Finance review

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Focused on profit protection and active cash management

A weak macroeconomic environment and customer destocking had a significant effect on Croda's financial performance in 2023 with sales down 11% and adjusted operating profit down 33% both on a pro forma basis. Given the challenging trading conditions, we took some immediate actions to address costs alongside driving improvements to the way that we work that will deliver sustained benefits over the long term. We actively managed our cash flow, resulting in a significant reduction in working capital and inventory days, and our balance sheet remains strong, enabling us to continue to invest through the downturn to drive future growth.

Currency translation

The US Dollar and the Euro together represent approximately 65% of the Group's currency translation exposure. Sterling was broadly flat against the US Dollar at an average for the year of US$1.243 (2022: US$1.237) and weakened slightly against the Euro to €1.149 (2022: €1.174) on a similar basis. The impact of changes in exchange rates for other smaller currencies, which represent 35% of the exposure, was more significant. Overall, the negative impact from currency translation was £9.1m on sales and £10.3m on adjusted operating profit. The disproportionate impact on adjusted operating profit reflected a £6m adverse effect from the application of IAS 29 ('Financial Reporting in Hyperinflationary Economies') to reporting in Argentina and Turkey, and a £2m foreign exchange loss from the devaluation of the Argentine peso, with the balance from the net effect of other currency movements. The transactional impact of foreign currency exchange was not material.

Impact of PTIC divestment

The Group successfully completed the divestment of the majority of the Performance Technologies and Industrial Chemicals (PTIC) business on 30 June 2022, with the retained industrials business, including the SIPO joint venture in China, becoming Industrial Specialties (IS). Given the divested business did not meet the requirements for classification as a discontinued operation, the first half of 2022 included the full PTIC business and the second half year only the retained business. It is estimated that, had the divestment occurred at the start of 2022, sales in 2022 would have been approximately £191m lower at £318m and 2022 adjusted operating profit would have been approximately £39m lower at £42m. Pro forma 2022 results have been adjusted for the divestment. On this basis, IS sales fell 35% to £206.1m and adjusted operating profit fell 78% to £9.4m.

Sales

Sales	2023 £m	Price/mix	Volume	Acquisition	Currency	Change	2022 £m
Consumer Care	**886.1**	1.9%	(3.6)%	1.0%	(0.6)%	(1.3)%	897.8
Life Sciences	**602.3**	3.2%	(15.4)%	0.7%	(0.2)%	(11.7)%	682.3
Industrial Specialties	**206.1**	(3.9)%	(55.1)%	0.0%	(0.5)%	(59.5)%	509.2
Group	**1,694.5**	10.9%	(30.0)%	0.6%	(0.4)%	(18.9)%	2,089.3
Estimated pro forma sales							
Group	**1,695**	11%	(30)%	1%	(1)%	(19)%	2,089
Pro forma adjustment							(191)
Group (pro forma)	**1,695**	5%	(16)%	1%	(1)%	(11)%	1,898

Reported sales were down 18.9% to £1,694.5m (2022: £2,089.3m). On a pro forma basis they were down 11%. Within this, price/mix improved by 5%, supported by positive mix in Consumer Care and weaker IS sales. Group volumes reduced by 16% pro forma, with a weaker macroeconomic environment and continued customer destocking across consumer, crop and industrial markets having a significant impact. While sales volumes remain significantly lower than 2022, they are slowly improving in Consumer Care and were 9% higher in the second half of 2023 than they were in the second half of 2022. Sales of ceramides and phospholipids contributed 1% following completion of the Solus Biotech acquisition in July, with a 1% headwind from currency translation mainly due to movements in smaller currencies to which the Group has less exposure.

