

**Velocys plc**

Annual Report and Accounts 2013



Velocys (formerly Oxford Catalysts) enables modular gas-to-liquids (GTL) plants to convert unconventional, remote and problem gas into valuable liquid fuels. Systems based on the Company's technology are significantly smaller than those using conventional technology, enabling modular plants that can be deployed cost effectively in remote locations and on smaller fields than is possible with competing systems. Together with world-class partners, Velocys provides complete modular GTL solutions that address an untapped market of up to 25 million barrels of fuel a day.

Velocys plc is listed on the AIM market of the London Stock Exchange (LSE: VLS). The Company has approximately 100 employees with facilities in Houston, Texas, USA and near Oxford, UK and Columbus, Ohio, USA.

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## Highlights

- Entered GTL joint venture with Waste Management, NRG Energy and Ventech (post year end)
- Velocys technology selected for further projects
  - Red Rock Biofuels
  - Pinto Energy
  - Waste Management (post year end)
- Ventech order of reactors for 1,400 bpd of capacity received; production underway
- PTT began FEED study for 1,000 bpd GTL plant using Velocys technology
- Sale of 175 bpd reactor (post year end) to a CIS customer
- Cemented manufacturing partnership with Shiloh Industries; strategic investment in Velocys (post year end)
- Cash\* at period end of £26.4 million (FY 2012: £9.5 million)

### **Pierre Jungels, CBE, Chairman of Velocys, said:**

“2013 was a strong year for Velocys. Our leadership position in smaller scale GTL is firmly established and market opportunities continue to advance. We enter 2014 confident and ready for commercial success.”

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\* Defined as cash, cash equivalents and short term investments (see note 20).

## Chairman's statement

We are at a remarkable time in the history of the fuels industry.

On the supply side, the abundance of natural gas, especially from shale and other unconventional resources, is ever more apparent. This gas is widely distributed, creating the possibility of energy independence for many more nations – but it is often hard to bring to market, where the quantities or distances do not justify a pipeline. On the demand side, liquids (diesel and jet fuel) continue to grow, driven by sectors where substitution of these fuels is very difficult. At the same time, environmental needs promote the search for lower-emission products and for sustainable supply chains, including decentralised production.

These conditions create a strong, stable market for the distributed, smaller scale gas-to-liquids (GTL) plants that Velocys technology is enabling. In North America, the shale gas revolution has opened up a future where cheap gas can power a newly competitive US through a wide range of downstream industries. Meanwhile, in other regions such as Russia and Central Asia, GTL is an attractive route to market for many stranded gas fields and for associated gas that is currently flared. Beyond GTL, there are also attractive opportunities to produce renewable fuels from biomass and waste, using the Company's Fischer-Tropsch (FT) process.

Velocys is perfectly positioned to capture these markets. During 2013, we fully established our commercial supply chains for both reactors and catalyst, as well as field service. An important milestone was the order from one of our partners, Ventech Engineers International, LLC (Ventech) for reactors totalling 1,400 barrels per day (bpd) of capacity. After the period end, we cemented another key partnership with our reactor core manufacturer, Shiloh Industries, Inc. (Shiloh). We see such partnerships as an important part of our strategy for building a strong business and addressing the complete needs of a GTL plant.

Velocys has grown its team to around 100 people, particularly strengthening the commercial and process engineering functions. It is a testament to both Velocys and the opportunities for smaller scale GTL that we continue to attract and retain world-class talent. I thank our staff for the enormous efforts they are making to secure the Company's future success.

Also in 2013, the Company consolidated its two brands (Velocys and Oxford Catalysts) to help it speak with one clear voice. Additionally, we opened a new office in

Houston, placing Velocys at the heart of the oil and gas industry. Roy Lipski, our CEO, is heading up this effort, and I am grateful to him and his family for making this move which is already proving highly beneficial.

Total revenues for the period were £4.8 million (2012: £7.6 million) due to the expected fall-off in development revenue during this transition phase to commercialisation. Cash\* at period end stood at £26.4 million (2012: £9.5 million), while cash outflow\*\* was £12.5 million (2012: £8.9 million).

### Outlook

Velocys enters 2014 with its commercial readiness established, a strong pipeline of projects moving through engineering stages, and a powerful market pull. I look forward with excitement to seeing us reap the benefits through 2014 and beyond.



**Pierre Jungels, CBE**  
Chairman  
26 March 2014

\* Defined as cash, cash equivalents and short term investments.

\*\* Defined as cash movement excluding monies from fund raising and issuance of shares.

## Chief Executive's report

### Introduction

In 2013, Velocys firmly consolidated its leading position and is poised to capture the exciting opportunity that has opened up for distributed fuels production. The Company has readied itself for sales in all aspects of the business, including engineering, supply chain and marketing. Velocys continues to be selected for commercial projects based on the performance and favourable economics of its technology, and is taking the initiative in helping those projects progress. A number are now close to fruition, and we look forward not only to securing those sales, but to the acceleration of this whole market.

### Market conditions

Throughout 2013, long-term market conditions continued to favour smaller scale GTL. Agencies such as the US Government's Energy Information Administration support a consensus view that the spread between oil and gas prices in North America is likely to remain high for decades to come. Furthermore, abundant gas is now recognised as a global phenomenon with still increasing recoverable reserves – but many of them without an economic route to market. GTL provides the means to convert this gas into inherently more valuable liquid hydrocarbons – high quality distillate fuels and speciality products such as lubricants and waxes.

The profile of the GTL industry, and of Velocys in particular, has risen significantly in 2013 as evidenced by a string of publications, such as a strong analyst's report in December from Bernstein entitled 'What if "Small Scale Gas To Liquids" Was the Next "Shale Gas"?', and an article in the Natural Gas Daily headed "The future will be micro for GTL technology". Altogether over 600 press articles mentioned Velocys. In addition, Velocys is increasingly being invited to comment on industry matters.

### Commercialisation

#### Sales and prospects

The Company's pipeline of prospects continues to grow in value, as new projects are added and existing ones progress to more advanced engineering stages. Furthermore, most customers see their immediate project as the first of many, and have identified additional sites to bring on projects in succession to their first one.

After period end, Velocys entered a joint venture with Waste Management, NRG Energy (NRG), and Ventech to develop GTL plants in the US and other selected geographies using a combination of renewable gas (biogas and landfill gas) and natural gas. Waste Management is North America's leading provider of comprehensive waste management services and the 200th largest company on the Fortune list; NRG is a

Fortune 500 company with the largest and most diverse competitive independent power generation portfolio in the US, and Ventech is a global leader in the design and construction of modular refineries. The joint venture is currently completing detailed engineering for its first proposed project to be located at Waste Management's East Oak landfill site in Oklahoma, USA. A final decision to proceed is expected later in the year. Development activities for additional facilities are planned to begin shortly.

In September 2013, Velocys was selected to supply FT technology for a 2,800 bpd GTL plant in the US being developed by Pinto Energy, LLC ("Pinto") at an 80-acre industrial site that it owns in the Port of Ashtabula, Ohio. Pinto will convert abundant low-cost natural gas from the Utica and Marcellus shale region into high value speciality products (solvents, lubricants and waxes), as well as ultra- clean transportation fuels. Pinto is working towards issuing the final notice to proceed in the third quarter of 2014. Start-up of the plant is expected in 2016. Pinto recently completed another important milestone and secured the air and storm water permits for this facility.

During the period, Calumet Specialty Product Partners, L.P. (Calumet), who in September 2012 selected the Velocys FT technology for a proposed GTL plant at their Karns City, Pennsylvania, USA refinery, completed initial engineering with Ventech and partook in a successful visit to the Company's demonstration facility in Brazil. Calumet is currently focused on a number of significant existing commitments, including the construction of a new refinery in North Dakota, and has not yet initiated more detailed engineering for the proposed GTL plant. Further updates will be provided as the project progresses.

In October, Velocys executed a commercial agreement with PTT Public Company Limited (PTT), the national energy company of Thailand and a Fortune Global 100 firm, to proceed with the commercial deployment of the Company's GTL technology in Thailand and other regions. Velocys and PTT have been collaborating since late 2009. In this next phase, PTT has commissioned Toyo Engineering Corporation (Toyo) to prepare a detailed front end engineering design (FEED) for a 1,000 bpd GTL plant. The engineering study is expected to be completed in the second half of 2014.

While the primary focus of the Company's commercial development efforts remains on GTL projects in North America, the portfolio of project opportunities is also growing in other regions. For example, Velocys now has more than a dozen active prospects in former Soviet

## Chief Executive's report (continued)

Union countries. This interest is driven by the need to capture the world's largest volume of flared gas and to monetise substantial stranded gas reserves. After the reporting period, Velocys announced the sale of a full-scale commercial reactor (175 bpd nominal capacity) to a customer in the region, underlining the suitability of Velocys technology for the opportunities there. The Company has been monitoring recent events in Russia and does not believe that presently its portfolio of opportunities is significantly impacted.

As well as GTL, Velocys also advanced several biomass-to-liquids (BTL) projects in 2013. In July, the Company was selected as the FT technology provider for the design and possible construction of a commercial BTL plant in Oregon, USA for Red Rock Biofuels, which is a subsidiary of IR1 Group LLC (IR1), an experienced biofuels project developer. This project was awarded a \$4.1 million grant from the US Department of Defense, to help fund detailed engineering for a 1,100 bpd facility. The proposed facility will convert some 170,000 tons per year of forestry derived biomass into liquid transportation fuels. IR1 expects to apply later this year for the additional grant funding of \$70 million available to support construction.

As previously reported, in 2012 Velocys was selected by project developer Solena Fuels Corporation (Solena) to provide its FT technology for GreenSky London, Europe's first commercial scale sustainable jet fuel facility being developed in partnership with British Airways, as well as for similar plants planned by Solena for other cities. Engineering work has continued on the project and further news is expected in due course.

As well as the announced projects, Velocys is working on a number of other prospects that remain confidential. Many opportunities are coming to the Company, and capital for plants is available. On projects which are at an advanced stage, Velocys is exploring how it can further align with its customers and partners to accelerate market adoption. The JV with Waste Management, NRG and Ventech is an example of this.

### Demonstration and pilot plants

The Company's demonstration plant in Fortaleza, Brazil, which includes both its FT and Steam Methane Reforming (SMR) reactors and which is targeted at offshore GTL, continued to operate during 2013 in collaboration with the Brazilian national oil company, Petrobras. At the end of the year, Velocys received the fifth and final demonstration success payment from its partners Toyo and MODEC. Referring to the Company's technology, Toyo has now publicly stated that it "has been successfully demonstrated in Brazil". Velocys expects that alongside its partners, it will be invited to bid for the first floating

GTL installation when Petrobras issues a formal tender. It will update the market further at that time.

In addition, during 2013, Velocys commissioned and began operation of its own fully integrated pilot plant at its technology centre in Columbus, Ohio. This facility is a showcase of the Velocys technology for customers, provides samples of liquid products, helps train plant operators, and enables validation of future technology improvements.

### Manufacturing and supply capability

Over the course of 2013, Velocys continued to make excellent progress implementing its strategy of attracting and qualifying world-class partners from various industries. The Company has created a high-quality, cost-effective reactor supply chain that can scale rapidly in order to meet customer demand.

Following year end, Velocys cemented a partnership with Shiloh, with whom it has been working since 2012, and who have set up the first mass-manufacturing cell for Velocys reactor cores. Shiloh is one of North America's leading suppliers of engineered metal products and light weighting solutions to the automotive industry. Initial capability supports annual sales of up to 10,000 bpd of capacity, and plans are in place to enable ramp up to 40,000 bpd in line with demand. Under the partnership agreement, both companies will work to continuously improve manufacturing of the Velocys FT reactor, and over time to enhance the effectiveness of the whole GTL plant. Concurrently, Shiloh purchased 601,326 shares of Velocys at 200p per share, representing a 32% premium to market price at the time. Shiloh is additionally investing several million dollars in manufacturing resources for Velocys, and is making available to the partnership a dedicated team of engineers.

Velocys has also fully qualified its catalyst supply chain, and continues to develop partnerships that will keep it at the forefront of catalyst development, manufacturing, and servicing. The Company's catalyst handling partner, Mourik International BV, has deemed that all the relevant processes, materials, and test methods for the Velocys FT reactors are fit and ready for commercial use.

### **Intellectual property**

Velocys has continued to grow and protect its intellectual property (IP) portfolio which now includes 894 patents granted and pending, and an even larger number of invention records. During the period, the Company filed 5 new patent applications, while 74 patents were granted in jurisdictions including the US, Australia, Canada, China, Japan, Russia, Taiwan, and various European countries.

Where it sees infringement by others, the Company has taken action to protect its IP. In March 2013, Velocys filed a case against CompactGTL in the UK, alleging infringement of two patents. In January 2014, the case was suspended while CompactGTL went into administration. It is now progressing again through the courts, with a trial expected in the third quarter of 2014.

### **Rebranding**

The parent company's name was changed from Oxford Catalysts Group PLC to Velocys plc on 25 September 2013, and a new brand identity rolled out. This enables Velocys to present a single front to its customers and investors, and completes the integration of the two companies, Oxford Catalysts and Velocys, that joined forces in 2008.

### **Resources**

The Company continues to develop its commercial capability and has recruited additional staff in business development, marketing, engineering and operations. This brings the total number of employees to approximately 100, with about three-quarters in the US and the remainder in the UK. In particular, the process engineering team was significantly bolstered in readiness for supporting early projects. We have been delighted to see how the Company's reputation in the industry is enabling it to attract the very best people. In addition to recruiting new talent, we have worked hard to develop and grow the skills of the very capable existing workforce at Velocys, ensuring that we keep harnessing the passion and innovation of everyone in the organisation.

Recognising the importance of Houston as a centre for activity and talent in the oil and gas industry, Velocys established a new office there for commercial and engineering activities. This presence is already proving to be a valuable asset, placing Velocys at the heart of the world's oil and gas market.



