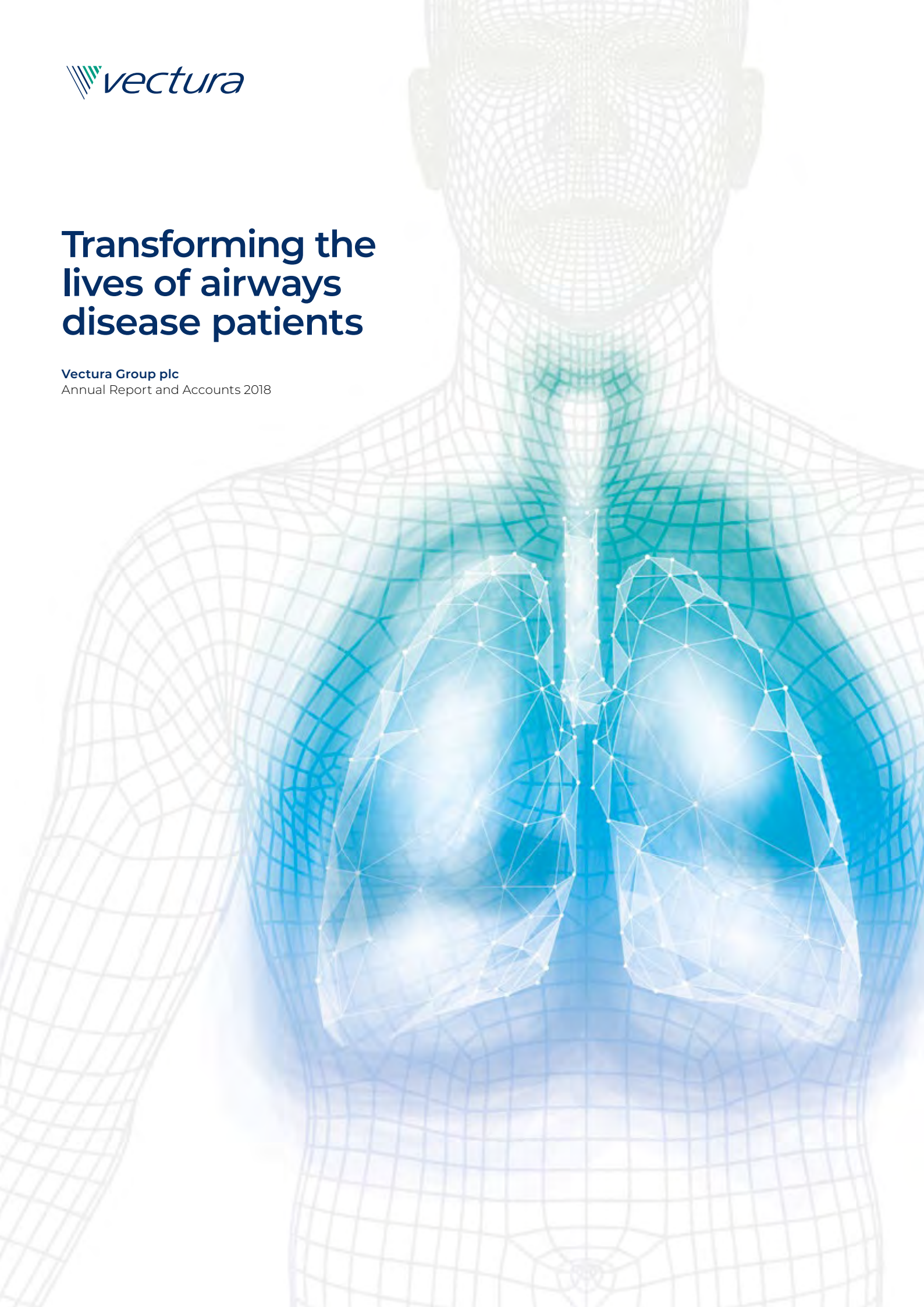
vectura

Transforming the lives of airways disease patients

Vectura Group plc
Annual Report and Accounts 2018



Our vision is to transform patients' lives through enhanced inhaled drug delivery

Investment case

Sustained revenue growth and consistent cash generation with significant pipeline potential

1

Differentiated inhalation development capabilities

+ Read about our business model on page 6

2

In-market product cash flow generation

+ Read about our in-market products on page 32

3

Focused R&D strategy with pipeline progression and partnering potential

+ Read about our pipeline on page 5

4

Focus on Operational Excellence

+ Read about our R&D on page 28

5

Strong cash flow generation and capital discipline

+ Read more in the Financial review on page 51

For more information visit
www.vectura.com

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Highlights

Strong 2018 financial and operational performance

Financial highlights

- Full year reported revenue of £160.5m, +8.4%
  - Inhaled portfolio revenues of £131.1m, +15.0%
  - Strong *flutiform*® performance with Vectura revenues of £79.6m, +13.7%, driven by strong product supply revenues, +17.0%
  - Generic GSK Ellipta® deal signed with Hikma, £6.6m revenue recognised in 2018
- R&D costs of £55.5m at the lower end of the guidance range, reflecting refocused portfolio prioritisation and initiatives to transform R&D productivity
- Adjusted EBITDA of £39.0m, up 51.2%, driven by revenue growth, improved gross margin, lower R&D costs and productivity improvements
- Operating loss of £105.4m, after ongoing amortisation and exceptional items, impacted by £39.8m intangible asset impairment following the discontinuation of the VR475 programme, as previously communicated
- Strong cash generation from operations, up 30.5% to £35.1m. Closing cash and cash equivalents of £108.2m, share buyback of £13.8m also completed in the year

+ Read more in our Financial review on page 51

Paul Fry
Chief Financial Officer

"Our full-year results for 2018 demonstrate strong cash generation and adjusted EBITDA growth.

Reported revenue
£m
£160.5m
+8.4%

12 months to 31/12/18: 160.5
12 months to 31/12/17: 148.0

Reported operating loss
£m
£105.4m
-9.6%

12 months to 31/12/18: (105.4)
12 months to 31/12/17: (96.2)

Adjusted EBITDA[1]
£m
£39.0m
+51.2%

12 months to 31/12/18: 39.0
12 months to 31/12/17: 25.8

Basic EPS
p
(13.2)p
-4.8%

12 months to 31/12/18: (13.2)
12 months to 31/12/17: (12.6)

Cash and cash equivalents
£m
£108.2m
+4.3%

As at 31/12/18: 108.2
As at 31/12/17: 103.7

1 Adjusted EBITDA is a non-IFRS measure which is calculated as operating loss, adding back amortisation and impairment, depreciation, share-based payments and exceptional items. A reconciliation of operating loss to adjusted EBITDA is presented in note 9 to the financial statements.

Operational highlights

- **Positive progression and expansion of inhaled generics pipeline**
  - VR315 repeat clinical trial on track to enable Hikma Pharmaceuticals ("Hikma") to resubmit data in 2019, supporting potential launch in 2020
  - Largest product agreement deal in Vectura's history signed with Hikma for the global development of generic versions of GSK's Ellipta® portfolio, up to $80m in future milestones plus a share of distributable net profit, up to a mid-teen percentage
  - VR2081 development continues with first clinical trial batches delivered to Sandoz
- **Growing clinical evidence supports the expansion of Vectura's enhanced nebulised portfolio**
  - As previously reported, the VR475 Phase III study did not meet the challenging primary endpoint of reduction in exacerbations in a severe adolescent and adult asthma population. Secondary data support differentiated performance versus conventional nebuliser and further validates confidence in the platform and symptom relief endpoints for VR647
  - Two positive studies for VR647 (US) in children completed; results support Phase III development and partnering progression
  - Commenced development of three new nebulised therapies, targeting niche or orphan disease segments
- **Operational Excellence driving improved performance and creating additional capacity**
  - Significant progress in R&D transformation, focused partner and alliance management and supply chain initiatives contributing to strong adjusted EBITDA performance and creating additional capacity for new nebulised pipeline projects

James Ward-Lilley
Chief Executive Officer

"Focused execution of the Group's strategy resulted in strong financial and operational performance in 2018.

At a glance

An industry-leading inhaled airways disease-focused business

450+

Employees

c.200

Experienced scientists in our clinical, regulatory, formulation and device teams

15m+

Our target number of patients using products utilising Vectura's Intellectual Property (IP) by 2025 (from 9m in 2018).

Source: Management approximation based on 60% compliance applied to IQVIA SMART MIDAS units.

Vectura is an industry-leading inhaled product formulation, device design and development business offering a uniquely integrated inhaled drug delivery platform. We develop inhalation products to help patients suffering from airways diseases.

Vectura's strategy is to maximise the value of differentiated inhaled formulation, device and development capabilities through partnering complex inhaled generics and the enhanced delivery of existing molecules.

Our locations

- **Corporate office**
  London, UK
- **Development sites**
  Chippenham and Cambridge, UK
  Muttenz, Switzerland
  Gauting, Germany
- **Oral manufacturing site**
  Lyon, France

A pipeline focused on inhaled generic and nebulised therapies

INHALED IN-MARKET PRODUCTS	INHALED GENERICS	VECTURA ENHANCED THERAPIES	OTHER PARTNERED PRODUCTS
10	8	5	1
	VR315 (Hikma) Asthma/COPD (US)		
flutiform® (Mundipharma Int. and Kyorin) Asthma	AB-rated substitutable generic Ellipta® portfolio (Hikma)[3]		
flutiform® *k-haler*® breath-actuated, (Mundipharma Int.) Asthma (EU)	AB-rated substitutable generic Ellipta® portfolio (Hikma)[3]		
Ultibro® (Novartis) COPD (Global)	AB-rated substitutable generic Ellipta® portfolio (Hikma)[3]	Vectura Enhanced Therapies Cardiopulmonary Vascular Disease	
Seebri® (Novartis) COPD (Global)	VR730 (Hikma) Asthma/COPD (US)	Vectura Enhanced Therapies Cystic Fibrosis	
Breelib™ (Bayer) PAH (EU & RoW, ex. US)	VR506 (Hikma) Asthma (US)	Vectura Enhanced Therapies Post-transplant immune compromised patients	
AirFluSal® Forspiro® (Sandoz) Asthma/COPD (EU & RoW, ex. US)	VR2081 (Sandoz) Asthma/COPD (US)	VR647 (US) Paediatric Asthma	
Ellipta® Portfolio (4 Products[1]) (GSK) (Global)	VR632 (Sandoz) Asthma/COPD (EU)[2]	VR736 (Ventaleon) Severe Influenza (Global)	QVM149 (Novartis) Asthma (EU, RoW)

1 Vectura has IP in four Ellipta® products: Breo®, Anoro®, Trelegy® and Incruse®.

2 Approved in EU; launches are imminent.

3 Progressing at least three of a possible five generic GSK Ellipta® assets.

+ Read about our products and portfolio from page 30

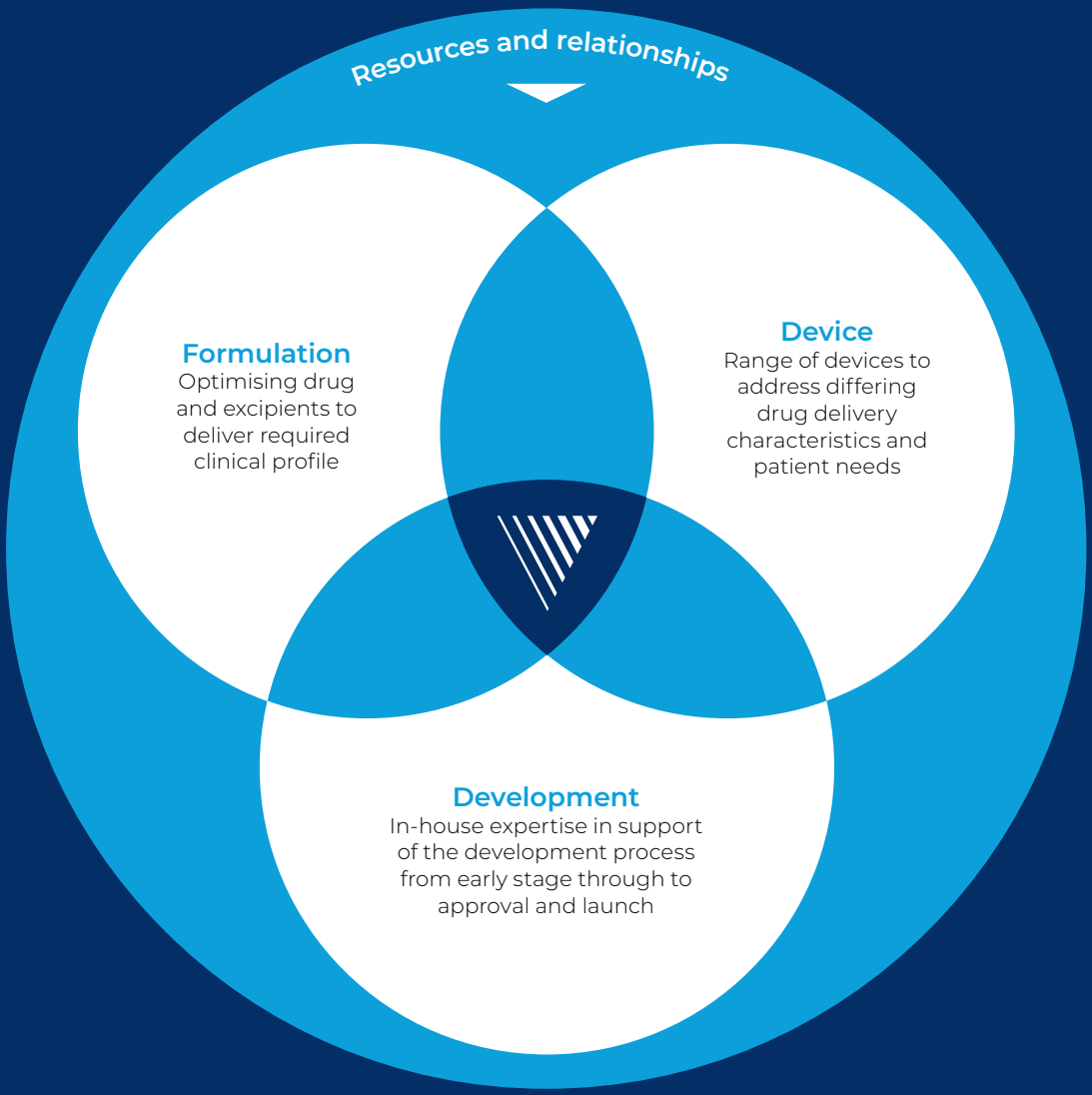
Our partners

Bayer, gsk, hikma., 金赫集团 KingYork, Kyorin, mundipharma, Novartis, Sandoz A Novartis Division

Business model

Proven capabilities to transform patients' lives and create shareholder value

Inhaled market opportunity



+ Read more about our capabilities on pages 18 to 21

Priority investment focus and partnering

Strong cash flow generation

Value creation for shareholders and others

Inhaled market opportunity

The inhaled market is large and diverse, with respiratory disease a major segment. There are high barriers to entry for companies focused on delivering complex inhaled generics and enhanced versions of known molecules. Vectura's capabilities, expertise and experience position us to have a significant impact on patients' lives and deliver shareholder value

+ Read more about market opportunity on pages 14 to 17

Resources and relationships

Our talented people
We have 450+ employees working internationally across five sites with extensive clinical, regulatory, formulation, device and development expertise

R&D
Vectura has a rich heritage of innovation. Our R&D expertise is at the heart of our company, creating value for patients and for shareholders

+ Read more about R&D on pages 28 and 29

Patient insight
We ensure our teams understand the impact on patients of the diseases we are targeting, as well as the science behind diagnosis and treatment

+ Read more about our patient focus on page 62

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

+ Read more on pages 59 and 60

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

Our strong partnerships
We have active partnerships with leading pharmaceutical and biotech companies

+ Read more about our partnering approach on page 61

Priority investment focus and partnering

Maximising the value of our differentiated inhaled formulation, device design and development capabilities by partnering both our complex inhaled generics portfolio and enhanced therapies

Strong cash flow generation

Product supply **Royalties[1]** **Development revenues**

+ Read more in our Financial review on pages 51 to 57

1 Royalties include share of net sales of EXPAREL® and other sales milestones or licensing revenues related to marketed products containing Vectura intellectual property – also referred to "Royalties and other marketed products" in note 3 to the financial statements.

Value creation for shareholders and others

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

Our patients
Developing products to improve patients' lives

Supporting patient access to affordable, quality products with our generics pipeline and by developing innovative treatments to address major areas of unmet medical need

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

Our partners
Leveraging Vectura's capabilities to support the scientific and operational development of new and inhaled generic products which deliver returns for our partners

Our environment and local communities
Offering good quality employment opportunities and a long-term positive impact on our environment and communities

Chairman's statement

Uniquely positioned

Dear Shareholder,

In the past twelve months, we have seen a significant improvement in overall business performance after a challenging 2017. The Group delivered strong financial performance, and of particular note was the signing of an agreement with Hikma to develop generic versions of GSK's Ellipta® portfolio, the Group's biggest ever product deal to date.

Despite the positive business progression, we are disappointed with our share price performance and this remains a key focus for the Board as we continue to concentrate on delivering shareholder returns.

Revenue growth and operational performance

Vectura's revenues continue to grow in line with our expectations to £160.5m, up 8.4% versus last year. This growth was underpinned by strong product supply demand from our partners for *flutiform*®, which grew 17% versus 2017, and the additional business development revenue of £6.6m recognised from the new deal with Hikma. In addition to continued revenue growth, the Group has delivered a number of supply chain initiatives which have contributed to improvements in product supply margins.

Our revised investment focus and implementation of our R&D transformation programme, announced in January 2018, allowed us to reduce our R&D expenditure from £60.3m to £55.5m, a fall of 8.0%, whilst creating additional capacity to support new scientific programmes more cost effectively.

The Group's operating loss reflects a number of significant non-cash items, including £41.5m impairment charges, largely driven by the impairment of the VR475 intangible asset, amortisation and depreciation charges and share-based payment compensation. As a result of the impairment charge recognised during the year, the Group's operating loss increased from £96.2m to £105.4m. Adjusted EBITDA, which adjusts for these non-cash items and exceptional items of £9.0m, was up 51.2% to £39.0m reflecting the Group's strong financial and operational performance during 2018.

The Group ended the year with a strong closing cash balance of £108.2m, demonstrating management's continued focus on capital allocation and financial discipline.

We continue to see operational progress with positive results for the VR647 clinical trials, paving the way for the design of a Phase III programme alongside partnering opportunities.

We have also seen good progress with the VR315 repeat clinical trial and made significant headway with the development of three new Vectura enhanced nebulised therapies, targeting orphan or niche disease segments.

Amid these successes, the Phase III study of VR475 in adult and adolescent patients with severe uncontrolled asthma did not meet its primary endpoint. We were disappointed with these results, although it was recognised from the outset that achieving statistical significance was a high hurdle to overcome in this setting. Following the results, the VR475 intangible asset was fully impaired. That said, the secondary endpoints reinforce our confidence in the differential characteristics of our nebulised platform.

Business model

Vectura has a unique place in the market. Its broad range of device and formulation capabilities provide 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.

The Company also has expertise in device development across its innovative pipeline, with a 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 medicines. Vectura's differentiated nebuliser technology has proven capability to provide significant improvements in efficacy, tolerability and/or reduction in treatment times over conventional nebulisers.

These capabilities are difficult to replicate and are the basis of how we create value as a business. We do this by leveraging our capabilities:

- licensing our device, formulation and development capabilities for new medicines or the reformulation and repurposing of existing medicines;
- licensing our device, formulation and development capabilities for significant inhaled generic treatments with major generics companies; and
- re-purposing and reformulating existing drugs for early development prior to partnering, once proof of concept is established, typically with our differentiated nebuliser technology.

Through our partnerships with different pharmaceutical companies, we receive fees and licensing income when key milestones are achieved, as well as royalties and sales milestones once a product has been launched onto the market. We may also receive a manufacturing margin where we are involved in the supply of products.

Pharmaceutical development is a lengthy and risky process especially for novel products. However, most of Vectura's programmes concern products which have been on the market where their efficacy and/or safety profile is well known.

Nevertheless, optimising value creation for our shareholders by using our competitive advantages requires a robust strategy and clear capital allocation priorities. The Board monitors and reviews both on a regular basis.

People and culture

At Vectura, we are highly dependent on the capabilities, innovation and creativity of our employees for our future growth and success. It is important that we have a culture and set of values that are understood and integrated across the business. In 2018, a continued effort was made to engage Vectura colleagues to engender a strong sense of pride and belief in the Group. A number of initiatives were introduced to spotlight the significant capabilities that exist and impressive science that is undertaken, ensuring everyone understands Vectura's significant opportunities and potential.

On behalf of the Board, I would like to thank each one of our employees for their hard work this year and their continued commitment to delivering our strategy and progressing the business for the benefit of all our stakeholders.

Board changes

In June 2018, we welcomed Anne Whitaker as a new Independent Non-Executive Director. Anne brings with her more than 25 years' experience in the life science industry, including senior leadership roles with large pharmaceutical, biotech and speciality pharma companies.

In July, Andrew Derodra, Chief Financial Officer, left the Company to take up a new role, and in October Paul Fry was appointed as his replacement.

Frank Condella, Non-Executive Director and Vice Chairman, stood down from the Board in October, having made significant contributions to the business, both in executive and non-executive roles. We all wish him the very best in his future endeavours.

In October we also announced that, from January 2019, Juliet Thompson will chair the company's Remuneration Committee, with Susan Foden standing down from the role. Susan remains on the Board and as a member of the Nominations Committee, as well as continuing her role as Senior Independent Director (SID).

Juliet's appointment as Remuneration Committee Chair is a relatively short-term appointment, as she will take up the position originally intended of Chair of the Audit Committee when Neil Warner stands down.

Governance

As a Board, we are committed to the principles of good corporate governance. We have continued to comply with the provisions of the 2016 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 section on pages 65 to 107. Moving forward, we are already working on activities that will enable us to confirm compliance with the new 2018 Code, which we will report on next year.

In November, I outlined to major shareholders a succession plan for the Vectura Board, aiming at a progressive and meaningful refresh of the Board.

By 2020, with the implementation of this plan, it is intended that the average tenure of the members of the Board will be reduced considerably.

A search has been initiated and is nearing completion for a new Non-Executive Director, with the intention of appointing someone with the appropriate experience and qualifications to become Chair of the Remuneration Committee in due course, once they have had sufficient time to get to know the Company and the Board.

In addition, we will continue to meet and prioritise the Hampton-Alexander Review requirements on diversity in the boardroom.

Shareholders

I would also like to thank our shareholders for their continued support. 2018 was a year of good progress and I am looking forward to that progress continuing in 2019. Our commitment to growing, partnering and innovating remains strong, as we work continuously to deliver shareholder value.

Outlook

The Group expects a sustained financial performance in 2019 after a strong 2018, with continued overall revenue growth offset by the gross profit impact from the loss of EXPAREL® revenues and the normalisation of the *flutiform*® gross margin. The Group expects the partnering of VR647 later this year. R&D guidance for the year remains unchanged at £45m to £55m.

I am looking forward with optimism to achieving our targets in 2019. Read more about our strategic priorities on pages 22 to 27.

Bruno Angelici
Chairman
25 March 2019

Chief Executive's statement

Positive progress

Following a challenging 2017, I am pleased to report on the progress and momentum regained by Vectura in 2018. We have delivered strong financial performance with disciplined operational execution; signed a major new generic development agreement; and made significant pipeline progress.

Following the refocusing of our investment strategy, and restructuring, we have seen improved levels of employee engagement and enhanced levels of trust, pride and belief in the business.

Market and business opportunity

It is useful to reflect on the inhaled market in which Vectura operates, reminding ourselves of the outstanding opportunity the company has to leverage its strengths to make a difference to patients' lives whilst also creating significant shareholder value.

These opportunities include:

- continued high levels of unmet medical need in large and well-established market segments, such as asthma and COPD;
- huge growth of respiratory disease in emerging markets, driven by pollution, smoking and improved diagnosis;
- rapid growth in specialist niche disease diagnosis, treatment and value;
- high levels of innovation, with many small and large molecules suitable for inhalation in development;
- high barriers of entry and few capable, proven inhaled competitors for the significant and largely untapped opportunity in the US inhaled generics market; and
- significant and valuable opportunities for potential reformulation and repurposing of existing inhaled and non-inhaled molecules for enhanced inhaled delivery.

Strategy

Vectura is a well-established company with proven capabilities and a differentiated operating and business model (see page 6).

Our strategic focus and prioritisation remains unchanged: to maximise the value of differentiated inhaled formulation, device and development capabilities through partnering complex inhaled generics and the enhanced delivery of existing molecules.

We continue to do this by investing in and growing our business, whilst demonstrating financial and capital allocation discipline.

Alongside our existing partnered licensing revenues, we have an industry-leading portfolio of complex inhaled generic products partnered with Hikma and Sandoz, providing material milestone and development revenues ahead of launch. In addition to our existing US paediatric VR647 programme, we have commenced development of three new programmes, in specialist niche indications, using existing molecules which we see as having the potential to become an important revenue source over time.

Financial performance

Revenues of £160.5m were up 8.4%. Product supply revenues of £85.6m grew 14.6% and made up over half of total Group revenues in 2018. Total development revenues of £16.5m were also up strongly (+71.9%) driven particularly by the new generic Ellipta® portfolio agreement with Hikma.

In addition, R&D expenditure was reduced to £55.5m. Through a series of strong operational excellence initiatives across the business, in alliance management, supply chain and procurement, adjusted EBITDA is up 51.2%, to £39.0m. Operating loss, which includes significant non-cash items such as impairment charges, amortisation and depreciation, and share based compensation, increased by 9.6% to £105.4m, largely driven by the impairment to the VR475 intangible asset. These non-cash and exceptional items are excluded from adjusted EBITDA. Based on our revenue growth, focused investment prioritisation and continued tight financial management, we ended the year with a cash balance of £108.2m (2017: £103.7m).

+ Read more about our global agreement with Hikma on page 37

In-market portfolio

Our key inhaled growth drivers, *flutiform*® and Ultibro® Breezhaler®, have continued to grow in competitive markets.

flutiform® generated total in-market sales of €221.7m, up 8.5% in value (CER) and up 12.2% in volume[1], contributing £79.6m revenue for Vectura, up 13.7% compared to 2017. The normalisation of Mundipharma supply chain requirements, supported by this strong in-market performance, resulted in a 17.0% increase in product supply revenue which contributed £74.2m to overall *flutiform*® revenues.

The European ICS/LABA market remains a highly competitive and genericised market which declined by 3.3%[1] in value during 2018. Despite the slowing of in-market sales growth rates, *flutiform*® sales in Europe grew 2.0%, to €114.4m, and grew 2.7% in volume, reaching a market value share of 3.8% of the ICS/LABA market[1]. We expect that the launch of the breath-activated *flutiform*® k-haler® and the addition of the positive opinion for the paediatric indication of *flutiform*® will reinforce the continued differentiation of the product in this challenging market.

The less mature and non-genericised Japanese market grew by 3.3%[1] in value. In-market sales of *flutiform*® grew strongly, up 12.8% in value, and 17.4% in volume, to €87.2m[1], despite price reductions of approximately 5.8% in place since April 2018. *flutiform*® remains at an early stage of its lifecycle in rest of world territories and has continued to grow strongly, with in-market sales of €20.1m up 35.1% compared to 2017[1].

Ultibro® Breezhaler® continues its class leadership of the dual bronchodilator LAMA/LABA class (ex. US), with growth of 7.9% compared to 2017[1], despite increased competition. In-market sales in Europe grew by 6.3% to $385.4m and also grew strongly in rest of world markets, up 23.2% to $73.4m[1]. In January 2019, Novartis reported 2018 combined net sales for Seebri® and Ultibro® of $602m (2017 combined net sales: $562m) and Vectura recognised £17.8m of total royalties for sales of these products.

We look forward to the completion of Novartis' QVM149 Phase III study, due to be completed in H2 2019, with regulatory submission in Europe and Japan also in H2 2019, triggering a filing milestone to Vectura of $2.5m and royalties on net sales upon launch.

Inhaled generics

We remain firmly committed and positive regarding the prospects for our inhaled generics portfolio. Recruitment is progressing well on the repeat clinical study for VR315. Hikma anticipates being able to submit data from the study to the US Food and Drug Administration (FDA) during 2019 to support its regulatory application, enabling a potential US launch in 2020.

The US market for complex substitutable inhaled respiratory generics remains very attractive. There are high technical and financial barriers to entry. Until the recent approval of Mylan's Wixela™ Inhub™, there were no substitutable complex inhaled generic drug device products on the market, and the ICS/LABA market volume remains significant, with over 36m devices supplied last year.

We continue to forecast significant volume and value opportunities for VR315 when it reaches the market.

In November 2018, we significantly expanded our pipeline of inhaled generics with the signing of an agreement with Hikma for the global development and commercialisation of generic versions of GSK's Ellipta® portfolio, utilising Vectura's proprietary Open-Inhale-Close dry powder inhaler device. Upon signing we received an upfront payment of US$15m, with potential for further payments of up to $80m. In the event of successful launch, Vectura will receive a share of distributable net profit up to a mid-teen percentage for each portfolio product (see page 37).

Alongside our Hikma partnership, we are continuing our pMDI development work on VR2081, a generic version of an existing major inhaled combination therapy for asthma and COPD in the US, with the first clinical trial batches delivered to the Group's partner, Sandoz.

1 IQVIA SMART MIDAS constant currency sales. Royalties payable to the Group by partners are based on agreed contractual definitions of net sales, which differ from IQVIA reported sales and may include other adjustments or deductions.

Chief Executive's statement continued

Inhaled generics continued

Vectura's proven capabilities in complex inhaled generic product development continue to be reflected in the EU with AirFluSal® Forspiro® royalty and product supply revenues continuing to grow well (revenue of £4.4m, up 15.8%). The recent approval of VR632 in the EU, an analogue of Symbicort®, has given a further validation of our inhaled generic development skills and capabilities.

Nebulised portfolio

We have also made important progress with our nebulised portfolio.

In August we successfully concluded two clinical trials to support the potential use of VR647 for the treatment of paediatric asthma. For full details, see page 38.

In November we announced that our Phase III study of VR475 in adult and adolescent patients with severe uncontrolled asthma did not meet its ambitious primary endpoint. As a consequence, we will not be pursuing further development and partnering of the programme, and have fully impaired the intangible asset. However, secondary data from the study provide further support for our nebuliser platform, as well as underlining Vectura's capability to successfully deliver a Phase III trial.

Evidence of the differentiated value of our nebulised portfolio continues to also be provided by the successful roll-out of Breelib™ by Bayer. I was pleased by the recent feedback from several key opinion leaders on the utility of the FOX® device; how effectively it is delivering iloprost to patients with pulmonary arterial hypertension; and the role it could potentially play in improving outcomes for people living with other respiratory diseases. Similarly, whilst we were disappointed that Sanofi chose not to progress with the Ablynx ALX-0171 anti-RSV nanobody during 2018, following its Phase II programme results, we were encouraged that the primary endpoint of anti-viral efficacy and target exposure using an adapted FOX® nebulised device was achieved.

2018 also saw the start of three new niche development programmes with existing molecules utilising our proprietary nebulised devices. These projects target niche or orphan disease segments (see page 39).

Operational excellence

Operational excellence has been a major area of focus for the business and driver of our strong adjusted EBITDA performance in 2018. Through R&D transformation, we have not only delivered our planned priority pharmaceutical development and clinical pipeline projects, but we have also been able to create headroom for additional activity, including funding the three early-stage new nebulised projects, all within reduced total R&D spend of £55.5m (reduced from £60.3m in 2017 and £65.1m in 2016 (twelve-month pro forma)). Whilst the operating loss has increased by 9.6%, this is largely driven by the impairment charge to the VR475 intangible asset.

We have also seen major improvements in our focus on alliance management activities. This included settlements on the return of specific AirFluSal® Forspiro® territory rights from Sandoz; a settlement of the VR2076 triple therapy project termination with Mundipharma; and the settlement of an outstanding IP-related agreement with Therabel.

Our newly established procurement team are also making great efforts in rationalising our supplier base, which is generating savings.

+ Read more about our R&D transformation on pages 28 and 29

+ Read more about our people on page 59

People, workplace and culture

Vectura's performance and outlook continues to be underpinned by the skills, capability, commitment and enthusiasm of our team. Following a challenging 2017 and an initial period of restructuring in 2018, I am pleased to report improved employee engagement as the business has stabilised and regained momentum.

We have continued to focus on leadership and performance, with a series of development programmes for senior colleagues to be cascaded to the wider line manager group in 2019.

This has been matched with some strong recruitment in Medical Affairs, Clinical Development, Device Development and Portfolio Management.

I was delighted to welcome Paul Fry to Vectura as Chief Financial Officer in October. Paul brings with him significant industry experience and is already making a positive impact in his role.

Brexit

The Group has closely reviewed the potential risks associated with Brexit and the Board believes Vectura has undertaken a robust approach to ensuring any impact within our control is mitigated as far as possible.

Mitigating activities have included continued close working with our supply chain network and partners, establishing a new EU legal entity, and transferring our notified regulatory body for our device assets.

For full details, please refer to the Risk Management and Principal Risks section.

> "Vectura's performance and outlook continues to be underpinned by the skills, capability, commitment and enthusiasm of our team.

GSK litigation

As previously reported in December 2018, the UK High Court ruled in favour of GSK in an action based on certain additional Vectura patents which GSK previously had an option to take a licence to under the patent licence and option agreement with Vectura dated 5 August 2010 and which they chose not to exercise. Having taken advice from experienced advisers on the issues covered in the judgement an appeal process has been initiated. The judgement applies only in respect of the UK patents and does not directly affect the proceedings which Vectura commenced against GSK under its US patents. There is no impact on the timing of US litigation; the Group still expects the US jury trial to go ahead in April/May 2019. The Group will provide an update on these litigation actions in due course.

Summary

Vectura's outlook remains positive. With multiple market opportunities; a clear focused strategy; continued cash flow generation from our in-market assets; an exciting and currently undervalued generics and nebulised pipeline; and a strong balance sheet, the Group is in a strong place. As noted earlier, realising our full patient and shareholder potential is only possible through our teams and, once again in 2018, they have worked hard, demonstrating innovation, flexibility and resilience. I would like to extend my heartfelt thanks for all their contributions.

We look forward to a positive 2019 and continued determination to create and deliver shareholder value.

James Ward-Lilley
Chief Executive Officer
25 March 2019

Respiratory market opportunity

Respiratory disease affects a significant portion of the population globally. Asthma and COPD alone affect over 480m patients[1,2]. Further, specialist disease segments with smaller populations often have high unmet needs for new therapeutic treatments. There are high barriers to entry for companies focused on delivering molecules to the lungs. However, Vectura's capabilities, expertise and experience position the Company to have a significant impact on patients' lives with new, reformulated or generic therapies.

1 WHO asthma factsheet, accessed January 2019: https://www.who.int/en/news-room/fact-sheets/detail/asthma.
2 WHO COPD factsheet, accessed January 2019: https://www.who.int/news-room/fact-sheets/detail/chronic-obstructive-pulmonary-disease-(copd).

MARKET OPPORTUNITY

Vectura has the capability to target key areas of unmet need in asthma and COPD

Asthma affects over 230m people worldwide[1] (see disease explainer) but despite being such a common disease, there are still areas of high unmet need that are the focus of future research:

- Children have few approved treatment options compared to adults. Our VR647 (US) programme has the potential to provide a new therapeutic option in this patient population.
- Many patients with moderate/severe asthma cannot be controlled with current therapy and new approaches are needed. QVM149 in Phase III trials for asthma may help meet this need.
- Compliance with existing therapies remains a significant challenge and the need for easier to use and more convenient devices is high. Vectura's device expertise can make a significant contribution to meeting this need.

Chronic obstructive pulmonary disease (COPD) affects over 250m people worldwide[2] (see disease explainer) but currently does not have therapeutic options that treat the underlying disease. Unmet needs driving new research in COPD include:

- improving the management of symptoms to allow patients to continue with their day-to-day lives; and
- as with asthma, improving convenience of devices to drive better compliance, where Vectura's device expertise can have a real impact.

MARKET OPPORTUNITY

Drug and device innovation

There are a significant number of clinical inhalation programmes ongoing, with >220 projects in inhalable medicines in the pipeline globally. This reflects the steady demand for new therapies to address growing unmet medical need. It is predominantly small- and medium-sized pharmaceutical companies (~80%) driving this innovation, even beyond the pre-clinical phase.

Source: Pipeline Analysis, Global Data, 2018.

DISEASE EXPLAINER

Asthma

Asthma is a chronic lung disease that inflames and narrows the airways. Asthma causes recurring periods of wheezing (a whistling sound when you breathe), chest tightness, shortness of breath, and coughing.

Source: National Heart, Lung and Blood Institute. What is asthma? Accessed February 2019: https://www.nhlbi.nih.gov/health-topics/asthma.

~230m people

have asthma and the disease is common among children[1]

380,000+

asthma deaths per year globally[1]

0–4 years

In the US, more than half of all children with asthma had one or more asthma attacks in 2016, with children aged 0–4 years most at risk

Source: Zahran HS etal, 2018 Vital Signs: Asthma in Children – United States, 2001–2016.

Asthma market 7MM*

$20.5bn

The total asthma market is projected to grow from $17.6bn in 2018 to $20.5bn in 2027

Source: Decision Resources, 2018.

* Seven major markets: US, 5EU (France, Germany, Italy, Spain and the UK) and Japan.

MARKET OPPORTUNITY

LABA/LAMA, triple combinations and biologics driving growth in asthma and COPD

In the major therapeutic classes, LABA/ICS combination treatments continue to be a mainstay of treatment with significant volumes globally. Volumes continue to grow, even as generics and competition impact the total market value.

- Vectura products: *flutiform*® (Mundipharma Int., Kyorin)

Dual LABA/LAMA bronchodilators like Novartis' Ultibro®/Utibron™ continue to drive significant growth in the COPD market. The LAMA class meanwhile is seeing some erosion as its use is replaced by combination therapies.

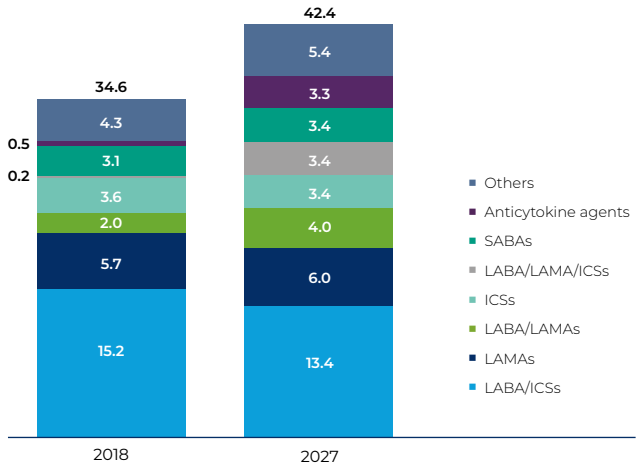
- Vectura products: Ultibro®/Utibron™ and Seebri® (Novartis)

Following approvals in COPD and strong initial growth for the class, triple combinations of LABA/LAMA/ICS are expected to enter the asthma market over the next 12–24 months.

- Vectura pipeline products: QVM149 (Novartis)

Biologic therapies remain a small but valuable class of treatments for certain subsets of patients and this class is expected to continue to grow. QVM149 Phase III studies, partnered with Novartis, are expected to be completed in H2 2019.

Asthma and COPD markets, G7 $bn



Graph sources: Decision Resources (a) Chronic Obstructive Pulmonary Disease, Disease Landscape & Forecast, November 2018 and (b) Asthma, Disease Landscape & Forecast, October 2018.

DISEASE EXPLAINER

COPD

COPD describes progressive lung diseases, including emphysema and chronic bronchitis, which cause increasing breathlessness and severely impacts people's lives.

There is significant room for improvement in diagnosis and treatment in both developed and developing markets.

~250m+ people

have COPD[2]

3m

deaths caused by COPD each year, making it the fourth leading cause of death

Source: Mannino, M. & Kiri, V., Changing the burden of COPD mortality. Int J Chron Obstruct Pulmon Dis. 2006 Sep; 1(3): 219–233.

COPD market 7MM*

$22.0bn

The total COPD market is projected to grow from $16.9bn in 2018 to $22.0bn in 2027

* Seven major markets: US, 5EU (France, Germany, Italy, Spain and the UK) and Japan.

Source: Decision Resources, 2018.

Markets continued

MARKET OPPORTUNITY

Complex inhaled generics are an attractive market with high barriers to entry and meet a key need for health systems and patients

In the US, inhaled generic prescription share is only 21%, compared to 87% in other delivery formulations, given the complexity of developing substitutable inhaled products. While price competition has had some impact on branded products in the US, prices are still much higher compared to Europe. Vectura is well positioned to take advantage of this with VR315 partnered with Hikma, and there are few competitors like us with the proven inhalation capabilities to target this significant and largely untapped market.

- Vectura pipeline products: VR315 (Hikma), VR2081 (Sandoz), generic GSK Ellipta® programme in development with Hikma.

