

Cash Flow Conversation Guide

Cash Flow: for every dollar spent on the business, how much is being returned?

- ✓ Understand the importance of cash flow to our Client's operations. This is the company's **working capital**.
- ✓ Understand the **Asset Conversion Cycle** (how they generate cash, use that cash, and why they occasionally need to borrow).
- ✓ Identify **TM & Product Solutions**.
- ✓ Understand the impact of **payment timing**:
 - Delaying the client's payment for Raw Materials **increases** their A/P
 - Speeding up the client's payment for their goods **decreases** their A/R.

Cash Conversion Cycle Definitions:

- **CCC** – Cash Conversion Cycle is a metric that shows the amount of time it takes a company to convert its investments in inventory to cash. The conversion cycle formula measures the amount of time, in days, it takes for a company to turn its resource inputs into cash.
- **DIO** – Days Inventory on Hand is the average number of days it takes a company to turn its inventory into sales. *“How long before a company sells its inventory?”*
- **DSO** – Days Sales Outstanding is the average number of days it takes a company to collect its receivables. *“How long before the company collects cash from its sales/service delivery?”*
- **DPO** – Days Payable Outstanding is the average number of days it takes a company to pay back its payables. *“How long before the company can pay off its suppliers?”*
- **Inventory & A/R** = LOC & S/T Ln. repayment.
- **Core Cash Flow/ Cash Flow from normal Ops** = L/T Ln. repayment.
- **COGS** – Cost of Goods Sold is the company's total cost related to the sale of the product. *“The cost of the materials and labor may be included in cost of goods sold. Additional costs incurred, like commissions or expense reports, are also included in COGS.”*



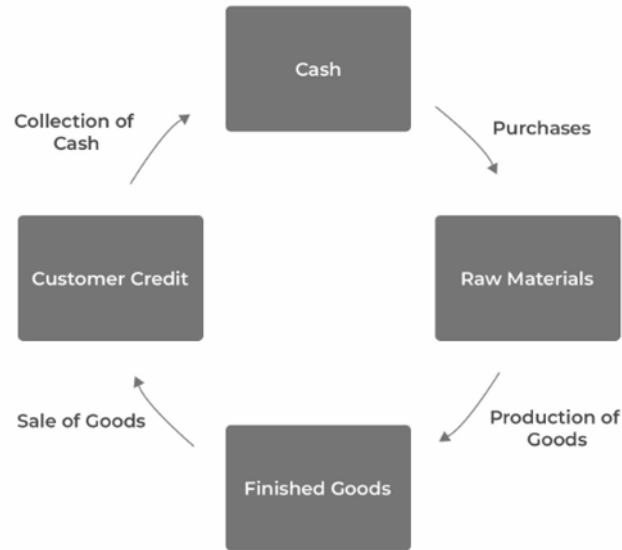
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Asset Conversion: Operating and Capital Investment Cycles Formulas:

- Cash Flow Timing Difference – $CCC = DIO + DSO - DPO$.
 - **Days** – $A/R\ DOH + Inv.\ DOH - A/P\ DOH$.
 - **Dollars** – $Daily\ Sales\ (Sales/365) \times CFTD\ (in\ days)$.
 - For a **service sector company**, which typically does not have inventory, the CCC simplifies to just receivable days minus payable days.
- Average Accounts Receivables (aka Average Inventory) – sum of starting and ending accounts receivable over a time period (*such as monthly or quarterly*), divided by 2.
- Revenue – $Sales \times Average\ Price\ of\ Service\ (Sales\ Price)$.
- A/P – the sum of accounts payable at the beginning and end of an accounting period, divided by 2.
- A/R – $Average\ Accounts\ Receivables\ divided\ by\ Revenue \times \text{Daily Sales}$ (*how many sales days in their year*).
- A/R DOH + Inv. DOH – Operating Cycle.
- Cost of Goods Sold – $Inventory + Purchases - Ending\ Inventory$.
- DIO – $Average\ Inventory / Cost\ of\ Goods\ Sold \times 365$.
- DSO – $Average\ Accounts\ Receivables / Total\ Credit\ Sales \times 365$.
- DPO – $Average\ Accounts\ Payable / Cost\ of\ Goods\ Sold \times 365$.



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Cash Management: How a client collects, handles, disburses, and invests their cash for solvency/stability

- ✓ Reducing days of A/R.
- ✓ Increase collection rate and COH.
- ✓ Extend Pay Cycle.
- ✓ Proper Debt Vehicles.
- ✓ Proper S/T Investment Vehicles.
- ✓ Present good business AND personal investment options as well as cash management tools since many small business owner's (≥8mm revenue) Balance Sheets are VERY closely tied.
- ✓ Without proper cash management tools and access to lending vehicles, the client will not be able to manage reoccurring OR unexpected expenses.
- ✓ TM helps with extra costs of external funding affect profit (Increased Interest Charges).
- ✓ Taking advantage of supplier specials and investing in equipment to help make production more efficient requires more COH/greater Cash Flow.
- ✓ Increased fraud exposure can lead to Internal/External theft and inability to identify reasons for imbalances.
- ✓ Resources are required to assist growth. If one cannot afford to fulfill current orders, it will not be able to take on more orders!