**Roy Lipski**  
Chief Executive  
26 March 2014

## Strategic report

The Directors present their review of the Company's performance during the year to 31 December 2013 and their assessment of the risks faced by the Company.

### Principal activities

Velocys designs and develops technology for the production of clean synthetic fuels from both conventional fossil fuels and renewable sources such as bio-waste. The business is primarily focused on the emerging market need for modular GTL plants in the range of 1,500 to 15,000 barrels per day.

It is estimated that this is a market that has the potential of producing as much as 25 million barrels of fuel a day. As this market becomes better recognised a number of competitors have entered it. Velocys is one of the most established companies in the market and is recognised as a world leader in the development of smaller-scale GTL technology.

The Company's business model incorporates the sale of reactors, licences for use of the reactor and catalyst technology, regular revenue from the catalyst which will be periodically renewed, and fees for engineering and support services.

The principal activity of Velocys plc (the "parent company") is a holding company. The two operating subsidiaries are Velocys, Inc. and Velocys Technologies Limited. In the Report and Accounts the three entities are referred to collectively as the "Company".

### Business review

A review of the Company's activities during the year and future strategy is dealt with in the Chairman's statement on page 2 and the Chief Executive's report on pages 3-5.

### Financial review

2013 was the first year in the Company's history where it had no revenue from development projects. This is an anticipated stage in the transition to commerciality, as activities become focused on commercial readiness. As a consequence revenues during the period were £4.8 million (2012: £7.6 million), derived from success payments on the Petrobras demonstration, income recognised on the sale of reactors to Ventech, and engineering revenues from customers.

Unfunded research and development costs and other administrative expenses increased to £16.8 million (2012: £12.5 million) as commercial activities ramp up. Adjusted losses\* for the period were £13.0 million (2012: £7.9 million). Cash outflow\*\* in the period was £12.5 million (2012: £8.9 million).

Velocys is well capitalised having successfully closed an equity funding on 3 January 2013 which raised £30.6 million (before expenses). At period end, the Company had £26.4 million of cash\*\*\* (FY 2012: £9.5 million).

### Costs

The breakdown of costs in 2013 was £10.5 million of R&D costs (2012: £7.1m) and £6.3m of administrative expenses (£5.4m). One of the main contributors to the increase in R&D spend was the cost of commissioning and starting to operate a pilot plant at the Ohio site.

In addition during 2013 Velocys began assembling a team of process engineers in the US and the UK. R&D spend also includes costs relating to patents and other IP. Administrative expenses include costs for the business development team, which was expanded in 2013.

### Key performance indicators

At the current stage of the business, the Directors consider that performance is best measured by achievement against technical and business development goals which are referred to in the Chief Executive's report. These include progress in demonstrations, progress towards commercial readiness, including having in place manufacturing capability and capability to support new projects, and progress in the development of our sales prospects.

### Employees

Velocys is committed to being a good employer and endeavours to train staff well, to pay them fairly and to maintain a safe environment in which they can work. Velocys is also committed to equal opportunity.

Velocys keeps detailed environmental health and safety records and takes the safety and wellbeing of its employees very seriously. During 2013 there were no lost-time accidents across the Company's sites, which brought the total number of operating hours without such an accident to over 2 million.

In 2013, the Company began recording data concerning the number of women employees in each area of the business. Of the 95 employees working for Velocys at 31 December 2013, 25% were women. The percentage of female employees broken down by area of the business was as follows.

\* Adjusted losses exclude the impact of foreign exchange losses: (2013: £0.3 million, 2012: £nil million) and non-cash items (depreciation, amortisation and share-based payments: (£3.7 million, 2012: £2.5 million).

\*\* Defined as movement in cash, cash equivalents and short term investments excluding monies from fund raising and issuance of shares.

\*\*\* Defined as cash, cash equivalents and short term investments (see note 20).



	2013
Scientific & engineering employees	14%
Sales, finance, HR & admin employees	71%
Senior managers	29%

Two of the eight members of the Board are women.

The Company will be exploring opportunities to expand this monitoring and looks forward to being able to use year-on-year data to help ensure that it is meeting its goals as an employer.

#### Environment

Velocys is concerned to manage the environmental impact of its operations and understands that the first step in doing this is to analyse the key components. Air travel and building operations have been identified as two of the major contributors of CO<sub>2</sub> emissions by the Company.

A lesser source is the operating of the Company's pilot plant at its Ohio facility.

In 2013, air travel by employees booked through the Company contributed 597.7 tonnes of CO<sub>2</sub>. There is no comparative data for 2012. From 2014 the Company will seek to capture data for air travel booked by employees. The Company will also look at the proportion of the emissions that are produced by travel between its sites.

The consumption of electricity at the business's three sites is the major part of the Company's CO<sub>2</sub> emissions attributable to building operations. KWh consumption is being recorded but Velocys will be looking at the energy mix of its suppliers in reaching an understanding of the resulting emissions.

The task for the Company in the coming year will be to seek to develop a more comprehensive model of its environmental impact and to understand the implications of its first set of year-on-year data.

#### **Operating risks**

The key operating risks of the Company and the measures taken to manage these are summarised below.

#### Technology

The Company manages the development of its technology through separate programmes. Each programme has a specific set of milestones, measurable goals, timeline and budget. Performance against each of these is monitored monthly. This enables the Company to identify issues at an early stage and take appropriate mitigating action.

#### Performance

As Velocys develops to commercialisation, it has worked to ensure that it will be able to meet the performance requirements for its products through a number of measures including:

- Working with vendors who fabricate Velocys' proprietary catalysts and reactors and negotiating with them to secure petrochemical industry standard warranties for these materials;
- Working with third parties to provide recommendations to the Company's quality assurance/control and then to review and validate the implementation of the programmes;
- Operating the Company's testing and pilot facilities to model client specific standard and upset conditions, and then developing mitigation or remediation strategies where testing identifies risk areas;
- Growing the staff including addition of personnel with relevant commercial experience;
- Working with world-class partners to enable products to be delivered to customers and combining with existing, well-proven technologies;
- Developing commercial terms that do not unduly commit Velocys to performance beyond its capability;
- As the operation of customer plants is outside its control, Velocys' agreements with its customers state that it shall not be liable to licensees for environmental, toxic waste, hazardous waste or pollution liability.

#### Scale up

Velocys has engaged in a series of programmes to demonstrate the scale up of its reactor technology from laboratory to commercial scale allowing the technology to be assessed at relevant scale. The first of its several demonstrations, at Güssing in Austria, was completed in 2010, which successfully demonstrated the FT reactor. A full scale (nominal 25 barrel per day) reactor was installed and successfully demonstrated at a customer site in the Asia-Pacific region in 2012. A demonstration programme for a fully integrated GTL unit for Petrobras in Brazil ran for much of 2013. In addition, Velocys has installed its own pilot plant at its Ohio facility.

In the case of catalysts scale up, the Company has worked with established, reputable catalyst

## Strategic report (continued)

manufacturers to develop the capability to make available commercial quantities of catalyst. Catalyst produced at each stage of the scale up process is tested to ensure it meets the relevant specification. The Company's FT catalyst which will be supplied with the full-scale FT reactors is now capable of being produced in commercial quantities.

### Market adoption

In order to minimise the risk of non-adoption of its technology by the market, the Company for the most part works with partners who are substantial players in their fields and who have significant interest in developing the technology commercially, as this would give them a competitive advantage. The Company has developed a substantial pipeline of opportunities which are being progressed through its own business development team as well as through its engineering partners. The Company continually monitors and assesses the strength of this pipeline.

### Funding

Velocys has transitioned from a development phase under which its activities were supported in part through partner-funded programmes to a commercialisation phase which is financed from the Company's own resources. The costs and time required for this commercialisation are uncertain and Velocys' policy is to ensure that it has sufficient resources in place to be able to fully pursue commercialisation opportunities. The Directors believe that by making use of the funds obtained at the start of 2013, and with the addition of funds in March 2014 noted in the Directors' report, the business is adequately funded for the foreseeable future.

### Manufacturing

Velocys works with leading manufacturers of equipment and catalysts to develop the manufacturing capability for commercial sales of its products. By using manufacturing partners with proven track-records in their respective fields, rather than developing capability in-house, the Directors consider that the manufacturing risk is significantly reduced.

### IP protection

The Company assigns significant resources through the IP Director and external lawyers to enhancing and protecting its IP, both in terms of patented and non-patented IP. In addition to investment in an extensive patent portfolio, the Company has processes to capture and manage knowhow and other knowledge assets.

### Personnel retention

The Company has in place policies designed to ensure it attracts and retains key personnel. These include a performance evaluation system, training, and incentive and share option schemes.

### **External risks**

The performance of Velocys is subject to macroeconomic conditions and changes in external factors such as interest and exchange rates, inflation, and oil and natural gas prices.

These risks are managed through monitoring and analysis of the economic climate and the operating environment, and by ensuring that Velocys has sufficient information to develop a thorough understanding of potential impacts, through which it can develop mitigating policies and contingencies. Additionally, where possible Velocys looks to ensure its contracts provide protection against adverse external factors.

The prices of oil and natural gas have a particular relevance to future demand for those of the business's products that will provide solutions for the production of oil substitutes using natural gas as a feedstock. It is reasonable to expect that higher oil prices will improve the economics of such products whilst higher natural gas prices will have the opposite effect. However, Velocys considers that there are numerous other drivers for future demand including regulatory requirements, security of supply, need for energy diversification, and specific local economics, taxes and subsidies, which mean that oil and gas prices are not the only significant factors, and are therefore not an undue risk for the business.

### **Financial risks**

The activities of Velocys expose it to a number of financial risks which are dealt with specifically below. The use of financial derivatives is governed by policies, which provide a set of written principles, approved by the Board of Directors, for the management of these risks. At present Velocys makes use of financial derivatives only in respect of the foreign exchange exposure arising from funding its US operations.

The financial instruments of the Company, including the parent company, comprise cash and cash equivalents, short-term investments, trade and other receivables, and trade and other payables. The main purpose of these financial instruments is to support the funding of business activities.

### Creditors

The Company's principal financial assets are cash, cash equivalents and short-term investments, trade and other receivables. The Company's credit risk is primarily attributable to its trade receivables, which are concentrated in a small number of high value customer accounts. The Company has policies to manage this risk, including where applicable, carrying out relevant financial checks on customers, requiring letters of credit or advance payments.

The credit risk of liquid funds is limited to counterparties (banks) with high credit ratings assigned by international credit rating agencies. Velocys has a treasury policy designed to ensure that cash, cash equivalents and short-term investments are only placed with high credit rated institutions and that the spread of such assets is sufficient that it is not overly exposed to any one institution.

### Interest rates

Movements in interest rates affect Velocys which holds cash balances and borrowings. As cash flows allow, a proportion of interest bearing assets are held at fixed rate to ensure certainty of interest income. All of the business's borrowings incur interest charges at a fixed rate.

### Liquidity

Company policy is to maintain sufficient cash balances to meet anticipated requirements to a medium term horizon. Funds are placed on time deposits with other cash balances held available for immediate withdrawal if required.

### Exchange rates

A significant part of Velocys' activities are located in the US and the funding requirements for these are denominated in US dollars. Where possible, revenue is receipted in US dollars, which acts as a natural hedge against this exposure. To reduce uncertainty over the impact of exchange rate movements, forward contracts are taken out fixing the rate of exchange, and a proportion of Velocys' liquid assets is held in US dollar denominated accounts.

In the Company's consolidated accounts, there are significant US dollar denominated goodwill and acquired intangible assets relating to the acquisition of the US subsidiary. These balances are subject to exchange rate fluctuations which result in movements in reserves; however, the Directors do not consider it necessary to hedge such exchange rate movements since they do not have any impact on the cash position of the Company.

### Capital management

Velocys' objectives when managing capital are to safeguard its ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders, and to maintain an optimal capital structure to reduce the cost of capital.

The Company believes that at this stage of its development, equity is the most suitable form of funding for its activities and this forms the basis of the capital that it manages. The Company's objectives when managing this capital are: to secure its ability to continue as a going concern; to have sufficient funds to protect it against unforeseen events and risks; to have sufficient funds to enable the Company to address the opportunities that can deliver future benefits to the Company's shareholders and provide them with a return which rewards the risks undertaken.

This is accomplished through a planning process that involves an annual strategy and risk review, annual budgeting and regular re-forecasting. The Company believes that it has sufficient cash and cash equivalents to meet its capital management objectives.

### **Future developments**

The Board aims to continue its corporate strategies as set out in the Chairman's statement and Chief Executive's report.

### **Company development activities**

The Company continues to invest in development. The catalyst and microchannel technologies currently being developed are expected to make significant contributions to the growth of the business. The Directors regard investment in development as important for success in the medium to long term.

Approved by the Board and signed on its behalf by:



**Roy Lipski**  
Chief Executive  
26 March 2014

## Directors' report

### Business risks

A full explanation of the Company's risks and its risk management policies is made in the Strategic report.

### Substantial shareholdings

On 6 March 2014, the Company had been notified of the following holdings of 3% or more of the issued share capital of Velocys plc.

	Number of shares held	Percentage of issued share capital
Lansdowne Partners	22,409,586	19.25%
Henderson Global Investors	15,312,406	13.15%
Invesco Asset Management	14,947,875	12.84%
Ruffer LLP	11,200,000	9.62%
Baillie Gifford & Co Ltd	4,551,242	3.91%
Ervington Investments Limited	4,000,000	3.44%

### Fund raising

On 11 December 2012, the Company announced the successful conditional placing of shares to raise £29.3m net of expenses. This placing was approved at a general meeting of its shareholders on 3 January 2013 and the shares were admitted to trading on AIM on 4 January 2013.