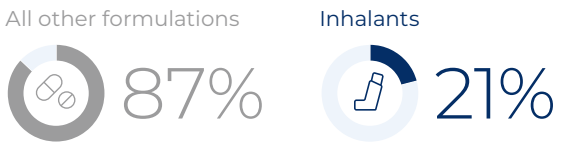
In Europe and the rest of the world, generics and analogue products are an important therapeutic option. Demographic trends in the rest of the world in particular are a strong driver for future opportunity.

- Vectura products: AirFluSal® Forspiro® (Sandoz).

While the ICS/LABA class is key to medium-term growth in generics, there is significant longer-term potential in LAMA, LABA/LAMA, and triple therapies. Our partnership programme with Hikma, announced this year, will position Vectura to participate in these valuable markets.

- Vectura pipeline products: generic GSK Ellipta® programme in development with Hikma.

2017 US generic prescription share %



Source: IQVIA Global Generic and Biosimilars Trends and Insights, presented at the Association for Accessible Medicines 13 February 2018.

> “While the ICS/LABA class is key to medium-term growth in generics, there is significant longer-term potential in LAMA, LABA/LAMA and triple therapies.

DISEASE EXPLAINER

Cystic fibrosis

Cystic fibrosis (CF) is a rare, progressive, genetic disease that causes persistent lung infections and limits the ability to breathe over time.

In people with CF, mutations in the cystic fibrosis transmembrane conductance regulator (CFTR) gene cause the CFTR protein to become dysfunctional. The CFTR protein controls the movement of salt ions across the epithelium of cells.

In the lungs, the defective ion transport causes accumulation of thick mucus and an inability to clear the secretions. This leads to inflammation, airway obstruction and chronic infection, ultimately leading to destruction of the lung tissue.

Source: CF Foundation, Decision Resources, Davies JC 2007.

There are a range of treatments currently available, targeting different aspects of the disease, to help loosen and clear the mucus in the lungs, improve absorption of nutrients and fight lung infection, as well as target underlying defects in the CFTR protein.

However, new treatments are still needed to improve lung function, reduce exacerbations and prolong life.

More than half of people with CF are over 18 years of age.

70,000

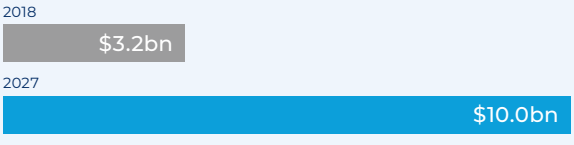
CF affects approximately 70,000 people worldwide

>75%

More than 75% of people with CF are diagnosed by two years of age

Source: Cystic Fibrosis Foundation, accessed March 2019: https://www.cff.org/What-is-CF/About-Cystic-Fibrosis/.

Cystic fibrosis market 7MM*



$10bn

Major-market sales of key CF therapies will grow at a 13% compound annual growth rate (CAGR) to over $10bn by 2027

Source: Decision Resources, 2018.

* Seven major markets: US, 5EU (France, Germany, Italy, Spain and the UK) and Japan.

MARKET OPPORTUNITY

Specialist diseases

People with rare, orphan and specialist respiratory diseases have high unmet needs and often few therapeutic options. Specialist markets are expected to grow significantly as disease understanding improves and new treatments are developed.

Although patient populations are smaller compared with asthma and COPD, competition may be less intense, and there is significant commercial opportunity for effective therapies. A global market worth $10bn in 2018 is expected to grow considerably in the years ahead, reaching $20bn by 2027.

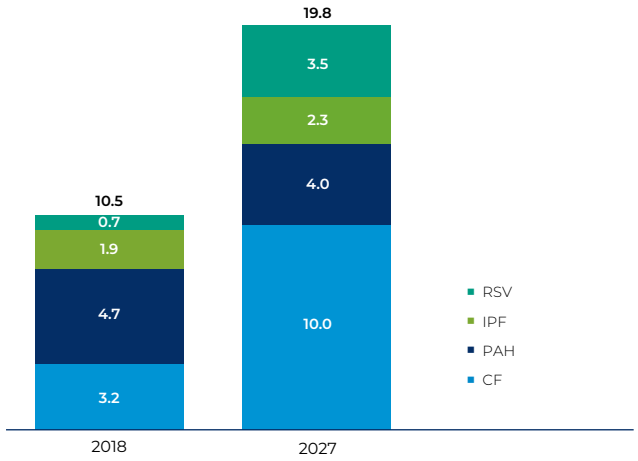
The specialist disease segment is well suited to nebulised therapy to better target the lung and avoid unwanted systemic effects and drug/drug interactions.

The nebuliser device market is currently worth c.$730m.

Source: Markets and Markets – devices forecast to 2020.

Graph source: Decision Resources 2018, RSV from Global Data 2018.

Specialist diseases Global sales, $bn



DISEASE EXPLAINER

Immunocompromised patients following lung transplant

Immunocompromised patients are potentially susceptible to infection from many different micro-organisms. Infections that are typically innocuous may cause significant disease states in immunocompromised hosts.

Patient groups include organ transplant or haematopoietic stem cell transplant recipients – their susceptibility to pathogens (bacteria, fungi, viruses and parasites) depends upon the nature of the underlying immune defects.

Globally, there are approximately 5,000 lung transplants each year, with over 175,000 stem cell and other solid organ transplants. Following lung transplant, infections are common and are associated with high morbidity and mortality.

Existing treatment options include systemic anti-infectives but these may have significant side-effects and drug/drug interactions which limit use. Inhaled anti-infectives may offer an effective, user-friendly alternative.

References: US SOT 2017 data: https://optn.transplant.hrsa.gov/, US HSCT 2014 data: CIBMTR (Center for International Blood and Marrow Transplant Research) https://bloodcell.transplant.hrsa.gov/research/transplant_data/transplant_activity_report/year-donor_type.pdf, EU SOT 2016 data: Organizacion Nacional De Transplantes http://www.ont.es/publicaciones/Documents/NEWSLETTER%202017_baja%20(2).pdf, ROW SOT 2010 data: GODT https://reports.ont.es/caaan.aspx includes Latin America, Canada, Eastern Mediterranean, Western Pacific, Africa, SE Asia, EU and ROW HSCT: 2013 data, European Society of Blood and Marrow Transplantation (EBMT): Hematopoietic SCT in Europe 2013 Bone Marrow Transplant. 2015 Apr; 50(4): 476–482. https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4387247/#sup1.

DISEASE EXPLAINER

Pulmonary arterial hypertension

Pulmonary arterial hypertension (PAH) is a rare, progressive, fatal disease that affects the arteries in the lungs and the right side of the heart.

Source: Mayo Clinic.

PAH has an annual mortality rate of 15% and a five-year survival of approximately 50%.

Source: Benza et al, Chest 2012.

PAH affects approximately 100,000 people worldwide.

Source: Decision Resources, 2018.

PAH severely impacts people's quality of life – amongst other symptoms, it causes shortness of breath, fatigue and weakness, and can make exercise increasingly difficult for patients. At later stages of the disease, patients may find themselves short of breath even while at rest.

In 2017, Vectura's partner Bayer launched Breelib™ for use with Ventavis, a well-established inhaled treatment for patients with PAH. Breelib™ is a small, handheld, battery-powered breath-activated vibrating mesh inhalation system developed by Vectura. This smart nebuliser utilises the FOX®'s flow rate and volume control technology. It provides patients with an easier to use device and a faster time of delivery for patients.

Source: Gessler T, Ghofrani HA, Held M, et al. The safety and pharmacokinetics of rapid iloprost aerosol delivery via the Breelib™ nebuliser in pulmonary arterial hypertension. Pulmonary Circulation 2017; 7(2):505-513.

Pulmonary arterial hypertension market 7MM*

Source: Decision Resources, 2018.

* Seven major markets: US, 5EU (France, Germany, Italy, Spain and the UK) and Japan.

Capabilities

Industry-leading inhalation development capabilities

Vectura is one of the few companies globally with the expertise to design, develop, industrialise and deliver the most complex inhaled therapies. We have 200 scientists in our clinical, regulatory, formulation and device teams whose capabilities drive our business.

Class-leading device technology

Vectura has deep 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 active drug doses. In particular, Vectura's differentiated smart nebuliser technology has the potential to provide significant improvement in delivery efficiency, efficacy and/or reduction in treatment time over conventional nebulisers[1].

Vectura continues to build its valuable technology platform of low-cost, high-volume DPI products and has recently signed an agreement with Hikma for the global development and commercialisation of up to five generic versions of GSK's Ellipta® portfolio. The agreement utilises Vectura's Open-Inhale-Close dry powder inhaler, which leverages proprietary technology from both the GyroHaler® device (marketed by Sandoz as AirFluSal® Forspiro®) and the Lever-operated device (licensed to Hikma for VR315 US). The Open-Inhale-Close device has been developed to be a simple, cost effective device with the same user interface as the GSK Ellipta® device and therefore targeted to be substitutable.

Andreas Meliniotis
Director, Device Development

"The agreement utilises Vectura's Open-Inhale-Close dry powder inhaler, which leverages proprietary technology from both the GyroHaler® and Lever-operated devices.

1 Fischer A, Stegemann J, Scheuch G, et al. Novel devices for individualized controlled inhalation can optimize aerosol therapy in efficacy, patient care and power of clinical trials. European Journal of Medical Research. 2009; 14: Suppl. 4: 71–77.

Vogelmeier C., Kardos P. et al. Nebulised budesonide using a novel device in patients with oral steroid-dependent asthma. European Respiratory Journal. 2015; 45: 1273–1282.

Gessler T, Ghofrani HA, Held M, et al. The safety and pharmacokinetics of rapid iloprost aerosol delivery via the Breelib™ nebulizer in pulmonary arterial hypertension. Pulmonary Circulation 2017; 7(2):505–513.

Sandy Munro
VP, Pharmaceutical Development

"We maximise the value of our product pipeline via the seamless integration of our highly differentiated device platforms, our class-leading formulation capability, and our clinical development and regulatory expertise.

Comprehensive enabling formulation technology

In addition to our industry-leading device platforms, Vectura has outstanding formulation capabilities to match. Our deep expertise provides us with competitive advantage in the development of generics for asthma and COPD. Beyond this, we can leverage our proprietary particle engineering technologies, or skills in liquid formulation, to develop innovative products. These can be based on the significantly enhanced delivery of known respiratory molecules, or by re-purposing established drugs – normally delivered orally or via injection – in inhaled format to treat niche diseases.

In particular, liquid formulation development has been a growth area for Vectura since the acquisition of our highly differentiated smart nebulisers. The technical requirements of specific delivery technologies, the properties of the drugs we are interested in developing, and the patient needs in specific disease areas mean we must have capability in solution and suspension approaches for small molecules and biologics in order to create new and improved therapies.

Capabilities continued

Advanced analytical capability

Vectura's advanced in-house analytical capability 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 methods required to characterise complex inhalation products, not just for small molecules and combinations thereof but also for complex biologic inhalation products.

In addition to analytical methods required to support regulatory submissions for new treatments, we are able to use more specialised techniques that give a more thorough drug product understanding and provide early insights into how drug products will behave in patients' hands. This is a particular area of focus in developing generics, where we have to demonstrate bioequivalence both in the laboratory and in a clinical setting. Vectura's expertise in this area sets the company apart from others.

Matthew Pollard
VP, Pharmaceutical Development

"Specialised techniques give a more thorough understanding and provide early insights into how drug products will behave in patients' hands.

Tony Hughes
Manufacturing Team Leader

"Batch manufacture of a bespoke paediatric variant of the FOX® nebuliser comprised multiple stages, requiring an in-depth understanding of the device platform and its engineering systems.

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.

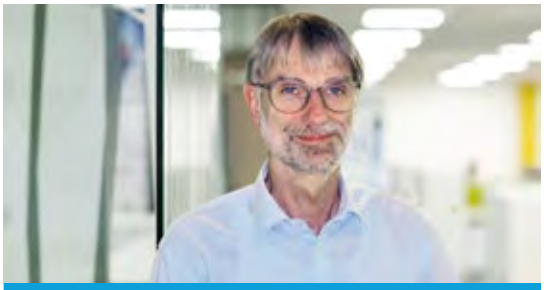
Recently, a cross-functional team of almost 50 colleagues manufactured and delivered nearly 6,000 devices of a bespoke variant of the FOX® nebuliser with face-mask and oxygen feed for use in a Phase IIb paediatric study. Batch manufacture comprised multiple stages, requiring an in-depth understanding of the device platform and its engineering systems, encompassing mechanical, software and electronic elements.

Control checks for aerosol performance and end-of-line quality control release testing were performed, with all devices CE marked and labelled with full serial numbering traceability, before being hygienically packaged. Results of the clinical trial were positive for the primary endpoint of anti-viral efficacy and target exposure was achieved.

Scale-up and industrialisation capabilities

Vectura has the expertise to develop manufacturing processes for pMDI products, 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.

Manufacturing process development of Vectura's *flutiform*® pMDI product, which we supply to partners Mundipharma and Kyorin, started on a very small scale of about 3kg and was progressed through scale-up to a pre-commercial batch size in our Muttenz pilot scale GMP pMDI filling plant. This allowed for the smooth transfer to our selected contract manufacturing organisation (CMO) in the UK, where the commercial process was successfully implemented and validated. Our CMO has supplied worldwide markets since 2012 without any interruption and is currently performing further upscaling to meet the increasing demands of *flutiform*®, which is a key source of product supply and royalty revenue for Vectura.



Manfred Fischer
VP, Pharmaceutical Development

> "Manufacturing process development of *flutiform*® started on a very small scale and was progressed through scale-up... and allowed for the smooth transfer to our CMO.

Helen Spain
VP, Regulatory Affairs

> "Knowing when and how to engage with regulatory bodies is also key in optimising clinical study designs and overall development programmes.

Airways disease regulatory and clinical expertise

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.

This has recently been demonstrated in the planning and successful execution of the VR647 pharmacokinetic and methodology studies in the US. The clinical development plan was constructed using the team's knowledge and expertise of respiratory disease, and with a comprehensive understanding of the regulatory framework and legislation for combination products and medical devices. Key opinion leader engagement was sought to ensure clinical protocol designs would meet expected patient need and would be operationally feasible. Knowing when and how to engage with regulatory bodies is also key in optimising clinical study designs and overall development programmes. Our combined experience in clinical, regulatory and statistics has ensured the VR647 clinical results are optimally interpreted and summarised to discuss with the FDA, supporting future Phase III activities.

Vectura strategy at a glance

Our strategy is to maximise the value of our differentiated inhaled formulation, device and development capabilities through partnering complex inhaled generics and the enhanced delivery of existing molecules. We are delivering our strategy though five key pillars:

STRONG FINANCIAL PERFORMANCE

MAXIMISING PARTNERING VALUE

MAXIMISING PIPELINE VALUE

OPERATIONAL EXCELLENCE

GREAT PLACE TO WORK

STRONG FINANCIAL PERFORMANCE

Vectura's revenues continue to grow in line with our expectations to £160.5m, up 8.4% versus last year. This growth was underpinned by strong demand from our partners for supply of *flutiform*®, which grew 17% versus 2017, and additional business development revenue of £6.6m recognised from the new Hikma deal for the global development and commercialisation of generic versions of GSK's Ellipta® portfolio, utilising Vectura's proprietary Open-Inhale-Close dry powder inhaler device. In addition to continued revenue growth, the Group has delivered a number of supply chain initiatives which have contributed to improvements in product supply margins.

During the year, Vectura reduced R&D expenditure from £60.3m to £55.5m, a fall of 8.0%, whilst creating additional capacity to support new programmes cost effectively.

The Group's operating loss reflects a number of significant non-cash items, including £41.5m impairment charges, largely driven by the impairment of the VR475 intangible asset, amortisation and depreciation charges and share-based payment compensation. As a result of the impairment charge recognised during the year, the Group's operating loss increased from £96.2m to £105.4m. Adjusted EBITDA, which adjusts for these non-cash items, share-based payment charges and exceptional items of £9.0m, was up 51.2% to £39.0m, reflecting the Group's strong financial and operational performance during 2018.

The Group ended the year with a strong closing cash balance of £108.2m, demonstrating management's continued focus on capital allocation and financial discipline. In the absence of attractive M&A opportunities to date, and given the Board's view of the intrinsic value of the business, it continues to review the Group's capital allocation priorities including the consideration of material shareholder returns.

Progress in 2018

- Delivered revenue target of £160.5m and exceeded adjusted EBITDA target, achieving £39.0m
- Operating loss has increased to £105.4m (2017: £96.2m), largely driven by the impairment of the VR475 intangible asset
- Strong closing cash and cash equivalents of £108.2m
- Completion of £15m share buyback in February 2018
- *flutiform*® partner stock levels normalising, resulting in revenue growth from supply of *flutiform*® of 17% in 2018

Priorities in 2019

- Deliver financial targets and maintain financial and capital allocation discipline

> "The Group ended the year with a strong closing cash balance, demonstrating management's continued focus on capital allocation and financial discipline.

Our strategy continued

MAXIMISING PARTNERING VALUE

In 2018, Vectura signed the largest partnership agreement in its corporate history: to develop and commercialise a wide range of generic GSK Ellipta® products with Hikma. After a competitive process, this deal validates our industry-leading complex inhaled generic development expertise. It further reflects the strong existing relationship we have with Hikma through the VR315 generic Advair® programme. With at least three and up to five therapies to be developed, this partnership will support continued success for Vectura over many years to come and enable improved access to critical medicines for asthma and COPD patients.

The Company has leveraged effective alliance management, including financial settlements in respect of the return of specific AirFluSal® Forspiro® territory rights from Sandoz, and the VR2076 triple therapy project termination with Mundipharma resulting in additional revenue in the year.

Progress in 2018

- Generic GSK Ellipta® deal signed with Hikma, the largest product deal in the Group's history, with an upfront payment of $15m. Completion of device development services will trigger a further $5m milestone payment
- Development revenue recognition with GSK Ellipta® agreement (£6.6m), Sandoz AirFluSal® territory settlement (£2.4m) and Mundiphama VR2076 settlement (£1.7m)
- Signing of six new partnering agreements at the Lyon site, with leverage of new bottling and blister line investments including increases in development revenues

Priorities for 2019

- Signing of a new partnership agreement for VR647
- Continuing to improve alliance contracting

> "The partnership will support continued success for Vectura over many years to come and enable improved access to critical medicines for patients.

MAXIMISING PIPELINE VALUE

Positive progression and expansion of inhaled generics pipeline

Recruitment is progressing well on the repeat clinical study for VR315. Hikma anticipates being able to submit data from the study to the US Food and Drug Administration (FDA) during 2019 to support its regulatory application, enabling a potential US launch in 2020.

The Group signed a global agreement with Hikma for the development and commercialisation of an AB-rated substitutable drug-device combination of generic versions of the GSK Ellipta® portfolio.

Vectura is continuing its pMDI development work on VR2081, with the first clinical trial batches delivered to the Group's partner, Sandoz.

VR632 was approved in Europe in May 2018, with launches planned throughout 2019. This approval triggered a £0.3m development milestone payment to the Group from Sandoz.

Our enhanced nebulised portfolio

The VR475 Phase III study did not meet its challenging primary endpoint of exacerbations reduction in the severe uncontrolled adult asthma population. As a result, the Group will not be pursuing further development of this programme.

Two positive VR647 clinical studies were completed (pharmacokinetic and usability) during 2018, supporting progression to a Phase III development programme.

Three new programmes were initiated in 2018, focusing on the inhaled management of cardiopulmonary vascular disease, cystic fibrosis and infection in post-transplant immunocompromised patients. These programmes could come to market within eight years and have potential for partnering within a three to five-year period, post-initiation.

Progress in 2018

- Good progress in addressing VR315 device and formulation Complete Response Letter queries. Proactive Vectura engagement in supporting design and implementation of ongoing Hikma-sponsored repeat clinical study
- Open-Inhale-Close device development successfully progressed, reflected in generic GSK Ellipta® agreement signed with Hikma
- VR2081 progression successful, reflected in milestone payment from Sandoz
- VR647 studies completed to time, cost and quality, with positive results enabling 2019 Phase III planning progression, including end of Phase II FDA meeting and progression of partnering negotiations
- VR475 Phase III study delivered to time, cost and quality. Primary endpoint not met and the Group will not be pursuing further development of this programme
- Development of three new Vectura enhanced therapies, with unbudgeted activities progressed through headroom created in R&D capacity

Priorities for 2019

- VR315 CRL response and repeat clinical trial to submit data from the study to the FDA during 2019 to support regulatory submission
- VR647: Phase III planning progression, including end of Phase II FDA meeting and progression of partnering negotiations
- Vectura enhanced therapies Wave 1: progression with at least one Orphan Drug Designation (ODD) in 2019
- Progressing our development of generic versions of GSK's Ellipta® portfolio

> “In 2018 we showed strong progress in our enhanced nebulised portfolio, including a successful set of studies for VR647, as well as initiating development on three new programmes.

OPERATIONAL EXCELLENCE

Operating efficiently and more effectively has been a major area of focus for the business and has been a key driver of the Group's strong adjusted EBITDA performance in 2018.

We implemented an R&D transformation programme, including reprioritisation of projects and use of systematic ways of working, and better resource forecasting and allocation, supported by enhanced enterprise-wide planning tools. This activity has created capacity to allow our teams to spend more time focusing on scientific project work and to support more programmes.

We have progressed with supply chain improvements, notably the agreement for transfer of the Holmes Chapel site ownership from Sanofi to Recipharm. As a result of these efforts, the Group has delivered strong *flutiform*® gross profit margin performance.

> R&D transformation has created capacity for our teams to spend more time focusing on science and innovation.

Progress in 2018

- Strong R&D transformation execution, enabling reduction in total R&D spend, with capacity generated for new nebulised projects including:
  - Portfolio prioritisation: stopping VR942 and VR588
  - Headcount restructuring and redeployment
  - Improved capacity and resource planning, enabling increased focus on science and innovation
- Significant progress in supply chain and procurement with on-target cost savings. *flutiform*® margin of 39.2% benefited from resolving a potential liability with a supplier and settlement of historic claims for reimbursement of costs as part of the Holmes Chapel site sale by Sanofi. In addition, partner contribution to new *flutiform*® manufacturing equipment was secured
- Effective Brexit mitigation planning

Priorities for 2019

- Mitigate potential impact of Brexit on our supply chain
- Deliver R&D transformation benefit to allow more science and innovation
- Continued focus on product supply margins

GREAT PLACE TO WORK

Our culture defines us at our best and was developed with insight from our people, patients, partners and investors. A key focus for 2018 was to embed our culture into our key management frameworks and systems, thereby laying the foundations for a great place to work.

This alignment also supports the updated Corporate Governance Code by ensuring our policies and practices are consistent with our values.

In addition, we have concentrated on effective talent development, retention and succession planning, alongside a continuous focus on employee engagement.

Progress in 2018

- Strengthened capabilities in Group leadership: talent, performance assessment and succession
- Improved employee engagement during the year, including strategy understanding and transformation changes
- Vectura values and culture embedded in systems and processes, including leadership development and behaviours assessment
- Launched a new campaign, Science Live, to educate and reinforce our value of "patient focus" and pride in our unique capabilities
- Launched a Charitable Support Policy, confirming our commitment to match employee fundraising and support volunteering in local communities

Priorities for 2019

- Continued focus on talent development, retention and succession planning, including the launch of a new Corporate Mentoring Scheme
- Continued focus on leadership and management development, including the introduction of a new Management Development Programme for supervisors and team leaders
- Support for the updated Corporate Governance Code with the appointment of a designated Non-Executive Director who will oversee the framework for interaction between the Board and the workforce
- Enhanced focus on improving our health and safety culture, including the continuing roll-out of a Wellbeing Campaign and the introduction of mental health first aiders

> "A key focus for 2018 was to embed our culture into our key management frameworks and systems, thereby laying the foundations for a great place to work.

Research and development

R&D

Bringing value-added products to patients via inhalation drug delivery

Recently transformed R&D ways of working have freed up time and resources for new, innovative programmes so we can create additional value and make a difference to patients.

01

Science and innovation

- Optimising time and resources to create capacity for new, highly valuable programmes that will benefit patients with high unmet medical needs
- Read more about our Vectura enhanced therapies portfolio on pages 38 and 39

02

Project delivery

- Driving efficiencies in existing programmes, allowing us to invest more time and resources in value-added work to accelerate task completion and/or maximise capacity

03

Resource planning

- Improving accuracy of plans and forecasting
- Leveraging consistent standard cycle times across projects

04

Performance leadership

- Improving people management practices with a focus on staff development and coaching in order to build employee capability

Our transformed R&D organisation:

- Uses simple ways of working to be more efficient and transparent
- Engrains a continuous improvement and collaboration mindset across the organisation
- Builds on our Company values and behaviours reinforcing the Vectura culture

+ Read more about Vectura culture on page 59

- Is embraced and driven by employees at all levels of the Company

PRODUCTS & PORTFOLIO

Vectura is an industry-leading inhaled product formulation, device design and development business with a range of valuable in-market partnered products and an exciting pipeline...

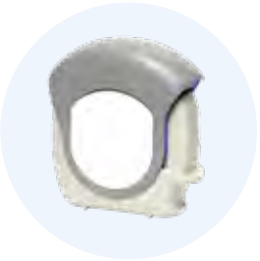
Class-leading device technology

DRY POWDER INHALERS

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

PRESSURISED METERED DOSE INHALERS

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

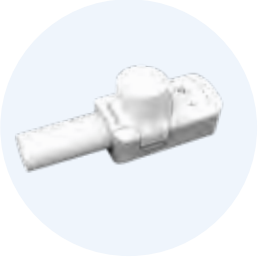
Dose indicating pMDI actuator

NEBULISED DEVICES

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®

Inhaled in-market

Continued growth of key partnered in-market products

The Group reported full year revenue of £160.5m, up 8.4% compared to the prior year. Inhaled revenues of £131.1m grew by 15.0%, with overall revenue growth being impacted by the anticipated decline in non-inhaled revenues to £29.4m, a 13.5% decline following the expiry of certain patents for EXPAREL®, ADVATE®, and Xatral®.

flutiform®

flutiform® continues to perform well in competitive markets, supported by recent lifecycle progress

Revenue
£79.6m

Gross profit margin
43.3%

> We expect that the launch of the breath-activated *flutiform*® k-haler® and the addition of the positive opinion for the paediatric indication of *flutiform*® in Europe will reinforce the continued differentiation of the product.

Kyorin

mundipharma

flutiform® (Mundipharma, Europe and Rest of world (excl. North America) / Kyorin, Japan)

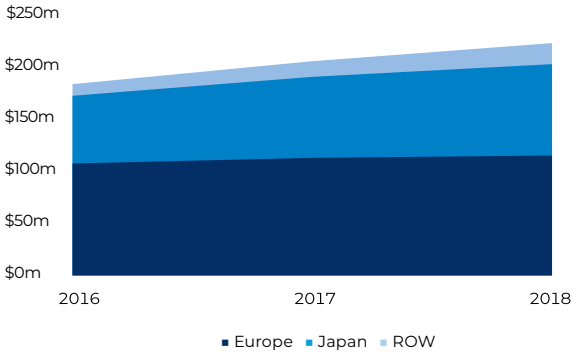
flutiform® generated total in-market sales of €221.7m, up 8.5% in value (CER) and up 12.2% in volume[1], contributing £79.6m revenue for Vectura, up 13.7% compared to 2017.

The European ICS/LABA market is a highly competitive and genericised market which declined by 3.3%[1] in value during 2018. Despite the slowing of in-market sales growth rates, *flutiform*® sales in Europe grew 2.0%, to €114.4m, and grew 2.7% in volume, reaching a market value share of 3.8% of the ICS/LABA market[1]. We expect that the launch of the breath-activated *flutiform*® k-haler® and the addition of the positive opinion for the paediatric indication of *flutiform*® will reinforce the continued differentiation of the product in this challenging market.

The less mature and non-genericised Japanese market grew by 3.3%[1] in value. In-market sales of *flutiform*® grew strongly, up 12.8% value and 17.4% in volume, to €87.2m[1], despite price reductions of approximately 5.8% in place since April 2018. *flutiform*® reached a market share of 15.4% in volume and 12.2% in value, up 1.2pp and 0.7pp respectively compared to 2017[1].

flutiform® remains at an early stage of its lifecycle in rest of world territories and has continued to grow strongly, with in-market sales of €20.1m up 35.1% compared to 2017[1].

flutiform® sales by region (€m MAT)[1]



1 IQVIA SMART MIDAS constant currency sales. Royalties payable by partners to the Group are based on agreed contractual definitions of net sales, which differ from IQVIA reported sales, and may include other adjustments or deductions.

Ultibro® Breezhaler®

Ultibro® Breezhaler® maintaining ex-US LAMA/LABA class leadership

Revenue
£13.7m

Gross profit margin
100%

> Ultibro® Breezhaler® continues its class-leadership of the dual bronchodilator class (ex. US), with growth of 7.9% compared to 2017, despite increased competition.

NOVARTIS

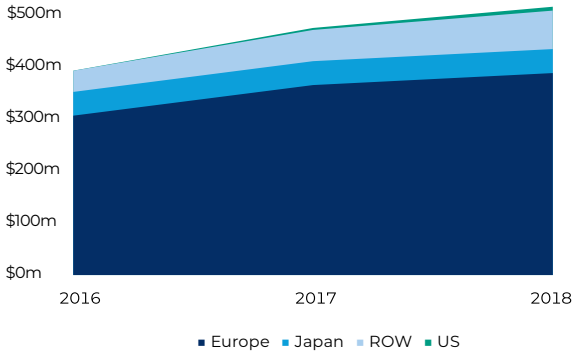
Ultibro® Breezhaler® and Utibron™ Neohaler® Inhalation Powder (Novartis/Sunovion, US)

Ultibro® Breezhaler® continues its class-leadership of the dual bronchodilator LAMA/LABA class (ex. US), with growth of 7.9% compared to 2017[1], despite increased competition. In-market sales in Europe grew by 6.3%, to $385.4m and also grew strongly in rest of world, up 23.2% to $73.4m[1]. Vectura recognised royalties of £17.8m in respect of sales of Ultibro® Breezhaler® and Seebri® Breezhaler® (2017: £17.3m).

Japanese in-market growth remains low at 0.4% with in-market sales of $45.8m, and limited sales in the US of $7.4m[1] reflecting the challenge for the fourth market entrant in a competitive market and market access restrictions.

Novartis expects the QVM149 Phase III study completion in H2 2019 with regulatory submission in Europe and Japan also in H2 2019, triggering a filing milestone to Vectura of $2.5m. The Group will earn royalties on net sales upon launch of the product. The product has the potential to be one of the first LAMA/LABA/ICS therapies for asthma. Current consensus estimates sales of $238m by 2024.[2]

Ultibro® sales by region (US$m MAT)[1]



1 IQVIA SMART MIDAS constant currency sales. Royalties payable to the Group by partners are based on agreed contractual definitions of net sales, which differ from IQVIA reported sales and may include other adjustments or deductions.

2 Evaluate Pharma Consensus Worldwide Peak Sales extracted March 2019.

Inhaled in-market continued

Continued growth of key partnered in-market products continued

NOVEL IP LICENSING

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

Seebri™ Neohaler®
(US – launched late 2017)

NOVARTIS

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

Asthma/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

Pulmonary arterial hypertension

Vectura's proprietary handheld FOX® nebuliser used to deliver Bayer's iloprost solution – delivery technology reduces mean inhalation time per treatment vs other smart nebuliser (10.9 min vs 2.6 min) meaning that a typical patient's inhalation time per day is reduced by 76%.

NOVEL IP LICENSING

Relvar® Ellipta®/ Breo® Ellipta®
(Global)
Launched 2013 (US and ROW)
Launched 2014 (EU)

gsk

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

COPD

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

Anoro® Ellipta®
(Global)
Launched 2014
(US, EU and ROW)

gsk

COPD

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

Trelegy® Ellipta®
(Global)
Launched 2017
(US and EU)

gsk

COPD

Once-daily triple therapy (ICS/LABA/LAMA) which utilises Vectura's formulation IP.

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

Non-inhaled product performance

The Group earns revenues from a number of legacy non-inhaled products. As anticipated, revenue from non-inhaled products declined by 13.5% to £29.4m, following the expiry of certain patents for EXPAREL®, ADVATE®, and Xatral®.

Vectura received £5.1m in revenues from net sales of EXPAREL® during 2018.

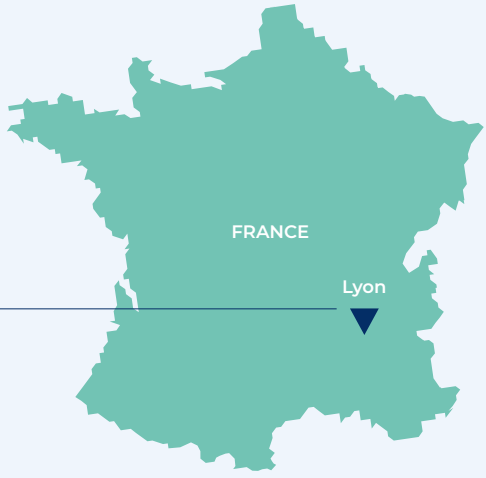
Solaraze® royalties were £2.0m for 2018 (2017: £2.9m), a decline of 31.0%.

Transforming our oral manufacturing site in Lyon

Over the past two years a significant transformation programme has taken place at Vectura's Lyon oral manufacturing site. This has included the development of an end-to-end contract development and manufacturing organisation approach, ranging from early stage development, scale-up, and manufacturing through to bottling and blister line packaging, including serialisation and aggregation. As a result of these initiatives, along with significant operational KPI improvements, the site signed six new manufacturing and development contracts in 2018. These new agreements have enabled the site to increase development revenues by 25% which has largely offset the reduction in Sular® product supply revenue and has mitigated the impact of the expected decline of royalty revenues from legacy products.

"Agility is our strength – being able to work with any type of client, from emerging pharma to big pharma companies, through to virtual and generic companies. Our goal is to help our clients save time and money without compromising on quality.

David Lescuyer
Executive Vice President, Vectura Group, and President of Skyepharma Production S.A.S



Our inhaled generics pipeline

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.

Whilst developing generics for oral or systemic formulations is relatively simple, developing inhaled generic products has additional complexities. Unlike Vectura, very few companies have the capabilities to succeed in this space.

The US is a large, largely untapped market for inhaled generics, with few new entrants into this complex area (see Market opportunity on pages 14 to 17).

Martin Oliver
SVP, Generic Programmes

> Our partnering model allows us to access high volume complex generic opportunities whilst managing the significant costs associated with their development.

+ Read more about R&D on pages 28 and 29

Hear Martin talk about the complexities of developing inhaled generics and why Vectura is well placed to succeed in this space.
Visit www.vectura.com

Our current generics pipeline

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.

It also builds on our track record with the launch of AirFluSal® Forspiro® and approval of VR632 in Europe, using the GyroHaler® device and demonstrating our ability to meet regulatory requirements in order to launch new products.

We currently have eight 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 in the US market.

In March 2018, Hikma confirmed an additional Clinical Endpoint Study was required by the FDA for the VR315 programme. Hikma anticipates being able to submit a response to the FDA with new clinical data in 2019.

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 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 largest US inhaled brands.

Significant patient need for accessible lower priced medicines remains. The US market opportunity for such inhaled respiratory generics remains highly attractive, with 2018 reported net sales of $1.5bn for GSK's Advair® in the US[2]. There are high technical and financial barriers to entry for these assets and few pharmaceutical companies, individually or collaboratively, are able to address these challenges effectively. Given the significant ICS/LABA market volume opportunity, which has continued to grow to more than 36m units per annum[1], we continue to forecast significant market volume and value opportunities for VR315 when it reaches the market.

In November 2018 Vectura and Hikma announced the extension of their partnership for substitutable inhaled generic products by entering in to an agreement to develop up to five new generic products for the GSK Ellipta® portfolio.

1 IQVIA SMART MIDAS Constant Currency.

2 Evaluate Pharma extracted March 2019.

Global agreement with Hikma is largest product deal in Vectura's history

Agreement with Hikma for the global development and commercialisation of generic versions of GSK's Ellipta® portfolio, utilising Vectura's proprietary Open-Inhale-Close dry powder inhaler device.

US$15m
upfront payment

US$80m
possible in development milestone payments

US$4bn
projected net sales for GSK's Ellipta® products in the US by 2024[1]

Summary

- Validates the utility of Vectura's market-leading formulation, device development and DPI technology
- Provides significant short, medium and long-term revenue potential
- Upfront payment of US$15m
- Up to US$80m in development milestone payments
- Mid-teen percentage profit share arrangement for each portfolio product
- Net sales for GSK's Ellipta® products in the US projected to be $4bn by 2024 and $5bn globally[1]

Partnership

By strengthening and expanding our partnership with Hikma, Vectura will develop a range of complex inhaled respiratory products that will deliver sustainable long-term growth. This presents a significant opportunity, with net sales for GSK's Ellipta® products in the US projected to be $4bn by 2024 and approximately $5bn globally.

The inhaled generic respiratory market is a key area of pipeline focus for Vectura. This agreement leverages the investment already made and the experience both companies have gained through the generic Advair® Diskus® programme.

The Open-Inhale-Close dry powder inhaler programme includes device development services, and the development of AB-rated substitutable generics of up to five of GSK's Ellipta®-based respiratory medicines.

1 Global Data Consensus Forecast accessed March 2019.

Open-Inhale-Close technology

This agreement leverages the investment already made and the experience both companies have gained through the generic Advair® Diskus® programme. The new Open-Inhale-Close device is an evolution of Vectura's Lever-operated multi-dose device used in the generic Advair® programme which will enable accelerated development under this new agreement. It has been developed to be a simple, cost-effective, high volume device designed to provide therapeutically equivalent products to the Ellipta® products such as Breo®, Anoro®, Arnuity®, Incruse® and Trelegy®.

+ Read more about our Open-Inhale-Close technology at www.vectura.com

Clinical evidence supporting our nebulised platform

VR647 (US) Phase II

On 21 August 2018, Vectura announced positive results from two clinical trials in this programme.

The first trial, a usability study conducted in 40 children aged one to four years old, showed that children aged two to four were able to easily use Vectura's VR647 system equipped with a mouthpiece, diverging from the common belief that young children must use a spacer, facemask or other devices when taking an asthma medicine.

The study showed 90% of children aged two and older were able to effectively use the mouthpiece connected to the breath-activated system, demonstrating tight control of breathing patterns with no loss of medication. Vectura is also exploring the development of a facemask for children under two years of age[1].

The second Phase II study evaluated VR647's pharmacokinetics in 17 US children aged between four and eight, with symptoms suggestive of asthma. Three different budesonide doses were delivered using Vectura's inhaler – at five, ten and 20 breaths – compared to an approved 1mg dose of budesonide delivered by a conventional jet nebuliser (Pulmicort Respules)[2].

The results indicated that the VR647 inhalation system delivers budesonide to the lungs more efficiently than the conventional nebuliser, allowing a lower delivered steroid dose, thus potentially shortening treatment time.

Those results help define dosing regimens for a planned Phase III programme.

1 Bacharier LB, Burgess G, Müllinger B, and Snape S. An open-label, non-drug study to evaluate the use of a mouthpiece with the VR647 inhalation system in patients aged less than five years. ATS 2019.

2 LaForce C, Surujbally R, Huyghe M, et al. Pharmacokinetics of budesonide suspension delivered by the VR647 inhalation system in pediatric patients with wheezing, reactive airway disease or mild asthma. ATS 2019.

VR475 (EU) Phase III

On 26 November 2018, the Company announced that a Phase III trial of VR475 (budesonide delivered by Vectura's proprietary nebuliser inhalation system) in severe, uncontrolled adult and adolescent asthma patients did not meet its primary endpoint.

The primary endpoint chosen for this clinical trial was the annualised clinically significant exacerbation (CSE) rate. The study was powered to show a 40% difference in the annualised rate of CSE vs placebo, which was a recognised high challenge from the beginning. Unfortunately, the study results only showed a trend in the reduction of CSE rates without reaching statistical significance. If this study had been positive, VR475 would have become a very relevant treatment alternative to expensive biologics, and less well tolerated oral steroids in the fragile and difficult-to-treat severe asthma population.

The trial did show some positive trends towards improvement over a conventional nebuliser, including improvements in lung function (i.e. FEV1 and FEF25–75%), which is an important signal of the value of the platform.

Vectura believes the result of the trial is specific to the primary endpoint and the difficult-to-treat severe asthma population selected. The Group will not be pursuing further development and partnering of VR475.

Vectura remains confident in its enhanced nebulised technology platform, and the secondary endpoints from this study support further development of our nebulised pipeline.

> “There are very few approved treatment options for children under five years of age. VR647 has the potential to provide high efficacy and a very good safety profile, with significantly reduced treatment times and with a lower steroid delivered dose. We look forward to outlining our Phase III and partnering plans.

Gonzalo de Miquel
Chief Medical Officer

Three new therapies added to our portfolio

$250m+
Individual peak sales potential per indication

Wave 1
Targeting orphan and niche diseases

3–5 years
Partnering potential within a three to five-year period

Our R&D strategy focuses upon the creation of products whose active ingredient has previously received regulatory approval in major territories such as the US and EU, and where the data and market exclusivity period has expired. These repurposed assets will utilise proprietary formulation and/or device technology to ensure the consistent delivery of therapeutic drug concentrations to relevant parts of the lung, thus improving their local efficacy and/or their systemic safety profiles. Such products represent an opportunity to provide better alternative treatment options to patient groups that continue to suffer from unmet medical needs. The first wave of differentiated products, targeting niche diseases, have been identified and development activities initiated. Development feasibility is progressing well for the inhaled management of:

- cardiopulmonary vascular disease;
- cystic fibrosis; and
- infection in post-transplant immunocompromised patients.

