VELOCYS

News release

Velocys plc

("Velocys" or "the Company")

23 May 2018

Final results for the year ended 31 December 2017

Velocys plc (VLS.L), the renewable fuels company, is pleased to announce its final audited results for the year ended 31 December 2017.

Highlights

ENVIA
- First Fischer-Tropsch product produced in February 2017.
- Velocys' reactors and catalyst perform in line with requirements at a commercial scale.
- First finished, saleable products produced in June.
- Velocys increased its equity share and voting rights in September.
- Key capacity milestone of 200 barrels per day reached in October. Finished products meet customer specifications and sales started to be made to offtakers.
- Generation of RINs announced in January 2018, with RINs verified in March 2018 (both events post-period end).
- Leak detected in May 2018 (post-period end). Root cause being investigated.

Mississippi biorefinery
- Partnership announced with TRI in January 2017.
- Invitation by US Department of Agriculture in June to advance to Phase II application for a loan guarantee. Appointment of SMBC as the lender of record.
- Milestones reached in October 2017:
  - FEL-2 engineering study completed.
  - Term sheets agreed with a number of potential offtakers.
  - Site option agreement signed with Adams County. Biorefinery to be located in Natchez, Mississippi.

Other highlights
- Industry partnership formed, including British Airways, aimed at developing waste-to-renewable jet fuel plants in the UK.
- Reshaping of the Company to deliver the demands of the strategy focused on renewable fuels.
- John Tunison appointed as Interim CFO in July 2017.
- Biorefinery being developed by third party project developer commences construction. Notice to proceed issued to Velocys (post-period end).

Financials
- Fundraise of over £10m (before expenses) in May 2017.
- Fundraise of £18.4m (before expenses) in January 2018 (post-period end) to be used principally to help fund the development of the Mississippi biorefinery, and to secure strategic investment into it.
- 2017 financial results:

– Revenue of £0.8m (FY 2016: £1.4m).
– Cash* at year end of £2.1m (FY 2016: £18.7m).
– Total impairments, primarily against intangible assets, of £34.6m.

* Defined as cash, cash equivalents and short-term investments (see note 11).

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

– 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.

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Chairman’s statement

Dr. Pierre Jungels, CBE

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

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

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

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

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

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

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

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

Fundraising

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

In January 2018 (post-period end) £18.4m (before expenses) was raised through a further fundraise, principally to help fund the development of our Mississippi biorefinery project, and to secure strategic investment into it. We included an open offer element in this fundraising round to enable all eligible shareholders an opportunity to participate. Our existing major shareholders again demonstrated their considerable support, but at the same time we were pleased by our ability to extend our shareholder base. The Board recognises that additional funding is still required to reach final investment decision (FID) on the Mississippi biorefinery project; further details are given in the Financial review and note 1.

Outlook

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

Chief Executive's report

David Pummell

Introduction

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

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

Strategy implementation

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

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

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

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

Our two fundraises in the last 12 months have provided us with a runway to implement our strategy, most notably to support the plan to achieve final investment decision (FID) for the Mississippi biorefinery project. As outlined in the Financial review further funding is required to reach this milestone. The Financial review (and note 7) also outlines the reasons behind a significant write down in value of certain assets, mostly goodwill and In-process technology made in these report and accounts.

Our biorefineries

ENVIA

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

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

ENVIA has achieved significant milestones in the last 12 months, notwithstanding a number of other challenges. For example, in Q2 2017, the Engineering, Procurement and Construction (EPC) contractor entered bankruptcy proceedings; the plant was down or in reduced operation for several weeks in early 2018 (post-period end) while repairs were carried out after extreme cold weather; and, as part of normal plant commissioning, a series of improvements have been made to control systems and other equipment to minimise plant downtime and improve reliability.

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

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

Mississippi biorefinery

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

Velocys and its partners are making progress towards completing all the required work packages to deliver a successful USDA loan guarantee application, secure project investment and deliver the FID. Velocys selected an engineering partner to carry out a scoping and optimisation study. Velocys and its engineering partner are working through the complex process of cost and value engineering, to optimise plant capital cost, operating cost, carbon intensity and the financial returns from the project. Reaching FID will be subject to securing further funding (see further details in the Financial review).

