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Annual report and accounts 2016
Developing a platform for growth

Velocys

Velocys is the Company at the forefront of smaller scale gas-to-liquids (GTL). It has a leadership position in connecting stranded and low value feedstocks, such as natural gas, landfill gas or biomass, with markets for premium products, such as renewable diesel, jet fuel and waxes. With its partners, Velocys is focused on delivering the most economically-compelling conversion solution; a fully integrated offer that can be deployed repeatedly to achieve scale.

Front cover and above: ENVIA Energy's GTL plant in Oklahoma City. ENVIA Energy is a joint venture, of which Velocys is a member, formed in March 2014 to produce renewable fuels and chemicals from landfill gas and natural gas.

Read more on page 8

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Developing a platform for growth

2016 has been an immensely important year for us. Our significantly increased involvement and operational control in the ENVIA Oklahoma plant has been critical to achieving first product there. We continue to transform the Company from being purely a technology provider to one with solid in-house experience in project governance, and GTL plant engineering and operations capabilities.

Highlights

ENVIA – involvement

January 2016 onwards

Greater equity stake and management control in the project for Velocys after a US$2.6m equity contribution and US$9.3m secured loan facility were made available to ENVIA. Key leadership role for Velocys in the commissioning, start-up and operation of the plant.

Read more on page 8

ENVIA – milestones

September 2016

Plant construction complete.

February 2017 (post-period end)

Production of first Fischer-Tropsch product.

Read more on page 8

Strategy

December 2016

Review of Company strategy completed and communicated. First strategic alliances formed with Morimatsu and TRI (post period end).

Read more on pages 2 3

Fundraise

May 2017 (post period end)

Fundraise of over £10m (before expenses) to progress the implementation of the new strategy.

Read more on pages 16 17

"Production of first Fischer-Tropsch product at ENVIA, which is the first commercial smaller scale GTL plant in the world, represented a significant milestone for Velocys. We have begun leveraging this success, implementing our new strategy, and focusing on specific markets and developing the partnerships to unlock them."

David Pummell
CEO

Read more on pages 12 13

Around the business

- Appointed David Pummell as CEO.
- Projects being developed by third parties continue to reach milestones:
  - Preliminary engineering studies completed, including a GTL project in Central Asia.
  - Air permit granted on a third party project in the US.
- Revenue of £1.4m (FY 2015: £2.0 m).
- Cash* at year end of £18.7m (FY 2015: £37.7 m).
- H2 2016 cash outflow of £5.4m versus H1 (£13.6m).

* Defined as cash, cash equivalents and short-term investments (see note 23).

Our business at a glance

Velocys has a strong, multi-disciplinary staff operating from its commercial centre in Houston, Texas and technical facilities near Oxford, UK and Columbus, Ohio. We have an experienced Fischer-Tropsch team, and our core competences extend beyond technology development to process engineering and the commissioning and start-up of commercial gas-to-liquids (GTL) projects.

Business influences

Throughout the strategic report we highlight content relating to four areas that will be critical to our future success.

1 Technical expertise
We are recognised as leaders in smaller scale GTL technology (plants with capacities of 500 to 10,000 barrels per day). We have expertise throughout the design, commissioning and operation of plants.

2 Commercial growth
First product has been produced at the commercial reference plant for Velocys' technology – a physical site where stakeholders can see our technology in situ. ENVIA Energy's plant will be a springboard for commercial growth.

3 Development of an integrated offer
In partnership, we are adopting a proactive approach, aiming to develop a fully integrated and cost-effective plant offer, reducing delivery risk and accelerating growth.

4 Focus markets
In the medium term we are focused on a small number of markets that we see as being high growth and material: renewable fuels in the US (and targeted Asian markets) and stranded gas-to-wax in North America.

"Velocys is well positioned, and our newly focused business model will drive commercialisation in the renewable fuels market, enabling our technology to be incorporated in multiple plants with standardised design."

David Pummell
CEO

Our strategy

Background

The thorough review of Velocys' strategy undertaken in 2016 focused on the best way to leverage the core assets and capabilities of the Company in the most attractive markets, where there should be a clear advantage over its competition through differentiation.

Strengths

- ENVIA Energy's Oklahoma City plant – first smaller scale GTL plant in the world.
- Differentiated technology – recognised as market leader.
- Prospective revenues from licensing model.
- World class technology, engineering capability and operations team.
- Experienced leadership team.

Market dynamics and challenges

- Oil price slowly recovering from cycle low.
- Fully exploiting our first mover advantage.
- Securing funding for Velocys plc and for first of a kind plants.
- Relentlessly driving down overall plant costs to access wider markets.

Four strategic aims

Business model – Increase control but remain 'capital light'

- Consolidate our market leading position.
- Develop and deliver projects with partners.
- Grow revenues from reactor, catalyst, operations and licence.
- Selectively inject early capital.

Strategic alliances – World class partnerships

- Work with partners with complementary resources and capabilities.
- Drive access and growth in material, high-return markets.
- Create scale and repeatability at pace.

"Velocys has identified a number of strategic aims; fundamentals on which the Company will focus during the early years of the roll out of its strategy."

David Pummell
CEO

Read the CEO's report on pages 12 13

The offer – One-stop shop

- Develop fully integrated, financed, cost-effective and operations-ready plant solution.

Leverage differentiated capabilities – Build from core technology base

- Build and enhance technology, engineering and operations capabilities.
- Work seamlessly with partners.
- Drive lowest cost.

Focus markets

As part of the strategy review the Company identified the following attractive markets on which it will continue to focus:

1. Renewable diesel and jet fuels, from woody biomass, in US markets. This is the market of Velocys' immediate focus.
2. Premium wax products, from both stranded gas and landfill gas in North America.
3. Renewable fuels, from woody biomass, in targeted Asian markets.

Velocys' medium-term goals are to:

- Build a leading market supply position in the above markets.
- Leverage the stranded GTL offer developed in North America to access Asian opportunities using stranded gas as feedstock.
- Develop an integrated GTL solution to reduce the flaring of associated gas offshore.

Read about our markets on pages 4 5

Delivery through partnership

We aim to drive the roll out of Velocys' technology by creating, with partners, an integrated plant offer in each of the focus markets, which includes fully integrated, designed, constructed and commissioned plants, fully financed, with feedstock and offtake agreements in place. We intend for this offer to be deployed across multiple plants.

The first phase of strategy implementation is to secure the robust technology partnership platform needed to develop the integrated offer for the renewable fuels market in the US. In early 2017 we announced the following new relationships:

- Morimatsu, for modularisation and fabrication.
- TRI, for gasification technology.

Read more in our CEO's report on pages 12 13

The next phase is to put in place a consortium of partners with the aim of delivering the wider commercial renewable fuels offer. Our commercial team is now engaging with a range of targeted potential partners from woody biomass suppliers, commodity traders and airlines, to providers of equity and debt financing. Our intent is that these partners will be strategically-aligned and have complementary resources, capabilities and influence in our target market to support the roll out of a number of plants and open up broader financing options. We have set ourselves the challenging goal of building this consortium and securing the first final investment decision for a renewable fuels plant.

The Company intends to assemble a consortium of partners to deliver the integrated offer for the stranded gas-to-wax market over a longer timescale.

As well as developing its own integrated offers for its focus markets, Velocys will continue licensing its technology to third party developers in these, and other, markets.

Revenue streams

Velocys' business model is based on making a relatively low investment in early stage project engineering and site development to accelerate the project development phase. This "capital light" approach to commercialisation demonstrates our commitment to our technology and chosen routes to market. Velocys' revenue will predominantly flow from the licensing of its technology, sales of its reactors and catalyst, and revenues from operations management support, plant commissioning and start-up services.

Our focus markets

The strategy review identified a number of attractive markets on which Velocys will focus its integrated offers, with the objective of creating sustainable growth. The renewable fuels market is Velocys' immediate focus. This and the stranded gas market offer significant volume and potential growth. Offshore flared gas is a longer-term, substantial proposition.


Supply of renewable diesel and jet fuels and premium wax products.


Monetisation of stranded gas, to produce wax in North America.


An integrated GTL solution to reduce the flaring of associated gas offshore.

Renewable fuels credits defined

- RFS – US federal Renewable Fuel Standard.
- RIN – US federal Renewable Identification Numbers credits.
- LCFS – Californian Low Carbon Fuel Standard.

Indicative renewable fuels credit values are based on prices in February 2017.

Market of primary focus – renewable fuels

The mandates of the US RFS and the Californian LCFS create an increasing demand for cellulosic biofuels. In California alone, a renewable diesel supply capacity shortfall of 50,000 to 80,000 barrels per day (bpd) is expected by 2023. For the US to meet COP21 commitments of using a 3% blend of renewable jet fuel in the overall fuel pool, over 40,000 bpd of new capacity would be needed by 2020. These are markets that Velocys can address with its smaller scale gas-to-liquids (GTL) technology. Using certain feedstocks, fuels produced using Fischer-Tropsch (FT) technology qualify for the highest level of RIN credits, with a price of around $194/barrel.

In California, Velocys' renewable diesel would qualify for the LCFS credit with an additional value of $33/barrel (based on a 60% greenhouse gas reduction relative to conventional fuels). In these markets, compared to other biomass-based fuel production technologies, Velocys' FT technology is cost competitive, is less reliant on incentives, has lower ongoing feedstock costs and has access to an abundance of potential feedstock.

This technology route is one of a very small number of ways to produce high quality renewable fuels that can be blended at high percentages with petroleum-based products and that are compatible with existing infrastructure and engines. This enables airlines and truck fleet operators, for example, to meet low carbon targets and corporate social responsibility obligations.

The Company is also pursuing opportunities for renewable fuels, from woody biomass, in targeted Asian markets.

Stranded gas

Smaller scale GTL can be an economic route to the monetisation of stranded gas resources that are hard to exploit by other means, even at times of low oil prices. Velocys' FT technology produces high value waxes at volumes that match market requirements. Speciality waxes command high prices even when the oil price is low. The economics for gas-to-wax plants are competitive with other gas monetisation options.

In this market Velocys is initially targeting Western Canada, where gas prices in certain fields are significantly lower than US market prices and there is no other viable route to market. This situation is expected to persist over the long term. This route to market could be adopted by Asian companies that own fields in the region and replicated in the other geographic markets where they own stranded gas reserves. There is further upside arising from an increased oil price, when plants producing fuels (rather than waxes) will become increasingly attractive.

Landfill gas

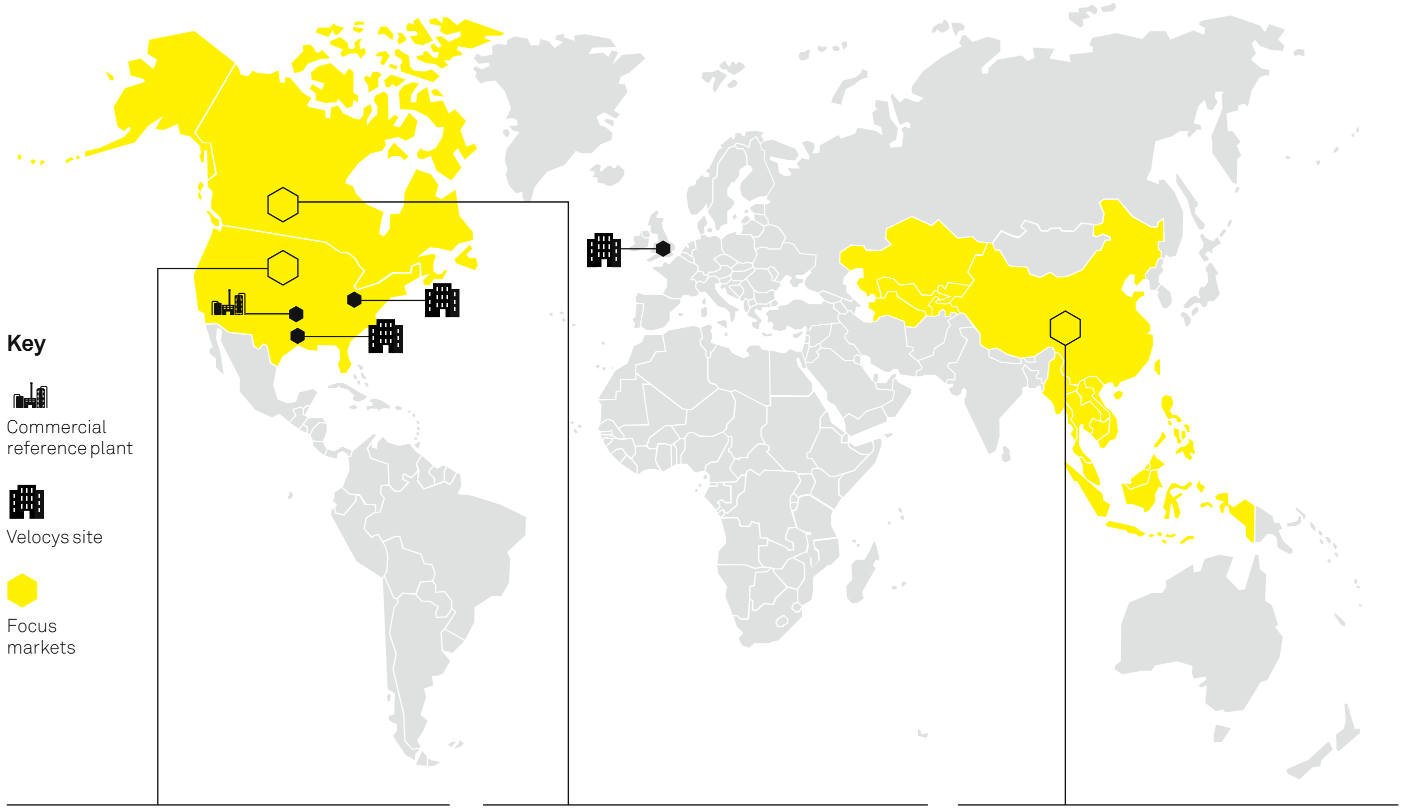
Approximately 250 million tonnes per year of municipal solid waste is sent to landfill in the US. The US Environmental Protection Agency estimates that 17% of total methane gas released from human activity in the US is from municipal solid waste landfills. As indicated at ENVIA's Oklahoma City plant, Velocys' FT technology is well placed to convert landfill gas to renewable fuels and waxes, the markets for which are discussed above. ENVIA continues to evaluate future projects using learnings from the first plant.

Longer-term market – offshore flared gas

With an identified partner, Velocys is targeting the development of a unique technical solution to unlock oil production offshore, where no other economical means of disposing of associated gas exists. This is a very large market – over two billion standard cubic feet of associated gas is flared offshore every day. Flaring regulations are tightening, and oil production from some fields could be restricted, or prevented altogether. A technology solution is needed that makes use of the gas and enables future offshore oil exploration.

Velocys plans initially to enter the extended well test market in North America, where a technology solution would provide a means to avoid high costs associated with multiple appraisal wells. Longer term, Velocys, with its partners, aims to access the flared gas market via on-board floating production, storage and offloading (FPSO) vessels for deployment in Asia and Latin America, where a large proportion of offshore associated gas is flared.

Markets of strategic focus



USA

- Renewable fuels and speciality products from landfill gas.
- Renewable jet fuel from biomass.
- Renewable diesel from biomass, particularly in California.
- Longer-term, prevention of gas flaring offshore.

Western Canada

- Monetisation of stranded gas.
- Supply of premium waxes.

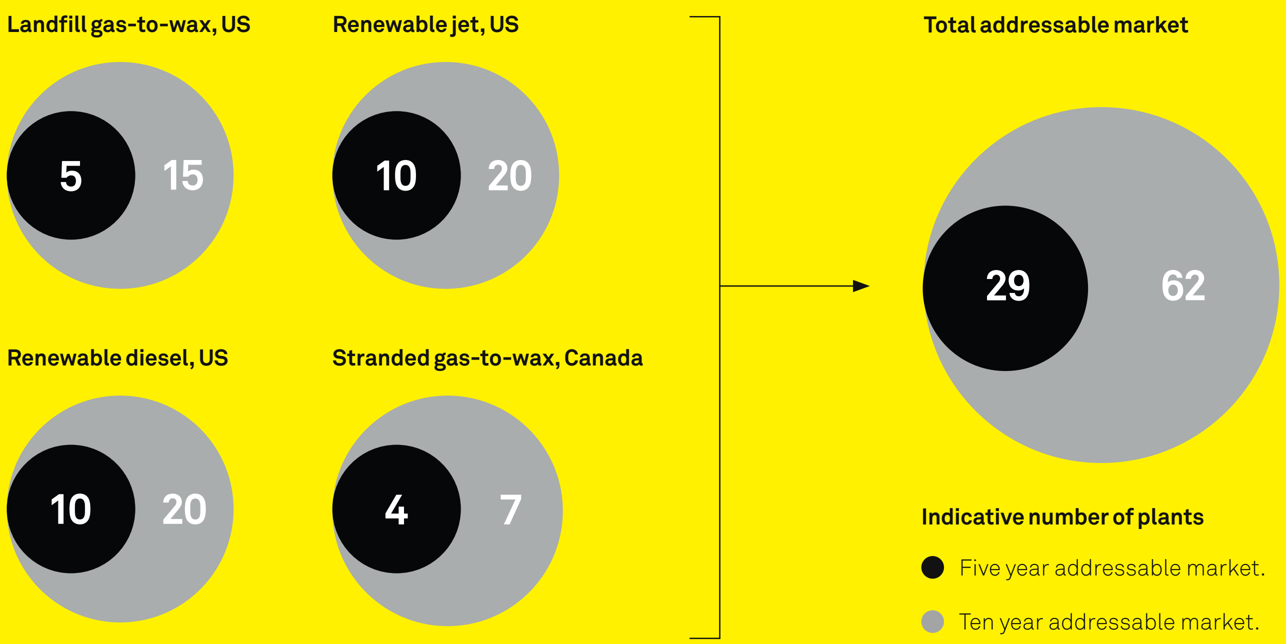
Asian market development

- Renewable fuels in targeted Asian markets.
- Longer-term, prevention of gas flaring offshore.

Note: Velocys will continue to license its technology to third party projects being developed in these and other regions.

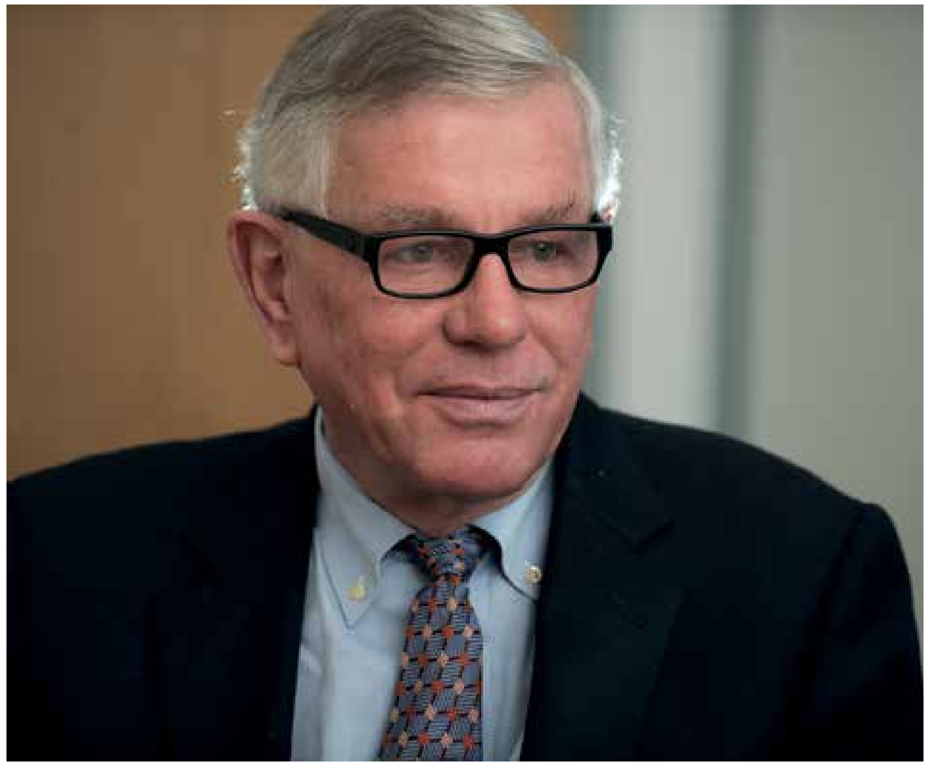
Large addressable markets

Substantial potential volume and growth.



Pierre Jungels, CBE
Chairman

"Velocys has a new focus, a differentiated technology, £10m of additional funding and a strategy for growth with which it is making good early progress. Despite a challenging funding environment and a persistently low oil price Velocys is developing a platform for delivery that should stand the Company in good stead as we move forward."



Chairman's statement

Introduction
After 15 years of effort, it has been immensely gratifying during 2016 to watch ENVIA's plant rise from an empty plot outside Oklahoma City. This tangible result is, however, just the end of the beginning; the challenge for the next few years is to transform the Company from having started up one gas-to-liquids (GTL) plant incorporating its technology into a highly profitable business.

The Company has made significant progress during the year in charting a course to commercial success, and in this, David Pummell has been instrumental. The delivery of this strategy will dominate the efforts of Velocys over the coming years.

Management and Board
David Pummell was appointed as CEO of Velocys in January 2016. He joined the Company with considerable experience to help us identify the right strategy and implement sustainable growth – skills that fit the Company's current stage of commercialisation and the future direction of Velocys. His experience, ideas and approach are complementary to the Company's senior management team – which remains a highly effective and able unit.

David is now focusing on how the Company needs to be reorganised and resourced to deliver our new strategy. I thank the management team and all the Company's employees, for their efforts and achievements this year.

Jan Verloop retired as a Non-Executive Director in September 2016. The GTL expertise that Jan brought to the Board was pivotal in guiding the Company's technology development from an innovative idea to a fully validated system. I thank him warmly for his ten years of valued service.

Mark Chatterji stepped down from his position as Non-Executive Director in April 2017. The Board is grateful to Mark for his advice and support since his appointment in September 2015.

We look forward to welcoming Andrew Morris to the Board following the completion of the proposed fundraising (separately announced on 15 May 2017).

Strategy and markets
The review of Velocys' strategy was a thorough process involving considerable internal resource, independent advice and guidance, and a number of months of concerted effort. Many market opportunities were evaluated across various dimensions to assess their attractiveness and deliverability. As a result the Board has confidence that this is the right strategy to accelerate the Company's entry into attractive and high growth markets, and to be the foundation for delivering revenue growth and achieving a sustainable cash generative business.

The funding environment in the oil and gas industry remains challenging. The Company's strategy ensures it is best prepared to withstand the ongoing uncertainty in the sector. During the strategy's implementation, partnerships and methods will be carefully chosen to reduce delivery risk and to make the integrated solution attractive to financing.

Velocys' fundraise in May 2017 of over £10m (subject to the passing of certain resolutions at a general meeting to be held in June 2017) together with cash brought forward (£18.7m at 2016 year end) and the measures taken to preserve cash will provide the Company with a financial platform for the important initial implementation phase of its strategy. The Board recognises that further funding will be needed in due course. Note 2 discusses uncertainties surrounding the extent and composition of future funding.

Velocys is focusing on defined, high value markets with substantial short-term potential for volume growth; the market of most immediate focus is renewable fuels. There is increasing pressure from legislation and public opinion to curb greenhouse gas emissions and reduce pollution. This has led to long-standing incentives for renewable fuel production in certain regions, notably in the US. Congress and the new US administration are continuing to enforce laws and policies focused on energy security and independence, including the renewable fuel standard, and jobs in rural regions. Successful delivery of the Velocys strategy would result in the construction of multiple, repeatable renewable fuels plants to meet this fundamental need.

Currently, Group I base oil facilities are the largest source of supply for the global wax industry. Wax pricing has remained high, decoupled from the oil price, and is forecast to strengthen because these facilities, particularly in North America and Europe, are being shut down and replaced with newer facilities that do not co-produce wax. Plant economics remain favourable for smaller scale gas-to-wax projects that access low price feedstocks, including from certain stranded gas fields in North America.

Our assessment of the focus markets is that they should provide attractive returns to both Velocys and its partners. We estimate that these combined markets have an addressable market size of 25-30 plants in the next five years and that they have significant upside growth potential. Velocys' business model is well positioned to exploit these opportunities and our goal is to build an integrated offer and secure the first final investment decision for a renewable fuels plant.

Outlook
Velocys has a new focus, a differentiated technology, £10m of additional funding and a strategy for growth with which it is making good early progress. Despite a challenging funding environment and a persistently low oil price Velocys is developing a platform for delivery that should stand the Company in good stead as we move forward. The successful demonstration of the Company's FT technology at ENVIA Oklahoma, the first smaller scale GTL plant in the world, will have significant, positive impact on this sector, not just this Company.

Pierre Jungels, CBE
Chairman
15 May 2017

Introduction to our corporate governance

Velocys has the ambition to grow significantly, and to develop into an established multinational business. The Company is in the process of implementing the required business level governance that is both scalable and has the flexibility to meet the requirements of delivering the new strategy. This governance covers the processes required to manage a number of parallel routes to market, with defined critical activities and key milestones that will drive risk management and decision making at both the executive and Board levels.

