Finance review
Consistent execution

Jez Maiden, Group Finance Director

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Consistent execution delivers record performance

With our powerful business model, broad portfolio, global footprint and flexible operations, we delivered an 11% increase in both sales and adjusted profit before tax in 2022, managing a challenging environment across global markets. On an IFRS basis, profit before tax grew by 90%, which includes a significant gain on the business divestment.

Currency translation

Sterling weakened against the US Dollar to US$1.237 (2021: US$1.375) but was broadly flat against the Euro (€1.174 (2021: €1.164)). Currency translation benefitted sales by £100.6m and adjusted operating profit by £19.6m. Transactional currency impact is correlated with translation, given that the UK and EU are meaningful centres of production for the Group, with the weakness of both Sterling and the Euro against the US Dollar having a net positive impact.

Impact of PTIC divestment

The Group received cash consideration of £651.0m, net of customary deductions, from the divestment of the majority of its PTIC business. The divestment generated a pre-tax gain on disposal of £356.0m which has been separately recognised in the Income Statement, within the Adjustments column. The divested business did not meet the requirements to be classified as a discontinued operation as Croda did not exit a geographical area of operation and it retained a proportion of the PTIC business, now reported as Industrial Specialties. In 2022, the revenue of Industrial Specialties was £509.2m and adjusted operating profit £81.0m (with the prior period restated to combine the PT and IC segments, which were previously reported separately). Taking account of the sales and profit retained by Croda under supply agreements for products manufactured at Croda retained sites and supplied to the acquirer, together with dis-synergy costs remaining with Croda which were previously allocated to the divested business, the estimated impact of the divestment on these results, had disposal occurred on 1 January 2022, would have been to reduce revenue by £191m and adjusted operating profit by £39m. Following the divestment, associated dis-synergy costs have been allocated across the Consumer Care and Life Sciences sectors. This reduced second half year return on sales in these two sectors by just under one percentage point compared with the prior year comparator period.

Strong sales from organic growth

Group sales grew by 10.6% to £2,089.3m (2021: £1,889.6m), comprising underlying growth of 4.6%, currency translation of 5.4% and acquisition impact of 0.6%. Within underlying growth, sales/price mix improved by 24.2%, reflecting the successful recovery of cost inflation and improved mix. By contrast, volume reduced by 19.6%, with an estimated 13 percentage points of the decline driven by the PTIC divestment, which resulted in lower sales in Industrial Specialties in the second half year.

Consumer Care sales increased by 17.7%, with underlying sales 9.7% higher. Sales/price mix was strong, partly offset by volume which reduced due to a strong comparator period, de-marketing of lower margin products in light of capacity constraints and customer destocking in the second half of 2022. Life Sciences sales increased by 19.2%, with underlying sales 13.9% higher, supported by both price/mix and volume growth. Second half year growth accelerated in Life Sciences, with a good performance in Seed Enhancement complementing continued Crop Protection growth.

2022 sales growth	First half %	Second half %	Full year %
Consumer Care	**24.0**	**11.8**	**17.7**
Life Sciences	**13.5**	**25.1**	**19.2**
Industrial Specialties	**23.9**	**(40.0)**	**(8.1)**
Group	**20.7**	**0.7**	**10.6**

Sales growth	2022 £m	Full year ended 31 December Price/mix	Volume	Acquisition	Currency	Change	Restated 2021 £m
Consumer Care	**897.8**	22.0%	(12.3)%	1.5%	6.5%	17.7%	763.0
Life Sciences	**682.3**	5.7%	8.2%	0.0%	5.3%	19.2%	572.3
Industrial Specialties	**509.2**	19.9%	(31.7)%	0.0%	3.7%	(8.1)%	554.3
Group	**2,089.3**	24.2%	(19.6)%	0.6%	5.4%	10.6%	1,889.6

Record Group profit delivery despite continued inflation

2022 saw a second consecutive year of raw material inflation driven by global commodity prices and geopolitical events, with prices of the top 75% of raw materials up by 23%, in addition to the 17% rise seen in 2021. Raw material costs peaked in the third quarter of 2022 and have seen modest declines since. Operating costs were impacted by increasing inflation during 2022, most notably in energy and labour costs. Croda's powerful business model enabled overall inflation recovery, protecting absolute profit. Operating costs also benefitted from a lower variable remuneration charge, reflecting the impact of a lower share price on share scheme costs.

