FRONTIER TECH INVESTOR

Britain’s “Green Skies Champion”

ARCHIVED

14/09/2022

Important risk warnings: Before investing you should consider carefully the risks involved, including those described below. If you have any doubt as to suitability or taxation implications, seek independent financial advice.

General - Your capital is at risk when you invest, never risk more than you can afford to lose. Past performance and forecasts are not reliable indicators of future results. Bid/offer spreads, commissions, fees and other charges can reduce returns from investments. There is no guarantee dividends will be paid.

Small cap shares - Shares recommended may be small company shares. These can be relatively illiquid meaning they are hard to trade and can have a large bid/offer spread. If you need to sell soon after you bought, you might get back less that you paid. This makes them riskier than other investments. Small companies may not pay a dividend.

Cryptocurrencies - The Financial Conduct Authority (FCA) does not regulate the Cryptocurrency market. This means that you will not have the protection of the Financial Ombudsman Service or the Financial Services Compensation Scheme.

Overseas shares – Some recommendations may be denominated in a currency other than sterling. The return from these may increase or decrease as a result of currency fluctuations. Dividends from overseas companies may be taxed at source in the country of issue.

Taxation - Profits from share dealing are a form of capital gain and subject to taxation. Tax treatment depends on individual circumstances and may be subject to change in the future.

Investment Director: Sam Volkering. Editors or contributors may have an interest in shares recommended. Information and opinions expressed do not necessarily reflect the views of other editors/contributors of Southbank Investment Research Limited. Full details of our complaints procedure, privacy policy and terms and conditions can be found at, www.southbankresearch.com.

Frontier Tech Investor is issued by Southbank Investment Research Ltd.

Registered in England and Wales No 9539630. VAT No GB629 7287 94. Registered Office: 2nd Floor, Crowne House, 56-58 Southwark Street, London, SE1 1UN.

ISSN 2398-2470

Contact Us

To contact customer services, please call us on 0203 966 4580, Monday to Friday, 9.00 am - 5.30pm.

Southbank Investment Research Ltd is authorised and regulated by the Financial Conduct Authority. FCA No 706697. https://register.fca.org.uk/.

...continued on next page...

Britain's "Green Skies Champion"

by Sam Volkering, Editor, *Frontier Tech Investor*

This was originally an issue from 13/08/2020. It was updated on 31/08/2022.

Thanks to the disruptions over the last few years, I've been on my longest streak ever of not getting on a plane and jetting overseas.

I was thinking about my last trip out to Australia and back. I was there on business, so it was a short trip. That was all the way back in January 2020.

I left for Melbourne exactly one week after I had got back from another trip. That was to Las Vegas, also for a week, also for business – the huge CES tech trade show and conference.

Little did I know that under two months later, the entire global aviation industry would be brought to its knees.

But thinking about my long-haul Australian and US trips just in January 2020, I wondered how many miles I had covered in total. I did a rough calculation and discovered that I covered around 24,312 miles in total over the space of just three weeks.

That's a lot of airtime, a lot of miles covered, a lot of jet fuel and a lot of carbon emissions that these days need to be offset.

Seeing the ongoing theme of green and clean energy being so dominant in the market at the moment, I asked myself a simple question: was I bothered about my part in contributing to the emissions that are apparently so damaging to our world?

I'm not sure I have a definitive answer on this one. And usually I'm pretty sure of my view on a lot of these topics.

On one hand, yes, I realise that in flying those distances, I'm effectively contributing to the emissions that do damage to our natural ecosystems. I contribute by driving to the airport. I contribute by sitting in that seat and flying all that way.

I am conscious of this fact. But I'm also not sorry about it. I'm not sorry because I need to travel back to Australia. I need to travel to the United States. I need to travel to all parts of the world in order to be effective at what I do.

I also need to travel to Australia because I have family there. While I'm conscious

...continued on next page...

of my contribution to emissions, what would the eco-warriors have me do otherwise? Never see my family again? Travel by electric power to Australia? Travel by train? By carbon fibre sailboat?

Of course none of those are feasible options. And here's the thing…

They never will be.

If I need to get from the UK (an island) on one side of the world to Australia (an island) right on the other side of the world, there is only one effective way to get there: plane.

There is *no other effective and efficient way* for any of us to travel around the world outside of a plane.

Cars are too time consuming and don't go everywhere. Trains are also limited by the rail networks they exist on. Boats are too slow, and equally as polluting as planes.

