VELOCYS

News release

Velocys plc

("Velocys" or "the Company")

29 September 2017

Interim results for the six months ended 30 June 2017

Velocys plc (VLS.L), the renewable fuels company, is pleased to announce its interim results for the six months ended 30 June 2017.

Highlights

- Key milestones at ENVIA Energy's Oklahoma City plant, the first smaller scale, commercial gas-to-liquids plant in the world include:
  - Production of first finished, saleable products.
  - Velocys' reactors and catalyst performing in line with performance requirements at commercial scale.
  - The Company has increased its equity share and voting rights with no cash or other consideration provided, following the exit on 28 September 2017 of NRG from the JV (post period end)
  - Key capacity milestone expected to be reached during October 2017 (post period end).
- New strategy as a renewable fuels company providing, with partners, economically attractive biorefineries to produce premium quality renewable jet and diesel fuel.
- Consistent progress towards our first biorefinery in the US, with our strategic partners:
  - Partnerships announced with Morimatsu and TRI.
  - Selection of IHI E&C for FEL-2 engineering study.
  - Invitation by US Department of Agriculture to advance to Phase II application for a loan guarantee of up to $200m.
  - Appointment of SMBC as the lender of record.
- Fundraise of £10m (before expenses).
- Reshaping of the Company, following completion of its primary development programme, to deliver the demands of the new strategy (post period end).
- John Tunison appointed as Interim CFO (post period end).
- Industry partnership formed, including British Airways, aimed at waste to renewable jet fuel plants in the UK (post-period end).
- Revenue of £0.2m (H1 2016: £0.5m).
- Cash* at period end £13.8m (31 December 2016: £18.7m).
- H1 2017 cash outflow £4.9m (H1 2016: £13.6m, H2 2016: £5.4m).

* Defined as cash, cash equivalents and short term investments

David Pummell, CEO of Velocys, said:

"As Velocys the Renewable Fuels Company, we have made considerable progress in our strategy implementation and subsequent restructuring of the business over the first part of the year. Successive operational milestones have been reached at ENVIA Oklahoma and we have made steady progress towards developing our first biorefinery in the US. The success of the Velocys Fischer-Tropsch system at ENVIA validates our technology at a commercial scale, and it will be this system that, we will take forward in our future biorefineries, subject to securing further funds.

- Ends –

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Certain information contained in this announcement would have constituted inside information (as defined by Article 7 of Regulation (EU) No 596/2014) prior to its release as part of this announcement.

www.velocys.com

Chairman’s statement

Pierre Jungels, CBE

The first half of 2017 has been a period of significant strategic change for Velocys. In February we announced that the first Fischer-Tropsch products had been made at ENVIA’s plant in Oklahoma City using Velocys’ reactors and catalyst, and by the end of the period the first finished, saleable products had been produced. This is the realisation of many years of dedicated effort, encompassing research and development, engineering, project management and the building of relationships in the industry. We have increased our equity share and voting rights at ENVIA following the exit of NRG from the JV and look forward to confirming that a key capacity milestone has been reached in October 2017.

During the period, Velocys also advanced its new strategy for commercialising its technology by driving forward the development of its first biorefinery. Creating a world-leading technology is a significant accomplishment, and now Velocys is focused on its commercialisation through the delivery to the market of repeatable biorefineries. Velocys needs world class partners to achieve this aim, and a number of these partnerships are now in place.

The Company’s transition from technology development to its commercial roll-out has meant the winding down of R&D programmes both in the UK and the US. The Company will maintain its corporate and commercial office in the UK. Further details on these changes are given in the CEO’s report.

After conducting a detailed strategic review, Velocys has taken the decision to focus its resources on the renewable fuels market. Other market opportunities, such as stranded gas conversion to liquids, are still available and their attractiveness to Velocys will continue to be reviewed as market conditions change in the future. These opportunities are seen as additive to the core strategy.

Our internal analysis confirms 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 market competitive price.

During the first half of the year there were a number of changes to the board at Velocys. Non-executive director Mark Chatterji left the Board in April and was replaced as the chair of the Audit and Risk Committee by Andrew Morris, who was nominated as a non-executive director at the start of June. Ross Allonby left the board in June. I would like to thank Mark and Ross for their contribution 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. Board costs have been reduced with the reduction in the number of non-executive directors, and by reducing the fees paid to existing non-executive directors by 10%.

Post-period end, on 21 July the Company announced that Susan Robertson would be stepping down as Chief Financial Officer, a role she has held for the last nine years. I would like to express my warmest thanks to Susan for her enormous contribution to Velocys during that time. I welcome John Tunison as our new Interim CFO, who is based in our Houston office.

Velocys completed a fundraise of £10m in May, primarily through the support of existing shareholders. Proceeds raised are being used primarily to fund the pre-FEED (FEL-2) engineering study for the first biorefinery, 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. Additional funding is now required; further details are given in the financial review.

