

MODULE

# Understanding How To Read & Evaluate A Company's 10-K

This module helps students understand the purpose of a 10k, what components a company decides to include in their 10k, and how these filings can provide exceptional insight into a company's future performance.

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# ★ Key Takeaways From This Module



## Guiding Questions

- Where do companies report their financial progress?
- How can investors track company's growth and future plans?
- How do companies balance and track their revenues vs. spending?
- What is their key information for investors to look out for in company documents?



## Enduring Understandings

- How to read and analyze company financial documents
- Understand the basics of accounting



# The All Important 10K

## What is a 10K?

It's a report that consists of all the financial information about the company for that year. It is required by the Securities and Exchange Commission (SEC) annually from public traded companies. This report is incredibly long and very detailed.

## Where to find a 10K

10-k filings are public information and are typically being posted on a company's website under investor relations. If they are not there though they can be found on the SEC website.

## Why are they important?

- **10Ks are the most comprehensive report on a company**
- **The information on company operations and financial health allows you to make informed decisions**
- **10Ks allow for comparisons across different years which allows for more accurate predictions**

# What's Included in the 10-k?



**Business  
Description**

**Risk Factors**

**Selected Financial  
Data**

**Financial Statements**

**Management's Discussion  
& Analysis**

# Business Description



The first section of the 10-k is a description of the business that the company conducts. This usually includes:



**Products**



**Main Costs**



**Services**



**Objectives**



# Risk Factors

Every company faces risks and that's unavoidable as an investor. However what you can avoid is companies that face a disproportionate amount of risk and those that aren't prepared to deal with risk.

The next section included in the 10-k is the risks the company faces. These are risks that have been **determined by the accountants and pertain to the future of the company.** This will usually include all of the risks that the company has deemed important and are usually **listed in the order of importance and magnitude.**

The company will also include how it is planning on **mitigating that risk or if it is ignoring the risk.**



## Examples of Risk Factors

Effects of COVID-19 in 2020

Legislative changes

Intensity of competitive landscape

Undiversified revenue streams

Limitations of organizational structure

Share price volatility

Risks in supply chain or nature of raw materials



# Selected Financial Data

The third section is filled with selected financial data. This consists of specific information from the past five years that management thinks is relevant to the company's performance.

## The Good

The selected financial data offers you a more **concise overview of the company's financial performance** than the financial statements section. It can also give you an indication of **areas of the business that the company is focusing on.**

## The Bad

Companies may choose to highlight financial metrics and information that make the company look good. **For example, a young company may choose to highlight their growing revenues without showing growing losses**

# Management's Discussion & Analysis



One of the sections in a 10-k is managements view on how the company is performing or what the data presented means.

- This typically consists of management explaining **why they made or lost money and what that means for the future of the company.**
- This is **usually positive** as it is the company talking about itself, however, sometimes management is honest about the dire straits they are in.
- This is the section where the company is telling their story of the financials, which is good but **you should make your own opinion by looking at them too.**





# Financial Statements



One of the last sections of the 10-k is the financial statement sections. This is a compilation of all of the business transactions over the year compiled into different reports. Each of these reports are connected and give you a holistic view of the company's financial performance. These reports will all have been audited by an independent auditor.

**Balance Sheet**



**Income Statement**

**Statement of Stockholders' Equity**

**Cash Flow Statement**



# The Balance Sheet

A **balance sheet** is one of the most recognized financial statements. The best way to describe it is as a snapshot of the company's financial position. It shows you what a company owns and owes and what is invested in the company.

More precisely, it gives the exact amount of the **assets, liabilities, and stockholders equity** of a company at a specific time and date.

**This is where your accounting equation comes in!** In every balance sheet, the company's stockholders' equity and liabilities will be equal to its assets. If you are constructing a balance sheet and that's not the case, then you know something's wrong.

As an investor you definitely want to check out the balance sheet as it helps you calculate the **rates of returns** and evaluate a **company's capital structure**.



# The Cash Flow Statement

This statement summarizes the cash and cash equivalents going in and out of the company. It is one of the most used financial statements by investors as it shows you how well the company is able to manage its cash, if it will be able to meet debt obligations and pay operating expenses, and its general financial stability. The ending value of a cash flow statement is usually equal to the cash balance in the balance sheet. It has 3 parts:

## Operating Activities

This section is the most looked at. It shows you the company's day to day action in the form of sales, cost of goods sold, wage expenses, etc. If a company is not showing a positive operating income, that's usually a bad sign

## Financing Activities

This section tells you about the company's cash inflows and outflows from creditors and shareholders. Taking on debt/ equity raises would be a positive entry whereas debt repayments would be a negative entry.

## Investing Activities

This section tells you about asset purchases and sales, and does not include non-cash asset expenses like depreciation. An asset sale would be a positive entry while an asset purchase would be a negative entry.



# The Income Statement

The Income statement is one of the three important financial statements. It is used to show the company's financial performance over a specific period. This is also known as the Profit and Loss Statement. It includes cash and non-cash incomes and expenses which ultimately give you the total net income.

## Income

The categories included under incomes typically are:

- **Operating revenue:** income from regular sale of good/services
- **Non-operating revenue:** income from peripheral activities eg: interest income
- **Gains:** incidental incomes, examples include profit on sale of an asset and lawsuit settlements

## Expenses

The categories included under expenses typically are:

- **Primary activity:** expenses incurred in the production of goods and services, or in the operation of the business
- **Secondary activity:** expenses from non-core business activities eg: interest payments
- **Losses:** incidental expenses, examples include loss on sale of an asset and lawsuit settlement payments

# Key Takeaways From This Module



## CORE & FUNDAMENTALS

- Companies are required to report their financials quarterly and annually
- A company's financial statements are a summary of their transactions over a certain period of time.

## APPLIED KNOWLEDGE

- The various sections in a 10k summarize a company's yearly financial information
- Companies use accounting to balance and keep track of their assets, liabilities and equity
- The three financial statements(balance sheet, cash flow, income statement) are connected and quantitatively display financial performance

## RELEVANCE FOR YOU

- With practice, you will be able to navigate 10-k's and balance sheets with ease.
- Financial reporting provides transparency around company operations, so you as an investor can deeply research a corporation before buying shares.