The composition of the Board has reflected the development of the Company, with a shift in emphasis from technological understanding to expertise in business, legal and finance.

The switch in late 2015 to having most Board members sitting on only one or two committees demonstrated the new focus that the Board has developed in its corporate governance.

The governance report gives:
- A clear and honest view of progress throughout the year.
- The outcome of our Board evaluation.
- Disclosure of Board discussions and the resulting actions.
- Our approach to ensuring long-term viability of the business.
- Our approach to risk and mitigation.

Read the Corporate governance report on pages 22 27

Our governance principles

Taking a lead
Adopting the corporate governance practices that the Company will need in the future.

Managing risk
Assessing the risks facing the business and overseeing management's strategies for mitigating these risks.

Engaging with shareholders
Ensuring shareholders are kept informed of the Company's direction and achievements through regular contact.

Supporting management
Constructively challenging the team on its plans and delivery.

ENVIA Energy project overview

ENVIA Energy is a joint venture, of which Velocys is a member, formed to produce renewable fuels and chemicals from landfill gas and natural gas using GTL. ENVIA's first plant, in Oklahoma City, will act as the commercial reference plant for Velocys' technology.

Aerial view of ENVIA's plant.

Milestones achieved
The historic moment for Velocys' technology came in early February 2017, with the start-up of the Fischer-Tropsch (FT) process units and the first FT product was successfully produced; a truly momentous milestone for the Company. The performance data (for example, for syngas purity, methane selectivity, liquid production, carbon monoxide conversion and activity index) that are available from the ENVIA plant meet the performance expectations set using models based on laboratory and pilot studies. Targets for the conversion of syngas to FT products and the yield of liquid products were achieved within 12 hours of the first start-up of the FT modules (the equivalent of one shift of plant operators).

This achievement came at the end of a sustained period of activity at the Oklahoma City site, as well as at suppliers' sites, during 2015 and 2016. Manufacture and certification of the Velocys FT reactors destined for use at ENVIA were completed by the Company's supply chain partners in September 2015. From the spring of 2016 the modular process units, the building blocks of the GTL plant, started to be delivered and set in place on site after being trucked from their fabrication facility near Houston, Texas. All other major packaged equipment skids, including the steam methane reformer, were delivered over the same time-frame. The number of personnel on site in Oklahoma peaked at over 150.

The lifeblood of the GTL process, the FT catalyst, made by a specialist manufacturer under contract to Velocys, was delivered to Oklahoma in September 2016. Velocys personnel were responsible for loading it into the reactors, which was duly accomplished with support from the Company's internationally-recognised partner, Mourik.

In September, with the construction of the plant complete, the pre-commissioning and commissioning process could begin. All the lines and vessels were hydro-tested and a rigorous plant-wide inspection process was completed. In line with best practice, the process systems were started up in sequence when upstream units were confirmed to be working robustly and safely. In such a way ENVIA best assured a successful, safe and stable start-up.

Next steps
At the time of writing, the operations team has completed debugging several (non-Fischer-Tropsch) units of the plant and will implement the pre-planned programme of ramping up production to target operational capacity over the coming months. Such activities are routine at this stage of starting up a plant of this complexity. First finished products (waxes, diesel and naphtha) are likely to be produced in a matter of weeks. In parallel, we are starting to welcome key stakeholders to visit the plant and witness first-hand Velocys' technology in situ.

A large proportion of the products made at the plant is manufactured using landfill gas – a renewable resource. Under the Renewable Fuels Standard (RFS) ENVIA has an approved pathway to generate RIN qualifying fuels. ENVIA expects to receive confirmation that the plant is operating as intended in the pathway, thus confirming the greenhouse gas reduction and the category of RIN credits generated.

Increased operational control for Velocys
In January 2016, as part of a stakeholder capital contribution, Velocys made available to ENVIA additional funding of US$11.9m (made up of an equity contribution and a loan commitment). As a result of this funding arrangement, Velocys increased its ownership share and was awarded additional voting rights, taking its share of voting rights to 28%. We also sought and gained greater operational management involvement in the project (see note 20).

Read more on page 17

Since that time Velocys has been supporting the Engineering, Procurement and Construction (EPC) contractor by, for example, providing an operability review, operating procedures and commissioning management. Additionally, under a secondment agreement with ENVIA, a Velocys operations team, which has worked under the ENVIA Plant Manager since July 2016, has brought essential support to the ENVIA team during commissioning, start-up and early stage operations. As planned, the majority of the Velocys team was demobilised in Q1 2017 as the permanent ENVIA operations team was phased in and fully trained. A small number of key Velocys staff are being seconded to ENVIA over a longer transition period and the wider Velocys team remains available to support ENVIA operations, as needed.

The ENVIA plant and the East Oak landfill site in the foreground with downtown Oklahoma City just visible on the skyline (left). The plant is co-fed by landfill gas produced at the adjacent landfill site and pipeline natural gas.

Fischer-Tropsch reactor manufacture at Velocys' supply chain partner in 2015.

Inside the control room.

Roger Harris in the tank farm.

From landfill gas to product offtake (foreground).

ENVIA Energy project overview (continued)

Some of the Fischer-Tropsch modules including those incorporating the Velocys Fischer-Tropsch reactors (right).

Paul Schubert (COO) and David Pummell (CEO) take a tour of the site with Johan Malan (Commissioning Manager).

World-class operational expertise

Members of the team talk about their previous experience and the Company's involvement at the ENVIA plant.

Q What previous experience did you bring to the ENVIA project?

A "I have more than 10 years' experience of the commercialisation of new chemical and large-scale GTL processes in countries such as South Africa and Qatar."

Roger Harris
Senior Manager, Operations & Technology Commercialisation

A "I have more than a decade of FT technology experience. I was the FT lead licensor for a commercial start-up of a GTL plant in the Nigerian Delta with a capacity of over 30,000 barrels per day."

Johan Malan
Commissioning Manager

Q What skills does the on-site Velocys team bring to the project?

A "We've brought in a wide range of Velocys personnel. Our catalyst loading team successfully loaded the commercial FT reactors on site. We've also taken a team of experienced people from our R&D teams and our pilot plant and seconded them to the ENVIA operations team. These people come with a wealth of experience in the development of our technology and most of them were involved in Velocys' demonstration-scale plants such as at one of Petrobras' sites in Brazil. We've also pulled together a highly experienced and motivated commissioning and start-up team."

Roger Harris

Q What is involved during the commissioning of a plant such as this?

A "Commissioning is all about the details and executing activities in a carefully pre-planned sequence to ensure safe and optimal progress. Every line needs to be flushed and blown down, every instrument loop checked and every unit prepared according to the vendor's specifications to ensure a successful start-up. The steps that have to be undertaken are very similar for any GTL plant, whether large or small- scale."

Johan Malan

Q How did the joint venture prepare for the start-up of the plant?

A "The team made extensive and detailed preparations for start-up; operating manuals and procedures have been fully completed and robust commissioning and start-up plans put in place."

Johan Malan

Q Why is the project in Oklahoma City so significant?

A "First product at ENVIA represented a huge milestone for Velocys as well as a significant step for ENVIA and the wider industry. It will be a springboard for the successful implementation of Velocys' new strategy, in particular demonstrating to potential partners the credibility of our technology, people and selected routes to markets."

David Pummell
CEO

A "Successful operation will provide commercial-scale performance data for stakeholders to analyse and a physical, tangible site where they can see our technology in situ. It's an impressive site and plant performance data that have been collected are aligned with our pilot plant data and process models."

Paul Schubert
COO

Q Will the Oklahoma City project lead to future projects with ENVIA?

A "The Oklahoma City plant is a commercial demonstration of our technology and will confirm that landfill gas can be converted to high value products. There are significant opportunities at landfills across the US to leverage the Oklahoma experience with our partners. ENVIA has been evaluating how to best use the learnings from Oklahoma and put the right plans in place for future projects."

David Pummell

A wealth of experience on site from Velocys' R&D and pilot plant teams and from personnel with experience at large-scale commercial GTL plants.

www.velocys.com/media_videopage15_ENVIA_OKC.php

View a video about Velocys' involvement in ENVIA's plant and the significance of the project to the Company.

David Pummell
Chief Executive Officer

Developing a platform for growth

- First product achieved at ENVIA (February 2017).
- Commercial scale validation of our technology.
- World-class operational expertise demonstrated.
- Definition of new Company strategy and good early progress with its implementation.
- Fundraise in Q2 2017 provides funding for immediate strategy initiatives.

CEO's report

Introduction

Looking back on my first year as CEO of Velocys I see that my initial optimism about the Company was well-founded. Velocys has a proven and uniquely competitive technology, employs a dedicated and knowledgeable workforce, and, with first Fischer-Tropsch product achieved at ENVIA Oklahoma City, we have a market leading position.

2016 has been a year of establishing a platform for Velocys' future growth. I have been enormously impressed with the advances made month-by-month by the high-performing on-site team at the ENVIA plant, and first product has now been achieved. Building on that position, our strategy has defined Velocys' future direction and the recent fundraise maintains our financial position so that we can start to implement the entry into our focus markets, with an initial focus on renewable fuels in the US.

Commercial strategy

My approach to management is continuously to drive simplicity, focus, delivery and robustness in everything we do. We took this approach to the strategy review carried out in 2016, and will continue to follow this path through every aspect of its roll out. The new strategy builds on the Company's successes to date, but adopts a business model in which we aim to considerably extend our influence over the integrated offer, project delivery and partner selection in specific high value markets that will enable us to grow the business in those areas identified in the strategy review.

A core theme of the new business model is to develop, jointly with partners, an integrated offer to customers in each market. Together, we are assembling all the necessary components for projects, including the integration of other licensors' technologies, to develop cost effective and operationally-ready plants, which are fully financed with feedstock and offtake agreements, and which could be deployed across multiple plants. This approach aims to create repeatable and scalable standard offers in each of our focus markets and starting with the renewable fuels market, to drive us towards establishing material market positions.

We will continue to refine our strategy as progress is made on the renewable fuels integrated offer. The Board is examining options to provide funding beyond the immediate strategy initiatives.

Velocys is committed to its technology and invests prudently in preliminary stage project engineering and project management to accelerate the route to market. This committed approach by Velocys is intended to be highly attractive to potential future strategic partners who would invest significant capital in these plants in due course. These early project investments would be converted into minor equity positions, as Velocys does not plan to take substantial equity stakes in projects incorporating its technology.

Focus markets

We have identified attractive markets on which Velocys will now focus to create sustainable high-growth businesses in the medium term. More details are given on page 4. We are developing alliances with companies that have the resources, scale and capabilities to support Velocys in accessing these markets and driving growth.

Strategy milestones reached

In Q1 2017 we announced the signing of commercial agreements with two strategic partners. TRI and Morimatsu are our partners for gasification technology and modularisation and fabrication engineering respectively. Both companies are innovative leaders in their fields and have committed significant resources to joint work programmes that are already underway.

Relentlessly driving to the most cost effective integrated plant offer is a cornerstone of our strategy. Key enablers are the modularisation of plants, routes to high quality and low cost fabrication, sourcing of equipment from the most competitive suppliers and the continuous improvement of plant integration engineering. This approach drives down capex and opex and also reduces the plant build schedule and risk of delays. With Morimatsu's, we are scoping out a programme of work to maximise these benefits across all gas-to-liquids (GTL) and biomass-to-liquids (BTL) plants. This ongoing collaboration builds on Morimatsu's successful delivery of targeted cost and footprint reductions in their design of the Fischer-Tropsch (FT) section of the plant.

With TRI we have begun the development of a joint engineering design for a BTL plant incorporating Velocys' FT technology with TRI's proven gasification technology to produce renewable diesel and jet fuel from woody biomass. TRI has agreed to support Velocys and its partners to further optimise overall plant costs and the financing of BTL plants through, for example, accessing governmental loan guarantee schemes and grants that would play a key role in de-risking the financing of the first BTL plant.

The commercial team is maintaining its efforts to build the consortium of partners that, we believe, will underpin a financial investment decision (FID) for a renewable fuels plant next year. There is a long way to go but I'm encouraged by the very positive engagement of potential partners who express the belief that we represent a credible route to building many plants in our chosen markets.

ENVIA Energy

The plant in Oklahoma City is the first commercial smaller scale GTL plant in the world. There was intense activity on site throughout 2016; the milestones achieved during the year are outlined on page 8. The first product milestone is as much a landmark event for the industry as it is for Velocys and ENVIA. At the time of writing, the operations team has completed debugging several (non-Fischer-Tropsch) units of the plant and will implement the pre-planned programme of ramping up production to target operational capacity over the coming months. Such activities are routine at this stage of starting up a plant of this complexity. First finished products (waxes, diesel and naphtha) are likely to be produced in a matter of weeks. In parallel, we are starting to welcome key stakeholders to visit the plant and witness first-hand Velocys' technology in situ.

We are delighted that the commissioning team delivered a safe and successful start-up of the FT modules and upstream units during a challenging period of exceptionally cold weather. There is a highly competent and experienced team on site that gets on with whatever needs to be done, solving the challenges that typically arise during the commissioning of a plant in the most professional way. My thanks go to the entire team, whose continued efforts have been instrumental in achieving this milestone.

In January 2016, Velocys made available to ENVIA additional funding of US$11.9m (made up of an equity contribution and loan commitment). Additional equity ownership and voting rights were granted to the Company and Velocys secured greater operational management involvement in the project. Through that increased involvement we have built on our market-leading technology base, enhancing our capabilities and strengthening our position as a Company with real-world operational capability.

Construction, commissioning and start-up of ENVIA's plant have naturally brought many learning points that Velocys will use in future projects. These include plant-wide integration design improvements that will increase the efficiency and economics of future GTL plants.

> **"The culmination of 15 years of incredible endeavour by Velocys has been realised at ENVIA Oklahoma City, the first smaller scale GTL plant in the world, where we have proven our technology and demonstrated our operational capabilities. We believe this will provide a firm foundation for growing the business at pace in our chosen strategic markets. We have a differentiated technology and we are now creating routes to market that will enable us to build material market positions. This is attracting considerable interest from world class potential partners and we are actively engaged in commercial discussions."**

Other projects

As previously reported, in the first half of 2016 Velocys investigated the potential acquisition of certain GTL assets of a US-based company that was in bankruptcy proceedings. However, it emerged that the deal available to Velocys was not in the Company's best interests and so it was not pursued to completion.

Velocys is keeping its options open regarding its Ashtabula site. The Company currently sees Western Canada as a promising location for a first gas-to-wax plant, where there is an abundance of stranded gas. Much of the work undertaken for the Ashtabula project (partners, engineering and knowledge of wax market dynamics) is entirely transferable to a wax plant of the same size at a different location.

Velocys will continue to license its technology to third party projects. A number of projects in Velocys' sales pipeline have continued to progress during 2016, albeit slower than we would have liked. Operation of ENVIA's plant is expected to accelerate some of these opportunities and stimulate the development of other third-party projects as well as those in our strategic markets.

The opportunity with a major fuels player in the US remains active; the air permit was issued for the plant in the summer of 2016. Red Rock Biofuels is still pursuing funding for its biomass-to-liquids plant of over 1,100 barrels per day (bpd) using forestry waste as feedstock in Oregon, USA. The funding process is taking longer than expected but Red Rock remains focused on achieving final investment decision this year.

Two engineering studies were completed by Velocys and its project partners in 2016:

- A project being developed on behalf of a national gas company in Central Asia that is seeking to develop its stranded gas reserves. Velocys' project partner is waiting for confirmation on the feedback from the project sponsor.
- The development of a waste-to-liquids project in the UK to produce jet fuel. Velocys is reviewing options with potential partners.

Pilot plant and technology

One of our most significant assets, the Velocys pilot plant, was put into standby mode in Q2 2016 following the completion of a comprehensive testing programme. Later this year we plan to relocate the skid-mounted FT section of the pilot plant from Ohio to TRI's facility in Durham, North Carolina, where it will form part of an integrated gasification/FT technology demonstration. This will provide additional assurances to prospective project investors and lenders for BTL plants, and is a requirement for the US Department of Agriculture loan guarantee qualification.

Also in 2016, a third-party independent engineering firm validated Velocys' design for larger 700 bpd FT reactors, use of which will substantially reduce the costs of larger plants. This positions Velocys well to respond cost-effectively to the needs of customers developing projects with plant capacities towards the upper end of its target range.

Outlook

In 2016 we developed a strategy for our sustainable future growth and we have made a fair start to 2017. Visitors to the Oklahoma City site, many of them potential partners, are struck by the physical reality of this achievement and are leaving with a real sense of the calibre of the team on the ground, and the significant potential of Velocys' technology and strategic business model. We have two priorities for 2017: firstly the implementation of the strategy, with focus on setting up the strategic consortium for the renewable fuels market that will aim to deliver multiple FIDs, operating plants and associated revenues in the coming years; and secondly, supporting the ENVIA team to achieve stable, full-capacity production with US federal renewable fuel credit qualification.

David Pummell
Chief Executive Officer
15 May 2017

Our technology

Velocys' technology is specifically designed for smaller scale gas-to-liquids (GTL) and biomass-to-liquids (BTL), combining super-active catalysts with intensified reactor systems. The technology is protected by several hundred patents in over 30 countries. Standardised modular plants can be deployed readily in a wide range of locations.

Cost-competitive, proven technology
Velocys is recognised as the technology market leader. Our Fischer-Tropsch (FT) technology has been tested for 1.3 million hours in the laboratory and for over 26,000 hours at pilot/demonstration scale. It is operationally ready and has now been deployed commercially at ENVIA's Oklahoma City plant.

Particularly in today's oil price environment, asset owners and project developers need to select a technology that allows them to achieve the best possible economic returns from their plant. Our FT reactor and catalyst system delivers high conversion efficiencies and yields of valuable, premium grade products. This increases the revenues that can be derived from a plant with a given input, enabling plant operators to penetrate markets (e.g. for high-value waxes) that would otherwise be inaccessible, and insulating projects from oil price volatility.

Use of Velocys' high stability catalyst results in an increased plant up-time. Velocys' customers can expect to use each batch of catalyst for at least two years, and potentially much longer, before change-out.

Velocys technology is robust, and optimised not only for peak performance but also to meet the challenges of everyday variations in, for example, feedstock composition. All the protocols required to operate a commercial plant have been demonstrated.

We maintain a targeted investment programme in engineering and technology know-how, to further optimise the technology and integrated plant design, and to improve the financial performance of GTL and BTL plants.

Capabilities in partnership
Working with strong partners that have complementary capabilities is contributing significantly to our aim of offering the most cost effective FT and fully integrated plant solution in our target markets. This extended capability through partnership will enable continued optimisation, standardisation and modularisation of plant engineering that will be the foundation for delivering multiple, repeatable plants.

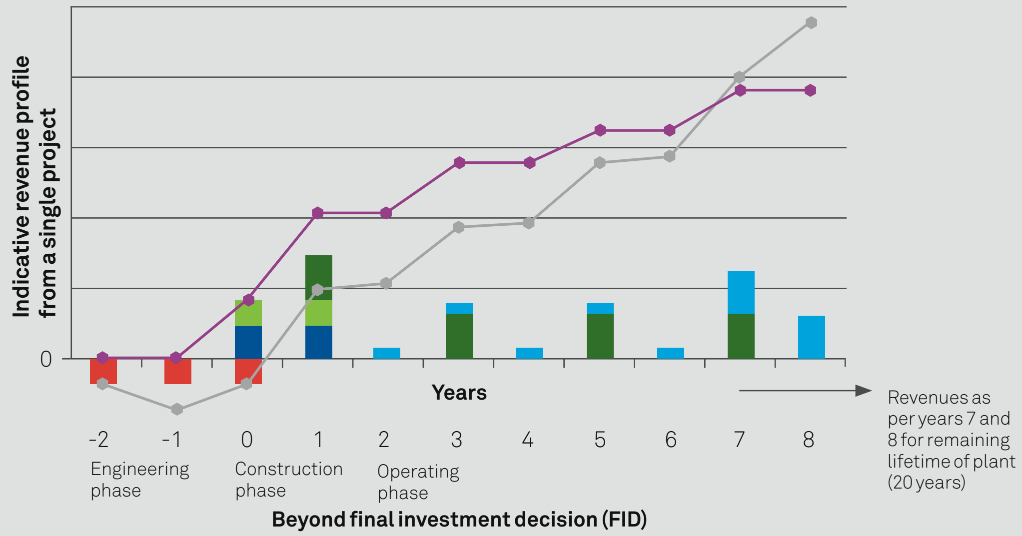

Velocys FT reactor cores.


One of Velocys' completed four-core FT reactors.

Revenue streams from technology sales

Revenues for Velocys will predominately flow from licensing its technology, initial sales of its reactors and catalyst, and ongoing sales of its catalyst (approximately every two years) throughout the lifetime of a plant.

Key:
- Catalyst revenue
- Reactor sales
- Licensing fees
- Project development cost/ investment
- Returns from project
- Cumulative (licensing, catalyst and reactor sales)
- Cumulative (all revenue streams)



Processes
The GTL and BTL processes have three main steps: production of syngas, the Fischer-Tropsch (FT) process and subsequent upgrading to produce finished products: high quality diesel, jet fuel and speciality products as well as naphtha.

Products
Fuels

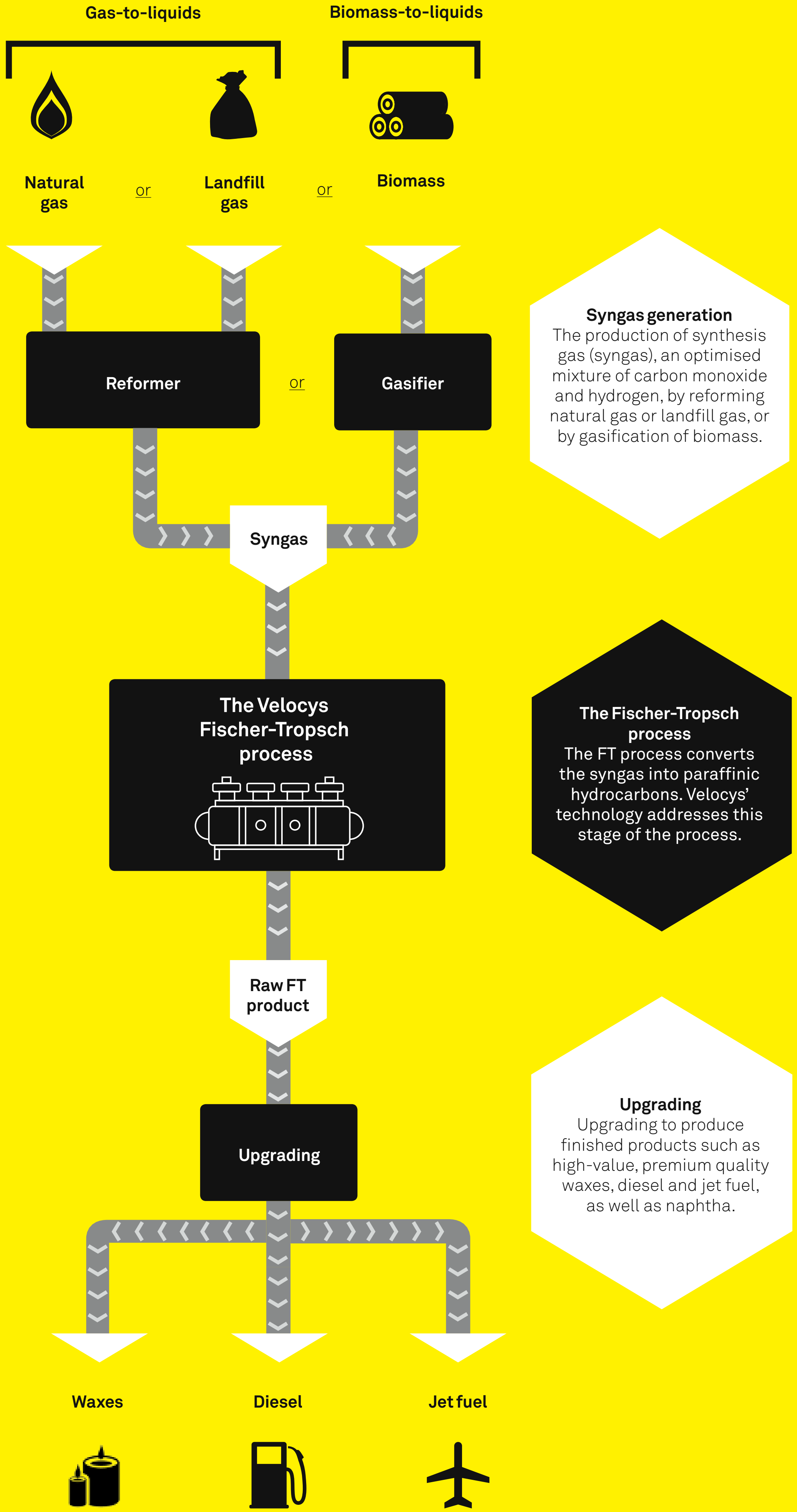
With the demand for diesel and jet fuel increasing, BTL can provide the renewable fuels that the US commodity market demands, and for which attractive incentivisation schemes have been created through both federal and state credits. FT fuels are fully compatible with existing infrastructure and engines, which is not the case for other methods of natural gas monetisation (LNG and CNG) or other methods of producing fuels from biomass (such as ethanol or fatty acid esters).

