Remuneration report

The following section sets out the Proposed Policy which will be submitted for approval by shareholders in a binding vote at the 2020 AGM on Wednesday 27 May 2020.

The Proposed Policy can also be found on the Group's website (www.vectura.com). It has been prepared in accordance with the provisions of the Companies Act 2006 (the "Act") and the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 (the "Regulations"). It also meets the requirements of the UK Listing Authority's Rules and the Disclosure Guidance and Transparency Rules.

Proposed Policy

The Proposed Policy is driven by the Group's strategy and business model and has been designed to reflect the Committee's remuneration philosophy, as summarised below.

Philosophy	Support value creation for shareholders over the longer term and create alignment with shareholders					
	Fixed remuneration			Variable remuneration		
Element	Base salary	Benefits	Pension	Annual bonus	LTIP	Share ownership guidelines and holding periods
How it is influenced by the remuneration philosophy	Broadly mid-market.			Set no higher than mid-market and is the least significant variable element. Has stretching financial and non-financial targets that support Vectura's annual goals and its overall strategy. Deferral of a proportion in shares increases alignment with shareholders.	The most significant element of the package. Has stretching targets that are clearly aligned with shareholder value. Performance measured over three years and subsequent holding requirement for a further two years to align with the long-term interests of the Group.	Significant personal holdings must be acquired and maintained and vested shares must be retained for a period.

Whilst the Committee does not consult directly with employees regarding its Proposed Policy, the Committee has regard to the policy for remuneration of employees across the Group in a number of respects:

- All employees are rewarded with a remuneration package that includes certain key benefits such as life assurance, permanent health insurance, private medical insurance, access to the pension scheme and participation in Vectura's all-employee share schemes and many employees are eligible to receive a bonus.
- The bonus scheme for Executive Directors and employees is designed to reward corporate and personal performance, and all individuals work towards challenging personal goals related to their roles.
- When determining the annual salary increases and remuneration packages for the Executive Directors, the Committee considers the general base salary increase for the wider employee workforce.

More information on wider employee conditions can be found on pages 41 and 42.

The following table and accompanying notes set out the main principles of reward for the Executive Directors as set out in the Proposed Policy.

Executive Directors			
Purpose and link to strategy	**Operation**	**Maximum opportunity**	**Performance metrics**
Base salary			
To recruit and retain Executive Directors of the highest calibre who are capable of delivering the Group's strategic objectives, reflecting the individual's experience and role within the Group. Base salary is designed to provide an appropriate level of fixed income to avoid an over-reliance on variable pay elements that could encourage excessive risk taking.	The Committee aims to set base salary at levels that are broadly aligned with the midpoints for equivalent roles in comparable companies in the UK, adjusted to reflect the Group's size and complexity. Salaries are normally reviewed annually and changes are generally effective from 1 January. The annual salary review of Executive Directors takes a number of factors into consideration, including: • business performance; • salary increases awarded to the overall employee population; • skills and experience of the individual over time; • scope of the individual's responsibilities; • changes in the size and complexity of the Group; • market competitiveness; and • the underlying rate of inflation.	Base salary increases are awarded at the discretion of the Committee; however, salary increases will normally be considered in relation to the average pay rises awarded to the wider employee workforce. Where a higher level of increase is appropriate given the performance and contribution of the incumbent, or where there has been a change in responsibilities, the Committee retains the discretion to award more significant base salary increases.	No formal metrics, although increases will take account of Group performance.
Benefits			
Benefits in kind offered to Executive Directors are provided on a market-competitive basis, to assist with the retention and recruitment of staff.	The Group aims to offer benefits that are in line with market practice. The main benefits currently provided are life assurance, permanent health insurance and private medical and dental insurance. Under certain circumstances, the Group will offer relocation allowances to employees. Executive Directors are eligible for other benefits which are introduced for the wider workforce on broadly similar terms.	The value of each benefit is not predetermined and is based upon the cost to the Group.	Not performance related.
Pensions			
The Group aims to provide market-competitive retirement benefits, to reward sustained contribution.	The Group operates a money purchase scheme and all employees, including Executive Directors, are invited to participate. For Executive Directors who are affected by the HMRC lifetime or annual allowances, the Group may provide cash supplements in respect of benefits above the allowance.	For new Executive Directors, the contribution level will be capped at appointment at the average contribution level for the workforce based in the United Kingdom. For Executive Directors appointed before the 2020 AGM, pension will be brought in line with the average contribution level for the workforce based in the United Kingdom by the end of 2022.	Not performance related.