Outlook

The Company has commenced its transition to a renewable fuels business, taking swift and concerted action to capitalise on its achievements at ENVIA. Through refreshing the organisational structure Velocys has renewed its focus, and is building a strong team to deliver the new strategy. There is significant emphasis for the team on delivering strategic partnerships to underpin the development of its biorefineries. Velocys has transformed in a short time and, we aim to sustain this effort through to final investment decision for the first biorefinery, which we are targeting in 2018, subject to securing further funds.

Chief Executive's report
David Pummell

Introduction
Velocys continues to make significant progress in its strategic plan to reposition itself as a renewable fuels company. With our partners, we plan to build economically-attractive biorefineries that produce premium quality renewable jet fuel and diesel. The success of the Velocys Fischer-Tropsch (FT) system at ENVIA validates our technology at commercial scale and it will be this system we will take forward in future biorefineries.

Although our strong focus will be the production of renewable fuels in the US market from the conversion of woody biomass waste materials, we remain open to other opportunities that complement our core strategy. We recently entered into an industry partnership that includes British Airways and Suez, aimed at developing waste-to-jet fuel plants in the UK. The changes recently made to the Renewable Transport Fuels Obligation (RTFO) now provides the necessary commercial platform to also exploit the UK market.

I would like to thank our talented, energetic team for the dedication and skills with which they tackle the many interrelated work streams we have underway, and for their professionalism during the recent internal restructuring process – as we transition to Velocys the renewable fuels company.

Strategy implementation
Velocys technology is in operation in the first smaller scale commercial gas-to-liquids (GTL) plant in the world. With this as a platform, the Company has adopted a bold long term vision that could place Velocys at the vanguard of the production of cellulosic renewable fuels in the world. We are all focused on its delivery. The three pillars of our strategy are:

- **Business model.** To initiate and drive the development of biorefineries from concept to full operations. To pursue multiple projects, continuously reducing delivery risk and accelerating growth. To take modest equity stakes if necessary in a few early projects, as well as deriving ongoing revenues from project delivery, technology supply and technical service support contracts.
- **Leverage capabilities.** Applying our engineering, operational and project management expertise, together with our proprietary technology, to continuously improve our offering, to reduce lead times and drive down costs. To work seamlessly with our partners to deliver modular, fully integrated, financeable, cost-effective and operations-ready biorefineries.
- **Strategic partnerships.** To forge enduring alliances that support multiple biorefinery opportunities, including those for investment, manufacturing, gasification, product offtake and feedstock supply, with strategic partners that have the resources, scale and capabilities to access the most attractive markets and build a material renewable fuels production position.

In June 2017, after it had been demonstrated that Velocys' FT reactors and catalyst at ENVIA were performing in line with requirements at a commercial scale, we concluded that the primary phase of our technology development programme had been successfully completed and took the decision to cease our R&D activities in the UK and certain related activities at our US technology centre in Ohio. The Company will continue to maintain a corporate management, commercial and operational office in Oxfordshire, UK, including the project management activities supporting the waste to renewable jet fuel opportunity in the UK. Velocys will continue to grow its capabilities from its operational base in Houston to take forward its new biorefinery delivery business model in the US.

These changes allow us to direct our resources towards those business-critical areas in which we need to deliver milestones in the short and medium term, as discussed below. They will also reduce the operational costs of the business on an annualised basis.

Our biorefineries

US renewable fuels

In H1 2017 we made good progress towards implementing the first stage of our strategy to develop a series of biorefineries in the US. A key milestone was reached in mid-June when the US Department of Agriculture (USDA) invited Velocys to submit a Phase II Application to obtain a loan guarantee for our first commercial-scale biorefinery. This invitation was made after a successful Phase I Application process. The loan guarantee could apply to up to $200 million of debt as part of the total installed cost of the project, accelerating the timeline and financially de-risking the project and thereby creating an attractive financeable solution for project investors.

Velocys has engaged the leading global project finance bank Sumitomo Mitsui Banking Corporation (SMBC) as the lender of record and as its financial advisor. Our goal is to complete all work packages required by the loan guarantee programme, finalising the build of the consortium of partners, concluding commercial negotiations, securing project equity funding, and securing a conditional commitment from the USDA and reaching FID during the course of 2018. We are in detailed discussions with a number of potential strategic partners and are targeting having both investment and commercial partnership deals in place at a time that is consistent with the programme plan to FID.

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

The skid-mounted FT section of the Velocys pilot plant has been relocated from Ohio to TRI's facility in Durham, North Carolina, where it will form part of an integrated gasification/FT technology demonstration. Work to combine the two technology platforms to form the integrated demonstration plant continues. The demonstration is a requirement for the USDA loan guarantee qualification. We will continue to provide ongoing technical and operational support to both the TRI joint demonstration programme and to the ENVIA Oklahoma plant.