On 11 March 2014 the Company announced the purchase of shares by Shiloh Industries Inc ("Shiloh") as part of a commercial partnership to manufacture the Velocys FT reactor. Shiloh subscribed for 601,326 new ordinary shares of 1 pence each at a price of 200p per share.

### Dividends

The Directors do not recommend any dividend for the year ended 31 December 2013 (2012: nil).

### Directors

The Directors of Velocys plc as at 31 December 2013, who served throughout the year and up to the date of approval of the financial statements, unless otherwise indicated, were as follows:

Pierre Jungels (Non-executive Chairman)  
Roy Lipski (Chief Executive)  
Susan Robertson (Chief Financial Officer)  
Paul Schubert (Chief Operating Officer, appointed 1 July 2013)  
Andrew Jamieson (Non-executive Director)

Jan Verloop (Non-executive Director)  
Sandy Shaw (Non-executive Director)  
Julian West (Non-executive Director, appointed 1 July 2013)

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. At the 2014 annual general meeting the following Directors will retire and offer themselves for re-election.

- Paul Schubert
- Julian West

### 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.

### Directors' interests

The Directors who held office at 31 December 2013 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).

Name of Director	Velocys plc Ordinary £0.01 shares	
	31 December 2013	31 December 2012
Pierre Jungels	223,031	223,031
Roy Lipski	2,417,098	2,417,098
Susan Robertson	304,874	304,874
Paul Schubert	–	–
Andrew Jamieson	25,000	25,000
Jan Verloop	150,837	150,837
Sandy Shaw	17,758	–
Julian West	75,000	–

Details of Directors' share options and service contracts are shown in the Directors' remuneration report.

### Annual general meeting

The annual general meeting of the Company will be held at the Company's Milton Park premises at 10.45am on Tuesday 10 June 2014.

### 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; and
- 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.

PricewaterhouseCoopers LLP have expressed their willingness to continue in office as auditors and a resolution to reappoint them will be proposed at the forthcoming annual general meeting.

Approved by the Board and signed on its behalf by:

A handwritten signature in black ink that reads "Roy Lipski". The signature is written in a cursive style with a horizontal line underneath the name.

**Roy Lipski**  
Chief Executive  
26 March 2014

## Corporate governance report

### Corporate governance

Companies who have their securities traded on AIM are not required to comply with the principles and provisions of the UK Corporate Governance Code (2010) and the amendments incorporated in the Corporate Governance Code (2012). The Board, however, has determined that the Company should maintain high standards of corporate governance and whilst not fully complying within this report with the UK Corporate Governance Code, including the full disclosure requirements, has adopted procedures and has taken steps to adopt the underlying principles, in so far as appropriate given the size of the Company and the nature of its operations.

### Board of Directors

The Company is controlled by the Board of Directors which comprises three Executives, one of whom is the Chief Executive, and five Non-executive Directors. All of the Non-executive Directors are considered to be independent. The Company terminated its business development consultancy arrangement with Andrew Jamieson at the end of 2012, although the arrangement was not material in either the amount of time required from Dr Jamieson, nor in the amount of income that it provided and was not considered to have any impact on his ability to be considered independent. The roles of Chief Executive and Chairman are separate. All Directors are able to take independent advice to assist them in their duties if necessary. The detailed biographies of all Directors are provided on the Company's web site.

The Board is responsible to shareholders for the proper management of Velocys and meets formally at least six times a year to set the overall direction and strategy of the Company, to review operating and financial performance and to consider and advise on senior management appointments. The Board also monitors and approves financial policy and budgets, including capital expenditure. All key operational decisions are subject to Board approval. The Company Secretary is responsible for ensuring that Board procedures are followed and that any and all applicable rules and regulations are complied with.

Directors are subject to election by shareholders at the first opportunity after their appointment. In addition, one third of Directors are subject to retirement by rotation at each annual general meeting. The Board has introduced a process for evaluating the effectiveness of the Board and its committees. This is by means of a questionnaire survey of all Board members and other relevant senior executives.

### Committees of the Board

#### Remuneration committee

The remuneration committee comprises the Non-executive Directors chaired by Sandy Shaw. This committee reviews, inter alia, the performance of the Executive Directors and sets the scale and structure of their remuneration and basis of their service agreements, having due regard to the interests of shareholders. The remuneration committee also determines the allocation of share options to Executive Directors. No Director has a service agreement exceeding one year.

One of the policies of the remuneration committee is that no individual participates in discussions or decisions concerning his or her own remuneration. The Directors' remuneration report is set out on pages 14 to 17.

#### Audit committee

The audit committee comprises the Non-executive Directors and is chaired by Dr Jan Verloop. Under its terms of reference it meets at least twice a year, and amongst other duties it reviews the monitoring of the Company's internal controls, accounting policies and financial reporting, and provides a forum through which the external auditors report. It meets at least once a year with the external auditors without Executive Directors present.

#### Nominations committee

The nominations committee consists of the Non-executive Directors, under the chairmanship of Dr Pierre Jungels. It meets at least once a year, and amongst its other duties it reviews the composition of the Board and its succession planning, and keeps under review the leadership needs of the Company with a view to ensuring the continued ability of the Company to compete effectively in the marketplace.

### Senior management team

The day-to-day management of the Company is overseen by the senior management team, consisting of the Executive Directors and other senior managers, under the leadership of the Chief Executive.

### Board and committee attendance at scheduled Board and committee meetings

	Board	Audit committee	Remuneration committee	Nominations committee
Number of meetings held in 2013	7	3	4	1
Attendance* by:				
– Pierre Jungels	100%	100%	100%	100%
– Roy Lipski	100%	n/a	n/a	n/a
– Susan Robertson	100%	n/a	n/a	n/a
– Paul Schubert	100%	n/a	n/a	n/a
– Andrew Jamieson	100%	100%	100%	100%
– Jan Verloop	100%	100%	100%	100%
– Sandy Shaw	100%	100%	100%	100%
– Julian West	100%	100%	100%	100%

\* The attendance percentage relates only to applicable meetings. In the case of Paul Schubert and Julian West this includes only those meetings since their appointment on 1 July 2013.

### **Relations with shareholders**

The Board considers effective communication with shareholders to be very important, and encourages regular dialogue with investors. The Board responds promptly to questions received verbally or in writing. Directors regularly attend meetings with shareholders and analysts throughout the year. 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 web site [www.velocys.com](http://www.velocys.com) contains full details of the Company's activities, press releases and other details, as well as a link to the relevant web page of the London Stock Exchange web site for share price details, share trading activities and graphs, as well as Regulatory News Service (RNS) announcements.

### **Maintenance of a sound system of internal control**

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 UK Corporate Governance Code and undertakes assessments of the major areas of the business and methods used to monitor and control them. In addition to financial risk, the review covers operational, commercial, regulatory and health and safety risks. The risk review is an ongoing process with reviews being undertaken on a regular basis.

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

### **Control environment**

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

### **Risk management**

The Company employs Directors and senior personnel with the appropriate knowledge and experience for a business engaged in activities in its field of operations, and undertakes regular risk assessments and reviews of its activities.

### **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.

### **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, sets out strict procedures and limits on how surplus funds are invested.

The Board has considered it inappropriate to establish an internal audit function, given the size of the Company. However, this decision will be reviewed as the operations of the Company develop.

### **Review of corporate governance disclosures**

The Board has voluntarily complied with those principal Corporate Governance principles of the UK Corporate Governance Code in so far as 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 consistent with the audited financial statements.

# Directors' remuneration report

## Introduction

It is not a requirement for companies that have securities listed on AIM to comply with the disclosure requirements of Directors' Remuneration Report Regulations 2013 or to comply with the UKLA Listing Rules and the disclosure provisions under schedule 8 to SI 2008/410 of the Companies Act 2006; consequently certain disclosures are not included below. The remuneration committee, however, is committed to maintaining high standards of corporate governance and has taken steps to comply with the principles of best practice in so far as they can be applied practically given the size of the Company and the nature of its operations.

## Unaudited information Remuneration report

The Board has applied the principles of good governance relating to Directors' remuneration as described below.

## Remuneration committee

The remuneration committee comprises the Non-executive Directors under the chairmanship of Sandy Shaw. The committee's constitution and operation is compliant with the provisions of the UK Corporate Governance Code on Corporate Governance. When setting its remuneration policy for Executive Directors, the committee gives consideration to the provisions and principles of the UK Corporate Governance Code.

## Remuneration policy for Executive Directors

The remuneration policy has been designed to ensure that Executive Directors receive appropriate incentive and reward given their performance, responsibility and experience. When assessing this, the remuneration committee looks to ensure that the policy aligns the interests of the Executive Directors with those of shareholders.

The Company's remuneration policy for Executive Directors is to:

- Consider the individual's experience and the nature, complexity and responsibilities of their work in order to set a competitive salary that attracts and retains management of the highest quality;
- Link individual remuneration packages to the Company's long-term performance through both bonus schemes and share option plans;
- Provide post-retirement benefits through payment into defined contribution pension schemes;
- Provide employment related benefits including provision of life assurance and medical insurance.

## Remuneration of Executive Directors

Executive Directors' remuneration is considered annually. The current remuneration package is based on an external review of Board and other senior executive remuneration commissioned by the remuneration committee in 2011. This review looked at the overall composition of the remuneration and made recommendations based on benchmarking with other companies similar in size, industry and stage of development. The basic components of this package are set out below. The remuneration committee has commissioned a new external review by independent remuneration experts to review the package for 2014 onwards. The results of this review have not yet concluded.

### Base salary

The base salary is reviewed annually at the beginning of each year. The review process undertaken by the remuneration committee has regard to the development of the Company and the contribution that individuals will continue to make. Consideration is also given to the need to retain and motivate individuals, and available information on the package levels in comparable organisations.

### Annual performance incentive

All Executive Directors are eligible, at the discretion of the remuneration committee, for an annual bonus. The remuneration committee sets 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 certain financial, as well as technical and business development.

### Pensions and other benefits

The Company contributes to individuals' defined contribution pension plans.

Other benefits provided are life assurance, private medical insurance and relocation allowances where applicable. No company car is provided, but Directors are paid an allowance for business miles travelled in accordance with HMRC guidelines. In the case of Roy Lipski and Paul Schubert who are located in the USA, they are entitled to the standard benefits provided to all of the Company's US full-time employees under the medical plan.



During 2013, Roy Lipski relocated from Plain City, Ohio to Houston, Texas and the Company paid for the costs of relocation for himself and his family, including housing rental costs for a defined period of time to facilitate this move. Where these costs were taxable, the Company paid gross up costs. These costs are included in the other benefits category in the analysis shown below.

#### ELTIP awards

Following the detailed remuneration review carried out in 2011 using external consultants, the remuneration committee concluded that setting of performance conditions for a company at the stage of development of Velocys is not appropriate. Therefore an ELTIP mechanism was introduced in 2011, where the remuneration committee may, at its discretion at the start of each year set the maximum number of options to be awarded to each executive at the start of the following year based on annual performance targets set for each executive. These awards will vest over a three year period. Associated with the ELTIP, the remuneration committee also established a discretionary employee benefit trust which shall facilitate ELTIPs granted and to be granted.

#### Remuneration policy for Non-executive Directors

The remuneration of the Non-executive Directors is determined by the Board as a whole, based on a review of current practices in other equivalent companies. The Non-executive Directors do not receive any pension payments towards private arrangements, nor do they participate in any of the bonus schemes. Fees are based on a fixed fee plus a fee for additional consulting services, of which there were none in 2013.

The Non-executive Directors each have service agreements which are reviewed annually by the Board. All Non-executive Directors retire by rotation and are re-elected every 3 years at the annual general meeting.

#### Audited information

##### Directors' remuneration

The Directors' received the following remuneration in relation to the year to 31 December 2013.

Name of Director	Salary and fees £	Bonus £	Other benefits £	2013 Totals £	Pension contributions £	2012 Totals £	2012 Pension £
<b>Executive</b>							
Roy Lipski *	237,444	197,260	106,313	541,017	14,050	488,785	13,555
Susan Robertson	165,766	105,676	929	272,371	11,547	282,860	11,266
Paul Schubert**	84,718	41,327	5,728	131,773	4,890	–	–
<b>Non-executive</b>							
Pierre Jungels	66,500	–	–	66,500	–	53,000	–
Sandy Shaw	40,000	–	–	40,000	–	8,750	–
Andrew Jamieson ***	40,000	–	–	40,000	–	50,000	–
Jan Verloop	39,281	–	–	39,281	–	32,451	–
Julian West**	22,500	–	–	22,500	–	–	–
<b>Aggregate emoluments and pension contributions</b>							
	696,209	344,263	112,970	1,153,442	30,487	915,846	24,821

\* Includes company reimbursed relocation costs associated with move to Houston as described above.

\*\* Includes only remuneration since date of appointment as a Director on 1 July 2013.

\*\*\* Up to the end of 2012 Dr Jamieson's fees comprised two elements: a fixed fee for his work as a director of the Company and a variable component for additional consultancy primarily related to business development paid under a separate service contract. This contract provided for consultancy work to be paid at a rate of £1,500 per day and in addition, at the end of each service year (31 March) for each day of consultancy, a number of share options were issued. This calculation was based on the number of shares equal to £500 per day at the share price on the date of issue and with a strike price equal to the nominal share price. The options were immediately exercisable and have an expiry date 10 years from date of grant. During 2013 3,390 options were granted in respect of the year ended 31 December 2012. This grant is included in the table of options below. No fees have been paid for 2013 and no further options will be granted.

## Directors' remuneration report (continued)

### Directors' share options

Aggregate emoluments disclosed above do not include any amounts for the value of the options to acquire ordinary shares in Velocys plc granted to or held by the Directors.

Details of all Directors' shareholdings are disclosed on page 10 in the Directors' report.

Details of all options held by the Directors at 31 December 2013 are as follows.