The strategic case for investment in Vectura enhanced therapies

- Ability to address high unmet medical needs and achieve premium product pricing
- Realise necessary clinical risk:benefit profile via targeted and consistent drug delivery
- Lower development risk/cost compared to new chemical/biological entities
- Intellectual proprietary product protection through combination with our unique inhalation technology platform
- Achieve attractive early upfront milestones and royalties via third-party licensing strategy

“

These new and differentiated assets represent an exciting opportunity to improve outcomes in a variety of patient groups with high unmet needs.

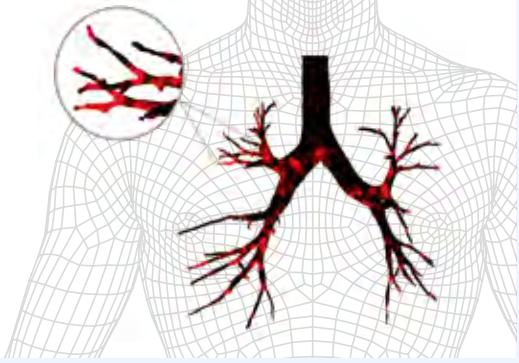
Frazer Morgan VP
Programme Development

Vectura AKITA® JET nebuliser drug deposition versus conventional jet nebuliser

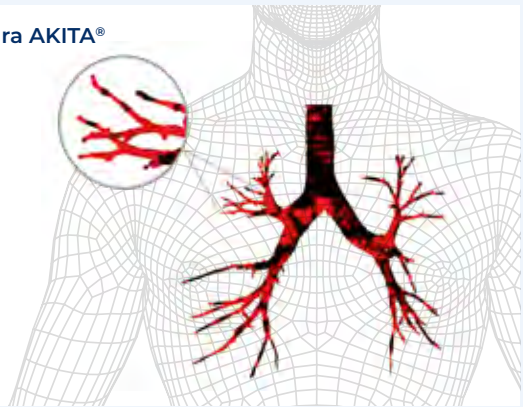
Computational fluid dynamics modelling suggests the AKITA® JET has the potential to more effectively deliver a larger proportion of drugs to the relevant area of the lung of patients with respiratory diseases than with a standard jet nebuliser.

In the images below, the orange colour represents the amount of drug deposited in the lungs, showing that it is higher when the AKITA® JET is used.

Conventional nebuliser



Vectura AKITA®



S. Munro, W. Vos, B. Mignot. Use of in silico deposition modelling to evaluate the lung deposition patterns of budesonide delivered from different inhaler devices in patients with severe asthma. Thorax, Volume 73; Issue Suppl 4. p.166.

Key performance indicators

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

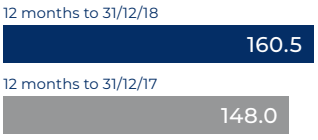
Vectura has simplified its financial KPIs in 2018. "Underlying revenue growth" and "Underlying EBITDA progression" are replaced by "Revenue growth" and "Adjusted EBITDA progression" which can be sourced directly from the consolidated financial statements. Previously, certain non-underlying items were excluded from revenue and adjusted EBITDA in order to highlight the performance of the ongoing business. However, the nature of the Group's business model means that non-underlying items do recur although not necessarily in consecutive periods and therefore some volatility of revenues and adjusted EBITDA between periods is expected with overall growth over the longer term.

Financial KPIs

Revenue growth

£m

£160.5m +8.4%



Link to strategy

Why is it a KPI? Revenue, being a statutory performance measure, is the Group's primary KPI as it drives both profit growth and cash generation. The KPI is the total of revenues generated by the Group's business model comprising:

- supply of finished or semi-finished product to commercial distribution partners;
- royalties and other marketed revenues; and
- upfront payments, milestones or other fees for work on pre-launch development programmes.

How is it measured? Revenue is recognised in accordance with the Group's accounting policies as presented in notes 2 and 31 of the consolidated financial statements.

2018 performance Revenues have increased by 8.4% driven by 17.0% growth in revenues earned from *flutiform*® product supply and the new deal signed with Hikma in 2018 to develop generic versions of GSK's Ellipta® portfolio generating both development revenues from the licensing of Vectura IP and revenues from development services performed in 2018. Growth is partially offset by an 8.3% reduction in royalty and other marketed revenues.

Adjusted EBITDA progression

£m

£39.0m +51.2%

Link to strategy

Why is it a KPI? Adjusted EBITDA is an important non-statutory measure used by the Board, the Executive Leadership Team and managers to monitor the Group's performance as it provides useful information about the profitability of the Group. The relevant corresponding IFRS measure is operating loss which is largely generated by non-cash items such as amortisation and impairment. As a result, adjusted EBITDA is considered a more appropriate measure for KPI purposes.

How is it measured? Adjusted EBITDA is defined as the Group's operating loss adding back exceptional items, amortisation and impairment, and charges for share-based payments and depreciation.

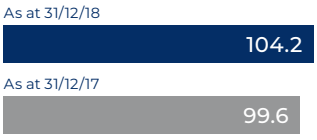
Refer to note 9 of the consolidated financial statements for a reconciliation of the Group's operating loss to adjusted EBITDA.

2018 performance Adjusted EBITDA has improved by more than 50% driven by revenue growth, a higher product supply margin and a reduction in R&D expenditure. In contrast, operating loss has increased by 9.6% as a result of the VR475 impairment charge (£39.8m).

Net cash

£m

£104.2m



Link to strategy

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

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

2018 performance The Group is cash generative and net cash has increased despite a £13.8m cash outflow from the share buyback programme.

Our strategy

Strong financial performance | Maximising partnering value | Maximising pipeline value | Operational excellence | Great place to work

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. In 2018, Vectura announced unfavourable top-line results from its Phase III study of VR475 in adult and adolescent patients with severe uncontrolled asthma, and positive findings from its VR647 Phase II pharmacokinetic and mouthpiece methodology studies.

Project milestones completed

10

12 months to 31/12/18: 10

12 months to 31/12/17: 12

Link to strategy

Clinical studies completed

3

12 months to 31/12/18: 3

12 months to 31/12/17: 1

Link to strategy

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. In 2018, Vectura signed an agreement with Hikma Pharmaceuticals PLC for the global development and commercialisation of up to five generic versions of GSK's Ellipta® portfolio, utilising Vectura's proprietary Open-Inhale-Close dry powder inhaler device. This is a highly significant and valuable agreement for Vectura. The agreement reflects the strong existing relationship with Hikma and confidence in the future of the substitutable inhaled generic segment including VR315, our joint generic Advair® programme. In 2018, the Group was notified by Sanofi/Ablynx that, despite positive results for the primary endpoint of the RESPIRE clinical trial for VR465, the project will not be progressed to the next phase of development. In addition, following the VR475 Phase III clinical trial not achieving its primary endpoint, the Group will no longer pursue further development and partnering of the programme.

Number of valuable new business development deals signed

1

12 months to 31/12/18: 1

12 months to 31/12/17: 1

Link to strategy

Employee engagement

44.25%

Average increase in favourable responses since previous survey

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.

2018 performance In March 2018, we conducted the annual employee engagement survey. This was during a period of significant restructuring and change in the Group. The results were down and they highlighted the need for a concerted effort to improve engagement. This was an area of intense discussion within the Executive Leadership Team and managers and a number of actions were taken and are continuing.

A shorter, follow-up survey focusing on the improvement areas was conducted in November. The response rate to this follow-up survey was strong, with an 88% response rate. There were significant improvements in all areas across the Group compared to the March 2018 survey.

Although these trends are positive, work continues in order to equal or exceed external benchmarks.

Link to strategy

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. These risks and uncertainties could adversely impact our ability to deliver our strategy, our business model and the environment in which we operate.

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. This strategy comprised a focus on relatively lower risk, high value development opportunities and ceasing investment in relatively higher risk, novel molecule and early stage programmes. The process has been in place for the year under review, and up to the date of approval of the Annual Report and Accounts.

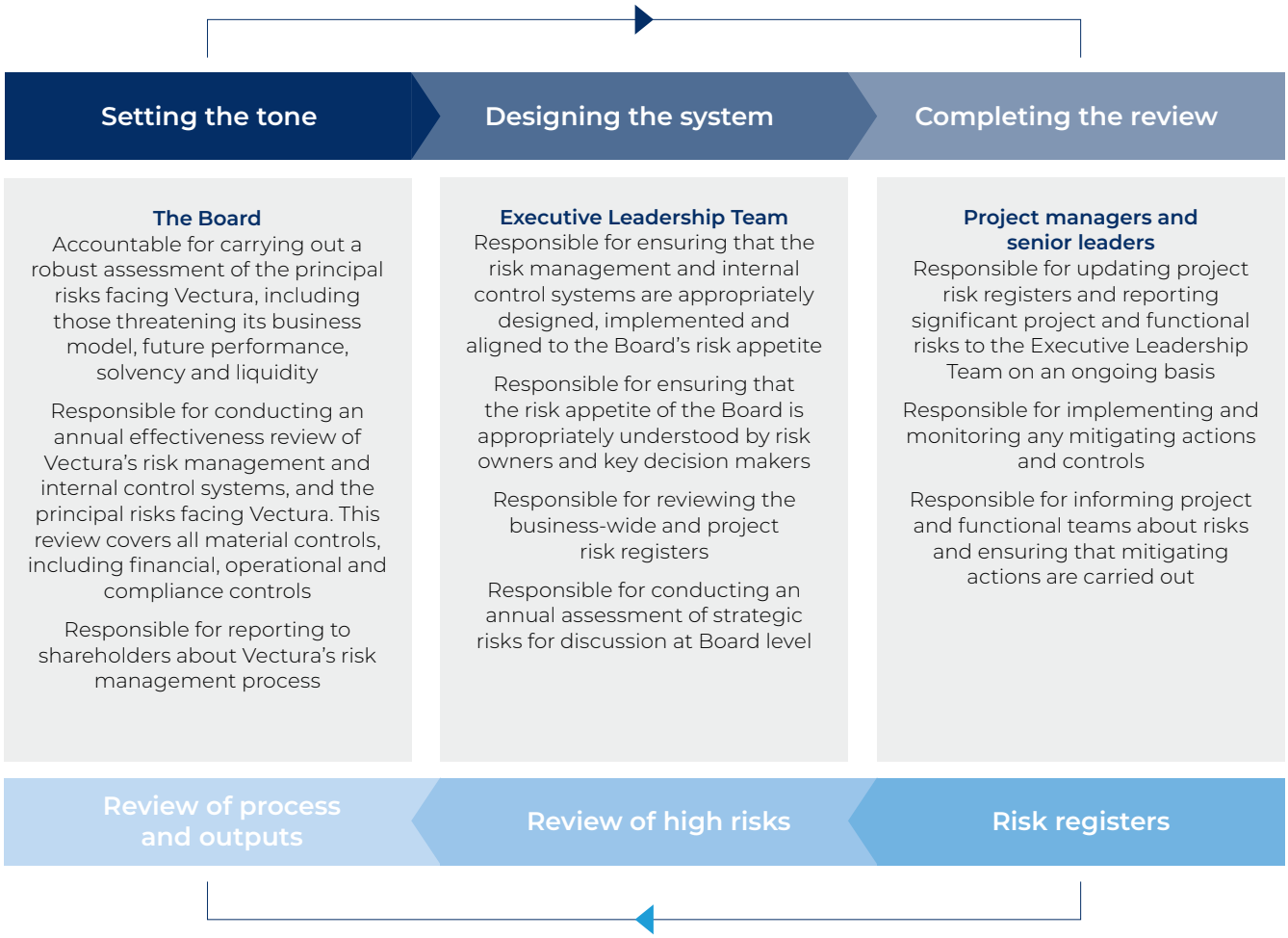
It is recognised that no risk management process can provide absolute assurance against loss.

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 businesses 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.

Our risk management framework



In response to the uncertainty and unknowns as to the terms of the UK exiting the EU following the referendum on 23 June 2016, an internal task force was formed comprising representation from the Group's Finance, Legal, Regulatory, Supply Chain and HR functions. The purpose of the task force was to identify risks and form risk mitigation strategies. This is within the context that, despite an expectation of a transition period post 29 March 2019, risk identification and mitigation should focus on the UK exiting the EU Single Market and EU Customs Union on 29 March 2019 ("hard Brexit") without a transition period. The task force updates the Executive Leadership Team and the Board. While the task force has focused on a hard Brexit scenario, Brexit could have many potential outcomes and it is impossible for all risks to be identified and mitigated, given the unprecedented level of uncertainty.

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 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 2018

Part of the principal risk of "Failure or delay in partnering VR647 and VR475" materialised in 2018 following the VR475 Phase III study not meeting its primary endpoint and the decision not to pursue further development and partnering of VR475. The risk has therefore been renamed to "Failure or delay in partnering VR647".

As a consequence of further risk identification and risk mitigation planning and the increased likelihood of the UK exiting the EU without a transition arrangement, the Group's principal risk of "Brexit uncertainty" is replaced by two risks and the principal Group risks are now grouped between Brexit-related risks and non-Brexit-related risks.

Following increased focus on the Vectura enhanced therapies, with three new programmes targeting orphan or niche disease segments, a new risk has been added: "Failure to effectively scale up the manufacture of the Group's nebulised platforms for partnering".

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

Risk management and principal risks continued

Principal risks

Principal risks specific to Vectura's business model – Brexit

Supply chain disruption in the short term from the UK exiting the EU in the event of a "hard Brexit"

Risk movement: Increasing

Strategic priorities impact:

What is the risk?
The Group's largest product, *flutiform*®, is manufactured in the UK and commercialised by its partners in Europe, Japan and Rest of World. The Group imports raw materials into the UK and the Group's partners export *flutiform*® from the UK into overseas markets. Delays to the cross border movement of goods could disrupt the *flutiform*® supply chain.

While this risk is most significant to the supply of *flutiform*®, it is not exclusive to the product. The Group also supplies AKITA® devices, the Breelib™ device and the Gyrohaler® device. However, these products are much less material to the Group's results.

What would the impact be?
Major disruption to the *flutiform*® supply chain could result in lost product supply revenues and lost in-market sales which generate royalties for Vectura. If in-market sales are lost, patients may switch to alternative products and not switch back when product availability returns.

What could cause the risk to be realised?
- Disruption at ports of entry and exit which significantly slow the movement of goods such that stocks of products in overseas markets cannot be sufficiently replenished, or imports of raw materials are limited, reducing manufacturing output below normal levels.
- Alternative routings or methods of transportation may be unavailable.
- New *flutiform*® release testing capability does not perform to the required level, slowing or reducing the release of batches into the EU.

How do we manage the risk?
- Partners have reviewed stock levels in the light of Brexit risks, and stock levels have been increased where deemed appropriate. Mitigation of these risks is reviewed regularly by the Group and its partners.
- The Group has reviewed its raw material inventory levels and has built stocks where appropriate.
- Vectura, partners and suppliers have engaged third-party logistics providers with import and export expertise.
- Alternative routings or methods of transportation available to Vectura, suppliers and partners have been reviewed and contingency plans developed.
- Training of internal supply chain staff on import/export complexities has been undertaken.
- Provision for *flutiform*® release testing in the EU has been implemented.

Risk movement
Increasing as the likelihood of a "hard Brexit" is higher.

Adverse regulatory changes resulting in higher operating costs over the short, medium and longer term

Risk movement: Increasing

Strategic priorities impact:

What is the risk?
If the UK leaves the European Union without a withdrawal agreement, future trading with the EU and other countries may result in increased costs for Vectura, for example costs associated with the application of new import or export tariffs.

In addition, from a regulatory perspective, an EU legal entity is required for medicinal product and medical device submissions and clinical trials in the EU. Vectura also requires a notified body with a legal entity in the EU. A notified body conducts conformity assessments for European directives related to medical devices.

What would the impact be?
Trading with the EU without a withdrawal agreement could impact the Group as follows:
- Tariffs on raw materials imported from the UK for *flutiform*® reducing product supply margins. These are incurred directly or via supplier price increases.
- Additional testing or regulatory compliance costs to Vectura, which erode product supply margins.
- Adverse regulatory changes increase cost of compliance, constraining funds for investment in research and development.

What could cause the risk to be realised?
- The UK leaves the EU without a withdrawal agreement.
- A beneficial trading relationship between the UK and EU is not established.
- Insufficient expertise and resources are available to deal with increased compliance activity.

How do we manage the risk?
- The Group has sought out guidance and intelligence from the relevant professional bodies and trade organisations to shape its planning.
- The Group has established a legal entity within the EU to enable it to comply with EU regulations for medicinal products and devices. The Group has also appointed a new EU notified body.
- The Group has established a capability to perform EU release testing post-Brexit.
- Resource and training requirements have been assessed and actioned accordingly.

Risk movement
Increasing as the likelihood of a "hard Brexit" is higher.

Strong financial performance | Maximising partnering value | Maximising pipeline value | Operational excellence | Great place to work

Principal risks specific to Vectura's business model – Non-Brexit

Supply chain disruption

Risk movement: Stable

Strategic priorities impact:

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 capacity constraints.
- Supplier loss of licence or regulatory action impacting Vectura.
- Termination of the manufacturing agreement with Recipharm for *flutiform*®. The agreement continues to 2020 and will be automatically renewed bi-annually 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.

Risk movement
Stable.

Failure or delay in partnering VR647 for Phase III development

Risk movement: Stable

Strategic priorities impact:

What is the risk?
The Group plans to balance risk and value generation by partnering VR647 in 2019.

Vectura may be unable to find a partner with suitable commercial strength and respiratory heritage for VR647 in a timely manner.

What would the impact be?
Failure to partner VR647 with a suitable partner in a timely manner or at all could materially impact future revenues, profitability and prospects of Vectura.

What could cause the risk to be realised?
- Phase III study requirements are prohibitive.
- Inability to identify a suitable partner.
- Inability to negotiate a deal with commercially attractive terms.
- Incorrect perception that VR475 Phase III results also impact VR647.

How do we manage the risk?
Vectura has acquired, developed and progressed VR647 based on its experience and knowledge of the respiratory market. As such, the Group believes that the 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.

Vectura has and is executing a communication strategy following the adverse VR475 Phase III study results. This includes highlighting the very different patient populations and clinical endpoints between VR475 and VR647.

Risk movement
Stable.

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Risk management and principal risks continued

Principal risks continued

Principal risks specific to Vectura's business model – Non-Brexit continued

Failure to launch VR315 in a competitive timeframe

Risk movement: Stable

Strategic priorities impact:

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 is completing an additional clinical endpoint study (CEP) at the request of the FDA.

What would the impact be?
Failure to complete the CEP 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.

Although Mylan received FDA approval for its generic of GSK's Advair® Diskus® at the end of January 2019, approval prior to VR315 had been anticipated by Vectura.

What could cause the risk to be realised?
- VR315 not being the second generic of GSK's Advair® Diskus® product.
- Sales (volumes and/or pricing) of GSK's Advair® Diskus® could decline faster than expected prior to launch of VR315.

How do we manage the risk?
The Group is unable to take direct action to mitigate this risk.

A joint clinical team is in place to oversee the conduct of the study which is on track. The clinical trial results and resubmission to the FDA are expected later in 2019.

Risk movement
Stable.

Partner failure

Risk movement: Stable

Strategic priorities impact:

What is the risk?
Vectura operates a partnering business model and is therefore reliant on partners for development, manufacturing 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 their 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, supply chain and commercialisation strategies deployed 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.
- Partner's marketing, supply chain or commercialisation strategy is suboptimal or not executed 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 internal and external 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.

Risk movement
Stable.

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Principal risks specific to the industry in which Vectura operates

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

Risk movement: Stable

Strategic priorities impact:

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 generic programmes and new enhanced therapies targeting niche or orphan disease segments 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?
- 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 pipeline 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 and continue to be implemented to maximise capacity in R&D.

Risk movement
Stable.

Failure to effectively scale up the manufacture of the Group's nebulised platforms for partnering

Risk movement: Increasing

Strategic priorities impact:

What is the risk?
In addition to VR647, the Group has added to its nebulised pipeline by starting development of three new Vectura enhanced therapies, targeting niche or orphan disease segments. Scaling up the Group's nebulisation platforms is critical to delivering value from these pipeline programmes.

What would the impact be?
Pipeline programmes may not be partnered resulting in failure to realise a return on investment.

The cost of manufacture may be too expensive which may limit or even prevent the commercial viability of the Group's pipeline programmes.

What could cause the risk to be realised?
- Failure to transfer knowledge and skills to the UK from the Group's German site following the announcement of the German site closure in 2018 (site will be closed in 2021).
- Failure to transfer manufacturing to a contract manufacturing partner.

How do we manage the risk?
In respect of the closure of the Group's German site:
- a retention scheme is in place for key employees;
- a transition team is in place; and
- plans are in place to increase resources in the UK.

An outsourced manufacturing partner has been selected. Transition of knowledge to the supplier is ongoing.

Risk movement
Increasing following the announcement of the closure of the Group's German site in 2018 (site will be closed in 2021).

Strong financial performance | Maximising partnering value | Maximising pipeline value | Operational excellence | Great place to work

Risk management and principal risks continued

Principal risks continued

Principal risks specific to the industry in which Vectura operates continued

Changes in the regulatory, operating or pricing environment

Risk movement: Stable

Strategic priorities impact:

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.

Risk movement
Stable.

Failure to attract or retain talent/key personnel

Risk movement: Stable

Strategic priorities impact:

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. Vectura does not believe Brexit, or immigration controls following the UK's departure from the EU, will increase this risk materially.

In 2018, Vectura announced plans to close its operations in Gauting, Germany, by 2021 with knowledge and skills to be transferred to the Group's sites in the UK.

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 candidates of the correct calibre and, in particular, those candidates in the UK to be able to take on the knowledge and skills from the Gauting site.
- Failure of reward/incentive strategy.

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 rolled out in 2018 and new manager development training has been developed and will be rolled out in 2019.

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 to target talent pools across a wide geography.

A retention scheme is in place for key Gauting site employees. In addition, a transition team is in place and plans are being executed to increase resources at the Group's UK sites to absorb knowledge and skills.

Risk movement
Stable.

Strong financial performance | Maximising partnering value | Maximising pipeline value | Operational excellence | Great place to work

Failure to protect intellectual property

Risk movement: Stable

Strategic priorities impact:

What is the risk?
Patent infringement by a competitor or partner 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.
- Partner failure to pay royalties on intellectual property licensed by Vectura. Vectura is currently taking action against GSK, claiming patent infringement following notification received from GSK in 2016 that it did not wish to exercise the option to take a licence to pay additional patents under the patent licence and option agreement with Vectura dated 5 August 2010 for GSK's Ellipta® products.

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.

Risk movement
Stable.

Strong financial performance | Maximising partnering value | Maximising pipeline value | Operational excellence | Great place to work

Viability statement

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, strong balance sheet including positive cash reserves in excess of £100m at 31 December 2018, the availability of the £50m revolving credit facility to August 2021 and 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 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. The Group continues to be strongly cash generative and has cash and cash equivalents in excess of £100m at 31 December 2018. The use of the Group's £50m revolving credit facility is not forecast during the three-year viability period. This facility expires in 2021 and the Board expects that it will be renewed. The three-year 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 2017 and involved collaborative input from a range of business functions to model a series of plausible "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.

The key assumptions underpinning the assessment during the period are as follows:

- Brexit proceeds in an orderly manner such that there is minimal disruption to the supply chain for *flutiform*®;
- growth of *flutiform*® product supply volumes and the related supply margin;
- manufacturing and assembly of *flutiform*® by Recipharm continues in line with contractual obligations;
- the rate of growth of net royalties from Seebri® and Ultibro® Breezhaler® received by Vectura;
- the timing and forecast of cash flows from partnering VR647 (US);
- the timing of receipt of development milestones from partnered programmes, particularly QVM149 and the development of generic versions of GSK's Ellipta® portfolio; and
- the timing of approval and forecast royalty revenues from VR315.

The Group continues to monitor closely evolving events concerning the UK's exit from the European Union. Despite the expectation of a transition period post 29 March 2019, the Group has implemented a number of measures to mitigate the risks should this not be the case. In such circumstances, the Group still expects transition to be relatively orderly within an expected range given the extent of these measures.

However, if the transition is not orderly, then the Group has assessed that the supply chain for *flutiform*® could be disrupted. Within this context, and to provide confidence of ongoing viability, the Group's plans have been stress tested against a severe, but reasonably possible downside scenario. In such a scenario, the *flutiform*® supply chain is assumed to be disrupted in 2019 resulting in lower product supply revenues and in-market sales, which also adversely impact royalty revenues. It has also been assumed that once supply is normalised, there is only a partial recovery of in-market sales. In addition, costs from assuming WTO tariffs on certain raw materials, sharing of incremental costs with the Group's partners and an increased batch failure rate from having to duplicate release testing for *flutiform*® both in the UK and the EU have been also modelled.

In addition to the above Brexit sensitivities, the following additional, reasonably plausible stress tests were performed:

- lower royalty revenues from Seebri® and Ultibro® Breezhaler® and the Group's other on-market products;
- significant delays in partnered development programmes; and
- significant delays in contracting with new or existing partners.

As a worst case, the combined impact of these downsides 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 2018 Annual Report and Accounts.

Strong financial performance

1. Revenue

Vectura adopted IFRS 15 – Revenue from Contracts with Customers on 1 January 2018. The collaborative agreement with Hikma to develop generic versions of GSK's Ellipta® portfolio is the first agreement that the Group has signed since the implementation of the standard and therefore this is the first agreement that has been accounted for in full in accordance with this standard.

1.1 Product supply revenue

The Group generates significant revenues from the supply of finished or semi-finished products, largely manufactured by third-party suppliers, to commercial distribution partners. Costs to deliver these revenues are reported under cost of sales. These revenues grew by 14.6% in 2018, largely driven by strong volume demand for *flutiform*®.

Total product supply revenues and gross margin

	2018 £m	2017 £m	% change
flutiform®	**74.2**	63.4	17.0%
Other inhaled products	**3.1**	2.7	14.8%
Other non-inhaled products	**8.3**	8.6	(3.5%)
Revenue	**85.6**	74.7	14.6%
Cost of sales	**(61.6)**	(57.2)	(7.7%)
Gross profit	**24.0**	17.5	37.1%
Gross profit margin %	***28.0%***	*23.4%*	*4.6ppts*

***flutiform*®**

Vectura earned 46.2% (2017: 42.8%) of total reported revenue from the supply of finished *flutiform*® products to Mundipharma (Europe and Rest of World) and Kyorin (Japan). Strong in-market growth of *flutiform*®, up 8.5% in value and 12.2% in volume[1], and the normalisation of Mundipharma supply chain requirements resulted in a 17.0% increase in product supply revenue.

***flutiform*® revenues**

In-market *flutiform*® sales[1] (constant currency)	2018 €m	2017 €m	% change
Territory			
Europe	**114.4**	112.2	2.0%
RoW (ex. North America)	**20.1**	14.9	35.1%
Japan	**87.2**	77.3	12.8%
Total in-market sales	**221.7**	204.4	8.5%

1 IQVIA SMART MIDAS constant currency sales. Royalties payable by partners to the Group are based on agreed contractual definitions of net sales, which differ from IQVIA reported sales and may include other adjustments or deductions.

Vectura product supply revenues and gross profit	2018 £m	2017 £m	% change
flutiform® product supply revenue	**74.2**	63.4	17.0%
Cost of sales	**(47.4)**	(40.1)	(18.2%)
One-off margin credits/(debits)	**2.3**	(1.1)	>100%
Gross profit	**29.1**	22.2	31.1%
Gross profit margin %	***39.2%***	*35.0%*	*4.2 ppts*
Gross profit margin % (ex. one-off credits/(debits))	***36.1%***	*36.8%*	*(0.7) ppts*

flutiform® gross margin was up 4.2 percentage points in 2018, benefiting from the release of a supplier provision booked in 2017 and a credit from Sanofi in settlement of historic claims prior to sale of the Holmes Chapel manufacturing facility to Recipharm. Despite market price reductions in Japan partially impacting the Group's supply prices, the gross margin earned for product supply sales, excluding one-off items, was 36.1% (2017: 36.8%).

The Group also earned royalties in 2018 on *flutiform*® sales made by Kyorin in Japan. Including these royalties, total revenues for *flutiform*® were £79.6m (2017: £70.0m).

> I'm delighted to present my first set of results for the Vectura Group which demonstrate strong financial delivery and operational performance.

Paul Fry
Chief Financial Officer

Financial review continued

Extract from the Consolidated income statement for the year ended 31 December 2018

	2018 £m	2017 £m	% change
Product supply revenues	**85.6**	74.7	14.6%
Royalty and other marketed revenues	**58.4**	63.7	(8.3%)
Development revenues	**16.5**	9.6	71.9%
Revenue	**160.5**	148.0	8.4%
Cost of sales	**(61.6)**	(57.2)	(7.7%)
Gross profit	**98.9**	90.8	8.9%
Research and development	**(55.5)**	(60.3)	8.0%
Other operating expenditure and income	**(12.8)**	(12.5)	(2.4%)
Exceptional items	**(9.0)**	(4.5)	(100%)
Amortisation and impairment charges	**(127.0)**	(109.7)	(15.8%)
Operating loss	**(105.4)**	(96.2)	(9.6%)
Adjusted EBITDA	**39.0**	25.8	51.2%
Adjusted EBITDA margin %	***24.3%***	*17.4%*	*6.9ppts*

1. Revenue continued

1.1 Product supply revenue continued

Other inhaled products

Vectura also earns revenue from the supply of devices to partners including the GyroHaler® device to Sandoz for the AirFluSal® Forspiro® product and the FOX® device to Bayer for use in their Breelib™ product. In total this revenue stream contributed £3.1m in the year, an increase of 14.8% compared to 2017. Vectura continues to focus on margin improvement initiatives to enhance the profitability of these revenue streams.

Other non-inhaled products

The Group's oral manufacturing facility in Lyon, France generates product supply revenues from sales of oral tablets to partners.

Product supply revenues from Lyon of £8.3m were lower than the prior year (2017: £8.6m), driven by a reduction in Sular® volumes which were unusually high in 2017 as a result of a competitor failure to supply. Excluding Sular®, non-inhaled product supply revenues grew 23.2%.

The operational focus of the Lyon site continues to be on improving profitability by replacing steady volume declines in mature and off-patent products, with growing new manufacturing volumes, supply revenues and associated development fees through new agreements. Six new such agreements were signed during 2018.

Some of the products manufactured at the Lyon site also earn the Group royalties, reported separately.

1.2 Royalty and other marketed revenues

The Group also generates revenues from products marketed by partners which incorporate Vectura's intellectual property. These revenues typically comprise royalties, share of sales arrangements or sales-based milestones, reflecting financial returns on historic R&D investments in partnered programmes. These revenues are earned without further material costs being incurred by the Group.

Total royalty and other marketed revenues

	2018 £m	2017 £m	% change
Ultibro® and Seebri®	**17.8**	17.3	2.9%
Ellipta®	**9.0**	9.0	—
flutiform®	**5.4**	6.6	(18.2%)
AirFluSal® Forspiro®	**2.9**	2.3	26.1%
Other non-inhaled royalties	**14.5**	17.4	(16.7%)
Royalty revenue	**49.6**	52.6	(5.7%)
Share of net sales of EXPAREL®	**5.1**	6.6	(22.7%)
Other inhaled marketed revenues	**3.7**	4.3	(14.0%)
Other non-inhaled marketed revenues	**—**	0.2	n/m
Royalty and other marketed revenues	**58.4**	63.7	(8.3%)

Ultibro® Breezhaler® and Seebri® Breezhaler® are now established and substantial products in Europe. Ultibro® continues to be the leading LAMA/LABA combination treatment ex-US and continues to grow well in Europe and Rest of World territories.

Ultibro® and Seebri® performance

Net sales[2]	2018 $m	2017 $m	% change
Ultibro® Breezhaler®	**454**	411	10.5%
Seebri® Breezhaler®	**148**	151	(2.0%)
Total in-market sales	**602**	562	7.1%

2 As reported by Novartis on 30 January 2019.

Vectura royalties	2018 £m	2017 £m	% change
Ultibro® Breezhaler®	**13.7**	12.7	7.9%
Seebri® Breezhaler®	**4.1**	4.6	(10.9%)
Total royalties	**17.8**	17.3	2.9%

Vectura revenues for Ultibro® and Seebri® Breezhaler® are derived from a royalty percentage of net sales reported by Novartis. Royalties from Ultibro® Breezhaler® increased by 7.9% in 2018 (+11.0% CER) while royalties from Seebri® Breezhaler® declined by 10.9% (-6.5% CER).

GSK's Ellipta® products continue to grow. Accordingly, Vectura has recognised the maximum annual royalty of £9.0m during 2018. The technology licensed to GSK is covered by granted patents with an earliest expiry date for one of the granted patent families in major markets of November 2019.

flutiform® royalties for Europe and most of the RoW territories are subject to the terms of the agreement with Mundipharma which limits the aggregate amount of royalties that can be earned by Vectura where royalties and product supply exceed 35% of Mundipharma's net sales. As a result of this cap, royalties from Mundipharma have reduced to virtually nil in 2018 (2017: £1.9m).

Strong in-market performance by Kyorin drove value and volume growth in Japan, up 12.8% and 17.4% respectively[1]. As a result, royalties from Japan grew by 10.4% (CER +12.5%), partially offsetting the reduction in Mundipharma royalties.

Other non-inhaled royalties comprise royalties earned on oral and other non-inhaled products which benefit from the Group's historical intellectual property. Many of these products are manufactured at the Group's production facility in Lyon.

Non-inhaled royalty and other marketed revenues

	2018 £m	2017 £m	% change
RAYOS®/LODOTRA®	**7.7**	6.7	14.9%
Requip®	**2.0**	2.9	(31.0%)
Solaraze®	**2.0**	2.9	(31.0%)
ADVATE®	**—**	1.2	(100%)
Xatral®	**0.1**	0.8	(87.5%)
Other products	**2.7**	3.1	(12.9%)
Total	**14.5**	17.6	(17.6%)

Total non-inhaled royalties continued a downward trend as products move towards the end of their lifecycle. Decreases in ADVATE® and Xatral® royalties were due to prior year patent expiry. This underlying decline was partially offset by strong RAYOS®/LODOTRA® royalty growth, up 14.9% to £7.7m, due to increased promotional activity. The licence agreement for RAYOS®/LODOTRA® has been amended with effect from 1 January 2019 with a minimum $8.0m annual royalty now payable to Vectura for RAYOS® for the calendar years 2019 to 2022.

Share of net sales of EXPAREL® is £5.1m, a reduction of £1.5m due to the share of net sales ceasing in September 2018 following expiry of the last expiring patent listed in the relevant agreement with Pacira. The Group remains eligible to receive a non-patent dependent $32m sales milestone when twelve-month net sales of EXPAREL® reach $500m on a cash received basis. Pacira reported 2018 net sales of EXPAREL® of $331m, a 17.0% increase compared to 2017. Current analyst consensus estimates are that Pacira will reach $500m annual net sales towards the end of 2023.

Other inhaled marketed revenues include a £1.3m milestone received on the anniversary of the first European launch of Breelib™. In 2017, Vectura recognised a £4.3m milestone from this launch. Under the terms of its agreement with Bayer, Vectura is eligible to receive a further €4.25m in milestones spread over the next five years, paid annually, and an additional €0.5m following commercial launch in Turkey.

Additionally, as part of an agreement with Sandoz regarding revised territory rights for AirFluSal® Forspiro®, Vectura recognised revenues of £2.4m during the period, of which £2.0m relates to the release of deferred income.

Financial review continued

1. Revenue continued

1.3 Development revenues

The Group also earns revenue from agreements with partners which draw on Vectura's device, formulation and development capabilities to deliver commercially attractive inhalation products. Under these agreements, during the development phase Vectura typically receives a series of cash flows in consideration for a variety of activities, which may comprise an upfront fee as consideration for the licence to access intellectual property, milestone payments for specific clinical or other development-based outcomes, or fees billed directly for work performed. Together these revenues have been categorised as development revenues. Revenues are recognised when contractual performance obligations are deemed to have been met, with the profile of these revenues varying by programme and over time.

Costs to deliver these revenues are reported under research and development (R&D) expenditure in the consolidated income statement and tend to be incurred on a more consistent basis over the life of the programme.

These agreements may also include sales-based royalties and commercial milestones post-launch. The economics of each partner agreement is structured differently in terms of the timing and mix of payments.

Development revenues by programme

	2018 £m	2017 £m	% change
Licensing of intellectual property			
Generic Ellipta® portfolio (Hikma)	**4.2**	—	n/m
Other inhaled programmes	**0.4**	0.6	(33.3%)
Total licensing revenues	**4.6**	0.6	>100%
Development services			
flutiform® K-Haler®	**2.4**	3.2	(25.0%)
Generic Ellipta® portfolio (Hikma)	**2.4**	—	n/m
VR2081 (Sandoz)	**1.3**	1.1	18.2%
VR2076	**1.7**	1.5	13.3%
Other inhaled development services	**2.6**	2.0	30.0%
Other non-inhaled development services	**1.5**	1.2	25.0%
Total development services	**11.9**	9.0	32.2%
Total development revenues	**16.5**	9.6	71.9%

Generic Ellipta® portfolio

In November, Vectura signed a global development and commercialisation agreement with Hikma for the development of an AB-rated substitutable drug-device combination of generic versions of the GSK Ellipta® portfolio. Upon signing of the deal, Vectura received an upfront cash payment of $15m (£11.4m). Of this, £6.6m was recognised in 2018 which comprises £4.2m from the licensing of intellectual property and £2.4m in respect of development services. The remaining income from the upfront payment of £4.8m is expected to be recognised over the next two years.

Licensing of intellectual property – Other inhaled programmes

In 2018, Vectura recognised £0.4m from the successful completion of the RESPIRE clinical trial for VR465 which used Vectura's adapted handheld FOX® nebuliser to deliver Ablynx/Sanofi's ALX-0171 medication to infants with Respiratory Syncytial Virus (RSV) infection.

K-haler® development

These revenues relate to fees charged for development work related to the *flutiform*® breath-activated k-haler®, launched in September 2018.

VR2081 (Sandoz)

A $5.0m upfront milestone from Sandoz was received in 2017 relating to the VR2081 programme. This milestone, plus the majority of the next two contractual development milestones, are deemed highly probable and therefore are being recognised as development work progresses on a percentage completion basis. Revenues recognised from ongoing development work are expected to be in the range of £1.0m–£2.0m in 2019.

VR2076

Following the conclusion of termination discussions with Mundipharma, deferred income and provisions amounting to £1.7m have been released in 2018 relating to past development work performed.

QVM149

Novartis expects the Phase III programme to complete in H2 2019 with regulatory submission in Europe and Japan also in H2 2019, triggering a filing milestone to Vectura of $2.5m. The Group will earn royalties on net sales upon launch of the product.

VR647

An end of Phase II meeting with the FDA is planned for H1 2019, enabling confirmation of Phase III programme design and partnering progression in H2 2019. Typically a partnering agreement will include a payment for a licence to intellectual property developed by Vectura which would be recognised as revenue upon signing, and a level of development fees recognised over time.

Other inhaled development services

In 2017 and 2018, other inhaled development services mainly comprise projects partnered with Hikma, with the increase in 2018 driven by development activity on the generic project VR730 (generic Salmeterol).

Other non-inhaled development services

The Group earned £1.5m in 2018 (2017: £1.2m) from the provision of development services related to products which are or will be manufactured at its oral tablet production facility in Lyon, France. This increase reflects the success the team is achieving in signing new contracts generating development fees with the prospect of converting these into more substantive product supply volumes once development activity is completed.

2. Research and development (R&D) expenses

The Group's R&D expenditure has been presented under two distinct categories:

a) Partnered – this category represents R&D expenditure funded by partners to progress the agreed contracted programmes. This expenditure is principally funded by Development revenues earned from the partner, which may be contingent upon the achievement of certain future milestones;

b) Pre-partnered– this category of R&D spend reflects investments funded by the Group on programmes yet to be partnered, as well as investments in its own innovative proprietary technology platforms. These investments are the basis for generating future partnering and licensing revenue opportunities.

Total R&D expenditure by category

	2018 £m	2017 £m	% change
Partnered R&D	**20.6**	25.7	(19.8%)
Pre-partnered R&D	**34.9**	34.6	0.9%
Total R&D	**55.5**	60.3	(8.0%)

Partnered R&D

Partnered R&D expenditure in 2018 represented 37.1% of total R&D expenditure (2017: 42.6%). The predominant focus of partnered R&D spend has been on generic programmes (70%) reflecting the change in the Group's strategic focus towards generic programmes.

Pre-partnered R&D

Pre-partnered R&D expenditure in 2018 represented 62.9% of total R&D expenditure (2017: 57.4%). This total expenditure included £6.7m of external R&D expenditure which related to the Phase III programme VR475. Development of VR475 is being wound down following the top-line results from the Phase III clinical study.

