


Pivoting to renewable fuels

Annual report and accounts 2017



Velocys is part of a growing movement to produce increased volumes of renewable fuels, in our case primarily from forestry residues. Our process is one of the few cost effective ways to meet the economy's need for large quantities of sustainable fuels. Our technology and operational expertise were pivotal in delivering the world's first commercial scale smaller scale gas-to-liquids plant. Now we are using our unique capabilities to drive the development of what will be a series of biorefineries, with our partners, from concept to full operations.



Product offtake from ENVIA's biorefinery in Oklahoma City – the first commercial project incorporating Velocys' technology.

The challenge



Petroleum based fuels emit greenhouse gases and pollution and are **not sustainable or renewable**.



Demand for diesel and jet fuel **continues to increase**, making the challenge bigger.



1st and 2nd generation biofuels have **not maximised sustainable carbon emissions reductions**.



2nd generation advanced cellulosic biofuels projects are **capital intensive and require legislative support**.

The solution



Abundant sustainable and renewable feedstocks exist.



Legislation at the national and state levels supports advanced 2nd generation biofuels and **momentum is building**.



Velocys with its commercial scale technology and new business model is now entering renewable fuels markets to **grow a material supply position**.

Market strategy



Identify **attractive markets** with scale and optimal locations for future plants.



Focus on our **priority market**: US biomass residues to renewable jet and diesel.



Build **consortia of strategic and financial partners** to deliver investment, scale and pace to market.



Leverage our engineering, operational and technology expertise to optimise future plant costs and timelines.

“I believe we will look back at 2017 as the year Velocys transformed into a renewable fuels company. Although some of these changes were difficult they have set up the Company for the future delivery of multiple biorefineries and long-term sustainable growth. The ENVIA plant has validated our Fischer-Tropsch technology at commercial scale and from this platform we plan to grow and be at the forefront of supplying significant quantities of cellulosic renewable fuels. We have a demanding plan to deliver in 2018, but we are well placed to meet these challenges.”



David Pummell
CEO

→ Read more on pages 8 to 9.

Pivoting to renewable fuels

2017 has been an important year of change for Velocys. We have transitioned from being a technology company to a renewable fuels business. ENVIA’s Oklahoma City plant is now in operation, our Mississippi biorefinery project is on its way to reaching final investment decision, and the UK waste-to-jet-fuel project is progressing well through its feasibility stage. In addition we provide technology licences and associated support to third party project developers.

Highlights – ENVIA

→ Read more about ENVIA on page 10.



Highlights – Mississippi biorefinery

→ Read more about the Mississippi biorefinery on pages 12 to 13.



Other highlights

UK renewable fuel project

September 2017

Industry partnership formed, including British Airways, aimed at developing waste-to-renewable jet fuel plants in the UK.

→ Read more on page 14.

Strategy

July 2017

Reshaping of the Company to deliver the demands of the strategy focused on renewable fuels.

→ Read more on pages 3 and 8.

Financial

May 2017

Fundraise of over £10m (before expenses).

January 2018 (post-period end)

Fundraise of £18.4m (before expenses) to be used principally to help fund the development of the Mississippi biorefinery, and to secure strategic investment into it.

2017 financial results

Revenue of £0.8m (FY 2016: £1.4m).

Cash* at year end of £2.1m (FY 2016: £18.7m).

Total impairments, primarily against intangible assets, of £34.6m.

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

→ Read more on pages 16 to 17.

Management team

John Tunison appointed as Interim CFO in July 2017.

Red Rock Biofuels

May 2018 (post-period end)

Biorefinery being developed by third party project developer commences construction. Notice to proceed issued to Velocys.

Contents

Strategic report	1–25
Our business at a glance	2
Our focus markets	4
Chairman's statement	6
CEO's report	8
Project overview – ENVIA	10
Project overview – Mississippi biorefinery	12
Project overview – UK waste-to-jet fuel	14
Our process	15
Financial review	16
Corporate social responsibility	19
Key performance indicators (KPIs)	19
Risks and mitigation	20
Governance	26–42
Corporate governance report	26
Directors' report	30
Directors' remuneration report	32
Statement of directors' responsibilities	36
Independent auditors' report	37
Financial statements	43–85
Consolidated income statement	43
Consolidated statement of comprehensive income	44
Consolidated statement of financial position	45
Consolidated statement of changes in equity	46
Consolidated statement of cash flows	47
Notes to the consolidated financial statements	48
Velocys plc statement of financial position	77
Velocys plc statement of changes in equity	78
Velocys plc statement of cash flows	79
Notes to the financial statements for Velocys plc	80
Directors, secretary and advisors to the Company	IBC



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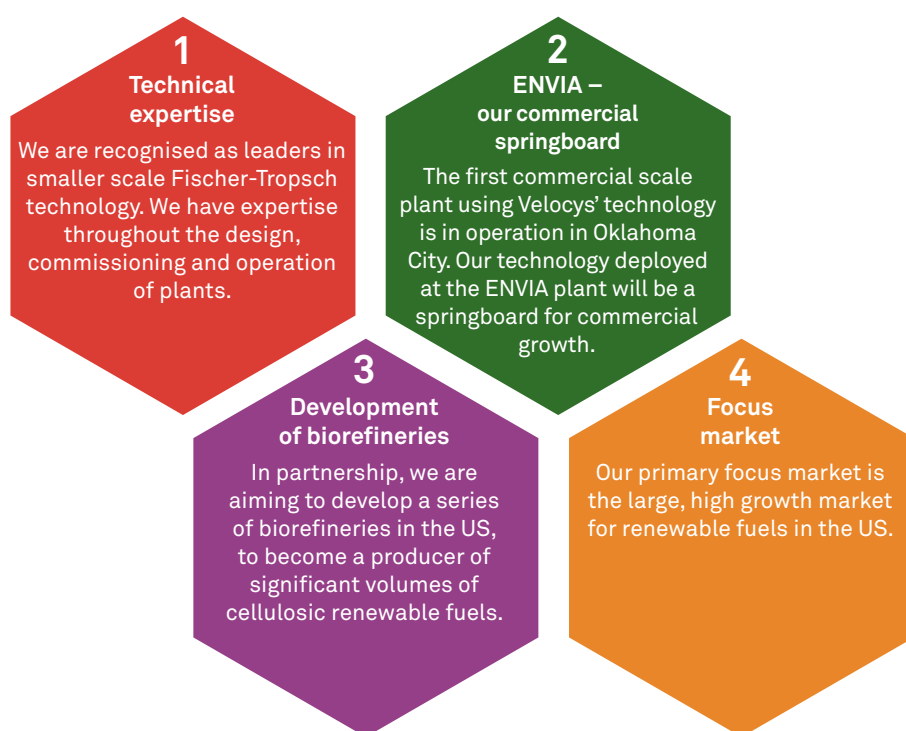
Follow us on twitter: [@velocysplc](https://twitter.com/velocysplc)

Our business at a glance

Velocys has a strong, multi-disciplinary team operating from its US project development and commercial centre in Houston, Texas, its UK project development and corporate office near Oxford, UK, and its technology and supply chain facility near Columbus, Ohio. We have experienced Fischer-Tropsch, process engineering, project development and plant commissioning and start-up teams unique to the industry.

Business influences

Velocys is managed as a single entity and referred to as “the Company”. Throughout the Strategic report we highlight content relating to four areas that will be critical to our future success.



“Velocys is well positioned, and we believe that our newly focused business model will drive commercialisation in the renewable fuels market, enabling our technology to be incorporated in multiple biorefineries that will help to expand the supply of renewable fuels that the world needs.”

David Pummell
CEO



Our vision

Our vision is to quickly become a producer of significant volumes of cellulosic biofuels with near term primary focus in the US market. Over the coming years the three pillars of Velocys' strategy will be:



1. Business model

We initiate and drive the development of biorefineries from concept to full operations. By taking the lead in projects, we reduce delivery risk and accelerate growth. We plan to convert some or all of our equity stakes in the development (or project) company into equity in the operating plants. We will derive a stream of dividends from those equity stakes in the operating biorefineries. We also expect ongoing revenues from technology supply, service contracts and the licensing of our technology.



2. Leverage capabilities

We work seamlessly with our partners to deliver modular, fully integrated, financeable, cost-effective and operations-ready biorefineries. Using Velocys' unique engineering and operational expertise as well as our proprietary technology, we continuously improve our integrated biorefinery offering.



3. Strategic partnerships

Our alliances, including manufacturing, gasification, product offtake and feedstock supply, are with strategic partners that have the resources, scale and capabilities to access large, high value markets at pace.

“These three strategic pillars are what we will use to deliver multiple operational biorefineries producing renewable fuels.”

David Pummell
CEO

Our biorefineries

The three biorefineries incorporating Velocys' technology currently in operation or under development are as follows.



ENVIA Oklahoma City

2016	2017	2018	2019	2020	2021	2022	2023
Construct	Commissioning then operational						

Process

Landfill gas to wax and diesel. Performing at a commercial scale.

Delivering

Renewable fuels and waxes as well as RINs. Our technology deployed at ENVIA is the springboard for our future biorefineries. → Read more on page 10.



Mississippi biorefinery

2017	2018	2019	2020	2021	2022	2023
Development			Construction		Commissioning then operational	

Process

Woody biomass to renewable fuels.

To deliver

The first of an expected series of repeatable biorefineries. → Read more on pages 12 to 13.



UK waste-to-jet fuel project

Process

Converting non-recyclable waste into renewable jet fuel.

To deliver

The first such commercial plant in the UK. → Read more on page 14.

Our focus markets

Following the Company's 2016 strategy review Velocys identified the market for renewable fuels in the United States as being particularly attractive for the commercialisation of its technology. This large and rapidly growing market is Velocys' immediate focus. Our strategy has the objective of creating sustainable growth.

Market of primary focus

More renewable fuels are urgently needed in the global fuel market. Many governments have mandated driving down greenhouse gas emissions by using cleaner, renewable fuels – a move widely supported by environmental agencies and non-governmental organisations. More are expected to follow suit. Industry and consumers also want to drive down their carbon footprint and reduce emissions cost-effectively, and swiftly.

US renewable fuels

The US jet fuel market is around 20bn gallons/year, and the US Energy Information Administration (EIA) expects an increase in global air travel by over 3% per year in the coming years. The airline industry (ICAO) has committed to carbon-neutral growth by 2020 and a 50% reduction in emissions by 2050. Incremental operational efficiencies will go a small way towards meeting these targets but nothing less than a huge increase in the supply of renewable jet fuel will be needed if they are to be met. By 2022 there is expected to be a worldwide demand of more than two billion gallons/yr of renewable jet fuel based on carbon neutral growth, of which more than 700m gallons per year will be required in North America.

In the US, diesel consumption is around 40bn gallons/year with 25% growth predicted by the EIA to 2040. There is an urgent and increasing demand for drop-in renewable fuels in this market that are fully compatible with existing infrastructure and engines. In California alone, the consumption of renewable diesel in 2016 was an estimated 300m gallons, but by 2030 the State will need some 1bn gallons of renewable diesel to meet its own obligations.

Using Velocys' technology, renewable fuels can be made cost-effectively from abundant reserves of biomass feedstock – meaning that scale of uptake is not restricted by feedstock availability. There is a plentiful supply of woody biomass in the US from entirely sustainable sources that do not compete with food crops for land. The forestry industry in the Southeastern United States has been in decline from falling demand for newsprint and paper; the infrastructure servicing the industry has spare capacity in many locations. As evidenced by, for example, the US Department of Energy's 2016 Billion Ton report, by 2030 it is estimated that there will be available over 200m dry tonnes/year of economically-accessible, non-federal timberland forestry biomass in the US – enough to support several dozen Velocys plants.

UK waste-to-sustainable jet fuel

The changes to the Renewable Transport Fuel Obligation (RTFO) that passed through Parliament in March 2018 (post-period end) are encouraging the UK to become a world leader in sustainable jet fuel. Millions of tonnes of waste are exported from the UK every year. The RTFO development fuel target for 2022 is 100m gallons/year. No qualifying development fuels are currently produced in the UK and a Velocys waste-to-jet fuel project would produce between 10 and 20% of the target. A Velocys waste-to-jet fuel plant could sell Renewable Transport Fuel Certificates worth up to £1.6/litre for a portion of the fuel.



Legislative support in the US

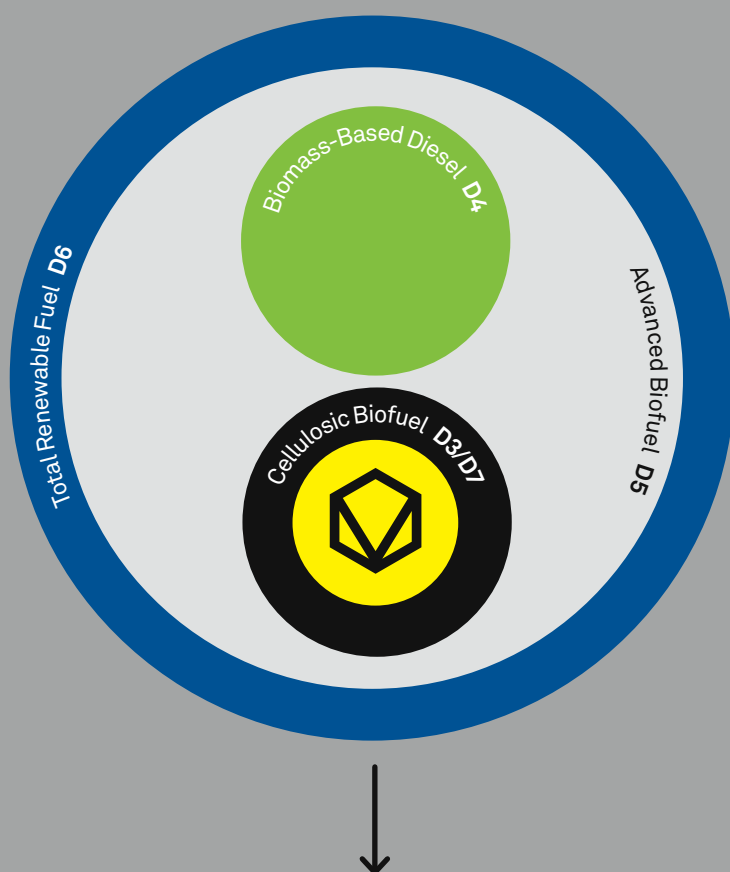
In the US, the Renewable Fuel Standard (RFS) was enacted by Congress in 2005 under the Energy Policy Act (and enhanced in 2007 under the Energy Independence and Security Act) to move the United States towards greater energy independence and to increase the production of clean renewable fuels. Under the status quo of this long-standing legislation, the programme continues indefinitely, with no legislative sunset, providing a long-term market and an incentive for renewable fuel production. In 2016 over 18bn gallons of renewable fuels were produced or imported into the USA that qualified under the RFS.

Under the RFS, Renewable Identification Numbers (RINs) are credits used to track compliance for obligated parties (oil companies who produce or import gasoline and/or diesel fuel), and are the “currency” of the programme. Yearly volume requirements (Renewable Volume Obligations, RVOs) are set for the obligated parties. Renewable fuel producers generate RINs, market participants trade the RINs and obligated parties either produce their own RINs or purchase RINs and then ultimately retire RINs for compliance, supplying the renewable fuel into the wider fuel market for on-highway use. RINs therefore carry a monetary value and act as a market-based incentive.

California

In California in 2006, the Legislature passed the California Global Warming Solutions Act, which created a comprehensive, multi-year programme to reduce greenhouse gas (GHG) emissions. Renewable diesel sold in California also qualifies for State Low Carbon Fuel Standard (LCFS) credits, traded in terms of carbon emissions prevented, and are currently worth around \$0.8 - \$1.2 per gallon for fuels that have a 60% GHG reduction. In 2016, legislation was passed that codifies a 2030 GHG emissions reduction target of 40% below 1990 levels. Requirements similar to those in California are in place in Oregon, Washington State and several Canadian provinces. States in the North Eastern US, such as Massachusetts, are also considering an LCFS-type regulation.

Types of RFS-qualifying fuels



Fuels produced by Velocys

The fuels produced at Velocys’ biorefineries using woody biomass as feedstock are expected to qualify as Cellulosic Biofuel under the RFS, for which the highest level of greenhouse gas reductions must be demonstrated. An indicative value of these D7 RINs is currently around \$4½ - \$5 per gallon.

The 2018 RVO for Cellulosic Biofuel is 288m gallons, yet the supply of D7 RINs is currently limited. A total of only 400,000 D7 RINs have ever been generated within the US. ENVI is expected to generate around 100,000 D7 RINs per month and Velocys’ Mississippi biorefinery is being designed to generate over 30m D3/D7 RINs per year. Delivering an ongoing domestic source of Cellulosic Biofuel will be a significant milestone for the US renewable fuels industry.

2018 Renewable Volume Obligations (RVOs)

19.29bn gal

Total Renewable Fuel

4.29bn gal

Advanced Biofuel

2.1bn gal

Biomass-Based Diesel

288m gal

Cellulosic Biofuel

Renewable fuel to be produced at Velocys’ biorefinery

20m gal/yr

From 2023

Chairman's statement



“Velocys is pursuing its new strategy and has completed its shift to becoming a renewable fuels business. It did so in mid-2017 after taking decisive action to capitalise on its achievements at ENVIA. The Company has strengthened its Executive Committee and adapted its organisational structure as it continues to build a strong team that has the long-term aim of delivering repeatable biorefineries.”

Dr. Pierre Jungels, CBE
Chairman

Introduction

2017 has been a year of considerable change for Velocys as it has pivoted from being purely a technology licensor to setting the foundations for future profit delivery as a renewable fuels company. After many years of concerted effort, encompassing R&D, engineering, project management and relationship building, the first commercial scale plant using Velocys' technology is in operation in Oklahoma City. Velocys has also advanced its new strategy for commercialising its technology; in 2017 the Company made considerable progress driving forward the development of its first biorefinery using woody biomass as feedstock. Notwithstanding the progress made throughout 2017, given the particular circumstances of the business' financial position at year end the Company decided to make a significant impairment against a range of, primarily, intangible assets.

Strategy and market

The creation of a world-leading technology that is operating at commercial scale has been a significant achievement. But now, as well as seeking opportunities to license its technology, Velocys is focused on its commercialisation through the delivery, with its partners, of repeatable biorefineries to become a producer of significant volumes of cellulosic renewable fuels. We will remember 2017 as the year Velocys transitioned from technology development to its commercial roll-out, which has meant the winding down of R&D programmes both in the UK and the US. The Company has maintained its corporate and commercial office in the UK.

After conducting its detailed strategic review, Velocys has taken the decision to focus its resources on the renewable fuels market. Our analysis shows that the Velocys route to the production of renewable fuels can be cost-effective using the reserves of sustainable biomass feedstock that are abundant in the US. Unlike other routes to renewable fuel production these biorefineries will not be constrained by the amount of feedstock available, and will therefore be well positioned to deliver significant quantities of renewable fuel to a large and growing market at a competitive price.

In a move that is consistent with our renewable fuels strategy of delivering integrated plants in collaboration with partners, we are also in the early stages of developing a UK waste-to-jet fuel project with world-class partners, which include British Airways.

Other market opportunities, such as stranded gas conversion to liquids or waxes, are still available and their attractiveness to Velocys will continue to be reviewed if market conditions change in the future. These opportunities give the Company future optionality.

Management and Board

In 2017 and early 2018 there were a number of changes to the Board. Andrew Morris was nominated as a Non-Executive Director and Chair of the Audit and Risk Committee at the start of June 2017, in place of Non-Executive Director Mark Chatterji who left the Board in April 2017. Ross Allonby and Julian West left the Board in June 2017 and February 2018 (post-period end) respectively. On behalf of the Board I thank Mark, Ross and Julian for their contributions to the Company. I would like to welcome Andrew, who brings a wealth of financial and business experience from companies similar to Velocys in terms of size, sector and complexity.

The appointment of Andrew Morris has helped to align Board competencies to those needed to guide the delivery of the Company's strategy. Board costs have been reduced through the reduction in the number of Non-Executive Directors, and by reducing the fees paid to existing Non-Executive Directors by 10%.

Susan Robertson stepped down as Chief Financial Officer in August 2017, a role she held for nine years. I would like to thank Susan for her contribution to Velocys during that time. In the summer we welcomed John Tunison as Interim CFO.



Introduction to our corporate governance

Velocys has the ambition to grow significantly, and to develop into a 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 the route into the renewable fuels 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 towards expertise in business, legal and finance.

The Corporate governance report on pages 26 to 29 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 risk and mitigation.
- Issues associated with closing the Company's UK-based laboratories and the associated sales of assets.

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.

Fundraising

Velocys completed a fundraise of over £10m (before expenses) in May 2017 primarily through the support of existing shareholders, who we thank for their continued support. The proceeds raised were used primarily to fund the pre-FEED (FEL-2) engineering study for the Mississippi biorefinery project, to undertake a joint technology demonstration with our partner TRI, and to extend Velocys' loan arrangement with ENVIA to support the plant in achieving steady state operations.

In January 2018 (post-period end) £18.4m (before expenses) was raised through a further fundraise, principally to help fund the development of our Mississippi biorefinery project, and to secure strategic investment into it. We included an open offer element in this fundraising round to enable all eligible shareholders an opportunity to participate. Our existing major shareholders again demonstrated their considerable support, but at the same time we were pleased by our ability to extend our shareholder base. The Board recognises that additional funding is still required to reach final investment decision (FID) on the Mississippi biorefinery project; further details are given in the Financial review and note 2.

Outlook

Velocys is pursuing its new strategy and has completed its shift to becoming a renewable fuels business. It did so mid-2017 after taking decisive action to capitalise on its achievements at ENVIA. The Company has strengthened its Executive Committee and adapted its organisational structure as it continues to build a strong team that has the long-term aim of delivering repeatable biorefineries. Velocys has transformed in a short time and its primary focus is to drive the delivery of the FID for the Mississippi biorefinery project, which the Company is targeting in the second half of 2019. A key step in this process will be to bring on board one or more strategic investors into the Mississippi project consortium to meet the remaining development capital requirement.

Dr. Pierre Jungels, CBE
Chairman
22 May 2018



Pivoting to renewable fuels

- ENVIA's plant in commercial production and RINs verified.
- Strategy pivot to a renewable fuels company.
- Sustained progress on Mississippi biorefinery project development.
- Fundraising to support plan to achieve final investment decision for the Mississippi biorefinery.
- Partnership formed to develop UK waste-to-renewable jet fuel project.
- Significant impairment made against a range of, primarily, intangible assets.

David Pummell
Chief Executive Officer

Introduction

2017 was a challenging year for Velocys, but despite this, the Company has made significant progress towards developing what we expect will be the first of a number of repeatable biorefineries. Our strategy is for Velocys to be at the heart of building plants that convert forestry residues into renewable fuels for the US market. Considerable headway has been made on the interrelated work streams required to progress the US Department of Agriculture (USDA) loan guarantee programme, including the delivery of the FEL-2 engineering study, and securing a 100-acre site in Natchez, Mississippi. The performance milestones the Velocys Fischer-Tropsch (FT) system reached at a commercial scale at ENVIA during 2017 and the first part of 2018 were crucial milestones on the way to delivering our future biorefineries.

None of this would be possible without the efforts of our talented, energetic team that has stepped up to the challenges we have faced with great determination, skill and prior experience. I particularly thank them for their professionalism during the internal restructuring process undertaken in the summer of 2017.