Our target is to secure a conditional commitment from the USDA in Q3 2018, and to reach FID in 2H 2019.

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

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

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

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

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

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

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

Financial review

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

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

Expenses and income
Total administrative expenses increased to £21.9m before exceptional items and £53.4m after exceptional items (2016: £17.4m before/£20.2m after exceptional items). £1.6m of this increase before exceptional items was due to a change in methodology used in the amortisation of intangible assets from the units-of-production to the straight line method (see note 7) and does not represent an increase in the cost base of the Company. The remaining increase before exceptionals reflected increased spending on project development, predominantly for the Mississippi project, including the pre-FEED engineering study and the joint technology demonstration with TRI.

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

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

Other income of £0.2m/£1.9m before/after exceptional items (2016: £0.3m/£2.8m before/after exceptional items) was from the sale of assets, mostly associated with the closure of the UK R&D facility (see note 5). In September 2017 Velocys increased its equity share and voting rights in ENVIA following the exit of NRG from the joint venture for no consideration. The Company has recorded an exceptional item being a gain on bargain purchase of £1,750,000 in respect of this step acquisition (see note 2 and note 9 for more information).

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

Cash outflow in 2017 was £16.6m (2016: £19.4m) comprising £16.3m consumed by operations, less an R&D tax credit received of £1.0m, and a £9.8m increase in the loan to ENVIA, offset by cash received through the May 2017 fundraise of £9.7m (after expenses). The net cash used in operating activities was reduced from £19.3m to £15.3m. The profile of the cash spend changed significantly in 2017 as the Company reduced its traditional R&D overheads and increased initial spending on project development activities that supported the new strategy.

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

Impairment on assets and investments
For the impairment assessment the recoverable amount has been determined based on its fair value less costs of disposal ('fair value'), by reference to the total value of the parent company's equity, using the discounted share issue price at the January 2018 fundraise of 10p per share. As a result an impairment of £31.5m was recorded against a range of assets, including goodwill and mainly In-process technology, as described in note 7. As described below there were additional

impairments to ENVIA (£2.7m) and other minor asset impairments (£0.4m). There has been no change in the Board's assessment of the long term potential of these assets. This impairment (excluding that in respect of goodwill) could be reversed in the future should there be a change in the estimates used to determine the asset's recoverable amount.

ENVIA finances and increased equity stake for Velocys

From the proceeds of Velocys' May 2017 fundraise (see below), \$3.4m (£2.7m) was allocated to increase the loan facility the Company made available to ENVIA in January 2016 in order to bridge ENVIA to becoming cash flow positive. In October 2017 in order to meet the key operational milestone of achieving 200 bpd and to support continued operations, Velocys increased the loan arrangement by a further \$0.7m to \$13.4m (£0.6m to £10.6m). This was necessitated after a lower revenue forecast, based on a revision of product and RIN pricing, was produced. The loan facility was increased by \$0.4m (£0.3m) in December 2017 and \$2.1m (£1.7m) in Q1 2018 (post-period end) – the additional support being required to enable ENVIA to progress its operational ramp-up and RIN qualification programmes. At each date, all other terms of the loan, which has a 10% coupon, remained unchanged. As of 31 December 2017, \$13.0m (£9.6m) of the loan note had been drawn down.

At the end of September 2017, the Company increased its voting rights in ENVIA after one of the members of the joint venture, NRG Energy, exited the joint venture (JV). NRG Energy transferred its ownership units and all associated economic rights associated with them to the other JV partners. The voting rights for the three remaining JV members, including Velocys, were accordingly increased to 33% each. There was no consideration paid in respect to this transaction, nor will there be in the future. This was reflected as a gain on bargain purchase as an exceptional item in the income statement, see notes 2 and 9. This change in voting rights has not impacted operations at the Oklahoma City plant.

At year end the Company's investment in ENVIA was impaired by £2.7m to predominantly reflect a revision of the expected income from RINs. Because the key capacity milestone of 200 bpd was successfully achieved at the plant in October 2017, the impairment to the ENVIA loan note made in the 2017 interims statement was reversed (see note 10). There are no remaining contractual milestones within the ENVIA joint venture agreement of the nature that gave rise to the impairment of the ENVIA loan note facility at 2017 interims.

