Back to Basics: The Best Way to Read a 10-k

Dave [00:00:00]:

All right, folks, welcome to Investing for Beginners podcast. Today we are going to do one of our back to the basics episodes. Today we're going to talk about how to read a ten k. Before we dive into that, let's talk about back to the basics. The reason why we're doing this is we're trying to help you become better investors. We will do a back to the basics episode every Thursday. So come back every Thursday and you can learn about kind of growing your knowledge base on learning to pick individual stocks. So today's episode we're going to talk about a very critical feature, which is a ten k.

Dave [00:00:34]:

And so, Andrew, do you want to kind of tell people what is a ten k and why is it important?

Andrew [00:00:38]:

A ten k is required by publicly traded companies on the Nasdaq and the NYSE. It is companies chance to tell you what they do, what the risks are, if you were to buy this investment, how the business is performing, all of those things that, as Warren Buffett said, ideally I would want all this information to, if I were to give a letter to a business partner to say, here's how the business is doing, the ten k should be like that. And so it is the closest thing as stock pickers that we have to getting a downloaded brain dump from management to us to hopefully give us information on whether this would be a good investment for us or not.

Dave [00:01:26]:

How often do they put these out?

Andrew [00:01:28]:

It's annual.

Dave [00:01:30]:

Okay. Only big companies do this, or do smaller companies do it as well?

Andrew [00:01:35]:

Robert, anyone who's trading on the SEC regulated exchanges. So that's what we know as NYC and Nasdaq.

Dave [00:01:43]:

Can you be a good complete investor without reading a ten k?

Andrew [00:01:47]:

If you're investing in a different way, I would say, like, if you're like more of a quant type person who's not looking that, you know, if your business objectives are different, then sure. But if you're buying for the business because you want to be a long term business owner partner with the business, then, yeah, you should definitely read this stuff.

Dave [00:02:09]:

Yeah. So if you are a new investor, do you feel like this is a good place to start? If you want to learn about a company?

Andrew [00:02:18]:

Yeah, I would say so. I would say approach it with some caution. It is depending on which company you're looking at, it can be like trying to drink out of a firehose and it can be riddled with tangled messes of lawyer jargon. And you have to figure out how to navigate that.

Dave [00:02:38]:

Yeah, legalese, it can be a very, you got to remember that a good portion of it is written by lawyers. And so there's a lot of wiggle ease in there to cover everybody's booty in case of any sort of miscommunication of information. So, I guess.

Andrew [00:02:56]:

And there's a lot of accounting in there. Oh, yeah, a lot of accounting.

Dave [00:03:00]:

A lot of accounting. A lot of counting. Yeah. There is math involved, but it's the math. I don't remember who said this, but all the math you need you to invest you learned in fourth grade. So we're not talking higher levels of calculus here. It's adding, subtracting, dividing, and that's about it. Okay, let's say you're going to start working on a new company.

Dave [00:03:21]:

What would be, I guess, the process for you working with the ten k, like, how would you start to approach it?

Andrew [00:03:27]:

I guess there's two different ways I would do that. One is if I kind of have a. An understanding of the business already, or if I'm looking for something in particular. And then another way of kind of doing the ten k is if kind of start more traditionally of, like, just trying to soak it all in. So probably the most useful, obviously, would be the second part. The second, you know, kind of going the traditional way. So I would start with the business overview, and then probably go to the risks. And then probably go to the discussion of the risks.

Andrew [00:04:07]:

How about you?

Dave [00:04:08]:

Yeah, I probably would do the same thing. I think the filtering process, usually, for me, starts with the business breakdown of how the company works. We were looking at Netflix's ten k a moment ago, and a, it's much shorter, and b, their business section is literally four pages, where if you go to a company like Datadog, it's 25 pages. And so there's far more technicality than listed in there. And so it makes it. It can make it harder. And if you don't understand the business, then I generally will pass on the company.

Andrew [00:04:47]:

I take a slightly different approach, and I guess I shouldn't have, like, said that with the whole business thing, because if I'm, like, really optimistic about a company and I catch myself being super biased on it, I'll go to the risk factors first, and then a lot of the tech companies, I won't even do much of the business overview, because they're almost, like, trying to overwhelm you with as many buzzwords as they can. So, like, if I look at a company like Cisco, for example, I would start at, like, give me the different revenue types. So, you know, okay, we are segmenting in these three segments, and maybe one of them drives a ton of profit, and the other two are, like, minimal, then knowing that I can ignore all the crap about this tech and that tech and this tech and that tech, because it makes such a small portion, and then I can really get to the meat and then really try to focus in on the. On that segment, and it makes the business overview a lot more digestible. Do that.

