by law and regulations, e.g. insider trading laws, and pursuant to the Listing Rules of the Financial Conduct Authority whereby certain employees of the Company require the prior approval from the Company to deal in the Company's securities.

The Company is not aware of any agreements between shareholders that may result in restrictions on voting rights and the transfer of securities.

Details of employee share schemes are set out in note 29 "Share-based payments". Shares were issued and allotted during the period only in relation to the administration of the Employee Share Plans. Shares held by the employee benefit trusts are not voted by the Trustees of each Trust.

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

Directors

The Directors who served during the period were as follows (in alphabetical order):

Per-Olof Andersson – Independent Non-Executive Director

Bruno Angelici – Chairman

Frank Condella – Non-Executive Vice Chairman

Andrew Derodra – Chief Financial Officer

Susan Foden – Senior Independent Non-Executive Director

Trevor Phillips – Retired with effect from 31 May 2017

Juliet Thompson – Independent Non-Executive Director

James Ward-Lilley – Chief Executive Officer

Neil Warner – Independent Non-Executive Director

Thomas Werner – Independent Non-Executive Director

With regard to the appointment and replacement of Directors, the Company is governed by its Articles, the 2014 UK Corporate Governance Code, the Companies Act 2006 and related legislation.

The Articles themselves may be amended by special resolution of the shareholders. The matters reserved for the Board are available on the Company's website, www.vectura.com.

The Articles provide that Directors may be appointed by an ordinary resolution of the Company's members or by a resolution of the Directors. All the Directors will retire at the 2018 Annual General Meeting and stand for re-election. The Board's recommendations concerning reappointment are contained in the report of the Nomination Committee on page 79. Biographical details of the Directors are available on pages 72 to 75 and in the Notice of Meeting.

The powers of the Directors are determined by applicable legislation and the Company's Articles of Association. As provided in those Articles, the Directors may exercise all the Company's powers provided that the Articles or applicable legislation do not stipulate that any such powers must be exercised by the Company's members. The Directors have been authorised to issue and allot Ordinary Shares, pursuant to the Articles. These powers are referred to shareholders at each Annual General Meeting for renewal.

Directors' interests

Details of Directors' interests in the share capital of the Company, together with details of the share incentives granted to them, are disclosed in the Remuneration report on pages 84 to 104.

As at the date of this report, the Directors of the Company had a beneficial interest in an aggregate of 1,382,169 Ordinary Shares, representing 0.21% of the Company's total voting rights.

Directors' indemnities and Directors' and Officers' liability insurance

The Company did not make any qualifying third-party indemnity provisions for the benefit of its Directors during the period and none are in force at the date of this report. The Company and the Group maintain insurance policies for its Directors and Officers in respect of liabilities which could arise in the discharge of their duties.

Contracts of significance in which a Director is interested

No Director was interested in a contract with the Company during the period except in relation to the terms of their appointment.

Shareholders

Substantial shareholdings

As at 31 December 2017 and 19 March 2018, being the latest practicable date, the Company had received notifications, in accordance with the Disclosure and Transparency Rules (DTR5) over shares and financial instruments, as detailed in the table below:

	As at 31 December 2017		As at latest practicable date	
	Number of Ordinary Shares	Percentage of voting rights and issued share capital	Number of Ordinary Shares	Percentage of voting rights and issued share capital
HBM Healthcare Investments (Cayman) Ltd	67,136,351	9.89	59,499,290	8.96
Invesco Ltd	66,324,278	9.78	66,079,222	9.95
Legal & General plc and subsidiaries	27,306,971	4.02	24,837,311	3.74

Acquisition of the Company's own shares

The Company purchased 1,422,503 of its own shares at an aggregate cost of £1,344,945.00 in the period under review. The nominal value of the shares was £355.63 and represented 0.21% of the issued share capital at that time. The purpose of the Buyback is to reduce the share capital of Vectura and all shares purchased will be immediately cancelled. The employee benefit trusts purchased 1,775,922 shares during the year to meet the awards requirements of the Employee Share Incentive Plan and the delivery of shares arising from exercises of options granted under the Long Term Incentive Plan or Listing Rule 9.4.2(2).

A resolution will be proposed at the 2018 AGM to give the Company authority to acquire Ordinary Shares following expiry of the current authority. The Directors will use this authority only after careful consideration, taking into account market conditions prevailing at the time, other investment opportunities, appropriate gearing levels and the overall position of Vectura. In particular, this authority will be exercised only if the Directors believe that it is in the best interests of shareholders generally and will increase earnings per share.

Acquisitions and disposals

There were no other significant acquisitions or disposals during the period.

Change of control

The Company, and various subsidiaries, are party to a number of agreements which have change of control clauses. If triggered, these could lead to delays in product development programmes and/or product commercialisation. In the event of a takeover bid, there are no specific agreements between the Company and its Directors providing for compensation for loss of office or employment (whether through resignation, purported redundancy or otherwise).

Annual General Meeting
The 2018 Annual General Meeting of the Company will take place at the offices of Clifford Chance, 10 Upper Bank Street, London E14 5JJ, at 10.30 a.m. on Thursday 17 May 2018. Please refer to the Notice of Annual General Meeting for details of the business to be transacted at the meeting.

Post balance sheet events
There were no disclosable post balance sheet events, other than the continuation of the Share buyback programme, as per note 33 of the consolidated financial statements.

Going concern
The Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future and therefore continue to adopt the going concern basis in preparing the financial statements.

Internal control
The Board, through the Audit Committee, has reviewed the assessment of risks and the internal control framework that Vectura operates and has considered the effectiveness of the system of internal control in operation in the Group for the period covered by this report and up to the date of its approval by the Board of Directors.

The UK Corporate Governance Code
The Board considers that the Company applies the principles of the UK Corporate Governance Code of the Financial Reporting Council, as described in the Corporate governance report on pages 70 to 108 and has complied with all relevant principles and provisions of the Code. As required by the Listing Rules of the FCA, the auditor has considered the Directors' statement of compliance in relation to those points of the Code which are specified for their review. The Directors consider that the Annual Report and financial statements, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's and the Group's performance, business model and strategy.

Directors' responsibility statement
In accordance with the FCA's Disclosure and Transparency Rules, the current Directors listed on page 108 confirm, to the best of their knowledge, that:

- the financial statements have been prepared in accordance with IFRS as adopted by the European Union and give a true and fair view of the assets, liabilities, financial position and loss of the Group and the undertakings included in the consolidation taken as a whole; and
- the management report, which is incorporated into the Directors' report, includes a fair review of the development and performance of the business and the position of the Group and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties faced by the Group.

Disclosure of audit information
The Directors confirm that, as at the date of this Annual Report being approved, so far as each Director is aware, there is no relevant audit information of which the Company's independent auditor is unaware and that he/she has taken all the steps that he/she ought to have taken as a Director in order to make himself or herself aware of any relevant audit information and to establish that the Company's independent auditor is aware of that information.

Independent auditor
A resolution to reappoint KPMG LLP as auditor will be proposed at the forthcoming Annual General Meeting. Details will be provided in the Notice of AGM.

Directors' remuneration
The Remuneration report on pages 84 to 104 sets out the remuneration policies operated by the Company and disclosures on Directors' remuneration and other disclosable information relating to Directors and Officers and their interests.

By order of the Board

John Murphy
General Counsel and Company Secretary
20 March 2018

Vectura Group plc
One Prospect West
Chippenham
Wiltshire SN14 6FH
United Kingdom

Registered No: 3418970

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

Company law requires the Directors to prepare Group and parent company financial statements for each financial year. Under that law they are required to prepare the Group financial statements in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU) and applicable law and have elected to prepare the parent company financial statements in accordance with UK accounting standards, including FRS 101 – Reduced Disclosure Framework.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and parent company and of their profit or loss for that period. In preparing each of the Group and parent company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable, relevant, reliable and prudent;
- for the Group financial statements, state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- for the parent company financial statements, state whether applicable UK accounting standards have been followed, subject to any material departures disclosed and explained in the parent company financial statements;
- assess the Group and parent company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Group or the parent company or to cease operations, or have no realistic alternative but to do so.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic Report, Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that complies with that law and those regulations.

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

Responsibility statement of the Directors in respect of the annual financial report

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
- the strategic report includes a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

We consider the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

James Ward-Lilley
Director
20 March 2018

Andrew Derodra
Director
20 March 2018

Financial statements

1. Our opinion is unmodified

We have audited the financial statements of Vectura Group plc (the "Company" or the "Group") for the year ended 31 December 2017 which comprise the Consolidated income statement, Consolidated statement of other comprehensive income, Consolidated balance sheet, Consolidated statement of changes in equity, Consolidated cash flow statement, Company balance sheet, Company statement of changes in equity, and the related notes, including the accounting policies in note 1.

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 December 2017 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 as adopted by the European Union (IFRSs as adopted by the EU);
- the parent Company financial statements have been properly prepared in accordance with UK accounting standards, including FRS 101 Reduced Disclosure Framework; 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.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the audit committee.

We were appointed as auditor by the shareholders on 25 May 2017. We have fulfilled our ethical responsibilities under, and we remain independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to listed public interest entities. No non-audit services prohibited by that standard were provided.

Overview	
Materiality: group financial statements as a whole	£1.45m (1%) of Revenue
Coverage	86% of Revenue
Risks of material misstatement	
Recoverability of inhaled in-market assets, smart nebuliser technology and non-inhaled in-market assets	
Revenue recognition	
Recoverability of parent company's investment in subsidiaries	

2. Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters, in decreasing order of audit significance, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

	The risk	Our response
Recoverability of inhaled in-market assets, smart nebuliser technology and non-inhaled in-market assets (£335 million) *Refer to 81 (Audit Committee Report), 123 (accounting policy) and 136-137 (financial disclosures).*	**Subjective valuation** Recent acquisitions have led to the recognition of intangible assets with a significant value, where the development or commercialisation of the underlying pharmaceutical assets are at the early stages of their useful economic lives. There is a risk that the carrying amount of the inhaled in-market assets, smart nebuliser technology and non-inhaled in-market assets may become impaired if financial performance or other events, such as regulatory approvals, are not in line with initial expectations. The Group's estimated future cash flows for each asset are used to support their recoverability. The cash flow forecasts rely on a number of critical assumptions and estimates including the likelihood of success of early and late stage development programs, the discount rates, the asset's future market share and associated pricing.	Our procedures included: — **Controls design:** assessing the design and implementation of key controls over the preparation of forecasts and the challenge of the assumptions within those forecasts by management; — **Our experience:** challenging the Group's assessment of impairment and impairment indicators depending on the asset concerned using our understanding of the asset's current and future performed gained form performing our audit procedures; — **Test of details:** agreeing significant observable inputs used in the discounted cash flow models to the related contracts and underlying data sets; — **Our sector experience:** assessing whether key assumptions used, in particular those relating to the sales growth, timing and likelihood of development milestone, forecast sale pricing and cash flow risk adjustment percentages, reflect our knowledge of the business and industry, including known or probable changes in the business environment; — **Benchmarking assumptions:** challenging, using our own valuation specialists, the key inputs used in the Group's calculation of the discount rates by comparing them to externally derived data, including available sources for comparable companies; — **Sensitivity analysis:** We performed breakeven analysis on the key assumptions noted above; — **Assessing transparency:** assessing whether the group's disclosures about the impairment test appropriately reflect the risks inherent in the valuation of intangible assets; **Our results** — We found the resulting estimate of the recoverable amount of inhaled in-market assets, smart nebuliser technology and non-inhaled in-market assets to be acceptable.

2. Key audit matters: our assessment of risks of material misstatement (continued)

	The risk	Our response
Revenue recognition Royalty income, signing and milestone payments; product and device sales *Refer to 81 (Audit Committee Report), 124 (accounting policy) and 128-129 (financial disclosures).*	The Group's total revenue includes the following principal revenue streams: royalty income, signing and milestone payments, and product and device sales. **Reliance on third party data:** Royalty income is earned on third party sales and is recognised based on information provided to the Group by its partners. The Group is reliant on the completeness and accuracy of third party royalty reports and has limited visibility over the level of third party product sales made (upon which royalties are earned). There is an inherent material risk over the accuracy of the royalty revenue accrued at the year end. For product and device sales of *flutiform®*, management is reliant on the third-party supplier notifying Vectura of the point at which the transfer of the risks and rewards occurs which is when the goods are "available for collection" by the licensing partner. Given the lack of direct control and limited visibility, particularly at the year end, there is a material inherent risk over the sales recognition at the year end. **Subjective estimate:** Recognition of signing and milestone payments is inherently subjective and management exercises judgement in determining whether the Group has fulfilled all of its performance obligations and the relevant period over which to recognise the associated revenues. Milestones are often individually material and the fulfilment of performance obligations is linked to the completion of a clinical milestone, a regulatory approval or transfer of intellectual property.	Our procedures included: — **Controls design:** assessing the design and implementation of key controls over the accuracy of royalty revenues and product sales notified by third parties. This included assessing the controls over accurately forecasting the third party sales; — **Test of details:** agreeing total royalty income to statements received from partners and to the cash collected during the year to assess the reasonableness of the income accrued at the year end. This included reconciliation of accrued but not billed income at the year end to the post year end royalty reports, cash (where received) and credit notes; — **Assessing forecasts:** assessing the reasonableness of the income accrued at the year end by considering the consistency between forecast royalties and those confirmed by third party royalty statements for the fourth quarter of the year; — **Test of details:** agreeing a statistical sample of December and January product and device sales invoices to supporting evidence, such as third party delivery confirmations, to assess the appropriateness of the period of revenue recognition. We have also considered the level of credit notes issued post year end. — **Test of details:** reviewing the relevant licence contracts supporting each potential material milestone recognised or unrecognised and assessing the assumptions made by the Group against the underlying contractual terms, the data received from market sources and the data received from the counter party. This included assessing the recognition or non-recognition of the milestone by comparing the judgement made to the underlying contractual terms; corroborating the facts and circumstances to underlying supporting documentation and external third party data; — **Assessing transparency:** considering the adequacy of the Group's disclosures in respect of the judgement and estimates around revenue recognition. **Our results** — We found revenue recognition to be acceptable.

2. Key audit matters: our assessment of risks of material misstatement (continued)

	The risk	Our response
Recoverability of parent company's investment in subsidiaries (£710.8 million) *Refer to 81 (Audit Committee Report), 153 (accounting policy) and 153 (financial disclosures).*	**Forecast-based valuation** The carrying amount of the parent company's investment in subsidiaries is significant and at risk of not being recoverable due to the carrying value of certain investment exceeding the net assets value of the subsidiary and/or the subsidiaries being loss-making. There is a risk that the carrying amount of investments may become impaired if forecast financial performance or other events, such as regulatory approvals, are not in line with expectations. The estimated recoverable amount of this balance is subjective due to the inherent uncertainty in forecasting trading conditions and cash flows used in the budgets. The critical assumptions include the likelihood of success of early and late stage development programs, the discount rates, their future market share and associated pricing.	Our procedures included: — **Controls design:** testing the controls over the forecasts prepared for the subsidiary, including annual approval and challenge of those forecasts by the directors; — **Benchmarking assumptions:** challenging the assumptions used in the cash flows included in the budgets based on our knowledge of the Group and the markets in which the subsidiary operate; — **Historical comparisons:** assessing the reasonableness of the budgets by considering the historical accuracy of the previous forecasts; — **Our sector experience:** evaluating the current level of trading, including identifying any indications of a downturn in activity, by examining the post year end management accounts and considering our knowledge of the Group and the market; and — **Assessing transparency:** assessing the adequacy of the parent company's disclosures in respect of the investment in subsidiary. **Our results** — We found the group's assessment of the investment in subsidiaries to be acceptable.

3. Our application of materiality and an overview of the scope of our audit

The materiality for the Group financial statements as a whole was set at £1.45m, determined with reference to a benchmark of Group revenue of £148.0m which it represents 1%. We consider total revenue to be the most appropriate benchmark as it provides a more stable measure year on year than group loss before tax.

Materiality for the parent company financial statements as a whole was set at £1.4m determined with reference to a benchmark of company total assets of which it represents 0.2%.

We reported to the Audit Committee any corrected or uncorrected misstatements exceeding £73k and any other identified misstatements that warranted reporting on qualitative grounds.

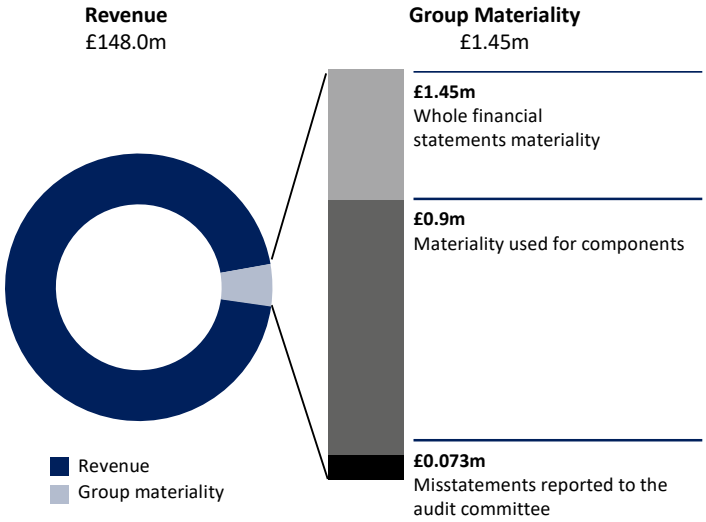
4 of the Group's 7 reporting components were subject to full scope audits for group purposes and a further 2 components were subjected to specified risk-focused audit procedures. The latter were not individually financially significant enough to require a full scope audit for group purposes, but did present specific individual risks that needed to be addressed.

