

Croda International Plc

Third quarter trading update conference call transcript

(1 July to 30 September 2023)

Key:

Steve Foots – Group Chief Executive

Louisa Burdett – Chief Financial Officer

David Bishop – Director of Investor Relations

Steve Foots, Group Chief Executive

Morning everyone, many thanks for joining this call. A few thoughts from me and then Louisa and back to me and then we'll take questions.

I hope you've all had a chance to read the trading update we issued first thing that covers the period of the 1st of July to date, our third quarter.

Whilst July and August are normally slow months for Croda, our performance in quarter three was weaker than anticipated as customers have continued to reduce their ingredient inventories in Consumer Care, Crop and in Industrial markets, depressing our sales volumes. So quite indiscriminate across all markets.

The macro environment is tougher than I've seen in my 30 years in the industry. And as we continue to see the ripple effects from COVID and the unprecedented and destocking that followed, it's difficult to be precise, but we believe the indiscriminate volume reset that we are seeing has been due to a combination of both destocking, which is the main driver in our Crop markets right now and a weaker demand environment, which is having an impact in some consumer markets and most obviously in Industrial markets.

Visibility remains low at about two weeks and with no indications of a significant rebound to come in the fourth quarter, we now expect full year 2023 Group adjusted PBT to be between £300m and £320m.

There are really three things that changed for us since our first half results in July and in order, firstly in Consumer Care, sales volumes in the Beauty Care business were lower than expected in July and August with North America not recovering from quarter two. Beauty Care sales volumes have improved in September, and we expect the recovery to continue through the remainder of the year, albeit now from a lower base.

Second half profit margins in Consumer Care are expected to be lower than half one due to the negative leverage impact of lower volumes and adverse business mix. Secondly, in Life Sciences sales have weakened further in Crop Protection, with improvement now expected to commence in the first half of next year.

And thirdly, weak industrial demand globally is continuing to adversely impact Industrial Specialities. Both Ingredients that we sell direct and via the Cargill supply agreement in particular. So, we're not expecting IS to be profitable in the second half of the year.

I'll make a couple of further comments about sector trading before handing over to Louisa to run through the self-help measures we've taken to protect profitability.

In Consumer Care the strong price mix is continuing to offset lower volumes in Beauty Actives. F&F sales remain strong, the business is having an excellent year. And Homecare sales are recovering well, led by sales of technologies that are differentiated by sustainability. Sales of our ECO surfactants for example are up by around 25% so far this year.

In Life Sciences, Seed Enhancement continues to perform well, with the business firmly on the right side of regulation, such as the EU's recent adoption of measures that will ban the use of microplastics in agriculture in the next five years, a really great opportunity for our microplastic free innovation in Seed Treatment.

In Pharma we expect to deliver lipid systems to our principal COVID-19 vaccine customers as planned and non-COVID sales to remain resilient as customers' innovation pipelines continue to develop.

Our Pharma business continues to make great progress with its industry leading position in biologics delivery. We are particularly excited to see the continued expansion of our Pharma Clinical pipelines for our nucleic acid-based drugs, including encouraging results from trials of mRNA vaccines for infectious diseases such as flu. Our recent partnerships and new product launches are helping to further strengthen our pipeline of opportunities. So, the Pharma pipeline going from strength to strength.

Now, over to Louisa to cover cost measures and our focus on cash.

Louisa Burdett, Chief Financial Officer

Good morning, everyone, and thanks Steve. So just on the cost point we have implemented some measures since the second half of this year to protect our short-term profitability. And as we've seen volumes reset downwards, we have been optimising our production to match that lower demand, largely through reduced shift patterns and plant shutdowns and more recently make to order contracts with customers.

That has helped us to reduce costs including energy and freight. But outside of production our main focus has been budgeted cost avoidance through tight control of headcount and other measures such as travel bans. Although some job losses have regrettably been necessary in the US. Variable pay is another saving, and these cost measures are incorporated into our guidance for the full year 2023.

But in addition to that there are opportunities to drive efficiency savings by simplifying our business processes and ways of working and by consolidating our site footprint. Principally those sites that serve Industrial customers such as Cikarang in Indonesia which we have closed. We are working through those plans now and the changes will result in some annual cost savings from 2024 onwards and we'll talk to you more about that at our full year results.

On cash we're actively managing the cash position, we're particularly focused on managing down inventory levels with some good progress since we last spoke to you. And we are continuing to strike a balance between investing in future growth opportunities and maintaining our capital discipline.

