Finance review

The resilience and cash-generative nature of our business model was demonstrated in 2020, despite the impact of the COVID-19 pandemic on market demand.

Jez Maiden
Group Finance Director

"With only a limited reduction in profit, Croda continued to invest in future growth, through both organic expansion and acquisition, whilst continuing to increase its dividend."

Sales
£1,390.3m
2019: £1,377.7m

Adjusted profit before tax
£300.6m
2019: £322.1m

Free cash flow
£176.9m
2019: £201.7m

Croda investment case

Highly differentiated approach
Flexible, local manufacturing providing resilience, and direct selling to customers.

Dynamic innovation engine
Open approach to innovation with 500 partners working on over 100 projects increasingly focused on sustainability.

Focused on faster-growing niches
Strong position in high-growth niches well aligned with growing consumer demand for sustainability.

High-quality business with superior financial performance
Highly cash-generative operations with world-class profit margins.

Strong balance sheet
Clear capital allocation policy prioritising disciplined investment in growth.

Attractive shareholder returns
Track record of creating shareholder value through high returns on capital and 29 years of consecutive dividend progression.

Strong cash generation and funding capacity supporting continued investment

The resilience and cash-generative nature of our business model was demonstrated in 2020, despite the impact of the COVID-19 pandemic on market demand. With only a limited reduction in profit, Croda continued to invest in future growth, through both organic expansion and acquisition, whilst continuing to increase its dividend.

Currency

The average sterling exchange rates across the Group's key currencies in 2020 were broadly unchanged at US$1.285 (2019: US$1.278) and €1.125 (2019: €1.141), resulting in limited impact of currency translation on reported sales and operating profit.

Sales

Sales in reported currency increased by 0.9% to £1,390.3m (2019: £1,377.7m). Constant currency sales increased by 1.1%. Underlying sales declined by 2.7%, more than offset by acquisition sales adding £51.8m.

Sales	£m	%
2019 reported	1,377.7	
Underlying growth/(decline)	(37.3)	(2.7)
Impact of acquisitions	51.8	3.8
2020 constant currency	1,392.2	1.1
Impact of currency translation	(1.9)	(0.2)
2020 reported	**1,390.3**	**0.9**

In the Core Business, constant currency sales increased by 2.3%. Sales volume increased by 1.2%, driven by growth in Life Sciences. Price/mix was 3.0% lower, reflecting adverse mix in Personal Care and Performance Technologies in challenging market conditions. Acquisitions added 4.1% to Core Business sales growth.

Sales	2020 reported currency £m	Year on year change	Constant currency change	2019 £m
Personal Care	475.9	(1.9)%	(1.8)%	485.2
Life Sciences	401.6	14.6%	14.8%	350.5
Performance Technologies	416.4	(3.2)%	(3.2)%	430.2
Core Business	1,293.9	2.2%	2.3%	1,265.9
Industrial Chemicals	96.4	(13.8)%	(13.4)%	111.8
Group	**1,390.3**	0.9%	1.1%	1,377.7

Constant currency sales in Life Sciences grew by nearly 15%, with a positive impact on demand in Health Care from COVID-19, supported by the Avanti acquisition in August. Personal Care sales were 2% lower, due to the impact of COVID-19 lockdowns on consumer demand, and Performance Technologies fell by 3%, particularly reflecting weakness in global automotive demand. Overall, the second half year was notably stronger than the first, as markets recovered and with the benefit of acquisitions. In particular, the fourth quarter saw underlying Personal Care sales restored to the prior year level, a return to sales growth in Performance Technologies and continued strong demand in Life Sciences.

2020 sales at constant currency	First Half %	Second Half %	Full Year %
Personal Care	(9.5)	6.2	(1.8)
Life Sciences	(1.7)	33.2	14.8
Performance Technologies	(5.6)	(0.6)	(3.2)
Core Business	(6.0)	11.3	2.3
Industrial Chemicals	(17.8)	(8.9)	(13.4)
Group	**(6.9)**	**9.6**	**1.1**

Adjusted profit

Adjusted operating profit decreased by 5.9% in reported currency to £319.6m (2019: £339.7m). Operating costs benefited from cost savings delivered at the end of 2019, lower discretionary spend in 2020 (for example, on travel and exhibitions) and no bonus charge. These savings were offset by the impact of acquisitions and a higher share-based payments charge, reflecting the strong share price performance and high levels of employee share plan participation. The loss from the ECO biosurfactants plant in North America increased by £7m to £11m, due to higher feedstock prices, caused by COVID-19 demand for sanitiser-grade bioethanol, and the plant only operating for part of the period whilst carrying a full cost base.