FT products are highly paraffinic and do not contain aromatics or sulphur. FT fuels burn cleaner than petroleum-derived fuels, resulting in lower emissions of NOx, SOx and particulates. Use of high-purity FT diesel also reduces engine noise and reduces wear and tear on vital engine components. FT fuels are often blended to instil their high performance (high Cetane) characteristics into lower quality petroleum-derived fuels.

Waxes

The purity and consistency of FT waxes is highly desirable in downstream processes, such as the production of cosmetics, pharmaceuticals and adhesives.

There is a rising global demand for waxes, though the wax market, both in the US and worldwide, continues to undergo structural changes, which have decreased supply and decoupled wax pricing from the oil price, making a smaller scale GTL plant targeting the production of waxes an attractive proposition. Velocys is best placed to take advantage of this opportunity. Our technology is best-in-class in terms of yield of long chain hydrocarbons, which form the basis of high value, premium wax products.



Susan Robertson
Chief Financial Officer

"The fundraise in Q2 2017 together with cash brought forward (£18.7m at 2016 year end) provide the Company with a financial platform for the important initial implementation phase of its drive towards commercialisation."

Financial review

Revenues
Revenue in 2016 was £1.4m (2015: £2.0m), which was entirely made up of service income from a number of engineering design studies and operational support services, including the secondment of employees to ENVIA's plant. This was in line with budget expectations. Gross margin was £0.4m (2015: £0.7m).

There was one key contract, with ENVIA. Revenue for reactor sales to ENVIA was recognised in 2015, while revenue from the lease of catalyst to ENVIA will start to be recognised in the financial results for H1 2017. Velocys expects to receive additional revenue from ENVIA from the change-out of its catalyst approximately every two years.

Expenses and income
Total administrative expenses decreased to £17.4m before exceptional items and £20.2m after exceptional items (2015: £25.5m before/£26.7m after exceptional items). The reduction reflected placing the Velocys pilot plant into standby mode, scaling back external project development spending and rigorous cost reduction across the Company, while it aimed to secure additional project revenues. In selecting measures to adopt, a primary concern of the Company has been to ensure that they will not impact Velocys' ability to deliver its commitments at ENVIA nor its core capabilities.

Other income of £0.3m before exceptional items (£2.8m after exceptional items – see below), was from a legal settlement (2015: £2.0m/£3.8m before/after exceptional items) (see note 9).

The exceptional items in 2016 included costs incurred during the pursuit of an opportunity to acquire certain gas-to-liquids (GTL) assets of a US-based company in administration, and the release of deferred revenue on the cancellation of the Ventech contract. The exceptional items in 2015 included the full impairment of the discounted value of expected future income upon obtaining a final investment decision for the Ashtabula project and release of deferred consideration. See note 4.

Assets and cash
Net assets of the Company were £63.7m, down from £68.5m in 2015; the main change was due to the cash outflow offset by the impact of the stronger US dollar exchange rate on the Company's US denominated assets. Having experienced a reduced spend in H2, Velocys retained a cash balance (cash and cash equivalents) at year end totalling £18.7m (2015: £37.7m), which has been subsequently increased with the addition of over £10m from the fundraise in May 2017 (see below).

Cash outflow in 2016 (excluding share issues) was £19.0m (2015: £22.0m). Cash outflow was £13.6m and £5.4m in H1 and H2 respectively. This imbalance was a result of the measures taken to preserve cash as well as the exceptional net expense of £2.4m it incurred in H1 in its pursuit of acquiring certain US GTL assets in administration (see note 4). This reduced underlying cost base has been carried forward into 2017 and the Company intends to continue taking measures to minimise its underlying cost base whilst continuing to spend prudently on strategy implementation.

The very large swing in the sterling to US dollar exchange rate in the wake of the UK's vote to leave the European Union gave rise to a £3.2m gain, recorded in Finance income in the Income statement. This reflected revaluation of the Company's dollar cash assets, and maturity of its forward foreign exchange contracts (see note 27). A further gain of £7.3m due to the translation of non-cash, US denominated assets was recorded through reserves.

ENVIA funding
In January 2016 Velocys made available $11.9m to ENVIA, which was made up of a $2.6m equity contribution and a $9.3m loan commitment. $0.4m of the loan had been drawn down by ENVIA by the end of 2016 and it is anticipated that the entirety of the remaining loan amount will be drawn down in H1 2017. The loan has a 10% coupon. In May 2017 Velocys extended its loan agreement with ENVIA to $12.7m (see below).

Fundraise
In May 2017 Velocys secured additional funding of over £10m (before expenses and subject to the passing of certain resolutions at a general meeting to be held shortly). This included convertible loan notes as well as a placing of new ordinary shares.

Proceeds from the fundraise will be used to fund working capital during the first phase of strategy implementation, particularly in the renewable fuels focus area, as well as the following activities to support the development of the integrated plant offer in that focus market:

- Initial engineering for US biomass-to-liquid (BTL) plants.
- Integrated technology demonstration for BTL.
- Project development activities (site selection, permitting).
- Consultants and financing (US sponsored programmes etc.).

The proceeds of the fundraise will also be used to maintain sufficient financial resources to support ENVIA's early operations over the coming few months.

Future funding
The financial statements have been prepared on the going concern basis, which assumes that the Company will have sufficient funds available to enable it to continue to trade for the foreseeable future. Management's financial forecasts of the Company's likely cash requirements include the following assumptions: (i) the Oklahoma City project reaching full operational capacity in 2017 (ii) the costs of ongoing development projects and the Company's ability to reduce certain overhead costs (iii) the Company raising additional funding during 2018. These assumptions are discussed further in note 2.

Susan Robertson
Chief Financial Officer
15 May 2017

Corporate social responsibility

Employees
Velocys is committed to being a good employer and endeavours to train staff well, to pay them fairly and to maintain a safe environment in which they can work. Velocys is committed to equal opportunity for all its employees. Of the 76 people working for Velocys at 31 December 2016, 33% were women (2015: 31%). The proportion has increased from a quarter to a third in the last two years. In 2016 two of the eight members of the Board were women (2015: two of nine members). The percentage of female employees broken down by areas of the business was as follows.

	2016	2015
Scientific & engineering	26%	25%
Sales, finance, HR & admin	56%	55%
Senior managers	29%	33%

Velocys keeps detailed environmental, health, and safety records and takes the safety and well-being of its employees very seriously. As an example, the Columbus, Ohio site successfully renewed its US Department of Labor Occupational Safety and Health Administration certification as meeting the requirements of its Consultation Safety and Health Recognition Program for an additional three years. This programme is a forward-looking, active-prevention safety programme requiring participation from highest management through all tiers of employees working at a site. During 2016 there were no Lost-Time Accidents (LTA) across the Company's sites, which took the total number of operating labour hours without such an accident to over 2.8m.

Environment
Velocys is careful to monitor the environmental impact of its operations. Air travel and buildings operation have been identified as two of the major factors in the Company's CO_2 emissions.

In 2016 air travel on the Company's behalf contributed 467t of CO_2 (2015: 497t). This equates to 5.2t per employee (2015: 4.6t). The proportion of air travel that was between the Company's offices in Oxfordshire, Ohio and Texas was 54% (2015: 51%); 8% of the emissions arose from travel to the site of ENVIA's plant in Oklahoma.

Emissions attributable to operation of its three sites included 769t from consumption of electricity (2015: 1,042t). The reduction was due to the Company signing up to plans from providers with an energy mix that favoured renewables and relied less on coal as a source of power. Emissions attributable to the consumption of gas were 436t (2015: 1,137t). This reduction was mainly due to having put the Velocys pilot plant into standby mode in Q2 of 2016.

Key performance indicators (KPIs)

Aside from the financial results outlined on pages 16-17 KPIs for the business are changing as a result of the strategy review. Most will be focused towards the delivery of the strategy although there will also be some underlying indicators such as technology robustness, supply chain and the Company's expertise and resources. The performance of the Company is expanded upon in the CEO's report on pages 12-13.

Risks and mitigation

The principal risks and uncertainties that are considered to have a potentially material impact on the Company's long-term performance and achievement of its strategy are set out in the following table.

Risk description and impact	Business influences	Risk management strategy
Operating risks		
Performance of Velocys' technology	1, 2	The Company rigorously tests its technology in the lab and pilot plant, modelling client-specific and upset conditions. A robust quality assurance programme is followed for the supply of commercial catalyst and reactors.
Velocys' core technology may not produce the quantity and/or quality of product expected.		The performance of the ENVIA plant observed to date indicates that the core technology is operating well and that it meets performance expectations according to models based on lab and pilot studies. Current activities at ENVIA involve debugging and debottlenecking, as is routine at this stage of start-up. Performance at ENVIA will be a good indicator of performance at other plants.
Supporting technologies at a gas-to-liquids (GTL) plant may not operate according to specification, preventing the Fischer-Tropsch (FT) section of a plant from functioning optimally.		Velocys works closely with plant operators on plant integration issues, including the protection of Velocys' FT technology from potential malfunctions in upstream units. ENVIA has operated the other sections of the plant in a mode that would have identified major problems with the supporting systems if they were present. No major problems were discovered. Risks remaining include, for example, vibration in pumps at high capacity, and insufficient heat within a specific vessel or pipe. Resolutions to these types of issues are straightforward (such as adding an auxiliary heater) and do not require modifications to the basic technology or discovery of new methodologies. A similar process is anticipated at other plants.
Inexpert operation of the plant may produce poorer than predicted performance.		The Velocys team, which has been pivotal in the commissioning and start-up of the ENVIA plant, includes employees that have been at all of Velocys' field trials, and personnel that participated in the commissioning and start-up of large scale GTL plants in South Africa, Qatar and Nigeria. This expertise has been transferred to the plant operators through Velocys' involvement in writing operating manuals and providing training. A small number of key Velocys personnel will remain seconded to ENVIA for much of 2017 and Velocys' personnel will be available to ENVIA for consultation over a longer time frame. A similar arrangement will be offered to operators of future plants.
Performance of integrated technology offer for biomass-to-liquids (BTL) plants Technology, such as syngas production or upgrading, supplied by other licensors, may not function as hoped.	1, 2	When selecting partners Velocys will continue to work with technology companies that have proven track records of commercial operation.
Incorrect operation of other licensors' technologies could cause the plant to fail, or to operate sub-optimally.		Velocys and its new partner TRI are collaborating on a joint technology demonstration to reduce the technology integration and plant financing risks associated with the development of a BTL plant.

Business influences

1. Technical expertise
2. Commercial growth
3. Development of an integrated offer
4. Focus markets

Risk description and impact	Business influences	Risk management strategy
Operating risks (continued)		
Health, safety and/or environment issues at a plant An accident or other incident might occur at a plant incorporating Velocys' technology, resulting in injury to personnel or their exposure to hazardous conditions.	2	The Company has an excellent in-house safety record. All employees are properly trained according to OSHA requirements for handling hazardous substances. Automatic trips and alarms are incorporated in plant designs to minimise the risk of such conditions arising. Having produced many of the training materials and operating manuals for the ENVIA plant, and gained operational experience on site, Velocys will aim to ensure that best operating practice is always adopted by plant owners. However, this is not within Velocys' control, and so Velocys' contracts state that it shall not be liable to licensees for environmental, toxic waste, hazardous waste or pollution liability.
An environmental incident might occur at a plant; emissions could exceed the permitted level.		The ENVIA plant has been designed to account for expected upset conditions and operate well within the emissions restrictions. Plant personnel are trained in proper operating procedures and to identify issues that could lead to an environmental situation developing and to act accordingly. This would be replicated at other plants. Other measures as above.
Loss of intellectual property (IP) protection Velocys' IP could be copied or infringed.	1, 2	Velocys actively manages its intellectual property, with several hundred patents currently held in around 30 countries. The Company has demonstrated its ability and ongoing determination to defend this portfolio through the courts, resulting in favourable settlements.
Velocys' IP could be threatened by an attack on its IT systems.		The Company has an email management system that stops malicious email from being delivered, and training programmes are in place to enable employees to identify threats from such emails. A security solution is in place to automatically detect and neutralise malware. To secure data at rest, Velocys uses encrypted drives in all mobile devices that leave its premises. The Company uses security appliances to protect the network from intrusion and hard security measures to prevent unauthorised physical access to servers.
Supply chain The supply chain may not be able to deliver reactors and catalyst on a timescale to meet customers' expectations.	2, 1	Velocys has longstanding relationships with its vendors for reactors, reactor components, and catalyst. The manufacturing methodologies are part of Velocys' IP. If one of the suppliers was unable to execute the process, or deliver certain orders in a timely way, supply could be transferred to another vendor.
Employee retention and recruitment	2, 3	Velocys provides competitive compensation to attract and retain staff.
Velocys may not be able to scale the organisation to deliver the integrated offer.		The Company chose to locate its engineering and commercial teams in Houston, and so is well placed to access a large pool of oil and gas industry expertise.
Velocys may lose key personnel that are needed to support, for example, the start-up of commercial plants or supply chain delivery.		Velocys does all it can to retain its talented staff in all aspects of FT and GTL technology and operations. Plant operating manuals and training documentation, plant design and reactor and catalyst builds are all well documented, which would allow knowledge retention should employees leave the Company. Any modifications to manufacturing protocols are added to the archive.

Risks and mitigation (continued)

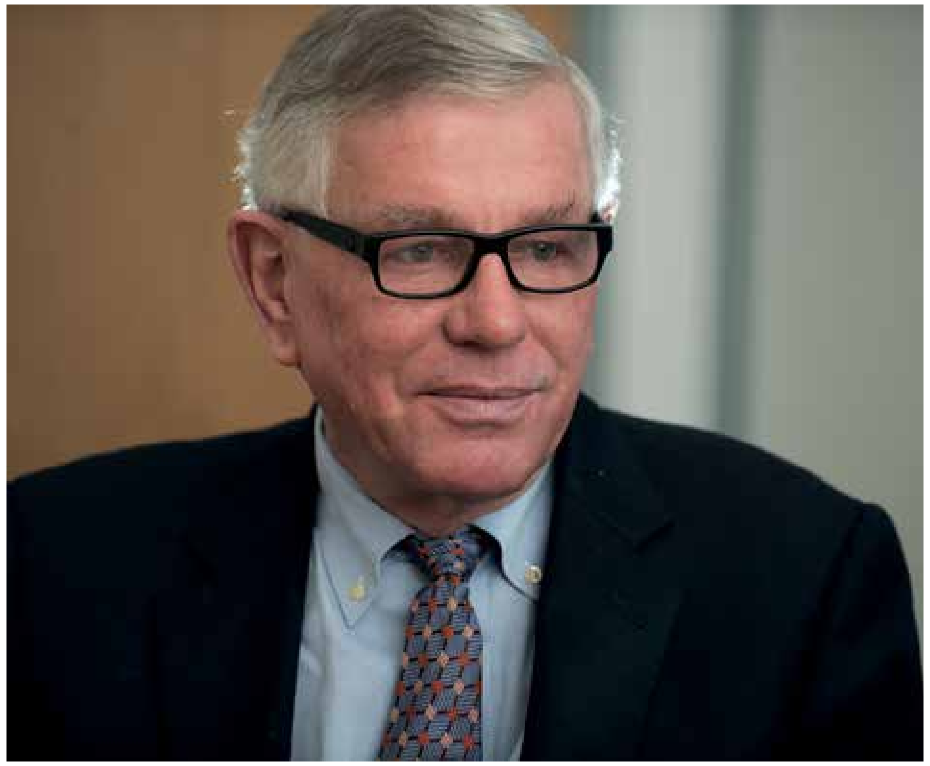
Risk description and impact	Business influences	Risk management strategy
Strategic risks		
Commercial offering Velocys may not be able to create or scale its integrated offer due, for example, to the inability to secure the key commercial partnerships or to successfully manage multiple partnerships in parallel.	2, 3	Velocys is actively investing to maintain its competitive advantage, and to be seen as the natural choice for companies seeking partners in its field. The Company is in discussion with a range of potential partners, each of whom appears to have a clear motivation for involvement in the integrated offer/market segment. Velocys is recruiting into its commercial team new members of staff with relevant skills and experience to enhance its ability to connect and negotiate with these partners at the highest level.
The reference plant does not continue to operate As Velocys is a minority partner in ENVIA the Company is reliant on the other partners and their continued involvement in the continued operation of the plant. If they should choose to discontinue the operation of the ENVIA plant this would limit the amount of operating data that is available to Velocys.	2, 3	The current economic projections show positive cash flow for the plant, justifying its continued operation. Velocys, as a shareholder and the provider of loan note funding, has the ability to influence such a decision. The on-site team has been building a comprehensive data set on operational performance from the start-up of each process unit, including the performance of the FT process.
Market risks		
Low oil prices Oil prices could track the US Energy Information Administration's (EIA's) reference case of an oil price (of West Texas Intermediate, WTI of $57 in 2018). Oil prices could track the EIA low oil price case (WTI $23 in 2018).	2, 4	Velocys' strategy review in 2016 identified high growth potential in target markets at current oil prices. These involve exploiting low cost feedstocks, producing premium products (including waxes, the price of which is decoupled from the oil price), and addressing local regulations, e.g., related to gas flaring. At oil prices in the US$20-30 range, the range of economic projects is smaller, but the same factors apply.
Future of renewable fuels credits Renewable fuels credits (the Renewable Fuel Standard, RFS) could be withdrawn at a federal level in the US. Renewable fuels credits could be withdrawn in California.	2, 3, 4	The RFS is important to many States with large agricultural economies, to energy security, and to jobs. Velocys engages actively with law makers in Washington and works with industry bodies to ensure its voice is heard. The other market on which Velocys is focussing in the near term, gas-to-wax plants in Canada, indicates attractive economics and is not reliant on renewable fuels credits. Withdrawal of the Low Carbon Fuel Standard (LCFS) is unlikely; California is proposing to expand this programme. Carbon pricing is stable in California and the State is considering extension of the mandate for carbon reductions. Velocys engages actively with California regulators, through industry groups, to ensure its voice is heard.

Business influences

1. Technical expertise
2. Commercial growth
3. Development of an integrated offer
4. Focus markets

Risk description and impact	Business influences	Risk management strategy
Market risks (continued)		
Competing technology Existing technologies that are economically-competitive with Velocys technology in specific niche applications could be fully commercialised. Competing technologies are indeed approaching commercialisation. However, the Company believes that the market is large enough so that there is room for multiple suppliers. New technologies could be developed that compete with Velocys' technology. The time required to take newly-developed technology at the lab scale and move it through pilot, demonstration scale, and then first commercial reference plant is generally in excess of 10 years.	1, 3	Velocys continues to invest in R&D, to improve catalyst productivity and the efficiency of the reactor system. In 2016 it invested over £10 million in its R&D programmes (including associated staff costs). Velocys continues to invest significant effort into comprehensive plant integration optimisation, with the aim of significant reductions in cost on a per barrel basis. Such advances take time to develop and provide Velocys with a significant competitive advantage beyond its core Fischer-Tropsch technology capability. Optimisation of the current generation of plant technology is being carried out by Velocys and the Company continues to invest in new technology and technology evaluation. For example, the Company is working with a technology licensor to jointly develop an integrated GTL solution suitable to reduce the flaring of associated gas offshore.
Brexit There is uncertainty around the impact of the UK leaving the European Union.	4	Velocys does not expect to have significant exposure to the European market in the short and medium terms. The main impact is likely to be felt through fluctuations in exchange rates.
Financial risks The potentially material financial risks associated with a multinational business, including foreign exchange are presented below. All other financial risks assessed by the Company are included in note 28.		
Financing The Company's cash usage is significant versus prospective future cashflows (particularly in the short term) and Velocys is reliant on the support of a small group of major shareholders. The timing of cashflows is difficult to predict given the Company's nascent strategy. Project finance may not be secured for plants using Velocys' technology.	2	The Board recognises that further funding will be needed. Note 2 discusses uncertainties surrounding the extent and composition of future funding. The Company believes that equity remains the preferred structure to support the business as a going concern in the near term, but will keep this under review. The recently announced fundraise included the issue of loan notes that are convertible into equity. As such, in management's view, they have the key characteristics of equity. Velocys continues to take measures to preserve cash in order to protect against unforeseen events. The Company is actively engaging with banks and financial advisers with high levels of expertise in project financing to support the financing plans for the types of projects it is developing.
Exchange rates As the Company operates in multiple currencies, it may be impacted by fluctuations in exchange rates.		Based on cashflow forecasts the required currency mix is identified and foreign exchange contracts taken out accordingly. A number of brokers are used to give a balanced market view. Financial risks are expanded upon in note 28.

Pierre Jungels, CBE
Chairman



"Velocys has the long-term ambition to grow significantly, and to develop into an established multinational business. We need to have the right governance and reward culture that supports and nurtures that development, and a capability that enables us to stay one step ahead of the growth curve."

Corporate governance report

Introduction
Companies whose securities are traded on the AIM market of The London Stock Exchange are not required to comply with the principles and provisions of the UK Corporate Governance Code 2016 ("Code"). However, the Board has determined that Velocys should maintain high standards of corporate governance and, whilst not complying fully with the Code including the full disclosure requirements, has taken steps to adopt the underlying principles of the Code in so far as the Board considers these to be appropriate given the size of the Company and the nature of its current operations. The information required under Disclosure Guidance and Transparency Rule 7.2.6 is included in this report.

Board of directors
Independence
Pierre Jungels has served more than three consecutive three year terms of office. However, the Board considers that he makes a significant contribution to the Company and that he has retained his independence of character and judgement notwithstanding his long-term relationship with the Company.

The Board regards each of the other Non-Executive Directors as being fully independent. In accordance with Code Provision B.7.1, resolutions will be proposed at the forthcoming Annual General Meeting for the re-appointment of all directors.

Avoidance of conflicts of interest
The Company has a procedure for the disclosure, review, authorisation and management of directors' conflicts of interest and potential conflicts of interest in accordance with the provisions of the Company's Act 2006. In deciding whether to authorise a conflict or potential conflict, the directors must have regard to their general duties under the Companies Act 2006. The authorisation of any conflict matter, and the terms of authorisation are subject to determination by the Board and regularly reviewed.

Velocys Board
Chairman: Pierre Jungels

Audit & Risk Committee
Chair: Mark Chatterji*
Under its revised terms of reference, the Audit & Risk Committee meets at least four times a year. Among its duties it reviews the Company's audit planning, risk management systems and processes and effectiveness of internal controls, accounting policies and financial reporting, provides a forum through which the external auditors report, and reviews and monitors their independence and the provision of additional services. At least once a year it meets with the external auditors without Executive Directors present.
Read more on risk management on page 27
*Resigned 25 April 2017.

Remuneration Committee
Chair: Sandy Shaw
This committee reviews, inter-alia, the performance of Executive Directors and sets the scale and structure of their remuneration and the basis of their service agreements, having due regard to the interests of shareholders. The committee also determines the allocation of share options to Executive Directors. No director has a service agreement exceeding one year. Under its terms of reference, no director is permitted to participate in decisions concerning his or her own remuneration.
Read the Directors' remuneration report on pages 30 33

Nominations Committee
Chair: Pierre Jungels
The committee meets at least twice a year, and among its duties it reviews the composition of the Board and its succession planning, the Board evaluation process and the findings from recent evaluations, director performance and recommendations for re-elections at the AGM, and considerations of director independence under the Code.

Division of responsibility
The roles of the Chairman and the Chief Executive are separated, with clear written guidance to support the division of responsibilities. The Chairman is principally responsible for leadership and effectiveness of the Board, setting the Board agenda, ensuring adequacy of information flow to the Board and adequacy of consideration of strategic issues, and promoting a culture of openness of debate at Board level and between directors and the senior management team. The Chief Executive is primarily responsible for the management of the business and implementation of the Company's strategy and policies; maintaining a close working relationship with the Chairman; and leading the senior management team.

Since January 2015, Julian West has acted as Senior Independent Director, providing a strong and skilled sounding board for the Chairman and serving as an intermediary for the other directors as necessary. In addition, he is available to shareholders to air concerns that have not been addressed through other formal channels.

The Board and its committees
The Board is responsible to shareholders for setting the Company's strategy and overseeing its execution, and for the overall management, control and performance of the Velocys business. It delegates certain responsibilities to designated committees, as set out above. The committees' terms of reference are reviewed annually against regulatory requirements and current best practice. Information on the work of the three Board committees is set out above.

The Corporate governance report continues on page 26

Our Board of directors

The Board includes individuals with a deep knowledge of oil and gas markets and industry contacts at the highest level.

Chairman & Executive Board

Name Dr Pierre Jungels, CBE
Role Chairman
Skills and experience
Pierre is an oil industry veteran, with over 30 years' experience – 12 of which were spent at main board level, including appointments as Chairman of Rockhopper Exploration plc, Chief Executive of Enterprise Oil plc, Executive Director of PetroFina, and Managing Director of British Gas. He also currently holds a non-executive directorship at Baker Hughes Inc. Pierre is a certified engineer and has a PhD in geophysics and hydraulics from the California Institute of Technology. He was twice President of the Institute of Petroleum.

