Vectura Group plc

2017 Preliminary Results

- Performance in-line with expectations, with strong in-market growth from key inhaled products -

Chippenham, UK - 21 March 2018: Vectura Group plc (LSE: VEC) ("Vectura", "the Group", "the Company"), an industry-leading inhaled product formulation, device design and development business, today announces its preliminary results for the year ended 31 December 2017.

Financial highlights

- Full year reported revenue of £148.0 million, in line with Board expectations (reported 9m 2016: £126.5 million)
    - 2016 full-year proforma[1,2] revenue was £183.6 million. 2017 reported revenue was lower due to reduced revenues from non-recurring sources[3] of £16.6 million in 2017 compared to £57.3 million in the 2016 proforma
    - 2017 underlying[2,4] revenue was £131.4 million; +4.0% driven by the Group's key-inhaled products
    - 2017 underlying revenue from *flutiform*®, Ultibro® and Seebri® Breezhaler® +5.4% to £85.8 million
        - Strong annual in-market net sales growth from key products: *flutiform*® +11.8% (CER) and Ultibro® Breezhaler® +20.6% (CER)[5,6]
        - Group reported revenue growth was moderated compared to in-market sales growth by previously-reported destocking in *flutiform*® and Ultibro® Breezhaler® supply chains, which had no impact on in-market sales momentum
- IFRS-reported operating loss of £96.2 million, due to the impact of a full year, non-cash charge for amortisation and impairment of intangible assets of £109.7 million, arising from prior acquisitions (9m 2016: £44.5 million operating loss and £64.0 million amortisation charge)
    - Adjusted EBITDA[2,7] was ahead of expectations at £25.8 million profit (reported 9m 2016: £34.1 million profit), driven by in-line revenue performance, delivery of merger synergy savings and tight R&D cost management. R&D costs of £60.3 million were at the lower end of the guidance range (reported 9m 2016: £45.6 million)
    - The reduction in adjusted EBITDA versus reported 9m 2016 reflects a full year of R&D costs in 2017
- Ongoing disciplined capital allocation and working capital management delivered strong operating cash inflows and the Group ended the year with a closing cash balance of £103.7 million (31 December 2016: £92.5 million)

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

[2] This press release includes certain non-IFRS measures, including full-year comparative financial information, underlying financial information and adjusted EBITDA. Reconciliation of these measures to their most directly comparable IFRS measures is provided in the Financial Review

[3] Non-recurring sources of revenue comprises milestones, development services and non-recurring royalties from ADVATE® and GSK Ellipta® products. Refer to the Financial Review for further information

[4] Underlying revenues exclude the impact of licensing milestones and development services revenues, which can vary materially from period to period, and also exclude material royalties that are not recurring as a result of patent expiry or legal dispute. A reconciliation of reported and proforma full-year financial information to underlying financial information is provided in the Financial Review

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

[6] Constant currency (CER) removes the effects of currency movements from the percentage growth rate quoted. Constant currency figures are taken either from partner announcements or from IQVIA data and are not calculated by the Company

[7] Adjusted EBITDA is defined as operating loss adding back amortisation and impairment, depreciation, share-based payments and exceptional items

Operational highlights

Refocused pipeline investment with progression of key priority programmes

- **Inhaled generics**
  - Two major new generics programmes added to the pipeline (VR2081 and VR410), with the potential for development of additional combination therapy (LAMA/LABA)
  - Following FDA interactions, Vectura is progressing the development of its Open-Inhale-Close device which has the potential to be an AB-rated substitutable generic drug-device combination for the GSK Ellipta® portfolio. This is a significant opportunity, with analyst projections of global net sales of the Ellipta® products of approximately $6 billion by 2023[8]. Pharmaceutical development has commenced, in parallel with partnering discussions
  - Post period update – Following the FDA rejection of CRL dispute resolution process, Hikma confirmed the enrolment of the first patients in a repeat clinical programme for VR315 (US) will take place in the coming weeks. Potential approval and launch during 2020
- **Vectura enhanced therapies utilising our proprietary smart nebulisation technology**
  - Lead programmes, VR475 (EU) Phase III and VR647 (US) Phase II, progressing well with potential extension of portfolio under assessment following technology validation from Breelib™ EU approval and launch

Tight financial management with R&D and capital allocation discipline

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

Outlook

With continuing strong in-market product performance, together with delivery of synergy savings and Operational Excellence benefits, the Board maintains its 2018 revenue growth expectations and reiterates its previously-reduced R&D investment guidance range of £55 million to £65 million for the year.

James Ward-Lilley, Chief Executive Officer of Vectura:

"It has been an important year of progress for Vectura. We have delivered a good set of financial results, in line with market expectations, and our key partnered inhaled products, *flutiform*® and Ultibro® Breezhaler®, have continued to show strong in-market growth. Notwithstanding the disappointing delays we have seen for our VR315 (US) generic Advair® programme, we continue to see substantial value in the development of complex inhaled generics. In light of this, we have extended our valuable inhaled generics portfolio. In addition, we have also progressed our enhanced therapy pipeline and fully delivered our merger integration plans.

Our refocused investment strategy, announced in January 2018, is underpinned by a strong core business, tight financial discipline and a skilled workforce. We are committed to fully leveraging the capabilities and technologies that differentiate us to maximise the value of our pipeline at a substantially lower cost and relative risk. We have clearly defined priorities and we look forward to a series of significant news flow catalysts during 2018."

[8] Global Data, extracted Q4 2017

Analyst briefing

James Ward-Lilley, Chief Executive Officer, and Andrew Derodra, Chief Financial Officer, will present the Preliminary Results for analysts today at 9.30am to 10.30am GMT. The presentation will be held at the offices of Numis Securities Ltd., 10 Paternoster Square, London, EC4M 7LT. There will be a simultaneous live conference call.

Dial-in details are:

Participant local dial-in:	+44 (0)330 336 9105
Participant free phone dial-in:	0800 358 6377
Participant code:	7882963

A live webcast of the meeting and the presentation slides, will be available on Vectura's website:
http://www.vectura.com/investors/presentations-webcasts/

- Ends -

Enquiries

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Forward-looking statements

This press release contains forward-looking statements, including statements about the discovery, development and commercialisation of products. Various risks may cause Vectura's actual results to differ materially from those expressed or implied by the forward-looking statements, including: adverse results in clinical development programmes; failure to obtain patent protection for inventions; commercial limitations imposed by patents owned or controlled by third parties; dependence upon strategic alliance partners to develop and commercialise products and services; difficulties or delays in obtaining regulatory approvals to market products and services resulting from development efforts; the requirement for substantial funding to conduct research and development and to expand commercialisation activities; and product initiatives by competitors. As a result of these factors, prospective investors are cautioned not to rely on any forward-looking statements. We disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

About Vectura

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 has eight key inhaled, two non-inhaled and ten oral products marketed by partners with growing global royalty streams, and a diverse partnered portfolio of drugs in clinical development. Our partners include Hikma, Novartis, Sandoz, Mundipharma, Kyorin, Baxter, GSK, UCB, Ablynx, Bayer, Chiesi, Almirall, Janssen, Dynavax and Tianjin KingYork.

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

For further information, please visit Vectura's website at www.vectura.com.

Operational Review

Continued growth across key inhaled in-market products

Vectura has a portfolio of revenue-generating partnered products, including eight key inhaled products (*flutiform*®, Seebri®/Ultibro® Breezhaler®, AirFluSal® Forspiro®, the three GSK Ellipta® products and Breelib™). As set out in the table below, the Group earns royalties on the in-market sales of seven of these products and also earns significant revenues from the supply of *flutiform*® to its partners Mundipharma and Kyorin. During the twelve-months ended 31 December 2017, the Group earned 75.0% of its total underlying revenues from these products (2016 proforma underlying: 75.5%). All of these products were launched within the last six-years and together generated in excess of $2.8 billion in-market net sales in the twelve-months to 31 December 2017 (Twelve-months to 31 December 2016: in excess of $2.0 billion)[9].

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

flutiform®

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

flutiform® continued to perform strongly and in-market net sales for the twelve-month period ended 31 December 2017 grew by 11.8% (CER) to €206.2 million[5], generating total underlying product supply and royalty revenue for the Group of £68.5 million (2016 proforma underlying: £65.8 million). Revenues earned by the Group grew at a rate below

[9] Internal calculations based upon royalty reports received from partners. Rolling twelve-months sales for the period ended 31 December 2017, compared to the rolling twelve-months sales for the period ended 31 December 2016

the rate of in-market sales growth, impacted by the previously-reported destocking in the supply chain during H2 2017, driven by partner working capital demand which is independent of in-market sales growth.

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

flutiform® (**Mundipharma**, **Europe & ROW (excluding North America and Japan))**
flutiform® continued to perform well, growing 5.0% (CER) in value[5] terms in a challenging and competitive European market ICS/LABA market which declined by 3.2%, and achieved a slight increase in market value share to 3.6%.[10]

Net sales in Rest of World territories were €15.3 million, up 32.5% (CER), and now contribute over 7% of total *flutiform*® net sales.[5]

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

flutiform® **(Kyorin, Japan)**
Japanese sales of *flutiform*® now account for 37.1% of total in-market *flutiform*® net sales in 2017 and Kyorin continues to drive success in a dynamic market, delivering a 19.8% (CER) increase in value year-on-year[5] and an increased value market share from 9.9% to 11.5%.[10] Overall, the ICS/LABA market in Japan continued to grow in value terms, up 1.2% in year-on-year.[10]

During 2017, Kyorin commenced a paediatric Phase III clinical trial to expand the indication of *flutiform*®. Kyorin has estimated that there are 2.6 million children between the ages of 5 and 14 who suffer from asthma in Japan.[11]

flutiform® **breath-triggered (Mundipharma),** an inhaled anti-inflammatory (ICS) and bronchodilator (LABA) combination therapy for the treatment of asthma in adults and adolescents (aged 12 years and older). Mundipharma's *k-haler*® is an aerosol device with a breath-triggered mechanism, activated with a low inspiratory force, which is designed to make it easier for patients to use correctly.

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

k-haler® is a registered trademark of Mundipharma.

Ultibro® Breezhaler® and Seebri® Breezhaler®

[10] IQVIA Q4 2017

[11] As reported by Kyorin

Ultibro® Breezhaler® and Seebri® Breezhaler® are now established and substantial products outside the US. In January 2018, Novartis reported 2017 combined net sales of $562 million (2016 combined net sales: $512 million)[12] and Vectura recognised £17.3 million of total royalties for sales of these products (2016 proforma underlying: £15.6 million).

The products are marketed by Novartis in the EU & ROW (excluding US) and during 2017 the products were launched in the US, marketed by Novartis' sub-licensing partner Sunovion. The US products are twice-daily dosed products marketed as Utibron™ Neohaler® and Seebri™ Neohaler®. Novartis is responsible for the manufacture of the products for Sunovion.

Ultibro® Breezhaler® (Novartis, Europe & ROW (excluding US)), *(indacaterol/glycopyrronium bromide, QVA149)* is a first-in-class once-daily fixed dose inhaled dual bronchodilator (LAMA/LABA) indicated as a maintenance bronchodilator treatment to relieve the symptoms of adult patients with COPD.

The product is now approved in over 100 countries including Japan, Europe and China (approved December 2017). Novartis reported net sales growth of 12.0% (CER) on an annual basis.[12] This growth rate was impacted by destocking in certain territories. Novartis reported Q4 net sales growth of 26.0% (CER)[12]. IMS data shows strong regional growth in Europe of 18.6% (CER) which accounts for 76.3% of total IMS reported in-market sales in 2017.[5]

This growth was fuelled by positive results from the FLAME[13] study and GOLD[14] changes, which recommend LAMA/LABA as a treatment option in the majority of symptomatic patients regardless of their exacerbation risk. This was further reinforced by new data published by Novartis from the FLASH[15] study, which demonstrated significantly improved lung function in COPD patients after a direct switch from Seretide®.

In February 2018, data from Novartis' CLAIM study was published in the Lancet Respiratory Medicine, which showed Ultibro® Breezhaler® provided significant improvements in cardiac and lung function in COPD patients with lung hyperinflation, compared to placebo. Many people living with COPD are at increased risk of death and disability due to comorbid cardiovascular disease[16]. Lung hyperinflation is common in people with COPD[17], and has been linked to impaired cardiac function and a worsening of COPD symptoms, especially breathlessness.[18,19,20] CLAIM is the first study to investigate the effects of dual bronchodilation on cardiac function and lung hyperinflation[21].

The CLAIM study met its primary endpoint demonstrating that treatment with Ultibro® Breezhaler® led to decreased lung hyperinflation and improvements in cardiac function[22] after 14 days of treatment.[21] This translated into clinically relevant patient benefits of improved health status and breathlessness (dyspnea), studied as exploratory endpoints.[21]

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[12] As reported by Novartis on 24 January 2018

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

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

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

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

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

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

[19] Watz H et al. Decreasing Cardiac Chamber Sizes and Associated Heart Dysfunction in COPD. Chest. 2010;138:32-38

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

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

[22] As measured by left ventricular end-diastolic volume (LV-EDV)

Seebri® Breezhaler® (Novartis, Europe & ROW (excluding US)), *(glycopyrronium bromide, NVA237)* is a once-daily fixed dose inhaled bronchodilator (LAMA) indicated as a maintenance bronchodilator treatment to relieve the symptoms of adult patients with COPD. In January 2018, Novartis reported 2017 net sales of $151 million.[12] As expected, this level of sales was consistent with 2016 as Novartis has continued to focus resource on Ultibro® Breezhaler® following the positive FLAME and FLASH results.

Utibron™ Neohaler® Inhalation Powder and Seebri™ Neohaler® (Novartis/Sunovion, US), *(indacaterol/glycopyrrolate and glycopyrrolate)* are a twice-daily inhaled dual bronchodilator (LAMA/LABA) and a twice-daily inhaled bronchodilator (LAMA) respectively, marketed in the U.S. by Sunovion Pharmaceuticals Inc. With its established U.S. respiratory focus and commercialisation expertise, Sunovion is proving to be a strong partner, providing health care providers with new treatment options for their COPD patients. Novartis is responsible for the manufacturing of the medicines for Sunovion.

During 2017, Sunovion launched both Utibron™ Neohaler® and Seebri™ Neohaler® in the US.

Ultibro®, Seebri®, Breezhaler®, Neohaler® are registered trademarks of Novartis AG. Seebri™ and Utibron™ are trademarks of Novartis AG.

GSK Ellipta® products. Vectura earns royalties on sales of Breo®/Relvar® Ellipta®, Anoro® Ellipta® and Incruse® Ellipta® under a legacy agreement between Skyepharma and GSK. Royalties earned under this agreement are subject to an annual cap of £9.0 million which was first reached in 2016 and was achieved again in 2017. The technology licensed to GSK is covered by granted patents with an earliest expiry date for one of the granted patents in major markets of November 2019.

Legacy Vectura agreement with GSK
In July 2016, Vectura announced that it had initiated legal proceedings against GSK in the US following GSK's decision not to extend the term of its legacy agreement with Vectura beyond 31 July 2016, by licensing additional patent families.

A jury trial originally scheduled for December 2018 has recently been rescheduled by the court and is now likely to occur in Q2 2019. Following initiation of the US action, GSK commenced an action in the UK challenging the equivalent UK patents and Vectura has counter sued for infringement. The outcome of this action is currently expected in Q4 2018. A cumulative total of £1.9 million of expenses have been incurred in respect of this litigation, recorded as an exceptional item to the end of 2017.

Anoro® Ellipta®, Relvar® Ellipta®/Breo® Ellipta® and Incruse® Ellipta® are registered trademarks of GSK.

AirFluSal® Forspiro® (Sandoz, EU & ROW), *(fluticasone propionate, salmeterol)* is an inhaled anti-inflammatory (ICS) and bronchodilator (LABA) combination delivered using a Vectura proprietary DPI for the treatment of asthma and/or COPD. This product has been launched to date in approximately 35 countries in Europe and elsewhere. Vectura recorded underlying royalties and device sales of £3.8 million for the twelve-month period to December 2017 (2016 proforma underlying: £4.9 million). This decline was the result of destocking within the AirFluSal® Forspiro® supply chain.

AirFluSal® and Forspiro® are registered trademarks of Novartis AG.

Breelib™ (Bayer, EU & ROW – excluding US), an adapted FOX® handheld smart nebuliser as an alternative delivery method for Bayer's marketed product Ventavis (iloprost solution) for the treatment of pulmonary arterial hypertension, marketed as Breelib™. The product was first launched by Bayer in Europe in April 2017. The product has now been launched in Poland, Germany, Austria, Portugal and UK with further roll-out continuing.

Vectura earned a €5.0 million milestone in 2017 upon the first launch in a European country and is eligible to receive contingent annual milestones on the anniversary of this first launch on a decreasing scale, over six years, to the total value of €5.75 million. Whilst the on-going financial value for the Group from this programme is limited, commercialisation of the FOX® device provides external platform validation. This validated platform technology has the potential to be used in multiple potential indications in further Vectura-led development of enhanced therapies for airways diseases.

Ventavis® is a registered trademark of Bayer AG and Breelib™ is a trademark of Bayer AG.

Oral and Non-inhaled

In addition to its core focus in airways diseases, Vectura has a number of legacy oral and non-inhaled revenue generating products. In total, these products generated underlying revenue of £24.3 million during 2017 (2016 proforma underlying: £23.7 million).

As previously guided, until expiry of certain patents, the earliest of which expire in September 2018, Vectura will continue to receive a three percent share of Pacira's cash receipts from net sales of EXPAREL®. The majority of the Group's patents on Xatral® also expired in August 2017 and the Board does not expect any further material royalties on this product in 2018 (2017 royalties: £0.9 million).