In June we announced that we had selected the engineering, procurement and construction (EPC) company IHI E&C to carry out the pre-FEED (FEL-2) engineering for the first biorefinery. IHI has an excellent track record across the entire biomass-to-liquids value chain. The study, which is proceeding to plan, is in its final phase. We expect to proceed to FEL-3 engineering in early 2018.

In addition to advanced term sheet negotiations with two possible offtakers for the first biorefinery in the US, the company is also advancing discussions with three other parties for the fungible product and environmental derivatives.

The process of selecting sites for our biorefineries is well advanced. We are looking beyond siting our first plant, as our aim is to develop partnerships that will deliver multiple biorefineries with a standard design. We have identified locations in the Southeast US that could host plants with capacities totalling 100 million gallons over the next 10 years. We are currently finalising the contract for placing an option on a preferred first site. We expect to be in a position to name the site later this year.

ENVIA Energy

In H1 2017, ENVIA Energy, with support from Velocys, achieved two key milestones at the Oklahoma City site. In February first FT product was successfully produced; an important milestone for the Company and a landmark event for ENVIA and indeed for the industry in general. First finished, saleable products (waxes, diesel and naphtha) were produced in June and (post period end) the offtakers have begun taking delivery of the plant's products. We have hosted multiple visits to the plant by key stakeholders and potential investor and commercial partners for our biorefinery market entry.

ENVIA's facility is the commercial reference plant for Velocys' technology. On that site we have successfully demonstrated that our FT reactors and catalyst are performing in line with requirements at commercial scale. The Velocys technology being used at ENVIA is the same technology that will be deployed in our biorefineries.

From the proceeds of Velocys' fund raise announced in May 2017, $3.4m was allocated to extend the loan facility the Company made available to ENVIA in January 2016 in order to bridge ENVIA to becoming cash flow positive. All other terms of the loan, which has a 10% coupon, remain unchanged. This provision demonstrates Velocys' commitment to support the ENVIA plant through to achieving steady state operations. As of 30 June 2017 $9.1m of the total loan note ($12.7m) had been drawn down. At the date of this announcement a small amount remains to support ENVIA's ongoing operations and production ramp-up.

Coincident with the timing of the release of Interim Accounts, effective 28 September 2017, the Company has increased its voting rights in ENVIA after one of the members of the joint venture, NRG Energy, exited the JV. NRG 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 to this transaction, nor will there be in the future. This change will have no impact on operations at ENVIA's gas-to-liquids plant in Oklahoma City, which is the commercial reference plant for Velocys' technology.

Over recent months the highly competent and experienced on-site team has continued to advance through the pre-planned programme of ramping up production to target operational capacity, at which time, the Company will await confirmation from the ENVIA Board that a key capacity milestone has been achieved; this is expected to be reached during October 2017. Additionally, a less ambitious revenue forecast based on a revision of product and RIN pricing has been produced by the Company.

Notwithstanding the encouraging performance of the plant, the Company has decided to record an impairment against its ENVIA loan facility receivable based on not yet reaching the key capacity milestone. The impairment recognises the risk of termination of ENVIA's lease and ability to continue operations if the key capacity milestone is not reached in October 2017. Reaching the key capacity milestone will result in a reversal of the impairment of the loan facility (see notes 10 and 11).

<u>UK – waste to renewable jet fuel</u>
In the UK we announced (post period end) that Velocys has entered into a partnership with a number of world class partners to prepare the business case for a commercial scale waste-to-jet fuel plant in the UK. Velocys will lead the initial feasibility stage of the project, for which all members of the partnership are providing funding.

Velocys intends to supply its technology to the plant and provide project management, engineering, operations and technical service support to the project. As well as Velocys the partners include: British Airways, who intend to offtake the jet fuel made at the plant; Suez, a world-leading expert in recycling and waste management; and Norma, an affiliate of Ervington Investments, Velocys' largest shareholder.

Velocys and its partners believe that there is the opportunity to develop a series of waste-to-jet fuel plants in the UK. The changes to the Renewable Transport Fuels Obligation (RTFO) recently published by the Department for Transport provide the necessary 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; once implemented, they are expected to provide long term policy support for this market.

Financial review

Revenues
Total revenues for the period were £0.2m (H1 2016: £0.5m). Most of the revenue was from the lease of catalyst to ENVIA (non-cash) with the rest made up by engineering services and feasibility studies.

Operating loss was £9.4m before and £10.1m after exceptionals (H1 2016: £9.5m before and £9.4m after exceptionals). The main changes in underlying results were lower staff costs due to a reduced headcount, and slightly higher overheads due to increased project development activity. A large proportion of the loss was US dollar denominated; the large swing in the exchange rate since H1 2016 increased this loss by approximately £0.9m. An impairment of £0.7m of the Company's loan receivable from ENVIA was recorded as an exceptional item affecting Operating loss (see notes 10 and 11).