Name David Pummell
Role Chief Executive Officer
Skills and experience
With over 30 years of energy and oil industry experience, David joined Velocys from ACAL Energy Ltd, a private equity backed fuel cell technology company, where he was CEO. Prior to this, David was CEO of MAPS Technology Ltd, where he successfully commercialised the technology leading to its subsequent acquisition by GE, before becoming CEO of Ceres Power Group plc, a developer of fuel cell micro combined heat and power (CHP) products. He began his career at BP as a chemical engineer before going on to hold a number of executive positions across the downstream business, including petrochemical manufacturing, supply chain, new business start-ups and a number of senior business and functional management roles during his 22-year tenure.

Name Susan Robertson
Role Chief Financial Officer
Skills and experience
Susan came to Velocys from the BOC Group where she had held various senior-level financial management and business development positions since 1990. Susan helped to set up and then, from 2003 to 2006, served as Vice President and CFO of Japan Air Gases (JAG), a joint venture between BOC Group and Air Liquide. Prior to taking up her position with JAG, she held finance positions with BOC in Japan, the UK and globally, as well as strategic and business development roles in the UK. Susan has an honours degree in economics from Cambridge University and is a chartered accountant (FCA) having originally trained with Arthur Andersen in London.

Name Dr Paul F. Schubert
Role Chief Operating Officer
Skills and experience
Paul has 35 years of experience in the petrochemical and natural gas industry. He has held various technical and general management roles with SGS Group, Syntroleum, Catalytica, Phillips Petroleum, and Engelhard. In these positions he was responsible for day-to-day operations, process development and commercialisation, plant design, and asset integrity management.

Paul is the inventor or co-inventor of 16 US patents and is the author of over 40 publications. He holds a PhD in Inorganic Chemistry from the University of Illinois, and a BS in Chemistry from the University of Arkansas.

Committee key

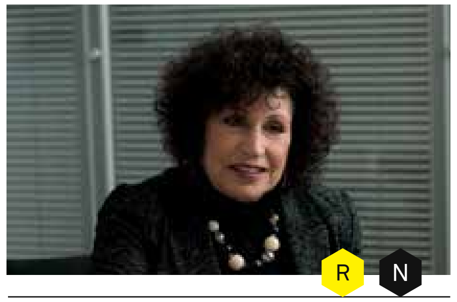
- A Audit and Risk Committee
- R Remuneration Committee
- N Nominations Committee
- Chairman of Committee

Sector experience

- Oil, gas and petrochemicals
- Banking and finance
- Energy
- Engineering
- Chemicals

Non-Executive Board

Name Julian West
Role Senior Independent Director
Skills and experience
Julian brings over forty years' experience of energy policy, in both the private and public sectors, and has broad expertise in international politics, privatisation, energy economics, and regulation of energy companies. Until 2008, he was a Senior Director at Cambridge Energy Research Associates (CERA), leading the firm's oil teams. Before joining CERA in 1996, Julian was an executive and main Board Director at Enterprise Oil plc, where he was responsible for the company's planning and business development. Previously, at the UK Department of Energy (1974-83), he focused on oil and energy policy and financial control and, under different administrations, served as Principal Private Secretary to a Minister of State and three Secretaries of State.



Name Sandy Shaw
Role Non-Executive Director
Skills and experience
Sandy has nearly 40 years of experience in the oil and gas industry. From 2008 until its take-over in 2013 Sandy was an Executive Director Corporate & Commercial, and Company Secretary of Valiant Petroleum PLC, a company of which she was a founder and initially a Non-Executive Director. She has held senior executive positions as group legal counsel and/or commercial director for numerous companies including Consort Resources, LASMO PLC (where she was also inter alia President of LASMO USA), Esso Petroleum, Marathon Oil and Mobil. Sandy has extensive oil and gas M&A experience, has overseen numerous material private equity subscriptions and led a £200m trade sale through to final negotiations. She has worked as a consultant to several oil and gas companies, as well as two UK law firms.

Name Ross Allonby
Role Non-Executive Director
Skills and experience
Ross brings considerable experience in the banking and finance sector to Velocys. He is a Founder, Managing Partner and CEO/CIO of First River Capital Partners LLP, an integrated advisory, origination, structuring and investment management business providing companies in emerging markets with debt financing solutions.

He was formerly Head of Emerging Markets (EM) Credit Trading at Bank of America Merrill Lynch, responsible for EM direct lending, loans, structured credit trading, EM special situations, EM distressed/high yield and EM flow trading. Prior to joining Merrill Lynch, he was a Director in the Capital Markets Group of Standard Bank, London, and had previously been a VP at Goldman Sachs.

Corporate governance (continued)

The Corporate governance report continues from page 23

The Board and its committees (continued)

Meetings

The Board meets formally at least six times a year to set the overall direction and strategy of the Company, to review operating and financial performance and to consider and advise on senior management appointments. The Board also monitors and approves financial policy and budgets, including capital expenditure.

Directors receive briefing papers in advance of meetings – a consolidated CEO's report encompassing all areas of the business, including health and safety information, status updates on project development and special projects, competitor activity and key issues facing the Company; and a CFO's report, which sets out performance against budget during the period since the previous meeting. Open dialogue is encouraged and all directors have the opportunity to challenge and seek further information or clarification as appropriate. All key operational decisions are subject to Board approval.

In addition to the scheduled Board meetings detailed above, a further three meetings in 2016, which were held at short notice to consider specific matters, were attended by all directors, apart from Ross Allonby who was unable to attend one meeting.

Reports by committee

The minutes of the Audit & Risk, Remuneration and Nomination Committees are circulated to the Board. The committee chairs also report to the Board on the outcome of committee meetings at the subsequent Board meeting.

Performance evaluation

This year's evaluation of the Board, its committees and individual directors has been carried out by the Company Secretary, taking the form of individual interviews with each director, and comprehensive questionnaires, which provided all directors with an opportunity to comment on Board and committee procedures. A performance evaluation of the Chairman has been carried out, led by the Senior Independent Director, and taking into account the views of all directors. As in the previous year, the results of the evaluation are being considered by the Board and each committee in open session and, where appropriate, actions arising from such reviews will be implemented and monitored.

Attendance at scheduled Board and committee meetings

	Board	Audit & Risk Committee	Remuneration Committee	Nominations Committee
Number of meetings held in 2016	7	5	4	4
Attendance* by:				
Pierre Jungels	100%	–	–	100%
Ross Allonby	86%	100%	75%	75%
Mark Chatterji	100%	100%	–	100%
David Pummell	100%	–	–	–
Susan Robertson	100%	–	–	–
Paul Schubert	100%	–	–	–
Sandy Shaw	100%	–	100%	100%
Julian West	100%	100%	100%	100%
Jan Verloop	100%	–	–	100%

* The attendance percentage relates only to applicable meetings. Jan Verloop resigned from the Board in September 2016.

Re-election

The Company's Articles of Association provide that directors are subject to election by shareholders at the first opportunity after their appointment, and that one third of directors are subject to retirement by rotation at each Annual General Meeting. At the 2017 meeting, all directors will once again stand for re-election, continuing the practice introduced in 2016.

Company Secretary

The Company Secretary, through the Chairman, is responsible for advising the Board on governance matters, and for ensuring that Board procedures are followed and that applicable rules and regulations are complied with. All directors have access to the advice and services of the Company Secretary. An agreed procedure exists for directors in the furtherance of their duties to take independent professional advice. During 2016, no director sought independent legal advice pursuant to the policy.

Relations with shareholders

The Board considers effective communication with shareholders to be very important, and encourages regular dialogue with investors. Directors regularly attend meetings with shareholders and analysts throughout the year, and the Board responds promptly to questions received. Shareholders will be given at least 21 days' notice of the Annual General Meeting, at which they will have the opportunity to discuss the Company's developments and performance.

The Company's website www.velocys.com contains full details of the Company's business activities, as well as press releases and other details. It links to the London Stock Exchange website for share price details, share trading activities and graphs, as well as Regulatory News Service (RNS) announcements.

Maintenance of a system of internal controls

The directors have overall responsibility for ensuring that the Company maintains a system of internal control to provide them with reasonable assurance that the assets of the Company are safeguarded and that shareholders' investments are protected. The system includes internal controls appropriate for a Company of the size of Velocys, and covers financial, operational, compliance (including health and safety) and risk management. Such systems are designed to manage, rather than eliminate, the risk of failure to achieve business objectives; any system can provide only reasonable, and not absolute, assurance against material misstatement or loss. The process in place for reviewing Velocys' systems of internal control includes procedures designed to identify and evaluate failings and weaknesses, and, in the case of any categorised as significant, procedures exist to ensure that necessary action is taken to remedy the failings.

The Board has considered its policies with regard to internal controls as set out in the Code and undertakes assessments of the major areas of the business and methods used to monitor and control them.

In addition to financial risk, the review covers operational, commercial, regulatory and health and safety risks. The risk review is an ongoing process with reviews being undertaken on a regular basis.

The key procedures designed to provide an effective system of internal controls that are operating up to the date of sign-off of this report are set out below.

Control environment

There is an organisational structure with clearly defined lines of responsibility and delegation of accountability and authority.

Risk management

The Company employs directors and senior personnel with the appropriate knowledge and experience for a business engaged in activities in its field of operations, and undertakes regular risk assessments and reviews of its activities. During 2016 the committee had two members, Mark Chatterji and Ross Allonby, who have recent and relevant financial experience. The committee keeps under annual review whether an internal audit function should be established. Although this is not considered necessary at the present time given the size of the Company, this decision will be reviewed as the operations of the Company develop.

In its approach to risk management the committee considers the complexity of the transaction of building GTL plants, which involves a large number of possible stakeholders – asset holder, project developer, EPC, financing party(ies), technology licensors and offtake partners. The risks associated with each of these parties, and the relationship that Velocys has with each one, are analysed to identify areas of potential risk. Additionally the committee considers risks that are beyond the Company's control, but against which it can take mitigating action. These include market risk and risk from competitors.

The Audit & Risk Committee reviews all of the Company's principal risk management policies and the ongoing development of a Company risk register.

Details of risks to the business that the Board considers to be potentially material are set out in the Strategic report on pages 18 to 21 and note 28. The risks posed by the UK Brexit vote and the US presidential election have been considered in the risk assessment process and, where appropriate, their impacts reflected in other relevant risks, rather than being presented as a standalone risk.

The risks presented are the principal risks that the Company believes it currently faces. However, additional risks, of which the Company is aware, or risks the Company currently considers to be less significant, could have a material adverse impact. The risks included are not presented in order of priority.

Financial information

The Company prepares detailed budget and working capital projections, which are approved annually by the Board and are maintained and updated regularly throughout the year. Detailed management accounts and working capital cash flows are prepared on a monthly basis and compared to budgets and projections to identify any significant variances.

The Audit & Risk Committee has considered the integrity of the Company's 2016 financial statements and reviewed the appropriateness of its critical accounting policies and the judgements made in applying them. The year-end financial statements were reviewed and discussed with PwC. In addition, the interim financial statements were reviewed by the committee. The committee considered, among others, the following specific matters:

- Carrying value of Goodwill and other Intangible assets; and investment in subsidiaries.
- Going concern.
- Accounting for ENVIA as an associate.

Audit review

The Audit & Risk Committee has discussed PwC's audit process, and the findings from the audit of the 2015 financial year were reviewed, along with feedback from the CFO on the effectiveness of the external audit process. The committee reviewed the quality and cost effectiveness of the external audit, and the independence and objectivity of the auditors. It obtained confirmation from PwC that their independence and ethics policies complied with FRC requirements, and that they remain independent and maintain internal safeguards to ensure their objectivity. No contractual obligations exist that restrict the Company's choice of external auditor and the committee is satisfied that the external auditor remains independent.

The committee has established policies determining the non-audit services that the external auditors can provide and the procedures required for approval of any such engagement. Further details of fees paid to PwC for both audit and non-audit work can be found in note 11 to the financial statements.

Management of liquid resources

The Board is risk averse when investing the Company's surplus cash. The Company's treasury management policy is reviewed periodically, and sets out strict procedures and limits on how surplus funds are invested.

Review of corporate governance disclosures

The Board has voluntarily complied with those key principles of the Code in so far as they are considered appropriate given the size of the Company and the nature of its operations. These have not been formally reviewed by the Company's auditors. The auditors' responsibility extends only to reading this report as a part of the Annual report and accounts and considering whether it is materially consistent with the audited financial statements.

Directors' report

The directors present their report and the audited consolidated financial statements for the year ended 31 December 2016

Company
Velocys plc is the parent of the Company. It is a public limited company incorporated and registered in England and Wales. The registered office address is given on the information page inside the back cover of this document.

Future developments
The Board aims to pursue its corporate strategies as detailed in the Strategic report on pages 1 to 21.

Dividends
The Directors do not recommend any dividend for the year ended 31 December 2016 (2015: nil).

Research and development
The Company's R&D activity will extend to joint development programmes with technology partners (such as TRI). Details of R&D expense and capitalised R&D are in notes 10 and 17.

Donations
The Company made no political donations during 2016.

Post-balance sheet events
Additional funding by the Company to ENVIA Energy, which was announced in February 2016, is described in the Strategic report on page 17, and in note 20 along with other post-balance sheet events.

Directors
The directors of Velocys plc as at 31 December 2016, who served throughout the year and up to the date of approval of the financial statements, unless otherwise stated, were as follows.

- Pierre Jungels (Non-Executive Chairman)
- David Pummell (Chief Executive Officer) – appointed 6 January 2017
- Susan Robertson (Chief Financial Officer)
- Paul Schubert (Chief Operating Officer)
- Julian West (Senior Independent Director)
- Jan Verloop (Non-Executive Director) – resigned 21 September 2016
- Sandy Shaw (Non-Executive Director)
- Mark Chatterji (Non-Executive Director) – resigned 25 April 2017
- Ross Allonby (Non-Executive Director)

Whilst the Company's Articles of Association require that all directors are subject to election by shareholders at the first opportunity after their appointment, and to re-election thereafter at intervals of not more than three years, the directors have decided that, in line with best corporate governance practice, at the 2017 Annual General Meeting all of the directors will again retire and offer themselves for re-election, as they did in 2016.

Directors' interests
The directors who held office at 31 December 2016 had the following interests in the shares of parent company undertakings (as recorded in the Register of Directors' Interests and including those of the spouse or civil partner and children under 18).

	Velocys plc Ordinary shares	
	31 December 2016	31 December 2015
Susan Robertson	304,874	304,874
Pierre Jungels	223,031	223,031
Julian West	75,000	75,000
Sandy Shaw	17,758	17,758
David Pummell	–	–
Paul Schubert	–	–
Mark Chatterji	–	–
Ross Allonby	–	–

Directors' share options and service contracts are detailed in the Directors' remuneration report.

Directors' qualifying third-party indemnity provision
The Company maintains directors' qualifying third-party indemnity insurance to provide cover for legal action against its directors. This has been in place throughout the year and remains in place at the date of this report.

Financial instruments
The Company's financial instruments are detailed in note 28. Financial risks, and exposure and risk management policies and objectives are detailed in the Strategic report on page 21, and in note 28.

Substantial shareholdings
The Company was notified of the following holdings of 3% or more of the issued share capital of Velocys plc as at 1 May 2017.

	Number of shares held	Percentage of issued share capital
Ervington Investments Limited	42,442,443	29.48%
Lansdowne Partners	26,631,808	18.50%
Invesco Asset Management	23,600,000	16.39%
Henderson Global Investors	17,593,137	12.22%
Hargreaves Lansdown Asset Management	5,472,676	3.80%

Greenhouse gas emissions
Details of the Company's greenhouse gas emissions are included in the Strategic report on page 17.

Annual General Meeting
The Annual General Meeting of the Company will be held at Milton Park Innovation Centre, 99 Park Drive, Milton Park, Oxfordshire OX14 4RY on Thursday 22 June 2017.

Auditors and disclosure of information to auditors
Each of the persons who is a director at the date of approval of this report confirms that:

- So far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware.
- The Director has taken all the steps that he / she ought to have taken as a director in order to make himself / herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of s418 of the Companies Act 2006.

Corporate governance
The Company's statement on corporate governance is available on pages 22 to 27.

Approved by the Board and signed on its behalf by:

David Pummell
Chief Executive Officer
15 May 2017

Directors' remuneration report

Introduction
The Remuneration Committee is resolute in maintaining high standards of corporate governance and has taken steps to comply with the principles of best practice in so far as it can be applied practically given the size of the Company. The Company is listed on AIM and is therefore not required to comply with the following regulations: disclosure requirements of the Directors' Remuneration Report Regulations 2013; the UKLA Listing Rules; the disclosure provisions under schedule 8 to SI 2008/410 of the large and medium-sized companies and groups (accounts and reports) regulations 2008. Consequently, certain disclosures contained in these regulations are not included below.

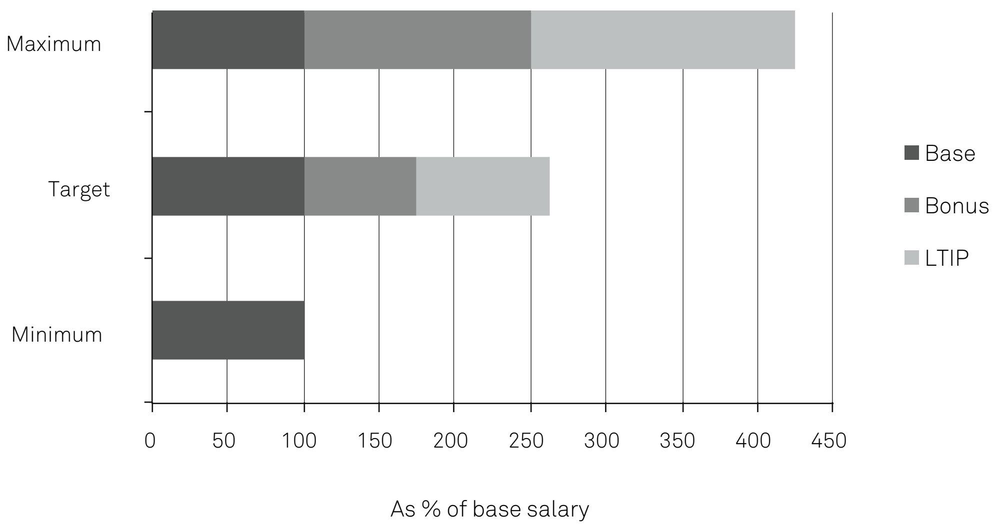
Unaudited information
Remuneration Committee
The following served as members of the Committee throughout the year ended 31 December 2016.
- Sandy Shaw (Chair)
- Julian West
- Ross Allonby

The Committee's constitution and operation is compliant with the provisions of the Code on Corporate Governance. In determining remuneration policy for Executive Directors, the Committee takes into consideration both the Code and the guidelines published by The Investment Association (formerly the Association of British Insurers).

Remuneration policy for Executive Directors
The remuneration policy has been designed to ensure that Executive Directors receive incentives and rewards appropriate to their performance, responsibility and experience. In making its assessment, the Remuneration Committee seeks to align the policy with the interests of the shareholders.

Key features of the policy are:
- Setting salaries to be competitive relative to the experience of the individual and the nature, complexity and responsibilities of their work in order to attract and retain management of the required quality.
- Linking individual remuneration packages to the Company's performance through bonus schemes and long-term share-based plans.
- Providing employment and post-retirement benefits in accordance with standard policies of the Company.

The following chart illustrates the proportion of fixed and variable elements in the remuneration package, assuming target and stretch performance is achieved.



Remuneration of Executive Directors
Executive Directors' remuneration is considered annually. In addition, the Remuneration Committee undertakes periodically a comprehensive review using external advisors. At the start of 2016, the arrival of the new CEO necessitated a review of the overall remuneration package for the Executive Directors. Current remuneration is based on the following principles.

Base salary
The base salary is reviewed annually at the beginning of each year. The review process undertaken by the Remuneration Committee considers the ongoing development of the Company, the contribution of the individual, the need to retain and motivate employees, and benchmark remuneration information from comparable organisations.

Annual performance incentive
All Executive Directors are eligible, at the discretion of the Remuneration Committee, for an annual bonus. The target bonus award for each individual is based on a percentage of base salary, which, for the year commencing 1 January 2016, was 75%. The maximum award for stretch target performance is twice the target amount. The Remuneration Committee sets performance targets for bonus awards at the beginning of each year. Awards are determined by both the performance of the individual and the Company as a whole at the end of each year. The performance targets for the Company comprise measures of financial, technical and business development goals. For 2016, the Remuneration Committee decided that no bonus would be awarded.

Long-term Incentive Plan (LTIP)
The committee believes that the LTIP scheme should provide to Executive Directors appropriate incentivisation, focus and reward for achievement, that is aligned with shareholder interests, and that includes relevant, demanding performance targets. The last LTIP scheme that the Company put in place was in 2014 and, due to the change in CEO and the intention to review the Company strategy, the committee decided not to make an award under this scheme during 2016. Instead, the committee intends to introduce a new equity-based incentive scheme in 2017. It may, in the allocation of such awards, take into consideration the fact that no 2016 awards were made.

Pensions and other benefits
The Company contributes to individuals' defined contribution pension plans in line with the Company-wide schemes in place. For UK-based employees, the Company contributions are 7% of base salary. For US-based employees, the contributions are 3% of pensionable pay (which includes bonus) up to the maximum allowable under US pensions law.

Other benefits provided are life insurance, private medical insurance and relocation allowances where applicable, in line with the Company's standard policies.

Directors' service contracts
Each of the Executive Directors has a service contract with a notice period of six months.

Remuneration policy for Non-Executive Directors
The remuneration of Non-Executive Directors is determined by the executive members of the Board in consultation with the Chairman, based on a benchmark review of current practices in similar companies. The Non-Executive Directors are paid a fixed fee and do not receive any pension payments, bonus or other benefits.

Non-Executive Directors are appointed for an initial three-year term and are typically expected to serve for two three-year terms. Either the Non-Executive Director or the Company can terminate the contract with three months' written notice; the Chairman's notice period is also three months. The Company may invite a Non-Executive Director to serve for further periods after the expiry of two three-year terms subject to a particularly rigorous review of performance, and taking into account the need for progressive refreshing of the Board. Under the Company's Articles of Association, all directors are required to stand for re-election by shareholders on appointment and thereafter at least once every three years. However, in line with best practice, the Company decided in 2016 to put all Non-Executive Directors up for re-election at its Annual General Meeting (AGM) and intends to do the same at the 2017 AGM.

Proposed ratification of breach of Article 92
During the three financial years ended 31 December 2016, fees were paid to the Chairman and other Non-Executive Directors in excess of the aggregate limit of £250,000 specified in Article 92 of the Articles adopted on 22 June 2011. This amount was set at the formation of the Company in 2006 and although the Articles allow this amount to be amended by ordinary resolution, and despite the growth of the Company since this point, no subsequent amendment has been made. The aggregate amount of these fees, as set out in the Company's Annual report and accounts for the years ended 31 December 2016 and 2015 is as follows.

	2016 £	2015 £
Aggregate fees paid to Chairman and Non-Executive Directors	268,500	271,853

At the Board meeting in September 2016, in light of the breach of Article 92, the Non-Executive Directors voluntarily agreed that they would each accept a cut in fees to reduce the annual cost of fees to within the limit of £250,000. In addition, a resolution will be proposed at the 2017 AGM to approve and ratify any payments to the Chairman and other Non-Executive Directors out of the funds of the Company by way of fees for their services in excess of the amount specified in Article 92 of the Articles as though the directors had been authorised pursuant to Article 92 of the Articles to make payments of such amounts.

Further information is set out in the Notice of Annual General Meeting, which is being published together with this Annual report and accounts.

Directors' remuneration report (continued)

Audited information

Directors' remuneration

Aggregate emoluments for current and former directors in 2016 totalled £1,085,137 (2015: £1,645,154), and Company pension contributions were £41,760 (2015: £31,734).

The directors who held office at 31 December 2016 received the following remuneration in relation to the year ended 31 December 2016.

Name of director	Salary and fees[1] £	Other benefits[2] £	**2016 Total** £	**2016 Pension** £	2015 Total £	2015 Pension £
Executive						
David Pummell	261,263	27,332	288,595	18,550	–	–
Susan Robertson	218,000	770	218,770	15,260	377,878	15,071
Paul Schubert	238,778	28,237	267,015	7,950	330,757	5,201
Non-Executive						
Pierre Jungels	78,000	–	78,000	–	80,000	–
Julian West	43,875	–	43,875	–	45,000	–
Mark Chatterji	43,875	23,076	66,951	–	12,188	–
Ross Allonby	43,875	–	43,875	–	3,750	–
Sandy Shaw	43,875	–	43,875	–	45,000	–
Aggregate emoluments and pension contributions	971,541	79,415	1,050,956	41,760	894,573	20,272

1 All salaries and fees are denominated in pounds sterling except for that of Paul Schubert, who is based in the US and paid in dollars. His remuneration has been converted from dollars to pounds at the exchange rate on the date of recognition of the cost. The average rate used for translation of his 2016 salary was £1= $1.36 compared to £1= $1.53 in 2015.

2 Other benefits include medical cover for Executive Directors and, in the case David Pummell, a joining allowance in lieu of car allowance. In the case of Paul Schubert, benefits include costs related to his relocation to Houston. In the case of Mark Chatterji, who is located in the US, other benefits include the cost of his travel from the US to the UK for Board meetings along with associated expenses that are paid by the Company.