To fly is actually the best way for us to get around the world.

As I say, that is not going to change in a hurry. While much of the world might face the return of lockdowns and travel restrictions, and people think the airline industry is going to radically change, they're wrong… to an extent.

Plane travel isn't going to disappear. It will return, and it will return at the levels and passenger volumes we are used to and saw in the years before the global pandemic hit.

It's hard to conceive that now, but it will come.

Airlines already operate on thin margins, with some in the United States complaining, "For every dollar of revenue we take in, we keep just under a nickel in profits."

However, in terms of economic viability many airlines (which already run on thin margins) are going to need to adopt ways to make their planes more efficient and most cost effective. They also need to ensure their planes are more environmentally friendly.

This has been an area of focus for airlines for a number of years now. And most new aircraft that roll off the shop floor from Boeing or Airbus employ new technologies such as composite materials and more fuel-efficient engine systems.

But it's not just the airlines and plane manufacturers that are needed to make the airline industry more economically viable, sustainable and "green" in the years that come as they recover from this current crisis.

For example, in 2014 the US airlines, manufacturers and the Federal Aviation Administration (FAA) rolled out NextGen, an all-new air traffic control system to

...continued on next page...

help aircraft operate more efficiently.

Airlines.org explained in a post about the new system,

> *Aircraft consume a great deal of fuel and fuel costs eat up a huge amount of airlines' operating costs. By reducing delays and allowing for more efficient ATC operations, NextGen will help reduce fuel consumption and related emissions by 12 percent per year. That's the equivalent of removing 2.2 million cars from the road for a year.*

Still, that's not enough.

In the years since NextGen, the importance of efficiency, particularly fuel efficiency and clean fuel, has been one of the most important issues in aviation.

Add to the growing social pressure on airlines to become "greener" and there's really only one outcome here for airlines and manufacturers: develop more environmentally friendly engines and fuels.

In the United States, it has already become one of the most pressing issues. And there's already action underway to tackle the problem head on.

Airlines for America released a "primer" report in September 2020 titled, "Deployment of Sustainable Aviation Fuel in the United States".

In its executive summary it notes,

> *The U.S. aviation industry has taken a leadership role in the development and deployment of sustainable aviation fuels (SAF). We remain committed to advancing the commercialization and deployment of SAF to help the industry meet its emissions reduction goals, diversify fuel supply and enhance energy security.*

There's no doubt this is an important area of development in global aviation moving forward. And it presents a unique opportunity for one particular UK-listed, UK-based company that's developing new, more sustainable fuels for transport and in particular the aviation industry.

Introducing your "Green Skies Champion" recommendation…

Velocys plc (LSE:VLS) is what we're calling our "Green Skies Champion".

Velocys is a technology company that has developed a processing technology capable of turning waste into sustainable fuels for heavy goods transportation

...continued on next page...

and aviation industries.

It is listed on the AIM market of the London Stock Exchange and has offices in Oxford, and Ohio and Houston over in the United States. The stock is currently trading at a price of around 6.46GBp with a market capitalisation of around £90 million.

Velocys has seen wild volatility in its stock over the last couple of years because of its involvement in developing new sustainable fuels for aviation. However, it was an announcement on 12 June 2020 by the UK government that really sent a rocket up the backside of this small-cap star.

During the Covid-19 daily briefing on 12 June, Grant Shapps, Secretary of State for Transport, announced a new "Jet Zero Council". The Jet Zero Council will try to figure out how to...

> *... decarbonise the aviation sector while supporting its growth and strengthening the UK's position as a world leader in the sector.*
>
> *The members will look at how to work across their sectors to achieve these goals, including through brand new aircraft and engine technologies. These could include using new synthetic and sustainable aviation fuels as a clean substitute for fossil jet fuel, and eventually the development of electric planes.*

It was in the 12 June briefing, however, that Shapps said,

> *"Our goal – within a generation – will be to demonstrate flight across the Atlantic, without harm to the environment.*
>
> *"And today we're backing a company called Velocys who are building a plant for aviation biofuels in Lincolnshire."*

This sent the Velocys stock price into overdrive. It went from around 5p to a high of 16.63p in a matter of days.

That announcement was an indicator of the kind of speed this stock can move with a tailwind behind it.

Thankfully for us, the stock price wound off a lot of that excitement and the stock achieved a level where we were ready to bring it into the portfolio for the huge potential its technology holds long term.

