VELOCYS

News release

Velocys plc

(“Velocys” or “the Company”)

15 May 2017

Final results for the year ended 31 December 2016

Velocys plc (VLS.L), the company at the forefront of smaller scale gas-to-liquids (GTL), is pleased to announce its final audited results for the year ended 31 December 2016.

Highlights

- Increased involvement at ENVIA Energy’s Oklahoma City plant:
  - Greater equity stake and management control in the project for Velocys.
  - Key leadership role for Velocys in the commissioning, start-up and operation of the plant.
- Key milestones reached at ENVIA Energy’s Oklahoma City plant:
  - Plant construction complete.
  - Production of first Fischer-Tropsch product (post period end).
- Review of Company strategy completed and communicated.
- First strategic alliances formed (post period end) with Morimatsu and TRI.
- Fundraise (post period end) of over £10m (before expenses) to progress the implementation of the new strategy.
- Appointment of David Pummell as CEO.
- Projects being developed by third parties continue to reach milestones:
  - Preliminary engineering studies completed, including a GTL project in Central Asia.
  - Air permit granted on a third party project in the US.
- Revenue of £1.4m (FY 2015: £2.0m).
- Cash* at year end of £18.7m (FY 2015: £37.7m).
- H2 2016 cash outflow of £5.4m versus H1 (£13.6m).

* Defined as cash, cash equivalents and short term investments (see note 8)

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

- Ends –

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

Notes to editors

About Velocys

Velocys is the company at the forefront of smaller scale gas-to-liquids (GTL), providing the bridge connecting stranded and low value feedstocks such as natural gas, landfill gas or biomass with markets for premium products such as renewable diesel, jet fuel and waxes.

With its partners, Velocys aims to deliver the most economically compelling conversion solution; a fully integrated offer that can be deployed at scale into the growing, attractive markets on which it focuses. Velocys technology, protected by several hundred patents in over 30 countries, is specifically designed for smaller scales, combining super-active catalysts with intensified reactor systems. Standardised modular plants can be deployed readily in a wide range of locations, and Velocys’ capabilities and extensive experience deliver a proven route to operation.

Velocys plc is admitted to trading on the AIM market of the London Stock Exchange (LSE: VLS). The Company has a strong, multi-disciplinary staff operating from its commercial centre in Houston, Texas, USA and technical facilities near Oxford, UK and Columbus, Ohio, USA. First product has been produced at its commercial reference plant, which is located adjacent to Waste Management’s East Oak landfill site in Oklahoma City.

www.velocys.com

Chairman's statement

Pierre Jungels, CBE

Introduction

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

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

Management and Board

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

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

Jan Verloop retired as a Non-Executive Director in September 2016. The GTL expertise that Jan brought to the Board was pivotal in guiding the Company's technology development from an innovative idea to a fully validated system. I thank him warmly for his 10 years of valued service.

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

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

Strategy and markets

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

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

Velocys' fundraise in May 2017 of over £10m (subject to the passing of certain resolutions at a general meeting to be held shortly) together with the cash brought forward (£18.7m at 2016 year end) and the measures taken to preserve cash will provide the Company with a financial platform for the important initial implementation phase of its strategy. The Board recognises that further funding will be needed in due course. Note 1 discusses uncertainties surrounding the extent and composition of future funding.

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

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

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

Outlook

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

Chief Executive's report

David Pummell

Introduction

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

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

Commercial strategy

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

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

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

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

Focus markets

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

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

Velocys' medium-term goals are to:

- Build a leading market supply position in the above markets.

- Leverage the stranded GTL offer developed in North America to access Asian opportunities using stranded gas as feedstock.
- Develop an integrated GTL solution to reduce the flaring of associated gas offshore.

We are developing alliances with companies that have the resources, scale and capabilities to support Velocys in accessing these markets and driving growth.

Strategy milestones reached

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

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

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

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

ENVIA Energy

The plant in Oklahoma City is the first commercial smaller scale GTL plant in the world. A historic moment for Velocys' technology came in early February 2017, with the start-up of the Fischer-Tropsch (FT) process units and the first FT product was successfully produced; a truly momentous milestone for the Company and a landmark event for the industry and for ENVIA.

The performance data (for example, for syngas purity, methane selectivity, liquid production, carbon monoxide conversion and activity index) that are available from the ENVIA plant meet the performance expectations set using models based on laboratory and pilot studies. Targets for the conversion of syngas to FT products and the yield of liquid products were achieved within 12 hours of the first start-up of the FT modules (the equivalent of one shift of plant operators).

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

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

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

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

There is a highly competent and experienced team on site that gets on with whatever needs to be done, solving the challenges that typically arise during the commissioning of a plant in the most professional way. My thanks go to the entire team, whose continued efforts have been instrumental in achieving this milestone.

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

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

Other projects

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

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

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

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

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

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

Pilot plant and technology

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

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

Outlook

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

Financial review

Revenues

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

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

Expenses and income

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

Other income of £0.3m before exceptional items (£2.8m after exceptional items – see below), was from a legal settlement (2015: £2.0m/£3.8m before/after exceptional items) (see note 5).