Cash (including short term investments) at period end stood at £13.8m (31 December 2016: £18.7m), while cash outflow was £4.9m (H1 2016: £13.6m). Cashflow included a fundraise of £10m (before expenses) in May, and drawdowns through the period by ENVIA on the loan facility provided by Velocys of £6.9m; cashflow excluding these items was £7.7m. The Company continues to carefully manage its underlying cost base and spend prudently on strategy implementation. It is expected that the cessation of most of the Company's R&D activities from July, and the restructuring of the business to expand in Houston will be cash neutral in 2017, with savings being realised from early 2018.

The Company incurs much of its expense in US dollars and has exposure to the US dollar exchange rate. This is hedged to the extent possible by holding cash reserves in US dollars and taking out forward contracts to cover future foreign exchange exposure, where material; there were no outstanding contracts at 30 June 2017. In addition, the majority of the Company's income is invoiced in dollars.

Fundraise
In May 2017 Velocys secured additional funding of £10m (before expenses). This included convertible loan notes as well as a placing of new ordinary shares.

Proceeds from the fundraise are being used to fund working capital during the first phase of strategy implementation as well as the following activities to support the development of the integrated biorefinery solution in the renewable fuels focus market:

- Initial engineering for first US biorefinery.
- Integrated technology demonstration with partner TRI.
- Project development activities (site selection, permitting).
- Consultants and financing (US sponsored programmes etc.).

The proceeds of the fundraise are also being used to maintain sufficient financial resources at ENVIA to support its early operations.

Future funding
The financial statements have been prepared on the going concern basis, which assumes that the Company will have sufficient funds available to enable it to continue to trade for the foreseeable future. Management's financial forecasts of the Company's likely cash requirements include the following assumptions: (i) the Oklahoma City project reaching and maintaining full operational capacity in 2017 (ii) the costs of ongoing development projects (iii) the Company raising additional funding in Q4 2017.

The Board is examining options to obtain the funding required for the operational needs of the Company and the delivery of the programmes and objectives described above. Obtaining funding has a material impact on the Company's status as a going concern. Developments will be communicated in due course during Q4 2017.

Consolidated income statement

for the six months ended 30 June 2017

	Note	**6 months ended 30 June 2017 (unaudited)**	**6 months ended 30 June 2017 (unaudited)**	**6 months ended 30 June 2017 (unaudited)**	6 months ended 30 June 2016 (unaudited)	6 months ended 30 June 2016 (unaudited) Restated	6 months ended 30 June 2016 (unaudited) Restated	Year ended 31 December 2016 (audited)	Year ended 31 December 2016 (audited)	Year ended 31 December 2016 (audited)
		£'000	**£'000**	**£'000**	£'000	£'000	£'000	£'000	£'000	£'000
		Before Exceptional items	Exceptional items (note 3)	Total	Before Exceptional items	Exceptional items (note 3)	Total	Before Exceptional items	Exceptional items (note 3)	Total
Revenue	4	234	-	234	509	-	509	1,445	-	1,445
Cost of sales		(52)	-	(52)	(443)	-	(443)	(1,060)	-	(1,060)
Gross profit		182	-	182	66	-	66	385	-	385
Administrative expenses		(9,561)	-	(9,561)	(9,837)	(2,428)	(12,265)	(17,429)	(2,809)	(20,238)
Impairments		-	(701)	(701)	-	-	-	-	-	-
Other income		14	-	14	263	2,496	2,759	272	2,496	2,768
Operating income (loss)		(9,365)	(701)	(10,066)	(9,508)	68	(9,440)	(16,772)	(313)	(17,085)
Share of (loss) profit of investments accounted for using the equity method		(259)	-	(259)	(207)	-	(207)	(306)	-	(306)
(Loss) income before finance income		(9,624)	(701)	(10,325)	(9,715)	68	(9,647)	(17,078)	(313)	(17,391)
Finance income	6	262	-	262	1,943	-	1,943	3,344	-	3,344
Finance costs	7	(541)	-	(541)	(17)	-	(17)	(26)	-	(26)
Finance income, net		(279)	-	(279)	1,926	-	1,926	3,318	-	3,318
(Loss) income before income tax		(9,903)	(701)	(10,604)	(7,789)	68	(7,721)	(13,760)	(313)	(14,073)
Income tax credit		546	-	546	396	-	396	1,404	-	1,404
(Loss) income for the period attributable to the owners of Velocys plc		(9,357)	(701)	(10,058)	(7,393)	68	(7,325)	(12,356)	(313)	(12,669)
Loss per share attributable to the owners of Velocys plc										
Basic and diluted loss per share (pence)	8	(6.50)		(6.99)	(5.18)		(5.13)	(8.62)		(8.84)

The results from the periods shown above are derived entirely from continuing operations.

