

Delivering the Croda difference



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Steve Foots
Group Chief Executive

Strong business model delivers resilient performance

The strength of the Croda business model was demonstrated in subdued market conditions in 2019. Our robust profit margin was maintained, with return on sales unchanged at 24.7%. We delivered strong cash conversion, with free cash flow up by over 30%. Our relentless focus on innovation continues to differentiate Croda and, as we enter 2020, our innovation pipeline remains healthy. This will be reinforced by new capacity coming on stream to support organic growth, notably the biosurfactant plant in North America which is now operational. Our recent technology acquisitions made good progress during the year and offer exciting future opportunities through their sustainable platforms.

Subdued market conditions in Personal Care and Performance Technologies

Group sales and profit were slightly lower, reflecting difficult market conditions in Personal Care and Performance Technologies. Core Business sales declined by 0.2% in reported currency to £1,265.9m (2018: £1,268.7m) and by 2.3% in constant currency. We broadly protected profit, with Group adjusted operating profit 0.8% lower in reported currency

The Strategic Report was approved by the Board on 24 February 2020 and signed on its behalf by Steve Foots.

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at £339.7m (2018: £342.5m), 1.8% lower in constant currency. This limited impact on profit reflects the strength of the Croda model, which delivered a richer quality of sales, with Core Business price/mix three percentage points better, and lower operating costs, which together offset much of the impact of lower volumes in Personal Care and Performance Technologies. We continued to invest in additional sales and innovation resource to target future growth, in line with our strategy and Purpose.

We have a strong business model in Personal Care. Despite weaker sales in the first nine months of the year, as trade headwinds impacted its two largest markets of North America and North Asia and customers destocked, the sector delivered margin growth and maintained adjusted operating profit. In line with our expectations, the fourth quarter saw a return to modest sales growth as headwinds reduced and key markets in North America and North Asia saw some recovery.

Life Sciences delivered a record sales performance, driven by the strength of the Health Care and Crop Protection platforms. Sector sales rose by almost 6% in constant currency, supported by new opportunities in speciality excipients, and margin expanded, delivering record profitability.

In contrast, after several years of strong profit growth, Performance Technologies delivered a disappointing performance amid economic uncertainty and weak demand, as lower sales volume impacted margin, reducing profitability.

As we exited the year, a somewhat improved outlook for the consumer business contrasted with challenges in industrial markets. We continue to invest in growth opportunities whilst keeping our existing cost base lean and fit for the future. We are reinvesting the benefits of cost savings in over 100 new roles to drive future growth, increasing our presence in China, expanding our digital programme, and investing in more sales and innovation resource in Personal Care and Life Sciences. These actions will protect Croda and help us grow.

Strong cash generation supporting dividend and investment

Cash generation increased in 2019, with free cash flow of £201.7m (2018: £154.9m), benefitting from better working capital management. We continued to invest in projects to deliver future growth, including finalisation of the North America biosurfactants plant, as well as doubling capacity of our US speciality excipients plant for Life Sciences, due on stream later in 2020, growing our industry-leading Beauty Actives platform in Personal Care and shifting Performance Technologies towards higher technology markets and products. We have a clear approach to capital allocation and paid £266.9m (2018: £110.5m) in dividends to shareholders, including a special return of excess capital in May 2019. We have proposed an increase in the full year ordinary dividend declared to 90.0p (2018: 87.0p) on adjusted basic earnings per share (EPS) of 185.0p (2018: 190.2p).

IFRS reported profit lower including increased exceptional charge

Group sales decreased by 0.7% to £1,377.7m (2018: £1,386.9m). Profit before tax on an IFRS basis decreased by 4.9% to £302.3m (2018: £317.8m). This reflected lower sales and a higher interest charge, including the impact of increased debt from the special dividend and acquisition of Biosector, together with a higher exceptional charge of £10.7m (2018: £4.9m), which in 2019 reflected the delivery of cost savings actions.