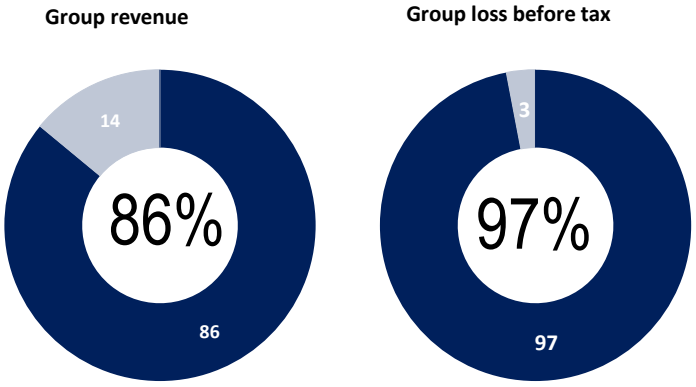
For the remaining 1 component, we performed analysis at an aggregated group level to re-examine our assessment that there were no significant risks of material misstatement within this component.

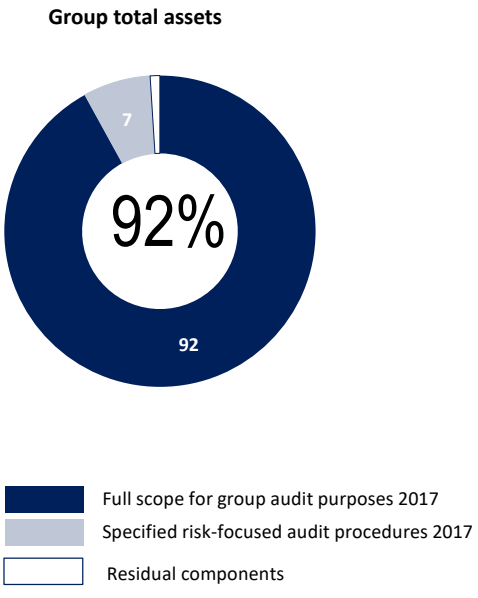
The components within the scope of our work accounted for the percentages illustrated opposite.

The group audit team instructed component auditors as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back. The Group team approved component materiality levels of £0.9m for the component audit teams, having regard to the mix of size and risk profile of the Group across the components. The work on 2 of the 6 components was performed by component auditors and the rest, including the audit of the parent company, was performed by the Group team.

The Group team visited 3 component locations, in the UK and Switzerland to assess the audit risk and strategy. Video and telephone conference meetings were also held with these component auditors. At these visits and meetings, the findings reported to the Group team were discussed in more detail, and any further work required by the Group team was then performed by the component auditor.







4. We have nothing to report on going concern

We are required to report to you if:

— we have anything material to add or draw attention to in relation to the directors' statement on page 107 to the financial statements on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the Group and Company's use of that basis for a period of at least twelve months from the date of approval of the financial statements; or

— the related statement under the Listing Rules set out on page 107 is materially inconsistent with our audit knowledge.

We have nothing to report in these respects.

5. We have nothing to report on the other information in the Annual Report

The directors are responsible for the other information presented in the Annual Report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

Strategic report and directors' report

Based solely on our work on the other information:

— we have not identified material misstatements in the strategic report and the directors' report;

— in our opinion the information given in those reports for the financial year is consistent with the financial statements; and

— in our opinion those reports have been prepared in accordance with the Companies Act 2006.

Directors' remuneration report

In our opinion the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Disclosures of principal risks and longer-term viability

Based on the knowledge we acquired during our financial statements audit, we have nothing material to add or draw attention to in relation to:

— the directors' confirmation within the viability statement (page 55) that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency and liquidity;

— the principal Risks disclosures describing these risks and explaining how they are being managed and mitigated; and

— the directors' explanation in the viability statement of how they have assessed the prospects of the Group, over what period they have done so and why they considered that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Under the Listing Rules we are required to review the viability statement. We have nothing to report in this respect.

Corporate governance disclosures

We are required to report to you if:

— we have identified material inconsistencies between the knowledge we acquired during our financial statements audit and the directors' statement that they consider that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy; or

— the section of the annual report describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee

We are required to report to you if the Corporate Governance Statement does not properly disclose a departure from the eleven provisions of the UK Corporate Governance Code specified by the Listing Rules for our review.

We have nothing to report in these respects.

6. We have nothing to report on the other matters on which we are required to report by exception

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

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

We have nothing to report in these respects.

7. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 108, the directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or other irregularities (see below), or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists.

Misstatements can arise from fraud, other irregularities or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

Irregularities – ability to detect

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our sector experience, through discussion with the directors and other management (as required by auditing standards).

We had regard to laws and regulations in areas that directly affect the financial statements including financial reporting (including related company legislation) and taxation legislation. We considered the extent of compliance with those laws and regulations as part of our procedures on the related annual accounts items.

In addition we considered the impact of laws and regulations in the specific areas of health and safety, anti-bribery, employment law and certain aspects of company legislation recognising the nature of the group's activities. With the exception of any known or possible non-compliance, and as required by auditing standards, our work in respect of these was limited to enquiry of the directors and other management. We considered the effect of any known or possible non-compliance in these areas as part of our procedures on the related annual accounts items.

We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit. This included communication from the group to component audit teams of relevant laws and regulations identified at group level, with a request to report on any indications of potential existence of non-compliance with relevant laws and regulations (irregularities) in these areas, or other areas directly identified by the component team.

As with any audit, there remained a higher risk of non-detection of non-compliance with relevant laws and regulations irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.

8. The purpose of our audit work and to whom we owe our responsibilities

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.

Adrian Wilcox
(Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
Canary Wharf
London
E14 5GL

20 March 2018

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2017

	Note	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
Revenue	3	**148.0**	126.5
Cost of sales		**(57.2)**	(41.9)
Gross profit		**90.8**	84.6
Selling and marketing expenses		**(4.0)**	(2.8)
Research and development expenses	5	**(60.3)**	(45.6)
Corporate and administrative expenses		**(10.2)**	(8.8)
Other income	7	**1.7**	1.5
Operating profit before exceptional items and amortisation		**18.0**	28.9
Amortisation and impairment	8	**(109.7)**	(64.0)
Exceptional items	10	**(4.5)**	(9.4)
Operating loss		**(96.2)**	(44.5)
Share of movement of associates	11	**(3.4)**	0.4
Finance income	12	**0.2**	4.4
Finance expenses	12	**(2.8)**	(0.4)
Loss before taxation		**(102.2)**	(40.1)
Net taxation credit	13	**16.5**	8.0
Loss after taxation		**(85.7)**	(32.1)
Adjusted EBITDA*	8	**25.8**	34.1
Loss per share			
Basic	14	**(12.6p)**	(5.3p)
Diluted	14	**(12.6p)**	(5.3p)

All results are attributable to shareholders of Vectura Group plc and are derived from continuing operations.

* Adjusted EBITDA represents operating profit before exceptional items and amortisation, adding back share-based payments and depreciation. Refer to note 8 "Adjusted EBITDA".

Following the Skyepharma merger on 10 June 2016, the Group changed its accounting reference date to 31 December from 31 March. As a result, the comparative period presented is for the nine-months ended 31 December 2016 and only includes Skyepharma's results since the merger date.

To support a review of trends in performance, certain unaudited proforma information is within the Financial review.

The accompanying notes form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF OTHER COMPREHENSIVE INCOME

For the year ended 31 December 2017

	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
Loss after taxation	**(85.7)**	(32.1)
Items that may be reclassified to the income statement:		
Exchange movements arising on consolidation	**(13.9)**	49.7
Related impact of taxation	**(1.2)**	(0.7)
Items that will not be reclassified to the income statement:		
Actuarial gains on remeasurement of defined benefit pensions	**1.1**	1.3
Related impact of taxation	**(0.2)**	(0.2)
Other comprehensive (loss)/income	**(14.2)**	50.1
Total comprehensive (loss)/income	**(99.9)**	18.0

All results are attributable to shareholders of Vectura Group plc and are derived from continuing operations.

In June 2016, the United Kingdom held a referendum and voted to leave the European Union. Sterling weakened against the functional currencies of the Group's principal overseas operations (based on period end exchange rates) – the US dollar, Swiss franc and euro. As these consolidated financial statements are presented in sterling, a £49.7m exchange gain was recognised on consolidation in the comparative period, and a loss on consolidation in the current year of £13.9m occurred as sterling strengthened against the US dollar and Swiss franc this year, based on the period end exchange rates.

The accompanying notes form an integral part of these consolidated financial statements.

CONSOLIDATED BALANCE SHEET

At 31 December 2017

	Note	31 December 2017 £m	31 December 2016 £m
ASSETS			
Non-current assets			
Goodwill	15	**161.4**	162.8
Intangible assets	16	**335.4**	456.8
Property, plant and equipment	17	**53.1**	54.8
Other non-current assets	18	**7.4**	4.0
Total non-current assets		**557.3**	678.4
Current assets			
Inventories	19	**23.4**	18.4
Trade and other receivables	20	**34.1**	56.6
Cash and cash equivalents	21	**103.7**	92.5
Total current assets		**161.2**	167.5
Total assets		**718.5**	845.9
LIABILITIES			
Current liabilities			
Trade and other payables	22	**(56.5)**	(59.8)
Corporation tax payable	22	**(11.4)**	(8.6)
Provisions	23	**(2.2)**	(1.9)
Total current liabilities		**(70.1)**	(70.3)
Non-current liabilities			
Other non-current payables	22	**(9.6)**	(12.2)
Provisions	23	**(3.2)**	(3.5)
Retirement benefit obligations	24	**(3.6)**	(5.9)
Deferred taxation	25	**(53.5)**	(76.8)
Total non-current liabilities		**(69.9)**	(98.4)
Total liabilities		**(140.0)**	(168.7)
Net assets		**578.5**	677.2
SHAREHOLDERS' EQUITY			
Share capital	28	**0.2**	0.2
Share premium		**102.8**	102.3
Translation reserve		**26.3**	41.4
Other reserves		**557.8**	557.0
Retained losses		**(108.6)**	(23.7)
Total shareholders' equity		**578.5**	677.2

The accompanying notes form an integral part of these consolidated financial statements. These consolidated financial statements and accompanying notes were approved by the Board of Directors on 20 March 2018 and were signed on its behalf by:

J Ward-Lilley
Director

A Derodra
Director

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2017

	Note	Share capital £m	Share premium £m	Merger reserve £m	Own shares reserve £m	Share-based payment reserve £m	Translation reserve £m	Retained losses £m	Total equity £m
At 31 March 2016		0.1	101.6	133.1	—	17.4	(7.6)	(7.4)	237.2
Loss for the nine-month period		—	—	—	—	—	—	(32.1)	(32.1)
Other comprehensive income		—	—	—	—	—	49.0	1.1	50.1
Total comprehensive income/(loss)		—	—	—	—	—	49.0	(31.0)	18.0
Skyepharma scheme of arrangement		0.1	—	424.3	—	—	—	—	424.4
Share transaction costs		—	—	(2.5)	—	—	—	—	(2.5)
Share-based payments	29	—	—	—	—	2.3	—	—	2.3
Exercise of share awards		—	0.7	—	—	—	—	—	0.7
Employee share trust transactions		—	—	(1.0)	(0.7)	—	—	(1.2)	(2.9)
Merger relief		—	—	(2.0)	—	—	—	2.0	—
Transfer between reserves		—	—	—	—	(13.9)	—	13.9	—
At 31 December 2016		0.2	102.3	551.9	(0.7)	5.8	41.4	(23.7)	677.2
Loss for the year		—	—	—	—	—	—	(85.7)	**(85.7)**
Other comprehensive (loss)/income		—	—	—	—	—	(15.1)	0.9	**(14.2)**
Total comprehensive loss for the year		—	—	—	—	—	(15.1)	(84.8)	**(99.9)**
Share-based payments	29	—	—	—	—	3.9	—	—	**3.9**
Exercise of share awards		—	0.5	—	—	—	—	—	**0.5**
Employee share trust transactions		—	—	—	(1.8)	—	—	—	**(1.8)**
Share buyback programme		—	—	—	—	—	—	(1.4)	**(1.4)**
Transfer between reserves		—	—	—	—	(1.3)	—	1.3	**—**
At 31 December 2017		**0.2**	**102.8**	**551.9**	**(2.5)**	**8.4**	**26.3**	**(108.6)**	**578.5**

The accompanying notes form an integral part of these consolidated financial statements.

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2017

	Notes	Year ended 31 December 2017 £m	Restated* 9 months ended 31 December 2016 £m
Cash flows from operating activities			
Operating loss		**(96.2)**	(44.5)
Amortisation and impairment	16	**109.7**	64.0
Depreciation	17	**5.7**	3.4
Share-based payments	29	**3.9**	2.3
(Increase)/decrease in inventories		**(5.9)**	0.8
Decrease/(increase) in trade and other receivables		**17.2**	(13.0)
(Decrease)/increase in trade and other payables		**(6.9)**	3.8*
Foreign exchange movements		**(0.2)**	3.0
Other non-cash items		**(0.4)**	(0.8)
Cash from operating activities before taxation		**26.9**	19.0*
Research and development tax credits received		**2.1**	2.4
Corporation tax paid		**(2.9)**	(2.6)
Net cash inflow from operating activities after taxation		**26.1**	18.8*
Cash flows from investing activities			
Skyepharma merger, net of cash acquired	27	**—**	(25.0)
Purchase of property, plant and equipment		**(9.5)**	(2.6)
Proceeds from sale of property, plant and equipment		**—**	2.9
Funding provided to ESOP trusts		**—**	(1.5)
Net cash outflow from investing activities		**(9.5)**	(26.2)*
Net cash inflow/(outflow) before financing activities		**16.6**	(7.4)
Cash flows from financing activities			
Share buyback programme		**(1.4)**	—
Proceeds from exercise of employee share options		**0.5**	0.3
Merger transaction costs		**—**	(2.5)*
Funding provided to ESOP trusts		**(1.8)**	—
Interest paid and other finance charges		**(0.3)**	(0.2)
Repayment of secured mortgage borrowings		**(0.2)**	(0.2)
Net cash outflow from financing activities		**(3.2)**	(2.6)*
Foreign exchange		**(2.2)**	2.7
Increase/(decrease) in cash and cash equivalents		**11.2**	(7.3)
Cash and cash equivalents at the beginning of the period		**92.5**	99.8
Cash and cash equivalents at the end of the period		**103.7**	92.5

* Following an FRC corporate reporting review of the Group's 2016 Annual Report and Accounts, in accordance with IAS 7 paragraph 16, exceptional merger transaction costs disclosed as cash flows from investing activities in the 2016 financial statements have been restated as cash flows from operating activities and cash flows from financing activities within the 2016 comparative above. This restatement does not impact closing cash or net debt; it solely relates to the classification of these 2016 exceptional cash outflows as financing and operating activities as opposed to investing activities as previously reported. Refer to note 30 "Cash flow information".

The accompanying notes form an integral part of these consolidated financial statements.

1. Presentation of the consolidated financial statements

1.1 General information

Vectura Group plc (the "Company") is a public limited company incorporated and domiciled in the United Kingdom. The Group's operations and principal activities are described in the Strategic report. The "Group" is defined as the Company, its subsidiaries and equity-accounted associates.

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), as adopted by the European Union ("EU-IFRS"). These consolidated financial statements also comply with IFRS as issued by the International Accounting Standards Board.

The financial information has been prepared on the historical cost basis modified to include revaluation to fair value of certain financial instruments and the recognition of net assets acquired including contingent liabilities assumed through business combination assets at their fair value on the acquisition date, modified by the revaluation of certain items, as stated in the accounting policies.

The Group's activities, together with the factors likely to affect its future development, performance and position are set out in the Business Review. The Group has made a loss for the year, however, it continues to be cash generative. A summary of the Group's financial position, cash generated in the year and accounting loss made after non-cash amortisation charges is included within the Financial review. The Group has considerable financial resources together with long-term contracts with a number of customers across different geographic areas and jurisdictions. The Directors believe that the Group is well placed to manage its business risks successfully despite the current uncertain economic outlook. The Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future, and as such they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

The financial statements of the parent company, Vectura Group plc (UK company number 03418970), have been prepared in accordance with FRS 101 – Reduced Disclosure Framework. The Company balance sheet is presented immediately after these consolidated financial statements which comprise the Consolidated income statement, Consolidated statement of other comprehensive income, Consolidated balance sheet, Consolidated statement of changes in equity, Consolidated cash flow statement and accompanying notes to the financial statements.

