

Chief Executive's Report

We are continuing to deliver



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Steve Foots
Group Chief Executive

Sales growth

+15.0%

NPP sales as % of Group sales

27.4%

Return on sales

24.0%

Relentless innovation driving record profit

Croda has delivered a record profit in 2016. We have grown sales through strategic acquisitions and organic growth in premium market niches, driving bottom line performance through high value products and relentless innovation. Our innovation pipeline is exciting, with sales from New and Protected Products (NPP) increasing for the fourth consecutive year and strong momentum across all market sectors. We continue to expand in higher growth markets, with Asia the stand out performer. We are growing with regional and smaller customers and are well positioned for the digital revolution across our customer base. We are investing in new technologies and further strengthening our existing market leading positions.

In a low growth environment Croda has continued to prioritise profitable growth over top line sales. In constant currency, adjusted profit before tax grew by 4.8%, whilst sales grew by 3.1%. As a global business but with 95% of sales made overseas, our results also benefited from favourable currency translation, with sales increasing by 15.0% and adjusted profit before tax up 13.2% to a record £288.3m.

Croda is a knowledge-based business, with innovation at the heart of our culture. NPP reached 27.4% (2015: 26.1%) of total sales as we added new Intellectual Property (IP) to the product portfolio, increasing our pricing power through the novel benefits we are able to deliver to customers. We continued to increase sales of premium products in Personal Care and Life Sciences, and returned to growth in Performance Technologies. In Life Sciences, progress was supported by the successful integration of Incotec, a leading Seed Enhancement business acquired in 2015. At the same time, we tightened our focus in less differentiated markets, successfully reducing sales of lower value-add products, exiting almost 20,000 tonnes of commodity sales in Industrial Chemicals and enhancing the product mix.

Croda's model is highly cash generative, delivering a superior Return on Invested Capital (ROIC) and excellent returns for investors. In 2016 we paid over £230m in dividends, including a £136m special dividend. We invested over £100m in capital expenditure for future organic growth, including an industry-leading bio-surfactants plant in North America to produce sustainably sourced ingredients for consumer markets. Despite this record level of investment, we increased free cash flow to over £155m and reduced leverage to the lower end of our target range at 1.1x net debt to EBITDA. ROIC remained excellent at 19.3% (restated 2015: 20.1%), despite dilution from ongoing investment and acquisition programmes.

Headline sales up 15.0%

Sales increased by 15.0% to £1,243.6m (2015: £1,081.7m). This included an 11.9% benefit from currency translation due to weaker Sterling. Sales in constant currency increased by 3.1%, with acquisitions contributing 4.7%.

Underlying sales (which excludes the impacts of currency translation and acquisition) declined by 1.6%, largely reflecting our strategy of reducing sales of low value-add co-products and tolling business in Industrial Chemicals. Within the Core Business (which excludes Industrial Chemicals), although underlying sales declined by 0.7% in the full year, there was a return to growth in the fourth quarter. Encouragingly, sales continued to grow in many premium markets, including actives in Personal Care, and in high purity excipients and crop delivery systems in Life Sciences. Offsetting this, we saw weaker demand in less differentiated areas of Personal Care, together with significantly lower sales from our generic Active Pharmaceutical Ingredient (API) contract in North America.

Strong profit growth with adjusted EPS up 15.4%

Adjusted profit before tax increased by 13.2% to £288.3m (2015: £254.7m). This was 4.8% higher in constant currency. Profit before tax on an IFRS basis was also up strongly at £275.7m (2015: £252.3m).

Return on sales increased by 40 basis points in constant currency, reflecting a richer product mix of 'high end' products and innovation. Reported return on sales was slightly lower at 24.0% (2015: 24.4%), due to the dilution impact of the Incotec acquisition and lower profit from the API contract in North America. Adjusted EPS rose 15.4% to 155.8p (2015: 135.0p) and the proposed final dividend has been increased by 8.6% to 41.25p (2015: 38.0p).

Investment in fast growing niches driving profit in Personal Care

Personal Care delivered a good profit improvement as ongoing innovation, growth in premium market niches and improved proximity to customers helped offset softer conditions in more mature and less differentiated markets. NPP increased to 40% of sector sales, driven by our Actives business, where sales grew by 6%, reflecting further success in Sederma. Asia delivered excellent growth with increasingly sophisticated, innovation-driven customers. In a market where regional and local players drive much innovation and growth, we are getting closer to more customers, replacing distributors with our direct selling model, delivered through locally based sales, marketing and technical personnel. We are better aligned to new independent, or 'Indie', brands, fast to market and increasingly delivered through digital channels.