IFRS operating profit was £444.7m (2021: £438.2m), the gain on the PTIC disposal was £356.0m and interest charge £20.7m, giving a profit before tax of £780.0m (2021: £411.5m). Operating costs included a charge for other adjusting items of £70.4m (2021: £30.4m), reflecting an unchanged charge for amortisation of intangible assets arising on acquisition of £34.3m (2021: £34.3m) and a charge for exceptional items of £36.1m (2021: £3.9m credit). In common with many companies, Croda separately identifies such items which require separate disclosure by virtue of their size or incidence. The charge for exceptional items comprised a gain on contingent consideration on a previous acquisition of £6.1m and an impairment charge of £42.2m, reflecting a £34.6m write-down of goodwill in the Flavours cash generating unit, where forecast sales and margin are behind the acquisition case, reducing the future value projection, and a £7.6m write-off of unusable manufacturing equipment in Japan. The adjusting charge within net interest relates to unwind of the discount on contingent consideration of £1.7m (2021: £3.3m).

Adjusted operating profit, measured excluding the adjusting items above, increased by 9.9% to £515.1m (2021: £468.6m), reflecting the higher sales. Return on sales was broadly unchanged at 24.7% (2021: 24.8%), with an improved margin mix from the reduced share of industrial sales and the lower variable remuneration charge offset by normalisation of the Life Sciences margin, after an exceptional 2021, and a lower Consumer Care margin due to the operating gearing effect of lower volume and a weaker product mix. Adjusted profit before tax increased by 11.4% to £496.1m (2021: £445.2m)

The effective tax rate on adjusted profit was 22.8% (2021: 21.2%), the prior year having benefitted from a one-off benefit from settlement of a previously uncertain tax position. The effective tax rate on IFRS profit was 16.2% (2021: 21.6%), the lower rate reflecting corporate tax exemptions available on the PTIC divestment. There were no significant adjustments between the Group's expected and reported tax charge based on its accounting profit. IFRS basic earnings per share (EPS) more than doubled to 465.8p (2021: 230.0p), while adjusted basic EPS increased by 8.8% to 272.0p (2021: 250.0p).

Growing sector profits

Consumer Care adjusted operating profit grew by 8.6%, driven by higher sales but at a lower margin, reflecting lower volume and an adverse business mix. Life Sciences adjusted operating profit grew by 10.0%, despite the prior year being buoyed by exceptional demand for COVID-19 vaccines, with sales growing in the rest of the Pharma business and in Crop Care. Industrial Specialties profit grew by 13.1%, a strong result given the business was significantly smaller, following the divestment of the majority of the business in June 2022 (with the second half of 2021 estimated to have benefitted from £27m of adjusted operating profit from the divested business (compared to £nil in the second half of 2022)). Group profit growth reflected underlying growth and currency translation benefit across all sectors, with no material impact from acquisitions (covering the first 12 months of ownership).

Sales and profit

	2022			2021		
	IFRS £m	**Adjustments £m**	**Adjusted £m**	IFRS £m	Adjustments £m	Adjusted £m
Sales	**2,089.3**	**–**	**2,089.3**	1,889.6	–	1,889.6
Cost of sales	**(1,103.7)**	**–**	**(1,103.7)**	(950.7)	–	(950.7)
Gross profit	**985.6**	**–**	**985.6**	938.9	–	938.9
Operating costs	**(540.9)**	**(70.4)**	**(470.5)**	(500.7)	(30.4)	(470.3)
Operating profit	**444.7**	**(70.4)**	**515.1**	438.2	(30.4)	468.6
Gain on business disposal	**356.0**	**356.0**	**–**	–	–	–
Net interest charge	**(20.7)**	**(1.7)**	**(19.0)**	(26.7)	(3.3)	(23.4)
Profit before tax	**780.0**	**283.9**	**496.1**	411.5	(33.7)	445.2
Tax	**(126.7)**	**(13.8)**	**(112.9)**	(88.7)	5.7	(94.4)
Profit after tax	**653.3**	**270.1**	**383.2**	322.8	(28.0)	350.8

