FINANCIAL STATEMENTS

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Independent auditor's report

to the members of Vectura Group plc

1. Our opinion is unmodified

We have audited the financial statements of Vectura Group plc ("the Company" or "the Group") for the year ended 31 December 2018 which comprise the Consolidated Income Statement, Consolidated Statement of Other Comprehensive Income, Consolidated Balance Sheet, Consolidated Statement of Changes in Equity, Consolidated Cash Flow Statement, Company Balance Sheet, Company Statement of Changes in Equity, and the related notes, including the accounting policies in note 2 and note 31.

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent Company's affairs as at 31 December 2018 and of the Group's loss for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union;
- the parent Company financial statements have been properly prepared in accordance with UK accounting standards, including FRS 101 *Reduced Disclosure Framework*; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the audit committee.

We were first appointed as auditor by the shareholders on 25 May 2017. The period of total uninterrupted engagement is for the 2 financial years ended 31 December 2018. We have fulfilled our ethical responsibilities under, and we remain independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to listed public interest entities. No non-audit services prohibited by that standard were provided.

Overview	
Materiality: Group financial statements as a whole	£1.5m (2017:£1.45m) 1% of Revenue (2017: 1% of Revenue)
Coverage	88% (2017: 86%) of Revenue

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

Independent auditor's report continued

to the members of Vectura Group plc

2. Key audit matters: including our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters in arriving at our audit opinion above, together with our key audit procedures to address those matters and our findings from those procedures in order that the Company's members as a body may better understand the process by which we arrived at our audit opinion. These matters were addressed, and our findings are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

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

	The risk	Our response
The recoverability of inhaled in-market assets, non-inhaled in-market assets and smart nebuliser technology assets £219.9m; 2017: £335.4m Impairment: £41.5m (2017: £8.7m) *Refer to pages 75-78 (Audit Committee Report), page 148 (accounting policy) and pages 134-135 (financial disclosures).*	**Subjective valuation:** Historic acquisitions have led to the recognition of intangible assets with a significant value. There is a risk that the carrying amount of the inhaled in-market assets, non-inhaled in-market assets and smart nebuliser technology assets may become impaired if financial performance or other events, such as regulatory approvals, are not in line with initial expectations. The Group's estimated future cash flows for each asset are used to support their recoverability. The cash flow forecasts rely on a number of critical assumptions and estimates including volume forecasts, cost of sales, discount rates, and associated pricing. The effect of these matters is that, as part of our risk assessment, we determined that the value in use of inhaled in-market assets, non-inhaled in-market assets and smart nebuliser technology assets has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount.	— **Assessing indicators of impairment:** challenged the Group's assessment of impairment indicators on the asset concerned using our understanding of the asset's current and future expected performance gained from performing our audit procedures; — **Our sector experience:** assessed whether key assumptions used, in particular those relating to volume forecasts, cost of sales, discount rates, and associated pricing, reflect our knowledge of the business and industry, including known or probable changes in the business environment; — **Discount rates:** challenged, using our own valuation specialists, the key inputs used in the Group's calculation of the discount rates by comparing them to externally derived data, including available sources for comparable companies; — **Historical comparisons:** assessed the reasonableness of the cash flow forecasts by considering the historical accuracy of the previous forecasts; — **Sensitivity analysis:** we performed breakeven analysis on the key assumptions noted above; — **Assessing transparency:** assessed whether the Group's disclosures about the impairment test appropriately reflect the risks inherent in the valuation of intangible assets. **Our findings** — We found the estimated recoverable amount for the inhaled in-market assets, non-inhaled in-market assets and smart nebuliser technology assets to be slightly optimistic (2017: slightly optimistic), resulting in greater headroom than might otherwise have been the case, with proportionate (2017: proportionate) disclosure of related assumptions and sensitivities.

Independent auditor's report continued

to the members of Vectura Group plc

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

	The risk	Our response
Recoverability of parent company's investments in subsidiaries £541.5 m; 2017: £710.8m Impairment: £199.3m (2017: £0m), of this balance £102.5m relates to Switzerland and £96.8m relates to Germany *Refer to pages 75-78 (Audit Committee Report), page 155 (accounting policy) and page 156 (financial disclosures).*	**Forecast-based valuation:** The carrying amount of the parent company's investments in subsidiaries is significant and at risk of being irrecoverable. There is a risk that the carrying amount of investments may become impaired if forecast financial performance or other events, such as regulatory approvals, are not in line with expectations. The estimated recoverable amount of this balance is subjective due to the inherent uncertainty in forecasting trading conditions and cash flows used in the budgets. The critical assumptions include the likelihood of success of early and late stage development programs, discount rates, product volumes, cost of sales, and associated pricing. The effect of these matters is that, as part of our risk assessment, we determined that the value in use of parent company's investments in subsidiaries have a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount.	Our procedures included: — **Our sector experience :** challenged the critical assumptions used in the cash flows included in the budgets based on our knowledge of the Group and the markets in which the subsidiary operate. The critical assumptions include the likelihood of success of early and late stage development programs, discount rates, product volumes, cost of sales, and associated pricing; — **Historical comparisons:** assessed the reasonableness of the budgets by considering the historical accuracy of the previous forecasts; — **Discount rates:** challenged, using our own valuation specialists, the key inputs used in the Group's calculation of the discount rates by comparing them to externally derived data, including available sources for comparable companies; — **Sensitivity analysis:** we performed breakeven analysis on the key assumptions noted above; — **Assessing transparency:** assessed the adequacy of the parent company's disclosures in respect of the investments in subsidiary. **Our findings** — We found the Group's assumptions used in the impairment models and the resulting estimate over the recoverable amount of parent company's investments in subsidiaries, when all factors are considered, to be balanced (2017: balanced). We found the resulting disclosures to be proportionate (2017: proportionate).

Independent auditor's report continued

to the members of Vectura Group plc

3 Our application of materiality and an overview of the scope of our audit

The materiality for the Group financial statements as a whole was set at £1.5m, determined with reference to a benchmark of Group revenue of £160.5m which it represents 1%. We consider total revenue to be the most appropriate benchmark as it provides a more stable measure year on year than Group loss before tax.

Materiality for the parent company financial statements as a whole was set at £1.45m (2017: £1.4m) determined with reference to a benchmark of company total assets of which it represents 0.2%.

We reported to the Audit Committee any corrected or uncorrected misstatements exceeding £75k and any other identified misstatements that warranted reporting on qualitative grounds.

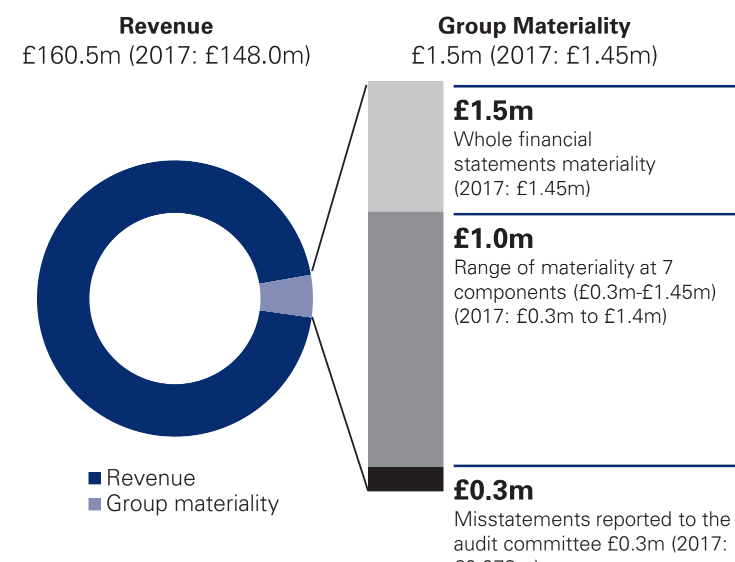
4 of the Group's 7 reporting components were subject to full scope audits for Group purposes and a further 2 components were subjected to specified risk-focused audit procedures. The latter were not individually financially significant enough to require a full scope audit for Group purposes, but did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

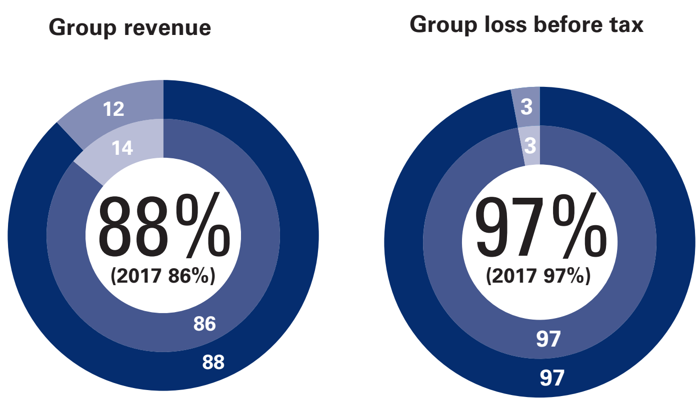
For the remaining 1 component, we performed analysis at an aggregated Group level to re-examine our assessment that there were no significant risks of material misstatement within this component.

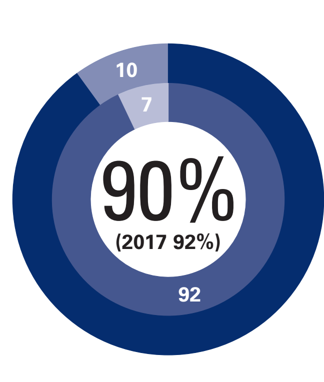
The components within the scope of our work accounted for the percentages illustrated opposite.

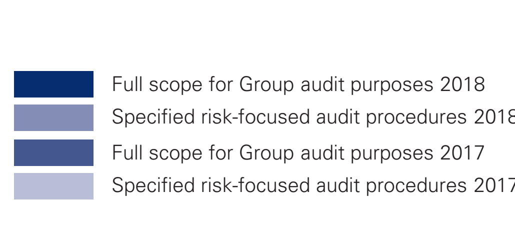
The Group audit team instructed component auditors as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back. The Group team approved component materiality levels of £1.0m for the component audit teams, having regard to the mix of size and risk profile of the Group across the components. The work on 1 of the 6 components was performed by component auditors and the rest, including the audit of the parent company, was performed by the Group team.

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









4. We have nothing to report on going concern

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

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

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

— Supply chain disruption, including disruption caused by Brexit;

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

— Failure to advance key pipeline development programmes.

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

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

— we have anything material to add or draw attention to in relation to the directors' statement in Note 1 to the financial statements on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the Company's use of that basis for a period of at least twelve months from the date of approval of the financial statements; or

— the related statement under the Listing Rules set out on page 106 is materially inconsistent with our audit knowledge.

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

5. We have nothing to report on the other information in the Annual Report

The directors are responsible for the other information presented in the Annual Report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

Strategic report and directors' report

Based solely on our work on the other information:

— we have not identified material misstatements in the strategic report and the directors' report;

— in our opinion the information given in those reports for the financial year is consistent with the financial statements; and

— in our opinion those reports have been prepared in accordance with the Companies Act 2006.

Directors' remuneration report

In our opinion the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Disclosures of principal risks and longer-term viability

Based on the knowledge we acquired during our financial statements audit, we have nothing material to add or draw attention to in relation to:

— the directors' confirmation within the Risk Management and Principal Risks statement on page 43 that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency and liquidity;

— the Principal Risks disclosures describing these risks and explaining how they are being managed and mitigated; and

— the directors' explanation in the Viability statement of how they have assessed the prospects of the Group, over what period they have done so and why they considered that period to be appropriate, and their

Independent auditor's report continued

to the members of Vectura Group plc

statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Under the Listing Rules we are required to review the viability statement. We have nothing to report in this respect.

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

Corporate governance disclosures

We are required to report to you if:

— we have identified material inconsistencies between the knowledge we acquired during our financial statements audit and the directors' statement that they consider that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy; or

— the section of the annual report describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

We are required to report to you if the Corporate Governance Statement does not properly disclose a departure from the eleven provisions of the UK Corporate Governance Code specified by the Listing Rules for our review.

We have nothing to report in these respects.

6. We have nothing to report on the other matters on which we are required to report by exception

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

— adequate accounting records have not been kept by the parent Company, or returns adequate for our audit have not been received from branches not visited by us; or

— the parent Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or

— certain disclosures of directors' remuneration specified by law are not made; or

— we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

7. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 107, the directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or other irregularities (see below), or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud, other irregularities or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

Irregularities – ability to detect

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our general commercial and sector experience, and through discussion with the directors and other management (as required by auditing standards) and discussed with the directors and other management the policies and procedures regarding compliance with laws and regulations, We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit. This included communication from the Group to component audit teams of relevant laws and regulations identified at Group level.