Oral products

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

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

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

Non-inhaled products

EXPAREL® (Pacira, US) is an injectable product for single-dose administration into the surgical site to produce post-surgical analgesia. Until expiry of certain patents, the earliest of which expire in September 2018, Vectura will continue to receive a three percent share of Pacira's cash receipts from net sales of EXPAREL® with £6.6 million recognised within other revenue recognised during 2017 (2016 proforma underlying: £5.8 million). Vectura is also eligible to receive a further sales milestone of $32 million when worldwide annual net sales of the product reach $500 million (on a cash-received basis) the receipt of this milestone is not patent dependent.

ADVATE® (Baxter, Global) is an Antihaemophilic Factor (Recombinant) for the treatment of haemophilia A and marketed worldwide by Baxter. Vectura's ADVATE® patent expired at the end of January 2016; however, due to higher than anticipated production of ADVATE® inventory by Baxter prior to this expiry, Vectura has continued to receive royalties from sales of this product totalling £1.0 million for 2017 (2016 proforma: £13.7 million), which is not included in underlying revenue as it is largely non-recurring in 2017 compared to 2016. Vectura does not anticipate further material royalties from sales of this product.

Solaraze® (Sandoz (US), Almirall (EU)) is a nonsteroidal anti-inflammatory drug (NSAID) treating actinic keratosis, a precancerous skin growth usually caused by sun exposure. Solaraze® royalties were £2.9 million for 2017 (2016

proforma underlying: £6.7 million). As previously announced, the prior period benefited from temporary market factors.

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

Refocused R&D investment strategy to increase leverage on highest value drivers

As announced in January 2018, Vectura plans to fully leverage its differentiated technology and skills, and maximise value with increased focus on partnered generic-drug device combinations and the Vectura enhanced therapies smart-nebuliser platform to enhance the inhaled performance of existing molecules. Further investment in relatively higher risk, novel molecule, early-stage programmes will cease, and the Company will seek opportunities to partner existing programmes of this type. This reduction in the overall pipeline risk profile will enable further leverage of Vectura's core capabilities to deliver additional value from lower risk projects.

Pipeline progression of priority projects

Inhaled generics

Partnered generic assets allow Vectura to access high-volume opportunities whilst managing the significant development cost associated with large generic programmes. Typically, Vectura's involvement includes both device and formulation development and as a result the Group can earn development services revenues as well as milestones and mid-teen percentage royalties on net sales of the final marketed products. As announced in January 2018, development of complex inhaled generics, particularly those for the US market, will become an area of increased focus for the Group.

The US generics market for inhaled products is a largely untapped market, with a number of blockbuster products that have either reached, or are reaching, patent expiry. The inherent complexity of developing an inhaled generic means that there are few companies who have the opportunity to benefit from this large market opportunity. These complexities include demonstrating bioequivalence of a generic inhaled product to the reference branded product as well as the device handling aspects.

Only a handful of companies have the expertise to develop inhaled generics for the US and, of these select companies, Vectura is the only one that has developed the device and formulation capabilities in house rather than via acquisition or in-licensing. The Group's competence and focus in the complex drug-device combination generics segment was reinforced in 2017 with the addition of two new material pipeline programmes, VR2081 and VR410.

Following FDA interactions, Vectura is progressing the development of its Open-Inhale-Close device which has the potential to be an AB-rated substitutable generic drug-device combination for the GSK Ellipta® portfolio. This is a significant opportunity, with analyst projections of global net sales for these products of approximately $6 billion by 2023.[8] Pharmaceutical development has commenced, in parallel with partnering discussions.

VR315 (Hikma, US) *(fluticasone propionate/salmeterol),* is the Group's partnered programme with Hikma for a generic version of Advair® Diskus® for the treatment of asthma and COPD in adolescents and adults for the US.

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

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

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

Throughout the process, Vectura has gained significant insight into the FDA approval process for complex inhaled generic programmes, which it believes has strengthened the likelihood of success for VR315. Whilst the regulatory bar remains high, the on-going dialogue with the FDA leaves Vectura well placed to react to any new requirements or challenges that lie ahead. These learnings support the Company's confidence that it has the capabilities to achieve US regulatory approval for its extensive inhaled generic pipeline, which includes generic versions of the three current largest US inhaled brands.

To date, only three companies have publicly stated that they have filed an ANDA for a generic Advair® Diskus® product and all three companies have received a CRL. There is considerable patient need for accessible lower priced medicines and in 2017, US sales of Advair® were $2.1bn[23]. This remains a significant market opportunity and we do not believe that there will be a large number of new entrants into this space, therefore those who can successfully cross the regulatory line stand to win valuable future market share.

Advair® Diskus® is a registered trademark of GSK.

VR2081 (Sandoz, US) *(undisclosed generic for the treatment of asthma and COPD),* is a programme partnered with Sandoz for the US development of a generic of an existing major inhaled combination therapy for asthma and COPD, delivered in a pMDI device. This agreement, announced in June 2017, further extends Vectura's established relationship with Sandoz and was the first partnering deal to be announced from the new wave of generics programmes that were announced post-merger with Skyepharma.

Vectura is responsible for the development of the formulation and manufacture of clinical batches for use in pilot clinical studies, whilst Sandoz is responsible for the clinical development, manufacture and commercialisation of VR2081.

Upon entering into the agreement, Vectura was eligible to receive an initial payment of $5 million from Sandoz and up to a further $5 million upon achievement of pre-determined development milestones. Vectura will also be eligible to receive royalties on sales of the marketed product, once approved. The total R&D cost borne by Vectura is expected to be below $20 million through to regulatory filing and subsequent launch, which is anticipated in the early to mid-2020's and is incorporated into current R&D guidance.

The initial $5.0 million development milestone was received in August 2017 and is being recognised as development services revenue across 2017 and 2018. This reflects the period over which development and production obligations will be delivered.

[23] Evaluate Pharma 2017

VR410 (Pulmatrix, US) *(branded generic tiotropium bromide)*, is a branded generic alternative to Spiriva® HandiHaler® in the US which has been accelerated through an exclusive licence agreement with Pulmatrix. The programme will deliver PUR0200 through one of Vectura's DPI devices.

Pulmatrix has been developing Pulmatrix's PUR0200, a once-daily, inhalable iSPERSE™ formulation of tiotropium bromide for COPD patients. Vectura plans to advance the product to the clinic in 2019 and plans to license the product (VR410) in the future to one or more sub-licensees who would contribute further to the remaining development and undertake commercialisation activities.

In addition, under the agreement, Vectura may develop the PUR0200 formulation in combination with one or more other active pharmaceutical ingredients. This provides Vectura with the opportunity for future additional combination assets to compete in the growing US LAMA/LABA market, which is projected to be worth $2.8 billion in 2022[24]. This development will be actively pursued once the monotherapy project is established.

Spiriva® and HandiHaler® are registered trademarks of Boehringer Ingelheim.

VR730 (Hikma, US), *(salmeterol)*, a generic inhaled bronchodilator (LABA) for asthma and COPD using Vectura's dry powder inhalation technology and delivered using one of the Group's proprietary DPI devices, partnered with Hikma. VR730 has the potential to address an important market; according to IMS, US sales of inhaled DPI and pMDI LABAs were approximately $112.6 million in 2017[25].

Under the terms of the agreement Vectura is responsible for completion of the formulation development and Hikma is responsible for the clinical development of the programme and the subsequent manufacture and US commercialisation of the product.

Formulation work to be completed by Vectura will largely be funded by Hikma and therefore this programme is not expected to materially impact the Group's level of future R&D investment. Upon signing the agreement in 2016, Vectura received an initial payment of $375,000 and is eligible to receive potential further development, filing, approval and launch milestones up to an aggregate of $1.125 million. The Group is also eligible for a share of future returns of the product in line with its existing generic agreements, subject to certain recoveries by Hikma for the costs of clinical studies.

VR2076 (Global), in December 2017, Mundipharma informed the Group of its decision to stop the development of VR2076, a fixed dose inhaled dual bronchodilator (LAMA/LABA) and anti-inflammatory (ICS) for asthma delivered in a pMDI. Given the early stage of this asset, this is not expected to have a material impact on the Group's revenues in 2018. As noted in the financial review, an impairment charge of £8.7 million was recognised to write-off this acquired intangible asset in 2017.

New generics, following the merger, the Group identified three to five significant new generic development opportunities. Pre-partnering development activities on these new mass-market pMDI and DPI opportunities are focused on initial formulation, preclinical development and preliminary regulatory interactions. VR2081 and VR410 are the first assets from this new wave of generic development programmes to be confirmed by Vectura and the Group have now added a third major programme which has the potential to be an AB-rated substitutable generic drug-device combination for the GSK Ellipta® portfolio of products.

Vectura enhanced therapies

[24] Evaluate Pharma 2017
[25] IQVIA Q4 2017 (CER)

Vectura's lead enhanced therapy programmes, VR475 and VR647 are products which seek to enhance the delivery of known molecules utilising Vectura's proprietary FAVORITE™ smart-nebuliser technology and are being developed for niche indications targeting specialist patient populations. As announced in January 2018, in the absence of additional specialist marketed products being acquired through M&A or in-licencing, Vectura will initiate partnering discussions for these two assets. This approach reflects the high cost, low financial leverage and opportunity cost associated with the commercialisation of single assets. Partnering of VR475 (EU) and VR647 (US) is anticipated in 2019, subject to successful completion of the current respective Phase III and Phase II activities.

Vectura sees further significant nebulised product opportunities where efficacy/safety ratios could be improved by utilising the FAVORITE™ technology platform across multiple potential indications. This platform gives Vectura the potential to target niche patient populations/orphan indications with high unmet medical need. Development risk is balanced as elements of the technology are already market proven and programmes will be focused on delivery of molecules with a known safety profile.

Following Breelib™ technology platform validation, initial feasibility for a series of additional enhanced delivery programmes has been initiated. A pipeline progress update will be provided at the interim reporting update in H2 2018.

VR475 (EU) is Vectura's leading and most advanced wholly-owned specialist pipeline drug/device combination asset. VR475 comprises nebulised budesonide together with Vectura's proprietary AKITA® nebuliser system that utilises Vectura's proprietary FAVORITE™ inhalation technology. This programme targets adult patients with severe asthma who are uncontrolled despite taking high levels of inhaled steroids. The programme seeks to demonstrate that FAVORITE™ inhalation technology could achieve a higher lung deposition into the small airways, thus optimising and shifting up budesonide's dose responsiveness, providing clinically relevant additional efficacy. Consequently, a large proportion of this patient population could be controlled using inhaled steroids without having to resort to unpleasant and unwanted oral corticosteroids or expensive biologic treatments. This has a clear patient benefit but also a significant benefit for healthcare systems and payors.

The programme is currently in Phase III and has the potential to address a significant market opportunity subject to delivery of a challenging exacerbations primary end point of the current study.

The product concept has already been tested in an oral corticosteroid ("OCS") sparing trial with positive results. The Phase III study is progressing well and patient recruitment has now completed. This study is expected to complete in Q4 2018.

Information on the design of the study was presented at ERS in September 2017 and partnering options are being considered for the further development and commercialisation of this asset in the EU where the opportunity would target approximately 1.5 million patients with severe persistent asthma who are uncontrolled on a high-dose ICS/LABA.[26]

VR647 (US) is Vectura's second wholly-owned specialist pipeline drug/device combination asset using the AKITA® JET smart nebuliser technology which has a significant opportunity to reduce delivery time in a well-established paediatric nebulised market. VR647 comprises nebulised budesonide together with Vectura's novel proprietary nebuliser system and is being positioned as a maintenance treatment and prophylactic therapy for children, from 12 months to 8 years, in the US market.

[26] Internal calculation based upon data obtained "Decision Resources, March 2017" and adjusted for relevant percentage patient populations obtained from Adelphi Priority DSP 2016 (unpublished data cited with permission)

VR647 harnesses Vectura's innovative smart nebuliser technology to achieve superior delivery of budesonide nebuliser suspension, a drug with a proven track record in an established and significant US market, where, according to IMS, sales of nebulised budesonide are approximately $770 million[27] per year. This programme provides an opportunity to significantly improve the currently available nebulised delivery of budesonide with a faster delivery time, better lung deposition at a lower nominal dose whilst maintaining similar efficacy, potentially with lower local and systemic side effects.

A Phase I pharmacokinetic study in adults exploring the relationship between different doses of budesonide delivered by Vectura's novel proprietary AKITA® nebuliser system and budesonide delivered by conventional nebulisation has been successfully completed and a Phase II study in children commenced in December 2017. The study is expected to complete in Q3 2018.

Novel device partnering

Typical novel molecule and/or device partnering arrangements provide Vectura with development services revenues, milestones and low single-digit royalties on high-value opportunities balancing financial exposure to programmes with higher molecule risk. Following the R&D investment review, Vectura will take a selective approach to future novel partnered development programmes and will stop Vectura investment in early-stage novel molecule development. As announced in January 2018, Vectura is seeking to partner VR942 (a dry powder biologic) and VR588 (a pan-JAK inhibitor) for further clinical development.

VR347 (Dynavax, Global), an innovative nebulised treatment for lung cancer patients delivered using Vectura's proprietary AKITA® smart nebuliser. In August, Vectura announced that the Company's AKITA® smart nebuliser will be used by Dynavax to deliver DV281, a novel Toll-Like Receptor 9 (TLR9) agonist designed specifically for local delivery to primary lung tumours and lung metastases in order to generate an anti-tumour immune response. Vectura's FAVORITE™ nebulisation technology combines optimising patients' inhalation technique with the effective control of the flow rate and volume of the drug being delivered. This approach maximises the efficiency of the nebulisation and enables consistent targeted drug deposition.

The AKITA® device will initially be used in the development programme with a plan to move to the FOX® handheld device as a next step. The agreement covers the Phase I and Phase II development programmes and Vectura will provide devices and device related support to Dynavax which is responsible for the rest of the programme. Whilst addressing a substantial market opportunity, in these early phases the Group is eligible to receive modest milestones and development services revenues and does not expect a material impact on R&D expenditure.

VR465 (Ablynx, Global) *(inhaled biologic),* Vectura's adapted handheld FOX® smart nebuliser device used to deliver Ablynx's first-in-class, wholly-owned inhaled anti-RSV Nanobody®, ALX-0171, for the treatment of respiratory syncytial virus ("RSV") in infants. RSV is the leading cause of infant hospitalisation and the primary viral cause of infant death[28]. Current treatment of RSV infections is primarily focused on symptomatic relief, hence the need for an effective and specific anti-RSV therapeutic.

ALX-0171 is a potential breakthrough treatment option for RSV infections in vulnerable patient populations and its inhaled method of delivery offers a major platform advantage. The FOX® device used in this programme has been adapted for use with neonates and infants, demonstrating the utility of the Vectura smart nebuliser technology.

Ablynx is undertaking a Phase IIb dose efficacy study, RESPIRE, in 180 infants hospitalised as a result of an RSV infection and in August 2017, announced that it had completed the sequential dose escalation part of the study in 36 infants

[27] 2017 FY IQVIA MIDAS Q4 2017
[28] Mazur et al, Lancet, 2015

hospitalised as a result of a RSV infection and that it had initiated the parallel dose part of the study with the aim of recruiting an additional 144 infants. Top-line results from this study are expected in Q4 2018.

In March 2018, Ablynx announced that it had started a Phase IIb study for ALX-0171 in infants hospitalised with an RSV infection in Japan.

QVM149 (Europe & ROW) *(indacaterol/glycopyrronium bromide/mometasone furoate)* is a once-daily fixed dose inhaled dual bronchodilator (LABA/LAMA) and anti-inflammatory (ICS) triple therapy for asthma from Novartis. This Phase III asset has first-to-market potential in the EU as an asthma treatment delivered in a DPI device.

QVM149 is an important programme for the Group with fixed combination triple therapy treatment expected to develop strongly and likely to take significant share from existing use of multiple "free combination" treatments as well as from the large volume of ICS/LABA combination treatment currently used.

Novartis has continued to make good progress with recruitment into its Phase III study and the study read-out and regulatory submission are expected in 2019.

Tight financial management and capital allocation discipline

In addition to the review of the R&D investment strategy, the Group undertook an Operational Excellence review of activities within the R&D function which has identified a number of opportunities to significantly enhance productivity. These productivity initiatives will allow the Group to free up capacity to support future pipeline opportunities and will also contribute towards R&D cost reductions through measured reduction in headcount.

Merger integration activities are substantially complete; the new organisational structure is embedded, and all priority integration projects have successfully concluded. In addition to the £10 million synergies that were announced at the time of the merger, the Group has identified annual non-headcount cost synergy opportunities of up to £2 million from 2018 with realisation initiatives underway. The majority of these annual synergy savings were realised in 2017. Total costs to deliver the synergy savings will be £9 million, of which, a total of £8.4 million has been recorded as an exceptional cost in the Group's results to date.

In November 2017, the Group initiated a £15 million share buyback and cancellation programme. This programme concluded post period on 28 February 2018.

Strategy

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

Throughout 2018, Vectura will seek to leverage strong cash flows from its in-market products to reinvest in programmes where it has identified the greatest potential value for patient benefit and shareholder return, within the existing R&D guidance range.

In line with the refocused investment strategy, the Group will continue to increase its focus on development of partnered generic drug-device combinations and the Vectura enhanced therapies pipeline. Vectura's enhanced therapies use the Group's proprietary smart-nebuliser technology to enhance the inhaled performance of existing molecules.

Vectura retains the option to accelerate growth potential through selective M&A and continues to assess opportunities that would provide both revenues and established specialist respiratory commercial capabilities.

Guidance and outlook

Vectura operates within the large and growing global airways disease market. This market is currently estimated to be worth c. $40 billion and is expected to grow to c. $56 billion by 2025.[29] The Board maintains its expectations for strong growth in total 2018 Group revenues, driven by performance from in-market inhaled products, particularly *flutiform*® and Ultibro®/Seebri® Breezhaler®.

