Independent Auditor’s Report to the Members of Croda International Plc

1. Our opinion is unmodified

We have audited the financial statements of Croda International Plc (“the Company”) for the year ended 31 December 2018 which comprise the Group Income Statement, the Group Statement of Comprehensive Income, the Group and Company Balance Sheets, Group Statement of Cash Flows, the Group and Company Statements of Changes in Equity, and the related notes, including the accounting policies on pages 105 to 111 and on page 140.

In our opinion:
• the financial statements give a true and fair view of the state of the Group’s and of the parent Company’s affairs as at 31 December 2018 and of the profit for the year then ended;
• the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union;
• the parent Company financial statements have been properly prepared in accordance with UK accounting standards, including FRS 101 Reduced Disclosure Framework; and
• the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Basis for opinion
We conducted our audit in accordance with International Standards on Auditing (UK) (“ISAs (UK)”) and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the Audit Committee.

We were first appointed as auditor by the shareholders on 25 April 2017. The period of uninterrupted engagement is for the one financial year ended 31 December 2018. We have fulfilled our ethical responsibilities under, and we remain independent of the Group in accordance with, UK ethical requirements including the FRC’s Ethical Standard as applied to listed public interest entities. No non-audit services prohibited by that standard were provided.

Overview
Materiality: Group financial statements as a whole £16 million 5% of group profit before tax
Coverage 79% of group profit before tax

Key audit matters
Recurring risks
Valuation of defined benefit pension scheme liabilities and certain of its assets
Environmental provision
Taxation
Recoverability of parent company’s intercompany receivables

2. Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgement, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us. These matters had the greatest effect on:
- the overall audit strategy;
- the allocation of resources in the audit;
- and directing the efforts of the engagement team.

We summarise below the key audit matters, in decreasing order of audit significance, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

Group
The risk
Our response
Valuation of defined benefit pension scheme liabilities and certain of its assets
Subjective valuations:
• The Group has three defined benefit pension schemes that are material in the context of the overall balance sheet and the results of the Group.
• Significant estimates, including the discount rate, the inflation rate, the mortality rate and GMP equalisation adjustment, are made in valuing the Group’s defined benefit pension obligations (before deducting the schemes’ assets). The UK scheme is still open to future accrual and new members, and small changes in the assumptions and estimates would have a significant effect on the financial position of the Group. The Group engages external actuarial specialists to assist them in selecting appropriate assumptions and calculate the obligations.

The effect of these matters is that, as part of our risk assessment, we determined that the valuation of the defined benefit obligations has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount.

The financial statements note 10 on pages 118 to 121 (financial disclosures) disclose the sensitivity estimated by the Group.

Judgments and estimations are also applied when valuing certain of the schemes’ unlisted real estate and infrastructure assets, including the choice of valuation methodology.

Our procedures included:
• Benchmarking assumptions: challenged key assumptions applied (discount rate, inflation rate, and mortality rate) with the support of our own actuarial specialists, including a comparison of key assumptions against market data.
• Sensitivity analysis: assessed the sensitivity of the defined benefit obligation to changes in certain assumptions.
• Test of details: obtained third party valuation confirmations directly from fund managers, and compared those confirmations with unaudited Net Asset Value (NAV) statements. Tested the ability of fund managers to prepare accurate valuations by validating the unaudited NAV statements to audited financial statements.
• Actuaries’ and fund managers’ credentials: assessed the competence, independence and integrity of the Group’s actuarial expert and third party fund managers.
• Accounting analysis: challenged the accounting subjectivities such as GMP equalisation treatment that have been applied.
• Assessing transparency: considered adequacy of the Group’s disclosures in respect of the sensitivity of the net deficit to changes in key assumptions.

Our results
The results of our testing were satisfactory and we found the valuation of retirement benefit liabilities and certain unlisted assets to be acceptable.