We do have quite a large number of inflight capital projects, including the Pharma expansion for LNP, facilities in India, China and Fragrances. But we are challenging the pace of these where we can, as well as all non-committed and non-safety critical capex projects.

Back to Steve for some final remarks and then we're going to open up to questions.

Steve Foots, Group Chief Executive

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Thanks Louisa. So, as you can see, we are focused on protecting profitability by controlling what we can control, but at the same time it's driving incremental sales growth by increasing customer sales activity. Our relationship with customers and their demand for innovation is going from strength to strength and this is what will drive the rebound on our performance, when the supply chains from our core markets have been fully rebased and the macro environment improves. So, let's stop there and Louisa and I are very happy to take your questions from now.

Telephone Operator

Thank you. If you would like to ask a question, please signal by pressing *1 on your telephone keypad. Please limit your question to one each, to allow everyone an opportunity to ask questions.

We will take the first question from the line of Chetan Udeshi from JP Morgan. The line is open now, please go ahead.

Chetan Udeshi, JP Morgan

Hi thanks, morning. I joined a few minutes late because I was in the queue to get the operator, so apologies if these were already addressed earlier in the call.

But I was just doing the math of inflight second half EBIT and I think you are especially saying the contract to your COVID business is expected to come as expected, so let's I think from memory it was £20m of earnings in Q4. So the implied second half PBT is about £115m and you guys did you know £175m. So let's say it's a decline of £60m give or take. Can you help us understand what is the magnitude of that decline, £60m, in the second half versus first half between the two divisions and different buckets?

The second question was just looking now into next year what are the key moving parts besides the macro improvement that we should be sort of thinking about?

And sorry, the last small question, you said the Pharma business ex lipid was resilient, can you maybe explain a bit, or expand a bit on that resilience topic. I mean are we talking about smaller declines than the rest of the Group, or is that business still growing year on year? Thank you.

Steve Foots, Group Chief Executive

All right, thanks Chetan, Louisa do you want to kick off on EBIT and I'll come back on '24 and Pharma?

Louisa Burdett, Chief Financial Officer

Yeah, absolutely. Hi Chetan. So, we previously guided to £370m to £400m PBT, we're not saying £300m to £320m. So, if you take the midpoint at £310m from the bottom of the previous range of £370m, we've got as you said about a £60m drop.

Broadly half of that is consumer care, to Steve's point we had a weak July and August with the Consumer Care run rate going backwards from our exit rate in H2, which we think was influenced by the summer. We are seeing a pick-up in September as Steve said and the Q4 projection is based on a small pick-up but from a lower base, a lower gradient as it were.

A quarter of the £60m drop is from Crop. And again, reiterating what Steve said, this is because that Q4 tick up that we'd assumed in our £370m guidance is not happening.

And then the last quarter is a combination broadly skewed towards Industrial Specialties. Obviously destocking in that sector. And then some adverse FX headwinds to make up the final bit of that quarter. So half, quarter, quarter is how I would split that £60m.

I'll pass it over to Steve for '24.

Steve Foots, Group Chief Executive

Well let me kick off with '24 and I'll play you in as well. So, we're not providing formal guidance for '24 yet as you'd probably expect with the volatility, particularly as visibility remains limited to a couple of weeks. I think £420m looks optimistic at this point from what we can see.

But increasingly positive sentiment coming in Consumer Care consumers, you know we should be fully through the destocking by the end of the year, turn of the year with Estée Lauder at the extreme, hopefully ready to place orders again in a normal way at the turn of the year. So, you know we're getting through that.

And by the end of the year Crop will have seen three successive pretty negative quarters of destocking. So, we should see improvement in the first half of next year there as well.

And then the Pharma business is making great progress, you know we're not expecting the \$60m of COVID lipid sales that we're delivering in quarter four to repeat in '24, but that will be replaced by some good revenue growth from the pipeline that's already coming through. So, I think that's sort of '24.

I mean on the – and we'll update in February as well. I think one of the big things is as volumes come back what we see is that margin will come back pretty quickly. But we can't call when that's going to happen. The product margins, as I call them, are still at very robust levels. So, you know when we get good quality revenue growth across the board, we should see some margin improvement coming through as the same time, is my point there. But again we'll update you more in February on that.

In Pharma it's just less negative, it's resilient though – so it's doing well. I think the area that has had some exposure there, like in Consumer has been the Consumer Health area, as you'd sort of expect, you know the dermatological creams, medicated shampoos, and the like. But if you look at the underlying business performance and if you accept the COVID normalisation to one side, which is the lipids and some reduction in vaccine adjuvants from the COVID, the underlying business is progressing very well, and we're really excited with that. So, we're pleased with that.

