CORPORATE ANALYSIS

Cash Conversion Cycle

The Cash Conversion Cycle (CCC) measures - in days - the time required till cash bound in the firm´s production process and inventory flows back through payments made by its customers. Therefore, the CCC also determines, how much minimum cash a firm requires – either by holding it or by having access to adequate bank credit and funding lines - to be able to maintain production and operations.

The extreme example of a seasonal industry, such as that of a ski manufacturer, underlines the importance of the CCC: Skis are foremost bought before the main skiing season, prior Christmas, so around November, December. Therefore, this is also around the time when the ski manufacturer collects cash from customers. – And the rest of the year? New models for the next season have to be developed and designed, to be ready for their presentation at big fairs, most of them taking place in early spring. Over spring and summer, production is in full swing, whereby raw material, personnel, rent, electricity have to be paid on time. Finally, in late fall skis are shipped to major distributors and – again – sold. – Therefore, one can imagine that in any seasonal industry it is absolutely essential to closely observe and optimally manage the CCC: In essence, one would have to pre-finance a full year of production before cash flows back to the firm. - And the consequences of a season with little or snow at all, may just be left to one´s imagination.

Therefore, understanding the CCC helps a firm to estimate the minimum liquidity and funding required so that it can meet payment requests from suppliers, workers and staff, landlords or utilities.

The CCC is calculated in subtracting Days Payable from the sum of Days Receivable, Inventory Turnover and the Cash Turnover. Latter is usually assumed to be driven by the Revenues per day, till the cash pool is – metaphorically – again fully replenished – or turned over.

To estimate and determine the amount of minimum cash a firm requires on the basis of the calculated number of days of the Cash Conversion Cycle one simply multiplies this figure with the firm´s daily Cost of Goods Sold and daily Overhead cost. – Whereby it would certainly be advisable to add some cushion on top of this figure.

CASH CONVERSION CYCLE

INCOME STATEMENT	BALANCE SHEET	
REVENUES	CASH	PAYABLES
- COST (PERS. MAT)	RECEIVABLES	
= EBITDA	INVENTORY	

DAYS CASH TURNOVER	CASH / DAILY REVENUES
+ DAYS RECEIVABLES	REC / DAILY REVENUES
+ DAYS INVENTORY TURNOVER	INV / DAILY COST (PERS. MA
- DAYS PAYABLES	PAY / DAILY COST (PERS. MAT) [ALTERNATIVE: DAILY PURCHASES]
CASH CONVERSION CYCLE (IN DAYS)	