By contrast to the Actives business, the market for Specialities was slower in 2016. We have a programme to drive greater product differentiation with multinational customers and expansion of our sustainable product portfolio. Overall, in constant currency, Personal Care adjusted operating profit increased by 4.0%, despite sales being 0.8% lower, improving reported return on sales by 100 basis points.

Focused acquisition and clever innovation offsetting API weakness in Life Sciences

Life Sciences achieved a good performance, with the majority of the business delivering robust sales and profit growth, supported by the acquisition of Incotec. In constant currency, sales rose by 19.0%, reflecting the integration of Incotec and initial synergies with our Crop Protection business. We continued to grow the diversified, IP-rich delivery systems business in the Health Care and Crop Protection markets, with sales in the latter growing by 4% in constant currency. Adjusted operating profit grew by 3.6% in constant currency, a strong result and overcoming a halving of sales in the North America generic API contract.

Improving sales and margin in Performance Technologies

Performance Technologies saw an improving sales trend through 2016, excellent profit growth and a better return on sales. This reflected increased innovation leading to new products for faster growth markets; continued geographic expansion outside its traditional European heartland; and an enhanced product mix through upgrading into more value-add products. At constant currency, sales grew by 1.4% in the year and by 6% in the fourth quarter, with adjusted operating profit 12.1% better in the full year. Business quality continued to improve. Our focus on value, rather than volume, saw exits from low value products in Coatings & Polymers, driving better profitability through greater differentiation. NPP sales improved, with progress in novel patented slip additives and speciality bio-based coatings. Sales expanded in Asia, with strategic investment underway in the Sipo joint venture in China. The sector remains on track to achieve a return on sales of 20% in the medium term, through better product mix and building market leading positions in 'high-tech' niches.

Refining the mix in Industrial Chemicals

2016 saw continued progress in our strategy to reduce sales from co-products and tolling in Industrial Chemicals, whilst creating new products for novel applications. During 2016, we reduced sales volume by almost 20,000 tonnes, including diverting glycerine by-product to a new bio-fermentation plant in the Netherlands to produce low cost, green energy. As a result, in constant currency, sales declined by 8.5%.

Continued sales growth in Asia and Europe

We saw good underlying sales growth across the Core Business in Asia and Europe. Asia underlying sales increased by 5%, with growth across all three market sectors, driven by increased proximity to local and regional customers. The market in Europe remained positive, with underlying sales up 2%, reflecting resilient consumer demand. These encouraging performances were offset by lower underlying sales in the Americas, with North America down by 6% and Latin America nearly 7% lower. North America included the adverse impact of lower API sales, whilst poor macro-economic conditions in Latin America saw weaker sales in US Dollar-denominated prices, although sales value was up in local currency terms. Encouragingly, both these regions showed an improving trend in the fourth quarter.

Our strategy



Delivering Growth

Delivering consistent top and bottom line growth



Driving Innovation

Increasing the proportion of protected innovation



Sustainable Solutions

Accelerating our customers' transition to sustainable ingredients

Continuing to deliver our strategy

Croda creates innovative ingredients for niche markets in order to create shareholder value. Our strategy to deliver this comprises three components:

1. Delivering consistent top and bottom line growth
2. Increasing the proportion of protected innovation
3. Accelerating our customers' transition to sustainable ingredients.

In 2016 we delivered in each of these three areas.

Delivering consistent top and bottom line growth

We aim to deliver profit growth ahead of sales value growth, in turn ahead of volume growth. Despite weak global demand, Croda made good progress in delivering top and bottom line growth in 2016. Sales value grew by 15.0% and adjusted operating profit by 12.9%.

In a low growth environment, less differentiated markets are becoming increasingly mature. In response, Croda is connecting to faster growth markets by developing faster growth technologies; expanding in faster growth geographies; and finding faster growth niches. Through our global sector teams, we identify and anticipate consumer trends and respond swiftly to satisfy customer needs through key technologies which are often unique to Croda. In 2016, these faster growth technologies included actives in Personal Care, crop delivery systems in Life Sciences and new coatings solutions in Performance Technologies.

We continue to develop in fast growth geographies. Asia continues to be a growth engine, accounting for 22% of sales in 2016. We have invested in new application laboratories, including in Korea, where many global personal care trends originate. We are establishing greater customer intimacy, with our locally-based sales, technical and warehousing ensuring close proximity to regional and local customers, as well as multinational customers. In the digital world, 2016 saw the rapid growth of new 'virtual' customers. We are structuring our Business to help these customers create, formulate and bring products to market quickly. In addition, in 2016 in Asia and Latin America we transitioned sales

from distributors to our direct selling model, giving us direct access to hundreds of new customers in growth territories, such as China and Indonesia.