In 2018, positive results were achieved from the VR647 Phase II pharmacokinetic and mouthpiece methodology studies, and preparations continue for the Phase III programme. As previously indicated, the Group will seek to partner VR647 for Phase III during 2019.

In 2018, Vectura initiated and is progressing three new pipeline projects based on combining existing proven molecules with our proprietary breath-controlled nebulised technology. Spend on these projects is expected to increase in 2019 as they approach the clinical phases.

R&D guidance for 2019 remains unchanged at £45m–£55m.

3. Other operating expenditure and income

Other operating expenditure comprises a £2.6m non-cash charge for share-based compensation (2017: £2.1m) as well as corporate, administrative and selling and marketing costs of £12.8m (2017: £12.1m).

These costs were partially offset by other operating income of £2.6m, up from £1.7m in 2017 due to partner contributions to new manufacturing equipment and a one-off credit from Sanofi prior to the sale of their Holmes Chapel facility.

4. Amortisation and impairment of intangible assets

As a result of the VR475 Phase III study not meeting its primary endpoint, the Group is not pursuing further development and partnering of the programme. The carrying value of the intangible asset recognised as part of the Activaero GmbH acquisition in March 2014 has been impaired in full, with a resulting £39.8m impairment charge. A further impairment charge of £1.7m has been recognised following the decision by Sanofi to cease development of the VR465 programme.

These impairments, as well as the full amortisation of the EXPAREL® intangible asset in 2018, result in a £17.3m increase in the overall amortisation and impairment charge versus the prior year.

5. Exceptional items

Exceptional items include £7.1m of costs arising from the progression of legal proceedings against GSK in the US and UK relating to enforcement of certain of Vectura's patents in respect of the Ellipta® products. These costs include a provision for reimbursement of GSK's legal costs in the UK following the recent first instance judgement in GSK's favour. Vectura has been granted leave to appeal this judgement. The first instance hearing in the US proceedings is scheduled for April/May 2019.

For a breakdown of exceptional items by category, please refer to note 10 of the consolidated financial statements.

6. Adjusted EBITDA

Adjusted EBITDA is a non-IFRS measure which management uses to assess the performance of the business. This has increased by over 50% to £39.0m in 2018 driven mainly by revenue growth, a higher product supply margin and lower R&D expenditure.

As shown in note 9 to the consolidated financial statements, adjusted EBITDA is calculated by adjusting the statutory reported operating loss 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.

Financial review continued

7. Net finance income/expense
Net finance income has arisen from £0.8m of foreign exchange gains. In 2017 foreign exchange losses were £1.4m and other financing expenses were £1.2m.

8. Loss before tax
The Group's statutory loss before tax of £104.8m has increased by 2.5% from £102.2m in 2017 as benefits from growth in revenues, an improved product supply margin, lower R&D expenditure and lower amortisation charges have been more than offset by the impairment charge relating to VR475.

9. Taxation
The Group's effective tax rate (ETR) is a 15.8% credit (2017: 16.2% credit). A net taxation credit of £16.6m (2017: £16.5m credit) has been recognised in the consolidated income statement, being the net effect of a current tax expense in the Group's US and Swiss operations offset by deferred tax credits on the amortisation and impairment of acquisition accounting fair value adjustments and the recognition of a non-current deferred tax asset in respect of non-trade losses.

10. Loss per share
Despite growth in adjusted EBITDA and operating cash flow, basic and diluted loss per share has increased to 13.2p (2017: 12.6p loss per share) as a result of the VR475 impairment charge and the lower weighted average number of shares following completion of the share buyback in February 2018.

11. Foreign exchange exposure
The Group receives revenue and incurs expenses in a number of foreign currencies and, as such, movements in foreign exchange rates can materially impact the Group's financial results. Had foreign currency rates in 2018 remained constant with those of 2017, the Group's reported adjusted EBITDA would have been approximately £1.0m higher.

As an indication, a 5% strengthening or weakening of sterling against the euro, US dollar and Swiss franc would have had an impact of between £3m and £4m on the Group's adjusted EBITDA in 2018.

Balance sheet
Goodwill
Goodwill is not amortised but is tested annually for impairment. No impairment was recognised following this review during 2018. The increase of £2.0m in goodwill to £163.4m at 31 December 2018 arises from foreign exchange gains upon revaluation of goodwill denominated in foreign currencies, primarily the Swiss franc.

Intangible assets
The carrying value of intangible assets at 31 December 2018 of £219.9m has decreased by £115.5m during the period. This is primarily due to amortisation of £85.5m and impairment charges of £41.5m for the VR475 and VR465 intangible assets. This negative movement was partially offset by foreign exchange gains of £10.6m upon revaluation of intangibles denominated in foreign currencies, primarily the Swiss franc, and £0.9m of software additions.

Property, plant and equipment
The net book value of property, plant and equipment is £57.8m, £4.7m higher than at 31 December 2017 due to additions of £8.5m and foreign exchange gains of £2.0m which were partially offset by depreciation of £5.8m. Additions comprise mainly of manufacturing equipment to support the production of *flutiform*®, the development of oral tablet production in Lyon, and equipment to support the Group's nebuliser platforms.

Inventory
Similar to last year, over 91% of inventories of £26.7m held at 31 December 2018 relate to *flutiform*®. The value of inventories has increased by £3.3m compared to 2017, driven by growth in *flutiform*® volumes, a longer stand time for semi-finished product and a foreign exchange uplift from translation of the balance sheet of the Group's Swiss operations into sterling.

Provisions
Total provisions have increased by £5.5m to £10.9m at 31 December 2018 (31 December 2017: £5.4m). Aside from the movements already discussed under exceptional items and under *flutiform*® gross margin, the principal change has been a reclassification of £5.8m from other payables to provisions due to increased uncertainty as to the timing of settlement.

Swiss defined benefit retirement liability
The Swiss defined benefit retirement liability has decreased by £0.5m to £3.1m (31 December 2017: £3.6m). This is largely due to curtailment gains of £0.7m arising from redundancies recorded in exceptional items, less £0.2m of other movements.

Cash and liquidity

Vectura continues to maintain strong liquidity with cash and cash equivalents of £108.2m, an increase of £4.5m versus 2017. The previously announced £15.0m share buyback programme completed in February 2018 with 2018 cash outflows of £13.8m.

Cash generated from operating activities was £35.1m in 2018 (2017: £26.9m). The difference to adjusted EBITDA of £39.0m is explained as follows:

	2018 £m
Adjusted EBITDA	**39.0**
Exceptional items cash outflow not in adjusted EBITDA[3]	**(4.1)**
Deferred income release – AirFluSal® Forspiro® (Sandoz)	**(2.0)**
Deferred income and provision release – VR2076	**(1.7)**
Cash milestone received versus revenue recognised – Generic Ellipta® portfolio (Hikma)	**4.8**
Release of *flutiform*® supplier provision	**(1.1)**
Other working capital movements	**0.2**
Cash generated from operating activities	**35.1**

3 Exceptional costs are mainly driven by cash outflows of £3.7m relating to GSK litigation.

The Group made scheduled corporation tax payments relating to its US and Swiss operations of £6.0m (2017: £2.9m). These were partially offset by research and development tax credits received of £1.0m (2017: £2.1m).

Net cash outflows from capital expenditure were £12.3m, £2.8m higher than 2017. These included investments in manufacturing equipment for *flutiform*® and for the Lyon site, as well as investment in the Group's laboratories and platform technologies.

The Group has access to a £50.0m multicurrency revolving credit facility with Barclays Bank PLC and HSBC Bank PLC. This facility expires in August 2021 and remains undrawn.

By order of the Board

Paul Fry
Chief Financial Officer
25 March 2019

Appendix to the Financial review

Breakdown of non-inhaled revenue and gross profit.

	2018 £m	2017 £m	% change
RAYOS®/LODOTRA®	**1.6**	1.1	45.5%
Sular®	**1.4**	3.0	(53.3%)
Diclofenac®	**1.5**	1.4	7.1%
Other	**3.8**	3.1	22.6%
Product supply revenue	**8.3**	8.6	(3.5%)
Solaraze®	**2.0**	2.9	(31.0%)
RAYOS®/LODOTRA®	**7.7**	6.7	14.9%
Requip®	**2.0**	2.9	(31.0%)
Other royalties	**2.8**	5.1	(45.1%)
EXPAREL® share of net sales	**5.1**	6.6	(22.7%)
Royalty and other marketed revenues	**19.6**	24.2	(19.0%)
Development services	**1.5**	1.1	36.4%
Licensing – other	**—**	0.1	n/m
Development revenues	**1.5**	1.2	25.0%
Total non-inhaled revenue	**29.4**	34.0	(13.5%)
Cost of sales	**(11.2)**	(10.9)	(2.8%)
Non-inhaled gross profit	**18.2**	23.1	(21.2%)

Operating responsibly

By operating responsibly we are building a business that is durable, maximising our commercial success and delivering long-term value for our shareholders and society. We assess our performance across four key areas.

Our people

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. Each of our employees contributes to and shares in Vectura's success.

+ Read more on pages 59 and 60

Our patients

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

+ Read more on page 62

Our partners

Vectura has developed and maintains a partnering model for its generic development programmes and certain Vectura enhanced delivery programmes.

+ Read more on page 61

Our social impact

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

+ Read more on page 63

Our people

> We have ensured all of our people processes reinforce our culture as the definitive expression of "how we do things" at Vectura.

Introduction

In 2017 we embarked on the journey to define our culture to establish a common understanding of how we expect our people to deliver on our purpose and strategy – in every internal and external interaction. It was important to us to ensure this journey was highly participative, and through a combination of channels we were able to gain insight into what our people, investors, patients and partners need from us, and what enables us to give our best collectively and individually.

We translated this insight into our culture and throughout 2018 have ensured all of our people processes reinforce our culture as the definitive expression of "how we do things at Vectura". This alignment enables us to demonstrate our support for the updated Corporate Governance Code by ensuring our policies and practices are consistent with our values.

Our employment practices

Our commitment to diversity

We believe in a diverse and gender-balanced workforce, and our Equal Opportunities Policy ensures the provision of equal opportunities in all aspects of employment. Whilst we do not meet the threshold which requires all companies that employ 250 UK-based employees or more to report their gender pay and bonus pay gaps, we have elected to do so voluntarily because we believe this is the right thing to do. Our Gender Pay Gap Report is published annually on our website and includes details of our diversity action plan that we continue to deliver.

Employee engagement

At Vectura, we wholeheartedly believe in the power of engagement and its impact on business performance and employee retention. To support the updated Corporate Governance Code, we have appointed Per-Olof Andersson as the nominated Non-Executive Director who will oversee engagement between the Board and the workforce.

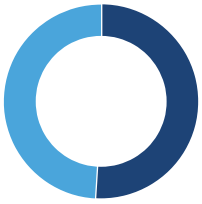
We operate an annual employee engagement survey and in 2018 conducted an additional pulse survey to validate the informal feedback we regularly receive. We typically see very high response rates (for example 90% of employees participated in the full engagement survey in March 2018) and use the results to initiate analysis and action planning at corporate, site and functional levels.

We have well-established engagement channels which we regularly review in light of our engagement survey results and we focus our efforts on some of the main drivers of engagement – purpose, autonomy and development.

Purpose

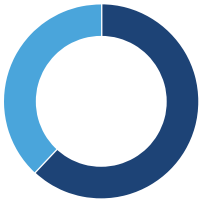
We ensure that corporate strategy is clearly communicated and well understood through regular all-employee Business Updates hosted by members of the ELT and BLT. Our refreshed monthly newsletters promote key initiatives and project updates, as well as people moves and social information. Individual goals are linked up to our corporate scorecard which is regularly updated and communicated. Our "Science Live" campaign, launched in 2018, connects us to our patients and our core purpose – transforming lives – whilst emphasising the uniqueness of our formulation and development capabilities.

Gender breakdown



- **Male** 230
- **Female** 223

Males/females in senior manager and above roles*

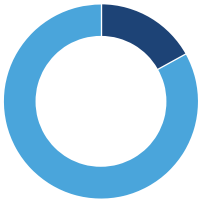


- **Male** 40
- **Female** 25

(Total senior managers: 65)

* Director level and above.

Percentage of employees working flexibly



- **Employees working flexibly** 17%

Our people continued

Our employment practices continued

Employee engagement continued

Autonomy

Our Employee Representative Forum of elected representatives from across the Group allows employees to drive the agenda and to discuss issues that matter to them. Our family-friendly policies enabled 17% of employees to work flexibly as at 31 December 2018 and our Leadership Development Programme clarifies the expectation, and provides the skills, for leaders to treat people as individuals by understanding and supporting their working preferences. We cement the personal accountability we all share for living our values and delivering our purpose by measuring both the "what" and the "how" via regular performance reviews, with the "how" assessed using our defined Company behaviours.

Development

Our Talent Management Framework has been rolled out to all functions resulting in the identification, support and development of our employees with "high potential". Personal development plans are encouraged for all and a Career Framework articulates the skills and experiences required to progress both laterally and/or vertically. In addition to investment in general training and development, we continue to offer all employees the opportunity to apply for scholarship funding through our Vocational Qualifications Award. In 2018 we have supported applications for a variety of professional qualifications including MSc in Medical Technology Regulatory Affairs, MSc in Clinical Research, IPMA (International Project Management Association) Level B&C and MBA (Master of Business Administration). We develop the essential skills needed to manage employees through our in-house Leadership Development Programme and regular Manager Forums. In 2019 we will introduce an additional internal training programme for supervisors and team leaders – our Management Development Programme. For the first time in 2018 we also launched a new and innovative approach to sharing our moments of pride through informal, employee-produced videos which were aired across the Company as a further reinforcement of our skills and capabilities.

Rewarding our people

We recognise the importance of a fair and competitive reward package and seek to provide well-constructed and regularly benchmarked reward systems which incentivise superior performance and align the interests of our employees with those of our shareholders.

The annual bonus is derived from corporate and individual performance and our remuneration packages include a pension entitlement, permanent health insurance, life insurance and medical care, and all employees can particulate in our share plans. For more details of our all-employee share plans, please refer to the Remuneration report. We help our people to understand the total value of their remuneration by providing an annual total reward statement.

In addition to the performance management process, recognition for the role models of our values or for those who have gone above and beyond in any aspect of their working life is provided through our Recognition Policy, comprised of "thank you" cards or small financial rewards, such as dinner with a partner, and through our "People's Champion" annual award ceremony.

Our commitment to health and safety

Keeping our colleagues safe is a priority for us. We have an established Health and Safety (H&S) Committee that monitors, reviews and drives improvements through our network of H&S representatives. Corporate updates are provided to the Board twice-yearly and functional reports are provided to the ELT, enabling it to reinforce the importance of compliance and a strong safety culture.

In 2018 we initiated our new Employee Wellbeing programme, which provides information, resources and support to help our people stay healthy. We have also announced our intention to train and appoint mental health first aiders in 2019. Acknowledging the importance of "psychological safety" for both employee wellbeing and engagement, we have clearly stated our requirement for leaders to role model the courage to admit mistakes and share reflections, in order to create an environment of openness and learning. Training is provided through our online training portal and face-to-face by our Health and Safety Manager and external training providers. We have also announced our intention to explicitly include HSE in our corporate scorecard in 2019, to reinforce its importance. James Ward-Lilley is the Board member to whom responsibility for health and safety has been assigned. We have an excellent safety record and there have been no major incidents or accidents to report to the Health and Safety Executive in the UK or to the equivalent bodies in Germany, Switzerland or France during the period.

Policies and practices

As a responsible employer operating in our highly regulated industry, we have a comprehensive Code of Conduct and supporting policies which set standards for ensuring that our business activities are conducted in a responsible manner for the benefit of our shareholders, clients, employees and suppliers. We believe that having empowered people, who understand their responsibilities, who display sound judgement and who act in an ethical way is key to the ongoing success of the Vectura Group. Our Code of Conduct is built around our values: our focus on patients, innovation, collaboration and achievement is key to our success. All employees and Board members are expected to demonstrate and promote high standards of ethical business conduct and to know and follow our Code with pride.

Our partners

> Our ambition is that by the end of 2020 the Collaboration in Partnership™ programme will cover the majority of our alliances.

Tim Wright
VP, Alliance Management

Living our Vectura culture starts with creating experiences that our employees and partners value. Experiences are strongly shaped by those we work with closest and by the quality of collaboration between teams, so with the help of Telos Partners we developed the Collaboration in Partnership™ programme that captures and develops the real experiences of alliance team members.

The process involves a short Health Check survey based on the defined Vectura behaviours, followed by a joint workshop to trigger collective action to improve.

To date, as a result of the programme, we are seeing a number of elements of successful partnerships emerging:

Insights into successful partnerships

REASON
Why the partnership exists

COMMUNICATION
How the partnership promotes dialogue

RESULTS
What the partnership will deliver

CONTACT
How the partnership maintains contact

RESPONSIBILITIES
What each person's role is in the partnership

COMMON GROUND
How the partnership promotes independence

These insights help to focus attention and check where best to prioritise effort to get the best returns. Many partnerships are working not just across different company cultures, but also across different country cultures and time zones.

Our approach is a catalyst to having the meaningful, real, candid discussions on what needs to be progressed and how it is best progressed for the good of the alliance/partnership. We put the attention as much on the relationships and behaviours within the Group as we do on the tasks in hand.

The Health Check survey data provides us with a measure and a starting point from which we can improve our partnerships. It also allows us to measure our Vectura culture – the experiences we are creating for our partners. We plan to repeat the Health Check with each alliance team every 18–24 months, keeping the attention on our ways of working and giving us a measure of improvement.

Tim Wright, Vectura's VP for Alliances, plans to develop the programme further: "Our ambition is that by the end of 2020 the Collaboration in Partnership™ programme will cover the majority of our alliances and will begin to include key commercial product suppliers. I want to ensure we are really living our culture and creating distinctive experiences for our partners... how we collaborate, innovate and achieve together to improve the lives of our patients is central to our culture and business."

Our patients

How we engage

We seek to address the needs of patients by understanding the different causes of airways diseases. We do this by maintaining an in-depth appreciation of clinical innovation, as well as a permanent dialogue with patients and their caregivers to understand their respective therapeutic needs.

Whilst in the past our main focus has been asthma, we believe that Vectura's device and formulation expertise may benefit patients living with other diseases too. This has been proven with the successful launch of Breelib™ for pulmonary arterial hypertension, and there are other conditions, such as lung infections and cystic fibrosis, where Vectura may be able to provide additional enhanced treatment options. We are constantly looking to match our future pipeline to the emerging treatment paradigm, always seeking to address patients' unmet needs.

We ensure that our employees understand the impact of the diseases we are targeting in patients, as well as the science behind the diagnosis and treatment of airways disease. Our internal "Science Live" programme showcases Vectura's science, innovation and patient focus through presentations and podcasts, from our own teams and from guest speakers.

Our teams actively consider patients' needs throughout the development process, striving to progress relevant products and easy-to-use device platforms to help improve patient adherence and thus compliance and treatment effectiveness.

In addition, during clinical development, we aim to seek patient and parent/caregiver feedback to make our clinical trial protocols more palatable to patients and as close to real life as possible.

Affordable quality products

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

Improving 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, and the need to improve patient compliance and outcomes and reduce overall costs of healthcare.

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. Vectura's 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 the clinical trials which it sponsors. These SOPs and policies ensure compliance with internationally recognised and adopted standards, and with national and international legislation in the relevant territories. They also ensure consistency across studies and programmes in the way that data is collected, analysed and stored. 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 teams actively consider patients' needs throughout the development process, striving to progress relevant products and easy-to-use device platforms to help improve patient adherence to treatments.

Gary Burgess
VP, Medical

Our social impact

We have defined our culture with a level of specificity that enables us to bring it to life in all internal and external interactions. One component of our culture is our mindset, which is "creating opportunities to improve lives". This mindset is our common way of thinking and ensures we consider the needs of others including our local communities.

As a responsible business, we are committed to having a long-term positive impact on our environment. We maintain close relationships with our local schools and universities, support our employees in local and national charity endeavours, and monitor our carbon footprint.

In 2018 we launched a new Charitable Support Policy which outlines our approach to matched fundraising and local volunteering. Our highly effective and active Social Committee continued to organise a multitude of fundraising events and, for the fourth year running, we supported a charity bike ride with 30 employees participating in a Muttenz to Lyon route. This raised £21,755 for Asthma UK and £1,531 for charities in Germany and Switzerland, as well as reinforcing our Company values.

We continue to collaborate academically with local universities and our science, technology, engineering and maths (STEM) group participation enables us to encourage students to select STEM subjects at an early age, with members of our laboratory teams providing valuable insight into a career in science with local schoolchildren.

Our carbon footprint

Due to the nature of our business, we consider that we have a low environmental impact. However, we are committed to protecting the environment and actively seek to make energy savings in a way that is beneficial and cost effective. Antony Fitzpatrick, Executive Vice President Operations, has responsibility for reporting relevant environmental matters to the Board. There have been no reportable incidents in 2018 at any of the Group's sites.

Energy efficiency

We continue to replace existing lighting with energy-efficient LED lighting. We have also installed light movement sensors in our car parks to limit energy consumption. Additionally we are replacing critical systems, such as chillers, with more efficient equipment to reduce overall energy consumption in our Chippenham site.

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 2018**	Year ended 31 December 2017
Scope 1	**2,543**	2,312
Scope 2	**1,249**	1,522
Total emissions (Scope 1 and 2)	**3,792**	3,834
Emissions reported (tonnes of CO_2 per sq ft)[2]	**0.01**	0.01

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.

Paul Fry
Chief Financial Officer
25 March 2019

GOVERNANCE

Introduction from the Chairman

In recognition of the length of service of a number of Board members and to ensure good governance, the Board has reviewed and taken significant steps in respect of the succession planning of the Board and its Committees to ensure continuity for the business.

Dear Shareholder

During the year the Board has focused on further improving the corporate culture of the Group and is committed to maintaining high standards of corporate governance and diversity, which we believe are integral to the long-term success of Vectura and its purpose of transforming the lives of airways disease patients. In recognition of the length of service of a number of Board members and to ensure good governance, the Board has reviewed and taken significant steps in respect of the succession planning of the Board and its Committees to ensure continuity for the business and where necessary a handover period. 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 Executive Directors' 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 fully with the applicable version (2016). However, following the publication of a new Code in 2018, the Group is well advanced in its planning for its adoption in respect of the 2019 accounting year. One of the requirements of the new Code is in relation to workforce engagement and the Board has designated Per-Olof Andersson, a Non-Executive Director, who will oversee the workforce engagement framework from 1 January 2019. This approach will be used in conjunction with our existing employee engagement mechanisms. As stated last year, the Company will continue to publish its gender pay gap reporting voluntarily on its website in support of the ethos of the legislation.

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 the matters reserved to the Board, the Market Abuse Regulation and Modern Slavery requirements in order to ensure that the Company is compliant and also that the governance framework is appropriate.

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.

Following a tender for the provision of the external audit, KPMG LLP was successful and its appointment was approved by shareholders at the 2017 Annual General Meeting. Following its reappointment in 2018, a resolution to reappoint KPMG as auditor will be put to the 2019 Annual General Meeting for approval.

Statement of compliance with the Code

The following sections contain an explanation of how good governance has been embedded into the 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 2018. The Board notes that the length of service of two Non-Executive Directors, who have served on the Vectura Board or the combined Skyepharma and Vectura Boards for over nine years. The Board believes that their continued service and experience will ensure a smooth implementation of succession plans and further details are contained in the Nomination Committee report on pages 73 to 74. 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
25 March 2019

Board of Directors

Bruno Angelici
N R
Non-Executive Chairman

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 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, and was the commercial vice president leading respiratory, inflammation and autoimmunity, global product and portfolio strategy. In this role he had responsibility for the development of AstraZeneca's respiratory, inflammation and autoimmunity strategy which included its on market assets Symbicort® and Pulmicort®, its biologics pipeline and the acquisitions of Almirall's respiratory business and Pearl Therapeutics. Prior to this, he led the AstraZeneca investor relations team from 2011 to 2012. James' extensive 28 year management career at AstraZeneca was across a range 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.

Paul Fry
Chief Financial Officer

Appointment to the Board Paul Fry was appointed Chief Financial Officer on 22 October 2018.

Experience and expertise He graduated from Oxford University in 1988 and qualified as an accountant with the Chartered Institute of Management Accountants in 1991.

Paul joined Vectura from Immunocore, a privately held T Cell Receptor biotechnology company, where he had been chief financial officer since January 2017. Before joining Immunocore, he served as director of global finance operations at Vodafone Plc, where he was responsible for key financial controller activities and core processes as well as large transformation programmes. Prior to his role at Vodafone, he spent more than 25 years at GlaxoSmithKline (GSK), where he held a number of senior roles including head of global finance services and as CFO for GSK's Italian pharmaceutical business.

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

Susan Foden
N
Non-Executive Director

Appointment to the Board Dr Susan Foden joined the Vectura Board in January 2007 and is Senior Independent Director.

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, Evgen Pharma plc and Oxford Ancestors Limited.

Per-Olof Andersson
A N
Non-Executive Director

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, bio-pharmaceuticals 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. To support the 2018 Corporate Governance Code, Per-Olof has been appointed as the nominated Non-Executive Director who will oversee engagement between the Board and the workforce.

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

Juliet Thompson
A R
Non-Executive Director

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 is deputy chairman of Nexstim plc, a Nasdaq-listed Finnish medical technology company, and sits on the boards of Novacyt S.A., a French 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. She was appointed a director and remuneration committee chair of Scapa Group plc on 21 January 2019, and also as a member of both its audit and risk and nomination committees.

Thomas Werner
Non-Executive Director

A N R

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 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 of the investment advisory committee of the Seventure (France) Health for Life capital investment fund. He is also vice chairman of Basilea Pharmaceutica Ltd.

Anne Whitaker
Non-Executive Director

N R

Appointment to the Board Anne Whitaker was appointed to the Vectura Board as a Non-Executive Director in June 2018.

Experience and expertise She has more than 25 years of experience in the life science industry, including senior leadership roles with large pharmaceutical, biotech and speciality pharma companies. She has significant experience in the US respiratory sector and was, until recently, serving as president and chief executive officer of KNOW Bio, LLC and its wholly owned subsidiary, Novoclem Therapeutics, Inc. Previously, Anne was executive vice president and company group chairman at Valeant Pharmaceuticals. Prior to that, Anne served as president and chief executive officer of Synta Pharmaceuticals, now part of Madrigal Pharmaceuticals, Inc. She also served as president, North America pharmaceuticals at Sanofi, and held several commercial leadership roles at GlaxoSmithKline.

Current external appointments Anne is currently a director and CEO of Dance Biopharma Holdings Inc., an independent director of Cree, Inc., a NASDAQ traded company, and an independent director of Mallinckrodt plc. She is also a trustee for the University of North Alabama.

Neil Warner
Non-Executive Director

A R

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.

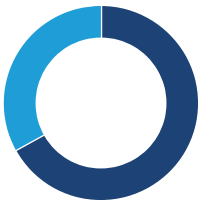
A Audit Committee

N Nomination Committee

R Remuneration Committee

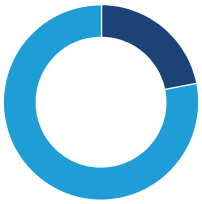
Committee Chairman

Board gender diversity



Male	66.7%
Female	33.3%

Board composition



Executive	22.2%
Non-Executive	77.8%

Board tenure

<1 year	22.2%
1–5 years	33.3%
5+ years	44.4%

+ Full biographies of the Board are available to view on www.vectura.com

Executive Leadership Team

James Ward-Lilley
Chief Executive Officer

Read James Ward-Lilley's experience and expertise on page 66.

Paul Fry
Chief Financial Officer

Read Paul Fry's experience and expertise on page 66.

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.

David Lescuyer
Executive Vice President – Oral Business

Appointment David 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.

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 Astra Zeneca with responsibility for the overall strategy, organisation, resource assignment and project prioritisation across Astra Zeneca's 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 director of global 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 is an independent non-executive director of ALK-Abello A/S.

Antony Fitzpatrick
Executive Vice President – Operations

Appointment Antony Fitzpatrick joined Vectura in July 2017.

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

Antony 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.

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.

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.

Leadership

The Board and its processes

Board membership

The Board currently comprises two Executive and seven Non-Executive Directors. Paul Fry joined the Board as an Executive Director and Chief Financial Officer on 22 October 2018 and Anne Whitaker joined the Board as a Non-Executive Director on 1 June 2018.

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, Paul Fry and Anne Whitaker will put themselves 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 Board is satisfied that the Non-Executive Directors who have been members of the Board for longer than nine years continue to demonstrate their independence and have no evidence that their length of tenure has impacted on this.

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 are reviewed annually to ensure that they are appropriate for the Group and 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 2018, in addition to seven scheduled formal Board meetings which were held, there were three 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	8/8
Frank Condella (left the Board on 31 October 2018)	6/6	—	5/5	—
Andrew Derodra (left the Board on 31 July 2018)	3/3	—	—	—
Paul Fry	1/1	—	—	—
James Ward-Lilley	7/7	—	—	—
Per-Olof Andersson	7/7	5/5	5/5	—
Susan Foden	7/7	—	5/5	8/8
Neil Warner	7/7	5/5	—	8/8
Thomas Werner*	5/7	3/5	3/5	6/8
Juliet Thompson	7/7	5/5	—	8/8
Anne Whitaker	3/3	—	2/2	2/2

* Dr Werner was unable to attend the May and September meetings due to illness.

Attendance above is in relation to members of the Board/Committees. Other 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 strategy, investor relations, legal affairs and environmental 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 outlook.

The Non-Executive Directors held meetings without management present after each Board meeting and, in addition, had discussions with 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.

Corporate governance report continued

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, the Executive Vice President – Operations and the Executive Vice President – Human Resources.

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, including those that would threaten the Group's business model, future performance, solvency or liquidity, and has also conducted an annual review of the effectiveness of the systems of internal control and risk management 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 42 to 49.

Induction 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. The Anti-Bribery and Modern 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.

Papers are typically sent out, usually electronically, one week before the meeting to give members of the Board an opportunity to clarify any points before the meeting and to prepare questions and observations on matters prior to the meeting.

Board evaluation

In accordance with the Code requirements and following the 2017 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 its online governance assessment service to review the role of the Board and its Committees. In addition, Susan 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 Directors.

The Chairman and the Board discussed the results of the review. 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 at Board meetings to create enhanced interaction between the Board and management, a better understanding of IT challenges, better use of the Non-Executive Directors' expertise and communicating long-term goals more effectively with shareholders and other stakeholders in the Company. During the year, the Board has continued to work to ensure effective succession planning by searching for further Non-Executive Directors with the appropriate skills and experience to replace the longer serving members of the Board.

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 or her 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 66 and 67. 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 2018 can be found in the table on page 69.

Remuneration Committee

The following were members of the Remuneration Committee during 2018: Susan Foden (Chair), Bruno Angelici, Neil Warner, Thomas Werner and Juliet Thompson. Anne Whitaker joined the Committee on 5 September 2018. The General Counsel and Company Secretary acted as Secretary to the Committee.

Susan Foden stood down from the Committee with effect from 31 December 2018 and Juliet Thompson took over the role as Chair from 1 January 2019. It was originally intended that Juliet Thompson would be a successor to Neil Warner in respect of Chair of the Audit Committee and this is a role that she still wishes to take on. As mentioned in the Nomination Committee report, a search has been initiated for a new Non-Executive Director with the intention of appointing someone with the appropriate experience and qualifications to become Chair of the Remuneration Committee in due course once they have sufficient time to get to know the Company and the Board. This search is nearing completion.

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 or her own remuneration. The General Counsel and Company Secretary acted as Secretary of the Committee.

The Remuneration Committee's full report appears on pages 79 to 103.

Audit Committee

The following were members of the Audit Committee during the year: Neil Warner (Chair), Per-Olof Andersson, Thomas Werner and Juliet Thompson.

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. Neil 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 having 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 75 to 78.

Corporate governance report continued

Nomination Committee

The following were members of the Committee during 2018: Bruno Angelici (Chair), Per-Olof Andersson, Susan Foden, Thomas Werner, Anne Whitaker and Frank Condella. Frank stood down from the Committee at the end of October and Anne Whitaker joined the Committee on 5 September 2018.

The General Counsel and Company Secretary acted as Secretary to the Committee.

Its work and activities are further described in its report on pages 73 to 74.

Relations with shareholders

Executive Management runs an extensive programme of roadshows and ad hoc meetings with both existing and potential new shareholders. In 2018, meetings were held in the UK, Europe and the United States 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 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.

At the 2018 AGM all of the resolutions put to shareholders were passed. However, a number of shareholders followed recommendations by several of the proxy voting agencies to vote against the resolutions to approve the Remuneration report and the reappointment of Susan Foden, Chair of the Remuneration Committee. As announced, following the results of the AGM voting, she has engaged with a number of shareholders to address their concerns going forward.

Since the AGM, the Remuneration Committee has consulted with major shareholders representing more than 50% of the shares held in the Company on a one-to-one basis, receiving detailed feedback on the remuneration structure and its operation. The Committee believes that this group represents a broad cross-section of the register and its views. As a result, in November 2018 the Company published an update of the actions it intends to take, on both its website and also by sending a copy of the update to the Investment Association (IA) for inclusion on the IA's public register. In addition, as already referred to above, Susan Foden has stepped down from the Committee with effect from 31 December 2018.

The Company continues to welcome 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 50.

Ensuring Board diversity, skills and independence

> During the year, the Nomination Committee continued its work to find a further Non-Executive Director to supplement the independence and knowledge of the existing Board and to ensure appropriate succession planning is in place, taking into account diversity of the Board.
>
> **Bruno Angelici**

The Nomination Committee during the period consisted of Bruno Angelici (Chair), Per-Olof Andersson, Susan Foden, Thomas Werner and Anne Whitaker, who joined on 5 September 2018. A copy of the Committee's terms of reference is available on the Company's website.

Review of the period

Frank Condella, Non-Executive Director and Vice Chairman, stepped down from the Board with effect from 31 October 2018.

During the year, the Nomination Committee continued its work to find a further Non-Executive Director to supplement the independence and knowledge of the existing Board and to ensure appropriate succession planning is in place, taking into account diversity of the Board. This resulted in the appointment of Anne Whitaker to the Board, a further female independent Non-Executive Director, in June 2018. Her recruitment was made with the assistance of an external search consultancy, Heidrick and Struggles, which does not have any other connection with the Group. Anne has more than 25 years' experience in the life science industry, including significant experience in the US respiratory sector. With this appointment, Board representation of female membership reached 33%. In addition, Andrew Derodra, Chief Financial Officer (CFO), resigned from the Group with effect from 31 July 2018 and Paul Fry was appointed as the new CFO in October 2018. In compliance with the 2018 Corporate Governance Code, Per-Olof Andersson was appointed as the nominated Non-Executive Director who will oversee engagement between the Board and the workforce.

Board evaluation

In accordance with the UK Corporate Governance Code and as advised in the 2016 report, an externally facilitated evaluation was carried out in 2017 by Independent Audit Limited (IAL), a company which has no other connection with the Group. This year a review of effectiveness of the Board and its Committees was carried out internally using IAL's online governance assessment service and for individual Directors questionnaires were completed. The results were based on self-assessment and, although collated by IAL, were not verified by it. A further externally facilitated evaluation will take place in 2019, taking into account the recommendations of the new 2018 UK Corporate Governance Code, which emphasises the importance of the evaluator's direct contact with the Board and individual Directors.

Nomination Committee report continued

Review of the period continued

Board succession planning

The Board has reviewed the succession plans for both its composition and that of its Committees and the continued development of the Board. The Board is recommending that it is in the best interests of the Group to retain the services of two Non-Executive Directors for a further period, one having served continuously on the Vectura Board and the other in aggregate, on the combined Skyepharma and Vectura Boards, for over nine years. It continues to be the belief of the other Board members that both Dr Susan Foden and Dr Thomas Werner should continue on the Board to assist in ensuring a smooth implementation of succession plans. The other members of the Board consider them to be 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. It is noted that whilst the proposals for the new 2018 Code originally incorporated a strict nine-year director independence test, those proposals were not carried forward into the 2018 Code, which will apply to the 2019 financial year, to allow for flexibility to extend a director's term to facilitate effective succession planning and development of a diverse board.

During the year, the experience and expertise of each of the Board members have been reviewed, in order to develop Board and Committee membership in a way that is in the best interests of the Company and its stakeholders and to ensure that there are sufficient Non-Executive Board members to carry out the necessary Committee remits both as chairpersons and members adhering to appropriate governance and diversity guidelines. As a result of this review, it has been agreed that an additional Non-Executive Director should be appointed to the Board in 2019. A search has been initiated for a new Non-Executive Director with the intention of appointing someone with the appropriate experience and qualifications to become Chair of the Remuneration Committee in due course, once they have had sufficient time to get to know the Company and the Board. This search is nearing completion and is being carried out with the assistance of an external search consultancy, Odgers Berndtson, which does not have any other connection with the Group.

As a result of shareholder consultation in respect of the vote on remuneration matters at the 2018 AGM, Dr Foden took the decision to stand down as Chair and as a member of the Remuneration Committee with effect from the end of December 2018. She will remain on the Board as the Senior Independent Director and will continue to serve as a member of the Nomination Committee. As previously announced and with effect from the beginning of January 2019, Juliet Thompson was appointed as the Remuneration Committee Chair.

It is proposed that by the 2020 AGM, Dr Foden and Dr Werner will stand down from the Board, together with Mr Warner, who will have served for just over nine years at that time. Following these changes, the Board will consist of eight Directors, three or four of whom will be women depending on the gender of any new Non-Executive Directors who are appointed during this period. The Board will then be refreshed in the sense that it will have a new Chair of both Remuneration and Audit Committees and a new Senior Independent Director, with no Directors having served more than 6.5 years and over half the Board having served for less than four years.

The Committee recommends the appointment of Paul Fry and Anne Whitaker and the reappointment of all other Directors standing for re-election at the 2019 AGM.

Diversity

Vectura Group plc is committed to encouraging equality and diversity among its workforce. We aim to create an inclusive working environment based on merit, fairness and respect to enable us to attract and retain the most talented people from all backgrounds and cultures. We are also working to achieve a diverse Board and, just as importantly, diverse management teams. Appointments to the Board are based on merit and consideration of the Group's strategic objectives. The Committee has a formal and rigorous appointment process involving most if not all Board members and makes recommendations based on the capabilities of individual candidates, having due regard for the benefits of diversity and the need to ensure the effective functioning of the Board at all times.

The Group supports the principles of the Hampton-Alexander report on gender. At present, the Board is comprised of three women and six men and therefore meets the Hampton-Alexander recommendation that 33% of a FTSE 350 board be women. We believe that members of the Board and senior management should collectively possess a diverse range of skills, expertise, national birthplace and ethnic and societal backgrounds. In terms of the next level of management, our Executive Leadership Team, excluding the Executive Directors, totalled seven, of which there are two female members. In 2018 the Group achieved the target female representation at this level including direct reports with 13 out of the 35 individuals being female, resulting in representation of 37% and meeting the 33% requirement. As a company, our strategy will be to maintain and improve on these levels, so that the objectives of the Hampton-Alexander Review continue to be met throughout 2019.

The Committee is aware of the recommendations of the Parker Review on Ethnic Diversity. This is being taken into account in future succession planning activities.

Bruno Angelici
Nomination Committee Chairman
25 March 2019

Monitoring all aspects of financial reporting and risk

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The main focus areas of the Committee in 2018 have been on application of IFRS 15 to the new global agreement with Hikma to develop generic versions of GSK’s Ellipta® portfolio, the accounting implications from the Phase III study of VR475 not reaching its clinical endpoint and ongoing review of the risk management process of the Group, particularly in relation to Brexit. Additionally, the Committee oversaw the transition of the CFO role.

Neil Warner

Main activities of the Committee

During the period, and through to the finalisation of the report and accounts for the year to 31 December 2018, the main activities and principal issues considered by the Audit Committee were as follows:

Application of IFRS 15 to the new arrangement with Hikma to develop generic versions of GSK’s Ellipta® portfolio

This is the first new contractual arrangement to which IFRS 15 has been applied. The Committee reviewed and concurred with the following judgements and estimates considered critical in recognising £6.6m of revenue in 2018:

- the judgement that the committed performance obligations are (1) the licence to use Vectura’s intellectual property and (2) the provision of services for development of Vectura’s Open-Inhale-Close device;
- the judgement that the licence to Vectura’s Open-Inhale-Close dry powder inhaler device is distinct from the device development activities as these activities could be provided by other parties and the licence could have been provided without the development activities;
- the assessment that there is no material right to the option to acquire future formulation and process services for up to five products on terms specified in the agreement;
- the estimate of the standalone selling price of the device development services based on a cost plus a margin approach and the device licence using the residual approach; and
- the transaction price at 31 December 2018 comprising the $15.0m upfront milestone only.

Restatement of share premium within reserves

The Committee noted that shares issued on 13 March 2014 with a market value of £41.3m, as part of consideration for the Activaero acquisition, were incorrectly recorded in non-distributable share premium. This should have been recognised as a separate merger reserve and has been corrected in the 2017 comparative balance sheet with a third balance sheet disclosed as required by IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors.

