Finance Report

Strong cash generation

"Delivering a robust cash flow is core to Croda's strategy. This cash was used to invest in new technologies and to increase innovation and expand production capacity."

Jez Maiden
Group Finance Director

Performance highlights

- Adjusted profit before tax up 13.2%
- Significant improvement in free cash flow

Sales value

£1,243.6m

Adjusted profit before tax

+13.2%

Free cash flow

£155.5m

Currency

Currency translation had a significant beneficial impact on both sales and profit in 2016 due to weaker Sterling. In the year, Sterling averaged US$1.354 (2015: US$1.528) and €1.224 (2015: €1.377). Currency translation increased sales compared to 2015 by £128.2m (11.9%) and adjusted profit before tax by £21.8m (8.3%).

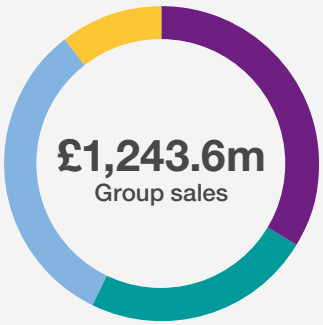
Sales

In 2016 sales grew by 15.0% to £1,243.6m (2015: £1,081.7m) (Figure 2). At constant currency, sales rose by 3.1%, reflecting the Incotec and Inventiva acquisitions. Underlying sales reduced by 1.6%, primarily due to planned a reduction of low value co-stream and tolling products in Industrial Chemicals.

Underlying sales in the Core Business declined by 0.7% (Figure 4). Sales volume increased by 0.6% with sales price/mix 1.3% lower, primarily due to a £12m reduction in Active Pharmaceutical Ingredient (API) sales in Life Sciences. Sales in Personal Care in the second half of the year were adversely affected by the distributor exit programme in Asia. Performance in Life Sciences was impacted by the decline in API sales, particularly in the second half of the year, masking good growth in Health Care and Crop Protection delivery systems. By contrast, Performance Technologies improved significantly in the second half of the year (Figure 1).

Figure 1

Sales by market sector (£m)



Personal Care	£420.6m
Life Sciences	£292.2m
Performance Technologies	£402.5m
Industrial Chemicals	£128.3m

Adjusted operating profit

Adjusted operating profit rose by 12.9% to £298.2m (2015: £264.2m)(Figure 3). On a constant currency basis, adjusted operating profit increased by 4.6%.

Adjusted operating profit in the Core Business grew across all sectors. Profit in Industrial Chemicals declined as a result of planned lower sales (Figure 5).

The net interest charge was broadly flat at £9.9m (2015: £9.5m), with higher debt from acquisitions and a special dividend offset by capitalised interest on the bio-surfactant plant construction. Adjusted profit before tax increased by £33.6m to £288.3m (2015: £254.7m)(Figure 6).

The effective tax rate on this profit was unchanged at 28.0% (2015: 28.0%). The tax rate is driven by the geographic mix of profit and the exposure to higher tax rates outside the UK, where the statutory rate was 20.0% (2015: 20.25%). There are no other significant adjustments between the Group's expected and reported tax charge based on its accounting profit.

The adjusted profit for the year was £207.6m (2015: £183.5m). Adjusted Earnings Per Share (EPS) increased by 15.4% to 155.8p (2015: 135.0p).

Figure 2

Sales (£m)

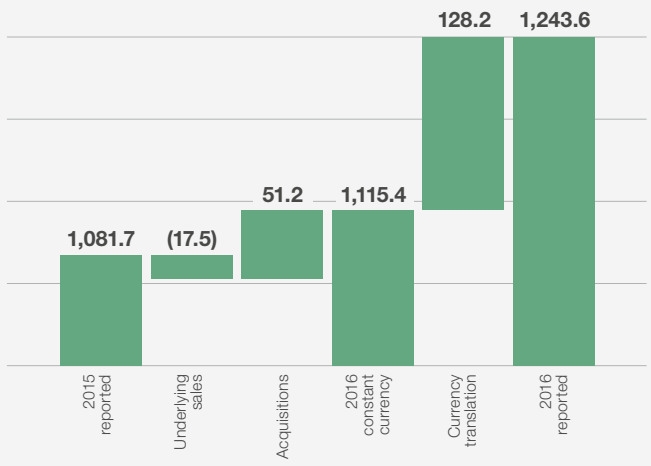


Figure 3

Adjusted operating profit (£m)