Dave [00:05:52]:

Yeah. That's a smart way to look at it. That is actually something I think I will start to incorporate because I think that makes a lot more sense. Because you're right. Sometimes they will spend a lot of time explaining something that is less than 1% of the whole business. And you can get bogged down into things that aren't really important, but they still have to disclose to you, but maybe aren't as critical to understanding the business. Like, you may understand two thirds of it, but to your point, maybe that 1% or one and a half percent of the business you don't understand is also not really materially important, I guess.

Andrew [00:06:26]:

Robert, anything else about the business overview that kind of, or maybe even the whole process, like, we didn't touch on, like, the notes, are you looking at the notes and then the actual financials at a certain point in time?

Dave [00:06:39]:

Yeah. So something I kind of got from you was a lot of times, if I've already looked at the company, I'll use Netflix, for example. I would go on Finchat and look at the financials on Finchat and have those looked appealing to me. Other words, like, I like the margins. I see revenue growth. I like, you know, maybe the balance sheet is, you know, has a nice structure that I really like, or their debt situation is good, that will not cause me, but that will encourage me to pick up the ten k and start learning more about the business. And so, frankly, generally, through the first pass through of reading the ten k, I probably won't pay much attention to the actual financials themselves, other than to give them a cursory glance, because I've already filtered it in that respect. Like, I don't need to see that their revenue growth over the last three years is 25%, because I already know that.

Dave [00:07:30]:

And so I won't spend much time on that. And I would probably segue more to the notes and trying to get at the maybe nitty gritty of some of those kinds of things. Maybe if we could back up for just a minute. Do you ever read a ten k? Like a book? In other words, you start at the beginning, you go all the way to the end, or do you. Do you tend to hop around, depending on maybe what you're kind of looking for in the company first?

Andrew [00:07:56]:

Yes and no.

Dave [00:07:57]:

Okay.

Andrew [00:08:00]:

I don't know if I've, like, read to the end, because when you get near the end, there is things like deferred tax liabilities, pension plans, and the average weighted discount rate that they use on the investment values of their pension funds and the derivatives and how they're estimating fair value using the black scholes model. All of that. Unless something in the numbers is screaming at you, I would think that you can usually ignore that stuff, and that kind of goes into that whole, like, accounting jungle that can be inside the ten k. Right. But, you know, it's like. It's a. There are trade offs. Right.

Andrew [00:08:39]:

Because if you read it like a book, you could pick something up that you wouldn't have otherwise. On the flip side, you can't do that with every company because there are literally thousands of them.

Dave [00:08:50]:

Yes.

Andrew [00:08:50]:

And we all have so much time here on this earth, so.

Dave [00:08:53]:

Right, yeah, exactly. Yeah. Do I want to spend that limited time reading about all the nitty gritty of the derivatives? Probably not. No, probably not. So I guess if you had to kind of break down the ten k into sections that you feel like, I really need to read through these, and then I can come back and start maybe picking and choosing different places, what would you kind of assign that to?

Andrew [00:09:23]:

Well, let's do it with Netflix, because I really think, for me personally, it's so different depending on what I'm trying to achieve. Unless you have a better system.

Dave [00:09:33]:

Nope. And my system is basically, you know, I just read through some of the sections, and I make questions, and then I go back and try to answer those questions, which usually leads to more questions, and then it starts to become, you know, it can become a complicated mess with, you know, lots of papers around me or lots of spreadsheets open and trying to figure, you know, this data thing out. So it. It could be very messy.

Andrew [00:09:56]:

Yeah, makes sense. That's. I feel like you were looking over my shoulder or something at some point last week.

Dave [00:10:05]:

All right, so, yeah, let's, I guess, walk through Netflix a little bit.

Andrew [00:10:09]:

Yeah. So what are your impressions of the company even before you would dig into the ten k?

Dave [00:10:14]:

It's obviously a company. I know. It's a product that I use and have used for a long time, so I tend to have. I probably have. Going into it. I probably have a bit of a bias about the company because I like the product and I've heard the CEO on a couple of speeches, and I've listened to a few of earnings calls, and I like him. And so that also probably gives me a little more happy juice about the company that I probably need to figure out a way to balance out. Because I think if you get too bullish going into learning about the company, that everything positive you learn, I feel like, is going to give you rose colored hinted glasses.