Fundraises

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

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

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

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

Net proceeds of the capital raising will be used predominantly:

- To fund development costs for the Mississippi biorefinery project to bridge to the on-boarding of one or more strategic investors.

- To progress the Company’s UK waste-to-renewable jet fuel project.
- To fund the Company’s working capital and central operating costs.
- To provide working capital to ENVIA in order to bridge the asset to sustainable cash generation.

Future funding
The financial statements have been prepared on the going concern basis, which assumes the Company will have sufficient funds available to enable it to continue to trade for the foreseeable future. The cash forecast includes the following assumptions: (i) securing strategic development capital investment into the Mississippi biorefinery project during the second half of 2018; and (ii) subject to (i), the Company assessing its cash requirements and determining whether it needs to raise additional funding during 2018 or 2019. These assumptions are discussed further in note 1.

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

Following FID in 2019 the Company’s funding requirements will depend on the final structure of the Mississippi biorefinery project consortium and on the Company’s strategy to develop and fund other projects.

Consolidated income statement

for the year ended 31 December 2017

	Note	**2017** £'000 Before exceptional items	**2017** £'000 Exceptional items (note 2)	**2017** £'000 Total	2016 £'000 Before exceptional items	2016 £'000 Exceptional items (note 2)	2016 £'000 Total
Revenue	3	759	–	759	1,445	–	1,445
Cost of sales		(409)	–	(409)	(1,060)	–	(1,060)
Gross profit		350	–	350	385	–	385
Administrative expenses		(21,930)	(31,486)	(53,416)	(17,429)	(2,809)	(20,238)
Other income	5	163	1,750	1,913	272	2,496	2,768
Operating loss		(21,417)	(29,736)	(51,153)	(16,722)	(313)	(17,085)
Share of loss of investments accounted for using the equity method	9	(1,784)	(2,736)	(4,520)	(306)	–	(306)
Loss before net finance (costs)/income		(23,201)	(32,472)	(55,673)	(17,078)	(313)	(17,391)
Finance income	4	730	–	730	3,344	–	3,344
Finance costs		(399)	–	(399)	(26)	–	(26)
Net finance (costs)/income		331	–	331	3,318	–	3,318
Loss before income tax		(22,870)	(32,472)	(55,342)	(13,760)	(313)	(14,073)
Income tax credit		739	–	739	1,404	–	1,404
Loss for the financial year attributable to the owners of Velocys plc		(22,131)	(32,472)	(54,603)	(12,356)	(313)	(12,669)
Loss per share attributable to the owners of Velocys plc							
Basic and diluted loss per share (pence)	6	(15.19)		(37.47)	(8.62)		(8.84)

Consolidated statement of comprehensive income

for the year ended 31 December 2017

	2017 £'000 Before exceptional items	**2017** £'000 Exceptional items (note 2)	**2017** £'000 Total	2016 £'000 Before exceptional items	2016 £'000 Exceptional items (note 2)	2016 £'000 Total
Loss for the year	(22,131)	(32,472)	(54,603)	(12,356)	(313)	(12,669)
Other comprehensive (expense)/income						
Items that may be reclassified to the income statement in subsequent periods						
Foreign currency translation differences	(4,411)	–	(4,411)	7,347	–	7,347
Total comprehensive (expense)/income for the year attributable to the owners of Velocys plc	(26,542)	(32,472)	(59,014)	(5,009)	(313)	(5,322)