Finance review continued

Profit and margin

	2023			2022		
	IFRS £m	Adjustments £m	Adjusted £m	IFRS £m	Adjustments £m	Adjusted £m
Sales	1,694.5	–	1,694.5	2,089.3	–	2.089.3
Cost of sales	(964.5)	–	(964.5)	(1,103.7)	–	(1,103.7)
Gross profit	730.0	–	730.0	985.6	–	985.6
Operating costs	(482.5)	(72.5)	(410.0)	(540.9)	(70.4)	(470.5)
Operating profit	247.5	(72.5)	320.0	444.7	(70.4)	515.1
Gain on business disposal	–	–	–	356.0	356.0	–
Net interest charge	(11.2)	–	(11.2)	(20.7)	(1.7)	(19.0)
Profit before tax	236.3	(72.5)	308.8	780.0	283.9	496.1
Tax	(64.2)	9.5	(73.7)	(126.7)	(13.8)	(112.9)
Profit after tax	172.1	(63.0)	235.1	653.3	270.1	383.2

	2023			2022		
Operating profit	IFRS £m	Adjustments £m	Adjusted £m	IFRS £m	Adjustments £m	Adjusted £m
Consumer Care	127.8	(32.5)	160.3	144.5	(60.2)	204.7
Life Sciences	131.7	(18.6)	150.3	220.3	(9.1)	229.4
Industrial Specialties	(12.0)	(21.4)	9.4	79.9	(1.1)	81.0
Group	247.5	(72.5)	320.0	444.7	(70.4)	515.1

Cost of sales benefitted from a 12% reduction in raw material costs in 2023, with freight and energy costs also reducing as we progressed through the year. In addition, underlying employee costs were broadly flat as a hiring freeze and natural attrition offset inflation-based salary increases.

Significant volume declines across most of our markets at a similar time led to low levels of capacity utilisation at our manufacturing sites, with negative operating leverage impacting profit margins. IFRS operating profit was £247.5m (2022: £444.7m) and profit before tax £236.3m (2022: £780.0m), the prior period having included the gain on the PTIC divestment of £356.0m. IFRS profit before tax included a charge for adjusting items of £72.5m (2022: £72.1m charge excluding the gain on business disposal), comprising a goodwill impairment of £20.8m to the carrying value of the Chinese SIPO joint venture in Industrial Specialties, a charge for amortisation of acquired intangible assets of £36.7m (2022: £34.3m), acquisition costs of £9.6m (2022: £nil) and restructuring costs associated with changes to the Group's operating model of £5.4m (2022: £nil). Prior year adjusting items included 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 and a £7.6m write-off of unusable manufacturing equipment in Japan. The adjusting charge within net interest related to unwind of the discount on contingent consideration of £1.7m.

Adjustments excluding gain on business disposal	2023 £m	2022 £m
Business acquisition costs	(9.6)	–
Restructuring costs	(5.4)	–
Impairments	(20.8)	(42.2)
Fair value movement on contingent consideration	–	6.1
Unwind of discount on contingent consideration (net interest)	–	(1.7)
Amortisation of intangible assets arising on acquisition	(36.7)	(34.3)
Total adjustments	(72.5)	(72.1)

	Full year ended 31 December					
Adjusted profit	2023 £m	Underlying growth £m	Acquisition impact £m	Currency impact £m	2022 £m	Change
Consumer Care	160.3	(41.3)	0.4	(3.5)	204.7	(21.7)%
Life Sciences	150.3	(73.9)	0.0	(5.2)	229.4	(34.5)%
Industrial Specialties	9.4	(70.0)	0.0	(1.6)	81.0	(88.4)%
Operating profit	320.0	(185.2)	0.4	(10.3)	515.1	(37.9)%
Net interest	(11.2)	–	–	–	(19.0)	(41.1)%
Profit before tax	308.8	–	–	–	496.1	(37.8)%

Estimated pro forma profit	2023 £m	2022 £m	Change
Adjusted operating profit	320	515	(38)%
Pro forma adjustment	–	(39)	
Adjusted operating profit (pro forma)	320	476	(33)%
Net interest	(11)	(13)	15%
Adjusted profit before tax (pro forma)	309	463	(33)%

Group adjusted operating profit reduced by 33% on a pro forma basis to £320.0m (2022 pf: £476m), with an adjusted operating margin of 18.9% (2022 pf: 25%). With a large reduction in sales volumes, the biggest impact on margin was operating leverage, with reduced fixed overhead coverage accounting for a reduction in operating margin of around five percentage points. Adverse mix, principally lower Covid-19 lipid sales, also had an impact, reducing operating margin by around three percentage points.