Operating profit

	2022			2021 restated		
	IFRS £m	**Adjustments £m**	**Adjusted £m**	IFRS £m	Adjustments £m	Adjusted £m
Consumer Care	**144.5**	**(60.2)**	**204.7**	168.0	(20.5)	188.5
Life Sciences	**220.3**	**(9.1)**	**229.4**	201.0	(7.5)	208.5
Industrial Specialties	**79.9**	**(1.1)**	**81.0**	69.2	(2.4)	71.6
Group	**444.7**	**(70.4)**	**515.1**	438.2	(30.4)	468.6

Adjusted profit

	Full year ended 31 December					
	2022 £m	Underlying growth £m	Acquisition impact £m	Currency impact £m	Restated 2021 £m	Change
Consumer Care	**204.7**	8.8	0.7	6.7	188.5	8.6%
Life Sciences	**229.4**	9.8	0.0	11.1	208.5	10.0%
Industrial Specialties	**81.0**	7.6	0.0	1.8	71.6	13.1%
Operating profit	**515.1**	26.2	0.7	19.6	468.6	9.9%
Net interest	**(19.0)**				(23.4)	(18.9)%
Profit before tax	**496.1**				445.2	11.4%

Finance review continued

The phasing of return on sales between the first and second half years reflected normal seasonality, together with a lower margin in Consumer Care in the second half year due to the dilution effect of lower volume and business mix.

2022 return on sales	First half %	Second half %	Full year %
Consumer Care	**26.6**	**18.9**	**22.8**
Life Sciences	**36.0**	**31.4**	**33.6**
Industrial Specialties	**17.7**	**12.3**	**15.9**
Group	**26.6**	**22.3**	**24.7**

Improving free cashflow

Free cash flow was £167.4m (2021: £153.6m), with working capital improving, as expected, in the second half year as raw material inflation peaked, resulting in a reduction in inventory and receivables values. Nevertheless, average values remained elevated at year end; of the £133.8m increase in working capital during the year, approximately £82m reflected the impact of inflation at a 'constant days cover'. The remaining £52m reflected investment for growth, primarily higher receivables. Net capital expenditure was £138.5m (2021: £158.5m), driving future growth opportunities and supported by government funding grants in the Pharma business. Investment was behind expectation, with some supply chain challenges, but is expected to recover the shortfall in 2023, in line with our plans.

Closing net debt was £295.2m (2021: £823.2m), benefitting from disposal proceeds. The leverage ratio reduced to 0.5x EBITDA (2021: 1.4x). As at 31 December 2022, the Group had committed funding in place of £1,122.5m, with undrawn committed facilities of £579.3m and £320.6m in cash.

Assessing evolving risks

The Group conducts scenario modelling as part of its viability and going concern evaluation, to evaluate the impact of uncertainties, continually reassessing evolving risks and their impact on the Group's strategy. These scenarios highlighted the resilience of the Group and its ability to withstand unexpected shocks.

Effective capital allocation

The divestment has released capital to be reinvested in faster growth markets, further developing our sustainability leadership in consumer care and crop care markets, whilst increasing our presence in pharmaceutical delivery systems. We are prioritising organic capital investment to create new technology platforms and expand capacity for future growth. This will be complemented with inorganic investment, where we can acquire complementary businesses and organically invest in them to grow, in line with our 'buy and build' model.