Consolidated statement of financial position

as at 31 December 2017

	Note	**2017** £'000	2016 £'000
Assets			
Non-current assets			
Intangible assets	7	755	34,035
Property, plant and equipment	8	1,801	5,637
Trade and other receivables	10	10,284	325
Investment in associate	9	2,580	5,865
		15,420	45,862
Current assets			
Inventories		388	1,461
Trade and other receivables		416	811
Current income tax asset		546	854
Derivative financial instruments		–	537
Restricted cash	11	620	–
Cash and cash equivalents	11	2,070	18,744
		4,040	22,407
Total assets		19,460	68,269
Liabilities			
Current liabilities			
Trade and other payables	12	(3,516)	(2,272)
Borrowings		(268)	(323)
		(3,784)	(2,595)
Non-current liabilities			
Trade and other payables		(718)	(1,343)
Borrowings		(273)	(593)
		(991)	(1,936)
Total liabilities		(4,775)	(4,531)
Net assets		14,685	63,738
Capital and reserves attributable to owners of Velocys plc			
Called up share capital		1,468	1,438
Share premium account		159,385	149,275
Merger reserve		369	369
Share-based payments reserve		16,085	15,843
Foreign exchange reserve		2,654	7,065
Accumulated losses		(165,276)	(110,252)
Total equity		14,685	63,738

Consolidated statement of changes in equity

for the year ended 31 December 2017

	Called up share capital £'000	Share premium account £'000	Merger reserve £'000	Share-based payment reserve £'000	Foreign exchange reserve £'000	Accumulated losses £'000	Total equity £'000
Balance at 1 January 2016	1,419	149,197	369	15,362	(282)	(97,583)	68,482
Loss for the year	–	–	–	–	–	(12,669)	(12,669)
Other comprehensive income							
Foreign currency translation differences	–	–	–	–	7,347	–	7,347
Total comprehensive income/(expense)	–	–	–	–	7,347	(12,669)	(5,322)
Transactions with owners							
Share-based payments – value of employee services	–	–	–	793	–	–	793
Proceeds from share issues	19	78	–	–	–	–	97
Employee option tax liability settled by the Company	–	–	–	(312)	–	–	(312)
Total transactions with owners	19	78	–	481	–	–	578
Balance at 1 January 2017	1,438	149,275	369	15,843	7,065	(110,252)	63,738
Loss for the year	–	–	–	–	–	(54,603)	(54,603)
Other comprehensive expense							
Foreign currency translation differences	–	–	–	–	(4,411)	–	(4,411)
Total comprehensive expense	–	–	–	–	(4,411)	(54,603)	(59,014)
Transactions with owners							
Share-based payments – value of employee services	–	–	–	242	–	–	242
Proceeds from share issues	30	689	–	–	–	–	719
Convertible loan notes	–	9,000	–	–	–	–	9,000
Interest on convertible loan note	–	421	–	–	–	(421)	–
Total transactions with owners	30	10,110	–	242	–	(421)	9,961
Balance at 31 December 2017	1,468	159,385	369	16,085	2,654	(165,276)	14,685

Consolidated statement of cash flows

for the year ended 31 December 2017

	Note	**2017** £'000	2016 £'000
Cash flows from operating activities			
Operating loss before taxation		(51,153)	(17,085)
Depreciation and amortisation		2,893	1,323
Gain on bargain purchase for ENVIA		(1,750)	–
Loss on disposal of property, plant and equipment		83	1
Loss on disposal of intangible assets		152	233
Impairment of assets		31,486	–
Impairment of inventory		340	–
Impairment of assets under construction		31	–
Amortisation of leased inventory		92	–
Share-based payments		242	793
Employee option tax liability settled by the Company		–	(312)
Changes in working capital (excluding the effects of exchange differences on consolidation)			
Trade and other receivables		358	234
Trade and other payables		914	(6,004)
Inventory		–	138
Cash consumed by operations		(16,312)	(20,679)
Tax credits received		1,047	1,330
Net cash used in operating activities		(15,265)	(19,349)
Cash flows from investing activities			
Purchase of property, plant and equipment		(34)	(291)
Purchase of intangible assets		(335)	(356)
Equity investment in ENVIA		–	(1,903)
Loan to ENVIA		(9,788)	(295)
Interest received		62	136
Cash moved to restricted cash		(620)	–
Decrease in funds placed on deposit for longer than 3 months	11	–	3,000
Net cash (used in)/generated from investing activities		(10,715)	291
Cash flows from financing activities			
Proceeds from issues of shares and convertible loan notes		10,160	6
Costs of issuing shares and convertible loan notes		(443)	–
Interest paid		(17)	(26)
Repayment of borrowings		(308)	(314)
Net cash generated from/(used in) financing activities		9,392	(334)
Net decrease in cash and cash equivalents		(16,588)	(19,392)
Cash and cash equivalents at beginning of year	11	18,744	34,736
Exchange movements on cash and cash equivalents		(86)	3,400
Cash and cash equivalents at end of year	11	2,070	18,744