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

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

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

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

The Group's cash position, £103.7 million as at 31 December 2017, is expected to continue to grow further by the end of 2018 with ongoing operating cash generation, net of the impact of the £15 million share buyback and cancellation programme which was completed on 28 February 2018, with the majority of the trades settled in 2018. Vectura continues to maintain its disciplined approach to capital allocation, and capital expenditure is expected to be in a normal annual range of £10 million to £15 million in 2018, with the majority of capacity expansion initiatives having been completed in previous years.

Financial review

Financial highlights	2017 Reported	Adjusting items	**2017 underlying**	**2016 proforma underlying**	**% movement**
Revenue	£148.0m	(£16.6m)	**£131.4m**	**£126.3m**	**4.0%**
Cost of sales	(£57.2m)	£0.8m	**(£56.4m)**	**(£55.1m)**	**(2.4%)**
Gross margin	£90.8m	(£15.8m)	**£75.0m**	**£71.2m**	**5.3%**
R&D expenditure	(£60.3m)	-	**(£60.3m)**	**(£65.1m)**	**7.4%**
Other operating expenditure & income	(£12.5m)	£2.1m	**(£10.4m)**	**(£12.9m)**	**19.4%**
Amortisation and impairment of intangible assets	(£109.7m)	£109.7m	**-**	**-**	**-**
Exceptional items	(£4.5m)	£4.5m	**-**	**-**	**-**

[29] Global Data Reports, Internal Projections (where Global Data not available at 2025), Decision Resources

Financial highlights	2017 Reported	Adjusting items	2017 underlying	2016 proforma underlying	% movement
Operating (loss)/profit	(£96.2m)	£100.5m	**£4.3m**	**(£6.8m)**	**>100%**
Adjusted EBITDA	£25.8m	(£15.8m)	**£10.0m**	**(£2.6m)**	**>100%**

Comparative financial information

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

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

Underlying financial information

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

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

Accordingly, certain underlying financial information is included in this report. Underlying financial information is calculated using the 2017 reported results and proforma 2016 proforma twelve-month financial information, excluding certain non-underlying items: (i) revenue from non-recurring sources comprising royalties and share of sales which have discontinued in either period (for example, due to patent expiry or legal dispute), milestones and development services revenue; (ii) non-cash share-based payment and amortisation of intangible assets charges; and, (iii) exceptional items. The underlying financial information therefore reflects the ongoing business in both periods and is consistent with how management reviews the business for the purpose of making long-term operating decisions.

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

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

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

Revenue

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

In line with expectations, 2017 reported revenue was £148.0 million, an increase of 17.0% compared to the prior nine-month period (reported 9m 2016: £126.5 million), with headline growth being impacted by the lack of comparability between the two periods as highlighted above.

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

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

Underlying revenues by revenue stream

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

Underlying revenues by product

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

Royalties

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

Royalty stream	2017 royalty (12m)	2016 proforma royalty (12m)	% movement
Ultibro® and Seebri® Breezhaler®	£17.3m	£15.6m	10.9%
Ellipta® portfolio	£9.0m	£9.0m	-
flutiform®	£5.1m	£5.0m	2.0%
AirFluSal® Forspiro®	£2.3m	£1.8m	27.8%
Solaraze®	£2.9m	£6.7m	(56.7%)
Other royalties	£13.5m	£9.8m	37.8%
Total underlying royalties	**£50.1m**	**£47.9m**	**4.6%**
ADVATE® royalties (patent expired Jan '16)	£1.0m	£13.7m	(92.7%)
Ellipta® portfolio (legacy Vectura agreement, legal dispute in process)	-	£12.9m	(>100%)
IFRS 3 Fair value adjustment – *flutiform*® royalties	£1.5m	-	>100%
Total royalties	**£52.6m**	**£74.5m**	**(29.4%)**

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

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

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

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

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

Royalties on net sales of *flutiform*®, which continues to benefit from strong and growing demand, particularly in Japan, contributed £5.1 million to 2017 underlying royalties (2016 proforma underlying: £5.0 million). Total in-market net sales of *flutiform*® were €206.2 million in 2017, 11.8% higher than 2016 on a constant currency basis.[5]

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

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

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

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

Product supply and device sales

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

Revenue earned from the supply of *flutiform*® to Mundipharma and Kyorin was up 4.3% to £63.4 million in 2017 (2016 proforma underlying: £60.8 million). As previously communicated, product supply revenue was impacted by customer supply chain destocking in the second half of 2017. Therefore, this relatively modest underlying growth is not reflective of the in-market net sales performance of this product, which, as noted above, grew by 11.8% on an annual constant currency basis during 2017.[5]

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

Signing and milestone payments

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

Vectura recognised signing and milestone payments of £5.1 million in 2017; this relates primarily to a €5.0 million (£4.2 million) milestone received from Bayer following the first European launch of Breelib™, the new nebuliser for Ventavis® (iloprost) based on the FOX® handheld smart nebuliser. Vectura is eligible to receive contingent annual

milestones on the anniversary of this first launch on a decreasing scale, over six years, to the total value of €5.75 million. Vectura also receives small product supply revenues for the supply of the FOX® device to Bayer but does not receive royalties on commercial sales of this product.

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

Development services

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

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

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

Other revenue

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

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

Implementation of IFRS 15 Revenue from contracts with customers

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

Cost of sales

Cost of sales increased by £2.1 million to £57.2 million (12m proforma 2016: £55.1 million). This increase is in-line with increased product supply and device sales revenue. Underlying gross profit from *flutiform*® product supply, excluding a £0.8 million charge associated with the fair value adjustment made to revenue for statutory reporting purposes, was

£23.8 million, which equates to a gross margin of 37.6% (2016 proforma underlying: gross profit of £19.0 million, 31.4% gross margin). The 6.2 percentage point increase in gross margin reflects increasing benefits of scale, cost reductions and a one-off cost initiative that accounts for approximately half of the improvement.

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

Research and development ("R&D") expenses

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

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

Other operating expenditure & income

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

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

Amortisation and impairment of intangible assets

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

Exceptional items

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

A total net exceptional charge of £4.5 million was recognised in the 2017 reported financial results (9 months ended 31 December 2016: £9.4 million charge).

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

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

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

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

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

Adjusted EBITDA and underlying adjusted EBITDA

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

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

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

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

Share of movements in associates

The charge of £3.4 million recognised in 2017 (9 months ended 31 December 2016: income of £0.4 million) includes £1.7 million for the Group's share of losses of its German associate (Ventaleon GmbH) and £1.6 million relating to the contributions necessary to finalise the valuation process for approval by the Chinese State authorities of the Group's 37.84% share in Tianjin Kinnovata Pharmaceutical Company Limited.

Net finance expenses/income

Net finance costs of £2.6 million (9 months ended 31 December 2016: net £4.0 million income) in 2017 mainly comprise of foreign exchange losses of £1.4 million (9 months ended 31 December 2016: £4.2 million gain).

Loss before tax

As expected, the Group's statutory loss before tax of £102.2 million has increased significantly compared to the prior nine-month statutory reporting period (9 months ended 31 December 2016: £40.1 million loss). This is due to the discontinued royalty revenues and significant non-recurring milestones recognised in 2016, increased amortisation charges and the change in accounting reference date, as noted above.

Taxation

The Group's effective tax rate ("ETR") for the year ended 31 December 2017 is a 16.2% credit (9 months ended 31 December 2016: 20.0% credit). The ETR is driven by tax charges on profits in Switzerland (8.5% charge) and the US (inclusive of prior year adjustments) (42.9% charge), and a small credit in the UK on losses and R&D incentives. The ETR is significantly impacted by deferred tax credits on the amortisation of acquired intangible assets (17.6% credit). The expectation of the long-term trend for the ETR is a high-teens credit percentage rate.

Loss after tax

Loss after tax was £85.7 million (9 months ended 31 December 2016: £32.1 million loss).

Loss per share

Basic loss per share has increased to 12.6 pence, reflecting the reduction in non-recurring revenues and increased R&D and amortisation charges, as noted above (9 months ended 31 December 2016: 5.3 pence loss per share).

Balance sheet

Goodwill

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

Intangible assets

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

Property, plant and equipment

During 2017, Vectura has invested £11.7 million of capital expenditure (9 months ended 31 December 2016: £3.1 million). This consists mainly of £3.8 million of equipment to support the manufacture of *flutiform*® actuators still under construction at 31 December 2017 and a £3.4 million investment in manufacturing equipment at the Group's oral manufacturing facility of which £2.5 million is under construction at 31 December 2017. Construction of the actuator equipment is expected to complete in H2 2018 and the construction of the oral manufacturing equipment is expected to complete in Q1 2018. Once completed, both assets will become operational and will be reclassified to property, plant and equipment and depreciated from this point.

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

Translation reserve

In accordance with IAS 21 Effects of changes in foreign exchange rates, the Group has recognised a net foreign exchange loss of £15.1 million (9 months ended 31 December 2016: £49.0 million gain) within reserves as a result of translating overseas operations denominated in local currencies to the presentational currency of the Group.

Cash position and liquidity

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

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

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

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

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

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

By order of the Board

Andrew Derodra
Chief Financial Officer
20 March 2018

Appendix to the Financial Review

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

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

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

Adjustment 2: In the December 2015 management accounts, certain royalties were over accrued by £2.1m with no implication on the 12 month March 2016 reported IFRS results. The adjusting entry has been posted in Q1 calendar year 2016 reducing royalty revenues accordingly. 2016 reported proforma revenues are therefore adjusted to exclude this understatement.

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

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

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

Reconciliation of recurring revenues to underlying revenues

	2016 Reported (9m)	2016 Reported proforma (12m)	2016 Proforma (12m)
Royalties	£47.5m	£72.4m	£74.5m
Product supply and device sales	£50.3m	£72.6m	£72.6m
Signing and milestone payments	£20.5m	£22.4m	£22.4m
Development services	£4.5m	£7.5m	£7.5m
Other revenues	£3.7m	£6.6m	£6.6m
Total revenue	**£126.5m**	**£181.5m**	**£183.6m**
Less:			
Signing and milestone payments	(£20.5m)	(£22.4m)	(£22.4m)
Development services	(£4.5m)	(£7.5m)	(£7.5m)
Revenue from recurring sources	**£101.5m**	**£151.6m**	**£153.7m**
Less:			
Annual rental income from Aenova	(£0.2m)	(£0.8m)	(£0.8m)
Recurring revenue	**£101.3m**	**£150.8m**	**£152.9m**
Less:			
ADVATE® royalties (patent expired Jan 16)	(£8.2m)	(£13.7m)	(£13.7m)
Ellipta® portfolio (legacy Vectura agreement, legal dispute in process)	(£7.3m)	(£12.9m)	(£12.9m)
Underlying revenues	**£85.8m**	**£124.2m**	**£126.3m**

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

Consolidated Income Statement

For the year ended 31 December 2017

	Note	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
Revenue	3	**148.0**	126.5
Cost of sales		**(57.2)**	(41.9)
Gross profit		**90.8**	84.6
Selling and marketing expenses		**(4.0)**	(2.8)
Research and development expenses	5	**(60.3)**	(45.6)
Corporate and administrative expenses		**(10.2)**	(8.8)
Other income	7	**1.7**	1.5
Operating profit before exceptional items and amortisation		**18.0**	28.9
Amortisation and impairment	8	**(109.7)**	(64.0)
Exceptional items	10	**(4.5)**	(9.4)
Operating loss		**(96.2)**	(44.5)
Share of movement of associates	11	**(3.4)**	0.4
Finance income	12	**0.2**	4.4
Finance expenses	12	**(2.8)**	(0.4)
Loss before taxation		**(102.2)**	(40.1)
Net taxation credit	13	**16.5**	8.0
Loss after taxation		**(85.7)**	(32.1)
Adjusted EBITDA*	8	**25.8**	34.1
Loss per share			
Basic	14	**(12.6p)**	(5.3p)
Diluted	14	**(12.6p)**	(5.3p)

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

***** Adjusted EBITDA represents operating profit before exceptional items and amortisation, adding back share-based payments and depreciation. Refer to note 8 "*Adjusted EBITDA"*.

Following the Skyepharma merger on 10 June 2016, the Group changed its accounting reference date to 31 December from 31 March. As a result, the comparative period presented is for the nine months ended 31 December 2016 and only includes Skyepharma's results since the Merger date. To support a review of trends in performance, certain unaudited proforma information is within the Financial Review.

The accompanying notes form an integral part of these Consolidated Financial Statements.

Consolidated Statement of Other Comprehensive Income

For the year ended 31 December 2017

	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
Loss after taxation	**(85.7)**	(32.1)
Items that may be reclassified to the Income Statement:		
Exchange movements arising on consolidation	**(13.9)**	49.7
Related impact of taxation	**(1.2)**	(0.7)
Items that will not be reclassified to the Income Statement:		
Actuarial gains on re-measurement of defined benefit pensions	**1.1**	1.3
Related impact of taxation	**(0.2)**	(0.2)
Other comprehensive (loss) / income	**(14.2)**	50.1
Total comprehensive (loss) / income	**(99.9)**	18.0

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

In June 2016, the United Kingdom held a referendum and voted to leave the European Union. Sterling weakened against the functional currencies of the Group's principal overseas operations (based on period end exchange rates) – the US Dollar, Swiss Franc and Euro. As these consolidated financial statements are presented in Sterling, a £49.7m exchange gain was recognised on consolidation in the comparative period, and a loss on consolidation in the current year of £13.9m occurred as Sterling strengthened against the US Dollar and Swiss Franc this year, based on the period end exchange rates.

The accompanying notes form an integral part of these Consolidated Financial Statements.

Consolidated Balance Sheet

At 31 December 2017

	Note	31 December 2017 £m	31 December 2016 £m
ASSETS			
Non-current assets			
Goodwill	15	**161.4**	162.8
Intangible assets	16	**335.4**	456.8
Property, plant and equipment	17	**53.1**	54.8
Other non-current assets	**18**	**7.4**	4.0
Total non-current assets		**557.3**	678.4
Current assets			
Inventories	19	**23.4**	18.4
Trade and other receivables	20	**34.1**	56.6
Cash and cash equivalents	21	**103.7**	92.5
Total current assets		**161.2**	167.5
Total assets		**718.5**	845.9
LIABILITIES			
Current liabilities			
Trade and other payables	22	**(56.5)**	(59.8)
Corporation tax payable	**22**	**(11.4)**	(8.6)
Provisions	23	**(2.2)**	(1.9)
Total current liabilities		**(70.1)**	(70.3)
Non-current liabilities			
Other non-current payables	22	**(9.6)**	(12.2)
Provisions	23	**(3.2)**	(3.5)
Retirement benefit obligations	24	**(3.6)**	(5.9)
Deferred taxation	25	**(53.5)**	(76.8)
Total non-current liabilities		**(69.9)**	(98.4)
Total liabilities		**(140.0)**	(168.7)
Net assets		**578.5**	677.2
SHAREHOLDERS' EQUITY			
Share capital	28	**0.2**	0.2
Share premium		**102.8**	102.3
Translation reserve		**26.3**	41.4
Other reserves		**557.8**	557.0
Retained losses		**(108.6)**	(23.7)
Total shareholders' equity		**578.5**	677.2

The accompanying notes form an integral part of these Consolidated Financial Statements. These Consolidated Financial Statements and accompanying notes were approved by the Board of Directors on 20 March 2018 and were signed on its behalf by:

J Ward-Lilley **A Derodra**

Director ***Director***

Consolidated Statement of Changes in Equity

For the year ended 31 December 2017

	Note	Share capital £m	Share premium £m	Merger reserve £m	Own shares reserve £m	Share-based payment reserve £m	Translation reserve £m	Retained losses £m	Total equity £m
At 31 March 2016		0.1	101.6	**133.1**	—	17.4	(7.6)	(7.4)	237.2
Loss for the nine month period		—	—	—	—	—	—	**(32.1)**	**(32.1)**
Other comprehensive income		—	—	—	—	—	**49.0**	**1.1**	**50.1**
Total comprehensive income / (loss)		—	—	—	—	—	**49.0**	**(31.0)**	**18.0**
Skyepharma scheme of arrangement		**0.1**	—	**424.3**	—	—	—	—	**424.4**
Share transaction costs		—	—	**(2.5)**	—	—	—	—	**(2.5)**
Share-based payments	**29**	—	—	—	—	**2.3**	—	—	**2.3**
Exercise of share awards		—	**0.7**	—	—	—	—	—	**0.7**
Employee share trust transactions		—	—	**(1.0)**	**(0.7)**	—	—	**(1.2)**	**(2.9)**
Merger relief		—	—	**(2.0)**	—	—	—	**2.0**	—
Transfer between reserves		—	—	—	—	**(13.9)**	—	**13.9**	—
At 31 December 2016		**0.2**	**102.3**	**551.9**	**(0.7)**	**5.8**	**41.4**	**(23.7)**	**677.2**
Loss for the year		—	—	—	—	—	—	**(85.7)**	**(85.7)**
Other comprehensive (loss) / income		—	—	—	—	—	**(15.1)**	**0.9**	**(14.2)**
Total comprehensive loss for the year		—	—	—	—	—	**(15.1)**	**(84.8)**	**(99.9)**
Share-based payments	**29**	—	—	—	—	**3.9**	—	—	**3.9**
Exercise of share awards		—	**0.5**	—	—	—	—	—	**0.5**
Employee share trust transactions		—	—	—	**(1.8)**	—	—	—	**(1.8)**
Share buyback programme		—	—	—	—	—	—	**(1.4)**	**(1.4)**
Transfer between reserves		—	—	—	—	**(1.3)**	—	**1.3**	—
At 31 December 2017		**0.2**	**102.8**	**551.9**	**(2.5)**	**8.4**	**26.3**	**(108.6)**	**578.5**

The accompanying notes form an integral part of these Consolidated Financial Statements.