The classification of cost of sales and administrative expenses within the Income Statement has been revised to align more closely with the Group's inventory valuation policy and market practice. As a result, 2019 comparative operating costs have been increased by £119.0m, with a corresponding reduction in cost of sales.

Income statement	2020 £m	2019 restated £m
Revenue	**1,390.3**	1,377.7
Cost of sales	**(758.2)**	(746.5)
Gross profit	**632.1**	631.2
Adjusted operating costs	**(312.5)**	(291.5)
Adjusted operating profit	**319.6**	339.7
Net interest charge	**(19.0)**	(17.6)
Adjusted profit before tax	**300.6**	322.1

On a constant currency basis, adjusted operating profit fell by 4.0%. This reflected the impact of the decline in underlying sales, together with an adverse impact from the lower price/mix, partly offset by £12.3m of incremental profit from in-year acquisitions. As a result, return on sales declined to 23.0% (2019: 24.7%).

Adjusted operating profit	£m	%
2019 reported	339.7	
Underlying growth	(26.0)	(7.7)
Impact of acquisitions	12.3	3.7
2020 constant currency	326.0	(4.0)
Impact of currency translation	(6.4)	(1.9)
2020 reported	**319.6**	**(5.9)**

Constant currency operating profit in Life Sciences increased by over £27m, reflecting revenue growth and an increase in high value-add Health Care sales. By contrast, profit fell in Personal Care and Performance Technologies, the former due to lower sales and adverse mix, as Beauty Formulation's 'at home' use products held up better during the pandemic than the higher value-add Beauty Actives and Effects businesses, and the latter due to lower sales, adverse mix and higher operating leverage.

Adjusted operating profit	2020 Reported £m	2020 Constant currency £m	2019 Reported £m
Personal Care	**136.5**	137.3	162.1
Life Sciences	**129.4**	134.3	107.1
Performance Technologies	**54.0**	54.6	69.4
Core Business	**319.9**	326.2	338.6
Industrial Chemicals	**(0.3)**	(0.2)	1.1
Group	**319.6**	326.0	339.7

In reported currency, the net interest charge increased to £19.0m (2019: £17.6m), reflecting higher net debt following the Avanti and Iberchem acquisitions. Adjusted profit before tax reduced to £300.6m (2019: £322.1m), a creditable performance in the challenging conditions created by the COVID-19 pandemic.

The effective tax rate reduced to 24.1% (2019: 25.6%). There were no significant adjustments between the Group's expected and reported tax charge based on its accounting profit. Adjusted profit after tax in reported currency was £228.2m (2019: £239.7m). Adjusted basic earnings per share (EPS) were 175.5p (2019: 185.0p), reflecting the lower profit and the share issuance for the Iberchem acquisition in November.

IFRS profit

IFRS profit is measured after exceptional items, acquisition costs and amortisation of intangible assets arising on acquisition, whereas the adjusted results are presented excluding these items. The charge for these adjusting items before tax was £31.1m (2019: £19.8m). Acquisition costs were significantly higher in 2020 at £11.7m (2019: £0.3m), reflecting the activity in the year. The charge for amortisation of intangible assets was £13.6m (2019: £8.8m), with the increase reflecting recent acquisitions. The charge for exceptional items was £5.8m (2019: £10.7m), reflecting the delivery of the cost-saving actions announced in the 2019 full year results and a discount unwind in contingent consideration.

These have been presented as exceptional by virtue of their nature and for consistency across reporting periods. Profit before tax on an IFRS basis was £269.5m (2019: £302.3m), the profit after tax on an IFRS basis was £201.6m (2019: £223.8m) and basic EPS were 155.1p (2019: 172.8p).

Income statement	2020 £m	2019 £m
Adjusted profit before tax	**300.6**	322.1
Exceptional items, acquisition costs & intangibles	**(31.1)**	(19.8)
Profit before tax (IFRS)	**269.5**	302.3
Tax	**(67.9)**	(78.5)
Profit after tax (IFRS)	**201.6**	223.8

From Personal Care to Consumer Care

As set out in the Chief Executive's Review, from 2021 the Group will report under four sectors – Consumer Care, Life Sciences, Performance Technologies and Industrial Chemicals. Consumer Care will comprise the Personal Care sector, including Iberchem and a customer currently reported within Life Sciences, and the Home Care business unit from Performance Technologies. In the 2021 accounts, the 2020 results will be restated for these changes. The table below sets out the new structure, showing both the actual 2020 result and the 2020 outcome had Iberchem and Avanti been owned for the full year ('pro-forma'). It does not include changes in allocation of central and indirect costs.