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

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

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

8. The purpose of our audit work and to whom we owe our responsibilities

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

Adrian Wilcox (Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

15 Canada Square

Canary Wharf

London

E14 5GL

25 March 2019

Consolidated income statement

For the year ended 31 December 2018

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

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

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

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

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

Consolidated statement of other comprehensive income

For the year ended 31 December 2018

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

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

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

Consolidated balance sheet

At 31 December 2018

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

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

The accompanying notes form an integral part of these consolidated financial statements. These consolidated financial statements and accompanying notes were approved by the Board of Directors on 25 March 2019 and were signed on its behalf by:

J Ward-Lilley
Director

P Fry
Director

Consolidated statement of changes in equity

For the year ended 31 December 2018

	Note	Share capital £m	Share premium £m	Other reserves: Merger reserve £m	Other reserves: Own shares reserve £m	Other reserves: Share-based payment reserve £m	Translation reserve £m	Retained losses £m	Total equity £m
At 31 December 2016 as previously reported		0.2	102.3	551.9	(0.7)	5.8	41.4	(23.7)	677.2
Share premium restatement*		—	(41.3)	41.3	—	—	—	—	—
At 31 December 2016 restated		0.2	61.0	593.2	(0.7)	5.8	41.4	(23.7)	677.2
Loss for the year		—	—	—	—	—	—	(85.7)	(85.7)
Other comprehensive (loss)/income		—	—	—	—	—	(15.1)	0.9	(14.2)
Total comprehensive loss		—	—	—	—	—	(15.1)	(84.8)	(99.9)
Share-based payments	28	—	—	—	—	3.9	—	—	3.9
Exercise of share awards		—	0.5	—	—	—	—	—	0.5
Employee share trust transactions		—	—	—	(1.8)	—	—	—	(1.8)
Share buyback programme		—	—	—	—	—	—	(1.4)	(1.4)
Transfer between reserves		—	—	—	—	(1.3)	—	1.3	—
At 31 December 2017		**0.2**	**61.5**	**593.2**	**(2.5)**	**8.4**	**26.3**	**(108.6)**	**578.5**
Adoption of IFRS 15	32	—	—	—	—	—	—	0.3	0.3
At 1 January 2018 as adjusted		**0.2**	**61.5**	**593.2**	**(2.5)**	**8.4**	**26.3**	**(108.3)**	**578.8**
Loss for the year		—	—	—	—	—	—	(88.2)	(88.2)
Other comprehensive income		—	—	—	—	—	13.7	0.2	13.9
Total comprehensive income/(loss) for the year		—	—	—	—	—	13.7	(88.0)	(74.3)
Share buyback programme	26	—	—	—	—	—	—	(13.8)	(13.8)
Share-based payments	28	—	—	—	—	3.7	—	—	3.7
Employee share schemes	28	—	0.1	—	0.3	(3.8)	—	3.3	(0.1)
Release of special reserves**		—	—	(8.2)	—	—	—	8.2	—
Merger reserve release		—	—	(143.8)	—	—	—	143.8	—
At 31 December 2018		**0.2**	**61.6**	**441.2**	**(2.2)**	**8.3**	**40.0**	**(54.8)**	**494.3**

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

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

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

Consolidated cash flow statement

For the year ended 31 December 2018

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

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

Notes to the consolidated financial statements

For the year ended 31 December 2018

1. Presentation of the consolidated financial statements

Vectura Group plc (the "Company") is a public limited company incorporated and domiciled in the United Kingdom. The Group's operations and principal activities are described in the Strategic report. The "Group" is defined as the Company, its subsidiaries and equity-accounted associates.

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union (EU-IFRS). These financial statements also comply with IFRS as issued by the International Accounting Standards Board.

The financial information has been prepared on the historical cost basis modified to include revaluation to fair value of certain financial instruments and the recognition of net assets acquired including contingent liabilities assumed through business combinations at their fair value on the acquisition date modified by the revaluation of certain items, as stated in the accounting policies.

The Group's activities together with the factors likely to affect its future development performance and position are set out in the Business review. The Group has made a loss for the year; however, it continues to be cash generative. A summary of the Group's financial position, cash generated in the year and accounting loss made after non-cash amortisation charges is included within the Financial review. The Group has considerable financial resources together with long-term contracts with a number of customers across different geographic areas and jurisdictions. The Directors believe that the Group is well placed to manage its business risks successfully despite the current uncertain economic outlook. The Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future, and as such they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

The financial statements of the parent company, Vectura Group plc (UK company number 03418970, registered address: One Prospect West, Chippenham, Wiltshire SN14 6FH), have been prepared in accordance with FRS 101 – Reduced Disclosure Framework. The Company balance sheet is presented immediately after these consolidated financial statements which comprise the Consolidated income statement, Consolidated statement of other comprehensive income, Consolidated balance sheet, Consolidated statement of changes in equity, Consolidated cash flow statement and accompanying notes to the financial statements.

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

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

This is the first set of the Group's annual financial statements in which IFRS 15 – Revenue from Contracts with Customers has been applied. Where licence agreements signed in prior years have satisfied all the performance obligations, the accounting principles of IAS 18 – Revenue continue to apply until the contract is complete.

The Group has applied IFRS 15 from 1 January 2018. A number of other new amendments are also effective from 1 January 2018 in relation to IFRS 2 – Share-based payments and IAS 28 – Investments in associates, but they do not have a material effect on the Group's financial statements. IFRS 9, which mandates adoption for 2018, was early adopted by the Group in the 2017 Annual Report.

Details about the transition to IFRS 15 and future material changes to accounting policies are provided as follows:

- note 32 – Transition to IFRS 15 – Revenue from Contracts with Customers on 1 January 2018;
- note 33 – Future impact of IFRS 16 – Leases from 1 January 2019; and
- note 34 – Future impact of IFRIC 23 – Accounting for uncertain tax positions from 1 January 2019.

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

1.1 Alternative performance measures (APMs)

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

Adjusted EBITDA is defined as operating loss, adding back amortisation and impairment, depreciation, share-based payments and exceptional items. Refer to note 9 "Adjusted EBITDA".

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

- costs associated with major corporate transactions;
- Board-approved spend on the integration of major corporate transactions; and
- other major transformation programmes.

Notes to the consolidated financial statements continued

For the year ended 31 December 2018

1. Presentation of the consolidated financial statements continued

1.1 Alternative performance measures (APMs) continued

Furthermore, significant and unusual items of litigation (e.g. GSK litigation) and significant and unusual items which individually distort the underlying performance of the business and therefore warrant highlighting separately to the users of the accounts are also included within exceptional items. Refer to note 10 “Exceptional items”.

Underlying and **non-recurring revenues** were previously presented in the 2017 financial statements in order to separate out revenues which can vary significantly each period. Following stakeholder feedback, this presentation was replaced and revenues have now been disaggregated according to whether they relate to product supply, development stage work or royalty and other marketed revenues. These revised categories are not considered APMs.

2. Critical accounting areas of judgement and estimation

The following critical judgements are those which have the most significant effect on the amounts recognised in the financial statements:

Applying IFRS 15 – Revenue from Contracts with Customers to long-term collaborative agreements

Collaborative development and marketing agreements which license the Group’s technology and intellectual property (IP) can and do have unique terms. Consequently, the accounting judgements required to apply IFRS 15 to each such agreement can differ significantly.

Accounting for the developments of generic inhaled therapies with Sandoz (VR2081) entered into in June 2017 and with Hikma (generic of GSK Ellipta® products) in November 2018 are explained further in note 32 and note 3 respectively.

(a) Identification of performance obligations

A contract with a customer is in the scope of the standard when it is legally enforceable and all of the following criteria are met:

- the contract is approved and the parties are committed to their obligations;
- rights to goods or services and payment terms can be identified;
- the contract has commercial substance; and
- collection of consideration is probable.

An agreement often provides a customer with an option to acquire additional services. Judgement is required to determine the extent to which the Group or the customer is committed to these services throughout the agreement.

This has been applied to the agreement with Hikma to develop generic versions of GSK’s Ellipta® portfolio. It has been judged that the licence to use Vectura’s intellectual property and the provision of services for development of Vectura’s Open-Inhale-Close device are considered committed as the initial $15.0m milestone received on signing of the agreement is non-refundable. Hikma also has the option to acquire future formulation and process development services for up to five products on terms specified in the agreement. It has been judged that these services are not committed until product development plans are agreed.

(b) Whether a licence to the Group’s intellectual property is capable of being distinct

A licence granted by the Group usually provides the partner with a right-to-use, but not to own, the IP related to a development. A licence is capable of being distinct from development services if, regardless of contractual terms, it could be sold separately.

The timing of revenue recognised from a licence of intellectual property depends on whether:

- the licence is capable of being distinct (i.e. could be sold separately as it exists at the point in time it was granted). In this case revenue is recognised at the point in time the licence is granted, normally at contract inception. This treatment applies to the development of the generic GSK Ellipta® portfolio with Hikma; or
- the licence is not capable of being distinct and therefore, the customer cannot obtain the value of the licence without the provision of additional services from Vectura. In this instance, revenue is recognised as those services accrue. This treatment applies to the development of VR2081 with Sandoz.

(c) Allocation of the transaction price based on standalone selling prices at contract inception

For collaborative agreements containing multiple performance obligations, the Group must determine the standalone selling price identified on inception of the contract. Once these have been determined, these are not subsequently amended. The key assumptions used to determine the standalone selling price include forecast revenues, the cost of satisfying the obligation, development timelines and probabilities of technical, regulatory and commercial success.

These prices are considered to be a judgement on inception of the contract as opposed to an estimate, because, unlike an estimate, these are not subsequently amended. Refer to note 3 for details of the judgements applied to the agreement with Hikma to develop generic versions of GSK’s Ellipta® portfolio.

2. Critical accounting areas of judgement and estimation continued

Uncertain tax positions

A provision for an uncertain tax position is recognised within current tax liabilities relating to recent utilisation of historical losses claimed in an overseas jurisdiction. The provision is recognised on the basis of the Group's interpretation of inherently complex tax legislation. The judgement of whether and how much to provide is formed after taking external professional advice, and is based on management's judgement of the potential tax that could be assessed as due. The tax provision is recognised at £4.9m (2017: £5.0m) in corporation tax payable within note 21. This provision is partially released to the consolidated income statement as each annual statute of limitation (the period during which the tax authority can enquire into each return) is closed, with the uncertainty expected to be fully resolved in 2021.

The following critical estimates, if changed in 2019, would materially impact reported performance:

Revenue – Variable consideration included in revenue contracts

Variable consideration includes the estimate of payments in the form of contingent development related and regulatory approval milestones. These milestones are included in the transaction price when the most likely outcome is they will be received. Once this is established, the entire transaction price is constrained to the extent that it is highly probable that a significant reversal of revenue will not occur in future periods. The estimate is reassessed for each reporting period.

The initial transaction price for the development of the generic GSK Ellipta® portfolio with Hikma has been assessed as $20.0m, which includes a fixed $15.0m non-refundable milestone received in 2018 and a second $5.0m milestone due on Hikma confirming completion of the device development services. The second milestone is being constrained (i.e. not recognised) until further development progress is made and there is greater certainty over the achievement of the second milestone. If this $5.0m milestone had not been constrained, additional revenue of £2.2m ($2.9m) would have been recognised in 2018.

Impairment of goodwill and intangible assets acquired through business combinations

Goodwill arising on a business combination is not amortised, but is tested annually for impairment. This testing requires judgement as to the value in use of the cash-generating units (CGUs) to which goodwill has been allocated. The actual performance of CGUs may differ from the valuations derived through this exercise. Refer to note 14 "Goodwill".

Intangible assets are reviewed for indicators of impairment and where such indicators exist a full impairment test is performed to ensure the recoverable amount is higher than the carrying value. Impairment tests are based on internal risk-adjusted future cash flows discounted to present value. Some of the more significant assumptions include the product supply volume forecast, margin (depending on pricing assumptions, raw material costs and cost of manufacture) and the appropriate discount rate to measure the inherent risks in the cash flows.

These valuations are inherently subjective. The sensitivity of the *flutiform*® intangible, being the Group's largest intangible asset, to downside scenarios is presented within note 15 "Intangible assets".

Useful economic lives of intangible assets acquired through business combinations

Intangible assets relating to in-market products are amortised with reference to average patent lives in the most applicable territories. The key estimate is which patent or midpoint of the patents to use, due to the varying strength of the patents and different time periods for different territories. Given the quantum of the intangible assets, any change in assumptions would have a significant impact on the amortisation charge.

Intangible assets relating to smart nebuliser-based technology acquired through the Activaero acquisition and leveraged in various development programmes are amortised in line with the expected consumption of economic benefits. These may change, for example on approval of a product incorporating the technology and in such cases, the useful economic life (UEL) is reviewed and adjusted accordingly. If the UEL changes, the Group's financial statements would be significantly impacted through changes to amortisation and deferred tax.

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

The Group operates a pension scheme in respect of its employees in Switzerland. As some of the risks of the scheme match the criteria under IAS 19 – Employee Benefits for a defined benefit plan, the scheme is accounted for as such. Application of IAS 19 involves estimates about uncertain future events based on independent actuarial valuation reports. The defined benefit obligation is sensitive to the actuarial assumptions outlined in note 23 "Retirement benefit obligations".

Notes to the consolidated financial statements continued

For the year ended 31 December 2018

3. Revenue

Detailed analysis and commentary on revenue is provided in the Financial review.

	2018 £m	2017 £m
Product supply revenues	**85.6**	74.7
Royalty and other marketed revenues	**58.4**	63.7
Development revenues	**16.5**	9.6
Total revenues	**160.5**	148.0

Development revenues include £8.5m (2017: £8.5m) for completed development service obligations, £3.7m (2017: £1.1m) for deferred income released on partially completed development service obligations and £4.2m (2017: £nil) in respect of granting of a licence related to the new collaborative arrangement with Hikma signed in 2018, being the first arrangement to which IFRS 15 has been applied outside of the standard's transition rules.

Revenue of £6.6m (2017: nil) has been recognised relating to the collaborative arrangement with Hikma signed in November 2018 to develop generic versions of GSK's Ellipta® portfolio. Of this amount, £4.2m (2017: £nil) was recognised when the Group provided Hikma with the right-to-use intellectual property related to Vectura's Open-Inhale-Close prototype device as it existed on the grant date. The remaining £2.4m has been recognised reflecting the degree of progress made towards completing the second performance obligation being the provision of development services on Vectura's Open-Inhale-Close device.

The Group has determined the transaction price to be $20.0m being the upfront milestone of $15.0m and a variable payment of $5.0m, which is contingent on successful completion of the device development services. The $5.0m variable payment has been constrained subject to further development progress being made resulting in reduced uncertainty.

In addition, Vectura is obliged to perform future formulation and process development activities for up to five products which will only be committed upon agreement of individual product development plans in the future. The Group has assessed these services to be offered at their standalone selling price such that no material right to discounted services exists.

Revenue by geographical location

	2018 £m	2017 £m
United Kingdom	**55.2**	49.2
Japan	**35.1**	33.0
Switzerland	**31.0**	27.3
United States of America	**15.8**	13.8
Rest of Europe	**13.3**	15.3
Rest of world	**10.1**	9.4
Total revenues	**160.5**	148.0

Geographical location is derived from customer invoicing points as opposed to patients receiving treatment.