Environmental provision
(Gross defined benefit obligation £1,208.7 million; 2017: £1,317.8 million)
Omitted exposure:
• The Group has numerous operating and legacy manufacturing sites worldwide. Environmental issues and related legal proceedings are inherent within the chemicals industry. There are a number of ongoing claims against the Group for soil and potential groundwater contamination and environmental damage.

• The accounting risk is that there is a material exposure which has not been provided for. The determination of the resulting environmental provision is inherently subjective and involves a significant level of judgement, including the interpretation of local environmental legislation.

Our procedures included:
• Enquiry with lawyers: obtained legal confirmation letters and inspected legal correspondence in relation to ongoing claims, and held discussions with the Group’s in-house legal team and specialists.
• Third party expert credentials: assessed the competence, independence and integrity of the Group’s third party experts used in estimating the provision.
• Comparisons: assessed legal expenses incurred and reviewed due diligence performed on acquisitions made in the period and compared these with the provisions identified.
• Assessing transparency: considered the adequacy of the Group’s disclosures in respect of the nature and extent of the exposure and the subjectivity in the forecasts.

Our results
We found the judgements made around accounting for environmental provisions and contingent liabilities to be acceptable.
Independent Auditors’ Report to the Members of Croda International Plc continued

Group

The risk

Taxation

Dispute outcome:
- The Group operates in multiple tax jurisdictions governed by national tax laws and regulations, and is required to estimate the impact of cross-border transactions including transfer pricing arrangements. Misinterpretation of these laws and regulations could give rise to a material misstatement.
- The Group also holds a number of specific judgemental tax accruals that relate to specific, open tax investigations/audits and other matters. The estimation of the accruals are dependent on the Directors’ assessment of the likely outcome of the outstanding matters.

Subjective estimate:
- The Directors have recorded accruals to cover potential liabilities arising from the risk of challenge to transfer pricing arrangements and ongoing tax investigations in different jurisdictions. There is a risk that the Group’s judgements do not adequately reflect the latest available, reliable information or an appropriate application of relevant tax legislation, and are either under or overstated as a result.
- The effect of these matters is that, as part of our risk assessment, we determined that the valuation of tax accruals has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole.

Parent

Recoverability of parent Company’s intercompany receivables (£1,675.4 million; 2017: £1,810.1 million)

Note to page 110 (accounting policy) and note H on page 142 (financial disclosures).

Our response:
- Our procedures included:
  - Tests of detail: Compared the carrying amount of the highest value receivables balances with the respective subsidiaries’ net asset values and forecast cash generation to identify with reference to the relevant debtors’ draft balance sheet, whether the net asset values, being an approximation of their maximum recoverable amount, were in excess of the carrying amount.
  - Other audit tests:
    - The results of our testing were satisfactory and we found the recoverability of intercompany receivables to be acceptable.

Group revenue

Group profit before tax

76%

Group total assets

85%

Profit before tax £317.8m

Group materiality £16.0m

Whole financial statements materiality £11.0m

Range of materiality at 16 components (£0.8m-£11.0m)

Group and the Company will continue in operation.

3. Our application of materiality and an overview of the scope of our audit

Materiality for the Group financial statements as a whole was set at £16.0 million, determined with reference to a benchmark of Group profit before income tax of £317.8 million, of which it represents 5.0%.

Materiality for the parent Company financial statements as a whole was set at £10.2 million, determined with reference to a benchmark of company total assets of £2,276.8 million, of which it represents 0.4%.

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.8 million, in addition to other identified misstatements that warranted reporting on qualitative grounds.

Profit before tax £317.8m

Group materiality £16.0m

Whole financial statements materiality £11.0m

Range of materiality at 16 components (£0.8m-£11.0m)

Profit before tax

Group materiality

£0.8m

Misstatements reported to the Audit Committee

Group revenue

Group profit before tax

76%

79%

58

79

58

85%

In our evaluation of the Directors’ considerations, we considered the inherent risks to the Group’s and Company’s business model and analysed how those risks might affect the Group’s and Company’s financial resources or ability to continue operating over the going concern period. The risks that we considered most likely to adversely affect the Group’s and Company’s available financial resources over this period were:

- The impact of a significant business continuity issue affecting the Group’s manufacturing facilities or those of its suppliers;
- A potential significant legal settlement relating to a compliance breach such as an environmental issue; and
- The impact of Brexit on the Group’s supply chain.

