OCCAM'S FORENSIC JURY™ · EDUCATION SERIES

Forensic Financial Analysis

for Value Investors

Teaching students to use Perplexity as a research co-pilot — without surrendering judgment to the machine.

John Gillespie · Founder, Occam's Forensic Jury · *Follow the Cash. Not the Noise.*

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$2.1B

in reported profit

$3.4B

in cash burn — same 10-K, same year.

Both numbers are true.

Only one tells you whether to invest.

Most retail investors read the income statement and stop. They never reconcile reported earnings against the cash flow statement, and they never read the footnotes that explain the gap.

Forensic analysis is the discipline of reading all three — and treating the cash flow statement as the truth-teller.

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The Three Lies of GAAP Earnings

Reported profit can be inflated three ways without breaking a single accounting rule. Your job is to find which lie is hiding in this filing.

01

Non-cash "one-time" charges

Stock-based comp, restructuring, and impairments quietly rebuilt every year. If they recur, they're operating expenses — no matter what the press release calls them.

02

Working capital traps

Earnings rise while receivables balloon and payables get stretched. Cash hasn't moved — but the income statement says it did. The balance sheet keeps the receipts.

03

Aggressive recognition

Channel stuffing, percent-of-completion games, capitalized costs that should have been expensed. The 10-K never lies — it just tells the truth in the footnote nobody reads.

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Where Perplexity Wins. Where You Don't.

Perplexity is the best research analyst you've ever hired. It is not — and will never be — your portfolio manager.

WHERE PERPLEXITY WINS

- Synthesizing 200-page 10-Ks down to the five things that matter
- Surfacing risk-language changes between filings
- Comparing peer disclosures side-by-side
- Pulling the footnote you'd otherwise miss
- Finding the analyst dissent buried in earnings calls

WHAT YOU STILL OWN

- The math — verify every number it cites
- The judgment — is the divergence benign or terminal?
- The sector logic — what multiple even applies?
- The thesis — written before you check the price
- The risk of being wrong, and the discipline to size for it

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Three Prompt Patterns That Work

"Tell me about Apple" returns marketing copy. These three patterns return forensic signal.