All financial information is presented in sterling, rounded to the nearest £0.1m. Previously issued financial information and other relevant resources are made available on our website: www.vectura.com.

1.2 Prior period Skyepharma merger and the comparability of financial periods

The results of Skyepharma have been included in the 2016 nine-month comparative numbers from the date of the merger on 10 June 2016 to 31 December 2016. In order to assist users to evaluate underlying trends and like for like performance given the differing comparative periods, the Directors have provided certain unaudited proforma information in the Financial review.

1.3 Alternative performance measures ("APMs")

Adjusted measures, which are used in these financial statements are also used by the Board and management for planning and reporting. These measures are also used in discussions with the investment analyst community. APMs are not displayed with more prominence, emphasis or authority than IFRS measures.

Adjusted EBITDA is defined as operating profit before exceptional items and amortisation, adding back charges for depreciation and share-based payments. Refer to note 8 "Adjusted EBITDA".

Underlying revenues are core ongoing revenue streams relating to licence royalties, product supply revenues and share of net sales of EXPAREL®.

Non-recurring revenues comprise project milestones and services which can vary significantly each period and discontinued end-of-life licence royalties, or royalties currently suspended owing to ongoing patent disputes.

Exceptional items are presented whenever significant expenses are incurred or income is received as a result of events considered to be outside the normal course of business, where the unusual nature and expected infrequency merits separate presentation to assist comparisons with previous periods. Refer to note 10 "Exceptional items". Items which are included within the exceptional category include:

- costs associated with major corporate transactions;
- Board-approved spend on the integration of major corporate transactions; and
- other major transformation programmes.

Furthermore, significant and unusual items of litigation (e.g. GSK litigation) and significant and unusual items which individually distort the underlying performance of the business and therefore warrant highlighting separately to the users of the accounts, e.g. one-off research and development project historical accruals release, are also included within exceptional items.

1.4 Critical accounting areas of judgment and estimation

In preparing these consolidated financial statements, critical judgements in the application of accounting policies can have a significant effect on the financial results; moreover, any changes in critical estimates and assumptions made could materially impact the amounts of assets, liabilities, revenue and expenses reported next year as actual amounts and results could differ from those estimates or those estimates could change in future.

1. Presentation of the consolidated financial statements continued

1.4 Critical accounting areas of judgment and estimation continued

The following critical accounting judgements are made in the application of accounting policies:

Revenue recognition on collaborative development and marketing arrangements spanning multiple periods

The Group enters into a wide variety of collaborative agreements with partners which may span several reporting periods and involve multiple revenue streams. Significant judgement is often required in assessing the obligations under such contracts and the revenue and costs that are applicable to be allocated to each reporting period. For royalty income, judgement is exercised as management are not directly responsible for the sale of the product to the market they prepare an estimate of the level of royalties to be earned and compare this to external sales data reported by partners and royalty statements received. For product supply of *flutiform*®, the Group is reliant on a third-party supplier notifying the point at which the transfer of the risks and rewards occurs which is when the goods are "available for collection" by the licensing partner. The recognition of income from non-recurring milestones requires an assessment of the Group's future obligations under the applicable contract, such as when development or sales targets have been met, to determine the most suitable revenue recognition profile. Further details are included in significant accounting policy 2.3 "Current revenue recognition" (on an IAS 18 Revenue basis).

Uncertain tax positions

A provision for an uncertain tax position is recognised within current tax liabilities relating to recent utilisation of historical losses claimed in an overseas jurisdiction. The provision is recognised on the basis of the Group's interpretation of inherently complex tax legislation. The judgement of whether and how much to provide is formed after taking external professional advice, and is based on Management's judgement of the potential tax that could be assessed as due. The provision is recognised at £5.0m (2016: £0.9m) in Corporation tax payable on the Balance sheet. This provision is partially released to the Consolidated income statement as each annual Statute of Limitation (when the tax authority can enquire into each return) is closed, with the uncertainty expected to be fully resolved by 2021. Refer to note 23 "Provisions".

This provision excludes any potential interest and penalties which could be levied on the Group. The Group have recognised a contingent liability in respect of penalties, which, based on external advice, could range from 0 to 40% of unpaid tax, with a maximum of 20% considered appropriate. This would result in estimated penalties of up to £1.0m, but this payment is not considered probable. Refer to note 31 "Commitments and contingent liabilities".

The following critical estimates if changed next year would materially impact reported performance:

Impairment of intangible assets acquired through the Skyepharma and Activaero business combinations

Intangible assets are reviewed for indications of impairment and, where such indicators exist, a full impairment test is performed to ensure the recoverable amount is higher than the carrying value. Impairment tests are based on internal risk-adjusted future cash flows discounted to present value. Some of the more significant assumptions include the estimated net cash flows for each year for each asset or product, including net revenues, directly attributable costs, and the probability of successful commercialisation, the appropriate discount rate to select to measure the inherent risk in each future cash flow stream, and the assessment of each asset's life cycle.

As these valuations are based on Board-approved budgets they are inherently judgemental. The sensitivity of intangible assets to downside scenarios is presented within note 16 "Intangible assets".

Useful economic lives of intangible assets acquired through the Skyepharma and Activaero business combinations

Intangible assets relating to on-market products are amortised with reference to average patent lives in the most applicable territories. The key estimate is which patent or midpoint of the patents to use, due to the varying strength of the patents and different time periods for different territories. Given the size of the values any point in that range would have a significant impact. Intangible assets relating to smart nebuliser-based technology acquired through the Activaero acquisition and leveraged in various development programmes are amortised in line with the expected consumption of economic benefits. These may change, for example on approval of a product incorporating the technology and in such cases, the useful economic life ("UEL") is reviewed and adjusted accordingly. If the UEL changes the Group's financial statements would be significantly impacted through changes to amortisation and deferred tax.

Actuarial assumptions applied to the Swiss pension benefits in the application of accounting policies

The Group operates a pension scheme in respect of its employees in Switzerland. As some of the risks of the scheme match the criteria under IAS 19 – Employee Benefits for a defined benefit plan, the scheme is accounted for as such. Application of IAS 19 involves estimates about uncertain future events based on independent actuarial valuation reports. The defined benefit obligation is sensitive to the actuarial assumptions outlined in note 24 "Retirement benefit obligations".

Deferred tax liabilities

The measurement of deferred tax liabilities takes account of relevant timing differences and tax legislation in the appropriate jurisdiction. As the rate in Switzerland currently depends on the status of the company, an estimated blended rate is applied for deferred tax valuation which reflects the effective tax rate of the Swiss entities, and there has been no change to the estimate in 2017. The deferred tax liabilities relate to a number of specific items, of which the classes are disclosed in note 25 "Deferred tax liabilities".

It should be noted that, whilst there is no current impact to the deferred tax balances recognised, or the rate applied, the deferred tax liabilities in respect of Switzerland are particularly sensitive to any future Swiss tax reform. As this is likely, future periods result could be materially impacted as a result of adopting the enacted Swiss tax rate from the reform. This disclosure is not a significant estimate in the scope of IAS 1.125, but is provided as an additional disclosure to highlight the potential impact of the Swiss tax reform. Refer to note 13 "Taxation".

2. Significant accounting policies

2.1 Basis of consolidation

These consolidated financial statements comprise the consolidated financial statements of Vectura Group plc, its subsidiaries and equity-accounted associates for the year ended 31 December 2017.

Subsidiaries are all entities over which the Group has direct or indirect control. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power to direct the activities of the entity. Subsidiaries are consolidated from the date on which control is obtained by the Group and are deconsolidated from the date that control ceases. All of the Group's material trading entities are wholly owned subsidiaries, where the Group holds 100% of the share capital.

Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated. Group accounting policies are consistently applied to all entities and transactions.

2.2 Foreign currency translation and transactions

Results of the Group's overseas entities are translated into the UK sterling presentational currency of the Group using monthly average exchange rates. On consolidation, exchange differences arising from the translation of overseas net assets are recognised in the translation reserve and recycled to the Consolidated income statement upon any full disposal.

Goodwill is denominated in the currency of the original cash-generating unit ("CGU") to which it was allocated on acquisition. Fair value adjustments arising on the acquisition of a foreign operation are treated as assets and liabilities denominated in the currency of the overseas operation. Any exchange differences on intercompany funding loans are deferred to equity, to the extent that these are considered permanent in accordance with IAS 21 – Foreign Exchange.

Trading entities have a functional currency consistent with the denomination of cash inflows and outflows, being also consistent with the primary currency of their location. Local market transactions in a different currency to each local functional currency are translated using average exchange rates, provided these are materially similar to the spot rate on the transaction date. These foreign exchange differences are recognised in the same category in the Consolidated income statement as the underlying transaction, except for milestone and royalty revenues, where foreign exchange is presented within net finance (expense)/income.

2.3 Current revenue recognition (under existing IAS 18 – Revenue guidance)

Revenue represents the amount receivable for goods and services provided and royalties earned, net of trade discounts, VAT and other sales-related taxes. Revenues from partnering contracts with multiple revenue streams or conditions are recognised separately in line with the contractual terms and the nature of the revenue streams.

Revenues are recognised when the Group's obligations related to the revenues have been discharged and their collection is reasonably assured as follows:

2.3.1 Royalty income

Royalty income is recognised on an accruals basis and represents income earned as a percentage of partner product sales in accordance with the terms of each agreement, net of amounts payable to other licensees. As management are not directly responsible for the sale of the product to the market they prepare an estimate the level of royalties to be earned and compare this to external sales data reported by partners and royalty statements received.

2.3.2 Share of net sales of EXPAREL®

The Group is entitled to receive a percentage of net sales of EXPAREL® (based on cash received by Pacira) in the USA, Japan, UK, France, Germany, Italy and Spain until the expiry of certain patents. The recognition of these amounts is in line with the royalty income recognition as per 2.3.1.

2.3.3 Signing and milestone payments

Signing and milestone payments represent amounts earned for licences or payments relating to development achievements.

Upfront signing milestones received on entering collaborative development agreements, as per industry practice, are deferred onto the Balance sheet and then subsequently released to revenue over the appropriate stage of completion of the development services provided.

Milestone payments received in advance are treated as deferred until the milestone is achieved. Milestones which are contingent upon achieving a development or sales target are recognised when achieving them is virtually certain and recovery is assured.

2.3.4 Development services

Development services revenues principally comprise of contract product development and contract clinical trial manufacturing fees invoiced to third parties. Revenues are recognised upon the completion of agreed tasks or spread over the duration of the task, as appropriate.

2.3.5 Product supply and device sales

Product supply revenues, being income derived from manufacturing and supply agreements, are generally recognised upon transfer to the customer of significant risks and rewards, usually upon the goods being available for collection and the customer being informed of this and where the sales price is agreed and collectability is reasonably assured.

2. Significant accounting policies continued

2.4 Segmental reporting

The Group is managed on the basis of a single reportable segment, being the development and supply of pharmaceutical products. This is consistent with the internal reporting provided to, and regularly reviewed by, the chief operating decision maker ("CODM"). The CODM is responsible for allocating resources and assessing performance of the operating segment and has been identified as the Board.

2.5 Research and development ("R&D") expenses

R&D expenses comprise internal employee costs and third-party service costs relating to feasibility studies, technical development, costs of chemistry, manufacturing of trial batches, clinical work and the registration and maintenance of intellectual property. As the nature of our R&D projects is associated with obtaining regulatory approval, these costs rarely meet the IAS 38 criteria for capitalisation and are normally charged to the Consolidated income statement as the expenses are incurred.

2.6 Other income

Other income relates to government grants for qualifying UK R&D under the research and development expenditure credit ("RDEC") scheme for large companies. Such grants are taxable and are presented as other income in the Consolidated income statement.

2.7 Current taxation

The net taxation credit on the loss for the year includes current and deferred tax. Current tax comprises the expected tax payable or receivable on the taxable income or loss for the year and any adjustment to the tax payable or receivable in respect of previous years. The amount of current tax payable or receivable is the best estimate of the tax amount expected to be paid or received using tax rates enacted at the reporting date.

2.8 Deferred taxation

Deferred taxation is recognised on all temporary differences arising between the local tax bases of assets and liabilities and their carrying amounts in the Group's consolidated financial statements.

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 is not discounted and is measured at the tax rates that are expected to apply when the related asset is realised or liability is settled, based on legislation enacted or substantively enacted at the balance sheet date.

2.9 Goodwill

On acquisition of a subsidiary or associate, the fair value of the consideration in excess of the identifiable net assets and liabilities is recognised as goodwill. Goodwill is not amortised, but is reviewed for impairment at least annually, or more frequently where there is an indication of possible impairment.

Goodwill is held in the functional currency of the CGU to which it was originally allocated for impairment testing, reflecting the original assessment of which CGUs would benefit from synergies from the combination. Following any significant reorganisation the denomination of goodwill is not changed but could be reallocated to different CGUs, being the lowest identifiable level that goodwill is monitored for the purposes of annual impairment testing.

2.10 Intangible assets

Intangible assets predominantly relate to on-market licences, patents and marketing rights separately acquired as part of the Skyepharma merger on 10 June 2016. The fair values of patents and licences relating to on-market products acquired were aggregated by product and initially measured at fair value. This fair value is subsequently amortised over estimated useful economic lives ("UEL"). Intangible assets relating to on-market products are amortised with reference to average patent lives in the most applicable territories.

Intangible assets also include smart nebuliser-based technology (FAVORITE™) separately acquired through the Activaero transaction on 13 March 2014 and leveraged in development programmes including VR475 (FAVOLIR®) and VR647 (SCIPE®). These assets are amortised in line with the expected consumption of economic benefits.

UEL assumptions do not exceed eight years and amortisation is applied on a straight-line basis.

2.11 Property, plant and equipment ("PP&E")

PP&E is initially recognised at cost, with depreciation subsequently applied evenly over its estimated life, less any residual value. PP&E is depreciated on a straight-line basis over the estimated useful lives, as follows:

- Land and buildings – 20 to 50 years
- Laboratory and supply chain equipment – 3 to 10 years

PP&E for the *flutiform*® supply chain is depreciated using the units-of-production method. No depreciation is provided on freehold land or assets under construction. On disposal of PP&E, the carrying value, less any proceeds, is recognised in the Consolidated income statement.

2. Significant accounting policies continued

2.12 Impairment of non-current assets

Impairment of goodwill is assessed by measuring the future cash flows of the CGU to which the goodwill relates versus the carrying value of the CGU. An impairment loss is recognised for goodwill in the Consolidated income statement when the carrying value of the CGU is less than its future cash flows. Impairments of goodwill are not reversed in subsequent periods.

The carrying values of all other non-current assets are reviewed for impairment, either on a standalone basis or as part of a larger cash-generating unit, when there is an indication that the assets might be impaired.

2.13 Inventories

Inventories are stated at the lower of cost and net realisable value. Costs include the direct costs and, where applicable, an allocation of overheads incurred in bringing inventories to their current location and condition. Net realisable value is based on estimated selling price, less any further costs expected to complete the sale of goods.

2.14 Financial instruments

For the purposes of recognition and measurement financial assets are classified into one of these categories:

- Trading activities: assets that are held for collection of contractual trading cash flows are measured at amortised cost. A gain or loss is recognised in the Consolidated income statement only when the asset is derecognised or impaired. Interest income is included in finance income using the effective interest rate method if applicable.
- Financial assets held for future sale: assets that are held for collection of contractual cash flows and for selling the financial assets are measured at fair value through other comprehensive income ("OCI").

In instances where the financial assets meets neither category, they are measured at fair value through profit and loss ("FVTPL"). Due to the short-term nature of the current receivables, their carrying amount is considered to be the same as their invoice amount as interest is not applicable to the contract.

For trade receivables, the Group applies the simplified approach permitted by IFRS 9, which requires expected lifetime losses to be recognised from initial recognition of the receivables. Financial liabilities are initially measured at fair value and subsequently measured at amortised cost.

2.15 Provisions

Provisions are liabilities where the exact timing and amount of the obligation is uncertain. Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of past events, when an outflow of resources is probable to settle the obligation and when an amount can be reliably estimated.

Where the time value of money is material, provisions are discounted to current values using appropriate rates of interest. The unwinding of the discounts is recorded in net finance income or expense.

2.16 Retirement obligations

The Group's obligations for its Swiss pension scheme are to pay defined contributions. However, in accordance with the Swiss law "LPP/BVG", the pension scheme incorporates certain guarantees, and has therefore been reported as a defined benefit pension plan in accordance with IFRS.

Pension obligations are measured as the present value of estimated future cash flows discounted at rates reflecting the yields of high-quality corporate bonds. Pension scheme assets are measured at fair value at the balance sheet date. Remeasurements of the net defined benefit liability, which comprise actuarial gains and losses, and the return on plan assets (excluding interest), are recognised immediately in OCI. When the benefits of a plan are changed or when a participant is curtailed, the resulting gain or loss on curtailment is recognised immediately in the Consolidated income statement.