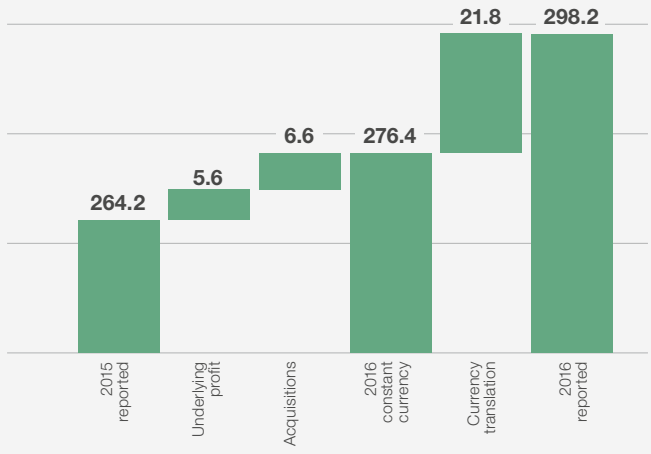


Figure 4

Underlying sales

	First half %	Second half %	Full year %
Personal Care	(0.5)	(1.4)	(0.9)
Life Sciences	(1.0)	(6.5)	(3.7)
Performance Technologies	(0.3)	3.3	1.4
Core Business	(0.5)	(0.9)	(0.7)
Industrial Chemicals	(12.4)	(3.9)	(8.5)
Group	(2.0)	(1.2)	(1.6)

Figure 5

Adjusted operating profit

	2016 Reported £m	2016 Constant currency £m	2015 Restated £m
Personal Care	**143.1**	**129.5**	124.5
Life Sciences	**82.0**	**77.8**	75.1
Performance Technologies	**66.2**	**63.7**	56.8
Core Business	**291.3**	**271.0**	256.4
Industrial Chemicals	**6.9**	**5.4**	7.8
Group	**298.2**	**276.4**	264.2

Figure 6

Summary income statement

	2016 £m	2015 £m
Sales	**1,243.6**	1,081.7
Operating costs	**(945.4)**	(817.5)
Adjusted operating profit	**298.2**	264.2
Net interest charge	**(9.9)**	(9.5)
Adjusted profit before tax	**288.3**	254.7

IFRS profit

Adjusted profit is 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 in better understanding the performance of the business and is adopted on a consistent basis for each half year and full year results.

The charge before tax for exceptional items, acquisition costs and amortisation of intangible assets arising on acquisition was £12.6m (2015: £2.4m). Acquisition costs were £1.1m (2015: £2.0m). The charge for amortisation of intangible assets was £3.1m (2015: £0.4m). Exceptional items were £8.4m (2015: £nil). The latter related to the rationalisation of Incotec, following its acquisition in 2015, with a number of smaller operations exited and larger operations consolidated. No further exceptional charge is expected for this project in 2017.

The profit after tax for the year on an IFRS basis was £197.6m (2015: £181.1m) and basic EPS were 148.2p (2015: 133.3p) (Figure 4).

Cash management

Delivering a strong cash flow is core to Croda's strategy. This cash is used to invest in new technologies in faster growth markets, both organically and by acquisition, to increase innovation and to expand production capacity.

In the year, EBITDA increased to £344.3m (2015: £302.3m), which funded net capital expenditure of £104.5m (2015: £91.1m). Working capital performance was excellent. As a result, free cash flow improved significantly to £155.5m (2015: £117.5m) (Figure 8).

Net debt increased by £104.8m to £364.1m (2015: £259.3m) including adverse currency translation of £31.8m. In addition to the ordinary dividend, a special dividend of £135.7m was paid in June 2016. Strong second half year cash generation saw leverage reduce from the half year to 1.1 times and is substantially below the maximum covenant level under the Group's bank facilities of three times.

During the first half of the year, the Group increased its committed debt facilities. Committed bank facilities were increased to £552m, with the majority extended to 2021. In addition, the Group placed the equivalent of US$256m (approximately £183m) in the US private placement market, maturing in 2023 and 2026, at an average fixed interest coupon of 2.1%. These facilities provide ample liquidity to meet the Group's immediate plans and potential opportunities, at a relatively low interest cost. At 31 December 2016 the Group had £471.6m (2015: £249.2m) of cash and undrawn committed credit facilities available.