Strategy implementation

With the ENVIA biorefinery in operation, the Company has the required commercial and technology springboard from which it aims to deliver its bold, long-term vision to place Velocys at the forefront of production of cellulosic renewable fuels. With a reorganisation of the senior team and the appointment of John Tunison as Interim CFO we now have a strong Executive Committee to bring decisive leadership to deliver this goal.

The three pillars of the strategy we have adopted are outlined on page 3. We are all focused on the delivery of the next phase on this journey. We are building a consortium of strategic and financial partners to deliver investment, scale and pace to market and are leveraging the Company's project management, commercial, engineering, operational and technology expertise to optimise future plant costs and timelines.

In the summer of 2017, after it had been demonstrated that the Velocys technology installed at ENVIA's Oklahoma City plant was performing as expected at a commercial scale, we concluded that the primary phase of our technology development programme had been successfully completed. In July 2017 we ceased certain R&D activities and total headcount was reduced from 76 at the end of 2016 to 42 at the end of 2017. The changes made allowed us to direct our resources towards those business-critical areas in which milestone-delivery is all important in the short and medium term. They will also reduce the ongoing operational costs of the business by nearly £2m per year.

The Company has maintained a corporate and commercial office in the UK, from where it will direct the implementation of its strategy and commercialisation of its considerable intellectual property portfolio. These UK-based capabilities are now located at the Harwell Science and Innovation Campus, and include the project management team supporting the UK waste-to-renewable jet fuel project. We will continue to expand and develop our capability to develop our US biorefineries from our operational base in Houston. In addition, we will further scale up resources to support the clients licensing our technology as well as to ensure protection of our intellectual property.

Our two fundraises in the last 12 months have provided us with a runway to implement our strategy, most notably to support the plan to achieve final investment decision (FID) for the Mississippi biorefinery project. As outlined in the Financial review (see page 17) further funding is required to reach this milestone. The Financial review (and note 17) also outlines the reasons behind a significant write down in value of certain assets, mostly Goodwill and In-process technology made in these report and accounts.

Our biorefineries

ENVIA

In 2Q 2018 we announced the disappointing news that a leak has been detected at the Oklahoma City plant that is believed to have originated inside one of the plant's two FT reactors. Based on a preliminary investigation the Company believes the root cause of the issue originated with the design of an ancillary system and is not a result of a flaw in the core Velocys FT technology. The Company is working with ENVIA and third party consultants to verify the root cause of the leak. Velocys remains committed to the ENVIA plant and will work with ENVIA to assess the likely repair cost and consequent funding requirements.

Successive milestones were met at ENVIA over the course of 2017, as outlined on page 10. Most recently (post-period end), we were pleased to report that the RINs produced at ENVIA were verified under the Quality Assurance Program approved by the US Environmental Protection Agency.

ENVIA has achieved significant milestones in the last 12 months, notwithstanding a number of other challenges. For example, in Q2 2017, the Engineering, Procurement and Construction (EPC) contractor entered bankruptcy proceedings; the plant was down or in reduced operation for several



“I believe we will look back at 2017 as the year Velocys transformed into a renewable fuels company.”

weeks in early 2018 (post-period end) while repairs were carried out after extreme cold weather; and, as part of normal plant commissioning, a series of improvements have been made to control systems and other equipment to minimise plant downtime and improve reliability. More details are given on page 10.

After the experiences of the last 12 months, I have enormous confidence in Velocys' highly-skilled technical team that are called on by ENVIA to support the Oklahoma plant. While ENVIA remedies the present issue, ENVIA's aim will be to operate the plant using one reactor. ENVIA is working with Velocys, the licensor, to develop a solution that will return the plant to full operation with minimal loss of revenue, whilst always assuring safety and minimising the risk of adverse impact to the environment. Working through these obstacles at the Oklahoma plant has afforded a number of learning opportunities that Velocys will apply to future biorefineries, reducing technology risk and further optimising operations.

An impairment was made against Velocys' investment in ENVIA, predominantly driven by a less ambitious revenue forecast based on a revision of operational availability and product and RIN pricing.

Mississippi biorefinery

Throughout 2017 we made encouraging progress towards the development of our first biorefinery in the US using woody biomass as feedstock (see pages 12 and 13 for more details). We welcome the significant support for the plant at county and state levels. The local community has responded positively to the prospect of the quality jobs that the construction and operation of the plant would bring to the area.

Velocys and its partners are making progress towards completing all the required work packages to deliver a successful USDA loan guarantee application, secure project investment and deliver the FID. Velocys selected an engineering partner to carry out a scoping and optimisation study. Velocys and its engineering partner are working through the complex process of cost and value engineering, to optimise plant capital cost, operating cost, carbon intensity and the financial returns from the project.

Reaching FID will be subject to securing further funding (see further details in the Financial review on pages 16 and 17). Other significant risks identified and associated mitigation actions with the project development programme are outlined on pages 20 to 22.

Our target is to secure a conditional commitment from the USDA in Q3 2018, and to reach FID in 2H 2019. These, and other intermediate milestones, are outlined in the timeline on page 12.

Although our focus is the delivery of the Mississippi biorefinery project, we are looking beyond this plant, as our strategic plan is to put in place strategic partnerships that will deliver multiple biorefineries. The site selection process for the Mississippi biorefinery produced a list of other highly suitable sites in a number of other states.

UK waste-to-renewable jet fuel

Consistent with our core strategy of delivering biorefineries producing renewable fuels, in Q3 2017 we entered into an industry partnership to develop a waste-to-jet fuel plant in the UK. Our approach to this opportunity leverages further our technology, integrated plant design and skills base.

Velocys intends to license its technology to the plant and provide project management, engineering, operations and technical service support to the project. The other project partners include British Airways, that intends to offtake the jet fuel produced. Velocys has led the initial feasibility stage of the project, for which all members of the partnership provided funding.

Velocys believes that there is an opportunity to develop a series of waste-to-jet fuel plants in the UK and recognises that there is a larger non-UK market to be exploited. The changes to the Renewable Transport Fuels Obligation (RTFO), recently passed through Parliament, have provided the commercial platform for this opportunity; for the first time, jet fuel is to qualify for credits under the RTFO. These changes to the RTFO are designed to promote sustainable aviation and heavy goods transport and are expected to provide long-term policy support for this market.

Biorefinery being developed by Red Rock Biofuels

In May 2018 (post-period end) Velocys' customer, Red Rock Biofuels (RRB), started constructing the biorefinery it is developing in Oregon, USA, which will incorporate Velocys' technology. The third party developer has issued a notice to proceed for the manufacture of Velocys' FT reactors and catalyst. RRB's Lakeview project is expected to deliver around \$15m revenues to Velocys during construction and early operations of the plant, and an additional \$30m or more over the life of the biorefinery. Over \$6m has already been invoiced and received from RRB.

The licensing of our technology to Red Rock Biofuels biorefinery is complementary to our strategy to develop our own biorefineries.

Outlook

I believe we will look back at 2017 as the year Velocys transformed into a renewable fuels company. Although some of these changes were difficult they have set up the Company for the future delivery of multiple biorefineries and long-term sustainable growth. The ENVIA plant has validated our FT technology at commercial scale and from this platform we plan to grow and be at the forefront of supplying significant quantities of cellulosic renewable fuels. We have a demanding plan to deliver in 2018, but we are well placed to meet these challenges.

David Pummell
Chief Executive Officer
22 May 2018

Project overview – ENVIA

ENVIA Energy, LLC (ENVIA) is a joint venture, of which Velocys is an equity partner, formed to produce renewable diesel, naphtha and wax from landfill gas and natural gas. The Velocys reactors and catalyst that are at the heart of the plant are performing at commercial scale in line with performance requirements. The same core Velocys technology will be deployed in future biorefineries that we and our partners are developing.

Operational milestones achieved

ENVIA, with significant financial, operational and commercial support from Velocys, achieved a number of key milestones at the Oklahoma City site over the course of 2017. In February 2017 the first Fischer-Tropsch (FT) products were successfully produced. The first finished, saleable products (waxes, diesel and naphtha in the approximate proportion 45%:45%:10%) were produced in June 2017, and from September, ENVIA commenced delivery of product to its offtakers. In October, the key capacity milestone of 200 barrels per day (bpd) was successfully reached. This enabled the impairment on the loan note recorded in the 2017 interim statement to be reversed (see note 20 for more details).

A large proportion of the products made at the plant is manufactured using landfill gas – a renewable resource. At the end of December 2017, the fuel produced at the Oklahoma City plant met the necessary requirements to be submitted for qualification under the Renewable Fuel Standard (RFS), and as a result ENVIA submitted a number of Renewable Identification Number (RIN) credits to the registration system.

In March 2018 (post-period end), the RINs produced at ENVIA were verified under the Quality Assurance Program approved by the US Environmental Protection Agency. In the same month, ENVIA signed a RIN purchase and sale agreement with TransMontaigne Product Services, LLC, which will purchase, at a fixed price, all of the available RINs generated for a six-month term beginning in April 2018. This was an important milestone for ENVIA as a significant proportion of the revenues of the plant could be derived from the ongoing sale of RINs. Financial modelling shows that RIN revenues are required for the plant to be cash flow positive.

The RINs produced at ENVIA are the first RINs generated by Velocys technology and the first generated anywhere in the US associated with a FT process on landfill gas. This landmark in itself represents a further validation step for Velocys' strategy to build biorefineries that convert forestry residues to renewable

fuels. It also demonstrates that Velocys has acquired the knowledge of the RIN qualification system to enable it to secure income from this revenue stream from its future biorefineries.

The ENVIA plant management team has implemented a strong Health, Safety and Environment (HSE) culture that has delivered over 600 days without lost time injuries on site as of the end of March 2018 (post-period end).

Operational involvement for Velocys

Under a secondment agreement with ENVIA, from July 2016 the Velocys operations team brought essential support to ENVIA during commissioning, start-up and the early stage operational optimisation. As planned, the majority of the Velocys operational and engineering team was demobilised in Q1 2017 as the permanent ENVIA operations team was phased in and fully trained. However, a small number of key Velocys operational management staff were seconded to ENVIA under contract over a longer transition period. The Velocys team continues to support ENVIA operations.

Challenges and learnings

In 2017 the commissioning and operation of the ENVIA plant by the ENVIA team brought many challenges and additional learning points that Velocys, as licensor, will be able to use in future projects. These operational challenges required additional funding of ENVIA from Velocys, and that is discussed in the Financial review on pages 16 to 17.

The EPC for the ENVIA project, Ventech Engineers International, LLC, entered bankruptcy proceedings in April 2017, during the commissioning of the plant. (VPI LF-GTL, who is a part owner of ENVIA Energy LLC, was not subject to the bankruptcy proceedings). During this period, Velocys was called upon to leverage its experienced team of technical advisors to support the ENVIA team on site, which allowed work to proceed close to the original plan, as well as supporting the delivery of the subsequent operational milestones.

As part of the commissioning process, throughout 2017 the ENVIA team, supported by Velocys' technical advisors, implemented improvements to the plant's control system. This has removed a number of single point failures of the plant and has significantly decreased the number of spurious trips associated with the non-FT units, leading to improved operational reliability.

Next operational steps

In the first few months of 2018 the ENVIA team has continued to deliver the plant improvements needed to optimise production and increase plant productivity. Until the leak reported earlier this month has been remedied, ENVIA's aim will be to operate the plant using one FT reactor. ENVIA's priority is to develop a solution that will return the plant to full operation with minimal loss of revenue, whilst always assuring safety and minimising the risk of impact to the environment.

ENVIA and Velocys are continuing to accumulate performance data from the ENVIA plant which will be shared with potential industry and financial partners for the Mississippi biorefinery.

Capital expenditure and financing

The ENVIA plant reached mechanical completion in September 2016. The plant capex to that date was around \$80m. The capacity of the ENVIA plant was designed to be 250 bpd, to match the amount of landfill gas available from the neighbouring landfill site.

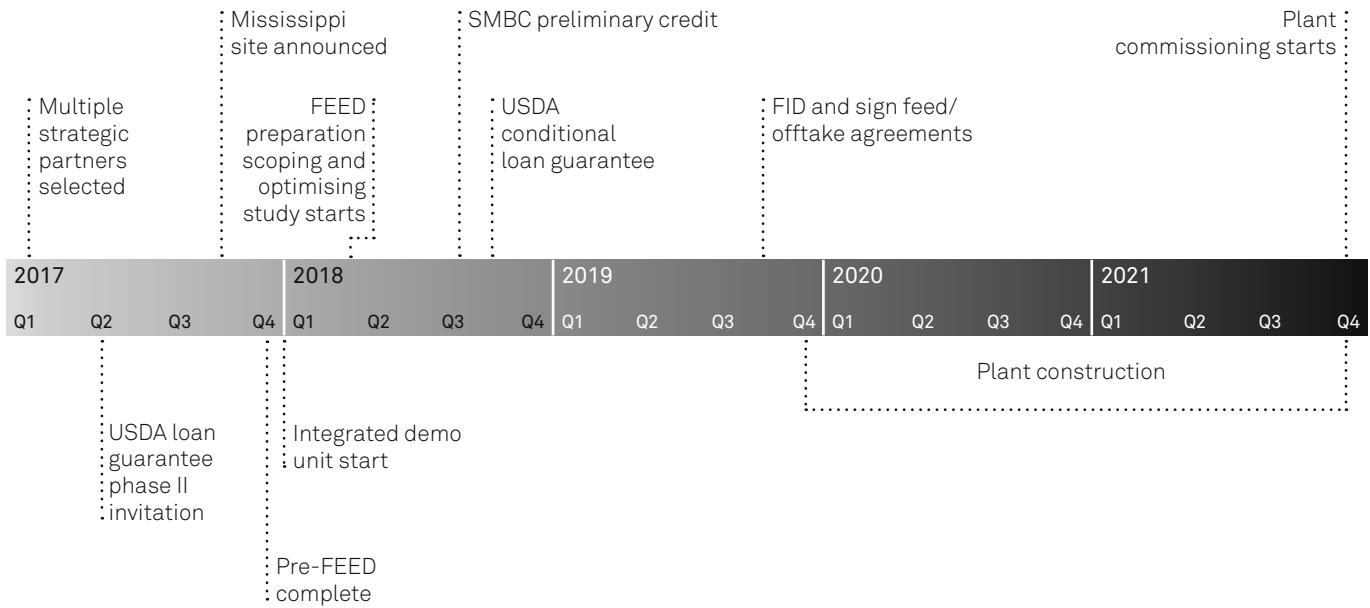
At year end the Company's investment in ENVIA was impaired by £2.7m predominantly to reflect a revision of the expected income from RINs. ENVIA plant finances and the increased equity stake for Velocys are discussed in the Financial review (pages 16 to 17).



Product offtake from the Oklahoma City plant.

Project overview – Mississippi biorefinery

Velocys’ first biorefinery using forestry residues as feedstock is being developed in Mississippi, USA. The Company has made considerable progress in 2017 towards the aim of achieving final investment decision and construction. This is the first of an expected series of biorefineries with standardised design. We have the aim of developing a material supply position of renewable fuels.



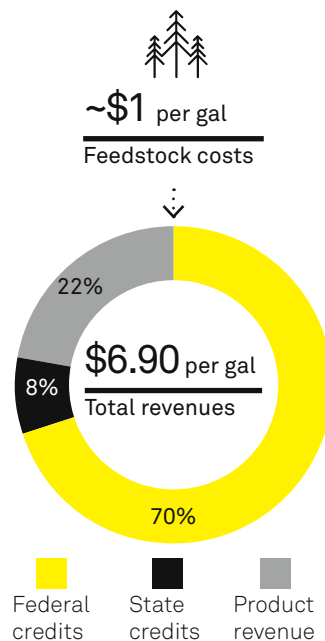
Introduction

The first Velocys biorefinery using forestry residues as feedstock will be sited in Natchez, Mississippi. It is being designed to produce approximately 20m gallons/yr of renewable fuels and 30m D3/D7 RINs/yr (from 2023) from approximately 900 tonnes/day of dry woody biomass residues.

Loan guarantee

A key milestone was reached in June 2017 when the US Department of Agriculture (USDA) invited Velocys to submit a Phase II Application to obtain a loan guarantee for the biorefinery. The loan guarantee could apply to up to \$200m of debt as part of the total installed cost of the project. This would be one of the components of the overall financing package for the project and, if successful, would financially de-risk the project. Velocys has engaged the leading global project finance bank Sumitomo Mitsui Banking Corporation (SMBC) as the lender of record. SMBC is also Velocys’ financial advisor for the project.

Feedstock costs and plant revenues



Technology partners and suppliers

The Company began the process of selecting technology partners for its biorefinery in early 2017 and continues to assess and refine its choice of partners. ThermoChem Recovery International (TRI) is the Company’s partner for the gasification of woody biomass. TRI is an innovative leader in its field and has committed significant resources to a joint work programme. The Company is also engaging with other technology licensors in key areas of the process design, integrating with Velocys’ Fischer-Tropsch (FT) technology. The Company has signed a supply contract for the fabrication of its reactor cores with Alabama Specialty Products, which has previously worked with Velocys in the development of its reactor cores and built the cores for its demonstration reactors.

Integrated technology demonstration

Early in 2017 the skid-mounted FT section of the Velocys pilot plant was relocated from Ohio to TRI's facility in Durham, North Carolina, where it was combined with TRI's gasification technology to form an integrated gasification/FT technology demonstration. An initial run has been completed at this integrated demonstration unit.



Site selection

In October 2017 Velocys signed a site option agreement with Adams County in the State of Mississippi to locate a biorefinery in Natchez, Mississippi. Velocys has been offered economic development incentives from Adams County estimated to be worth the equivalent of \$42m. The project expects to qualify for additional incentives worth up to \$15m, provided via Mississippi's Advantage Jobs Act and other statutory tax incentives. These incentive packages would reduce the Company's future tax liabilities and are subject to Velocys meeting certain minimum requirements for capital investment and local employment opportunities.

Velocys has also received commitments from Adams County worth approximately \$4m, relating to the land and upgrades to the site, and a further \$1m site upgrade commitments from local utility suppliers.

The site and local area have many advantages:

- Excellent transportation infrastructure options including barge, rail and road.
- Accessible utilities.
- The availability of an abundant local supply of low cost RFS-qualifying forestry residues.
- A local workforce skilled in servicing the forestry industry.

- Land that meets all the required criteria including space and terrain to support an industrial development.
- A local community with facilities and amenities that will attract additional skilled personnel during construction and ongoing plant operations.
- An attractive regulatory and tax regime.

The 100-acre Natchez site was confirmed after the Company analysed a broad set of operational and tax considerations at twelve possible sites in four states in the Southeastern United States. Due diligence was completed at each of these sites and incentive offers were received from each state in question. This process has laid the foundation for the potential locations of future biorefineries.

Site permitting and environmental review activities are ongoing and will continue through to FID and beyond. In the short term, review activities are focused on finalising the Environmental Assessment. Velocys has the aim of being a responsible member of the local community in Mississippi and is engaging with the community and local authorities to ensure that key stakeholders are on board to create a platform of success for the project.



Engineering

The pre-FEED engineering study was successfully completed in Q4 2017 by IHI E&C. In Q1 2018, after a competitive process, Velocys selected an engineering partner to carry out a scoping and optimisation study. Velocys and its engineering partner are continuing to work through the process of cost and value engineering to optimise plant capital cost, operating costs, carbon intensity and the total returns from the project. The phasing of the FEED work is expected to allow FID to be reached in 2H 2019.

Feedstock and offtake

The Company has agreed term sheets with several potential offtakers for the renewable fuels and the RINs and Low Carbon Fuel Standard (LCFS) credits to be produced by the Mississippi biorefinery. Draft product offtake agreements are being negotiated, and as such Velocys is well placed to sign final offtake agreements shortly prior to FID. After discussions with a number of potential suppliers of feedstocks to the biorefinery, the Company has confidence that it can source sufficient local RFS-qualifying feedstock that meets the Company's target overall feedstock price. Feedstock agreements have been prepared, and supply logistics are being tested as part of the IDU process in order to reduce operational risk. Velocys is a member of the Roundtable on Sustainable Biomaterials to ensure that it has all the appropriate sustainability policies in place supporting feedstock supply.

The programme delivering FID

The project continues to move forward as planned but there remain a number of risks that require mitigation as the project advances (see pages 20 to 22). For example, it is uncertain whether all the permits will be secured to build and operate a biorefinery on the site selected. There remain a number of key milestones still to be delivered, and in particular, project equity funding has not yet been secured. The immediate focus is to complete all the work packages required by the USDA loan guarantee programme. The Company is in detailed discussions with a number of potential strategic partners and is planning to secure the investment to fund the remaining project development activities in the second half of 2018. The aim is to reach FID during 2H 2019.

Project overview – UK waste-to-jet fuel

A partnership, including British Airways, Suez and Velocys, has been formed to prepare the business case for the UK's first commercial scale waste-to-renewable fuels plant. This plant would take hundreds of thousands of tonnes per year of post-recycled waste, destined for landfill or incineration, and convert it into clean-burning, sustainable fuels.

The market and project

The changes to the Renewable Transport Fuels Obligation (RTFO), recently passed through Parliament, provide the required commercial platform for this project; for the first time, jet fuel is to qualify for credits under the RTFO. These changes to the RTFO are designed to promote sustainable aviation and heavy goods transport; once implemented, they are expected to provide long-term policy support for this market.

The partners

Members of the partnership include:



Velocys intends to supply its technology to the plant and provide project management, engineering, operations and technical service support to the project going forward. Velocys is leading the initial feasibility stage of the project.



British Airways, the UK's largest international airline, which intends to fly with the renewable jet fuel produced by the plant.



Suez, a world leading expert in recycling and waste management, which intends to provide technical and operational expertise and manage the supply of feedstock to the project.

NORMA Investments

Norma Investments, an affiliate of Ervington Investments, Velocys' largest investor, which is a potential investor in the project.

All members of the partnership are providing funding for the initial feasibility stage of the project that began in September 2017. The plant is being designed to have a capacity of around 30,000 tonnes of fuel/year (10m gal/yr). The project is at an early stage and therefore there remains uncertainty with regards to: project economics, whether the partners will be willing to fund the project through successive development phases to FID, and whether the

combination of risk and return will make the project attractive to other investors and lenders. However, the Company is optimistic that the project will progress to the next development stage and the overall plan is that FID will be delivered in 1H 2020.

Project benefits



The jet fuel produced is expected to deliver over **70% greenhouse gas reduction** and **90% reduction in particulate matter emissions** compared with conventional jet fuel, thereby contributing to both carbon emissions reductions and local air quality improvements around major airports.



Each 10,000 tonnes of renewable road fuels produced would result in a net reduction of CO₂ equivalent to **taking 7,600 cars off the road.**



The planned plant would produce enough fuel to power all BA's flights on the Boeing 787 Dreamliner from London to San Jose, California and New Orleans, Louisiana.



Operation of the plant would lead to **significant reduction of the amount of waste going to landfill.**



The process is fundamentally different to incineration. There are no toxic emissions, no fly ash or bottom ash and a greater proportion of the energy content in the waste is reused.





Our process

Our proven Fischer-Tropsch technology is one of a very small number of economic, sustainable routes to produce renewable fuels that can be blended at high percentages with petroleum-based products, and that are compatible with existing infrastructure and engines.

