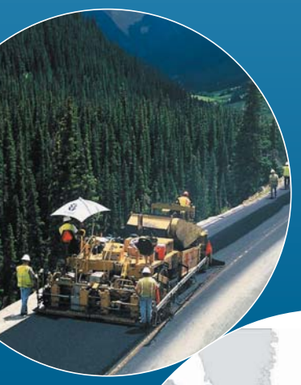
CRH
The International Building Materials Group

A MODEL OF FINANCIAL PERFORMANCE

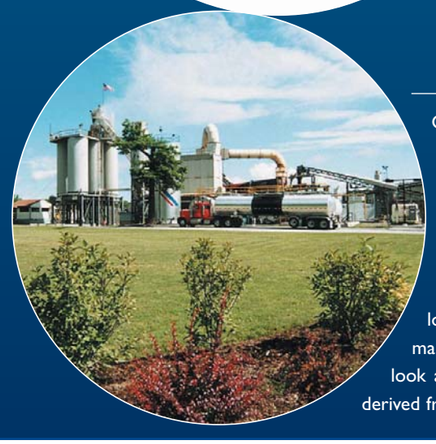


INTRODUCTION

CRH plc is a leading international supplier of building materials. It is a prime example of a modern transnational company, operating in 23 countries at the end of 2003. The Group's corporate headquarters is located at Belgard Castle, Co. Dublin.

The CRH Group was formed in 1970 through the merger of Irish Cement and Roadstone and has pursued a carefully planned growth strategy ever since. This growth has come from a continuous development programme focused on acquisitions, capital expenditure, and expansion of its building materials product portfolio. This has led the CRH Group to acquire operations in many countries including: Argentina, Belgium, Finland, France, Germany, Poland, Russia and the Baltics, Spain, Switzerland, the United Kingdom and the United States. This process continues, and in June 2004, the Group announced the purchase of a joint venture stake in a leading Portuguese-headquartered building materials company. The CRH Group now employs almost 60,000 people at approximately 2,000 locations and pays more than €2bn in wages and salaries each year.

CRH plc is a publicly quoted company which is listed on the Irish and London Stock Exchanges and on NASDAQ in the United States. More information can be found on the Group's website at www.crh.com



CRH – THE HIGH PERFORMANCE GROUP

CRH's strategic objective is to "be an international leader in building materials delivering superior performance and growth". In this case study, we will look at some financial measures of performance as they apply to the CRH Group.

WHAT IS PERFORMANCE?

The performance of a company can be viewed in many ways. The view taken will determine the measures used to assess performance. For example, a human resource manager might look at *staff retention* or *productivity measures*. A marketing manager might be interested in market share. A sales manager might be interested in *sales volume*, while an accountant might look at *cost of sales* and margins. Cost of sales and margins are financial measures and can be derived from a company's financial statements.

FINANCIAL STATEMENTS

Publicly quoted companies must publish accounts on a periodic basis. Company accounts usually take the form of *financial statements*, which allow an observer to assess the performance and financial status of the company. Two widely used financial statements are the *Profit and Loss Account* (also known as the P&L Account) and the *Balance Sheet*.

A P&L Account shows how a company has traded over a specific time period such as one year. It shows revenues and costs, and indicates whether the company has made a profit or a loss for that period. It will generally show both *gross profit* and *net profit*.

In effect, a Balance Sheet shows "what assets the company owns" and "what liabilities the company owes" on a particular date. In money terms, these two amounts are equal, since the assets that the company owns are financed by what the company owes (to shareholders and other creditors). The term *Balance Sheet* comes from this simple fact.

Simplified versions of the Group's P&L Account and Balance Sheet for 2003 are shown. When the accounts of a number of subsidiary companies are combined for publication they are known as *consolidated* accounts. The accounts in this study are the CRH plc consolidated accounts. Individual accounts are prepared in the different national currencies of the countries in which CRH operates and are converted into euro for the purposes of the Group's consolidated financial statements presented in the Annual Report. Most companies also prepare *Cash Flow Statements*. We will not deal with these in this study.

FINANCIAL RATIOS

Some performance information can be taken directly from individual financial statements. For example, the P&L Account will always show the revenue/sales for the period, expenses for the period, as well as the level of profit. Other information is derived by calculating the *ratio* of two individual measures. A ratio is the relationship between two numbers and is calculated by dividing one by the other. As we will see, sometimes the two numbers come from the same financial statement. Some other ratios require a number from the P&L Account and a number from the Balance Sheet. Financial ratios are widely used by managers, analysts, and investors for assessing the performance of a business. We will use some well-known (and relatively simple) financial ratios to examine the performance of the CRH Group under certain headings.

