APPLIED FINANCIAL STATEMENT ANALYSIS

ASSIGNMENT- 6-10

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DEFINE CASH CONVERSION CYCLE:

The Cash Conversion Cycle [CCC] is a metric that measures the time [in days] it takes for a company to convert its investments in inventory can other resources into cash flows from sales. It reflects the efficiency with which a company manages its working capital. The CCC helps a company understanding how long each doller invested in operations is tied up before it is converted into cash.

The formula for the Cash Conversion Cycle is:

CCC = Days Inventory Outstanding (DIO) + Days Sales Outstanding (DSO) - Days Payables Outstanding (DPO)

KEY COMPONENTS:

1. DAY INVENTORY OUTSTANDING (DIO):

The average number of days the company takes to turn its inventory into sales. A lower DIO indicates efficient inventory management.

$$DIO = \frac{\text{Average Inventory}}{\text{Cost of Goods Sold (COGS}} \times 365$$

2. DAYS SALES OUTSTANDING (DSO):

The average number of days it takes the company to collect payment after making a Sale. A lower DSO means the company is collecting payements from customers quickly.

$$DSO = \frac{\text{Accounts Receivable}}{\text{Total Credit Sales}} \times 365$$

3. DAYS PAYABLES OUTSTANDING (DPO):

The average number of days the company takes to pay its supplies after receiving inventory. A higher DPO is generally better for cash flow as the company can hold onto its cash longer.

$$DPO = \frac{\text{Accounts Payable}}{\text{COGS}} \times 365$$