I think in terms of – just to go on in terms of the pipeline, you know in Pharma particularly Virodex we launched just recently as you heard from us in the middle of the year, you know that's going to generate some mid-single digits million of pounds of revenues. Squalene will do well next year, as will PHAD as well. So, all of those three are recent launches and will generate around, you know around £10m worth of revenue just on those three products alone.

And then of course we've got the flu vaccines which are coming more broadly. And you know the clinical research as you've probably seen with Moderna, Sanofi, Pfizer and everybody else is developing at pace and we're watching with interest, well more than interest. And obviously we've got a number of lipids in some of those formulations as well.

So you know the Pharma pipeline looks really encouraging. One or two more new launches that you haven't heard from us, particularly into this whole bio processing area that we're focused on as well. You'll hear more about that probably in February. So, we're seeing Pharma in a good way.

I think the other areas, just on the innovation side, just to support when this demand comes back, in Seed, I talked about that in my opening remarks. But this microplastic free regulation change is significant. You know we saw it coming a couple of years ago, it's been formalised

in Europe just last week. What that means is an extra revenue stream from '24 for Seed Treatment for microplastic free and into '25. So that's great. And we're world leaders in that microplastic free. So you know we'd expect that.

And just to complete it for Consumer Care, you know ECO surfactants growing very well as you'd expect. You know we took that big decision a few years ago. And the patented biotech, surfactant launches coming later this in so far as lipids and we've got a patented biodegradable platform, hair conditioning platform coming out later this year too. So all of those add to growth.

So you know at the innovation level we're really pleased, the customer activity is great, and the innovation pipelines are healthy. We just need the world to rebased in its supply chain and demand to get back to some sort of level you know probably a moderated level from where it was in '19, but a level that is still relatively high. And that's our model. But we are quite naturally cautious for next year where we are today. So hopefully in a long way Chetan that answers that.

Chetan Udeshi, JP Morgan

That answers most questions. Thank you.

Telephone Operator

Thank you, we will take the next question from the line of Gunther Zechmann, from Bernstein. The line is open now, please go ahead.

Gunther Zechmann, Bernstein

Hi, good morning, a couple of questions please. The Ag recovery that you now guided to be pushed out to H1 2024, Steve you mentioned there's just two weeks order book visibility, so what is the basis other than what you said in the previous question that it will have had, that business, three quarters of destocking by year end?

And then Louisa if I can ask you on capital discipline, the paragraph in the press release, should we expect some capex cuts on that and in what area, what is the new capax guidance please?

And lastly, maybe for Louisa as well, how much should we expect from the cost measures that you have initiated? Thank you.

Steve Foots, Group Chief Executive

Yeah, thanks Gunther, yeah just on the Ag then and I'll pass to Louisa. I mean look on the Ag side it's our best guesstimate based on that – you know when we talked to you in June and then July it was the same, you know the mechanisms we use are there is a concentration of customers and we know them very well, you know we have strategic partnerships with most of them. So our intelligence is as accurate as it can be listening to our customers.

But of course, as you probably get with everybody else at the moment, the customers' forecasting is about as inaccurate as ours, you know so they know what they know. But they don't know for sure. So we have to rely a lot on what they tell us. But I think their message is look, it's still actually quite buoyant out there on a relative basis with crop prices still high.

So you know the trading environment isn't bad, though their general sense is just given when they look at their stock levels relative to – there's about four or five key products that nobody else can supply in the world apart from Croda, you know we're registered in thousands of formulations in Crop with those going back to the ICI days actually with Uniqema and Syngenta way back. So we can model that quite well with the demand on that and that is what we tend to look at.

So it's based on more customer conversations, but you know we'd rather be cautious on that than not, because we simply don't see the datapoints that would encourage us to say that we're going to have a better quarter four than we think. And the order intake wouldn't suggest at the moment that we're going to see like a hockey stick or some sort of ramp up. So that's why we've called it the way we have.

Louisa, over to you.

Louisa Burdett, Chief Financial Officer

Yeah, sure I'll start with capital and then move through cash and cost. We have previously guided Gunther to £170m to £180m on capex. I'm expecting that to moderate towards the lower end of that guidance range.