Adverse outcome of Phase III study of VR475

The Committee reviewed management’s impairment assessment following the announcement that the Phase III study of VR475 did not meet its primary endpoint. It was agreed that the carrying value of the acquired VR475 intangible asset of c. £40m should be impaired in full and the carrying value of Vectura Group plc’s investment in Germany of £116.7m should be impaired to £19.9m. This carrying value post impairment is supported by the VR647 programme, which received positive Phase II results in 2018. Despite VR475 and VR647 utilising the same device, VR647 is not impacted by this adverse result.

Audit committee report continued

Main activities of the Committee continued

Alternative performance measures

2018 is the first set of financial statements not distorted by the Skyepharma merger, which took place in June 2016, and the change in accounting reference date from 31 March to 31 December. The Committee therefore welcomed the removal of twelve-month proforma alternative performance measures and those for underlying and non-recurring revenues. The remaining alternative performance measures for the Group, being adjusted EBITDA and exceptional items remain appropriate to explain the performance of the Group.

Oversight of CFO transition

With the departure of Andrew Derodra in July, the Committee oversaw the transition of the CFO role to Paul Fry who joined in October.

Review of critical areas of accounting judgement and estimates

In addition to the above, 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 judgements and estimates – revenue:** In addition to the application of IFRS 15 to the new agreement with Hikma to develop generic versions of GSK's Ellipta® portfolio detailed above, the Committee reviewed and agreed with management's assessment of variable consideration to be included in the transaction price for the Group's other existing collaborative development and marketing arrangements in the development phase.
- **Critical estimate – intangibles impairment:** In addition to the impairment of the VR475 intangible described above, the Committee concurred with the impairment of the VR465 intangible as, despite the trial achieving a positive primary endpoint, Ablynx/Sanofi had decided not to continue with the programme. The impairment tests for cash-generating units (CGUs) to which goodwill has been allocated and other intangible assets where impairment indicators had been identified were reviewed together with the key assumptions, including an increase to the Group's weighted average cost of capital which is used as the base to derive the discount rates for the impairment tests. The Committee noted that the increase is driven by a higher market volatility premium caused by Brexit amongst other factors. The Committee agreed with the adjustments to the Group's weighted average cost of capital to derive discount rates for the impairment tests of the UK and German CGU and Switzerland CGU. The sensitivities and the related content in the consolidated financial statements were reviewed by the Committee with the level of disclosure considered appropriate.
- **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 life of the remaining smart nebuliser based technology asset and agreed with the assessments made.
- **Critical judgement – uncertain tax position:** The Committee noted that there had been no developments in 2018 that have changed this judgement.
- **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 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. In addition to the impairment of the investment in Germany detailed above, the Committee agreed with the impairment of the investment in Switzerland and the US which is mainly driven by an increase in the discount rate. The Committee also noted the release of merger reserves to mitigate the impact of these impairments on distributable reserves of the parent company (Germany partial, Switzerland and the US in full).

New accounting standards

The Committee noted that the Group's only material operating lease arrangements relate to commercial property leases at its operational sites. Management's assessment from adopting IFRS 16 from 1 January 2019 was reviewed and agreed by the Committee comprising the cumulative effect adjustment to opening equity, key judgements and the disclosure provided in note 33 to the consolidated financial statements.

In addition, the Committee reviewed the initial assessment from adopting IFRIC 23 from 1 January 2019 noting the uncertainty on tax legislation from the UK's exit from the European Union and lack of clarity of tax reforms in Switzerland.

Brexit uncertainty

The Committee agreed with management's assessment of the Group's principal risks relating to Brexit and the quantification of these risks in a range of downside sensitivities. The most severe sensitivity would result in impairment of the Group's *flutiform*® intangible and goodwill allocated to the Switzerland cash-generating unit. In addition, the parent company's investment in Switzerland would be further impaired.

Going concern and viability

The Audit Committee reviewed management's assessment of going concern and viability noting the level of uncertainty caused by Brexit. The Committee still considers the three-year viability period to be appropriate. The Group continues to be strongly cash generative and has cash and cash equivalents in excess of £100m at 31 December 2018. Additionally, the Group's £50m revolving credit facility which expires in August 2021 is expected to be renewed.

Management's viability stress tests, including the scenario relating to the principal risks from Brexit, were considered by the Committee to be reasonably plausible. The Committee agreed with the assessment of the Group as a going concern and its viability over a three-year period.

Fair, balanced and understandable assessment

In addition to the annual reporting being understandable, the Committee also considered it to be fair and balanced. The report acknowledges the challenges from the adverse outcome of the VR475 Phase III clinical study and Brexit uncertainty amongst others as well as the strengths and opportunities of the Group.

Independence and non-audit services performed by the external auditor

2018 is the second year where KPMG is the Group's appointed auditor. The UK requires the tender of the audit after ten years and rotation after 20 years. Following KPMG's first year audit, the fees for the annual and interim audit were reviewed against the costs incurred and a proposal made for a fee increase. Following challenge by the Committee, the fees for the 2018 annual and interim audits were agreed including a commitment from both KPMG and Vectura to improve the efficiency of the audit to minimise costs.

In 2018, the non-audit services performed by KPMG related to the review of the Group's interim financial report.

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

Committee evaluation

The Board undertook a full evaluation of the Committee members and its performance during the year. It was concluded that the skills of the respective members and the performance of the Committee were appropriate.

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 could 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.

Audit committee report continued

Annual Reports and periodic reports continued

The Committee reviews the Report and Accounts, 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 control systems resides with the Board, the Committee reviews the Group's principal risks and internal financial control, 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 are determined by the Committee and 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 are 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, 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.

Neil Warner
Audit Committee Chairman
25 March 2019

2018 remuneration aligned to strong business performance, taking account of shareholder feedback

> As Committee Chair I have spent a significant amount of time since the 2018 AGM engaging with shareholders to further understand the areas of concern raised.
>
> **Susan Foden**

Dear Shareholder

On behalf of the Board, I am pleased to present my final Vectura Remuneration Committee report ("Report") for the year ended 31 December 2018. I have now stepped down as Chairman and as a member of Vectura's Remuneration Committee ("Committee"), and Juliet Thompson has taken on this role effective from 1 January 2019. This Report looks both back at the activities of the Committee for the last financial year under my Chairmanship, and also forward to implementation of the Remuneration Policy ("Policy") in 2019 under Juliet Thompson's Chairmanship. I have been nominated by the Directors to present the part of this statement in respect of decisions made during the 2018 financial year, with Juliet Thompson as the new Committee Chair presenting the part of the statement that outlines the operation of the policy for the year ahead.

The Committee was naturally disappointed with the outcome of the resolution to approve the Directors' report at last year's Annual General Meeting, with 41.46% of shareholders voting against the report. As Committee Chair I have spent a significant amount of time since the 2018 AGM engaging with shareholders to further understand the areas of concern raised. These meetings and consultations, conducted on a one-on-one basis, have engaged shareholders collectively representing more than 50% of the shares in the Company and have allowed me to receive detailed feedback on our Policy and its operation.

Many investors who were consulted indicated that they were supportive of the metrics and target setting. The concerns raised were principally in relation to the bonus outturn for 2017. One concern related to the appropriateness of even a low percentage payout for the achievement of synergy targets, which was included at 4% of the total award, when the Company's main financial targets had not been met. In addition, concern was shared about the weighting given to so-called "soft objectives" including personal objectives and the lack of detail to explain decisions in these categories. Some shareholders also indicated that from their point of view the financial metrics were insufficiently weighted.

Remuneration Committee report continued

Acknowledging this feedback, the Committee has:

- ensured that no element of bonus award within the financial measures for the financial year 2018 relates to synergy targets;
- ensured that the weighting of the financial performance of the Company with respect to the annual bonus for the financial year 2019 is increased to 60% of the total. The Committee noted that the weighting on financial performance will be kept under review and may increase further in future years;
- provided more information on achievements against the non-financial targets for 2018;
- assessed, when considering the overall outturn against the objectives, whether that outturn is warranted based on the overall performance of the business and applied downward discretion; and
- continued to monitor and ensure plans are in place to fulfil the CEO's and other executives' progress towards meeting their shareholding guidelines.

In January 2019, I wrote to shareholders outlining the remuneration outcomes with respect to 2018 and to provide further details of the Committee's key decisions for 2019. Responses to this consultation are further referenced in the Report, and key decisions are highlighted below.

Board changes

During the year, the Committee considered the remuneration package of the incoming CFO, Paul Fry, who joined on 22 October 2018. His package was set at a level that the Committee considers appropriate and reflects the skills and experience Paul brings to the business. In addition, the Committee agreed to compensate Paul on joining Vectura for the forfeiture of his bonus and existing equity entitlements resulting from his departure from Immunocore. In doing so the Committee adopted a prudent approach and accordingly the compensation relating to his forfeited equity entitlements was set at a significant discount, according to the Company's assessment of their potential value, and is subject to forfeiture requirements. In addition, an element of this pay out is linked to future Vectura performance. Details of these awards and the cash value of forfeited bonus can be found on page 98. Andrew Derodra's exit terms were in line with the Policy. He was not entitled to any additional payments beyond his contractual entitlement, which was limited to salary, pension and benefits. He was not eligible for an annual bonus in respect of 2018 and his outstanding long-term incentive awards lapsed on his departure.

Outturns for the period under review

As reported in the Financial review set out on pages 51 to 57, the Group has delivered a strong financial performance in 2018. In reviewing performance against the 2018 scorecard, we were pleased to see that the financial performance targets had been met or exceeded. The Committee gave particular attention to the results of the VR475 trial. Shareholders will be aware that the primary exacerbations reduction endpoint set for this study was challenging given the severity of the underlying asthma and we were mindful of the need to balance our conclusions between the actual outcome of the trial in terms of primary data significance and the performance of the team in ensuring the trial had the best chance of success and delivery on time. The former as we know was disappointing. The latter was effected especially well. On balance, the Committee felt that a partial payout in relation to the targets set for VR475 was a fair reflection of the outcome and that a nil award in this category would not acknowledge the performance of the team in this regard. In determining whether the overall bonus outturn was a fair reflection of the level of achievement against the scorecard objectives, as well as the performance of the leadership in the year, the Committee gave careful consideration to overall delivery of the Group. This included good progress with the inhaled generics pipeline, including signing of the largest product agreement deal in Vectura's history with Hikma for the global development of generic versions of GSK's Ellipta® portfolio, making positive progress in the responses to the Complete Response Letter for VR315 and the repeat clinical trial and good formulation development progress with VR2081 partnered with Sandoz. The Group saw successful Phase II results for its VR647 US paediatric nebulised budesonide programme and initiated the development of a further three new nebulised projects.

Internally the senior team has led a major transformation of the R&D activities undertaken by the Group, including reprioritisation of projects, restructuring and downsizing, where necessary and establishing new ways of working. This improved focus has been completed effectively with clear financial and project performance benefits and enabled additional capacity to be generated for newly started projects within a significantly reduced overall R&D spend. The importance of this continuous effort to improve internal and external communication has also taken a high personal priority for the CEO and the internal reorganisation and strengthening of the investor relations function within the Company reflects this. In considering the CEO's personal performance, we were mindful of the extra responsibilities assumed by James Ward-Lilley in the three-month period in which he also took on key CFO responsibilities, not least in the communication of the interims in Q3 2018. This minimised disturbance to the Finance team as well as delivering the obvious implied cost savings. The recruitment of Paul Fry as CFO in October is further endorsement of the CEO's continued ability to build a strong and professional team at senior level.

Achievement against the scorecard resulted in an overall annual bonus outturn to Executive Directors for the financial year to 31 December 2018 of 85% of the maximum. However, the Committee was mindful of investor feedback and significant voting against the Report last year. In addition, despite the stabilisation of Vectura's share price and relatively competitive performance versus comparator groups from Q2 2018, there remained lack of overall share price progression during the year. The Committee considered whether it would be appropriate to require a higher level of bonus deferral in respect of the bonus earned in the year. After very careful consideration, and having discussed its thinking with investors, the Committee determined that, despite the strong business performance, it should exercise discretion to reduce the bonus outcome for the CEO and CFO to 70% of maximum (CEO being 135% of salary and CFO being 125% of salary). A detailed breakdown of the targets set, the payments awarded, and how discretion was applied is set out on pages 93 to 96.

LTIP awards were granted to the Executive Directors in March 2018 according to policy at 185% of salary, with the purpose of incentivising management through the use of stretching TSR and adjusted cumulative EBITDA measures. The Committee is cognisant of investors' views on LTIP award where there has been a significant fall in the share price. Prior to the grant of the March 2018 awards, the Committee

considered carefully whether the award levels under current policy remained appropriate in this regard. It was noted that in early January 2018, the Company was subject to bid speculation, and this led to a short-term rise in share price in late 2017/early 2018. Following this period of speculative trading, in volatile market conditions, the share price has stabilised and, in the ten month period from 1 March to 31 December 2018, outperformed FTSE All share, FTSE 250 and Small, Mid Cap and AIM comparator groups[1]. At the time of making the 2018 awards, the Committee considered the undisturbed price of around 80p to 90p, at which the Company shares were traded prior to and post this bid speculation, to be more relevant reference points and thus considered that it would be acceptable to make the award at the normal level. This decision will be borne in mind when the level of the 2019 awards is considered.

The performance period of the first tranche of the 2016 LTIP award ended on 31 December 2018. 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 August 2019. The second and third tranches are subject to a five-year performance period that will end on 31 December 2020. Vectura's TSR is currently below median against both comparator groups. Further details of LTIP vesting against targets are set out on pages 97 and 98 of the Report.

Remuneration for 2019 – Statement from Juliet Thompson

The salaries of the Executive Directors were reviewed early in 2019. The salary of James Ward-Lilley was increased in line with the general workforce increase in the UK of 2.4% to £528,190. Reflecting that he joined part way through the year and his base salary was set at a competitive level on recruitment, the increase in the salary of Paul Fry was 1.2% to £339,020.

For 2019, the Committee has reviewed the metrics used in the annual bonus scorecard, and ensured that these reflect feedback from shareholders concerning the weighting of financial metrics and that these are stretching reflecting Vectura's strategic priorities for 2019.

In considering the level of awards to be granted in 2019, the Committee will consider a number of factors including the Company's share price performance, and whether to grant a reduced 2019 LTIP award level. Further details will be disclosed at the time of grant and details of the targets for 2019 can be found on page 103.

During 2019 we will be undertaking a review of our policy which requires renewal at the Company's AGM in 2020. This will consider amongst other things the alignment of the Policy with Vectura's strategy, culture and values as well as with arrangements for the wider workforce. As part of this review we will also consider the requirements of the new UK Corporate Governance Code and the latest guidance from investors and representative bodies including the introduction of post-employment shareholding requirements and the alignment of pensions with those received by the wider workforce.

1 Source: FactSet, Bloomberg and Numis Smaller Companies Index.

AGM

Our Report will be subject to an advisory vote at our forthcoming AGM. I very much hope that you will join me in supporting the resolution at the AGM.

Finally I would like to thank all those shareholders with whom I have met during my years as Chair of the Committee for setting aside their time to offer guidance and feedback. It has been much appreciated.

Yours sincerely

Dr Susan Foden
Chair of the Remuneration Committee until 31 December 2018

Juliet Thompson
Chair of the Remuneration Committee from 1 January 2019
25 March 2019

Principal subjects of the Committee's business during the period

The Committee met eight times during the year ended 31 December 2018.

The principal matters considered by the Committee during the period are summarised below:

- follow up and consideration of shareholder feedback following the AGM;
- review of achievement against the 2018 corporate goals, including the achievement against personal goals for Executive Directors, approval of the percentage of the bonus pool to be paid out across the Group, and consideration of the use of discretion in the bonus award;
- determination of performance against the TSR conditions for awards under the Long-Term Incentive Plan (LTIP);
- approval of the grant of the 2018 LTIP awards and performance conditions;
- determination of the leaver arrangements for Andrew Derodra;
- determination of the joiner arrangements for Paul Fry;
- review of Executive Leadership Team packages against external benchmarking;
- approval of 2019 base salary increases for Executive Directors and other members of the Executive Leadership Team, ensuring that, with the exception of special cases, these are aligned both internally and externally;
- 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.

Remuneration at a glance

Remuneration link to strategy

- Strong financial performance
- Maximising pipeline value
- Maximising partnering value
- Operational excellence
- Great place to work

Link to remuneration policy

2018 annual bonus metrics included revenue generation, Adjusted EBITDA, partnering deals, pipeline and organisation development.

LTI awards linked to achievement of Vectura's strategy through the use of relative total shareholder return (TSR) and an adjusted cumulative EBITDA metric.

Key strategic highlights

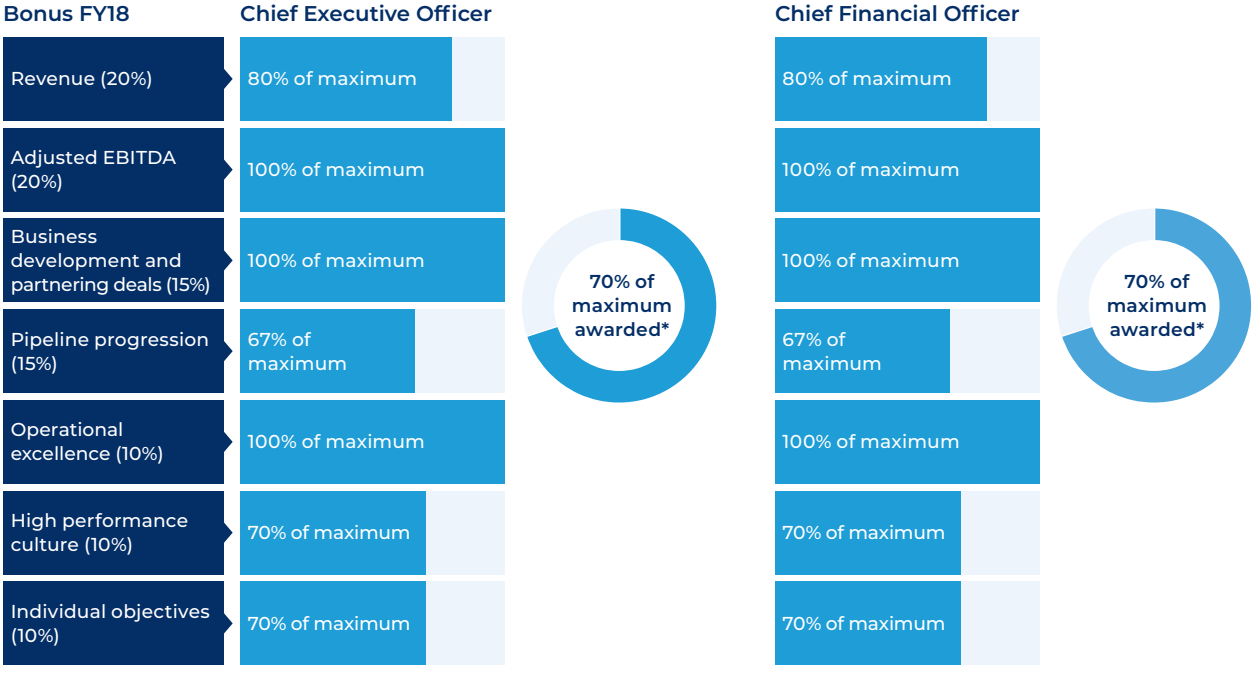
Revenue actual
£160.5m vs. **Revenue 2017** £148.0m

Adjusted EBITDA actual
£39.0m vs. **Adjusted EBITDA 2017** £25.8m

- Agreement signed with Hikma for global development of generic versions of GSK's Ellipta® portfolio, receiving an upfront milestone of US$15m
- Significant progress on nebulised portfolio, disclosed three new Vectura enhanced therapies
- Positive VR647 Phase II results supporting Phase III development and partnering opportunities
- Disappointing VR475 Phase III results but delivered a well-executed Phase III clinical trial programme

Outcomes in 2018

Annual bonus



* Following Remuneration Committee discretion to reduce from 85% to 70% of maximum.

Single total remuneration figure £000

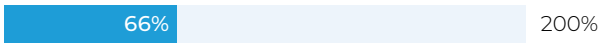
Chief Executive Officer

Chief Financial Officer

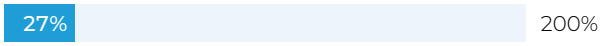
■ Fixed pay ■ Bonus (cash)

Shareholding – achievement against guideline

Chief Executive Officer 3 years, 3 months in post



Chief Financial Officer 0 years, 3 months in post



Full details of the single total remuneration figure can be found on page 92.

Package for 2019

Salary	• Salaries increased by 2.4% for CEO in line with the UK workforce and by 1.2% for CFO • Chief Executive: £528,190 • Chief Financial Officer: £339,020
Pension and benefits	• No change • Pension 20% of salary
Annual bonus	• Maximum opportunity is unchanged at 135% of base salary for CEO and 125% for CFO The scorecard will be: • Financial goals (revenue and adjusted EBITDA) (60%) • Corporate objectives, including strategy, partnering deal and organisation development (30%) • Great place to work (10%)
Long-term incentive plan	• Maximum opportunity up to 185% of base salary • Measures are unchanged being relative TSR and adjusted cumulative EBITDA • Two-year holding period applies

Remuneration report

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 in full can also be found 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 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 and approved by the Committee on an annual basis with the Group CEO reporting to the Committee on the personal performance of the senior team. 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 (LTI) opportunities are applicable, with LTIs for senior executives below Executive Director level made in part as nil cost options and in part as restricted stock vesting after three years.

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 Policy.

Executive Directors			
Purpose and link to strategy	**Operation**	**Maximum opportunity**	**Performance metrics**
Base salary			
To recruit and retain Executive Directors 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 midpoints 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. 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 Executive Directors who are affected by the HMRC lifetime or annual allowances, the Company may provide cash supplements in respect of benefits above the allowance.	Up to 20% of basic salary contribution to the Group Personal Pension Plan or equivalent cash allowance.	Not performance related.

Remuneration report continued

Directors' remuneration policy continued

Executive Directors continued

Purpose and link to strategy	Operation	Maximum opportunity	Performance metrics
Annual performance bonus			
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 April. 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)			
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.

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-Executive Directors 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.

Directors' remuneration policy continued

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 the 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 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.

Relative TSR has been chosen as a performance metric for 50% of the 2017, 2018 and 2019 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 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, 2018 and 2019, 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 2019 are outlined on page 103 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 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 set out on pages 84 to 87. 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 metrics;
- 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 opposite show hypothetical values of the 2019 remuneration package for each Executive Director under four assumed performance scenarios and these scenarios are based upon the Policy set out on pages 84 to 87. The information presented below uses the level of salary, benefits and pension entitlements for each of the Directors as at 1 January 2019.

Base salaries for 2019: CEO – £528,190 and CFO – £339,020. Benefits of £9,000 and £6,000, 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.

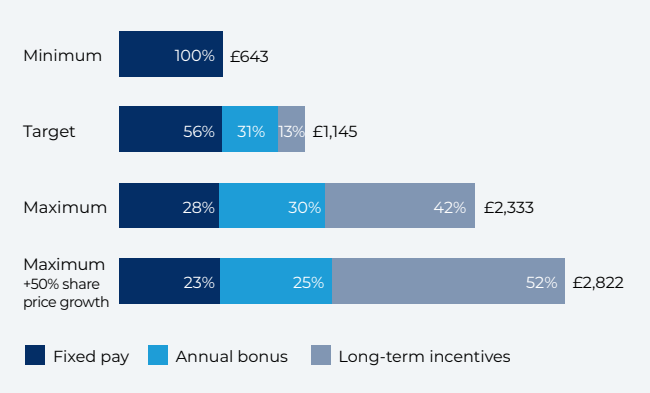
On-target remuneration receivable – this scenario assumes that the Directors receive a bonus payout of 67.5% (CEO) or 62.5% (CFO) of salary (i.e. 50% of maximum award) and that LTIP awards worth 27.5% of salary at grant would ultimately vest.

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.

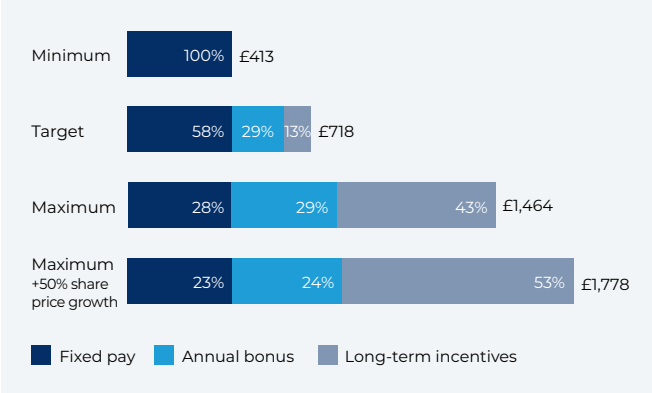
Stretch remuneration receivable plus 50% share price growth – this scenario assumes that the Directors receive a maximum bonus payout and that a maximum LTIP award of 185% of salary would ultimately vest with a 50% share price growth.

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

Chief Executive Officer (£000)



Chief Financial Officer (£000)



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;
- Executive Directors 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, 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.

Remuneration report continued

Directors' remuneration policy continued

Other remuneration policies continued

Non-Executive Directors' terms of engagement continued

The dates of appointment of each of the Directors serving at 31 December 2018 are summarised in the table below.

	Date of contract or date of appointment
Executive Directors	
J Ward-Lilley	24 September 2015
P Fry	22 October 2018
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
T Werner	10 June 2016
J Thompson	1 December 2017
A Whitaker	1 June 2018

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, and Thomas Werner, who was previously a non-executive director of Skyepharma plc, who both have service greater than nine years. Notwithstanding their length of service, Susan and Thomas are considered by the Board to be independent in both character and judgement and there has been significant Board refreshment during their tenure. Further details of the evaluation are contained in the Corporate governance report on page 70.

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 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 and Anne Whitaker in June 2018.

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 Policy outlined above has been designed with due regard to the policy for remuneration of employees across the Group.

The remuneration of 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 ranging from 50% to 75% of salary and lower LTIP opportunities are made, in part as nil cost options and in part as restricted stock vesting after three years. 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 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 seriously shareholders' views and voting on the 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 key revisions within the enactment of 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. During the year 2018 the Committee engaged extensively with major shareholders both in the run-up to and following the 2018 AGM and in early 2019 wrote to shareholders outlining the principal outcomes for 2018 and 2019.

Annual report on remuneration

Remuneration Committee ("the Committee")

Governance

The Committee consists entirely of independent Non-Executive Directors. The Committee members during the year were as follows:

Susan Foden (Chair)
Bruno Angelici
Juliet Thompson
Thomas Werner
Neil Warner
Anne Whitaker (from September 2018)

Susan Foden stood down from the Committee and as Chair with effect from 31 December 2018 and Juliet Thompson took over the role of Chair with effect from 1 January 2019.

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 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 Aon Rewards Solutions (Aon plc's executive remuneration consultancy), which acts as the Committee's principal, and only material, advisor. Aon advises on all aspects of Vectura's remuneration policy and reviews Vectura's remuneration structures against corporate governance best practice.

Aon 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 £127,079 from Aon, which included £65,925 fees in support of the Committee's annual agenda and £61,154 of ad hoc project-based work. In addition to its support to the Committee, Aon provided support in relation to share plans and IFRS 2 calculations to the Committee, the fees for which amounted to £30,247.

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.

Remuneration report continued

Audited information

Directors' remuneration – financial year ended 31 December 2018

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 2018, being nil.

	Year	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	**2018**	**516**	**9**	**487**	**—**	**103**	**—**	**4**	**1,119**
	2017	502	28	407	—	100	—	4	1,041
A Derodra[1]	**2018**	**208**	**4**	**—**	**—**	**42**	**—**	**—**	**254**
	2017	348	4	257	—	70	—	4	683
P Fry[2]	**2018**	**66**	**1**	**58**	**—**	**13**	**311**	**—**	**449**
	2017	—	—	—	—	—	—	—	—
Non-Executive Directors									
B F J Angelici	**2018**	**150**	**—**	**—**	**—**	**—**	**—**	**—**	**150**
	2017	150	—	—	—	—	—	—	150
F Condella[3,4,6]	**2018**	**63**	**—**	**—**	**—**	**—**	**10**	**—**	**73**
	2017	75	—	—	—	—	14	—	89
S E Foden	**2018**	**60**	**—**	**—**	**—**	**—**	**—**	**—**	**60**
	2017	60	—	—	—	—	—	—	60
N W Warner	**2018**	**58**	**—**	**—**	**—**	**—**	**—**	**—**	**58**
	2017	58	—	—	—	—	—	—	58
P-O Andersson[4,6]	**2018**	**50**	**—**	**—**	**—**	**—**	**4**	**—**	**54**
	2017	50	—	—	—	—	10	—	60
T Werner	**2018**	**50**	**—**	**—**	**—**	**—**	**—**	**—**	**50**
	2017	50	—	—	—	—	—	—	50
J Thompson[7]	**2018**	**50**	**—**	**—**	**—**	**—**	**—**	**—**	**50**
	2017	4	—	—	—	—	—	—	4
A Whitaker[5]	**2018**	**29**	**—**	**—**	**—**	**—**	**6**	**—**	**35**
	2017	—	—	—	—	—	—	—	—
Total	**2018**	**1,300**	**14**	**545**	**—**	**158**	**331**	**4**	**2,352**
	2017	1,297	32	664	—	170	24	8	2,195

1 A Derodra stepped down from the Board on 31 July 2018.

2 P Fry joined the Board on 22 October 2018 and started to receive an employer pension contribution of 20% of salary. "Other" includes a cash payment of £142,692 made in respect of forfeited bonuses, which reflects (i) an entitlement to a cash retention bonus of £50,000, (ii) compensation of an additional project related cash bonus of £20,000 and (iii) a pro-rated annual bonus of £72,692. These awards are subject to certain clawback provisions. "Other" also includes forfeitable shares worth £167,500 as part of a buyout of equity entitlements at Immunocore. Details of these awards can be found on page 98.

3 F Condella stepped down from the Board on 31 October 2018.

4 P-O Andersson, F Condella and A Whitaker receive a £2,000 allowance for each Board meeting that requires transatlantic travel and these amounts are shown as "Other" in the table above.

5 A Whitaker joined the Board on 1 June 2018.

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. P-O Andersson received £22,000 in travel allowance payments in 2017, of which £2,000 relates to travel in the year ended 31 March 2016, £6,000 to travel in the nine-month period ended 31 December 2016 and £4,000 to travel in January 2018.

7 J Thompson joined the Board on 1 December 2017.

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.

(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 97 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) For Paul Fry, refer to footnote 2. For the remaining Executive and Non-Executive Directors, this relates to transatlantic travel allowances (refer to note 4).

(g) 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.

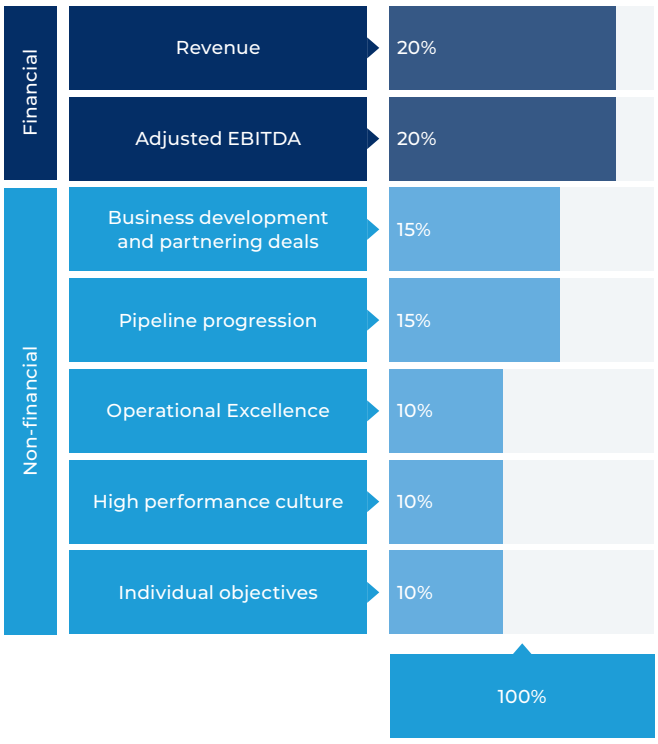
Additional requirements in respect of the single total figure table of remuneration (audited information)

Performance-related pay earned in the year to 31 December 2018

Annual performance bonus

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 sought to set stretching corporate goals, including financial measures, 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.

For 2018, the Executive Directors were measured against a scorecard of financial and non-financial objectives, as follows:



The maximum bonus opportunity was 135% of basic salary for the CEO and 125% for Paul Fry (which was pro-rated for time served in the year). In accordance with his leaver terms, Andrew Derodra is not eligible to receive a bonus in respect of FY 2018.

Remuneration report continued

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

The Committee assessed the metrics as follows:

Financial metrics

Vectura's sector is notable for the long development cycles involved in successfully bringing products to market. Each programme carries a different level of risk with different probability of success rate and each has different development requirements, meaning that certain programmes will take longer to realise value or get to market than others. Each year the Committee sets targets for the bonus which are considered stretching in the context of the business plan for the year. The targets for the 2017 bonus took account of a business plan that, if successful, would result in a step-change increase in revenue and adjusted EBITDA from 2016's performance. Revenue in 2018 has shown good growth since the merger in June 2016. Growth in adjusted EBITDA in 2018 is significant driven by revenue growth, improved gross margin, lower R&D costs and productivity improvements. The targets for 2018 were again based on the business plan that required an increase in both revenue and adjusted EBITDA from 2017's actual levels before any payment would be triggered. Actual performance against both measures was close to the maximum levels.

		Threshold						Maximum	Actual
Revenue (20% weighting)	Revenue (£m)	—	148	152	156	160	164	168	160.5
	% of bonus	—	20%	45%	70%	80%	90%	100%	80%
Adjusted EBITDA (20% weighting)	Adjusted EBITDA (£m)	26.4	28.1	29.7	31.4	33.0	35.5	38.0	39.0
	% of bonus	20%	35%	50%	65%	80%	90%	100%	100%
Total		**4%**	**11%**	**19%**	**27%**	**32%**	**36%**	**40%**	**36%**

Non-financial metrics

Performance measure	Weighting	Targets	Level of bonus awarded as a % of metric (% of full bonus)	Commentary
Business development and partnering new deals	15%	Signing of high value generics partnership.	15%	Global development and commercialisation deal signed with Hikma for development of generic versions of GSK's Ellipta® portfolio. This is the largest ever product deal signed by Vectura with an upfront of $15m, with a further $5m milestone expected in the first three years.
		Licensing revenue recognition of more than £5m.		Revenue recognised in respect of the new Hikma agreement (£6.6m). Sandoz AirFluSal® Forspiro® territory agreement (£2.4m) and Mundipharma VR2076 settlement (£1.7m).
		Engagement of partners for VR475 and VR647.		VR475 development stopped post Phase III results. VR647 prioritised partners engaged with a view to progressing a deal post Phase II or post Phase III clinical trial outcome.
		Lyon site leverage of new deals and progress of site transformation.		Strong Lyon site operational KPIs. Signing of six new partnering agreements with leverage of new bottling and blister line investments as well as an increase in development revenues.

Performance measure	Weighting	Targets	Level of bonus awarded as a % of metric (% of full bonus)	Commentary
Pipeline progression 15%		VR475 – Phase III study completion with top-line results December 2018.	10%	VR475 delivered on time to quality and cost. Primary endpoints not met and thus regulatory submission and partnering discussions could not be progressed.
		Start regulatory presubmission meetings Q3 and MAA backbone frame in place and Q4.		Partial payout reflects performance of the team in ensuring best chance of trial success and delivery against time lines.
		Medical affairs publication and market communication plan implemented.		Medical affairs publication in progress.
		Complete development of commercial launch plan for partner benchmarking/ benchmarking.		Completed and endorsed.
		VR647 Phase II study progression with Phase II pharmacokinetic mouthpiece results in Q3.		Studies completed to time, cost and quality with positive results enabling 2019 Phase III planning progression including end of Phase II FDA meeting and progression of partnering negotiations.
		Effective implementation of Vectura enhanced therapies pipeline strategy with selected assets progressing in development.		Positive strategy execution with asset development progression. Strategy and asset communication as part of the Group's interim results 2018. Unbudgeted activities progressed through headroom created in R&D capacity.
		Progression of key generics programmes: VR315 CRL response and progression to resubmission.		Good progress in addressing device and formulation queries. Proactive Vectura engagement in supporting design and implementation of ongoing Hikma sponsored repeat clinical study.
		Development of Open-Inhale-Close device and formulation development for partnering.		Successfully progressed and reflected in new agreement signed with Hikma.
		VR2081 progression to time/cost enabling PK study initiation.		Successfully completed and reflected in milestone payment from Sandoz.
Operational Excellence	10%	Delivery of R&D transformation enhancing productivity output/cost ratio and key systems and processes simplified.	10%	Strong R&D transformation execution enabling reduction in total R&D spend with capacity generated for new nebulised projects including: • Portfolio prioritisation – stopping VR942 and VR588 projects • Headcount restructuring and redeployment • Improved capacity and resource planning enabling increase in productive tasks Significant progress in supply chain and procurement, with on target cost savings. *flutiform*® margin of 39.24% benefiting from resolving a potential liability with a supplier and settlement of historic claims for reimbursement of costs as part of the Holmes Chapel site sale. In addition, partner contribution to new *flutiform*® manufacturing equipment was secured. Future site strategy agreed with Board with clear implementation plan.
High performance culture	10%	Increasing depth, breadth and diversity of talent and succession candidates at ELT/BLT and BLT-1 levels.	7%	Strengthened capabilities in Group leadership: talent, performance assessment and succession ELT/BLT and BLT-1 levels.
		Effective talent retention and development.		Significant improved employee engagement during the year including strategy understanding and transformation changes.
		Effective leverage of Vectura culture, values and behaviours in all new system and process implementation.		Vectura values and culture embedded in systems and processes including leadership development and behaviours assessment. Progress and outcomes shared with the full Board.
Individual objectives	10%	Corporate, functional and team target.	7%	See details below.
Total	**60%**		**49%**	

Remuneration report continued

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

Personal objectives

The personal objectives set in respect of the 2018 bonus plan are set out below:

	Personal objectives	Key aspects of performance against individual objectives	Performance
J Ward-Lilley	Increased key investor understanding and attractiveness and credibility of Vectura Investment case through effective communication.	Continued progress in simplification of investor/analyst communication particularly at interims. Additional interim CFO responsibilities assumed for the period July to October 2018. Positive investor feedback in clarity of expectations of 2018 newsflow.	Met
	Effective corporate development assessment and implementation.	Continued ongoing refresh of potential corporate activity.	Partially met
	Corporate Strategy Refresh 2019–2026.	Refresh of corporate strategy completed to a high standard and with significant time commitment and planning. Good engagement with ELT members to achieve this.	Partially met
	Efficient and effective corporate governance and Board interactions.	CEO reports to Board meetings of high quality and planning and preparation for meetings to a high standard. Generally good progress in interaction in Board meetings. Important interim CFO role played during summer period including oversight of finance operations and interim reporting.	Met
P Fry	On-boarding and familiarisation with Vectura strategy, team and finance function.	Completed.	
	On-boarding and familiarisation with key external stakeholders including major investors, key advisors and analysts.	Completed.	
	Operational delivery of year-end financial performance and agreement of 2019 budget plan.	Completed.	

As noted in the Chairman's statement, the Committee reviewed the formulaic outcome of the scorecard and concluded that the scorecard outturn, as shown above, reflected the performance of the Executive Directors in the year. Given overall performance and shareholder feedback, the Committee decided to exercise its discretion to reduce the outturn from 85% to 70% of maximum.

The resulting annual bonus awards under the policy approved, i.e. bonus awards of up to 100% of salary payable in cash, with the remainder deferred into shares for two years is as follows:

	Bonus scorecard outcome	Actual % of maximum	Maximum opportunity % of salary	Actual % of salary	Total cash % of salary	Total shares % of salary
J Ward-Lilley	85%	70%	135%	94.5%	94.5%	—
P Fry*	85%	70%	125%	87.5%	87.5%	—

* Bonus award pro-rated for the period worked from 22 October 2018 to 31 December 2018.

LTIP scheme

Scheme interests vested during the period

On 1 August 2016, 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 1 August 2019 (with performance measured up to 31 December 2018) 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 Aon, as follows:

Measure	Threshold[1] 15%	Maximum[1] 100%	Actual	Vesting
TSR against constituents of the FTSE 250 companies (excluding real estate and financial services) (50% of award)	Median 4.6%	Upper quartile 41.0%	-56.1%	0%
TSR against selected European pharmaceutical companies (50% of award)[2]	Median 15.9%	Upper quartile 50.9%	-56.1%	0%

1 Linear vesting between these points.

2 The full European pharmaceutical comparator group used for these awards is Ablynx NV, ALK-Abelló A/S, Almirall SA, arGEN-X N.V, Basilea Pharmaceutica AG, BTG plc, Circassia Limited, Clinigen Group Plc, Consort Medical, Cosmo Pharmaceuticals S.p.A., DBV Technologies S.A., Evotec AG, Faes Farma, Genmab A/S, Hikma Pharmaceuticals PLC, Indivior PLC, Molecular Partners AG, Morphosys AG, Orion Oyj, Pharma Mar, Recipharm AB (publ), Recordati SpA, Stada-Arzneimittel AG, Stallergenes Swedish Orphan Biovitrum AB, Vernalis plc and Zealand Pharma.