RETURN ON INVESTMENT (ROI)

If you have money in a bank *deposit account* you will get an additional amount each year in the form of interest. This additional amount is some percentage of your original *capital*. For example, if you invest €100 at an *interest rate* of 10 percent, your investment will be worth €110 at the end of the year. People who invest in a business also expect some *return*, that is, they expect to make some money on their investment in the form of dividends. However, this can only happen if the company makes a profit.

People who invest in a company own the shares in that company and are called shareholders. The money they invest is called *equity*. When a company makes a profit it can keep that profit within the business for the purpose of future investment or distribute it to shareholders. These payments to shareholders are called dividends. If profit is kept in the business it is shown in the Balance Sheet under Reserves. As well as their original equity, the shareholders also own any reserves. The sum of the equity and the reserves is called shareholders' funds.

We now look at two popular measures of return on investment.

Return on Shareholders' Funds (ROSF)

This ratio measures the company's return to its ordinary shareholders considering the capital they have invested in that company.

$$\text{Return on Shareholders' Funds} = \frac{\text{Profit (after tax and preference dividends)}}{\text{Ordinary Shares + Reserves}} \times 100$$

As shown, the ROSF for the Group in 2003 was 13.2%.

Return on Capital Employed (ROCE)

This ratio measures the profit generated by the company considering the total capital invested in the company.

The total capital invested in the company (Capital Employed) is made up of Shareholders' Funds (Ordinary Share Capital + Reserves) as well as money borrowed from banks or other institutions (Long-Term Liabilities).

$$\text{Return on Capital Employed} = \frac{\text{Profit (before interest and tax)}}{\text{Ordinary Shares + Reserves + Long Term Liabilities}} \times 100$$

The Group's Return on Capital Employed for 2003 was 11.1%.

PROFITABILITY

Profitability measures a company's ability to generate profits efficiently. If you sell an item for €100 and make a profit of €5, your profit margin is 5%. In business, we generally distinguish between two types of margin.

Gross Profit Margin

This ratio measures the company's mark-up on sales.

$$\text{Gross Profit Margin} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

We can see that the Gross Profit Margin for the Group during 2003 was 30.7%.

Net Profit Margin

This ratio measures the company's profitability relative to sales after deducting operating expenses.

$$\text{Net Profit Margin} = \frac{\text{Profit before interest and tax (PBIT)}}{\text{Sales}} \times 100$$

The Net Profit Margin for the Group was 9.1% in 2003.

Net margins in food retailing can be very low (around 1% - 3%), while a shop selling jewellery might expect margins of more than 50%. So margins should only be used to compare businesses in similar sectors. However, they are useful in tracking the performance of the same business for a period of time.

LIQUIDITY

Liquidity ratios measure the ability of the company to pay its bills as they fall due. Cash, money in a bank current account, debtors and stocks of goods are all *liquid assets* with cash being the most liquid and stocks of goods generally the least liquid. On the other hand, things like buildings and vehicles are considered to be *fixed assets* and cannot be converted to cash so easily since the business needs these assets to function.

Two measures of liquidity are commonly used:

Current Ratio

This ratio measures the relationship between Current Assets and Current liabilities. Current assets consist of money or items which can be turned into money within one year. They are made up of cash and bank, debtors, and stocks of goods. Current liabilities are amounts which are due within one year. They are made up of bills due, bank overdrafts and trade creditors. If the Current Ratio is greater than 1:1, the company's current assets are larger than its current liabilities. This means that current liabilities can be paid off easily. Analysts might expect this ratio to be ideally over 2:1 but at least 1.5:1. We can see that the Current Ratio for the Group at the end of 2003 was 1.87:1. This is a very strong current ratio.

$$\frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Quick Ratio (Acid Test/Liquid Ratio)

This is a more severe test because it excludes stock from the equation. This is because stock of goods is the least liquid of all current assets. Analysts might expect to see a ratio of approximately 1:1 or more here. As shown, the value of this ratio for the Group at the end of 2003 was 1.36:1.

$$\frac{\text{Current Assets (less stock of goods)}}{\text{Current Liabilities}}$$

LIQUIDITY IS NOT PROFITABILITY

Liquidity should not be confused with profitability. A company can make a profit but still go out of business because it does not have sufficient cash. Cash flow is measured in the Cash Flow Statement while profit is measured in the P&L Account. Note also that the term solvency is sometimes confused with liquidity.

FINANCIAL STRENGTH

Measures in this category indicate the ability of the company to meet certain commitments.

Two widely-used measures are as follows:

Debt Equity Ratio (Gearing)

This ratio examines the capital structure (funds) of the company. A business has two types of long-term funds at its disposal - the money invested by shareholders (shareholders' funds) and any money borrowed in the form of the long-term loans (debt capital).

$$\frac{\text{Debt Capital}}{\text{Equity Capital}}$$

The term *gearing* refers to the ratio between these two types of funds. A business with a ratio of 1:1 is said to be *neutrally geared*. If it has a ratio greater than 1:1 it is *highly geared* and if it has a ratio less than 1:1 it is *lowly geared*.

