DilutionScore Methodology: How We Measure Dilution Risk for Every Stock

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The definitive explanation of TraderTools's DilutionScore - the 5 components, how each is weighted, what scores mean in practice, and how to use scores to protect your portfolio.

The DilutionScore is TraderTools's proprietary composite metric that measures the cumulative dilution risk for a publicly traded company at a given point in time. Rather than forcing you to manually synthesize data from warrants tables, cash position footnotes, SEC filing histories, and share count trends, the DilutionScore aggregates five key risk factors into a single 0-100 number that tells you, at a glance, how dangerous a stock is from a dilution perspective.

This document explains exactly how the DilutionScore is calculated - the five components, how each is weighted, how scores are normalized, and what different score levels mean in practice. We believe investors should understand what they're looking at.

The Philosophy Behind the Score

Dilution is not a single event - it's a process. A company's dilution risk is determined not just by what's already happened (shares issued) but by what's pending (warrants, convertibles), what's probable (cash runway, filing history), and what's been structured (deal terms). Any metric that looks at only one dimension will miss the full picture.

The DilutionScore is designed to be a leading indicator, not a lagging one. We want to flag high-risk situations before the next offering is announced, not after your position is down 30%. That means the score weights forward-looking indicators - cash runway, warrant overhang, active shelf registrations - more heavily than backward-looking ones.

Scale: DilutionScore runs from 0 to 100. Higher is worse. A score of 0 indicates minimal dilution risk across all five components. A score of 100 indicates extreme dilution risk - the kind of situation where the stock is likely to be structurally impaired by ongoing share issuance.

The Five Components

1. Cash Runway

Weight: 30%

How many months of operating expenses the company can fund with current cash. The single strongest predictor of imminent dilutive financing.

2. Warrant & Convert Overhang

Weight: 25%

Total warrants plus convertible note shares as a percentage of basic shares outstanding. Measures the dilution already baked in but not yet exercised.

3. Share Issuance Velocity

Weight: 20%

The rate at which shares outstanding has grown over the trailing 12 months. A high velocity

indicates an active, ongoing dilution program.

4. Filing Activity

Weight: 15%

Number and recency of S-3, S-1, 424B, and PIPE-related 8-K filings in the trailing 18 months. Measures how actively the company uses capital markets.

5. Structural Risk

Weight: 10%

Presence of going concern opinion, toxic financing terms (variable-rate converts, ratchets), or active ATM program. Binary factors with outsized impact.

Component 1: Cash Runway (30%)

Cash runway is the single strongest predictor of near-term dilution. Companies with less than 6 months of cash remaining at their current burn rate will almost certainly need to raise capital - and in small-cap markets, that almost always means dilutive equity issuance.

We calculate cash runway as: (Cash + Equivalents) ÷ Monthly Operating Cash Burn

The data comes from the most recently filed 10-Q or 10-K. For operating cash burn, we use the trailing 3-month average from the cash flow statement rather than the single most recent quarter, which can be distorted by one-time items.

Scoring for this component:

* >18 months runway: 0 points (no near-term risk)
* 12-18 months: 15 points
* 6-12 months: 40 points
* 3-6 months: 70 points
* <3 months: 100 points (maximum risk)

Component 2: Warrant & Convert Overhang (25%)

This component measures the dilution that already exists in the form of outstanding warrants and convertible securities - shares that haven't been issued yet but will be if prices move or conversions occur.

We calculate overhang as: (Total Warrant Shares + Potential Convert Shares) ÷ Basic Shares Outstanding

For convertible notes, we use the current conversion price to determine potential shares. If the note has variable-rate or ratchet conversion provisions, we use the floor price or a worst-case conversion scenario and flag it in the structural risk component as well.

Scoring thresholds:

* <10% overhang: 0-15 points
* 10-25% overhang: 15-40 points
* 25-50% overhang: 40-70 points
* 50-100% overhang: 70-90 points
* >100% overhang: 90-100 points

Component 3: Share Issuance Velocity (20%)

A company can have a reasonable cash position and modest warrant overhang today, but if its shares outstanding has grown 150% over the past 12 months, that trajectory tells an important story about management's willingness to dilute shareholders and the company's ability to operate without repeated equity raises.

We calculate this as the year-over-year percentage increase in basic shares outstanding, sourced from the most recent 10-Q compared to the same period in the prior year.

Scoring:

* <10% share growth YoY: 0-10 points
* 10-25% growth: 10-30 points
* 25-50% growth: 30-60 points
* 50-100% growth: 60-80 points
* >100% growth: 80-100 points

Component 4: Filing Activity (15%)

The frequency and recency of dilution-related SEC filings is a strong proxy for how actively a company is using the capital markets - and therefore how likely additional dilution is. We track:

* S-3 and S-1 registration statements filed in trailing 18 months
* 424B prospectus supplements (actual offerings pulled from shelf)
* 8-K filings with Item 3.02 (unregistered sales) - the PIPE indicator
* S-3/A amendments (active management of shelf registrations)

A company that has filed 6 prospectus supplements and 3 PIPE-related 8-Ks in the last 18 months is a fundamentally different risk profile than one that filed a single clean S-3 two years ago. This component captures that difference.

Component 5: Structural Risk (10%)

Some risk factors are binary - they're either present or they're not - but their presence is so significant that they need their own component. The structural risk component adds points for any of the following:

* Going concern opinion in the most recent audited financial statements: +40 points to this component
* Active ATM program (424B3 filed on shelf): +25 points
* Variable-rate convertible notes or full ratchet anti-dilution provisions: +60 points
* Beneficial ownership waivers already executed (PIPE investors have signaled they're done waiting): +20 points
* Delinquent SEC filings (NT 10-Q or NT 10-K filed): +30 points

This component is capped at 100 before applying the 10% weight to the composite score.

What Different Score Levels Mean

0-25

Low Risk. Strong cash position, modest dilutive overhang, limited recent filing activity. Dilution

risk exists but is not a near-term concern for most positions.

26-50

Moderate Risk. Some combination of tightening cash, meaningful warrant overhang, or active shelf registration. Monitor closely; a financing is plausible within 12 months.

51-75

High Risk. Multiple risk factors elevated simultaneously. Near-term capital raise is likely. Position sizing and stop discipline are critical at this score level.

76-100

Critical Risk. Extreme dilution pressure - low cash, high overhang, active filings, possible going concern. Companies at this level frequently issue stock at 20-40% discounts. This data pattern warrants thorough independent research before any investment decision. This does not constitute a recommendation to buy, sell, or short any security.

Score Update Frequency

DilutionScores are updated in real time when new SEC filings are processed. Scores for cash runway and filing activity update immediately on new 10-Q, 10-K, S-3, 424B, or 8-K filings. Scores for share issuance velocity update when new quarterly filings provide updated share counts. The composite score is recalculated within minutes of any relevant filing.

What the DilutionScore Is Not

The DilutionScore is a dilution-specific risk metric. It is not a buy/sell recommendation, a measure of company quality or growth prospects, a prediction of stock price performance, or a replacement for your own investment research. A company can have a high DilutionScore and still appreciate in price if the underlying business performs well enough. Conversely, a low DilutionScore doesn't make a company a good investment.

Use the DilutionScore as one input in your process - specifically, as a filter for identifying situations where equity dilution risk is elevated enough to warrant extra scrutiny in position sizing and risk management.

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