Capital allocation and cash management

The Group's capital allocation policy remains to:

1. **Reinvest for growth** – invest in organic capital expenditure to drive shareholder value creation through new capacity, product innovation and expansion in attractive geographic markets to drive sales and profit growth;
2. **Provide regular returns to shareholders** – pay a regular dividend to shareholders, representing 40 to 50% of adjusted earnings over the business cycle;
3. **Acquire disruptive technologies** – to supplement organic growth, continue to target a number of exciting technology acquisitions in existing and adjacent markets, with a focus on our Consumer and Life Sciences businesses; and
4. **Maintain an appropriate balance sheet and return excess capital** – maintaining an appropriate balance sheet to meet future investment and trading requirements, we are targeting a leverage ratio of 1 to 2x over the medium-term cycle. We consider returning excess capital to shareholders when leverage falls below our target range and sufficient capital is available to meet our investment opportunities, and last returned over £150m through a special dividend in 2019.

In 2020, at a time when other companies were cutting back investment, Croda continued to execute this policy. We invested in future organic growth, with net capital expenditure accelerating to £121.0m (2019: £106.8m), targeting our strategic delivery areas. We have expanded Life Sciences, investing to scale drug delivery, doubling our US speciality excipient capacity and expanding in Japan, while reprioritising £10m in 2020 to deliver COVID-19 solutions for our customers. We have invested to fast-grow in Asia with new labs and digital presence, expanded capacity in Smart Materials in Performance Technologies and invested to grow our sustainable product offerings.

Croda has operated for many years with a prudent leverage and dividend distribution policy. This enabled the Board, after careful consideration of all stakeholders and treating all groups consistently and fairly, to pay the final 2019 ordinary dividend of 50.5 pence per share (£65.0m) in May 2020. In addition, given the resilience of the business model during the COVID-19 pandemic, Croda maintained the interim dividend of 39.5p (2019: 39.5p), paid in October 2020. Given 2020 earnings performance, limited leverage and balance sheet strength, the Board is recommending a full year ordinary dividend of 91.0p (2019: 90.0p). This is a 1.1% increase on the prior year, a 10.5% increase in cash cost and represents 52% of adjusted EPS, with the ratio expected to come within the policy range over the medium term.

2020 saw significant allocation of capital to acquisitions. Building on our leading position in Health Care, in August we completed the acquisition of Avanti Polar Lipids, LLC for an initial consideration of US$185m and a potential earn-out of up to a further US$75m. This acquisition was funded from a US$200m unsecured, committed three-year term loan, with financial covenant requirements consistent with the Group's facilities. Combined with Avanti's cash generation, the acquisition had a limited impact on Croda's leverage and liquidity. Consumer Care is also a priority for capital allocation and in November we acquired Iberchem for a total consideration of €820m. The acquisition was funded by a combination of the Group's existing debt facilities and an equity placing which raised net proceeds of £615m. Return on invested capital (ROIC) reduced to 14.6% (2019: 17.0%), primarily due to the significant allocation of capital to acquisitions during the year. The Economic Value Added (EVA) underpin to Croda's Remuneration Policy reinforces the importance of delivering superior ROIC which is expected to improve as the profit benefits of recent acquisitions develop.

With working capital broadly flat in the year, free cash flow remained robust at £176.9m (2019: £201.7m).

	Sales			Adjusted operating profit		
2020 reported currency	As reported £m	New structure £m	Pro-forma £m	As reported £m	New structure £m	Pro-forma £m
Consumer Care	**475.9**	**527.8**	**666.6**	**136.5**	**146.5**	**171.0**
Life Sciences	**401.6**	**392.5**	**410.5**	**129.4**	**124.5**	**127.5**
Performance Technologies	**416.4**	**373.6**	**373.6**	**54.0**	**48.9**	**48.9**
Core Business	**1,293.9**	**1,293.9**	**1,450.7**	**319.9**	**319.9**	**347.4**
Industrial Chemicals	**96.4**	**96.4**	**96.4**	**(0.3)**	**(0.3)**	**(0.3)**
Group	**1,390.3**	**1,390.3**	**1,547.1**	**319.6**	**319.6**	**347.1**

Cash flow	2020 £m	2019 £m
Adjusted operating profit	**319.6**	339.7
Depreciation and amortisation	**68.2**	57.6
EBITDA	**387.8**	397.3
Working capital	**(2.3)**	1.6
Net capital expenditure	**(121.0)**	(106.8)
Payment of lease liabilities	**(7.6)**	(8.8)
Non-cash pension expense	**7.7**	2.8
Interest & tax	**(87.7)**	(84.4)
Free cash flow	**176.9**	201.7
Dividends	**(115.9)**	(266.9)
Issue of new equity	**615.5**	–
Acquisitions	**(869.7)**	(5.0)
Other cash movements including acquisition costs	**(26.6)**	(17.9)
Net cash flow	**(219.8)**	(88.1)
Net movement in borrowings	**237.3**	115.4
Net movement in cash and cash equivalents	**17.5**	27.3