Sector performance led by record year in Life Sciences

The standout performance in 2019 was in Life Sciences, with record sales accompanied by an improved margin. Sales grew by 5.9% and adjusted operating profit increased 11.6% both in constant currency. With return on sales at 30.6% (2018: 29.5%), this demonstrates the opportunity for Life Sciences to achieve similar returns and at a similar scale to Personal Care. After excellent first half sales growth, demand in the second half year was weaker, partly due to slower demand in Seed Enhancement, but margins continued to expand. We expect to deliver mid to high single digit percentage sales growth across the medium term, driven by our leading technology positions in speciality health care excipients and crop protection delivery systems.

Personal Care demand slowed, against a strong comparator in 2018, as trade headwinds impacted the US and North Asia markets, with sales 3.0% lower in constant currency. US consumer spending in the Personal Care and Beauty category was broadly flat on the prior year and we saw a marked reduction in customer inventories around the middle of the year which adversely impacted our sales. In North Asia, restrictions on Daigou sales into China hit sales to our customers in Japan and Korea, whilst local Chinese customers were under pressure from trade uncertainties and new legislation. Encouragingly, the fourth quarter saw Personal Care sales in North Asia and North America return to modest growth, with local demand in China recovering well and sales to Japan/Korea back into positive territory. The strength of the Personal Care model was demonstrated through an improvement in return on sales to 33.4%.

After three successive years of double digit percentage profit growth, 2019 marked a disappointing year for Performance Technologies amid sustained economic uncertainty and weak demand. Poor global automotive sales in the first half were followed by a general slowing in broader industrial markets in Europe and North America in the second half year. Sales were 7.3% lower in constant currency and return on sales reduced to 16.1%. Despite this shorter term weakness, the fundamentals for Performance Technologies remain attractive, with a progressive shift in the business towards renewable technologies, greater innovation and providing sustainable solutions.

Case study:

Cambridge Institute for Sustainability Leadership

The corporate purpose and sustainability commitment we share in this report really began to take shape in 2018 when we started a project with the Cambridge Institute for Sustainability Leadership (CISL). This Institute draws on world-leading research and networks to work with business leaders, helping to address critical global challenges. CISL challenged us to articulate our corporate purpose and our commitment to sustainability, aligning these with the SDGs upon which we could have the greatest impact. They guided us towards good practice and helped 'stress test' our 2030 ambition that is now embedded in our Climate, Land and People Positive Commitment (see page 29 in this report).



Regional performance weaker across all regions

The weakness in sales was reflected across all regions. In Europe sales were 2% lower in constant currency as good Personal Care demand was more than offset by weak industrial markets. Market conditions in North America were noticeably tougher through the first nine months, with full year constant currency sales down 6%, reflecting the US/China trade dispute and lower automotive and consumer product demand. Asia was also unusually weak, with constant currency sales 1% lower than prior year, reflecting uncertainties over macroeconomic growth and changes to selling legislation in China. Latin America constant currency sales were down 2%, with strong crop demand offset by weak Personal Care sales. In the fourth quarter, although European markets slowed, both North America and Asia saw an encouraging return to growth, both up 3% in constant currency on 2018, driven by better consumer demand.

Adjusted results are stated before exceptional items, acquisition costs and amortisation of intangible assets arising on acquisition, and tax thereon. Constant currency results reflect current year performance for existing business translated at the prior year's average exchange rates. Alternative performance measures are defined in the Finance Review.

Smart Science to Improve Lives™ – our Purpose and ambitious sustainability commitment

At Croda, we have made it our Purpose to use our Smart Science to Improve Lives™. Croda was built upon a foundation of using smart science to turn renewable raw materials into innovative ingredients to give sustainable benefits in use. This focus still sits at the core of Croda, driving innovation and sustainability to create market-leading products and ensure that we have a positive effect on the environment and society. In line with this Purpose, our ambition is to become the most sustainable supplier of innovative ingredients. By aligning our smart science with the United Nations Sustainable Development Goals (SDGs), we will ensure that we are helping to tackle some of the biggest challenges the world is facing. We commit that by 2030 we will be Climate, Land and People Positive; in other words, the impact that Croda has in these three key areas of sustainability will be net positive for the planet.