As a result, tranche one of the LTIP options awarded to current Executive Directors in 2016 will lapse.

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	2016 LTIP – tranche one	1 August 2019	312,335	0%	0.025	—
Total						—

The Committee determined that Trevor Phillips, who left as a good leaver on 25 May 2017, remained eligible to receive pro-rata vesting of his 2016 LTIP award. As a result of the outcome of the performance conditions, his 2016 award will lapse on 1 August 2019, based on the outcome of the above performance conditions. All of Andrew Derodra's awards lapsed following his departure from the Board and the Company.

Scheme interests awarded during the period (audited)

Long-Term Incentive Plan (LTIP)

After due and careful consideration by the Committee the following awards of nominal cost options were granted to the Executive Directors under the 2015 LTIP on 22 March 2018:

Director	Date of grant	Number of options awarded	Value of award	Share price used to determine level of award p[2]	Face value £	Exercise price p	% that vests at threshold	End of performance period[1]
J Ward-Lilley	22 March 2018	1,286,051	185%	74.2	954,250	0.025	15	31 December 2020
A Derodra[3]	22 March 2018	890,620	185%	74.2	660,840	0.025	15	31 December 2020
Total		**2,176,671**			**1,615,090**			

1 Details of the relevant performance conditions are set out overleaf.

2 The share price used for awards made on 22 March was the closing mid-market price on the date prior to the award.

3 The award lapsed following his resignation from the Board and the Company.

Remuneration report continued

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

Scheme interests awarded during the period (audited) continued

Long-Term Incentive Plan (LTIP) continued

The awards granted under the 2015 LTIP scheme on 22 March 2018 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	Threshold[1] 15%	Maximum[1] 100%
50%	3 years	Relative TSR against FTSE 250 companies (excluding real estate and financial services)	Median	Upper quartile
50%	3 years	Cumulative adjusted growth in adjusted EBITDA	Median	Upper quartile

1 Linear vesting between these points.

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 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 as set out in our Policy.

Buyout of Paul Fry's entitlements at his previous employer

Paul Fry joined the Board on 22 October 2018. In addition to the package outlined above, the Committee agreed to compensate Paul for the forfeiture of his existing bonus and equity entitlements resulting from his departure from Immunocore. In buying out his equity entitlements the Committee sought to adopt a prudent approach and accordingly these awards were struck at a significant discount to the Company's assessment of the potential value of his entitlements at Immunocore and subject to forfeiture, with an element of the buyout linked to future Vectura performance as an award under the LTIP. These awards were made on 22 October 2018 and are:

Award granted under LR 9.4.2(2)	Number of shares awarded	Share price used to determine level of award p	Face value £	Exercise price p	% that vests at threshold	Vesting date
Buyout of Immunocore award[1] (forfeitable share award)	225,741	74.2	167,500	nil	—	22 April 2020

1 A one-off award of forfeitable ordinary shares. The shares will remain subject to forfeiture if Paul should leave before 22 April 2020 and are subject to clawback and malus.

Award granted under LTIP	Number of options awarded	Share price used to determine level of award p	Face value £	Exercise price p	% that vests at threshold	Vesting date
Buyout of Immunocore award (LTIP award)[1] (performance share award)	225,741	74.2	167,500	nil	—	22 October 2021

1 Ordinary nil cost options granted under the LTIP. These will normally vest on 22 October 2021 and remain exercisable until 21 October 2028. Vesting is subject to the same employment, TSR performance and adjusted EBITDA criteria as apply to LTIP awards granted to other Executive Directors in 2018, details of which can be found above.

Paul's bonus entitlements were bought out in cash and comprised an entitlement to a cash retention bonus of £50,000, an additional project-based cash bonus of £20,000 and a pro-rated annual bonus of £72,692. These awards are subject to certain clawback provisions.

The Committee believes that these represent an appropriate level of compensation for his forfeited awards, taking account of their value, degree of conditionality and timing of vesting.

SIP – free share awards

An award of free shares was made to all employees on 30 May 2018 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 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	4,298	83.75	3,599.58	100	31 May 2021
Total	**4,298**		**3,599.58**		

Sharesave

Vectura Group plc also operates a Sharesave (SAYE) share option scheme which is open to employees including Executive Directors. Under this scheme all eligible employees are invited to subscribe for options, which may be granted at a discount of up to 20% to 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 SAYE 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.

	Received in cash £000	Received as pension £000
Executive Directors		
J Ward-Lilley	103	—
A Derodra[1]	42	—
P Fry[2]	13	—
Total	**158**	**—**

1 A Derodra stood down from the Board on 31 July 2018.

2 P Fry joined the Board on 22 October 2018 and receives an employer pension contribution of 20% of salary.

Payments made for loss of office and payments to past Directors (audited information)

Andrew Derodra resigned from the Board during the year under review. He was not entitled to any additional payments beyond his contractual entitlement, which was limited to salary, pension and benefits. He is not eligible for an annual bonus in respect of 2018 and his outstanding long-term incentive awards lapsed on his departure.

There were no other payments to past Directors.

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. Executive Directors are required to build up and maintain an interest in Vectura shares of 200% of base salary. There is currently no prescribed timescale in which to meet the guidelines although the Committee monitor progress towards achievement of the guidelines. The value of the shareholding shown below is assessed using the share price on 22 March 2019, being 73.35p. Base salary is as at 1 January 2019.

Executive Directors are required to retain at least half of any share awards vesting as shares (after paying any tax due) until they reach the guideline level.

The CEO currently holds 66% as a percentage of salary. The Committee continues to keep under review the plan for building the CEO's shareholding in the Company to ensure that he meets the 200% requirement within, or close to, five years from the date of his appointment. The Committee notes that based on the date the shares were acquired, he would have held 115% as a percentage of salary.

Remuneration report continued

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

Statement of Directors' shareholdings and share interests (audited information) continued

The Directors who have held office during the year ended 31 December 2018 and their interests (in respect of which transactions are notifiable to the Company under the Financial Conduct Authority's rules) in the share capital of Vectura Group plc at 31 December 2018 are shown in the following tables.

	31 December 2018 ordinary shares of 0.025p each	Unvested and subject to continued employment only	Value of shares as a % of salary	Unvested and subject to performance conditions
Executive Directors				
J Ward-Lilley	**461,860**	9,014	66%	3,221,284
A Derodra[1]	**32,860**	—	7%	—
P Fry[2]	**—**	225,741	27%	225,741
Non-Executive Directors				
B F J Angelici	**237,903**	—	—	—
F Condella	**10,000**	—	—	—
S E Foden	**17,500**	—	—	—
P-O Andersson	**50,000**	—	—	—
N W Warner	**30,477**	—	—	—
T Werner	**124,341**	—	—	—
J Thompson	**49,033**	—	—	—
A Whitaker[3]	**—**	—	—	—

1 As at the date of stepping down from the Board being 31 July 2018, all outstanding awards lapsed on his departure.

2 P Fry joined the Board on 22 October 2018. The value of shares as a percentage of salary includes his award of forfeited shares, net of tax.

3 A Whitaker joined the Board as at 1 June 2018.

	LTIP awards subject to performance conditions					Share option awards not subject to performance conditions	
	Unvested					Unvested	Vested
	2015 award[1]	2016 award[2]	2017 award[3]	**2018 award[4]**	Awards granted under LR 9.4.2(2) and LTIP schemes[5]	Approved scheme[6]	Approved scheme
J Ward-Lilley	378,152	780,838	776,242	**1,286,051**	—	9,014	—
P Fry	—	—	—	**225,741**	225,741	—	—

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 97, 312,335 of unvested options above will lapse.

3 The 2017 awards are subject to performance conditions measured 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 adjusted EBITDA.

4 The 2018 awards are subject to performance conditions measured over three years from 1 January 2018. 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 adjusted EBITDA. For P Fry, this is the award granted under the LTIP on 22 October 2018, which is subject to the same performance conditions as the 2018 LTIP award.

5 For the CFO, unvested awards relate to the Award granted under LR 9.4.2(2), which vest subject to continued employment (and clawback and malus). Details of these awards can be found on page 98.

6 For the CEO, Share Incentive Plan awards were granted on 28 December 2016 and 30 May 2018. The awards are subject to a three-year holding period with no performance conditions. Details of these awards can be found on page 99.

Unaudited information

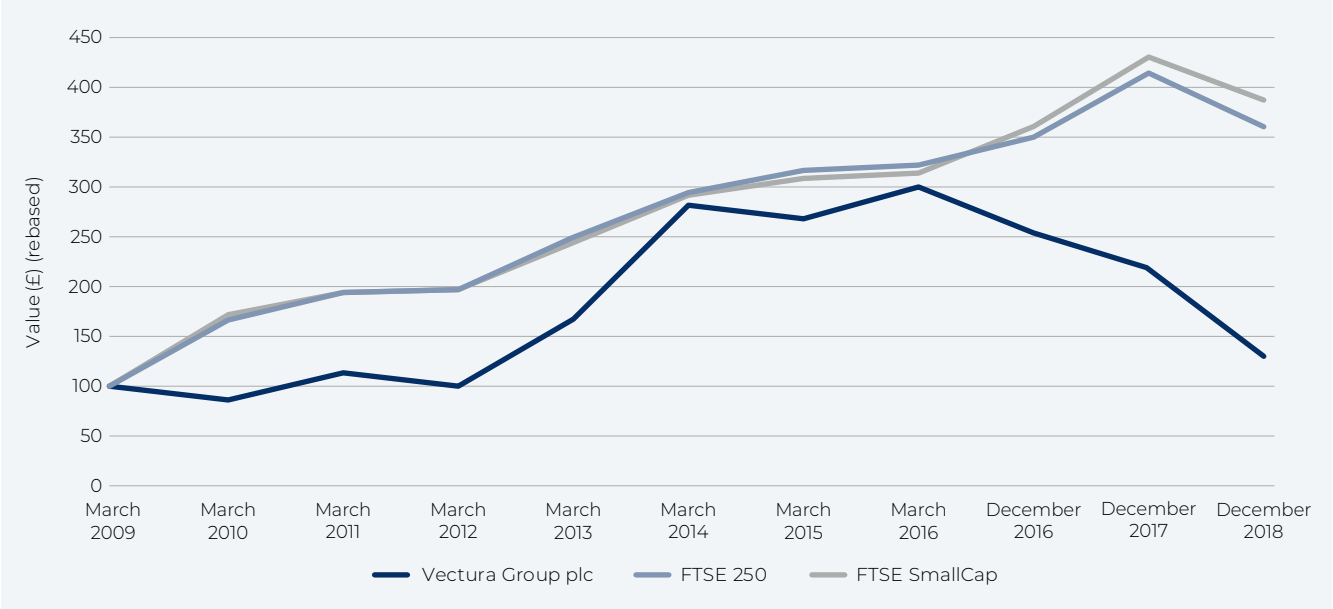
Performance graph and table

The following graph shows Vectura Group plc's cumulative total shareholder return (TSR) over the last ten financial years relative to the FTSE 250 index and the FTSE SmallCap index. These indices were chosen as Vectura is or was recently one of the constituent companies and the Committee considers that they remain 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: FactSet.



This graph shows the value, by 31 December 2018, of £100 invested in Vectura Group plc on 31 March 2009, compared with the value of £100 invested in the FTSE 250 and FTSE SmallCap indices 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:

							Chris Blackwell	James Ward-Lilley			
	2009/10 £000	2010/11 £000	2011/12 £000	2012/13 £000	2013/14 £000	2014/15 £000	2015/16 £000	2015/16 £000	2016[1] £000	2017 £000	**2018 £000**
Chief Executive Officer total remuneration	711	669	971	594	748	1,951	1,110	1,178	1,409	1,041	**1,119**
Actual bonus as a % of the maximum	47	62	53	59	100	80	—	92	99.5	60	**70**
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, FY 2017 or FY 2018.

3 Upon appointment, J 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 pages 98 and 99 of the Report and Accounts for the financial year ended 31 December 2017 for further details.

The Company notes the new reporting requirements related to the disclosure of a CEO to employee pay ratio that comes into force for financial years commencing on or after 1 January 2019. The Company has chosen not to adopt this disclosure early but will comply in next year's Report.

Remuneration report continued

Unaudited information continued

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.

James Ward-Lilley

		Chief Executive Officer	All employees[1]
	2018 £000	Percentage change (FY 2017 vs FY 2018)	Percentage change
Salary	**516**	2.7	2.6
Benefits	**9**	(67.7)	(12.8)
Bonus	**487**	19.7	24.2

1 Percentage 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.

	FY 2017 £m	**FY 2018 £m**	Change £m
Total employee remuneration	42.1	**41.1**	(1.0)
Employee headcount as at 31 December	478	**453**	(25)
Revenue	148.0	**160.5**	12.5
Research and development expenditure	(60.3)	**(55.5)**	4.8
Adjusted EBITDA	25.8	**39.0**	13.2
Distributions to shareholders	—	**—**	—

Statement of shareholder voting at 2018 AGM

At last year's AGM held on 17 May 2018, 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 report	293,649,674	208,004,264	501,653,938	22,537,300	524,191,238
% of votes cast	58.54%	41.46%			

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

Details of the Committee's response to the voting outcome can be found in the Chairman's statement.

The Policy was last put to a binding shareholder vote at the AGM held on 25 May 2017 with the following outcome:

	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%			

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

Statement of implementation of Policy in 2019

Base salary	Salaries increased by 2.4% for the CEO in line with the UK workforce and 1.2% for the CFO: • Chief Executive: £528,190 • Chief Financial Officer: £339,020
Annual 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 adjusted EBITDA: 60% • New business: 10% • VR315: 15% • Other pipeline: 5% • Great place to work: 10% The performance targets set for the above measures will be disclosed in Vectura's 2019 Annual Report and Accounts in accordance with the policy set out on pages 84 to 87 of this report.

LTIP	Awards granted in 2019 will normally consist of:
	• A grant of performance shares, at a level to be determined by the Committee, taking into account the Company's recent share price performance and the fact that awards at the normal level of 185% of salary were granted in 2018.
	• It is intended that performance will be measured over three financial years based against the two following performance conditions:
	  • 50% against relative TSR; and
	  • 50% against growth in cumulative adjusted EBITDA. Targets have not been set at the time of publication but will be disclosed to shareholders at the time of grant.
	• 15% of the total award vesting at threshold/median performance, increasing to 100% vesting at stretch/upper quartile performance.
	• On vesting these awards will be subject to a further two-year holding period.
	• Recovery and withholding conditions continue to apply:
	  • Any changes to the metrics will be subject to consultation with major shareholders and disclosed at the time of grant.

Non-Executive Directors' fees

Non-Executive Director and Chairman fees will be unchanged from the current fees which were effective from 1 July 2016 with the exception of P-O Andersson who will receive an additional £4,000 for his role in overseeing the engagement between the Board and the workforce:

	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
25 March 2019

Directors' report – additional disclosures

The Directors' report comprises pages 104 to 106 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 2018. The following additional disclosures are made in compliance with the Companies Act 2006, the Disclosure and Transparency Rules and the 2016 UK Corporate Governance Code (the "Code").

Description of operations, principal activities and review of business

The strategic review of the business of the Company and its subsidiaries is given on pages 1 to 50. 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 69 to 72;
- Directors' remuneration report on pages 79 to 103, including Directors' interests in shares;
- Strategic report on pages 28 to 29 in respect of the Group's activities in the fields of research and development;
- Financial review on pages 51 to 57;
- disclosures on the Group's greenhouse gas emissions are included in the Sustainability report on page 63; and
- disclosures on financial instruments; and capitalised interest in note 25 "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 July 2018 are set out on page 65.

Results and dividends

The Group made a loss after tax for the twelve months to 31 December 2018 of £88.2m (twelve months to 31 December 2017: loss of £85.7m). 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 (European Union) political party and will continue to adhere to this policy.

Employees

Further information on our employees including diversity, employee engagement, and health and safety is contained in our Sustainability report on pages 58 to 63.

Human rights

While Vectura does not have a human rights policy, a copy of the Company's Modern Slavery statement 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 are not present in our supply chains or business and which the Board has adopted.

Capital structure

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 26 "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 shareholding. 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 (FCA) 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 28 "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):

Bruno Angelici	– Chairman
Per-Olof Andersson	– Independent Non-Executive Director
Frank Condella	– Independent Non-Executive Vice Chairman stepped down 31 October 2018
Andrew Derodra	– Chief Financial Officer resigned with effect from 31 July 2018
Susan Foden	– Senior Independent Non-Executive Director
Paul Fry	– Chief Financial Officer appointed 22 October 2018
Juliet Thompson	– Independent Non-Executive Director
James Ward-Lilley	– Chief Executive Officer
Neil Warner	– Independent Non-Executive Director
Thomas Werner	– Independent Non-Executive Director
Anne Whitaker	– Independent Non-Executive Director appointed 1 June 2018

With regard to the appointment and replacement of Directors, the Company is governed by its Articles, the 2016 UK Corporate Governance Code, the Companies Act 2006 and related legislation.

The Articles themselves may be amended by special resolution of the shareholders. Details of 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 2019 Annual General Meeting and stand for election or re-election. The Board's recommendations concerning appointment or reappointment are contained in the report of the Nomination Committee on pages 73 and 74. Biographical details of the Directors are available on pages 66 and 67 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 103.

As at the date of this report, the Directors of the Company had a beneficial interest in an aggregate of 971,114 ordinary shares, representing 0.14% 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 2018 and 20 March 2019, 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 2018		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
Invesco Ltd	72,617,132	10.91	71,708,993	10.77
HBM Healthcare Investments (Cayman) Ltd	47,817,011	7.18	42,085,900	6.32
Prudential plc and subsidiaries	29,196,294	4.39	29,795,804	4.48
AXA Investment Managers	25,003,818	3.75	25,018,045	3.75

Directors' report – additional disclosures continued

Acquisition of the Company's own shares

The Company purchased 14,682,736 of its own shares at an aggregate cost of £13,651,445.34 in the year under review. The nominal value of the shares was £3,670.68 and represented 2.21% of the issued share capital at that time. The purpose of the buyback was to reduce the share capital of Vectura and all shares purchased were immediately cancelled. The employee benefit trusts purchased 532,276 shares during the year to meet the awards requirements of the Employee Share Incentive Plan and options granted under the Long-Term Incentive Plan or Listing Rule 9.4.2(2).

A resolution will be proposed at the 2019 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 2019 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 Wednesday 29 May 2019. 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.

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 section on page 65 to 107 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 107 confirm, to the best of their knowledge, that:

- the financial statements have been prepared in accordance with IFRS as adopted by the EU 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 who held office at the date of approval of this Directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware and each Director has taken all the steps that he/she ought to have taken as a Director to make himself/herself aware of any relevant audit information and to establish that the Company's 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 are provided in the Notice of AGM.

Directors' remuneration

The Remuneration report on pages 84 to 103 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
25 March 2019

Vectura Group plc
One Prospect West
Chippenham
Wiltshire SN14 6FH
United Kingdom

Registered No: 3418970

Directors' responsibilities statement

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 comply 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
25 March 2019

Paul Fry
Director
25 March 2019

FINANCIAL STATEMENTS

Independent auditor's report

to the members of Vectura Group plc

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 2018 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 2 and note 31.

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 2018 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;
- 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 first appointed as auditor by the shareholders on 25 May 2017. The period of total uninterrupted engagement is for the 2 financial years ended 31 December 2018. 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	£1.5m (2017:£1.45m) 1% of Revenue (2017: 1% of Revenue)
Coverage	88% (2017: 86%) of Revenue

Key audit matters		vs 2017
Recurring risks	Recoverability of inhaled in-market assets, non-inhaled in-market assets and smart nebuliser technology assets	⟷
	Revenue recognition	⟷
	Recoverability of parent company's investments in subsidiaries	▲
Brexit	**New:** The impact of uncertainties due to Britain exiting the European Union on our audit	

Independent auditor's report continued

to the members of Vectura Group plc

2. Key audit matters: including 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 arriving at our audit opinion above, together with our key audit procedures to address those matters and our findings from those procedures in order that the Company's members as a body may better understand the process by which we arrived at our audit opinion. These matters were addressed, and our findings 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
The impact of uncertainties due to Britain exiting the European Union on our audit *Refer to page 44 (principal risks), page 50 (viability statement), pages 75-78 (Audit Committee Report), pages 148 and 155 (accounting policy) and pages 133 and 156 (financial disclosures).*	**Unprecedented levels of uncertainty:** All audits assess and challenge the reasonableness of estimates, in particular described in the recoverability of inhaled in-market assets, non-inhaled in-market assets and smart nebuliser technology (below), parent company's investments in the subsidiaries (below) and related disclosures and the appropriateness of the going concern basis of preparation of the financial statements. All of these depend on assessments of the future economic environment and the Group's future prospects and performance. In addition, we are required to consider the other information presented in the Annual Report including the principal risks disclosure and the viability statement and to consider the directors' statement 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. Brexit is one of the most significant economic events for the UK and at the date of this report its effects are subject to unprecedented levels of uncertainty of outcomes, with the full range of possible effects unknown.	We developed a standardised firm-wide approach to the consideration of the uncertainties arising from Brexit in planning and performing our audits. Our procedures included: — **Our Brexit knowledge:** We considered the directors' assessment of Brexit-related sources of risk for the Group's business and financial resources compared with our own understanding of the risks. We considered the directors' plans to take action to mitigate the risks; — **Sensitivity analysis:** When addressing the recoverability of inhaled in-market assets, non-inhaled in-market assets and smart nebuliser technology assets and parent company's investments in the subsidiaries, we compared the directors' sensitivity analysis to our assessment of the full range of reasonably possible scenarios resulting from Brexit uncertainty and, where forecasts cash flows are required to be discounted, considered adjustments to discount rates for the level of remaining uncertainty; — **Assessing transparency:** As well as assessing individual disclosures as part of our procedures on the recoverability of inhaled in-market assets, non-inhaled in-market assets and smart nebuliser technology assets, and parent company's investments in the subsidiaries we considered all of the Brexit related disclosures together, including those in the strategic report, comparing the overall picture against our understanding of the risks. **Our findings** — Overall, we found the estimates, including those as described in recoverability of inhaled in-market assets, non-inhaled in-market assets and smart nebuliser technology assets, and parent company's investments in the subsidiaries to be balanced and related disclosures and disclosures in relation to going concern to be proportionate. However, no audit should be expected to predict the unknowable factors or all possible future implications for a company and this is particularly the case in relation to Brexit.

	The risk	Our response
The recoverability of inhaled in-market assets, non-inhaled in-market assets and smart nebuliser technology assets £219.9m; 2017: £335.4m Impairment: £41.5m (2017: £8.7m) *Refer to pages 75-78 (Audit Committee Report), page 148 (accounting policy) and pages 134-135 (financial disclosures).*	**Subjective valuation:** Historic acquisitions have led to the recognition of intangible assets with a significant value. There is a risk that the carrying amount of the inhaled in-market assets, non-inhaled in-market assets and smart nebuliser technology 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 volume forecasts, cost of sales, discount rates, and associated pricing. The effect of these matters is that, as part of our risk assessment, we determined that the value in use of inhaled in-market assets, non-inhaled in-market assets and smart nebuliser technology assets has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount.	— **Assessing indicators of impairment:** challenged the Group's assessment of impairment indicators on the asset concerned using our understanding of the asset's current and future expected performance gained from performing our audit procedures; — **Our sector experience:** assessed whether key assumptions used, in particular those relating to volume forecasts, cost of sales, discount rates, and associated pricing, reflect our knowledge of the business and industry, including known or probable changes in the business environment; — **Discount rates:** challenged, 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; — **Historical comparisons:** assessed the reasonableness of the cash flow forecasts by considering the historical accuracy of the previous forecasts; — **Sensitivity analysis:** we performed breakeven analysis on the key assumptions noted above; — **Assessing transparency:** assessed whether the Group's disclosures about the impairment test appropriately reflect the risks inherent in the valuation of intangible assets. **Our findings** — We found the estimated recoverable amount for the inhaled in-market assets, non-inhaled in-market assets and smart nebuliser technology assets to be slightly optimistic (2017: slightly optimistic), resulting in greater headroom than might otherwise have been the case, with proportionate (2017: proportionate) disclosure of related assumptions and sensitivities.

Independent auditor's report continued

to the members of Vectura Group plc

	The risk	Our response
Development revenue recognition £6.6m; 2017: £5.1m *Refer to pages 75-78 (Audit Committee Report), page 147 (accounting policy) and page 126 (financial disclosures).*	**Accounting treatment:** Revenue recognition in connection to the agreement the Group reached with Hikma Pharmaceuticals plc ("Hikma") to develop a generic version of GSK's Ellipta portfolio has required management to exercise significant judgment in applying IFRS 15 ("Revenue from Contracts with Customers"). In particular, management have exercised judgment in determining the number of performance obligations contained within the contract and whether the licence granted to Hikma is a distinct performance obligation. This in turn has determined the extent to which consideration of $15m received in 2018 has been recognised as revenue in 2018. **Subjective estimate:** Allocation of the transaction price between performance obligations requires estimation of the stand-alone selling prices of those performance obligations. That estimate is subjective and requires the Group to forecast the costs of satisfying those performance obligations.	Our procedures included: **Accounting treatment:** — **Accounting analysis:** We have examined the judgments taken in respect of the agreement with Hikma. We challenged the conclusion made by the Group that the licence granted was distinct from the provision of development services and that future formulation and process development activities were not committed. We have considered alternative treatments and whether these would lead to a more appropriate treatment than that proposed by management; — **Test of detail:** We have inspected the relevant licence contract. We compared the accounting judgment made to the underlying contractual terms; corroborating the facts and circumstances to underlying supporting documentation and external third party data; — **Assessing transparency:** We have considered the adequacy of the Group's disclosures in respect of the accounting treatment. **Subjective estimate:** — **Assessing forecasts:** In respect of the estimation of the stand alone selling prices of the performance obligations, we assessed whether key assumptions used, in particular those relating to R&D staff hours and the probability of technical, regulatory and commercial success, reflect our knowledge of the business and industry, including known or probable changes in the business environment. — **Assessing transparency:** We have considered the adequacy of the Group's disclosures in respect of the estimates around revenue recognition. **Our findings** — We found the judgements taken in applying IFRS 15 to the agreement with Hikma for the development of a generic version of GSK's Ellipta® portfolio to be balanced. We found the resulting disclosures to be proportionate. — We found the estimate of the stand-alone selling price to be balanced. We found the resulting disclosures to be proportionate.

	The risk	Our response
Recoverability of parent company's investments in subsidiaries £541.5 m; 2017: £710.8m Impairment: £199.3m (2017: £0m), of this balance £102.5m relates to Switzerland and £96.8m relates to Germany *Refer to pages 75-78 (Audit Committee Report), page 155 (accounting policy) and page 156 (financial disclosures).*	**Forecast-based valuation:** The carrying amount of the parent company's investments in subsidiaries is significant and at risk of being irrecoverable. 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, discount rates, product volumes, cost of sales, and associated pricing. The effect of these matters is that, as part of our risk assessment, we determined that the value in use of parent company's investments in subsidiaries have a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount.	Our procedures included: — **Our sector experience :** challenged the critical 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. The critical assumptions include the likelihood of success of early and late stage development programs, discount rates, product volumes, cost of sales, and associated pricing; — **Historical comparisons:** assessed the reasonableness of the budgets by considering the historical accuracy of the previous forecasts; — **Discount rates:** challenged, 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:** assessed the adequacy of the parent company's disclosures in respect of the investments in subsidiary. **Our findings** — We found the Group's assumptions used in the impairment models and the resulting estimate over the recoverable amount of parent company's investments in subsidiaries, when all factors are considered, to be balanced (2017: balanced). We found the resulting disclosures to be proportionate (2017: proportionate).

Independent auditor's report continued

to the members of Vectura Group plc

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 £1.5m, determined with reference to a benchmark of Group revenue of £160.5m 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 £1.45m (2017: £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 £75k and any other identified misstatements that warranted reporting on qualitative grounds.

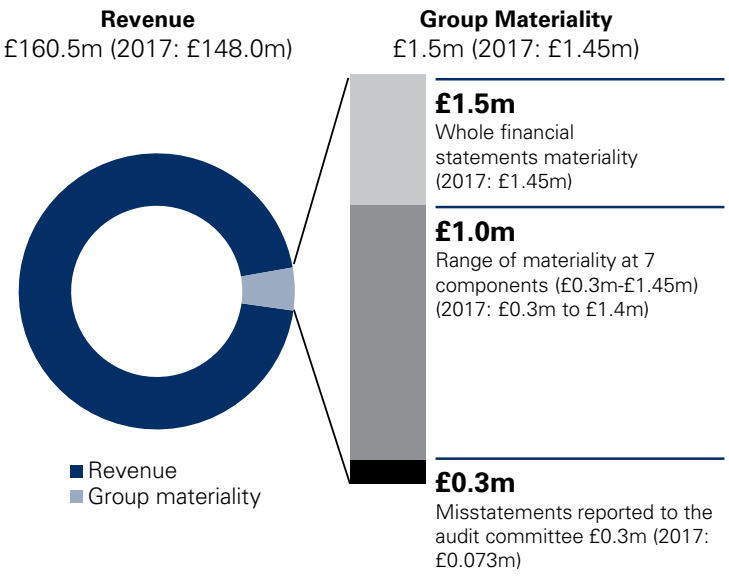
4 of the Group's 7 reporting components were subject to full scope audits for Group purposes and a further 2 components were subjected to specified risk-focused audit procedures. The latter were not individually financially significant enough to require a full scope audit for Group purposes, but did present specific individual risks that needed to be addressed.

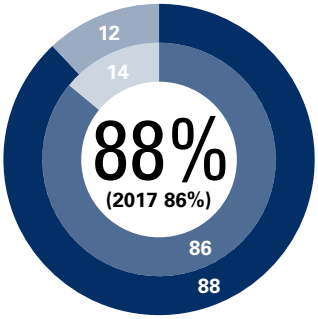
For the remaining 1 component, we performed analysis at an aggregated Group level to re-examine our assessment that there were no significant risks of material misstatement within this component.

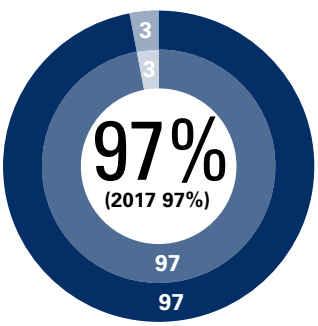
The components within the scope of our work accounted for the percentages illustrated opposite.

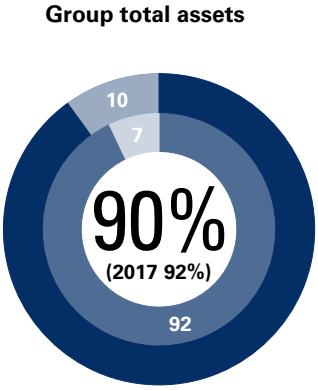
The Group audit team instructed component auditors as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back. The Group team approved component materiality levels of £1.0m for the component audit teams, having regard to the mix of size and risk profile of the Group across the components. The work on 1 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.

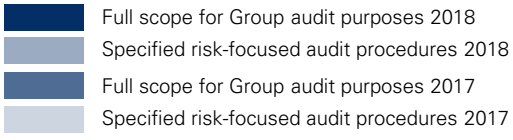
The Group team visited 3 component locations, in the UK, Switzerland and France to assess the audit risk and strategy. Video and telephone conference meetings were also held with these component auditors. At these visits and meetings, the findings reported to the Group team were discussed in more detail, 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

The Directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Company or the Group or to cease their operations, and as they have concluded that the Company's and the Group's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over their ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

Our responsibility is to conclude on the appropriateness of the Directors' conclusions and, had there been a material uncertainty related to going concern, to make reference to that in this audit report. However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the Group and the Company will continue in operation.

In our evaluation of the Directors' conclusions, we considered the inherent risks to the Group's and Company's business model and analysed how those risks might affect the Group's and Company's financial resources or ability to continue operations over the going concern period. The risks that we considered most likely to adversely affect the Group's and Company's available financial resources over this period were:

— Supply chain disruption, including disruption caused by Brexit;

— The impact of a significant business continuity issue affecting the Group's manufacturing facilities or those of its suppliers or partners;

— Failure to advance key pipeline development programmes.

As these were risks that could potentially cast significant doubt on the Group's and the Company's ability to continue as a going concern, we considered sensitivities over the level of available financial resources indicated by the Group's financial forecasts taking account of reasonably possible (but not unrealistic) adverse effects that could arise from these risks individually and collectively and evaluated the achievability of the actions the Directors consider they would take to improve the position should the risks materialise. We also considered less predictable but realistic second order impacts, such as the impact of Brexit and the erosion of customer or supplier confidence, which could result in a rapid reduction of available financial resources.

Based on this work, we are required to report to you if:

— we have anything material to add or draw attention to in relation to the directors' statement in Note 1 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 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 106 is materially inconsistent with our audit knowledge.

We have nothing to report in these respects, and we did not identify going concern as a key audit matter.

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 Risk Management and Principal Risks statement on page 43 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

Independent auditor's report continued

to the members of Vectura Group plc

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.

Our work is limited to assessing these matters in the context of only the knowledge acquired during our financial statements audit. As we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgments that were reasonable at the time they were made, the absence of anything to report on these statements is not a guarantee as to the Group's and Company's longer-term viability.

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 107, 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 general commercial and sector experience, and through discussion with the directors and other management (as required by auditing standards) and discussed with the directors and other management the policies and procedures regarding compliance with laws and regulations, 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.

The potential effect of these laws and regulations on the financial statements varies considerably.

Firstly, the Group is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related companies legislation), distributable profits legislation, and taxation legislation. We assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Secondly, the Group is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation or the loss of the Group's licence to operate. We identified the following areas as those most likely to have such an effect: regulations relating to the manufacture and research of pharmaceuticals, intellectual property, health and safety, anti-bribery, employment law, and certain aspects of company legislation recognising the nature of the Group's activities and its legal form. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and other management and inspection of regulatory and legal correspondence, if any. Through these procedures we became aware of actual or suspected non-compliance and considered the effect as part of our procedures on the related financial statement items. The actual or suspected non-compliance was not sufficiently significant to our audit to result in our response being identified as a key audit matter. Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations (irregularities) is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it. In addition, as with any audit, there remained a higher risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. We are not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

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 and the terms of our engagement by the company . 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 the further matters we are required to state to them in accordance with the terms agreed with the company, 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
25 March 2019

Consolidated income statement

For the year ended 31 December 2018

	Note	2018 £m	2017 £m
Revenue	3	**160.5**	148.0
Cost of sales		**(61.6)**	(57.2)
Gross profit		**98.9**	90.8
Selling and marketing expenses		**(3.4)**	(4.0)
Research and development expenses	5	**(55.5)**	(60.3)
Corporate and administrative expenses		**(12.0)**	(10.2)
Other operating income	7	**2.6**	1.7
Operating profit before exceptional items and amortisation		**30.6**	18.0
Amortisation and impairment	9	**(127.0)**	(109.7)
Exceptional items	10	**(9.0)**	(4.5)
Operating loss		**(105.4)**	(96.2)
Loss from associates		**(0.2)**	(3.4)
Finance income	11	**1.3**	0.2
Finance expenses	11	**(0.5)**	(2.8)
Loss before taxation		**(104.8)**	(102.2)
Net taxation credit	12	**16.6**	16.5
Loss after taxation		**(88.2)**	(85.7)
Adjusted EBITDA*	9	**39.0**	25.8
Loss per share (basic and diluted)	13	**(13.2p)**	(12.6p)

All results are attributable to shareholders of Vectura Group plc and are derived from continuing operations.

* Adjusted EBITDA is a non-IFRS measure comprising operating loss, adding back amortisation and impairment, depreciation, share-based payments and exceptional items. Refer to note 9 "Adjusted EBITDA".

During the period, the Group transitioned to IFRS 15 – Revenue from Contracts with Customers. Owing to transitional relief available, the comparative period has not been restated. Refer to note 32.

The accompanying notes form an integral part of these consolidated financial statements.

Consolidated statement of other comprehensive income

For the year ended 31 December 2018

	2018 £m	2017 £m
Loss after taxation	**(88.2)**	(85.7)
Items that may be reclassified to the income statement:		
Exchange movements arising on consolidation	**14.2**	(13.9)
Related impact of taxation	**(0.5)**	(1.2)
Items that will not be reclassified to the income statement:		
Actuarial gains on remeasurement of defined benefit pensions	**0.2**	1.1
Related impact of taxation	**—**	(0.2)
Other comprehensive income/(loss)	**13.9**	(14.2)
Total comprehensive loss	**(74.3)**	(99.9)

All results are attributable to shareholders of Vectura Group plc and are derived from continuing operations.

The accompanying notes form an integral part of these consolidated financial statements.

Consolidated balance sheet

At 31 December 2018

	Note	2018 £m	2017 (Restated)* £m	2016 (Restated)* £m
ASSETS				
Non-current assets				
Goodwill	14	**163.4**	161.4	162.8
Intangible assets	15	**219.9**	335.4	456.8
Property, plant and equipment	16	**57.8**	53.1	54.8
Other non-current assets	17	**10.1**	7.4	4.0
Total non-current assets		**451.2**	557.3	678.4
Current assets				
Inventories	18	**26.7**	23.4	18.4
Trade and other receivables	19	**35.3**	34.1	56.6
Cash and cash equivalents	20	**108.2**	103.7	92.5
Total current assets		**170.2**	161.2	167.5
Total assets		**621.4**	718.5	845.9
LIABILITIES				
Current liabilities				
Trade and other payables	21	**(61.1)**	(56.5)	(59.8)
Corporation tax payable	21	**(10.1)**	(11.4)	(8.6)
Provisions	22	**(1.1)**	(2.2)	(1.9)
Total current liabilities		**(72.3)**	(70.1)	(70.3)
Non-current liabilities				
Other non-current payables	21	**(6.2)**	(9.6)	(12.2)
Provisions	22	**(9.8)**	(3.2)	(3.5)
Retirement benefit obligations	23	**(3.1)**	(3.6)	(5.9)
Deferred taxation	24	**(35.7)**	(53.5)	(76.8)
Total non-current liabilities		**(54.8)**	(69.9)	(98.4)
Total liabilities		**(127.1)**	(140.0)	(168.7)
Net assets		**494.3**	578.5	677.2
SHAREHOLDERS' EQUITY				
Share capital	26	**0.2**	0.2	0.2
Share premium	27	**61.6**	61.5*	61.0*
Translation reserve		**40.0**	26.3	41.4
Other reserves	27	**447.3**	599.1*	598.3*
Retained losses		**(54.8)**	(108.6)	(23.7)
Total shareholders' equity		**494.3**	578.5	677.2

* Restated amounts of £41.3m relate to the correction of pre-Skyepharma merger share premium and merger reserves recognised on the acquisition of Activaero in 2014. The restated merger reserves were subsequently utilised in full and, as a result, no longer remain. Refer to note 27.

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 25 March 2019 and were signed on its behalf by:

J Ward-Lilley
Director

P Fry
Director

Consolidated statement of changes in equity

For the year ended 31 December 2018

	Note	Share capital £m	Share premium £m	Other reserves: Merger reserve £m	Other reserves: Own shares reserve £m	Other reserves: Share-based payment reserve £m	Translation reserve £m	Retained losses £m	Total equity £m
At 31 December 2016 as previously reported		0.2	102.3	551.9	(0.7)	5.8	41.4	(23.7)	677.2
Share premium restatement*		—	(41.3)	41.3	—	—	—	—	—
At 31 December 2016 restated		0.2	61.0	593.2	(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		—	—	—	—	—	(15.1)	(84.8)	(99.9)
Share-based payments	28	—	—	—	—	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**	**61.5**	**593.2**	**(2.5)**	**8.4**	**26.3**	**(108.6)**	**578.5**
Adoption of IFRS 15	32	—	—	—	—	—	—	0.3	0.3
At 1 January 2018 as adjusted		**0.2**	**61.5**	**593.2**	**(2.5)**	**8.4**	**26.3**	**(108.3)**	**578.8**
Loss for the year		—	—	—	—	—	—	(88.2)	(88.2)
Other comprehensive income		—	—	—	—	—	13.7	0.2	13.9
Total comprehensive income/(loss) for the year		—	—	—	—	—	13.7	(88.0)	(74.3)
Share buyback programme	26	—	—	—	—	—	—	(13.8)	(13.8)
Share-based payments	28	—	—	—	—	3.7	—	—	3.7
Employee share schemes	28	—	0.1	—	0.3	(3.8)	—	3.3	(0.1)
Release of special reserves**		—	—	(8.2)	—	—	—	8.2	—
Merger reserve release		—	—	(143.8)	—	—	—	143.8	—
At 31 December 2018		**0.2**	**61.6**	**441.2**	**(2.2)**	**8.3**	**40.0**	**(54.8)**	**494.3**

* Reserves were restated to reduce share premium and increase merger reserves by £41.3m to correct share premium recognised on the acquisition of Activaero in 2014 in accordance with s610 of the Companies Act. The restated Merger reserves were subsequently utilised in full and, as a result, no longer remain. Refer to note 27.