Revenue from major customers

Three major customers contributed individually in excess of 10% of total Group revenues: Customer A – £43.9m (2017: £35.2m), Customer B – £35.1m (2017: £33.0m) and Customer C – £22.4m (2017: £17.1m).

Customer contract balances

The following table details trade receivables, contract assets and contract liabilities with customers:

	Note	2018 £m	2017 £m
Trade receivables	19	**15.1**	11.5
Customer contract assets – accrued royalty revenues	19	**10.2**	14.2
Customer contract liabilities – advanced consideration received	21	**(6.5)**	(4.6)

Accrued royalty revenues are transferred to trade receivables when the right to payment becomes unconditional upon receipt of royalty statements. Of the £11.4m payment received in respect of the new collaborative arrangement with Hikma, £4.8m has been deferred to be recognised as progress is made towards completing the second performance obligation.

Contract liabilities consists of advance payments from customers being released as performance obligations are satisfied. As part of an agreement with Sandoz regarding revised territory rights for AirFluSal® Forspiro®, Vectura recognised revenues of £2.4m during the period, of which £2.0m relates to the release of deferred income. In respect of VR2081, £1.3m of deferred income was also released and recognised as revenues for the services performed in 2018.

4. Segmental information

The Group is managed on the basis of a single reportable segment, being the development and supply of pharmaceutical products, and as such no separate segmental information is provided as it would not be different from the consolidated income statement. The Chief Operating Decision Maker, represented by the Board, allocates resources on the basis of integrated management information, which focuses on adjusted EBITDA as detailed in note 9.

Non-current assets at 31 December by geographical location are as follows:

	2018 £m	2017 Restated* £m
Switzerland	**286.8**	356.7*
United Kingdom	**125.5**	106.1*
Germany	**19.6**	71.9
United States of America	**—**	11.6
France	**19.3**	11.0*
Total non-current assets	**451.2**	557.3

* In 2018, £19.0m (2017: £17.9m) of non-current assets located in the United Kingdom and £7.0m (2017: £5.4m) located in France, used to support the manufacture and production of *flutiform*®, were reported against Switzerland in the prior year in order to align with the allocation of these assets for CGU impairment testing purposes. These are now reported against the location in which they are located physically.

5. Research and development expenses

	2018 £m	2017 £m
Partnered R&D	**20.6**	25.7
Pre-partnered R&D	**34.9**	34.6
Total research and development expenses	**55.5**	60.3

Partnered research and development expenditure represents expenditure funded by partners to progress agreed contracted programmes. Pre-partnered research and development expenditure reflects investments funded by the Group on programmes yet to be partnered, as well as investments in the Group's own innovative proprietary technology platforms.

6. Employees

The average number of full time equivalent employees and aggregate remuneration of employees was as follows:

	2018 Number	2017 Number
Research and development and related support services	**275**	310
Business development and corporate administration	**16**	19
Manufacturing and supply chain	**143**	135
Total average number of full time equivalent employees	**434**	464

Aggregate remuneration	2018 £m	2017 £m
Wages and salaries	**34.7**	34.6
Social security costs	**4.9**	4.8
Payments to defined benefit pension plans	**0.2**	0.7
Payments to defined contribution pension plans	**1.3**	2.0
Total aggregate remuneration	**41.1**	42.1

In addition, costs of £2.5m (2017: £2.0m) were incurred for individuals not directly employed by the Group and certain redundancy costs, qualifying as exceptional items, are presented within note 10.

Directors' remuneration is detailed in the Remuneration report. In accordance with Schedule 5 (11.1) of the Companies Act 2006, employee benefits accruing under the Vectura Long-Term Incentive Share plan are excluded from this disclosure as they do not solely relate to payments made for 2018 employment services.

Notes to the consolidated financial statements continued

For the year ended 31 December 2018

7. Other operating income

The Group will claim R&D expenditure credits (RDEC) of £1.5m (2017: £1.7m) in the year ended 31 December 2018 alongside the tax return filing process. As these credits are subject to corporation tax, they are presented as other income. Other than the tax authorities acceptance of the tax return, there are no other unfulfilled conditions or contingencies attaching to this income.

During the year the Group received cash of £1.0m (2017: £2.1m) in respect of earlier year R&D tax credit claims. A receivable of £3.8m (2017: £3.8m) remains outstanding as at the balance sheet date.

The Group recognised £0.6m (2017: nil) of other income in relation to a 70% contribution from a customer for additional serialisation supply chain equipment required to comply with the new guidelines issued by the European Medicines Agency.

Upon the purchase by Recipharm of Sanofi's manufacturing facility in Holmes Chapel, UK, the Group recognised £0.5m as other income in relation to the novation of the Group's Manufacturing and Supply Agreement from Sanofi to Recipharm. A further £1.3m received was recognised in cost of sales as it relates to compensation for historic costs incurred and previously charged to cost of sales.

8. Auditor's remuneration

The analysis of auditor's remuneration is as follows:

	2018 £m	2017 £m
Audit of the Group's annual accounts	**0.6**	0.4
Audit of the Group's subsidiaries	**0.1**	0.1
Total audit fees	**0.7**	0.5
Other services	**0.1**	0.1
Total non-audit fees	**0.1**	0.1
Total fees payable to the Group auditor	**0.8**	0.6

Included in the audit fees for the Group's annual accounts is £35,000 (2017: £25,000) payable for the audit of the parent company.

9. Adjusted EBITDA

Adjusted EBITDA is a non-statutory measure used by the Board, the Executive Leadership Team and managers of the business to monitor the Group's performance.

	Note	2018 £m	2017 £m
Operating loss		**(105.4)**	(96.2)
Exceptional items	10	**9.0**	4.5
Amortisation and impairment of intangible assets	15	**127.0**	109.7
Depreciation of property, plant and equipment	16	**5.8**	5.7
Share-based payments	28	**2.6**	2.1
Adjusted EBITDA		**39.0**	25.8

10. Exceptional items

Exceptional items are presented whenever significant expenses are incurred or income is received as a result of events considered to be outside the normal course of business, where the unusual nature and expected infrequency merits separate presentation to assist comparisons with previous years.

	2018 £m	2017 £m
Legal fees[1]	**7.1**	1.8
Skyepharma merger integration costs[2]	**1.4**	4.5
Site closure costs[3]	**1.3**	—
Other exceptional items[4]	**0.2**	0.4
Research and development accrual release[5]	**(1.0)**	(2.2)
Total exceptional items	**9.0**	4.5

Classification if costs were not presented as exceptional:

1 Classified as research and development expenditure.

2 Classified within corporate and administrative expenses and research and development expenditure.

3 Classified separately as restructuring costs.

4 Classified within cost of sales.

5 Classified within cost of sales and research and development expenditure.

Legal fees of £7.1m (2017: £1.8m) relate to ongoing legal proceedings against GSK from enforcement of Vectura's patents in respect of the GSK Ellipta® products. In the UK, a judgement was handed down by the High Court on 13 December 2018 ruling in favour of GSK. Reimbursement of GSK's legal costs in the UK following this judgement are included in the exceptional charge. In the US, a jury trial is scheduled in Delaware for April 2019.

Post-merger integration costs of £1.4m (2017: £4.5m) include redundancy and other costs from initiatives to combine the businesses, streamline ways of working and enhance productivity, and £0.9m (2017: £1.8m) of share-based payment charges. These arise from retention shares granted to key members of management considered critical to the integration process. The charges are lower than the comparative period primarily because the awards with an 18-month service condition vested on 22 March 2018.

The decision to close one of the Group's four operational sites, Gauting in Germany, by June 2021 was communicated in June 2018. Activities will be transferred to the remaining sites during the closure period. A provision of £1.1m has been recognised for redundancies arising from the closure. The provision assumes the redundancy payments are made at the end of the closure period and is discounted at a rate of 1% (being a proxy for the German risk-free rate). The remaining £0.2m relates to share-based payment charges specifically for the retention of staff during the closure period.

Other exceptional items include the final redundancy costs from restructuring of the Group's manufacturing facility in Lyon which commenced in July 2016.

Following a detailed review of the research and development accruals during 2017, a number of individually immaterial historical accruals were identified where it was no longer considered probable that these accruals would result in future cash outflows. The accruals, totalling £2.2m, were released in the 2017 consolidated income statement and a final £1.0m has been released in 2018. These are presented within exceptional items to enable users to understand the impact of the credit on the current year performance. Management has determined that there is no material impact of the accruals on any comparative income statement, balance sheet or cash flow statement.

Notes to the consolidated financial statements continued

For the year ended 31 December 2018

11. Finance income and expense

	2018 £m	2017 £m
Bank interest income	**0.2**	0.2
Unwinding of financial assets	**0.3**	—
Foreign exchange gains	**0.8**	—
Finance income	**1.3**	0.2
Bank interest expense	**(0.3)**	(0.2)
RCF commitment fees	**(0.2)**	(0.2)
Other financing items	**—**	(1.0)
Foreign exchange losses	**—**	(1.4)
Finance expense	**(0.5)**	(2.8)

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

12. Taxation

	2018 £m	2017 £m
Current taxation	**(4.6)**	(5.9)
Adjustments to prior periods recognised	**(0.1)**	0.4
Total current taxation charge	**(4.7)**	(5.5)
Deferred taxation	**21.3**	22.0
Net taxation credit	**16.6**	16.5

Deferred taxation charges of £0.5m (2017: £1.4m) were recognised in other comprehensive income.

Current taxation arises from trading profits generated in Switzerland and the US. Deferred tax relates predominantly to credits arising on the unwinding of tax liabilities on the intangible assets acquired as a result of the acquisition of Activaero in 2014 and the Skyepharma merger in 2016.

The Group's effective tax rate (ETR) before other comprehensive income (OCI) is a 15.8% credit (2017: 16.2% credit). This equates to the applicable UK tax rate of 19%, adjusted for a number of factors discussed below.

UK taxation

The UK sub-group is loss-making and benefits from the R&D expenditure credit (RDEC). The RDEC is subject to UK corporation tax and therefore is included within the Consolidated income statement and presented as other operating income (refer to note 7). In addition, certain UK companies are able to participate in the UK Patent Box regime, the benefit of which is expected to increase as new products are approved. The UK corporation tax rate will reduce to 17% from 1 April 2020, which has been substantively enacted. The impact on the Group accounts is expected to be immaterial.

US taxation

Taxable income arose in respect of the percentage of net sales received from EXPAREL®. This ceased from September 2018.

Swiss taxation

The Group continues to be tax-paying in Switzerland and continues to monitor the Swiss tax reform, expected to be enacted from 1 January 2020.

12. Taxation continued

Effective tax rate (ETR)

In Switzerland and the US, the Group is profitable and subject to taxation at the local rates (Swiss ETR 9.7% charge (2017: 8.5%), and the US corporate rate applied is 21% (2017: 35%)). The uncertain tax position disclosed has decreased by £0.1m in the year. These charges, along with a significant credit (ETR: 19.8% credit) in respect of deferred tax liabilities relating to intangible assets acquired on the Skyepharma and Activaero acquisitions (refer to note 24 “Deferred tax liabilities”), together drive the Group’s ETR credit of 15.8% (2017: 16.15%).

	2018 £m	2017 £m
Loss before tax	**(104.8)**	(102.2)
Loss before tax multiplied by standard rate of UK corporation tax of 19% (2017: 19.25%)	**19.9**	19.7
Effects of:		
UK Patent Box benefit	**—**	0.1
Expenses not deductible for tax purposes	**(0.1)**	(2.5)
Unrecognised deferred tax*	**(8.9)**	(5.4)
Prior year deferred tax	**0.4**	0.5
Recognition of deferred tax on losses	**2.0**	—
Differences arising from prior period computations	**(0.1)**	0.4
Differences in effective overseas tax rates	**3.4**	2.1
Impact of deferred tax rate change	**—**	1.6
Total tax credit for the year	**16.6**	16.5

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

The ETR (excluding the future release of the uncertain tax position) is expected to remain in the 10–15% credit for 2019 as a result of both the taxable Swiss profits and the significant credit in respect of deferred tax liabilities on intangibles acquired, which is expected to continue for the remainder of their useful lives. If VR315 US progresses to market as expected, the Group’s loss before tax would decrease, and the ETR (before the release of the uncertain tax position) is expected to increase to 20–30% credit ETR as the UK moves into a profitable position and utilises brought forward tax losses. This is subject to change as the impact of Swiss tax reform becomes certain, and the credit is expected to reduce in future years as the Group’s intangible assets are amortised in line with their respected useful economic lives.

13. Loss per share

Basic loss per share of 13.2p per share (2017: 12.6p per share) equals diluted loss per share of 13.2p per share (2017: 12.6p per share). The following table provides details of the impact as if shares had been considered dilutive.

	2018	2017
Loss after taxation (£m)	**(88.2)**	(85.7)
Weighted average number of shares (m)	**666.1**	678.9
Effect of dilutive potential shares (m)	**6.3**	6.2
Diluted weighted average number of shares (m)	**672.4**	685.1

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14. Goodwill

	2018 £m	2017 £m
At beginning of the year	**161.4**	162.8
Foreign exchange	**2.0**	(1.4)
At end of the year	**163.4**	161.4
Allocation to cash-generating units (CGUs)		
UK and Germany	**100.1**	100.1
Switzerland	**63.3**	61.3
At end of the year	**163.4**	161.4

Goodwill has been allocated to cash-generating units (CGUs), being the Group's geographic locations for operations and intellectual property. The recoverable amounts of each CGU is assessed using a fair value less costs of disposal model. This is calculated using a discounted cash flow approach, with a post-tax discount rate applied to the projected risk-adjusted post-tax cash flows and terminal value. IAS 36 – Impairment of Assets requires the use of pre-tax cash flows and pre-tax discount rates. However, discounting post-tax cash flows at a post-tax discount rate provides materially the same result when there are neither temporary differences nor available tax losses at the measurement date.

The Group's weighted average cost of capital (WACC) of 10% (2017: 9%) is used in the calculation to discount the cash flows to reflect the impact of risks relevant to the Group and the time value of money. The Group rate is then adjusted for risks specific to each CGU.