Name of Director	At 31 December 2012	Granted	Exercised	Lapsed	At 31 December 2013	Exercise price (£)	Earliest date of exercise	Date of expiry	Exercisable at 31 December 2013
<b>Roy Lipski</b>									
Bonus 2009	342,000	-	-	-	342,000	0.01	31/03/10	31/03/20	342,000
ELTIP 2008	100,000	-	-	-	100,000	0.01	24/01/11	19/11/18	100,000
ELTIP 2009	140,000	-	-	-	140,000	0.01	31/01/12	04/11/19	140,000
ELTIP 2011	625,000	-	-	-	625,000	0.58	20/09/11	20/09/21	625,000
ELTIP 2012	818,000	-	-	-	818,000	0.49	01/01/15	01/02/22	-
ELTIP 2012	613,000	-	-	-	613,000	0.49	01/01/12	01/02/22	408,666
ELTIP 2013	-	1,126,563	-	-	1,126,563	1.59	01/01/16	12/04/23	-
ELTIP 2013	-	281,640	-	-	281,640	1.59	12/04/13	12/04/23	93,880
<b>Total</b>	<b>2,638,000</b>	<b>1,408,203</b>	<b>-</b>	<b>-</b>	<b>4,046,203</b>				<b>1,709,546</b>
<b>Susan Robertson</b>									
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	-
ELTIP 2012	273,803	-	-	-	273,803	0.49	01/01/12	01/02/22	182,536
ELTIP 2013	-	502,930	-	-	502,930	1.59	01/01/16	12/04/23	-
ELTIP 2013	-	125,732	-	-	125,732	1.59	12/04/13	12/04/23	41,911
<b>Total</b>	<b>1,277,081</b>	<b>628,662</b>	<b>-</b>	<b>-</b>	<b>1,905,743</b>				<b>862,725</b>
<b>Paul Schubert</b>									
EMI	-	-	-	-	320,513	0.56	04/10/14	04/10/21	-
ELTIP 2012	-	-	-	-	119,000	0.49	01/01/15	01/02/22	-
ELTIP 2012	-	-	-	-	52,600	0.49	01/01/12	01/02/22	23,066
ELTIP 2013	-	-	-	-	502,930	1.59	01/01/16	12/04/23	-
ELTIP 2013	-	-	-	-	125,733	1.59	12/04/13	12/04/23	41,911
<b>Total</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,120,776</b>				<b>64,977</b>
<b>Andrew Jamieson</b>									
2010	6,500	-	-	-	6,500	0.01	31/03/11	31/03/21	6,500
2012	10,204	-	-	-	10,204	0.01	20/04/12	19/04/22	10,204
2013	-	3,390	-	-	3,390	0.01	01/05/13	05/01/23	3,390
<b>Total</b>	<b>16,704</b>	<b>3,390</b>	<b>-</b>	<b>-</b>	<b>20,094</b>				<b>20,094</b>

The market price of the parent company's shares as at 31 December 2013 was 145p (2012: 154p) and the range during the year was 124p to 201p (2012: 40p to 163p). Details of options and the cost of such share-based payments are given in note 13.

Dr Schubert's options are unchanged from 1 July 2013 when he was appointed a Director.

## Statement of Directors' responsibilities

The Directors are responsible for preparing the annual report, the Strategic report, the Directors' report, the Directors' remuneration report and the financial statements in accordance with applicable law and regulations.

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

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

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and of Velocys plc and enable them to ensure that the financial statements and the Directors' remuneration report comply with the Companies Act 2006 and, as regards the Company financial statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Company and of Velocys plc and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

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

On behalf of the Board



**Roy Lipski**  
Chief Executive  
26 March 2014

# Independent auditors' report to the members of Velocys plc

## Report on the financial statements

### Our opinion

In our opinion:

- The financial statements, defined below, give a true and fair view of the state of the Company's and of the parent company's affairs as at 31 December 2013 and of the Company's loss and the Company's and the parent company's cash flows for the year then ended;
- The Company financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- The parent company financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- The financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulations.

This opinion is to be read in the context of what we say in the remainder of this report.

### What we have audited

The Company financial statements and parent company financial statements (the "financial statements"), which are prepared by Velocys plc, comprise:

- The consolidated and parent company statement of financial position as at 31 December 2013;
- The consolidated income statement and statement of comprehensive income for the year then ended;
- The consolidated and parent company statement of cash flows for the year then ended;
- The consolidated and parent company statement of changes in equity for the year then ended;
- The accounting policies; and
- The notes to the financial statements, which include other explanatory information.

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

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

Certain disclosures required by the financial reporting framework have been presented elsewhere in the Annual report and accounts (the "Annual report"), rather than in the notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited.

### What an audit of financial statements involves

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- Whether the accounting policies are appropriate to the Company's and the parent company's circumstances and have been consistently applied and adequately disclosed;
- The reasonableness of significant accounting estimates made by the Directors; and
- The overall presentation of the financial statements.

In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially

incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion the information given in the Chairman's statement, the Chief Executive's report, the Strategic report, the Directors' report and the Directors' remuneration report for the financial year for which the financial statements are prepared is consistent with the financial statements.

**Opinion on additional disclosures**

Directors' remuneration report

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

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

**Other matters on which we are required to report by exception**

Adequacy of accounting records and information and explanations received

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

- We have not received all the information and explanations we require for our audit; or
- Adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- The parent company financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Directors' remuneration

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

**Responsibilities for the financial statements and the audit**

Our responsibilities and those of the Directors

As explained more fully in the statement of Directors' responsibilities, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

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

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

**Sam Taylor** (Senior Statutory Auditor)  
for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
Reading  
26 March 2014

## Consolidated income statement for the year ended 31 December 2013

	Note	2013 £'000	2012 £'000
<b>Revenue</b>	5	4,753	7,632
Cost of sales		(3,300)	(4,769)
<b>Gross profit</b>		1,453	2,863
Unfunded research and development costs		(10,477)	(7,088)
Share-based payments	13	(2,782)	(1,341)
Other administrative expenses		(6,339)	(5,369)
<b>Total administrative expenses</b>		(19,598)	(13,798)
<b>Operating loss</b>	9	(18,145)	(10,935)
Finance income	6	419	152
Finance costs	7	(364)	(53)
Other income	8	58	–
<b>Finance income, net</b>		113	99
Loss before income tax		(18,032)	(10,836)
Income tax credit	12	1,111	437
<b>Loss for the financial year attributable to the owners of Velocys plc</b>		(16,921)	(10,399)
<b>Loss per share attributable to the owners of Velocys plc</b>			
Basic and diluted loss per share (pence)	14	(14.60)	(11.47)

The notes on pages 28 to 53 are part of these consolidated financial statements.

The Company has elected to take the exemption under Section 408 of the Companies Act 2006 to not present the parent company income statement and statement of comprehensive income. The loss for the parent company for the year was £6,322,000 (2012: loss £8,359,000).

## Consolidated statement of comprehensive income for the year ended 31 December 2013

	<b>2013</b>	2012
	£'000	£'000
<b>Loss for the year</b>	(16,921)	(10,399)
<b>Other comprehensive expense</b>		
<b>Items that will be reclassified subsequently to profit or loss when specific conditions are met</b>		
Foreign currency translation differences	(269)	(1,269)
<b>Total comprehensive expense for the year</b>	(17,190)	(11,668)

The notes on pages 28 to 53 are part of these consolidated financial statements.

## Consolidated statement of financial position as at 31 December 2013

	Note	2013 £'000	2012 £'000
<b>Assets</b>			
<b>Non-current assets</b>			
Intangible assets	15	24,971	25,205
Property, plant and equipment	16	2,084	1,896
		27,055	27,101
<b>Current assets</b>			
Trade and other receivables	18	1,112	1,592
Current income tax asset		1,750	600
Inventory	19	263	330
Short-term investments – funds held on deposit	20	11,875	–
Cash and cash equivalents	20	14,475	9,451
		29,475	11,973
<b>Total assets</b>		56,530	39,074
<b>Current liabilities</b>			
Trade and other payables	21	(6,284)	(3,927)
Borrowings	23	(104)	(74)
		(6,388)	(4,001)
<b>Non-current liabilities</b>			
Trade and other payables	22	(232)	(147)
Borrowings	23	(1,192)	(1,181)
		(1,424)	(1,328)
<b>Total liabilities</b>		(7,812)	(5,329)
<b>Net assets</b>		48,718	33,745
<b>Capital and reserves attributable to the owners of Velocys plc</b>			
Called up share capital	25	1,164	914
Share premium account	25	95,793	66,662
Merger reserve		369	369
Share-based payment reserve		9,813	7,031
Accumulated losses		(58,421)	(41,231)
<b>Total equity</b>		48,718	33,745

The notes on pages 28 to 53 are part of these consolidated financial statements.

The financial statements on pages 20 to 53 were approved by the Board of Directors and authorised for issue on 26 March 2014. They were signed on its behalf by:



**Susan Robertson**  
Chief Financial Officer  
Company number 5712187



## Velocys plc statement of financial position as at 31 December 2013

	Note	2013 £'000	2012 £'000
<b>Assets</b>			
<b>Non-current assets</b>			
Investments	17	77,355	52,665
<b>Current assets</b>			
Current income tax asset		1,300	150
<b>Total assets</b>		78,655	52,815
Net assets		78,655	52,815
<b>Capital and reserves attributable to the owners of Velocys plc</b>			
Called up share capital	25	1,164	914
Share premium account	25	95,793	66,662
Share-based payment reserve		9,813	7,031
Accumulated losses		(28,115)	(21,792)
<b>Total equity</b>		78,655	52,815

The notes on pages 28 to 53 are part of these consolidated financial statements.

The financial statements on pages 20 to 53 were approved by the Board of Directors and authorised for issue on 26 March 2014. They were signed on its behalf by:



**Susan Robertson**  
Chief Financial Officer

Company number 5712187

## Consolidated statement of changes in equity as at 31 December 2013

	Called up share capital £'000	Share premium account £'000	Share-based payments reserve £'000	Merger reserve £'000	Accumulated losses £'000	Total equity £'000
<b>Balance at 1 January 2012</b>	902	65,270	5,690	369	(29,563)	42,668
<b>Comprehensive income</b>						
Loss for the year	-	-	-	-	(10,399)	(10,399)
<b>Other comprehensive income</b>						
Foreign currency translation differences	-	-	-	-	(1,269)	(1,269)
<b>Total comprehensive expense</b>	-	-	-	-	(11,668)	(11,668)
<b>Transactions with owners</b>						
Share-based payments – value of employee services	-	-	1,341	-	-	1,341
Proceeds from share issues	12	1,392	-	-	-	1,404
<b>Total transactions with owners</b>	12	1,392	1,341	-	-	2,745
<b>Balance at 1 January 2013</b>	914	66,662	7,031	369	(41,231)	33,745
<b>Comprehensive income</b>						
Loss for the year	-	-	-	-	(16,921)	(16,921)
<b>Other comprehensive income</b>						
Foreign currency translation differences	-	-	-	-	(269)	(269)
<b>Total comprehensive expense</b>	-	-	-	-	(17,190)	(17,190)
<b>Transactions with owners</b>						
Share-based payments – value of employee services	-	-	2,782	-	-	2,782
Proceeds from share issues	250	29,131	-	-	-	29,381
<b>Total transactions with owners</b>	250	29,131	2,782	-	-	32,163
<b>Balance at 31 December 2013</b>	1,164	95,793	9,813	369	(58,421)	48,718

The notes on pages 28 to 53 are part of these consolidated financial statements.

## Velocys plc statement of changes in equity as at 31 December 2013

	Called up share capital £'000	Share premium account £'000	Share-based payments reserve £'000	Accumulated losses £'000	Total equity £'000
<b>Balance at 1 January 2012</b>	902	65,270	5,690	(13,433)	58,429
<b>Comprehensive income</b>					
Loss for the year	–	–	–	(8,359)	(8,359)
<b>Total comprehensive expense</b>	–	–	–	(8,359)	(8,359)
<b>Transactions with owners</b>					
Share-based payments – value of employee services	–	–	1,341	–	1,341
Proceeds from share issues	12	1,392	–	–	1,404
<b>Total transactions with owners</b>	12	1,392	1,341	–	2,745
<b>Balance at 1 January 2013</b>	914	66,662	7,031	(21,792)	52,815
<b>Comprehensive income</b>					
Loss for the year	–	–	–	(6,323)	(6,323)
<b>Total comprehensive expense</b>	–	–	–	(6,323)	(6,323)
<b>Transactions with owners</b>					
Share-based payments – value of employee services	–	–	2,782	–	2,782
Proceeds from share issues	250	29,131	–	–	29,381
<b>Total transactions with owners</b>	250	29,131	2,782	–	32,163
<b>Balance at 31 December 2013</b>	1,164	95,793	9,813	(28,115)	78,655

The notes on pages 28 to 53 are part of these consolidated financial statements.

## Consolidated statement of cash flows for the year ended 31 December 2013

	Note	2013 £'000	2012 £'000
<b>Cash flows from operating activities</b>			
Operating loss before taxation		(18,145)	(10,935)
Depreciation and amortisation		878	1,170
Share-based payments		2,782	1,341
Changes in working capital (excluding the effects of exchange differences on consolidation)			
– Trade and other receivables		702	(234)
– Trade and other payables		2,594	441
– Inventory		62	(34)
Taxes (paid) credit received		(39)	387
Other		6	-
<b>Net cash used in operating activities</b>		<b>(11,160)</b>	<b>(7,864)</b>
<b>Cash flows from investing activities</b>			
Purchase of property, plant and equipment	16	(971)	(696)
Purchase of intangible fixed assets	15	(418)	(358)
Interest received		197	225
Interest paid		(38)	(53)
Proceeds from sale of fixed assets		52	-
(Increase) decrease in funds placed on deposit	20	(11,875)	6,459
<b>Net cash (used in) from investing activities</b>		<b>(13,053)</b>	<b>5,577</b>
<b>Cash flows from financing activities</b>			
Proceeds of issuance of ordinary shares		29,381	1,404
Increase (decrease) in borrowing	23	70	(63)
<b>Net cash from financing activities</b>		<b>29,451</b>	<b>1,341</b>
<b>Net increase (decrease) in cash and cash equivalents</b>		<b>5,238</b>	<b>(946)</b>
Cash and cash equivalents at beginning of year	20	9,451	10,579
Exchange losses on cash and cash equivalents		(214)	(182)
<b>Cash and cash equivalents at end of year</b>		<b>14,475</b>	<b>9,451</b>

The notes on pages 28 to 53 are part of these consolidated financial statements.