** A Board resolution in July 2018 confirmed that certain creditor conditions, imposed pursuant to the July 2011 share capital reduction, had been satisfied. Specifically, all specified external creditors had been paid and all intercompany creditors had either been paid or provided their consent. Therefore, non-distributable special reserves of £8.2m, for the protection of these creditors, have been released to distributable retained earnings.

The accompanying notes form an integral part of these consolidated financial statements.

Consolidated cash flow statement

For the year ended 31 December 2018

	Note	2018 £m	2017 £m
Cash flows from operating activities			
Loss after taxation		**(88.2)**	(85.7)
Adjustments reconciling loss after tax to operating cash flows	29	**123.3**	112.6
Cash generated from operating activities		**35.1**	26.9
Research and development tax credits received		**1.0**	2.1
Corporation tax paid		**(6.0)**	(2.9)
Net cash inflow from operating activities		**30.1**	26.1
Cash flows from investing activities			
Purchase of intangible assets		**(0.8)**	(0.2)
Purchase of property, plant and equipment		**(11.5)**	(9.5)
Interest received		**0.2**	0.2
Net cash outflow from investing activities		**(12.1)**	(9.5)
Cash flows from financing activities			
Share buyback programme	26	**(13.8)**	(1.4)
Funding relating to the issue of shares and share options		**(0.2)**	(1.3)
Repayment of mortgage borrowings and other finance charges		**(0.8)**	(0.5)
Net cash outflow from financing activities		**(14.8)**	(3.2)
Effects of foreign exchange fluctuations on cash held		**1.3**	(2.2)
Increase in cash and cash equivalents		**4.5**	11.2
Cash and cash equivalents at the beginning of the year		**103.7**	92.5
Cash and cash equivalents at the end of the year		**108.2**	103.7

The accompanying notes form an integral part of these consolidated financial statements.

Notes to the consolidated financial statements

For the year ended 31 December 2018

1. Presentation of the consolidated financial statements

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 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 combinations 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, registered address: One Prospect West, Chippenham, Wiltshire SN14 6FH), 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.

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. These policies can be found in the following notes:

- note 2 – critical areas of accounting judgement or estimation in applying significant accounting policies; and
- note 31 – details of the Group's significant accounting policies.

This is the first set of the Group's annual financial statements in which IFRS 15 – Revenue from Contracts with Customers has been applied. Where licence agreements signed in prior years have satisfied all the performance obligations, the accounting principles of IAS 18 – Revenue continue to apply until the contract is complete.

The Group has applied IFRS 15 from 1 January 2018. A number of other new amendments are also effective from 1 January 2018 in relation to IFRS 2 – Share-based payments and IAS 28 – Investments in associates, but they do not have a material effect on the Group's financial statements. IFRS 9, which mandates adoption for 2018, was early adopted by the Group in the 2017 Annual Report.

Details about the transition to IFRS 15 and future material changes to accounting policies are provided as follows:

- note 32 – Transition to IFRS 15 – Revenue from Contracts with Customers on 1 January 2018;
- note 33 – Future impact of IFRS 16 – Leases from 1 January 2019; and
- note 34 – Future impact of IFRIC 23 – Accounting for uncertain tax positions from 1 January 2019.

All financial information is presented in sterling, and is rounded to the nearest £0.1m unless otherwise stated. Previously issued financial information and other relevant resources are made available on our website: www.vectura.com.

1.1 Alternative performance measures (APMs)

Alternative performance 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 loss, adding back amortisation and impairment, depreciation, share-based payments and exceptional items. Refer to note 9 "Adjusted EBITDA".

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 years. 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.

Notes to the consolidated financial statements continued

For the year ended 31 December 2018

1. Presentation of the consolidated financial statements continued

1.1 Alternative performance measures (APMs) continued

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 are also included within exceptional items. Refer to note 10 "Exceptional items".

Underlying and **non-recurring revenues** were previously presented in the 2017 financial statements in order to separate out revenues which can vary significantly each period. Following stakeholder feedback, this presentation was replaced and revenues have now been disaggregated according to whether they relate to product supply, development stage work or royalty and other marketed revenues. These revised categories are not considered APMs.

2. Critical accounting areas of judgement and estimation

The following critical judgements are those which have the most significant effect on the amounts recognised in the financial statements:

Applying IFRS 15 – Revenue from Contracts with Customers to long-term collaborative agreements

Collaborative development and marketing agreements which license the Group's technology and intellectual property (IP) can and do have unique terms. Consequently, the accounting judgements required to apply IFRS 15 to each such agreement can differ significantly.

Accounting for the developments of generic inhaled therapies with Sandoz (VR2081) entered into in June 2017 and with Hikma (generic of GSK Ellipta® products) in November 2018 are explained further in note 32 and note 3 respectively.

(a) Identification of performance obligations

A contract with a customer is in the scope of the standard when it is legally enforceable and all of the following criteria are met:

- the contract is approved and the parties are committed to their obligations;
- rights to goods or services and payment terms can be identified;
- the contract has commercial substance; and
- collection of consideration is probable.

An agreement often provides a customer with an option to acquire additional services. Judgement is required to determine the extent to which the Group or the customer is committed to these services throughout the agreement.

This has been applied to the agreement with Hikma to develop generic versions of GSK's Ellipta® portfolio. It has been judged that the licence to use Vectura's intellectual property and the provision of services for development of Vectura's Open-Inhale-Close device are considered committed as the initial $15.0m milestone received on signing of the agreement is non-refundable. Hikma also has the option to acquire future formulation and process development services for up to five products on terms specified in the agreement. It has been judged that these services are not committed until product development plans are agreed.

(b) Whether a licence to the Group's intellectual property is capable of being distinct

A licence granted by the Group usually provides the partner with a right-to-use, but not to own, the IP related to a development. A licence is capable of being distinct from development services if, regardless of contractual terms, it could be sold separately.

The timing of revenue recognised from a licence of intellectual property depends on whether:

- the licence is capable of being distinct (i.e. could be sold separately as it exists at the point in time it was granted). In this case revenue is recognised at the point in time the licence is granted, normally at contract inception. This treatment applies to the development of the generic GSK Ellipta® portfolio with Hikma; or
- the licence is not capable of being distinct and therefore, the customer cannot obtain the value of the licence without the provision of additional services from Vectura. In this instance, revenue is recognised as those services accrue. This treatment applies to the development of VR2081 with Sandoz.

(c) Allocation of the transaction price based on standalone selling prices at contract inception

For collaborative agreements containing multiple performance obligations, the Group must determine the standalone selling price identified on inception of the contract. Once these have been determined, these are not subsequently amended. The key assumptions used to determine the standalone selling price include forecast revenues, the cost of satisfying the obligation, development timelines and probabilities of technical, regulatory and commercial success.

These prices are considered to be a judgement on inception of the contract as opposed to an estimate, because, unlike an estimate, these are not subsequently amended. Refer to note 3 for details of the judgements applied to the agreement with Hikma to develop generic versions of GSK's Ellipta® portfolio.

2. Critical accounting areas of judgement and estimation continued

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 tax provision is recognised at £4.9m (2017: £5.0m) in corporation tax payable within note 21. This provision is partially released to the consolidated income statement as each annual statute of limitation (the period during which the tax authority can enquire into each return) is closed, with the uncertainty expected to be fully resolved in 2021.

The following critical estimates, if changed in 2019, would materially impact reported performance:

Revenue – Variable consideration included in revenue contracts

Variable consideration includes the estimate of payments in the form of contingent development related and regulatory approval milestones. These milestones are included in the transaction price when the most likely outcome is they will be received. Once this is established, the entire transaction price is constrained to the extent that it is highly probable that a significant reversal of revenue will not occur in future periods. The estimate is reassessed for each reporting period.

The initial transaction price for the development of the generic GSK Ellipta® portfolio with Hikma has been assessed as $20.0m, which includes a fixed $15.0m non-refundable milestone received in 2018 and a second $5.0m milestone due on Hikma confirming completion of the device development services. The second milestone is being constrained (i.e. not recognised) until further development progress is made and there is greater certainty over the achievement of the second milestone. If this $5.0m milestone had not been constrained, additional revenue of £2.2m ($2.9m) would have been recognised in 2018.

Impairment of goodwill and intangible assets acquired through business combinations

Goodwill arising on a business combination is not amortised, but is tested annually for impairment. This testing requires judgement as to the value in use of the cash-generating units (CGUs) to which goodwill has been allocated. The actual performance of CGUs may differ from the valuations derived through this exercise. Refer to note 14 "Goodwill".

Intangible assets are reviewed for indicators 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 product supply volume forecast, margin (depending on pricing assumptions, raw material costs and cost of manufacture) and the appropriate discount rate to measure the inherent risks in the cash flows.

These valuations are inherently subjective. The sensitivity of the *flutiform*® intangible, being the Group's largest intangible asset, to downside scenarios is presented within note 15 "Intangible assets".

Useful economic lives of intangible assets acquired through business combinations

Intangible assets relating to in-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 quantum of the intangible assets, any change in assumptions would have a significant impact on the amortisation charge.

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 23 "Retirement benefit obligations".

Notes to the consolidated financial statements continued

For the year ended 31 December 2018

3. Revenue

Detailed analysis and commentary on revenue is provided in the Financial review.

	2018 £m	2017 £m
Product supply revenues	**85.6**	74.7
Royalty and other marketed revenues	**58.4**	63.7
Development revenues	**16.5**	9.6
Total revenues	**160.5**	148.0

Development revenues include £8.5m (2017: £8.5m) for completed development service obligations, £3.7m (2017: £1.1m) for deferred income released on partially completed development service obligations and £4.2m (2017: £nil) in respect of granting of a licence related to the new collaborative arrangement with Hikma signed in 2018, being the first arrangement to which IFRS 15 has been applied outside of the standard's transition rules.

Revenue of £6.6m (2017: nil) has been recognised relating to the collaborative arrangement with Hikma signed in November 2018 to develop generic versions of GSK's Ellipta® portfolio. Of this amount, £4.2m (2017: £nil) was recognised when the Group provided Hikma with the right-to-use intellectual property related to Vectura's Open-Inhale-Close prototype device as it existed on the grant date. The remaining £2.4m has been recognised reflecting the degree of progress made towards completing the second performance obligation being the provision of development services on Vectura's Open-Inhale-Close device.

The Group has determined the transaction price to be $20.0m being the upfront milestone of $15.0m and a variable payment of $5.0m, which is contingent on successful completion of the device development services. The $5.0m variable payment has been constrained subject to further development progress being made resulting in reduced uncertainty.

In addition, Vectura is obliged to perform future formulation and process development activities for up to five products which will only be committed upon agreement of individual product development plans in the future. The Group has assessed these services to be offered at their standalone selling price such that no material right to discounted services exists.

Revenue by geographical location

	2018 £m	2017 £m
United Kingdom	**55.2**	49.2
Japan	**35.1**	33.0
Switzerland	**31.0**	27.3
United States of America	**15.8**	13.8
Rest of Europe	**13.3**	15.3
Rest of world	**10.1**	9.4
Total revenues	**160.5**	148.0

Geographical location is derived from customer invoicing points as opposed to patients receiving treatment.

Revenue from major customers

Three major customers contributed individually in excess of 10% of total Group revenues: Customer A – £43.9m (2017: £35.2m), Customer B – £35.1m (2017: £33.0m) and Customer C – £22.4m (2017: £17.1m).

Customer contract balances

The following table details trade receivables, contract assets and contract liabilities with customers:

	Note	2018 £m	2017 £m
Trade receivables	19	**15.1**	11.5
Customer contract assets – accrued royalty revenues	19	**10.2**	14.2
Customer contract liabilities – advanced consideration received	21	**(6.5)**	(4.6)

Accrued royalty revenues are transferred to trade receivables when the right to payment becomes unconditional upon receipt of royalty statements. Of the £11.4m payment received in respect of the new collaborative arrangement with Hikma, £4.8m has been deferred to be recognised as progress is made towards completing the second performance obligation.

Contract liabilities consists of advance payments from customers being released as performance obligations are satisfied. As part of an agreement with Sandoz regarding revised territory rights for AirFluSal® Forspiro®, Vectura recognised revenues of £2.4m during the period, of which £2.0m relates to the release of deferred income. In respect of VR2081, £1.3m of deferred income was also released and recognised as revenues for the services performed in 2018.

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 9.

Non-current assets at 31 December by geographical location are as follows:

	2018 £m	2017 Restated* £m
Switzerland	**286.8**	356.7*
United Kingdom	**125.5**	106.1*
Germany	**19.6**	71.9
United States of America	**—**	11.6
France	**19.3**	11.0*
Total non-current assets	**451.2**	557.3

* In 2018, £19.0m (2017: £17.9m) of non-current assets located in the United Kingdom and £7.0m (2017: £5.4m) located in France, used to support the manufacture and production of *flutiform*®, were reported against Switzerland in the prior year in order to align with the allocation of these assets for CGU impairment testing purposes. These are now reported against the location in which they are located physically.

5. Research and development expenses

	2018 £m	2017 £m
Partnered R&D	**20.6**	25.7
Pre-partnered R&D	**34.9**	34.6
Total research and development expenses	**55.5**	60.3

Partnered research and development expenditure represents expenditure funded by partners to progress agreed contracted programmes. Pre-partnered research and development expenditure reflects investments funded by the Group on programmes yet to be partnered, as well as investments in the Group's own innovative proprietary technology platforms.

6. Employees

The average number of full time equivalent employees and aggregate remuneration of employees was as follows:

	2018 Number	2017 Number
Research and development and related support services	**275**	310
Business development and corporate administration	**16**	19
Manufacturing and supply chain	**143**	135
Total average number of full time equivalent employees	**434**	464

Aggregate remuneration	2018 £m	2017 £m
Wages and salaries	**34.7**	34.6
Social security costs	**4.9**	4.8
Payments to defined benefit pension plans	**0.2**	0.7
Payments to defined contribution pension plans	**1.3**	2.0
Total aggregate remuneration	**41.1**	42.1

In addition, costs of £2.5m (2017: £2.0m) were incurred for individuals not directly employed by the Group and certain redundancy costs, qualifying as exceptional items, are presented within note 10.

Directors' remuneration is detailed in the Remuneration report. In accordance with Schedule 5 (11.1) of the Companies Act 2006, employee benefits accruing under the Vectura Long-Term Incentive Share plan are excluded from this disclosure as they do not solely relate to payments made for 2018 employment services.

Notes to the consolidated financial statements continued

For the year ended 31 December 2018

7. Other operating income

The Group will claim R&D expenditure credits (RDEC) of £1.5m (2017: £1.7m) in the year ended 31 December 2018 alongside the tax return filing process. As these credits are subject to corporation tax, they are presented as other income. Other than the tax authorities acceptance of the tax return, there are no other unfulfilled conditions or contingencies attaching to this income.

During the year the Group received cash of £1.0m (2017: £2.1m) in respect of earlier year R&D tax credit claims. A receivable of £3.8m (2017: £3.8m) remains outstanding as at the balance sheet date.

The Group recognised £0.6m (2017: nil) of other income in relation to a 70% contribution from a customer for additional serialisation supply chain equipment required to comply with the new guidelines issued by the European Medicines Agency.

Upon the purchase by Recipharm of Sanofi's manufacturing facility in Holmes Chapel, UK, the Group recognised £0.5m as other income in relation to the novation of the Group's Manufacturing and Supply Agreement from Sanofi to Recipharm. A further £1.3m received was recognised in cost of sales as it relates to compensation for historic costs incurred and previously charged to cost of sales.

8. Auditor's remuneration

The analysis of auditor's remuneration is as follows:

	2018 £m	2017 £m
Audit of the Group's annual accounts	**0.6**	0.4
Audit of the Group's subsidiaries	**0.1**	0.1
Total audit fees	**0.7**	0.5
Other services	**0.1**	0.1
Total non-audit fees	**0.1**	0.1
Total fees payable to the Group auditor	**0.8**	0.6

Included in the audit fees for the Group's annual accounts is £35,000 (2017: £25,000) payable for the audit of the parent company.

9. 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.

	Note	2018 £m	2017 £m
Operating loss		**(105.4)**	(96.2)
Exceptional items	10	**9.0**	4.5
Amortisation and impairment of intangible assets	15	**127.0**	109.7
Depreciation of property, plant and equipment	16	**5.8**	5.7
Share-based payments	28	**2.6**	2.1
Adjusted EBITDA		**39.0**	25.8

10. Exceptional items

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 years.

	2018 £m	2017 £m
Legal fees[1]	**7.1**	1.8
Skyepharma merger integration costs[2]	**1.4**	4.5
Site closure costs[3]	**1.3**	—
Other exceptional items[4]	**0.2**	0.4
Research and development accrual release[5]	**(1.0)**	(2.2)
Total exceptional items	**9.0**	4.5

Classification if costs were not presented as exceptional:

1 Classified as research and development expenditure.

2 Classified within corporate and administrative expenses and research and development expenditure.

3 Classified separately as restructuring costs.

4 Classified within cost of sales.

5 Classified within cost of sales and research and development expenditure.

Legal fees of £7.1m (2017: £1.8m) relate to ongoing legal proceedings against GSK from enforcement of Vectura's patents in respect of the GSK Ellipta® products. In the UK, a judgement was handed down by the High Court on 13 December 2018 ruling in favour of GSK. Reimbursement of GSK's legal costs in the UK following this judgement are included in the exceptional charge. In the US, a jury trial is scheduled in Delaware for April 2019.

Post-merger integration costs of £1.4m (2017: £4.5m) include redundancy and other costs from initiatives to combine the businesses, streamline ways of working and enhance productivity, and £0.9m (2017: £1.8m) of share-based payment charges. These arise from retention shares granted to key members of management considered critical to the integration process. The charges are lower than the comparative period primarily because the awards with an 18-month service condition vested on 22 March 2018.

The decision to close one of the Group's four operational sites, Gauting in Germany, by June 2021 was communicated in June 2018. Activities will be transferred to the remaining sites during the closure period. A provision of £1.1m has been recognised for redundancies arising from the closure. The provision assumes the redundancy payments are made at the end of the closure period and is discounted at a rate of 1% (being a proxy for the German risk-free rate). The remaining £0.2m relates to share-based payment charges specifically for the retention of staff during the closure period.

Other exceptional items include the final redundancy costs from restructuring of the Group's manufacturing facility in Lyon which commenced in July 2016.

Following a detailed review of the research and development accruals during 2017, a number of individually immaterial historical accruals were identified where it was no longer considered probable that these accruals would result in future cash outflows. The accruals, totalling £2.2m, were released in the 2017 consolidated income statement and a final £1.0m has been released in 2018. These 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.

Notes to the consolidated financial statements continued

For the year ended 31 December 2018

11. Finance income and expense

	2018 £m	2017 £m
Bank interest income	**0.2**	0.2
Unwinding of financial assets	**0.3**	—
Foreign exchange gains	**0.8**	—
Finance income	**1.3**	0.2
Bank interest expense	**(0.3)**	(0.2)
RCF commitment fees	**(0.2)**	(0.2)
Other financing items	**—**	(1.0)
Foreign exchange losses	**—**	(1.4)
Finance expense	**(0.5)**	(2.8)

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.

12. Taxation

	2018 £m	2017 £m
Current taxation	**(4.6)**	(5.9)
Adjustments to prior periods recognised	**(0.1)**	0.4
Total current taxation charge	**(4.7)**	(5.5)
Deferred taxation	**21.3**	22.0
Net taxation credit	**16.6**	16.5

Deferred taxation charges of £0.5m (2017: £1.4m) were 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 in 2014 and the Skyepharma merger in 2016.

The Group's effective tax rate (ETR) before other comprehensive income (OCI) is a 15.8% credit (2017: 16.2% credit). This equates to the applicable UK tax rate of 19%, adjusted for a number of factors discussed below.

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 operating income (refer to note 7). In addition, certain 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 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 arose in respect of the percentage of net sales received from EXPAREL®. This ceased from September 2018.

Swiss taxation

The Group continues to be tax-paying in Switzerland and continues to monitor the Swiss tax reform, expected to be enacted from 1 January 2020.

12. Taxation continued

Effective tax rate (ETR)

In Switzerland and the US, the Group is profitable and subject to taxation at the local rates (Swiss ETR 9.7% charge (2017: 8.5%), and the US corporate rate applied is 21% (2017: 35%)). The uncertain tax position disclosed has decreased by £0.1m in the year. These charges, along with a significant credit (ETR: 19.8% credit) in respect of deferred tax liabilities relating to intangible assets acquired on the Skyepharma and Activaero acquisitions (refer to note 24 "Deferred tax liabilities"), together drive the Group's ETR credit of 15.8% (2017: 16.15%).

	2018 £m	2017 £m
Loss before tax	**(104.8)**	(102.2)
Loss before tax multiplied by standard rate of UK corporation tax of 19% (2017: 19.25%)	**19.9**	19.7
Effects of:		
UK Patent Box benefit	**—**	0.1
Expenses not deductible for tax purposes	**(0.1)**	(2.5)
Unrecognised deferred tax*	**(8.9)**	(5.4)
Prior year deferred tax	**0.4**	0.5
Recognition of deferred tax on losses	**2.0**	—
Differences arising from prior period computations	**(0.1)**	0.4
Differences in effective overseas tax rates	**3.4**	2.1
Impact of deferred tax rate change	**—**	1.6
Total tax credit for the year	**16.6**	16.5

* 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 (excluding the future release of the uncertain tax position) is expected to remain in the 10–15% credit for 2019 as a result of both the taxable Swiss profits and the significant credit in respect of deferred tax liabilities on intangibles acquired, which is expected to continue for the remainder of their useful lives. If VR315 US progresses to market as expected, the Group's loss before tax would decrease, and the ETR (before the release of the uncertain tax position) is expected to increase to 20–30% credit ETR as the UK moves into a profitable position and utilises brought forward tax losses. This is subject to change as the impact of Swiss tax reform becomes certain, and the credit is expected to reduce in future years as the Group's intangible assets are amortised in line with their respected useful economic lives.

13. Loss per share

Basic loss per share of 13.2p per share (2017: 12.6p per share) equals diluted loss per share of 13.2p per share (2017: 12.6p per share). The following table provides details of the impact as if shares had been considered dilutive.

	2018	2017
Loss after taxation (£m)	**(88.2)**	(85.7)
Weighted average number of shares (m)	**666.1**	678.9
Effect of dilutive potential shares (m)	**6.3**	6.2
Diluted weighted average number of shares (m)	**672.4**	685.1

Notes to the consolidated financial statements continued

For the year ended 31 December 2018

14. Goodwill

	2018 £m	2017 £m
At beginning of the year	**161.4**	162.8
Foreign exchange	**2.0**	(1.4)
At end of the year	**163.4**	161.4
Allocation to cash-generating units (CGUs)		
UK and Germany	**100.1**	100.1
Switzerland	**63.3**	61.3
At end of the year	**163.4**	161.4

Goodwill has been allocated to cash-generating units (CGUs), being the Group's geographic locations for operations and intellectual property. The recoverable amounts of each CGU is assessed using a fair value less costs of disposal model. This 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. 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 provides materially the same result when there are neither temporary differences nor available tax losses at the measurement date.

The Group's weighted average cost of capital (WACC) of 10% (2017: 9%) is used in the calculation to discount the cash flows to reflect the impact of risks relevant to the Group and the time value of money. The Group rate is then adjusted for risks specific to each CGU.

Cash flows relating to the Swiss CGU are discounted at 9% (2017: 8%) and to the UK and Germany CGU at 11% (2017: 9%). Whilst no specific Brexit adjustment is made to the discount rates, market volatility caused by Brexit is incorporated into risk-free rates, equity market returns and economic expectations and has contributed to the increase in the Group's WACC.

Cash flows are based on the most recent budget approved by the Board covering 2019 and the Ten Year Plan to 2028. 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	Brexit proceeds in an orderly manner with minimal disruption to the *flutiform*® supply chain
	Time to develop and launch pipeline products
	Net sales forecasts and related royalty inflows
	Timing of partnering pipeline products and milestone achievement
	Gross profit margins on product supply
	Discount rate
	Taxation rate
Determination of assumptions	Forecast development plans
	Net sales forecasts are determined from partner forecasts and external market data
	Milestone amounts and royalty rates reflect past experience and forecast sales from market data
	Margins reflect past experience, adjusted for expected future changes
	Discount rates based on Group WACC, adjusted for country specific risks
	Taxation rates based on appropriate rates for each region
Specific projected cash flow year	Ten years (reflecting a longer-term planning cycle)
Terminal growth rate	Nil
Discount rate	UK and Germany: 11% Switzerland: 9%

14. Goodwill continued

The Group conducted a sensitivity analysis on the impairment test of each CGU's carrying value. The UK and Germany CGU valuation indicates significant headroom such that a plausible change in any key assumption is unlikely to result in an impairment of the related goodwill. The forecast cash flows would need to reduce in excess of 65% (2017: 70%) before impairment arises. This is primarily because this CGU comprises a significant number of internally generated intangibles.

The Swiss CGU has relatively low headroom primarily because it includes significant acquired intangibles, the largest being *flutiform*®. The sensitivity analysis indicates that either a decline of annual cash flows in excess of 11% or an increase in the discount rate by 1.5% would, all other assumptions being equal, cause impairment. A 1% increase in the discount rate combined with a 3.5% reduction in annual cash flows would likely cause impairment.

The sensitivity of the Swiss CGU to the potential outcomes of the UK exiting the EU ("Brexit") has been considered. Brexit could have a range of potential outcomes, of which the most severe is considered to be the UK exiting the EU on 29 March 2019 without a transition period ("hard Brexit"). In this scenario, the Group believes that there is a reasonable possibility that the Group's *flutiform*® supply chain could be disrupted. *flutiform*® is manufactured in the UK with raw materials imported mainly from the EU into the UK and the Group's partners export finished product from the UK into the EU and Japan.

As the cash flows from *flutiform*® form part of the recoverable amount of the Swiss CGU, sensitivities have been modelled ranging from minimal disruption to the *flutiform*® supply chain to severe but still reasonably possible disruption such that partner and patient demand cannot be satisfied. The sensitivities also consider an increase in operating costs from adverse regulatory changes. Details relating to the sensitivities are as follows:

Key assumptions	Severity and duration of border disruption
	Stock levels of finished products and raw materials
	Level of switching in market between *flutiform*® and other available brands
	Tariff levels and other regulatory or trading costs
	Extent of sharing of incremental costs with the Group's partners
	Changes in batch failure rates following implementation of new release testing process
Determination of assumptions	External inputs from professional bodies, trade associations and governmental bodies
	Internal risk mitigation reviews and those with partners and suppliers
	The Group's own inventory tracking and supply forecasts
	Potential applicable tariffs and duties from the World Trade Organization (WTO)
	Internal expertise and experience of regulatory and testing regimes
Specific projected cash flow year	Ten years (reflecting a longer-term planning cycle)
Terminal growth rate	Nil
Discount rate	9%

The impact of these sensitivities range from no impairment to an impairment of goodwill allocated to the Swiss CGU of £57.7m in the most severe but reasonably possible case. There remains a high level of uncertainty as at the date of approval of these financial statements as to how and whether specific risks will materialise. The full implications of Brexit will not be understood until future tariffs, trade, regulatory, tax, and other free trade agreements to be entered into by the United Kingdom are established. Furthermore, Vectura could experience changes to laws and regulations post Brexit, in areas such as intellectual property rights, employment, environment, supply chain logistics, data protection and health and safety, which may be relevant in assessing the Group's assets.

Notes to the consolidated financial statements continued

For the year ended 31 December 2018

15. Intangible assets

	Inhaled in-market assets £m	Smart nebuliser technology* £m	Non-inhaled in-market assets £m	Other £m	Total £m
Cost:					
At 1 January 2017	327.2	132.7	156.8	16.7	633.4
Additions	—	—	—	0.2	0.2
Disposals	(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
Additions	—	—	—	0.9	0.9
Foreign exchange	15.8	1.6	4.2	0.8	22.4
At 31 December 2018	**324.9**	**139.9**	**81.0**	**17.8**	**563.6**
Amortisation:					
At 1 January 2017	(31.3)	(48.8)	(91.4)	(5.1)	(176.6)
Amortisation	(49.4)	(20.6)	(29.6)	(1.4)	(101.0)
Impairment	—	—	—	(8.7)	(8.7)
Disposals	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)
Amortisation	(48.0)	(14.5)	(22.8)	(0.2)	(85.5)
Impairment	—	(41.5)	—	—	(41.5)
Foreign exchange	(5.7)	(1.7)	(3.6)	(0.8)	(11.8)
At 31 December 2018	**(127.8)**	**(129.4)**	**(69.8)**	**(16.7)**	**(343.7)**
Net book value:					
At 31 December 2018	**197.1**	**10.5**	**11.2**	**1.1**	**219.9**
At 31 December 2017	235.0	66.6	33.4	0.4	335.4

* Used in pipeline programmes.

Inhaled in-market assets comprise the *flutiform*® and GSK's Ellipta® assets recognised on the Skyepharma merger. The Group receives product supply revenue on the *flutiform*® asset and royalties on both assets.

Non-inhaled in-market assets include several near end of life licences, patents, know-how agreements and marketing rights recognised on the Skyepharma merger, which are in use, and from which the Group continues to receive royalties.

The carrying value of the smart nebuliser technology asset at 31 December 2018 represents the amortised cost attributed to technology acquired through the Activaero transaction on 13 March 2014 being leveraged in the VR647 development programmes.

Impairment losses of £39.8m (2017: nil) arose from the decision to discontinue development of VR475 following the Phase III study results and a £1.7m charge (2017: nil) following the decision by Sanofi not to continue with the VR465 development programme despite positive Phase II study results.

Impairment tests on intangible assets are undertaken if events occur which call into question the carrying values of the assets. The assumptions relating to future cash flows, estimated useful lives and discount rates are based on business forecasts and are therefore inherently judgemental. Future events could cause the assumptions used in these impairment tests to change with a consequent adverse effect on the future results of the Group.

15. 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:

Intangible type	Inhaled in-market assets
Specific asset	*flutiform*®
Key assumptions	• Product supply volume forecast • Margin (depending on pricing assumptions, raw material costs and cost of manufacture) • Discount rate
Determination of key assumptions	• Internal forecasts with input from partners and external market data • Margins reflect past experience, adjusted for expected changes in pricing, raw material costs and cost of manufacture • Discount rate based on Group WACC, with a 1% risk deduction for being on-market and therefore having no development risk
Discount rate	• 9% (2017: 8%)

The Group has conducted a sensitivity analysis based on a number of reasonably possible downsides scenarios relating to reductions in margin (up to 6% reduction), volumes (up to 30% reduction) and the discount rate. All other assumptions being constant, an increase in the discount rate in excess of 16.5%, a reduction in volumes in excess of 23.0% or a reduction in margin in excess of 9.5% would cause impairment. In addition, the Brexit sensitivities in note 14 would have an impact ranging from no impairment of the *flutiform*® intangible to an impairment of £21.0m in the most severe case. The risk of future impairment of the *flutiform*® intangible is mitigated by further amortisation of the asset in 2019.

The Group's intangibles are amortised on a straight-line basis using the following useful economic lives (UELs):

	Carrying value £m	Acquisition date	Useful economic life from acquisition date
Inhaled in-market assets	197.1	June 2016	3.5–7 years
Smart nebuliser technology	10.5	March 2014	8 years
Non-inhaled in-market assets	11.2	June 2016	3.5 years

The Group's sensitivity analysis shows that, had UELs been extended for 2018 by one year, then the impairment and amortisation charge would be £17.8m lower. Had UELs been reduced for 2018 by one year, then the impairment and amortisation charge would be £27.3m higher.

Following a contract renegotiation, effective from 1 January 2019, the UEL for non-inhaled in-market assets was extended by an additional four years.

Notes to the consolidated financial statements continued

For the year ended 31 December 2018

16. Property, plant and equipment

	Land and buildings £m	Laboratory and supply chain equipment £m	Assets under construction £m	Total £m
Cost:				
At 1 January 2017	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
Additions	0.2	3.1	5.2	8.5
Reclassification	0.7	4.9	(5.6)	—
Disposals	—	(2.2)	—	(2.2)
Foreign exchange	0.6	1.6	0.2	2.4
At 31 December 2018	**19.6**	**56.3**	**6.1**	**82.0**
Depreciation:				
At 1 January 2017	(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)
Charge for the period	(0.7)	(5.1)	—	(5.8)
Disposals	—	2.2	—	2.2
Foreign exchange	(0.1)	(0.3)	—	(0.4)
At 31 December 2018	**(1.8)**	**(22.4)**	**—**	**(24.2)**
Net book value:				
At 31 December 2018	**17.8**	**33.9**	**6.1**	**57.8**
At 31 December 2017	17.1	29.7	6.3	53.1

Land valued at £5.1m (2017: £5.1m) is not depreciated. The Group has invested £8.5m in capital expenditure in 2018 (2017: £11.7m) mainly in manufacturing equipment to support the production of *flutiform*®, the development of oral tablet production in Lyon and equipment to support the Group's nebuliser platforms.

Investments in a bottling line at the Group's manufacturing facility in Lyon of £2.2m and new moulds for the manufacture of components for the *flutiform*® actuator of £3.4m have been brought into use and therefore have been reclassified from assets under construction.

Two freehold properties and an adjoining warehouse facility in Switzerland are currently being actively marketed for sale. Renovation and planned capital expenditure for structural works to enable the sale have commenced and are not material in 2018. This work is expected to complete in the second half of 2019. As these buildings are not available for immediate sale they have not been reclassified as held for sale.

17. Other non-current assets

Other non-current assets comprise the following items:

	2018 £m	2017 £m
Non-current financial assets held at amortised cost	**6.8**	6.0
Deferred tax assets on tax basis differences	**3.3**	1.4
Total other non-current assets	**10.1**	7.4

Non-current financial assets principally include £6.4m (2017: £5.8m) of amounts receivable from development partners for manufacturing equipment which the Group has funded. The customer for the largest asset, at £6.1m (2017: £5.8m), has agreed to reimburse Vectura from 1 May 2020 for at least the value of the original costs incurred.

Deferred tax assets are recognised on differences between the tax base in the IFRS accounts for IAS 19 pension liabilities, provisions related to the profitable Swiss operations, and the recognition of £2.0m relating to tax losses where the future utilisation appears probable.

18. Inventories

	2018 £m	2017 £m
Raw materials	**8.9**	11.6
Work in progress	**14.6**	8.6
Finished goods	**4.2**	4.4
Less provision for impairment	**(1.0)**	(1.2)
Total inventories	**26.7**	23.4

Inventory purchases of £58.0m were expensed to cost of sales (2017: £52.4m).

19. Trade and other receivables

	2018 £m	2017 £m
Trade receivables	**15.1**	11.5
Customer contract assets	**10.2**	14.2
Less provision for impairment	**(0.1)**	(1.1)
Net trade receivables	**25.2**	24.6
Prepayments and other receivables	**6.3**	5.7
Research and development tax credits	**3.8**	3.8
Total trade and other receivables	**35.3**	34.1

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. Customer contract assets contain accrued royalties and licence and development milestones as well as contributions to fixed asset investments pursuant to the *flutiform*® supply chain.

The Group applies the IFRS 9 simplified approach to providing for expected credit losses in accordance with applicable guidance for non-banking entities. Under the simplified approach Vectura is required to measure lifetime expected credit losses for all trade receivables.

The expected credit loss allowance provision is determined below as follows, and incorporates forward looking information:

		Current	More than 30 days past due	More than 60 days past due	More than 90 days past due	Total £m
	Expected loss rate	—	—	100%	100%	
2018	Gross carrying amount	24.7	0.4	0.1	0.1	**25.3**
	Loss allowance provision	—	—	—	(0.1)	**(0.1)**
2017	Gross carrying amount	24.6	—	0.1	1.0	**25.7**
	Loss allowance provision	—	—	(0.1)	(1.0)	**(1.1)**

The Group's expected credit loss policy is to provide in full for any trade receivable over 60 days past due, by exception; however, as all amounts in this category were fully cash settled in January 2019 no provision was made.

In the comparative period an amount of £1.0m over 90 days past due was fully provided for as the customer contract was terminated in December 2018. The receivable was released and the provision was utilised in the current period for nil gain or loss.

20. Cash and cash equivalents

Cash and cash equivalents at 31 December are denominated in the following currencies:

	31 December 2018 £m	31 December 2017 £m
Sterling	**45.2**	44.5
Euros	**25.6**	24.5
US dollars	**21.1**	20.5
Swiss francs	**16.3**	14.2
Cash and cash equivalents	**108.2**	103.7

The Group invests its funds in short-term overnight bank deposits, with access at a maximum of 24 hours' notice. The Group has access to a £50m unsecured committed multi-currency revolving credit facility (RCF) with Barclays Bank PLC and HSBC Bank plc. The facility expires in August 2021.

Notes to the consolidated financial statements continued

For the year ended 31 December 2018

21. Trade and other payables

	2018 £m	2017 £m
Trade payables	**25.6**	23.7
Accruals	**28.8**	25.5
Customer contract liabilities	**4.1**	4.0
Other payables	**2.4**	3.1
Property mortgage	**0.2**	0.2
Trade and other current liabilities	**61.1**	56.5
Other payables	**—**	5.1
Customer contract liabilities	**2.4**	0.6
Property mortgage	**3.8**	3.9
Other non-current payables	**6.2**	9.6
Trade and other payables	**67.3**	66.1

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.

Accruals principally relate to manufacturing fees payable for *flutiform*® semi-finished products, external R&D project costs, employee benefits and related taxes, legal fees and other costs accrued but not invoiced. Customer contract liabilities relate to deferred revenues where the cash has been received from the customer in advance of work being performed and, therefore, in advance of revenue being recognised.

The property mortgage is secured on the Group's Swiss buildings, and had a fixed rate of interest of 2.6% per annum up to 28 February 2019, when it was renewed at a fixed rate of 1.3% with a term ending 30 August 2019. Owing to the nature of Swiss roll-over mortgages, the principle of the loan balance is presented as long term given the Group's intention to continue to roll-over the principal balance until the related property is sold which is expected to be in more than one year. All expected interest payments are presented as current.

In addition to current trade and other payables of £61.1m (2017: £56.5m), the Group recognises a corporation tax payable of £10.1m (2017: £11.4m).

22. Provisions

	Employee £m	Property £m	Commercial £m	Total £m
At 1 January 2018	2.2	1.9	1.3	5.4
Transfer from other payables	—	—	5.8	5.8
Charged/(released) during the period	1.4	0.7	(1.8)	0.3
Utilised during the year	(0.4)	(0.2)	—	(0.6)
At 31 December 2018	**3.2**	**2.4**	**5.3**	**10.9**
Current	0.6	0.2	0.3	1.1
Non-current	2.6	2.2	5.0	9.8

Provisions of £10.9m (2017: £5.4m) have increased as a result of the transfer of a commercial liability of £5.8m, which was previously recognised in other payables. This transfer reflects the uncertainty of the phasing of future payments and the obligation is now considered to be constructive in nature. In this one instance, as the phasing of repayments cannot be reliably measured and owing to immateriality, no discounting has been applied. Of this provision, £0.8m has been released during the period.

A further £1.1m has also been released from commercial provisions in respect of a *flutiform*® supplier provision as payment is no longer considered probable, and this is partially offset by the recognition of a £0.3m provision for reimbursement of GSK's legal costs in the UK, which is expected to be settled in 2019 and is therefore presented as current. Refer to note 10 "Exceptional items".

Employee provisions relate to the Group's Gauting (Germany) and Lyon (France) sites. A provision of £1.2m has been made for redundancy payments following the decision to close the German site by June 2021. A provision of £1.4m for French statutory lump sum payments, payable upon the retirement of employees at the Lyon facility, with payments not expected in the medium term, and £0.6m for French redundancies payable in 2019. Refer to note 10 "Exceptional items".

Property provisions are recognised 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.

23. Retirement benefit obligations

Swiss defined benefit pension plan

The amounts recognised in the balance sheet for the Swiss scheme are as follows:

	2018 £m	2017 £m
Present value of funded obligations	**(16.2)**	(17.7)
Fair value of plan assets	**13.1**	14.1
Balance sheet liability	**(3.1)**	(3.6)

The Swiss sub-group has affiliated itself with PKG Pensionskasse for the provision of its occupational pension provision 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 policy holders' 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% from: 6.0% in 2016.

There have been no further updates since December 2017.