Consolidated Cash Flow Statement

For the year ended 31 December 2017

		Year ended 31 December 2017 £m	Restated* 9 months ended 31 December 2016 £m
Cash flows from operating activities			
Operating Loss		**(96.2)**	(44.5)
Amortisation and impairment	**16**	**109.7**	64.0
Depreciation	**17**	**5.7**	3.4
Share-based payments	**29**	**3.9**	2.3
(Increase) / decrease in inventories		**(5.9)**	0.8
Decrease / (increase) in trade and other receivables		**17.2**	(13.0)
(Decrease) / increase in trade and other payables		**(6.9)**	3.8*
Foreign exchange movements		**(0.2)**	3.0
Other non-cash items		**(0.4)**	(0.8)
Cash from operating activities before taxation		**26.9**	19.0*
Research and development tax credits received		**2.1**	2.4
Corporation tax paid		**(2.9)**	(2.6)
Net cash inflow from operating activities after taxation		**26.1**	**18.8***
Cash flows from investing activities			
Skyepharma merger, net of cash acquired	27	-	(25.0)
Purchase of property, plant and equipment		**(9.5)**	(2.6)
Proceeds from sale of property, plant and equipment		**-**	2.9
Funding provided to ESOP trusts		**-**	**(1.5)**
Net cash outflow from investing activities		**(9.5)**	(26.2)*
Net cash inflow / (outflow) before financing activities		**16.6**	(7.4)
Cash flows from financing activities			
Share buyback programme		**(1.4)**	**—**
Proceeds from exercise of employee share options		**0.5**	0.3
Merger transaction costs		**-**	(2.5)*
Funding provided to ESOP trusts		**(1.8)**	—
Interest paid and other finance charges		**(0.3)**	(0.2)
Repayment of secured mortgage borrowings		**(0.2)**	(0.2)
Net cash outflow from financing activities		**(3.2)**	(2.6)*
Foreign exchange		**(2.2)**	2.7
Increase / (decrease) in cash and cash equivalents		**11.2**	(7.3)
Cash and cash equivalents at the beginning of the period		**92.5**	99.8
Cash and cash equivalents at the end of the period		**103.7**	92.5

* Following an FRC Corporate Reporting Review of the Group's 2016 Annual Report and Accounts, in accordance with IAS 7 paragraph 16 exceptional merger transaction costs disclosed as cash flows from investing activities in the 2016 financial statements have been restated as cash flows from operating activities and cash flows from financing activities within the 2016 comparative above. This restatement does not impact closing cash or net debt, it solely relates to the classification of these 2016 exceptional cash outflows as financing and operating activities as opposed to investing activities as previously reported. Refer to note 30 "*Cash flow information*"

The accompanying notes form an integral part of these Consolidated Financial Statements.

1. PRESENTATION OF THE CONSOLIDATED FINANCIAL STATEMENTS

1.1 General information

The financial information set out above does not constitute the Group's statutory accounts for the year ended 31 December 2017 or nine month period ended 31 December 2016 but is derived from those accounts. Statutory accounts for the nine month period ended 31 December 2016 have been delivered to the Registrar of Companies, and those for 2017 will be delivered in due course. The auditor has reported on those accounts; their reports were (i) unqualified, (ii) did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying their report and (iii) did not contain a statement under section 498 (2) or (3) of the Companies Act 2006.

The Group's Annual Report and Accounts will be made available to shareholders in April 2018.

The Consolidated Financial Statements, from which the financial information set out above is derived, has been prepared in accordance with International Financial Reporting Standards ("IFRS"), as adopted by the European Union ("EU-IFRS"). The Consolidated Financial Statements also comply with IFRS as issued by the International Accounting Standards Board.

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.

All financial information is presented in Sterling, rounded to the nearest £0.1m. Previously issued financial information and other relevant resources are made available on our website: www.vectura.com.

1.2 Prior period Skyepharma merger and the comparability of financial periods

The results of Skyepharma have been included in the 2016 nine month comparative numbers from the date of the merger on 10 June 2016 to 31 December 2016. In order to assist users to evaluate underlying trends and like for like performance given the differing comparative periods, the Directors have provided certain unaudited proforma information in the Financial Review.

1.3 Alternative performance measures ("APMs")

Adjusted measures, which are used in these financial statements are also used by the Board and management for planning and reporting. These measures are also used in discussions with the investment analyst community. APMs are not displayed with more prominence, emphasis or authority than IFRS measures.

Adjusted EBITDA is defined as operating profit before exceptional items and amortisation, adding back charges for depreciation and share-based payments. Refer to note 8 "*Adjusted EBITDA*".

Underlying revenues are core ongoing revenue streams relating to license royalties, product supply revenues and share of net sales of EXPAREL®.

Non-recurring revenues comprise project milestones and services which can vary significantly each period and discontinued end of life license royalties, or royalties currently suspended owing to ongoing patent disputes.

Exceptional Items are presented whenever significant expenses are incurred or income is received as a result of events considered to be outside the normal course of business, where the unusual nature and expected infrequency merits separate presentation to assist comparisons with previous periods. Refer to note 10 *"Exceptional items".* Items which are included within the exceptional category include:

- Costs associated with major corporate transactions
- Board approved spend on the integration of major corporate transactions
- Other major transformation programmes

Furthermore significant and unusual items of litigation (e.g. GSK litigation) and significant and unusual items which individually distort the underlying performance of the business and therefore warrant highlighting separately to the users of the accounts e.g. one-off research and development project historical accruals release, are also included within exceptional items.

1.4 Critical accounting areas of judgment and estimation

In preparing these consolidated financial statements, critical judgements in the application of accounting policies can have a significant effect on the financial results, moreover any changes in critical estimates and assumptions made could materially impact the amounts of assets, liabilities, revenue and expenses reported next year as actual amounts and results could differ from those estimates or those estimates could change in future.

The following critical accounting judgements are made in the application of accounting policies

Revenue recognition on collaborative development and marketing arrangements spanning multiple periods

The Group enters into a wide variety of collaborative agreements with partners which may span several reporting periods, and involve multiple revenue streams. Significant judgement is often required in assessing the obligations under such contracts and the revenue and costs that are applicable to be allocated to each reporting period. For royalty income, judgement is exercised as management are not directly responsible for the sale of the product to the market they prepare an estimate of the level of royalties to be earned and compare this to external sales data reported by partners and royalty statements received. For product supply of *flutiform®*, the Group is reliant on a third-party supplier notifying the point at which the transfer of the risks and rewards occurs which is when the goods are "available for collection" by the licensing partner. The recognition of income from non-recurring milestones requires an assessment of the Group's future obligations under the applicable contract, such as when development or sales targets have been met, to determine the most suitable revenue recognition profile. Further details are included in significant accounting policy 2.3 "Current revenue recognition" (on an IAS 18 Revenue basis).

Uncertain tax positions

A provision for an uncertain tax position is recognised within current tax liabilities relating to recent utilisation of historical losses claimed in an overseas jurisdiction. The provision is recognised on the basis of the Group's interpretation of inherently complex tax legislation. The judgement of whether and how much to provide is formed after taking external professional advice, and is based on Management's judgement of the potential tax that could be assessed as due. The provision is recognised at £5.0m (2016: £0.9m) in Corporation Tax Payable on the balance sheet. This provision is partially released to the Income Statement as each annual Statute of Limitation (when the tax authority can enquire into each return) is closed, with the uncertainty expected to be fully resolved by 2021. Refer to note 23 *"Provisions".*

This provision excludes any potential interest and penalties which could be levied on the Group. The Group have recognised a contingent liability in respect of penalties, which, based on external advice, could range from 0 to 40% of unpaid tax, with a maximum of 20% considered appropriate. This would result in estimated penalties of up to £1.0m, but this payment is not considered probable. Refer to note 31 *"Commitments and contingent liabilities".*

The following critical estimates if changed next year would materially impact reported performance:

Impairment of intangible assets acquired through the Skyepharma and Activaero business combinations

Intangible assets are reviewed for indications of impairment and where such indicators exist a full impairment test is performed to ensure the recoverable amount is higher than the carrying value. Impairment tests are based on internal risk-adjusted future cash flows discounted to present value. Some of the more significant assumptions include the estimated net cash flows for each year for each asset or product, including net revenues, directly attributable costs, and the probability of successful commercialisation, the appropriate discount rate to select to measure the inherent risk in each future cash flow stream, and the assessment of each asset's life cycle.

As these valuations are based on Board approved Budgets they are inherently judgemental. The sensitivity of intangible assets to downside scenarios is presented within note 16 "*Intangible assets*".

Useful economic lives of intangible assets acquired through the Skyepharma and Activaero business combinations

Intangible assets relating to on-market products are amortised with reference to average patent lives in the most applicable territories. The key estimate is which patent or midpoint of the patents to use, due to the varying strength of the patents and different time periods for different territories. Given the size of the values any point in that range would have a significant impact. Intangible assets relating to smart nebuliser-based technology acquired through the Activaero acquisition and leveraged in various development programmes are amortised in line with the expected consumption of economic benefits. These may change, for example on approval of a product incorporating the technology and in such cases, the useful economic life ("UEL") is reviewed and adjusted accordingly. If the UEL changes the Group's financial statements would be significantly impacted through changes to amortisation and deferred tax.

Actuarial assumptions applied to the Swiss pension benefits in the application of accounting policies

The Group operates a pension scheme in respect of its employees in Switzerland. As some of the risks of the scheme match the criteria under IAS 19 Employee Benefits for a defined benefit plan, the scheme is accounted for as such. Application of IAS 19 involves estimates about uncertain future events based on independent actuarial valuation reports. The defined benefit obligation is sensitive to the actuarial assumptions outlined in note 24 "*Retirement benefit obligations".*

Deferred tax liabilities

The measurement of deferred tax liabilities takes account of relevant timing differences and tax legislation in the appropriate jurisdiction. As the rate in Switzerland currently depends on the status of the company, an estimated blended rate is applied for deferred tax valuation which reflects the effective tax rate of the Swiss entities, and there has been no change to the estimate in 2017. The deferred tax liabilities relate to a number of specific items, of which the classes are disclosed in note 25 *"Deferred tax liabilities".*

It should be noted that, whilst there is no current impact to the deferred tax balances recognised, or the rate applied, the deferred tax liabilities in respect of Switzerland are particularly sensitive to any future Swiss tax reform. As this is likely, future periods result could be materially impacted as a result of adopting the enacted Swiss tax rate from the reform. This disclosure is not a significant estimate in the scope of IAS 1.125, but is provided as an additional disclosure to highlight the potential impact of the Swiss tax reform. Refer to note 13 *"Taxation"*.

2. SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of consolidation

These Consolidated Financial Statements comprise the consolidated financial statements of Vectura Group plc, its subsidiaries and equity-accounted associates for the year ended 31 December 2017.

Subsidiaries are all entities over which the Group has direct or indirect control. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power to direct the activities of the entity. Subsidiaries are consolidated from the date on which control is obtained by the Group and are 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.

2.2 Foreign currency translation and transactions

Results of the Group's overseas entities are translated into the UK Sterling presentational currency of the Group using monthly average exchange rates. On consolidation, exchange differences arising from the translation of overseas net assets are recognised in the translation reserve and recycled to the Consolidated Income Statement upon any full disposal.

Goodwill is denominated in the currency of the original Cash Generating Unit ("CGU") to which it was allocated on acquisition. Fair value adjustments arising on the acquisition of a foreign operation are treated as assets and liabilities denominated in the currency of the overseas operation. Any exchange differences on intercompany funding loans are deferred to equity, to the extent that these are considered permanent in accordance with IAS 21 Foreign Exchange.

Trading entities have a functional currency consistent with the denomination of cash inflows and outflows being also consistent with the primary currency of their location. Local market transactions in a different currency to each local functional currency are translated using average exchange rates provided these are materially similar to the spot rate on the transaction date. These foreign exchange differences are recognised in the same category in the Consolidated Income Statement as the underlying transaction, except for milestone and royalty revenues where foreign exchange is presented within net finance (expense) / income.

Revenue represents the amount receivable for goods and services provided and royalties earned, net of trade discounts, VAT and other sales-related taxes. Revenues from partnering contracts with multiple revenue streams or conditions are recognised separately in line with the contractual terms and the nature of the revenue streams.

Revenues are recognised when the Group's obligations related to the revenues have been discharged and their collection is reasonably assured as follows:

2.3.1 Royalty income

Royalty income is recognised on an accruals basis and represents income earned as a percentage of partner product sales in accordance with the terms of each agreement, net of amounts payable to other licensees. As management are not directly responsible for the sale of the product to the market they prepare an estimate the level of royalties to be earned and compare this to external sales data reported by partners and royalty statements received.

2.3.2 Share of net sales of EXPAREL®

The Group is entitled to receive a percentage of net sales of EXPAREL® (based on cash received by Pacira) in the USA, Japan, UK, France, Germany, Italy and Spain until the expiry of certain patents. The recognition of these amounts is in line with the royalty income recognition as per 2.3.1.

2.3.3 Signing and milestone payments

Signing and milestone payments represent amounts earned for licences or payments relating to development achievements.

Upfront signing milestones received on entering collaborative development agreements, as per industry practice, are deferred onto the balance sheet and then subsequently released to revenue over the appropriate stage of completion of the development services provided.

Milestone payments received in advance are treated as deferred until the milestone is achieved. Milestones which are contingent upon achieving a development or sales target are recognised when achieving them is virtually certain and recovery is assured.

2.3.4 Development services

Development services revenues principally comprise of contract product development and contract clinical trial manufacturing fees invoiced to third parties. Revenues are recognised upon the completion of agreed tasks or spread over the duration of the task, as appropriate.

2.3.5 Product supply and device sales

Product supply revenues being income derived from manufacturing and supply agreements are generally recognised upon transfer to the customer of significant risks and rewards, usually upon the goods being available for collection, the customer being informed of this and where the sales price is agreed and collectability is reasonably assured.

2.4 Segmental reporting

The Group is managed on the basis of a single reportable segment, being the development and supply of pharmaceutical products. This is consistent with the internal reporting provided to, and regularly reviewed by, the Chief Operating Decision Maker ("CODM"). The CODM is responsible for allocating resources and assessing performance of the operating segment and has been identified as the Board.

2.5 Research and development ("R&D") expenses

R&D expenses comprise internal employee costs and third party service costs relating to feasibility studies, technical development, costs of chemistry, manufacturing of trial batches, clinical work and the registration and maintenance of intellectual property. As the nature of our R&D projects is associated with obtaining regulatory approval, these costs rarely meet the IAS 38 criteria for capitalisation and are normally charged to the Consolidated Income Statement as the expenses are incurred.

2.6 Other income

Other income relates to government grants for qualifying UK R&D under the Research and Development expenditure credit ("RDEC") scheme for large companies. Such grants are taxable and are presented as other income in the Consolidated Income Statement.

2.7 Current taxation

The net taxation credit on the loss for the year includes current and deferred tax. Current tax comprises the expected tax payable or receivable on the taxable income or loss for the year and any adjustment to the tax payable or receivable in respect of previous years. The amount of current tax payable or receivable is the best estimate of the tax amount expected to be paid or received using tax rates enacted at the reporting date.

2.8 Deferred taxation

Deferred taxation is recognised on all temporary differences arising between the local tax bases of assets and liabilities and their carrying amounts in the Group's consolidated financial statements.

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

Deferred tax is not discounted and is measured at the tax rates that are expected to apply when the related asset is realised or liability is settled, based on legislation enacted or substantively enacted at the balance sheet date.

2.9 Goodwill

On acquisition of a subsidiary or associate, the fair value of the consideration in excess of the identifiable net assets and liabilities is recognised as goodwill. Goodwill is not amortised, but is reviewed for impairment at least annually, or more frequently where there is an indication of possible impairment.

Goodwill is held in the functional currency of the CGU to which it was originally allocated for impairment testing reflecting the original assessment of which CGUs would benefit from synergies from the combination. Following any significant reorganisation the denomination of goodwill is not changed but could be reallocated to different CGUs being the lowest identifiable level that goodwill is monitored for the purposes of annual impairment testing.

2.10 Intangible assets

Intangible assets 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 (FAVORITE™) separately acquired through the Activaero transaction on 13 March 2014 and leveraged in development programmes including VR475 (FAVOLIR®) and VR647 (SCIPE®). These assets are amortised in line with the expected consumption of economic benefits.

UEL assumptions do not exceed 8 years and amortisation is applied on a straight-line basis.

2.11 Property, plant and equipment ("PP&E")

PP&E is initially recognised at cost with depreciation subsequently applied evenly over its estimated life less any residual value. PP&E is depreciated on a straight-line basis over the estimated useful lives, as follows:

- Land and Buildings – 20 to 50 years
- Laboratory and supply chain equipment – 3 to 10 years

PP&E for the *flutiform*® supply chain is depreciated using the units-of-production method. No depreciation is provided on freehold land or assets under construction. On disposal of PP&E, the carrying value, less any proceeds, is recognised in the Consolidated Income Statement.

2.12 Impairment of non-current assets

Impairment of goodwill is assessed by measuring the future cash flows of the CGU to which the goodwill relates versus the carrying value of the CGU. An impairment loss is recognised for goodwill in the Consolidated Income Statement when the carrying value of the CGU is less than its future cash flows. Impairments of goodwill are not reversed in subsequent periods.

The carrying values of all other non-current assets are reviewed for impairment, either on a standalone basis or as part of a larger cash generating unit, when there is an indication that the assets might be impaired.

2.13 Inventories

Inventories are stated at the lower of cost and net realisable value. Costs include the direct costs and, where applicable, an allocation of overheads incurred in bringing inventories to their current location and condition. Net realisable value is based on estimated selling price, less any further costs expected to complete the sale of goods.