As mentioned earlier, the airline industry isn't going to pack up and go home. It's here to stay and is a fundamental part of the fabric of modern society. However, it needs to undertake significant change to be sustainable, viable and "green" long term.

The measures that are being put into place by global governments like the UK are a key step in making that happen. But it's also companies like Velocys that will deliver it.

Velocys uses a process known as the Fischer-Tropsch process in its reactors to turn synthesis gas into liquid transport fuels. The company describes the whole process as, "an integrated end-to-end process that converts solid wastes, first to synthesis gas and then to liquid transport fuels."

This isn't some overnight success. The company was founded in 2001 and its first pilot plant in Australia was launched in 2010.

Furthermore, the plans for a proposed waste-to-jet fuel plant in North East Lincolnshire were submitted in August 2019. The good news, however, is that on 20 May 2020 approval was given and then on 12 June 2020, in conjunction with the statement from Shapps, the company also announced the following:

> *... formal notice of the decision to grant planning permission for the Altalto Immingham plant has now been issued by North East Lincolnshire Council (NELC).*

That means it is full steam ahead to develop this pioneering plant.

The plant itself isn't solely on the shoulders of Velocys either. It's a Joint Development Agreement project with British Airways and Foresight Group LLP. Foresight is a private equity company who acquired the Altalto site on 24 March 2022 and has the option to invest up to £100 million in the project site.

To repeat: this small-cap £90 million company is working on a pioneering waste-to-jet fuel plant in north east Lincolnshire with the UK's major airline (owned by £5 billion giant IAG) British Airways.

In August 2021, the UK government awarded Velocys a £2.4 million grant under the Green Fuels Green Skies initiative, to cover 100% of the costs to advance this critical waste conversion facility for the UK for the next seven months.

It's a huge project, which I believe will be the catalyst for bigger things to come long term for Velocys.

The company also inked a deal with Southwest Airlines in November 2021 giving its subsidiary, Velocys Renewables LLC, a contract to supply that US airline with 219 million gallons of SAF zero-to-low carbon emissions fuel at a fixed price.

This long-term offtake agreement will see the SAF come from Velocys' Bayou Fuels facility. Furthermore, with the recent Inflation Reduction Act of 2022 passing in the United States, SAF is one of the beneficiaries of the act's funding.

According to Velocys, tax credits and associated incentives for SAF is, "expected to underpin the financing of Bayou Fuels, Velocys' advanced SAF reference project in Natchez, Mississippi, US."

...continued on next page...

This agreement has the potential to add billions of dollars to the company's revenues over the life of the contract. For a company that made £3.4 million in gross profit in 2021, I'm sure you can see why this would be an absolute game-changer…

We believe that this small-cap UK pioneer has big long-term potential. It's at the precipice of disrupting the entire global aviation fuel industry and it's only just started its run.

Financials and risks

Now it's important to recognise this is all pioneering technology and things are only just getting started now.

The Lincolnshire plant will still need to be built and tested before going into actual production. That's why, at the time of the announcement from the government on 12 June 2020, it was noted that the company and the plant, "…could be producing sustainable aviation fuel in commercial scale by the middle of this decade ."

We see this as a long-term play but the gear in motion now could lift the company, and the stock price, in further anticipation of what's coming in the next few years.

And should it announce further development of other plants, for example in the United States, it could see the stock price lift off (so to speak) again.

With this being a long-term play, with pioneering technology and early-stage development of the commercial fuel plants, the financials aren't of the most critical importance right now.

Nonetheless, the financials do give us a guide as to the direction the company is heading.

Its most recent numbers are from its year ending 31 December 2021. Of note were revenues of £8.3 million (compared to £0.2 million in 2020), operating loss of £9 million (£8.8 million in 2020), and net cash at end of period of £25.5 million.

While the operating loss increased, the revenue numbers are clearly moving in the right direction. And, frankly, losses are expected for a company still in its development phase.

Velocys is not a fundamental value investment financial story here. It's a growth company that's going from research and development to tangible projects and development (with global player BA). This transition phase isn't going to necessarily deliver financial riches, but the anticipation is it will, which is why we've brought in the stock.

…continued on next page…

Velocys is pursuing plenty of leads around the globe. In February 2021, Velocys finalised a deal with Japanese firm Toyo Engineering Corp. to bring SAF and other renewable fuels to Japan.

This Toyo agreement shows there's still a lot of potential for Velocys in the global market. However, ongoing deal flow and deals like this will be needed for the stock to maintain momentum.