Cash flows relating to the Swiss CGU are discounted at 9% (2017: 8%) and to the UK and Germany CGU at 11% (2017: 9%). Whilst no specific Brexit adjustment is made to the discount rates, market volatility caused by Brexit is incorporated into risk-free rates, equity market returns and economic expectations and has contributed to the increase in the Group's WACC.

Cash flows are based on the most recent budget approved by the Board covering 2019 and the Ten Year Plan to 2028. Details relating to the discounted cash flow models used in the impairment tests of the cash-generating units are as follows:

Valuation basis	Fair value less cost of disposal
Key assumptions	Brexit proceeds in an orderly manner with minimal disruption to the *flutiform*® supply chain Time to develop and launch pipeline products Net sales forecasts and related royalty inflows Timing of partnering pipeline products and milestone achievement Gross profit margins on product supply Discount rate Taxation rate
Determination of assumptions	Forecast development plans Net sales forecasts are determined from partner forecasts and external market data Milestone amounts and royalty rates reflect past experience and forecast sales from market data Margins reflect past experience, adjusted for expected future changes Discount rates based on Group WACC, adjusted for country specific risks Taxation rates based on appropriate rates for each region
Specific projected cash flow year	Ten years (reflecting a longer-term planning cycle)
Terminal growth rate	Nil
Discount rate	UK and Germany: 11% Switzerland: 9%

14. Goodwill continued

The Group conducted a sensitivity analysis on the impairment test of each CGU's carrying value. The UK and Germany CGU valuation indicates significant headroom such that a plausible change in any key assumption is unlikely to result in an impairment of the related goodwill. The forecast cash flows would need to reduce in excess of 65% (2017: 70%) before impairment arises. This is primarily because this CGU comprises a significant number of internally generated intangibles.

The Swiss CGU has relatively low headroom primarily because it includes significant acquired intangibles, the largest being *flutiform*®. The sensitivity analysis indicates that either a decline of annual cash flows in excess of 11% or an increase in the discount rate by 1.5% would, all other assumptions being equal, cause impairment. A 1% increase in the discount rate combined with a 3.5% reduction in annual cash flows would likely cause impairment.

The sensitivity of the Swiss CGU to the potential outcomes of the UK exiting the EU ("Brexit") has been considered. Brexit could have a range of potential outcomes, of which the most severe is considered to be the UK exiting the EU on 29 March 2019 without a transition period ("hard Brexit"). In this scenario, the Group believes that there is a reasonable possibility that the Group's *flutiform*® supply chain could be disrupted. *flutiform*® is manufactured in the UK with raw materials imported mainly from the EU into the UK and the Group's partners export finished product from the UK into the EU and Japan.

As the cash flows from *flutiform*® form part of the recoverable amount of the Swiss CGU, sensitivities have been modelled ranging from minimal disruption to the *flutiform*® supply chain to severe but still reasonably possible disruption such that partner and patient demand cannot be satisfied. The sensitivities also consider an increase in operating costs from adverse regulatory changes. Details relating to the sensitivities are as follows:

Key assumptions	Severity and duration of border disruption Stock levels of finished products and raw materials Level of switching in market between *flutiform*® and other available brands Tariff levels and other regulatory or trading costs Extent of sharing of incremental costs with the Group's partners Changes in batch failure rates following implementation of new release testing process
Determination of assumptions	External inputs from professional bodies, trade associations and governmental bodies Internal risk mitigation reviews and those with partners and suppliers The Group's own inventory tracking and supply forecasts Potential applicable tariffs and duties from the World Trade Organization (WTO) Internal expertise and experience of regulatory and testing regimes
Specific projected cash flow year	Ten years (reflecting a longer-term planning cycle)
Terminal growth rate	Nil
Discount rate	9%

The impact of these sensitivities range from no impairment to an impairment of goodwill allocated to the Swiss CGU of £57.7m in the most severe but reasonably possible case. There remains a high level of uncertainty as at the date of approval of these financial statements as to how and whether specific risks will materialise. The full implications of Brexit will not be understood until future tariffs, trade, regulatory, tax, and other free trade agreements to be entered into by the United Kingdom are established. Furthermore, Vectura could experience changes to laws and regulations post Brexit, in areas such as intellectual property rights, employment, environment, supply chain logistics, data protection and health and safety, which may be relevant in assessing the Group's assets.

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15. Intangible assets

	Inhaled in-market assets £m	Smart nebuliser technology* £m	Non-inhaled in-market assets £m	Other £m	Total £m
Cost:					
At 1 January 2017	327.2	132.7	156.8	16.7	633.4
Additions	—	—	—	0.2	0.2
Disposals	(3.5)	—	(74.6)	—	(78.1)
Foreign exchange	(14.6)	5.6	(5.4)	(0.8)	(15.2)
At 31 December 2017	309.1	138.3	76.8	16.1	540.3
Additions	—	—	—	0.9	0.9
Foreign exchange	15.8	1.6	4.2	0.8	22.4
At 31 December 2018	**324.9**	**139.9**	**81.0**	**17.8**	**563.6**
Amortisation:					
At 1 January 2017	(31.3)	(48.8)	(91.4)	(5.1)	(176.6)
Amortisation	(49.4)	(20.6)	(29.6)	(1.4)	(101.0)
Impairment	—	—	—	(8.7)	(8.7)
Disposals	3.5	—	74.6	—	78.1
Foreign exchange	3.1	(2.3)	3.0	(0.5)	3.3
At 31 December 2017	(74.1)	(71.7)	(43.4)	(15.7)	(204.9)
Amortisation	(48.0)	(14.5)	(22.8)	(0.2)	(85.5)
Impairment	—	(41.5)	—	—	(41.5)
Foreign exchange	(5.7)	(1.7)	(3.6)	(0.8)	(11.8)
At 31 December 2018	**(127.8)**	**(129.4)**	**(69.8)**	**(16.7)**	**(343.7)**
Net book value:					
At 31 December 2018	**197.1**	**10.5**	**11.2**	**1.1**	**219.9**
At 31 December 2017	235.0	66.6	33.4	0.4	335.4

* Used in pipeline programmes.

Inhaled in-market assets comprise the *flutiform*® and GSK's Ellipta® assets recognised on the Skyepharma merger. The Group receives product supply revenue on the *flutiform*® asset and royalties on both assets.

Non-inhaled in-market assets include several near end of life licences, patents, know-how agreements and marketing rights recognised on the Skyepharma merger, which are in use, and from which the Group continues to receive royalties.

The carrying value of the smart nebuliser technology asset at 31 December 2018 represents the amortised cost attributed to technology acquired through the Activaero transaction on 13 March 2014 being leveraged in the VR647 development programmes.

Impairment losses of £39.8m (2017: nil) arose from the decision to discontinue development of VR475 following the Phase III study results and a £1.7m charge (2017: nil) following the decision by Sanofi not to continue with the VR465 development programme despite positive Phase II study results.

Impairment tests on intangible assets are undertaken if events occur which call into question the carrying values of the assets. The assumptions relating to future cash flows, estimated useful lives and discount rates are based on business forecasts and are therefore inherently judgemental. Future events could cause the assumptions used in these impairment tests to change with a consequent adverse effect on the future results of the Group.

15. Intangible assets continued

For the purposes of impairment testing, a value in use approach is applied. Details relating to the value in use calculations used for the impairment testing are as follows:

Intangible type	Inhaled in-market assets
Specific asset	*flutiform*®
Key assumptions	• Product supply volume forecast • Margin (depending on pricing assumptions, raw material costs and cost of manufacture) • Discount rate
Determination of key assumptions	• Internal forecasts with input from partners and external market data • Margins reflect past experience, adjusted for expected changes in pricing, raw material costs and cost of manufacture • Discount rate based on Group WACC, with a 1% risk deduction for being on-market and therefore having no development risk
Discount rate	• 9% (2017: 8%)

The Group has conducted a sensitivity analysis based on a number of reasonably possible downsides scenarios relating to reductions in margin (up to 6% reduction), volumes (up to 30% reduction) and the discount rate. All other assumptions being constant, an increase in the discount rate in excess of 16.5%, a reduction in volumes in excess of 23.0% or a reduction in margin in excess of 9.5% would cause impairment. In addition, the Brexit sensitivities in note 14 would have an impact ranging from no impairment of the *flutiform*® intangible to an impairment of £21.0m in the most severe case. The risk of future impairment of the *flutiform*® intangible is mitigated by further amortisation of the asset in 2019.

The Group's intangibles are amortised on a straight-line basis using the following useful economic lives (UELs):

	Carrying value £m	Acquisition date	Useful economic life from acquisition date
Inhaled in-market assets	197.1	June 2016	3.5–7 years
Smart nebuliser technology	10.5	March 2014	8 years
Non-inhaled in-market assets	11.2	June 2016	3.5 years

The Group's sensitivity analysis shows that, had UELs been extended for 2018 by one year, then the impairment and amortisation charge would be £17.8m lower. Had UELs been reduced for 2018 by one year, then the impairment and amortisation charge would be £27.3m higher.

Following a contract renegotiation, effective from 1 January 2019, the UEL for non-inhaled in-market assets was extended by an additional four years.

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16. Property, plant and equipment

	Land and buildings £m	Laboratory and supply chain equipment £m	Assets under construction £m	Total £m
Cost:				
At 1 January 2017	18.2	37.9	15.1	71.2
Additions	0.2	5.2	6.3	11.7
Reclassification	—	8.8	(8.8)	—
Transfer to other non-current assets	—	—	(6.3)	(6.3)
Foreign exchange	(0.3)	(3.0)	—	(3.3)
At 31 December 2017	18.1	48.9	6.3	73.3
Additions	0.2	3.1	5.2	8.5
Reclassification	0.7	4.9	(5.6)	—
Disposals	—	(2.2)	—	(2.2)
Foreign exchange	0.6	1.6	0.2	2.4
At 31 December 2018	**19.6**	**56.3**	**6.1**	**82.0**
Depreciation:				
At 1 January 2017	(0.4)	(16.0)	—	(16.4)
Charge for the period	(0.6)	(5.1)	—	(5.7)
Foreign exchange	—	1.9	—	1.9
At 31 December 2017	(1.0)	(19.2)	—	(20.2)
Charge for the period	(0.7)	(5.1)	—	(5.8)
Disposals	—	2.2	—	2.2
Foreign exchange	(0.1)	(0.3)	—	(0.4)
At 31 December 2018	**(1.8)**	**(22.4)**	**—**	**(24.2)**
Net book value:				
At 31 December 2018	**17.8**	**33.9**	**6.1**	**57.8**
At 31 December 2017	17.1	29.7	6.3	53.1

Land valued at £5.1m (2017: £5.1m) is not depreciated. The Group has invested £8.5m in capital expenditure in 2018 (2017: £11.7m) mainly in manufacturing equipment to support the production of *flutiform*®, the development of oral tablet production in Lyon and equipment to support the Group's nebuliser platforms.

Investments in a bottling line at the Group's manufacturing facility in Lyon of £2.2m and new moulds for the manufacture of components for the *flutiform*® actuator of £3.4m have been brought into use and therefore have been reclassified from assets under construction.

Two freehold properties and an adjoining warehouse facility in Switzerland are currently being actively marketed for sale. Renovation and planned capital expenditure for structural works to enable the sale have commenced and are not material in 2018. This work is expected to complete in the second half of 2019. As these buildings are not available for immediate sale they have not been reclassified as held for sale.

17. Other non-current assets

Other non-current assets comprise the following items:

	2018 £m	2017 £m
Non-current financial assets held at amortised cost	**6.8**	6.0
Deferred tax assets on tax basis differences	**3.3**	1.4
Total other non-current assets	**10.1**	7.4

Non-current financial assets principally include £6.4m (2017: £5.8m) of amounts receivable from development partners for manufacturing equipment which the Group has funded. The customer for the largest asset, at £6.1m (2017: £5.8m), has agreed to reimburse Vectura from 1 May 2020 for at least the value of the original costs incurred.

Deferred tax assets are recognised on differences between the tax base in the IFRS accounts for IAS 19 pension liabilities, provisions related to the profitable Swiss operations, and the recognition of £2.0m relating to tax losses where the future utilisation appears probable.

18. Inventories

	2018 £m	2017 £m
Raw materials	**8.9**	11.6
Work in progress	**14.6**	8.6
Finished goods	**4.2**	4.4
Less provision for impairment	**(1.0)**	(1.2)
Total inventories	**26.7**	23.4

Inventory purchases of £58.0m were expensed to cost of sales (2017: £52.4m).

19. Trade and other receivables

	2018 £m	2017 £m
Trade receivables	**15.1**	11.5
Customer contract assets	**10.2**	14.2
Less provision for impairment	**(0.1)**	(1.1)
Net trade receivables	**25.2**	24.6
Prepayments and other receivables	**6.3**	5.7
Research and development tax credits	**3.8**	3.8
Total trade and other receivables	**35.3**	34.1

The carrying values of trade receivables approximate their fair values because these balances are expected to be cash settled in the near future unless a provision is made. Customer contract assets contain accrued royalties and licence and development milestones as well as contributions to fixed asset investments pursuant to the *flutiform*® supply chain.

The Group applies the IFRS 9 simplified approach to providing for expected credit losses in accordance with applicable guidance for non-banking entities. Under the simplified approach Vectura is required to measure lifetime expected credit losses for all trade receivables.

The expected credit loss allowance provision is determined below as follows, and incorporates forward looking information:

		Current	More than 30 days past due	More than 60 days past due	More than 90 days past due	Total £m
	Expected loss rate	—	—	100%	100%	
2018	Gross carrying amount	24.7	0.4	0.1	0.1	**25.3**
	Loss allowance provision	—	—	—	(0.1)	**(0.1)**
2017	Gross carrying amount	24.6	—	0.1	1.0	**25.7**
	Loss allowance provision	—	—	(0.1)	(1.0)	**(1.1)**

The Group's expected credit loss policy is to provide in full for any trade receivable over 60 days past due, by exception; however, as all amounts in this category were fully cash settled in January 2019 no provision was made.

