# Delivering the Croda difference

## "Our business model is working well – a dynamic innovation engine creating exciting products, balanced global manufacturing and unrivalled customer intimacy."

**Steve Foots**
Group Chief Executive

*Results are stated in adjusted[1] terms and growth at constant currency rates[2] unless otherwise stated. Alternative performance measures are defined in the Finance Review.*

### Our strategy – delivering across three strong legs of growth

Croda delivers consistently superior shareholder value by being a leading speciality ingredient company, driving sustainable innovation, superior performance and creating value for our customers and consumers. Our objectives are to:

- Deliver consistent top and bottom line growth
- Increase the proportion of protected innovation
- Accelerate our customers' transition to sustainable ingredients.

In 2018 we made strong progress in delivering these three objectives by connecting to faster growth markets through our 'Growing the Core' and 'Stretching the Growth' strategy. Growing the Core is focused on delivering robust top line growth above the market rate, at industry-leading margins, with a capital-light model. Stretching the Growth is focused on accelerating future sales in core and adjacent markets and technologies to drive faster growth and future profitability.

### Delivering sustained sales and profit growth

Croda continues to deliver sustained sales and profit growth through the economic cycle. In 2018 we further refined the Business, growing profit ahead of sales, ahead of volume. Our business model is working well – a dynamic innovation engine creating exciting new products to meet new consumer needs; a balanced global manufacturing footprint; and an unrivalled direct selling capability, with local customer intimacy. Within our Core Business there are three strong legs of growth – Personal Care, Life Sciences and Performance Technologies – which have robust market positions, leading technologies and focused innovation. These are driving profit growth and improved cash generation.

### Safety – at the heart of everything we do

Safety is at the centre of everything we do. In 2018 our process safety programme passed a major milestone, with the successful completion of the evaluation of almost 200 higher hazard process risks identified across the Group against demanding new internal standards. Our occupational health and safety performance remained broadly flat at an OSHA recordable incident rate of 0.72. In 2018 we launched a safety leadership programme across the global management team. I am delighted with the commitment of the senior leadership across the Group, with more engagement, visibility and audits, putting safety at the top of the agenda. This programme is expected to deliver improvement over the coming years and help us meet our 2020 OSHA recordable incident rate target of 0.60.

### Growing the Core – delivering strong performance

In 2018 we continued to Grow the Core, with the top line momentum seen in 2017 continuing through 2018. Sales increased to £1,386.9m, with Core Business sales 3.8% higher, supported by volume growth across the Consumer businesses and stronger pricing and sales mix.

All three Core Business sectors grew sales and profit. Personal Care continued its strong performance, growing sales by 6.8% and profit by 4.9%. Life Sciences also delivered good year-on-year sales and profit growth, more than offsetting the headwind from the Active Pharmaceutical Ingredient (API) contract that we exited in December 2017. Performance Technologies continued to make encouraging progress on actively demarketing higher volume, lower margin products and driving growth in higher value applications, to create a more profitable, technology-rich business.

In line with our 'value over volume' philosophy, we continued to prioritise bottom line growth. Adjusted profit before tax was 6.2% higher in constant currency, at £331.5m in reported currency. Return on sales increased by 50 basis points to 24.7%. Basic earnings per share (EPS) grew by 8.8% and free cash flow increased by almost 60%.

### Progress in reported results (IFRS)

On a reported basis, sales and profit rose slightly, as adverse currency translation reduced the growth in constant currency. Sales at reported rates increased 1.0% to £1,386.9m (2017: £1,373.1m). Profit before tax on an IFRS basis increased by 1.2% to £317.8m (2017: £314.1m). IFRS basic EPS were broadly flat at 181.4p (2017: 180.8p).

With free cash generation improving and capital investment reducing, the Board has proposed an increase in the full year ordinary dividend of 7.4% to 87.0p (2017: 81.0p), together with an additional return of capital of £150m, by way of a special dividend of 115p per share.

### Stretching the Growth – investing for the future

Alongside Growing the Core by delivering consistent sales and profit growth, in 2018 we increased investment in Stretching the Growth. This investment focuses on accelerating product innovation, investing in new technologies and increasing intellectual property. These investments will accelerate sales over time, deliver compelling returns and continue to underpin robust cash conversion, all driving enhanced shareholder returns for the future.