Dave [00:10:56]:

Right. It's going to make everything seem that much better than may or may not be in reality. So that, to me, even before I dive into the company, even thinking about the numbers, whether it's margins or free cash flow or subscribers or growth or whatever, I've already got a positive bias on the company before I even dig in.

Andrew [00:11:18]:

Oh, yeah, me too. And then if the stock has been, like, a darling and it's made a bunch of people a bunch of money, which most of them have.

Dave [00:11:26]:

Right, then you attach even more fomo to the wagon than probably even normally would, for sure.

Andrew [00:11:35]:

So in that case, if you're trying to tame down your bullishness, you would go the risk.

Dave [00:11:39]:

Risk factors, yeah, that would make a lot of sense. You know, in Netflix's case, if you look through the business section, it's four pages, but in reality, it's really one page of, like, the business, and the rest of it is more, you know, we go gobbledygoop about, you know, other things not necessarily related to how Netflix operates. And so, yeah, I would definitely skip to the risks. If you were going to look at the risk section for Netflix, what would be some things that maybe you think you might want to try to look for?

Andrew [00:12:10]:

Initially, I would scan and look for anything that looks out of the ordinary. That's kind of what I do for everything.

Dave [00:12:17]:

Okay. And maybe we could dig in that a little bit. So when you say scan and look for things out of the norm, if you're newer to the company, how would you skew that? Or how would you. I know, how would you try to determine that?

Andrew [00:12:30]:

How do you train your brain to work like an AI model?

Dave [00:12:34]:

Right.

Andrew [00:12:34]:

You just got to put in the reps. Right? I don't know how else how you're going to know what's out of the ordinary until you've seen a bunch of them.

Dave [00:12:41]:

Right.

Andrew [00:12:41]:

Unfortunately, it's you you talk about all the time. It's kind of like a muscle. Every time you put in reps, you get better at doing it. So if it takes you two or 3 hours to read through risk factors, when you first start. Maybe as you gain experience, you can take a lot less time and you can start scanning and skimming and things like that.

Dave [00:13:01]:

Would you ever use, like, the control f function that we've talked about to maybe try to look for something specific? Maybe if it's. Maybe if you know a little more about the company than coming in cold into, you know, something you don't know anything about.

Andrew [00:13:13]:

Yeah, for sure.

Dave [00:13:15]:

Yep. Okay. How deep do you go on the wrist section? Like, will you read every single section, or are there some that tend towards the air, quote, boilerplate, like they have to say, kind of COVID their butts kind of thing, but it's not necessarily material relevant to this particular company.

Andrew [00:13:33]:

Yeah, people love this answer, yes or no. Yes or no. So how many companies say, like, we are cyclical? Yeah, almost all of them, right?

Dave [00:13:42]:

Yeah.

Andrew [00:13:43]:

But if I'm looking at, like, Deere, John Deere and company, or Caterpillar, like, very cyclical companies, I would laser focus on that part because I want to hear what they have to say about their cyclicality because I know they are cyclical. In the case of, like, Netflix, I know a lot of tech companies talk about, oh, we use third party cloud providers. A lot of them say that. But for Netflix, I would want to laser in on that section because I know that with the millions of people that have the app on their tvs and their phones, that's a huge amount of their business. It's a huge part of their business. Yeah. If there's any downtime with that, that could really hurt them. And it takes a lot of computing power and data centers and all of that just to keep that.

Andrew [00:14:33]:

The plumbing of that running is very intense, and it's probably more intense than you would see at, like, an insurance company or something.

Dave [00:14:44]:

Right.

Andrew [00:14:44]:

So I would laser focus on that part.

Dave [00:14:47]:

Yeah. I mean, that makes a lot of sense if you think a little deeply about it, because, I mean, the expectation is when you click on the app, on your phone or on your tv, that the choices of whatever you want to watch are going to be there immediately. And as soon as you hit play, you expect it to play immediately. And if it doesn't, we all get all bent out of shape. Right. If the wheel starts to turn for, like, 5 seconds. So, you know, we all just have a mellow down, like the world is coming to an end. But that's the expectation that the company is set.

Dave [00:15:17]:

So to your point, that plumbing is uber critical to their business, and if that falters even a little bit, how many people are going to bail on Netflix and go somewhere else, especially if it's a long term problem.