In the comparative period an amount of £1.0m over 90 days past due was fully provided for as the customer contract was terminated in December 2018. The receivable was released and the provision was utilised in the current period for nil gain or loss.

20. Cash and cash equivalents

Cash and cash equivalents at 31 December are denominated in the following currencies:

	31 December 2018 £m	31 December 2017 £m
Sterling	**45.2**	44.5
Euros	**25.6**	24.5
US dollars	**21.1**	20.5
Swiss francs	**16.3**	14.2
Cash and cash equivalents	**108.2**	103.7

The Group invests its funds in short-term overnight bank deposits, with access at a maximum of 24 hours' notice. The Group has access to a £50m unsecured committed multi-currency revolving credit facility (RCF) with Barclays Bank PLC and HSBC Bank plc. The facility expires in August 2021.

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21. Trade and other payables

	2018 £m	2017 £m
Trade payables	**25.6**	23.7
Accruals	**28.8**	25.5
Customer contract liabilities	**4.1**	4.0
Other payables	**2.4**	3.1
Property mortgage	**0.2**	0.2
Trade and other current liabilities	**61.1**	56.5
Other payables	—	5.1
Customer contract liabilities	**2.4**	0.6
Property mortgage	**3.8**	3.9
Other non-current payables	**6.2**	9.6
Trade and other payables	**67.3**	66.1

Trade and other payables are unsecured unless otherwise indicated, due to the short-term nature of current payables, their carrying values approximates their fair value.

Accruals principally relate to manufacturing fees payable for *flutiform*® semi-finished products, external R&D project costs, employee benefits and related taxes, legal fees and other costs accrued but not invoiced. Customer contract liabilities relate to deferred revenues where the cash has been received from the customer in advance of work being performed and, therefore, in advance of revenue being recognised.

The property mortgage is secured on the Group's Swiss buildings, and had a fixed rate of interest of 2.6% per annum up to 28 February 2019, when it was renewed at a fixed rate of 1.3% with a term ending 30 August 2019. Owing to the nature of Swiss roll-over mortgages, the principle of the loan balance is presented as long term given the Group's intention to continue to roll-over the principal balance until the related property is sold which is expected to be in more than one year. All expected interest payments are presented as current.

In addition to current trade and other payables of £61.1m (2017: £56.5m), the Group recognises a corporation tax payable of £10.1m (2017: £11.4m).

22. Provisions

	Employee £m	Property £m	Commercial £m	Total £m
At 1 January 2018	2.2	1.9	1.3	5.4
Transfer from other payables	—	—	5.8	5.8
Charged/(released) during the period	1.4	0.7	(1.8)	0.3
Utilised during the year	(0.4)	(0.2)	—	(0.6)
At 31 December 2018	**3.2**	**2.4**	**5.3**	**10.9**
Current	0.6	0.2	0.3	1.1
Non-current	2.6	2.2	5.0	9.8

Provisions of £10.9m (2017: £5.4m) have increased as a result of the transfer of a commercial liability of £5.8m, which was previously recognised in other payables. This transfer reflects the uncertainty of the phasing of future payments and the obligation is now considered to be constructive in nature. In this one instance, as the phasing of repayments cannot be reliably measured and owing to immateriality, no discounting has been applied. Of this provision, £0.8m has been released during the period.

A further £1.1m has also been released from commercial provisions in respect of a *flutiform*® supplier provision as payment is no longer considered probable, and this is partially offset by the recognition of a £0.3m provision for reimbursement of GSK's legal costs in the UK, which is expected to be settled in 2019 and is therefore presented as current. Refer to note 10 "Exceptional items".

Employee provisions relate to the Group's Gauting (Germany) and Lyon (France) sites. A provision of £1.2m has been made for redundancy payments following the decision to close the German site by June 2021. A provision of £1.4m for French statutory lump sum payments, payable upon the retirement of employees at the Lyon facility, with payments not expected in the medium term, and £0.6m for French redundancies payable in 2019. Refer to note 10 "Exceptional items".

Property provisions are recognised in respect of an onerous lease in Switzerland and the commitment to restore the Group's leased R&D facilities in Chippenham to their original 2012 condition in 2027.

23. Retirement benefit obligations

Swiss defined benefit pension plan

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

	2018 £m	2017 £m
Present value of funded obligations	**(16.2)**	(17.7)
Fair value of plan assets	**13.1**	14.1
Balance sheet liability	**(3.1)**	(3.6)

The Swiss sub-group has affiliated itself with PKG Pensionskasse for the provision of its occupational pension provision for its employees and pension recipients. The pension scheme provides benefits in the case of disability, death, old age and termination. The risk benefits are defined in relation to the pensionable salary. The retirement pension is calculated based on the projected savings capital with interest and a conversion rate.

The highest corporate body of the foundation is the Board of Trustees. It handles the general management of the pension scheme, ensures compliance with the statutory requirements, defines the strategic objectives and policies of the pension scheme and identifies the resources for their implementation. It determines the objectives and principles of the asset management and the implementation and monitoring of the investment process.

The Board of Trustees of the PKG pension fund announced in December 2017 that:

- active policy holders' retirement assets will earn 2.25% interest as of 31 December 2017; and
- further reduction in the relevant pension conversion (into an annuity) rates to 5.4% from: 6.0% in 2016.

There have been no further updates since December 2017.

Vectura, as employer, matches employees' contributions to the scheme on a monthly basis. The amount of contributions to be paid by the employer and employee are determined by the Board of Trustees or the pension fund commission such that on retirement participants can choose to receive a cash lump sum or convert their savings capital into an annuity to be paid monthly over the course of their retirement.

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

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

	2018 £m	2017 £m
Opening present value of the defined benefit obligation	**(17.7)**	(21.3)
Current service cost	**(0.8)**	(0.9)
Gain on plan modification	**—**	1.0
Exceptional gain on curtailment (note 10)	**0.7**	0.2
Recognised in the income statement	**(0.1)**	0.3
Benefits paid and withdrawals	**2.8**	2.1
Employee contributions	**(0.5)**	(0.5)
Balance sheet cash movements	**2.3**	1.6
Foreign exchange translation	**(0.8)**	0.8
Actuarial gains	**0.1**	0.9
Recognised through OCI	**(0.7)**	1.7
Present value of the defined benefit obligation	**(16.2)**	(17.7)

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23. Retirement benefit obligations continued

Swiss defined benefit pension plan continued

The movement in the fair value of the plan assets was as follows:

	2018 £m	2017 £m
Fair value of the plan assets the beginning of the year	**14.1**	15.4
Foreign exchange	**0.6**	(0.6)
Benefits paid and withdrawals	**(2.8)**	(2.1)
Actuarial gains recognised on plan assets through OCI	**0.1**	0.2
Employer contributions	**0.6**	0.7
Employee contributions	**0.5**	0.5
Fair value of the plan assets	**13.1**	14.1

Plan assets comprise:

	2018 £m	2018 %	2017 £m	2017 %
Equity	**3.7**	**28.2**	4.4	31.2
Bonds	**6.1**	**46.6**	0.6	4.3
Property	**2.5**	**19.1**	5.8	41.1
Cash	**0.1**	**0.8**	2.5	17.7
Other	**0.7**	**5.3**	0.8	5.7
Total plan assets	**13.1**	**100.0**	14.1	100.0

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

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

The latest asset coverage ratio of 114.1% (2017: 107.4%) published by the fund (for the previous year), to which the assets prices relate, is not relevant to Vectura as the Group's share of assets in the fund is capped at the level of participant savings contribution. Therefore, the Group will not share in any upside on the significantly larger quasi-governmental asset pool. Expected employer contributions to post-employment benefit plans for the year ending 31 December 2019 are £0.6m (2018: £0.8m).

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

	31 December 2018 £m	31 December 2017 £m
Actuarial gain recognised in OCI	**0.2**	1.1
Cumulative actuarial gains recognised within retained losses	**2.6**	2.4

The principal actuarial assumptions made by the actuaries were:

Salary growth	**1.25%**	1.00%
Pension increase	**Nil**	Nil
Discount rate	**0.80%**	0.65%
Male life expectancy from retirement age (years)	**22.5**	22.5
Female life expectancy from retirement age (years)	**25.5**	25.5

The average service period to retirement for scheme participants is approximately 10 years (2017: 9.5 years).

23. Retirement benefit obligations continued

Swiss defined benefit pension plan continued

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

	Change in assumption	Monetary effect of increase in assumption £m	Monetary effect of decrease in assumption £m
Discount rate	+1%/-0.8%	(1.6)	1.3
Pension increases	+/- 1%	(1.4)	Not applicable
Salary growth	+/- 2%	0.6	(0.5)
Life expectancy	+/- 2 years	(1.0)	1.0

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

Defined contribution plans – UK and Germany

In addition, the Group operates various defined contribution plans for its employees outside of Switzerland. The Group's contributions to these plans are charged to the Consolidated income statement in the year to which they relate, and the assets are held in separate trustee-administered funds. The charge to the Consolidated income statement in relation to defined contribution plans is £1.3m as disclosed in note 6 "Employees".

24. Deferred tax liabilities

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

	Intangible assets £m	Foreign exchange gains £m	Tangible assets £m	Total £m
At 31 December 2016	69.8	5.1	1.9	76.8
Credited to income statement	(22.0)	—	—	(22.0)
Charged to OCI	—	1.2	—	1.2
Foreign exchange	(2.2)	(0.3)	—	(2.5)
At 31 December 2017	45.6	6.0	1.9	53.5
Credited to income statement	(19.1)	—	(0.6)	(19.7)
Charged to OCI	—	0.5	—	0.5
Foreign exchange	1.2	0.2	—	1.4
At 31 December 2018	**27.7**	**6.7**	**1.3**	**35.7**

Deferred tax liabilities associated with intangible assets unwind to offset the tax distortion that would otherwise occur as the assets are amortised. As a result of the impairment of the carrying value of the smart nebuliser technology intangible asset attributed to VR475 (refer to note 15), the deferred tax liability of €12.7m (£11.1m) has been credited back in the period to the Consolidated income statement. In addition, as a result of the impairment and the announcement to close the Gauting site, the deferred tax asset on German tax losses of £5.3m (2017: £5.3m) has been released as a debit against the deferred tax liability release for VR475.

Deferred tax liabilities on Swiss and US unrealised foreign exchange gains arise on permanent funding loans because foreign exchange gains are deferred on the local balance sheet in accordance with Swiss and US laws.

The Group did not recognise deferred tax assets on tax losses amounting to £254.9m (2017: £248.4m). The majority of the losses are unlikely to offset taxable profits as they mostly relate to non-trading losses in investment holding companies. There are no current plans to recover these losses in the foreseeable future.

The future value of deferred tax liabilities in Switzerland are sensitive to the anticipated future Swiss tax reform. The Swiss Corporate Tax and Old Age Insurance Reform Bill will be put to a public vote by Swiss citizens on 19 May 2019. If the vote is successful, the reform will enter into force on 1 January 2020. The Group is monitoring the situation closely and, while the overall tax burden is unlikely to change materially, there are a number of complex provisions in the legislation and a number of areas yet to be finalised and hence once enacted will likely cause an adjustment to the amounts recognised in these consolidated financial statements in the next accounting period.

Notes to the consolidated financial statements continued

For the year ended 31 December 2018

25. Financial instruments

The Group has exposure to credit, liquidity and currency risks from its use of financial instruments. This note sets out the Group's key policies and processes for managing these risks.

In the previous year, the Group adopted IFRS 9 – Financial Instruments. IFRS 9 introduced three new requirements for 1) the classification and measurement of financial assets and financial liabilities, 2) the impairment of financial assets and 3) general hedge accounting and as disclosed in 2017 this had limited impact on the Group's financial reporting.

	Fair value through profit and loss		Amortised cost		Total	
	2018 £m	2017 £m	**2018 £m**	2017 £m	**2018 £m**	2017 £m
Cash and cash equivalents	**—**	—	**108.2**	103.7	**108.2**	103.7
Trade receivables	**—**	—	**25.2**	24.6	**25.2**	24.6
Other non-current assets	**6.8**	6.0	**—**	—	**6.8**	6.0
Non-derivative financial assets	**6.8**	6.0	**133.4**	128.3	**140.2**	134.3
Trade and other payables	**—**	—	**(56.8)**	(57.4)	**(56.8)**	(57.4)
Mortgage borrowings	**—**	—	**(4.0)**	(4.1)	**(4.0)**	(4.1)
Provisions	**(5.9)**	(5.4)	**(5.0)**	—	**(10.9)**	(5.4)
Non-derivative financial liabilities	**(5.9)**	(5.4)	**(65.8)**	(61.5)	**(71.7)**	(66.9)
Financial instruments	**0.9**	0.6	**67.6**	66.8	**68.5**	67.4

The Group's financial instruments are measured at amortised cost unless consideration is contingent. Contingent assets and liabilities are held at fair value through profit and loss (FVTPL) on the basis of their expected discounted cash flows, being the present value of expected payments discounted using a risk-free discount rate adjusted as appropriate. Therefore no separate fair value analysis is presented.

The Group has no external debt, except for a Swiss mortgage at a fixed rate of interest, and therefore does not consider the impact of interest rate risk to be material to its results or operations and accordingly no sensitivity analysis is shown.

(a) Credit risk

The impairment provisions for financial assets disclosed in note 19 are based on assumptions about risk of default and expected loss rates. The Group uses judgement in making these assumptions and selecting the inputs to the impairment calculation, based on the Group's past history, existing market conditions as well as forward looking estimates at the end of each reporting period.

(b) Capital management

The Group manages its capital to ensure that all entities in the Group will be able to continue as a going concern while maximising the return to stakeholders. The capital structure of the Group consists of:

	2018 £m	2017 £m
Cash and cash equivalents	**108.2**	103.7
Swiss property mortgage	**(4.0)**	(4.1)
Net cash	**104.2**	99.6
Equity	**494.3**	578.5
Net cash to equity ratio	**21%**	17%

In addition, the Group has access to a £50m RCF and no funds were drawn against this as at 31 December 2018. The facility expires in August 2021. Refer to note 20 "Cash and cash equivalents".