2.17 Share-based payments

The Group operates a number of employee equity-settled share-based compensation plans as part of the Total Reward Strategy. Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date of the awards is expensed over the vesting period based on the Group's estimate of awards that will eventually vest. The cost of equity-settled share transactions is recognised, together with a corresponding increase in equity, over the vesting period.

2.18 Employee share trusts

The Group provides finance to ESOP trusts to either purchase company shares on the open market, or to subscribe for newly issued share capital, to meet the Group's obligation to provide shares when employees exercise their options or awards. Costs of running the ESOP trusts are charged to the Consolidated income statement. Shares held by the ESOP trusts are deducted from reserves and presented in equity as own shares until such time that an employee exercises their award.

2.19 Share buyback and cancellation programme

As repurchased shares are cancelled immediately after being bought back, the amount of the consideration paid and directly attributable costs are booked to retained earnings.

2. Significant accounting policies continued

2.20 New accounting requirements

Adopted in the period – IFRS 9 – Financial Instruments

The Group adopted IFRS 9 on 1 January 2017, albeit it had no financial impact on either the current or comparative period. IFRS 9 addresses the classification, measurement and derecognition of financial assets and financial liabilities and introduces new rules for hedge accounting, a new impairment model for financial assets and early recognition of expected credit losses.

The Group is not involved with complex financial instruments, has not to date applied hedge accounting, nor has any history of material credit losses. As such, the only impact of adoption has been on disclosures. IFRS 9 provides a new hedge accounting model which is optional to apply and is closer aligned to commercial activities, such that it may in the future be applied if the Board deem applicable. Refer to note 26 "Financial instruments".

Adopted in the period – IFRIC 22 – Foreign Currency Transactions and Advance Consideration

IFRIC 22 clarifies the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of advanced payments for assets or liabilities for deferred income. This guidance has been adopted in advance of formal EU endorsement, which is expected imminently, as it provides additional clarification to the application of existing accounting policies rather than any amendments to those policies.

The date that payments are made is the reference date for foreign exchange and should not be remeasured for changes in exchange rates occurring afterwards on the date of recognition of the transaction to which that consideration relates.

2.21 New standards not adopted that will be adopted in the next reporting period

IFRS 15 – Revenue from Contracts with Customers

The Group will have to apply IFRS 15 to the next reporting period as it will be mandatory to do so. IFRS 15 establishes a comprehensive framework for determining whether, when and how much revenue is recognised in each reporting period, which is particularly relevant for longer-term development, licensing and marketing contracts.

Transitional impact of IFRS 15 on Vectura – cumulative effect method

The Group has performed an IFRS 15 assessment on all revenue contracts, taking advantage of the practical expedient available removing the requirement to apply IFRS 15 to contracts that are considered completed on 1 January 2018.

A contract is considered complete once all performance obligations relevant to the receipt of future revenues have been satisfied. This applies to all royalties for licences of on-market products. The existing IAS 18 treatment is maintained, which is compliant with IFRS 15 guidance for sales and usage-based license royalties.

Product supply performance obligations arise on receipt of customer purchase orders to transfer inventory to the customer. As there is only one performance obligation to allocate revenues across, the new guidance will not generate a difference (consistent with the current treatment).

However, 2017 revenues are estimated to be £0.5m higher on an IFRS 15 basis due to accelerated recognition of development revenues, but this review is ongoing. It is not expected that IFRS 15 will result in a material impact on underlying core revenue streams (royalties, product supply and share of net sales). Because the impact of this transitional adjustment is limited, the Group plans to adopt IFRS 15 using the cumulative effect method through equity as opposed to restating the 2017 comparative when reporting the 2018 results.

Impact of IFRS 15 on subsequent periods

Previous industry practice was to spread upfront signing milestones over the development period, on a basis consistent with the service being provided, irrespective of whether a licence is transferred on signing. However, IFRS 15 requires an assessment be made of how much of the signing milestone relates to R&D services and how much relates to the licence. The revenue allocated to the licence performance obligation will be recognised when the licence is transferred, which is normally upon signing consistent with current treatment, and the amount allocated to R&D services will be recognised as that service is delivered.

The Group is required to identify performance obligations in its agreements under IFRS 15. In certain cases, performance obligations identified under an IFRS 15 assessment may differ from those under the current accounting policy assessments, thereby altering the timing of revenue recognition and classification between income streams.

Acceleration of development milestones where future receipt is considered probable: the receipt of future development-stage milestones will be accelerated to the extent that their future receipt is considered highly probable and significant reversal of revenue will not occur in the future.

It is therefore expected that a significantly higher proportion of signing milestones will be recognised immediately on entering into new collaborative arrangements.

2.22 New standards not adopted mandatory at 1 January 2019

The following standards and interpretations are mandatory for periods beginning on or after 1 January 2019 with early adoption possible. At present the Group has not adopted these but indicates the likely future impact below.

IFRS 16 – Leases

IFRS 16 eliminates the classification of leases as either operating leases or finance leases and introduces a single lessee accounting model where the lessee is required to recognise assets and liabilities for all material leases that have a term of greater than a year. There are recognition exemptions for short-term leases and leases of low-value items. The Group has completed an initial impact assessment on its consolidated financial statements but has not yet completed its detailed assessment.

2. Significant accounting policies continued

2.22 New standards not adopted mandatory at 1 January 2019 continued

IFRS 16 – Leases continued

The Group has operating lease commitments of £6.6m (2016: £7.5m) as disclosed in note 31 "Commitments and contingent liabilities". The IFRS 16 lease liability is expected to be in the region of £4.5m on initial recognition based on the current lease portfolio. A corresponding asset of approximately £2.5m reflecting the Group's right to use the asset will also be recognised. Rental charges of approximately £1.0m will be recognised outside of adjusted EBITDA, replaced with additional interest and depreciation of a similar value. As a detailed assessment has yet to be performed it is unclear what other adjustments, if any, will be required upon initial adoption.

IFRIC 23 – Uncertainty over Income Tax Treatments

IFRIC 23 has been issued to clarify the accounting for uncertainty within tax positions. This guidance precedes significant changes expected to tax legislation across a number of jurisdictions applicable to locations in which the Group operates. The application of a weighted average probability to the interpretation of uncertain country-specific tax legislation would not materially reduce the value of assets and liabilities recognised in these consolidated financial statements.

However, it is not possible to assess how this new guidance will impact reported tax balances from 2019 onwards.

A far-reaching proposal to reform the current Swiss tax regime currently lacks clarification as to the application and transitional arrangements at both federal and cantonal level. It also remains unclear as to the terms and timing of the planned UK exit from the European Union and the associated impact on tax legislation.

2.23 Comparative period accounting for the Skyepharma merger (the "merger")

The acquisition method of accounting was applied to Skyepharma on the merger date with assets and liabilities recognised at their fair value on the acquisition date, in accordance with IFRS 3. An overview of the impact is provided below. Refer to note 27 "Prior period business combination – Skyepharma merger".

	10 June 2016 £m
Intangible assets recognised at fair value on the merger date	379.5
Property, plant and equipment	39.5
Fair value of current net assets acquired	28.3
Net deferred tax liabilities	(56.3)
Fair value of other net assets acquired	(16.3)
Fair value of Skyepharma net assets acquired	374.7
Goodwill recognised	100.8

Refer to note 15 "Goodwill", note 16 "Intangible assets" and note 25 "Deferred tax liabilities" for the most significant areas of the financial statements impacted by the subsequent measurement of the acquisition balance sheet.

3. Revenue

Revenue by income stream

	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
Product supply and device sales	**74.7**	50.3
Royalties	**50.1**	32.0
Net sales from EXPAREL®	**6.6**	3.5
Underlying revenue	**131.4**	85.8
Signing and milestone payments	**5.1**	20.5
Development services	**9.0**	4.5
Royalties	**2.5**	15.5
Other	**—**	0.2
Non-recurring revenue	**16.6**	40.7
Total revenue	**148.0**	126.5

Underlying revenue relates to core revenues comprising licence royalties, product supply revenues and share of net sales of EXPAREL®.

Revenues from non-recurring sources comprise of milestones and development services revenues, which can vary materially between reporting periods and non-recurring royalties related to the discontinued royalties from ADVATE® and the termination of legacy Vectura royalties with GSK for the Ellipta® products which is currently subject to a legal dispute (refer to note 10 "Exceptional items").

3. Revenue continued

Revenue by geographic location

	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
United Kingdom	**49.2**	45.6
Japan	**33.0**	17.7
Switzerland	**27.3**	20.1
Rest of Europe	**15.3**	11.3
United States of America	**13.8**	31.3
Rest of world	**9.4**	0.5
Total revenue	**148.0**	126.5

The geographic split of revenue is based on the location of the customer being invoiced, as opposed to the country in which products are delivered or services are provided to patients.

Revenue from major customers

For the year ended 31 December 2017 three customers contributed individually in excess of 10% of total revenue as follows: Customer A – £35.2m, Customer B – £33.0m and Customer C – £17.1m. In the comparative nine-month period revenue earned from the Group's major customers was as follows: Customer A – £31.0m, Customer B – £22.4m, Customer C – £17.6m and Customer D – £13.3m.

4. Segmental information

The Group is managed on the basis of a single reportable segment, being the development and supply of pharmaceutical products, and as such no separate segmental information is provided as it would not be different from the Consolidated income statement. The chief operating decision maker, represented by the Board, allocates resources on the basis of integrated management information, which focuses on adjusted EBITDA as detailed in note 8.

Non-current assets by geographical location are as follows:

	31 December 2017 £m	31 December 2016 £m
Switzerland	**356.7**	442.6
United Kingdom	**106.1**	103.0
Germany	**71.9**	94.5
United States of America	**11.6**	30.9
France	**11.0**	7.4
Total non-current assets	**557.3**	678.4

5. Research and development expenses

	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
Vectura enhanced assets	**34.2**	21.1
Novel patented molecule partnering projects	**14.3**	15.0
Generic/analogue and device partnering projects	**9.5**	8.7
Other oral projects	**2.3**	0.8
Total research and development expenses	**60.3**	45.6

6. Employees

The average number of full-time equivalent employees were as follows:

	Year ended 31 December 2017 Number	9 months ended 31 December 2016* Number
Research and development and related support services	310	281
Business development and corporate administration	19	24
Manufacturing and supply chain	135	97
Total average number of full-time equivalent employees	**464**	402

* Employees at the Swiss R&D and French manufacturing sites were only included for 74% of the comparative nine-month period following the Skyepharma merger which was effective on 10 June 2016. In addition, the above employee data includes staff employed on fixed term contracts to assist with the delivery of integration initiatives, as well as covers for maternity, paternity and illness. Headcount at the end of the year was 478 (2016: 453).

The aggregate remuneration of employees was as follows:

Aggregate remuneration	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
Wages and salaries	34.6	22.8
Social security costs	4.8	3.8
Payments to defined benefit pension plans	0.7	0.7
Payments to defined contribution pension plans	2.0	0.7
Total aggregate remuneration	**42.1**	28.0

Directors' remuneration is detailed in the Remuneration report and key management personnel is detailed in note 32 "Related-party transactions".

7. Other income

The Group will claim R&D expenditure credits ("RDEC") of £1.7m in the year ended 31 December 2017 alongside the tax return filing process (2016: £1.5m). As these credits are subject to corporation tax they are presented as other income. Other than HMRC's acceptance of the tax return, there are no unfulfilled conditions or other contingencies attaching to this income.

During the year the Group received £2.1m (2016: £2.5m) in respect of R&D tax credit claims. A receivable of £3.8m (2016: £4.5m) remains outstanding at the balance sheet date.

8. Adjusted EBITDA

Adjusted EBITDA is a non-statutory measure used by the Board, the Executive Leadership Team and managers of the business to monitor the Group's performance as it provides useful information about the business' underlying cash-generating performance.

Adjusted EBITDA is defined as operating profit before exceptional items and amortisation, adding back charges for share-based payments and depreciation.

	Note	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
Loss before taxation		(102.2)	(40.1)
Amortisation and impairment of intangible assets	16	109.7	64.0
Exceptional items	10	4.5	9.4
Share of movement of associates	11	3.4	(0.4)
Net finance expense/(income)	12	2.6	(4.0)
Operating profit before exceptional items and amortisation		18.0	28.9
Depreciation of property, plant and equipment	17	5.7	3.4
Share-based payments	29	2.1	1.8
Adjusted EBITDA		25.8	34.1

9. Auditor's remuneration

Following a competitive tender process, led by the Audit Committee, KPMG LLP and other member firms of the KPMG network were formally appointed as the Group's external auditor at the Annual General Meeting on 25 May 2017. Deloitte LLP had previously been the Group's auditor since 2007.

KPMG (2016: Deloitte) respective fees as the consolidated Group's statutory auditors were as follows:

	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
Audit of the Group's annual accounts	0.4	0.1
Audit of the Group's subsidiaries	0.1	0.1
Total audit fees	0.5	0.2
Other services	0.1	—
Total non-audit fees	0.1	—
Total fees payable to the Group auditor	0.6	0.2

The fees shown in relation to 2017 were payable to KPMG LLP and those shown in relation to 2016 were payable to Deloitte LLP.

In the comparative period Ernst & Young was retained as auditor for the Group's subsidiaries in Switzerland, France and the United States of America. In 2017 Ernst & Young remains the statutory auditor for France. Total audit fees payable to Ernst & Young in 2016 were £0.3m, in addition to the fees included in the above table.

KPMG fees for other services comprise £65,000 for the 2017 interim review and £40,000 of permissible non-audit fees related to its appointment as liquidator of 14 UK dormant subsidiary entities. Refer to note 5 "Disposal of dormant subsidiaries" of the parent company financial statements.

10. Exceptional items

	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
Merger transaction costs[1]	—	6.1
Post-merger integration costs[3]	4.5	3.9
One-off research and development accrual release[2]	(2.2)	—
Legal fees[2]	1.8	0.1
Other exceptional items[4]	0.4	(0.7)
Total exceptional items	4.5	9.4

Classification if costs were not presented as exceptional:

1 Classified as corporate and administrative expenses.

2 Classified as research and development expenditure.

3 Classified within corporate and administrative expenses and research and development expenditure.

4 Classified within cost of sales and research and development expenditure.

Post-merger integration costs include £2.7m (2016: £3.0m) of one-off instances of spend on projects required to combine the two businesses. This primarily relates to human resources, finance and information technology and costs from a third-party consultancy to harmonise ways of working and enhance productivity across the UK, Swiss and German R&D functions.

In addition, post-merger integration costs include a share-based payment charge of £1.8m (2016: £0.5m). Upon completion of the merger, 1,490,982 exceptional nominal awards were granted to key members of management considered critical to the integration process. These awards vest in full provided that an 18-month or 36-month service condition is met from their September 2016 grant date. The grant date fair value was £1.41 per share and the total share-based payment charge, reduced when lapses occur, is expensed evenly.

As part of the merger integration and alignment, management has performed a detailed review of the research and development accruals during 2017, including historical accruals. This activity identified a number of individually immaterial historic accruals where it is no longer considered probable that these accruals will result in future cash outflows. The accruals, totalling £2.2m, have been released in the 2017 Consolidated income statement and are presented within exceptional items to enable users to understand the impact of the credit on the current year performance. Management has determined that there is no material impact of the accruals on any comparative income statement, balance sheet or cash flow statement.

10. Exceptional items continued

Legal fees arise from progression of legal proceedings against GSK relating to enforcement of Ventura's patents in respect of the Ellipta® products.

Other exceptional items include £0.8m (2016: £0.4m) of restructuring at the Group's manufacturing facility in Lyon, France following the facility transferring back to Ventura in July 2016. The remainder of the restructuring costs will be incurred in 2018. Other exceptional items also include a £0.2m credit relating to the movement in an onerous lease provision in Switzerland, and gains from Swiss pension curtailments of £0.2m (2016: £1.1m) which have been presented as exceptional as they relate to post-merger structuring. Refer to note 24 "Retirement benefit obligations".

11. Associates

During the year the carrying values of the associates were fully written off to £nil (2016: £1.7m) owing to share of losses and other charges recognised in the Consolidated income statement of £3.4m (2016: £0.4m credit).

The Group does not recognise further losses as it currently has no future obligations to fund future losses or to make payments on behalf of the other entity.

Ventaleon GmbH

Following expenditure associated with Phase Ib and Phase II clinical trials, the Group's share of Ventaleon's losses for the year to 31 December 2017 was £1.5m (2016: £0.4m credit), inclusive of £0.1m foreign exchange gain. The Group impaired the remaining value of £0.3m.

Tianjin Kinnovata Pharmaceutical Co. Ltd

During the year, the Group received confirmation that the Chinese State authorities had approved the valuation of assets contributed by Ventura to this associate in return for a 37.84% share in Tianjin Kinnovata Pharmaceutical Company Limited ("Kinnovata"). The investment is held through Innovata (HK) Limited. Refer to parent company financial statements note 6 "Subsidiary, associate and dormant undertakings" for details of the classes of shares held through the sub-structure.

Kinnovata will develop, manufacture and commercialise the Clickhaler® and Duohaler® respiratory products for the Chinese market. Ventura contributed the intellectual property associated with Clickhaler® and Duohaler® and will be entitled to a 5% royalty on future net sales.