This ratio is a measure of the mix of funds being used by the business. The greater its proportion of debt capital, the more pressure it is under to service the debt. The decision to increase the amount of debt in order to fund growth is always a financial balancing act. We can see that the Group's ratio at the end of 2003 was 0.83:1. By these definitions the Group is low geared.

Interest Cover

This is a measure of the company's ability to pay the interest it owes on loans. A high cover indicates that the company has no difficulty paying this interest. It is normally calculated by dividing PBIT by the amount of interest. At the end of 2003, the CRH Group's Balance Sheet indicated a value of 8.3 times. This would be considered to be a very strong position.

$$\frac{\text{Profit before interest and tax (PBIT)}}{\text{Interest}}$$

SHAREHOLDER VALUE

We have seen how shareholders are interested in profit because profit is an indicator of the return on their investment. They also pay attention to a related group of measures called *Investment Ratios*. These ratios measure the performance of the company's *ordinary* shares in the financial market - the CRH Group has approximately 530 million ordinary shares in issue. The most common are:

Earnings per Share (EPS)

This ratio measures the profit earned by each ordinary share.

$$\frac{\text{Profit (After tax, and preference dividends)}}{\text{Number of Ordinary Shares issued}}$$

It is not really a ratio but an actual value expressed in money terms (in cent). At the end of 2003, the Group's EPS was 120.9 cent.

Dividend per Share (DPS)

This ratio measures the dividend paid on each ordinary share (measured in cent).

$$\frac{\text{Total Ordinary Dividends (Paid and Proposed)}}{\text{Number of Ordinary Shares issued}}$$

At the end of 2003, the Group's DPS was 27.9 cent.

Price Earnings Ratio (P/E)

This ratio measures the number of years it would take a share to recover its share price if current profit performance is maintained into the future.

$$\frac{\text{Market Price per Share}}{\text{Earnings per Share}}$$

In effect, what this measure indicates is the number of years that a shareholder would be willing to wait to recover the price paid for the shares. At the end of 2003, the market price for the Group's shares was €16.28, so the P/E value as at that date was 13.5. This ratio is usually taken to be an indicator of investor confidence in the future.

Profit & Loss Account / Balance Sheet		
Return on Investment Return on Shareholders' Funds	Profit After Tax and Preference Dividends / Shareholders Funds	13.2%
Return on Capital Employed	Profit before Interest and Tax / Capital Employed	11.1%
Profitability Gross Profit Margin	Gross Profit / Sales	30.7%
Net Profit Margin	Net Profit / Sales	9.1%
Liquidity Current ratio	Current Assets / Current Liabilities	1.87:1
Liquid Ratio	Current Assets - Stock / Current Liabilities	1.36:1
Financial Strength Debt/Equity (Gearing)	Long-Term Debt / Equity Capital	0.83:1
Interest Cover	Profit before Interest and Tax / Interest	8.3
Shareholder Value Earnings per Share	Profit After Tax and Preference Dividends / Number of Ordinary Shares	120.9c
Dividend per Share	Total Dividends Paid / Average Number of Ordinary Shares	27.9c
Price Earnings Ratio	Market Price of Share / Earnings per Share	13.5

Some financial ratios showing how the Profit & Loss Account and Balance Sheet contribute to them and their values for CRH. Source CRH plc Annual Report 2003.

CONCLUSION

It is clear that CRH is in the hands of strong management. It enjoys continuous growth, a significant proportion of which is through acquisitions. The various financial measures indicate vigorous trading performance and a high level of shareholder confidence. This study has not dealt with cash flow. Cash flow is extremely important for any business and CRH always manages it well. You can see the Cash Flow Statement on the company's website www.crh.com. Tasks & Activities for this case study can be found on the Tasks & Activities page at the back of the pack.

Group P&L Account Year Ending 31 Dec. 2003

	€m
Group Turnover	10,774
Cost of Sales	(7,461)
Gross Profit	3,313
Profit before Interest and Tax	982
Interest	118
Profit before Tax	864
Profit after Tax	646
Profit after Tax & Preference Dividends	641
Ordinary Dividends (Paid & Proposed)	148
Average no. of Ordinary Shares	530m
Market Price (as of 31 Dec. 2003)	€16.28 per share

Group Balance Sheet 31 Dec. 2003

	€m
Fixed Assets	6,969
Current Assets	
Stocks	1,117
Debtors	1,681
Cash	1,298
	4,096
Current Liabilities	2,193
Net Current Assets	1,903
Total Assets less Current Liabilities	8,872
Long-Term Loans etc.	4,023
	4,849
Shareholders' Funds	4,849