Andrew [00:15:33]:

Yeah. I don't know how many of their investors would want to see the actual bill.

Dave [00:15:39]:

Probably not. No, I'm sure that's. I have some risks that I probably just kind of gloss over. Do you have any? Like, if I see earthquake, you know we're susceptible to earthquakes, right. Okay. You know. You know if you're in the middle of the United States and you say you're susceptible to earthquakes. Okay, yeah, maybe someday.

Dave [00:15:58]:

But if that actually happens, we got bigger problems. So I probably gloss over that. Something like that. What about you?

Andrew [00:16:05]:

Something I'll gloss over. Probably the ESG stuff.

Dave [00:16:08]:

Yeah, I do that, too. I do that, too. And you can correct me if I'm wrong. My understanding is they generally list the most air quote serious risks in order, and maybe that's not correct. Okay, so it's not correct. I was under the impression that they kind of listed them in order of severity or potential potentiality or whatever, but that may not be.

Andrew [00:16:31]:

I haven't noticed that. I mean, but it's possible that I. What's risky to me is not risky to other people, so.

Dave [00:16:37]:

Right.

Andrew [00:16:38]:

Yeah.

Dave [00:16:39]:

Right. That brings up a question. What would be on your list of, like, okay, this is super risky. I need to know more. That. Or is that more company by company?

Andrew [00:16:47]:

Yeah, I guess a couple of the general ones I always try to look for. If there's a situation where there's a majority owner or there's a person with a lot of influence, Warren Buffett at Berkshire, Elon Musk at Tesla, I want to read about that and figure out what's the situation there. And then as it relates to that, are there provisions in place that keep. And this would apply whether there's a majority owner or not, but something that would people from being able to buy the company or take over the company, it's a way that you could cash out on an investment potentially when it gets acquired, and sometimes when that's not an option, the stock sometimes doesn't do as well. So that's probably not, like, a great example, but just something that's like, kind of I've tuned to pay attention to. Do you have stuff like that?

Dave [00:17:38]:

Yeah, it kind of depends on the company. Some of it will be tech related things. So if the company is more tech oriented, then there could be specific tech oriented things that are things that I want to drill into and maybe understand a lot better. To your point, with Netflix, with their plumbing, that's something you really critically need to know about the business. You know, if I'm looking at a payments company, there may be something about the rails or something about their network that I really need to know more about and understand how that could be disrupted or interrupted. And so those are kinds of things that I think it really would need to know. Or if I'm working with a company that produces a, let's say, okay, let's say we're working with a company that produces silicone chips for semiconductors and they have one provider of the base silicon, and that's it. I want to know who that is and then I want to look.

Dave [00:18:40]:

Then I would probably take that company and look at that company and see what their situation is. Maybe not necessarily because it's something I want to invest in, but if I know how critical that is to this company's product and that company is on desk door or a super risky or very volatile as far as their operations go, that's going to have a bearing on the company. I'm looking at being able to get the product they need to make the stuff to sell to other people. And so that, to me, is something that I kind of look at. The supply chain, I guess, is the best way of putting it. If I, you know, as best I can, some companies will tell you more than others. And that's one of the frustrating things about reading through some of these risks. You may come up with a list of ten questions, but they may only answer four of them.

Dave [00:19:25]:

Sometimes you got to go a little bit farther to try to discover that. So that's, I guess those are some of the things I try to look.

Andrew [00:19:31]:

At, the supplier stuff. And like any customers, other big customers, if that's in the risk factors, I love to see that too. If to your like, going further on your example, if there was a semiconductor manufacturer and they're depending on that silicon, I would look at other people in the industry, other semiconductor manufacturers, see if they're talking about something in the risk factors that maybe this company is not. And sometimes that can help fill in some of the gaps of information and knowledge that I might be lacking at the time.

Dave [00:20:05]:

Right. Okay.

Andrew [00:20:06]:

This is just like a random observation, but it always seems like the smaller the company, the more they disclose very big generality. But you look at Netflix and Apple and Amazon and all them like, very short on the disclosures. When I try to learn about an industry and I don't know much about it, I'll go to sometimes the smallest company, because a lot of times they'll be the most frank about stuff.

Dave [00:20:35]:

Right.

Andrew [00:20:36]:

For whatever reason, I don't know why.

Dave [00:20:38]:

Maybe because they aren't big enough yet to have maybe serious competition or they aren't regarded as, I don't know, maybe their proprietary secrets aren't. They don't need to hoard their information as much because they're not as afraid of people coming to steal from them as other people are. Steal from an Amazon, for example. Not saying that's the case. It's just an observation potential.