2.14 Financial Instruments

For the purposes of recognition and measurement financial assets are classified into one of these categories

- Trading activities: Assets that are held for collection of contractual trading cash flows are measured at amortised cost. A gain or loss is recognised in the consolidated income statement only when the asset is derecognised or impaired. Interest income is included in finance income using the effective interest rate method if applicable.

- Financial assets held for future sale: Assets that are held for collection of contractual cash flows and for selling the financial assets are measured at fair value through other comprehensive income ("OCI").

In instances where the financial assets meets neither category, they are measured at fair value through profit and loss ("FVTPL"). Due to the short-term nature of the current receivables, their carrying amount is considered to be the same as their invoice amount as interest is not applicable to the contract.

For trade receivables, the Group applies the simplified approach permitted by IFRS 9, which requires expected lifetime losses to be recognised from initial recognition of the receivables. Financial Liabilities are initially measured at fair value and subsequently measured at amortised cost.

2.15 Provisions

Provisions are liabilities where the exact timing and amount of the obligation is uncertain. Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of past events, when an outflow of resources is probable to settle the obligation and when an amount can be reliably estimated.

Where the time value of money is material, provisions are discounted to current values using appropriate rates of interest. The unwinding of the discounts is recorded in net finance income or expense.

2.16 Retirement obligations

The Group's obligations for its Swiss pension scheme are to pay defined contributions. However, in accordance with the Swiss law "LPP/BVG", the pension scheme incorporates certain guarantees, and has therefore been reported as a defined benefit pension plan in accordance with IFRS.

Pension obligations are measured as the present value of estimated future cash flows discounted at rates reflecting the yields of high quality corporate bonds. Pension scheme assets are measured at fair value at the balance sheet date. Remeasurements of the net defined benefit liability, which comprise actuarial gains and losses, and the return on plan assets (excluding interest) are recognised immediately in OCI. When the benefits of a plan are changed or when a participant is curtailed, the resulting gain or loss on curtailment is recognised immediately in the Consolidated Income Statement.

2.17 Share-based payments

The Group operates a number of employee equity-settled share-based compensation plans as part of the Total Reward Strategy. Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date of the awards 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.

2.18 Employee share trusts

The Group provides finance to ESOP Trusts to either purchase company shares on the open market, or to subscribe for newly issued share capital, to meet the Group's obligation to provide shares when employees exercise their options or awards. Costs of running the ESOP Trusts are charged to the Consolidated Income Statement. Shares held by the ESOP Trusts are deducted from reserves and presented in Equity as Own Shares until such time that an employee exercises their award.

2.19 Share buyback and cancellation programme

As re-purchased shares are cancelled immediately after being bought back, the amount of the consideration paid and directly attributable costs are booked to retained earnings.

2.20 New accounting requirements

Adopted in the period - **IFRS 9** ***"Financial Instruments"***

The Group adopted IFRS 9 on 1 January 2017, albeit it had no financial impact on either the current or comparative period. IFRS 9 addresses the classification, measurement and derecognition of financial assets and financial liabilities, introduces new rules for hedge accounting, a new impairment model for financial assets and early recognition of expected credit losses.

The Group is not involved with complex financial instruments, has not to date applied hedge accounting, nor has any history of material credit losses. As such the only impact of adoption has been on disclosures. IFRS 9 provides a new hedge accounting model which is optional to apply and is closer aligned to commercial activities, such it may in future be applied if the Board deem applicable. Refer to note 26 "*Financial Instruments*".

Adopted in the period - IFRIC 22 "*Foreign Currency Transactions and Advance Consideration*"

IFRIC 22 clarifies the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of advanced payments for assets or liabilities for deferred income. This guidance has been adopted in advance of formal EU endorsement, which is expected imminently, as it provides additional clarification to the application of existing accounting policies rather than any amendments to those policies.

The date that payments are made is the reference date for foreign exchange and should not be remeasured for changes in exchange rates occurring afterwards on the date of recognition of the transaction to which that consideration relates.

2.21 New standards not adopted that will be adopted in the next reporting period

IFRS 15 "*Revenue from Contracts with Customers*"

The Group will have to apply IFRS 15 to the next reporting period as it will be mandatory to do so. IFRS 15 establishes a comprehensive framework for determining whether, when and how much revenue is recognised in each reporting period, which is particularly relevant for longer term development, licensing and marketing contracts.

Transitional impact of IFRS 15 on Vectura - cumulative effect method

The Group has performed an IFRS 15 assessment on all revenue contracts, taking advantage of the practical expedient available removing the requirement to apply IFRS 15 to contracts that are considered completed on 1 January 2018.

A contract is considered complete once all performance obligations relevant to the receipt of future revenues have been satisfied. This applies to all royalties for licences of on-market products. The existing IAS 18 treatment is maintained, which is compliant with IFRS 15 guidance for sales and usage based license royalties.

Product supply performance obligations arise on receipt of customer purchase orders to transfer inventory to the customer. As there is only one performance obligation to allocate revenues across, the new guidance will not generate a difference (consistent with the current treatment).

However 2017 revenues are estimated to be £0.5m higher on an IFRS 15 basis due to accelerated recognition of development revenues, but this review is ongoing. It is not expected that IFRS 15 will result in a material impact on underlying core revenue streams (royalties, product supply and share of net sales). Because the impact of this transitional adjustment is limited, the Group plans to adopt IFRS 15 using the cumulative effect method through equity as opposed to restating the 2017 comparative when reporting the 2018 results.

Impact of IFRS 15 on subsequent periods

Previous industry practice was to spread upfront signing milestones over the development period, on a basis consistent with the service being provided, irrespective of whether a licence is transferred on signing. However, IFRS 15 requires an assessment be made of how much of the signing milestone relates to R&D services and how much relates to the license. The revenue allocated to the licence performance obligation will be recognised when the licence is transferred which is normally upon signing consistent with current treatment, the amount allocated to R&D services will be recognised as that service is delivered.

The Group is required to identify performance obligations in its agreements under IFRS 15. In certain cases, performance obligations identified under an IFRS 15 assessment may differ from those under the current accounting policy assessments, thereby altering the timing of revenue recognition and classification between income streams.

Acceleration of development milestones where future receipt is considered probable: the receipt of future development stage milestones will be accelerated to the extent that their future receipt is considered highly probable and significant reversal of revenue will not occur in the future.

It is therefore expected that a significantly higher proportion of signing milestones will be recognised immediately on entering into new collaborative arrangements.

2.22 New standards not adopted mandatory at 1 January 2019

The following Standard and Interpretation are mandatory for periods beginning on or after 1 January 2019 with early adoption possible. At present the Group has not adopted these but indicates the likely future impact below.

IFRS 16 *"Leases"*

IFRS 16 eliminates the classification of leases as either operating leases or finance leases and introduces a single lessee accounting model where the lessee is required to recognise assets and liabilities for all material leases that have a term of greater than a year. There are recognition exemptions for short-term leases and leases of low-value items. The Group has completed an initial impact assessment on its consolidated financial statements but has not yet completed its detailed assessment.

The Group has operating lease commitments of £6.6m (2016: £7.5m) as disclosed in note 31 *"Commitments and contingent liabilities*". The IFRS 16 lease liability is expected to be in the region of £4.5m on initial recognition based on the current lease portfolio. A corresponding asset of approximately £2.5m reflecting the Group's right to use the asset will also be recognised. Rental charges of approximately £1.0m will be recognised outside of Adjusted EBITDA replaced with additional interest and depreciation of a similar value. As a detailed assessment has yet to be performed it is unclear what other adjustments, if any, will be required upon initial adoption.

IFRIC 23 *"Uncertainty over Income Tax Treatments*"

IFRIC 23 has been issued to clarify the accounting for uncertainty within tax positions. This guidance precedes significant changes expected to tax legislation across a number of jurisdictions applicable to locations in which the Group operates. The application of a weighted average probability to the interpretation of uncertain country-specific tax legislation would not materially reduce the value of assets and liabilities recognised in these consolidated financial statements.

However, it is not possible to assess how this new guidance will impact reported tax balances from 2019 onwards. A far reaching proposal to reform the current Swiss Tax regime currently lacks clarification as to the application and transitional arrangements at both federal and cantonal level. It also remains unclear as to the terms and timing of the planned UK exit from the European Union and the associated impact on tax legislation.

2.23 Comparative period accounting for the Skyepharma merger (the "merger")

The acquisition method of accounting was applied to Skyepharma on the merger date with assets and liabilities recognised at their fair value on the acquisition date, in accordance with IFRS 3. An overview of the impact is provided below. Refer to note 27 "*Prior Period Business Combination – Skyepharma merger".*

	10 June 2016
	£m
Intangible assets recognised at fair value on the merger date	379.5
Property plant and equipment	39.5
Fair value of current net assets acquired	28.3
Net deferred tax liabilities	(56.3)
Fair value of other net assets acquired	(16.3)
Fair value of Skyepharma net assets acquired	**374.7**
Goodwill recognised	**100.8**

Refer to note 15 "*Goodwill*", note 16 "*Intangible assets*", note 25 "*Deferred tax liabilities*" for the most significant areas of the financial statements impacted by the subsequent measurement of the acquisition balance sheet.

3 Revenue

Revenue by income stream

	Year ended 31 December 2017	**9 months ended 31 December 2016**
	£m	**£m**
Product supply and device sales	**74.7**	50.3
Royalties	**50.1**	32.0
Net sales from EXPAREL®	**6.6**	3.5
Underlying revenue	**131.4**	85.8
Signing and milestone payments	**5.1**	20.5
Development services	**9.0**	4.5
Royalties	**2.5**	15.5
Other	**-**	0.2
Non-recurring revenue	**16.6**	40.7
Total revenue	**148.0**	126.5

Underlying revenue relates to core revenues comprising license royalties, product supply revenues and share of net sales of EXPAREL®.

Revenues from non-recurring sources comprise of milestones and development services revenues, which can vary materially between reporting periods based and non-recurring royalties related to the discontinued royalties from ADVATE® and the termination of legacy Vectura royalties with GSK for the Ellipta® products which is currently subject to a legal dispute (refer to note 10 *"Exceptional items"*).

Revenue by geographic location

	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
United Kingdom	**49.2**	45.6
Japan	**33.0**	17.7
Switzerland	**27.3**	20.1
Rest of Europe	**15.3**	11.3
United States of America	**13.8**	31.3
Rest of world	**9.4**	0.5
Total revenue	**148.0**	126.5

The geographic split of revenue is based on the location of the customer being invoiced, as opposed to the country in which products are delivered or services provided to patients.

Revenue from major customers

For the year ended 31 December 2017 three customers contributed individually in excess of 10% of total revenue as follows: Customer A – £35.2m, Customer B – £33.0m and Customer C – £17.1m. In the comparative nine month period revenue earned from the Group's major customers was as follows: Customer A – £31.0m, Customer B – £22.4m, Customer C – £17.6m and Customer D – £13.3m.

4 Segmental information

The Group is managed on the basis of a single reportable segment, being the development and supply of pharmaceutical products and as such no separate segmental information is provided as it would not be different from the Consolidated Income Statement. The Chief Operating Decision Maker, represented by the Board, allocates resources on the basis of integrated management information, which focuses on Adjusted EBITDA as detailed in note 8.

Non-current assets by geographical location are as follows:

	31 December 2017 £m	31 December 2016 £m
Switzerland	**356.7**	**442.6**
United Kingdom	**106.1**	103.0
Germany	**71.9**	94.5
United States of America	**11.6**	30.9
France	**11.0**	7.4
Total non-current assets	**557.3**	678.4

5 Research and development expenses

	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
Vectura enhanced assets	**34.2**	21.1
Novel-patented molecule partnering projects	**14.3**	15.0
Generic/analogue and device partnering projects	**9.5**	8.7
Other oral projects	**2.3**	0.8
Total research and development expenses	**60.3**	45.6

6 Employees

The average number of full time equivalent employees were as follows:

	Year ended 31 December 2017	9 months ended 31 December 2016*
	Number	Number
Research and Development and related support services	**310**	281
Business development and corporate administration	**19**	24
Manufacturing and supply chain	**135**	97
Total average number of full time equivalent employees	**464**	402

*Employees at the Swiss R&D and French manufacturing sites were only included for 74% of the comparative nine month period following the Skyepharma merger which was effective on 10 June 2016. In addition, the above employee data includes staff employed on fixed term contracts to assist with the delivery of integration initiatives, as well as covers for maternity, paternity and illness. Headcount at the end of the year was 478 (2016: 453).

The aggregate remuneration of employees was as follows:

Aggregate remuneration	Year ended 31 December 2017	9 months ended 31 December 2016
	£m	**£m**
Wages and salaries	**34.6**	22.8
Social security costs	**4.8**	3.8
Payments to defined benefit pension plans	**0.7**	0.7
Payments to defined contribution pension plans	**2.0**	0.7
Total aggregate remuneration	**42.1**	28.0

Directors' remuneration is detailed in the Remuneration Report and key management personnel is detailed in note 32 *"Related-party transactions".*

7 Other Income

The Group will claim R&D Expenditure Credits ("RDEC") of £1.7m in the year ended 31 December 2017 alongside the tax return filing process (2016: £1.5m). As these credits are subject to corporation tax they are presented as other income. Other than HMRC's acceptance of the tax return, there are no unfulfilled conditions or other contingencies attaching to this income.

During the year the Group received £2.1m (2016: £2.5m) in respect of R&D tax credit claims. A receivable of £3.8m (2016: £4.5m) remains outstanding at the balance sheet date.

8 Adjusted EBITDA

Adjusted EBITDA is a non-statutory measure used by the Board, the Executive Leadership Team and managers of the business to monitor the Group's performance as they provide useful information about the business's underlying cash generating performance.

Adjusted EBITDA is defined as operating profit before exceptional items and amortisation, adding back charges for share-based payments and depreciation.

	Note	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
Loss before taxation		**(102.2)**	(40.1)
Amortisation and impairment of intangible assets	16	**109.7**	64.0
Exceptional items	10	**4.5**	9.4
Share of movement of associates	11	**3.4**	(0.4)
Net finance expense / (income)	12	**2.6**	(4.0)
Operating profit before exceptional items and amortisation		**18.0**	28.9
Depreciation of property, plant and equipment	17	**5.7**	3.4
Share-based payments	29	**2.1**	1.8
Adjusted EBITDA		**25.8**	34.1

9 Auditor's remuneration

Following a competitive tender process, led by the Audit Committee, KPMG LLP and other member firms of the KPMG network were formally appointed as the Group's external auditor at the Annual General Meeting on 25 May 2017. Deloitte LLP had previously been the Group's auditors since 2007.

KPMG (2016: Deloitte) respective fees as the consolidated Group's statutory auditors were as follows:

	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
Audit of the Group's annual accounts	**0.4**	0.1
Audit of the Group's subsidiaries	**0.1**	**0.1**
Total audit fees	**0.5**	0.2
Other services	**0.1**	—
Total non-audit fees	**0.1**	—
Total fees payable to the Group auditors	**0.6**	0.2

The fees shown in relation to 2017 were payable to KPMG LLP and those shown in relation to 2016 were payable to Deloitte LLP.

In the comparative period, Ernst & Young were retained as auditor for the Group's subsidiaries in Switzerland, France and the United States of America. In 2017 Ernst & Young remain the statutory auditors for France. Total audit fees payable to Ernst & Young in 2016 were £0.3m in addition to the fees included in the above table.

KPMG fees for other services comprise £65,000 for the 2017 interim review and £40,000 of permissible non-audit fees related to their appointment as liquidators of 14 UK dormant subsidiary entities. Refer to note 5 "*Disposal of dormant subsidiaries*" of the Parent Company financial statements.

10 Exceptional items

	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
Merger transaction costs [1]	—	6.1
Post-merger integration costs [3]	**4.5**	3.9
One-off research and development accrual release [2]	**(2.2)**	—
Legal fees [2]	**1.8**	0.1
Other exceptional items [4]	**0.4**	(0.7)
Total exceptional items	**4.5**	9.4

Classification if costs were not presented as exceptional:

[1] Classified as corporate and administrative expenses
[2] Classified as research and development expenditure
[3] Classified within corporate and administrative expenses and research and development expenditure
[4] Classified within cost of sales and research and development expenditure

Post-merger integration costs include £2.7m (2016: £3.0m) of one-off instances of spend on projects required to combine the two businesses. This primarily relates to Human Resources, Finance and Information Technology and costs from a third party consultancy to harmonise ways of working and enhance productivity across the UK, Swiss and German R&D functions.

In addition, post-merger integration costs include a share based payment charge of £1.8m (2016: £0.5m). Upon completion of the merger, 1,490,982 exceptional nominal awards were granted to key members of management considered critical to the integration process. These awards vest in full provided that an 18-month or 36-month service condition is met from their September 2016 grant date. The grant date fair value was £1.41 per share and the total share-based payment charge, reduced when lapses occur, is expensed evenly.

As part of the merger integration and alignment, management has performed a detailed review of the research and development accruals during 2017, including historical accruals. This activity identified a number of individually immaterial historic accruals where it is no longer considered probable that these accruals will result in future cash outflows. The accruals, totalling £2.2m, have been released in the 2017 consolidated income statement and are presented within exceptional items to enable users to understand the impact of the credit on the current year performance. Management has determined that there is no material impact of the accruals on any comparative income statement, balance sheet or cash flow statement.

Legal fees arise from progression of legal proceedings against GSK relating to enforcement of Vectura's patents in respect of the Ellipta® products.

Other exceptional items include £0.8m (2016: £0.4m) of restructuring at the Group's manufacturing facility in Lyon, France following the facility transferring back to Vectura in July 2016. The remainder of the restructuring costs will be incurred in 2018. Other exceptional items also include a £0.2m credit relating to the movement in an onerous lease provision in Switzerland, and gains from Swiss pension curtailments of £0.2m (2016: £1.1m) which have been presented as exceptional as they relate to post-merger structuring. Refer to note 24 "*Retirement benefit obligations"*.