Notes to the consolidated financial statements

1. Accounting policies

Basis of preparation

This document contains abridged preliminary financial information for the year ended 31 December 2017 together with comparatives. The information presented has been prepared in accordance with those parts of the Companies Act 2006 applicable to companies reporting under International Financial Reporting Standards ('IFRS's) as adopted by the European Union, however the information in itself does not contain sufficient information to comply with IFRSs. It has been prepared on a going concern basis and under the historical cost convention as modified by the revaluation of certain financial assets and liabilities (including derivative instruments) at fair value, where relevant.

The financial information contained in this document does not constitute Consolidated statutory accounts as defined in Sections 404 and 435 of the Companies Act 2006. It is based on, and is consistent with, the Company's statutory accounts for the year ended 31 December 2017 and those financial statements will be delivered to the Registrar of Companies following the Company's Annual General Meeting. The auditors' report on those accounts is unqualified and does not contain a statement under Section 498(2) or (3) of the Companies Act 2006.

The auditors' report on those financial statements does draw attention to a material uncertainty relating to going concern and the details of the directors' disclosure of this material uncertainty is included below. Company statutory accounts for the year ended 31 December 2016 were approved by the Board of Directors on 15 May 2017 and have been filed with the Registrar of Companies.

Going concern

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

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

The nature of the Company's nascent strategy means that the timing of milestones and funds generated from developments are difficult to predict at this stage. The directors have prepared financial forecasts to estimate the likely cash requirements of the Company and Velocys plc over the next 12 months from the date of approval of the financial statements.

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

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

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

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

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

Accounting policies and accounting developments

The accounting policies adopted are consistent with those disclosed in the Company's statutory accounts for the year ended 31 December 2017.

No new standards, amendments or interpretations, effective for the first time for the financial year beginning on or after 1 January 2017 have had a material impact on the Company.

A number of new standards and amendments and revisions to existing standards have been published and are mandatory for the Group's future accounting periods. They have not been early adopted in these consolidated financial statements. The following new standards, amendments to standards and interpretations are mandatory for the first time for the financial year beginning 1 January 2018. The Company has not chosen to early adopt these standards, but they are considered relevant for future accounting periods.

IFRS 9 Financial instruments

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

- The standard removes the category of assets, loan and receivables, which in 2017 included cash and cash equivalents, trade receivables and the loan to the Company's associate investment, ENVIA. These will be reclassified under the new standard as financial assets held at amortised cost, on the basis that the business model under which they are held is to collect repayment of the asset or loan and interest accrued thereon, with a fixed date for repayment.
- The standard requires any amortisation of these assets to be calculated on an expected future credit losses basis, rather than on incurred losses.
- The Company regularly uses forward foreign exchange contracts to manage its foreign exchange risk although at the end of 2017 it had none outstanding. Under IFRS 9 these will continue to be classified as derivative financial instruments and measured at fair value through profit and loss.

IFRS 15 Revenue from contracts with customers
The Company has reviewed the requirements of the standard and has identified the revenue streams expected to be impacted and the performance obligations due under their respective contracts. It does not believe that allocating the contract prices across these performance obligations will have any impact on the opening 2018 balance sheet. Revenue in 2017 was derived from engineering services and the lease of catalyst. Service revenue is recognised, and in most cases invoiced, on a monthly basis in line with service performance. Catalyst lease revenue is recognised monthly over the life of the catalyst; revenue in 2017 was immaterial.

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

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

IFRS 16 Leases
This standard will replace IAS 17 Leases and sets out the principles for the recognition, measurement, presentation and disclosure of leases. Lessees will be required to recognise a lease liability reflecting future lease payments and a right-of-use asset for lease contracts. The IASB has included an optional exemption that can be applied by lessees for certain short-term leases and leases of low-value assets. A key change arising from IFRS 16 is that most operating leases will be accounted for on the balance sheet for lessees.