Clearly the geopolitical environment is calling out for the kind of products Velocys is looking to bring to market. The risk is that the company can't capitalise on this opportunity, and the stock price languishes.

The management faces the challenge to get this company from the fringes of development and concept to a commercial and profitable entity.

We believe they can achieve it.

Considering these risks and the financial situation, I'm happy with the current position of the company. However, you should be aware that due to the transition from R&D to a commercially viable company, there still may be a situation where the company looks to the market again for another capital raise to accelerate things like the Lincolnshire plant or further development in Japan.

Velocys' last capital raise came in November 2021, so another one could well be on the horizon. Be aware that as shareholders it has the potential to dilute your holdings should it again issue more stock for a raise.

While our view is long term, it's quite obvious the stock is volatile.

Expect volatility and market risk while being in the stock.

Still, considering the position of the company, its technology and the current push from industry and from government for a "green recovery", Velocys is primed to ride this opportunity and I think deliver tremendous upside to shareholders.

Buying instructions

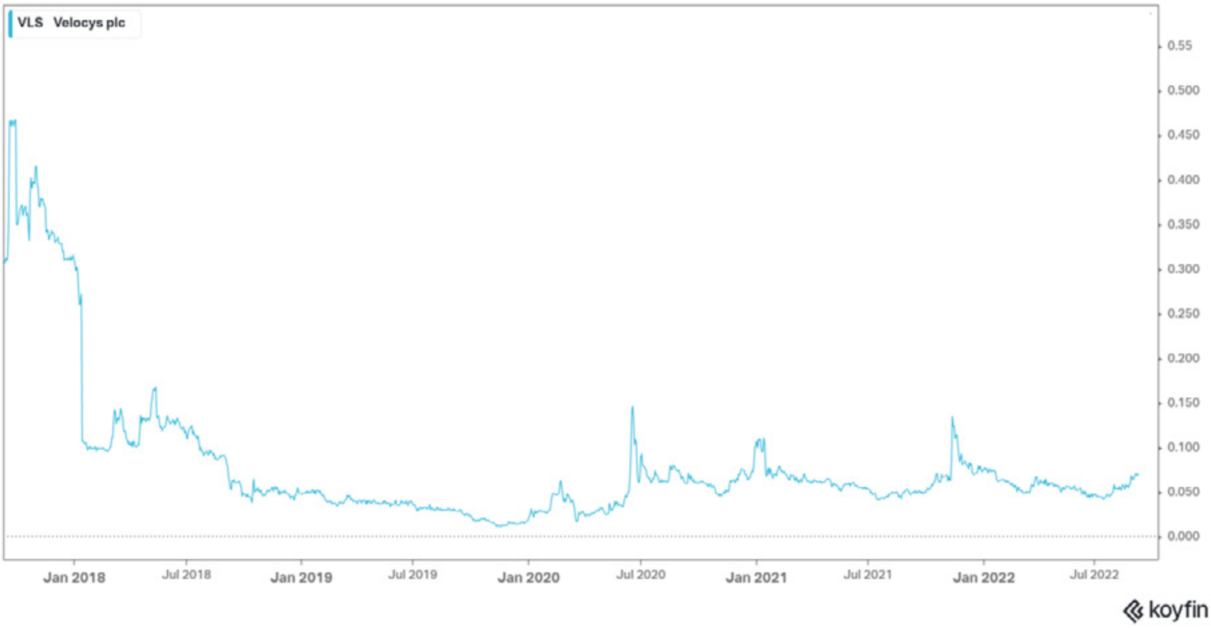
As noted, **Velocys plc (LSE:VLS)** is listed on the London Stock Exchange. the stock is currently trading at a price of around 6.46GBp with a market capitalisation of around £90 million.

Average volume in the stock is around 1.8 million – which equates to roughly £116,280 traded per day. These volumes and values do vary a lot, but it's fair to say that the stock is on the right side of illiquid, which means you should be aware of short-term swings should there be new coverage of the stock in the market.

As a reminder, we recommend sticking within our buy-up-to limits and not over bidding for the stock. Should it trade over the buy-up-to price, we'd suggest being patient for an opportunity to enter the stock once the dust settles.

...continued on next page...

Action to take: buy Velocys



Source: Koyfin

Please make sure you review the latest advice before purchasing. Click here for the latest portfolio.

Regards,

Sam Volkering
Editor, *Frontier Tech Investor*