Remuneration report continued

Proposed Policy continued

Executive Directors continued

Purpose and link to strategy	Operation	Maximum opportunity	Performance metrics
Annual performance bonus			
An annual bonus rewards the achievement of stretching objectives that support the Group's corporate goals and delivery of the business strategy together with goals in relation to personal performance. Delivery of a proportion in shares provides alignment with shareholders and facilitates the operation of clawback.	Objectives are agreed with the Committee, and the Board as a whole, at the start of each financial year. Different performance measures and weightings may be used each year, as agreed with the Committee, to take into account changes in the business strategy. Bonuses are paid at the discretion of the Committee. The Committee takes into account overall corporate performance and individual performance when determining the final bonus amount to be awarded. Bonuses are typically paid in April. 25% of any bonus is normally compulsorily deferred into shares for two years. Participants may also be entitled to receive dividend equivalents on vested shares. Under the rules of the scheme, the Committee can claw back up to 100% of the bonus awarded in the event of material misstatement of the Group's financial results, an error in assessing the performance conditions to which an award is subject or for any other matter which it deems relevant.	Bonuses are limited to a maximum of 135% of base salary for the CEO and 125% of base salary for the CFO.	Corporate goals typically include revenue generation, development of pipeline progress, partnering successes and control of cash expenditure, although the Committee has the discretion to set other targets. Goals set are specific, measurable and linked to the Group's long-term strategy. Up to 20% of the maximum is payable at threshold performance against each measure.
LTIP			
The Committee believes that a key component of the overall remuneration package is the provision of equity awards to senior executives through the LTIP, which is designed to incentivise growth in the longer term and align them with shareholders' interests.	Discretionary annual award of nil or nominal cost options that vest according to performance conditions normally measured over three financial years. Participants may also be entitled to receive dividend equivalents on vested shares. Awards granted to Executive Directors from 2017 onwards are subject to an additional two-year post-vesting holding requirement on the net of tax value of shares vesting. Awards will be subject to clawback where there has been a misstatement of the Group's financial results, an error in assessing the performance conditions to which an award is subject or for any other matter which the Committee deems relevant. Awards are subject to the discretions contained in the relevant plan rules.	Annual awards of up to 185% of salary may be granted.	Awards normally based on key measures linked to achievement of Vectura's strategy such as relative total shareholder return (TSR) and/or financial metrics measured over three years. The Committee retains the discretion to vary the chosen relative TSR peer group or the weighting between the metrics and/or introduce new metrics aligned to the Group's strategy for awards in future years, providing they are not materially less challenging in the circumstances. The Committee would normally consult with its major shareholders before making significant changes to the performance conditions. 25% of the maximum award vests at the threshold/median performance level, rising to 100% vesting at maximum/upper quartile. Awards are also subject to an underpin based on the Committee's assessment of the Group's underlying performance against a range of factors, including the Group's underlying financial performance, absolute shareholder returns and progress against milestones over the performance period. Any exercise of discretion will be fully disclosed to shareholders. The performance conditions for previous LTIP awards are described in the Report.