(c) Financial risk management

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

(d) Liquidity risk management

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

25. Financial instruments continued

(e) Currency risk management

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

The Group faces currency exposures arising from the translation of profits and losses earned in foreign currency. These exposures are not hedged. Exposures also arise from foreign currency-denominated trading transactions undertaken by subsidiaries. The Group's policy is to offset such currency exposure by matching foreign currency revenues with expenditure in the same foreign currency. Where there are no imminent foreign currency denominated transactions, the surplus foreign currency cash balances are exchanged for the functional currency of the subsidiary. Where it has not been possible to use natural hedges, currency options and forward currency contracts may be used.

On 8 November 2018, the Group entered a forward contract to hedge the transactional foreign currency exposure from the forecast receipt of the $15.0m upfront milestone arising from the global agreement with Hikma to develop generic version of GSK's Ellipta® portfolio.

A 10% strengthening of the euro, sterling, US dollar and Swiss franc functional currencies within the Group against non-functional currencies of its subsidiaries would result in the loss before taxation being £4.0m lower (2017: £7.0m lower) and items recognised directly in other comprehensive income being £10.8m higher (2017: £14.6m higher). A 10% weakening would have an equal but opposite effect on loss before taxation and other comprehensive income. The Group considers a 10% strengthening or weakening of the functional currency against the non-functional currency of its subsidiaries as a reasonably possible change in foreign exchange rates.

26. Ordinary share capital

Allotted, called up and fully paid	£m	Number of shares
Ordinary shares of 0.025p, each at 1 January 2018	0.2	678,508,698
Issued to satisfy Vectura employee share plans	—	1,561,183
Share buyback programme – cancellations	—	(14,682,736)
Ordinary shares of 0.025p, each at 31 December 2018	**0.2**	**665,387,145**

On 14 November 2017, the Group announced that the Board had approved a share buyback to return up to £15m of capital to shareholders. On 28 February 2018, the £15.0m share buyback programme was completed with £13.6m (2017: £1.4m) of capital returned to shareholders in 2018 at a weighted average price of 93p per share. Directly attributable costs of £0.2m have been expensed to equity.

During the year, the Group allotted 1,561,183 (2017: 1,961,880) ordinary shares of 0.025p each related to employee share option awards. Refer to note 28 "Share-based payments".

27. Restatement of share premium within reserves

Following completion of the share buyback programme, a review of the Vectura Group plc's distributable reserves was performed. It was identified that shares issued on 13 March 2014 with a market value of £41.3m, as part consideration for the Activaero acquisition, were incorrectly recorded in non-distributable share premium.

The share premium of £41.3m should have been recognised as a separate reserve, usually referred to as a merger reserve, and therefore this amount has been reclassified in the comparative year. Merger reserves are initially non-distributable, but can in future become distributable and the entire restated amount became distributable and, as such, was released from merger reserves to retained losses in November 2018 following impairment of the German investment (refer to note 6 of the single entity accounts). See Statement of changes in equity for amounts previously reported.

28. Share-based payments

The Group operates various share-based compensation plans as described within the Remuneration report. All share-based payments are for the purposes of employee share incentivisation and are equity settled for shares within Vectura Group plc in accordance with the vesting conditions.

	2018 £m	2017 £m
Equity settled LTIP and RSA plans	**2.6**	2.1
Exceptional share-based payments – merger and site closure	**1.1**	1.8
Total share-based payments	**3.7**	3.9

The employee share award plans are designed to support a strong culture of long-term shareholder value creation. Details of the long-term incentive plan (LTIP), the Group's main plan, are set out on page 144. The Group also operates a Share Incentive Plan (SIP) and a Save-As-You-Earn (SAYE) plan. The disclosures relevant for these plans are made in the Remuneration report as they are not considered material.

Notes to the consolidated financial statements continued

For the year ended 31 December 2018

28. Share-based payments continued

Exceptional share-based payments include £0.9m (2017: £1.8m) related to 18-month (vested March 2018) and 36-month (vesting September 2019) retention awards granted following the Skyepharma merger on 10 June 2016. The remaining £0.2m (2017: nil) relates to share-based payment charges specifically for the retention of staff following the decision to close the Group's operational site in Gauting.

Equity-settled Long-Term Incentive Plan (LTIP) including restricted stock awards (RSA)

Under the approved Group's remuneration policy, equity awards are a key component of the overall remuneration package for senior management and executives.

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

	2018 Number of awards	2017 (Restated) Number of awards
Beginning of the year	**14,376,319**	13,776,512
Granted	**7,243,746**	3,770,532
Exercised	**(1,558,596)**	(1,495,589)
Forfeited	**(3,778,764)**	(1,675,136)
End of the year	**16,282,705**	14,376,319

In 2018, LTIPs granted to Executive Directors' were 185% of salary (2017: 185%) subject to performance over three years. The performance condition is subject to two measures, being:

(a) performance is measured subject to a relative TSR metric against a bespoke sector peer group (2017: against the FTSE 250 (excluding real estate and financial services companies) and a bespoke sector peer group); and

(b) measured subject to a relevant three-year cumulative adjusted EBITDA target as set by the Remuneration Committee.

Employees at the Executive Leadership Team (ELT) level were granted LTIPs at 95% of salary (2017: 105%). 50% (2017: 70%) of these awards are subject to the same TSR and adjusted EBITDA as the Executive Directors, with the remaining 45% (2017: 35%) classified as restricted stock awards.

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

Other key management personnel below ELT level receive awards entirely of restricted stock options.

Valuation of share awards

The treatment of vesting and non-vesting conditions attached to awards in the valuation process varies in accordance with the requirements of IFRS 2.

LTIPs for Executive Directors and ELT

For the year ended 31 December 2018, the calculation of the grant date fair value for those awards with a total shareholder return (TSR) condition was as follows:

	2018	2017
Number of TSR awards granted	**1,691,099**	1,114,638
Service condition	**3 years**	3 years
Holding condition	**2 years**	2 years
Nominal share value	**0.025p**	0.025p
Share price on grant date	**74.2p**	117.6p

The TSR condition is a market-based performance condition; this has been incorporated into the fair value calculation and no subsequent adjustments may be made.

For awards subject to a TSR condition, volatility is calculated over the period of time commensurate with the remainder of the performance period immediately prior to the date of grant being 14.41% (2017: 28.12%). The risk-free interest rate obtainable from government securities (i.e. gilts in the UK) over a period commensurate with the expected term was 1.2% (2017: 0.09%) and there was no dividend yield expected (2017: nil).

The adjusted EBITDA condition is a non-market condition, and the vesting outcome assumption is adjusted at each reporting period for the likelihood of the number of shares that will ultimately vest. For the LTIP and RSA that will be subject to a holding period, the Chaffe model (an at-market put option variant of the Black-Scholes model) has been used to determine a discount for the lack of marketability.

28. Share-based payments continued

Valuation of share awards continued

LTIPs for key management personnel below ELT

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

Exceptional share-based awards

Share-based payments within exceptional items were £1.1m (2017: £1.8m).

Upon completion of the merger, 1,618,215 exceptional nil cost awards were granted to key members of management, excluding Executive Directors, considered critical to the integration process. These awards had a grant date fair value of £1.41 and were subject to an 18-month or 36-month service condition with a personal performance underpin from their grant date on 22 September 2016. Those with an 18-month service condition have vested in March 2018, and therefore only a partial charge is included this year. The remaining charge for the 36-month holding condition (vesting on 21 September 2019) is being expensed evenly over the remaining vesting period at £0.3m per quarter assuming no further lapses or forfeitures occur.

A total of 1,026,568 retention awards with a two-year vesting period were issued to German employees critical to the knowledge transfer of the Vectura enhanced therapy programmes associated with the German site closure. These awards had an IFRS 2 grant date fair value of £0.7m which is being spread evenly over the associated 24-month vesting period from their grant date on 27 June 2018.

Share trusts

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

29. Cash flow information

Cash generated from operating activities

	2018 £m	2017 £m
Cash flows from operating activities		
Loss after taxation	**(88.2)**	(85.7)
Adjustments		
Net taxation credit	**(16.6)**	(16.5)
Amortisation and impairment	**127.0**	109.7
Depreciation	**5.8**	5.7
Net finance (income)/expense	**(0.8)**	2.6
Share-based payments (including those in exceptional items)	**3.7**	3.9
Increase in inventories	**(2.0)**	(5.9)
(Increase)/decrease in trade and other receivables	**(1.9)**	17.2
Decrease/(increase) in trade and other payables	**7.2**	(6.9)
Loss from associates	**0.2**	3.4
Other non-cash items	**0.7**	(0.6)
Total adjustments	**123.3**	112.6
Cash generated from operating activities	**35.1**	26.9

Analysis of movement in financial liabilities

	2018 £m	2017 £m
At the beginning of the year	**4.1**	4.5
Repayments	**(0.3)**	(0.3)
Interest expense	**0.1**	0.1
Foreign exchange movements	**0.1**	(0.2)
At the end of the period	**4.0**	4.1

Financial liabilities entirely relate to a Swiss property mortgage secured on the Swiss R&D facility. Repayments include £0.2m (2017: £0.2m) of capital repayments.

Notes to the consolidated financial statements continued

For the year ended 31 December 2018

30. Contingent liabilities

The Group has multiple collaborative development agreements with its partners, across separate development and licensing agreements. Within some agreements, the Group has committed to make payments to the development partner contingent upon future events or has committed to fund or partially fund costs within the associated development programme. As it is not possible to reliably estimate the potential outflow, and the potential for the outflow is considered remote, no liability is held on the balance sheet for such items.

Accruals of £1.1m (2017: £nil) for costs associated with completion of the VR475 clinical trial and clinical study report have been recognised to the extent that they can be reliably measured or have been communicated by the outsourced clinical research organisation (CRO). Additional future costs may arise upon the final reconciliation by the CRO, expected to occur in Q2 2019, although these are not expected to be of a magnitude that would represent a significant risk of material change to next year's financial statements.

The Group has an uncertain tax provision. Should any challenge from the relevant tax authority arise, it is possible that penalties (between 0 and 40% of underpaid taxation) could be levied. Based on external professional advice, penalties in excess of 20% are considered remote, and penalties towards the lower end of the range are considered more likely, but not probable. As a result, the Group considers a contingent liability of up to £1.0m (2017: £1.0m) in respect of penalties to be appropriate, but as the amount remains uncertain and payment is not considered probable, no provision is held on the balance sheet.

The Group's licensing agreements with partners typically include the right to audit partner royalty statements. Audits are undertaken periodically and their conclusion can result in reimbursement of royalties paid to Vectura, additional royalties payable to Vectura or no changes to historical royalty statements. One royalty review is currently in progress.

31. Significant accounting policies

31.1 Basis of consolidation

These consolidated financial statements comprise the consolidated financial statements of Vectura Group plc, its subsidiaries and equity-accounted associates for the year ended 31 December 2018.

Subsidiaries are all entities over which the Group has direct or indirect control. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power to direct the activities of the entity. Subsidiaries are consolidated from the date on which control is obtained by the Group and are de-consolidated from the date that control ceases. All of the Group's material trading entities are wholly owned subsidiaries, where the Group holds 100% of the share capital.

Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated. Group accounting policies are consistently applied to all entities and transactions.

31.2 Foreign currency translation and transactions

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

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

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

31. Significant accounting policies continued

31.3 Revenue from contracts with customers

Revenue is measured at the fair value of the consideration which is expected to be received in exchange for the goods and services provided, net of applicable taxes.

The Group has initially applied IFRS 15 from 1 January 2018. Information about the transitional impact of IFRS 15 is described in note 32 “IFRS 15 – Revenue from Contracts with Customers”.

The Group presents revenues as follows:

Revenue is measured at the fair value of the consideration which is expected to be received in exchange for the goods and services provided, net of applicable taxes. In accordance with IFRS 15, the Group recognises revenue through application of the five-step model as follows:

- the Group identifies a contract with a customer;
- the performance obligations within this contract has been identified;
- the transactions price has been determined;
- this transaction price has been allocated to the performance obligations in the contract; and
- revenue is recognised as or when each performance obligation is satisfied.

Product supply revenues

The Group generates revenues from the supply of finished or semi-finished products, largely manufactured by third-party suppliers, to commercial distribution partners. Revenue is recognised when the customer gains control of the goods which is when the performance obligation is satisfied.

Royalties and other marketed revenues

Where a licence of intellectual property is the predominant item to which a royalty relates, then revenues are recognised upon the occurrence of partner net sales.

Other marketed revenues primarily include sales or usage-based milestones for which revenue is recognised consistently with royalties as stated above.

Development revenues

Revenues related to development stage programmes are allocated to the following performance obligations as applicable:

(a) Licence to the Group’s intellectual property

A licence granted by the Group usually provides the partner with a right-to-use, but not to own, the IP related to a development that has not yet received regulatory approval as it exists at contract inception. A licence is capable of being distinct from development services if, regardless of contractual terms, it could be sold separately as it exists at the point in time it was granted.

The timing of revenue recognised from a licence of intellectual property depends on whether:

- the licence is capable of being distinct (i.e. could be sold separately as it exists at the point in time it was granted). In this case revenue is recognised when control is transferred, normally at contract inception; or
- the licence is not capable of being distinct and therefore, the customer cannot benefit from the value of purchasing it without the provision of additional services from Vectura. In this instance, revenue is recognised as those services accrue.

(b) Development services

Revenue from a contract to provide development services is recognised by reference to the stage of completion of the contract. Stage of completion is estimated by either completion of relevant milestones or proportion of estimated hours for work performed to date, as appropriate.

31.4 Segmental reporting

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

31.5 Research and development (R&D) expenses

R&D expenses comprise internal employee costs and third-party service costs relating to feasibility studies, technical development, costs of chemistry, manufacturing of trial batches, clinical work and the registration and maintenance of intellectual property.