Directors' share options

Aggregate emoluments disclosed above include amounts paid through the employee benefit trust (EBT) in relation to share options exercised. In 2016 no payments were made to serving directors (2015: none) and a payment of £13,300 was made in respect of an exercise by the former CEO under his 2015 settlement agreement.

Details of all directors' shareholdings are disclosed on page 28 in the Directors' report.

Details of options held by the directors at 31 December 2016 are as follows.

Name of director	At 31 December 2015	Granted	Exercised	Lapsed	At 31 December 2016	Exercise price (£)	Earliest date of exercise	Date of expiry	Exercisable at 31 December 2016
Susan Robertson									
EMI	62,893	–	–	–	62,893	1.59	29/10/10	01/04/18	62,893
Bonus 2008	42,105	–	–	–	42,105	0.01	31/03/09	31/03/19	42,105
Bonus 2010	37,655	–	–	–	37,655	0.01	20/03/11	20/03/21	37,655
ELTIP 2009	105,000	–	–	–	105,000	0.01	31/01/12	21/11/19	105,000
ELTIP 2011	390,625	–	–	–	390,625	0.01	20/09/11	20/09/21	390,625
ELTIP 2012	365,000	–	–	–	365,000	0.49	01/01/15	01/02/22	365,000
ELTIP 2012	273,803	–	–	–	273,803	0.49	01/01/12	01/02/22	273,803
ELTIP 2013	502,930	–	–	–	502,930	1.59	01/01/16	12/04/23	502,930
ELTIP 2013	125,732	–	–	–	125,732	1.59	12/04/13	12/04/23	125,732
ELTIP 2014	440,316	–	–	–	440,316	1.64	01/01/17	01/04/24	–
ELTIP 2014	110,079	–	–	–	110,079	1.64	01/04/14	01/04/24	110,079
ELTIP 2015	56,742	–	–	–	56,742	Nil	01/01/17	26/02/25	–
ELTIP 2015	189,139	–	–	–	189,139	Nil	01/01/17	26/02/25	–
ELTIP 2015	47,425	–	–	–	47,425	Nil	01/01/18	26/02/25	–
ELTIP 2015	158,083	–	–	–	158,083	Nil	01/01/18	26/02/25	–
Total	2,907,527	–	–	–	2,907,527				2,015,822

Name of director	At 31 December 2015	Granted	Exercised	Lapsed	At 31 December 2016	Exercise price (£)	Earliest date of exercise	Date of expiry	Exercisable at 31 December 2016
Paul Schubert									
EMI	207,894	–	–	–	207,894	0.92	04/10/14	04/10/21	207,894
ELTIP 2012	119,000	–	–	–	119,000	0.49	01/01/15	01/02/22	119,000
ELTIP 2013	502,930	–	–	–	502,930	1.59	01/01/16	12/04/23	502,930
ELTIP 2013	41,911	–	–	–	41,911	1.59	01/01/15	12/04/23	41,911
ELTIP 2014	336,711	–	–	–	336,711	1.64	01/01/17	01/04/24	–
ELTIP 2014	56,119	–	–	–	56,119	1.64	01/01/15	01/04/24	56,119
ELTIP 2015	43,344	–	–	–	43,344	Nil	01/01/17	26/02/25	–
ELTIP 2015	144,482	–	–	–	144,482	Nil	01/01/17	26/02/25	–
ELTIP 2015	36,227	–	–	–	36,227	Nil	01/01/18	26/02/25	–
ELTIP 2015	120,758	–	–	–	120,758	Nil	01/01/18	26/02/25	–
Total	1,609,376	–	–	–	1,609,376				927,854

No options were exercised by acting directors during 2016. The total charge for share-based payments during the year in respect of directors was £357,000.

Shareholding requirements

The Company has not previously had in place guidelines covering shareholdings of Executive Directors. It is intended that the new equity-based incentive scheme, to be introduced in 2017, will include such guidelines designed to ensure that Executive Directors retain an interest in the Company.

Former directors

Jan Verloop, who was a member of the Board at 1 January 2016 and resigned during the year, received the following remuneration.

Name of director	Salary and fees £	Other benefits £	**2016 Total** £	**2016 pension** £	2015 Total £	2015 pension £
Jan Verloop	34,181	–	34,181	–	44,666	–

Share price

The market price of the parent company's shares as at 31 December 2016 was 37p (2015: 42p) and the range during the year was 25p to 44p (2015: 34p to 169p). Details of options and the cost of share-based payments are given in note 15.

Statement of directors' responsibilities
in respect of the financial statements

The directors are responsible for preparing the Annual report and the financial statements in accordance with applicable law and regulation.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements for the parent company (Velocys plc) and the Company (Velocys plc and its subsidiaries) in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the parent company, and of the profit or loss of the Company for that period. In preparing the financial statements, the directors are required to:

- Select suitable accounting policies and then apply them consistently.
- State whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements.
- Make judgements and accounting estimates that are reasonable and prudent.
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and of Velocys plc and enable them to ensure that the financial statements and the Directors' remuneration report comply with the Companies Act 2006 and, as regards the Company financial statements, Article 4 of the IAS Regulation.

The directors are also responsible for safeguarding the assets of the Company and of Velocys plc and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

The directors consider that the Annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy.

Each of the directors, whose names and functions are listed in the Directors' report confirm that, to the best of their knowledge:

- The financial statements of the Company and of Velocys plc, which have been prepared in accordance with IFRSs as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit of the Company.
- The Strategic report includes a fair review of the development and performance of the business and the position of the Company and parent company, together with a description of the principal risks and uncertainties that it faces.

On behalf of the Board

David Pummell
Chief Executive Officer
15 May 2017

Independent auditors' report
to the members of Velocys plc

Report on the financial statements

Our opinion

In our opinion:

- Velocys plc's consolidated financial statements ("Velocys") and parent company financial statements (the "financial statements") give a true and fair view of the state of Velocys' and of the parent company's affairs as at 31 December 2016 and of Velocys' loss and Velocys' and the parent company's cash flows for the year then ended;
- Velocys' financial statements have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Emphasis of matter – Velocys and parent company - going concern

In forming our opinion on Velocys' financial statements and the parent company financial statements, which is not modified, we have considered the adequacy of the disclosure made in note 2 to the financial statements concerning Velocys' and the parent company's ability to continue as a going concern. As outlined in note 2 to the financial statements, the directors' forecasts are dependent on key assumptions in relation to the ENVIA Oklahoma project startup reaching full operational capacity within 2017, the costs of ongoing development projects, coupled with Velocys reducing certain existing overhead costs, and Velocys raising additional funding by the second quarter of 2018. These conditions, along with the other matters explained in note 2 to the financial statements, indicate the existence of a material uncertainty which may cast significant doubt about Velocys' and the parent company's ability to continue as a going concern. Velocys' financial statements and the parent company financial statements do not include the adjustments that would result if Velocys and parent company were unable to continue as a going concern.

What we have audited

The financial statements, included within the Annual report and accounts (the "Annual Report"), comprise:

- the Consolidated statement of financial position and Velocys plc statement of financial position as at 31 December 2016;
- the Consolidated income statement and Consolidated statement of comprehensive income for the year then ended;
- the Consolidated statement of cash flows and Velocys plc statement of cash flows for the year then ended;
- the Consolidated statement of changes in equity and Velocys plc statement of changes in equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

Certain required disclosures have been presented elsewhere in the Annual Report, rather than in the notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited.

The financial reporting framework that has been applied in the preparation of the financial statements is IFRSs as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006, and applicable law.

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic report and the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic report and the Directors' report have been prepared in accordance with applicable legal requirements.

In addition, in light of the knowledge and understanding of Velocys, the parent company and their environment obtained in the course of the audit, we are required to report if we have identified any material misstatements in the Strategic report and the Directors' report. We have nothing to report in this respect.

Opinion on additional disclosures

Directors' remuneration report

The parent company voluntarily prepares a Directors' remuneration report in accordance with the provisions of the Companies Act 2006. The directors have requested that we audit the part of the Directors' remuneration report specified by the Companies Act 2006 to be audited as if the parent company were a quoted company.

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

Other matters on which we are required to report by exception

Adequacy of accounting records and information and explanations received

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

- we have not received all the information and explanations we require for our audit; or
- 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 are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Independent auditors' report (continued)
to the members of Velocys plc

Directors' remuneration
Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

Responsibilities for the financial statements and the audit
Our responsibilities and those of the directors
As explained more fully in the Statement of directors' responsibilities set out on page 34, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the parent company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

What an audit of financial statements involves
We conducted our audit in accordance with ISAs (UK & Ireland). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:
- whether the accounting policies are appropriate to Velocys' and the parent company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report. With respect to the Strategic report and Directors' report, we consider whether those reports include the disclosures required by applicable legal requirements.

Sam Taylor (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Reading
15 May 2017

Consolidated income statement
for the year ended 31 December 2016

	Note	**2016** £'000 Before exceptional items	**2016** £'000 Exceptional items (note 4)	**2016** £'000 Total	2015 £'000 Before exceptional items	2015 £'000 Exceptional items (note 4)	2015 £'000 Total
Revenue	6	1,445	–	1,445	2,002	–	2,002
Cost of sales		(1,060)	–	(1,060)	(1,275)	–	(1,275)
Gross profit		385	–	385	727	–	727
Administrative expenses		(17,429)	(2,809)	(20,238)	(25,483)	(1,204)	(26,687)
Other income	9	272	2,496	2,768	2,009	1,763	3,772
Operating (loss) income	10	(16,722)	(313)	(17,085)	(22,747)	559	(22,188)
Share of loss of investments accounted for using the equity method	20	(306)	–	(306)	–	–	–
(Loss) income before finance income		(17,078)	(313)	(17,391)	(22,747)	559	(22,188)
Finance income	7	3,344	–	3,344	1,155	–	1,155
Finance costs	8	(26)	–	(26)	(53)	–	(53)
Finance income, net		3,318	–	3,318	1,102	–	1,102
(Loss) income before income tax		(13,760)	(313)	(14,073)	(21,645)	559	(21,086)
Income tax credit	13	1,404	–	1,404	1,035	–	1,035
(Loss) income for the financial year attributable to the owners of Velocys plc		(12,356)	(313)	(12,669)	(20,610)	559	(20,051)
Loss per share attributable to the owners of Velocys plc							
Basic and diluted loss per share (pence)	16	(8.62)		(8.84)	(14.52)		(14.13)

The notes on pages 45 to 74 are part of these consolidated financial statements.

Consolidated statement of comprehensive income
for the year ended 31 December 2016

	2016 £'000 Before exceptional items	2016 £'000 Exceptional items (note 4)	2016 £'000 Total	2015 £'000 Before exceptional items	2015 £'000 Exceptional items (note 4)	2015 £'000 Total
(Loss) income for the year	(12,356)	(313)	(12,669)	(20,610)	559	(20,051)
Other comprehensive income						
Items that may be reclassified subsequently to profit or loss if certain conditions are met						
Foreign currency translation differences	7,347	–	7,347	1,869	–	1,869
Total comprehensive (expense) income for the year	(5,009)	(313)	(5,322)	(18,741)	559	(18,182)

The notes on pages 45 to 74 are part of these consolidated financial statements.

Consolidated statement of financial position
as at 31 December 2016

	Note	2016 £'000	2015 £'000
Assets			
Non-current assets			
Intangible assets	17	34,035	28,378
Property, plant and equipment	18	5,637	5,507
Trade and other receivables	21	325	–
Available-for-sale investment	20	–	3,375
Investment in associate	20	5,865	–
		45,862	37,260
Current assets			
Inventories	22	1,461	1,393
Trade and other receivables	21	811	911
Current income tax asset		854	780
Derivative financial instruments	27	537	156
Short term investments – funds held on deposit	23	–	3,000
Cash and cash equivalents	23	18,744	34,736
		22,407	40,976
Total assets		68,269	78,236
Liabilities			
Current liabilities			
Trade and other payables	24	(2,272)	(7,380)
Borrowings	26	(323)	(288)
		(2,595)	(7,668)
Non-current liabilities			
Trade and other payables	25	(1,343)	(1,327)
Borrowings	26	(593)	(759)
		(1,936)	(2,086)
Total liabilities		(4,531)	(9,754)
Net assets		63,738	68,482
Capital and reserves attributable to owners of Velocys plc			
Called up share capital	29	1,438	1,419
Share premium account	29	149,275	149,197
Merger reserve		369	369
Share-based payments reserve		15,843	15,362
Foreign exchange reserve		7,065	(282)
Accumulated losses		(110,252)	(97,583)
Total equity		63,738	68,482

The notes on pages 45 to 74 are part of these consolidated financial statements.

The financial statements on pages 37 to 74 were approved by the Board of directors and authorised for issue on 15 May 2017.
They were signed on its behalf by:

Susan Robertson
Chief Financial Officer

Company number 05712187

Velocys plc statement of financial position
as at 31 December 2016

	Note	2016 £'000	2015 £'000
Assets			
Non-current assets			
Investments in subsidiaries	19	66,831	126,289
Current assets			
Trade and other receivables	21	31	32
Current income tax asset		650	600
Total assets		67,512	126,921
Current liabilities			
Trade and other payables	24	(72)	(140)
Total liabilities		(72)	(140)
Net assets		67,440	126,781
Capital and reserves attributable to owners of Velocys plc			
Called up share capital	29	1,438	1,419
Share premium account	29	149,275	149,197
Share-based payment reserve		15,843	15,362
Accumulated losses		(99,116)	(39,197)
Total equity		67,440	126,781

The notes on pages 45 to 74 are part of these consolidated financial statements.

The Company has elected to take the exemption under Section 408 of the Companies Act 2006 not to present the parent company Income statement and Statement of comprehensive income. The comprehensive loss for the parent company for the year was £59,919,000 (2015: loss £5,433,000), which included a £65,716,000 impairment of investment in subsidiary in 2016 (2015: £nil) see note 19.

The financial statements on pages 37 to 74 were approved by the Board of directors and authorised for issue on 15 May 2017. They were signed on its behalf by:

Susan Robertson
Chief Financial Officer

Company number 05712187

Consolidated statement of changes in equity
for the year ended 31 December 2016

	Called up share capital £'000	Share premium account £'000	Merger reserve £'000	Share-based payment reserve £'000	Foreign exchange reserve £'000	Accumulated losses £'000	Total equity £'000
Balance at 1 January 2015	1,419	149,225	369	13,220	(2,151)	(77,532)	84,550
Comprehensive income							
Loss for the year	–	–	–	–	–	(20,051)	(20,051)
Other comprehensive income							
Foreign currency translation differences	–	–	–	–	1,869	–	1,869
Total comprehensive expense	–	–	–	–	1,869	(20,051)	(18,182)
Transactions with owners							
Share-based payments – value of employee services	–	–	–	2,142	–	–	2,142
Employee benefit trust reimbursement	–	(28)	–	–	–	–	(28)
Total transactions with owners	–	(28)	–	2,142	–	–	2,114
Balance at 1 January 2016	1,419	149,197	369	15,362	(282)	(97,583)	68,482
Comprehensive income							
Loss for the year	–	–	–	–	–	(12,669)	(12,669)
Other comprehensive income							
Foreign currency translation differences	–	–	–	–	7,347	–	7,347
Total comprehensive expense	–	–	–	–	7,347	(12,669)	(5,322)
Transactions with owners							
Share-based payments – value of employee services	–	–	–	793	–	–	793
Proceeds from share issues	19	78	–	–	–	–	97
Employee option tax liability settled by the Company	–	–	–	(312)	–	–	(312)
Total transactions with owners	19	78	–	481	–	–	578
Balance at 31 December 2016	1,438	149,275	369	15,843	7,065	(110,252)	63,738

The notes on pages 45 to 74 are part of these consolidated financial statements.

Velocys plc statement of changes in equity
for the year ended at 31 December 2016

	Called up share capital £'000	Share premium account £'000	Share-based payment reserve £'000	Accumulated losses £'000	Total equity £'000
Balance at 1 January 2015	1,419	149,225	13,220	(33,764)	130,100
Comprehensive income					
Loss for the year	–	–	–	(5,433)	(5,433)
Total comprehensive expense	–	–	–	(5,433)	(5,433)
Transactions with owners					
Share-based payments – value of employee services	–	–	2,142	–	2,142
Employee benefit trust reimbursement	–	(28)	–	–	(28)
Total transactions with owners	–	(28)	2,142	–	2,114
Balance at 1 January 2016	1,419	149,197	15,362	(39,197)	126,781
Comprehensive income					
Loss for the year	–	–	–	(59,919)	(59,919)
Total comprehensive income	–	–	–	(59,919)	(59,919)
Transactions with owners					
Share-based payments – value of employee services	–	–	793	–	793
Proceeds from share issues	19	78	–	–	97
Employee option tax liability settled by the Company	–	–	(312)	–	(312)
Total transactions with owners	19	78	481	–	578
Balance at 31 December 2016	1,438	149,275	15,843	(99,116)	67,440

The notes on pages 45 to 74 are part of these consolidated financial statements.

Consolidated statement of cash flows
for the year ended 31 December 2016

	Note	2016 £'000	2015 £'000
Cash flows from operating activities			
Operating loss before taxation		(17,085)	(22,188)
Depreciation and amortisation		1,323	1,277
Loss on disposal of property, plant and equipment		1	5
Loss on disposal of intangible assets		233	383
Impairment of intangible assets		–	1,473
Write-down of deferred consideration and deferred tax liability		–	(2,032)
Share-based payments		793	2,142
Loss on derivative financial instruments		–	279
Employee option tax liability settled by the Company		(312)	–
Changes in working capital (excluding the effects of exchange differences on consolidation)			
– Trade and other receivables		234	(301)
– Trade and other payables		(6,004)	(975)
– Inventory		138	(1,066)
Cash consumed by operations		(20,679)	(21,003)
Tax credits received		1,330	2,031
Net cash used in operating activities		(19,349)	(18,972)
Cash flows from investing activities			
Purchase of property, plant and equipment		(291)	(2,262)
Purchase of intangible assets		(356)	(395)
Equity investment in ENVIA		(1,903)	(1,535)
Loan to ENVIA		(295)	–
Interest received		136	401
Decrease in funds placed on deposit	23	3,000	25,083
Net cash generated from investing activities		291	21,292
Cash flows from financing activities			
(Employee benefit trust reimbursement) net proceeds of issuance of ordinary shares		–	(28)
Proceeds from share issues		6	–
Interest paid		(26)	(33)
Decrease in borrowings	26	(314)	(271)
Net cash used in financing activities		(334)	(332)
Net (decrease) increase in cash and cash equivalents		(19,392)	1,988
Cash and cash equivalents at beginning of year	23	34,736	31,693
Exchange gains on cash and cash equivalents		3,400	1,055
Cash and cash equivalents at end of year	23	18,744	34,736

The notes on pages 45 to 74 are part of these consolidated financial statements.

Velocys plc statement of cash flows
for the year ended 31 December 2016

	2016 £'000	2015 £'000
Cash flows from operating activities		
Operating loss before taxation	(72,485)	(8,956)
Impairment of subsidiaries	65,716	–
Employee option tax liability settled by the Company	(312)	–
Changes in working capital (excluding the effects of exchange differences on consolidation)		
– Trade and other receivables	(68)	55
– Intercompany balances	6,066	7,310
– Trade and other payables	1	46
Cash consumed by operations	(1,082)	(1,545)
Tax credit received	1,070	1,573
Net cash generated from operating activities	(12)	28
Cash flow from investing activities		
Interest received	6	–
Net cash generated from investing activities	6	–
Cash flows from financing activities		
(Employee benefit trust reimbursement) net proceeds of issuance of ordinary shares	–	(28)
Proceeds from share issues	6	–
Net cash used in financing activities	6	(28)
Net movement in cash and cash equivalents	–	–
Cash and cash equivalents at beginning of year	–	–
Cash and cash equivalents at end of year	–	–

The notes on pages 45 to 74 are part of these consolidated financial statements.

Notes to the financial statements

1. General information
Velocys plc is a company incorporated in England and Wales and domiciled in England. It operates through a number of subsidiaries in the UK and the US, and collectively they are referred to in the financial statements as the "Company" or "Velocys", with Velocys plc as "Velocys plc" or the "parent company". The nature of the Company's operations and its principal activities are set out in the Strategic report on pages 1 to 21 and the Directors' report on pages 28 and 29.

The parent company is a public limited company listed on AIM.

2. Accounting policies
The principal accounting policies applied in the preparation of these consolidated and parent company financial statements are summarised below. The policies have been consistently applied to each year presented unless otherwise stated.

Basis of preparation
The consolidated and parent company financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU), IFRS Interpretations Committee (IFRS IC) Interpretations and the Companies Act 2006 applicable to companies reporting under IFRS. The statements have been prepared under the historical cost convention as modified by the revaluation of certain financial assets and liabilities (including derivative instruments) at fair value.

The preparation of financial statements to conform to IFRS requires the use of certain critical accounting estimates and the exercise of management's estimate in the application of the Company's accounting policies. Areas involving a higher degree of judgement or complexity, and areas where assumptions and estimates are significant to the financial statements are referenced in note 3.

Going concern
The financial statements have been prepared on the going concern basis, which assumes that the Company will have sufficient funds available to enable it to continue to trade for the foreseeable future. The nature of the Company's nascent strategy means that the timing of milestones and funds generated from developments are difficult to predict at this stage. Management has prepared financial forecasts to estimate the likely cash requirements of the Company over the next 12 months.

The forecasts include certain assumptions with regard to the following:
(a) successful completion of the ENVIA Oklahoma project start up reaching full operational capacity within 2017 leading to sustainable stable operations and the subsequent operating cash flows arising from its interest in and commitments to this project.
(b) the costs of ongoing development projects coupled with the Company's ability to reduce certain existing overhead costs.
(c) the Company raising additional funding during 2018, without which the Company will have a funding shortfall by the second quarter of 2018. The directors continue to review possible sources of additional funding which may include Company level equity, project level funding and third party licence sales, although at the time of the approval of the financial statements there are no agreements in place beyond the £10 million fund raise announced in May 2017.

Based on these assumptions, the forecasts show that there is sufficient funding in the Company to continue their activities for the foreseeable future being not less than 12 months from the date of approval of these financial statements and the directors have therefore prepared the financial statements on a going concern basis.

However, there are uncertainties in these assumptions, including the costs and timing of completion of the ENVIA start up, the amount of costs of ongoing development projects, the ability to reduce certain overheads, the ability to raise additional funding, and adverse variations in these assumptions would mean that the Company may be unable to realise its assets and discharge its liabilities in the normal course of business. These conditions indicate the existence of a material uncertainty which may cast significant doubt about the Company's ability to continue as a going concern. The financial statements do not include the adjustments that may be required if the Company was unable to continue as a going concern.

Accounting developments
No new standards, amendments or interpretations, effective for the first time for the financial year beginning on or after 1 January 2016 have had a material impact on the Company or Velocys plc.

The following new standards, amendments to standards and interpretations are mandatory for the first time for the financial year beginning 1 January 2017. The Company has not chosen to early adopt these standards, but they are considered relevant for future accounting periods.

- Amendment to IAS 7, 'Statement of cash flows' on disclosure initiative. These amendments to IAS 7 introduce an additional disclosure that will enable users of financial statements to evaluate changes in liabilities arising from financing activities. The amendment is part of the IASB's Disclosure Initiative, which continues to explore how financial statement disclosure can be improved.

The following new standards, amendments to standards and interpretations are mandatory for the first time for the financial year beginning 1 January 2018. The Company has not chosen to early adopt these standards, but they are considered relevant for future accounting periods.

- IFRS 9, 'Financial instruments'. The Company is continuing to assess the impact of IFRS 9; it is not anticipated that adoption of the standard will have a significant impact on the financial statements.
- IFRS 15, 'Revenue from contracts with customers'. This converged standard will improve the financial reporting of revenue and improve comparability of the top line in financial statements globally. Companies using IFRS will be required to apply the revenue standard for reporting periods beginning on or after 1 January 2018. The Company continues to review the requirements of IFRS 15 Revenue from contracts with customers. It has identified the revenue streams expected to be impacted and the performance obligations due under their respective contracts. It does not believe that allocating the contract prices across these performance obligations will have a material impact to the Income statement. In respect of 2016 revenue, which was all from engineering services, it would not result in any adjustment. The Company has not chosen to early adopt the standard.

2. Accounting policies (continued)
Accounting developments (continued)
The following new standard is mandatory for the first time for the financial year beginning 1 January 2019. This standard is subject to endorsement by the European Union.

- IFRS 16 'Leases'. This standard will replace IAS 17 'Leases' and sets out the principles for the recognition, measurement, presentation and disclosure of leases. Lessees will be required to recognise a lease liability reflecting future lease payments and a right-of-use asset for lease contracts. The IASB has included an optional exemption that can be applied by lessees for certain short-term leases and leases of low-value assets. A key change arising from IFRS 16 is that most operating leases will be accounted for on the balance sheet for lessees. As outlined in note 30, at 31 December 2016 the Company has £1,829,000 of operating lease commitments and these are likely to be recognised on the balance sheet as at transition. The standard replaces IAS 17 'Leases', and related interpretations.

Financial risk management policies
Financial risk management policies are set out in the Strategic report on page 21, and in note 28.

Capital management policies
Capital management policies are set out in note 28.