Executive Directors continued

Purpose and link to strategy	Operation	Maximum opportunity	Performance metrics
All-employee share schemes			
All employees, including Executive Directors, are encouraged to become shareholders of the Group through participation in our all-employee share schemes. The Group currently offers UK employees the opportunity to participate in the Vectura Sharesave (SAYE) scheme and the Vectura Share Incentive Plan (SIP). Where possible, similar plans will operate for overseas employees.	Both of the schemes offered are HMRC-approved schemes and operate on standard terms.	Participation limits are set by the relevant tax authorities from time to time.	Not performance related and no performance conditions apply.
Share ownership guidelines			
Share ownership guidelines for Executive Directors and senior employees are designed to strengthen the alignment between the interests of senior management with those of Vectura's shareholders.	In accordance with best practice, share ownership requirements apply during and after employment. During employment, Executive Directors are required to retain at least half of any LTIP awards vesting as shares (after paying any tax due) until they have reached the required level of holding. After their employment, Executive Directors are required to maintain a holding in the Group's shares until the second anniversary of the date they ceased to be an Executive Director.	During their employment, Executive Directors are required to build and retain a holding of the Group's shares equivalent to at least 200% of their base salary. After their employment, Executive Directors are required to hold the lower of: (i) their holding on their date of resignation; and (ii) 100% of base salary.	Not performance related.

Chair and Non-Executive Directors

Purpose and link to strategy	Operation	Maximum opportunity	Performance metrics
Fees			
Set at a level that is sufficient to attract and retain a high-calibre Non-Executive Chair and Directors who have a broad range of skills and experience to oversee the implementation of the Group's strategy.	The Chair and the Non-Executive Directors receive fees paid in cash, with additional fees received for chairing Committees of the Board, for fulfilling the role of Senior Independent Director or the Employee Engagement designated NED. Additional fees may also be paid in the event that a Director's normal annual time commitment is significantly exceeded in any year. Fees are normally paid monthly and reviewed annually. The Chair and the Non-Executive Directors do not participate in any performance-related incentive schemes, nor do they receive any benefits, other than limited travel (including transatlantic travel fee) and hospitality-related benefits, in connection with their roles.	When reviewing fee levels, account is taken of market movements in the fees of the Non-Executive Chair and Directors, Board Committee responsibilities and ongoing time commitments.	Not performance related.

Remuneration report continued

Proposed Policy continued

Notes to the Proposed Policy table

For the avoidance of doubt, any commitments entered into by the Group prior to the approval and implementation of the Proposed Policy outlined above may be honoured, even if they are not consistent with the Policy prevailing at the time the commitment is fulfilled.

The Proposed Policy differs from the Policy in the following areas:

- the annual bonus deferral mechanism has been strengthened so that 25% of any bonus must be deferred in shares;
- pensions for new Executive Directors will be set at the average level for the workforce in the United Kingdom, and pensions for existing Executive Directors will be in line with this average by the end of 2022;
- the threshold level of vesting for the LTIP has been brought in line with market practice and is set at 25% of the award; and
- a post-cessation shareholding requirement has been introduced.

In operating the Proposed Policy, the Committee may exercise the discretion set out below and in accordance with the relevant sections of the various plan rules.

Performance conditions

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

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

Relative TSR has been chosen as a performance metric for 50% of the 2020 LTIP awards as it is aligned with shareholders' expectations and it reflects the returns that we generate for our shareholders relative to the returns of the general market. The FTSE 250 index (excluding financial services and real estate companies) has been chosen as it is a published index, is transparent for shareholders and provides a robust comparator group of similarly sized companies.

The Committee believes that a financial metric for the remaining 50% of the LTIP awards reflects the Group's growth ambitions and the increasing maturity of our business. Over the life of the Proposed Policy, the choice of financial metric and basis of measurement may be varied to reflect the Group's development and strategic priorities. For awards granted in 2020 cumulative adjusted EBITDA has been selected as the financial metric; however, the Committee intends to keep the choice of metric under review for future awards.

The proposed performance conditions for the LTIP awards to be granted in 2020 are outlined on page 86 of the Report.