There were a number of non-trading impacts that benefitted the adjusted operating margin by a total of approximately two percentage points. The most significant of these was a one and a half percentage point benefit from a negligible variable remuneration charge due to the impact of a lower share price on share scheme costs and because the annual bonus for 2023 was not triggered. Consumer Care also benefitted from the release of an accrual for an earn out associated with the Iberchem acquisition. Following the PTIC divestment, associated dis-synergy costs that were previously allocated to the divested business have been reallocated across the Consumer Care and Life Sciences sectors. This benefitted Industrial Specialties but reduced the operating margin in Consumer Care and Life Sciences by approximately half a percentage point each.

Whilst there are likely to be some bounce-back costs in 2024 as trading normalises, including a higher charge for variable remuneration and higher employee costs, there are also opportunities for margin expansion from higher sales volumes and improved mix, particularly if volume recovery is broad-based across all markets. There will also be benefits from our simplified operating model.

Net finance costs were £11.2m (2022: £19.0m), with receipt of £665.0m proceeds from the PTIC divestment on 30 June 2022 and payment of the £227.4m consideration for Solus Biotech on 4 July 2023 being the main drivers of changes over recent periods, as well as higher interest rates. Net finance costs are expected to be £15-20m in 2024. Adjusted profit before tax was £308.8m (2022 pf: £463m). The effective tax rate on adjusted profit was 23.9% (2022: 22.8%) and the effective tax rate on IFRS profit was 27.2% (2022: 16.2%). The 2023 IFRS tax rate was higher than the effective tax rate on adjusted profit as the exceptional costs were mainly capital in nature and therefore not tax deductible. The prior year IFRS tax rate was lower than the effective tax rate on adjusted profit having benefitted from corporate tax exemptions available on the PTIC divestment. Releases of prior year tax provisions benefitted the Group's adjusted effective tax rate by approximately two percentage points, otherwise there were no significant adjustments between the Group's expected and reported adjusted tax charge based on its accounting profit. IFRS basic earnings per share (EPS) were 122.5p (2022: 465.8p) and adjusted basic EPS were 167.6p (2022: 272.0p).

Improving free cash flow

As a result of active cash management during 2023, free cash flow improved to £165.5m (2022 restated: £157.4m), with a working capital inflow of £29.1m (2022: £133.8m outflow). The working capital inflow was principally driven by lower inventory with stock days falling by approximately 20%. The improvement in working capital was despite the impact on receivables of approximately $60m of lipid sales shipped to our principal Covid-19 vaccine customers during the final quarter.

Net capital expenditure was £170.1m (2022: £138.5m), driving future growth opportunities and supported by government funding grants in the Pharma business.

	Full year ended 31 December	
Cash flow	**2023 £m**	2022 (restated) £m
Adjusted operating profit	**320.0**	515.1
Depreciation and amortisation	**89.5**	86.4
EBITDA	**409.5**	601.5
Working capital	**29.1**	(133.8)
Interest & tax paid	**(93.5)**	(154.0)
Non-cash pension expense	**(4.4)**	4.5
Share-based payments	**(4.2)**	(11.0)
Other cash movements	**1.0**	1.0
Net cash generated from operating activities	**337.5**	308.2
Net capital expenditure	**(170.1)**	(138.5)
Interest received	**8.3**	5.1
Payment of lease liabilities	**(17.0)**	(17.4)
Exceptional items cash outflow add back	**6.8**	–
Free cash flow	**165.5**	157.4
Dividends	**(150.7)**	(144.4)
Acquisitions	**(241.8)**	(21.2)
Business disposal net of cash in disposed business	**(4.6)**	579.0
Exceptional items: cash outflow	**(7.9)**	(1.0)
Other cash movements	**(10.3)**	(7.5)
Net cash flow	**(249.8)**	562.3
Net movement in borrowings	**125.1**	(381.8)
Net movement in cash and cash equivalents	**(124.7)**	180.5