In becoming Climate Positive, we will support the transition to a low carbon economy. We will work closely with our customers, developing ingredients that deliver carbon savings in use. By 2030, we will make significant progress towards net zero carbon emissions associated with our activities, we will further increase the bio content of our raw materials and the use of our ingredients will save significantly more carbon emissions than required in their manufacture. In becoming Land Positive, we will save more land than we use. We will increase agricultural land use efficiency, protect biodiversity and support food supply by sourcing sustainably and inspiring innovation in our crop business. By 2030, the land area saved through improved yields and crop resilience of our agricultural ingredients and technologies will exceed that used to grow all our raw materials.

In becoming People Positive, we will promote healthy lives and wellbeing through the development and application of our ingredients and technologies. By 2030, we will have used our smart science to improve millions of extra lives.

We are launching a full range of these sustainability ambitions and 2030 targets. We believe that Croda is strongly positioned to deliver both superior financial performance and help to create a sustainable planet.

Protecting our people and the communities in which we operate is critical to Croda. In 2019 our process safety performance continued to improve, with no serious incidents or any with major accident potential, achieving an almost threefold reduction in incidents. Our personal injury performance was another success story. For the first time in our history, we achieved two consecutive months free of any recordable injuries and we met our target of achieving a Total Recordable Injury Rate (TRIR) of 0.6 a year ahead of schedule. We were also pleased to be recognised as Company of the Year by the UK Chemical Industry Association and as one of Britain's Most Admired Companies and the most admired British chemical company by Management Today, for the third year running. We were voted Best Product Innovation in the Global ICIS Innovation Awards for a novel patented polymer molecule which serves as a building block for the development of more stable and effective products.

Strategy delivery

Building on our Purpose, the Board reviewed our strategy through to 2030. We have expanded our long term view, sharpened our sector priorities and increased our focus on higher growth geographies. Our strategy is to deliver:

- **Growth** – consistent top and bottom line growth, with profit growing ahead of sales, ahead of volume;
- **Innovation** – the lifeblood of our business, we seek to increase the proportion of NPP that we sell; and
- **Sustainability** – aligning our business with our Purpose and accelerating our customers' transition to sustainable ingredients.

Our ability to connect to faster growth markets through faster growth technologies, faster growth geographies and faster growth market niches will enable us to deliver this strategy.

We are fully aligned with the megatrends which shape our markets and which will drive growth. Life Sciences delivers better health and well being, through its focus on disease prevention and cure, and improved crop yields, through better delivery systems to feed a growing population from the same land with less environmental impact. Personal Care is meeting the expectations of consumers with growing incomes seeking clean and natural beauty, whilst protecting the health of consumers through more effective solar protection. Performance Technologies is focusing on renewable technologies, delivering affordable and clean energy, and helping customers meet their climate action goals.

Our sector strategic priorities are to:

- **Strengthen to grow in Personal Care.** As the leading innovator in a market driven by an ageing population, rising disposable incomes and a demand for sustainable products, Personal Care will continue to scale its industry-leading Beauty Actives business, broaden the product portfolio in Beauty Effects and continue to reinvent the Beauty Formulation category. This should deliver good top line growth and maintain the current excellent margin over the medium term;
- **Expand to grow in Life Sciences.** With its growing margin and exciting technologies aligned to global health and food sustainability trends, we will continue to build our Life Sciences brand as a high value add solution provider to our pharmaceutical and crop customers, enhance our product range and look to acquire adjacent businesses and technologies. This should grow the top line and increase the current margin over the medium term; and
- **Refine to grow in Performance Technologies.** Able to meet demands for sustainable solutions in advanced technologies, Performance Technologies will continue to refine its existing product portfolio, focus on fast growth markets and develop its geographic footprint. This should deliver modest sales growth at an improved margin over the medium term.