Consolidated statement of comprehensive income

for the six months ended 30 June 2017

	Note	**6 months ended 30 June 2017 (unaudited) £'000**	**6 months ended 30 June 2017 (unaudited) £'000**	**6 months ended 30 June 2017 (unaudited) £'000**	6 months ended 30 June 2016 (unaudited) £'000	6 months ended 30 June 2016 (unaudited) £'000	6 months ended 30 June 2016 (unaudited) £'000	Year ended 31 December 2016 (audited) £'000	Year ended 31 December 2016 (audited) £'000	Year ended 31 December 2016 (audited) £'000
		Before Exceptional items	Exceptional items (note 3)	Total	Before exceptional items	Exceptional items (note 3)	Total	Before Exceptional items	Exceptional items (note 3)	Total
(Loss) income for the period		(9,357)	(701)	(10,058)	(7,393)	68	(7,325)	(12,356)	(313)	(12,669)
Other comprehensive income										
Items that may be reclassified subsequently to profit or loss if certain conditions are met										
Foreign currency translation differences	9	(2,594)	-	(2,594)	3,702	-	3,702	7,347	-	7,347
Total comprehensive (expense) income for the period		(11,951)	(701)	(12,652)	(3,691)	68	(3,623)	(5,009)	(313)	(5,322)

Consolidated statement of financial position

as at 30 June 2017

	Note	**30 June 2017 (unaudited) £'000**	30 June 2016 (unaudited) £'000	31 December 2016 (audited) £'000
Assets				
Non-current assets				
Intangible assets		32,184	31,394	34,035
Property, plant and equipment		4,882	5,608	5,637
Trade and other receivables		6,336	-	325
Investment in associate	10	5,299	5,449	5,865
		48,701	42,451	45,862
Current assets				
Inventories		1,362	1,517	1,461
Trade and other receivables		395	491	811
Current income tax asset		1,400	1,176	854
Derivative financial instruments		-	985	537
Cash and cash equivalents		13,841	24,141	18,744
		16,998	28,310	22,407
Total assets		65,699	70,761	68,269
Liabilities				
Current liabilities				
Trade and other payables		(2,808)	(3,162)	(2,272)
Borrowings		(274)	(320)	(323)
		(3,082)	(3,482)	(2,595)
Non-current liabilities				
Trade and other payables		(1,053)	(1,497)	(1,343)
Borrowings		(425)	(682)	(593)
		(1,478)	(2,179)	(1,936)
Total liabilities		(4,560)	(5,661)	(4,531)
Net assets		61,139	65,100	63,738
Capital and reserves attributable to owners of Velocys plc				
Called up share capital		1,438	1,419	1,438
Share premium account		159,048	148,966	149,275
Merger reserve		369	369	369
Share-based payment reserve		16,123	15,834	15,843
Foreign exchange reserve		4,471	3,420	7,065
Accumulated losses		(120,310)	(104,908)	(110,252)
Total equity		61,139	65,100	63,738

The financial statements were approved by the Board of Directors on 28 September 2017, and were signed on its behalf by:

David Pummell, Chief Executive Officer

Consolidated statement of changes in equity

for the six months ended 30 June 2017

	Called up share capital £'000	Share premium account £'000	Merger reserve £'000	Share-based payments 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
Comprehensive income							
Loss for the year	-	-	-	-	-	(12,669)	(12,669)
Other comprehensive income							
Foreign currency translation differences	-	-	-	-	7,347	-	7,347
Total comprehensive expense	-	-	-	-	7,347	(12,669)	(5,322)
Transactions with owners							
Share-based payments – value of employee services	-	-	-	793	-	-	793
Proceeds from share issues	19	78	-	-	-	-	97
Employee option tax liability settled by the Company	-	-	-	(312)	-	-	(312)
Total transactions with owners	19	78	-	481	-	-	578
Balance at 1 January 2017	1,438	149,275	369	15,843	7,065	(110,252)	63,738
Comprehensive income							
Loss for the period	-	-	-	-	-	(10,058)	(10,058)
Other comprehensive income							
Foreign currency translation differences	-	-	-	-	(2,594)	-	(2,594)
Total comprehensive income (expense)	-	-	-	-	(2,594)	(10,058)	(12,652)
Transactions with owners							
Share-based payments – value of employee services	-	-	-	280	-	-	280
Proceeds from share issues	-	9,773	-	-	-	-	9,773
Employee option tax liability settled by the Company	-	-	-	-	-	-	-
Total transactions with owners	-	9,773	-	280	-	-	10,053
Balance at 30 June 2017	1,438	159,048	369	16,123	4,471	(120,310)	61,139