Closing net debt was £537.6m (2022: £295.2m), including payment of the £227.4m consideration for the Solus Biotech acquisition that was funded from cash and debt facilities. The balance sheet remains strong with a leverage ratio of 1.3x EBITDA (2022: 0.5x), within our 1-2x target range. As at 31 December 2023, the Group had committed funding in place of £1,050.0m, with undrawn committed facilities of £381.2m and £172.5m in cash. We received the most favourable rate of interest on our sustainable banking facility as our emissions reductions met the specified targets.

Retirement benefits

The post-tax asset on retirement benefit plans at 31 December 2023, measured on an accounting valuation basis under IAS 19, was £64.9m (2022: £75.2m). Cash funding of the various plans is driven by the schemes' ongoing actuarial valuations. The Trustee and Company are working on the 30 September 2023 triennial actuarial valuation for the largest pension plan, the UK Croda Pension Scheme. Initial results shared with the Company show that the funding position has improved and that the cost of providing benefits has fallen.

Alternative Performance Measures (APMs):

We use a number of APMs to assist in presenting information in this report. 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 statement include:

- Constant currency results: these reflect current year performance for existing business translated at the prior year's average exchange rates. 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. The definition of constant currency profit has been revised in the year to reflect the impact on the Group of its operations in hyperinflationary countries. Constant currency results are reconciled to reported results in the review of financial performance below. The APMs are calculated as follows:
  a. For constant currency profit, translation is performed using the entity reporting currency before the application of IAS 29 hyperinflation and any associated one-off foreign exchange gains or losses;
  b. 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 comparison. 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;
- Pro forma results: these reflect the current year performance measured against 2022 adjusted for the estimated impact of the divestment of the majority of Performance Technologies and Industrial Chemicals on 30 June 2022. Given the divested business did not meet the requirements for classification as a discontinued operation, the first half of 2022 included the full PTIC business and the second half year only included the retained business. The Board believes that the pro forma information assists shareholders by providing a meaningful basis upon which to analyse business performance and make year-on-year comparisons. Pro forma analysis is used by management for budgeting and reporting purposes including the internal assessment of operating performance across the Group. In the first half of 2022, it is estimated that the divested operations contributed revenue of £191m, adjusted operating profit of £39m and adjusted profit before tax of £33m. Pro forma results are presented on a rounded basis due to the estimated nature of the measures. The level of estimation risk in arriving at the pro forma numbers is not considered material for the Group. Pro forma adjustments only impact Industrial Specialties and the Group, with no changes to Consumer Care or Life Sciences;
- Adjusted results: these are stated before exceptional items (as disclosed in the review of financial performance below) and amortisation of intangible assets arising on acquisition, and tax thereon. The Board believes that the adjusted presentation (and the columnar format adopted for the Group income statement) assists shareholders by providing a meaningful 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;
- Operating margin or 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 Chief Executive's 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, net retirement benefit assets/(liabilities), earlier goodwill written off to reserves and accumulated amortisation of acquired intangible assets. The definition of ROIC has been revised in the year to exclude the Group's net retirement benefit balances from invested capital, given they are not operating in nature. Comparative information has been restated to reflect the new definition, resulting in restated ROIC of 14.4% for 2022 (previously 14.1%). 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, with its aim being to maintain a ROIC of at least two times the cost of capital over the cycle, and that it is useful to shareholders in assessing the superior 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. 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 net cash generated from operating activities adjusted for the cash effect of exceptional items less net capital expenditure and payment of lease liabilities, plus interest received. The definition of free cash flow has been revised in the year to better align with the most directly reconcilable line in the Group's IFRS cash flow statement. Comparative information has been restated to reflect the new definition resulting in restated free cash flow of £157.4m for 2022 (previously £167.4m). 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.