Chief Executive’s Review

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 terms and growth at constant currency rates unless otherwise stated. Alternative measures of performance 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 specialist 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 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 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 50%.

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 strongly, the Board has proposed an increase in the full year ordinary dividend of 7.4% to 87.1p (2017: 81.5p), together with a conditional retention 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 creation, at growing 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 needs. A marine technology contract was secured by a successful Open Innovation programme, where we are working with over 450 university and small enterprise partners to supplement our R&D capabilities. This 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 Inocentis, which gave us a presence in seed enhancement, a growing market in Crop Care within our Life Sciences sector. Since acquisition, we have refocused Inocentis, more than doubling profit and improving innovation capability and strong returns from our investment. Building on this, in 2018 we made a complementary acquisition in Health Care with the acquisition of Biosector, a leading global specialist in vaccine adjuvants, extending our existing high purity pharmaceutical delivery systems portfolio.

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 Inocentis and Plant Impact, and very recently our Health Care business has started to integrate the expertise of vaccine adjuvant specialist Biosector. Our 2018 results show that, in time, our acquisition and subsequent investment in these businesses is yielding results, with our refocus of Inocentis 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 advance 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 external extension of our existing pharmaceutical excipients portfolio and we can now offer our customers an industry renowned product portfolio of adjuvants, including those of leading brands Alhydrogel® and Adju-Phos®, as well as their technically advanced saponin and other adjuvant systems. Biosector’s rich development pipeline is an excellent indication of their innovative thinking, with second and third generation adjuvant platforms in development.

Case study: Investing in Life Sciences

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Acquisitions typically have limited sales on acquisition completion and therefore initial profit headwinds, they provide significant protected future growth opportunities as we commercialise the technologies. We spent £31m on technology acquisitions, associates and investments between December 2017 and December 2018. We have a total operating loss from these in 2018 of approximately £1m, primarily from IonPhasE. This does not result in 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, 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 ‘in kind’ 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**

In Growing the Core, Personal Care delivered a strong performance. The sales growth seen in the second half of 2017 continued in 2018, up 6.8% and operating profit 4.9% higher. Return on sales fell marginally to 32.9% (2017: 33.3%), mainly due to the acquisition of Plant Impact with its 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 grow the ‘in-kind’ 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 products in priming, pelleting and film coating.

In Stretching the Growth, our Personal Care sales increased significantly, as demand for premium products continues to rise. As a result of the acquisition of Biosector, Croda has a strong position in the high performance, inorganic ‘Smart Materials’ market. This provides opportunities for growth through higher margins. We also invested in new investment in Indonesia, focusing on the development of a new plant to supply the local market. In addition, we continued to develop new customers, particularly in the exciting ‘in kind’ space.

**Superior growth in profitability in Performance Technologies**

Performance Technologies continued to transition to a higher value, technology-oriented business. Sales grew by 1.4%, with growth in high value sales largely offset by exiting higher volume, lower margin products. This resulted in 3% lower year-on-year. The improved product mix saw adjusted operating profit 15.0% higher and return on sales marginally higher to 18.7% (2017: 16.5%), well on its way to this sector.

In Growing the Performance, Technology and Skin Care business, we continue to drive higher value sales. Energy Technologies saw double digit growth, driven by demand for its environmentally friendly lubricants 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 part of the Digital (Centrica) Centre of Excellence, an e-commerce pilot is being developed to expand customer reach, providing flexibility for organic investment, acquisition and capital returns to shareholders. We continue to drive a period of higher capital expenditure, which saw the construction of our industry-leading bio-surfactants plant in North America. Consequently, cash free flow improved by almost 60% year-on-year, to £155.4m (2017: £98.5m). 

We also see the benefits of over £200m in the last four years in bolt-on acquisitions and technology investment. Consequently, free cash flow improved significantly allowing our customers to build sustainably on their existing plants. We have completed a period of capital investment, with growth of speciality sales largely offset by reducing sales in lower value markets in order 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.

**Sustainability leadership – ‘Smart Science to Improve Lives’**

As the world’s population grows, we need to provide future generations with sufficient food and 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 in order to reduce 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 EOC 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, so we can meet our sustainability goals and emerging growth opportunities for our business. The creation of an SDGs team will help us address some of the more pressing challenges facing the world today.

**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, Sedorma21, and our newly acquired biotechnology specialist, IonPhasE has been integrated into the Smart Materials division, our businesses exit from CO2 free cash generation, this has allowed both an increase in the ordinary dividend and a special return of excess capital to shareholders.

**Outlook**

In 2018, Croda has continued to deliver sustained sales and profit growth. Looking ahead, whilst global macroeconomic 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.