The difficulty we have got as I said in my statements is that we are – we've got some of these large inflight committed projects that are difficult to slow down in the short term that we've got for the rest of the year. So we're doing what we can on that, as I said trying to challenge the pace, but sometimes it's not helpful to moderate those because they tend to get more expensive. But I'm expecting it to be at the lower end of that capital – previous capital guidance range.

But positively though on cash more broadly, the working capital discipline in the business continues to be strengthening, the regions have done really well in getting their stocks down. Obviously with slower sales the debtors are down. And at the end of the quarter, we're in a really good inflow working capital position.

I'm keeping the guidance for the full year that we will have an outflow just because – I'm sorry an outflow on working capital just because of the timing of the lipids' debtors. But the working capital discipline is good, and I think that's going to help our cash position.

On cost measures, look we don't have a very significant cost base. If you look at our cost base we're not known to be – well we're kind of known to be Yorkshire I mean. And given the cyclical nature of this volume drop we're trying to balance that short term profitability but not damaging our growth for the future, because we are innovative, and our model is predicated on you know that local proximity to customers. You know whilst I don't want this to sound defensive, a lot of our sites are shared, so it's quite difficult to push through total shutdowns of plants which is where often you get some of the big savings from. But we are doing what we can, we are controlling what we can across multiple themes.

And we have done quite a lot of cost avoidance around new headcount and travel. And where incremental costs have occurred like salary inflation in the year, we are going to counter that with clearly no variable pay, which will keep us whole. And I have already mentioned some redundancies in the US, which will give us some small, annualised cost savings from '24.

But look the big piece that we're working on at the moment is whether we can look more at our ways of working, some of the fragmented ways we work across the globe and thinking about that for 2024 and beyond. So that's the theme of how we're looking at our costs Gunther but it's this balance of trying not to pull too much cost down when really the issue is not cost, it's needing to as Steve said, get that revenue back, customer demand. So, I'll leave it there.

Gunther Zechmann, Bernstein

Thank you both.

Telephone Operator

Thank you. We will take the next question from the line of Nicola Tang from BNP Paribas. The line is open now, please go ahead.

Nicola Tang, BNP Paribas

Thanks. Hi, everyone. Thanks for taking the questions. Actually, they're both on the Consumer Care side. Steve, sorry, I missed the very beginning comment you made. I think you talked about, kind of, pricing versus volume dynamic and, sorry there, I missed that. I was wondering if you could repeat and just perhaps talk a bit about how pricing has been developing and whether you feel like maybe there are areas where you've maybe pushed pricing too hard and its tested elasticity or whether the volume declines that we're seeing are still related to, you know, weaker end demand and the destocking side?

And then maybe could you give a bit more of a steer in terms of the margin decline in Consumer Care in the second half versus the first half? Perhaps, with respect to some of the drivers around this lands, you know, less operating leverage, but perhaps some of the initial cost savings or, you know, stuff like that coming through combined with the mix and also maybe you could comment on how inputs have trended as well? Thanks. Sorry, that's them all, yeah.

Steve Foots, Group Chief Executive

Thanks, Nicola. Yeah, well, let me do the first question and I'll pass to Louisa on margins. Yeah, if you look at the Consumer Care mix analysis of Quarter three versus Quarter two in 2023, you know, the trend, overall, actually, volumes are up 2% but the price effect is down 5%, which equates hardly any, you know, 0% mix effect, so that means, overall, it's, sort of, a negative 2%. So, actually, yeah, it's pretty robust.

It's slightly different across the different businesses, but we're not seeing a big volume decline really. You know, you're saying, actually, you're 2% up, and that's being driven by Home Care and Fragrance and Flavours up well and Beauty Actives and Beauty Care down modestly more than anything else.

So, I think, you know, you saw that graph that we put up in July in one of the earlier slides when we're looking at the recovery of volumes in Consumer Care, you can just extrapolate that line along its bottom from June/July, and there's some potential uptick now. September's a little bit better and order intake for October looks a little bit better. So, it is what it is.

I think I would make an overarching comment that we're not worried that volumes are declining significantly further, we're just not seeing that uptick that we would expect to continue. But, as I said, July and August looks like, for us and the industry, it looked like, you know, everyone shut up shop early and closed the door, effectively, and you found in all markets, from Industrial to Crop to Consumer, that it was it lower than we expected. So, we're all playing catch-up and we're playing catch-up as well now, so that's that.

Well, let me pass to Louisa on the market side and I might come back and make another comment.

Louisa Burdett, Chief Financial Officer

Yeah. Hi, Nicola. You know that we finished H1 at 21% in Consumer Care and obviously we're going to be lower than that in the second half, principally driven by that July and August performance, which was weak, and that gearing effect.