In 2018 we continued to invest in our product innovation pipeline. With the opening of our Beijing Crop Care and Singapore tribology labs, we now have 34 customer innovation centres globally, enabling us to work more closely with local customers to meet their consumers' needs. This in-house innovation was supported by a successful Open Innovation programme, where we are working with over 450 university and small enterprise partners to supplement our R&D capability. Product innovation was also supported by our Smart Partnering Programme, where we work jointly with other companies to leverage each other's strengths and expertise. The output of this greater innovation investment saw sales of New and Protected Products (NPP) reach 28.2% (2017: 27.6%) of total Group sales.

In 2018 we invested in new technologies, both organically and inorganically. We completed construction of the biggest capital investment in Croda's history in North America which will introduce sustainable bio-surfactants to our markets for the first time. After an initial period of successful operation, in November 2018 a small leak occurred at the plant, found to be due to an incorrect gasket fitted during construction. A thorough investigation is underway and we will bring the plant back on stream in a safe manner later in 2019. Until that time, unrecovered operating costs of approximately £2m per quarter are being incurred. There is also a resultant delay in the expected capture of additional margin and growth from the exciting new market opportunities created by our ECO range of green surfactants.

We continue to invest in a number of smaller, organic capital projects to increase capacity and develop new technologies. In addition, we are investing inorganically, seeking to acquire mid-sized businesses complementary to our existing markets. In 2015 we acquired Incotec, which gave us a presence in seed enhancement, a growing market in Crop Care within our Life Sciences sector. Since acquisition, we have refocused Incotec, more than doubling profit and improving innovation capability, delivering a strong return on our initial investment. Building on this, in 2018 we made a complementary acquisition in Health Care with the £64m purchase of Biosector, a leading global specialist in vaccine adjuvancy, extending our existing high purity pharmaceutical delivery systems portfolio.

We are also acquiring small, disruptive technology companies, using a global network of over 45 in-house technology scouts across Croda. In 2017, we purchased IonPhasE, a novel electrostatic dissipative polymer technology for Performance Technologies, and in 2018 we made two nascent technology acquisitions – Nautilus, a marine biotechnology company with potential applications in Personal Care and other markets, and Plant Impact, an innovative biostimulant technology for Crop Care. Whilst technology

### Case study: Investing in Life Sciences

Through investments and acquisition, we have enhanced all aspects of our Life Sciences sector in recent years. Crop Care and Seed Enhancement have benefited from the acquisitions of both Incotec and Plant Impact, and very recently our Health Care business has started to integrate the expertise of vaccine adjuvant specialists Biosector. Our 2018 results show that, in time, our acquisition and subsequent investment in these businesses is yielding results, with our refocus of Incotec seeing their capacity for innovation and product development increase, leading to a more than doubling of profit since acquisition.

#### Enhancing our Health Care portfolio

Our acquisitions help us enhance our existing skillsets across the Group. Through acquiring Biosector we are enhancing our capabilities and knowledge to strengthen our Health Care product portfolio, bringing significant benefits to our customers. Biosector has unprecedented industry experience as a vaccine adjuvant specialist, with their product portfolio comprising innovative aluminium and saponin-based adjuvants.

#### Why Biosector?

Vaccine adjuvants are a complementary extension of our existing pharmaceutical excipients portfolio and we can now offer our customers an industry renowned product portfolio of adjuvants, including the well-known brands Alhydrogel® and Adju-Phos®, as well as their technically advanced saponin-based adjuvant systems. Biosector's rich development pipeline is an excellent indication of their innovative thinking, with second and third generation adjuvant platforms in development.

[1] Adjusted results are stated before exceptional items, acquisition costs and amortisation of intangible assets arising on acquisition, and tax thereon.
[2] Constant currency results reflect current year performance for existing business translated at the prior year's average exchange rates.

acquisitions typically have limited sales on acquisition and therefore bring initial profit headwinds, they provide significant protected future growth opportunities as we commercialise the technologies. We spent £39m on technology acquisitions, associates and investments between December 2017 and December 2018, with a total operating loss from these in 2018 of approximately £6m, primarily from Plant Impact. We expect the operating loss from these acquisitions to moderate in 2019 as sales are developed.

2018 also saw new investment programmes in Digital and Sustainability. We created a Digital Centre of Excellence, to drive greater use of digital selling and marketing across Croda, supported by easier access for customers to our rich libraries of formulation, regulatory and sustainability data. This will enable Croda to access the growing number of local and 'Indie' brand customers emerging across the world. We also invested in high throughput screening – the ability to test large numbers of ingredients using artificial intelligence. Alongside this, we are enhancing our sustainability leadership in the industry, of which more later.