4. We have nothing to report on going concern

The Directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Company or the Group or to cease their operations, and as they have concluded that the Company’s and the Group’s financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over their ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

Our responsibility is to conclude on the appropriateness of the Directors’ conclusions and, had there been a material uncertainty related to going concern, to make reference to that in this audit report. However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor’s report is not a guarantee that the Group and the Company will continue in operation.

Of the Group’s 80 reporting components, we subjected 8 to full scope audits for group purposes and 8 to specified risk-focused audit procedures. One component for which we performed specified risk-focused procedures was not individually financially significant enough to require an audit for group reporting purposes, but did present some specific individual risks that were addressed. The other 7 components for which we performed other than audits for group reporting purposes were not individually significant but were included in the scope of our group reporting work in order to provide further coverage over the Group’s results. We subjected these 8 components to specified risk-focused audit procedures over a combination of revenue (6 components), property, plant and equipment (2 components) and defined benefit pension assets and liabilities (1 component). The components within the scope of our work accounted for 79% of the total profits and losses that made up group profit before tax.

The remaining 24% of total group revenue, 21% of group profit before tax and 15% of total group assets is represented by 84 components, none of which individually represented more than 3% of any of total group revenue, group profit before tax or total group assets. For the residual components, we performed analysis at an aggregated group level to re-examine our assessment that there were no significant risks of material misstatement within these.

The Group team instructed component auditors as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back. The Group team approved the component materialities, which ranged from £0.8m to £11.0m, having regard to the mix of size and risk profile of the Group across the components. The work on 12 of the 16 components was performed by component auditors in Germany, Italy, France, the Netherlands, Singapore, Japan, Brazil, Spain, China and India, and the rest, including the audit of the parent company, was performed by the Group team at locations in the UK and the USA.

The Group team visited 3 component locations in Singapore, France and Brazil, to assess the audit risk and strategy. Video and telephone conference meetings were also held with these component auditors and certain others that were not physically visited. At these visits and meetings, the findings reported to the Group team were discussed in more detail, and any further work required by the Group team was then performed by the component auditor.

In evaluation of the Directors’ conclusions, we considered the inherent risks to the Group’s and Company’s business model and assessed how those risks might affect the Group’s and Company’s financial resources or ability to continue operating over the going concern period. The risks that we considered most likely to adversely affect the Group’s and Company’s available financial resources over this period were:

- The impact of a significant business continuity issue affecting the Group’s manufacturing facilities or those of its suppliers;
- A potential significant legal settlement relating to a compliance breach such as an environmental issue; and
- The impact of Brexit on the Group’s supply chain.

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A potential significant legal settlement relating to a compliance breach such as an environmental issue; and

The impact of Brexit on the Group’s supply chain.
Independent Auditor’s Report to the Members of Croda International Plc continued

As these were risks that could potentially cast significant doubt on the Group’s and the Company’s ability to continue as a going concern, we considered sensitivities over the level of available financial resources indicated by the Group’s financial forecasts taking account of reasonably possible (but not unrealistic) adverse effects that could arise from them, including the individually and collectively and evaluated the achievability of the actions the Directors consider they would take to improve the position should the risks materialise. We also considered less probable but realistic second order impacts, such as the impact of erosion of customer or supplier confidence arising from Brexit, which could result in a rapid reduction of available financial resources.

Based on this work, we are required to report to you if:

• we have anything material to add or draw attention to in relation to the Directors’ statement in the Accounting Policies on pages 105 and 140 on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the Group and Company’s use of that basis for a period of at least twelve months from the date of approval of the financial statements; or

• if the related statement under the Listing Rules set out on page 92 is materially inconsistent with our audit knowledge.