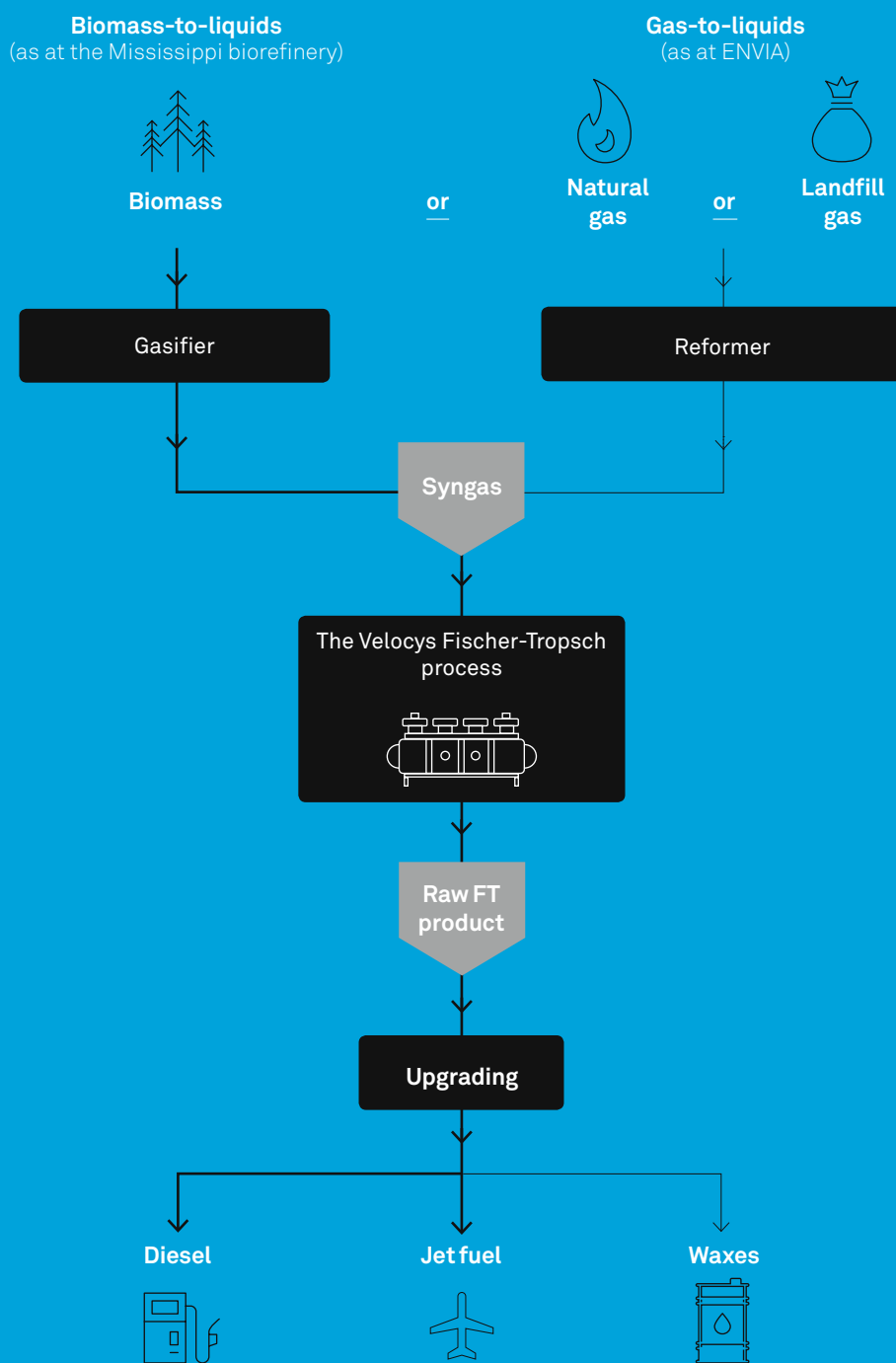
Processes

The gas-to-liquids and biomass-to-liquids processes for which our proven technology can be used have three main steps: production of syngas; the Fischer-Tropsch (FT) conversion process; and upgrading to produce finished products. The biorefinery can be “tuned” to produce either high quality, clean jet fuel or diesel with a small volume of naphtha as a co-product. With a variation to the upgrading unit operations, other products can be generated, such as waxes. The Company’s Mississippi biorefinery will use forestry residues as feedstock, but it is possible to use other feedstocks in plants deploying Velocys’ technology. For example, landfill gas and natural gas are used as feedstock at ENVIA.

Fuels produced

With the demand for diesel and jet fuel increasing, plants using FT technology and biomass as feedstock could provide a significant supply of renewable fuels that the US market demands. There is considerable legislative support for these renewable fuels at both the US federal and state level. FT fuels are fully compatible with existing infrastructure and engines, which is not the case for other methods of producing fuels from biomass (such as ethanol or fatty acid esters).

Renewable fuels produced by the FT process are highly paraffinic and do not contain aromatics or sulphur. These fuels burn cleaner than petroleum-derived fuels, resulting in lower emissions of NOx, SOx and particulates. Therefore they contribute to local air quality improvements as well as reduced greenhouse gas emissions. FT fuels are often blended to improve the performance characteristics of lower quality petroleum-derived fuels (e.g. to increase Cetane number).



Syngas generation

The production of synthesis gas (syngas), an optimised mixture of carbon monoxide and hydrogen, by reforming natural gas or landfill gas, or by gasification of biomass or waste.

The Fischer-Tropsch process

The FT process converts the syngas into paraffinic hydrocarbons.

Upgrading

Upgrading to produce finished products such as high quality diesel, jet fuel, waxes, as well as naphtha.

Key

- Process to be used at the Mississippi biorefinery.
- Other inputs/outputs possible using Velocys’ technology (for example, at ENVIA).

Financial review



“The fundraises in Q2 2017 and Q1 2018 (post-period end) provide Velocys with the funds to help take forward the development of the Mississippi biorefinery whilst we engage with potential strategic project development capital investors.”

Andrew Morris

Non-Executive Director & Chair of the Audit & Risk Committee

Revenues

Revenue in 2017 was £0.8m (2016: £1.4m), which was made up of lease of catalyst to ENVIA, engineering support for ENVIA and revenues from feasibility studies, predominantly for the UK waste-to-jet fuel project. Gross profit was £0.4m (2016: £0.4m).

There was one key contract, with ENVIA. Revenue from the lease of catalyst to ENVIA was recognised in the financial results throughout 2017 on a monthly basis, in line with the lease terms. Revenue for reactor sales to ENVIA was recognised in 2015.

Expenses and income

Total administrative expenses increased to £21.9m before exceptional items and £53.4m after exceptional items (2016: £17.4m before/£20.2m after exceptional items). £1.6m of this increase before exceptional items was due to a change in methodology used in the amortisation of intangible assets from the units-of-production to the straight-line method (see note 17) and does not represent an increase in the cost base of the Company. The remaining increase before exceptionals reflected increased spending on project development, predominantly for the Mississippi project, including the pre-FEED engineering study and the joint technology demonstration with TRI.

The savings that arose during 2017 from the reduction in the number of employees and the closing of the Company's UK R&D facility in the summer of 2017 offset the costs of closure during the year. Full year savings will be realised in 2018 and are likely to be just less than £2m.

The increase in administrative expenses after exceptional items is discussed in the section Impairment on assets and investments below.

Other income of £0.2m/£1.9m before/after exceptional items (2016: £0.3m/£2.8m before/after exceptional items) was from the sale of assets, mostly associated with the closure of the UK R&D facility (see note 9). In September 2017 Velocys increased its equity share and voting rights in ENVIA following the exit of NRG from the joint venture for no consideration. The Company has recorded an exceptional item being a gain on bargain purchase of £1,750,000 in respect of this step acquisition (see note 4 and note 19 for more information). The disposal of assets from the facility is discussed in the Corporate governance report on page 29.

Assets and cash

Net assets of the Company were £14.7m, down from £63.7m in 2016. £34.6m of this decrease is due to the impairment of assets (see below) and £16.6m is due to the reduction in cash balance. Velocys retained a cash balance (cash and cash equivalents) at year end totalling £2.1m (excluding restricted cash) (2016: £18.7m), which has been subsequently increased with the addition of £17.0m from the fundraise in January 2018 (after expenses).

Cash outflow in 2017 was £16.6m (2016: £19.4m) comprising £16.3m consumed by operations, less an R&D tax credit received of £1.0m, and a £9.8m increase in the loan to ENVIA, offset by cash received through the May 2017 fundraise of £9.7m (after expenses). The net cash used in operating activities was reduced from

£19.3m to £15.3m. The profile of the cash spend changed significantly in 2017 as the Company reduced its traditional R&D overheads and increased initial spending on project development activities that supported the new strategy.

Compared to 2016, movement in foreign exchange had relatively little impact.

Impairment on assets and investments

For the impairment assessment the recoverable amount has been determined based on its fair value less costs of disposal ('fair value'), by reference to the total value of the parent company's equity, using the discounted share issue price at the January 2018 fundraise of 10p per share. As a result an impairment of £31.5m was recorded against a range of assets, including Goodwill and mainly In-process technology, as described in note 17. As described below there were additional impairments to ENVIA (£2.7m) and other minor asset impairments (£0.4m). There has been no change in the Board's assessment of the long-term potential of these assets. This impairment (excluding that in respect of Goodwill) could be reversed in the future should there be a change in the estimates used to determine the asset's recoverable amount.

ENVIA finances and increased equity stake for Velocys

From the proceeds of Velocys' May 2017 fundraise (see below), \$3.4m (£2.7m) was allocated to increase the loan facility the Company made available to ENVIA in January 2016 in order to bridge ENVIA to becoming cash flow positive. In October 2017 in order to meet the key operational milestone of achieving 200 bpd and to



- To fund the Company's working capital and central operating costs.
- To provide working capital to ENVIA in order to bridge the asset to sustainable cash generation.

Future funding

The financial statements have been prepared on the going concern basis, which assumes the Company will have sufficient funds available to enable it to continue to trade for the foreseeable future. The cash forecast includes the following assumptions: (i) securing strategic development capital investment into the Mississippi biorefinery project during the second half of 2018; and (ii) subject to (i), the Company assessing its cash requirements and determining whether it needs to raise additional funding during 2018 or 2019. These assumptions are discussed further in note 2.

In January 2018 the Company estimated that its total remaining operating costs and the Mississippi biorefinery project costs, as of year-end 2017, to get to FID (assumed at the time to be mid-year 2019), would be £40-50m. The Company's plan is to secure investment by one or more strategic partners in to the Mississippi biorefinery project in 2H 2018. Should the Company not secure strategic investment, it will need to seek further funding in order to cover development costs and working capital requirements. This funding may be achieved from one or a combination of, a capital raising (including the possibility of a placement of ordinary shares within the next 12 months) or the realisation of certain assets for example: selling its stake or security in the ENVIA project; selling additional technology licences (such as the licence recently sold to Red Rock Biofuels); and selling non-core intellectual property.

Following FID in 2019 the Company's funding requirements will depend on the final structure of the Mississippi biorefinery project consortium and on the Company's strategy to develop and fund other projects. Risks and uncertainties regarding the Mississippi project are detailed on pages 20 to 22.

Andrew Morris
Non-Executive Director & Chair of the Audit & Risk Committee
22 May 2018

support continued operations, Velocys increased the loan arrangement by a further \$0.7m to \$13.4m (£0.6m to £10.6m). This was necessitated after a lower revenue forecast, based on a revision of product and RIN pricing, was produced. The loan facility was increased by \$0.4m (£0.3m) in December 2017 and \$2.1m (£1.7m) in Q1 2018 (post-period end) – the additional support being required to enable ENVIA to progress its operational ramp-up and RIN qualification programmes. At each date, all other terms of the loan, which has a 10% coupon, remained unchanged. As of 31 December 2017, \$13.0m (£9.6m) of the loan note had been drawn down.

At the end of September 2017, the Company increased its voting rights in ENVIA after one of the members of the joint venture, NRG Energy, exited the joint venture (JV). NRG Energy transferred its ownership units and all associated economic rights associated with them to the other JV partners. The voting rights for the three remaining JV members, including Velocys, were accordingly increased to 33% each. There was no consideration paid in respect of this transaction, nor will there be in the future. This was reflected as a gain on bargain purchase as an exceptional item in the income statement, see notes 4 and 19. This change in voting rights has not impacted operations at the Oklahoma City plant.

At year end the Company's investment in ENVIA was impaired by £2.7m to predominantly reflect a revision of the expected income from RINs. Because the key capacity milestone of 200 bpd was successfully achieved at the plant in October 2017, the impairment to the ENVIA loan note made in the 2017 interims statement was reversed (see note 20). There are no remaining

contractual milestones within the ENVIA joint venture agreement of the nature that gave rise to the impairment of the ENVIA loan note facility at 2017 interims.

Fundraises

In May 2017 Velocys secured additional funding of over £10m (before expenses). This included convertible loan notes as well as a placing of new ordinary shares. Proceeds from this fundraising were used to fund working capital during the first phase of the renewable fuels strategy implementation, as well as the following activities supporting the development of the Mississippi biorefinery project:

- Pre-FEED engineering study.
- The Integrated Demonstration Unit programme.
- Site selection and permitting.
- Consultants and financing.

As noted above, the proceeds of the May 2017 fundraise were also used to extend the loan note facility the Company made available to ENVIA to support the pre-cash generative phase of operation.

In January 2018 (post-period end) Velocys raised a total of £18.4m (before expenses) via a firm placing and open offer. Both funding elements were strongly supported by existing major shareholders. Over half of the firm placing shares were placed with the Company's existing shareholders and the rest with a number of significant new shareholders.

Net proceeds of the capital raising will be used predominantly:

- To fund development costs for the Mississippi biorefinery project to bridge to the on-boarding of one or more strategic investors.
- To progress the Company's UK waste-to-renewable jet fuel project.





Corporate social responsibility and KPIs

Employees

Velocys is committed to being a good employer and endeavours to train staff well, to pay them fair market value and to maintain a safe environment in which they can work. Velocys is committed to equal opportunities for all its employees. Of the 42 people working for Velocys at 31 December 2017, 33% were female (2016: 33%). At the end of 2017, one of the six members of the Board was female (2016: two of eight members). The percentage of female employees broken down by areas of the business was as shown to the right.

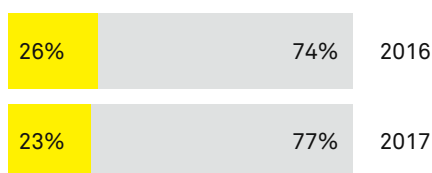
The restructuring of the Company in mid-2017 reduced the seven senior managers of the Senior Management Team to four members of the Executive Committee. This partially accounted for the difference in the percentage of female senior managers between 2016 and 2017 (2017: 0%, 2016: 29%).

Velocys takes the safety and well-being of its employees very seriously. As an example, in October 2016 the Columbus, Ohio site successfully renewed for an additional three years its Safety and Health Achievement Recognition Program (SHARP) certification with the US Department of Labor's Occupational Safety and Health Administration. SHARP certification recognises Velocys' exemplary injury and illness prevention programme. Velocys has created a culture of safety, health, and environmental responsibility and continuous improvement that extends from the CEO to all employees. Each employee is encouraged to actively participate in, and take responsibility for, their own safety and health through various opportunities, such as by providing suggestions for improvement, participating in safety and environmental training and site meetings. Holding leadership positions on the site's Safety Committee, or serving on an investigation team that performs root cause analysis of potential hazards or near misses at the site is actively encouraged.

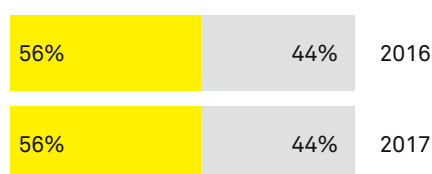
Velocys maintains detailed records that are required for regulatory compliance, and also ensures safety policy, programme, and hazard communication documents are available to all staff. As a result of the proactive culture adopted throughout Velocys, during 2017, there were no Lost-Time Accidents (LTA) across the Company's sites. This takes the total number of operating labour hours without an LTA to over 2.5m in the United States and over 350,000 in the United Kingdom.

Gender diversity

Scientific & engineering



Sales, finance, HR & admin



■ Women ■ Men

Environment

Velocys recognises that as a renewable fuels company it has a duty to limit the environmental impact of its own operations. As such, the Company 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 CO₂ emissions.

In 2017 air travel on the Company's behalf contributed 464t of CO₂ (2016: 467t). This equates to 7.7t per employee (2016: 5.2t). The proportion of air travel that was between the Company's offices in Oxfordshire, Ohio and Texas was 38% (2016: 54%); 16% of the emissions arose from travel to the site of ENVIA's plant in Oklahoma and 14% of the emissions arose from travel to the site of the Integrated Technology Demonstration in North Carolina.

Emissions attributable to operation of its three sites included 430t from consumption of electricity (2016: 769t). Emissions attributable to the consumption of gas were 143t (2016: 436t). These reductions were due to the ceasing of certain R&D operations in July 2017 including the closing down of the UK R&D facility.

Key performance indicators (KPIs) and milestones

As a result of the strategy review carried out in 2016, the Company's KPIs and milestones have changed significantly over the last two years. A new set of KPIs are in the process of being developed. In 2017 the key milestones for the Company were as follows:







1. Capitalise the business to progress the strategy throughout the year.
2. Complete construction, commissioning, start-up and RIN qualification at ENVIA.
3. Execute the Company-wide restructuring programme.
4. Secure entry to Phase II of the USDA Loan Guarantee Program.
5. Secure early stage consortium funding for the UK waste-to-jet-project feasibility study.

Financial results were reviewed on a regular basis by directors. As the Company's remaining cash was reduced at the end of the year, a careful monitoring of the cash and cash commitments was undertaken to ensure that all the fiduciary responsibilities and commitments of the directors were met.

The performance of the Company against these milestones is expanded upon in the CEO's report on pages 8 to 9. The financial results are outlined on pages 16 to 17.

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 delivery of its strategy are set out in the following table.

Risk description and impact	Business influences	Risk management strategy
Risks specific to ENVIA		
As one of three members of the ENVIA joint venture (JV), the Company relies on the continued support of the other members to keep the plant in operation. If the plant ceases to operate due to withdrawal of one or more JV members, this would reduce the amount of operating data available to Velocys, which might affect the design of the Mississippi biorefinery. Cessation of plant operations could also jeopardise ENVIA's ability to pay back amounts loaned to ENVIA by Velocys.	 	The on-site team has been building a comprehensive data set of operational performance. Prior to the leak at ENVIA in May 2018 economic projections showed positive cash flow for the ENVIA plant during 2Q 2018, which will now be delayed. A solution is being developed to return the plant to full operation with minimal loss of revenue.
No ENVIA EPC recourse Due to the bankruptcy filing of Ventech Engineers International, LLC, there may be no financial recourse to the EPC of the ENVIA plant for problems that would normally be the responsibility of the EPC. The inability to recover damages against the EPC could result in ENVIA's having to shoulder liabilities that should otherwise be allocated to the EPC, resulting in additional expense for Velocys and other JV members.		ENVIA, with support from Velocys, is continuing to identify and mitigate ongoing EPC legacy issues at the plant in a timely and cost-effective way. The impact of this risk is significantly reduced as the operational life of ENVIA increases.
Product offtake and acceptance There can be no guarantee that contracts with offtakers of product – wax, diesel and naphtha – will be adhered to, or renewed, or that product specifications will reliably be met. Failure to have reliable, long-term offtakers or active spot sales of products could affect revenue forecasts and ongoing operations.		ENVIA is in frequent dialogue with multiple product offtakers (current and potential) to ensure that the revenues from sales of products will continue with new offtakers should current offtakers default on their obligations. Products are being accepted and sold in the market.
Revenues from sale of RINs RINs generated by ENVIA have been verified and now have Q-RIN status, but there are no guarantees that the plant will run within the required operational parameters that allow RINs to be generated and maximise revenues. This may hinder ENVIA in its efforts to become sustainably net cash generative and this would adversely affect the members of the JV, including Velocys.		The on-site ENVIA team will continue to deliver the plant improvements needed to optimise operations to maximise production of on-specification products and Q-RINs.
Risks specific to Mississippi biorefinery project Any risk or combination of risks listed here has the potential of preventing the project from reaching FID, which would prevent Velocys from extracting value from its development activities.		
USDA loan guarantee The Company is applying for a USDA loan guarantee of up to \$200m as part of the total installed cost of the project. If other companies exhaust the capacity of the programme or if Velocys does not complete the necessary work programmes to achieve conditional commitment before the end of September 2018 and if the programme is no longer authorised in the 2019 Congressional Fiscal Year then Velocys will need to seek alternative forms of financing and/or underwriting, and it is not guaranteed that it could do so.		Velocys has engaged advisers in Washington DC to ensure it understands the requirements of the USDA loan guarantee programme. Velocys and its advisors continuously monitor the USDA programme and any potential changes. The Company is prioritising the delivery of the work packages required by the USDA programme to maximise the probability of securing the loan guarantee for the full \$200m. Velocys is actively engaging with strategic investors and financial advisers to support the financing plans and manage the associated financing risks for the Mississippi project.
Project finance Velocys will need to secure strategic project investment for development capital costs to progress the Mississippi biorefinery project to FID. If this is not secured or is delayed this would adversely affect the project timeline and may impact the financial status of the Company.		The Company has commenced a process to select and on-board one or more strategic and/or financial investors to support financing the remaining project development capital requirements for the Mississippi project. A financial advisor, appointed by Velocys, will manage the process of due diligence, deal construction and closure.



Business influences

1. Technical expertise
 2. ENVIA – our commercial springboard
 3. Development of biorefineries
 4. Focus market
- Further details on our business influences, see page 2.