## Strong sales growth and robust margin in Personal Care

The Group's largest sector, Personal Care, delivered a strong performance in 2018. The sales growth seen in the second half of 2017 continued throughout 2018, with sales up 6.8% and operating profit 4.9% higher. Return on sales fell marginally to 32.9% (2017: 33.3%), reflecting a broader sales mix.

In Growing the Core, Personal Care delivered healthy growth across all three of its businesses. Our world-leading Beauty Actives business saw sales rise by high single digit percentage. Beauty Effects delivered solid growth, focused on the creation of ingredients for instant impact and skin effects, particularly popular with the millennial generation of consumers. In Beauty Formulation, improved commercial focus, innovation and better multinational customer engagement saw continued growth across our heritage ingredient portfolio. Croda ingredients have been formulated into several major global multinational relaunches and we continue to develop new customers, particularly in the exciting 'Indie' space.

In Stretching the Growth, the acquisition of Nautilus from our open innovation partner, the University of Prince Edward Island, added a range of 'blue' biotechnology marine organisms to the existing synthetic and plant-based portfolio of Beauty Actives. Following an initial anchor investment in 2017, we increased our minority investment in the multi-award winning digital device company, Cutitronics. We also expanded R&D capabilities in Brazil and South Africa, and doubled R&D and operational capacity in our flagship Beauty Actives business. NPP sales in Personal Care reached a record 43% of total sales (2017: 41%).

## API sales successfully replaced in Life Sciences

Following the 2017 planned exit from its North American API contract, Life Sciences successfully replaced these lost sales in 2018, with growth in the rest of the Health Care and in the Crop Care businesses. Overall sales grew by 2.8% (and by 6.7% adjusted to exclude the impact of the API exit). Adjusted operating profit rose by 3.1%, with return on sales marginally lower at 29.5% (2017: 30.1%), following the acquisition of Plant Impact with its initial start-up loss.

In Growing the Core, sales in our Health Care business were flat year-on-year, as strong growth in high purity excipients offset the API exit. Crop Protection saw mid single digit percentage sales growth, despite second half year uncertainty in North America from the US/China trade dispute. We continued to increase collaboration with crop science customers, both globally and locally. Our Seed Enhancement business benefited from recent European investment in innovation, with steady sales growth driven by industry-leading positions in priming, pelleting and film coating.

In Stretching the Growth, we commenced a £25m project in North America to double manufacturing capacity for the fast growing high purity excipients business, as demand for complex drug delivery systems continues to grow. Alongside this platform, the acquisition of Biosector provides Croda with access to an industry renowned portfolio of adjuvants, serving both human and veterinary vaccine markets. We also expanded global R&D capabilities, including new investment in Incotec in China and North America. The acquisition of Plant Impact established our third Crop Care market, a biostimulants business with good growth trends driven by the need to sustainably feed a rising global population from a fixed land area. The ongoing integration of Plant Impact leverages Croda's global crop sales network and the first new product sales are expected later in 2019, supporting progress towards profitability thereafter.

## Superior growth in profitability in Performance Technologies

Performance Technologies continued to transition to a higher value, technology-orientated business. Sales grew by 1.4%, with growth of speciality sales largely offset by exiting higher volume, lower margin products, with total volume sold 8% lower year-on-year. The improved product mix saw adjusted operating profit 15.0% higher and return on sales increased significantly to 18.7% (2017: 16.5%), well on its way towards our 20% medium term goal for this sector.

In Growing the Core, Performance Technologies is driving three core platforms. Energy Technologies saw the strongest sales growth in 2018, driven by demand for its environmentally friendly lubricant additives which increase efficiency in automotive and marine engines. Smart Materials saw sales growth in higher value applications whilst reducing sales in lower value markets in polymer additives and coatings. Home Care & Water completed its programme of reducing low margin sales for oil and gas applications, selectively growing its presence in the higher value home care market. As a result of improving the core product portfolio, Performance Technologies saw double digit percentage growth in operating profit for the third year in succession.

In Stretching the Growth, Performance Technologies is investing in higher value technologies, improving knowledge intensity (including sales, marketing and technical capabilities) whilst reducing capital deployed (in asset intensity). New opportunities are being developed in renewable energy markets and higher value materials. This is being supported by greater testing capability, generating better application data to support novel market niches. As part of the Digital Centre of Excellence, an e-commerce pilot is being developed to expand customer reach, with the customer base being broadened beyond the sector's traditional European heartland into North America and Asia. Following acquisition in December 2017, IonPhasE has been integrated into the Smart Materials business, distributors exited and sales transitioned to Croda's global team.