## Velocys plc statement of cash flows for the year ended 31 December 2013

	<b>2013</b>	2012
	£'000	£'000
<b>Cash flows from operating activities</b>		
Loss before income tax	(7,743)	(8,320)
Movement in intercompany balances	(21,638)	6,824
Cash consumed by operations	(29,381)	(1,496)
Tax credit received	–	92
<b>Net cash used in operating activities</b>	(29,381)	(1,404)
<b>Cash flows from financing activities</b>		
Proceeds of issuance of ordinary shares	29,381	1,404
<b>Net cash from financing activities</b>	29,391	1,404
<b>Net movement in cash and cash equivalents</b>	–	–
Cash and cash equivalents at beginning of year	–	–
<b>Cash and cash equivalents at end of year</b>	–	–

The notes on pages 28 to 53 are part of these consolidated financial statements.

# Notes to the financial statements

## 1 General information

Velocys plc is a company incorporated in England and Wales and domiciled in England. It operates through its subsidiaries Velocys, Inc. and Velocys Technologies Limited; collectively they are referred to in the Notes as the "Company", with Velocys plc as the "parent company". The nature of the Company's operations and its principal activities are set out in the summary on the inside front cover and on the highlights page, the Directors' report on page 10 and in the Chairman's statement and Chief Executive's report on pages 2 to 4.

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

## 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 all the years presented unless otherwise stated.

### Basis of preparation

The consolidated and parent company financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU), IFRIC Interpretations and the Companies Act 2006 applicable to companies reporting under IFRS and Article 4 of the IAS Regulation. The consolidated and parent company financial statements have been prepared under the historical cost convention, as modified for fair value under IFRS 13 "Fair value measurement".

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. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in note 3.

### Going concern

The Directors have at the time of approving the financial statements, a reasonable expectation that the Company and the parent company have adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the financial statements.

### Accounting developments

The following new standards, amendments to standards and interpretations are mandatory for the first time for the financial year beginning 1 January 2013.

- Amendment to IAS 1, "Financial statements presentation", regarding other comprehensive income. The main change resulting from these amendments is a requirement for entities to group items presented in 'other comprehensive income' (OCI) on the basis of whether they are potentially reclassifiable to the profit or loss subsequently.

The following new standards, amendments to standards and interpretations are mandatory for the first time for the financial year beginning 1 January 2013, but are not currently relevant for the Company.

- Amendment to IAS 12, "Income taxes", on deferred tax. This amendment introduces an exception to the existing principle for the measurement of deferred tax assets or liabilities arising on investment property measured at fair value. As a result of the amendments, SIC-21, "Income taxes – recovery of revalued non-depreciable assets", will no longer apply to investment properties carried at fair value. The amendment is not effective until 1 January 2013. The Company does not hold any investment properties measured at fair value.
- Amendment to IFRS 1, "First time adoption", on government loans. This amendment addresses how a first time adopter would account for a government loan with a below-market rate of interest when transitioning to IFRS. This is not applicable to the Company.
- Amendment to IFRS 7, "Financial instruments: Disclosures", on offsetting financial assets and financial liabilities. These new disclosures are intended to facilitate comparison between those entities that prepare IFRS financial statements and those that prepare US GAAP financial statements. The standard is not expected to have any impact on the Company.
- IFRS 11, "Joint arrangements", issued in May 2011. The standard is not applicable to the Company.

- IFRS 12, “Disclosures of interests in other entities” includes the disclosure requirements for all forms of interests in other entities, including joint arrangements, associates, special purpose vehicles and other off balance sheet vehicles. The standard is not applicable to the Company.
- IFRS 13, “Fair value measurement”, aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The standard is not expected to have any impact on the Company.
- IAS 27, “Separate financial statements”. This standard includes the provisions on separate financial statements that are left after the control provisions of IAS 27 have been included in the new IFRS 10. The standard will not impact the Company.
- IAS 28, “Associates and joint ventures”. This standard includes the requirements for joint ventures, as well as associates, to be equity accounted following the issue of IFRS 11. The standard is not applicable to the Company.

The following new standards, amendments to standards and interpretations have been issued but were not effective for the financial year beginning 1 January 2013 and have not been adopted early.

- IFRS 10, “Consolidated financial statements” builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company. The standard is not applicable until 1 January 2014 but is available for early adoption. The Company has assessed that this will not impact the entities which are consolidated.
- IFRS 9, “Financial instruments”, issued in December 2009. This addresses the classification and measurement of financial assets. The standard is not applicable until 1 January 2015 but is available for early adoption. The Company has assessed that this will not impact the accounting for its financial assets.
- Amendment to IAS 32, “Financial instruments: Presentation”, on offsetting financial assets and financial liabilities. This amendment updates the application guidance in IAS 32, “Financial instruments: Presentation”, to clarify some of the requirements for offsetting financial assets and financial liabilities on the balance sheet. This is applicable for accounting periods beginning on or after 1 January 2014. This is not currently relevant to the Company.
- Amendments to IFRS 10, “Consolidated financial statements”, IFRS 12 and IAS 27 for investment entities. These amendments mean that many funds and similar entities will be exempt from consolidating most of their subsidiaries. This is applicable for accounting periods beginning on or after 1 January 2014. This is not currently relevant to the Company.
- Amendment to IFRS 9, “Financial instruments” regarding general hedge accounting. These amendments bring into effect a substantial overhaul of hedge accounting that will allow entities to better reflect their risk management activities. The effective date is to be determined. This is not currently relevant to the Company.
- Amendment to IAS 36 “Impairment of assets”. These amendments address the disclosure of information about the recoverable amount of impaired assets if that amount is based on fair value less costs of disposal. This is applicable for accounting periods beginning on or after 1 January 2014.
- IAS 39 “Financial instruments: Recognition and measurement”, on novation of derivatives and hedge accounting. This is applicable for accounting periods beginning on or after 1 January 2014. This is not currently relevant to the Company.
- Amendment to IAS 19 regarding defined benefit plans. The standard is not applicable to the Company as there is no defined benefit pension scheme. This is applicable for accounting periods beginning on or after 1 July 2014.
- IFRIC 21 “Levies”. This is applicable for accounting periods beginning on or after 1 January 2014. This is not currently relevant to the Company.

#### **Financial risk management policies**

Financial risk management policies are set forth in the Strategic report on pages 8-9.

## Notes to the financial statements (continued)

### Significant accounting policies

#### Consolidation – subsidiaries

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Company. The cost of an acquisition is measured as the fair value of the assets acquired, equity instruments issued and liabilities incurred or assumed at the date of exchange plus, for acquisitions completed prior to 1 January 2010, costs directly attributable to the acquisition. For acquisitions completed on or after 1 January 2010, directly attributable costs are expensed. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the parent company's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement. Acquired subsidiaries are consolidated from the date on which control of the subsidiary is transferred to the Company.

Intercompany transactions, balances and unrealised gains and losses on transactions between Company entities are eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Company.

#### Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, which is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Senior Management Team.

#### Foreign currency translation

##### Functional and presentation currency

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

##### Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the consolidated 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'.

##### Entities within the Company

The results and financial position of all the Company entities (none of which has the currency of a hyper-inflationary economy) that have a functional currency different from the presentation currency 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 (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the rate on the dates of the transactions); and
- 3) All resulting exchange differences are recognised as a movement within equity.

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.



### **Cash and cash equivalents**

Cash and cash equivalents includes cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities on the balance sheet.

Bank accounts held which have an original maturity of more than three months, or which are subject to significant restrictions over access, are not presented as cash and cash equivalents. Such amounts are shown separately as short-term investments or other financial assets with appropriate disclosure of the related terms.

### **Inventory**

Inventories are stated at the lower of cost or net realisable value. 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 research and development funded contracts are expensed to that contract immediately, those held for own development are also expensed when acquired. Items purchased for ongoing commercial sale are held in inventory and expensed when used or sold.

### **Leases**

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

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

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

### **Revenue recognition**

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of trade discounts, value added tax and other sales related taxes and after eliminating sales within the Company.

Revenue from product sales is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer. This will be either on delivery of the goods or service, or over the manufacturing period, where the right to consideration is accrued on a percentage of completion basis.

Revenue from development contracts is measured in accordance with the Company's policy on development contracts. Revenue on most development contracts is earned on a time and materials basis, supplemented by milestones, and is recognised as the work is performed. In the situation where contracts are for fixed services and value, where the outcome of a development contract can be estimated reliably, revenue and costs are recognised by reference to the stage of completion of the contract activity at the balance sheet date. This is normally measured by the proportion that costs incurred for work performed to date bear to the estimated total costs, except where this would not be representative of the stage of completion.

Where the outcome of a development contract cannot be estimated reliably, contract revenue is recognised to the extent of contract costs incurred where it is probable that they will be recoverable. Contract expenses are recognised as costs in the year in which they are incurred. When it is probable that total contract costs will exceed revenue, the total expected loss is recognised as an expense immediately.

Contracts for development work may include either upfront payments or milestone payments, payable on successful attainment of defined milestones. Where upfront non-refundable payments are received on signing of an agreement, such payments are deferred and amortised over the life of the agreement to which it relates. For milestone payments, revenue is only recognised when the milestone has been successfully achieved and no further obligations remain.

## Notes to the financial statements (continued)

Revenue is recognised only when the collection of related receivables is probable. When uncertainty arises about the collectability of an amount that has already been recorded in revenue, any provision required as a result of that uncertainty is recognised as an expense and not a reduction in revenue.

Grants are recognised as income over the periods necessary to match them, on a systematic basis, with the costs which they are intended to compensate. Grant income is not recognised until the conditions for their receipt have been complied with and there is assurance that the grant will be received.

Where a grant is received to fund the acquisition of property, plant and equipment, the income is deferred and recognised over the useful economic life of the related asset.

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

Recognition of revenue with regards to the commercial sale of FT reactors and catalyst is dependent on the terms of the sales agreement.

Where a sales agreement requires the manufacture of a reactor to bespoke specifications, the right to revenue will accrue over the manufacturing period. Revenue will be recognised based on a percentage completion basis assessed against total costs associated with the manufacturing process.

Where a sales agreement requires the supply of a reactor from existing inventory, the right to recognise revenue is only earned on supply of the reactor. Recognition will occur at the point when substantially all risk and reward associated with the reactor has passed to the customer.

### **Intangible assets**

#### Licences

Purchased licences are capitalised at the present value of the minimum licence payments. Amortisation will commence when related revenue starts to be earned and it will be charged in equal annual instalments over the life of the patents to which the licences relate. Provision is made for any impairment.

#### Patents and trademarks

Patents and trademarks are included at cost less accumulated amortisation and amortised in equal annual instalments over a period of 20 years, which is their estimated useful economic life. Provision is made for any impairment. Where patent expenditure is funded by arrangements with development partners, the costs of such patents are not capitalised, but are expensed as cost of sales.

#### Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the parent company's share of the identifiable net assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in 'Intangible assets'. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment reviews are performed more frequently if events or changes in circumstances indicate a potential impairment. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose, identified according to operating segment.

#### Software

Purchased software is measured initially at cost and is amortised on a straight-line basis over its estimated useful life of 3 years. Provision is made for any impairment.

#### In process technology

In process technology consists of purchased intangibles and capitalised development costs and is carried at cost less accumulated amortisation and impairment losses. When the development phase is completed, amortisation of the intangibles will begin.

#### Purchased intangibles

Purchased intangibles arose from the acquisition of Velocys, Inc. These purchased intangibles are valued using discounted cash flow valuations of the projected future benefits arising from the technology acquired. See "Impairment of non-financial assets" below.

#### Capitalised development costs

Development costs are normally charged to the income statement in the year they are incurred except in those circumstances where, during the development phase of a project, the Company is able to identify an intangible asset and demonstrate that the asset will generate probable future economic benefits. In such cases, provided the criteria defined under IAS 38 are met, then the costs are capitalised as in process technology. The costs in respect of funded projects are recognised to the extent that the costs meet the relevant criteria, net of any amounts reimbursed by research partners.

Development costs are amortised, from the point the asset is available for use in the manner intended by management, on a straight-line time basis or other appropriate basis over the period of its expected benefit. See "Impairment of non-financial assets" below.

#### **Impairment of non-financial assets**

Assets that have an indefinite useful life, for example goodwill and investments are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date. Assets that are not yet being amortised are reviewed for impairment on an annual basis.

#### **Property, plant and equipment**

Property, plant and equipment is stated at 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 its working condition for its intended use. Depreciation is provided on all property, plant and equipment at rates calculated to write off the cost or valuation, less estimated residual value, of each asset on a straight-line basis over its expected useful life, as follows: plant and machinery, 3-5 years. No depreciation is provided on assets under construction. Residual value is calculated on prices prevailing at the balance sheet date. Residual values and useful lives are reviewed annually and adjusted, if appropriate, at each balance sheet date.

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

#### **Investments**

Investments are shown at cost less provision for impairment. See "Impairment of non-financial assets" above.

#### **Share-based payments**

Velocys plc issues share options to certain Company employees, which are accounted for as equity settled. Equity settled share-based payments are measured at fair value (excluding the effect of non market-based vesting conditions) at the date of grant. The fair value, determined at the grant date of the equity settled share-based payments, is expensed on a straight-line basis over the vesting period, based on the Company's estimate of shares that will eventually vest and adjusted for the effect of non market-based vesting conditions.