Risk description and impact	Business influences	Risk management strategy
Risks specific to Mississippi biorefinery project (continued)		
<p>Independent Engineer's report Successful completion of the USDA loan guarantee application requires a review by an Independent Engineer. The IE's report will require successful and timely extended runs at both ENVIA and the Integrated Technology Demonstration.</p>		<p>Velocys has engaged the Independent Engineer early in the process to ensure it understands their requirements and provides the information needed by them at the time required. The performance at ENVIA and the Integrated Technology Demonstration is monitored closely. See page 23 for a discussion of technology integration risks.</p>
<p>SMBC underwriting of the USDA loan guarantee The global leading project finance bank, Sumitomo Mitsui Banking Corporation (SMBC), is Velocys' lender of record for the USDA loan guarantee programme. In this role SMBC will be required to hold 15% of the project debt for the USDA loan guarantee. Failure to pass SMBC credit committee preliminary and final approval in the currently anticipated timeframe could materially impact the financing options for the project.</p>		<p>Velocys and SMBC are working closely together to ensure the requirements of the SMBC credit committee are clearly understood. Both SMBC and Velocys are working closely with the USDA to ensure the USDA-required deliverables are being used to drive the combined Velocys and SMBC activities.</p>
<p>Capital expenditure and operational expenditure required There remains uncertainty regarding the expenditure required to build and operate the biorefinery as well as the scope and strength of the EPC wrap and the credit worthiness of the EPC. Capex or opex could be higher than desired, which could negatively impact plant economics and financing.</p>		<p>Velocys has chosen an engineering partner for FEED. Completion of the FEED package will reduce the uncertainty surrounding plant capital expenditure. The project will optimise plant capital cost, operating costs, carbon intensity and the total returns from the project. Velocys has engaged an estimating advisor to validate the FEED package provided by the EPC. These risks are normal for this stage of the project. Going forward, risks will be mitigated and reduced as the project continues.</p>
<p>Performance of and integration with other licensors' technology Syngas production, syngas clean-up or product upgrading technology, supplied by other licensors, may not function as hoped or may not integrate as envisaged with Velocys technology, which could cause the plant to operate sub-optimally.</p>	 	<p>Velocys works with technology companies that have proven track records of commercial operation. Velocys and its technology partner TRI are collaborating on a joint technology demonstration, which is currently in operation. Although the demonstration is not complete, initial performance indicates good performance of the FT system operating on biomass-generated syngas. A successful outcome will significantly reduce but not eliminate the technology integration risks associated with the development of the biorefinery.</p>
<p>Carbon intensity threshold Due to process constraints Velocys may not be able to meet cost-effectively the required carbon intensity threshold needed to maximise the LCFS credits it could obtain in California. Failure to do so would limit revenues from plant operations.</p>		<p>Velocys is actively factoring into the engineering design the carbon intensity impacts to provide the maximum product revenue that is economically viable.</p>

Risks and mitigation (continued)

Risk description and impact	Business influences	Risk management strategy
Risks specific to Mississippi biorefinery project (continued)		
<p>Site considerations The site is adjacent to the Mississippi River and a catastrophic flooding event could impact the site and plant itself. If the levee constructions were not completed by the local economic development agency, project delays and additional costs could arise.</p> <p>During construction, start-up/commissioning and operations of the biorefinery, hurricanes, tornadoes and forest fires could also adversely affect timelines, operability or costs.</p> <p>The Company must issue a comprehensive Environmental Assessment, which needs to be endorsed by the relevant state and federal authorities. If the Company does not receive a Finding of No Significant Issues (FONSI) it could lead to delays, additional costs or the requirement to find an alternative site.</p> <p>Changes to the local demand for woody biomass or ability of the existing forestry industry infrastructure to transport RFS qualifying feedstock to the plant could increase the cost of supply or increase complexity by increasing the distance over which feedstock has to be sourced.</p>	<p>3</p> <p>3</p> <p>3</p> <p>3</p>	<p>The biorefinery will be protected by a levee, currently under construction, which puts the site outside the 100-year flood plain. Construction of the level and biorefinery will run concurrently. Velocys will monitor the levee construction progress and take appropriate action for mitigation if required. During the build of the biorefinery Velocys intends to ensure it has the necessary flood insurance in place.</p> <p>The design of the facility is incorporating the relevant codes for the potential weather conditions for the safe start-up and shutdown in adverse weather situations. The team will also put in place an emergency response plan prior to start of construction and start-up that will align with local and state emergency plans for emergency situations that includes adverse weather conditions.</p> <p>The Company performed thorough due diligence of the Natchez site prior to confirming it as the biorefinery's location. This included site visits and analysis of a broad set of operational considerations, including environmental considerations. Velocys is working with a local environmental consultant to work through the Environmental Assessment, ensuring the early identification of any potential issues. The assessment is integrated in the overall project planning process and is monitored closely.</p> <p>Velocys has engaged a consultant with experience of the forestry industry around Natchez and has had preliminary discussions with multiple potential suppliers. The Company is currently confident that it can cost-effectively source RFS-qualifying feedstock.</p>
Risks specific to UK waste-to-jet fuel project		
<p>UK policy There could continue to be a lack of clarity on future waste policy, including maintaining the UK landfill tax and/or policy uncertainty around waste for large scale capital intensive schemes.</p>		<p>The project partners are engaging with the UK government to provide input to policy decisions related to the project.</p>
<p>Project partnership and economics There are no guarantees that the project will proceed through successive development phases. Existing project partners may not be willing to fund the project to FID. Capex, opex and revenue estimates derived during engineering studies, combined with views on risk, may make the project unattractive to other investors and lenders.</p>		<p>The experienced Velocys project team is managing the completion of the engineering feasibility study, reducing uncertainty on project economics, and is validating all the key economic assumptions. Regular meetings with the partners have driven alignment on project requirements and timeline to making investment decisions.</p>









Business influences



1. Technical expertise
2. ENVIA – our commercial springboard
3. Development of biorefineries
4. Focus market

Risk description and impact	Business influences	Risk management strategy
Other operational risks		
<p>Performance of Velocys' technology</p> <p>Velocys' core technology may not produce the quantity and/or quality of product expected.</p> <p>Supporting technologies at a biorefinery may not operate according to specification, preventing the Fischer-Tropsch (FT) section of a plant from functioning optimally. This could introduce costs and delays to the project inducing delays or reductions in the revenues possible from sales of product or RINs.</p> <p>Inexpert operation of the plant may produce poorer than predicted performance.</p>		<p>The Company has rigorously tested its technology in the lab, at pilot plant scale, and at commercial scale at the ENVIA plant. It has modelled steady state and upset operations under conditions that will be experienced at future commercial plants.</p> <p>At ENVIA Velocys' core technology has performed during start up and steady state operations in line with requirements at a commercial scale and meets the performance expectations according to models based on lab and pilot studies. Indications are that Velocys' technology will be able to meet both quantity and quality expectations for finished products.</p> <p>Velocys works closely with other technology licensors and EPC companies on plant integration requirements, including the protection of Velocys' FT technology from potential malfunctions in process units other than the central FT units. Velocys' strategy is to de-risk its future projects by selecting commercially-proven technologies and piloting significant components of the flowsheet.</p> <p>Velocys' team includes qualified employees and management with significant expertise in the operation of petrochemical and gas-to-liquids plants. For its projects, Velocys is focused on engaging operators who are fully qualified and well-trained in the operation of such plants. Velocys' predictions of performance are conservatively based on the personnel and management resources that it has on hand and plans to obtain as its projects proceed to implementation.</p>
<p>Health, safety and/or environmental issues at a plant</p> <p>An accident or other incident might occur at a plant incorporating Velocys' technology, resulting in injury to personnel or their exposure to hazardous conditions.</p> <p>An environmental incident might occur at a plant; emissions could exceed the permitted level.</p>		<p>The Company has an excellent in-house safety record. All employees are trained according to OSHA requirements for handling hazardous substances and the Company's HSE procedures and practices are outlined on page 19. Velocys intends to provide significant input into training materials and operating manuals for its future plants. Velocys will provide operational management services to support future biorefineries that the Company, as well as third party developers, develop.</p> <p>Plants such as ENVIA and the plants Velocys intends to develop are carefully designed from inception to account for expected upset conditions and to continue to operate within the environmental and regulatory framework even if problems arise. Plant personnel are trained in procedures that identify issues that could lead to adverse environmental effects and to act accordingly.</p>
<p>Loss of intellectual property (IP) protection</p> <p>Velocys' IP could be stolen, copied or infringed.</p>		<p>Velocys actively manages and invests in its intellectual property and currently holds several hundred patents in around 30 countries. It has a track record of successfully defending its IP portfolio through the courts.</p>

Risks and mitigation (continued)

Risk description and impact	Business influences	Risk management strategy
Other operational risks (continued)		
<p>Supply chain The supply chain may not be able to deliver reactors and catalyst on a timescale to meet required plant build timescales.</p>		<p>A robust quality assurance programme is followed for the supply of commercial catalyst and reactors. The manufacturing methodologies are part of Velocys' IP and therefore transferable.</p>
<p>Employee retention and recruitment Velocys may not be able to scale the organisation to deliver its biorefinery projects.</p>		<p>Velocys provides competitive compensation to attract and retain staff.</p> <p>The Company has been restructured over the last 12 months to focus its activities on project development, engineering and commercial management. The Company is putting in place the required governance and processes within key functions that will be operational when the Company needs to scale up its activities. In addition, Velocys has co-located its project management, engineering and commercial teams in Houston, which has a readily-available talent pool.</p>
Market risks		
<p>Low oil prices Oil prices could track the US Energy Information Administration's (EIA's) Annual Energy Outlook 2018 low oil price case (that assumes a price of Brent crude in 2017 of \$52 per barrel by 2050).</p>		<p>Velocys' target market is renewable fuels in the US. This market involves using low cost feedstocks and producing premium products eligible for valuable RIN and LCFS credits. These credits provide a significant financial hedge to the impact of a low oil price on the price of diesel and jet fuel.</p>
<p>Future of renewable fuels credits Renewable fuels credits (such as RINs under the Renewable Fuel Standard, RFS) could be withdrawn (or their value reduced) at a Federal level in the US. Further details on the RFS are given on page 4.</p> <p>Renewable fuels credits (such as those issued under the Low Carbon Fuel Standard in California) could be withdrawn.</p> <p>The economics of Velocys' biorefineries are dependent on the receipt of these RFS and LCFS credits to maintain revenues above operational costs.</p>		<p>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 RFS continues to see strong support from a wide range of stakeholders.</p> <p>California is proposing to expand the LCFS programme to include jet fuel. 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. Similar LCFS requirements are in place in Oregon, Washington State and several Canadian provinces.</p>
<p>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 to support multiple suppliers.</p>		<p>Velocys and its partners continue to invest in plant integration optimisation and modularisation, 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.</p>
<p>Brexit There is uncertainty around the impact of the UK leaving the European Union.</p>		<p>Velocys does not expect to have significant exposure to the European market in the short and medium terms.</p>

**Business influences**

1. Technical expertise
2. ENVIA – our commercial springboard
3. Development of biorefineries
4. Focus market

Risk description and impact	Business influences	Risk management strategy
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 25.		
Company financing The Company's cash usage is significant versus prospective future cash flows (particularly in the short term) and Velocys is reliant on the support of a small group of major shareholders.		The Board recognises that further funding will be needed to reach FID for the Mississippi biorefinery project. Note 2 to the financial statements 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. Velocys continues to take measures to preserve cash in order to protect against unforeseen events.
Exchange rates As the Company operates in US dollars and pounds sterling it may be impacted by fluctuations in exchange rates.		Based on regularly updated cash flow 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 25.

Approved by the Board and signed on its behalf by:



David Pummell
 Chief Executive Officer
 22 May 2018

Corporate governance report



“Velocys has the long-term ambition to grow significantly and to develop into an established multinational business. The Company needs to have the right governance, processes and culture to support and nurture this growth. It also needs to have the ability to attract and retain members of the team with the capability to deliver its strategy.”

Dr. Pierre Jungels, CBE
Chairman

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”). For example, the Company does not comply with:

- FCA Listing Rule 9.8.6R (which includes the ‘comply or explain’ requirement);
- FCA Disclosure Guidance and Transparency Rules (DTR) Section 7.2 (which set out certain mandatory disclosures);
- Competition and Markets Authority’s Final Order 1 (for UK incorporated FTSE 350 companies only).

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

In accordance with the Code provision A.3.1, at the time of Pierre Jungels’ appointment as Chairman, he met the independence criteria set out in this provision. While thereafter the test of independence is not appropriate in relation to the chairman, 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.

Pierre Jungels has served more than three consecutive three year terms of office. 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.

The Board is in the process of reviewing its succession plan for all Board members.

Avoidance of conflicts of interest

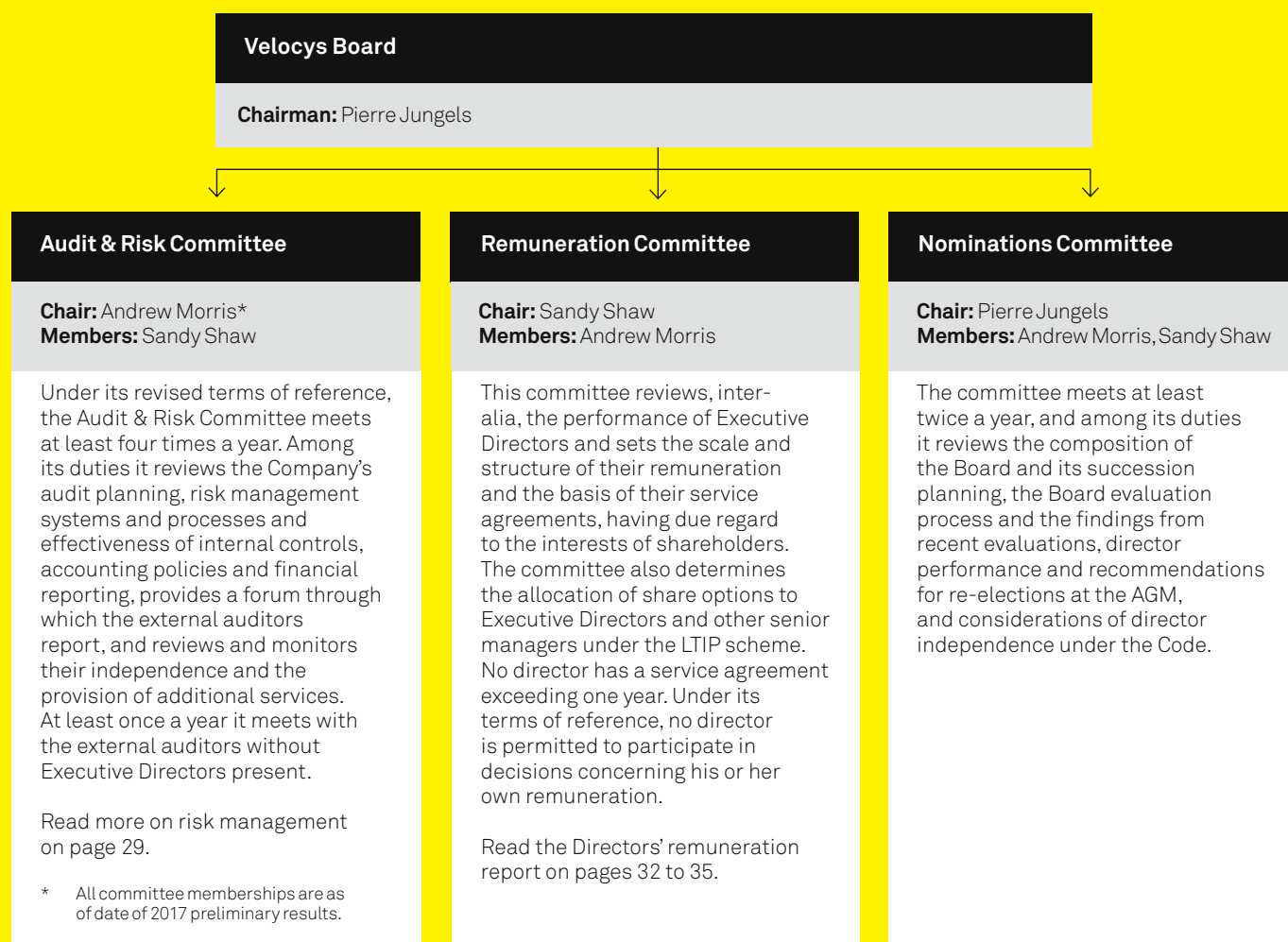
The Company has a procedure for the disclosure, review, authorisation and management of directors’ conflicts of interest and potential conflicts of interest in accordance with the provisions of the Companies Act 2006. In deciding whether to authorise a conflict or potential conflict, the directors must 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.

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, that due consideration is given to strategic issues, and promotion of a culture of openness of debate at Board level, and between directors and the executive committee. 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 executive committee. From January 2015 to February 2018, Julian West acted as Senior Independent Director.

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 on page 27.



Attendance at Board and committee meetings

	Scheduled Board meetings	Special Board meetings	Audit & Risk Committee	Remuneration Committee	Nominations Committee
Number of meetings held in 2017	7	11	6	5	4
Attendance* by:					
Pierre Jungels	100%	91%	–	–	100%
David Pummell	100%	82%	–	–	–
Susan Robertson	100%	100%	–	–	–
Paul Schubert	100%	82%	–	–	–
Sandy Shaw	100%	82%	–	100%	100%
Julian West	100%	91%	100%	100%	100%
Andrew Morris	100%	100%	100%	100%	100%
Ross Allonby	100%	43%	100%	100%	100%
Mark Chatterji	100%	100%	100%	–	100%

* The attendance percentage relates only to applicable meetings (for example, percentages do not include meetings held prior to appointment or following the resignation of particular directors).

Corporate governance report (continued)

Skills and experience of the Board of directors

The Board includes individuals with a deep knowledge of markets worldwide and relationships at the highest level of industry.

Name Dr. Pierre Jungels, CBE

Role Chairman

Skills and experience

Pierre is an oil industry veteran, with over 40 years' experience – over 25 of which were spent at main Board level, which included appointments as Chairman of Rockhopper Exploration plc, Chief Executive of Enterprise Oil plc, Executive Director of PetroFina, and Managing Director of British Gas. 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 executive business and functional management roles in the London corporate head-office during his 22-year tenure.

Name Dr. Paul F. Schubert

Role Chief Operating Officer

Skills and experience

Paul has over 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.

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 Andrew Morris

Role Non-Executive Director

Skills and experience

Andrew has extensive experience as Chairman, CEO, CFO and Group Finance Director with significant involvement in financing and business development for AIM companies, SMEs and private equity backed organisations. He has considerable experience in the power and renewable energy, energy from waste and biofuels sectors. For five years he acted as Commercial & Finance Director for Advanced Plasma Power Limited, a privately funded company that owns gasification and plasma waste treatment technology. He is currently CEO of Envirofusion, a company with nascent technology in the waste-to-energy and biomass-to-power sector. He began his career at Price Waterhouse in London and is a qualified accountant.

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 Executive Committee 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. All key operational decisions are subject to Board approval.

In addition to the scheduled Board meetings detailed on page 27, a further 11 meetings in 2017 were held at short notice to consider specific matters.

Reports by committee

The minutes of the Audit & Risk, Remuneration and Nominations Committee 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 and its committees has been carried out by the Company Secretary, taking the form of comprehensive questionnaires, which provided all directors with an opportunity to comment on Board and committee procedures. A performance evaluation of the Chairman was carried out, led by the Non-Executive Directors, and taking into account the views of all directors. As in the previous year, the results of the evaluation have been considered by the Board and each committee in open session and, where appropriate, actions arising from such reviews will be implemented and monitored.

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 2018 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 2017, 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.

Disposal of assets

As part of the closure of the Milton Park site, a large number of assets were taken out of the business. A comprehensive survey was undertaken of all fixed assets, lower value assets, spares and inventory parts at the site. Management signed off on the process for disposal of these assets, and the process was carefully documented. Assets that could be sold were targeted at potential end users, dealers, clearance agents and scrap merchants. A price covering the carrying net book value of each asset was targeted. All sales were invoiced.

Risk management

The Company employs directors and senior personnel with the appropriate knowledge and experience for a business active in its field of operations, and undertakes regular risk assessments and reviews of its activities. During 2017 the members of the Audit & Risk Committee were Andrew Morris (appointed as Chairman on 1 June 2017), Mark Chatterji (resigned as Chairman on 25 April 2017) and Ross Allonby (resigned 15 June 2017), all of whom had recent and relevant financial experience. Julian West was also a member throughout 2017 and Sandy Shaw was appointed to the committee in February 2018. 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 process of developing and building biorefineries, which involves a large number of stakeholders – asset holder, project developer, EPC, financing party(ies), technology licensors, offtake partners and investors. The risks associated with each of these parties, and the relationship that Velocys has with each one, are individually 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 20 to 25 and note 25. The risks posed by the UK's vote to leave the European Union have been considered in the risk assessment process.

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 2017 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:

- Going concern.
- Intangible assets – impairment assessment.
- Gain on bargain purchase arising from step acquisition of associate.
- Investment in associate – impairment assessment.
- Share of profit and loss of associate.
- Equity instrument – convertible loan note.

Audit review

The Audit & Risk Committee has discussed PwC's audit process, and has reviewed the findings from the audit of the 2017 financial year as well as 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 consolidated financial statements.

Directors' report

The directors present their report and the audited consolidated financial statements for the year ended 31 December 2017

Company

Velocys plc is the parent of the Company. It is a public limited company listed on AIM and incorporated and registered in the United Kingdom. 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 25.

Dividends

The Directors do not recommend any dividend for the year ended 31 December 2017 (2016: nil).

Research and development

The Company's R&D activity now includes 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 2017 (2016: nil).

Post-balance sheet events

Additional fundraising by the Company was announced on 15 January 2018. This is described in the Strategic report on page 17 and in note 28 along with other post-balance sheet events.

Directors

The directors of Velocys plc who were in office during the year and up to the date of signing the financial statements, unless otherwise stated, were as follows.

- Pierre Jungels (Non-Executive Chairman)
- David Pummell (Chief Executive Officer)
- Susan Robertson (Chief Financial Officer) – resigned as director 21 July 2017
- Paul Schubert (Chief Operating Officer)
- Julian West (Senior Independent Director) – resigned 6 February 2018
- Sandy Shaw (Non-Executive Director)
- Mark Chatterji (Non-Executive Director) – resigned 25 April 2017
- Ross Allonby (Non-Executive Director) – resigned 15 June 2017
- Andrew Morris (Non-Executive Director) – appointed 1 June 2017

While 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 2018 Annual General Meeting all of the directors will again retire and offer themselves for re-election, as they did in 2017.

Directors' interests

The directors who held office at 31 December 2017 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 2017	31 December 2016
Pierre Jungels	223,031	223,031
Julian West	75,000	75,000
Sandy Shaw	17,758	17,758
David Pummell	–	–
Paul Schubert	–	–
Andrew Morris	–	–

The following Board members purchased shares as part of the January 2018 fundraise (as recorded in the Register of Directors' Interests and including those of the spouse or civil partner and children under 18): Pierre Jungels (200,000), David Pummell (50,000), Sandy Shaw (100,000) and Andrew Morris (100,000).

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 25. Financial risks, and exposure and risk management policies and objectives are detailed in the Strategic report on page 25, and in note 25.

Substantial shareholdings

The Company has been notified of the following holdings of 3% or more of the issued share capital of Velocys plc as at 8 May 2018.

	Number of shares held	Percentage of issued share capital
Ervington Investments Limited	82,642,443	25.02%
Lansdowne Partners	75,913,020	22.98%
Janus Henderson Investors	39,221,271	11.87%
CQS Asset Management Limited	30,000,000	9.08%
Invesco Asset Management	23,600,000	7.14%
Hargreaves Lansdown Asset Mgt	13,719,680	4.15%

Going concern

The financial statements have been prepared on the going concern basis, which assumes that the Company and Velocys plc will have sufficient funds available to enable them to continue to trade for the foreseeable future.

The Company expects to develop its projects, in particular, providing additional financial support to ENVIA until it reaches cash flow breakeven forecast later in 2018 and progressing the Mississippi biorefinery and UK waste-to-renewable jet fuel projects, which will require significant development and capital expenditure.

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. The directors have prepared financial forecasts to estimate the likely cash requirements of the Company and Velocys plc over the next 12 months from the date of approval of the financial statements.

The forecasts show that the Company and Velocys plc require additional external funding within the 12-month forecast period to be able to continue as a going concern. The directors anticipate that this will come from one, or a combination of, the following three sources, with agreements being actively sought from third parties:

- Strategic investment of development capital into the Mississippi biorefinery project, which is expected during 2H 2018.
- Placement of Company ordinary shares, which may occur within the next twelve (12) months.
- Additional third party licence sales, such as the recently announced Red Rock Biofuels project.

The directors are confident that the funding required for the Company and Velocys plc to continue as a going concern will be secured within a period of 12 months from the date of approval of the financial statements, and have therefore prepared the financial statements on a going concern basis.