Significant accounting policies
Foreign currency translation
Functional and presentation currency
Items included in the financial statements of each of the Company's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The consolidated financial statements are presented in sterling (£), which is Velocys plc's functional and the Company's presentation currency.

Transactions and balances
Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the Income statement. Foreign exchange gains and losses that relate to borrowings and cash and cash equivalents are presented in the Income statement within Finance income or Finance costs.

The net investment that the Company has in its subsidiary undertakings is its interest in the net assets of that subsidiary. The inclusion of long-term loans and receivables ("Loans to subsidiaries") as part of the net investment in the subsidiary undertaking is determined where settlement is neither planned nor likely to occur in the foreseeable future. All loans to subsidiaries by the parent company meet these criteria.

On this basis the loans to subsidiaries, being monetary items that are receivable from a foreign subsidiary undertaking, are regarded as an extension of the Company's net investment in that foreign subsidiary undertaking. Exchange differences, arising on a monetary item that forms part of the Company's net investment in a foreign operation that is a subsidiary or associate, are recorded as follows.

- In the consolidated financial statements that include the foreign operation and the reporting entity, exchange differences are recognised initially in a separate component of Other comprehensive income and, on disposal of the net investment, in profit or loss.
- In the parent company financial statements, exchange differences are recognised in the Income statement.

Entities within Velocys
The results and financial position of all Velocys entities that have a functional currency different from the presentation currency (none of which is of a hyper-inflationary economy) are translated into the presentation currency as follows:

1. assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
2. income and expenses for each income statement are translated at average exchange rates; and
3. all resulting exchange differences are recognised as a movement within other comprehensive income.

On consolidation, exchange differences arising from the translation of the net investment in foreign operations are taken to shareholders' equity.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

Other significant accounting policies are incorporated in the note to which they apply.

3. Critical accounting estimates and judgements
The preparation of financial information in conformity with IFRS requires the use of estimates and judgements that affect the reported amounts of assets and liabilities at the reporting date and the reported amounts of revenues and expenses during the reporting period. Although these estimates and judgements are based on management's best knowledge of the amount, event or action, actual results ultimately may differ. Estimates and judgements that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial period are discussed in the relevant note and listed below.

Item of critical estimate and/or judgement	Note
Exceptional items – recognition of previously deferred income	4
Intangible assets – impairment assessment	17
Investment in subsidiaries – impairment assessment	19
Recognition of investment in associate	20

4. Exceptional items
Items that are significant by virtue of their size or nature, which are considered non-recurring and which are excluded from the underlying profit measures used by the Board to monitor and measure the underlying performance of the Company are classified as exceptional operating items. They include, for instance, costs directly attributable to the integration of an acquired business, significant site consolidation costs and other significant restructuring costs. Exceptional operating items are included within the appropriate Consolidated income statement category but are highlighted separately in the notes to the financial statements.

The following exceptional items have been included in the Consolidated income statement.

	2016 £'000	2015 £'000
Costs of unsuccessful acquisition	(2,809)	–
Recognition of previously deferred income	2,496	–
Impairment of intangible assets	–	(1,473)
Deferred tax liability write down	–	269
Deferred consideration release	–	1,763
Total	(313)	559

In 2016, the Company sought to acquire certain assets of a US-based GTL company that had gone into administration but did not complete the acquisition. The Company received a partial reimbursement by the acquirer of the plant. This transaction was judged to be exceptional by its nature as a potential business combination. Costs of the unsuccessful acquisition in the table above represent amounts spent net of the related reimbursement.

The Company recognised £2,496,000 of previously deferred income in respect of the cancellation of a contract with Ventech for reactors. The deferred income arose on receipt of upfront payments. The full amount was recognised as Other income. It has been included in exceptional items as it was a significant, one-off change to a material contract.

The impairment of intangible assets in 2015 related to customer contracts, and was the discounted value of future income, which the Company had expected to receive in 2015 upon obtaining a final investment decision (FID) by outside investors in the Ashtabula project. As FID was not reached in 2015, this balance and the related deferred tax liability were written down to £nil.

The deferred consideration arrangement required the Company to issue shares in Velocys plc to the former owners of Velocys Project Solutions, also contingent upon the achievement of FID at Ashtabula. It was written down to £nil in 2015 and no shares were issued.

Critical estimates and judgements
The recognition as income in 2016 of non-refundable amounts from Ventech previously recorded in deferred income is based on an assessment of the contractual position, taking into account both the terms of the original contract and subsequent amendments. The Company believes that all obligations under this contract have been fulfilled and therefore that it is probable that the economic benefits associated with the transaction have flowed to the Company and that recognition of the related income is appropriate. This is a binary judgement, and, therefore, the Company has recognised revenue at the point at which the probability criterion was met.

5. Segmental information

The Company's chief operating decision-making unit is the Senior Management Team (SMT). The SMT reviews the Company's internal reporting in order to assess performance and allocate resources, and has determined the operating segments based on these reports.

The SMT considers that the business comprises a single activity, which is the design, development, marketing and sale of technology for the production of synthetic fuels (and speciality products). The newly announced strategy extends this activity to facilitating project development by putting together partnerships with technology licensors, engineers, feedstock suppliers, off-takers and financing entities. However, this is still considered to be part of the same synthetic fuels activity. The SMT reviews the Company's profit or loss and its cash flows, assets and liabilities on a Company-wide basis. In carrying out these reviews, the SMT considers all material items of income and expenditure that are directly attributable to individual commercial projects and development programmes. The internal management reports do not allocate assets and liabilities or shared overheads to individual products or projects.

The business has one segment on the basis that the key end use market is that of synthetic fuels production. At this stage, the synthetic fuels segment represents 100% of the business and therefore represents the only material segment. Based on management's judgement, all products and services offered within the operating segment have similar economic characteristics.

Internal and external reporting is on a consolidated basis, with purchases and sales between subsidiaries eliminated on consolidation. Therefore, the segmental and financial information is the same as that set out in the Consolidated income statement, Consolidated statement of comprehensive income, the Consolidated statement of financial position, the Consolidated statement of cash flows and the Consolidated statement of changes in equity.

The SMT assesses the performance of the operating segment based on a measure of operating loss.

The Company's operating segment operates in three main geographical areas. Revenue is allocated based on the country in which the customer is located.

	2016 £'000	2015 £'000
Europe	273	400
Americas	1,163	1,589
Asia Pacific	9	13
Total revenue	1,445	2,002

Revenues during the year originated in the United Kingdom and United States.

The total amount of revenue recognised from customers where revenue comprises 10% or more of Company revenue is as follows:

	2016 £'000	2015 £'000
Customer 1	619	1,480
Customer 2*	444	400
Customer 3	163	–
Customers less than 10%	219	122
Total revenue	1,445	2,002

* Relates to different customers in 2016 and 2015.

Non-current assets held in the United States are as follows:

	2016 £'000	2015 £'000
Intangible assets	33,590	27,956
Property, plant and equipment	5,355	5,075
Trade and other receivable	325	–
Available-for-sale investment	–	3,375
Investment in associate	5,865	–
Total	45,135	36,406

All other non-current assets were held in the United Kingdom and amounted to £727,000 (2015: £854,000).

6. Revenue

Revenue is measured as the fair value of consideration received or receivable for goods and services provided in the normal course of business, net of trade discounts, value added tax and other sales-related taxes after eliminating sales within the Company. Revenue is recognised only when the amount of revenue can be reliably measured and it is probable that future economic benefits will flow to the Company. When uncertainty subsequently arises, any resulting provision is recognised as an expense and not a reduction in revenue.

Revenue related to Fischer-Tropsch (FT) reactors, catalyst and licence

The purchase of an FT reactor is part of an integrated package consisting of the three revenue streams for the Company; the sale of the FT reactor, the use of the FT catalyst for a certain term and revenue from the licence fee that grants rights to use the related intellectual property (IP) for the length of the licence term. The IP is not transferred at the end of the licence term.

In order to recognise revenue, each component of the FT process is identified, which includes the sale of the reactor, an initial licence fee, the sale of catalyst and ongoing engineering services. Values are based on the terms of the sales contract. Once the fair value of the components has been determined, revenue is recognised in line with the underlying nature of the contract.

FT reactor revenue and costs are recognised when substantially all risk and reward associated with the reactor has passed to the customer. Under the Company's standard terms this is on delivery of the reactor, where "delivery" means available for shipping to the customer's site, although this term may vary as contracts are negotiated.

Catalyst sales income will be recognised monthly over the term of the arrangement.

Licence fee revenue will be recognised on commencement of the contract provided that the fair value of the licence fee can be determined. However, if no reliable fair value can be determined, any revenue associated with the licence fee will be deferred and recognised in line with the reactor sales. Where a proportion of the licence fee is at risk until the successful completion of a performance test, this proportion is not recognised as revenue until the test is passed; any payments received are held in deferred income until that time.

Where the underlying costs associated with any component cannot be estimated, any profit element identified is deferred until such time as the costs can be reliably estimated.

Revenue related to engineering services

Revenue from engineering services is earned on a time and materials basis, and is recognised as the work is performed.

As engineering services were the source of all 2016 revenue, no critical estimates were required.

The majority of the Company's revenue is derived from a small number of significant commercial customers and development partners, who are not related parties.

	2016 £'000	2015 £'000
FT reactor, catalyst and licence	–	1,820
Engineering services	1,445	182
Total	1,445	2,002

7. Finance income

	2016 £'000	2015 £'000
Interest income on bank deposits	129	329
Net fair value gains on forward foreign exchange contracts	668	381
Foreign exchange gains	2,547	445
Total Finance income	3,344	1,155

Interest income is accrued on a time basis by reference to the principal outstanding and the applicable interest rate.

8. Finance costs

	2016 £'000	2015 £'000
Unwinding of discount on deferred licence payments payable	–	20
Interest on finance leases	5	9
Interest on borrowings	21	24
Total Finance costs	26	53

9. Other income

Other income consists of items such as sales of fixed assets, contractual and legal settlements and any other operating income recognised outside of commercial activities. Other income derived from sales of fixed assets and non-commercial activities is recognised on an accruals basis. Legal settlements are recognised as income when a final judgement is received.

	2016 £'000	2015 £'000
Before exceptional items:		
Contractual and legal settlements	252	1,996
Sale of fixed assets	20	13
Total other income before exceptional items	272	2,009
Exceptional items (see note 4):		
Recognition of deferred income	2,496	–
Deferred consideration release	–	1,763
Total other income exceptional items	2,496	1,763
Total other income	2,768	3,772

In 2016 Other income included receipts from settlements with Toyo and MODEC, which offset costs previously recorded in Administrative expenses, and the recognition of deferred income in respect of cancellation of the Ventech contract (see note 4).

In 2015 Other income included receipt of settlements arising from two legal disputes, with CompactGTL and Johnson Matthey, which offset previously recorded Administrative expenses and the release of deferred consideration that would have been due to the former owners of Velocys Project Solutions if FID been achieved at Ashtabula in 2015 (see note 4).

10. Expenses by nature

	2016 £'000	2015 £'000
Employee benefit expense (see note 12)	10,212	13,480
Sub-contractor and consultant costs	1,837	2,385
Depreciation of property, plant and equipment: owned (note 18)	1,077	975
Depreciation of property, plant and equipment: leased (note 18)	55	50
Amortisation of intangible assets (note 17)	191	252
Operating lease expense – plant and machinery	72	31
Operating lease expense – other	517	475
Patent and other IP costs	313	579
Materials expense	642	3,924
Services	677	738
Inventories write-down	148	218
Other expenses	2,748	3,651
Total cost of sales and administrative expenses before exceptional items	18,489	26,758

Included in administrative expenses were research and development costs of £10,075,000 (2015: £13,199,000).

11. Auditor's remuneration

	2016 £'000	2015 £'000
Fees payable to Company's auditor and its associates for the audit of parent company and consolidated financial statements	78	62
Fees payable to Company's auditor and its associates for other services:		
– The audit of Company's subsidiaries	39	31
– Taxation compliance service	25	13
Total	142	106

12. Employee benefit expense

Short term employee benefits

Accruals are included to reflect the cost of short term compensation to employees for absences such as paid leave.

Pensions

The Company operates various defined contribution pension schemes for its employees. The Company has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefit derived from the current and prior periods.

The amount charged to the Income statement in respect of pension costs and other post-retirement benefits is the contributions payable in the year. Differences between contributions payable and contributions actually paid are shown as accruals in the balance sheet. The Company has no further payment obligations once the contributions have been paid.

The average monthly number of Company employees (including Executive Directors) was as follows.

	2016 number	2015 number
Research, design and development	65	79
Administration	25	29
Total average headcount	90	108

Their aggregate remuneration comprised the following items.

	2016 £'000	2015 £'000
Wages and salaries	8,312	9,822
Social security costs	673	679
Other pension costs	314	326
Severance expense	120	511
Share-based payments granted to directors and employees (note 15)	793	2,142
Total remuneration	10,212	13,480

The parent company has no employees and no remuneration.

Details of directors' remuneration are given in the audited information in the Directors' remuneration report on pages 30 to 33, which forms part of these financial statements.

Included in wages and salaries were costs for research and development employees of £5,256,000 (2015: £6,011,000).

13. Income tax

Current tax, including UK corporation tax and foreign tax, is provided for at the amount expected to be paid (or recovered) based on the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Company	**2016 £'000**	2015 £'000
Current tax:		
R&D tax credit relating to prior years	(550)	(255)
R&D tax credit relating to current year	(854)	(780)
Current tax total	(1,404)	(1,035)
Deferred tax:		
Write off of intangible assets	–	269
Income tax total	(1,404)	(766)

Due to the availability of losses incurred in the year, there is no charge to corporation tax. The Company recognised £1,404,000 for R&D tax credits (2015: £1,035,000). The credit relating to the current year is on an accruals basis, which is an estimate of the amount to be claimed from HMRC based on the activity level and significant R&D costs of the current year compared to previous years. The credit relating to prior years is the difference between the brought forward accrual and the settlement from HMRC.

The accrual for the current year, which is the majority of the credit, is based on an assessment of the Company's projects, to determine which ones qualify under the HMRC's rules, and to estimate the level of allowable cost within each, based on the nature of costs.

13. Income tax (continued)
The actual tax credit for the current and previous year is higher (2015: higher) than the theoretical amount that would arise using the weighted average tax rate applicable to the results of the consolidated entities, for the reasons set out in the following reconciliation.

Company	2016 £'000	2015 £'000
Loss before income tax	(14,073)	(21,086)
Tax calculated at domestic tax rates applicable to losses in the respective countries	(4,147)	(5,594)
Tax effects of:		
– Expenses not deductible for tax purposes	51	468
– Unutilised tax losses	4,096	5,126
– R&D tax credit	(1,404)	(1,035)
Current tax total	(1,404)	(1,035)

The weighted average applicable tax rate was 29.5% (2015: 26.5%).

The standard rate of corporation tax in the United Kingdom changed from 21% to 20% with effect from 1 April 2015. Accordingly, profits in the United Kingdom for 2016 were taxed at 20%. Legislation to reduce the main rate of corporation tax to 19% from 1 April 2017 was enacted on 18 November 2015. Legislation to further reduce the rate to 17% from 1 April 2020 was enacted on 15 September 2016. Unrecognised UK deferred tax balances have been measured at 17% (recognised: £nil).

US corporate income tax is based on a graduated scale ranging from 15% to 35% tax rate depending on the level of taxable income. Most US companies with taxable income under $10,000,000 have an effective rate of 34%. Unrecognised US deferred tax balances have been measured at 34% (recognised: £nil).

14. Deferred tax
Deferred tax is recognised, using the liability method, on temporary differences arising between the tax basis of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affected neither accounting nor taxable profit or loss. Tax amounts are determined using tax rates (and laws) that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised. Deferred tax is provided on temporary differences arising on investments in subsidiaries except where the timing of the reversal of the temporary difference is controlled by the parent company and it is probable that the temporary difference will not reverse in the foreseeable future.

The movement in deferred tax in the year was as follows.

Company	2016 £'000	2015 £'000
Recognised		
Deferred tax liability	–	269
Write off of intangible assets	–	(269)
Deferred tax carried forward	–	–

Company	2016 £'000	2015 £'000
Unrecognised		
Deferred tax assets		
– Trading losses	(27,366)	(22,918)
– Equity settled options	(195)	(605)
Total	(27,561)	(23,523)

At 31 December 2016 the Company had a net unrecognised deferred tax asset of £27,366,000 (2015: £22,918,000) arising from trading losses since incorporation. No recognition (2015: £nil) of the net deferred tax asset has been made at 31 December 2016 on the grounds of uncertainty over its recoverability in light of the Company's nascent revenue streams and commitment to continued investment in research and development and therefore there is no impact on the current or prior year income statement.

Of this unrecognised deferred tax asset, £11,775,000 (2015: £16,580,000 reported, £11,733,000 restated) is anticipated to remain available indefinitely to offset against future taxable trading profits of the entities in which the losses arose. The remainder has expiry dates between 2023 and 2036 (2015: 2023 and 2035).

The amount of the above net unrecognised deferred tax asset attributable to the parent company was £8,381,000 (2015: £8,278,000), all of which is anticipated to remain available indefinitely (2015: all).

15. Share-based payments
Velocys plc issues share options to employees of its subsidiaries that are accounted for as equity settled. There are a number of schemes covering employees, executives and external consultants; most are based on a service period but some include performance conditions, both market based and non-market based.

Options are measured at fair value (excluding the effect of non market-based vesting conditions) at the date of grant. For executive options with market performance conditions attached the Monte Carlo pricing model is used, all other options apply the Black-Scholes model.

The basic assumptions that feed into both models are volatility of the share price, annual risk free rate and dividend yield. Volatility is estimated using the average daily share price from the previous five years, the risk free rate is based on the Bank of England's yield curve tables, and it is assumed no dividend will be paid over the life of the option. Additionally, for the Monte Carlo model, expected life is assumed to be the earliest point at which the shares may vest. This has been adjusted, using management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

At the end of each reporting period, the Company revises its estimates of the number of options that are expected to vest, based on non-market vesting conditions and service calculations. It recognises the impact of the revision to original estimates in the Income statement, recorded in Administrative expenses, with a corresponding adjustment to equity.

When options are exercised the Company issues new shares; proceeds received, net of attributable transaction costs, are credited to share capital and premium.

For the parent company, grants of options are treated as a capital contribution to the subsidiary of which the option holder is an employee. The share based payment expense is recognised as an additional investment in the subsidiary with a corresponding credit to equity.

The number of options outstanding at 31 December 2016 and the expense recognised in the profit or loss for these schemes, along with bonus shares and other schemes, are as follows.

	2016		2015	
Scheme	Options outstanding	Income statement £'000	Options outstanding	Income statement £'000
Employees UK/US	3,228,556	275	4,188,283	281
ELTIP (Executives)	8,166,548	496	10,912,628	1,843
Velocys, Inc.	83,248	–	95,978	–
Bonus shares	79,760	–	421,760	–
Other	253,879	22	253,879	18
Total	11,811,991	793	15,872,528	2,142

Employees UK/US
This scheme covers all employees of the Company, and was previously referred to as the EMI scheme; however, the Company ceased to qualify for EMI status due to the value of its gross assets.

Options are granted to employees when they join the Company, they vest three, four or five years from the date of joining, subject to the employee completing a corresponding service period, and expire after ten years. The exercise price is the mid-market value of Velocys plc's ordinary shares on the day prior to grant. Options are fair valued at grant date using the Black-Scholes model, and expensed over the vesting period.

During 2015 options were granted to certain employees that will vest in January 2017 subject to meeting certain non-market performance conditions; other conditions are per the main employee scheme. The fair value assessment of these options included a review of the likely fulfilment of the performance conditions.

Movements in the number of options outstanding and their related weighted average exercise prices are as follows.

	2016		2015	
	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options
At 1 January	109.60p	4,188,283	119.33p	4,179,111
Granted	28.86p	104,615	107.09p	1,159,173
Forfeited	131.47p	(1,062,332)	161.30p	(1,138,335)
Exercised	81.29p	(2,000)	59.16p	(11,666)
At 31 December	121.26p	3,228,566	109.60p	4,188,283

Of the 3,228,566 options outstanding at 31 December 2016, 1,875,442 were exercisable (2015: 1,371,533). The weighted average exercise price of the exercisable shares was 57.88p (2015: 71.38p).

15. Share-based payments (continued)
Options outstanding at the end of the year have the following expiry dates and exercise prices.

		2016		2015	
Year of expiry	Range of exercise price	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
2017	124.00p	16,129	124.00p	16,129	124.00p
2018	159.00p	62,893	159.00p	62,893	159.00p
2020	57.50 – 70.72p	42,616	68.83p	51,748	58.55p
2021	51.00 – 74.79p	1,024,140	68.09p	1,316,140	59.72p
2022	48.00 – 117.06p	425,000	93.08p	468,200	79.19p
2023	129.88 – 213.79p	494,000	200.73p	514,000	168.18p
2024	146.00 – 303.54p	293,334	227.39p	603,334	196.17p
2025	62.50 – 182.90p	775,839	126.83p	1,155,839	106.88p
2026	29.75 – 40.65p	94,615	31.91p	–	–
Total	29.75– 303.54p	3,228,566	121.26p	4,188,283	109.60p

The weighted average fair value of options granted during the year was13.65p (2015: 29.32p) per option. The significant inputs into the model were as follows.

	2016	2015
Weighted average share price at grant date	28.86	107.09
Weighted average exercise price	28.86	107.09
Expected volatility	54%	44%
Weighted average annual risk free rate	0.4%	0.8%
Dividend yield	0%	0%
Weighted average expected life	4.0 years	2.9 years

Total expense recognised in the income statement for share options granted to directors and employees was £275,000 (2015: £281,000).

Executive options
Executive options (also referred to as "ELTIP" in the Directors' remuneration report, and "ELTIP" and "NELTIP" in the 2015 Annual report and accounts) are awarded to Executive Directors and senior managers of the Company.

The fair value of options is recognised from the start of the relevant service period to the end of the vesting period.

Executive options granted up to and including 2014, are exercisable at a price of 1p or at a price equal to the mid-market value of the parent company's ordinary shares on the day prior to the grant. Options vest immediately or after a period of one, two or three years from grant, they expire after ten years and are forfeited if the employee leaves the Company before the options vest.

Options, including Restricted Stock Units (RSUs), awarded after 2014 were divided into those with a service period and those with market performance conditions. Except for the former CEO, service period options represented 23% of the award; they vest two years after the conclusion of the period over which performance is measured; the market performance conditions on which the rest of the award was based pertain to the compound annual growth rate of the Company's market capitalisation excluding fund raising subsequent to 1 January 2015; market performance options are measurable after three years from the start of the service period, with possible re-measurements one, and two years later; options are subject to the discretion of the Board if the employee leaves the Company before the options vest.

For the former CEO, a five-year award was made in 2015, for which service period options represented 30% of the RSUs. Market performance options were measurable after five years from the start of the service period, with a possible re-measurement one year later. Under the terms of the 2015 Settlement Agreement between the Company and the former CEO, 2,216,666 RSUs from this award were deemed to have vested; the remainder was forfeited. In 2016 it was agreed that only 1,330,000 of these RSUs would be transferred to the former CEO, and in respect of the balance, the Company would settle the expected associated tax liability.

No options have been granted in 2016 (2015: 8,364,386 options). However, the Remuneration Committee intends to introduce a new equity-based incentive scheme for executives in 2017, and, in the allocation of such awards, may take into consideration the fact that no 2016 awards were made.

Movements in the number of options outstanding and their related weighted average exercise prices are as follows.

	2016		2015	
	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options
At 1 January	64.23p	10,912,627	110.71p	9,526,635
Granted	–	–	98.10p	8,364,386
Forfeited	Nil	(1,176,079)	Nil	(6,978,394)
Exercised	0.15p	(1,570,000)	–	–
At 31 December	84.92p	8,166,548	69.70p	10,912,627

Of the 8,166,548 options outstanding at 31 December 2016, 6,022,848 were exercisable (2015: 7,051,571). The weighted average exercise price of the exercisable shares was 115.14p (2015: 42.90p).

Share options and RSUs outstanding at the end of the year have the following expiry dates (RSU latest exercise dates) and exercise prices.

		2016		2015	
Year of expiry	Range of exercise price	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
2016	Nil	–	Nil	2,216,667	Nil
2017	Nil	135,558	Nil	135,834	Nil
2018	Nil	213,883	Nil	343,639	0.29p
2019	Nil – 1.00p	524,680	0.20p	697,779	0.35p
2020	Nil	352,852	Nil	532,134	Nil
2021	1.00p – 58.00p	1,175,000	39.05p	1,175,000	39.05p
2022	49.00p	2,498,503	49.00p	2,498,503	49.00p
2023	159.00p	1,841,837	159.00p	1,841,837	159.00p
2024	153.00p – 163.50p	1,424,235	163.04p	1,471,235	162.72p
Total	Nil – 163.50p	8,166,548	84.92p	10,912,628	64.23p

No options have been granted in respect of 2016; the weighted average fair value of the market performance options and the service period options granted in 2015 was 108.13p per option. The significant inputs into the model were as follows.

	2016	2015
Weighted average share price at grant date	–	155.00p
Weighted average exercise price	–	Nil
Weighted average expected volatility	–	51%
Weighted average annual risk free rate	–	0.79%
Dividend yield	–	0%
Weighted average expected life	–	2.68 years

Total expense recognised in the income statement for executive options granted to directors and employees was £496,000 in 2016 (2015: £1,843,000). No further expense was accrued within the share-based payments charge (2015: £nil).