We've also got, as you've alluded to, you know, we're really pleased with the F&F performance which is really strong, and Home Care's also performing well, but it's, obviously, a very small part of our business and at the lower end of margin.

So, our margin in H2 is going to be lower than that 21% and, by default, the full year margin in Consumer Care will be lower than the 20% than we'd signalled before. So, yes, we've got some pressure from that Beauty Care part of the portfolio.

Steve Foots, Group Chief Executive

I would just add as well, Nicola, one thing, you know, a lot of our site is shared across all markets, so, you know, when you look at the big value drop between quarter two and quarter three in terms of sales, at the top there's been, you know, a reduction in Industrial Specialties and reduction in Crop in sales volume, they're the two, but they share, in some cases, in quite a lot of cases, they share Consumer Care sites as well.

So, you know, you have this unusual situation that we don't talk about too often where you get some margin reduction in Consumer because of weakness in other markets, and you've got that running through as well through the second half as well. So, that's exacerbating the problem for now, so that's why there's probably, you know, an impact to the margin that perhaps you wouldn't have expected from exit rates in quarter two, if you get my drift.

Nicola Tang, BNP Paribas

Just to clarify on that, is it shared – you know - are you talking about the three segments, so there are headwinds across the three segments?

Steve Foots, Group Chief Executive

No, I'm talking about like a factory that's selling into all businesses. You know, if you see a bigger reduction in Industrial sales, Industrial Specialty sales or Crop sales, like the Mevisa site in Spain or our Atlas Point site in America where they supply it all, if you get a reduction in some businesses, then the margin effect, because the margin could be impacted in the Consumer business as well. So there is a bit of weakness in Consumer, but the margin impact is additional to that because of the weakness in other businesses on the same plant if you understand, so it's the cost absorption across the site.

Nicola Tang, BNP Paribas

Okay, got it. Thank you.

Louisa Burdett, Chief Financial Officer

And just to finish that up and maybe just, sort of, anchor this, you know, we talked about 21% in the first half, I would imagine that there's probably going to be a, you know, 2% to 3% impact on the full year margin in Consumer Care for the full year, negative obviously.

Nicola Tang, BNP Paribas

Yeah, thank you.

Telephone Operator

Thank you. We will take the next question from the line of Matthew Yates from Bank of America. The line is open now, please go ahead.

Matthew Yates, Bank of America

Hey. Morning, everyone. I appreciate this might be the easiest times given you're one of the first companies to update on trading over the summer, but, in the first half, there was an acknowledgement that some of the weakness was self-inflicted, or market share loss and you were going to respond with some more tactical pricing. Can you just share some thoughts as to has that pricing initiative failed to recover any volume? Do you think you need to do more to try and retake some share, or is the weakness you're seeing really not a function price elasticity at all, in terms of just customer buying decisions? Thank you.

Steve Foots, Group Chief Executive

Yeah. Thanks, Matthew. Yeah, I mean, it's targeted, it's working to a degree, but, when we thought most of it, or a significant amount, would just be coming, each quarter, through '23. What we're seeing from our customers is they're just saying – look, we don't need it. We recognise where you are but we're still sitting on stock levels that are higher than we'd like - So, I think it's a fundamental market issue.

You know, we're pretty sophisticated at what we need to do, and we can measure it, Matthew. You know, there's about \$50m or \$60m of target business that we wanted to go after and we're probably in the books, or, you know, through this year, it's probably, you know, 20% of that, maybe a little bit more, and we're guiding everything else. We're not losing it, it's just, you know, the customers actually don't want it yet and they're saying they will buy it when stock levels are getting back to normal. So, it's a fundamental market issue.

I think the other thing I would say is, particularly the multinationals, you find that, not just in Consumer but in Crop, is we think they're taking their stock levels down to lower levels than they've previously done in the past, and that's more from their organisation, as you can imagine the pressure on their cash and balance sheet. So, I suspect that we're going to end the year with quite emergency stock levels in some of our customers or, so well just let's say lower stock levels than they would normally want to carry, and I think that's a consequence of just the environment that we're trading in as well. So, we're obviously watching that closely as well.

Matthew Yates, Bank of America

Okay. And just as a follow-up, you referenced that chart that shows, you know, potentially a couple of false starts we've had this year on calling a trough and an improvement, and your guidance is certainly not making any heroic assumptions into year end. Your comments around September and October, do you think that's really just volume that was deferred from what may have otherwise been earlier in the summer, or is there anything about order patterns in terms of frequency of magnitude that does suggest any confidence coming back from the customers thus far?