However, as at the date of approval of the financial statements no additional funding is committed beyond the £18.4m fundraising announced in January 2018 (as explained in the Financial review on pages 16 to 17). Should additional funding not be secured within the 12 months from the date of approval of these financial statements, the Company and Velocys plc would not be a going concern. As such, these conditions indicate the existence of a material uncertainty that may cast significant doubt on the Company and Velocys plc's ability to continue as a going concern.

The financial statements do not include the adjustments that would arise if the Company and Velocys plc were unable to continue as a going concern.

Greenhouse gas emissions

Details of the Company's greenhouse gas emissions are included in the Strategic report on page 19.

Annual General Meeting

The Annual General Meeting of the Company will be held at the offices of Mayer Brown International LLP, 201 Bishopsgate, London, EC2M 3AF on Friday 29 June 2018.

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 26 to 29.

Approved by the Board and signed on its behalf by:



David Pummell
Chief Executive Officer
22 May 2018

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 2017 (unless otherwise specified):

- Sandy Shaw (Chair)
- Julian West – resigned 6 February 2018
- Ross Allonby – resigned 15 June 2017
- Andrew Morris – appointed 1 June 2017

The Committee's constitution and operation is compliant with the provisions of the UK Corporate Governance Code. 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).

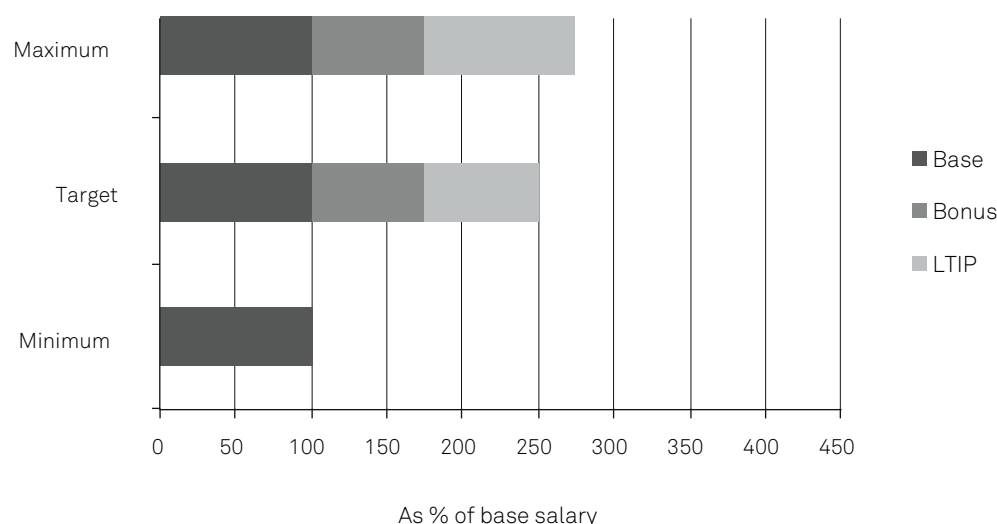
Remuneration policy for Executive Directors

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. No such advice was taken in 2017. 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 2017, 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 2017 performance, paid in 2018 (post-period end), the Remuneration Committee decided that bonus payments to the Executive Directors would be awarded at the target level of 75%, of which half has been paid in cash (and half will be settled by the award, in due course, of market value share options that will be subject to a specific performance condition).

Long-term Incentive Plan (LTIP)

The committee believes that the LTIP scheme should provide to Executive Directors and other senior managers the appropriate incentivisation, focus and reward for achievement, that is aligned with shareholder interests. The last LTIP scheme that the Company put in place was in 2014 and, due to other changes in the business during 2017, the committee decided not to make an award under this scheme during the year. Instead, the committee intends to make a new equity-based incentive award in 2018. It will, in the allocation of such awards, take into consideration the fact that no 2016 or 2017 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 2018 AGM.

Fees paid to Non-Executive Directors

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.

In 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. The aggregate amount of these fees, as set out in the Company's Annual report and accounts for the years ended 31 December 2017 and 2016 is as follows.

	2017	2016
	£	£
Aggregate fees paid to Chairman and Non-Executive Directors	225,125	268,500

Audited information

Directors' remuneration

Aggregate emoluments for current and former directors in 2017 totalled £1,056,867 (2016: £1,052,619), and Company pension contributions were £24,837 (2016: £40,097).

The directors who held office at 31 December 2017 received the following remuneration in relation to the year ended 31 December 2017.

Directors' remuneration report (continued)

Audited information (continued)

Directors' remuneration (continued)

Name of director	2017					2016				
	Salary & fees ¹ £	Other benefits ² £	Bonus £	Pension £	Total £	Salary & fees ¹ £	Other benefits ² £	Bonus £	Pension £	Total £
Executive										
David Pummell	265,000	850	99,375	18,550	383,775	261,263	27,332	–	18,550	307,145
Paul Schubert	252,257	42,375	85,809	6,287	386,728	238,778	28,237	–	7,950	274,965
Non-Executive										
Pierre Jungels	72,000	–	–	–	72,000	78,000	–	–	–	78,000
Julian West	40,500	–	–	–	40,500	43,875	–	–	–	43,875
Andrew Morris	23,625	–	–	–	23,625	–	–	–	–	–
Sandy Shaw	40,500	–	–	–	40,500	43,875	–	–	–	43,875
Aggregate emoluments and pension contributions	693,882	43,225	185,184	24,837	947,128	665,791	55,569	–	26,500	747,860

- 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 2017 salary was £1= \$1.29 compared to £1= \$1.36 in 2016.
- Other benefits include medical cover for Executive Directors and, in the case David Pummell, a joining allowance in 2016 in lieu of car allowance. In the case of Paul Schubert, benefits include costs related to his relocation to Houston.

Directors' share options

Aggregate emoluments disclosed above include amounts paid through the employee benefit trust (EBT) in relation to share options exercised. In 2017 no payments were made to serving or former directors (2016: none).

Details of all directors' shareholdings are disclosed on page 30 in the Directors' report.

Details of options held by the directors at 31 December 2017 are as follows.

Name of director	At 31 December 2016				At 31 December 2017		Exercise price (£)	Earliest date of exercise	Date of expiry	Exercisable at 31 December 2017
	Granted	Exercised	Lapsed							
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	336,711	
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	43,344	
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				1,307,909	

No options were exercised by acting directors during 2017. The total charge for share-based payments during the year in respect of directors was £46,000.

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 award, to be made in 2018, will include such guidelines designed to ensure that Executive Directors retain an interest in the Company.

Former directors

The directors listed below, who were members of the Board at 1 January 2017 and resigned during the year, received the following remuneration.

Name of director	2017				2016			
	Salary & fees £	Other benefits ¹ £	Pension £	Total £	Salary & fees £	Other benefits ¹ £	Pension £	Total £
Executive								
Susan Robertson	271,259	–	–	271,259	218,000	770	15,260	234,030
Non-Executive								
Mark Chatterji	13,500	16,438	–	29,938	43,875	23,076	–	66,951
Ross Allonby	18,563	–	–	18,563	43,875	–	–	43,875
	303,322	16,438	–	319,760	305,750	23,846	15,260	344,856

1. In the case of Mark Chatterji, who was located in the US, other benefits included the cost of his travel from the US to the UK for Board meetings along with associated expenses paid by the Company.

Susan Robertson resigned on 21 July 2017, Mark Chatterji on 25 April 2017 and Ross Allonby on 15 June 2017.

During her employment Susan Robertson was entitled to a target bonus of 75% of her salary, and to life insurance and private medical insurance in line with the Company's standard policies.

At the time that Mrs Robertson left the Company, she held options over the Company's shares as follows.

Name of director	At 31 December 2016	Granted	Exercised	Lapsed	At 31 December 2017	Exercise price (£)	Earliest date of exercise	Date of expiry	Exercisable at 31 December 2017
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	440,316
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	56,742
ELTIP 2015	189,139	–	–	189,139	–	–	–	–	–
ELTIP 2015	47,425	–	–	6,587	40,838	Nil	01/01/18	26/02/25	–
ELTIP 2015	158,083	–	–	158,083	–	–	–	–	–
Total	2,907,527	–	–	353,809	2,533,718				2,512,880

In addition to EMI, bonus and ELTIP awards above, following her departure from the Company, Susan Robertson was awarded 100,000 options with a fair value of £47,000 (calculated using an average share price of 47p based on a period of one year prior to the date of grant), to vest over a three-year period and to be exercised between 17 August 2020 and 17 August 2027.

Share price

The market price of the parent company's shares as at 31 December 2017 was 32p (2016: 37p) and the range during the year was 31p to 92p (2016: 25p to 44p). Details of options and the cost of share-based payments are given in note 15.

Approved by the Board and signed on its behalf by:



Sandra Shaw

Non-Executive Director and Chair of the Remuneration Committee
22 May 2018

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 Company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and parent company financial statements 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 parent company and of the profit or loss of the Company and parent 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 for the Company financial statements and IFRSs as adopted by the European Union have been followed for the parent company financial statements, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company and parent company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company and parent company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and parent company and enable them to ensure that the financial statements 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 parent company 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 parent 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 and parent company's performance, business model and strategy.

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

- the parent company financial statements, 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 loss of the company;
- the Company financial statements, 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 loss of the Company; and
- 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
22 May 2018

Independent auditors' report

to the members of Velocys plc

Report on the audit of the financial statements

Opinion

In our opinion, the Company's consolidated financial statements and Velocys plc's financial statements (the "financial statements"):

- give a true and fair view of the state of the Company's and of Velocys plc's affairs as at 31 December 2017 and of the Company's loss and the Company's and Velocys plc's cash flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union and, as regards Velocys plc's financial statements, as applied in accordance with the provisions of the Companies Act 2006; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual report and accounts 2017 (the "Annual Report"), which comprise: the Consolidated and Velocys plc statements of financial position as at 31 December 2017; the Consolidated income statement and Consolidated statement of comprehensive income, the Consolidated and Velocys plc statements of cash flows, and the Consolidated and Velocys plc statements of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Material uncertainty relating to going concern – Company and Velocys plc

In forming our opinion on the financial statements, which is not modified, we have considered the adequacy of the disclosure made in note 2 to the financial statements concerning the Company's and Velocys plc's ability to continue as a going concern. In order to continue as a going concern the Company and Velocys plc need to secure additional external funding within 12 months from the date of approval of the financial statements. At the time of the approval of the financial statements no such funding is committed. 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 the Company's and Velocys plc's ability to continue as a going concern. The financial statements do not include the adjustments that would result if the Company and Velocys plc were unable to continue as a going concern.

Explanation of material uncertainty

The Directors' report included in the Annual Report and note 2 to the financial statements details the directors' disclosures of the material uncertainties relating to going concern.

The directors have prepared financial forecasts to estimate the likely cash requirements of the Company and Velocys plc over a period of 12 months from the date of approval of the financial statements. The forecasts show that the Company and Velocys plc require additional external funding within the 12 month forecast period to be able to continue as a going concern. The directors anticipate that this will come from one or more of three potential sources, as set out in note 2 to the financial statements. Given the risks associated with raising additional funding, the directors have drawn attention to this in disclosing a material uncertainty relating to going concern in the basis of preparation to the financial statements.

What audit procedures we performed

In concluding there is a material uncertainty, we examined the Company's and Velocys plc's cash flow forecast for the 12 month period to 30 April 2019 and agreed that these are based on Board approved budgets. We also requested the directors to extend their forecast to June 2019. The forecast included certain assumptions as set out in note 2 to the financial statements. We tested these assumptions by performing the following audit procedures:

- We tested the mathematical accuracy of the cash flow forecast and we did not identify any material exceptions in these tests.
- We compared the planned cash outflow to historical actual results and considered management's assumptions to be supportable.
- We examined documentation supporting the mitigating actions identified by management to extend the Company's and Velocys plc's cash position, should additional funding not be achieved in line with forecast. We considered management's assumptions to be reasonable.
- We held discussions with management to understand the nature of downside risks, to obtain an update on the current status of the sources of funding options being sought, as set out in note 2 to the financial statements, including the plan to bring them to fruition, and we considered whether there were additional risks that needed to be reflected in the forecasts. We used our understanding of the Company and industry to assess the possibility of such risks arising and their potential impact. We considered management's assumptions to be reasonable, however, at the time of the approval of the financial statements, we determined that there are no agreements for additional funding in place.

Additionally we considered the adequacy of the disclosure in note 2 to the financial statements and found it to be sufficient to inform members about the directors' conclusions on the appropriateness of using the going concern basis being adopted.

Independent auditors' report (continued)

to the members of Velocys plc

Our audit approach

Overview

Materiality	<ul style="list-style-type: none">• Overall Company materiality: £1.0 million (2016: £1.1 million), equivalent to 4.4% of loss before income tax, before exceptional items.• Overall Velocys plc materiality: £150,000 (2016: £1,000,000), based on 1% of total assets.
Audit scope	<ul style="list-style-type: none">• We identified two financially significant components which were subject to full scope audits.• We performed a full scope audit of Velocys plc.• We performed specified audit procedures at two further components to address specific risk characteristics or to provide sufficient overall coverage of particular financial statement line items.• All audit work was performed by the Company engagement team.• Components where we performed audit procedures accounted for 93% of Company loss before tax and 98% of Company total assets.
Key audit matters	<ul style="list-style-type: none">• Valuation of Intangible assets (Company) and Investments in subsidiaries (Velocys plc).• Valuation of Investment in associate (Company).• Classification and measurement of convertible loan note instrument (Company and Velocys plc).

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

As in all of our audits we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Key audit matter**Valuation of Intangible assets (Company) and Investments in subsidiaries (Velocys plc).**

Refer also to note 17 of the consolidated financial statements (pages 62 to 64) and note 7 of the Velocys plc financial statements (pages 82 to 83).

The carrying value of the Company's intangible assets is £0.8m, following an impairment loss of £28.8m recorded in the current year.

The carrying value of Velocys plc's investments in subsidiaries is £14.4m following an impairment loss of £57.3m recorded in the current year.

The Company's intangible assets and Velocys plc's investments in subsidiaries are subject to impairment testing at least annually or more frequently if events or changes in circumstances indicate the carrying value may not be recoverable. In assessing whether there was any indication of impairment, management identified that the carrying amount of the Company's and Velocys plc's net assets was more than Velocys plc's market capitalisation.

For the assessment of the recoverable amount of the Company's intangible assets and Velocys plc's investments in subsidiaries, the recoverable amount was determined for the cash-generating unit ('CGU') to which these assets belong. The Company has one CGU, being synthetic fuels production.

The recoverable amount of the CGU was determined based on its fair value less costs of disposal ('fair value'), using Velocys plc's market capitalisation, by applying the share price of 10 pence from the equity issued on 15 January 2018 to the number of shares in issue at 31 December 2017. This provided a fair value of £14.7m, resulting in an impairment loss:

- £31.5m has been recorded against the Company's assets, of which £28.8m related to intangible assets; and
- £57.3m has been recorded against Velocys plc's investments in subsidiaries.

Our audit focused on the risk that the carrying value of the Company's intangible assets and Velocys plc's investments in subsidiaries could be overstated and further impairments could be necessary. We also considered whether the amount and allocation of the impairment loss recorded was appropriate.

How our audit addressed the key audit matter

We assessed the level at which impairment testing was performed. Based on our knowledge of the business, including the use of assets and internal reporting, we agreed with management's judgement that, for the assessment of the recoverable amount of the Company's intangible assets and Velocys plc's investments in subsidiaries, the Company has one CGU.

We evaluated management's approach to calculate the CGU's recoverable amount, based on its fair value, using Velocys plc's market capitalisation. Management's assessment applied the share price of 10 pence from the equity issued on 15 January 2018 to the enlarged share capital, resulting in a fair value of £33.1m. We concluded that the application of this market approach was appropriate and that this represents an orderly transaction between market participants under current market conditions and was based on the same information as that which existed at 31 December 2017. However, we did not consider that including the increase in the value of the business resulting from the injection of additional capital was appropriate. On this basis management recalculated the fair value as £14.7m by applying the share price of 10 pence from the equity issued on 15 January 2018 to the number of shares in issue at 31 December 2017. We recalculated the fair value derived from applying this methodology and we did not identify a material exception.

We tested the accuracy of the impairment loss calculated and the allocation of the impairment loss assets within the CGU, by comparing the carrying value of assets with their recoverable amount. We did not identify any material exceptions in these tests.

We also assessed the Company's and Velocys plc's disclosures regarding the significant accounting judgements in calculating the impairment recorded. We consider that these disclosures appropriately draw attention to the significant areas of judgement that support management's conclusion.

Independent auditors' report (continued)

to the members of Velocys plc

Key audit matter

Valuation of Investment in associate (Company).

Refer also to note 19 of the consolidated financial statements (pages 66 to 68).

The Company holds an investment in its associate, ENVIA Energy, LLC ('ENVIA'). The investment is subject to impairment testing at least annually or more frequently if events or changes in circumstances indicate the carrying value may not be recoverable. The carrying value of this investment is £2.6m, following an impairment loss of £2.7m recorded in the current year.

The recoverable amount of the Company's investment in ENVIA was determined based on ENVIA's value in use multiplied by the Company's interest in the investment, based on a value distribution model as defined by the joint venture agreement. ENVIA's value in use was calculated by the estimated future cash flows for the period from 2018 to 2019 and subsequently extrapolating these cash flows to 2037, to reflect the expected economic life of the asset, by applying an estimated long-term growth rate. Management assessed a number of potential outcomes and assigned a probability of the likelihood of each of these outcomes occurring. The estimated future cash flows were discounted to their present value.

Certain assumptions used in calculating ENVIA's value in use are subjective and require estimates to be made. The key estimates and assumptions assessed were:

- The future cash flow growth assumptions used in the discounted cash flow model. In particular:
 - The operational capacity and production yield of the plant;
 - The sales price for the product (waxes, diesel and naphtha) produced; and
 - The sales price for the Renewable Identification Numbers ('RIN') produced.
- The growth rate used beyond the period covered by the forecast; and
- The discount rate applied to future cash flows.

Our audit focused on the risk that the carrying value of this asset could be overstated. We also considered whether the amount of the impairment recorded was appropriate.

Classification and measurement of convertible loan note instrument (Company and Velocys plc).

Refer also to note 26 of the consolidated financial statements (pages 75 to 76).

On 15 May 2017 Velocys plc issued £9.0m of unsecured convertible loan note instruments to existing shareholders.

The final maturity date of the loan notes is 18 months from the date of issue, after which Velocys has the right but not the obligation to convert the outstanding principal and interest into a fixed number of ordinary shares, at a conversion price of £0.50 per share. The fixed annual interest rate is 8.0%, with accrued interest also being convertible into additional ordinary shares.

Our audit focussed on assessing whether the financial instrument met the relevant criteria to be classified as an equity instrument.

How our audit addressed the key audit matter

We tested the integrity of the underlying discounted cash flow model. We did not identify any material exceptions.

We obtained corroborating evidence to support growth assumptions. We found that the assumptions used by the directors were supported by the evidence that we obtained.

We evaluated the long-term growth rate by comparing it to the Gross Domestic Product growth rate in the United States, the country in which ENVIA operates. We observed it to be within our expected range.

We evaluated the discount rate, by comparing key inputs, where relevant, to externally derived data for comparable listed organisations. We engaged our internal specialists in assessing the overall discount rate used, and observed it to be within our expected range.

We performed sensitivity analysis in respect of the key assumptions. We determined that a reasonably possible change in a number of the key assumptions, either individually or collectively, would result in the carrying amount of the Company's investment in ENVIA exceeding its recoverable amount. We consider that management have taken reasonable steps to address this by assessing a number of potential outcomes and assigning a probability of the likelihood of each of these outcomes occurring.

We obtained the joint venture agreement and recalculated the Company's interest in the investment, based on the defined value distribution model. We observed it to have been accurately calculated and applied to ENVIA's value in use.

We also assessed the Company's disclosures regarding the significant accounting estimates in calculating recoverable amount of the Company's investment in ENVIA. We determined that the disclosures appropriately draw attention to the significant areas of estimation uncertainty.

We obtained and read the convertible loan note instrument contract and management's accounting assessment, which was prepared in conjunction with their advisors, to assess whether the financial instrument met the relevant criteria to be classified as an equity instrument. In particular we:

- Agreed the inputs included in management's assessment to the contractual terms; and
- Evaluated whether all of the relevant terms and conditions of the contract had been considered in management's assessment.

Our procedures confirmed that the convertible loan notes are appropriately classified as an equity instrument. In particular our assessment confirmed that Velocys plc does not have a contractual obligation to deliver cash to the loan note holders, and the loan notes convert into a fixed number of shares at a fixed price.

We also assessed the Company's disclosures regarding this significant accounting judgement and consider that these disclosures appropriately draw attention to the significant areas of judgement that support management's conclusion.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the Company and Velocys plc, the accounting processes and controls, and the industry in which they operate.

The Company's accounting process is structured around a local finance function in each of the Company's operating territories in the United Kingdom ('UK') and United States ('US'). These functions maintain their own accounting records and controls. In establishing the overall Company audit strategy and plan, we determined the type of work that needed to be performed at the legal entities ('entities') in the Company.

For each entity we determined whether we required an audit of their complete reported financial information ("full scope") or whether specified procedures addressing specific risk characteristics or particular financial statement line items would be sufficient. Velocys, Inc. and Velocys Technologies Limited were determined as individually financially significant because they contributed more than 15% of the Company's loss before income tax, before exceptional items. In addition we performed a statutory audit for Velocys plc. We also performed specified procedures on VMH Assets LLC and Velocys (USA Holdings) LLC to address specific risk characteristics or to provide sufficient overall coverage. Velocys (USA Holdings) LLC holds the Company's investment in its associate, ENVIA. The Company engagement team conducted all necessary audit procedures.

In aggregate, the components where we performed audit procedures accounted for 93% of Company loss before tax and 98% of Company total assets. This gave us the evidence we needed for our opinion on the financial statements as a whole.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Risk description and impact	Company consolidated financial statements	Velocys plc financial statements
Overall materiality	£1.0 million (2016: £1.1 million).	£150,000 (2016: £1.0 million).
How we determined it	4.4% of loss before income tax before exceptional items.	1% of total assets.
Rationale for benchmark applied	Based on the benchmarks used in the Annual Report, we believe that loss before income tax before exceptional items is the primary measure used by the members in assessing the financial performance of the Company. We consider it appropriate to eliminate exceptional items, which are considered non-recurring, to preserve the link between materiality and the underlying performance of the Company.	We believe that total assets is the primary measure used by the members in assessing the performance and position of the entity and reflects Velocys plc's principal activity as a holding company.

For each component in the scope of our Company audit, we allocated a materiality that is less than our overall Company materiality. The range of materiality allocated across components was between £390,000 and £900,000. Certain components were audited to a local statutory audit materiality that was also less than our overall Company materiality.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £50,000 (Company audit) (2016: £60,000) and £7,500 (Velocys plc audit) (2016: £51,000) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

Independent auditors' report (continued)

to the members of Velocys plc

Reporting on other information (continued)

With respect to the Strategic report and Directors' report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, ISAs (UK) require us also to report certain opinions and matters as described below.

Strategic report and Directors' report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic report and Directors' report for the year ended 31 December 2017 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the Company and Velocys plc and their environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic report and Directors' report.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of directors' responsibilities set out on page 36, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Company's and Velocys plc's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or Velocys plc or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

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

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for Velocys plc'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.