Fair value is measured by use of the Black-Scholes pricing model. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations. When options are exercised the proceeds received, net of attributable transaction costs, are credited to share capital and premium.

The grant by the parent company of options on its equity instruments to employees of subsidiary undertakings is treated as a capital contribution. The fair value of employee services received, measured by reference to the grant date fair value, is recognised over the vesting period as an increase to investments in subsidiary undertakings with a corresponding credit to equity.

## Notes to the financial statements (continued)

At each balance sheet date, the Company revises its estimates of the number of options that are expected to vest. It recognises the impact of the revision to original estimates, if any, in the profit and loss account with a corresponding adjustment to reserves.

### Short term employee benefits

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

### Pension costs

The Company operates various defined contribution pension schemes for its employees. The amount charged to the income statement in respect of pension costs and other post-retirement benefits is the sum of contributions payable in the year. Differences between contributions payable and contributions actually paid are shown as either accruals or prepayments in the balance sheet. The Company has no further payment obligations once the contributions have been paid.

### Taxation

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

Deferred tax is recognised using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, 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 transaction affects neither accounting nor taxable profit or loss. Deferred income tax is 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 income 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 income 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.

### Financial instruments

#### Trade receivables

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivables. 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 the use of an allowance account, and the amount of the loss is recognised in the income statement within 'cost of sales'. When a trade receivable is uncollectible, it is written off against the allowance account for trade receivables. Subsequent recoveries of amounts previously written off are credited against 'cost of sales' in the income statement.

#### Trade payables

Trade payables are stated at fair value and subsequently held at amortised cost.

#### Financial liabilities and equity instruments

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Company after deducting all of its liabilities.

#### Borrowings

Interest bearing loans and overdrafts are initially recorded at fair value, taken as 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.

#### Provisions

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount has been reliably estimated.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

#### Derivative financial instruments

The Company enters into forward contracts and options to fund its US operations. Derivative financial instruments are classified as current assets or current liabilities where they have a maturity period within 12 months. Where derivative financial instruments have a maturity period greater than 12 months, they are classified within either non-current assets or non-current liabilities. Financial assets and liabilities are initially recognised and subsequently measured at fair value. The gain or loss on re-measurement to fair value is recognised immediately in the income statement, in net finance income.

### **3 Critical accounting estimates and judgements**

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

#### **Investments**

The carrying value of investments is considered in the context of market capitalisation and future forecast earnings.

#### **Share-based payments**

The fair value calculation of share-based payments requires several assumptions and estimates. Their details are disclosed in note 13. Such assumptions and estimates could change and could affect the amount recorded.

#### **Valuation of acquired intangible assets**

Estimation of the fair values of acquired intangible assets requires assumptions as to value, future life and future cash flows for impairment tests. There is a high degree of judgement required in making these assumptions which impact both the initial fair value acquired and the carrying value as at the balance sheet date (see note 15).

At 31 December 2013, the carrying value of the Company's intangible assets was £24,971,000 (2012: £25,205,000). This carrying value includes no charge in 2013 (2012: nil).

#### **Revenue recognition and cost of sales**

In order to recognise revenue, the fair value of each component of the Fischer-Tropsch process is identified; which includes the sale of the reactor, an initial licence fee, the lease of catalyst, and ongoing engineering services. This fair value will be based on the sales contract and historical actual data.

Once the fair value of the components has been determined, revenue will then be recognised in line with the underlying nature of the contract. Revenue for the reactor will be recognised over the construction period. Where the fair value of the licence fee can be determined this will be recognised upon commencing the contract, if however no reliable fair value can be determined any revenue associated with the licence fee will be deferred and recognised in line with the reactor sales. Catalyst lease income will be recognised monthly whilst the service element will be recognised when services are provided.

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

## Notes to the financial statements (continued)

### 4 Segmental information

The chief operating decision-maker has been identified as the Senior Management Team ("SMT"). This committee reviews the Company's internal reporting in order to assess performance and allocate resources. Management has determined the operating segments based on these reports.

The SMT considers that the business comprises a single activity which is the design and development of technology for synthetic fuels production. The SMT reviews the Company's profit or loss and its cash flows, assets and liabilities on a company-wide basis. In carrying out these reviews, the SMT considers all material items of income and expenditure that are directly attributable to individual development programmes. The internal management reports do not allocate assets and liabilities or shared overheads to individual products or projects.

Based on the above considerations, there is considered to be one reportable segment, synthetic fuels. The business is segmented on the basis that the key end use market is that of synthetic fuels production. At this stage, the synthetic fuels segment represents over 90% of the business and therefore represents the only material segment.

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

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

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

	2013			2012		
	Europe £'000	Americas £'000	Asia Pacific £'000	Europe £'000	Americas £'000	Asia Pacific £'000
Total revenue	45	1,924	2,784	194	3,329	4,109

Non-current assets, consisting primarily of goodwill, other intangible assets and property, plant and equipment, totalling £26,039,000 (2012: £26,045,000) were located in the United States. All other non-current assets are held in the United Kingdom.

### 5 Revenue from partners

The majority of revenue of the Company is derived from a small number of significant development partners, who are not related parties. The total amounts recognised from partners where revenue comprises 10% or more of Company revenue is as follows.

	2013 £'000	2012 £'000
Partner 1	2,783	4,031
Partner 2	1,835	–
Partners less than 10%	135	3,601
Total	4,753	7,632

### 6 Finance income

	2013 £'000	2012 £'000
Interest income on bank deposits	419	136
Foreign exchange gains	–	16
	419	152

## 7 Finance costs

	2013 £'000	2012 £'000
Unwinding of discount on deferred licence payments payable	20	20
Interest on finance leases	11	5
Interest on borrowings	27	28
Foreign exchange losses	306	–
	364	53

## 8 Other income

	2013 £'000	2012 £'000
Sale of fixed assets	58	–
	58	–

## 9 Expenses by nature

	2013 £'000	2012 £'000
Employee benefit expense (see note 11)	11,217	8,763
Sub-contractor and consultant costs	1,664	2,332
Depreciation of property, plant and equipment: owned (note 16)	703	1,036
Depreciation of property, plant and equipment: leased (note 16)	37	28
Amortisation of intangible assets (note 15)	138	106
Operating lease payments – plant and machinery	7	12
Operating lease payments – other	413	325
Patent and other IP costs	1,213	864
Materials expense	4,077	2,788
Other expenses	3,429	2,313
Total costs of sales, unfunded research and development costs, share-based payments and other administrative expenses	22,898	18,567

## 10 Auditors' remuneration

During the year the Company (including its overseas subsidiaries) obtained the following services from the Company's auditors.

	2013 £'000	2012 £'000
Fees payable to Company's auditors for the audit of parent company and consolidated financial statements	25	23
Fees payable for the audit of Company's subsidiaries pursuant to legislation	59	48
Fees payable to the Company's auditors for other services		
– Tax services	18	24
	102	95

## Notes to the financial statements (continued)

### 11 Employee benefit expense

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

	2013	2012
	Number	Number
Research, design and development	69	60
Administration	22	19
Total average headcount	91	79

Employees' aggregate remuneration comprised the following costs.

	2013	2012
	£'000	£'000
Wages and salaries	7,719	6,804
Social security costs	504	427
Pension costs	207	185
Severance expense	5	6
Share-based payments granted to Directors and employees	2,782	1,341
	11,217	8,763

Details of Directors' remuneration are given in the audited information in the remuneration report on pages 15-16 which forms part of these financial statements.

### 12 Income tax

#### Current tax

Due to the availability of losses incurred in the year, there is no charge to corporation tax. The Company has accrued £1,150,000 in respect of R&D tax credit claims for the years ending 31 December 2012 and 2013 (2012: £437,000 in respect of claims for years ending 31 December 2011 and 2012). A claim for the year ending 31 December 2012 was submitted to HMRC at the end of 2013. A tax charge of £39k was incurred in the US in respect of 2012, and paid in the year.

#### Deferred tax

At 31 December 2013 the Company has a net unrecognised deferred tax asset of £14,860,000 (2012: £13,099,000) arising from trading losses from incorporation. No recognition (2012: nil) of the net deferred tax asset has been made at 31 December 2013 on the grounds of uncertainty over its recoverability in light of the Company's nascent revenue streams and commitment to continued investment in research and development and therefore there is no impact on the current or prior year income statement.

Of this unrecognised deferred tax asset, £9,911,000 (2012: £7,301,000) is anticipated to remain available indefinitely to offset against future taxable trading profits of the companies in which the losses arose. The remainder has expiry dates between 2023 and 2033 (2012: 2023 and 2031).

The standard rate of corporation tax in the United Kingdom changed from 24% to 23% with effect from 1 April 2013. Accordingly, profits in the United Kingdom were taxed at an effective rate of 23.25%. Legislation to reduce the main rate of corporation tax from 23% to 21% from 1 April 2014 was included in the Finance Act 2013, substantively enacted on 17 July 2013, and consequently deferred tax balances have been remeasured. A further reduction of the main rate to 20% is proposed to take effect from 1 April 2015. This further rate reduction had not been substantively enacted at the balance sheet date and, therefore, is not included in these financial statements. The impact of this further change is not expected to be material.

The actual tax charge for the current and previous year is higher (2012: higher) than the theoretical amount that would arise using the weighted average tax rate applicable to the results of the consolidated entities, for the reasons set out in the following reconciliation.



	<b>2013</b>	2012
	£'000	£'000
Loss on ordinary activities before tax	(18,145)	(10,836)
Tax calculated at domestic tax rates applicable to losses in the respective countries	(4,875)	(2,596)
Tax effects of:		
– Expenses not deductible for tax purposes	9	36
– Unutilised tax losses	4,866	2,560
– R&D tax credit relating to prior years	(236)	163
– R&D tax credit	(875)	(600)
Current tax credit for year (see above)	(1,111)	(437)

The weighted average applicable tax rate was 27.0% (2012: 24.0%).

### 13 Share-based payments Equity settled share option scheme

The Company has four share option schemes that cover all employees.

#### EMI scheme

The EMI scheme covers all employees of the Company. Options are exercisable at a price equal to the mid-market value of the parent company's ordinary shares on the day prior to grant and vest after the earlier of three, four or five years from grant or date of joining the Company. Options expire after 10 years and are forfeited if the employee leaves the Company before the options vest.

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

	<b>2013</b>		2012	
	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options
At 1 January	60.90p	3,351,010	62.33p	2,871,595
Granted	145.45p	903,200	63.43p	1,000,887
Forfeited	59.72p	(375,300)	68.08p	(339,654)
Exercised	63.43p	(67,674)	55.00p	(181,818)
At 31 December	80.17p	3,811,236	60.90p	3,351,010

Of the 3,811,236 options outstanding at 31 December 2013, 191,740 were exercisable (2012: 106,545). The weighted average exercise price of the exercisable shares was 95.38p (2012: 126.71p).

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

Year of expiry	Range of exercise price	<b>2013</b>		2012	
		Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
2017	124.00p	16,129	124.00p	16,129	124.00p
2018	159.00p	62,893	159.00p	62,893	159.00p
2019	54.50p	12,523	119.78p	27,523	54.50p
2020	52.77 – 69.00p	100,195	70.66p	152,869	59.92p
2021	47.31 – 59.50p	2,091,296	55.29p	2,431,796	56.36p
2022	43.67 – 156.00p	638,200	66.49p	659,800	67.25p
2022	118.87 – 169.36p	890,000	145.15p	–	–
Total	43.67 – 169.36p	3,811,236	80.17p	3,351,010	60.90p

## Notes to the financial statements (continued)

The weighted average fair value of options granted during the year determined using the Black-Scholes valuation model was 38.21p (2012: 15.15p) per option. The significant inputs into the model were as follows.

	2013	2012
Weighted average share price at grant date	145.45	63.43p
Weighted average exercise price	145.45	63.43p
Expected volatility (i)	30%	30%
Annual risk free rate	3%	3%
Dividend yield	0%	0%
Expected life	4.0 Years	3.0 Years

(i) The expected volatility was determined by reference to comparable companies and review of historic actual volatility based on statistical analysis of daily share prices since the date of Velocys plc's listing on AIM.

Total expense recognised in the income statement for share options granted to Directors and employees was £163,000 in 2013 (2012: £109,000).

### Executive long-term incentive plan (ELTIP)

The ELTIP scheme covers executives of the Company. Options 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 after a period of one, two or three years from grant, expire after 10 years and are forfeited if the employee leaves the Company before the options vest.

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

	2013		2012	
	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options
At 1 January	31.71p	1,595,000	24.89p	2,050,000
Granted	–	–	–	–
Forfeited	–	–	0.01p	(455,000)
At 31 December	31.71p	1,595,000	31.71p	1,595,000

Of the 1,595,000 options outstanding at 31 December 2013, 1,595,000 were exercisable (2012: 1,178,334). The weighted average exercise price of the exercisable shares was 31.71p (2012: 28.71p).

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

Year of expiry	Range of exercise price	2013		2012	
		Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
2018	1.00p	100,000	1.00p	100,000	1.00p
2019	1.00p	245,000	1.00p	245,000	1.00p
2021	1.00 – 58.00p	1,250,000	40.19p	1,250,000	40.19p
Total	1.00 – 58.00p	1,595,000	31.71p	1,595,000	31.71p

No share options were issued in 2013 (2012: nil). Total expense recognised in the income statement for share options granted to Directors and employees was £27,000 in 2013 (2012: £252,000).

The Company has set up a trust whereby the exercise value of the options may be paid to executives when options are exercised. The exercise value of the options is accrued in the share based payment charge.

#### New executive long-term incentive plan (NELTIP)

Under the NELTIP scheme 3,052,222 share options were granted to executives of the Company in April 2013 after certain performance conditions relating to the year ended 31 December 2012 were satisfied. The fair value of the share options was recognised from the commencement of the performance related period to the date of vesting. Options will be granted in April 2014 in respect of the year ended 31 December 2013 subject to performance conditions being met.

