CASH FLOW CHEAT SHEET

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WHAT IS CASH FLOW CONVERSION?

Cash Flow Conversion measures how effectively a business turns its profits into actual cash.

A high conversion means profits are quickly becoming usable cash; a low conversion suggests profits are tied up in receivables, stock, or poor payment terms.

THE CASH FLOW CYCLE (WORKING CAPITAL CYCLE)

The process showing how cash moves through the business.

1. **Cash Out → Inventory / Raw Materials**
   - Money spent on goods, production, or stock.
2. **Inventory → Sales (Receivables)**
   - Goods sold, often on credit.
3. **Receivables → Cash In**
   - Payment collected from customers.
4. **Cash In → Pay Suppliers / Reinvest**
   - Funds used to pay bills, reduce debt, or reinvest.

Cycle Length Matters:

The shorter the cycle, the faster the business turns resources into cash.

WHY CASH FLOW CONVERSION MATTERS

- Liquidity vs. Profitability – Explains why a profitable business can still run out of cash.
- Investor & Lender Confidence – Strong cash conversion reassures financiers.
- Growth Capacity – Cash availability determines ability to reinvest and expand.
- Crisis Readiness – Healthy cash conversion is the buffer during downturns.

BENCHMARKS & INDUSTRY NORMS

- **Retail** → Very short CCC (days).
- **Manufacturing** → Moderate CCC (weeks).
- **Construction** → Long CCC (months).
- **Healthcare** → Variable, often reliant on insurance / NHS payments.

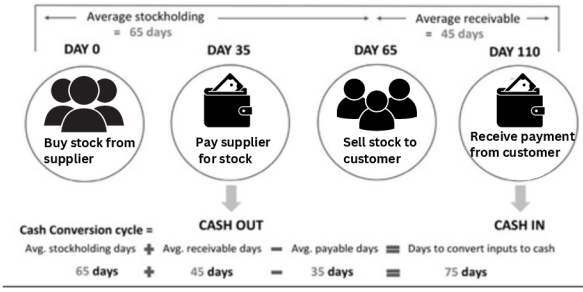
CASH FLOW CONVERSION FORMULA

$$\text{Cash Flow Conversion Ratio} = \frac{\text{Operating Cash Flow}}{\text{EBITDA}}$$

INTERPRETATION:

- > 1.0 → Excellent: generating more cash than accounting profit.
- ≈ 1.0 → Healthy: cash closely matches profits.
- < 1.0 → Warning: cash tied up in working capital or poor collections.

THE CASH CONVERSION CYCLE



KEY METRICS IN THE CASH FLOW CYCLE

Days Inventory Outstanding (DIO)
Average time inventory sits before being sold.

$$DIO = \frac{\text{Average Inventory}}{\text{COGS per Day}}$$

Days Sales Outstanding (DSO)
Average time to collect receivables.

$$DSO = \frac{\text{Accounts Receivable}}{\text{Sales per Day}}$$

Days Payables Outstanding (DPO)
Average time to pay suppliers.

$$DPO = \frac{\text{Accounts Payable}}{\text{COGS per Day}}$$

Cash Conversion Cycle (CCC)
Measures how long each £1 is tied up before turning back into cash.

$$CCC = DIO + DSO - DPO$$

Target: Shorter CCC = faster liquidity and better cash flow health.

CHECKPOINTS FOR HEALTHY CASH FLOW CONVERSION

- Is the CCC trending downward (improving)?
- Are receivables collected promptly?
- Is inventory turnover strong?
- Are supplier payment terms optimized?
- Does Operating Cash Flow align with EBITDA over time?
- Is enough cash available for growth and debt obligations?

Tip: Improving just one element (faster collections, smarter stock levels, or longer supplier terms) can dramatically improve cash flow conversion.

STRATEGIES TO IMPROVE CASH FLOW CONVERSION

- **Speed Up Collections**
  - Offer early payment discounts.
  - Use automated invoicing & reminders.
- **Manage Inventory Efficiently**
  - Reduce excess stock.
  - Use "just-in-time" methods.
- **Negotiate Better Supplier Terms**
  - Extend payment deadlines.
  - Build strong supplier relationships.
- **Boost Sales with Low Cash Lag**
  - Push for cash sales where possible.
  - Avoid long credit terms unless necessary.
- **Control Overheads**
  - Regularly review subscriptions & non-essential costs.

RED FLAGS TO WATCH FOR

- Rising sales but declining cash balances.
- Increase in receivables days (DSO growing).
- Suppliers demanding faster payment (shortening DPO).
- EBITDA positive but Operating Cash Flow negative.
- Frequent use of overdraft / short-term loans.