Other required reporting

Companies Act 2006 exception reporting

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 Velocys plc, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of directors' remuneration specified by law are not made; or
- Velocys plc's financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Other voluntary reporting

Directors' remuneration

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



Sam Taylor (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP Chartered Accountants and Statutory Auditors

Reading

22 May 2018

Consolidated income statement

for the year ended 31 December 2017

		2017	2017	2017	2016	2016	2016
		£'000	£'000	£'000	£'000	£'000	£'000
	Note	Before exceptional items	Exceptional items (note 4)	Total	Before exceptional items	Exceptional items (note 4)	Total
Revenue	6	759	–	759	1,445	–	1,445
Cost of sales		(409)	–	(409)	(1,060)	–	(1,060)
Gross profit		350	–	350	385	–	385
Administrative expenses		(21,930)	(31,486)	(53,416)	(17,429)	(2,809)	(20,238)
Other income	9	163	1,750	1,913	272	2,496	2,768
Operating loss	10	(21,417)	(29,736)	(51,153)	(16,722)	(313)	(17,085)
Share of loss of investments accounted for using the equity method	19	(1,784)	(2,736)	(4,520)	(306)	–	(306)
Loss before finance net finance (costs)/income		(23,201)	(32,472)	(55,673)	(17,078)	(313)	(17,391)
Finance income	7	730	–	730	3,344	–	3,344
Finance costs	8	(399)	–	(399)	(26)	–	(26)
Net finance (costs)/income		331	–	331	3,318	–	3,318
Loss before income tax		(22,870)	(32,472)	(55,342)	(13,760)	(313)	(14,073)
Income tax credit	13	739	–	739	1,404	–	1,404
Loss for the financial year attributable to the owners of Velocys plc		(22,131)	(32,472)	(54,603)	(12,356)	(313)	(12,669)
Loss per share attributable to the owners of Velocys plc							
Basic and diluted loss per share (pence)	16	(15.19)		(37.47)	(8.62)		(8.84)

The notes on pages 48 to 76 are part of these consolidated financial statements.

Consolidated statement of comprehensive income

for the year ended 31 December 2017

	2017 £'000	2017 £'000	2017 £'000	2016 £'000	2016 £'000	2016 £'000
	Before exceptional items	Exceptional items (note 4)	Total	Before exceptional items	Exceptional items (note 4)	Total
Loss for the year	(22,131)	(32,472)	(54,603)	(12,356)	(313)	(12,669)
Other comprehensive (expense)/income Items that may be reclassified to the income statement in subsequent periods						
Foreign currency translation differences	(4,411)	–	(4,411)	7,347	–	7,347
Total comprehensive (expense)/income for the year attributable to the owners of Velocys plc	(26,542)	(32,472)	(59,014)	(5,009)	(313)	(5,322)

The notes on pages 48 to 76 are part of these consolidated financial statements.

Consolidated statement of financial position

as at 31 December 2017

	Note	2017 £'000	2016 £'000
Assets			
Non-current assets			
Intangible assets	17	755	34,035
Property, plant and equipment	18	1,801	5,637
Trade and other receivables	20	10,284	325
Investment in associate	19	2,580	5,865
		15,420	45,862
Current assets			
Inventories	21	388	1,461
Trade and other receivables		416	811
Current income tax asset		546	854
Derivative financial instruments		–	537
Restricted cash	22	620	–
Cash and cash equivalents	22	2,070	18,744
		4,040	22,407
Total assets		19,460	68,269
Liabilities			
Current liabilities			
Trade and other payables	23	(3,516)	(2,272)
Borrowings		(268)	(323)
		(3,784)	(2,595)
Non-current liabilities			
Trade and other payables	24	(718)	(1,343)
Borrowings		(273)	(593)
		(991)	(1,936)
Total liabilities		(4,775)	(4,531)
Net assets		14,685	63,738
Capital and reserves attributable to owners of Velocys plc			
Called up share capital	26	1,468	1,438
Share premium account	26	159,385	149,275
Merger reserve		369	369
Share-based payments reserve		16,085	15,843
Foreign exchange reserve		2,654	7,065
Accumulated losses		(165,276)	(110,252)
Total equity		14,685	63,738

The notes on pages 48 to 76 are part of these consolidated financial statements.

The financial statements on pages 43 to 76 were approved by the Board of directors and authorised for issue on 22 May 2018. They were signed on its behalf by:



David Pummell
Chief Executive Officer

Company number 05712187

Consolidated statement of changes in equity

for the year ended 31 December 2017

	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 2016	1,419	149,197	369	15,362	(282)	(97,583)	68,482
Loss for the year	-	-	-	-	-	(12,669)	(12,669)
Other comprehensive income							
Foreign currency translation differences	-	-	-	-	7,347	-	7,347
Total comprehensive income/(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 1 January 2017	1,438	149,275	369	15,843	7,065	(110,252)	63,738
Loss for the year	-	-	-	-	-	(54,603)	(54,603)
Other comprehensive expense							
Foreign currency translation differences	-	-	-	-	(4,411)	-	(4,411)
Total comprehensive expense	-	-	-	-	(4,411)	(54,603)	(59,014)
Transactions with owners							
Share-based payments – value of employee services	-	-	-	242	-	-	242
Proceeds from share issues	30	689	-	-	-	-	719
Convertible loan notes	-	9,000	-	-	-	-	9,000
Interest on convertible loan note	-	421	-	-	-	(421)	-
Total transactions with owners	30	10,110	-	242	-	(421)	9,961
Balance at 31 December 2017	1,468	159,385	369	16,085	2,654	(165,276)	14,685

The notes on pages 48 to 76 are part of these consolidated financial statements.

Consolidated statement of cash flows

for the year ended 31 December 2017

	Note	2017 £'000	2016 £'000
Cash flows from operating activities			
Operating loss before taxation		(51,153)	(17,085)
Depreciation and amortisation		2,893	1,323
Gain on bargain purchase for ENVIA		(1,750)	-
Loss on disposal of property, plant and equipment		83	1
Loss on disposal of intangible assets		152	233
Impairment of assets		31,486	-
Impairment of inventory		340	-
Impairment of assets under construction		31	-
Amortisation of leased inventory		92	-
Share-based payments		242	793
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		358	234
Trade and other payables		914	(6,004)
Inventory		-	138
Cash consumed by operations		(16,312)	(20,679)
Tax credits received		1,047	1,330
Net cash used in operating activities		(15,265)	(19,349)
Cash flows from investing activities			
Purchase of property, plant and equipment		(34)	(291)
Purchase of intangible assets		(335)	(356)
Equity investment in ENVIA		-	(1,903)
Loan to ENVIA		(9,788)	(295)
Interest received		62	136
Cash moved to restricted cash		(620)	-
Decrease in funds placed on deposit for longer than 3 months	22	-	3,000
Net cash (used in)/generated from investing activities		(10,715)	291
Cash flows from financing activities			
Proceeds from issues of shares and convertible loan notes		10,160	6
Costs of issuing shares and convertible loan notes		(443)	-
Interest paid		(17)	(26)
Repayment of borrowings		(308)	(314)
Net cash generated from/(used in) financing activities		9,392	(334)
Net decrease in cash and cash equivalents		(16,588)	(19,392)
Cash and cash equivalents at beginning of year	22	18,744	34,736
Exchange movements on cash and cash equivalents		(86)	3,400
Cash and cash equivalents at end of year	22	2,070	18,744

The notes on pages 48 to 76 are part of these consolidated financial statements.

Notes to the consolidated 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 25. The parent company financial statements are included on pages 77 to 85. The parent company’s securities are traded on the Alternative Investment Market (AIM) of The London Stock Exchange under the symbol “VLS”.

2. Accounting policies

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

Basis of preparation

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU, hereafter referred to as “IFRS”), 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, where relevant.

The preparation of financial statements to conform to IFRS requires the use of certain critical accounting estimates and the exercise of management’s judgement 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 and Velocys plc will have sufficient funds available to enable them to continue to trade for the foreseeable future.

The Company expects to develop its projects, in particular, providing additional financial support to ENVIA until it reaches cash flow breakeven forecast later in 2018 and progressing the Mississippi biorefinery and UK waste-to-renewable jet fuel projects, which will require significant development and capital expenditure.

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. The directors have prepared financial forecasts to estimate the likely cash requirements of the Company and Velocys plc over the next 12 months from the date of approval of the financial statements.

The forecasts show that the Company and Velocys plc require additional external funding within the 12-month forecast period to be able to continue as a going concern. The directors anticipate that this will come from one, or a combination of, the following three sources, with agreements being actively sought from third parties:

- Strategic investment of development capital into the Mississippi biorefinery project, which is expected during 2H 2018.
- Placement of Company ordinary shares, which may occur within the next twelve (12) months.
- Additional third party licence sales, such as the recently announced Red Rock Biofuels project.

The directors are confident that the funding required for the Company and Velocys plc to continue as a going concern will be secured within a period of 12 months from the date of approval of the financial statements, and have therefore prepared the financial statements on a going concern basis.

However, as at the date of approval of the financial statements no additional funding is committed beyond the £18.4m fundraise announced in January 2018 (as explained in the Financial review on pages 16 to 17). Should additional funding not be secured within the 12 months from the date of approval of these financial statements, the Company and Velocys plc would not be a going concern. As such, these conditions indicate the existence of a material uncertainty that may cast significant doubt on the Company and Velocys plc’s ability to continue as a going concern.

The financial statements do not include the adjustments that would arise if the Company and Velocys plc were 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 2017 have had a material impact on the Company.

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 full impact of IFRS 9, which becomes effective for accounting periods beginning on or after 1 January 2018. The main changes are expected to relate to:

- The standard removes the category of assets, loan and receivables, which in 2017 included cash and cash equivalents, trade receivables and the loan to the Company's associate investment, ENVIA. These will be reclassified under the new standard as financial assets held at amortised cost, on the basis that the business model under which they are held is to collect repayment of the asset or loan and interest accrued thereon, with a fixed date for repayment.
- The standard requires any amortisation of these assets to be calculated on an expected future credit losses basis, rather than on incurred losses.

The Company regularly uses forward foreign exchange contracts to manage its foreign exchange risk although at the end of 2017 it had none outstanding. Under IFRS 9 these will continue to be classified as derivative financial instruments and measured at fair value through profit and loss.

IFRS 15 Revenue from contracts with customers

The Company has reviewed the requirements of the standard and 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 any impact on the opening 2018 balance sheet. Revenue in 2017 was derived from engineering services and the lease of catalyst. Service revenue is recognised, and in most cases invoiced, on a monthly basis in line with service performance. Catalyst lease revenue is recognised monthly over the life of the catalyst; revenue in 2017 was immaterial.

Receipt of Red Rock Biofuels revenue is material, and the impacts of adoption of the new standard are currently being assessed.

The following new standard is mandatory for the first time for the financial year beginning 1 January 2019. The Company has not chosen to early adopt this standard in 2018.

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 27, at 31 December 2017 the Company had £1,662,000 of operating lease commitments and on transition the Company will recognise a right-of-use asset and a lease liability in respect of these commitments. Thereafter the nature of the lease expense will change from rent to depreciation and interest charges. The Company's operating lease expense in 2017 was £879,000, although this included £375,000 in respect of the vacated Milton Park premises. It is not expected that the change in the profile of the remaining expense will have a material impact on the Company's loss before tax.

Financial risk management policies

Financial risk management policies are set out in the Strategic report on page 25, and in note 25.

Capital management policies

Capital management policies are set out in note 25.

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 (£).

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.

Notes to the consolidated financial statements (continued)

2. Accounting policies (continued)

Transactions and balances (continued)

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 in the consolidated financial statements, with exchange differences being recognised initially in a separate component of Other comprehensive income and, on disposal of the net investment, in profit or loss.

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 statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. Although these estimates and judgements are based on management's best knowledge of the amount and/or timing, actual results ultimately may differ. These estimates and judgements are regularly reviewed and revised as necessary. The areas that involve a higher degree of judgement or complexity, or that have the most significant effect on the amounts included in these consolidated financial statements are listed below and described in the relevant note.

	Note
Items involving a critical estimate	
Gain on bargain purchase arising from step acquisition of associate	19
Investment in associate – impairment assessment	19
Items involving a judgement	
Intangible assets – impairment assessment	17
Share of profit and loss of associate	19
Equity instrument – convertible loan note	26

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. 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.

	2017 £'000	2016 £'000
Administrative expenses		
Intangible assets impairment	(28,760)	–
Property, plant and equipment impairment	(2,185)	–
Inventories impairment	(541)	–
Unsuccessful acquisition costs	–	(2,809)
	(31,486)	(2,809)
Share of loss of investments	(2,736)	–
Other income		
Recognition of deferred income	–	2,496
Gain on bargain purchase	1,750	–
	986	2,496
Total	(32,472)	(313)

Administrative expenses

At varying points during 2017, the carrying value of the Company's net assets exceeded the market capitalisation indicating a potential impairment at year end. This conclusion was supported by the fundraise in January 2018, which was discounted to 10p per share, and which prompted the share price to drop to 10p immediately afterwards. As a result, an impairment of £31.5m was recorded against a range of assets, as described in note 17. The assets impacted by the impairment were Intangible assets, Inventories and Property, plant and equipment. Critical estimates and judgements are included in note 17.

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, recorded as an exceptional item of £2,809,000, represent amounts spent net of the related reimbursement.

Share of loss of investments

The Company is required to assess, at the end of each reporting period, whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset. During 2017 the first saleable products using Velocys' reactors and catalyst (waxes, diesel and naphtha) have been produced to customer specification and the offtakers have begun taking delivery. Despite these milestones, ENVIA's recoverable amount, based on its value in use, calculated using a discounted cash flow model, has decreased significantly, to reflect a revision of the expected income from RINs and a small risk associated with the expiry of a clause in the JV agreement preventing a majority vote requiring unanimous consent to halt operations at the plant. The Company has recorded an impairment of its investment in ENVIA of £2,736,000 (2016: £nil).

Other income

In 2016 the Company recognised £2,496,000 as Other income. This relates to non-refundable amounts from Ventech previously recorded in deferred income in respect of the cancellation of a contract with Ventech for reactors. The judgment to recognise this 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.

In September 2017 Velocys increased its equity share and voting rights at ENVIA following the exit of NRG from the joint venture, for no consideration. The voting rights for the three remaining joint venture members, including Velocys, were accordingly increased to 33% each. The increased interest in the associate has been acquired through an increase in an existing stake. Velocys applied the 'cost approach', whereby there is a requirement to assess the fair value of both the consideration and the net assets being acquired. The fair value of the net assets being acquired was 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. The Company has recorded a gain on bargain purchase of £1,750,000 in respect of this step acquisition. See note 19 for more information.

5. Segmental information

The Company's chief operating decision-making unit is the Executive Committee (ExCo). The ExCo 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 ExCo considers that the business comprises a single activity, which is the design, development, marketing and sale of technology for the production of synthetic fuels. This includes facilitating project development by putting together partnerships with technology licensors, engineers, feedstock suppliers, offtakers and financing entities. The ExCo 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 ExCo 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 financial statements.

The ExCo 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.

Notes to the consolidated financial statements (continued)

5. Segmental information (continued)

	2017 £'000	2016 £'000
Europe	142	273
Americas	591	1,163
Asia Pacific	26	9
Total revenue	759	1,445

Revenues during the year originated in the United Kingdom and United States, with immaterial revenue from feasibility studies elsewhere in the world.

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

	2017 £'000	2016 £'000
Customer 1	484	619
Customer 2	–	444
Customer 3	–	163
Customers less than 10%	275	219
Total revenue	759	1,445

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

	2017 £'000	2016 £'000
Intangible assets	415	33,590
Property, plant and equipment	1,782	5,355
Trade and other receivable	10,284	325
Investment in associate	2,580	5,865
Total	15,061	45,135

All other non-current assets were held in the United Kingdom and amounted to £359,000 (2016: £727,000).

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 contracts. Once the fair value of the components has been determined, revenue is recognised in line with the underlying nature of the contract.

In 2017 there was no reactor or licence fee revenue. Catalyst sales income is recognised monthly over the term of the arrangement.

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.

The majority of the Company's revenue is derived from a small number of significant commercial customers and development partners.

	2017 £'000	2016 £'000
FT reactor, catalyst and licence	484	–
Engineering services	275	1,445
Total	759	1,445

7. Finance income

	2017	2016
	£'000	£'000
Interest income on bank deposits	61	129
Interest on loan to associate	669	–
Net fair value gains on forward foreign exchange contracts	–	668
Foreign exchange gains	–	2,547
Total	730	3,344

8. Finance costs

	2017	2016
	£'000	£'000
Interest on finance leases	1	5
Interest on borrowings	16	21
Net fair value losses on forward foreign exchange contracts	61	–
Foreign exchange losses	321	–
Total	399	26

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.

	2017	2016
	£'000	£'000
Before exceptional items:		
Contractual and legal settlements	–	252
Sale of fixed assets	163	20
Total other income before exceptional items	163	272
Exceptional items (see note 4):		
Gain on bargain purchase	1,750	–
Recognition of deferred income	–	2,496
Total other income exceptional items	1,750	2,496
Total	1,913	2,768

Notes to the consolidated financial statements (continued)

10. Expenses by nature

	2017	2016
	£'000	£'000
Employee benefit expense (see note 12)	9,022	10,212
Sub-contractor and consultant costs	2,364	1,837
Depreciation of property, plant and equipment: owned (note 18)	1,101	1,077
Depreciation of property, plant and equipment: leased (note 18)	35	55
Amortisation of intangible assets (note 17)	1,757	191
Impairment of inventory	340	148
Impairment of assets under construction	31	–
Operating lease expense – plant and machinery	71	72
Operating lease expense – other	808	517
Patent and other IP costs	225	313
Materials expense	972	642
Services	2,181	677
Legal	872	318
Travel	942	853
Other expenses	1,618	1,577
Total cost of sales and administrative expenses before exceptional items	22,339	18,489
Exceptional items - impairment of assets (note 4)	31,486	2,809
Total cost of sales and administrative expenses	53,825	21,298

Included in administrative expenses were research and development costs of £11,064,000 (2016: £10,075,000).

11. Auditor's remuneration

	2017	2016
	£'000	£'000
Payable to PricewaterhouseCoopers LLP and its associates:		
For the audit of the parent company and consolidated financial statements in respect of the current year	94	78
For the audit of the parent company and consolidated financial statements in respect of the prior year	35	–
For the audit of the financial statements of subsidiaries of the parent company in respect of the current year	25	39
Other services:		
Audit-related assurance services	7	–
Taxation advisory services in respect of the current year	10	25
Total	171	142

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 accrued. 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.

	2017 number	2016 number
Research, design and development	37	65
Administration	23	25
Total average headcount	60	90

Their aggregate remuneration comprised the following items.

	2017 £'000	2016 £'000
Wages and salaries	7,787	8,312
Social security costs	519	673
Other pension costs	232	314
Severance expense	242	120
Share-based payments granted to directors and employees (note 15)	242	793
Total remuneration	9,022	10,212

Details of directors' remuneration are given in the audited information in the Directors' remuneration report on pages 32 to 35, which forms part of these financial statements.

During the year a number of employees were made redundant due to the scaling down of R&D activities. Redundancy payments, including payments in lieu of notice and holiday totalled £242,000.

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.

	2017 £'000	2016 £'000
Current tax:		
R&D tax credit relating to prior years	(193)	(550)
R&D tax credit relating to current year	(546)	(854)
Current tax total	(739)	(1,404)
Income tax total	(739)	(1,404)

Due to the availability of losses incurred in the year, there is no charge to corporation tax. The Company recognised £739,000 for R&D tax credits (2016: £1,404,000). 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 HMRC's rules, and to estimate the level of allowable cost within each, based on the nature of costs.

The actual tax credit for the current and previous year is lower (2016: lower) 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.

	2017 £'000	2016 £'000
Loss before income tax after exceptional items	(55,342)	(14,073)
Tax calculated at domestic tax rates applicable to losses in the respective countries	(18,004)	(4,147)
Tax effects of:		
Expenses not deductible for tax purposes	20	51
Impairment loss not deductible for tax purposes	8,696	-
Unutilised tax losses for which no deferred tax asset is recognised	9,288	4,096
R&D tax credit	(739)	(1,404)
Income tax total	(739)	(1,404)

Notes to the consolidated financial statements (continued)

13. Income tax (continued)

In the table Impairment loss not deductible for tax purposes removes the tax impact of the In-process technology and Goodwill impairments (see note 17). Goodwill created from a stock purchase such as that of Velocys Inc. is not deductible for US tax purposes. Goodwill created from purchasing the assets of the company (such as Velocys Projects Solutions LLC) is tax deductible.

The weighted average applicable tax rate was 32.5% (2016: 29.5%).

The standard rate of corporation tax in the United Kingdom changed from 20% to 19% with effect from 1 April 2017. The applicable tax rate for 2017 is therefore 19.25%. Legislation to 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 has been 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 had an effective rate of 34%. In December 2017 the US Congress voted to reduce the tax rate to 21%. Unrecognised US deferred tax balances have been measured at 21% (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.

There was no movement in recognised deferred tax in the year or the comparative period.

	2017 £'000	2016 £'000
Unrecognised Deferred tax assets		
Trading losses	(24,720)	(27,366)
Equity settled options	(54)	(195)
Total	(24,774)	(27,561)

At 31 December 2017 the Company had a net unrecognised deferred tax asset of £24,720,000 (2016: £27,366,000) arising from trading losses since incorporation. No recognition (2016: £nil) of the net deferred tax asset has been made at 31 December 2017 on the grounds of uncertainty over its recoverability in light of the Company's nascent revenue streams and commitment to continued investment in the development of its biorefineries, and therefore there is no impact on the current or prior year income statement.

Of this unrecognised deferred tax asset £12,035,000 (2016: £11,775,000) 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 2037 (2016: 2023 and 2036).

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 historical satisfaction of non-market vesting and service conditions. 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. The Company does not hold any treasury shares.

The number of options outstanding at 31 December 2017 and the expense recognised in the profit or loss for these schemes, along with bonus shares and other schemes, are as follows.

Scheme	2017		2016	
	Options outstanding	Income statement £'000	Options outstanding	Income statement £'000
Employees UK/US	2,036,100	105	3,228,556	275
ELTIP (Executives)	7,597,733	91	8,166,548	496
Velocys, Inc.	63,570	–	83,248	–
Bonus shares	79,760	–	79,760	–
Other	212,625	46	253,879	22
Total	9,989,788	242	11,811,991	793

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, which 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.

Non-market performance options that were granted to certain employees in 2015 did not meet the target conditions and did not vest in 2017.

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

	2017		2016	
	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options
At 1 January	121.26p	3,228,566	109.60p	4,188,283
Granted	48.97p	160,000	28.86p	104,615
Forfeited	67.90p	(1,352,466)	131.47p	(1,062,332)
Exercised	–	–	81.29p	(2,000)
At 31 December	117.95p	2,036,100	121.26p	3,228,566

Of the 2,036,100 options outstanding at 31 December 2017, 1,484,764 were exercisable (2016: 1,875,442). The weighted average exercise price of the exercisable shares was 43.88p (2016: 57.88p).