During the year contributions of £1.6m, comprising £0.6m for new equipment and a £1.0m waiver of a loan outstanding, were made. These transactions are considered to be at arms-length. The Group is not committed to making any further contributions and Ventura's share could be diluted if it does not participate in future capital raises.

No value of future benefit is attributed to the investment and no gain is recognised as a result of Ventura's contribution.

12. Net finance (expense)/income

	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
Bank interest income	**0.2**	0.2
Bank interest expense	**(0.2)**	(0.3)
RCF commitment fees	**(0.2)**	(0.1)
Other financing items	**(1.0)**	—
Net finance expense before foreign exchange	**(1.2)**	(0.2)
Foreign exchange (losses)/gains	**(1.4)**	4.2
Net finance (expense)/income	**(2.6)**	4.0

The Group does not have any significant borrowings. Bank interest expense is £0.2m (2016: £0.3m) comprising of interest payable on Swiss property mortgages, and bank interest income of £0.2m (2016: £0.2m) has been earned from cash on deposit.

Foreign exchange relates to foreign currency cash on deposit in Switzerland and the UK, and the revaluation of royalty and milestone receivables in foreign currency in Switzerland and the UK.

13. Taxation

	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
Current taxation on profitable subsidiaries	(5.9)	(4.4)
Adjustments to prior periods recognised	0.4	1.4
Total current taxation charge	**(5.5)**	(3.0)
Deferred taxation (note 25)	22.0	11.0
Net taxation credit	**16.5**	8.0

Deferred taxation charges of £1.4m (2016: £0.9m) were also recognised in other comprehensive income.

Current taxation arises from trading profits generated in Switzerland and the US. Deferred tax relates predominantly to credits arising on the unwinding of tax liabilities on the intangible assets acquired as a result of the acquisition of Activaero and the Skyepharma merger.

The Group's effective tax rate ("ETR") before OCI is a 16.15% credit. This equates to the applicable UK tax rate of 19.25%, adjusted for a number of factors discussed below.

The implementation of the Organisation for Economic Co-operation and Development's guidelines on Base Erosion and Profit Shifting ("BEPS") is not expected to impact the Group's tax position.

UK taxation

The UK sub-group is loss making and benefits from the R&D expenditure credit ("RDEC"). The RDEC is subject to UK corporation tax and therefore is included within the Consolidated income statement and presented as other income. Refer to note 7 "Other income". In addition, UK companies are able to participate in the UK Patent Box regime, the benefit of which is expected to increase as new products are approved. The UK corporation tax rate has reduced to 19% with effect from 1 April 2017, and will reduce to 17% from 1 April 2020, which has been substantively enacted. The impact on the Group accounts is expected to be immaterial.

US taxation

Taxable income arises in respect of the percentage of net sales received from EXPAREL®. Vectura expects its future US after-tax earnings to be positively impacted by the recently enacted changes to US corporate taxes, largely due to the reduction of the US federal corporate income tax rate from 35% to 21% (effective 1 January 2018) which will be applied to the final contingent $32m milestone. The ultimate impact of the change in the US corporate tax rate is under review. The lowering of the US corporate income tax rate to 21% resulted in a reduction in the value of Vectura's US deferred tax liabilities. A credit to the Consolidated income statement of £1.6m was recognised as a result. The Group does not recognise any deferred tax assets in respect of the US, and therefore no adjustment to the carrying value for the rate change was required.

Swiss taxation

Vectura continues to monitor the impact of Swiss corporate tax reform. On 6 September 2017, the Swiss Federal Council indicated that tax proposal 17 ("TP17") shall be dispatched to the Parliament in spring 2018. The Group monitors the situation closely and, while the overall tax burden is unlikely to change materially, there are a number of complex provisions in the legislation and a number of areas yet to be finalised and hence, once enacted, will likely cause an adjustment to the amounts recognised in these consolidated financial statements.

Effective tax rate ("ETR")

In Switzerland and the US, the Group is profitable and subject to taxation at the local rates (Swiss ETR 8.5% charge, and the US corporate rate applied is 34% (ETR 2017: 42.9% charge)). The uncertain tax position disclosed has increased by £4.1m in the year (which includes a prior period adjustment following a change in basis as advised by the Group's tax advisors). These charges, along with a significant credit (ETR: 17.6% credit) in respect of deferred tax liabilities relating to intangible assets acquired on the Skyepharma and Activaero acquisitions (refer to note 25 "Deferred tax liabilities"), together drive the Group's ETR of 16.15% (credit).

13. Taxation continued

Effective tax rate ("ETR") continued

	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
Loss before tax	(102.2)	(40.1)
Loss before tax multiplied by standard rate of UK corporation tax of 19.25% (31 December 2016: 20%)	19.7	8.0
Effects of:		
UK Patent Box benefit	0.1	1.2
Expenses not deductible for tax purposes*	(2.5)	(1.2)
Unrecognised deferred tax**	(5.4)	(1.2)
Prior year deferred tax	0.5	(0.6)
Research and development tax credits	—	1.4
Differences arising from prior period computations	0.4	0.2
Differences in effective overseas tax rates	2.1	0.2
Impact of deferred tax rate change	1.6	—
Total tax credit for the period	16.5	8.0

* Expenses not deductible for tax purposes in the previous period relate to merger transaction costs.

** Unrecognised deferred tax mainly relates to losses incurred for which no deferred tax assets have been recognised as future recovery, or timing of recovery, cannot be supported.

The ETR is expected to remain in the low-teens (credit) percentage rate in the short to medium term as a result of reduced loss relief available to offset against taxable profits, as well as the expected increase in the Swiss tax rate following the proposed reform. The significant credit in respect of deferred tax liabilities on intangibles acquired is expected to continue in the short to medium term and this will continue to drive a credit ETR.

14. Loss per share

	Year ended 31 December 2017 p	9 months ended 31 December 2016 p
Basic	(12.6)	(5.3)
Diluted	(12.6)	(5.3)

Options granted under employee share plans are anti-dilutive for the year ended 31 December 2017.

The following table provides details of the dilutive impact as if the shares had been considered dilutive.

The calculation is based on the following data:

	Year ended 31 December 2017	9 months ended 31 December 2016
Loss after taxation (£m)	(85.7)	(32.1)
Weighted average number of shares (m)	678.9	608.9
Effect of dilutive potential shares (m)	6.2	5.3
Diluted weighted average number of shares (m)	685.1	614.2

In accordance with IAS 33 – Earnings Per Share the future impact of share buyback programmes are not relevant to loss per share as these are calculated on the basis of shares in issue at the reporting date.

15. Goodwill

	31 December 2017 £m	31 December 2016 £m
At beginning of the period	**162.8**	57.4
Skyepharma merger (note 27)	**—**	100.8
Foreign exchange	**(1.4)**	4.6
At end of the period	**161.4**	162.8
Allocation to cash-generating units (CGUs)		
UK and Germany	**100.1**	99.8
Switzerland	**61.3**	63.0
At end of the period	**161.4**	162.8

The recoverable amounts of the cash-generating units are assessed using a fair value less costs of disposal model. Fair value less costs of disposal is calculated using a discounted cash flow approach, with a post-tax discount rate applied to the projected risk-adjusted post-tax cash flows and terminal value.

The discount rate used is based on the Group weighted average cost of capital ("WACC") of 9% (2016: 9%) as assessed by external experts. Management considers this to be its best approximation of a market participant rate as required by IAS 36. The discount rate is adjusted for specific country or currency risks but at present, as both cash-generating units have global large pharmaceutical partners, operations and/or customers in each other's territory, share access to short-term funding through the revolving credit facility ("RCF"), it is considered that the same discount rate should be applied to each CGU. There is currency risk associated with Switzerland, there is risk in the UK associated with Brexit and in the medium term both countries are expected to be closely affiliated with, but outside of, the European Union.

Cash flows are based on the most recent budget approved by the Board covering 2018 and 2019 and the Ten-Year Plan to 2027. Details relating to the discounted cash flow models used in the impairment tests of the cash-generating units are as follows:

Valuation basis	Fair value less cost of disposal
Key assumptions	Time to develop and launch pipeline products Net sales forecasts and related royalty inflows Milestones for pipeline products Profit margins for product supply Terminal growth rate Discount rate Taxation rate
Determination of assumptions	Net sales forecasts are determined from partner forecasts and external market data. Milestone amounts and royalty rates reflect past experience and forecast sales potential determined from external market data Margins reflect past experience, adjusted for expected changes. Terminal growth rates based on management's estimate of future long-term average growth rates. Discount rates based on Group WACC, adjusted where appropriate. Taxation rates based on appropriate rates for each region.
Specific projected cash flow period	Ten years (reflecting a longer term planning cycle)
Terminal growth rate	nil
Discount rate	9%

The available headroom for the UK and Germany CGU has reduced versus 31 December 2016 following the delay in approval for VR315 (US). In addition, headroom for the Swiss CGU is lower as a result of stopping the development of VR2076.

The Group conducted a sensitivity analysis on the impairment test of each CGU's carrying value. The Group considered 12% to be a reasonably possible downside sensitivity. While this reduces headroom, it does not alter management's assessment of future impairment risk, which is not considered significant. The UK and German CGU valuation indicates sufficient headroom such that a reasonably possible change in a key assumption is unlikely to result in an impairment of the related goodwill. The forecasts would need to reduce in excess of 70% primarily because this CGU comprises internally generated intangibles which are included in the valuation, but not the carrying value of the assets comprising the CGU.

15. Goodwill continued

The Swiss CGU also shows significant headroom. It has been calculated that a 33% reduction in the forecast or a 10% reduction in the forecast using a 12% discount rate would likely cause goodwill impairment next year, but, as this assessment excludes the impact of any new business or upside in existing business, the risk of this happening is considered remote. Impairment of this CGU has been removed as a critical accounting estimate this year principally because the intangible assets are being amortised and each year the risk of impairment decreases.

IAS 36 – Impairment of Assets requires the use of pre-tax cash flows and pre-tax discount rates. However, discounting post-tax cash flows at a post-tax discount rate should give materially the same result when there are neither temporary differences nor available tax losses at the measurement date.

16. Intangible assets

	Inhaled in-market assets £m	Smart nebuliser technology* £m	Non-inhaled in-market assets £m	Other £m	Total £m
Cost:					
At 1 April 2016	3.5	123.1	74.6	—	201.2
Skyepharma merger	292.5	—	72.0	15.0	379.5
Additions	—	—	0.1	—	0.1
Foreign exchange	31.2	9.6	10.1	1.7	52.6
At 31 December 2016	327.2	132.7	156.8	16.7	633.4
Additions	—	—	—	0.2	0.2
Disposals and write-offs	(3.5)	—	(74.6)	—	(78.1)
Foreign exchange	(14.6)	5.6	(5.4)	(0.8)	(15.2)
At 31 December 2017	**309.1**	**138.3**	**76.8**	**16.1**	**540.3**
Amortisation:					
At 1 April 2016	(3.5)	(31.4)	(74.1)	—	(109.0)
Charge for the period	(27.5)	(14.7)	(16.7)	(5.1)	(64.0)
Foreign exchange	(0.3)	(2.7)	(0.6)	—	(3.6)
At 31 December 2016	(31.3)	(48.8)	(91.4)	(5.1)	(176.6)
Charge for the period	(49.4)	(20.6)	(29.6)	(1.4)	(101.0)
Impairment	—	—	—	(8.7)	(8.7)
Disposals and write-offs	3.5	—	74.6	—	78.1
Foreign exchange	3.1	(2.3)	3.0	(0.5)	3.3
At 31 December 2017	**(74.1)**	**(71.7)**	**(43.4)**	**(15.7)**	**(204.9)**
Net book value:					
At 31 December 2017	**235.0**	**66.6**	**33.4**	**0.4**	**335.4**
At 31 December 2016	295.9	83.9	65.4	11.6	456.8

* used in pipeline programmes.

The intangible assets recognised on the Skyepharma merger principally comprise of *flutiform*®, EXPAREL®, GSK's Ellipta® products, other marketed products and VR2076 (now fully impaired). These intangible assets are being amortised over a period of between two and seven years with reference to average applicable patent lives in the Group's main territories.

Inhaled in-market assets include a large number of acquired licences, patents, know-how agreements and marketing rights, which are in use, and the Group receives royalties or product supply revenue from these. Non-inhaled in-market assets include a large number of near end-of-life acquired licences, patents, know-how agreements and marketing rights, which are in use, and from which the Group continues to receive royalties.

Intangible assets also include smart nebuliser-based technology (FAVORITE™) separately acquired through the Activaero transaction on 13 March 2014 and leveraged in development programmes including VR475 (FAVOLIR®) and VR647 (SCIPE®). These assets are amortised in line with the consumption of economic benefits.

In December 2017 Mundipharma informed the Group of its decision to stop the development of the pMDI triple therapy for asthma and COPD (VR2076), in an early formulation phase. As an acquired programme from the Skyepharma merger, VR2076 had a book value of £8.7m, which accordingly has been fully impaired.

16. Intangible assets continued

For the purposes of impairment testing a value in-use approach is applied.

Details relating to the value in use calculations used for the impairment testing are as follows:

Transaction	Skyepharma merger 10 June 2016		Activaero acquisition 13 March 2014	
Intangible type	Inhaled in-market assets	Non-inhaled in-market assets	Smart nebuliser technology	
Specific asset subject to impairment	*flutiform*®	EXPAREL®	VR475 (FAVOLIR®)	VR647 (SCIPE®)
Key assumptions	Product supply volume forecast Margin (depending on pricing assumptions, raw material costs and cost of manufacture) Discount rate	Timing of $320m sales milestone from achieving annual net sales of $500m	Net sales forecasts and royalty rates thereon Probability of success	
Determination of key assumptions	Internal forecasts with input from partners and external market data (pricing trends, competition etc) Margins reflect past experience, adjusted for expected changes in pricing, raw material costs and cost of manufacture Discount rate based on Group WACC, adjusted for 1% on-market product discount	Internal forecasts supported by analyst expectations of EXPAREL® performance	Internal forecasts utilising external market data Internal experience of appropriate commercial terms with potential partners Probability of reaching market Discount rate based on Group WACC	
Discount rate	8%	8%	9%	

The Group has conducted a sensitivity analysis based on reasonably possible downsides on the value-in-use calculations used for impairment testing.

For the *flutiform*® intangible, three downside scenarios were performed being (1) a 10% reduction in revenues due to volume changes (2) a 5% reduction in the percentage margin from customer supply or raw material price changes and (3) an increase in the discount rate from 8% to 9%. The first two sensitivity scenarios result in impairment while the third sensitivity results in a break-even position. The risk of future impairment from these downside scenarios is mitigated by future amortisation of the *flutiform*® intangible.

For VR475 (FAVOLIR®) and VR647 (SCIPE®), a reduction in probability of reaching market from 74% to 60% would not trigger any impairment. A 20% reduction in net sales forecasts would also not cause impairment of either asset. A 5% reduction in the forecast percentage royalty from partnering VR475 (FAVOLIR®) and a 20% reduction in the value of forecast milestones from partnering VR647 (SCIPE®) would not trigger impairment.

For the EXPAREL® intangible, a two year delay in the forecast receipt of the $32.0m milestone would not result in impairment.

The remaining amortisation periods of the Group's intangible assets as at 31 December 2017 are:

	Carrying value £m	Remaining amortisation period Years
Intangibles recognised from the Skyepharma merger		
Inhaled in-market assets	235.0	1 to 6.5
Non-inhaled in-market assets	33.4	1 to 3
Intangibles recognised from the Activaero acquisition		
Smart nebuliser technology	66.6	5

17. Property, plant and equipment

	Land and buildings £m	Laboratory and supply chain equipment £m	Assets under construction £m	Total £m
Cost:				
At 1 April 2016	1.1	17.0	6.4	24.5
Skyepharma merger	15.5	17.0	7.0	39.5
Additions	0.1	2.1	0.9	3.1
Foreign exchange	1.5	1.8	0.8	4.1
At 31 December 2016	18.2	37.9	15.1	71.2
Additions	0.2	5.2	6.3	11.7
Reclassification	—	8.8	(8.8)	—
Transfer to other non-current assets	—	—	(6.3)	(6.3)
Foreign exchange	(0.3)	(3.0)	—	(3.3)
At 31 December 2017	**18.1**	**48.9**	**6.3**	**73.3**
Depreciation:				
At 1 April 2016	—	(12.9)	—	(12.9)
Charge for the period	(0.4)	(3.0)	—	(3.4)
Foreign exchange	—	(0.1)	—	(0.1)
At 31 December 2016	(0.4)	(16.0)	—	(16.4)
Charge for the period	(0.6)	(5.1)	—	(5.7)
Foreign exchange	—	1.9	—	1.9
At 31 December 2017	**(1.0)**	**(19.2)**	**—**	**(20.2)**
Net book value:				
At 31 December 2017	**17.1**	**29.7**	**6.3**	**53.1**
At 31 December 2016	17.8	21.9	15.1	54.8

Land valued at £5.1m (2016: £5.1m) is not depreciated. The Group has invested £11.7m in capital expenditure (2016: £3.1m) mainly in manufacturing equipment to support the production of *flutiform®*, the development of oral tablet production in Lyon and laboratory equipment.