The exceptional items in 2016 included costs incurred during the pursuit of an opportunity to acquire certain gas-to-liquids (GTL) assets of a US-based company in administration, the release of deferred revenue on the cancellation of the Ventech contract, and negative goodwill arising from the allotment of additional equity in ENVIA in respect of the commitment to provide loan funding. The exceptional items in 2015 included the full impairment of the discounted value of expected future income upon obtaining a final investment decision for the Ashtabula project and release of deferred consideration. See note 2.

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

Cash outflow in 2016 (excluding share issues) was £19.0m (2015: £22.0m). Cash outflow was £13.6m and £5.4m in H1 and H2 respectively. This imbalance was a result of the measures taken to preserve cash as well as the exceptional net expense of £2.4m it incurred in H1 in its pursuit of acquiring certain US GTL assets in administration (see note 2). This reduced underlying cost base has been carried forward into 2017 and the Company intends to continue taking measures to minimise its underlying cost base whilst continuing to spend prudently on strategy implementation.

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

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

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

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

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

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

Future funding
The financial statements have been prepared on the going concern basis, which assumes that the Company will have sufficient funds available to enable it to continue to trade for the

foreseeable future. Management's financial forecasts of the Company's likely cash requirements include the following assumptions: (i) the Oklahoma City project reaching full operational capacity in 2017 (ii) the costs of ongoing development projects and the Company's ability to reduce certain overhead costs (iii) the Company raising additional funding during 2018. These assumptions are discussed further in note 1.

Consolidated income statement

for the year ended 31 December 2016

	Note	**2016** £'000 Before exceptional items	**2016** £'000 Exceptional items (note 2)	**2016** £'000 Total	2015 £'000 Before exceptional items	2015 £'000 Exceptional items (note 2)	2015 £'000 Total
Revenue	3	1,445	-	1,445	2,002	-	2,002
Cost of sales		(1,060)	-	(1,060)	(1,275)	-	(1,275)
Gross profit		385	-	385	727	-	727
Administrative expenses		(17,429)	(2,809)	(20,238)	(25,483)	(1,204)	(26,687)
Other income	5	272	2,496	2,768	2,009	1,763	3,772
Operating (loss) income		(16,722)	(313)	(17,085)	(22,747)	559	(22,188)
Share of loss of investments accounted for using the equity method	7	(306)	-	(306)	-	-	-
(Loss) income before finance income		(17,078)	(313)	(17,391)	(22,747)	559	(22,188)
Finance income	4	3,344	-	3,344	1,155	-	1,155
Finance costs		(26)	-	(26)	(53)	-	(53)
Finance income, net		3,318	-	3,318	1,102	-	1,102
(Loss) income before income tax		(13,760)	(313)	(14,073)	(21,645)	559	(21,086)
Income tax credit		1,404	-	1,404	1,035	-	1,035
(Loss) income for the financial year attributable to the owners of Velocys plc		(12,356)	(313)	(12,669)	(20,610)	559	(20,051)
Loss per share attributable to the owners of Velocys plc							
Basic and diluted loss per share (pence)	6	(8.62)		(8.84)	(14.52)		(14.13)

Consolidated statement of comprehensive income

for the year ended 31 December 2016

	2016 £'000 Before exceptional items	**2016** £'000 Exceptional items (note 2)	**2016** £'000 Total	2015 £'000 Before exceptional items	2015 £'000 Exceptional items (note 2)	2015 £'000 Total
(Loss) income for the year	(12,356)	(313)	(12,669)	(20,610)	559	(20,051)
Other comprehensive income						
Items that may be reclassified subsequently to profit or loss if certain conditions are met						
Foreign currency translation differences	7,347	-	7,347	1,869	-	1,869
Total comprehensive (expense) income for the year	(5,009)	(313)	(5,322)	(18,741)	559	(18,182)

Consolidated statement of financial position

as at 31 December 2016

	Note	**2016** £'000	2015 £'000
Assets			
Non-current assets			
Intangible assets		34,035	28,378
Property, plant and equipment		5,637	5,507
Trade and other receivables		325	-
Available-for-sale investment	7	-	3,375
Investment in associate	7	5,865	-
		45,862	37,260
Current assets			
Inventories		1,461	1,393
Trade and other receivables		811	911
Current income tax asset		854	780
Derivative financial instruments		537	156
Short term investments – funds held on deposit	8	-	3,000
Cash and cash equivalents	8	18,744	34,736
		22,407	40,976
Total assets		68,269	78,236
Liabilities			
Current liabilities			
Trade and other payables		(2,272)	(7,380)
Borrowings		(323)	(288)
		(2,595)	(7,668)
Non-current liabilities			
Trade and other payables		(1,343)	(1,327)
Borrowings		(593)	(759)
		(1,936)	(2,086)
Total liabilities		(4,531)	(9,754)
Net assets		63,738	68,482
Capital and reserves attributable to owners of Velocys plc			
Called up share capital		1,438	1,419
Share premium account		149,275	149,197
Merger reserve		369	369
Share-based payments reserve		15,843	15,362
Foreign exchange reserve		7,065	(282)
Accumulated losses		(110,252)	(97,583)
Total equity		63,738	68,482