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

Year of expiry	Range of exercise price	2017		2016	
		Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
2017	–	–	–	16,129	124.00p
2018	159.00p	62,893	159.00p	62,893	159.00p
2020	57.50 – 64.49p	24,352	64.49p	42,616	68.83p
2021	51.00 – 68.19p	774,855	62.57p	1,024,140	68.09p
2022	48.00 – 81.53p	80,000	73.32p	425,000	93.08p
2023	129.88 – 194.94p	484,000	184.38p	494,000	200.73p
2024	Nil – 276.77p	200,000	218.38p	293,334	227.39p
2025	57.07 – 180.00p	240,000	145.53p	775,839	126.83p
2026	27.60 – 37.06p	70,000	28.95p	94,615	31.91p
2027	43.73p	100,000	43.73p	–	–
Total	Nil – 276.77p	2,036,100	117.95p	3,228,566	121.26p

Notes to the consolidated financial statements (continued)

15. Share-based payments (continued)

The weighted average fair value of options granted during the year was 22.49p (2016: 13.65p) per option. The significant inputs into the model were as follows.

	2017	2016
Weighted average share price at grant date	48.97p	28.86p
Weighted average exercise price	48.97p	28.86p
Expected volatility	61%	54%
Weighted average annual risk free rate	0.3%	0.4%
Dividend yield	0%	0%
Weighted average expected life	4.0 years	4.0 years

Total expense recognised in the income statement for share options granted to directors and employees was £105,000 (2016: £275,000).

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.

The only options granted in 2017 were to Susan Robertson, who was leaving the Company (2016: no options granted). However, the Remuneration Committee intends to introduce a new equity-based incentive scheme for executives in 2018, and, in the allocation of such awards, may take into consideration the fact that no 2016 or 2017 awards were made.

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

	2017		2016	
	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options
At 1 January	84.92p	8,166,548	64.23p	10,912,627
Granted	46.01p	100,000	-	-
Forfeited	4.76p	(385,310)	Nil	(1,176,079)
Exercised	32.03p	(283,506)	0.15p	(1,570,000)
At 31 December	89.85p	7,597,732	84.92p	8,166,548

Of the 7,597,732 options outstanding at 31 December 2017, 7,244,534 were exercisable (2016: 6,022,848). The weighted average exercise price of the exercisable shares was 94.22p (2016: 115.14p).

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

Year of expiry	Range of exercise price	2017		2016	
		Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
2017	–	–	–	135,558	Nil
2018	Nil	225,172	Nil	213,883	Nil
2019	Nil – 1.00p	335,541	0.31p	524,680	0.20p
2020	Nil	194,769	Nil	352,852	Nil
2021	1.00 – 58.00p	1,175,000	39.05p	1,175,000	39.05p
2022	49.00p	2,313,178	49.00p	2,498,503	49.00p
2023	159.00p	1,841,837	159.00p	1,841,837	159.00p
2024	153.00 – 163.50p	1,412,235	163.13p	1,424,235	163.04p
2027	1.00p	100,000	1.00p	–	–
Total	Nil – 163.50p	7,597,732	89.85p	8,166,548	84.92p

The weighted average fair value of options granted during the year was 47.00p (2016: no options) per option. The significant inputs into the model were as follows.

	2017	2016
Weighted average share price at grant date	47.00p	–
Weighted average exercise price	47.00p	–
Expected volatility	61%	–
Weighted average annual risk free rate	0.3%	–
Dividend yield	0%	–
Weighted average expected life	3.0 years	–

Total expense recognised in the income statement for executive options granted to directors and employees was £91,000 in 2017 (2016: £496,000). No further expense was accrued within the share-based payments charge (2016: £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 £nil (2016: £13,300).

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 ten 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.

Notes to the consolidated financial statements (continued)

15. Share-based payments (continued)

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

	2017		2016	
	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options
At 1 January	\$1.10	83,248	\$1.08	95,978
Forfeited	\$0.93	(19,678)	\$0.93	(12,730)
Exercised	–	–	–	–
At 31 December	\$0.93	63,570	\$1.10	83,248

Of the options outstanding presented above, 63,570 (2016: 83,248) were exercisable as of 31 December 2016. The weighted average share price of the exercisable shares was \$0.93 (2016: \$1.10).

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

Year of expiry	Exercise price per share	2017		2016	
		Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
2017	–	–	–	9,218	\$2.45
2021	\$0.93	63,570	\$0.93	74,030	\$0.93
Total	\$0.93	63,570	\$0.93	83,248	\$1.10

Total expense recognised in the income statement for share options granted under the Velocys, Inc. plan was £nil (2016: £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, 2017.

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.

	2017		2016	
	Exercise price	Number of options	Exercise price	Number of options
At 1 January	1.00p	79,760	1.00p	421,760
Exercised	–	–	1.00p	(342,000)
At 31 December	1.00p	79,760	1.00p	79,760

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

Year of expiry	Exercise price	2017		2016	
		Number of options	Number of options	Number of options	Number of options
2019	1.00p	42,105	42,105	42,105	42,105
2021	1.00p	37,655	37,655	37,655	37,655
Total	1.00p	79,760	79,760	79,760	79,760

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 2017 (2016: nil). All expense has been recognised prior to 2016.

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 ten 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.

	2017		2016	
	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options
At 1 January	87.39p	253,879	87.39p	253,879
Granted	1.00p	81,000	–	–
Exercised	1.00p	(122,254)	–	–
At 31 December	104.15p	212,625	87.39p	253,879

Of the options outstanding at 31 December 2017, 172,625 were exercisable (2016: 163,879). The weighted average exercise price of the exercisable shares was 103.89p (2016: 77.58p).

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

Year of expiry	Range of exercise price	2017		2016	
		Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
2021	–	–	–	6,500	1.00p
2022	–	–	–	10,204	1.00p
2023	1.00 – 53.10p	29,500	53.10p	54,050	29.44p
2024	145.25p	21,375	145.25p	21,375	145.25p
2025	105.25 – 143.50p	161,750	108.03p	161,750	108.03p
Total	1.00 – 145.25p	212,625	104.15p	253,879	87.39p

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 were granted in 2017. Two further awards were made in 2017 and subsequently granted. The number of options was determined by the average share price in the quarter prior to the service period, and the options vested immediately.

The weighted average fair value of options granted during the year using the Black-Scholes valuation model was 57.59p per option (2016: no options granted). The significant inputs into the model were as follows.

	2017	2016
Weighted average share price at grant date	48.88p	–
Weighted average exercise price	1.00p	–
Weighted average expected volatility	61%	–
Weighted average annual risk free rate	0.0%	–
Dividend yield	0%	–
Weighted average expected life	0 years	–

The share-based payment expense for the year includes a cost of £46,000 (2016: £22,000) relating to options granted to consultants.

Share-based payments charge

The total charge for share-based payments during the year was £242,000 (2016: £793,000) of which £46,000 (2016: £357,000) relates to options granted to directors and the remainder to other employees.

Notes to the consolidated financial statements (continued)

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.

	2017	2016
Loss attributable to owners of Velocys plc (£'000s)	(54,603)	(12,669)
Weighted average number of ordinary shares in issue	145,729,727	143,282,963
Basic and diluted loss per share (pence)	(37.47)	(8.84)

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 2017 there were no other potentially dilutive instruments (see note 26). Details of share options are given in note 15.

17. Intangible assets

Significant accounting policies

Cost or valuation and amortisation

Goodwill

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 the opening balance sheet, £5,445,000 of the Goodwill balance related to the acquisition of Velocys, Inc. in 2008 and £2,668,000 to the acquisition of Velocys Project Solutions, LLC (VPS) in 2014. In 2017 the Goodwill balance was written down to nil (see Impairment below).

In-process technology

In-process technology consists of purchased intangibles and capitalised development costs and 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.

Prior to 2017, amortisation was charged using the units-of-production method based on useful economic lives of the assets projected over future sales of 1,400 four-core reactors. Amortisation began in 2015 based on the manufacture of the first commercial reactors. From 1 January 2017, following an update to the Company's business model, whereby it is concentrating on the development of biorefineries rather than the licensing of technology to third parties, the expected pattern of consumption of the future economic benefits has been revised. The Company estimates that the total useful economic life of the asset is 20 years, from the completion of the first two reactors in August 2015. Amortisation is charged on a straight-line basis over the remaining estimated useful economic life of the asset, being 18.7 years from 1 January 2017 resulting in an increase of the amortisation charge for the year of £1,577,000. Subsequently, it was decided to impair the In-process technology asset (see below).

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. Capitalised development costs are carried at cost less accumulated amortisation and impairment losses. Amortisation is charged over periods expected to benefit, typically up to 20 years, commencing with launch of the product. 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 2017 and 2016. This resulted in a loss on disposal of patents of £152,000 (2016: loss of £213,000).

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 had been fully impaired in 2015 related to an expected project development fee negotiated during 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

Intangible 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 carrying value exceeds recoverable amount, the difference is recognised as an expense in the income statement. The recoverable amount used for impairment testing is the higher of 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 that are largely independent of cash inflows from other assets or groups of assets. The Company has one CGU 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.

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.

Were the fair value of the business to change in the coming 12 months, due to an increase or further decrease in the market capitalisation of Velocys plc, the impairment disclosed in this note would be reversed or the Company's assets would be further impaired accordingly.

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 varying points during 2017, the carrying amount of the Company's net assets exceeded Velocys plc's market capitalisation;
- The fundraising, completed in January 2018, was discounted to 10p per share, and which prompted the share price to drop to 10p immediately afterwards, further reducing the Velocys plc's market capitalisation.

To assess the recoverability of the intangible assets, the recoverable amount is calculated 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 detailed in the accounting policy set out above, the Company is considered to operate as a single CGU. Due to the early stage of the Company's strategy, its biorefinery development plans are still at too early a stage to provide reliable revenue forecasts for long-term discounted cash flow analysis. Consequently, the CGU's recoverable amount has been determined based on its fair value less costs of disposal (fair value), by reference to the total value of the parent company's equity based on the AIM-listed shares of the parent company, consistent with the impairment assessment performed in the prior year.

The fair value should reflect the assets and liabilities of the existing business at 31 December 2017. The Company considers that using a fair value less cost of disposal value of £33.1m, based on the share price of 10 pence from the equity raised on 15 January 2018 to the enlarged share capital, for the 31 December 2017 impairment assessment would imply that the combined business would be in excess of this at the date of the fundraising in January 2018, following the cash injection. The assessment has taken account of the decrease in the share price resulting from the January 2018 fundraising, and applied a per share value of 10p to the number of shares in issue at 31 December 2017. This gave a valuation of £14.7m and, unlike the December 2016 assessment, a control premium was not applied, as most of the Company's significant investors were participating in the January 2018 fundraising at the discounted price. As a result of this fair value assessment, the Company has recorded an impairment charge of £31.5m (2016: £nil).

The method of allocation of the impairment was as follows:

- Write down Goodwill to nil, resulting in an impairment of £7,398,000.
- The other assets in the CGU on a pro rata basis, based on the carrying amount of each asset in the CGU. However, within this allocation framework, each asset is reduced only to the highest of:
 - (i) Its fair value less costs of disposal, if measurable.
 - (ii) Its value in use, if this can be determined.
 - (iii) Nil.

This resulted in the following impairment allocation:

- In-process technology £20,610,000.
- Patents, licence and trademarks £752,000.
- Property, plant and equipment £2,185,000.
- Inventories £541,000.

Notes to the consolidated financial statements (continued)

17. Intangible assets (continued)

	Goodwill £'000	In-process technology £'000	Patents, licence and trademarks £'000	Customer contracts £'000	Software £'000	Total £'000
2017						
Cost						
At 1 January 2017	8,113	25,942	2,248	1,473	101	37,877
Additions	–	–	335	–	–	335
Disposals	–	–	(282)	–	–	(282)
Write-off of customer contracts	–	–	–	(1,473)	–	(1,473)
Foreign exchange movement	(715)	(2,261)	(142)	–	(5)	(3,123)
At 31 December 2017	7,398	23,681	2,159	–	96	33,334
Accumulated amortisation and impairment						
At 1 January 2017	–	1,628	678	1,473	63	3,842
Charge for the year	–	1,577	144	–	36	1,757
Disposals	–	–	(130)	–	–	(130)
Write-off of customer contracts	–	–	–	(1,473)	–	(1,473)
Impairment	7,398	20,610	752	–	–	28,760
Foreign exchange movement	–	(134)	(40)	–	(3)	(177)
At 31 December 2017	7,398	23,681	1,404	–	96	32,579
Net book amount						
At 31 December 2017	–	–	755	–	–	755

	Goodwill £'000	In-process technology £'000	Patents, licence and trademarks £'000	Customer contracts £'000	Software £'000	Total £'000
2016						
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)
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

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. Property, plant and equipment were included in the list of items to which an impairment was applied subsequent to the impairment review (see note 17). The value of the impairment was £2,185,000 (2016: £nil).

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.

	Assets under construction £'000	Land £'000	Plant and machinery £'000	Total £'000
2017				
Cost				
At 1 January 2017	104	1,330	12,200	13,634
Additions	18	–	16	34
Disposals	–	–	(2,545)	(2,545)
Transfers to plant and machinery	(64)	–	64	–
Foreign exchange	(7)	(118)	(1,004)	(1,129)
At 31 December 2017	51	1,212	8,731	9,994
Accumulated depreciation and impairment				
At 1 January 2017	–	–	7,997	7,997
Charge for the year	–	–	1,136	1,136
Disposals	–	–	(2,462)	(2,462)
Impairment	31	666	1,519	2,216
Foreign exchange	–	–	(694)	(694)
At 31 December 2017	31	666	7,496	8,193
Net book amount				
At 31 December 2017	20	546	1,235	1,801

Notes to the consolidated financial statements (continued)

18. Property, plant and equipment (continued)

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 and impairment				
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

As at 31 December 2017, the Company had entered into contractual commitments for the acquisition of property, plant and equipment amounting to £2,000 (2016: £12,000).

19. Investment in associate

This investment relates solely to 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. An update on the ENVIA project is available in the Strategic report on pages 10 to 11.

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. In January 2016, Velocys entered into a financing arrangement with ENVIA under which it contributed additional equity finance of \$2.6m and committed to provide loan finance of up to \$9.3m. 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 from 9% to 28%. The investment has since been recognised as an Investment in associate, reflecting the significant influence that Velocys holds in ENVIA, including voting rights exceeding 20% and a seat on ENVIA's board. The Company recorded the transaction as a step acquisition under the equity method in 2016.

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. During 2017 Velocys committed to a series of extensions to the loan, which increased the facility to \$13.8m (£10.3m) (see note 20), however these extensions did not result in a change in the Company's ownership interest or voting rights. In September 2017, one of the joint venture partners, NRG, withdrew its interest and assigned its ownership and voting units to the remaining partners such that each was left with voting rights of 33%. No consideration was given in respect of this transfer. The Company recorded the transaction as a step acquisition under the equity method in 2017.

The Company's share of post-acquisition profit or loss is recognised in the Income statement based on its economic interest. 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 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.

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.

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.

Critical estimates and judgements

Change in ownership rights – fair value assessment of ENVIA's net assets

In September 2017 Velocys increased its equity share and voting rights at ENVIA following the exit of NRG from the joint venture, for no consideration. The voting rights for the three remaining joint venture members, including Velocys, were accordingly increased to 33% each. The increased interest in the associate has been acquired through an increase in an existing stake. There is an accounting policy choice available for the acquisition of an associate in stages (step acquisition). Velocys applied the 'cost approach', whereby there is a requirement to assess the fair value of both the consideration and the net assets being acquired. The fair value of the net assets being acquired was 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, which requires the use of a number of key assumptions.

The calculations use projections derived from cash flow forecasts developed by Velocys, covering the two-year period from 2018 to 2019, and subsequently extrapolated to 2037, which is considered to be the economic life of the asset, using the estimated long-term growth rate. The cash flow forecast relies on the intimate working knowledge of the plant that Velocys has gained since the beginning of the start-up process. Ongoing uncertainties, for example, with the availability and price of RINs, are taken into account by using a number of different scenarios in the model. IAS 36 requires that when performing an impairment review that risk is incorporated into the impairment model. This can be done either in the cash flows or through the discount rate. The Company has incorporated risk through the cash flow forecasts by assessing a number of potential outcomes and assigning a probability of the likelihood of each of these outcomes occurring. The range of the value in use based on these potential outcomes is significant, which reflects the early stage nature of the venture. The Company has recorded a gain on bargain purchase of £1,750,000 in respect of this step acquisition. The key assumptions included in calculating the recoverable amount are set out below.

(i) Sales volume

The plant capacity is 250 bpd production and the model assumes 200 bpd average actual production at the plant due to varied reduction in availability due to time out for catalyst regeneration, catalyst change out or other maintenance. It assumes that a large majority of the product will qualify for RINs. There are offtake agreements in place for all products that exceed five years for 100% of products produced and there is a six-month contract in place for all of the available RIN credits generated; therefore the sales volume risk is solely based on operational availability. As indicated above, sensitivity analysis reveals that a decrease to 186 bpd from the 200 bpd modelled availability (which is over 25 bpd below operating plan) would be required in order to generate a material change in the cash flows. The impact of aggressive sensitivity modelling of RIN availability does not have a material impact on cash flows.

(ii) Sales price/RIN credits

The model is based on an oil price (WTI) of \$57.50 per barrel and a RIN price of \$2.40 per gallon until October 2018 and then \$3.05 per gallon, with scenarios looking at an increase or reduction in these prices of 10%. The prices of diesel, naphtha and wax are all indexed to the oil price and/or rack pricing that is highly correlated to the price of oil. Although volatility of oil price could significantly vary revenues, the price has been relatively stable for the past 12 months and, based on current WTI futures, is projected to trade in this range for the remainder of 2018. There is a possibility within the range of modelled scenarios for RIN pricing to result in a material impact on cash flows, but not on a risk-adjusted basis, as the current forward outlook shows price recovery.

(iii) Long-term growth rates

A long-term growth rate of 2% was used to extrapolate the cash flows for the period from 2020 to 2037. This is based on the US long-term GDP growth rates, the principal country in which ENVIA operates, and in preference to an industry average rate, given the early stage of development in the industry and resulting uncertainty. A reduction in the growth rate to 0% would not result in a material reduction in the gain on bargain recorded, or to the impairment recognised.

(iv) Discount rate

The discount rate is based on an estimate of ENVIA's weighted average cost of capital (WACC) being the average rate of return ENVIA expects to compensate all its investors. ENVIA has both equity and debt capital in the form of the loan from Velocys. At September 2017 (step acquisition) and December 2017 (impairment assessment) a post-tax discount rate ('discount rate') of 10.95% (2016: 8.45%) was applied to the model. It is a reasonable assumption that the discount rate might vary in a range up to 12.7%; this would not result in a material change to the value of ENVIA's net assets.

Impairment assessment as at 31 December 2017

The Company is required to assess, at the end of each reporting period, whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset. During 2017 the first saleable products using Velocys' reactors and catalyst have been produced to customer specification and the offtakers have begun taking delivery of the waxes, diesel and naphtha. Despite these milestones, ENVIA's recoverable amount, based on its value in use, calculated using a discounted cash flow model, has decreased significantly, predominantly driven by a lower revenue forecast based on a revision of product and RIN pricing produced by the Company. The recoverable amount of the investment was 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, which requires the use of a number of key assumptions. These are included in the 'Change in ownership rights - fair value assessment of ENVIA's net assets' section above. The Company has recorded an impairment of £2,736,000 (2016: £nil).

Notes to the consolidated financial statements (continued)

19. Investment in associate (continued)

Critical judgements

Share of ENVIA's identifiable assets and liabilities and its share of profit and loss

Under the equity method the profit or loss of the investor includes its share of the profit or loss of the investee. The Company bases the calculation of its share of ENVIA's identifiable assets and liabilities and its net losses on a value distribution model developed by ENVIA that uses the LLC agreement agreed with each of the other parties that hold ownership units. The resulting percentage share differs to both the Company's proportion of ownership units held in ENVIA and its proportion of voting units. This value distribution is considered a more appropriate measure of the Company's economic interest in ENVIA.

	2017 £'000	2016 £'000
Investment in associate		
At 1 January	5,865	–
Movement from available-for-sale	–	3,375
Investment	–	1,938
Gain on bargain purchase	1,750	–
Share of loss	(1,784)	(306)
Impairment	(2,736)	–
Foreign exchange	(515)	858
At 31 December	2,580	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.

	2017 (unaudited) £'000	2016 (unaudited) £'000
ENVIA Energy, LLC		
Summarised balance sheet		
Non-current assets	57,667	63,303
Current assets	2,978	5,066
Current liabilities	(435)	(5,716)
Non-current liabilities	(10,966)	(381)
Net assets	49,244	62,272
Summarised statement of comprehensive loss		
Revenue	409	–
Loss from continuing operations	(7,851)	(3,155)
Total comprehensive loss	(7,851)	(3,155)

20. Trade and other 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 Finance costs 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 Finance costs.

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

	2017 £'000	2016 £'000
Non-current		
Loan receivable	10,284	325
Total	10,284	325

At the end of 2017 Velocys had committed to provide up to \$13.8m (£10.3m) 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 subject to prior notice. As at 31 December 2017, draw downs on this facility had been made by ENVIA in the amount of \$13.0m (£9.6m) (2016: \$0.4m (£0.3m)).

In the interim accounts for 30 June 2017, the Company recorded an impairment of £701,000 to the loan to ENVIA, reflecting the risk to the operation of the plant of not meeting an operational milestone. The milestone was achieved after the interim accounts were published and the impairment has been reversed.

21. 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.

	2017 £'000	2016 £'000
Raw materials and consumables	31	95
Finished goods	357	1,366
Total	388	1,461

In 2017, the Company impaired £340,000 of inventory which was primarily the value of a remaining inventoried reactor and an immaterial amount of catalyst. The Company impaired the reactor as a reflection of the fact that it is unlikely the Company will find a buyer for this reactor due to subsequent advances in the reactor design.

As part of the impairment allocation described in note 17 the Company has impaired £541,000 of inventories in 2017.

Notes to the consolidated financial statements (continued)

22. Cash and cash equivalents and restricted cash

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. Restricted cash relates to an \$800,000 letter of credit provided to ENVIA under the first amendment to the loan agreement. This is determined to be restricted on the basis that for a certain period the funds can only be accessed by ENVIA.

	2017 £'000	2016 £'000
Cash and cash equivalents	2,070	18,744
Restricted cash	620	–
Total	2,690	18,744

Cash and cash equivalents is denominated in UK sterling and US dollars, and restricted cash is denominated in US dollars, as follows.

	2017 £'000	2016 £'000
Cash and cash equivalents		
UK sterling denominated	1,245	7,114
US dollar denominated	825	11,630
Restricted cash		
US dollar denominated	620	–
Total	2,690	18,744

23. Trade and other payables: current

	2017 £'000	2016 £'000
Trade payables	604	722
Other taxation and social security	52	51
Accruals	2,242	991
Deferred income	618	508
Total	3,516	2,272

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 (2016: 60 days or less).

24. Trade and other payables: non-current

	2017 £'000	2016 £'000
Accruals	98	110
Deferred income	620	1,233
Total	718	1,343

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

Deferred income includes funds received for catalyst to be earned over a two-year period commencing February 2017 at the start-up of the ENVIA reactors.

25. Financial instruments

Financial assets

Financial assets are classified upon initial recognition and the classification depends on the nature of the asset and the purpose for which the assets were acquired. At 31 December 2017 the Company only holds financial assets classified as loans and receivables.

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. From time to time it also holds short-term investments, which are cash deposits on fixed terms of interest for more than three months. It last held short-term investments in 2015.