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

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

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

Administrative expenses
At varying points during 2017, the carrying value of the Company's net assets exceeded the market capitalisation indicating a potential impairment at year end. This conclusion was supported by the fundraise in January 2018, which was discounted to 10p per share, and which prompted the share price to drop to 10p immediately afterwards. As a result, an impairment of £31.5m was recorded against a range of assets, as described in note 7. The assets impacted by the impairment were Intangible assets, Inventories and Property, plant and equipment. Critical estimates and judgements are included in note 7.

In 2016 the Company sought to acquire certain assets of a US-based GTL company that had gone into administration but did not complete the acquisition. The Company received a partial reimbursement by the acquirer of the plant. This transaction was judged to be exceptional by its nature as a potential business combination. Costs of the unsuccessful acquisition, recorded as an exceptional item of £2,809,000, represent amounts spent net of the related reimbursement.

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

Other income
In 2016 the Company recognised £2,496,000 as Other income. This relates to non-refundable amounts from Ventech previously recorded in deferred income in respect of the cancellation of a contract with Ventech for reactors. The judgment to recognise this income is based on an assessment of the contractual position, taking into account both the terms of the original contract and subsequent amendments. The Company believes that all obligations under this contract have been fulfilled and therefore that it is probable that the economic benefits associated with the transaction have flowed to the Company and that recognition of the related income is appropriate. This is a binary judgement, and, therefore, the Company has recognised revenue at the point at which the probability criterion was met.

In September 2017 Velocys increased its equity share and voting rights at ENVIA following the exit of NRG from the joint venture, for no consideration. The voting rights for the three remaining joint venture members, including Velocys, were accordingly increased to 33% each. The increased interest in the associate has been acquired through an increase in an existing stake. Velocys applied the 'cost approach', whereby there is a requirement to assess the fair value of both the consideration and the net assets being acquired. The fair value of the net assets being acquired was determined by its value in use, assessed by the estimated future cash flows discounted to their present value using an appropriate pre-tax discount rate model. The Company has recorded a gain on bargain purchase of £1,750,000 in respect of this step acquisition. See note 9 for more information.

3. Revenue
The Company's revenue is analysed as follows:

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

4. Finance income

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

5. Other income

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

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.

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

Diluted loss per share is calculated by adjusting the weighted average number of shares in issue to assume conversion of all potential dilutive shares. Share options have not been included in the number of shares used for the purpose of calculating diluted loss per share since these would be anti-dilutive for the period presented. At the end of 2017 there were no other potentially dilutive instruments.

7. Intangible assets

Critical estimates and judgements

In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, a number of indicators of potential impairment. The Company identified that:

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

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

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

The method of allocation of the impairment was as follows:

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

This resulted in the following impairment allocation:

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

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

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

8. Property, plant and equipment

Assets are reviewed for impairment annually and also whenever events or changes in circumstances indicate their carrying value may not be recoverable. To the extent the carrying value exceeds the recoverable amount, the difference is recorded as an expense in the Income statement. The recoverable amount used for impairment testing is the higher of the value in use and fair value less costs of disposal. For the purpose of impairment testing, assets are generally tested individually or at a CGU level, which represents the lowest level for which there are separately identifiable cash inflows, which are largely independent of cash inflows from other assets or groups of assets. Property, plant and equipment were included in the list of items to which an impairment was applied subsequent to the impairment review (see note 7). The value of the impairment was £2,185,000 (2016: £nil).

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

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

9. Investment in associate

This investment relates 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.

Associates are all entities over which the Company has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. In January 2016, Velocys entered into a financing arrangement with ENVIA under which it contributed additional equity finance of $2.6m and committed to provide loan finance of up to $9.3m. As a result of the new funding arrangement, Velocys increased its ownership share and was awarded additional voting rights, taking its share of voting rights from 9% to 28%. The investment has since been recognised as an Investment in associate, reflecting the significant influence that Velocys holds in ENVIA, including voting rights exceeding 20% and a seat on ENVIA's board. The Company recorded the transaction as a step acquisition under the equity method in 2016.