11 Associates

During the year the carrying values of the associates were fully written off to £nil (2016: £1.7m) owing to share of losses and other charges recognised in the Consolidated Income Statement of £3.4m (2016: £0.4m credit).

The Group does not recognise further losses as it currently has no future obligations to fund future losses or to make payments on behalf of the other entity.

Ventaleon GmbH

Following expenditure associated with phase 1b and phase 2 clinical trials, the Group's share of Ventaleon's losses for the year to 31 December 2017 were £1.5m (2016: £0.4m credit), inclusive of £0.1m foreign exchange gain. The Group impaired the remaining value of £0.3m.

Tianjin Kinnovata Pharmaceutical Co. Ltd

During the year, the Group received confirmation that the Chinese State authorities had approved the valuation of assets contributed by Vectura to this associate in return for an effective 37.84% share in Tianjin Kinnovata Pharmaceutical Company Limited ("Kinnovata"). The investment is held through Innovata (HK) Limited. Refer to Parent Company note 6 *"Subsidiary, associate and dormant undertakings"* for details of the classes of shares held through the sub-structure.

Kinnovata will develop, manufacture and commercialise the Clickhaler® and Duohaler® respiratory products for the Chinese market. Vectura contributed the intellectual property associated with Clickhaler® and Duohaler® and will be entitled to a 5% royalty on future net sales.

During the year contributions of £1.6m, comprising £0.6m for new equipment and a £1.0m waiver of a loan outstanding, were made. These transactions are considered to be at arms-length. The Group is not committed to make any further contributions and Vectura's share could be diluted if it does not participate in future capital raises.

No value of future benefit is attributed to the investment and no gain is recognised as a result of Vectura's contribution.

12 Net finance income / (expense)

	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
Bank interest income	**0.2**	0.2
Bank interest expense	**(0.2)**	(0.3)
RCF commitment fees	**(0.2)**	(0.1)
Other financing items	**(1.0)**	-
Net finance expense before foreign exchange	**(1.2)**	(0.2)
Foreign exchange (losses) / gains	**(1.4)**	4.2
Net finance (expense) / income	**(2.6)**	4.0

The Group does not have any significant borrowings. Bank interest expense is £0.2m (2016: £0.3m) comprising of interest payable on Swiss property mortgages, and bank interest income of £0.2m (2016: £0.2m) has been earned from cash on deposit.

Foreign exchange relates foreign currency cash on deposit in Switzerland and the UK, and the revaluation of royalty and milestone receivables in foreign currency in Switzerland and the UK.

13 Taxation

	Year ended 31 December 2017	9 months ended 31 December 2016
	£m	£m
Current taxation on profitable subsidiaries	**(5.9)**	(4.4)
Adjustments to prior periods recognised	**0.4**	1.4
Total current taxation charge	**(5.5)**	(3.0)
Deferred taxation (note 25)	**22.0**	11.0
Net taxation credit	**16.5**	8.0

Deferred taxation charges of £1.4m (2016: £0.9m) were also recognised in other comprehensive income.

Current taxation arises from trading profits generated in Switzerland and the US. Deferred tax relates predominantly to credits arising on the unwinding of tax liabilities on the intangible assets acquired as a result of the acquisition of Activaero and the Skyepharma merger.

The Group's effective tax rate ("ETR") before OCI is a 16.15% credit. This equates to the applicable UK tax rate of 19.25%, adjusted for a number of factors discussed below.

The implementation of Organisation for Economic Co-operation and Development guidelines on Base Erosion and Profit Shifting ("BEPS") is not expected to impact the Group's tax position.

UK Taxation
The UK sub-Group is loss-making and benefits from the R&D Expenditure Credit ("RDEC"). The RDEC is subject to UK corporation tax and therefore is included within the Consolidated Income Statement and presented as Other Income. Refer to note 7 "*Other Income*". In addition, UK companies are able to participate in the UK Patent Box regime, the benefit of which is expected to increase as new products are approved. The UK corporation tax rate has reduced to 19% with effect from 1 April 2017, and will reduce to 17% from 1 April 2020, which has been substantively enacted. The impact on the group accounts is expected to be immaterial.

US Taxation
Taxable income arises in respect of the percentage of net sales received from EXPAREL®. Vectura expects its future US after-tax earnings to be positively impacted by the recently-enacted changes to US corporate taxes, largely due to the reduction of the US federal corporate income tax rate from 35% to 21% (effective 1 January 2018) which will be applied to the final contingent $32m milestone. The ultimate impact of the change in the US corporate tax rate is under review. The lowering of the US corporate income tax rate to 21% resulted in a reduction in the value of Vectura's US deferred tax liabilities. A credit to the consolidated income statement of £1.6m was recognised as a result. The Group does not recognise any deferred tax assets in respect of the US, and therefore no adjustment to the carrying value for the rate change was required.

Swiss Taxation
Vectura continues to monitor the impact of Swiss Corporate Tax reform. On 6 September 2017, the Swiss Federal Council indicated that tax proposal 17 ("TP17") shall be dispatched to the Parliament in Spring 2018. The Group monitors the situation closely and, while the overall tax burden is unlikely to change materially, there are a number of complex provisions in the legislation and a number of areas yet to be finalised and hence once enacted will likely cause an adjustment to the amounts recognised in these Consolidated Financial Statements.

Effective tax rate ("ETR")
In Switzerland and the US, the Group is profitable and subject to taxation at the local rates (Swiss ETR 8.5% charge, and the US corporate rate applied is 34% (ETR 2017: 42.9% charge)). The uncertain tax position disclosed has increased by £4.1m in the year (which includes a prior period adjustment following a change in basis as advised by the Group's tax advisors). These charges, along with a significant credit (ETR: 17.6% credit) in respect of deferred tax liabilities relating

to intangible assets acquired on the Skyepharma and Activaero acquisitions (refer to note 25 “Deferred Tax Liabilities”), together drive the Group’s ETR of 16.15% (credit).

	Year ended 31 December 2017	9 months ended 31 December 2016
	£m	£m
Loss before tax	**(102.2)**	(40.1)
Loss before tax multiplied by standard rate of UK corporation tax of 19.25% (31 December 2016: 20%)	**19.7**	8.0
Effects of:		
UK Patent box benefit	**0.1**	1.2
Expenses not deductible for tax purposes*	**(2.5)**	(1.2)
Unrecognised deferred tax**	**(5.4)**	(1.2)
Prior year deferred tax	**0.5**	(0.6)
Research and development tax credits	**-**	1.4
Differences arising from prior period computations	**0.4**	0.2
Differences in effective overseas tax rates	**2.1**	0.2
Impact of Deferred Tax rate change	**1.6**	-
Total tax credit for the period	**16.5**	8.0

*Expenses not deductible for tax purposes in the previous period relate to merger transaction costs

** Unrecognised deferred tax mainly relates to losses incurred for which no deferred tax assets have been recognised as future recovery, or timing of recovery, cannot be supported.

The ETR is expected to remain in the low-teens (credit) percentage rate in the short to medium term as a result of reduced loss relief available to offset against taxable profits, as well as the expected increase in the Swiss tax rate following the proposed reform. The significant credit in respect of deferred tax liabilities on intangibles acquired is expected to continue in the short to medium term and this will continue to drive a credit ETR.

14 Loss per share

	Year ended 31 December 2017	9 months ended 31 December 2016
	pence	pence
Basic	**(12.6)**	(5.3)
Diluted	**(12.6)**	(5.3)

Options granted under Employee Share plans are antidilutive for the year ended 31 December 2017.

The following table provides details of the dilutive impact as if the shares had been considered dilutive. The calculation is based on the following data

	Year ended 31 December 2017	9 months ended 31 December 2016
Loss after taxation (£m)	**(85.7)**	(32.1)
Weighted average number of shares (m)	**678.9**	608.9
Effect of dilutive potential shares (m)	**6.2**	5.3
Diluted weighted average number of shares (m)	**685.1**	614.2

In accordance with IAS 33 *“Earnings Per Share”* the future impact of share buyback programmes are not relevant to loss per share as these are calculated on the basis of shares in issue at the reporting date.

15 Goodwill

	31 December 2017	31 December 2016
	£m	£m
At beginning of the period	**162.8**	57.4
Skyepharma merger (note 27)	**-**	100.8
Foreign exchange	**(1.4)**	4.6
At end of the period	**161.4**	162.8
Allocation to cash generating units (CGUs)		
UK and Germany	**100.1**	99.8
Switzerland	**61.3**	63.0
At end of the period	**161.4**	162.8

The recoverable amounts of the cash generating units are assessed using a fair value less costs of disposal model. Fair value less costs of disposal is calculated using a discounted cash flow approach, with a post-tax discount rate applied to the projected risk-adjusted post-tax cash flows and terminal value.

The discount rate used is based on the Group weighted average cost of capital ("WACC") of 9% (2016: 9%) as assessed by external experts. Management consider this to be their best approximation of a market participant rate as required by IAS 36. The discount rate is adjusted for specific country or currency risks but at present as both cash generating units have global large pharmaceutical partners, operations and/or customers in each other's territory, share access to short term funding through the Revolving Credit Facility ("RCF"), it is considered that the same discount rate should be applied to each CGU. There is currency risk associated with Switzerland, there is risk in the UK associated with Brexit and in the medium term both countries are expected to be closely affiliated with, but outside of, the European Union.

Cash flows are based on the most recent budget approved by the Board covering 2018 and 2019 and the 10 Year Plan to 2027. Details relating to the discounted cash flow models used in the impairment tests of the cash generating units are as follows:

Valuation basis	Fair value less cost of disposal
Key assumptions	Time to develop and launch pipeline products Net sales forecasts and related royalty inflows Milestones for pipeline products Profit margins for product supply Terminal growth rate Discount rate Taxation rate
Determination of assumptions	Net sales forecasts are determined from partner forecasts and external market data. Milestone amounts and royalty rates reflect past experience and forecast sales potential determined from external market data Margins reflect past experience, adjusted for expected changes. Terminal growth rates based on management's estimate of future long-term average growth rates. Discount rates based on Group WACC, adjusted where appropriate. Taxation rates based on appropriate rates for each region
Specific projected cash flow period	10 years (reflecting a longer term planning cycle)
Terminal growth rate	nil
Discount rate	9%

The available headroom for the UK and Germany CGU has reduced versus 31 December 2016 following the delay in approval for VR315 US. In addition, headroom for the Swiss CGU is lower as a result of stopping the development of VR2076.

The Group conducted a sensitivity analysis on the impairment test of each CGU's carrying value. The Group considered 12% to be a reasonably possible downside sensitivity. While this reduces headroom, it does not alter Management's assessment of future impairment risk which is not considered significant. The UK and German CGU valuation indicates sufficient headroom such that a reasonably possible change in a key assumption is unlikely to result in an impairment of the related goodwill. The forecasts would need to reduce by in excess of 70% primarily because this CGU comprises internally generated intangibles which are included in the valuation, but not the carrying value of the assets comprising the CGU.

The Swiss CGU also shows significant headroom. It has been calculated that a 33% reduction in the forecast or a 10% reduction in the forecast using a 12% discount rate would likely cause Goodwill impairment next year, but as this assessment excludes the impact of any new business, or upside in existing business the risk of this happening is considered remote. Impairment of this CGU has been removed as a critical accounting estimate this year principally because the intangible assets are being amortised and each year the risk of impairment decreases.

IAS 36 *"Impairment of Assets"* requires the use of pre-tax cash flows and pre-tax discount rates. However, discounting post-tax cash flows at a post-tax discount rate should give materially the same result when there are neither temporary differences nor available tax losses at the measurement date.

16 Intangible assets

	Inhaled in-market assets £m	Smart nebuliser technology* £m	Non-inhaled in-market assets £m	Other £m	Total £m
Cost:					
At 01 April 2016	3.5	123.1	74.6	—	201.2
Skyepharma merger	292.5	—	72.0	15.0	379.5
Additions	—	—	0.1	—	0.1
Foreign exchange	31.2	9.6	10.1	1.7	52.6
At 31 December 2016	327.2	132.7	156.8	16.7	633.4
Additions	—	—	—	0.2	0.2
Disposals and write-offs	(3.5)	—	(74.6)	—	(78.1)
Foreign exchange	(14.6)	5.6	(5.4)	(0.8)	(15.2)
At 31 December 2017	309.1	138.3	76.8	16.1	540.3
Amortisation:					
At 01 April 2016	(3.5)	(31.4)	(74.1)	—	(109.0)
Amortisation	(27.5)	(14.7)	(16.7)	(5.1)	(64.0)
Foreign exchange	(0.3)	(2.7)	(0.6)	—	(3.6)
At 31 December 2016	(31.3)	(48.8)	(91.4)	(5.1)	(176.6)
Amortisation	(49.4)	(20.6)	(29.6)	(1.4)	(101.0)
Impairment	—	—	—	(8.7)	(8.7)
Disposals and write-offs	**3.5**	—	**74.6**	—	78.1
Foreign exchange	3.1	(2.3)	3.0	(0.5)	3.3
At 31 December 2017	(74.1)	(71.7)	(43.4)	(15.7)	(204.9)
Net book value:					
At 31 December 2017	**235.0**	**66.6**	**33.4**	**0.4**	**335.4**
At 31 December 2016	295.9	**83.9**	65.4	11.6	456.8

* used in pipeline programmes

The intangible assets recognised on the Skyepharma merger principally comprise *flutiform*®**,** EXPAREL®, GSK's Ellipta® products, other marketed products and VR2076 (now fully impaired). These intangible assets are being amortised over a period of between two and seven years with reference to average applicable patent lives in the Group's main territories.

Inhaled in-market assets include a large number of acquired licences, patents, know-how agreements and marketing rights, which are in use, and the Group receives royalties or product supply revenue from these. Non-inhaled in market assets include a large number of near end of life acquired licences, patents, know-how agreements and marketing rights, which are in use, and from which the Group continues to receive royalties.

Intangible assets also include smart nebuliser-based technology (FAVORITE™) separately acquired through the Activaero transaction on 13 March 2014 and leveraged in development programmes including VR475 (FAVOLIR®) and VR647 (SCIPE®). These assets are amortised in line with the consumption of economic benefits.

In December 2017 Mundipharma informed the Group of their decision to stop the development of the pMDI triple therapy for asthma and COPD (VR2076), in an early formulation phase. As an acquired programme from the Skyepharma merger, VR2076 had a book value of at £8.7m which accordingly has been fully impaired.

For the purposes of impairment testing a value in-use approach, consistent with the approach described in the table below.

Details relating to the value in use calculations uses for the impairment testing are as follows:

Transaction	Skyepharma merger 10 June 2016		Activaero acquisition 13 March 2014
Intangible type	Inhaled in-market assets	Non-inhaled in-market assets	Smart nebuliser technology
Specific asset subject to impairment	*flutiform*®	EXPAREL®	VR475 (FAVOLIR®) VR647 (SCIPE®)
Key assumptions	Product supply volume forecast Margin (depending on pricing assumptions, raw material costs and cost of manufacture) Discount rate	Timing of $32.0m sales milestone from achieving annual net sales of $500m	Net sales forecasts and royalty rates thereon Probability of success
Determination of key assumptions	Internal forecasts with input from partners and external market data (pricing trends, competition etc.) Margins reflect past experience, adjusted for expected changes in pricing, raw material costs and cost of manufacture. Discount rate based on Group WACC, adjusted for 1% on-market product discount	Internal forecasts supported by analyst expectations of EXPAREL® performance	Internal forecasts utilising external market data Internal experience of appropriate commercial terms with potential partners Probability of reaching market Discount rate based on Group WACC
Discount rate	8%	8%	9%

The Group has conducted a sensitivity analysis based on reasonably possible downsides on the value-in-use calculations used for impairment testing.

For the *flutiform*® intangible, three downside scenarios were performed being (1) a 10% reduction in revenues due to volume changes (2) a 5% reduction in the percentage margin from customer supply or raw material price changes and (3) an increase in the discount rate from 8% to 9%. The first two sensitivity scenarios result in impairment while the third sensitivity results in a break-even position. The risk of future impairment from these downside scenarios is mitigated by future amortisation of the *flutiform*® intangible.

For VR475 (FAVOLIR®) and VR647 (SCIPE®), a reduction in probability of reaching market from 74% to 60% would not trigger any impairment. A 20% reduction in net sales forecasts would also not cause impairment of either asset. A 5% reduction in the forecast percentage royalty from partnering VR475 (FAVOLIR®) and a 20% reduction in the value of forecast milestones from partnering VR647 (SCIPE®) would not trigger impairment.

For the EXPAREL® intangible, a two year delay in the forecast receipt of the $32.0m milestone would not result in impairment.

The remaining amortisation periods of the Group's intangible assets as at 31 December 2017 are:

	Carrying value	**Remaining amortisation period**
	£m	**Years**
Intangibles recognised from the Skyepharma merger		
Inhaled in-market assets	235.0	1 to 6.5
Non-inhaled in-market assets	33.4	1 to 3
Intangibles recognised from the Activaero acquisition		
Smart nebuliser technology	66.6	5 years

17 Property, plant and equipment

	Land and buildings	Laboratory and supply chain equipment	Assets under construction	Total
	£m	£m	£m	£m
Cost:				
At 01 April 2016	1.1	17.0	6.4	24.5
Skyepharma merger	15.5	17.0	7.0	39.5
Additions	0.1	2.1	0.9	3.1
Foreign exchange	1.5	1.8	0.8	4.1
At 31 December 2016	18.2	37.9	15.1	71.2
Additions	0.2	5.2	6.3	11.7
Reclassification	—	8.8	(8.8)	—
Transfer to other non-current assets	—	—	(6.3)	(6.3)
Foreign exchange	(0.3)	(3.0)	—	(3.3)
At 31 December 2017	18.1	48.9	6.3	73.3
Depreciation:				
At 01 April 2016	—	(12.9)	—	(12.9)
Charge for the period	(0.4)	(3.0)	—	(3.4)
Foreign exchange	—	(0.1)	—	(0.1)
At 31 December 2016	(0.4)	(16.0)	—	(16.4)
Charge for the period	(0.6)	(5.1)	—	(5.7)
Foreign exchange	—	1.9	—	1.9
At 31 December 2017	(1.0)	(19.2)	—	(20.2)
Net book value:				
At 31 December 2017	**17.1**	**29.7**	**6.3**	**53.1**
At 31 December 2016	17.8	21.9	15.1	54.8

Land valued at £5.1m (2016: £5.1m) is not depreciated. The Group has invested £11.7m in capital expenditure (2016: £3.1m) mainly in manufacturing equipment to support the production of *flutiform®*, development of Oral tablet production in Lyon and laboratory equipment.