Net debt and liquidity

After currency translation, net debt increased to £800.5m (31 December 2019: £547.7m). The Group has a strong balance sheet, having completed its debt refinancing in 2019, with no material debt maturities falling due before 2023. Aligned with Croda's commitment to be Climate Positive by 2030, our 'green' banking facility requires Croda to reduce its carbon use every year by a specified amount to receive the most favourable rate of interest. As at 31 December 2020, the Group had committed funding in place of £1,244.3m, with undrawn long-term committed facilities (net of overdrafts) of £378.3m and £106.5m in cash. As a result, the leverage ratio was 1.8x (31 December 2019: 1.4x), well within a covenant maximum of 3.5x, measured semi-annually.

In the first half year, we reviewed the liquidity and covenant forecasts for the Group for the potential impact of COVID-19 on trading activities. We also considered sensitivities in respect of potential downside scenarios and the mitigating actions available, relative to a base case scenario. The downside scenarios assumed a significant reduction in demand, a material increase in working capital and substantial margin erosion. The evaluation showed that, even in the most pessimistic downside scenario, the Group would continue to have robust liquidity and financial covenant headroom. In the event, the full year result was ahead of the base case scenario. Following the year end, we have repeated the scenario planning and confirmed that the Group is expected to continue to maintain robust liquidity and ample headroom.

Brexit update

Through the implementation of detailed contingency plans, we saw minimal operational impact from the UK's withdrawal from the European Union (EU) at the end of 2020. We initiated changes to our European trading model, temporarily increased inventory levels to mitigate any risks of delays at borders and ensured that customer service was maintained. We continue to monitor the post-Brexit situation, particularly with regard to cross-border shipping and the proposed UK chemicals regulatory regime.

Retirement benefits

The post-tax deficit on retirement benefit plans at 31 December 2020 on an accounting valuation basis under IAS19 reduced to £25.3m (2019: £60.1m). Cash funding of the various plans is driven by the schemes' ongoing actuarial valuations. While the triennial actuarial valuation as of 30 September 2020 for the largest pension plan, the UK Croda Pension Scheme, is not yet complete, the scheme is expected to be fully funded on a Technical Provisions basis with no deficit contribution required.

Alternative performance measures

We use a number of alternative performance measures to assist in presenting information in this Report in an easily analysable and comprehensible form. We use such measures consistently at the half year and full year and reconcile them as appropriate. The measures used in this statement include:

- *Constant currency results*: these reflect current year performance for existing business translated at the prior year's average exchange rates and include the impact of acquisitions. For constant currency profit, translation is performed using the entity reporting currency. For constant currency sales, local currency sales are translated into the most relevant functional currency of the destination country of sale (for example, sales in Latin America are primarily made in US dollars, which is therefore used as the functional currency). Sales in functional currency are then translated into Sterling using the prior year's average rates for the corresponding period. Constant currency results are reconciled to reported results in this Finance review*;*
- *Underlying sales and operating profit:* these reflect constant currency values adjusted to exclude the impact of acquisitions. They are reconciled to reported results in this Finance review;
- *Adjusted results*: these are stated before exceptional items, acquisition costs and amortisation of intangible assets arising on acquisition, and tax thereon. The Board believes that the adjusted presentation (and the columnar format adopted for the Group income statement) assists shareholders by providing a meaningful basis upon which to analyse underlying business performance and make year-on-year comparisons. The same measures are used by management for planning, budgeting and reporting purposes and for the internal assessment of operating performance across the Group. The adjusted presentation is adopted on a consistent basis for each half year and full year results;
- *Core Business*: this comprises Personal Care, Life Sciences and Performance Technologies;
- *Return on sales*: this is adjusted operating profit divided by sales, at reported currency;
- *Net debt*: comprises cash and cash equivalents (including bank overdrafts), current and non-current borrowings and lease liabilities;
- *Leverage ratio*: this is the ratio of net debt to Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA) adjusted to include EBITDA from acquisitions in the last 12-month period. EBITDA is adjusted operating profit plus depreciation and amortisation; and
- *Free cash flow*: comprises EBITDA less movements in working capital, net capital expenditure, payment of lease liabilities, non-cash pension expense, and interest and tax payments.