Steve Foots, Group Chief Executive

Yeah, I mean, I'll pass to Louisa in a minute, but, I mean, just my overarching comment is I think we were surprised. It's July and August that we've been surprised with on the downside as we exited. You could argue August was always likely to be quiet because it normally is, but July was very quiet as well, and that's right across every industry. So, you're starting from a lower base.

September is on its way back, but September, for me, is always, you know, in 30 years of the industry with 6 cycles, you tend to look at September as a sort of swing month to replenish for the year, and it's coming back, but you wouldn't say it's swinging back in a really positive way, it's just coming off its bottom.

Order intake is mixed around the world, but the area that's improving for us is Europe for Beauty Care particularly and generally in Consumer. But it's still difficult to quantify what that really means because, you know, easily order intake, you know, orders can be pushed out at a drop of a hat, or pushed in at a drop of a hat, but sentiment definitely is improving, and I would say, particularly in Europe, but, Louisa, do you want to just add one or two more comments to that?

Louisa Burdett, Chief Financial Officer

Yeah, I'll just build on that with the Western European comment and, look, it's just reiterating that it is patchy, but if we look at our September order intake in Western Europe, which we're obviously tracking, they do look comfortably higher than '21 and '22, and we've got orders

exceeding sales for about the fourth month in a row. So, that's given us some preview that we're going to get some lag benefit, you know, maybe in late Q4 and H1. But stress that we're not seeing that across all regions, which, you know, underpins what Steve's saying, that get a consistent picture through this is quite difficult, but we just continue to monitor those signs where we can.

Matthew Yates, Bank of America

Okay. Thanks, Louisa. Thanks, Steve.

Steve Foots, Group Chief Executive

Yeah, thank you.

Telephone Operator

Thank you. As a reminder, if you would like to ask a question, please signal by pressing *1 on your telephone keypad. We will take the next question from the line of Charlie Webb from Morgan Stanley. The line is open now, please go ahead.

Charlie Webb, Morgan Stanley

Morning, everyone. Sorry to kind of follow up on the question that's been asked, I think, a number of times, but just if you can help us a little bit more, me a little bit more around the kind of, negative operating leverage you see in Consumer Care, and you, obviously, also flagged mix. So I'm just trying to understand here, is this the case where, obviously, demand is weak, you're obviously taking plant utilisation rates lower than you would otherwise like, have you also been forced to sell products you other wouldn't like to sell, as in lower margin products, and that's the negative mix effect just to keep utilisation rates at a kind of critical level? I'm just trying to, you know – this is indeed a surprise negative, it's just trying to get my head around your initial comments.

Steve Foots, Group Chief Executive

Yeah, sure. Let me start with the commercial point and then Louisa can add to that, but, I mean, on the commercial point, I mean, look, we never go back to full factories full of really crap business I call it. You know, we don't need to do that. There's still plenty of what I'd call, you know, pretty good business out there that we can go after.

And don't forget, you know, as a reminder, you know, in America particularly, we called out, with our analytics, 75% of all of the volume decline is coming from market, you know, a combination of destocking and demand, and we still think that's the case, our analytics haven't changed there, so the 25%, the self-help bit where we've had factories offline and we're trying to come back with new business, you know.

You know, and Matthew's point was around the same line, you know, has that failed, or, you know, are you not getting the business back? So, we had a targeted way of doing that, and we do that in a very good way, and we can monitor that literally weekly or monthly.

You know, 20% of the target business probably that we wanted to get we're going to get this year, the rest of it will come next year, and that's only because customers are sitting still on high levels, and as I was saying, we get it, we understand, but we actually don't need it at the moment, and, actually, we've got a lot of customers wanting to buy from Croda, so, you know, we're in a good position.

So, I think your pricing point is a little bit round the edges where the average price is coming off, but, you know, it's trivial in the grand scheme of things. The real issue is it's like a perfect storm when you've got all markets that are weak together on shared sites and, you know, utilisation rates are below where we would normally expect it, quite significantly in some

places, then what you get is that you can get disproportion of cost across there which can harm some businesses more than others.

So, you know, it's unusual. In 30 years, I've never seen Industrial Specialties down, Crop down, Consumer down all the same time for that length of time, that's the issue, and you get these weird effects.