In January 2017, the Group's investment in expanding capacity of *flutiform®* at the Sanofi manufacturing facility in Holmes Chapel, previously classified as an asset under construction, became fully operational and accordingly was reclassified to supply chain equipment.

Transfers to other non-current assets relates to manufacturing equipment, located at a supplier site that will no longer be used by the Group. Instead a future sale at a minimum of book value has been agreed with the development partner. Refer to note 18 "*Other non-current assets*". Assets under construction at the reporting date relate to replacement tooling equipment and, also associated with the production of *flutiform®*, a further £1.6m of spend on this equipment has been committed for next year.

18 Other non-current assets

Other non-current assets comprise the following items:

	31 December 2017	31 December 2016
	£m	£m
Non-current financial assets held at amortised cost	**6.0**	0.2
Deferred tax assets on overseas tax basis differences	**1.4**	2.1
Investments in associates (note 11)	**-**	1.7
Total other non-current assets	**7.4**	4.0

Non-current financial assets principally include £5.8m (2016: nil) of amounts receivable from a development partner for manufacturing equipment which Vectura has funded. The development partner has agreed to reimburse Vectura for the original costs incurred, although the exact timing of recovery is dependent upon other contractual terms and contingent events, with the earliest possible repayment being on 1 May 2020.

Nevertheless, as the cost recovery has been contractually agreed, it is considered certain and therefore the item has been classified as a financial asset at amortised cost using the effective interest method. The asset was previously classified as an asset under construction at historical cost of £6.4m, and will unwind to that previous value in 2020. The financing charge on transfer has been recorded in the Consolidated Income Statement.

Deferred tax assets are recognised on differences between the tax base in the IFRS accounts for IAS 19 pension liabilities and certain contingent liabilities related to the profitable Swiss operations.

19 Inventories

	31 December 2017	31 December 2016
	£m	£m
Raw materials	**11.6**	9.0
Work in progress	**8.6**	7.8
Finished goods	**4.4**	4.1
Less provision for impairment	**(1.2)**	(2.5)
Total inventories	**23.4**	18.4

Inventory purchases of £52.4m were included within cost of sales (2016: £37.4m).

20 Trade and other receivables

	31 December 2017	31 December 2016
	£m	£m
Trade receivables	**11.5**	22.2
Accrued income	**14.2**	20.0
Less provision for impairment	**(1.1)**	(1.1)
Net trade receivables	**24.6**	41.1
Prepayments and other receivables	**5.7**	11.0
Research and development tax credits	**3.8**	4.5
Total trade and other receivables	**34.1**	56.6

The carrying values of trade receivables approximate their fair values because these balances are expected to be cash-settled in the near future unless a provision is made.

In determining the expected credit losses for these assets, the Group has taken into account the historical default experience, the financial position of the counterparties, as well as the future prospects considering various external sources of actual and forecast economic information, as appropriate, in estimating the probability of default of each of these financial assets occurring within their respective loss assessment time horizon.

The Group applies the simplified approach to providing for expected credit losses prescribed by IFRS 9, which requires the use of the lifetime expected loss provision for all trade receivables.

The expected credit loss allowance provision at 31 December 2017 is determined below as follows and incorporates forward looking information:

Expiry profile	Current	More than 30 days past due	More than 60 days past due	More than 90 days past due	**Total 2017**
Expected loss rate	nil	nil	100%	100%	
Gross carrying amount	24.6	-	0.1	1.0	**25.7**
Loss allowance provision	-	-	(0.1)	(1.0)	**(1.1)**

21 Cash and cash equivalents

The Group's cash and cash equivalents are denominated in the following currencies:

	31 December 2017	31 December 2016
	£m	£m
Sterling	**44.5**	27.8
Euros	**24.5**	24.2
US Dollars	**20.5**	34.0
Swiss Francs	**14.2**	6.5
Cash and cash equivalents	**103.7**	92.5

The Group invests its funds in short-term bank deposits. The Group has access to these deposits at a maximum of 24 hours' notice. In addition to the cash and cash equivalents above, the Group has access to a £50m unsecured committed multi-currency revolving credit facility ("RCF") with Barclays Bank PLC and HSBC Bank plc.

22 Trade and other payables

	31 December 2017	31 December 2016
	£m	**£m**
Trade payables	**23.7**	22.4
Accruals	**25.5**	31.1
Other payables	**3.1**	4.4
Deferred income	**4.0**	1.7
Property mortgage	**0.2**	0.2
Trade and other current liabilities	**56.5**	59.8
Other payables	**5.1**	6.2
Deferred income	**0.6**	1.7
Property mortgage	**3.9**	4.3
Other non-current payables	**9.6**	12.2
Trade and other payables	**66.1**	72.0

Trade and other payables are unsecured unless otherwise indicated, due to the short-term nature of current payables, their carrying values approximates their fair value. The Swiss property mortgage is secured on the building, has a fixed rate of interest of 2.6% per annum, and an expiry date of 28 February 2019.

In addition to current trade and other payables of £56.5m (2016: £59.8m), corporation tax of £11.4m (2016: £8.6m) is payable within 12 months.

23 Provisions

	Employee	Property	Other	Total
	£m	**£m**	**£m**	**£m**
At 1 January 2017	**2.3**	**1.9**	**1.2**	**5.4**
Charged during the period	**0.9**	**0.2**	**1.2**	**2.3**
Utilised during the period	**(1.0)**	**(0.2)**	**(1.2)**	**(2.4)**
Foreign exchange movements	**-**	**-**	**0.1**	**0.1**
At 31 December 2017	**2.2**	**1.9**	**1.3**	**5.4**
Current	0.8	0.2	1.2	2.2
Non-current	1.4	1.7	0.1	3.2

Provisions are liabilities of uncertain timing or amount. Employee provisions include French statutory one-off lump sum payments due on the retirement of employees at the Group's manufacturing facility in Lyon, France.

Property provisions have been established in respect of an onerous lease in Switzerland and the commitment to restore the Group's leased R&D facilities in Chippenham to their original 2012 condition in 2027. Other provisions relate to the best estimate of certain contractual liabilities outstanding at the balance sheet date and in the comparative period related to exceptional redundancy costs which were fully utilised during the year. Refer to note 10 "*Exceptional items*". The uncertain tax provision of £5.0m (2016: £0.9m) is included in corporation tax payable and is therefore not reflected above.

24 Retirement benefit obligations

Swiss defined benefit pension plan

The amounts recognised in the balance sheet for the Swiss scheme are as follows:

	31 December 2017	31 December 2016
	£m	£m
Present value of funded obligations	**(17.7)**	**(21.3)**
Fair value of plan assets	**14.1**	15.4
Balance sheet liability	**(3.6)**	(5.9)

The Swiss sub-Group has affiliated itself with PKG Pensionskasse for the provision of its occupational pension 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 policyholders' retirement assets will earn 2.25 percent interest as of 31 December 2017
- Further reduction in the relevant pension conversion (into an annuity) rates to 5.4% (2016: 6.0%)

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 chose to receive a cash lump sum or convert their savings capital into an annuity to be paid monthly over the course of their retirement.

The law (Swiss Federal Law on Occupational Retirement, Survivors' and Disability Pension Plans and its associated ordinances) provides for minimum pension benefits and also a minimum amount for the savings contributions. The amount of the contributions to be paid by the employer and the employee is determined by the highest corporate body and/or the pension fund commission. These can exceed the statutory minimum. The employer contribution must be at least as high as the employee contributions.

The movement in the present value of the defined benefit obligation is as follows:

	Year ended 31 December 2017	9 months ended 31 December 2016
	£m	£m
Opening Present value of the defined benefit obligation	**(21.3)**	-
Recognised upon Skyepharma merger on 10 June 2016	**-**	(19.9)
Current service cost	**(0.9)**	(0.6)
Gain on plan modification	**1.0**	-
Exceptional gain on curtailment (note 10)	**0.2**	1.1
Recognised in the income statement	**0.3**	1.1
Benefits paid and withdrawals	**2.1**	(0.3)
Employee contributions	**(0.5)**	(0.3)
Balance sheet cash movements	**1.6**	(0.6)
Foreign exchange translation	**0.8**	(2.3)
Actuarial gains	**0.9**	1.0
Recognised through OCI	**1.7**	(1.3)
Present value of the defined benefit obligation	**(17.7)**	(21.3)

The movement in the fair value of the plan assets since the merger is as follows:

	Year ended 31 December 2017	9 months ended 31 December 2016
	£m	£m
Fair value of the plan assets the beginning of the period	**15.4**	-
Recognised upon Skyepharma merger on 10 June 2016	**-**	12.8
Foreign exchange	**(0.6)**	1.3
Benefits paid and withdrawals	**(2.1)**	0.3
Actuarial gains recognised on plan assets through OCI	**0.2**	0.3
Employer contributions	**0.7**	0.4
Employee contributions	**0.5**	0.3
Fair value of the plan assets the end of the period	**14.1**	15.4

Plan assets comprise:

	2017 £m	**2017 %**	2016 £m	2016 %
Equity	**4.4**	**31.2**	4.8	31.2
Bonds	**0.6**	**4.3**	6.9	44.8
Property	**5.8**	**41.1**	2.9	18.8
Cash	**2.5**	**17.7**	0.3	1.9
Other	**0.8**	**5.7**	0.5	3.3
Total plan assets	**14.1**	**100.0**	15.4	100.0

Other includes higher risk investments such as commodities or emerging market investments. Despite the IFRS IAS 19 requirement to recognise these assets, they are not controlled by the Group but by the Swiss Pension fund.

The pension fund manages these in accordance with Swiss pension regulations to generate a higher return on the fund but does not provide any further details as to the composition of the assets or for example the quoted prices of equity held in the fund (as such Vectura is unable to disclose quoted equity prices as required by IAS 19.142).

The latest asset coverage ratio of 107.4% published by the fund, to which the assets prices relate, is not relevant to Vectura as the Group's share of assets in the fund is capped at the level of participant savings contribution. Therefore, the Group will not share in any upside on the significantly larger quasi-governmental asset pool. Expected contributions to post-employment benefit plans for the period ending 31 December 2018 are £0.8m (2017: £0.6m).

The cumulative actuarial gain recognised in other comprehensive income since the merger is as follows:

	31 December 2017 £m	31 December 2016 £m
Actuarial gain recognised in OCI	**1.1**	1.3
Cumulative actuarial gains recognised within retained losses	**2.4**	1.3

The principal actuarial assumptions made by the actuaries were:

Salary growth	**1.00%**	1.00%
Discount rate	**0.65%**	0.60%
Male life expectancy from retirement age (years)	**22.5**	22.4
Female life expectancy from retirement age (years)	**25.5**	25.4

The average service period to retirement for scheme participants is approximately nine and a half years.

The sensitivity of the defined benefit obligation to changes in the weighted principal assumptions is:

	Change in assumption	Monetary effect of increase in assumption £m	Monetary effect of decrease in assumption £m
Discount rate	+/- 1%	**(2.3)**	**1.4**
Salary growth	+/- 2%	**0.8**	**(0.8)**
Life expectancy	+/- 2 years	**3.6**	**(3.0)**

The above sensitivity analyses are based on a change in one assumption while holding all other assumptions constant. In practice, this is unlikely to occur, and changes in some of the assumptions may be correlated. The sole exception is the variation of the discount rate with simultaneous variation of the interest rate for projection of savings capital.

Defined contribution plans UK and Germany

In addition the Group operates various defined contribution plans for its employees in the UK and Germany. The Group's contributions to these plans are charged to the Consolidated Income Statement in the year to which they relate, and the assets are held in separate trustee-administered funds. The charge to the Consolidated Income Statement in relation to defined contribution plans is £2.0m as disclosed in note 6 *"Employees".*

25 Deferred tax liabilities

The principal deferred tax liabilities relate to differences between the tax and accounting base of intangible assets and buildings uplifted as a consequence of fair value accounting requirements. Deferred tax liabilities are as follows:

	Intangible assets £m	Foreign exchange gains £m	Other £m	Total £m
At 01 April 2016	(20.8)	-	0.4	(20.4)
Recognised on acquisition of Skyepharma merger	(55.1)	(3.9)	-	(59.0)
Credited/ (charged) to income statement	13.3	-	(2.3)	11.0
Charged to OCI	-	(0.7)	-	(0.7)
Foreign exchange	(7.2)	(0.5)	-	(7.7)
At 31 December 2016	**(69.8)**	**(5.1)**	**(1.9)**	**(76.8)**
Credited to income statement	**22.0**	**-**	**-**	**22.0**
Charged to OCI	**-**	**(1.2)**	**-**	**(1.2)**
Foreign exchange	**2.2**	**0.3**	**-**	**2.5**
At 31 December 2017	**(45.6)**	**(6.0)**	**(1.9)**	**(53.5)**

Deferred tax liabilities associated with the Skyepharma merger and Activaero intangible assets unwind to offset the tax distortion that would otherwise occur as the assets are amortised. Deferred tax liabilities on Swiss and US unrealised foreign exchange gains arise on permanent funding loans because foreign exchange gains are deferred on the local balance sheet in accordance with Swiss and US laws. A deferred tax asset on German tax losses of £5.3m (2016: £4.3m) has been offset against the deferred tax liability on Activaero intangible assets.

The Group did not recognise deferred tax assets on tax losses amounting to £226.2m (2016: £187.9m). The majority of the losses are unlikely to offset taxable profits as they mostly relate to non-trading losses in Investment holding companies. There are no current plans to recover these losses in the foreseeable future.

Following the recently-enacted US tax changes and the lowering of the US corporate income tax rate to 21%, revaluation of Vectura's US deferred tax liabilities has occurred. The impact in the current year is a one-off non-cash credit to the Consolidated Income Statement of £1.6m. Refer to note 13 "*Taxation"*.

26 Financial instruments

In the current year, the Group has applied IFRS 9 *"Financial Instruments"* (as revised in July 2014). IFRS 9 introduces three new requirements for 1) the classification and measurement of financial assets and financial liabilities, 2) the impairment of financial assets and 3) general hedge accounting.

Vectura is not a financial institution and does not have any complex financial instruments. Vectura does not apply hedge accounting and the Group's customers are considered credit worthy and pay consistently within agreed payments terms. As such, other than on disclosures, IFRS 9 is not assessed as having a significant impact on the Group. Details of these new requirements as well as their impact are described as follows.

Area	**Impact of IFRS 9 adoption**
Classification and measurement	Reclassification of financial assets into the IFRS 9 categories has had no overall impact on their respective measurement bases.
Impairment of financial assets	New requirements to recognise expected credit losses on day one are not expected to materially impact the Group, whose customer base typically has favorable credit history and significant cash resources. One bad debt was fully provided for as soon as loss was expected in prior period and hence no restatement of the comparative is required. In future, any impairment on debtors will need separate disclosure on an income statement line item with debtors ageing analysis to be provided in the disclosure note.
Hedge accounting	Vectura currently does not apply hedge accounting at present, and has not done so in previous periods.

On 1 January 2017, the Group has assessed which business models apply to the financial assets held by the Group on 1 April 2016, the date of initial application of IFRS 9, and has classified its financial instruments into the appropriate IFRS 9 categories.

The initial application of IFRS 9 has not had any impact on the Group's financial assets as regards their classification and measurement:

	31 December 2017	31 December 2016
	£m	£m
Cash and cash equivalents held at amortised cost	**103.7**	92.5
Trade receivables and accrued income held at amortised cost	**24.6**	41.1
Financial assets at amortised cost	**6.0**	0.2
Financial liabilities at amortised cost	**(53.3)**	(58.0)
	81.0	75.8

The following items are not financial instruments as defined by IFRS 9

(a) prepayments made/advances received (right to receive future good or service, not cash or a financial asset)
(b) tax receivables and payables and similar items (statutory rights or obligations, not contractual), or
(c) deferred revenue and warranty obligations (obligation to deliver good or service, not cash or financial asset)

Impairment of financial assets

In relation to the impairment of financial assets, IFRS 9 requires an expected credit loss model as opposed to an incurred credit loss model under IAS 39 *"Financial Instruments: Recognition and Measurement".* The expected credit loss model requires the Group to account for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk since initial recognition of the financial assets. In other words, it is no longer necessary for a credit event to have occurred before credit losses are recognised.

IFRS 9 allows a simplified approach for measuring the loss allowance at an amount equal to lifetime expected credit losses for trade receivables and contract assets.

The Group has three types of financial assets subject to the expected credit loss model:

- Trade receivables for sales of inventory
- Trade receivables for R&D services
- Accrued royalty and milestone income

The Group was required to revise its impairment methodology under IFRS 9 for each of these classes of assets. There was no impact of the change in impairment methodology on the carrying values disclosed.
Provisions against impaired assets are disclosed in note 20 "*Trade and other receivables"*.