Investments in associates are accounted for using the equity method of accounting from the date on which it becomes an associate. Under the equity method, a cost approach is followed whereby the cost of all purchases are accumulated, including transaction costs, to determine the amount of the investment. The notional purchase price allocation, including goodwill arising on the purchase of the additional stake, is calculated using fair value information at the date when the additional interest is acquired. Goodwill is calculated as the excess of the cost of the investment over the Company's share of the net fair value of the investee's identifiable assets and liabilities and included in the carrying amount of the investment. During 2017 Velocys committed to a series of extensions to the loan, which increased the facility to $13.8m (£10.3m) (see note 10), however these extensions did not result in a change in the Company's ownership interest or voting rights. In September 2017, one of the joint venture partners, NRG, withdrew its interest and assigned its ownership and voting units to the remaining partners such that each was left with voting rights of 33%. No consideration was given in respect of this transfer. The Company recorded the transaction as a step acquisition under the equity method in 2017.

The Company's share of post-acquisition profit or loss is recognised in the Income statement based on its economic interest. There are no post-acquisition movements in Other comprehensive income in the Company's investments in associates. Distributions received from an associate reduce the carrying amount of the investment. The carrying amount of the investment is adjusted to recognise the investor's share of the change in net assets of the investee after the date of acquisition.

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

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

<u>Critical estimates and judgements</u>

<u>Change in ownership rights - fair value assessment of ENVIA's net assets</u>

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

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

(i) Sales volume

The plant capacity is 250 bpd production and the model assumes 200 bpd average actual production at the plant due to varied reduction in availability due to time out for catalyst regeneration, catalyst change out or other maintenance. It assumes that a large majority of the product will qualify for RINs. There are offtake agreements in place for all products that exceed 5 years for 100% of products produced and there is a 6-month contract in place for all of the available RIN credits generated; therefore the sales volume risk is solely based on operational availability. As indicated above, sensitivity analysis reveals that a decrease to 186 bpd from the 200 bpd modelled availability (which is over 25 bpd below operating plan) would be required in order to generate a material change in the cash flows. The impact of aggressive sensitivity modelling of RIN availability does not have a material impact on cash flows.

(ii) Sales price / RIN credits

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

(iii) Long term growth rates

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

(iv) Discount rate

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

Impairment assessment as at 31 December 2017
The Company is required to assess, at the end of each reporting period, whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset. During 2017 the first saleable products using Velocys' reactors and catalyst have been produced to customer specification and the off-takers have begun taking delivery of the waxes, diesel and naphtha. Despite these milestones, ENVIA's recoverable amount, based on its value in use, calculated using a discounted cash flow model, has decreased significantly, predominantly driven by a lower revenue forecast based on a revision of product and RIN pricing produced by the Company. The recoverable amount of the investment was determined by its value in use, assessed by the estimated future cash flows discounted to their present value using an appropriate pre-tax discount rate model, which requires the use of a number of key assumptions. These are included in the 'Change in ownership rights - fair value assessment of ENVIA's net assets' section above. The Company has recorded an impairment of £2,736,000 (2016: £nil).

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

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

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

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

10. Trade and other receivables

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

At the end of 2017 Velocys had committed to provide up to $13.8m (£10.3) to ENVIA through a senior loan note due on 31 December 2019 and bearing a 10% interest rate, with an optional extension to 31 December 2020 subject to prior notice. As at 31 December 2017, draw downs on this facility had been made by ENVIA in the amount of $13.0m (£9.6m) (2016: $0.40m (£0.3m)).

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

11. Cash and cash equivalents and restricted cash

Cash and cash equivalents includes cash in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less. Restricted cash relates to an $800,000 letter of credit provided to ENVIA under the first amendment to the loan agreement. This is determined to be restricted on the basis that for a certain period the funds can only be accessed by ENVIA.

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

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

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

12. Trade and other payables: current

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

13. Post-financial position events

The following events occurred after 31 December 2017.

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

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

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

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

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

14. Statutory information

Copies of the 2017 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, Harwell Innovation Centre, 173 Curie Avenue, Harwell, OX11 0QG, UK, as well as from the Company's website www.velocys.com.

15. Annual General Meeting

The Annual General Meeting (AGM) is to be held on 29 June 2018. Notice of the AGM will be dispatched to shareholders with the Company's Annual report and accounts.