These elements are reflected in the Group's capital allocation policy, to:

1. Reinvest for growth – investment in organic capital expenditure to drive shareholder value creation through new capacity, product innovation and expansion in attractive geographic markets to drive sales and profit growth;
2. Provide regular returns to shareholders – pay a regular dividend to shareholders, representing 40 to 50% of adjusted earnings over the business cycle. The full year dividend has been raised by 8% to 108.0p (2021: 100.0p);
3. Acquire disruptive technologies – to supplement organic growth, we are targeting a number of exciting technology acquisitions in existing and adjacent markets, with a focus on strengthening our Consumer Care business and expanding in Life Sciences; and
4. Maintain an appropriate balance sheet and return excess capital – maintain an appropriate balance sheet to meet future investment and trading requirements, targeting a leverage ratio of 1 to 2x over the medium-term cycle. We consider returning excess capital to shareholders when leverage falls below our target range and sufficient capital is available to meet our investment opportunities.

Retirement benefits

The post-tax asset on retirement benefit plans at 31 December 2022, measured on an accounting valuation basis under IAS19, was £75.2m (2021: £5.8m), with the surplus primarily reflecting higher discount rates. Cash funding of the various plans is driven by the schemes' ongoing actuarial valuations. The triennial actuarial valuation of the largest pension plan, the UK Croda Pension Scheme, was performed as at 30 September 2020 and indicated that the scheme was 101% funded on a technical provisions basis. Consequently, no deficit recovery plan is required. Although the UK scheme utilises a Liability Driven Investment (LDI) structure, its gearing level is modest and no solvency issues were encountered during the UK gilt 'crisis' during September 2022.

Post balance sheet events

On 3 February 2022, we agreed to acquire Solus Biotech, a global leader in premium, biotechnology-derived beauty actives, from Solus Advanced Materials for a total consideration of KRW350bn (approximately £232m) on a debt-free, cash-free basis. Employing 95 people in South Korea, Solus expands Croda's Asian manufacturing capability and will create a new biotechnology R&D hub in the region. The business generated approximately KRW43bn (c.£28m) of sales in 2022. The pending acquisition will provide access to Solus' existing biotech-derived ceramide and phospholipid technologies, and its emerging capabilities in natural retinol, and will enhance and complement Beauty Actives portfolio and increase our exposure to targeted prestige segments. The acquisition is subject to regulatory approval and will be funded from cash and debt facilities.

Cash flow

	Full year ended 31 December	
	2022 £m	2021 £m
Adjusted operating profit	**515.1**	468.6
Depreciation and amortisation	**86.4**	79.0
EBITDA	**601.5**	547.6
Working capital	**(133.8)**	(102.5)
Net capital expenditure	**(138.5)**	(158.5)
Payment of lease liabilities	**(17.4)**	(14.4)
Non-cash pension expense	**4.5**	11.2
Interest & tax	**(148.9)**	(129.8)
Free cash flow	**167.4**	153.6
Dividends	**(144.4)**	(132.5)
Acquisitions	**(21.2)**	(58.8)
Business disposal net of cash in disposed businesses	**579.0**	–
Other cash movements	**(18.5)**	19.0
Net cash flow	**562.3**	(18.7)
Net movement in borrowings	**(381.8)**	37.6
Net movement in cash and cash equivalents	**180.5**	18.9

Alternative Performance Measures (APMs)

We use a number of APMs to assist in presenting information in this report in an easily analysable and comparable form. We use such measures consistently at the half year and full year, and reconcile them as appropriate. Whilst the Board believes the APMs used provide a meaningful basis upon which to analyse the Group's financial performance and position, which is helpful to the reader, it notes that APMs have certain limitations, including the exclusion of significant recurring items, and may not be directly comparable with similarly titled measures presented by other companies.