Consolidated statement of changes in equity

for the year ended 31 December 2016

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

Consolidated statement of cash flows

for the year ended 31 December 2016

	Note	**2016** £'000	2015 £'000
Cash flows from operating activities			
Operating loss before taxation		(17,085)	(22,188)
Depreciation and amortisation		1,323	1,277
Loss on disposal of property, plant and equipment		1	5
Loss on disposal of intangible assets		233	383
Impairment of intangible assets		-	1,473
Write-down of deferred consideration and deferred tax liability		-	(2,032)
Share-based payments		793	2,142
Loss on derivative financial instruments		-	279
Employee option tax liability settled by the Company		(312)	-
Changes in working capital (excluding the effects of exchange differences on consolidation)			
-Trade and other receivables		234	(301)
-Trade and other payables		(6,004)	(975)
-Inventory		138	(1,066)
Cash consumed by operations		(20,679)	(21,003)
Tax credits received		1,330	2,031
Net cash used in operating activities		(19,349)	(18,972)
Cash flows from investing activities			
Purchase of property, plant and equipment		(291)	(2,262)
Purchase of intangible assets		(356)	(395)
Equity investment in ENVIA		(1,903)	(1,535)
Loan to ENVIA		(295)	-
Interest received		136	401
Decrease in funds placed on deposit	8	3,000	25,083
Net cash generated from investing activities		291	21,292
Cash flows from financing activities			
(Employee benefit trust reimbursement) net proceeds of issuance of ordinary shares		-	(28)
Proceeds from share issues		6	-
Interest paid		(26)	(33)
Decrease in borrowings		(314)	(271)
Net cash used in financing activities		(334)	(332)
Net (decrease) increase in cash and cash equivalents		(19,392)	1,988
Cash and cash equivalents at beginning of year	8	34,736	31,693
Exchange gains on cash and cash equivalents		3,400	1,055
Cash and cash equivalents at end of year	8	18,744	34,736

Notes to the financial statements

1. Principal accounting policies

Basis of preparation

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

The accounting policies adopted are consistent with those disclosed in the Company's statutory accounts for the year ended 31 December 2016.

This news release does not include all the statements required for full annual financial statements, and should be read in conjunction with the consolidated financial statements of the Company as at 31 December 2016.

These accounts have been audited and the audit report is unqualified, containing an emphasis of matter statement over the existence of a material uncertainty which may cast significant doubt about Velocys' and the parent company's ability to continue as a going concern, as discussed below, and does not contain a statement under section 237 of the Companies Act. The accounts will be delivered to the Registrar of Companies following the Company's Annual General Meeting on 22 June 2017.

Going concern

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

The forecasts include certain assumptions with regard to the following:

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

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

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

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.

2. Exceptional items

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

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

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

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

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

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

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

Critical estimates and judgements

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

3. Revenue

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

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

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

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

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

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

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

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

Revenue related to engineering services

Revenue from engineering services is earned on a time and materials basis, and is recognised as the work is performed. As engineering services were the source of all 2016 revenue, no critical estimates were required.

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

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

4. Finance income

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

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

5. Other income

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

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

In 2016 Other income included receipts from settlements with Toyo and MODEC, which offset costs previously recorded in Administrative expenses, and the recognition of deferred income in respect of cancellation of the Ventech contract (see note 2).

In 2015 Other income included receipt of settlements arising from two legal disputes, with CompactGTL and Johnson Matthey, which offset previously recorded Administrative expenses and the release of deferred consideration that would have been due to the former owners of Velocys Project Solutions if FID been achieved at Ashtabula in 2015 (see note 2).

6. Loss per share

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

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

Diluted loss per share is calculated by adjusting the weighted average number of shares in issue to assume conversion of all potential dilutive shares. Share options have not been included in the number of shares used for the purpose of calculating diluted loss per share since these would be anti-dilutive for the period presented. At the end of 2016 there were no other potentially dilutive instruments (see note 9).

7. Investments

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

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories of financial instruments. At 31 December 2015, the investment was recorded at cost, which was also considered to be fair value.

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

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

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

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

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

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

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

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

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

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

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

UK sterling denominated

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

US dollar denominated

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

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

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

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

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

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

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

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

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

10. Statutory information
Copies of the 2016 Annual report and accounts will be posted to shareholders at least 21 days before the Company's Annual General Meeting and may be obtained, free of charge for one month from the date of posting, from the registered office of Velocys plc, 115e Olympic Avenue, Milton Park, Abingdon, OX14 4SA, as well as from the Company's website www.velocys.com.

11. Annual General Meeting
The Annual General Meeting (AGM) is to be held on 22 June 2017. Notice of the AGM will be dispatched to shareholders with the Company's Annual report and accounts.