Loans and receivables also includes Trade receivables and Other receivables (see note 20), 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. Assets in the comparative year were forward foreign exchange contracts that matured in 2017.

Financial liabilities

Financial liabilities are classified according to the substance of the contractual arrangements.

Financial liabilities at amortised cost

Financial liabilities at amortised cost includes Trade payables, all of which are current liabilities (see note 23), Borrowings and Finance leases. 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.

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 cash inflows (particularly in the short term) and Velocys is reliant on the support of a small group of major shareholders. The timing of cash flows is difficult to predict given the long development time and reliance on external parties. The Board recognises that further funding will be needed. Note 2 discusses uncertainties surrounding the extent and composition of future funding. The Company is targeting strategic project investment during the middle of 2018, at which point financing optionality is created.

The fundraise in May 2017 included the issue of loan notes that are convertible into equity. In management's view, they have the key characteristics of equity (see note 26). 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.

Notes to the consolidated financial statements (continued)

25. Financial instruments (continued)

Exchange rates

A significant proportion of commercial activity and development costs are US-dollar denominated. Where possible, revenue is received in US dollars to act as a natural hedge against this exposure. Additionally, a proportion of liquid assets is held in US dollars.

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.

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.

	2017		2016	
	Income statement £'000	Equity £'000	Income statement £'000	Equity £'000
GBP:USD exchange rate +/- 10%	98	1,162	1,421	1,421

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 2017		
	Loans and receivables £'000	Assets at fair value through profit and loss £'000	Total £'000
Assets			
Trade and other receivables excluding non-financial assets	10,575	–	10,575
Cash and cash equivalents	2,070	–	2,070
Restricted cash	620	–	620
Total	13,265	–	13,265

	31 December 2016		
	Loans and receivables £'000	Assets at fair value through profit and loss £'000	Total £'000
Assets			
Derivative financial instruments	–	537	537
Trade and other receivables excluding non-financial assets	765	–	765
Cash and cash equivalents	18,744	–	18,744
Total	19,509	537	20,046

The credit risk of Trade and other receivables is considered to be low based on the following:

- Velocys is a secured creditor of ENVIA.
- ENVIA's net asset position significantly exceeds the receivable value.
- ENVIA forecasts it will have net cash inflow in Q2 2018, and being a JV partner, have access to information that supports this forecast.
- Velocys is an equity investor; therefore has significant influence over the activities of the investments.

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

	2017		2016	
	£'000	%	£'000	%
Short-term bank deposits, cash at bank and in hand				
Aa2	102	5	663	3
Aa3	1,040	50	8,817	47
A1	904	44	8,747	47
A2	24	1	–	–
A3	–	–	517	3
Total	2,070	–	18,744	–
Restricted cash				
Aa2	620	100	–	–

Notes to the consolidated financial statements (continued)

25. Financial instruments (continued)

Financial liabilities are as follows.

	31 December 2017	
	Financial liabilities at amortised cost £'000	Total £'000
Liabilities as per balance sheet		
Borrowings	540	540
Trade and other payables excluding non-financial liabilities	604	604
Accruals	2,340	2,340
Finance lease liabilities	1	1
Total	3,485	3,485

	31 December 2016	
	Financial liabilities at amortised cost £'000	Total £'000
Liabilities as per balance sheet		
Borrowings	880	880
Trade and other payables excluding non-financial liabilities	722	722
Accruals	991	991
Finance lease liabilities	36	36
Total	2,629	2,629

The ageing of financial liabilities is as follows.

	2017	2016
	£'000	£'000
Within one year	3,232	2,036
Within two to five years	253	593
Total	3,485	2,629

26. Called up share capital and reserves

Share capital and share premium include ordinary shares in Velocys plc issued to shareholders and options that have been exercised by employees and associated consultants.

Convertible loan note instruments ('loan notes') issued by the Company allow the issuer the right to exchange all outstanding loan notes and all accrued interest thereon for equity in the parent company. The Company assesses whether the loan notes and the conversion feature should be classified as a financial liability or equity instrument. In making this assessment the Company assesses whether there is an obligation for the Company to:

- a) deliver cash to another entity; or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the Company (as the issuer); and
- b) if the instrument will or may be settled in the issuer's own equity instruments it is:
 - (i) a non-derivative that includes no contractual obligation for the Company to deliver a variable number of its own equity instruments; or
 - (ii) a derivative that will be settled only by the Company exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments.

If these criteria are met, the loan notes will be recorded as an equity instrument.

Judgement

In May 2017 18,000,000 loan notes were issued to the Company's two largest shareholders at a price of £0.50 per share. The final maturity date of the loan notes is 18 months from the date of issue, after which the Company has the right but not the obligation to convert the outstanding principal and interest into a fixed number of ordinary shares, at a conversion price of £0.50 per share. The fixed annual interest rate is 8.0%, with accrued interest also being convertible into additional ordinary shares.

Based on the contractual terms it was determined that the Company does not have a contractual obligation to deliver cash to the loan note holders, and the loan notes convert into a fixed number of shares at a fixed price. Based on these criteria being met the loan notes were recorded as an equity instrument. The interest accrued on the loan notes is recorded as a distribution to holders of the loan notes within equity.

	Number of shares* (thousands)	Ordinary shares £'000	Share premium £'000
At 1 January 2016	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
Employee share options scheme: Shares issued including 1p exercise price options	406	4	–
Proceeds from share issues	2,578	26	689
Convertible loan notes	–	–	9,000
Interest on convertible loan notes	–	–	421
At 31 December 2017	146,860	1,468	159,385

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

A total of 10,014,317 (2016: 11,811,991) options to subscribe for ordinary shares of Velocys plc have been granted and are outstanding at 31 December 2017 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 in 2016.

In May 2017 18,000,000 convertible loan notes were issued to the Company's two largest shareholders.

On 15 January 2018 Velocys announced that it had secured around £18.4m of additional funding (before expenses), having issued 183,662,946 ordinary shares (see Financial review on pages 16 to 17).

Notes to the consolidated financial statements (continued)

26. Called up share capital and reserves (continued)

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 £2,654,000 (2016: a credit balance of £7,051,000).

The share-based payment reserve records the IFRS 2 charge for equity settled share-based payment awards. At 31 December 2017 the Company's share-based payment reserve was £16,085,000 (2016: £15,843,000).

27. Commitments

The Company leases certain property, plant and equipment. 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. Leases under which the Company incurs substantially all the risks and rewards of ownership are classified as finance leases, however are not material to the Company.

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.

	2017	2016
	£'000	£'000
Future aggregate minimum lease payments		
Within one year	395	491
Between one and five years	1,267	1,319
After more than five years	–	194
Total	1,662	2,004

Capital commitments are not material.

At 31 December 2017 the Company had committed to make available additional loan funding to ENVIA of £593,000 (\$800,000), which is repayable by 31 December 2019.

28. Post-financial position events

The following events occurred after 31 December 2017.

On 15 January 2018 Velocys announced that it had secured around £18.4m of additional funding (before expenses).

On 16 January 2018 the Company announced that ENVIA believed that fuel produced at its Oklahoma City plant met the necessary requirements to be submitted for qualification under the Renewable Fuel Standard and that the facility had submitted a certain number of RINs to the registration system. Confirmation that the RINs produced at ENVIA had been verified was announced on 15 March 2018.

The resignation of Non-Executive Director Julian West from the Board was announced on 7 February 2018.

On 4 May 2018 the Company announced that the third party project developer Red Rock Biofuels had commenced construction of its Oregon plant and had issued a notice to proceed (NTP) to Velocys.

On 15 May 2018 the Company announced that ENVIA had detected a leak that is believed to have originated inside one of the plant's two Fischer-Tropsch (FT) reactors. The Company is confident that the issue is not a result of a flaw in the core Velocys FT technology. The carrying value of the investment has not been adjusted to reflect the impacts of this event.

29. Related parties

For 2017 the Company recognised catalyst lease revenue totalling £484,000 related to a catalyst lease agreement with ENVIA, an associate in which the Company has ownership and voting rights as detailed in note 19 of the consolidated financial statements. During 2017 Velocys committed to provide up to \$13,810,000 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 2017, draw downs on this facility had been made by ENVIA in the amount of £13,010,000 (2016: \$400,000 – see note 19).

The Company provided engineering services of £100,000 to Norma Investments Limited, which is the parent company of Ervington Investments, the largest shareholder in Velocys plc with a holding of 28.9% at 31 December 2017.

Velocys plc statement of financial position

as at 31 December 2017

	Note	2017 £'000	2016 £'000
Assets			
Non-current assets			
Investments in subsidiaries	7	14,441	66,831
Current assets			
Trade and other receivables		6	31
Current income tax asset	5	438	650
Total assets		14,885	67,512
Current liabilities			
Trade and other payables		(184)	(72)
Total liabilities		(184)	(72)
Net assets		14,701	67,440
Capital and reserves attributable to owners of Velocys plc			
Called up share capital	9	1,468	1,438
Share premium account	9	159,385	149,275
Share-based payment reserve	9	16,085	15,843
Accumulated losses			
At 1 January		(99,116)	(39,197)
Loss for the year attributable to owners		(62,700)	(59,919)
Convertible loan note interest		(421)	-

The notes on pages 80 to 85 are part of these parent company financial statements.

The financial statements on pages 77 to 85 were approved by the Board of directors and authorised for issue on 22 May 2018. They were signed on its behalf by:



David Pummell
Chief Executive Officer
22 May 2018

Company number 05712187

Velocys plc statement of changes in equity

for the year ended 31 December 2017

	Called up share capital £'000	Share premium account £'000	Share-based payment reserve £'000	Accumulated losses £'000	Total equity £'000
Balance at 1 January 2016	1,419	149,197	15,362	(39,197)	126,781
Loss for the year	–	–	–	(68,085)	(68,085)
Foreign currency translation differences	–	–	–	8,166	8,166
Total comprehensive expense	–	–	–	(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 1 January 2017	1,438	149,275	15,843	(99,116)	67,440
Loss for the year	–	–	–	(56,839)	(56,839)
Foreign currency translation differences	–	–	–	(5,861)	(5,861)
Total comprehensive expense	–	–	–	(62,700)	(62,700)
Transactions with owners					
Share-based payments – value of employee services	–	–	242	–	242
Proceeds from share issues	30	689	–	–	719
Convertible loan notes	–	9,000	–	–	9,000
Interest on convertible loan notes	–	421	–	(421)	–
Total transactions with owners	30	10,110	242	(421)	9,961
Balance at 31 December 2017	1,468	159,385	16,085	(162,237)	14,701

The notes on pages 80 to 85 are part of these parent company financial statements.

Velocys plc statement of cash flows

for the year ended 31 December 2017

	2017	2016
	£'000	£'000
Cash flows from operating activities		
Operating loss before taxation	(62,294)	(72,485)
Impairment of subsidiaries	57,256	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	25	(68)
Intercompany balances	(5,648)	6,066
Trade and other payables	115	1
Cash consumed by operations	(10,546)	(1,082)
Tax credit received	829	1,070
Net cash used in operating activities	(9,717)	(12)
Cash flow from investing activities		
Interest received	–	6
Net cash generated from investing activities	–	6
Cash flows from financing activities		
Proceeds from issues of shares and convertible loan notes	10,160	6
Costs of issuing shares and convertible loan notes	(443)	–
Net cash generated from financing activities	9,717	6
Net movement in cash and cash equivalents	–	–
Cash and cash equivalents at beginning of year	–	–
Cash and cash equivalents at end of year*	–	–

* Velocys plc does not hold a bank account or cash and cash equivalents; however significant non-cash transactions are presented. For additional information in respect of the issue of convertible loan notes see note 26 to the consolidated financial statements.

The notes on pages 80 to 85 are part of these parent company financial statements.

Notes to the financial statements of Velocys plc

1. General information

Velocys plc is a non-trading holding 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”.

Velocys plc is a public limited company listed on AIM.

2. Accounting policies

The principal accounting policies applied in the preparation of these parent company financial statements are the same as those of the Company unless otherwise specified. The additional accounting policy for the parent company relates to the Investments in subsidiaries (see note 7). The policies have been consistently applied to each year presented unless otherwise stated.

Basis of preparation

The basis of preparation is the same as the Company, as set out on page 48 of the consolidated financial statements. The parent company has taken advantage of the legal dispensation contained in Section 408 of the Companies Act 2006 allowing it not to publish a separate income statement and related notes and not to publish a separate statement of other comprehensive income. The comprehensive loss for the parent company for the year was £62,700,000 (2016: loss £59,919,000), which included a £57,256,000 impairment of investment in subsidiary in 2017 (2016: £65,716,000) see note 7.

Going concern

The going concern of Velocys plc is intrinsically linked to that of its subsidiaries, through which it trades in the UK and the US. The going concern basis of preparation is consistent with that set out for the Company. See page 48 of the consolidated financial statements.

Accounting developments

No new standards, amendments or interpretations, effective for the first time for the financial year beginning on or after 1 January 2017 have had a material impact on Velocys plc. The following standards with significant changes to the accounting framework will be relevant to future periods.

IFRS 15 Revenue from contracts with customers (IFRS 15) and IFRS 9 Financial instruments (IFRS 9) are mandatory for the first time for the financial year beginning 1 January 2018. IFRS 15 is not expected to be relevant to Velocys plc as it does not generate revenue. The parent company's financial assets comprise its loans to subsidiaries, which upon adoption of IFRS 9 will be reclassified from Loans and receivables to Financial assets held at amortised cost, as they are held only for repayment of principal and interest. The standard requires any amortisation of these assets to be calculated on an expected future credit losses basis, rather than on incurred losses. An impairment was recorded in 2017 spread across the subsidiary loans; details of how this was calculated are included in note 7. The Company does not consider that the impairment provision recorded would be materially different in accordance with IFRS 9.

IFRS 16 Leases is mandatory for the first time for the financial year beginning 1 January 2019. This standard is subject to endorsement by the European Union. This standard is not expected to be relevant to Velocys plc as it has not entered into any lease arrangement.

Financial risk management policies

Financial risk management policies are set out in the Strategic report on page 25, and in note 25 of the consolidated financial statements.

Capital management policies

Capital management policies are set out in note 25 of the consolidated financial statements.

3. Critical accounting estimates and judgements

In applying the parent company's accounting policies set out in note 2, the parent company is required to make certain estimates and judgements concerning the future. Although these estimates and judgements are based on management's best knowledge of the amount and or timing, actual results ultimately may differ. These estimates and judgements are regularly reviewed and revised as necessary. The estimates and judgements that have the most significant effect on the amounts included in these financial statements are listed below and described in the relevant note.

Item of critical estimate

Note

Investment in subsidiaries – impairment assessment

7

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 Executive Committee to monitor and measure the underlying performance of the parent company are classified as exceptional items. They include, for instance, impairments to the parent company's investments. Exceptional items are included within the appropriate parent company income statement category but are highlighted separately in the notes to the financial statements.

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

	2017 £'000	2016 £'000
Impairment of investment in subsidiaries	(57,256)	(65,716)
Total	(57,256)	(65,716)

At the end of both 2016 and 2017 the parent company reviewed for impairment its investments in subsidiaries in light of the respective closing market capitalisation, and in both years concluded that an impairment was required. Details including critical estimates are included in note 7.

5. Income tax

	2017 £'000	2016 £'000
Current tax:		
R&D tax credit relating to prior years	(179)	(470)
R&D tax credit relating to current year	(438)	(650)
Current tax total	(617)	(1,120)
Income tax total	(617)	(1,120)

Due to the availability of losses incurred in the year, there is no charge to corporation tax. The parent company recognised £617,000 for R&D tax credits (2016: £1,120,000).

The actual tax credit for the current and previous year is lower (2016: higher) than the theoretical amount that would arise using the weighted average tax rate for the reasons set out in the following reconciliation.

	2017 £'000	2016 £'000
Loss before income tax	(57,456)	(69,211)
Tax calculated at domestic tax rates applicable to losses in the respective countries	(11,060)	(13,842)
Tax effects of:		
Expenses not deductible for tax purposes	4	37
Impairment loss not deductible for tax purposes	11,022	13,143
Unutilised tax losses	34	662
R&D tax credit	(617)	(1,120)
Income tax total	(617)	(1,120)

The impairment loss not deductible for tax purposes represents the impairment of investment in subsidiaries as described in note 7.

The weighted average applicable tax rate was 19.25% (2016: 20%).

The standard rate of corporation tax in the United Kingdom changed from 20% to 19% with effect from 1 April 2017. Accordingly, profits in the United Kingdom for 2017 were taxed at 19.25%. Legislation to reduce the rate to 17% from 1 April 2020 was enacted on 15 September 2016. The parent company has not recognised a deferred tax asset or liability in 2017 (2016 £nil). Unrecognised UK deferred tax balances have been measured at 17% (recognised: £nil).

Notes to the financial statements of Velocys plc (continued)

6. Deferred tax

The parent company has not recognised a deferred tax asset or liability in 2017 (2016 £nil).

	2017 £'000	2016 £'000
Unrecognised Deferred tax assets		
Trading losses	(8,411)	(8,381)
Total	(8,411)	(8,381)

At 31 December 2017 the Company had a net unrecognised deferred tax asset of £8,411,000 (2016: £8,381,000) arising from trading losses since incorporation. No recognition (2016: £nil) of the net deferred tax asset has been made at 31 December 2017 on the grounds of uncertainty over its recoverability in light of the Company's nascent revenue streams and commitment to continued investment in the development of its biorefineries, and therefore there is no impact on the current or prior year's income statement.

All of the unrecognised deferred tax asset (2016: all) is anticipated to remain available indefinitely to offset against future taxable trading profits.

7. Investments in subsidiaries

Investments in subsidiaries are held by Velocys plc 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.

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.

Critical estimates and judgements

Assets are reviewed for impairment annually and also whenever events or changes in circumstances indicate their carrying value may not be recoverable. 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 varying points during 2017, the carrying amount of the parent company's net assets exceeded the Velocys plc's market capitalisation;
- The fundraise, completed in January 2018, was discounted to 10p per share, and which prompted the share price to drop to 10p immediately afterwards, further reducing the Velocys plc's market capitalisation.

As set out in note 17 to the consolidated financial statements, an impairment assessment was carried out on the Company's intangible assets and an impairment was indicated. Velocys plc 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 its 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 £57,256,000 (2016: £65,716,000) was recognised. This impairment eliminated on consolidation.

	2017			2016		
	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	47,770	19,061	66,831	89,369	36,920	126,289
Movement in loans	13,919	240	14,159	(2,792)	–	(2,792)
Capital contributions	–	–	–	–	884	884
Impairment of subsidiaries	(41,842)	(15,414)	(57,256)	(46,973)	(18,743)	(65,716)
Foreign exchange	(9,293)	–	(9,293)	8,166	–	8,166
At 31 December	10,554	3,887	14,441	47,770	19,061	66,831

Velocys plc 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	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
YellowRock GTL Services, LLC**	Delaware, USA	Secondment of employees to plants	100
VMH Assets LLC**	Ohio, USA	Holds manufacturing assets in Ohio	100

The following are dormant subsidiaries.

Dormant subsidiaries	Incorporated	Immediate parent	% Holding
Oxford Catalysts UK Limited*	England and Wales	Velocys plc	100
Velocys Projects Ltd*	England and Wales	Velocys plc	100
Velocys Project Solutions, LLC***	Delaware, USA	Velocys (USA Holdings) LLC	100
Velocys Renewables LLC**	Ohio, USA	Velocys (USA Holdings) LLC	100
Ashtabula Energy, LLC***	Delaware, USA	Velocys Project Solutions, LLC	100
Bayou Fuels One LLC	Delaware, USA	Velocys Projects Ltd	100
Bradford GTL LLC***	Delaware, USA	Velocys Project Solutions, LLC	100
JAB Land-Ashtabula**	Ohio, USA	Ashtabula Energy, LLC	100
Susquehanna GTL LLC***	Delaware, USA	Velocys Project Solutions, LLC	100
Westlake GTL, LLC**	Delaware, USA	Velocys (USA Holdings) LLC	100

* Located at Harwell Innovation Centre, 173 Curie Avenue, Harwell, Oxfordshire, OX11 0QG, UK.

** Located at 7950 Corporate Boulevard, Plain City, OH 43064, USA.

*** Located at 2603 Augusta Drive, Suite 1175, Houston, TX 77057, USA.

Notes to the financial statements of Velocys plc (continued)

8. Financial instruments

Financial assets

Velocys plc classifies, measures and accounts for its financial assets in the same way as the Company as a whole (see note 25 to the consolidated financial statements).

Financial risks

The risks that the parent company faces are intrinsically linked to those of the Company, in that they stem from the subsidiaries' ability to repay the intercompany loans. The loans to US subsidiaries are denominated in US dollars. No mitigation of this risk is taken at parent company level.

Financial assets of Velocys plc are as follows.

	31 December 2017
	Loans and receivables £'000
Assets	
Trade and other receivables excluding non-financial assets	10,554
	31 December 2016
	Loans and receivables £'000
Assets	
Trade and other receivables excluding non-financial assets	47,770

Parent company loans and receivables are all intercompany loans. An impairment of £57,256,000 (2016: £65,716,000) was recorded against the intercompany loans. Details, including critical estimates and judgements, are included in note 3.

	31 December 2017
	Financial liabilities at amortised cost £'000
Liabilities	
Trade and other payables excluding non-financial liabilities	88
	31 December 2016
	Financial liabilities at amortised cost £'000
Liabilities	
Trade and other payables excluding non-financial liabilities	–

The parent company liability is an obligation to fund the Employee Benefit Trust (EBT) in 2018 in respect of a share options exercise (see consolidated accounts note 15).

9. Share capital

Disclosures in respect of share capital of the Velocys plc are provided in note 26 to the consolidated financial statements on page 75.

10. Commitments

The Company has no capital commitments (2016: nil) or operating lease commitments (2016: nil).

11. Related party transactions

The parent company has the following amounts due from its subsidiaries:

	2017	2016
	£'000	£'000
Balances with subsidiary companies		
Velocys Technologies Limited	1,727	21,170
Velocys (USA Holdings) LLC	2,865	5,205
Velocys, Inc.	5,962	21,395
Total due from subsidiaries	10,554	47,770

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

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 £nil (2016: £13,300).

12. Other information

Directors' remuneration

Details of the remuneration paid to directors of the parent company are provided in the Directors' remuneration report on pages 32 to 35.

Velocys plc does not have any employees. Refer to note 12 in the consolidated financial statements for Company employees.

Auditor's remuneration

Details of remuneration paid for the audit of the Company are disclosed in note 11 to the consolidated financial statements on page 54.

Notes

Directors, secretary and advisors to the Company

Registered office

Velocys
Harwell Innovation Centre
173 Curie Avenue
Harwell, OX11 0QG

Velocys plc registration no.
05712187

Directors

Pierre Jungels (Non-Executive Chairman)
David Pummell (Chief Executive Officer)
Paul Schubert (Chief Operating Officer)
Sandy Shaw (Non-Executive Director)
Andrew Morris (Non-Executive Director)

Company secretary

Jeremy Gorman

Nominated advisors and joint brokers

Numis Securities Limited
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10 Paternoster Square
St Pauls
London
EC4M 7LT

Joint brokers

Canaccord Genuity Limited
88 Wood Street
London
EC2V 7QR

Registrars

Link Market Services Limited
The Registry
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BR3 4TU

Bankers

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