In January 2017, the Group's investment in expanding the capacity of *flutiform®* at the Sanofi manufacturing facility in Holmes Chapel, previously classified as an asset under construction, became fully operational and accordingly was reclassified to supply chain equipment.

Transfers to other non-current assets relate to manufacturing equipment, located at a supplier site that will no longer be used by the Group. Instead a future sale at a minimum of book value has been agreed with the development partner. Refer to note 18 "Other non-current assets". Assets under construction at the reporting date relate to replacement tooling equipment and, also associated with the production of *flutiform®*, a further £1.6m of spend on this equipment has been committed for next year.

18. Other non-current assets

Other non-current assets comprise the following items:

	31 December 2017 £m	31 December 2016 £m
Non-current financial assets held at amortised cost	**6.0**	0.2
Deferred tax assets on overseas tax basis differences	**1.4**	2.1
Investments in associates (note 11)	**—**	1.7
Total other non-current assets	**7.4**	4.0

18. Other non-current assets continued

Non-current financial assets principally include £5.8m (2016: nil) of amounts receivable from a development partner for manufacturing equipment which Vectura has funded. The development partner has agreed to reimburse Vectura for the original costs incurred, although the exact timing of recovery is dependent upon other contractual terms and contingent events, with the earliest possible repayment being on 1 May 2020.

Nevertheless, as the cost recovery has been contractually agreed, it is considered certain and therefore the item has been classified as a financial asset at amortised cost using the effective interest method. The asset was previously classified as an asset under construction at historical cost of £6.4m, and will unwind to that previous value in 2020. The financing charge on transfer has been recorded in the Consolidated income statement.

Deferred tax assets are recognised on differences between the tax base in the IFRS accounts for IAS 19 pension liabilities and certain contingent liabilities related to the profitable Swiss operations.

19. Inventories

	31 December 2017 £m	31 December 2016 £m
Raw materials	**11.6**	9.0
Work in progress	**8.6**	7.8
Finished goods	**4.4**	4.1
Less provision for impairment	**(1.2)**	(2.5)
Total inventories	**23.4**	18.4

Inventory purchases of £52.4m were included within cost of sales (2016: £37.4m).

20. Trade and other receivables

	31 December 2017 £m	31 December 2016 £m
Trade receivables	**11.5**	22.2
Accrued income	**14.2**	20.0
Less provision for impairment	**(1.1)**	(1.1)
Net trade receivables	**24.6**	41.1
Prepayments and other receivables	**5.7**	11.0
Research and development tax credits	**3.8**	4.5
Total trade and other receivables	**34.1**	56.6

The carrying values of trade receivables approximate their fair values because these balances are expected to be cash settled in the near future unless a provision is made.

In determining the expected credit losses for these assets, the Group has taken into account the historical default experience and the financial position of the counterparties, as well as the future prospects considering various external sources of actual and forecast economic information, as appropriate, in estimating the probability of default of each of these financial assets occurring within their respective loss assessment time horizon.

The Group applies the simplified approach to providing for expected credit losses prescribed by IFRS 9, which requires the use of the lifetime expected loss provision for all trade receivables.

The expected credit loss allowance provision at 31 December 2017 is determined below as follows and incorporates forward looking information:

Expiry profile	Current	More than 30 days past due	More than 60 days past due	More than 90 days past due	Total 2017
Expected loss rate	nil	nil	100%	100%	
Gross carrying amount	24.6	—	0.1	1.0	**25.7**
Loss allowance provision	—	—	(0.1)	(1.0)	**(1.1)**

21. Cash and cash equivalents

The Group's cash and cash equivalents are denominated in the following currencies:

	31 December 2017 £m	31 December 2016 £m
Sterling	44.5	27.8
Euros	24.5	24.2
US dollars	20.5	34.0
Swiss francs	14.2	6.5
Cash and cash equivalents	**103.7**	92.5

The Group invests its funds in short-term bank deposits. The Group has access to these deposits at a maximum of 24 hours' notice. In addition to the cash and cash equivalents above, the Group has access to a £50m unsecured committed multi-currency revolving credit facility ("RCF") with Barclays Bank PLC and HSBC Bank plc.

22. Trade and other payables

	31 December 2017 £m	31 December 2016 £m
Trade payables	23.7	22.4
Accruals	25.5	31.1
Other payables	3.1	4.4
Deferred income	4.0	1.7
Property mortgage	0.2	0.2
Trade and other current liabilities	**56.5**	59.8
Other payables	5.1	6.2
Deferred income	0.6	1.7
Property mortgage	3.9	4.3
Other non-current payables	**9.6**	12.2
Trade and other payables	**66.1**	72.0

Trade and other payables are unsecured unless otherwise indicated; due to the short-term nature of current payables, their carrying values approximates their fair value. The Swiss property mortgage is secured on the building and has a fixed rate of interest of 2.6% per annum and an expiry date of 28 February 2019.

In addition to current trade and other payables of £56.5m (2016: £59.8m), corporation tax of £11.4m (2016: £8.6m) is payable within twelve months.

23. Provisions

	Employee £m	Property £m	Other £m	Total £m
At 1 January 2017	2.3	1.9	1.2	5.4
Charged during the period	0.9	0.2	1.2	2.3
Utilised during the period	(1.0)	(0.2)	(1.2)	(2.4)
Foreign exchange movements	—	—	0.1	0.1
At 31 December 2017	**2.2**	**1.9**	**1.3**	**5.4**
Current	0.8	0.2	1.2	2.2
Non-current	1.4	1.7	0.1	3.2

Provisions are liabilities of uncertain timing or amount. Employee provisions include French statutory one-off lump sum payments due on the retirement of employees at the Group's manufacturing facility in Lyon, France.

Property provisions have been established in respect of an onerous lease in Switzerland and the commitment to restore the Group's leased R&D facilities in Chippenham to their original 2012 condition in 2027. Other provisions relate to the best estimate of certain contractual liabilities outstanding at the balance sheet date and in the comparative period related to exceptional redundancy costs which were fully utilised during the year. Refer to note 10 "Exceptional items". The uncertain tax provision of £5.0m (2016: £0.9m) is included in corporation tax payable and is therefore not reflected above.

24. Retirement benefit obligations

Swiss defined benefit pension plan

The amounts recognised in the balance sheet for the Swiss scheme are as follows:

	31 December 2017 £m	31 December 2016 £m
Present value of funded obligations	(17.7)	(21.3)
Fair value of plan assets	14.1	15.4
Balance sheet liability	**(3.6)**	(5.9)

The Swiss sub-Group has affiliated itself with PKG Pensionskasse for the provision of its occupational pension for its employees and pension recipients. The pension scheme provides benefits in the case of disability, death, old age and termination. The risk benefits are defined in relation to the pensionable salary. The retirement pension is calculated based on the projected savings capital with interest and a conversion rate.

The highest corporate body of the foundation is the Board of Trustees. It handles the general management of the pension scheme, ensures compliance with the statutory requirements, defines the strategic objectives and policies of the pension scheme and identifies the resources for their implementation. It determines the objectives and principles of the asset management and the implementation and monitoring of the investment process.

The Board of Trustees of the PKG pension fund announced in December 2017 that:

- active policyholders' retirement assets will earn 2.25% interest as of 31 December 2017; and
- further reduction in the relevant pension conversion (into an annuity) rates to 5.4% (2016: 6.0%).

Vectura, as an employer, matches employees' contributions to the scheme on a monthly basis. The amount of contributions to be paid by the employer and employee are determined by the Board of Trustees or the pension fund commission such that on retirement participants can chose to receive a cash lump sum or convert their savings capital into an annuity to be paid monthly over the course of their retirement.

The law (Swiss Federal Law on Occupational Retirement, Survivors' and Disability Pension Plans and its associated ordinances) provides for minimum pension benefits and also a minimum amount for the savings contributions. The amount of the contributions to be paid by the employer and the employee is determined by the highest corporate body and/or the pension fund commission. These can exceed the statutory minimum. The employer contribution must be at least as high as the employee contributions.

The movement in the present value of the defined benefit obligation is as follows:

	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
Opening present value of the defined benefit obligation	(21.3)	—
Recognised upon Skyepharma merger on 10 June 2016	—	(19.9)
Current service cost	(0.9)	(0.6)
Gain on plan modification	1.0	—
Exceptional gain on curtailment (note 10)	0.2	1.1
Recognised in the income statement	0.3	1.1
Benefits paid and withdrawals	2.1	(0.3)
Employee contributions	(0.5)	(0.3)
Balance sheet cash movements	1.6	(0.6)
Foreign exchange translation	0.8	(2.3)
Actuarial gains	0.9	1.0
Recognised through OCI	1.7	(1.3)
Present value of the defined benefit obligation	(17.7)	(21.3)

24. Retirement benefit obligations continued

Swiss defined benefit pension plan continued

The movement in the fair value of the plan assets since the merger is as follows:

	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
Fair value of the plan assets the beginning of the period	15.4	—
Recognised upon Skyepharma merger on 10 June 2016	—	12.8
Foreign exchange	(0.6)	1.3
Benefits paid and withdrawals	(2.1)	0.3
Actuarial gains recognised on plan assets through OCI	0.2	0.3
Employer contributions	0.7	0.4
Employee contributions	0.5	0.3
Fair value of the plan assets the end of the period	**14.1**	15.4

Plan assets comprise:

	2017 £m	2017 %	2016 £m	2016 %
Equity	4.4	31.2	4.8	31.2
Bonds	0.6	4.3	6.9	44.8
Property	5.8	41.1	2.9	18.8
Cash	2.5	17.7	0.3	1.9
Other	0.8	5.7	0.5	3.3
Total plan assets	**14.1**	**100.0**	15.4	100.0

Other includes higher risk investments such as commodities or emerging market investments. Despite the IFRS IAS 19 requirement to recognise these assets, they are not controlled by the Group but by the Swiss pension fund.

The pension fund manages these in accordance with Swiss pension regulations to generate a higher return on the fund but does not provide any further details as to the composition of the assets or, for example, the quoted prices of equity held in the fund (as such Vectura is unable to disclose quoted equity prices as required by IAS 19.142).

The latest asset coverage ratio of 107.4% published by the fund, to which the assets prices relate, is not relevant to Vectura as the Group's share of assets in the fund is capped at the level of participant savings contribution. Therefore, the Group will not share in any upside on the significantly larger quasi-governmental asset pool. Expected contributions to post-employment benefit plans for the period ending 31 December 2018 are £0.8m (2017: £0.6m).

The cumulative actuarial gain recognised in other comprehensive income since the merger is as follows:

	31 December 2017 £m	31 December 2016 £m
Actuarial gain recognised in OCI	1.1	1.3
Cumulative actuarial gains recognised within retained losses	2.4	1.3
The principal actuarial assumptions made by the actuaries were:		
Salary growth	1.00%	1.00%
Discount rate	0.65%	0.60%
Male life expectancy from retirement age (years)	22.5	22.4
Female life expectancy from retirement age (years)	25.5	25.4

The average service period to retirement for scheme participants is approximately nine and a half years.

24. Retirement benefit obligations continued

Swiss defined benefit pension plan continued

The sensitivity of the defined benefit obligation to changes in the weighted principal assumptions is:

	Change in assumption	Monetary effect of increase in assumption £m	Monetary effect of decrease in assumption £m
Discount rate	+/- 1%	(2.3)	1.4
Salary growth	+/- 2%	0.8	(0.8)
Life expectancy	+/- 2 years	3.6	(3.0)

The above sensitivity analyses are based on a change in one assumption while holding all other assumptions constant. In practice, this is unlikely to occur, and changes in some of the assumptions may be correlated. The sole exception is the variation of the discount rate with simultaneous variation of the interest rate for projection of savings capital.

Defined contribution plans – UK and Germany

In addition the Group operates various defined contribution plans for its employees in the UK and Germany. The Group's contributions to these plans are charged to the Consolidated income statement in the year to which they relate, and the assets are held in separate trustee-administered funds. The charge to the Consolidated income statement in relation to defined contribution plans is £2.0m as disclosed in note 6 "Employees".

25. Deferred tax liabilities

The principal deferred tax liabilities relate to differences between the tax and accounting base of intangible assets and buildings uplifted as a consequence of fair value accounting requirements. Deferred tax liabilities are as follows:

	Intangible assets £m	Foreign exchange gains £m	Other £m	Total £m
At 1 April 2016	(20.8)	—	0.4	(20.4)
Recognised on acquisition of Skyepharma merger	(55.1)	(3.9)	—	(59.0)
Credited/(charged) to income statement	13.3	—	(2.3)	11.0
Charged to OCI	—	(0.7)	—	(0.7)
Foreign exchange	(7.2)	(0.5)	—	(7.7)
At 31 December 2016	(69.8)	(5.1)	(1.9)	(76.8)
Credited to income statement	22.0	—	—	22.0
Charged to OCI	—	(1.2)	—	(1.2)
Foreign exchange	2.2	0.3	—	2.5
At 31 December 2017	**(45.6)**	**(6.0)**	**(1.9)**	**(53.5)**

Deferred tax liabilities associated with the Skyepharma merger and Activaero intangible assets unwind to offset the tax distortion that would otherwise occur as the assets are amortised. Deferred tax liabilities on Swiss and US unrealised foreign exchange gains arise on permanent funding loans because foreign exchange gains are deferred on the local balance sheet in accordance with Swiss and US laws. A deferred tax asset on German tax losses of £5.3m (2016: £4.3m) has been offset against the deferred tax liability on Activaero intangible assets.

The Group did not recognise deferred tax assets on tax losses amounting to £226.2m (2016: £187.9m). The majority of the losses are unlikely to offset taxable profits as they mostly relate to non-trading losses in Investment holding companies. There are no current plans to recover these losses in the foreseeable future.

Following the recently-enacted US tax changes and the lowering of the US corporate income tax rate to 21%, revaluation of Vectura's US deferred tax liabilities has occurred. The impact in the current year is a one-off non-cash credit to the Consolidated income statement of £1.6m. Refer to note 13 "Taxation".

26. Financial instruments

In the current year, the Group has applied IFRS 9 – Financial Instruments (as revised in July 2014). IFRS 9 introduces three new requirements for 1) the classification and measurement of financial assets and financial liabilities, 2) the impairment of financial assets and 3) general hedge accounting.

Vectura is not a financial institution and does not have any complex financial instruments. Vectura does not apply hedge accounting and the Group's customers are considered creditworthy and pay consistently within agreed payments terms. As such, other than on disclosures, IFRS 9 is not assessed as having a significant impact on the Group. Details of these new requirements as well as their impact are described as follows.

Area	Impact of IFRS 9 adoption
Classification and measurement	Reclassification of financial assets into the IFRS 9 categories has had no overall impact on their respective measurement bases.
Impairment of financial assets	New requirements to recognise expected credit losses on day one are not expected to materially impact the Group, whose customer base typically has favourable credit history and significant cash resources. One bad debt was fully provided for as soon as loss was expected in the prior period and hence no restatement of the comparative is required. In future, any impairment on debtors will need separate disclosure on an income statement line item, with debtors ageing analysis to be provided in the disclosure note.
Hedge accounting	Vectura currently does not apply hedge accounting at present, and has not done so in previous periods.

On 1 January 2017, the Group has assessed which business models apply to the financial assets held by the Group on 1 April 2016, the date of initial application of IFRS 9, and has classified its financial instruments into the appropriate IFRS 9 categories.

The initial application of IFRS 9 has not had any impact on the Group's financial assets as regards their classification and measurement:

	31 December 2017 £m	31 December 2016 £m
Cash and cash equivalents held at amortised cost	103.7	92.5
Trade receivables and accrued income held at amortised cost	24.6	41.1
Financial assets at amortised cost	6.0	0.2
Financial liabilities at amortised cost	(53.3)	(58.0)
	81.0	75.8

The following items are not financial instruments as defined by IFRS 9

(a) prepayments made/advances received (right to receive future good or service, not cash or a financial asset)

(b) tax receivables and payables and similar items (statutory rights or obligations, not contractual), or

(c) deferred revenue and warranty obligations (obligation to deliver goods or services, not cash or financial assets).

Impairment of financial assets

In relation to the impairment of financial assets, IFRS 9 requires an expected credit loss model as opposed to an incurred credit loss model under IAS 39 – Financial Instruments: Recognition and Measurement. The expected credit loss model requires the Group to account for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk since initial recognition of the financial assets. In other words, it is no longer necessary for a credit event to have occurred before credit losses are recognised.

IFRS 9 allows a simplified approach for measuring the loss allowance at an amount equal to lifetime expected credit losses for trade receivables and contract assets.

The Group has three types of financial assets subject to the expected credit loss model:

- trade receivables for sales of inventory;
- trade receivables for R&D services; and
- accrued royalty and milestone income.

The Group was required to revise its impairment methodology under IFRS 9 for each of these classes of assets. There was no impact of the change in impairment methodology on the carrying values disclosed.