Figure 7

IFRS profit

	2016 £m	2015 £m
Adjusted profit before tax	**288.3**	254.7
Exceptional items, acquisition costs and intangibles	**(12.6)**	(2.4)
Profit before tax	**275.7**	252.3
Tax	**(78.1)**	(71.2)
Profit after tax	**197.6**	181.1

Figure 8

Cash flow

	2016 £m	2015 £m
Adjusted operating profit	**298.2**	264.2
Depreciation and amortisation	**46.1**	38.1
EBITDA	**344.3**	302.3
Working capital	**7.2**	(1.4)
Net capital expenditure	**(104.5)**	(91.1)
Additional pension contributions	**(10.9)**	(18.5)
Interest & tax	**(80.6)**	(73.8)
Free cash flow	**155.5**	117.5
Dividends	**(230.2)**	(90.9)
Acquisitions	**(1.4)**	(104.0)
Other (including currency translation)	**(28.7)**	(1.7)
Movement in net debt	**(104.8)**	(79.1)

Dividend and capital allocation

Croda seeks to deliver high quality profits, measured through a superior ROIC, earnings growth and strong cash returns. The Group's capital allocation policy is to:

1. **Reinvest for growth** – we reinvest in capital projects to grow sales, increase product innovation and expand in attractive geographic markets to deliver a superior ROIC. During 2016, capital investment was approximately two times depreciation, funding asset replacement, new investment in key technologies and construction of the bio-surfactant plant;

2. **Provide regular returns to shareholders** – we pay a regular dividend to shareholders, representing 40% to 50% of adjusted earnings over the business cycle. The Board has proposed an increase of 7.2% in the full year dividend to 74.0p, (2015: 69.0p), covered 2.1 times from adjusted EPS;

3. **Acquire promising technologies** – we supplement organic growth by acquiring new technologies and through 'bolt-on' acquisitions in existing and adjacent markets. Following the acquisition of Incotec in December 2015, we added Inventiva, an encapsulation technology business, in 2016; and

4. **Maintain an appropriate balance sheet and return excess capital** – we maintain an appropriate balance sheet to meet future investment and trading requirements. We target leverage of 1 to 1.5 times (excluding deficits on retirement benefit schemes); we are prepared to move above this range if circumstances warrant and will consider further returns to shareholders in the event that leverage falls below the target range.

Retirement benefits

The deficit after tax on retirement benefit plans, measured on an accounting valuation basis under IAS19, increased to £112.7m (2015: £55.9m), with an increase in liabilities due to lower discount rates. However, cash funding of the various plans within the Group is driven by the schemes' ongoing actuarial valuation reviews. No deficit funding payments are currently required to the Group's largest pension scheme, the UK Croda Pension Scheme, with the next valuation due towards the end of 2017.

Alternative performance measures

We use a number of alternative performance measures to assist in presenting information in this statement 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 sales and profit: these reflect current year results for existing business translated at the prior year's average exchange rates, and include the impact of acquisitions. They are reconciled to reported results in Figure 2 and Figure 3;
- Underlying sales: these reflect constant currency values adjusted to exclude the impact of acquisitions. They are reconciled to reported sales in Figure 2;
- Adjusted profit: this is profit before exceptional items, acquisition costs and amortisation of intangible assets arising on acquisition. It is reconciled to reported results in Figure 7;
- Adjusted EPS: this is earnings per share using the adjusted profit after tax and is reconciled in note 7 to the accounts;
- Return on sales: this is adjusted operating profit divided by sales;
- Return on Invested Capital (ROIC): this is adjusted operating profit after tax divided by the average invested capital for the year for the Group. Invested capital represents the net assets of the Group, adjusted for earlier goodwill written off to reserves, net debt, retirement benefit liabilities, provisions and deferred taxes;
- Net debt: this comprises cash and cash equivalents (including bank overdrafts), current and non-current borrowings and obligations under finance leases; and
- Leverage: this is the ratio of net debt to Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA). EBITDA is adjusted operating profit plus depreciation.

The Core Business comprises Personal Care, Life Sciences and Performance Technologies. Sales in Latin America are primarily based on US dollars, which is used as the functional currency for constant currency sales translation. ROIC for 2015 has been restated to include Incotec, which was acquired in December 2015.

Jez Maiden
Group Finance Director