Committee discretion

The Committee operates under the powers it has been delegated by the Board. In addition, it complies with rules that have either been approved by shareholders (LTIP and Deferred Share Bonus Plan (DSBP)) or by the Board (annual performance bonus scheme). These rules provide the Committee with certain discretions which serve to ensure that the implementation of the Proposed Policy is fair, both to the individual Directors and to the shareholders. The Committee also has discretion to set components of remuneration within a range, from time to time. The extent of such discretions is set out in the relevant rules and the Maximum opportunity or the Performance metrics sections of the Proposed Policy table set out on pages 69 to 71. To ensure the efficient administration of the variable incentive plans outlined above, the Committee will apply certain operational discretions.

These include the following:

- selecting the participants in the incentive plans on an annual basis;
- determining the timing of grants of awards and/or payments;
- determining the quantum of awards and/or payments (within the limits set out in the Proposed Policy table on pages 69 to 71);
- reviewing performance against LTIP performance metrics;
- determining the extent of vesting based on the assessment of performance;
- making the appropriate adjustments required in certain circumstances, for instance for changes in capital structure;
- determining "good leaver" status for incentive plan purposes and applying the appropriate treatment; and
- undertaking the annual review of weighting of performance measures and setting targets for the incentive plans, where applicable, from year to year.

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

Remuneration scenarios for Executive Directors

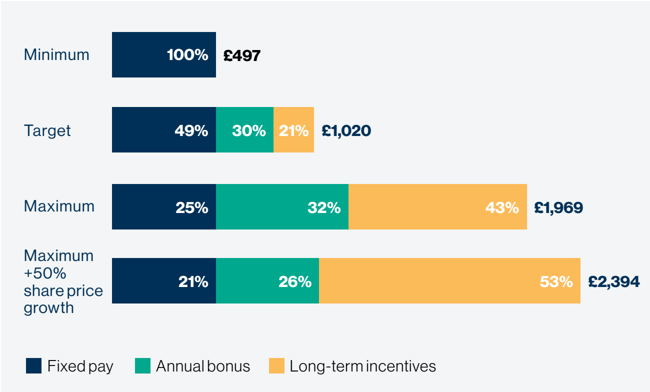
The charts on page 73 show hypothetical values of the 2020 remuneration package for each Executive Director under four assumed performance scenarios and these scenarios are based upon the Proposed Policy set out on pages 68 to 71. The information presented below uses the level of salary, benefits and pension entitlements for each of the Executive Directors as at 1 January 2020.

Base salaries for 2020: CEO – £460,000 and CFO – £372,922. Benefits of £9,000 and £6,000, respectively, and a pension allowance of 6% of salary for the CEO and 15% of salary for the CFO have been assumed.

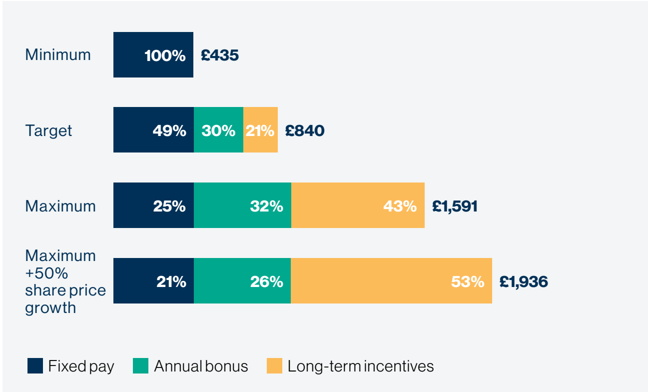
Below target remuneration receivable – this scenario assumes that there is no annual bonus payment and no awards under the LTIP vest.

On-target remuneration receivable – this scenario assumes that the Executive Directors receive a bonus payout of 67.5% (CEO) or 62.5% (CFO) of salary (i.e. 50% of maximum award) and that LTIP awards worth 46.25% of salary at grant would ultimately vest.

CEO (£000)



CFO (£000)



Stretch remuneration receivable – this scenario assumes that the Executive Directors receive a maximum bonus payout of 135%/125% (CEO/CFO) of their salary and that a maximum LTIP award of 185% of salary would ultimately vest.