Consolidated statement of cash flows

for the six months ended 30 June 2017

	6 months ended 30 June 2017 (unaudited) £'000	6 months ended 30 June 2016 (unaudited) £'000	Year ended 31 December 2016 (audited) £'000
Cash flows from operating activities			
Operating loss before taxation	(10,066)	(9,440)	(17,085)
Depreciation and amortisation	582	674	1,323
Loss on disposal of property, plant and equipment	-	-	1
Loss on disposal of intangible assets	148	91	233
Share-based payments	280	472	793
Impairments	701	-	-
Employee option tax liability settled by the Company	-	(311)	(312)
Changes in working capital (excluding the effects of exchange differences on consolidation)			
-Trade and other receivables	394	454	234
-Trade and other payables	414	(4,480)	(6,004)
-Inventory	37	(14)	138
Cash consumed by operations	(7,510)	(12,554)	(20,679)
Tax credits received	-	-	1,330
Net cash used in operating activities	(7,510)	(12,554)	(19,349)
Cash flows from investing activities			
Purchase of property, plant and equipment	(12)	(159)	(291)
Purchase of intangible assets	(197)	(205)	(356)
Equity investment in ENVIA	-	(1,805)	(1,903)
Loan to ENVIA	(6,922)	-	(295)
Interest received	38	84	136
Decrease in funds placed on deposit	-	3,000	3,000
Net cash (used in) generated from investing activities	(7,093)	915	291
Cash flows from financing activities			
Proceeds from share issues	9,714	-	6
Interest paid	(9)	(14)	(26)
Decrease in borrowings	(172)	(147)	(314)
Net cash generated from (used in) financing activities	9,533	(161)	(334)
Net decrease in cash and cash equivalents	(5,070)	(11,800)	(19,392)
Cash and cash equivalents at the beginning of the year	18,744	34,736	34,736
Exchange gains on cash and cash equivalents	167	1,205	3,400
Cash and cash equivalents at the end of the period	13,841	24,141	18,744

Notes to the accounts

for the six months ended 30 June 2017

1. Basis of preparation and accounting policies

The unaudited interim financial statements have not been prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU), IFRS Interpretations Committee Interpretations, or the Companies Act 2006 applicable to companies reporting under IFRS and Article 4 of the IAS Regulation. They do not include all the statements required for full annual financial statements, and should be read in conjunction with the consolidated financial statements of the Company as at 31 December 2016.

Accounting policies

Convertible loan notes have been issued by the Company as one aspect of its fundraising. They have a maturity date after which the Company has the right but not the obligation to convert them to a fixed number of Ordinary shares. Interest accruing on the loans is convertible to additional Ordinary shares. The loan notes are therefore recognised as an equity instrument.

The Company has made available a loan facility that includes an option for the borrower to extend the repayment date by one year. The rate of interest during the extended period is fixed at the same rate as during the original repayment period. The Company recognises an embedded derivative in the option to extend, which is recorded in the balance sheet, separate from the value of the host contract, which is the value of the total contract less the value of the embedded derivative.

Judgements and estimates

In preparing these condensed interim financial statements, the significant judgements made by management in applying the Company's accounting policies and the key sources of estimation uncertainty were as stated within the consolidated financial statements for the year ended 31 December 2016, except for the following items.

A judgement was made that the convertible loan notes issued by the Company in May 2017 constituted an equity instrument. This was based on the fact that the noteholders do not have the right under the agreement to force the redemption of the notes, or to pursue the Company for insolvency as creditors.

A judgement was made that the market capitalisation of Velocys plc at the date of announcing the results did not constitute a trigger for impairment. Applying the same valuation method that was used in the December 2016 accounts gave a fair value in excess of the net assets of the Company.

The recognition of an embedded derivative in ENVIA's option to extend the repayment date of the loan from Velocys, relied on the estimate of market interest rates in the extension period, and these being different from the fixed rate in the contract.

Estimates relating to the fair value of the investment in ENVIA as an associate are contained within note 10.

Going concern

The financial statements have been prepared on the going concern basis, which assumes that the Company will have sufficient funds available to enable it to continue to trade for the foreseeable future, subject to fundraising in Q4 2017. Management's financial forecasts of the Company's likely cash requirements include the following assumptions: (i) the Oklahoma City project reaching full operational capacity in 2017 (ii) the costs of ongoing development projects and the Company's ability to reduce certain overhead costs (iii) the Company raising additional funding in Q4 2017.

<u>Accounting developments</u>
A number of new standards and amendments and revisions to existing standards have been published and are mandatory for the Company's future accounting periods. They have not been early adopted in these condensed consolidated financial statements. None of these are expected to have a significant impact on the consolidated financial statements when adopted.

Since the publication of the 2016 financial statements, there has been no change to the Company's assessment of the impact of Amendment to IAS 7, 'Cash flow statements', regarding the Disclosure initiative (not yet EU endorsed as of 1 May 2017).