Provisions against impaired assets are disclosed in note 20 "Trade and other receivables".

26. Financial instruments continued

Impairment of financial assets continued

a. Credit risk

The impairment provisions for financial assets disclosed in note 18 "Other non-current assets" are based on assumptions about risk of default and expected loss rates. The Group uses judgement in making these assumptions and selecting the inputs to the impairment calculation, based on the Group's past history and existing market conditions, as well as forward-looking estimates at the end of each reporting period.

b. Capital management

The Group manages its capital to ensure that all entities in the Group will be able to continue as a going concern while maximising the return to stakeholders. The capital structure of the Group consists of equity (as disclosed in the Consolidated statement of changes in equity), retained earnings, cash and cash equivalents (note 21 "Cash and cash equivalents"), an RCF (note 21 "Cash and cash equivalents") and a Swiss property mortgage (note 22 "Trade and other payables"). The Group seeks to manage its capital through an appropriate mix of these items. At 31 December 2017, and to the date that these financial statements were issued, no funds were drawn against the RCF.

c. Financial risk management

The primary risks that the Group is exposed to through its use of financial instruments are liquidity risk, foreign currency risk and credit risk. Board authorisation is required for all significant agreements that may affect the Group risk structure. It is, and has been throughout the year, the Group's policy that no speculative trading in financial instruments is undertaken.

d. Liquidity risk management

Liquidity risk is the risk that the Group does not have sufficient financial resources to meet its obligations as they fall due. 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. The Group's policy is to maintain continuity of funding through available cash and cash equivalents, an RCF and through the issue of shares where appropriate.

e. Currency risk management

The Group's presentation currency is sterling. The Group is subject to exposure on the translation of the assets of foreign subsidiaries whose functional currencies differ from that of the Group. The Group's primary balance sheet translation exposures are to the Swiss franc, euro and US dollar. The Group aims to minimise balance sheet translation exposures, where it is practical to do so, by funding subsidiaries with long-term loans, on which exchange differences are taken to reserves.

The Group faces currency exposures arising from the translation of profits earned in foreign currency. These exposures are not hedged. Exposures also arise from foreign currency-denominated trading transactions undertaken by subsidiaries. The Group's policy is to offset such currency exposure by matching foreign currency revenues with expenditure in the same foreign currency. Where there are no imminent foreign currency-denominated transactions, the surplus foreign currency cash balances are exchanged for the functional currency of the subsidiary. Where it has not been possible to use natural hedges, currency options and forward currency contracts may be used. No options or forward contracts have been entered into in the period (2016: none).

A 10% strengthening of the euro, sterling, the US dollar and Swiss franc functional currencies within the Group against non-functional currencies of its subsidiaries would result in the loss before taxation being £7.0m lower and items recognised directly in other comprehensive income being £14.6m higher. A 10% weakening would have an equal but opposite effect on loss before taxation and other comprehensive income. The Group considers a 10% strengthening or weakening of the functional currency against the non-functional currency of its subsidiaries as a reasonably possible change in foreign exchange rates.

27. Prior period business combination – Skyepharma merger

On 10 June 2016, an all-share merger (the "merger") between Vectura and Skyepharma was completed by way of a scheme of arrangement of Skyepharma. Immediately following the transaction, on a fully diluted basis, the previous shareholders of Vectura owned 61.3% of the enlarged Group, with the previous shareholders of Skyepharma owning 38.7%. These percentages are broadly proportional to the revised Board structure.

Under the terms of the merger, Skyepharma shareholders received 2.7977 Vectura shares in exchange for each Skyepharma share held, with the option to take a partial cash alternative for a portion of their shareholding, which in aggregate was capped at £70.0m. The final uptake of this partial cash alternative was £52.1m. As Skyepharma had £27.1m of net cash on the acquisition date balance sheet, the net cash outflow before transaction costs was £25.0m.

27. Prior period business combination – Skyepharma merger continued

The fair values of Skyepharma assets and liabilities acquired on 10 June 2016 were as follows:

	Note	Book value £m	Fair value adjustments £m	Fair value acquired £m
ASSETS				
Non-current assets				
Intangible assets	A	6.5	373.0	379.5
Property, plant and equipment	B	28.3	11.2	39.5
Deferred taxation	C	2.0	0.7	2.7
Other financial assets		0.4	(0.4)	—
		37.2	384.5	421.7
Current assets				
Inventories	D	13.2	3.5	16.7
Trade and other receivables		22.3	—	22.3
Cash and cash equivalents		27.1	—	27.1
Other financial assets		0.1	(0.1)	—
		62.7	3.4	66.1
Total assets acquired		99.9	387.9	487.8
LIABILITIES				
Current liabilities				
Trade and other payables	E	(25.5)	(3.8)	(29.3)
Corporate taxation payables		(5.9)	—	(5.9)
Borrowings		(0.2)	—	(0.2)
Deferred income		(0.2)	—	(0.2)
Provisions		(2.2)	—	(2.2)
		(34.0)	(3.8)	(37.8)
Non-current liabilities				
Borrowings		(4.1)	—	(4.1)
Retirement benefit obligations		(8.3)	—	(8.3)
Provisions and other payables	E	(1.1)	(2.8)	(3.9)
Deferred taxation	C	(3.9)	(55.1)	(59.0)
		(17.4)	(57.9)	(75.3)
Total liabilities		(51.4)	(61.7)	(113.1)
Net assets acquired		48.5	326.2	374.7

A: Intangible assets: Skyepharma previously did not generally recognise internally generated intangible assets. IFRS 3 requires purchased intangible assets to be recognised at fair value. The intangible assets acquired by Vectura were valued by independent external experts on the basis of the net present value of income streams less costs associated with those streams.

B: Property, plant and equipment: fair value adjustments on land, buildings and equipment in Switzerland and France were recognised based upon property valuations obtained from independent external experts.

C: Deferred taxation: deferred tax liabilities were recognised in relation to the fair value uplift on net assets such that the notional tax consequence of amortisation can be matched to the period in which the amortisation occurs.

D: Inventories: inventories were uplifted to their fair value and have subsequently been sold through.

E: Trade and other payables and provisions: this relates to the recognition of contingent liabilities required by IFRS 3. On acquisition, Skyepharma was committed to make certain payments to a development partner contingent upon future receipt of sales milestones and royalties received, with the payments deducted from these amounts receivable from the partner. Accordingly, a liability of £6.6m was recognised and is expected to unwind by the end of 2020. There was no difference between the fair value and the carrying value of trade and other receivables at the merger date.

28. Ordinary share capital

Allotted, called up and fully paid	£m	Number of shares
Ordinary shares of 0.025p, each at 1 January 2017	0.2	677,969,321
Issued to satisfy Vectura employee share plans	—	1,961,880
Share buyback programme – cancellations	—	(1,422,503)
Ordinary shares of 0.025p, each at 31 December 2017	**0.2**	**678,508,698**

During the period, the Group allotted 1,961,880 (2016: 1,365,633) ordinary shares of 0.025p each related to employee share option awards. Refer to note 29 "Share-based payments".

On 14 November 2017, the Group announced that the Board has approved a share buyback to return up to £15m of capital to shareholders. The Board believes that, in addition to the implementation of the current investment strategy, the buyback reflects strong financial management discipline and is an efficient allocation of capital.

At 31 December 2017, 1,422,503 shares had been repurchased at a weighted average price of 95p per share. A total of £1.34m has been returned to shareholders to date. Directly attributable costs of £11,240 has been expensed to equity. On 28 February 2018 the programme was completed. Refer to note 33 "Post balance sheet events".

29. Share-based payments

The Group operates various share-based compensation plans and further information is provided in the Remuneration report. Share-based payments are solely made for the purposes of employee share compensation and as applicable are all settled for equity in Vectura Group plc.

	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
Equity settled LTIP and RSA plans	**2.1**	1.8
Exceptional share-based payments	**1.8**	0.5
Total share-based payments	**3.9**	2.3

The employee share award plans are designed to support a strong culture of long-term shareholder value creation. Details of the Long-Term Incentive Plan, the Group's main plan, are set out below. The Group also operates a Share Incentive Plan ("SIP") and a Save-As-You-Earn ("SAYE") Plan, albeit the accounting charges are not considered material and hence the disclosures of these plans are made within the Remuneration report.

Equity-settled Long-Term Incentive Plan ("LTIP") including restricted stock awards ("RSA")

Under the approved Group's remuneration policy equity awards are a key component of the overall remuneration package for senior management and executives. During the year, Vectura concluded a review of the LTIP arrangements and following approval at the 2017 AGM changes were introduced for Executive Directors and for all other employees as detailed below.

Transactions on the share plan for executives, senior management and key professionals during the year were as follows:

	Year ended 31 December 2017 Number of awards	9 months ended 31 December 2016 Number of awards
Beginning of the period	**9,175,233**	9,717,832
Granted	**3,770,532**	1,842,847
Exercised	**(1,495,589)**	(1,065,633)
Forfeited	**(2,709,714)**	(1,319,813)
End of the period	**8,740,462**	9,175,233

In 2016 the main Board Directors received LTIP grants worth 250% of salary subject to performance over three and five-year periods. The performance condition was subject to two relative TSR metrics, against the FTSE 250 (excluding real estate and financial services companies) and a bespoke sector peer group.

29. Share-based payments continued

Equity-settled Long-Term Incentive Plan ("LTIP") including restricted stock awards ("RSA") continued

In 2017, LTIPs granted to Executive Directors were reduced to 185% of salary (74% of 2016 levels), with the removal of the five-year performance element and changes to the vesting scale for TSR. Half of this three-year performance continues to be measured subject to a relative TSR metric against the FTSE 250 (excluding real estate and financial services). The remaining half of the award will be subject to a three-year cumulative adjusted EBITDA target as set by the Remuneration Committee.

Employees at the Executive Leadership Team (ELT) level were granted LTIPs at 105% of salary. 35% of these awards were subject to the same TSR and adjusted EBITDA metrics as the main Board participants, with the remaining 70% classified as restricted stock awards. Below ELT, and where applicable, participants receive awards entirely of restricted stock options.

Restricted stock awards are subject to service conditions, i.e. the requirement for recipients of awards to remain in employment with Vectura over the three-year vesting period and subject to a personal performance underpin. Any vested shares granted to the main Board member and Executive Leadership Team must be held for two years after vesting.

The treatment of vesting and non-vesting conditions attached to awards in the valuation process varies in accordance with the requirements of IFRS 2. For the year ended 31 December 2017, the calculation of the grant date fair value for the total shareholder return was as follows:

Number of TSR awards granted	1,114,638
Service condition	3 years
Holding condition	2 years
Share price on grant date	117.6p
Exercise (nominal) price	0.025p

The TSR condition (50% of the 2017 award and all of the 2016 award) is a market-based performance condition; this has been incorporated into the fair value calculation and no subsequent adjustments may be made.

For awards subject to a TSR condition, volatility is calculated over the period of time commensurate with the remainder of the performance period immediately prior to the date of grant being 28.12% (2016: 27.24%). The risk-free interest rate obtainable from government securities (i.e. gilts in the UK) over a period commensurate with the expected term was 0.09% (2016: 0.13%) and there was no dividend yield expected (2016: nil).

The adjusted EBITDA condition (50% of the 2017 awards for main Board and ELT) is a non-market condition; the fair value calculation is adjusted at each period end for the likelihood of the number of shares that will ultimately vest. All awards require recipients to remain in employment with the Company over the vesting period. For the LTIP and RSA awards that will be subject to a holding period, the Chaffe model (an at-market put option variant of the Black-Scholes model) has been used to determine a discount for the lack of marketability.

For the below ELT RSA awards, the probability of the non-market-based underpin condition being achieved does not need to be incorporated into the fair value at date of grant, but is evaluated periodically to true up the estimate for the number of awards expected to vest.

Exceptional share-based awards

Share-based payments within exceptional items were £1.8m (2016: £0.5m). Upon completion of the merger 1,490,982 exceptional nil-cost awards were granted to key members of management, excluding Executive Directors, considered critical to the integration process. These awards vest in full provided that an 18-month or 36-month service condition from their date of grant on 22 September 2016 and personal performance targets are met.

There are no performance conditions associated with these awards. The grant date fair value was £1.41 per share and the total share-based payment charge, assuming no lapses occur, will be expensed evenly to 21 March 2018 or 21 September 2019, depending on the applicable service conditions.

The increase compared to the previous period is owing to a full year's charge in 2017 compared to a quarter of a year's charge in 2016. £0.2m of exceptional charges were credited back in the period for employees with retention awards that left employment of the Group and hence did not satisfy the service condition.

Share trusts

The Group operates two share trusts. The Group's own-share reserve represents the weighted average cost of shares in the Estera Employee Benefit Trust and the Vectura Employee Benefit Trust, which are held for the purposes of fulfilling obligations in respect of executive awards and employee share plans.

30. Cash flow information

Restatement of comparative cash flow information

The FRC's corporate reporting review of the Group's Annual Report and Accounts to 31 December 2016 highlighted that IAS 7 – Statement of Cash Flows paragraph 16A prevents items being classified as investing activities unless a corresponding asset is also capitalised.

As a result of this review the comparative Consolidated cash flow statement has been restated. Cash outflows related to exceptional merger costs of £11.9m have now been presented within cash flows from operating activities and cash flows from financing activities, as opposed to cash flows from investing activities in the Consolidated cash flow statement. Net cash inflow from operating activities in 2016 has decreased by £9.4m from £28.2m to £18.8m and net cash outflow from investing activities has decreased by £11.9m from a cash outflow of £38.1m to cash outflow of £26.2m. Net cash outflow from financing activities has decreased by £2.5m from an outflow of £0.1m to an outflow of £2.6m.

9 months ended 31 December 2016	Previously reported £m	Restatement £m	Restated £m
Cash flow statement line item			
(Decrease)/increase in trade and other payables	7.1	(3.3)	3.8
Non-recurring transaction costs paid	6.1	(6.1)	—
Exceptional merger costs	(11.9)	11.9	—
Merger transaction costs	—	(2.5)	(2.5)

The FRC's enquiries regarding this matter are now complete. There are no further amendments to the financial statements other than enhancements to the presentation of Alternative Performance Measures. It must be noted that the FRC's review is limited to the published 2016 Annual Report and Accounts; it does not benefit from a detailed understanding of underlying transactions and provides no assurance that the Annual Report and Accounts are correct in all material respects. Further details are provided within the Audit Committee report.

Analysis of movement in financial liabilities

	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
At the beginning of the period	4.5	—
Skyepharma merger	—	4.3
Repayments	(0.3)	(0.3)
Interest expense	0.1	0.1
Foreign exchange movements	(0.2)	0.4
At the end of the period	4.1	4.5

Financial liabilities entirely relate to Swiss property mortgages secured on the Swiss R&D facility. Repayments include £0.2m (2016: £0.2m) of capital repayments.

31. Commitments and contingent liabilities

Operating leases

The Group is committed to making rental payments under non-cancellable UK property leases at Chippenham, Cambridge Science Park and Grosvenor Gardens, London, as follows:

	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
Within one year	1.1	1.1
Between two and five years	2.9	3.5
Over five years	2.6	2.9
Total operating lease commitments	6.6	7.5

Share buyback and cancellation programme

On 14 November 2017 Vectura Group plc announced that the Board has approved a share buyback and cancellation programme to return up to £15.0m of capital to shareholders. A purchase for cancellation programme of the Company's ordinary shares of 0.025p each commenced to a maximum consideration of £15.0m, expiring on 11 May 2018.

Numis Securities Limited was required to buy back shares independently of, and uninfluenced by, the Group. At 31 December 2017 £1.4m had been returned to shareholders and, accordingly, the Group had a commitment in relation to the remaining £13.6m of cash committed to the programme. The programme completed in February 2018, refer to note 33 "Post balance sheet events".

31. Commitments and contingent liabilities continued

Contingent liabilities

The Group has multiple collaborative development agreements with its Partners, across separate development and licensing agreements. Within some agreements, the Group has committed to make payments to the development partner contingent upon future events, such as sales milestones and royalties received, or has committed to fund or partially fund costs within the associated development programme. Historically, a number of these payments have not been claimed by some partners. As it is not possible to reliably estimate the potential outflow, and the potential for the outflow is considered remote, no liability is held on the balance sheet for such items.

The Group has an uncertain tax provision. Should any challenge from the relevant tax authority arise, it is possible that penalties (between 0–40% of underpaid taxation) could be levied. Based on external professional advice, penalties in excess of 20% are considered remote, and penalties towards the lower end of the range are considered more likely, but not probable. As a result, the Group considers a contingent liability of up to £1.0m (2016: £nil) in respect of penalties to be appropriate, but as the amount remains uncertain and payment is not considered probable, no provision is held on the balance sheet.

32. Related-party transactions

Associates

In order to finalise the valuation process of the Group's Chinese associate, costs of £1.6m have been incurred comprising £0.6m for the cost of new equipment and a £1.0m waiver of a loan previously made to the associate. These contributions are considered arm's length related-party transactions, necessary to finalise the valuation process.