Options are exercisable at a price either equal to the mid-market value of the parent company's ordinary shares on the day prior to the grant or to the nominal value of the shares. Options vest immediately or after a period of one, two or three years from grant, they expire after 10 years and are forfeited if the employee leaves the Company before the options vest.

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

	2013		2012	
	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options
At 1 January	49.00p	2,587,103	49.00p	2,587,103
Granted	159.00p	3,052,222	–	–
Forfeited	–	–	–	–
Exercised	49.00p	(36,000)	–	–
At 31 December	108.92p	5,603,325	49.00p	2,587,103

Of the 5,603,325 options outstanding at 31 December 2013, 906,215 were exercisable (2012: 369,367). The weighted average exercise price of the exercisable shares was 73.70p (2012: 49.00p). Options for 2011 were granted in 2011 whereas options for 2012 were granted in April 2013.

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

Year of expiry	Range of exercise price	2013		2012	
		Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
2022	49.00p	2,551,103	49.00p	2,587,103	49.00p
2023	159.00p	3,052,222	159.00p	–	–
Total	49.00 – 159.00p	5,603,325	108.92p	2,587,103	49.00p

No options had been granted under this scheme in respect of the financial year ending 31 December 2013, however based on performance at this date it is anticipated that an award of up to 2,459,000 options will be made in April 2014 under this scheme. The weighted average fair value of the options to be granted in respect of year ended 31 December 2013 using the Black-Scholes valuation model is 100.91p (2012: 87.47p) per option. The significant inputs into the model were as follows.

	2013*	2012
Weighted average share price at grant date	159.00p	145.00p
Weighted average exercise price	64.20p	64.17p
Expected volatility (i)	30%	30%
Annual risk free rate	3%	3%
Dividend yield	0%	0%
Expected life	3.6 Years	3.0 Years

(i) The expected volatility was determined by reference to comparable companies and review of historic actual volatility based on statistical analysis of daily share prices since the date of Velocys plc's listing on AIM.

\* These are in relation to share options that are to be granted in 2014 and are based on estimates. Next year's accounts will be adjusted to reflect the actual charge.

## Notes to the financial statements (continued)

Total expense recognised in the income statement for share options granted to Directors and employees was £1,452,000 in 2013 (2012: 260,000). In addition, an expense of £849,000 relating to shares yet to be granted for the year ended 31 December 2013 has been accrued within the share-based payments charge (2012: £597,000).

The Company has set up a trust whereby the exercise value of the options may be paid to executives when options are exercised. The exercise value of the options is accrued in the share based payment charge.

### Velocys scheme

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

After 1 year of service from vest start date: 25% of grant  
Each month subsequent to 1 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, then Oxford Catalysts Group PLC, option (the ratio of the value of one share of Velocys, Inc. stock to one share of Velocys plc, formerly Oxford Catalysts 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 10 years from date of grant.

Details of the share options outstanding under the Pre-acquisition scheme are as follows.

	2013		2012	
	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options
At 1 January	\$0.94	344,291	\$0.97	565,382
Forfeited	\$1.10	(61,976)	\$1.11	(128,698)
Exercised	\$0.77	(79,900)	\$0.77	(92,393)
At 31 December	\$0.95	202,415	\$0.94	344,291

Of the options outstanding presented above, 70,536 (2012: 171,872) were exercisable as of 31 December 2013. The weighted average share price of the exercisable shares was \$0.99 (2012: \$0.94).

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

Year of expiry	Range of exercise price per share	2013		2012	
		Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
2013	\$0.77	–	–	70,161	\$0.77
2014	\$0.77	951	\$0.77	951	\$0.77
2015	\$0.77	60,367	\$0.77	81,702	\$0.77
2016	\$2.21 – \$2.22	–	–	9,840	\$2.21
2017	\$2.21 – \$2.54	9,218	\$2.45	9,218	\$2.45
2021	\$0.93	131,879	\$0.93	172,419	\$0.93
Total	\$0.77 – \$2.54	202,415	\$0.95	344,291	\$0.94

Total expense recognised in the income statement for share options granted under the Velocys, Inc. plan was £4,000 (2012: £4,000).

### 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 will be made under these schemes during, or in respect of, 2013.

The Velocys Technologies Limited bonus share scheme awarded nominal value share options (1p) that were issued after year end. The awards vested on the date of grant and expire 10 years thereafter. As there are no awards under this scheme for 2013, the share-based payment expense for the year includes no cost in 2013 (2012: nil) for the Velocys Technologies Limited bonus share options. Details of the bonus shares outstanding under the Velocys Technologies Limited bonus share scheme are as follows.

	2013		2012	
	Exercise price	Number of options	Exercise price	Number of options
At 1 January	1p	421,760	1p	384,105
Adjustment	–	–	1p	37,655
At 31 December	1p	421,760	1p	421,760

The adjustment was in respect of shares granted on 21 March 2011.

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

Year of Expiry	Exercise price	2013	2012
		Number of options	Number of options
2019	1p	42,105	42,105
2020	1p	342,000	342,000
2021	1p	37,655	37,655
Total	1p	421,760	421,760

The Velocys, Inc. bonus share scheme consists of deferred shares awarded subsequent to year end at a nominal price of 1p. 20% of the award is granted on each anniversary of the date of award. Shares remaining to be granted in future years totalled 16,418. Bonus share awards in 2013 were nil.

The share-based payment expense for the year includes no cost in 2013 (2012: £ nil) relating to shares granted under the Velocys, Inc. bonus share scheme.

### Other share options

Since 2011 the Board has approved the granting of share options to a small number of consultants who provide a strategic service to the business.

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

	2013		2012	
	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options
At 1 January	23.37p	527,054	81.28p	146,850
Granted	21.44p	75,210	1.00p	380,204
Forfeited	1.00p	(70,000)	–	–
Exercised	1.00p	(300,000)	–	–
At 31 December	58.38p	232,264	23.37p	527,054

Of the 232,264 options outstanding at 31 December 2013, 189,944 were exercisable (2012: 16,704). The weighted average exercise price of the exercisable shares was 72.65p (2012: 1.00p). A further 21,375 options will be granted

## Notes to the financial statements (continued)

to consultants at the start of 2014 in respect of the year ended 31 December 2013. The weighted average exercise price of these options is 145.25p.

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

Year of expiry	Range of exercise price	2013		2012	
		Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
2021	1.00 – 85.00p	146,850	81.28p	146,850	81.28p
2022	1.00p	10,204	39.71p	380,204	1.00p
2023	1.00 – 53.10p	75,210	1.00p	–	–
Total	1.00 – 85.00p	232,264	58.38p	527,054	23.37p

The weighted average fair value of options granted during the year determined using the Black-Scholes valuation model was 126.43p (2012: 71.38p) per option. The weighted average fair value of options to be granted in 2014 in respect of 2013 was estimated to be 176.00p per option. The significant inputs into the model were as follows.

	2013	2012
Weighted average share price at grant date	147.85p	78.40p
Weighted average exercise price	21.44p	4.75p
Expected volatility (i)	30%	30%
Annual risk free rate	3%	3%
Dividend yield	0%	0%
Expected life	0.8 Years	3.0 Years

(i) The expected volatility was determined by reference to comparable companies and review of historic actual volatility based on statistical analysis of daily share prices since the date of Velocys plc's listing on AIM.

The share-based payment expense for the year includes a cost of £249,000 (2012: £101,000) related to options granted to consultants. An expense of £38,000 relating to the year ended 31 December 2013 has been accrued within the share-based payment charge.

### Share-based payments charge

The total charge for share-based payments during the year was £2,782,000 (2012: £1,341,000) of which £1,786,000 (2012: £842,000) relates to options granted to Directors and the remainder to other employees.

### 14 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.

	2013	2012
Loss attributable to owners of Velocys plc (£'000s)	(16,921)	(10,399)
Weighted average number of ordinary shares in issue	115,929,849	90,659,989
Basic and diluted loss per share (pence)	(14.60)	(11.47)

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. There are no other potentially dilutive instruments. Details of share options are given in note 13.

## 15 Intangible assets

Company	Goodwill	In-process	Patents, licence and	Software	Total
2013	£'000	technology £'000	trademarks £'000	£'000	£'000
<b>Cost</b>					
At 1 January 2013	4,147	19,844	1,454	128	25,573
Additions	–	–	328	90	418
Foreign exchange movement	(85)	(404)	(30)	(7)	(526)
At 31 December 2013	4,062	19,440	1,752	211	25,465
<b>Accumulated amortisation</b>					
At 1 January 2013	–	–	277	91	368
Charge for the year	–	–	114	24	138
Foreign exchange movement	–	–	(9)	(3)	(12)
At 31 December 2013	–	–	382	112	494
<b>Net book amount</b>					
At 31 December 2013	4,062	19,440	1,370	99	24,971
2012	Goodwill £'000	In-process technology £'000	Patents, licence and trademarks £'000	Software £'000	Total £'000
<b>Cost</b>					
At 1 January 2012	4,334	20,738	1,152	112	26,336
Additions	–	–	337	21	358
Foreign exchange movement	(187)	(894)	(35)	(5)	(1,121)
At 31 December 2012	4,147	19,844	1,454	128	25,573
<b>Accumulated amortisation</b>					
At 1 January 2012	–	–	188	82	270
Charge for the year	–	–	93	13	106
Foreign exchange movement	–	–	(4)	(4)	(8)
At 31 December 2012	–	–	277	91	368
<b>Net book amount</b>					
At 31 December 2012	4,147	19,844	1,177	37	25,205

In-process technology is yet to be brought into use and hence is not being amortised.

Intangible assets in use are amortised over their expected useful lives and are reviewed when there is an indication that impairment may have occurred.

Goodwill and in-process technology intangible assets that are not yet ready for use are subject to an annual impairment review. The impairment review for in-process technology is performed for each Cash Generating Unit (CGU) identified in accordance with the Company's accounting policy. It has been determined that there are six CGUs, each representing a separate technology stream for which distinct revenue streams are either being currently generated or are anticipated in the future.

Goodwill originates entirely from the acquisition of the Velocys Inc. subsidiary in 2008. It is not possible to allocate goodwill to each individual CGU as goodwill is considered to relate to the synthetic fuel group of CGUs as a whole. This group represents an operating segment as described in further detail within the segmental disclosures in note 4. Five of the six in-process technology CGUs are included within this segment which represents over 95% of the total value of intangible assets.

An impairment test is a comparison of the carrying value of the assets of the CGU (or group of CGUs for goodwill) with their recoverable amount. Where the recoverable amount is less than the carrying value, an impairment results. The Company has carried out its annual impairment testing at 31 December each year. The recoverable amounts of the CGUs are determined based on the value in use (VIU) calculations for all but one of the technology streams, which due to the stage of its development has been measured at the estimated fair value less cost to sell. The VIU calculation is based upon the estimated discounted future cash flows to be generated by the respective technology stream.

## Notes to the financial statements (continued)

### Key assumptions

The key assumptions in the VIU calculations are the discount rate applied and sales and gross margin forecasts for the period of the expected useful life of the technology.

### Sales and gross margin forecasts

Future sales forecasts are based upon the commercialisation of the Company's technology in what is an emerging and nascent market. Forecast sales and gross margin levels are therefore dependent upon speed of uptake of the Company's technology, the size of the markets and the penetration achieved in those markets.

In all cases the approved budget for the following financial year forms the initial basis for the forecasts. Growth rate assumptions have then been applied to revenue for periods of between 6 and 7 years for each CGU. Revenue growth beyond this period has not been assumed in the VIU calculations as it is difficult at this stage to assess a long term growth rate. An expected useful life for each technology stream has been estimated at 15 years in each case.

### Discount rate

The discount rate applied to each CGU represents a post-tax rate that reflects market assessment of the time value of money at the balance sheet date and the risks specific to each CGU. The pre-tax discount rates applied to each CGU are between 25% and 30% (2012: 25% and 30%).

### Summary of results

During the year, goodwill and in-process technology intangible assets were tested for impairment with no impairment charge resulting (2012: nil).

The forecasts used in the impairment review as at 31 December 2013 indicate significant headroom when comparing recoverable amount against carrying value. However, given the early stage of adoption there remains a significant level of judgment involved in making the assumptions for revenues and margins.

Amortisation of intangible assets is charged to other administrative expenses in the consolidated income statement. Under no reasonable scenario is an impairment expected to arise.

### Parent company

The parent company has no intangible assets (2012: nil).



## 16 Property, plant and equipment

<b>Company 2013</b>	Assets under construction £'000	Plant and machinery £'000	Total £'000
<b>Cost</b>			
At 1 January 2013	200	6,264	6,464
Additions	418	553	971
Disposals	–	(185)	(185)
Transfers to plant and machinery	(456)	456	–
Foreign exchange	(2)	(135)	(137)
At 31 December 2013	160	6,953	7,113
<b>Accumulated depreciation</b>			
At 1 January 2013	–	4,568	4,568
Charge for the year	–	740	740
Disposals	–	(185)	(185)
Foreign exchange	–	(94)	(94)
At 31 December 2013	–	5,029	5,029
<b>Net book amount</b>			
At 31 December 2013	160	1,924	2,084
<hr/>			
2012	Assets under construction £'000	Plant and machinery £'000	Total £'000
<b>Cost or valuation</b>			
At 1 January 2012	9	6,171	6,180
Additions	260	436	696
Disposals	–	(189)	(189)
Transfers to plant and machinery	(64)	64	–
Foreign exchange	(5)	(218)	(223)
At 31 December 2012	200	6,264	6,464
<b>Accumulated depreciation</b>			
At 1 January 2012	–	3,850	3,850
Charge for the year	–	1,064	1,064
Disposals	–	(186)	(186)
Foreign exchange	–	(160)	(160)
At 31 December 2012	–	4,568	4,568
<b>Net book amount</b>			
At 31 December 2012	200	1,696	1,896

The net book amount of leased assets included above is £162,000 (2012: £40,000). Depreciation is charged to other administrative expenses in the consolidated income statement.