We are developing in faster growing niches by investing organically in new technologies, expanding capacity in existing technologies and acquiring technology-rich businesses. In 2016 we continued our investment in a new bio-surfactants plant in North America, we expanded the Sederma skin actives facility and opened a new R&D facility in Crop Care in Europe. We integrated the most recent 'bolt-on' acquisition in Life Sciences, Incotec, a 'below the ground' crop technology with excellent synergies to the existing Crop Protection business. We have successfully repositioned Incotec for top line growth and margin improvement. In 2016 we added an encapsulation delivery technology to Croda's portfolio through the acquisition of Inventiva in Brazil.

Increasing the proportion of protected innovation

Innovation is the lifeblood of Croda and is deeply embedded across our global sectors. It is a key differentiator between ourselves and our peers, making us a preferred supplier for many customers.

In constant currency, NPP sales have increased by over 40% since 2012, from 20.5% of total sales to 27.3% today. We have an extensive innovation pipeline, supported by 250 Open Innovation partnerships with universities, specialist research laboratories and Small and Medium-sized Enterprises (SMEs). In 2016 we secured funding for a number of PhD R&D chemists through the UK's Biotechnology and Biological Sciences Research Council (BBSRC). We are targeting to grow NPP twice as fast as non-NPP sales.

Personal Care has the richest innovation, with NPP sales reaching 40% of sector sales in 2016. Building on our pioneering heritage in skin active ingredients, we are developing our Actives business with a target to deliver half of Personal Care sales from high value, protected niches. In 2016, we saw sales grow in plant cell cultures from 'IRB by Sederma', new biological systems in hair care and enjoyed rapid growth in metal oxide sun care ingredients for cosmetics. We are investing in a new state-of-the-art Materials Innovation Factory at the University of Liverpool, alongside a key multinational customer.

In Life Sciences, NPP sales now account for over 30% of sales. In 2016 we developed new applications for ultra-pure systems for the delivery of complex pharmaceutical drugs. Customers need to deliver more from new and existing drug actives and Croda's clever technology delivers the purity and stability required. We are supporting this by investing in additional capacity. Collaborative product development with multinational customers is securing significant growth in Crop Protection.

In Performance Technologies we are building the innovation pipeline from a low historical base. In 2016 we achieved a preliminary registration for MyCroFence™, a novel non-leaching anti-microbial coatings technology, and delivered new innovative products in lubricant additives, helping NPP sales in this sector to reach almost 20% of total sales.

Accelerating our customers' transition to sustainable ingredients

We are passionate about sustainability, a key component of our growth plans. We are an industry leader in using sustainable raw materials and processes to meet consumer demand. This demand is expected to grow; in Personal Care, for example, more than 25% of customer product launches now make a sustainability claim.

With around two-thirds of raw materials already coming from natural sources, we are ideally positioned to help deliver our customers' promises and assist them in achieving their sustainability targets.

In 2016 we progressed construction of the US\$175m bio-surfactant plant in North America. Due to commission in the second half of 2017, the facility will replace petrochemical feedstocks with a new and unique 'ECO' range of 100% sustainable surfactant products, creating growth opportunities across the Core Business.

We continue to reduce our own environmental impact. Waste to landfill has been cut by 60% since 2010.

In the Netherlands we commissioned a bio-fermentation plant to convert glycerine by-products into greener energy.

In Spain, we are investing to reduce the quantity of water used by 90% through water recycling and high-efficiency cooling systems.

Future opportunities

Our priorities for 2017 are to drive profitability through a greater focus on premium, faster growth niches; improve performance in less differentiated markets; and continue to grow margins in Performance Technologies and Inotec.

We have seen some encouraging signs of improving sales trends, which have continued into 2017. We are supporting this through innovation and investment. Innovation will be supported by technology-driven acquisitions, investments and smart partnering, including more Open Innovation. Focused investment in new manufacturing capabilities will also access higher growth, including new 'ECO' products, expansion in high purity Health Care systems and extending our leadership in Polymer Additives. We will continue to leverage our industry leading position in sustainability.

Croda is a strongly cash generative business with substantial balance sheet capacity. We will remain disciplined in both our capital allocation and in driving returns for shareholders.

We are confident of delivering continued progress in our performance in 2017. Additionally, if current exchange rates are maintained, there will be a further currency benefit to reported results.



Steve Foots
Group Chief Executive