At the time of exercising share options, executives of the Company may apply to an employee benefit trust managed by Oxford Catalysts Trustees Limited for a distribution in respect of the exercise value of their options. The trustees then request a contribution from the Company in respect of the grant made. The total value of funds distributed to executives by Oxford Catalysts Trustees Limited during the year in respect of executive options was £13,300 (2015: £nil).

15. Share-based payments (continued)

Velocys, Inc. scheme

The Velocys, Inc. Stock Compensation Plan ("Pre-Acquisition Scheme") was acquired as part of the acquisition of Velocys, Inc. by Velocys plc, formerly Oxford Catalysts Group PLC, on 20 November 2008. The scheme was started in 2001 and covers all US-based employees. Prior to the acquisition, Velocys, Inc.'s Board of directors granted non-qualified share options to employees with expiry 10 years from grant date. The options' exercise price was equal to the stock's fair market value at the date of grant. Options are forfeited if an employee leaves the Company. Generally, options vest as follows.

After one year of service from vest start date:	25% of grant
Each month subsequent to one year of service:	1/48th of grant

Pursuant to the terms and conditions of the acquisition of Velocys, Inc., each vested and unvested Pre-Acquisition Scheme option existing on the acquisition date was converted into 0.3659 of a Velocys plc, formerly Oxford Catalyst Group PLC, option (the ratio of the value of one share of Velocys, Inc. stock to one share of Velocys plc, formerly Oxford Catalyst Group PLC stock) with a corresponding increase to the exercise price. Share options are exercisable in US dollars.

During 2011, the Company reviewed employee incentives and concluded that the Pre-Acquisition Scheme options did not provide the intended incentive or retention value for its employees due to significant shifts in the market price since the original grants. Consequently, holders of these options were offered the opportunity to forfeit their options and have new options issued. All such new issues vest in three years and expire ten years from date of grant.

Details of the share options outstanding under the Velocys, Inc. scheme are as follows.

	2016		2015	
	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options
At 1 January	$1.08	95,978	$1.00	130,062
Forfeited	$0.93	(12,730)	$0.82	(21,503)
Exercised	$0.00	–	$0.77	(12,581)
At 31 December	$1.10	83,248	$1.08	95,978

Of the options outstanding presented above, 83,248 (2015: 95,978) were exercisable as of 31 December 2016. The weighted average share price of the exercisable shares was $1.10 (2015: $1.08).

Share options outstanding at the end of the year have the following expiry dates and exercise prices.

		2016		2015	
Year of expiry	Range of exercise price per share	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
2017	$2.21 – $2.54	9,218	$2.45	9,218	$2.45
2021	$0.93	74,030	$0.93	86,760	$0.93
Total	$0.77 – $2.54	83,248	$1.10	95,978	$1.08

Total expense recognised in the income statement for share options granted under the Velocys, Inc. plan was £nil (2015: £nil).

Bonus shares

The Company previously maintained two bonus share schemes for certain executives: one in respect of employees of Velocys Technologies Limited and one in respect of employees of Velocys, Inc. Under both schemes, the value of the bonus was based upon the executive's salary as well as the Company and the executive achieving certain targets throughout the year. No awards were, or will be, made under these schemes during, or in respect of, 2016.

The Velocys Technologies Limited bonus share scheme awarded nominal value share options (1p) that were issued subsequent to the end of previous financial years. The awards vested on the date of grant and expire 10 years thereafter. Details of the bonus shares outstanding under the Velocys Technologies Limited bonus share scheme are as follows.

	2016		2015	
	Exercise price	Number of options	Exercise price	Number of options
At 1 January	1.00p	421,760	1.00p	421,760
Exercised	1.00p	(342,000)	–	–
At 31 December	1.00p	79,760	1.00p	421,760

Velocys Technologies Limited bonus share options outstanding at the end of the year have the following expiry dates.

		2016	2015
Year of expiry	Exercise price	Number of options	Number of options
2019	1.00p	42,105	42,105
2020	1.00p	–	342,000
2021	1.00p	37,655	37,655
Total	1.00p	79,760	421,760

The Velocys, Inc. bonus share scheme consists of deferred shares awarded subsequent to year end at a nominal price of 1p. 20% of the award is due to be granted on each anniversary of the date of award. Shares remaining to be granted in future years totalled 16,418.

No bonus share grants were made for either scheme in 2016 (2015: nil). All expense has been recognised prior to 2015.

Other share options

The Board has approved the granting of share options to a small number of consultants (non-employees) who provide a strategic service to the business.

Options are granted either in respect of a completed service period, in which case they vest immediately, or in respect of a future service period, in which case they vest over periods of up to three years. They expire after 10 years. Exercise prices range from £nil to the mid-market value of Velocys plc's ordinary shares on the day prior to grant. Options are fair valued at grant date using the Black-Scholes model (which is not the fair value of goods and services received). For a completed service period, fair value is expensed over the service period plus the vesting period, for a future service period, fair value is expensed over the vesting period.

Movements in the number of consultants' share options outstanding and their related weighted average exercise prices are as follows.

	2016		2015	
	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options
At 1 January	87.39p	253,879	51.15p	92,129
Granted	–	–	108.03p	161,750
Forfeited	–	–	–	–
Exercised	–	–	–	–
At 31 December	87.39p	253,879	87.39p	253,879

Of the 253,879 options outstanding at 31 December 2016, 163,879 were exercisable (2015: 103,879). The weighted average exercise price of the exercisable shares was 77.58p (2015: 51.88p).

15. Share-based payments (continued)
Share options outstanding at the end of the year have the following expiry dates and exercise prices.

		2016		2015	
Year of expiry	Range of exercise price	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
2021	1.00p	6,500	1.00p	6,500	1.00p
2022	1.00p	10,204	1.00p	10,204	1.00p
2023	1.00 – 53.10p	54,050	29.44p	54,050	29.44p
2024	145.25p	21,375	145.25p	21,375	145.25p
2025	105.25 – 143.5p	161,750	108.03p	161,750	108.03p
Total	1.00 – 145.25p	253,879	87.39p	253,879	84.67p

No options were granted during 2016. In 2016 an award was made to Jan Verloop, who resigned from the Board of Velocys plc in September 2016, in respect of consultancy services thereafter performed in 2016; these options will be granted in 2017. The number of options is determined by the average share price in the quarter prior to the service period, and the options will vest immediately.

The weighted average fair value of options granted in 2015 using the Black-Scholes valuation model was 22.51p per option. The significant inputs into the model were as follows.

	2016	2015
Weighted average share price at grant date	–	108.03p
Weighted average exercise price	–	108.03p
Weighted average expected volatility	–	43%
Weighted average annual risk free rate	–	0.8%
Dividend yield	–	0%
Weighted average expected life	–	1.66 years

The share-based payment expense for the year includes a cost of £22,000 (2015: £18,000) relating to options granted to consultants.

Share-based payments charge
The total charge for share-based payments during the year was £793,000 (2015: £2,142,000) of which £357,000 (2015: £1,544,000) relates to options granted to directors and the remainder to other employees.

16. Loss per share
The basic loss per share is calculated by dividing the loss attributable to owners of the parent company by the weighted average number of ordinary shares in issue during the year.

	2016	2015
Loss attributable to owners of Velocys plc (£'000s)	(12,669)	(20,051)
Weighted average number of ordinary shares in issue	143,282,963	141,915,307
Basic and diluted loss per share (pence)	(8.84)	(14.13)

Diluted loss per share is calculated by adjusting the weighted average number of shares in issue to assume conversion of all potential dilutive shares. Share options have not been included in the number of shares used for the purpose of calculating diluted loss per share since these would be anti-dilutive for the period presented. At the end of 2016 there were no other potentially dilutive instruments (see note 33). Details of share options are given in note 15.

17. Intangible assets
Significant accounting policies
Cost or valuation and amortisation
Goodwill
Of the total Goodwill of £8,113,000, £5,445,000 (2015: £4,519,000) originates from the acquisition of Velocys, Inc. in 2008 and £2,668,000 (2015: £2,214,000) from the acquisition of VPS in 2014. Goodwill represents the excess of the cost of an acquisition over the fair value of the Company's share of the identifiable assets acquired and liabilities and contingent liabilities assumed at the date of acquisition. Goodwill is not amortised.

In-process technology
In-process technology consists of purchased intangibles and capitalised development costs and is carried at cost less accumulated amortisation and impairment losses.

Purchased intangibles arose from the acquisition of Velocys, Inc. and Velocys Project Solutions, LLC (VPS).

In respect of intangible assets acquired as part of a business combination, the Company recognises these as distinct from goodwill provided they are separable or arise from contractual or other legal rights, and their fair value can be measured reliably.

Intangible assets are initially recognised at fair value, which is regarded as their cost. They are subsequently held at cost less accumulated amortisation and impairment losses. Amortisation is charged when assets are brought into use. The Company uses the units-of-production method of amortisation with the measured unit being reactors produced. The number of units used in the model is approximately 1,400 (2015: 1,400) four-core reactors based on projections of future sales. Amortisation began in 2015 based on the manufacture of the first commercial reactors. It is charged to Administrative expenses in the Income statement.

Research costs are recognised as an expense in the Income statement as they are incurred.

Development costs, where the related expenditure is separately identifiable and measurable, and management are satisfied as to the ultimate technical and commercial viability of the project and that the asset will generate future economic benefit based on all relevant available information, are recognised as an intangible asset. Costs arising from funded projects are also recognised to the extent that they meet the relevant criteria, net of any amounts reimbursed by research partners. Capitalised development costs are carried at cost less accumulated amortisation and impairment losses. They are amortised, from the point the asset is available for use in the manner intended by management, on the units of production basis, over the period of the assets' expected benefit. Development costs not meeting the criteria for capitalisation are expensed as incurred.

Patents, licences and trademarks
Patents and trademarks are recorded at cost less accumulated amortisation and impairment losses. Amortisation is charged on a straight line basis over a period of 20 years, which is their estimated useful economic life. Residual values and useful lives are reviewed annually and adjusted if appropriate. The Company decided to abandon certain non-core patents in 2016 and 2015. This resulted in a loss on disposal of patents of £213,000 (2015: £375,000).

Licences are recorded at the present value of minimum licence payments. Amortisation is charged when related revenue starts to be earned and will be charged on a straight line basis over the life of the licences. Residual values and useful lives are reviewed annually and adjusted if appropriate.

Customer contracts
Customer contracts are carried at cost less impairment losses. The customer contract value that was written off in 2015 related to an expected project development fee negotiated in the acquisition of VPS in 2014. Its value was contingent on achieving a final investment decision on the Ashtabula project in 2015, which did not happen.

Software
Purchased software is recorded at cost less accumulated amortisation and impairment losses. Amortisation is charged on a straight-line basis over its estimated useful life of three years.

Impairment
Goodwill is tested annually for impairment, and also whenever events or changes in circumstance indicate the carrying value may not be recoverable. Goodwill is allocated to cash-generating units for the purpose of impairment testing; however, since 2015 just a single cash-generating unit, synthetic fuels, has been recognised. This reflected the fact that, although the Company has several technology streams, it measures progress and performance using one business segment (see note 5).

The Company has no indefinite-life intangible assets other than goodwill. For intangible assets that are not yet available for use, impairment testing is performed annually. The carrying amounts of the Company's available-for-use intangible assets (excluding goodwill) are reviewed at each balance sheet date or when events or changes in circumstance indicate their carrying value may not be recoverable to determine whether there is any indication of impairment. If such an indication exists, the asset's recoverable amount is estimated.

17. Intangible assets (continued)
To the extent the carrying amount exceeds the recoverable amount, the difference is recorded as an expense in the Income statement. The recoverable amount used is the higher of the value in use and fair value less costs of disposal. For the purpose of impairment testing, assets are generally assessed individually or at a CGU level, which represents the lowest level for which there are separately identifiable cash inflows that are largely independent of cash inflows from other assets or groups of assets. The determination of CGUs is consistent with that detailed for goodwill.

An impairment loss in respect of goodwill is not reversed. An impairment loss in respect of intangible assets (excluding goodwill) is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the loss was recognised, or if there has been a change in the estimate used to determine the recoverable amount. A loss is reversed only to the extent that the asset's carrying amount does not exceed that which would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

An impairment has not been recorded for 2016. The impairment of a customer contract in 2015 related to the failure of the Ashtabula project to achieve final investment decision within a specified timeframe after the acquisition of VPS. The remainder of Intangibles, (Patents, licence and trademarks, and Software) are internally generated.

Critical estimates and judgements
In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, a number of indicators of potential impairment. The Company identified that, at the annual impairment assessment date (being the balance sheet date), the carrying amount of the net assets of the Company of £63.9m was greater than its market capitalisation of £53.4m.

The CGU's recoverable amount has historically been determined by its value in use, assessed by the estimated future cash flows discounted to their present value using an appropriate pre-tax discount rate model. Due to the recent launch of the Company's new strategy, which involves a much more pro-active approach to market development and a focus on a few key markets, an assessment of future cash flows based on reaching final investment decision on new GTL or BTL plants involved a particularly high level of judgement. Consequently, a fair value less costs of disposal basis was adopted for the 31 December 2016 assessment.

The value for market capitalisation has been obtained by calculating the total value of the parent company's equity based on the AIM-listed shares of the parent company, adjusted for a control premium. This premium is an amount that a buyer is willing to pay over the current market price of a publicly traded company in order to acquire a controlling share in that company. The control premium estimate applied is a key assumption. Management have estimated a premium of 25%. A reduction in this assumption to 18% would result in a material impairment of goodwill. In concluding on the impairment assessment, management have also considered information from after the reporting period. This does not indicate that an impairment at the end of the reporting period was required. A review of the market capitalisation after the reporting date was considered to be important in assessing the relative importance of the share price at 31 December 2016. The market cap has increased in 2017, particularly in light of several Company announcements with respect to achieving first product at the ENVIA GTL plant and the signing of a number of strategic partnership agreements. The current market capitalisation of the Company is significantly in excess of the carrying amount of the net assets of the Company.

Based on this assessment the recoverable amount was in excess of the carrying amount of intangible assets, and therefore an impairment was not recorded (2015: £nil).

2016	Goodwill £'000	In-process technology £'000	Patents, licence and trademarks £'000	Customer contracts £'000	Software £'000	Total £'000
Cost						
At 1 January 2016	6,733	21,529	1,927	1,473	128	31,790
Additions	–	–	356	–	1	357
Disposals	–	–	(301)	–	(40)	(341)
Foreign exchange movement	1,380	4,413	266	–	12	6,071
At 31 December 2016	8,113	25,942	2,248	1,473	101	37,877
Accumulated amortisation						
At 1 January 2016	–	1,356	547	1,473	36	3,412
Charge for the year	–	–	145	–	46	191
Disposals	–	–	(88)	–	(20)	(108)
Impairment	–	–	–	–	–	–
Foreign exchange movement	–	272	74	–	1	347
At 31 December 2016	–	1,628	678	1,473	63	3,842
Net book amount						
At 31 December 2016	8,113	24,314	1,570	–	38	34,035

2015	Goodwill £'000	In-process technology £'000	Patents, licence and trademarks £'000	Customer contracts £'000	Software £'000	Total £'000
Cost						
At 1 January 2015	5,958	20,610	1,995	1,473	328	30,364
Additions	–	–	393	–	2	395
Disposals	–	–	(523)	–	(208)	(731)
Foreign exchange movement	775	919	62	–	6	1,762
At 31 December 2015	6,733	21,529	1,927	1,473	128	31,790
Accumulated amortisation						
At 1 January 2015	–	1,328	528	–	161	2,017
Charge for the year	–	28	152	–	72	252
Disposals	–	–	(148)	–	(200)	(348)
Impairment	–	–	–	1,473	–	1,473
Foreign exchange movement	–	–	15	–	3	18
At 31 December 2015	–	1,356	547	1,473	36	3,412
Net book amount						
At 31 December 2015	6,733	20,173	1,380	–	92	28,378

18. Property, plant and equipment
Property, plant and equipment is stated at historical cost, net of depreciation and any provision for impairment. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to working condition for its intended use. Depreciation is provided on all property, plant and equipment at rates calculated to write off the cost, less estimated residual value, of each asset on a straight-line basis over its expected useful life, which for plant and machinery is three to ten years. No depreciation is provided on land or assets under construction.

Residual values and useful lives are reviewed annually. Values are estimated using benchmark prices at the balance sheet date; useful lives are estimated based on management expectations of future project requirements and operational assessment of the state of assets.

Assets are reviewed for impairment annually and also whenever events or changes in circumstances indicate their carrying value may not be recoverable. To the extent the carrying value exceeds the recoverable amount, the difference is recorded as an expense in the Income statement. The recoverable amount used for impairment testing is the higher of the value in use and fair value less costs of disposal. For the purpose of impairment testing, assets are generally tested individually or at a CGU level which represents the lowest level for which there are separately identifiable cash inflows which are largely independent of cash inflows from other assets or groups of assets.

Expenditure funded by research partners is only capitalised where there are no significant rights acquired by the third party over the asset and the asset has a clear enduring use beyond the specific funding project, these are regularly reviewed.

2016	Assets under construction £'000	Land £'000	Plant and machinery £'000	Total £'000
Cost				
At 1 January 2016	63	1,104	10,118	11,285
Additions	246	–	45	291
Disposals	–	–	(95)	(95)
Transfers to plant and machinery	(222)	–	222	–
Foreign exchange	17	226	1,910	2,153
At 31 December 2016	104	1,330	12,200	13,634
Accumulated depreciation				
At 1 January 2016	–	–	5,778	5,778
Charge for the year	–	–	1,132	1,132
Disposals	–	–	(94)	(94)
Foreign exchange	–	–	1,181	1,181
At 31 December 2016	–	–	7,997	7,997
Net book amount				
At 31 December 2016	104	1,330	4,203	5,637

Notes to the financial statements (continued)

18. Property, plant and equipment (continued)

2015	Assets under construction £'000	Land £'000	Plant and machinery £'000	Total £'000
Cost				
At 1 January 2015	778	1,053	7,827	9,658
Additions	224	–	2,038	2,262
Disposals	–	–	(1,082)	(1,082)
Transfers to plant and machinery	(954)	–	954	–
Foreign exchange	15	51	381	447
At 31 December 2015	63	1,104	10,118	11,285
Accumulated depreciation				
At 1 January 2015	–	–	5,593	5,593
Charge for the year	–	–	1,025	1,025
Disposals	–	–	(1,077)	(1,077)
Foreign exchange	–	–	237	237
At 31 December 2015	–	–	5,778	5,778
Net book amount				
At 31 December 2015	63	1,104	4,340	5,507

As at 31 December 2016, the Company had entered into contractual commitments for the acquisition of property, plant and equipment amounting to £12,000 (2015: £23,000).

19. Investments in subsidiaries

On acquisition, subsidiaries are accounted for in the consolidated accounts using the purchase method. The cost is measured as the fair value of the assets acquired, equity instruments issued and liabilities incurred or assumed at the date of exchange, irrespective of minority interest. For acquisitions completed prior to 1 January 2010, costs directly attributable to the acquisition are included in this calculation, for subsequent acquisitions they are expensed. The excess of cost over fair value is recorded as goodwill. If cost is less than fair value, the difference is recognised in the Income statement. Subsidiaries are consolidated from the date on which control is transferred to the Company.

Investments in subsidiaries are held by the parent company at historical cost less impairment. The net investment that the parent company has in its subsidiary undertakings is its interest in the net assets of that subsidiary. The inclusion of long-term loans and receivables (Loans to subsidiaries) as part of the net investment in the subsidiary undertaking (Investment in subsidiaries) is determined by the fact that settlement is neither planned nor likely to occur in the foreseeable future. All loans to subsidiaries by the parent company meet this criterion.

The carrying amounts of the parent company's Investments in subsidiaries are reviewed at each balance sheet date, or when events or changes in circumstance indicate their carrying value may not be recoverable, to determine whether there is any indication of impairment. If such an indication exists, the asset's recoverable amount is estimated. To the extent the carrying amount exceeds the recoverable amount, the difference is recorded as an expense in the Income statement. The recoverable amount used for impairment testing is the higher of the value in use and fair value less costs of disposal. For the purpose of impairment testing, assets are generally assessed individually or at a CGU level, which represents the lowest level for which there are separately identifiable cash inflows that are largely independent of cash inflows from other assets or groups of assets.

As set out in note 17, an impairment assessment was carried out on the Company's intangible assets and no impairment was indicated. The parent company used the same basis for calculating the recoverable amount to determine the total value of the three subsidiaries held by the parent company, based on the judgement that there is limited value attributable to the parent company, as a non-trading holding company. The parent company has both equity and debt investments in the three subsidiaries, which are compared to the recoverable amount. On this basis, the impairment assessment indicated that the carrying value of the investments in subsidiaries was higher than the recoverable amount, determined by fair value less costs of disposal. As a result, an impairment of £65,716,000 (2015: £nil) was recognised. This impairment eliminated on consolidation.

An impairment loss in respect of Investments in subsidiaries is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised or if there has been a change in the estimate used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed that which would have been determined if no impairment loss had been recognised.

Intercompany transactions, balances and unrealised gains and losses on transactions are eliminated in the consolidated accounts. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with Company policies.

Critical estimates and judgements

In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, a number of indicators of potential impairment. The parent company identified that at the annual impairment assessment date, being the balance sheet date, the carrying amount of the net assets of the parent company of £67.4m was more than its market capitalisation of £53.5m. The critical estimates and judgements applied in calculating the recoverable amount are set out in note 17.

			2016			2015
Velocys plc	Loan to subsidiaries £'000	Capital contributions to subsidiaries £'000	Total investment in subsidiaries £'000	Loan to subsidiaries £'000	Capital contributions to subsidiaries £'000	Total investment in subsidiaries £'000
Investments in subsidiaries						
At 1 January	89,369	36,920	126,289	93,820	34,932	128,752
Movement in loans	(2,792)	–	(2,792)	(3,655)	–	(3,655)
Capital contributions	–	884	884	–	1,988	1,988
Impairment of subsidiaries	(46,973)	(18,743)	(65,716)	–	–	–
Foreign exchange	8,166	–	8,166	(796)	–	(796)
At 31 December	47,770	19,061	66,831	89,369	36,920	126,289

The parent company has direct investments in the following subsidiary undertakings.

Subsidiary undertakings	Country of incorporation or principal business address	Principal activity	% Holding (all ordinary share capital)
Velocys Technologies Limited*	England and Wales	Design and development of catalysts, and exploitation of platform catalyst technologies	100
Velocys (USA Holdings) LLC**	Ohio, USA	Holding company for US subsidiaries	100
Oxford Catalysts Trustees Limited*	England and Wales	Holds assets and makes distributions in respect of employee remuneration	100

The following companies are subsidiaries of the Company whose immediate parent is not Velocys plc.

Subsidiary undertakings	Country of incorporation or principal business address	Principal activity	% Holding (all ordinary share capital)
Velocys, Inc.**	Delaware, USA	Design, development and exploitation of its microchannel technologies	100
Velocys Project Solutions, LLC***	Delaware, USA	Project development of smaller scale GTL plants	100
Ashtabula Energy, LLC***	Delaware, USA	Project development of smaller scale GTL plant in Ashtabula, Ohio	100
YellowRock GTL Services, LLC**	Delaware, USA	Secondment of employees to plants	100
VMH Assets LLC**	Ohio, USA	Holds manufacturing assets in Ohio	100
JAB Land-Ashtabula**	Ohio USA	Holds land for smaller scale GTL plant in Ashtabula Ohio	100
Westlake GTL, LLC**	Delaware, USA	Project development of smaller scale GTL plant	100

The following are dormant subsidiaries.

Dormant subsidiaries	Incorporated	Immediate parent	% Holding
Oxford Catalysts UK Limited*	England and Wales	Velocys plc	100
Bradford GTL LLC***	Delaware, USA	Velocys Project Solutions, LLC	100
Susquehanna GTL LLC***	Delaware, USA	Velocys Project Solutions, LLC	100

* Located at 115e Olympic Avenue, Milton Park, Abingdon, Oxfordshire OX14 4SA, UK.
** Located at 7950 Corporate Boulevard, Plain City, OH 43064, USA.
*** Located at 2603 Augusta Drive, Suite 1175, Houston, TX 77057, USA.

20. Investments
Investments consist solely of Velocys' holding in ENVIA Energy, LLC (ENVIA) located at 1021 Main Street, Suite 1000 Houston, TX 77002. ENVIA is a US company and is the holding company for the project located in Oklahoma (the ENVIA project). The Company first invested in ENVIA in 2014 as entry into a joint venture to develop GTL plants in the US using a combination of renewable biogas (including landfill gas) and natural gas. The first of these plants, ENVIA Oklahoma City produced its first product in 2017. A description of the ENVIA project is available in the Strategic report on pages 8-11.

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories of financial instruments – see note 28 for a description of these classes and the accounting policy for available-for-sale financial assets. At 31 December 2015, the investment was recorded at cost, which was also considered to be fair value.