Remuneration of key management personnel

The remuneration of the Directors, who are the key management personnel of the Group, was £2.6m and is set out below:

	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
Short-term employee benefits	1.0	0.9
Annual incentive plan	0.7	0.8
Non-Executive Directors' fees	0.4	0.3
Post-employment benefits	0.2	0.2
Share-based payments	—	0.4
Other	0.3	0.9
Total remuneration of key management personnel	2.6	3.5

Please refer to the Remuneration report for the remuneration of each Director.

At 31 December 2017 P-O Andersson owed the Group £3,600 (2016: nil) this outstanding amount was fully recovered in January 2018, no other amounts were outstanding between the Group and the Directors (2016: nil).

33. Post balance sheet events

Subsequent to the balance sheet date, a further £13.6m of shares have been repurchased as part of the £15.0m share buyback and cancellation programme completed by the end of February 2018. The weighted average price of shares purchased was 93p per share.

COMPANY BALANCE SHEET

at 31 December 2017

	Note	31 December 2017 £m	31 December 2016 £m
ASSETS			
Non-current assets			
Investments in subsidiary undertakings	4	**710.8**	710.8
Current assets			
Amounts due from subsidiary undertakings		**6.0**	2.5
Cash and cash equivalents		**13.8**	—
Total current assets		**19.8**	2.5
Total assets and net assets		**730.6**	713.3
SHAREHOLDERS' EQUITY			
Share capital	7	**0.2**	0.2
Share premium		**102.8**	102.3
Share-based payment reserve		**8.4**	5.8
Merger reserve	8	**551.7**	551.7
Retained earnings		**67.5**	53.3
Total shareholders' equity		**730.6**	713.3

Company registered number: **03418970**

The accompanying notes form an integral part of these individual financial statements prepared under FRS 101 – Reduced Disclosure Framework.

As permitted by Section 408 of the Companies Act 2006, the Company's Income statement and related notes have not been presented in these financial statements. The profit for the year ended 31 December 2017 was £16.1m (loss for the nine months to 31 December 2016: £10.6m); this included £29.0m of dividends from subsidiary undertakings.

The Company financial statements of Vectura Group plc were approved and authorised for issue by the Board of Directors on 20 March 2018 and were signed on its behalf by:

J Ward-Lilley
Director

A Derodra
Director

COMPANY STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December 2017

	Share capital £m	Share premium £m	Merger reserve £m	Share-based payment reserve £m	Retained earnings £m	Total equity £m
At 31 March 2016	0.1	101.6	131.9	17.4	49.1	300.1
Loss for the period	—	—	—	—	(10.6)	(10.6)
Skyepharma scheme of arrangement	0.1	—	424.3	—	—	424.4
Merger relief	—	—	(2.0)	—	2.0	—
Share transaction costs	—	—	(2.5)	—	—	(2.5)
Employee share transactions	—	0.7	—	2.3	(1.1)	1.9
Transfers within reserves	—	—	—	(13.9)	13.9	—
At 31 December 2016	0.2	102.3	551.7	5.8	53.3	713.3
Profit for the year (note 2)	—	—	—	—	16.1	16.1
Employee share transactions	—	0.5	—	3.9	(1.8)	2.6
Share buyback and cancellation programme	—	—	—	—	(1.4)	(1.4)
Transfers within reserves	—	—	—	(1.3)	1.3	—
At 31 December 2017	**0.2**	**102.8**	**551.7**	**8.4**	**67.5**	**730.6**

The profit for the year ended 31 December 2017 was £16.1m (2016: loss £10.6m), which included £29.0m (2016: nil) of dividend income from subsidiary undertakings.

The accompanying notes form an integral part of these Company financial statements prepared under FRS 101 – Reduced Disclosure Framework.

1. Presentation of the financial statements

1.1 Critical accounting areas of judgment and estimation

In preparing these financial statements, critical judgements in the application of accounting policies can have a significant effect on the financial results, moreover any changes in critical estimates and assumptions made could materially impact the amounts of assets, liabilities, revenue and expenses reported next year as actual amounts and results could differ from those estimates or those estimates could in future change.

The following critical estimates if changed next year would materially impact reported performance:

Carrying value of investments in subsidiary undertakings

The Company's investments in subsidiary undertakings are carried at historical cost less any provision for impairment. The Company's investments in the UK arise from the acquisition of Coordinated Drug Development Limited in August 1999 and Innovata Plc in January 2007, Germany from the Activaero transaction in March 2014 and the Swiss and US investments on the Skyepharma merger in June 2016. As these investments are not amortised, their carrying values are at risk of impairment. Their recoverable amount is assessed with reference to the discounted cash flow forecasts associated with these territories including their products, research and development programmes, technologies and intellectual property (which for the more recent transactions are typically recognised as purchased intangible assets in the Consolidated financial statements of the Group).

It is likely that any significant diminution in expected value from the underlying operations from the investments would result in impairment. The Company continues to monitor progress of its investments in Switzerland. The carrying value of the investment in Germany is particularly sensitive to the outcome of the VR475 (FAVOLIR®) Phase III study and VR647 (SCIPE®) Phase II study scheduled for completion in the second half of 2018.

2. Basis of preparation – accounting policies for the Company financial statements

In preparing these financial statements, the Company applies the recognition, measurement, and disclosure requirements of International Financial Reporting Standards ("IFRS") as adopted by the EU ("IFRS"), but makes amendments where necessary in order to comply with the Companies Act 2006 and has excluded certain information as permitted by FRS 101 – Reduced Disclosure Framework. Details of Directors' remuneration, share options and retirement benefits are given in the Remuneration report.

These financial statements, which are prepared using the historical cost convention and on a going concern basis, are prepared in accordance with Financial Reporting Standard 101 – Reduced Disclosure Framework and with UK accounting presentation and the Companies Act 2006 as at 31 December 2016, with comparative figures as at 31 December 2016. As permitted by section 408 of the Companies Act 2006, the income statement of the Company is not presented in this Annual Report.

The Company also takes exemptions in relation to share-based payments, financial instruments, capital management, presentation of comparative information in respect of certain assets, presentation of a cash flow statement and certain related-party transactions, on the basis that equivalent disclosures are given in the Group's consolidated financial statements. Key accounting policies and judgements relate to investments in subsidiary undertakings and are disclosed in note 4 "Investments in subsidiary undertakings".

3. Dividend income

The Company received dividend income from subsidiary undertakings totalling £29.0m (2016: nil). The Company's immediate subsidiary undertaking Skyepharma Limited declared ordinary dividends of £14.0m and £15.0m, which were fully settled for cash in September and November 2017 respectively. No amounts remain outstanding.

4. Investments in subsidiary undertakings

Investments in subsidiaries are stated at historical cost less any provision for impairment. The carrying amounts of the Company's investments are reviewed at each reporting date to determine whether there is an indication of impairment. If such an indication exists, then the recoverable amount of the asset is estimated to ensure that the carrying value remains supportable.

Any impairment charges are recognised in the income statement and are reflected in an allowance against the carrying value. The distributable reserves of Vectura Group plc are protected from the impact of any decrease in the valuations of investments to the extent of the merger reserves, which become distributable to offset any changes in the investment carrying value. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through the Company income statement.

Subsidiary undertakings	UK subsidiaries £m	German subsidiaries £m	Swiss & US subsidiaries £m	Total £m
At 31 March 2016	125.6	108.7	—	234.3
Additions	—	—	476.5	476.5
At 31 December 2016	125.6	108.7	476.5	710.8
At 31 December 2017	**125.6**	**108.7**	**476.5**	**710.8**

5. Disposal of dormant subsidiaries

On 7 December 2017, the Group disposed of 14 dormant UK-based subsidiaries by appointing KPMG as liquidator pursuant to a member voluntary liquidation process. As these entities were dormant they were disposed of for nil consideration, and as these entities only contained intercompany positions, thereby already fully eliminated out upon consolidation, there was no impact on the Group's results.

The entities subject to the member voluntary liquidation process are as follows; (1) Quadrant Healthcare (UK) Limited, (2) Andaris Group Limited, (3) Quadrant Holdings Cambridge Limited, (4) Microshot Limited, (5) Quadrant Bioresource Limited, (6) Andaris (DDS) Limited, (7) Quadrant Trustee Limited, (8) Protosome Limited, (9) Sun Wharf Stratford Limited, (10) Vine (Building Maintenance) Limited, (11) Vine Industries Limited, (12) Vinestand Limited, (13) Playscheme Limited and (14) Big Ben Scaffolding Limited.

As the liquidation process has yet to be completed, the liquidator has confirmed that no contingent liabilities have been identified and hence no further costs in relation to these entities are expected to be incurred.

6. Subsidiary, associate and dormant undertakings

In accordance with section 409 of the Companies Act 2006 a full list of subsidiaries, partnerships, associates, joint ventures and joint arrangements, the country of incorporation and the effective percentage of equity owned at 31 December 2017 are disclosed below. Unless otherwise stated the share capital disclosed comprises ordinary shares which are indirectly held by Vectura Group plc.

	Country/region of incorporation	Ordinary shareholding	Nature of business
Vectura Limited[1]	United Kingdom	100%	Pharmaceuticals
Innovata Limited[1]	United Kingdom	100%	Pharmaceuticals
Vectura Delivery Devices Limited[1]	United Kingdom	100%	Pharmaceuticals
Innovata Biomed Limited[4]	United Kingdom	100%	Pharmaceuticals
Quadrant Drug Delivery Limited[1]	United Kingdom	100%	Pharmaceuticals
Skyepharma Limited*[2]	United Kingdom	100%	Holding company
Vectura Group Investments Limited*[1]	United Kingdom	100%	Holding company
Jagotec AG[6]	Switzerland	100%	Pharmaceuticals
Skyepharma AG[6]	Switzerland	100%	Pharmaceuticals
Skyepharma Holding AG[9]	Switzerland	100%	Holding company
Skyepharma Production SAS[7]	France	100%	Manufacturing
Vectura Inc*[3]	United States	100%	Pharmaceuticals
Skyepharma Holding Inc[10]	United States	100%	Holding company
Skyepharma US Inc[8]	United States	100%	Non-trading company
Vectura GmbH*[11]	Germany	100%	Pharmaceuticals
Ventaleon GmbH[12]	Germany	30.66%	Associate – pharmaceuticals
Innovata HK Limited[5]	Hong Kong	82.37%	Holding company
Tianjin Kinnovata Pharmaceutical Co. Ltd[15,16]	China	45.95%	Associate – pharmaceuticals
Quadrant Healthcare Limited[1]	United Kingdom	100%	Dormant
Quadrant Technologies Limited[1]	United Kingdom	100%	Dormant
Vine Exhibition Limited[2]	United Kingdom	100%	Dormant
Vine Northern Limited[2]	United Kingdom	100%	Dormant
QDose Limited[1]	United Kingdom	50%	Dormant
Krypton Limited[13]	Gibraltar	100%	Dormant
Skyepharma Management AG[6]	Switzerland	100%	Dormant
Genta Jago Technologies B.V.[14]	Netherlands	50%	Dormant

* Directly held by the Company.

6. Subsidiary, associate and dormant undertakings continued

The registered address for each entity disclosed below corresponds to the entity's principal places of business:

1 One Prospect West, Chippenham, Wiltshire, SN14 6FH.
2 46-48 Grosvenor Gardens, London, SW1W 0EB.
3 20 William Street Suite 130 Wellesley MA 02481.
4 2nd Floor North, Saltire Court 20 Castle Terrace, Edinburgh, EH1 2EN.
5 Unit 1802, 18/F, Asia Trading Centre, 79 Lei Muk Road, Kwai Chung, N.T., Hong Kong.
6 Eptingerstrasse 61, 4132 Muttenz, Switzerland.
7 Zone Industrielle Chesnes-Ouest, 55, Rue de Montmurier, B.P. 45, 38291 Saint-Quentin-Fallavier, France.
8 2711 Centerville Road, Suite 400, Wilmington, Delaware 19808, USA.
9 Treuhand AG, Chollerstrasse 3, 6300 Zug, Switzerland.
10 Corporation Trust Center, 1209 Orange Street, Wilmington, New Castle, Delaware 19801, USA.
11 Robert-Koch-Allee 29, 82131 Gauting, Germany.
12 Wohraer Str. 37, 35285, Gemünden/Wohra, Germany.
13 Suite 1, Burns House, 19 Town Range, Gibraltar.
14 Herikerbergweg 238, 1101 CM Amsterdam.
15 Eleventh Street, Tianjin Economic-Technological Development Area, the PRC.
16 The effective shareholding is 37.84% (Innovata HK Limited holding of 82.37% and indirect holding of Tiranjin Konnovata Pharmaceutical Co. Ltd of 45.95%).

7. Share capital

Allotted, called up and fully paid	£m	Number of shares
Ordinary shares of 0.025p, each at 31 December 2016	0.2	677,969,321
Issued to satisfy Vectura employee share plans	—	1,961,880
Share buyback programme	—	(1,422,503)
Ordinary shares of 0.025p each at 31 December 2017	**0.2**	**678,508,698**

Redeemable preference shares of 34,000 at £1 par value have no associated voting, dividend or coupon rights but are eligible to be repaid before any distribution to shareholders; the shares can be repaid by the Company at any time.

8. Merger reserves

A merger reserve is used where more than 90% of the shares in a subsidiary are acquired and the consideration includes the issue of new shares by the Company, thereby attracting merger relief under section 612 and section 613 of the Companies Act 2006. Merger relief under the UK Companies Act 2006 is available to allow recognition of a merger reserve as opposed to non-distributable share premium. The merger reserves are non-distributable reserves, but become distributable to offset any future diminution in the investment value or where that investment is disposed of for qualifying consideration.

9. Distributions to shareholders

Share buyback and cancellation programme

On 14 November 2017 Vectura Group plc announced that the Board has approved a share buyback to return up to £15.0m of capital to shareholders. A purchase for cancellation programme of the Company's ordinary shares of 0.025p each commenced to a maximum consideration of £15.0m, expiring on 11 May 2018.

At 31 December 2017 1,422,503 shares had been repurchased at a weighted average price of 95p per share. A total of £1.4m had been returned to shareholders at the year end.

Dividend policy

Vectura has not paid dividends in the past. The declaration and payment of any dividends in the future will depend on the results of operations, financial conditions, cash requirements, future prospects, profits available for distribution and other factors deemed by the Vectura Board to be relevant at the time.

At present, the Vectura Board does not expect to pay any dividends in the near to medium term. The Board will continue to reassess this position based on the factors above.

10. Post balance sheet events

Subsequent to the balance sheet date, a further £13.6m of shares have been repurchased with the £15.0m share buyback and cancellation programme completed by the end of February 2018. The weighted average price of shares purchased was 93p per share.

Directors
Bruno Angelici
Non-Executive Chairman

Frank Condella
Non-Executive Vice Chairman

James Ward-Lilley
Chief Executive Officer

Andrew Derodra
Chief Financial Officer

Susan Foden
Non-Executive Director and Senior Independent Director

Neil Warner
Non-Executive Director

Dr Per-Olof Andersson
Non-Executive Director

Thomas Werner
Non-Executive Director

Juliet Thompson
Non-Executive Director

Company Secretary
John Murphy

Corporate broker
J.P. Morgan Cazenove
25 Bank Street
Canary Wharf
London
E14 5JP, UK

Corporate broker
Numis Securities Limited
The London Stock Exchange Building
10 Paternoster Square
London
EC4M 7LT, UK

Public relations
Consilium Strategic Consulting
41 Lothbury
London
EC2R 7HG, UK

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

Auditor
KPMG LLP
15 Canada Square
London
E14 5GL, UK

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

Legal advisors
Clifford Chance
10 Upper Bank Street
Canary Wharf
London
E14 5JJ, UK

Vectura Group plc
(Registered office)
One Prospect West
Chippenham
Wiltshire
SN14 6FH, UK

Forward-looking statement
This Annual Report and Accounts contains forward-looking statements, including statements about the discovery, development and commercialisation of products. Various risks may cause Vectura's actual results to differ materially from those expressed or implied by the forward-looking statements, including: adverse results in clinical development programmes; failure to obtain patent protection for inventions; commercial limitations imposed by patents owned or controlled by third parties; dependence upon strategic alliance partners to develop and commercialise products and services; difficulties or delays in obtaining regulatory approvals to market products and services resulting from development efforts; the requirement for substantial funding to conduct research and development and to expand commercialisation activities; and product initiatives by competitors. As a result of these factors, prospective investors are cautioned not to rely on any forward-looking statements. We disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Vectura Group plc's commitment to environmental issues is reflected in this annual report which has been printed on UPM Fine, made from an FSC® certified material. Printed in the UK by CPI colour using their environmental printing technology. Both manufacturing mill and the printer are registered to the Environmental Management System ISO14001 and are Forest Stewardship Council® (FSC) chain-of-custody certified.

Produced by

designportfolio

Vectura Group plc
One Prospect West
Chippenham
Wiltshire SN14 6FH
United Kingdom

T +44 (0)1249 667700
F +44 (0)1249 667701
www.vectura.com

Registered in England and Wales
Number: 03418970