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

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

Other remuneration policies

Termination and loss of office payments

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

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

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

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

Executive Directors' service contracts

It is the Group's policy that Executive Directors should have contracts with an indefinite term and which provide for a maximum period of twelve months' notice. The Executive Directors may accept outside appointments, with prior Board approval, provided that these opportunities do not negatively impact on their ability to fulfil their duties to the Group. Whether any related fees are retained by the individual or are remitted to the Group will be considered on a case-by-case basis. In accordance with the Code all Executive Directors are subject to annual re-election at each AGM.

Remuneration report continued

Proposed Policy continued

Other remuneration policies continued

Non-Executive Directors' terms of engagement

All Non-Executive Directors have specific terms of engagement which are terminable on not less than three months' notice by either party and not less than six months' notice in the case of the Chair. The remuneration of Non-Executive Directors is determined by the Board within the limits set by the Articles of Association and based on a review of fees paid to Non-Executive Directors of similar companies. In accordance with the Code all Non-Executive Directors are subject to annual re-election at each AGM.

The dates of appointment of each of the Directors serving at 31 December 2019 are summarised in the table below.

	Date of contract or date of appointment
Executive Directors	
W Downie	7 November 2019
P Fry	22 October 2018
Non-Executive Directors	
P-O Andersson	1 April 2015
B F J Angelici	1 December 2013
K Matthews	29 March 2019
J Thompson	1 December 2017
N W Warner	1 February 2011
T Werner	10 June 2016
A Whitaker	1 June 2018

An external independent Board evaluation was performed by Independent Audit Limited (IAL) in November 2019 and the Board confirmed that all Non-Executive Directors were regarded as independent, including Dr Thomas Werner, who was previously a non-executive director of Skyepharma plc and who has service greater than nine years. Notwithstanding his length of service, Thomas is considered by the Board and IAL to be independent in both character and judgement and there has been significant Board refreshment during his tenure. Further details of the evaluation are contained in the Nomination Committee report on page 57.

Remuneration for new appointments

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

In setting base salaries for new Executive Directors, the Committee will consider the existing salary package of the new Executive Director and the individual's level of experience. Where it is appropriate to offer a below-median salary on initial appointment, the Committee will have the discretion to allow phased salary increases over a period of time for a newly appointed Executive Director, even though this may involve increases in excess of inflation and the increases awarded to the wider workforce.

In setting the annual bonus, the Committee may wish to set different performance metrics (to those of other Executive Directors) in the first year of appointment.

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

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

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

The terms of appointment for a Non-Executive Director will be in accordance with the Proposed Policy for Non-Executive Directors as set out in the Proposed Policy table on page 71. This was the case with the appointment of Dr Kevin Matthews in March 2019.

Consideration of employment conditions elsewhere in the Group

Whilst the Committee did not consult directly with employees regarding the Proposed Policy, the Committee considered the general base salary increase for the wider employee workforce when determining the annual salary increases and remuneration packages for the Executive Directors. Accordingly, the Committee confirms that the Proposed Policy has been designed with due regard to the policy for remuneration of employees across the Group.

The remuneration of senior executives below Board level is reviewed by the Committee on an annual basis. The remuneration packages of these senior executives are consistent with the Proposed Policy outlined earlier, save that lower bonus percentages ranging from 50% to 75% of salary and lower LTIP opportunities are made, in part as nil-cost options and in part as restricted stock vesting after three years. Variable pay elements for senior executives are driven principally by market comparatives and the overall impact of the role the individual holds at Vectura. Long-term incentives are provided to those individuals identified as having significant potential to influence Group performance.

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

How shareholders' views are taken into account

The Committee takes seriously shareholders' views and voting on the Report. In developing the Proposed Policy, the Committee engaged directly with major shareholders and their representative bodies.

The Committee will continue to engage directly with major shareholders and their representative bodies should any material changes to the Policy be proposed. During the year 2019, the Committee engaged extensively with major shareholders both in the run-up to and following the 2019 AGM and in the second half of 2019 wrote to shareholders outlining the proposed changes to the Policy in order to seek their views and took those into account in the Policy changes.