### Parent company

The parent company has no property, plant or equipment (2012: nil).

As at 31 December 2013, the Company had entered into contractual commitments for the acquisition of property, plant and equipment amounting to £24,000 (2012: £38,000).

## Notes to the financial statements (continued)

### 17 Investments

	2013			2012		
	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
<b>Velocys plc</b>						
<b>Investment in subsidiaries</b>						
At 1 January	26,040	26,625	52,665	32,995	25,284	58,279
Movement in loans	23,858	–	23,858	(6,667)	–	(6,667)
Capital contributions	–	2,782	2,782	–	1,341	1,341
Foreign exchange	(1,950)	–	(1,950)	(288)	–	(288)
At 31 December	47,948	29,407	77,355	26,040	26,625	52,665

The Directors believe the carrying value of the investments is supported by their expected future cash flows. Investments include long term loans to both Velocys, Inc. and Velocys Technologies Limited. Investments are stated at cost.

The parent company has investments in the following subsidiary undertakings.

<b>Subsidiary undertakings</b>	Country of incorporation or principal business address	Principal activity	% Holding (all ordinary share capital)
Velocys Technologies Limited	England and Wales	Design and development of catalysts, and exploitation of platform catalyst technologies	100
Velocys, Inc.	Delaware, USA	Design, development and exploitation of its microchannel technologies	100

The parent company has investments in the following dormant subsidiaries.

<b>Dormant subsidiary</b>	Incorporated	Principal activity	% Holding
Oxford Catalysts UK Limited	England and Wales (07671880)	Dormant company	100%
Oxford Catalysts Trustees Limited	England and Wales (07788054)	Dormant company	100%

### 18 Trade and other receivables

	Company	
	2013 £'000	2012 £'000
<b>Current</b>		
Trade receivables	102	772
Prepayments and accrued income	797	401
Other receivables	213	419
	1,112	1,592

The parent company had no trade and other receivables (2012: nil).

The fair value of trade and other receivables is not materially different to the book value above (2012: not materially different). The majority of the trade receivables are due from large multinational groups and hold a low credit risk. The maximum exposure to credit risk at the reporting date is the carrying value of each class of receivable plus cash balances held. The Company does not hold any collateral as security (2012: nil).

As at 31 December 2013 Company trade receivables of £71,000 (2012: £58,000) were past due but not impaired. These related to a number of partners for whom there is no history of default. The ageing analysis of these trade receivables past the due date is as follows.

	Company	
	2013 £'000	2012 £'000
Up to 3 months	71	58
	71	58

The parent company had no trade and other receivables past due but not impaired (2012: nil).

Trade receivables outstanding at year end represent approximately 8 days' sales (2012: 37 days).

The Company believes that the full amount of trade receivables recognised is recoverable after allowance has been made for doubtful debts. At 31 December 2013, the parent company had no overdue trade receivables (2012: nil). The other classes within trade and other receivables do not contain impaired assets (2012: nil).

The allowance for doubtful debt relates to two smaller companies who no longer appear to be in a position to pay. Details of the allowance for doubtful debt are as follows:

	2013 £'000	2012 £'000
Allowance for doubtful debt included in trade receivables		
Provision		
At 1 January	90	90
At 31 December	90	90

Trade and other receivables are denominated in the following currencies:

	2013 £'000	2012 £'000
UK sterling	662	307
US dollars	450	1,285
	1,112	1,592

## 19 Inventory

	Company	
	2013 £'000	2012 £'000
Raw materials and consumables	–	37
Finished goods	263	293
Total	263	330

The parent company has no inventory.

## Notes to the financial statements (continued)

### 20 Short term investments, cash and cash equivalents

	Company	
	<b>2013</b>	2012
	£'000	£'000
Short term investments – funds held on deposit	11,875	–
Cash and cash equivalents	14,475	9,451
<b>Total</b>	<b>26,350</b>	<b>9,451</b>

Under IFRS 7, cash held on term deposits of greater than 3 months has been classified as a short term investment.

All short term investments are in UK sterling denominated accounts. Cash and cash equivalents are held in both US dollars and UK sterling denominated accounts as follows:

UK sterling denominated:

	Company	
	<b>2013</b>	2012
	£'000	£'000
Short term investments – funds held on deposit	11,875	–
Cash and cash equivalents	8,813	6,596
	<b>20,688</b>	<b>6,596</b>

US dollar denominated:

	Company	
	<b>2013</b>	2012
	£'000	£'000
Cash and cash equivalents	5,662	2,855
	<b>5,662</b>	<b>2,855</b>

The parent company has no cash or cash equivalents (2012: nil).

### 21 Trade and other payables: current

	Company	
	<b>2013</b>	2012
	£'000	£'000
Trade payables	1,526	959
Other taxation and social security	65	60
Accruals	3,863	2,339
Deferred income	830	569
	<b>6,284</b>	<b>3,927</b>

The parent company has no current trade and other payables (2012: nil).

The fair values of trade and other payables are not considered to be materially different to their carrying values based on discounted cash flows.

### 22 Trade and other payables: non-current

	Company	
	<b>2013</b>	2012
	£'000	£'000
Accruals	96	5
Deferred licence payments	136	142
	<b>232</b>	<b>147</b>

The parent company has no non-current trade and other payables (2012: nil).

The deferred licence payments payable represents the discounted value of the minimum licence payments due under the terms of a licence agreement between Velocys and Isis Innovation Ltd (Isis), the technology transfer office of the University of Oxford. Under this agreement, Isis granted Velocys the worldwide rights for the duration of the patents to certain intellectual property and is entitled to a royalty of 4% of direct sales and 11% of any indirect sales incorporating the licensed intellectual property. In addition, there are certain minimum payments; the first of these payments of £5,000 became payable in 2009. Thereafter, the minimum payment rose by £5,000 per annum for the next 3 years then remains at £20,000 (plus an inflation escalator) per annum for the remainder of the contract. The discounted value of these payments is included in intangible assets.

The fair values of trade and other payables are not considered to be materially different to their carrying values based on discounted cash flows.

### 23 Borrowings

The parent company had no borrowings in 2013 (2012: nil). Maturity of borrowings for the Company is as follows.

	Group	
	2013	2012
	£'000	£'000
Within 1 year	104	74
Within 2 to 5 years	969	730
Greater than 5 years	223	451
	1,296	1,255

On 1 December 2009, Velocys plc's wholly owned subsidiary, Velocys, Inc. (Velocys) entered into a loan agreement with the State of Ohio (the State) allowing Velocys to borrow up to \$2.25 million to fund qualified capital projects. Under this loan agreement a qualified capital project is one that is for research and development purposes, is completed by 30 June 2010 (subsequently extended to 31 August 2012) and the costs of which are at least 25% funded by Velocys. The interest rate for the loan is 2.00% per annum with a service fee of 0.25% of the principal balance. The loan is repaid to the State using a blended payment schedule as follows:

- For the first five years of the loan, the principal is paid in consecutive monthly instalments based upon an original amortisation over 20 years with any interest accrued during that particular month;
- For the remaining term of the loan, the principal is paid in consecutive monthly instalments based upon the remaining term of the loan (5 years) with any interest accrued during that particular month.

The loan is secured by all plant and machinery acquired using the loan proceeds as well as a guarantee of payment provided by the Company. The gross book value of the property secured is £1,994,000 (2012: £2,035,000). The loan was fully drawn down in 2012. After repayments of principal, the amount outstanding on the loan as at 31 December 2013 is £1,134,000 (2012: £1,218,000).

All remaining borrowings arise from finance lease obligations. The fair values of borrowings are not considered to be materially different to their carrying values based on discounted cash flows.

### 24 Derivative financial instruments

The Company sells UK sterling and buys US dollars to fund its operations in the United States, for which purpose it makes use of forward contracts and options. At 31 December 2013 the notional principal amounts of the outstanding forward foreign exchange contracts were £4,000,000 (2012: nil), and the notional principal amount of the outstanding forward foreign exchange option was £1,000,000 (2012: nil). All the outstanding contracts will mature during 2014. Gains and losses against the US dollar exchange rate as at 31 December 2013 are recognised in finance costs in the consolidated income statement and in current liabilities in the consolidated statement of financial position.

## Notes to the financial statements (continued)

### 25 Called up share capital

Company and parent company	Number of shares (thousands)	Ordinary shares £'000	Share Premium £'000
At 1 January 2012	90,210	902	65,270
Employee share options scheme: shares issued	288	3	141
Equity investment by Ventech	934	9	1,251
At 31 December 2012	91,432	914	66,662
Employee share options scheme: shares issued	500	5	99
Fund raising January 2013	24,479	245	29,032
At 31 December 2013	116,411	1,164	95,793

Velocys plc does not have an authorised share capital as this requirement was abolished under the Companies Act 2006 from 1 October 2010 and updates to the articles of association to bring these in line with the Companies Act 2006 were approved at the Company's annual general meeting in June 2011.

A total of 11,702,661 (2012: 8,826,218) options to subscribe for ordinary shares of Velocys plc have been granted and are outstanding at 31 December 2013 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 13.

In December 2012, the Company announced the placing of 24,479,300 shares at £1.25 per share to raise £30 million (before expenses). This placing was approved at a general meeting of its shareholders on 3 January 2013 and the shares were admitted to trading on AIM on 4 January 2013.

### 26 Commitments

Capital commitments are disclosed in note 16.

#### Operating lease commitments

The Company leases various offices under non-cancellable operating lease agreements. The lease terms are between 2 and 5 years and the majority of lease agreements are renewable at the end of the lease period at market rate.

	2013 £'000	2012 £'000
Future aggregate minimum lease payments under non-cancellable property leases:		
– Within one year	377	267
– Between one and five years	1,478	1,428
– After more than five years	842	1,017
	2,697	2,712
	2013 £'000	2012 £'000
Future commitments under non-cancellable operating plant and equipment leases:		
– Within one year	1	1
– Between one and five years	4	1
	5	2

#### **Licence from Battelle**

As part of the diligence requirements set forth in one of the licence agreements between Velocys, Inc., the subsidiary acquired from The Battelle Memorial Institute ("Battelle") in 2008, and Battelle, Velocys is required to pay annual licence payments of \$150,000 to Battelle for each of four separate fields of use commencing in the year ending 30 September 2013. The future of the licence arrangement is the subject of current discussions with Battelle, although licence payments will be required until expiration of the licence or until the Company decides to allow the field of use to become non-exclusive. Battelle can, at its own discretion defer the licence requirements. Since the licence payments remain at the discretion of the Company, they are not capitalised.

#### **27 Pension arrangements**

The Company operates a number of defined contribution schemes for which the pension cost charge for the year amounted to £207,000 (2012: £185,000).

#### **28 Related party transactions**

There were no material related party transactions.

#### **29 Contingent liabilities**

In April 2010, Velocys Inc., a subsidiary of Velocys plc, filed a lawsuit in the US against Catacel Corp. ("Catacel"), a supplier of catalysts to CompactGTL plc ("CompactGTL"), claiming infringement of several of the Company's United States patents. In October 2011, the judge in this case, found in favour of a sanctions motion against the other side. A ruling on damages to be awarded to Velocys in relation to this is still pending at the date of these financial statements.

In response to this case, CompactGTL challenged the validity of eight patents in the US, one of which is included in the infringement claim. As at the date of these financial statements, seven of these patents have already successfully passed re-examination (including the one which is included in the infringement claim) and one is still pending. In addition, CompactGTL filed a case in the UK courts challenging the validity of seven UK patents but did not progress this case further.

In March 2013, Velocys Inc. filed a case against CompactGTL in the UK courts alleging infringement of two of the patents, which are among the seven UK patents previously challenged by CompactGTL. These patents are the UK equivalent of three of the US patents referred to above that successfully passed re-examination in the US. It has been agreed with the courts that the validity claims by CompactGTL for these two patents will be incorporated into this case.

Whilst the outcome of these cases is not certain, the Directors are confident of the Company's infringement cases against Catacel and CompactGTL, as well as the validity of those of its patents that are being challenged, particularly in light of the successful re-examination record to date. Furthermore, the Directors consider that even in the unlikely event of a successful challenge to the few remaining patents in question, this would have no material detrimental impact on the Company's business or the overall strength of its patent portfolio.

Costs incurred to date relating to these cases have been expensed. However, given the nature of UK patent challenges, should its case be unsuccessful, the Company may be liable for some of CompactGTL's UK legal costs (and vice versa). On this basis, no provision has been recognised in respect of this action.

## Directors, secretary and advisors to the Company

<b>Velocys plc registration no.</b>	5712187
<b>Registered office</b>	115e Olympic Avenue Milton Park Abingdon Oxfordshire OX14 4SA
<b>Directors</b>	Dr Pierre Jungels (Non-executive Chairman) Roy Lipski (Chief Executive) Susan Robertson (Chief Financial Officer) Dr Paul F. Schubert (Chief Operating Officer) Dr Andrew Jamieson (Non-executive Director) Dr Jan Verloop (Non-executive Director) Sandy Shaw (Non-executive Director) Julian West (Non-executive Director)
<b>Company secretary</b>	Susan Robertson
<b>Brokers &amp; nominated advisors</b>	Numis Securities Limited The London Stock Exchange Building 10 Paternoster Square St Pauls London EC4M 7LT
<b>Registrars</b>	Capita Registrars Limited The Registry 34 Beckenham Road Beckenham Kent BR3 4TU
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<b>Public relations</b>	Lionsgate Communications Limited First Floor, 29-30 St James's St London WC2A 1PB
<b>Chartered accountants and statutory auditors</b>	PricewaterhouseCoopers LLP One Reading Central 23 Forbury Road Reading RG1 3JH



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