At the end of January 2016, Velocys entered into a financing arrangement with ENVIA under which it contributed additional equity finance of $2,587,000 and committed to provide loan finance of up to $9,310,000. This senior loan note bears interest at 10%, and is repayable on 31 December 2019 with an option to extend to 31 December 2020. As at 31 December 2016, one draw down on this facility had been made by ENVIA in the amount of $400,000 (see note 21). As a result of the new funding arrangement, Velocys increased its ownership share and was awarded additional voting rights, taking its share of voting rights to 28%.

Associates are all entities over which the Company has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. From this point the investment has been recognised as an Investment in associate, accounted for under the equity method. This judgement was based on the level of influence Velocys holds in ENVIA, including voting rights exceeding 20% and a seat on ENVIA's board. Investments in associates are accounted for using the equity method of accounting from the date on which it becomes an associate. Under the equity method, a cost approach is followed whereby the cost of all purchases are accumulated (including transaction costs) to determine the amount of the investment. The notional purchase price allocation (including goodwill arising on the purchase of the additional stake) is calculated using fair value information at the date when the additional interest is acquired. Goodwill is calculated as the excess of the cost of the investment over the Company's share of the net fair value of the investee's identifiable assets and liabilities and included in the carrying amount of the investment. The allocation was fair valued, which gave rise to goodwill of £320,000; this has been included in Investment in the Investment in associate table below. Velocys' share of losses since the end of January 2016, arising from administration costs incurred by ENVIA ahead of the start-up of its first GTL plant, has been reflected in the Income statement. The carrying amount of the investment is adjusted to recognise the investor's share of the change in net assets of the investee after the date of acquisition.

The Company's share of post-acquisition profit or loss is recognised in the Income statement. There are no post-acquisition movements in Other comprehensive income in the Company's investments in associates. Distributions received from an associate reduce the carrying amount of the investment.

The Company determines at each reporting date whether there is any objective evidence that the investment in the associate is impaired. If this is the case, the Company calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value and recognises the amount adjacent to share of profit/(loss) of associates in the income statement. See note 17 for impairment of non-financial assets.

Gains and losses resulting from upstream and downstream transactions between the Company and its associate are recognised in the financial statements only to the extent of unrelated investors' interests in the associates. Unrealised losses are eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Company. There have been no dilution gains and losses arising in investments in associates.

Critical estimates and judgements
On acquisition of significant influence, the Company has recognised 9.7% of the net fair value of ENVIA's identifiable assets and liabilities in its investment in ENVIA and, for the period from such acquisition to 31 December 2016, recognised 9.8% as its share of post-acquisition losses in ENVIA. These percentages differ to both the Company's proportion of ownership units held in ENVIA and its proportion of voting units, which are outlined above. They are considered more appropriate measures of the Company's economic interest in ENVIA at both acquisition and for the period ending 31 December 2016, where the distribution of both ENVIA's identifiable assets and liabilities and its net losses is defined by the LLC agreement agreed with each of the other parties that hold ownership units in ENVIA. The investment is denominated in US dollars; in 2015 it was considered to be an available-for-sale asset.

Company	2016 £'000	2015 £'000
Available-for-sale investment		
At 1 January	3,375	1,711
Investment	–	1,535
Foreign exchange	–	129
Movement to associate	(3,375)	–
At 31 December	–	3,375

Company	2016 £'000	2015 £'000
Investment in associate		
At 1 January	–	–
Movement from available-for-sale	3,375	–
Investment	1,938	–
Share of loss	(306)	–
Foreign exchange	858	–
At 31 December	5,865	–

Summarised financial information for ENVIA
Set out below is the unaudited summarised financial information for ENVIA. The information below reflects the amounts presented in the financial statements of ENVIA adjusted for differences in accounting policies between the Company and ENVIA. ENVIA financial statements are not prepared under IFRS but management does not consider US GAAP to be materially different from IFRS for this purpose.

ENVIA Energy, LLC	2016 (unaudited) £'000
Summarised balance sheet	
Current assets	5,066
Non-current assets	63,303
Current liabilities	(5,716)
Non-current liabilities	(381)
Summarised statement of comprehensive income	
Revenue	–
Loss from continuing operations	(3,155)
Other comprehensive income	–
Total comprehensive income	(3,155)

The Company's interest in associate was calculated as follows.

	2016 £'000
Fair value as at recognition of investment as associate	51,643
Investment (9.7%)	4,993
Loss for the period	(3,155)
Investment (9.8%)	(306)
Goodwill	320
Foreign exchange	858
Carrying value	5,865

Notes to the financial statements (continued)

21. Trade and other receivables

Trade receivables

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments (more than 30 days overdue) are considered indicators that the trade receivable is impaired.

The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The carrying amount of the asset is reduced through an allowance account, and the amount of the loss is recognised in Cost of sales in the Income statement. When a receivable is uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against Cost of sales.

Company	2016 £'000	2015 £'000
Non-current		
Loan receivable	325	–
Total	325	–

Velocys has committed to provide up to US$9,310,000 to ENVIA through a senior loan note due on 31 December 2019 and bearing a 10% interest rate, with an optional extension to 31 December 2020 with prior notice. As at 31 December 2016, one draw down on this facility had been made by ENVIA in the amount of £325,000 ($400,000). See note 20.

Company	2016 £'000	2015 £'000
Current		
Trade receivables	397	4
Prepayments and accrued income	371	324
Other receivables	43	583
Total	811	911

Parent company	2016 £'000	2015 £'000
Current		
Prepayments and accrued income	31	15
Other receivables	–	17
Total	31	32

The fair value of trade and other receivables is not materially different to the book value above (2015: not materially different). The trade receivables hold a low credit risk. The maximum exposure to credit risk at the reporting date is the carrying value of each class of receivable plus cash balances held. The Company does not hold any collateral as security (2015: £nil).

As at 31 December 2016 Company trade receivables of £249,000 (2015: £4,000) were past due but not impaired. The aging analysis for the 2016 amounts past the due date, which were received in full in 2017, is as follows.

Company	2016 £'000	2015 £'000
Up to three months	249	4
Total	249	4

The Company's trade receivables outstanding at year end represent approximately 102 days' sales (2015: 1 day). These are existing customers with no history of default. The parent company had no trade receivables at 31 December 2016 (2015: £nil).

The Company believes that the full amount of trade receivables recognised is recoverable. At 31 December 2016, the parent company had no overdue trade receivables (2015: £nil). The other classes within trade and other receivables do not contain impaired assets (2015: £nil).

Trade and other receivables are denominated in the following currencies:

Company	2016 £'000	2015 £'000
UK sterling	224	233
US dollars	587	678
Total	811	911

22. Inventories

Inventories are stated at the lower of cost or net realisable value less provision for impairment. Cost is determined on a first-in, first-out basis and includes transport and handling costs. In the case of manufactured products, cost includes all direct expenditure including production overheads. Where necessary, provision is made for obsolete, slow-moving and defective inventories. Items purchased for use in externally funded research and development projects are expensed to that contract immediately. Items held for the Company's own development are also expensed when acquired. Items purchased for ongoing commercial sale are held in inventory and expensed when used or sold.

Company	2016 £'000	2015 £'000
Raw materials and consumables	95	77
Finished goods	1,366	1,316
Total	1,461	1,393

In 2016, the Company wrote off £104,000 of the value of an inventoried reactor as a reflection of the fact that its selling price is below cost. The book value of the inventoried reactor is £311,000.

23. Short term investments, cash and cash equivalents

Cash and cash equivalents includes cash in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less. Bank accounts held which have an original maturity of more than three months, or which are subject to significant restrictions over access are shown as short term investments or other financial assets with appropriate disclosure of the related terms. See note 28.

Company	2016 £'000	2015 £'000
Short term bank deposits	–	3,000
Cash at bank and in hand	18,744	34,736
Total cash and cash equivalents	18,744	37,736

Both short term investments, and cash and cash equivalents, are denominated in UK sterling and in US dollars, as follows:

UK sterling denominated

Company	2016 £'000	2015 £'000
Short term bank deposits	–	3,000
Cash at bank and in hand	7,114	23,570
Total UK sterling denominated	7,114	26,570

US dollar denominated

Company	2016 £'000	2015 £'000
Short term bank deposits	–	–
Cash at bank and in hand	11,630	11,166
Total US dollar denominated	11,630	11,166

The parent company has no cash or cash equivalents (2015: £nil).

Notes to the financial statements (continued)

24. Trade and other payables: current
Provisions for claims are recognised when the Company has a present constructive or legal obligation as a result of past events, and it is probable that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. See note 28.

Company	2016 £'000	2015 £'000
Trade payables	722	1,372
Other taxation and social security	51	14
Accruals	991	3,265
Deferred income	508	2,638
Deferred consideration	–	91
Total	2,272	7,380

The parent company has trade and other payables of £72,000 (2015: £140,000), all of which are accruals.

Due to their short maturity, the fair value of trade and other payables are not considered to be materially different to their carrying values, based on discounted cash flows.

All trade payables are due in 60 days or less (2015: 60 days or less).

Deferred consideration relates to the acquisition of VPS in 2014, under which a number of 'holdback' shares were designated to cover post-acquisition adjustments; these shares were issued during 2016.

25. Trade and other payables: non-current

Company	2016 £'000	2015 £'000
Accruals	110	65
Deferred income	1,233	1,262
Total	1,343	1,327

The fair values of trade and other payables are not considered to be materially different to their carrying values.

Deferred income for 2016 includes funds received for catalyst to be earned over a two-year period commencing at the start-up of the ENVIA reactors.

26. Borrowings
Maturity of borrowings for the Company is as follows.

Company	2016 £'000	2015 £'000
Within one year	323	288
Within two to five years	593	759
Total	916	1,047

The majority of Borrowings relates to a loan entered into on 1 December 2009 by Velocys plc's wholly owned subsidiary, Velocys, Inc. with the State of Ohio (the State) allowing Velocys, Inc. to borrow up to $2.25m to fund qualified capital projects for research and development projects. All such projects were required to be completed by 31 August 2012 and have 25% of costs funded by Velocys Inc. The interest rate for the loan is 2.00% per annum with a service fee of 0.25% on the principal balance. The Company's fixed rate borrowings are carried at amortised cost. They are therefore not subject to interest rate risk as defined in IFRS 7, since neither the carrying amount nor the future cash flows will fluctuate because of a change in market interest rates. The loan is repaid to the State using a blended payment schedule as follows.

- For the first five years of the loan, the principal is paid in consecutive monthly instalments based upon an original amortisation over 20 years with any interest accrued during that particular month.
- For the remaining term of the loan, the principal is paid in consecutive monthly instalments based upon the remaining term of the loan (five years) with any interest accrued during that particular month.

The loan is secured by all plant and machinery acquired using the loan proceeds as well as a guarantee of payment provided by the parent company. The gross book value of the capital projects secured is £2,672,000 (2015: £2,217,000). The loan was fully drawn down in 2012. After repayments of principal, the amount outstanding on the loan as at 31 December 2016 is £880,000 (2015: £964,000).

All remaining Borrowings of £36,000 (2015: £83,000) arise from finance lease obligations. The fair values of Borrowings are not considered to be materially different to their carrying values based on discounted cash flows.

27. Derivative financial instruments
The Company is funded in sterling but buys US dollars to fund its operations in the United States, which exposes it to foreign exchange risk. This is mitigated through the use of forward contracts at fixed rates of exchange with fixed maturity dates. Derivative financial instruments are initially recognised at fair value on the date the derivative contract is entered into and are subsequently remeasured at fair value at each balance sheet date using values determined indirectly from quoted prices that are observable for the asset or liability. This is a level 2 fair value measurement. Gains and losses against the US dollar exchange rate as at 31 December 2016 are recognised in Finance income in the Income statement. At 31 December 2016 the notional principal amounts of the outstanding forward foreign exchange contracts were £2,714,000 (2015: £3,217,000), and the revalued amounts were £3,251,000 (2015: £3,373,000). The unrealised foreign exchange gain on these contracts as at 31 December 2016 was £537,000 (2015: £156,000). All the outstanding contracts will mature during 2017.

28. Financial instruments
Financial assets
The Company classifies its financial assets in the following categories: at fair value through profit or loss, loans and receivables and available-for sale. The classification depends on the nature of the asset and the purpose for which the assets were acquired. Financial assets are classified upon initial recognition.

Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

The Company's principal financial asset is Cash and cash equivalents. In 2015 it also held short-term investments, which are cash deposits on fixed terms of interest for more than three months (see note 23).

Loans and receivables also includes Trade receivables and Other receivables (see note 21), which are classified as current assets, and the loan to ENVIA (see notes 19 and 20), which is classified as non-current as its maturity is more than 12 months from the balance sheet date. Loans and receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment.

Assets at fair value through profit and loss
Financial assets carried at fair value through profit or loss are initially recognised at fair value, and transaction costs are expensed in the Consolidated income statement.

For Velocys, this category includes only derivative financial instruments (see note 27). The Company enters into forward contracts to mitigate the risk of needing to fund its US operations in dollars. An asset is recognised when there is a foreign exchange gain upon re-measurement of the contract. The Company hasn't taken a forward position further than 12 months from the reporting date. Therefore all assets have been recognised as current. The gain or loss on re-measurement to fair value is recognised immediately in the Income statement, in Net finance income.

Available for sale
Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless the investment matures or management intends to dispose of the assets within 12 months after the balance sheet date. Available for sale financial assets are subsequently carried at fair value; movements are recorded in the Statement of comprehensive income.

In 2015 the Company's investment in ENVIA was recognised as an Available for sale financial asset. At the end of January 2016 the investment and voting interest were increased and was subsequently recognised as an Investment in associate (see note 20). Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss.

Financial liabilities
Financial liabilities are classified according to the substance of the contractual arrangements entered into. In 2015 and 2016 the Company had only one category of liability.

Financial liabilities at amortised cost
Financial liabilities at amortised cost includes Trade payables, all of which are current liabilities (see note 25), Borrowings and Finance leases (see note 26). Trade payables are stated at fair value and subsequently held at amortised cost using the effective interest method. Under Borrowings, interest bearing loans and overdrafts are initially recorded at the fair value of proceeds received net of direct issue costs, and thereafter at amortised cost. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are recognised in the income statement using the effective interest method and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

All of the above financial assets and liabilities are level 2 fair value measurements.

Notes to the financial statements (continued)

28. Financial instruments (continued)
Financial risks
The activities of Velocys expose it to a number of financial risks, which are dealt with specifically below.

Financing
The Company's cash usage is significant versus prospective future cashflows (particularly in the short term) and Velocys is reliant on the support of a small group of major shareholders. The timing of cashflows is difficult to predict given the Company's nascent strategy. The Board recognises that further funding will be needed. Note 2 discusses uncertainties surrounding the extent and composition of future funding. The Company believes that equity remains the preferred structure to support the business as a going concern in the near term, but will keep this under review. The recently announced fundraise included the issue of loan notes that are convertible into equity. As such, in management's view, they have the key characteristics of equity. Velocys continues to take measures to preserve cash in order to protect against unforeseen events.

Equity forms the basis of the Company's capital. Its objectives when managing this capital are:
- To secure its ability to continue as a going concern.
- To keep its cost of capital low through an optimised capital structure.
- To preserve sufficient funds to protect it against unforeseen events and risks.
- To be in a position to take advantage of opportunities that can deliver a return to shareholders.

The Company's revenue stream relies on projects incorporating its technology securing project finance. The Company's strategy is to take a pro-active role in this process. It is actively engaging with banks and financial advisors with high levels of expertise in project financing to support the financing plans for the types of projects it is developing.

Exchange rates
A significant proportion of commercial activity and R&D costs are US-dollar denominated. Where possible, revenue is receipted in US dollars to act as a natural hedge against this exposure. Additionally, a proportion of liquid assets is held in US dollars, and future exchange rate uncertainty is managed through the use of forward contracts at fixed rates of exchange.

The use of financial derivatives is governed by Company policies, which are approved by the Board of directors, and which provide a set of written principles for the management of these risks. At present Velocys makes use of financial derivatives only in the management of the foreign exchange exposure arising from funding its US operations.

The consolidated financial statements contain significant US-dollar denominated intangible assets relating to the acquisition of Velocys, Inc., which give rise to movements in reserves when exchange rates fluctuate. These movements are not hedged as they do not impact the cash position.

The table below illustrates the Company's sensitivity to changes in the US dollar exchange rate at the balance sheet date. The analysis covers only financial assets and liabilities.

	2016		2015	
	Income statement £'000	Equity £'000	Income statement £'000	Equity £'000
GBP:USD exchange rate +/- 10%	1,421	1,421	1,157	1,157

Liquidity
The Company maintains sufficient cash balances to meet anticipated requirements. Cash flow forecasts are regularly reviewed, cash balances are held immediately available as necessary, and surplus funds are placed on time deposits of varying duration.

Credit
The Company's credit risk is primarily attributable to its trade receivables, which are concentrated in a small number of high value customer accounts. This risk is managed by carrying out relevant financial checks on customers, and where necessary, requiring letters of credit or advance payments.

The credit risk of liquid funds is limited through a Company treasury policy, maintained to ensure that liquid assets are only placed with highly-rated institutions, and that the spread of such assets restricts exposure to any one counterparty. Risk is assessed using an external credit rating agency's long-term ratings.

Interest rates
Variations in interest rates affect only Velocys' cash holdings, as its borrowing is payable at a fixed rate. As far as the cash flow forecast allows for certainty, funds are placed on fixed rate deposits. The effect of interest rates on exchange rates is not anticipated.

Financial assets are as follows.

				31 December 2016
Company	Loans and receivables £'000	Assets at fair value through profit and loss £'000	Available for sale £'000	Total £'000
Assets as per balance sheet				
Derivative financial instruments	–	537	–	537
Trade and other receivables excluding non-financial assets	765	–	–	765
Short term investments – funds held on deposit	–	–	–	–
Cash and cash equivalents	18,744	–	–	18,744
Total	19,509	537	–	20,046

				31 December 2015
Company	Loans and receivables £'000	Assets at fair value through profit and loss £'000	Available for sale £'000	Total £'000
Assets as per balance sheet				
Available-for-sale financial assets	–	–	3,375	3,375
Derivative financial instruments	–	156	–	156
Trade and other receivables excluding non-financial assets	587	–	–	587
Short term investments – funds held on deposit	3,000	–	–	3,000
Cash and cash equivalents	34,736	–	–	34,736
Total	38,323	156	3,375	41,854

The credit risk of short term investments and cash and cash equivalents is summarised in the following table.

	2016		2015	
Short-term bank deposits, cash at bank and in hand	£'000	%	£'000	%
Aa2	663	3	3,447	9
Aa3	8,817	47	5,698	15
A1	8,747	47	15,044	40
A2	–	–	12,034	32
A3	517	3	1,513	4
Total	18,744		37,736	

28. Financial instruments (continued)
Financial liabilities are as follows.

Company	31 December 2016 Financial liabilities at amortised cost £'000
Liabilities as per balance sheet	
Borrowings	880
Trade and other payables excluding non-financial liabilities	722
Finance lease liabilities	36
Total	1,638

Company	31 December 2015 Financial liabilities at amortised cost £'000
Liabilities as per balance sheet	
Borrowings	964
Trade and other payables excluding non-financial liabilities	1,372
Finance lease liabilities	83
Total	2,419

The aging of financial liabilities is as follows.

Company	2016 £'000	2015 £'000
Within one year	1,045	1,660
Within two to five years	593	759
Total	1,638	2,419

Financial assets of the parent company are as follows. The parent company has no financial liabilities.

Parent company	31 December 2016 Loans and receivables £'000
Assets as per balance sheet	
Trade and other receivables excluding non-financial assets	47,770

Parent company	31 December 2015 Loans and receivables £'000
Assets as per balance sheet	
Trade and other receivables excluding non-financial assets	89,369

Parent company loans and receivables are all intercompany loans.

29. Called up share capital and reserves
Called up share capital

Company and parent company	Number of shares* (thousands)	Ordinary shares £'000	Share premium £'000
At 1 January 2015	141,896	1,419	149,225
Employee share options scheme: Shares issued including 1p exercise price options	27	–	(28)
At 31 December 2015	141,923	1,419	149,197
Employee share options scheme: Shares issued including 1p exercise price options	1,912	19	(13)
Holdback shares	41	–	91
At 31 December 2016	143,876	1,438	149,275

* All shares have been issued, authorised and fully paid.

A total of 11,811,991 (2015: 15,613,701) options to subscribe for ordinary shares of Velocys plc have been granted and are outstanding at 31 December 2016 under the employee options schemes operated within the Company and contracts for options granted to a limited number of consultants. Details are given in note 15.

On 25 June 2014 the Company acquired Velocys Project Solutions, LLC. A number of holdback shares was designated to cover adjustments in the period after acquisition. The remaining balance of 41,644 shares was issued during 2016.

Reserves
Foreign exchange reserve relates to the exchange differences arising from the retranslation of the results and opening net assets of foreign subsidiaries. Changes in the reserve are included in other comprehensive income. The Company's foreign exchange reserve was a credit balance of £7,051,000 (2015: a debit balance of £282,000).

The share based payment reserve records the IFRS 2 charge for equity settled share based payment awards. At 31 December 2016 the Company's and parent company's share-based payment reserves were both £15,843,000 (2015: £15,362,000).

30. Commitments
Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

The Company leases certain property, plant and equipment. Leases under which the Company incurs substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised on commencement of the lease at the lower of the fair value of the leased property and the present value of the minimum lease payments.

Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of finance charges, are included in other long-term payables. The interest element of the finance cost is also charged to the income statement in Finance costs over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The property, plant and equipment acquired under finance leases is depreciated over the shorter of the useful life of the asset and the lease term.

Operating lease commitments
The Company leases various offices under non-cancellable operating lease agreements. The lease terms are between two and five years and the majority of lease agreements are renewable at the end of the lease period at market rate.

Company	2016 £'000	2015 £'000
Future aggregate minimum lease payments under non-cancellable property leases:		
– Within one year	489	408
– Between one and five years	1,312	1,217
– After more than five years	194	415
Total	1,995	2,040

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Company	2016 £'000	2015 £'000
Future commitments under non-cancellable operating plant and equipment leases:		
– Within one year	2	2
– Between one and five years	7	3
Total	9	5

Capital commitments are disclosed in note 18.

The Company is committed to make available additional loan funding to ENVIA of £7.2m ($9.3m), which is repayable by 31 December 2020.

The parent company does not have any commitments (2015: £nil).

31. Pension arrangements
The Company operates a number of defined contribution schemes for which the pension cost charge for the year amounted to £314,000 (2015: £326,000).

32. Related party transactions
The parent company has the following amounts due from its subsidiaries:

Balances with subsidiary companies	2016 £'000	2015 £'000
Velocys Technologies Limited	21,170	58,637
Velocys (USA Holdings) LLC	5,205	6,191
Velocys, Inc.	21,395	24,541
Total due from subsidiaries	47,770	89,369

All amounts are unsecured and have no fixed date of repayment. All intercompany loans are charged at 5%.

For 2016 the Company provided engineering services totalling £619,000 to ENVIA, an associate in which the Company has ownership and voting rights as detailed in note 20. At 31 December 2016 the Company had a receivable due from ENVIA of £145,000. During 2016 Velocys committed to provide up to $9,310,000 to ENVIA through a senior loan note, which bears interest of 10%, and is due for repayment on 31 December 2019 with an optional extension to 31 December 2020. As at 31 December 2016, one draw down on this facility had been made by ENVIA in the amount of £325,000 ($400,000 - see note 20). In 2015 ENVIA was not a related party.

The Company provided engineering services of £110,000 to Norma Investments Limited, which is the parent company of Ervington Investments, the largest shareholder in Velocys plc with a holding of 29.5% at 31 December 2016.

Oxford Catalysts Trustees Limited
At the time of exercising their share options, executives of the Company may apply to the employee benefit trust managed by Oxford Catalysts Trustees Limited for a distribution in respect of the exercise value of their options. The trustees then request a contribution from the Company in respect of the grant made. The total value of funds contributed by the Company to Oxford Catalysts Trustees Limited during the year was £13,300 (2015: £nil).

33. Post-financial position events
The following events occurred after 31 December 2016.

On 17 January 2017 the Company announced that it had signed a memorandum of understanding with Morimatsu, the Company's preferred supplier of module fabrication and engineering. Velocys proceeded, on 3 March, to confirm that it had reached a definitive agreement with Morimatsu.

On 26 January 2017 a strategic alliance was announced with TRI, the Company's preferred supplier of gasification systems for its biomass-to-liquids (BTL) plants.

On 6 February 2017 it was announced that first product had been made at ENVIA Energy's GTL plant in Oklahoma City.

Velocys announced on 26 April 2017 that Mark Chatterji had stepped down from his position as Non-Executive Director.

The Company announced on 15 May 2017 that it had secured £10m of additional funding.

In May 2017 Velocys agreed to provide further loan finance to ENVIA of $3.4 million; this did not affect the Company's share of ownership or voting rights.

Directors, secretary and advisors to the Company

Registered office
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Velocys plc registration no.
05712187

Directors
Pierre Jungels (Non-Executive Chairman)
David Pummell (Chief Executive Officer)
Susan Robertson (Chief Financial Officer)
Paul Schubert (Chief Operating Officer)
Julian West (Senior Independent Director)
Ross Allonby (Non-Executive Director)
Sandy Shaw (Non-Executive Director)

Company secretary
Jeremy Gorman

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Joint brokers
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