As the nature of our R&D projects is associated with obtaining regulatory approval, these costs are normally charged to the Consolidated income statement as the expenses are incurred.

Notes to the consolidated financial statements continued

For the year ended 31 December 2018

31. Significant accounting policies continued

31.6 Other operating income

Other income relates to government grants for qualifying R&D and customer contributions for contributions to property, plant and equipment required for the supply chain process.

The Government grants recognised in other income relate to qualifying UK R&D under the research and development expenditure credit (RDEC) scheme for large companies and the French R&D tax credit regime. Such grants are taxable and are presented as other income in the Consolidated income statement.

31.7 Current taxation

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

31.8 Deferred taxation

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

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

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

31.9 Earnings per share

Basic loss per share amounts are calculated by dividing the loss after taxation of the Group by the weighted average number of shares outstanding during the year.

31.10 Goodwill

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

31.11 Intangible assets

Intangible assets predominately relate to on-market licences, patents and marketing rights separately acquired as part of the Skyepharma merger on 10 June 2016. The fair values of patents and licences relating to on-market products acquired were aggregated by product and initially measured at fair value. This fair value is subsequently amortised over estimated useful economic lives (UEL). Intangible assets relating to on-market products are amortised with reference to average patent lives in the most applicable territories.

Intangible assets also include smart nebuliser-based technology acquired separately through the Activaero transaction on 13 March 2014. These assets are amortised in line with the expected consumption of economic benefits.

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

31.12 Property, plant and equipment (PP&E)

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

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

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

31.13 Impairment of non-current assets

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

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

31.14 Inventory

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

31. Significant accounting policies continued

31.15 Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits. Bank overdrafts that are repayable on demand, if used, form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose only of the cash flow statement.

31.16 Financial instruments

IFRS 9 – Financial Instruments became effective for years starting on or after 1 January 2018; however, the Group chose to early adopt the standard on 1 January 2017 and therefore no transitional disclosure is included in these consolidated financial statements. The adoption of IFRS 9 had no material impact on the Group's financial statements. Refer to note 26 of the Annual Report and Accounts 2017.

For the purposes of recognition and measurement, financial assets are classified into one of the following categories:

- Trading activities: Assets that are held for collection of contractual trading cash flows are measured at amortised cost. A gain or loss is recognised in the Consolidated income statement only when the asset is derecognised or impaired. Interest income is included in finance income using the effective interest rate method if applicable.
- Financial assets held for future sale: Assets that are held for collection of contractual cash flows and for selling the financial assets are measured at fair value through other comprehensive income (FVOCI).

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

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

31.17 Provisions

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

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

31.18 Retirement obligations

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

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

31.19 Share-based payments

The Group operates a number of employee equity-settled share-based compensation plans as part of its reward strategy. Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date of the awards are expensed over the vesting period based on the Group's estimate of awards that will eventually vest. The cost of equity-settled share transactions is recognised, together with a corresponding increase in equity, over the vesting period.

31.20 Employee share trusts

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

31.21 Share buyback and cancellation programme

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

Notes to the consolidated financial statements continued

For the year ended 31 December 2018

32. IFRS 15 – Revenue from Contracts with Customers

Vectura adopted IFRS 15 – Revenue from Contracts with Customers with effect from 1 January 2018. The new standard specifies a comprehensive five-step, principal-based framework to the recognition of revenue generated through customer contracts replacing IAS 18 – Revenue and related supplementary IFRS guidance.

The Group should recognise revenue when it transfers goods or services to a customer. The amount of revenue recognised should represent the consideration for goods and services performed at the date of each reporting period to which the Group expects to become entitled.

There has been no impact on revenue recognition for product supply, royalty and other marketed revenues or for development revenues except those containing more than one performance obligation which is the case for VR2081 as described below.

The Group's collaborative agreements tend to have multiple performance obligations. IFRS 15 is therefore expected to impact future collaborative agreements which the Group may enter into as they will typically include a licence to the Group's intellectual property and development services. Judgement will be required to assess whether the licence is capable of being distinct and therefore whether it represents a separate performance obligation. Where this is the case, an amount of any upfront payment on contract inception will be allocated to the licence and is recognised based on standalone selling prices, whereas previously, under IAS 18, the upfront payment would have been spread over the life of Vectura's development obligations. In addition, certain development phase milestones will be recognised on the basis of progression towards, and the level of certainty over, the achievement of a milestone, as opposed to only once a milestone has been achieved, as would have been the case under IAS 18.

Transitional cumulative effect adjustment at 1 January 2018

The Group has initially applied IFRS 15 using the cumulative effect method. Under this method, the comparative information is not restated, but £0.3m of deferred income from VR2081 was released to retained losses net of related taxes.

The Group has applied IFRS 15 using the practical expedient to apply the new rules only to contracts that were not completed as at the start of 2018. As such, IFRS 15 has been applied to collaborative developments entered into since the start of the comparative period presented as described below.

VR2081 – £1.3m (2017: £1.1m)

A $5.0m upfront milestone from Sandoz was received in 2017 relating to the VR2081 programme. This milestone plus the following two contractual development milestones of $1.0m each, are deemed highly probable and therefore are being recognised as development work progresses on a percentage of completion basis. Revenues from ongoing development work in 2019 are expected to be around £2.0m. As the licence was not considered distinct, there is only one performance obligation.

33. Operating leases and the future impact of IFRS 16 – Leases applied from 1 January 2019

The Group is required to apply IFRS 16 – Leases from the mandatory transitional date 1 January 2019.

IFRS 16 has not been applied to the 2018 financial results and instead this disclosure note explains the impact of adoption on future reporting periods. Historically, the Group has only entered into material leases relating to commercial properties at the main UK operational sites.

Currently under IAS 17, because the risk and rewards of property ownership revert to the landlord at the end of the lease term, the lease is classified as an operating lease with annual rental and service charges recognised in the consolidated income statement on an accruals basis over the lease term and nothing is recognised on the balance sheet.

Payments for property leases for the Group's premises located at Chippenham, Cambridge Science Park and Grosvenor Gardens, London, were as follows:

	31 December 2018 £m	31 December 2017 £m
Within one year	**1.1**	1.1
Between two and five years	**3.5**	2.9
Over five years	**2.1**	2.6
Total operating lease commitments	**6.7**	6.6

Following the announcement to close the Gauting site, the Group's facilities requirements have been reviewed. As a result, operating leases have been extended further.

Future IFRS 16 Leases accounting policy applied from 1 January 2019

At inception of a contract, the Group assesses whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

To assess whether a contract conveys the right to control the use of an identified asset, the Group assesses whether: an identified physically distinct asset can be identified; the Group has the right to obtain substantially all of the economic benefits from the asset throughout the period of use; and has the ability to direct the use of the asset over the lease term being able to restrict the usage of third parties as applicable.

33. Operating leases and the future impact of IFRS 16 – Leases applied from 1 January 2019 continued

The modified retrospective approach to transition

Under the modified retrospective approach, the Group will apply IFRS 16 from the beginning of 2019, calculating lease assets and liabilities as at the beginning of 2019 as follows:

Lease liabilities will be measured at the present value of the remaining lease payments, discounted at an applicable incremental borrowing rate, which will be obtained from a financial institution privy to the facts, circumstances, location, security and term of each lease liability. This rate is likely to range between 2% and 3%.

Non-lease service charges will be combined into property leases, which will be treated as a single lease component. The effective interest method will be used for calculating the amortised cost of a finance lease and allocating interest income over the relevant period on a lease by lease basis.

Under IFRS 16, liabilities for future periods that can be cancelled by exercising a break clause will not be included in the lease liability unless it is reasonably certain at the reporting date that the Group will extend the committed lease term and not exercise the break clause.

It is likely that judgements relating to the lease term will, in future, represent a critical accounting judgement as changes to these assumptions would materially impact the balance sheet asset and liabilities recognised.

Right-of-use assets will be measured at an amount equal to the lease liability, except where there is considered to be a significant difference between the lease liability and the asset value calculated as though IFRS 16 had always been applied.

Practical expedients on transition

The Group will use the following practical expedients when applying IFRS 16 to leases previously classified as operating leases under IAS 17:

- use the transitional discount rate as if it had always applied in the past;
- use hindsight when determining the lease term which previously contained renewal options;
- exclude initial direct costs from measuring the right-of-use asset at the date of initial application; and
- adjust the right-of-use assets by the amount of IAS 37 onerous contract provisions immediately before the date of initial application, as an alternative to an impairment review.

The exemption not to recognise right-of-use assets and liabilities for leases with less than twelve months of lease term on the transition date will be utilised in respect of the six-month rolling lease in Germany and hence €56k per annum will continue to be charged to the consolidated income statement as rent on an accruals basis.

The definition of a lease under IFRS 16 will only be applied to contracts entered into or changed on or after 1 January 2019. The practical expedient to grandfather the assessment of which transactions are leases will be taken such that IFRS 16 will only apply to contracts previously identified as leases. Contracts not considered as leases under IAS 17 will not be reassessed, albeit all material supplier service arrangements will be reviewed to ensure all material assets that contain embedded leases are captured.

Cumulative adjustment to retained earnings as at 1 January 2019

The Group will not restate 2018 financial information and will recognise the cumulative effect adjustment in equity on transition using the modified retrospective approach as detailed following the table below:

Transitional adjustment as at 1 January 2019	Property £m
Right-of-use assets	3.3
Discounted lease liabilities*	(3.7)
Cumulative adjustment to retained earnings	(0.4)

* Rental prepayments of £0.2m and an onerous contract provision of £1.0m will also be reclassified into the lease liability.

The following table summarises the impacts of adopting IFRS 16 on the Group's opening consolidated balance sheet as at 1 January 2019:

	As reported 31 December 2018 £m	Transitional adjustments £m	Opening balance 1 January 2019 £m
Property, plant and equipment	57.8	3.3	61.1
Prepayments and other receivables	6.3	(0.2)	6.1
Provisions	(10.9)	1.0	(9.9)
Finance lease liabilities	—	(4.5)	(4.5)
Net assets and retained earnings	494.3	(0.4)	493.9

Notes to the consolidated financial statements continued

For the year ended 31 December 2018

34. IFRIC 23 – Uncertainty over Income Tax Treatments as at 1 January 2019

IFRIC 23 has been issued to clarify the accounting for uncertainty within tax positions, and provides two methods for measurement. Where the outcome is considered binary, the "most likely amount" is applied, but where the results could be within a range, the "expected value method" (which considers the weighted average of possible outcomes) should be applied. The Group holds one uncertain tax position, and due to the binary nature of an outcome, the method adopted under IFRIC 23 is the most likely amount. As a result, the Group expects no change the recognition of the uncertain tax position under the new standard to be adopted from 1 January 2019.

35. Related-party transactions

Associates

In August 2018, the Group paid a final instalment of £150,000 to a German supplier on confirmation that a new Clickhaler® and Duohaler® cap filling and assembly line has received formal factory acceptance testing clearance and has been shipped to the Group's Chinese associate.

Remuneration of key management personnel

The remuneration of the Directors, who are the key management personnel of the Group, was £2.4m and is set out below:

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Short-term employee benefits	**0.8**	1.0
Annual incentive plan	**0.7**	0.7
Non-Executive Directors' fees	**0.5**	0.4
Post-employment benefits	**0.1**	0.2
Other	**0.3**	0.3
Total remuneration of key management personnel	**2.4**	2.6

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

Company balance sheet

As at 31 December 2018

	Note	2018 £m	2017 (Restated)* £m
ASSETS			
Non-current assets			
Investments in subsidiary undertakings	4	**541.5**	710.8
Current assets			
Amounts due from subsidiary undertakings		**11.5**	6.0
Cash and cash equivalents		**0.1**	13.8
Total current assets		**11.6**	19.8
Total assets and net assets		**553.1**	730.6
SHAREHOLDERS' EQUITY			
Share capital	5	**0.2**	0.2
Share premium		**61.6**	61.5*
Share-based payment reserve		**8.3**	8.4
Merger reserve	6	**441.0**	593.0*
Retained earnings		**42.0**	67.5
Total shareholders' equity		**553.1**	730.6

* Reserves were restated to reduce share premium and increase merger reserves by £41.3m to correct share premium recognised on the acquisition of Activaero in 2014 in accordance with s610 of the Companies Act. The restated merger reserves were subsequently utilised in full and as a result no longer remains. Refer to note 5 and note 6.

Company registered number: 03418970.

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

The Company financial statements of Vectura Group plc were approved and authorised for issue by the Board of Directors on 25 March 2019 and were signed on its behalf by:

J Ward-Lilley
Director

P Fry
Director

Company statement of changes in equity

For the year ended 31 December 2018

	Share capital £m	Share premium £m	Merger reserve £m	Share-based payment reserve £m	Retained earnings £m	Total equity £m
At 31 December 2016 as previously reported	0.2	102.3	551.7	5.8	53.3	713.3
Share premium restatement*	—	(41.3)	41.3	—	—	—
At 31 December 2016 restated	0.2	61.0	593.0	5.8	53.3	713.3
Profit for the year (note 2)	—	—	—	—	16.1	16.1
Employee share transactions	—	0.5	—	3.9	(1.8)	2.6
Share buyback and cancellation programme	—	—	—	—	(1.4)	(1.4)
Transfers within reserves	—	—	—	(1.3)	1.3	—
At 31 December 2017	**0.2**	**61.5**	**593.0**	**8.4**	**67.5**	**730.6**
Loss for the year (note 2)	—	—	—	—	(167.1)	(167.1)
Share-based payments	—	—	—	3.7	—	3.7
Employee share transactions	—	0.1	—	(3.8)	3.4	(0.3)
Share buyback and cancellation programme	—	—	—	—	(13.8)	(13.8)
Release of special reserves	—	—	(8.2)	—	8.2	—
Merger reserve release	—	—	(143.8)	—	143.8	—
At 31 December 2018	**0.2**	**61.6**	**441.0**	**8.3**	**42.0**	**553.1**

* Reserves were restated to reduce share premium and increase merger reserves by £41.3m to correct share premium recognised on the acquisition of Activaero in 2014 in accordance with s610 of the Companies Act. Refer to note 27 of the consolidated financial statements.

