10-K and 10-Q Reports: Predicting Dilution Through Financial Analysis

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Use annual and quarterly reports to analyze cash runway, going concern warnings, and future dilution risk.

Why Financial Reports Predict Dilution

The best predictor of future dilution is simple: companies running out of money will raise capital. By analyzing 10-K (annual) and 10-Q (quarterly) reports, you can calculate how long a company can survive before needing to dilute shareholders.

?? The 6-Month Rule

When a company has less than 6 months of cash runway, dilution is almost inevitable. This is when CFOs get desperate and accept unfavorable terms - including toxic convertible notes and heavily discounted offerings.

Calculating Cash Runway

Cash runway tells you how many months a company can operate before running out of money.

Cash Runway = Cash & Equivalents ÷ Monthly Cash Burn

Where Monthly Cash Burn = (Operating Cash Flow ÷ Months in Period)

Where to Find These Numbers

* Cash & Equivalents: Balance Sheet -> Current Assets
* Operating Cash Flow: Statement of Cash Flows -> "Net cash used in operating activities"
* 10-Q covers 3 months, so divide by 3
* 10-K covers 12 months, so divide by 12

Red Flags in Financial Reports

1. Going Concern Warnings

Search for the phrase "going concern" or "substantial doubt" in the filing. This is the auditor's warning that the company may not survive 12 months. It's an almost guaranteed precursor to dilution.

2. Increasing Cash Burn

Compare quarter-over-quarter cash burn. If a company burned $5M last quarter and $8M this quarter, runway is shrinking faster than the balance sheet suggests.

3. Debt Covenants

Check the notes for debt covenant violations or waivers. Companies in technical default often raise equity to repay or renegotiate debt.

4. Management Discussion

The MD&A (Management Discussion & Analysis) section often hints at future capital raises. Look for phrases like "may need additional financing" or "exploring strategic alternatives."

10-K vs 10-Q: What's the Difference?

* 10-K (Annual): Filed within 60-90 days of fiscal year end. Comprehensive, audited financials. Contains full-year data and detailed risk factors.

* 10-Q (Quarterly): Filed within 40-45 days of quarter end. Unaudited but more timely. Contains 3-month and year-to-date data.

* 10-K/A or 10-Q/A: Amendments correcting errors - watch for restatements that worsen the picture.

? Warning: Delayed Filings

If a company files an NT 10-K or NT 10-Q (notification of late filing), investigate immediately.
Late filings often mean the company is scrambling to explain bad news or restructure finances.

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