Andrew [00:21:05]:

Or their business could be that much simpler.

Dave [00:21:08]:

Yeah, there's that, too. Is there anything else about the risk factors or that section that you will pay attention to or you think is worth people paying attention to?

Andrew [00:21:18]:

Yeah, I mean, it's going to be, again, like, company, company by company. If a company has a lot of labor unions or that's a risk, then you definitely want to drill in there. If they deal with commodities, you want to drill in there.

Dave [00:21:31]:

There.

Andrew [00:21:31]:

It's to your point about the tech and the supply chain and the customers. So, yeah.

Dave [00:21:38]:

Okay, so I guess what would be the next section after you kind of have dissected the risk section, where would you look next?

Andrew [00:21:46]:

Yeah. So for Netflix, I would just go back to the business overview, make sure there's not anything in there that's, like, blowing my mind and kind of crazy, right? I don't see anything there in my. So in this particular case, because we have a couple options, we can kind of get into the nitty gritty of what questions we want answered about how is the company doing? And so I like you. I like to use shortcut tools to sometimes make things faster. So you mentioned Finchat, which I love to use all the time. I also use Quickfs.net dot. And so when I ran Netflix through there, I noticed that there was a very, very big tens of billions of dollars in the cash flow statement that was being deducted. And it was in other on quick fs because it's a tool, they're making shortcuts.

Andrew [00:22:38]:

So I'm like, all right, what is the other? And so my next step for Netflix would be to go to Netflix's cash flow statement and try to identify, because $20 billion or whatever it was, that's a big chunk of change, even for Netflix. So that's where I would go. And then kind of like how you like to talk about a lot following that curiosity, trying to paint the picture of, like, what's the real story with the company here? Go to the source. Or I get the source information and they are doing so it's actually 12 billion additions to content assets.

Dave [00:23:17]:

Okay.

Andrew [00:23:18]:

And so if we think about their business model, and I don't know if this was, maybe this is covered somewhere else in the annual report, in the ten k. That's really how they're investing in their business, is they're adding all these Netflix originals, and that's something that can separate them from a paramount plus or Disney plus or one of these other guys when they have their own content library. So I can kind of look at that and I can see it's been trending down over time and cash flow has been trending up. So theyre getting this kind of operating leverage where theyre still able to find growth, even though theyre not needing to reinvest as much as they used to. That can be a sweet spot for shareholders sometimes.

Dave [00:24:02]:

Yeah.

Andrew [00:24:02]:

So I would probably want to know, all right, whats the story behind? Why is it, why was it 17 billion, now 16, now twelve? And then see if theres an explanation in the MD and a section which is discussion and analysis. See what they're saying about it in there. Where would you have gone after we went down this rabbit trail? Where do you think you would have gone after the risks?

Dave [00:24:28]:

I would have thought of a, I guess a shortcut. And one of the things that, I don't know why, it just hit me one day, I was listening to an earnings call, and I thought to myself, you know, it wasn't about Netflix. It was another company. And I thought to myself, you know what they seem to talk about these certain KPI's fairly regularly, subconsciously are telling me are important, because that's what they use to communicate what's important about the company. So I just, I don't know why a light bulb went on, and I was like, okay, Finchat separates one of their tabs by KPI's. And so I went to this company's KPI's, and I saw what was important, like, what Pinchat is listing is important. And I saw the numbers. And then I went back to the ten k, and I used control f to search for those terms to see what the company was saying about those particular KPI's.

Dave [00:25:20]:

So that I could see, for example, if I look at Netflix, one of the things that's really important to them is they segment their revenue by geography. And so we can see, looking at Finchat, I could see that UCAn, which is the United States and Canada, is growing pretty well. And so, but EMA, which is european, is not growing as fast. So that would be a question id want to ask myself. So why is the United States seems to be doing well? What does the company think about that? And why is Europe struggling? And because its the second biggest geography of revenue for the company, its important to understand. So if the company tells me that, hey, we just came off a quarter or a year that we grew at 12%, but next year were only expecting seven, and, you know, the United States is still doing well, but Europe is not, that has a direct bearing on how the company is growing. And so I would want to dig into why, you know, do they tell me in the MDA that the management discussion, why is this doing well or why is it not doing well? And so that's a little trick that I've kind of picked up recently. I started doing it a couple months ago and it's something I try to do regularly is look at the KPI, see if I notice anything, go back to the MDA and use control f function to try to search out some of those answers.