The loss for the year ended 31 December 2018 was £167.1m inclusive of £31.2m of dividend income (2017: profit of £16.1m including of £29.0m of dividend income).

The accompanying notes form an integral part of these Company financial statements prepared under FRS 101 – Reduced Disclosure Framework.

Notes to the Company financial statements

For the year ended 31 December 2018

1. Presentation of the financial statements

1.1 Critical accounting areas of judgement and estimation

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

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

Carrying value of investments in subsidiary undertakings

The Company's investments in subsidiary undertakings are carried at historical cost less any provision for impairment. The Company's investments in the UK arise from the acquisition of Coordinated Drug Development Limited in August 1999 and Innovata Plc in January 2007, Germany from the Activaero transaction in March 2014 and the Swiss and US investments on the Skyepharma merger in June 2016.

As these investments are not amortised, their carrying values are at risk of impairment. The carrying value of investments is compared to their recoverable amounts which are assessed with reference to the discounted cash flow forecasts associated with these territories. This is including their products, research and development programmes, technologies and intellectual property.

As reported in 2017, the carrying value of the investment in Germany is particularly sensitive to the outcome of the VR475 (FAVOLIR®) Phase III study and VR647 (SCIPE®) Phase II study scheduled for completion in the second half of 2018. Whilst the VR647 phase II outcome was positive, it was decided that the Group would not pursue VR475 (FAVOLIR®) following the Phase III results and, as such, the German investment has been impaired by £96.8m. Refer to note 4.

The carrying value of the Swiss and US investment has also been assessed. Notwithstanding strong current year and forecasted *flutiform*® performance, the impacts from an increased discount rate of 9% (2017: 8%) and a lower final year cash flow used for the calculation of the *flutiform*® terminal value, as well as lower forecasted cash flows for VR2081, have together resulted in a provision for impairment of £102.5m (2017: £nil).

As the Swiss and US investment has been impaired to the recoverable amount, any further reduction in value will cause impairment. Should the recoverable amount increase, for example if factors arose supporting a reduction in the discount rate, the provision for impairment would be reversed. This area therefore remains a critical accounting estimate.

2. Basis of preparation – accounting policies for the Company financial statements

In preparing these financial statements, the Company applies the recognition, measurement, and disclosure requirements of International Financial Reporting Standards (IFRS) as adopted by the EU (EU-IFRS), but makes amendments where necessary in order to comply with the Companies Act 2006 and has excluded certain information as permitted by FRS 101 – Reduced Disclosure Framework. Details of Directors' remuneration, share options and retirement benefits are given in the remuneration report.

These financial statements, which are prepared using the historical cost convention and on a going concern basis, are prepared in accordance with FRS 101 – Reduced Disclosure Framework and with UK accounting presentation and the Companies Act 2006 as at 31 December 2018, with comparative figures as at 31 December 2017.

As permitted by section 408 of the Companies Act 2006, the Company's income statement and related notes have not been presented in these financial statements. The loss for the year ended 31 December 2018 was £167.1m inclusive of £31.2m of dividend income (2017: profit of £16.1m inclusive of £29.0m of dividend income).

The Company also takes exemptions in relation to share-based payments, financial instruments, capital management, presentation of comparative information in respect of certain assets, presentation of a cash flow statement and certain related-party transactions, on the basis that equivalent disclosures are given in the Group's consolidated financial statements.

Key accounting policies and judgements relate to investments in subsidiary undertakings. Investments in subsidiaries are stated at historical cost less any provision for impairment. The carrying amounts of the Company's investments are reviewed at each reporting date to determine whether there is an indication of impairment. If such an indication exists, then the recoverable amount of the asset is estimated to ensure that the carrying value remains supportable.

Any impairment charges are recognised in the income statement and are reflected in an allowance against the carrying value. The distributable reserves of Vectura Group plc are protected from the impact of any decrease in the valuations of investments to the extent of the available merger reserves. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through the Company income statement.

Notes to the Company financial statements continued

For the year ended 31 December 2018

3. Dividend income

The Company received dividend income from subsidiary undertakings totalling £31.2m (2017: £29.0m). The dividend was settled for cash and no amounts remain outstanding.

4. Investments in subsidiary undertakings

Subsidiary undertakings	UK subsidiaries £m	German subsidiaries £m	Swiss & US subsidiaries £m	Total £m
At 31 December 2017	125.6	108.7	476.5	710.8
Additions – capital contributions	22.0	8.0	—	30.0
Provision for impairment	—	(96.8)	(102.5)	(199.3)
At 31 December 2018	**147.6**	**19.9**	**374.0**	**541.5**

Following the Phase III clinical trial results of VR475, and the decision not to pursue further development, the carrying value of the German investment has been impaired to reflect the carrying value of VR647, the remaining asset in Germany. In addition, mainly as a result of an increased discount rate, the Swiss and US investments have been impaired to their recoverable amounts. Refer to note 1.

Dividend income of £31.2m (2017: £29.0m) originating from Switzerland, the licence holder of *flutiform*®, was immediately contributed to fund the operations of the UK and German investments. Capital contributions of £30.0m (and was therefore an unrealised profit within the profit and loss) were made after settlement of a £1.2m intra-Group payable.

The sensitivity of the Swiss and US investment to the potential outcomes of the UK existing the EU ("Brexit") has been considered. A range of sensitivities have been modelled from minimal disruption to the *flutiform*® supply chain to severe but still reasonably possible disruption such that partner and patient demand cannot be satisfied. The sensitivities also consider an increase in operating costs from adverse regulatory changes. Details relating to the key assumptions and determination of these assumptions is provided in Note 14 of the Group's consolidated financial statements. The impact of these sensitivities range from no further impairment to an additional impairment of £121.3m in the most severe but reasonably plausible case.

Should the recoverable amount of the Swiss and US investment increase, for example if factors arose supporting a reduction in the discount rate, the provision for impairment in 2018 would be reversed. This area therefore remains a critical estimate.

5. Share capital

Allotted, called up and fully paid	£m	Number of shares
Ordinary shares of 0.025p, each at 31 December 2017	0.2	678,508,698
Issued to satisfy Vectura employee share plans	—	1,561,183
Share buyback programme	—	(14,682,736)
Ordinary shares of 0.025p each at 31 December 2018	**0.2**	**665,387,145**

Redeemable preference shares of 34,000 at £1 par value have no associated voting, dividend or coupon rights but are eligible to be repaid before any distribution to shareholders, the shares can be repaid by the Company at any time.

Following completion of the share buyback programme, a review of the Vectura Group plc's distributable reserves was performed. It was identified that shares issued on 13 March 2014 with a market value of £41.3m, as part consideration for the Activaero acquisition, were incorrectly recorded in non-distributable share premium rather than as a merger reserve.

6. Merger reserves

A merger reserve is used where more than 90% of the shares in a subsidiary are acquired and the consideration includes the issue of new shares by the Company, thereby attracting merger relief under section 612 and section 613 of the Companies Act 2006. Merger relief under the UK Companies Act 2006 is available to allow recognition of a merger reserve as opposed to non-distributable share premium. The merger reserves are non-distributable reserves, but become distributable to offset any future diminution in the investment value or where that investment is disposed of for qualifying consideration.

The share premium of £41.3m should have been recognised as a separate reserve, usually referred to as a merger reserve, and therefore this amount has been reclassified in the comparative year as a restatement. These merger reserves are initially non-distributable, but became distributable in November 2018 following impairment of the German investment and application of merger relief. See Statement of changes in equity for full details.

7. Distributions to shareholders

Share buyback and cancellation programme

On 14 November 2017 Vectura Group plc announced that the Board has approved a share buyback to return up to £15.0m of capital to shareholders. A purchase for cancellation programme of the Company's ordinary shares of 0.025p each, to a maximum consideration of £15.0m completed by the end of February 2018.

During the completion of the buyback, 14,682,736 were repurchased at a weighted average price of 93p per share, being a total of £13.6m of capital returned to shareholders in 2018.

At 31 December 2017 1,422,503 shares had been repurchased at a weighted average price of 95p per share. A total of £1.34m had been returned to shareholders by the year ended 31 December 2017.

Dividend policy

Vectura has not paid dividends in the past and is not proposing one for the year ended 31 December 2018. The declaration and payment of any dividends in the future will depend on the results of operations, financial conditions, cash requirements, future prospects, profits available for distribution and other factors deemed by the Vectura Board to be relevant at the time.

Notes to the Company financial statements continued

For the year ended 31 December 2018

8. Other statutory information

In accordance with section 409 of the Companies Act 2006 a full list of subsidiaries and associates, the country of incorporation and the effective percentage of equity owned at 31 December 2018 are disclosed below. Unless otherwise stated the share capital disclosed comprises ordinary shares which are indirectly held by Vectura Group plc.

All subsidiary companies are resident for tax purposes in their country of incorporation unless otherwise stated.

	Country/region of incorporation	Ordinary shareholding	
Vectura Limited	United Kingdom	100%	One Prospect West, Chippenham, Wiltshire SN14 6FH
Innovata Limited	United Kingdom	100%	One Prospect West, Chippenham, Wiltshire SN14 6FH
Vectura Delivery Devices Limited	United Kingdom	100%	One Prospect West, Chippenham, Wiltshire SN14 6FH
Innovata Biomed Limited	United Kingdom	100%	2nd Floor North, Saltire Court, 20 Castle Terrace, Edinburgh EH1 2EN
Quadrant Drug Delivery Limited	United Kingdom	100%	One Prospect West, Chippenham, Wiltshire SN14 6FH
Vectura Group Services Limited*	United Kingdom	100%	46–48 Grosvenor Gardens, London SW1W 0EB
Vectura Group Investments Limited*	United Kingdom	100%	One Prospect West, Chippenham, Wiltshire SN14 6FH
Jagotec AG	Switzerland	100%	Eptingerstrasse 61, 4132 Muttenz, Switzerland
Skyepharma AG	Switzerland	100%	Eptingerstrasse 61, 4132 Muttenz, Switzerland
Skyepharma Holding AG	Switzerland	100%	Treuhand AG, Chollerstrasse 3, 6300 Zug, Switzerland
Skyepharma Production SAS	France	100%	38291 Saint-Quentin-Fallavier, France
Vectura Inc*	United States	100%	20 William Street, Suite 130, Wellesley, MA 02481, USA
Vectura Ireland Limited	Republic of Ireland	100%	The Brickhouse, Clanwilliam Court, Block 1, Lower Mount Street, Dublin 2, D02 CF97
Skyepharma Holding Inc	United States	100%	1209 Orange Street, Wilmington, New Castle, DE 19801, USA
Skyepharma US Inc	United States	100%	2711 Centerville Road, Suite 400, Wilmington, DE 19808, USA
Vectura GmbH*	Germany	100%	Robert-Koch-Allee 29, 82131 Gauting, Germany
Ventaleon GmbH	Germany	30.66%	Wohraer Str. 37, 35285, Gemünden/Wohra, Germany
Innovata HK Limited	Hong Kong	82.35%	Unit 1802, 79 Lei Muk Road, Kwai Chung, N.T., Hong Kong
Tianjin Kinnovata Pharmaceutical Co. Ltd	China	45.95%	Eleventh Street, Tianjin Economic-Technological Development PRC
Quadrant Healthcare Limited	United Kingdom	100%	One Prospect West, Chippenham, Wiltshire SN14 6FH
Quadrant Technologies Limited	United Kingdom	100%	One Prospect West, Chippenham, Wiltshire SN14 6FH
Vine Exhibition Limited	United Kingdom	100%	46–48 Grosvenor Gardens, London SW1W 0EB
Vine Northern Limited	United Kingdom	100%	46–48 Grosvenor Gardens, London SW1W 0EB
QDose Limited	United Kingdom	50%	One Prospect West, Chippenham, Wiltshire SN14 6FH
Krypton Limited	Gibraltar	100%	19 Town Range, Gibraltar
Skyepharma Management AG	Switzerland	100%	Eptingerstrasse 61, 4132 Muttenz, Switzerland
Genta Jago Technologies B.V.	Netherlands	50%	Herikerbergweg 238, 1101 CM Amsterdam, Netherlands

* Directly held by the Company.

Glossary

The following abbreviations are used throughout these financial statements

CGU	Cash-generating unit
EBITDA	Earnings before interest, tax, depreciation and amortisation
EPS	Earnings per share
FVOCI	Fair value through other comprehensive income
FVTPL	Fair value through profit or loss
Notes	Notes to the consolidated financial statements
OCI	Other comprehensive income
IAS 1	Presentation of Financial Statements
IAS 7	Statement of Cash Flows
IAS 16	Property, Plant and Equipment
IAS 17	Leases (superseded in 2019)
IAS 18	Revenue (superseded in 2018)
IAS 19	Employee Benefits

IAS 21	The Effects of Changes in Foreign Exchange Rates
IAS 28	Investments in Associates and Joint Ventures
IAS 33	Earnings per Share
IAS 36	Impairment of Non-Current Assets
IAS 37	Provisions, Contingent Liabilities and Contingent Assets
IAS 38	Intangible Assets
IFRIC 23	Uncertainty over Income Tax Treatments
IFRS 2	Share-based Payments
IFRS 3	Business Combinations
IFRS 9	Financial Instruments
IFRS 15	Revenue from Contracts with Customers
IFRS 16	Leases

Shareholder information

Directors

Bruno Angelici
Non-Executive Chairman

James Ward-Lilley
Chief Executive Officer

Paul Fry
Chief Financial Officer

Susan Foden
Non-Executive Director and
Senior Independent Director

Neil Warner
Non-Executive Director

Per-Olof Andersson
Non-Executive Director

Thomas Werner
Non-Executive Director

Juliet Thompson
Non-Executive Director

Anne Whitaker
Non-Executive Director

Company Secretary

John Murphy

Corporate broker

J.P. Morgan Cazenove
25 Bank Street
Canary Wharf
London
E14 5JP, UK

Corporate broker

Numis Securities Limited
The London Stock Exchange Building
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