## Core Business growth across all regions

We saw good organic sales growth in our Core Business across all geographic regions. After a period of regional economic weakness, sales in Latin America continued to recover, increasing 9% in 2018. Alongside gradual macroeconomic improvement, this growth benefited from investment to expand Crop Care production capacity in Brazil to better meet local customer needs.

In Asia sales were 7% ahead, driven by growth in Japan, with Personal Care particularly strong. We continue to expand our reach in Asia with local and regional customers across all sectors.

The market in Europe remained solid, with sales up 3%, including the successful integration of IonPhasE and growth in newer geographic markets in Eastern Europe, Middle East and Africa.

North America growth slowed to 1%, specifically reflecting the exit of the API contract, together with slower growth of Crop Care customers' products into the important China market. Excluding the API exit, North America sales rose 4%, driven by strong Personal Care demand.

## Robust financial platform supported by lower capital investment

Croda's balance sheet remains robust, providing flexibility for organic investment, acquisition and capital returns to shareholders. We have completed a period of higher capital expenditure, which saw the construction of our industry-leading bio-surfactants plant in North America. Consequently, free cash flow improved by almost 60% year-on-year, to £155.4m (2017: £98.5m). We have also invested over £200m in the last four years in bolt-on and technology acquisitions and continue to invest in product innovation through enhanced in-house R&D capabilities.

Leverage (the ratio of net debt to EBITDA) at the end of 2018 was prudent at 1.1 times (2017: 1.0x). Along with improving free cash generation, this has allowed both an increase in the ordinary dividend and a special return of excess capital to shareholders.

## Sustainability leadership – 'Smart Science to Improve Lives'

As the world's population grows, we need more food, more water and more energy. But the world has finite resources and we need to create a future which is sustainable. With our long heritage of producing sustainable ingredients from natural resources, Croda aims to be a leader, accelerating innovation and reducing the environmental impacts of our activities – a provider of innovative, sustainable ingredients and technologies, creating positive change for the planet and society, whilst maintaining superior returns.

This truly reflects our new purpose – 'Smart Science to Improve Lives'. We use science and entrepreneurial spirit to provide innovative solutions that benefit our customers, colleagues and the wider world. We will keep contributing towards global environmental and social challenges by applying science to create new, better and sustainably sourced solutions.

We are passionate about sustainability – it is the right thing to do but also an integral part of how our sustainable ingredients add value to our customers' products. Our bio-surfactants plant will enable the launch of a new ECO range of products, allowing our customers to build sustainably focused consumer brands without sacrificing performance.

During 2018 we have mapped Croda's activities to the United Nations' 17 Sustainable Development Goals (SDGs) of the 2030 Agenda for Sustainable Development, identifying both how we can meet our sustainability goals and emerging growth opportunities for our business. The SDGs are a commitment to address some of the more pressing challenges facing the world today.

Croda is making a difference in improving health and wellbeing, reducing the environmental burden on the planet, improving life on land and supporting our local communities. In Personal Care, we provide solar protection ingredients to protect consumers from harmful exposure to the sun. In Health Care, our newly acquired Biosector business is improving vaccine effectiveness to treat global diseases. In Crop Protection, we develop adjuvants that minimise spray-drift and reduce pesticide burden run-off. In Seed Enhancement, we create coatings that allow precision treatment of active ingredients and reduction in pesticide application. In our recently acquired Plant Impact business, we develop biostimulants for enhanced plant vigour, promoting growth, crop quality and yields to get more out of the same planted land use. In Performance Technologies, our phase change materials control temperature to ensure safe transportation of essential medicines, even in the remotest areas. This is the Croda Difference and we will continue to enhance our sustainability leadership to improve lives.

## Outlook

In 2018, Croda has continued to deliver sustained sales and profit growth. Looking ahead, whilst global market conditions remain challenging, we continue to invest for the future and are confident that our strategy of Growing the Core and Stretching the Growth will deliver further progress in 2019.

**Steve Foots**
Group Chief Executive

### Case study: Carbon neutral

It is vital that we continue to identify ways to reduce our carbon emissions. We are proud that, through the offsetting of their emissions, our Beauty Actives business, Sederma and Crodarom, became carbon neutral for their manufacturing processes in 2018.

By working with ClimateCare for the purchase of carbon credits, we are able to support the Rimba Rya project in Indonesia. The Rimba Rya Biodiversity Reserve is protecting a large area of tropical rainforest, which was previously lined up for conversion to palm oil estates. With our support, not only will this rainforest be preserved, important local community employment opportunities will be funded as an alternative to deforestation. Wider benefits also include clean water filters and low fuel cooking stoves for local families.