Vectura, as 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 choose 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:

	2018 £m	2017 £m
Opening present value of the defined benefit obligation	**(17.7)**	(21.3)
Current service cost	**(0.8)**	(0.9)
Gain on plan modification	**—**	1.0
Exceptional gain on curtailment (note 10)	**0.7**	0.2
Recognised in the income statement	**(0.1)**	0.3
Benefits paid and withdrawals	**2.8**	2.1
Employee contributions	**(0.5)**	(0.5)
Balance sheet cash movements	**2.3**	1.6
Foreign exchange translation	**(0.8)**	0.8
Actuarial gains	**0.1**	0.9
Recognised through OCI	**(0.7)**	1.7
Present value of the defined benefit obligation	**(16.2)**	(17.7)

Notes to the consolidated financial statements continued

For the year ended 31 December 2018

23. Retirement benefit obligations continued

Swiss defined benefit pension plan continued

The movement in the fair value of the plan assets was as follows:

	2018 £m	2017 £m
Fair value of the plan assets the beginning of the year	**14.1**	15.4
Foreign exchange	**0.6**	(0.6)
Benefits paid and withdrawals	**(2.8)**	(2.1)
Actuarial gains recognised on plan assets through OCI	**0.1**	0.2
Employer contributions	**0.6**	0.7
Employee contributions	**0.5**	0.5
Fair value of the plan assets	**13.1**	14.1

Plan assets comprise:

	2018 £m	2018 %	2017 £m	2017 %
Equity	**3.7**	**28.2**	4.4	31.2
Bonds	**6.1**	**46.6**	0.6	4.3
Property	**2.5**	**19.1**	5.8	41.1
Cash	**0.1**	**0.8**	2.5	17.7
Other	**0.7**	**5.3**	0.8	5.7
Total plan assets	**13.1**	**100.0**	14.1	100.0

Other plan assets includes higher risk investments such as commodities or emerging market investments. Despite the 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 114.1% (2017: 107.4%) published by the fund (for the previous year), 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 employer contributions to post-employment benefit plans for the year ending 31 December 2019 are £0.6m (2018: £0.8m).

The cumulative actuarial gain recognised in other comprehensive income is as follows:

	31 December 2018 £m	31 December 2017 £m
Actuarial gain recognised in OCI	**0.2**	1.1
Cumulative actuarial gains recognised within retained losses	**2.6**	2.4

The principal actuarial assumptions made by the actuaries were:

Salary growth	**1.25%**	1.00%
Pension increase	**Nil**	Nil
Discount rate	**0.80%**	0.65%
Male life expectancy from retirement age (years)	**22.5**	22.5
Female life expectancy from retirement age (years)	**25.5**	25.5

The average service period to retirement for scheme participants is approximately 10 years (2017: 9.5 years).

23. 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%/-0.8%	(1.6)	1.3
Pension increases	+/- 1%	(1.4)	Not applicable
Salary growth	+/- 2%	0.6	(0.5)
Life expectancy	+/- 2 years	(1.0)	1.0

The above sensitivity analysis 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 outside of Switzerland. 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 £1.3m as disclosed in note 6 "Employees".

24. 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	Tangible assets £m	Total £m
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
Credited to income statement	(19.1)	—	(0.6)	(19.7)
Charged to OCI	—	0.5	—	0.5
Foreign exchange	1.2	0.2	—	1.4
At 31 December 2018	**27.7**	**6.7**	**1.3**	**35.7**

Deferred tax liabilities associated with intangible assets unwind to offset the tax distortion that would otherwise occur as the assets are amortised. As a result of the impairment of the carrying value of the smart nebuliser technology intangible asset attributed to VR475 (refer to note 15), the deferred tax liability of €12.7m (£11.1m) has been credited back in the period to the Consolidated income statement. In addition, as a result of the impairment and the announcement to close the Gauting site, the deferred tax asset on German tax losses of £5.3m (2017: £5.3m) has been released as a debit against the deferred tax liability release for VR475.

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.

The Group did not recognise deferred tax assets on tax losses amounting to £254.9m (2017: £248.4m). 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.

The future value of deferred tax liabilities in Switzerland are sensitive to the anticipated future Swiss tax reform. The Swiss Corporate Tax and Old Age Insurance Reform Bill will be put to a public vote by Swiss citizens on 19 May 2019. If the vote is successful, the reform will enter into force on 1 January 2020. The Group is monitoring 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 in the next accounting period.

Notes to the consolidated financial statements continued

For the year ended 31 December 2018

25. Financial instruments

The Group has exposure to credit, liquidity and currency risks from its use of financial instruments. This note sets out the Group's key policies and processes for managing these risks.

In the previous year, the Group adopted IFRS 9 – Financial Instruments. IFRS 9 introduced 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 and as disclosed in 2017 this had limited impact on the Group's financial reporting.

	Fair value through profit and loss		Amortised cost		Total	
	2018 £m	2017 £m	**2018 £m**	2017 £m	**2018 £m**	2017 £m
Cash and cash equivalents	**—**	—	**108.2**	103.7	**108.2**	103.7
Trade receivables	**—**	—	**25.2**	24.6	**25.2**	24.6
Other non-current assets	**6.8**	6.0	**—**	—	**6.8**	6.0
Non-derivative financial assets	**6.8**	6.0	**133.4**	128.3	**140.2**	134.3
Trade and other payables	**—**	—	**(56.8)**	(57.4)	**(56.8)**	(57.4)
Mortgage borrowings	**—**	—	**(4.0)**	(4.1)	**(4.0)**	(4.1)
Provisions	**(5.9)**	(5.4)	**(5.0)**	—	**(10.9)**	(5.4)
Non-derivative financial liabilities	**(5.9)**	(5.4)	**(65.8)**	(61.5)	**(71.7)**	(66.9)
Financial instruments	**0.9**	0.6	**67.6**	66.8	**68.5**	67.4

The Group's financial instruments are measured at amortised cost unless consideration is contingent. Contingent assets and liabilities are held at fair value through profit and loss (FVTPL) on the basis of their expected discounted cash flows, being the present value of expected payments discounted using a risk-free discount rate adjusted as appropriate. Therefore no separate fair value analysis is presented.

The Group has no external debt, except for a Swiss mortgage at a fixed rate of interest, and therefore does not consider the impact of interest rate risk to be material to its results or operations and accordingly no sensitivity analysis is shown.

(a) Credit risk

The impairment provisions for financial assets disclosed in note 19 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, 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:

	2018 £m	2017 £m
Cash and cash equivalents	**108.2**	103.7
Swiss property mortgage	**(4.0)**	(4.1)
Net cash	**104.2**	99.6
Equity	**494.3**	578.5
Net cash to equity ratio	**21%**	17%

In addition, the Group has access to a £50m RCF and no funds were drawn against this as at 31 December 2018. The facility expires in August 2021. Refer to note 20 "Cash and cash equivalents".

(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 the issue of shares where appropriate.

25. Financial instruments continued

(e) Currency risk management

The Group's presentation currency is sterling. The Group is subject to exposure on the translation of the assets and liabilities 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 and losses 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.

On 8 November 2018, the Group entered a forward contract to hedge the transactional foreign currency exposure from the forecast receipt of the $15.0m upfront milestone arising from the global agreement with Hikma to develop generic version of GSK's Ellipta® portfolio.

A 10% strengthening of the euro, sterling, 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 £4.0m lower (2017: £7.0m lower) and items recognised directly in other comprehensive income being £10.8m higher (2017: £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.

26. Ordinary share capital

Allotted, called up and fully paid	£m	Number of shares
Ordinary shares of 0.025p, each at 1 January 2018	0.2	678,508,698
Issued to satisfy Vectura employee share plans	—	1,561,183
Share buyback programme – cancellations	—	(14,682,736)
Ordinary shares of 0.025p, each at 31 December 2018	**0.2**	**665,387,145**

On 14 November 2017, the Group announced that the Board had approved a share buyback to return up to £15m of capital to shareholders. On 28 February 2018, the £15.0m share buyback programme was completed with £13.6m (2017: £1.4m) of capital returned to shareholders in 2018 at a weighted average price of 93p per share. Directly attributable costs of £0.2m have been expensed to equity.

During the year, the Group allotted 1,561,183 (2017: 1,961,880) ordinary shares of 0.025p each related to employee share option awards. Refer to note 28 "Share-based payments".

27. Restatement of share premium within reserves

Following completion of the share buyback programme, a review of the Vectura Group plc's distributable reserves was performed. It was identified that shares issued on 13 March 2014 with a market value of £41.3m, as part consideration for the Activaero acquisition, were incorrectly recorded in non-distributable share premium.

The share premium of £41.3m should have been recognised as a separate reserve, usually referred to as a merger reserve, and therefore this amount has been reclassified in the comparative year. Merger reserves are initially non-distributable, but can in future become distributable and the entire restated amount became distributable and, as such, was released from merger reserves to retained losses in November 2018 following impairment of the German investment (refer to note 6 of the single entity accounts). See Statement of changes in equity for amounts previously reported.

28. Share-based payments

The Group operates various share-based compensation plans as described within the Remuneration report. All share-based payments are for the purposes of employee share incentivisation and are equity settled for shares within Vectura Group plc in accordance with the vesting conditions.

	2018 £m	2017 £m
Equity settled LTIP and RSA plans	**2.6**	2.1
Exceptional share-based payments – merger and site closure	**1.1**	1.8
Total share-based payments	**3.7**	3.9

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 (LTIP), the Group's main plan, are set out on page 144. The Group also operates a Share Incentive Plan (SIP) and a Save-As-You-Earn (SAYE) plan. The disclosures relevant for these plans are made in the Remuneration report as they are not considered material.

Notes to the consolidated financial statements continued

For the year ended 31 December 2018

28. Share-based payments continued

Exceptional share-based payments include £0.9m (2017: £1.8m) related to 18-month (vested March 2018) and 36-month (vesting September 2019) retention awards granted following the Skyepharma merger on 10 June 2016. The remaining £0.2m (2017: nil) relates to share-based payment charges specifically for the retention of staff following the decision to close the Group's operational site in Gauting.

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.

Transactions on the LTIP share plan for executives, senior management and key professionals during the year were as follows:

	2018 Number of awards	2017 (Restated) Number of awards
Beginning of the year	**14,376,319**	13,776,512
Granted	**7,243,746**	3,770,532
Exercised	**(1,558,596)**	(1,495,589)
Forfeited	**(3,778,764)**	(1,675,136)
End of the year	**16,282,705**	14,376,319

In 2018, LTIPs granted to Executive Directors' were 185% of salary (2017: 185%) subject to performance over three years. The performance condition is subject to two measures, being:

(a) performance is measured subject to a relative TSR metric against a bespoke sector peer group (2017: against the FTSE 250 (excluding real estate and financial services companies) and a bespoke sector peer group); and

(b) measured subject to a relevant three-year cumulative adjusted EBITDA target as set by the Remuneration Committee.

Employees at the Executive Leadership Team (ELT) level were granted LTIPs at 95% of salary (2017: 105%). 50% (2017: 70%) of these awards are subject to the same TSR and adjusted EBITDA as the Executive Directors, with the remaining 45% (2017: 35%) classified as restricted stock awards.

Restricted stock awards are subject to service conditions, i.e. the requirement for recipients of awards to remain in employment with Vectura over a three-year vesting period and subject to a personal performance underpin. Any vested shares granted to the Executive Directors and Executive Leadership Team must be held for two years after vesting.

Other key management personnel below ELT level receive awards entirely of restricted stock options.

Valuation of share awards

The treatment of vesting and non-vesting conditions attached to awards in the valuation process varies in accordance with the requirements of IFRS 2.

LTIPs for Executive Directors and ELT

For the year ended 31 December 2018, the calculation of the grant date fair value for those awards with a total shareholder return (TSR) condition was as follows:

	2018	2017
Number of TSR awards granted	**1,691,099**	1,114,638
Service condition	**3 years**	3 years
Holding condition	**2 years**	2 years
Nominal share value	**0.025p**	0.025p
Share price on grant date	**74.2p**	117.6p

The TSR condition 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 14.41% (2017: 28.12%). The risk-free interest rate obtainable from government securities (i.e. gilts in the UK) over a period commensurate with the expected term was 1.2% (2017: 0.09%) and there was no dividend yield expected (2017: nil).

The adjusted EBITDA condition is a non-market condition, and the vesting outcome assumption is adjusted at each reporting period for the likelihood of the number of shares that will ultimately vest. For the LTIP and RSA 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.

28. Share-based payments continued

Valuation of share awards continued

LTIPs for key management personnel below ELT

For the below ELT restricted stock awards, the probability of the non-market-based (holding) 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 £1.1m (2017: £1.8m).

Upon completion of the merger, 1,618,215 exceptional nil cost awards were granted to key members of management, excluding Executive Directors, considered critical to the integration process. These awards had a grant date fair value of £1.41 and were subject to an 18-month or 36-month service condition with a personal performance underpin from their grant date on 22 September 2016. Those with an 18-month service condition have vested in March 2018, and therefore only a partial charge is included this year. The remaining charge for the 36-month holding condition (vesting on 21 September 2019) is being expensed evenly over the remaining vesting period at £0.3m per quarter assuming no further lapses or forfeitures occur.

A total of 1,026,568 retention awards with a two-year vesting period were issued to German employees critical to the knowledge transfer of the Vectura enhanced therapy programmes associated with the German site closure. These awards had an IFRS 2 grant date fair value of £0.7m which is being spread evenly over the associated 24-month vesting period from their grant date on 27 June 2018.

Share trusts

The Group consolidates 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 the Group's share awards.

29. Cash flow information

Cash generated from operating activities

	2018 £m	2017 £m
Cash flows from operating activities		
Loss after taxation	**(88.2)**	(85.7)
Adjustments		
Net taxation credit	**(16.6)**	(16.5)
Amortisation and impairment	**127.0**	109.7
Depreciation	**5.8**	5.7
Net finance (income)/expense	**(0.8)**	2.6
Share-based payments (including those in exceptional items)	**3.7**	3.9
Increase in inventories	**(2.0)**	(5.9)
(Increase)/decrease in trade and other receivables	**(1.9)**	17.2
Decrease/(increase) in trade and other payables	**7.2**	(6.9)
Loss from associates	**0.2**	3.4
Other non-cash items	**0.7**	(0.6)
Total adjustments	**123.3**	112.6
Cash generated from operating activities	**35.1**	26.9

Analysis of movement in financial liabilities

	2018 £m	2017 £m
At the beginning of the year	**4.1**	4.5
Repayments	**(0.3)**	(0.3)
Interest expense	**0.1**	0.1
Foreign exchange movements	**0.1**	(0.2)
At the end of the period	**4.0**	4.1

Financial liabilities entirely relate to a Swiss property mortgage secured on the Swiss R&D facility. Repayments include £0.2m (2017: £0.2m) of capital repayments.

Notes to the consolidated financial statements continued

For the year ended 31 December 2018

30. 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 or has committed to fund or partially fund costs within the associated development programme. 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.

Accruals of £1.1m (2017: £nil) for costs associated with completion of the VR475 clinical trial and clinical study report have been recognised to the extent that they can be reliably measured or have been communicated by the outsourced clinical research organisation (CRO). Additional future costs may arise upon the final reconciliation by the CRO, expected to occur in Q2 2019, although these are not expected to be of a magnitude that would represent a significant risk of material change to next year's financial statements.

The Group has an uncertain tax provision. Should any challenge from the relevant tax authority arise, it is possible that penalties (between 0 and 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 (2017: £1.0m) 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.

The Group's licensing agreements with partners typically include the right to audit partner royalty statements. Audits are undertaken periodically and their conclusion can result in reimbursement of royalties paid to Vectura, additional royalties payable to Vectura or no changes to historical royalty statements. One royalty review is currently in progress.

31. Significant accounting policies

31.1 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 2018.

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 de-consolidated 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.

31.2 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 customer contract assets (trade receivables and accrued royalty revenues) denominated in a foreign currency where foreign exchange is presented within net finance (expense)/income.

31. Significant accounting policies continued

31.3 Revenue from contracts with customers

Revenue is measured at the fair value of the consideration which is expected to be received in exchange for the goods and services provided, net of applicable taxes.

The Group has initially applied IFRS 15 from 1 January 2018. Information about the transitional impact of IFRS 15 is described in note 32 "IFRS 15 – Revenue from Contracts with Customers".

The Group presents revenues as follows:

Revenue is measured at the fair value of the consideration which is expected to be received in exchange for the goods and services provided, net of applicable taxes. In accordance with IFRS 15, the Group recognises revenue through application of the five-step model as follows:

- the Group identifies a contract with a customer;
- the performance obligations within this contract has been identified;
- the transactions price has been determined;
- this transaction price has been allocated to the performance obligations in the contract; and
- revenue is recognised as or when each performance obligation is satisfied.

Product supply revenues

The Group generates revenues from the supply of finished or semi-finished products, largely manufactured by third-party suppliers, to commercial distribution partners. Revenue is recognised when the customer gains control of the goods which is when the performance obligation is satisfied.

Royalties and other marketed revenues

Where a licence of intellectual property is the predominant item to which a royalty relates, then revenues are recognised upon the occurrence of partner net sales.

Other marketed revenues primarily include sales or usage-based milestones for which revenue is recognised consistently with royalties as stated above.

Development revenues

Revenues related to development stage programmes are allocated to the following performance obligations as applicable:

(a) Licence to the Group's intellectual property

A licence granted by the Group usually provides the partner with a right-to-use, but not to own, the IP related to a development that has not yet received regulatory approval as it exists at contract inception. A licence is capable of being distinct from development services if, regardless of contractual terms, it could be sold separately as it exists at the point in time it was granted.

The timing of revenue recognised from a licence of intellectual property depends on whether:

- the licence is capable of being distinct (i.e. could be sold separately as it exists at the point in time it was granted). In this case revenue is recognised when control is transferred, normally at contract inception; or
- the licence is not capable of being distinct and therefore, the customer cannot benefit from the value of purchasing it without the provision of additional services from Vectura. In this instance, revenue is recognised as those services accrue.

(b) Development services

Revenue from a contract to provide development services is recognised by reference to the stage of completion of the contract. Stage of completion is estimated by either completion of relevant milestones or proportion of estimated hours for work performed to date, as appropriate.

31.4 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.

31.5 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 are normally charged to the Consolidated income statement as the expenses are incurred.

Notes to the consolidated financial statements continued

For the year ended 31 December 2018

31. Significant accounting policies continued

31.6 Other operating income

Other income relates to government grants for qualifying R&D and customer contributions for contributions to property, plant and equipment required for the supply chain process.

The Government grants recognised in other income relate to qualifying UK R&D under the research and development expenditure credit (RDEC) scheme for large companies and the French R&D tax credit regime. Such grants are taxable and are presented as other income in the Consolidated income statement.

31.7 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.

31.8 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.

31.9 Earnings per share

Basic loss per share amounts are calculated by dividing the loss after taxation of the Group by the weighted average number of shares outstanding during the year.

31.10 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.

31.11 Intangible assets

Intangible assets predominately 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 acquired separately through the Activaero transaction on 13 March 2014. These assets are amortised in line with the expected consumption of economic benefits.

UEL assumptions do not exceed six years and amortisation is applied on a straight-line basis.

31.12 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.

31.13 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 years.

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.

31.14 Inventory

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.

31. Significant accounting policies continued

31.15 Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits. Bank overdrafts that are repayable on demand, if used, form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose only of the cash flow statement.

31.16 Financial instruments

IFRS 9 – Financial Instruments became effective for years starting on or after 1 January 2018; however, the Group chose to early adopt the standard on 1 January 2017 and therefore no transitional disclosure is included in these consolidated financial statements. The adoption of IFRS 9 had no material impact on the Group's financial statements. Refer to note 26 of the Annual Report and Accounts 2017.

For the purposes of recognition and measurement, financial assets are classified into one of the following 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 (FVOCI).

In instances where the financial assets meet 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.

31.17 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.

31.18 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.

31.19 Share-based payments

The Group operates a number of employee equity-settled share-based compensation plans as part of its 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 are 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.

31.20 Employee share trusts

The Group provides finance to Employee Share Ownership Plan (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.

31.21 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 is booked to retained earnings.

Notes to the consolidated financial statements continued

For the year ended 31 December 2018

32. IFRS 15 – Revenue from Contracts with Customers

Vectura adopted IFRS 15 – Revenue from Contracts with Customers with effect from 1 January 2018. The new standard specifies a comprehensive five-step, principal-based framework to the recognition of revenue generated through customer contracts replacing IAS 18 – Revenue and related supplementary IFRS guidance.

The Group should recognise revenue when it transfers goods or services to a customer. The amount of revenue recognised should represent the consideration for goods and services performed at the date of each reporting period to which the Group expects to become entitled.

There has been no impact on revenue recognition for product supply, royalty and other marketed revenues or for development revenues except those containing more than one performance obligation which is the case for VR2081 as described below.

The Group's collaborative agreements tend to have multiple performance obligations. IFRS 15 is therefore expected to impact future collaborative agreements which the Group may enter into as they will typically include a licence to the Group's intellectual property and development services. Judgement will be required to assess whether the licence is capable of being distinct and therefore whether it represents a separate performance obligation. Where this is the case, an amount of any upfront payment on contract inception will be allocated to the licence and is recognised based on standalone selling prices, whereas previously, under IAS 18, the upfront payment would have been spread over the life of Vectura's development obligations. In addition, certain development phase milestones will be recognised on the basis of progression towards, and the level of certainty over, the achievement of a milestone, as opposed to only once a milestone has been achieved, as would have been the case under IAS 18.

Transitional cumulative effect adjustment at 1 January 2018

The Group has initially applied IFRS 15 using the cumulative effect method. Under this method, the comparative information is not restated, but £0.3m of deferred income from VR2081 was released to retained losses net of related taxes.

The Group has applied IFRS 15 using the practical expedient to apply the new rules only to contracts that were not completed as at the start of 2018. As such, IFRS 15 has been applied to collaborative developments entered into since the start of the comparative period presented as described below.

VR2081 – £1.3m (2017: £1.1m)

A $5.0m upfront milestone from Sandoz was received in 2017 relating to the VR2081 programme. This milestone plus the following two contractual development milestones of $1.0m each, are deemed highly probable and therefore are being recognised as development work progresses on a percentage of completion basis. Revenues from ongoing development work in 2019 are expected to be around £2.0m. As the licence was not considered distinct, there is only one performance obligation.

33. Operating leases and the future impact of IFRS 16 – Leases applied from 1 January 2019

The Group is required to apply IFRS 16 – Leases from the mandatory transitional date 1 January 2019.

IFRS 16 has not been applied to the 2018 financial results and instead this disclosure note explains the impact of adoption on future reporting periods. Historically, the Group has only entered into material leases relating to commercial properties at the main UK operational sites.

Currently under IAS 17, because the risk and rewards of property ownership revert to the landlord at the end of the lease term, the lease is classified as an operating lease with annual rental and service charges recognised in the consolidated income statement on an accruals basis over the lease term and nothing is recognised on the balance sheet.

Payments for property leases for the Group's premises located at Chippenham, Cambridge Science Park and Grosvenor Gardens, London, were as follows:

	31 December 2018 £m	31 December 2017 £m
Within one year	**1.1**	1.1
Between two and five years	**3.5**	2.9
Over five years	**2.1**	2.6
Total operating lease commitments	**6.7**	6.6

Following the announcement to close the Gauting site, the Group's facilities requirements have been reviewed. As a result, operating leases have been extended further.

Future IFRS 16 Leases accounting policy applied from 1 January 2019

At inception of a contract, the Group assesses whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

To assess whether a contract conveys the right to control the use of an identified asset, the Group assesses whether: an identified physically distinct asset can be identified; the Group has the right to obtain substantially all of the economic benefits from the asset throughout the period of use; and has the ability to direct the use of the asset over the lease term being able to restrict the usage of third parties as applicable.

33. Operating leases and the future impact of IFRS 16 – Leases applied from 1 January 2019 continued

The modified retrospective approach to transition

Under the modified retrospective approach, the Group will apply IFRS 16 from the beginning of 2019, calculating lease assets and liabilities as at the beginning of 2019 as follows:

Lease liabilities will be measured at the present value of the remaining lease payments, discounted at an applicable incremental borrowing rate, which will be obtained from a financial institution privy to the facts, circumstances, location, security and term of each lease liability. This rate is likely to range between 2% and 3%.

Non-lease service charges will be combined into property leases, which will be treated as a single lease component. The effective interest method will be used for calculating the amortised cost of a finance lease and allocating interest income over the relevant period on a lease by lease basis.

Under IFRS 16, liabilities for future periods that can be cancelled by exercising a break clause will not be included in the lease liability unless it is reasonably certain at the reporting date that the Group will extend the committed lease term and not exercise the break clause.

It is likely that judgements relating to the lease term will, in future, represent a critical accounting judgement as changes to these assumptions would materially impact the balance sheet asset and liabilities recognised.

Right-of-use assets will be measured at an amount equal to the lease liability, except where there is considered to be a significant difference between the lease liability and the asset value calculated as though IFRS 16 had always been applied.

Practical expedients on transition

The Group will use the following practical expedients when applying IFRS 16 to leases previously classified as operating leases under IAS 17:

- use the transitional discount rate as if it had always applied in the past;
- use hindsight when determining the lease term which previously contained renewal options;
- exclude initial direct costs from measuring the right-of-use asset at the date of initial application; and
- adjust the right-of-use assets by the amount of IAS 37 onerous contract provisions immediately before the date of initial application, as an alternative to an impairment review.

The exemption not to recognise right-of-use assets and liabilities for leases with less than twelve months of lease term on the transition date will be utilised in respect of the six-month rolling lease in Germany and hence €56k per annum will continue to be charged to the consolidated income statement as rent on an accruals basis.

The definition of a lease under IFRS 16 will only be applied to contracts entered into or changed on or after 1 January 2019. The practical expedient to grandfather the assessment of which transactions are leases will be taken such that IFRS 16 will only apply to contracts previously identified as leases. Contracts not considered as leases under IAS 17 will not be reassessed, albeit all material supplier service arrangements will be reviewed to ensure all material assets that contain embedded leases are captured.

Cumulative adjustment to retained earnings as at 1 January 2019

The Group will not restate 2018 financial information and will recognise the cumulative effect adjustment in equity on transition using the modified retrospective approach as detailed following the table below:

Transitional adjustment as at 1 January 2019	Property £m
Right-of-use assets	3.3
Discounted lease liabilities*	(3.7)
Cumulative adjustment to retained earnings	(0.4)

* Rental prepayments of £0.2m and an onerous contract provision of £1.0m will also be reclassified into the lease liability.

The following table summarises the impacts of adopting IFRS 16 on the Group's opening consolidated balance sheet as at 1 January 2019:

	As reported 31 December 2018 £m	Transitional adjustments £m	Opening balance 1 January 2019 £m
Property, plant and equipment	57.8	3.3	61.1
Prepayments and other receivables	6.3	(0.2)	6.1
Provisions	(10.9)	1.0	(9.9)
Finance lease liabilities	—	(4.5)	(4.5)
Net assets and retained earnings	494.3	(0.4)	493.9

Notes to the consolidated financial statements continued

For the year ended 31 December 2018

34. IFRIC 23 – Uncertainty over Income Tax Treatments as at 1 January 2019

IFRIC 23 has been issued to clarify the accounting for uncertainty within tax positions, and provides two methods for measurement. Where the outcome is considered binary, the "most likely amount" is applied, but where the results could be within a range, the "expected value method" (which considers the weighted average of possible outcomes) should be applied. The Group holds one uncertain tax position, and due to the binary nature of an outcome, the method adopted under IFRIC 23 is the most likely amount. As a result, the Group expects no change the recognition of the uncertain tax position under the new standard to be adopted from 1 January 2019.

35. Related-party transactions

Associates

In August 2018, the Group paid a final instalment of £150,000 to a German supplier on confirmation that a new Clickhaler® and Duohaler® cap filling and assembly line has received formal factory acceptance testing clearance and has been shipped to the Group's Chinese associate.

Remuneration of key management personnel

The remuneration of the Directors, who are the key management personnel of the Group, was £2.4m and is set out below:

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Short-term employee benefits	**0.8**	1.0
Annual incentive plan	**0.7**	0.7
Non-Executive Directors' fees	**0.5**	0.4
Post-employment benefits	**0.1**	0.2
Other	**0.3**	0.3
Total remuneration of key management personnel	**2.4**	2.6

Please refer to the Remuneration report for the remuneration of each Director.

Company balance sheet

As at 31 December 2018

	Note	2018 £m	2017 (Restated)* £m
ASSETS			
Non-current assets			
Investments in subsidiary undertakings	4	**541.5**	710.8
Current assets			
Amounts due from subsidiary undertakings		**11.5**	6.0
Cash and cash equivalents		**0.1**	13.8
Total current assets		**11.6**	19.8
Total assets and net assets		**553.1**	730.6
SHAREHOLDERS' EQUITY			
Share capital	5	**0.2**	0.2
Share premium		**61.6**	61.5*
Share-based payment reserve		**8.3**	8.4
Merger reserve	6	**441.0**	593.0*
Retained earnings		**42.0**	67.5
Total shareholders' equity		**553.1**	730.6

* Reserves were restated to reduce share premium and increase merger reserves by £41.3m to correct share premium recognised on the acquisition of Activaero in 2014 in accordance with s610 of the Companies Act. The restated merger reserves were subsequently utilised in full and as a result no longer remains. Refer to note 5 and note 6.

Company registered number: 03418970.

The accompanying notes form an integral part of these individual financial statements.

The Company financial statements of Vectura Group plc were approved and authorised for issue by the Board of Directors on 25 March 2019 and were signed on its behalf by:

J Ward-Lilley
Director

P Fry
Director

Company statement of changes in equity

For the year ended 31 December 2018

	Share capital £m	Share premium £m	Merger reserve £m	Share-based payment reserve £m	Retained earnings £m	Total equity £m
At 31 December 2016 as previously reported	0.2	102.3	551.7	5.8	53.3	713.3
Share premium restatement*	—	(41.3)	41.3	—	—	—
At 31 December 2016 restated	0.2	61.0	593.0	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**	**61.5**	**593.0**	**8.4**	**67.5**	**730.6**
Loss for the year (note 2)	—	—	—	—	(167.1)	(167.1)
Share-based payments	—	—	—	3.7	—	3.7
Employee share transactions	—	0.1	—	(3.8)	3.4	(0.3)
Share buyback and cancellation programme	—	—	—	—	(13.8)	(13.8)
Release of special reserves	—	—	(8.2)	—	8.2	—
Merger reserve release	—	—	(143.8)	—	143.8	—
At 31 December 2018	**0.2**	**61.6**	**441.0**	**8.3**	**42.0**	**553.1**

* Reserves were restated to reduce share premium and increase merger reserves by £41.3m to correct share premium recognised on the acquisition of Activaero in 2014 in accordance with s610 of the Companies Act. Refer to note 27 of the consolidated financial statements.

The loss for the year ended 31 December 2018 was £167.1m inclusive of £31.2m of dividend income (2017: profit of £16.1m including of £29.0m of dividend income).

The accompanying notes form an integral part of these Company financial statements prepared under FRS 101 – Reduced Disclosure Framework.

Notes to the Company financial statements

For the year ended 31 December 2018

1. Presentation of the financial statements

1.1 Critical accounting areas of judgement 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. The carrying value of investments is compared to their recoverable amounts which are assessed with reference to the discounted cash flow forecasts associated with these territories. This is including their products, research and development programmes, technologies and intellectual property.

As reported in 2017, 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. Whilst the VR647 phase II outcome was positive, it was decided that the Group would not pursue VR475 (FAVOLIR®) following the Phase III results and, as such, the German investment has been impaired by £96.8m. Refer to note 4.

The carrying value of the Swiss and US investment has also been assessed. Notwithstanding strong current year and forecasted *flutiform*® performance, the impacts from an increased discount rate of 9% (2017: 8%) and a lower final year cash flow used for the calculation of the *flutiform*® terminal value, as well as lower forecasted cash flows for VR2081, have together resulted in a provision for impairment of £102.5m (2017: £nil).

As the Swiss and US investment has been impaired to the recoverable amount, any further reduction in value will cause impairment. Should the recoverable amount increase, for example if factors arose supporting a reduction in the discount rate, the provision for impairment would be reversed. This area therefore remains a critical accounting estimate.

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 (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 FRS 101 – Reduced Disclosure Framework and with UK accounting presentation and the Companies Act 2006 as at 31 December 2018, with comparative figures as at 31 December 2017.

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 loss for the year ended 31 December 2018 was £167.1m inclusive of £31.2m of dividend income (2017: profit of £16.1m inclusive of £29.0m of dividend income).

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. 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 available merger reserves. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through the Company income statement.

Notes to the Company financial statements continued

For the year ended 31 December 2018

3. Dividend income

The Company received dividend income from subsidiary undertakings totalling £31.2m (2017: £29.0m). The dividend was settled for cash and no amounts remain outstanding.

4. Investments in subsidiary undertakings

Subsidiary undertakings	UK subsidiaries £m	German subsidiaries £m	Swiss & US subsidiaries £m	Total £m
At 31 December 2017	125.6	108.7	476.5	710.8
Additions – capital contributions	22.0	8.0	—	30.0
Provision for impairment	—	(96.8)	(102.5)	(199.3)
At 31 December 2018	**147.6**	**19.9**	**374.0**	**541.5**

Following the Phase III clinical trial results of VR475, and the decision not to pursue further development, the carrying value of the German investment has been impaired to reflect the carrying value of VR647, the remaining asset in Germany. In addition, mainly as a result of an increased discount rate, the Swiss and US investments have been impaired to their recoverable amounts. Refer to note 1.

Dividend income of £31.2m (2017: £29.0m) originating from Switzerland, the licence holder of *flutiform*®, was immediately contributed to fund the operations of the UK and German investments. Capital contributions of £30.0m (and was therefore an unrealised profit within the profit and loss) were made after settlement of a £1.2m intra-Group payable.

The sensitivity of the Swiss and US investment to the potential outcomes of the UK existing the EU ("Brexit") has been considered. A range of sensitivities have been modelled from minimal disruption to the *flutiform*® supply chain to severe but still reasonably possible disruption such that partner and patient demand cannot be satisfied. The sensitivities also consider an increase in operating costs from adverse regulatory changes. Details relating to the key assumptions and determination of these assumptions is provided in Note 14 of the Group's consolidated financial statements. The impact of these sensitivities range from no further impairment to an additional impairment of £121.3m in the most severe but reasonably plausible case.

Should the recoverable amount of the Swiss and US investment increase, for example if factors arose supporting a reduction in the discount rate, the provision for impairment in 2018 would be reversed. This area therefore remains a critical estimate.

5. Share capital

Allotted, called up and fully paid	£m	Number of shares
Ordinary shares of 0.025p, each at 31 December 2017	0.2	678,508,698
Issued to satisfy Vectura employee share plans	—	1,561,183
Share buyback programme	—	(14,682,736)
Ordinary shares of 0.025p each at 31 December 2018	**0.2**	**665,387,145**

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.

Following completion of the share buyback programme, a review of the Vectura Group plc's distributable reserves was performed. It was identified that shares issued on 13 March 2014 with a market value of £41.3m, as part consideration for the Activaero acquisition, were incorrectly recorded in non-distributable share premium rather than as a merger reserve.

6. 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.

The share premium of £41.3m should have been recognised as a separate reserve, usually referred to as a merger reserve, and therefore this amount has been reclassified in the comparative year as a restatement. These merger reserves are initially non-distributable, but became distributable in November 2018 following impairment of the German investment and application of merger relief. See Statement of changes in equity for full details.

7. 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, to a maximum consideration of £15.0m completed by the end of February 2018.

During the completion of the buyback, 14,682,736 were repurchased at a weighted average price of 93p per share, being a total of £13.6m of capital returned to shareholders in 2018.

At 31 December 2017 1,422,503 shares had been repurchased at a weighted average price of 95p per share. A total of £1.34m had been returned to shareholders by the year ended 31 December 2017.

Dividend policy

Vectura has not paid dividends in the past and is not proposing one for the year ended 31 December 2018. 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.

Notes to the Company financial statements continued

For the year ended 31 December 2018

8. Other statutory information

In accordance with section 409 of the Companies Act 2006 a full list of subsidiaries and associates, the country of incorporation and the effective percentage of equity owned at 31 December 2018 are disclosed below. Unless otherwise stated the share capital disclosed comprises ordinary shares which are indirectly held by Vectura Group plc.

All subsidiary companies are resident for tax purposes in their country of incorporation unless otherwise stated.

	Country/region of incorporation	Ordinary shareholding	
Vectura Limited	United Kingdom	100%	One Prospect West, Chippenham, Wiltshire SN14 6FH
Innovata Limited	United Kingdom	100%	One Prospect West, Chippenham, Wiltshire SN14 6FH
Vectura Delivery Devices Limited	United Kingdom	100%	One Prospect West, Chippenham, Wiltshire SN14 6FH
Innovata Biomed Limited	United Kingdom	100%	2nd Floor North, Saltire Court, 20 Castle Terrace, Edinburgh EH1 2EN
Quadrant Drug Delivery Limited	United Kingdom	100%	One Prospect West, Chippenham, Wiltshire SN14 6FH
Vectura Group Services Limited*	United Kingdom	100%	46–48 Grosvenor Gardens, London SW1W 0EB
Vectura Group Investments Limited*	United Kingdom	100%	One Prospect West, Chippenham, Wiltshire SN14 6FH
Jagotec AG	Switzerland	100%	Eptingerstrasse 61, 4132 Muttenz, Switzerland
Skyepharma AG	Switzerland	100%	Eptingerstrasse 61, 4132 Muttenz, Switzerland
Skyepharma Holding AG	Switzerland	100%	Treuhand AG, Chollerstrasse 3, 6300 Zug, Switzerland
Skyepharma Production SAS	France	100%	38291 Saint-Quentin-Fallavier, France
Vectura Inc*	United States	100%	20 William Street, Suite 130, Wellesley, MA 02481, USA
Vectura Ireland Limited	Republic of Ireland	100%	The Brickhouse, Clanwilliam Court, Block 1, Lower Mount Street, Dublin 2, D02 CF97
Skyepharma Holding Inc	United States	100%	1209 Orange Street, Wilmington, New Castle, DE 19801, USA
Skyepharma US Inc	United States	100%	2711 Centerville Road, Suite 400, Wilmington, DE 19808, USA
Vectura GmbH*	Germany	100%	Robert-Koch-Allee 29, 82131 Gauting, Germany
Ventaleon GmbH	Germany	30.66%	Wohraer Str. 37, 35285, Gemünden/Wohra, Germany
Innovata HK Limited	Hong Kong	82.35%	Unit 1802, 79 Lei Muk Road, Kwai Chung, N.T., Hong Kong
Tianjin Kinnovata Pharmaceutical Co. Ltd	China	45.95%	Eleventh Street, Tianjin Economic-Technological Development PRC
Quadrant Healthcare Limited	United Kingdom	100%	One Prospect West, Chippenham, Wiltshire SN14 6FH
Quadrant Technologies Limited	United Kingdom	100%	One Prospect West, Chippenham, Wiltshire SN14 6FH
Vine Exhibition Limited	United Kingdom	100%	46–48 Grosvenor Gardens, London SW1W 0EB
Vine Northern Limited	United Kingdom	100%	46–48 Grosvenor Gardens, London SW1W 0EB
QDose Limited	United Kingdom	50%	One Prospect West, Chippenham, Wiltshire SN14 6FH
Krypton Limited	Gibraltar	100%	19 Town Range, Gibraltar
Skyepharma Management AG	Switzerland	100%	Eptingerstrasse 61, 4132 Muttenz, Switzerland
Genta Jago Technologies B.V.	Netherlands	50%	Herikerbergweg 238, 1101 CM Amsterdam, Netherlands

* Directly held by the Company.

Glossary

The following abbreviations are used throughout these financial statements

CGU	Cash-generating unit
EBITDA	Earnings before interest, tax, depreciation and amortisation
EPS	Earnings per share
FVOCI	Fair value through other comprehensive income
FVTPL	Fair value through profit or loss
Notes	Notes to the consolidated financial statements
OCI	Other comprehensive income
IAS 1	Presentation of Financial Statements
IAS 7	Statement of Cash Flows
IAS 16	Property, Plant and Equipment
IAS 17	Leases (superseded in 2019)
IAS 18	Revenue (superseded in 2018)
IAS 19	Employee Benefits
IAS 21	The Effects of Changes in Foreign Exchange Rates
IAS 28	Investments in Associates and Joint Ventures
IAS 33	Earnings per Share
IAS 36	Impairment of Non-Current Assets
IAS 37	Provisions, Contingent Liabilities and Contingent Assets
IAS 38	Intangible Assets
IFRIC 23	Uncertainty over Income Tax Treatments
IFRS 2	Share-based Payments
IFRS 3	Business Combinations
IFRS 9	Financial Instruments
IFRS 15	Revenue from Contracts with Customers
IFRS 16	Leases

Shareholder information

Directors

Bruno Angelici
Non-Executive Chairman

James Ward-Lilley
Chief Executive Officer

Paul Fry
Chief Financial Officer

Susan Foden
Non-Executive Director and
Senior Independent Director

Neil Warner
Non-Executive Director

Per-Olof Andersson
Non-Executive Director

Thomas Werner
Non-Executive Director

Juliet Thompson
Non-Executive Director

Anne Whitaker
Non-Executive Director

Company Secretary

John Murphy

Corporate broker

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25 Bank Street
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Corporate broker

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BS99 7NH, UK

Auditor

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15 Canada Square
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E14 5GL, UK

Bankers

Barclays Bank plc
1 Churchill Place
Canary Wharf
London
E14 5HP, UK

Legal advisors

Clifford Chance
10 Upper Bank Street
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E14 5JJ, UK

Vectura Group plc

(Registered office)
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SN14 6FH, UK

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FOX®, AKITA®and FAVOLIR® are registered trade marks of Vectura GmbH.
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This Annual Report and Accounts contains forward-looking statements, including statements about the discovery, development and commercialisation of products. There can be no assurance that such forward-looking statements will prove to be accurate, as future events could differ significantly from those anticipated in such statements. 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. Nothing in this Annual Report and Accounts should be construed as a profit forecast.

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