2. Publication of non-statutory accounts

The condensed consolidated financial statements presented in this document have not been audited or reviewed and do not constitute Group statutory accounts as defined in section 434 of the Companies Act 2006. Group statutory accounts for the year ended 31 December 2016 were approved by the Board of Directors on 15 May 2017 and delivered to the Registrar of Companies. The auditors' report on those accounts, which was not modified, drew attention to the adequacy of the disclosure made in the financial statements concerning Velocys' ability to continue as a going concern, under section 498(2) or (3) of the Companies Act 2006.

3. Exceptional items

Items that are material because of their size or nature, and/or that are non-recurring are considered as exceptional items and are presented with the line items to which they best relate. Exceptional items, as detailed below, have been included in the consolidated income statement.

Exceptional items were as follows:

	6 months ended 30 June 2017 (unaudited) £'000	6 months ended 30 June 2016 (unaudited) £'000	Year ended 31 December 2016 (audited) £'000
Impairment of loan receivable	(701)	-	-
Costs of unsuccessful acquisition	-	(2,428)	(2,809)
Recognition of previously deferred income	-	2,496	2,496
	(701)	68	(313)

The Company has decided to record an impairment against the loan receivable of £0.7m. Achieving a key capacity milestone is expected during October 2017, and will result reversal of the loan impairment.

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

Also in 2016, the Company recognised £2,496,000 of previously deferred income in respect of the cancellation of a contract with Ventech for reactors. The deferred income arose on receipt of upfront payments. The full amount was recognised as Other income. It has been included in exceptional items as it was a significant, one-off change to a material contract.

The excess of the Company's share of the net fair value of ENVIA's identifiable assets and liabilities over the cost of the investment relates to negative goodwill arising at the point that the Company acquired an additional share of the business and therefore started to account for its investment in ENVIA on an equity basis. This transaction was reversed in H2 2016 on revision of the accounting treatment.

4. Segmental information

Business segments
At 30 June 2017 the Company is organised as a world-wide business comprising a single segment.

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

	6 months ended 30 June 2017 (unaudited) £'000	6 months ended 30 June 2016 (unaudited) £'000	Year ended 31 December 2016 (audited) £'000
Europe	-	273	273
Americas	225	236	1,163
Asia Pacific	9	-	9
	234	509	1,445

5. Restatement

The interim statements from 30 June 2016 included negative goodwill on the Company's investment in ENVIA arising from the increased share in ENVIA on the provision of additional equity and loan funding by the Company. The accounting was revised for this transaction at yearend 2016 and the negative goodwill reversed. Restated numbers, which are in line with the 2016 Annual report are as follows.

	6 months ended 30 June 2016 (unaudited) £'000 Before restatement	6 months ended 30 June 2016 (unaudited) £'000 After restatement
Consolidated income statement:		
Loss for the period attributable to the owners of Velocys plc*	(3,894)	(7,325)
Consolidated statement of financial position:		
Investments	9,122	5,449

* There was no impact on Operating loss.

6. Finance income

	6 months ended 30 June 2017 (unaudited) £'000	6 months ended 30 June 2016 (unaudited) £'000	Year ended 31 December 2016 (audited) £'000
Interest income on bank deposits	36	76	129
Interest on loan to associate	226	-	-
Net fair value gains on forward foreign exchange contracts	-	1,116	668
Foreign exchange gains	-	751	2,547
	262	1,943	3,344

7. Finance costs

	6 months ended 30 June 2017 (unaudited)	6 months ended 30 June 2016 (unaudited)	Year ended 31 December 2016 (audited)
	£'000	£'000	£'000
Interest on finance leases	1	3	5
Interest on borrowings	10	14	21
Net FX losses on forward FX contracts	60	-	-
Interest on embedded derivative *	195	-	-
Interest on convertible loan note	59	-	-
Foreign exchange losses	216	-	-
	541	17	26

*See note 12

8. Loss per share

The calculation of loss per share is based on the following losses and number of shares:

	6 months ended 30 June 2017 (unaudited)			6 months ended 30 June 2016 (unaudited)			Year ended 31 December 2016 (audited)		
	Loss £'000	Number of shares '000	Pence per share	Loss £'000	Number of shares '000	Pence per share	Loss £'000	Number of shares '000	Pence per share
Basic & fully diluted	(10,058)	143,981	(6.99)	(7,325)	142,748	(5.13)	(12,669)	143,283	(8.84)

9. Foreign currency translation

The foreign currency translation differences included in the Consolidated statement of comprehensive income primarily related to differences arising on the translation into pounds sterling of a) the Company's net investment in Velocys, Inc. whose assets and liabilities are denominated in US dollars, and b) goodwill and fair value adjustments arising from the acquisition of Velocys, Inc. in 2008 which are also denominated in US dollars.