I mean, of course, on the upside, when business comes back, obviously you get the margin coming back. The most important thing for the Chief Exec is I look at the quality of the margin, and the quantity of the margin is really robust at the product level. But what you're seeing and what we're seeing is this, you know, net out because of the inefficiencies in factories, which is something that, you know, we never talk about because we need to.

So, that's the issue, it's a combination of those factors, but, Louisa, any more facts for Charlie you want to mention?

Louisa Burdett, Chief Financial Officer

No, I'm not going to labour the same point, I think you've pointed quite correctly to the fact that this is plant utilisation rates. And, Charlie, it comes back to down to, sort of, what we're thinking about on costs because, you know, if you think about our fixed cost base in the factories versus our fixed cost base in, sort of, more indirect cost, you know, Steve talks about the product margins being stable but, you know, if we're thinking about this being lower for longer, you know, the footprint of not necessarily the production sites which are more difficult to change but, you know, maybe some of our legal entities and places like that to help the denominator in this unit cost equation.

So, I would just reemphasise that this is plant utilisation rather than us, as I said, going for a more negative mix of products.

Charlie Webb, Morgan Stanley

Okay, and just one, kind of, quiet, kind of, follow-up on IS, you know, given that's, kind of, turned negative, so part of that is going to relate to this lower operating rate, is some of it also just product margins given these are, kind of, byproducts you sell in the market? Are they also very weak? I get, obviously, that the Specialty side of the business, that hasn't changed, but maybe in IS it has.

Steve Foots, Group Chief Executive

Not really. I mean, it's much the same. You know, a significant amount of our trade now goes through Cargill, so a lot of the ex-Croda people are with Cargill. And, you know, when you talk to them as well, you know, their business is well off for, you know, quarters three and four. So, it's demand led.

You know, the margins, I think I've always said, you know, they're not all byproducts, actually, Charlie, you know, 30%, 40% of that business is byproducts, and actually what we've got left that we trade with, we sold most of the byproduct business with the deal. So, what we've got left is a sensible business with, you know, half-decent margins.

So, it's not a margin collapse there, it's a leverage issue, that Louisa talked about, and also just general demand issues because of destocking, you know, around the patch, and that's right across the piece there as well, it's not seemingly one industry within the Industrial Specialties market, you know, it's broad brush.

Charlie Webb, Morgan Stanley

Okay. Thank you very much.

Telephone Operator

Thank you. We will take the next line from Kevin Fogarty from Numis. The line is open now, please go ahead.

Kevin Fogarty, Numis

Hi. Morning, everyone. Thanks for the opportunity. I have one question left and it was really around the Industrial Specialty business and just you, kind of, highlighted in previous answers, just in terms of the kind of, weakness you've seen there, I just wondered if you could give any commentary around particular end markets, where you've seen that weakness? Has there been any kind of standout end market and any, sort of, real change I guess in the last couple of quarters? You know, have some sectors been weaker than others or surprises in terms of demand there? That would be helpful.

Steve Foots, Group Chief Executive

Yeah, I mean, I think it's difficult. I understand the question and it's difficult to give you an answer, but we look at, you know, the two arrangements we've got, we've got the core Croda business, so if you look at our, sort of, forecast for the year, you know, the core Croda business is likely to be down around about 25%, 26%, but the supply agreement, so the other bit of the business, which is a bit smaller than that, is 44% down, and that's the supply agreements with Cargill.

So, the point we're making is it's that business that we've transferred to Cargill is weighing on us as well. I mean, our Industrial business is down, the Cargill business that they have is things like polymer additives into the polymer industry and you've got things like into construction, that's the main area there.

But generally, for us, if I just look at our business, there isn't one market, you know, it just seems to be just everywhere, and July and August particularly were quite indiscriminate everywhere.

Kevin Fogarty, Numis

Great. Okay, thanks for the added colour. Thanks a lot.

Telephone Operator

Thank you. We will take the next question from the line of Charles Bentley from Jefferies. The line is open, please go ahead.

Charles Bentley, Jefferies

Hi. Thank you very much for taking my question. Just on this point around Consumer Care and the balance for the year, I mean, you talk about recovery, is that versus, kind of, July and August or, kind of, continuing versus where we are September and 2022 levels? Just in the context of the risk to Q4 being worse than expected, I mean, Steve, you said, look, your customers are taking inventory levels to levels that you've not seen in a long time, rates are where they are, the cost of holding inventory is much higher. I mean, if I was them, I'd probably be destocking into the year end, so is there not a risk that that kind of forecast of things improving through Q4 proves optimistic and maybe, kind of, September and October's a bit high? It would just be helpful, kind of, whether or not that's factored into the guidance or not. Thank you.