PATTERN 01 · DISCLOSURE DIFF

Hunt for what changed when nobody was looking.

```
Compare the Risk Factors section in {COMPANY}'s last three 10-Ks. Identify every risk that was added, removed, softened, or strengthened. Quote the before-and-after language.
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PATTERN 02 · FOOTNOTE HUNTER

Pull the disclosures management buried.

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From {COMPANY}'s most recent 10-K, find every footnote referencing {revenue recognition / capitalized costs / contingent liabilities}. Summarize each, quote the exact language, and explain how it affects reported earnings.
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PATTERN 03 · PEER TRIANGULATION

Make the outlier name itself.

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Compare how {COMPANY}, {PEER 1}, and {PEER 2} disclose {segment data / debt covenants / customer concentration}. Which company's disclosure is the most aggressive or least transparent, and why?
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Story 1: The Detective Hunt (Trend Analysis)

- **The Hook**: Imagine investing in a company that looks highly profitable today, only to realize its core profits have been quietly shrinking for three years.

- **The Lesson**: Spotting structural shifts before they become obvious in the headlines.

- **The Prompt**:
- "Act as a forensic financial analyst. Search the SEC 10-K filings for [Company Name] over the last three fiscal years. Create a markdown table comparing total revenue, gross profit margin, and net income margin. Identify the single largest driver behind the change in margins and summarize it in two bullet points."

Story 2: The Red Flag Finder (Liquidity Risks)

- **The Hook**: A booming tech startup suddenly goes bankrupt because they ran out of cash, despite record-breaking sales on paper.

- **The Lesson**: Differentiating between accounting profits and actual cash survival.

- **The Prompt**:

- "Analyze the most recent 10-Q filing for [Company Name]. Calculate the current ratio and the quick ratio. Search the 'Management's Discussion and Analysis' (MD&A) section for any mentions of liquidity risks, credit facility constraints, or upcoming debt maturities. Summarize any potential red flags in plain English."

Story 3: The Efficiency Checkup (Asset Optimization)

•**The Hook**: Two retail giants generate the exact same revenue, but one makes double the profit simply because they manage their inventory twice as fast.

•**The Lesson**: Evaluating how efficiently management deploys capital and assets.

•**The Prompt**:
•"Look at the balance sheet and income statement of [Company Name] for the latest fiscal year. Find the Inventory Turnover Ratio and Days Sales Outstanding (DSO). Compare these specific metrics against their primary competitor, [Competitor Name], using the latest available web data. Which company is managing its working capital more efficiently, and why?"

Story 4: The Hidden Narrative (Footnote Secrets)

- **The Hook:** The main financial statements look pristine but buried deep on page 74 of the footnotes is a pending multi-billion-dollar lawsuit.

- **The Lesson**: Uncovering hidden risks, legal liabilities, and off-balance-sheet items.

- **The Prompt**:
- "Scan the footnotes and 'Commitments and Contingencies' section of [Company Name]’s latest 10-K filing. Identify any active legal proceedings, major regulatory investigations, or off-balance-sheet liabilities. Provide a summary of the potential financial impact of these items on future earnings."

Story 5: The Growth Reality Check (Cash Flow vs Earnings)

- **The Hook**: A company reports massive net income growth, but their bank account is empty because customers aren't paying their bills yet.

- **The Lesson**: Using the Cash Flow Statement to verify the quality and truthfulness of reported earnings.

- **The Prompt**:
- "Compare the Net Income on the Income Statement to the Operating Cash Flow on the Cash Flow Statement for [Company Name] over the last two years. Is there a widening gap between accounting profits and cash generated? Search for reasons in the changes in working capital (accounts receivable/payable) and explain the quality of their earnings."

The Divergence Razor

Net income, operating cash flow, and free cash flow should tell roughly the same story. When they diverge, somebody is making a choice — and the cash flow statement always wins.

Net Income

What the income statement says you earned. Subject to accruals, capitalization, and judgment.

→

Operating Cash Flow

What actually moved through the bank. Strips out non-cash items but still includes working capital.

→

Free Cash Flow

OCF minus capex. The number that pays dividends, retires debt, and buys back shares.

THE RAZOR: | Net Income − OCF | / | Net Income | > 25% → *flag for forensic review*

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Worked Example: Three Prompts, 20 Minutes

SETUP Company X reports **$500M net income** on **$180M operating cash flow.** Razor = 64%. The income statement and cash flow statement disagree by two-thirds. *Now you ask Perplexity:*

Q1 In Company X's most recent 10-K, identify every working capital movement and explain what is driving the gap between net income and operating cash flow. Quote the relevant footnote language.

Q2 Has accounts receivable grown faster than revenue over the past 3 years? If so, by how much, and what does management say about collection terms?

Q3 Show stock-based compensation as a percentage of operating cash flow over the last 5 years for Company X. If the trend is rising, what does that imply about the quality of reported earnings?

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The Cash-Based Rule of 40

Most investors use Revenue Growth + EBITDA margin. EBITDA is a fiction. We use OCF margin instead — because cash either showed up or it didn't.

RULE OF 40 (CASH) = Revenue Growth % + Operating Cash Flow Margin %

≥ 40
Healthy
Growth that isn't being faked. Cash supports the story.

20 – 40
Watchlist
Growth slowing, or cash conversion weakening. Read the next quarter carefully.

< 20
Cash-stressed
Regardless of headline EPS, this business is consuming more than it produces.

PROMPT · Pull the last 5 years of revenue and operating cash flow for {COMPANY}. Compute YoY growth and OCF margin. Flag any year where the cash Rule of 40 score fell below 20.

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☠ The Zombie Death Clock

A zombie company is one whose interest expense exceeds its operating cash flow. It survives only by refinancing — which works until rates rise or credit tightens. Then it doesn't.

THE CLOCK = Operating Cash Flow / Interest Expense

OCF / INTEREST	STATUS	WHAT IT MEANS
> 5×	● Healthy	Coverage comfortable — interest is a small claim on cash.
2 – 5×	● Watch	Coverage tightening — small operational shock could compress further.
1 – 2×	● Zombie territory	Cash barely covers debt service. Equity holders are the residual claimants on a thin sliver.
< 1×	● Walking dead	OCF cannot cover interest. Survival depends on capital markets staying open.

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Match the Model to the Business

Applying a SaaS DCF to a REIT is malpractice. A REIT FFO multiple won't tell you anything useful about a bank. Seven businesses, seven models.

01
Standard DCF
Operating businesses with stable cash flow
`WACC, FCF, terminal growth`

02
REIT
Real estate — depreciation distorts GAAP earnings
`FFO, AFFO, NAV per share`

03
BDC
Business development companies
`NAV, NII, dividend coverage`

04
Bank
Banks and consumer lenders
`TBV, NIM, efficiency, ROTCE`

05
Pipeline / MLP
Energy infrastructure — yield-driven
`DCF/unit, coverage, leverage`

06
Cyclicals
Commodities, autos, semiconductors
`Normalized EPS, mid-cycle multiple`

07
Insurance
P&C and life insurers
`Book value, combined ratio`

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Ticker to Thesis in 60 Minutes

The discipline isn't speed. It's sequence. Each step assumes the previous one passed.

00 – 05	**Pull the 10-K**	Perplexity: "Summarize {ticker}'s most recent 10-K in five paragraphs — business, segments, risks, capital structure, recent changes."
05 – 15	**Cash truth test**	Run the Divergence Razor. If $\lvert NI - OCF \rvert / \lvert NI \rvert > 25\%$, ask Perplexity to explain the gap before going further.
15 – 25	**Quality screens**	Compute Cash Rule of 40. Compute the Zombie Death Clock. Either one in red? Note it before you fall in love with the story.
25 – 40	**Sector valuation**	Apply the model that matches the business. Triangulate against two peers. Sanity-check Perplexity's inputs against the actual filing.
40 – 50	**Read the footnotes**	Hunt the disclosures Perplexity flagged. The footnote you skip is the one the loss is hiding in.
50 – 60	**Write the thesis FIRST**	Write your thesis before checking the price. Anchoring is the silent killer of independent judgment.

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Examples (Company X, Apple, Enron, WeWork, SVB) are illustrative or historical post-mortems, not current investment recommendations.

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FOLLOW THE CASH.
NOT THE NOISE.

The numbers don't lie. The narratives do.
AI just makes the work tractable.

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