The measures used in this report include:

- **Constant currency results:** these reflect current year performance for existing business translated at the prior year's average exchange rates and include the impact of acquisitions. Constant currency results are the primary measure used by management to monitor the performance of overseas business units, since they remove the impact of currency translation into Sterling, the Group's reporting currency, over which those overseas units have no control. Constant currency results are similarly useful to shareholders in understanding the performance of the Group excluding the impact of movements in currency translation over which the Group has no control. Constant currency results are reconciled to reported results in the Finance Review. The APMs are calculated as follows:
    - For constant currency profit, translation is performed using the entity reporting currency;
    - For constant currency sales, local currency sales are translated into the most relevant functional currency of the destination country of sale (for example, sales in Latin America are primarily made in US dollars, which is therefore used as the functional currency). Sales in functional currency are then translated into Sterling using the prior year's average rates for the corresponding period;
- **Underlying results:** these reflect constant currency values adjusted to exclude acquisitions in the first year of impact. They are used by management to measure the performance of each sector before the benefit of acquisitions are included, in order to assess the organic performance of the sector, thereby providing a consistent basis on which to make year-on-year comparisons. They are seen as similarly useful to shareholders in assessing the performance of the business. Underlying results are reconciled to reported results in the Finance Review;
- **Adjusted results:** these are stated before exceptional items and amortisation of intangible assets arising on acquisition, and tax thereon. Exceptional items are those items that in the Directors' view are required to be separately disclosed by virtue of their size or incidence. Movements in contingent consideration have been presented as exceptional as they are not directly representative of the underlying business performance in the period and therefore this presentation provides a meaningful basis to make comparisons between reporting periods. The gain on business disposal and impairment charges have been presented as exceptional due to their size and one-off nature. The Board believes that the adjusted presentation (and the columnar format adopted for the Group income statement) assists shareholders by providing a basis upon which to analyse business performance and make year-on-year comparisons. The same measures are used by management for planning, budgeting and reporting purposes and for the internal assessment of operating performance across the Group. The adjusted presentation is adopted on a consistent basis for each half year and full year results;
- **Return on sales:** this is adjusted operating profit divided by sales, at reported currency. Management uses the measure to assess the profitability of each sector and the Group, as part of its drive to grow profit by more than sales value, in turn by more than sales volume, as set out in the Group Performance Review;
- **Return on invested capital (ROIC):** this is adjusted operating profit after tax divided by the average adjusted invested capital. Adjusted invested capital represents net assets adjusted for net debt, earlier goodwill written off to reserves and accumulated amortisation of acquired intangible assets. Calculations and reconciliations are provided in the five year record of the Group's Annual Report. The Board believes that ROIC is a key measure of efficient capital allocation, in line with its policy set out in the Finance Review, with its aim being to maintain a ROIC of two to three times the cost of capital over the cycle, and that it is useful to shareholders in assessing the returns delivered by the Group and the impact of deploying more capital to grow future returns faster;
- **Net debt:** comprises cash and cash equivalents (including bank overdrafts), current and non-current borrowings and lease liabilities. Management uses this measure to monitor debt funding levels and compliance with the Group's funding covenants which also use this measure. It believes that net debt is a helpful additional measure for shareholders in assessing the risk to equity holders and the capacity to invest more capital in the business;
- **Leverage ratio:** this is the ratio of net debt to Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA) adjusted to include EBITDA from acquisitions or disposals in the last 12 month period calculated in line with the banking covenant definition. EBITDA is adjusted operating profit plus depreciation and amortisation. Calculations and reconciliations are provided in the five year record of the Group's Annual Report. The Board monitors the leverage ratio against the Group's debt funding covenants and overall appetite for funding risk, in approving capital expenditure and acquisitions. It believes that the APM is a helpful additional measure for shareholders in assessing the risk to equity holders and the capacity to invest more capital in the business;
- **Free cash flow:** comprises EBITDA less movements in working capital, net capital expenditure, payment of lease liabilities, non-cash pension expense, and interest and tax payments. The Board uses free cash flow to monitor the Group's overall cash generation capability, to assess the ability of the Company to pay dividends and to finance future expansion, and, as such, it believes this is useful to shareholders in their assessment of the Group's performance;
- **New and Protected Products (NPP)**: these are products which are protected by virtue of being either newly launched, protected by intellectual property or by unique quality characteristics. NPP is used by management to measure and assess the level of innovation across the Group.