10. Investments

	6 months ended 30 June 2017 (unaudited)	6 months ended 30 June 2016 (unaudited)	Year ended 31 December 2016 (audited)
	£'000	£'000	£'000
Available-for-sale investment:			
At 1 January	-	3,375	3,375
Movement to associate	-	(3,375)	(3,375)
	-	-	-

	6 months ended 30 June 2017 (unaudited)	6 months ended 30 June 2016 (unaudited)	Year ended 31 December 2016 (audited)
	£'000	£'000	£'000
Investment in associate:			
At 1 January	5,865	-	-
Movement from available-for-sale	-	3,375	3,375
Investment	-	1,805	1,938
Share of loss	(259)	(207)	(306)
Foreign exchange	(307)	476	858
	5,299	5,449	5,865

Investments consist solely of Velocys' holding in ENVIA Energy, LLC (ENVIA) which is the holding company for the project located in Oklahoma (the ENVIA project).

At the end of January 2016, Velocys entered into a financing arrangement with ENVIA under which it contributed additional equity finance of $2,587,000 and committed to provide loan finance of up to $9,310,000. As a result, Velocys increased its ownership share and was awarded additional voting rights, taking its share of voting rights to 28%. Up to this point the investment had been recognised as an Available-for-sale financial asset, thereafter it has been recognised as an Investment in associate, accounted for under the equity method. ENVIA was also thereafter considered to be a related party of Velocys.

In May 2017, an additional $3.4m loan was made available to ENVIA, taking the total facility to $12.7m. The loan note bears interest at 10%, and is repayable on 31 December 2019 with an option to extend the maturity date to 31 December 2020. ENVIA had drawn down $9,110,000 on this facility as at 30 June 2017 ($0.4m at 31 December 2016).

The Company's share of post-acquisition profit or loss is recognised in the Income statement; there are no post-acquisition movements in Other comprehensive income. For the period, the Company has recognised 9.8% as its share of ENVIA's post-acquisition loss (end of January 2016 to December 2016: 9.8%).

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.

As at 30 June 2017 the Company estimated that the fair value of its Investment had not been impaired after considering a number of factors, which include a better understanding of the timing of qualification of RINs, a revised forecast for the plant revenues from both RINs and product pricing the plant having not achieved a key capacity milestone (post period end) and increased equity share related to exit of NRG from the JV (post period end).

Critical estimates and judgements
The value of the investment relied on a judgement of the likelihood of the plant passing its key capacity milestone during October based on current performance data, and on estimates of future revenues and costs of the ENVIA plant based on expected product prices and qualification for RIN credits, and on anticipated operational savings as well increased equity share from NRG exit from the JV.

11. Trade and other receivables: non-current

Non-current trade and other receivables is comprised solely of the Company's loan to ENVIA. At 30 June 2017 ENVIA had drawn $9,110,000 (December 2016: $400,000) of the $12.4m loan facility made available by Velocys. The Company determined that a risk factor attached to meeting the next operational milestone exists which could result in risk of ENVIA lease termination and ability to operate, and deemed that an impairment of the loan of £0.7m was required; this estimate was based on the likelihood of passing the key capacity milestone during October 2017. Achieving the key capacity milestone would result in a reversal of the impairment.

12. Derivative financial instruments

The loan to ENVIA referred to in note 11 contains an option for the borrower to extend the repayment date by 12 months from December 2019 to December 2020. The interest rate during the extended period is 10%, the same as during the initial period, and as this is not related to expected market rates it is deemed an embedded derivative within the loan agreement. Based on the difference in discounted cashflows between the two repayment dates, the derivative is valued at -£246,000. The liability is recorded as a reduction of the trade receivable with the charge recognised as a Finance cost in the Income statement.

13. Movement in equity

On 15 May 2017 Velocys announced a fundraise of £10m. This constituted a placing of Ordinary shares and an issue of convertible loan notes. The placing was of 2,577,777 Ordinary shares at a price of £0.45 with existing and new shareholders. These shares represent 1.8% of Ordinary share capital. A total of 18 million convertible loan notes were issued at a price of £0.50 to the Company's two largest shareholders, Ervington Investments Limited and Lansdowne Partners. The final maturity date of the loan notes is 18 months from the date of issue, and the interest rate is 8%, with interest also being convertible into equity. Interest is therefore recorded in equity as it is accrued.

14. Post-financial position events

On 21 July the Company announced that it would be ceasing R&D activities at its UK site on Milton Park in Oxfordshire, and ceasing certain related R&D activities at its technical site in Ohio.

Also in July, Velocys announced that CFO Susan Robertson had decided to leave the company. John Tunison, an experienced interim CFO with nearly 15 years' experience working in finance leadership roles has since joined the Company, and is based in Houston.

In September Velocys also announced the formation of a consortium including British Airways and Suez to address an opportunity for a waste to jet fuel plant in the UK.

As discussed in the CEO's report, in September 2017 Velocys increased its voting rights in ENVIA Energy after one of the members of the joint venture, NRG Energy, exited the JV.