Steve Foots, Group Chief Executive

Yeah, thanks. I mean, probably best for Louisa to take you through that. I think she's better placed for that question.

Louisa Burdett, Chief Financial Officer

Yeah, so in terms of the trajectory, the way the Q4 guidance has been positioned is that the trajectory is lower than the run rate we were coming out of in Q2, but it is slightly higher than the run rate we saw in July and August. So, I guess it's a balance between a weak first two months of the quarter and, you know, a slightly stronger Q2.

So, you know, we think that we've positioned this appropriately otherwise, you know, we wouldn't have put the guidance out, but, you know, with the sentiment, you know, it's clearly weaker and we were surprised at how weak July and August were, but hopefully, you know, we're not projecting too much incremental growth in the fourth quarter and we typically have quite a soft December, which is factored into the forecast.

Charles Bentley, Jefferies

Okay, great, and just to follow up on that, is that still assuming year-on-year growth for Q4 then?

Louisa Burdett, Chief Financial Officer

Was that for the Group?

Charles Bentley, Jefferies

For Consumer Care, sorry, volumes.

Louisa Burdett, Chief Financial Officer

For volumes? Yes, that's just slightly, yes, because we've had a weak Q4 last year as well.

Charles Bentley, Jefferies

Thank you very much.

Telephone Operator

Thank you. We will take the next question from the line Alex Sloane from Barclays. The line is open now, please go ahead.

Alex Sloane, Barclays

Yeah. Hi. Morning, all. Thanks for taking the questions. Actually, it was just to circle back on the comment Steve made around customer inventory levels and maybe those being taken down levels, you know, not previously seen before by year end. I wonder if you could frame that in terms of, you know, how you're expecting inventory levels of key customers to sit at year end versus maybe pre-pandemic levels and how that might differ across key end markets? Thanks.

Steve Foots, Group Chief Executive

Yeah, I mean, it's just anecdotes that we've heard from a number of customers, and we'll model that in the right way. I mean, you know, you can look at that as well through their annual reports and, you know, their releases, but, you know, I wouldn't say it's unilateral everywhere, but, clearly, when we're looking at this, and I'm talking about multinationals particularly in Consumer, it feels like it's a natural – you know we shouldn't be surprised with that. I mean, we've seen this before, you know.

I think I've said to you all quite a few times now, in the 6 cycles that I've seen in 30 years, in every cycle, you know, the industry gets it wrong with management of stock. So, in a upcycle, you know, we put too much stock into our supply chains, and, in the downcycle, we exaggerate it on the downside, and I think, you know, I wouldn't be surprised if this is a case where it's exaggerated on the downside just because of sentiment but also because it's near the end of the year as well.

And you tend to find, psychologically in organisations with your customers that, as you move towards the end of the year, well, there's no surprise that you probably get a bit more pressure for balance sheet working capital management in the right way. So, you know, that could skew you to the downside.

So, I'm not saying it's everywhere, but the industry gets it wrong, and I suspect it'll get it wrong this time as well, but, you know, the usual thing about this cycle is that it's very difficult to predict growth. I don't think we're going to see a big hockey stick when we wake up in January, and I don't think anybody's predicting that, but I suspect that, you know, we'll have a better understanding as we come to you in February as to what the supply chains are doing.

But we would expect, by February, that the supply chain for Consumer Care in the multinationals has been corrected, that's what we believe, and that we can have a much better understanding of what that means for, one, real demand for next year, and then, two, for pickup in stock from where we are. We'll get their assessment of that then. So, hopefully, that answers that.

Alex Sloane, Barclays

Thank you.

Steve Foots, Group Chief Executive

Yeah, okay. Well, thanks, everybody, for that. You know, a perfect storm for us and probably for the industry, but everything's coming together. You know, weak core markets, weak Europe and America and weak margins because of loading on the factories unprecedented and something I haven't seen in 30 years.

The upside of that, of course, is the potential is significant, the innovation pipeline is excellent, really great, particularly in Pharma, but Crop and Consumer Care too. Product margins are robust and once our business recovers, you know, sales and margins will come back together. So, that's the upside, it's just we'll manage you through that as well as you manage us through that as well, I guess, through the course of the early part of next year, but we'll update you in February as where things stand.

But there's no panic in Croda, and, actually, the innovation pipelines are in a really good place, so we just have to manage ourselves through this, like you do. So, take care, thank you and we'll see you in February.

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