

Financial ratios

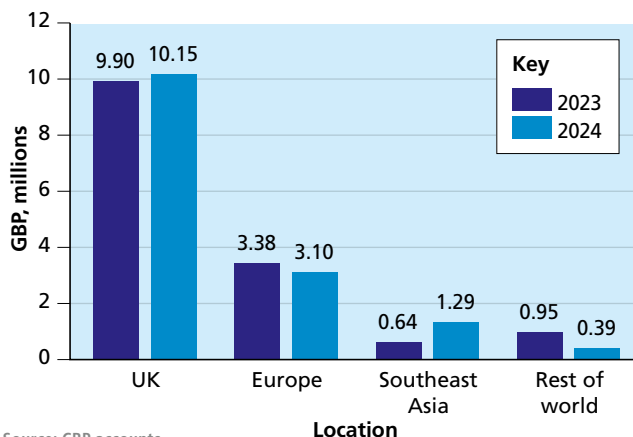
Who is Danny/stock.adobe.com

Ian Marcousé examines the financial position of a global manufacturing business

Corrosion Resistant Products Ltd (CRP) is a business employing 71 people in Littleborough, north Manchester. Its sales held steady at £14.9 million in 2023 and 2024, but with substantial and rising profits. Its website says it is a leading global manufacturer and distributor of fluoropolymer-lined pipes and equipment. Its market is businesses that build oil refineries or pipelines and – it probably hopes – the proposed small nuclear power stations planned by Rolls-Royce.

A boom in infrastructure spending would be a fine thing for CRP because it would allow a continuation of the boom in its sales to Southeast Asia in 2024 (Figure 1). Fortunately, it has very little business activity in the USA, so President Trump's tariffs are not a concern.

The business seems to be slow moving but integrated with the local area. Manufacturing manager Steven Herbert is quoted on the Rochdale Training website saying that after the success of their first apprentice, they are taking on two additional apprentices this year and plan to take on more in the future. He says that they use Rochdale Training



Source: CRP accounts

Figure 1 CRP's sales revenue by geography

because 'they embed the real engineering skills required to meet the needs of the local engineering industry'.

CRP's accounts, shown in abbreviated form in Tables 1 and 2, look very sound. However, a similarly named company, Corrosion Resistant Materials Ltd, went into liquidation earlier in 2025. Hopefully this will not affect CRP's confidence in its growth prospects. Training up new apprentices is a promising sign for the business.

Table 1 Profit and loss accounts for CRP Ltd (to 31 December)

	2023 (GBP, millions)	2024 (GBP, millions)
Sales revenue	14.87	14.92
Cost of sales	(8.71)	(8.33)
Gross profit	6.16	6.59
Administration	(2.43)	(2.54)
Operating profit	3.73	4.05

Table 2 Balance sheet for CRP Ltd (as of 31 December)

	2023 (GBP, millions)	2024 (GBP, millions)
Non-current assets	1.46	1.36
Stocks (inventories)	3.47	3.41
Receivables	3.59	4.39
Cash	0.19	0.19
Current liabilities	(2.28)	(2.64)
Non-current liabilities	(0.15)	(0.17)
Total equity	6.28	6.54

Questions

30 marks, 40 minutes

- Calculate the percentage change in CRP's sales in Southeast Asia in 2024 compared with 2023. (2 marks)
 - Explain how CRP might respond to the huge growth in its Southeast Asian sales in 2024. (4 marks)
- Calculate the change in CRP's operating margin between 2023 and 2024. (4 marks)
 - Assess **two** factors that may have led to this change. (8 marks)
- Imagine that CRP is considering a £6 million investment in a new manufacturing site in Europe. Using relevant accounting ratios, assess whether CRP's financial health is sufficiently strong to finance this investment. (12 marks)

Answers and marking

- Percentage change = $\frac{\text{change}}{\text{original}} \times 100$
 $= \frac{0.65}{0.64} \times 100 = +101.56\%$
 - CRP should find out why its sales have doubled and look to build on what is discovered. If it is largely the work of a brilliant sales executive who works in Asia, then CRP should provide them with any extra budget necessary. If it is because a local rival has collapsed, then CRP should provide more staff to visit that rival's customers and take advantage before new rivals enter the market.
- Operating margin $\frac{\text{operating profit}}{\text{sales revenue}} \times 100$
2023: $\frac{£3.73 \text{ million}}{£14.87 \text{ million}} \times 100 = 25.08\%$
2024: $\frac{£4.05 \text{ million}}{£14.92 \text{ million}} \times 100 = 27.14\%$
There is an increase of 2.06%.
 - One factor highlighted in the profit and loss accounts is that a reduction in cost of sales (direct costs such as raw materials and factory labour) led to a significant rise in gross profit. The



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£430,000 rise in gross profit was enough to cover the £110,000 rise in administration overheads, while still leaving enough for a £320,000 rise in operating profit. CRP's ability to reduce the cost of sales at a time of constant complaints about cost inflation is impressive.

Another possibility is that the broadly static revenue figure disguises a more complex situation where prices rose sharply, leading to a similar fall in sales volume. For instance, CRP may have sold 10% fewer items at 10% higher prices. If this was the case, then the cost of sales would inevitably fall because it is, in effect, the company's variable costs.

- 3 To measure financial health, the two most obvious measures are liquidity and gearing. Taking the current ratio as the liquidity measure, the figures come out as follows:

	2023	2024
Current ratio	3.18	3.03
Gearing ratio	2.33%	2.53%

The above figures are unusually positive. Liquidity has fallen between 2023 and 2024, but from one remarkably high figure to another. Implicitly, CRP's finance director could generate significant amounts of cash from the company's working capital. For instance, it could target a current ratio of half this level and still be within accountants' common

recommendation that the ratio should be around 1.5. For example, stretching credit terms to suppliers would increase current liabilities yet generate cash that could then be invested in the company's long-term future. It looks easy to raise around £2.5 million this way.

Then there is gearing, which can easily be lifted to 30–35% of capital employed without causing any concerns. The 2024 gearing level is:

$$\frac{£170,000}{£6,710,000} \times 100 = 2.53\%$$

If the business were to take out a new loan of £3.5 million, the gearing would become:

$$\frac{£3,670,000}{£10,210,000} \times 100 = 35.95\%$$

This would still fall within the usual consideration that long-term debts should be less than 50% of capital employed.

Therefore, CRP's exceptionally strong balance sheet means that it can finance a £6 million investment without any need for drastic action such as bringing in new shareholders or selling off existing assets.

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