We have nothing to report in these respects, and we did not identify going concern as a key audit matter.

5. We have nothing to report on the other information in the Annual Report

The Directors are responsible for the other information presented in the Annual Report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

Strategic Report and Directors’ Report

Based solely on our work on the other information:

• we have not identified material misstatements in the strategic report and the Directors’ report;

• in our opinion the information given in those reports for the financial year is consistent with the financial statements; and

• in our opinion those reports have been prepared in accordance with the Companies Act 2006.

Directors’ remuneration report

In our opinion the part of the Directors’ Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Disclosures of principal risks and longer-term viability

Based on the knowledge we acquired during our financial statements audit, we have nothing material to add or draw attention to in relation to:

• the Directors’ confirmation on page 39 in relation to the viability statement on page 43 that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency and liquidity;

• the Key Risks disclosures describing these risks and explaining how they are being managed and mitigated; and

• the Directors’ explanation in the viability statement of how they have assessed the prospects of the Group, over what period they have done so and why they considered that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Under the Listing Rules we are required to review the viability statement. We have nothing to report in this respect.

Our work is limited to assessing these matters in the context of only the knowledge acquired during our financial statements audit. As we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of anything to report on these statements is not a guarantee as to the Group’s and Company’s longer-term viability.

Corporate governance disclosures

We are required to report to you if:

• we have identified material inconsistencies between the knowledge we acquired during our financial statements audit and the Directors’ statement that they consider that the Annual Report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group’s and performance, business model and strategy; or

• the section of the Annual Report describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

We are required to report to you if the Corporate Governance Statement does not properly disclose a departure from the eleven provisions of the UK Corporate Governance Code specified by the Listing Rules for our review.

We have nothing to report in these respects.

6. We have nothing to report on the other matters on which we are required to report by exception

Under the Companies Act 2006, we are required to report to you if, in our opinion:

• adequate accounting records have not been kept by the parent Company, or returns adequate for our audit have not been received from branches not visited by us; or

• the parent Company financial statements and the part of the Directors’ Remuneration Report to be audited are not in agreement with the accounting records and returns; or

• certain disclosures of Directors’ remuneration specified by law are not made; or

• we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

7. Respective responsibilities

Directors’ responsibilities

As explained more fully in their statement set out on page 93, the Directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, assessing the Group and parent Company’s ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor’s responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or other irregularities (see below), or error, and to issue our opinion in an auditor’s report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISA (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud, other irregularities or error and are considered material if, individually, or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC’s website at www.frc.org.uk/auditorsresponsibilities.

Irregularities – ability to detect

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our general commercial and sector experience, through discussion with the Directors and other management (as required by auditing standards), from inspection of the Group’s regulatory and legal correspondence, and discussed with the Directors and other management, the policies and procedures regarding compliance with laws and regulations. We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit. This included communication from the Group to component audit teams of relevant laws and regulations identified at group level.

The potential effect of these laws and regulations on the financial statements varies considerably.

Firstly, the Group is subject to laws and regulations that directly affect the financial statements including financial reporting legislation, non-financial reporting legislation, Companies legislation, distributable profits legislation, and taxation legislation, and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Secondly, the Group is subject to many other laws and regulations, where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or liquidation or the loss of the Company’s licence to operate. We identified the following areas as those most likely to have such an effect: health and safety and product safety, anti-bribery and corruption, employment law, tax and environmental legislation, recognising the nature of the Group’s activities. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to review of the Directors and other management and inspection of regulatory and legal correspondence, if any. These limited procedures did not identify actual or suspected non-compliance.

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations (irregularities) is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it. In addition, as with any audit, there remained a higher risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. We are not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

8. The purpose of our audit work and to whom we owe our responsibilities

This report is made solely to the Company’s members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we may state to the Company’s members those matters we are required to state to them in an auditor’s report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company’s members, as a body, for our audit work, for this report, or for the opinions we have formed.

Chris Heard (Senior Statutory Auditor) on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

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26 February 2019