In 2019, despite the challenging markets, we made progress in delivering this strategy. Group NPP was broadly unchanged at 28.1% (2018: 28.2%) of total sales on a constant currency basis

and we continued to invest to accelerate innovation in the future. We have 35 customer innovation centres, acquiring a new application lab in Rewitec with upgraded centres planned in Shanghai and the US in 2020. These facilities enable us to work more closely with both global and local customers. This was supplemented by more than 100 active research projects with our network of over 500 Open Innovation partners, in universities and SMEs, with over a quarter of projects directly linked to delivering our sustainability objectives. In addition, our recent technology acquisitions and investments are delivering product development opportunities which could generate meaningful sales over the next five to ten years. Enza is developing novel patented chemistries to enhance existing products and is utilising Croda's investment in high throughput screening at the Materials Innovation Factory at the University of Liverpool. Nautilus is using its library of marine organisms to develop sustainable applications in haircare and crop applications. Encapsulation technology from SiSaf is showing promise in Personal Care and Life Sciences and Cutitronics is developing a prototype skin assessment and delivery device. Plant Impact has been restructured, to focus on generating data packages for its innovative range of biostimulants, which should lead to new sales by 2021.

Recent acquisitions are demonstrating exciting growth opportunities in new niche markets, driven by sustainability needs. IRB by Sederma continues to grow, using plant stem cells to deliver sustainable beauty active ingredients. IonPhasE is extending its range of electrostatic dissipative polymers and its geographic sales footprint through the Croda salesforce, and delivered its first profit in 2019. Rewitec was acquired during the year, creating a new range of lubricant additives to extend the life of wind turbines. Biosector, a leader in vaccine adjuvancy, was integrated into Croda's in-house sales network, replacing former distributors with direct access to more customers. We expect increasing demand for both human and animal vaccines to drive future growth.

We are pleased by the recommissioning of the North American biosurfactant plant, which became fully operational at the start of 2020, following a leak in late 2018 which caused the operation of the plant to be extensively reviewed to ensure safe operation. We have begun replacing traditional petrochemical surfactants with our ECO range of bio-based products offering identical performance from sustainable ingredients for the first time, particularly for personal and home care applications. 2020 should see additional margin captured, with volume growth following as customers launch new and replacement bio-based products.

Further capacity expansion is following from 2020 for speciality excipients, new polymer additive products and botanical ingredients.

We are continuing to invest in our digital programme, focused on digital solutions across our Engage, Create, Make and Sell business model. In Engage, we are developing a knowledge platform to store and share IP across our R&D teams. In Create, we are using in-silico modelling to develop new products and

artificial intelligence (AI) to help seed customers screen out unhealthy seeds. In Make, we are improving global supply chain management to deliver better customer service and lower inventories, while introducing new tools to enhance manufacturing efficiency. In Sell, we are driving more traffic to our websites, with more literature downloads, samples supplied and new customers engaged via 'live chat'.

Whilst we focus on driving competitive advantage through our relentless innovation machine and unique customer intimacy, we are also managing our costs. Delivering cost savings helps offset cost inflation whilst demand remains weak and funds reinvestment in growth opportunities. These include additional resources for sales and innovation in Asia growth markets and in Health Care. We continue to invest to deliver exciting sales and profit opportunities across our business, aligned with our Purpose of using Smart Science to Improve Lives™.

Covid-19

As the Covid-19 virus has developed over recent weeks, we have been assessing the impact on our employees and our business to ensure that both are effectively supported and managed. At this time, to the best of our knowledge, no Croda employees have been infected by the virus. Our sales offices have reopened, as have our two production units, albeit with more limited operations than usual. China represents 6% of Croda's Core Business sales, 2% of Group production and a limited component of our raw material supply chain. However, there is potential for some disruption to customer and consumer demand. We will continue to monitor the impact.

Outlook

In 2019, we delivered a resilient performance with a strong margin maintained and increased cash flow, despite subdued market conditions. This is testament to Croda's focused strategy and strong business model.

In the year ahead, subject to trading conditions remaining similar, we expect to make further progress in our consumer markets, whilst demand in industrial markets is expected to remain weak but stable. Growth will be second half weighted.

With our new Purpose, Smart Science to Improve Lives™, we will continue to increase the positive impact our products deliver for our customers and their consumers. We will also reduce the negative impact our activities have on our fragile world. The combination of a healthy innovation pipeline, recent investments, cost saving benefits and a robust business model is expected to underpin performance.



Steve Foots
Group Chief Executive