(a) Credit risk

The impairment provisions for financial assets disclosed in note 18 "*Other non-current assets"* are based on assumptions about risk of default and expected loss rates. The Group uses judgement in making these assumptions and selecting the inputs to the impairment calculation, based on the Group's past history, existing market conditions as well as forward looking estimates at the end of each reporting period.

(b) Capital management

The Group manages its capital to ensure that all entities in the Group will be able to continue as a going concern while maximising the return to stakeholders. The capital structure of the Group consists of equity (as disclosed in the Consolidated Statement of Changes In Equity), retained earnings, cash and cash equivalents (note 21 "*Cash and cash*

equivalents"), an RCF (note 21 "*Cash and cash equivalents*") and a Swiss property mortgage (note 22 "*Trade and other payables*"). The Group seeks to manage its capital through an appropriate mix of these items. At 31 December 2017, and to the date that these financial statements were issued, no funds were drawn against the RCF.

(c) Financial risk management

The primary risks that the Group is exposed to through its use of financial instruments are liquidity risk, foreign currency risk and credit risk. Board authorisation is required for all significant agreements that may affect the Group risk structure. It is, and has been throughout the year, the Group's policy that no speculative trading in financial instruments is undertaken.

(d) Liquidity risk management

Liquidity risk is the risk that the Group does not have sufficient financial resources to meet its obligations as they fall due. The Group manages liquidity risk by maintaining adequate reserves and by continually monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities. The Group's policy is to maintain continuity of funding through available cash and cash equivalents, an RCF and through the issue of shares where appropriate.

(e) Currency risk management

The Group's presentation currency is Sterling. The Group is subject to exposure on the translation of the assets of foreign subsidiaries whose functional currencies differ from that of the Group. The Group's primary balance sheet translation exposures are to the Swiss Franc, Euro and US Dollar. The Group aims to minimise balance sheet translation exposures, where it is practical to do so, by funding subsidiaries with long-term loans, on which exchange differences are taken to reserves.

The Group faces currency exposures arising from the translation of profits earned in foreign currency. These exposures are not hedged. Exposures also arise from foreign currency-denominated trading transactions undertaken by subsidiaries. The Group's policy is to offset such currency exposure by matching foreign currency revenues with expenditure in the same foreign currency. Where there are no imminent foreign currency denominated transactions, the surplus foreign currency cash balances are exchanged for the functional currency of the subsidiary. Where it has not been possible to use natural hedges, currency options and forward currency contracts may be used. No options or forward contracts have been entered into in the period (2016: none).

A 10 per cent 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 £7.0m lower and items recognised directly in other comprehensive income being £14.6m higher. A 10 per cent weakening would have an equal but opposite effect on loss before taxation and other comprehensive income. The Group considers a 10 per cent strengthening or weakening of the functional currency against the non-functional currency of its subsidiaries as a reasonably possible change in foreign exchange rates.

27 Prior period business combination – Skyepharma merger

On 10 June 2016, an all-share merger (the "merger") between Vectura and Skyepharma was completed by way of a scheme of arrangement of Skyepharma. Immediately following the transaction, on a fully-diluted basis, the previous shareholders of Vectura owned 61.3% of the enlarged Group, with the previous shareholders of Skyepharma owning 38.7%. These percentages are broadly proportional to the revised Board structure.

Under the terms of the merger, Skyepharma shareholders received 2.7977 Vectura shares in exchange for each Skyepharma share, with the option to take a partial cash alternative for a portion of their shareholding, which in aggregate was capped at £70.0m. The final uptake of this partial cash alternative was £52.1m. As Skyepharma had £27.1m of net cash on the acquisition date balance sheet, the net cash outflow before transaction costs was £25.0m.

The fair values of Skyepharma assets and liabilities acquired on 10 June 2016 were as follows:

	Note	Book value £m	Fair value adjustments £m	Fair value acquired £m
ASSETS				
Non-current assets				
Intangible assets	A	6.5	373.0	379.5
Property, plant and equipment	B	28.3	11.2	39.5
Deferred taxation	C	2.0	0.7	2.7
Other financial assets		0.4	(0.4)	—
		37.2	384.5	421.7
Current assets				
Inventories	D	13.2	3.5	16.7
Trade and other receivables		22.3	—	22.3
Cash and cash equivalents		27.1	—	27.1
Other financial assets		0.1	(0.1)	—
		62.7	3.4	66.1
Total assets acquired		99.9	387.9	487.8
LIABILITIES				
Current liabilities				
Trade and other payables	E	(25.5)	(3.8)	(29.3)
Corporate taxation payables		(5.9)	—	(5.9)
Borrowings		(0.2)	—	(0.2)
Deferred income		(0.2)	—	(0.2)
Provisions		(2.2)	—	(2.2)
		(34.0)	(3.8)	(37.8)
Non-current liabilities				
Borrowings		(4.1)	—	(4.1)
Retirement benefit obligations		(8.3)	—	(8.3)
Provisions and other payables	E	(1.1)	(2.8)	(3.9)
Deferred taxation	C	(3.9)	(55.1)	(59.0)
		(17.4)	(57.9)	(75.3)
Total liabilities		(51.4)	(61.7)	(113.1)
Net assets acquired		48.5	326.2	374.7

A: Intangible assets: Skyepharma previously did not generally recognise internally-generated intangible assets. IFRS 3 requires purchased intangible assets to be recognised at fair value. The intangible assets acquired by Vectura were valued by independent external experts on the basis of the net present value of income streams less costs associated with those streams.

B: Property, plant and equipment: Fair value adjustments on land, buildings and equipment in Switzerland and France were recognised based upon property valuations obtained from independent external experts.

C: Deferred taxation: Deferred tax liabilities were recognised in relation to the fair value uplift on net assets such that the notional tax consequence of amortisation can be matched to the period in which the amortisation occurs.

D: Inventories: Inventories were uplifted to their fair value, and have subsequently been sold through.

E: Trade and other payables and provisions: This relates to the recognition of contingent liabilities required by IFRS 3. On acquisition, Skyepharma was committed to make certain payments to a development partner contingent upon future receipt of sales milestones and royalties received, with the payments deducted from these amounts receivable from the partner. Accordingly, a liability of £6.6m was recognised and is expected to unwind by the end of 2020. There was no difference between the fair value and the carrying value of trade and other receivables at the merger date.

28 Ordinary share capital

Allotted, called up and fully paid	£m	Number of shares
Ordinary shares of 0.025p, each at 1 January 2017	**0.2**	**677,969,321**
Issued to satisfy Vectura employee share plans	**—**	1,961,880
Share buyback programme - cancellations	**—**	(1,422,503)
Ordinary shares of 0.025p, each at 31 December 2017	**0.2**	**678,508,698**

During the period, the Group allotted 1,961,880 (2016: 1,365,633) ordinary shares of 0.025p each related to employee share option awards. Refer to note 29 *"Share-based payments".*

On 14 November 2017, the Group announced that the Board has approved a share buyback to return up to £15m of capital to shareholders. The Board believes that in addition to the implementation of the current investment strategy, the Buyback reflects strong financial management discipline and is an efficient allocation of capital.

At 31 December 2017 1,422,503 shares had been repurchased at a weighted average price of 95 pence per share. A total of £1.34m has been returned to shareholders to date. Directly attributable costs of £11,240 has been expensed to equity. On 28 February 2018 the programme was completed. Refer to Note 33 "*Post Balance sheet events*".

29 Share-based payments

The Group operates various share-based compensation plans and further information is provided in the Remuneration Report. Share-based payments are solely made for the purposes of employee share compensation and as applicable are all settled for equity in Vectura Group plc.

	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
Equity settled LTIP and RSA plans	**2.1**	1.8
Exceptional share-based payments	**1.8**	0.5
Total share-based payments	**3.9**	2.3

The employee share award plans are designed to support a strong culture of long-term shareholder value creation. Details of the long-term incentive plan, the Group's main plan, are set out below. The Group also operates a share incentive plan ("SIP") and a Save-As-You-Earn Plan ("SAYE") albeit the accounting charges are not considered material and hence the disclosures of these plans are made within the Remuneration Report.

Equity Settled Long-Term Incentive Plan ("LTIP") including Restricted Stock Awards ("RSA")

Under the approved Group's remuneration policy equity awards are a key component of the overall remuneration package for senior management and executives. During the year, Vectura concluded a review of the LTIP arrangements and following approval at the 2017 AGM changes were introduced for Executive Directors and for all other employees as detailed below.

Transactions on the share plan for executives, senior management and key professionals during the year were as follows:

	Year ended 31 December 2017 Number of awards	9 months ended 31 December 2016 Number of awards
Beginning of the period	9,175,233	9,717,832
Granted	3,770,532	1,842,847
Exercised	(1,495,589)	(1,065,633)
Forfeited	(2,709,714)	(1,319,813)
End of the period	**8,740,462**	**9,175,233**

In 2016 the Main Board directors received LTIP grants worth 250% of salary subject to performance over three and five year periods. The performance condition was subject to two relative TSR metrics, against the FTSE 250 (excluding real estate and financial services companies) and a bespoke sector peer group.

In 2017 LTIPs granted to Executive Directors' were reduced to 185% of salary (74% of 2016 levels), with the removal of the five year performance element, and changes to the vesting scale for TSR. Half of this three year performance continues to be measured subject to a relative TSR metric against the FTSE 250 (excluding real estate and financial services). The remaining half of the award will be subject to a three year cumulative Adjusted EBITDA target as set by the Remuneration Committee.

Employees at the Executive Leadership Team (ELT) level were granted LTIPs at 105% of salary. 35% of these awards were subject to the same TSR and Adjusted EBITDA metrics as the Main Board participants with the remaining 70% classified as restricted stock awards. Below ELT and where applicable, participants receive awards entirely of restricted stock options.

Restricted stock awards are subject to service conditions, i.e. the requirement for recipients of awards to remain in employment with Vectura over the three year vesting period and subject to a personal performance underpin. Any vested shares granted to the Main Board member and Executive Leadership Team must be held for two years after vesting.

The treatment of vesting and non-vesting conditions attached to awards in the valuation process varies in accordance with the requirements of IFRS 2. For the year ended 31 December 2017, the calculation of the grant date fair value for the Total Shareholder Return was as follows:

Number of TSR awards granted	1,114,638
Service condition	3 years
Holding condition	2 years
Share price on grant date	117.6 pence
Exercise (nominal) price	0.025 pence

The TSR condition (50% of the 2017 award and all of the 2016 award) is a market-based performance condition; this has been incorporated into the fair value calculation and no subsequent adjustments may be made.

For awards subject to a TSR condition, volatility is calculated over the period of time commensurate with the remainder of the performance period immediately prior to the date of grant being 28.12% (2016: 27.24%).The risk-free interest rate obtainable from government securities (i.e. Gilts in the UK) over a period commensurate with the expected term was 0.09% (2016: 0.13%) and there was no dividend yield expected (2016: nil).

The Adjusted EBITDA condition (50% of the 2017 awards for Main Board and ELT) is a non-market condition; the fair value calculation is adjusted at each period end for the likelihood of the number of shares that will ultimately vest. All awards require recipients to remain in employment with the Company over the vesting period. For the LTIP and RSA awards that will be subject to a holding period, the Chaffe model (an at-market put option variant of the Black-Scholes model) has been used to determine a discount for the lack of marketability.

For the below-ELT RSA awards, the probability of the non-market-based underpin condition being achieved does not need to be incorporated into the fair value at date of grant, but is evaluated periodically to true up the estimate for the number of awards expected to vest.

Exceptional share-based awards

Share-based payments within exceptional items were £1.8m (2016: £0.5m). Upon completion of the merger 1,490,982 exceptional nil cost awards were granted to key members of management, excluding Executive Directors, considered critical to the integration process. These awards vest in full provided that an 18-month or 36-month service condition from their date of grant on 22 September 2016 and personal performance targets are met.

There are no performance conditions associated with these awards. The grant date fair value was £1.41 per share and the total share-based payment charge, assuming no lapses occur, will be expensed evenly to 21 March 2018 or 21 September 2019, depending on the applicable service conditions.

The increase compared to the previous period is owing to a full year's charge in 2017 compared to a quarter of a year's charge in 2016. £0.2m of exceptional charges were credited back in the period for employees with retention awards that left employment of the Group and hence did not satisfy the service condition.

Share trusts

The Group operates two share trusts. The Group's own-share reserve represents the weighted average cost of shares in the Estera Employee Benefit Trust and the Vectura Employee Benefit Trust, which are held for the purposes of fulfilling obligations in respect of executive awards and employee share plans.

30 Cash flow information

Restatement of comparative cash flow information

The FRC's Corporate Reporting Review of the Group's Annual Report and Accounts to 31 December 2016 highlighted that IAS 7 Statement of Cash Flows paragraph 16A prevents items being classified as investing activities unless a corresponding asset is also capitalised.

As a result of this review the comparative Consolidated Cash Flow Statement has been restated. Cash outflows related to exceptional merger costs of £11.9m have now been presented within cash flows from operating activities and cash flows from financing activities, as opposed to cash flows from investing activities in the Consolidated Cash Flow Statement. Net cash inflow from operating activities in 2016 has decreased by £9.4m from £28.2m to £18.8m and net cash outflow from investing activities has decreased by £11.9m from a cash outflow of £38.1m to cash outflow of £26.2m. Net cash outflow from financing activities has decreased by £2.5m from an outflow of £0.1m to an outflow of £2.6m.

9 months ended 31 December 2016	Previously reported £m	Restatement £m	Restated £m
Cash flow statement line item			
(Decrease) / increase in trade and other payables	7.1	(3.3)	3.8
Non-recurring transaction costs paid	6.1	(6.1)	—
Exceptional merger costs	(11.9)	11.9	—
Merger transaction costs	—	(2.5)	(2.5)

The FRC's enquiries regarding this matter are now complete. There are no further amendments to the financial statements other than enhancements to the presentation of Alternative Performance Measures. It must be noted that the FRC's review is limited to the published 2016 Annual Report and Accounts, it does not benefit from a detailed understanding of underlying transactions and provides no assurance that the annual report and accounts are correct in all material respects. Further details are provided within the Audit Committee report.

Analysis of movement in financial liabilities

	Year ended 31 December 2017 £m	9 months ended 31 December 2016 £m
At the beginning of the period	**4.5**	-
Skyepharma merger	-	4.3
Repayments	**(0.3)**	(0.3)
Interest expense	**0.1**	0.1
Foreign exchange movements	**(0.2)**	0.4
At the end of the period	**4.1**	**4.5**

Financial liabilities entirely relate to Swiss property mortgages secured on the Swiss R&D facility. Repayments include £0.2m (2016: £0.2m) of capital repayments.

31 Commitments and contingent liabilities

Operating leases

The Group is committed to make rental payments under non-cancellable UK property leases at Chippenham, Cambridge Science Park and Grosvenor Gardens, London, as follows:

	Year ended 31 December 2017 £m	**9 months ended** 31 December 2016 £m
Within one year	**1.1**	1.1
Between two and five years	**2.9**	3.5
Over five years	**2.6**	2.9
Total operating lease commitments	**6.6**	7.5

Share buyback and cancellation programme

On 14 November 2017 Vectura Group plc announced that the Board has approved a share buyback and cancellation programme to return up to £15.0m of capital to shareholders. A purchase for cancellation programme of the Company's ordinary shares of 0.025p each commenced to a maximum consideration of £15.0m expiring on 11 May 2018.

Numis was required to buyback shares independently of, and uninfluenced by, the Group. At 31 December 2017 £1.4m had been returned to shareholders and accordingly the Group had a commitment in relation to the remaining £13.6m of cash committed to the programme. The programme completed in February 2018, refer to note 33 "*Post balance sheet events".*

Contingent liabilities

The Group has multiple collaborative development agreements with its Partners, across separate development and licensing agreements. Within some agreements, the Group has committed to make payments to the development partner contingent upon future events, such as sales milestones and royalties received, or has committed to fund or partially fund costs within the associated development programme. Historically, a number of these payments have not been claimed by some partners. As it is not possible to reliably estimate the potential outflow, and the potential for the outflow is considered remote, no liability is held on the balance sheet for such items.

The Group has an uncertain tax provision. Should any challenge from the relevant tax authority arise, it is possible that penalties (between 0 – 40% of underpaid taxation) could be levied. Based on external professional advice, penalties in excess of 20% are considered remote, and penalties towards the lower end of the range are considered more likely, but not probable. As a result, the Group considers a contingent liability of up to £1.0m (2016: £nil) in respect of penalties to be appropriate, but as the amount remains uncertain and payment is not considered probable, no provision is held on the balance sheet.

32 Related-party transactions

Associates

In order to finalise the valuation process of the Group's Chinese associate, costs of £1.6m have been incurred comprising £0.6m for the cost of new equipment and a £1.0m waiver of a loan previously made to the associate. These contributions are considered arms-length related party transactions, necessary to finalise the valuation process.

Remuneration of key management personnel

The remuneration of the Directors, who are the key management personnel of the Group, was £2.6m and is set out below:

	Year ended 31 December 2017 £m	**9 months ended** 31 December 2016 £m
Short-term employee benefits	**1.0**	0.9
Annual incentive plan	**0.7**	0.8
Non-Executive Directors' fees	**0.4**	0.3
Post-employment benefits	**0.2**	0.2
Share-based payments	**-**	0.4
Other	**0.3**	0.9
Total remuneration of key management personnel	**2.6**	3.5

Please refer to the Remuneration Report for the remuneration of each Director.

At 31 December 2017 P-O Andersson owed the Group £3,600 (2016: nil) this outstanding amount was fully recovered in January 2018, no other amounts were outstanding between the Group and the Directors (2016: nil).

33 Post balance sheet events

Subsequent to the balance sheet date, a further £13.6m of shares have been repurchased as part of the £15.0m share buyback and cancellation programme completed by the end of February 2018. The weighted average price of shares purchased was 93 pence per share.