Dave [00:26:42]:

Because some of the stuff that you're going to read, to your point earlier about the muscle, the more you read these, the more they're going to use a similar ish language on certain parts. And so sometimes if you read the business section, the company will repeat exactly the same thing at the beginning of the MDA that they did in the business section. So the first, you know, two or three paragraphs may be a complete copy of something you've already read. And so I'll just skip that and go right to something else. And so that's a little trick that I kind of picked up. Kind of similar to what you were doing is looking at the financials and then kind of going back and trying to figure out an answer.

Andrew [00:27:18]:

Yeah, I love that. That's awesome. And I like the context, too. Like you're looking at it, but you're also putting in the context. Okay, you can is the biggest, EMEA is the second biggest. And it's like your mind starting to filter and separate between noise and signal.

Dave [00:27:37]:

Right.

Andrew [00:27:37]:

I think that's, if that's a scale, too, I think taking the fire hose and being able to.

Dave [00:27:47]:

Yeah, I generally don't do much with the, like I said before, I don't generally do much with the financials at this point, other than looking at something like these KPI's to just give me a sense of what's driving the business and what they think is important because obviously they're insiders. They know it way better than I do. And so if I hear the CEO talking about ARPU or not, then it's like, okay, then that, that tells me that they don't think that's important to their business anymore. So I'm not gonna, if they don't think it is, then I'm not gonna spend a lot of time obsessing about it because they have obviously told me that this is not as important.

Andrew [00:28:27]:

What would be the next step from here? Or is it, does it depend?

Dave [00:28:32]:

Yeah, it depends, really. Trying to look through the KPI's and then look through what's going on with the business based on what I kind of try to find out about that. And generally, a lot of times what happens is you just, you answer one question, but you create two more. And so I just, I tend to have lots of, I guess, separate mini rabbit holes that I can go down. Let's say that they're talking about subscriber growth or a metric that maybe I'm not super familiar with in a company. Let's say it's meta. For example, some of their metrics that they talk about that are important for growth of their users and whatnot, I'm not super up on because I've not studied them closely. That may be a time for, I may do a sidebar and go, okay, I need to learn more about this and I can come back so I can understand this, so I can, you know, it's maybe not the most efficient way sometimes, but to me, it feels more like I'm using this as an educational experience.

Dave [00:29:31]:

So if I can learn more about that particular metric the next time I encounter, I don't have to go back and question that. I can just move on to understanding that. How about you?

Andrew [00:29:42]:

Yeah, you're describing my first year of getting really serious in the radio. I mean, we kind of have the luxury of having the platform and the blog that we write on did write on.

Dave [00:29:55]:

Yes.

Andrew [00:29:55]:

And that really helped hash out. And then having that writing that I could go back to when I forgot what I learned was also very helpful because it was like, oh, yeah, that means, yeah, yeah. Do you think, like, having a journal then or something would help somebody who is trying to.

Dave [00:30:13]:

I think it would be, you know, a tremendous asset to have something like that. Not only because, to your point, once you're starting to put things down, we tend to learn better by doing that. And also taking the knowledge that you've earned and putting it to use also helps cement it in the brain. Doesn't mean it's always going to stay there. And the older you get, the less it stays there. But I think that's the best way to learn, and it'll. It'll help you retain the information a little bit better. Maybe not specifically per company, but if you're focusing on a certain industry, you know, if you're looking at Netflix and you're also looking at Paramount plus and Disney and, you know, Warner Brothers, and they're going to have similar language in their ten ks, and so what's important to them is going to be important to a lot of them.

Dave [00:30:58]:

And so once you kind of get a handle on that, it's a lot easier to read the other ones because you don't have to go back and forth with all that info kind of thing. So I probably spend more time in the MDA than I do in the risk section, but that's just a generality. Kind of will depend. What about you?

Andrew [00:31:14]:

Yeah, I don't know. I don't know how long I'm in stuff. Pull me out. No excuse. I think my secret weapon has been the whole pen and paper. I have notebooks full of notes that I take, and so I'm always, like, actively reading. As I'm reading, I'm taking notes, and that's helping me retain the things that I feel are important. So after reading a ten k to completion, how I view as completion might have maybe like a front page and then a back page with risks, you know, that would be if I had to make an average.

Andrew [00:31:54]:

Could be more, could be less, depends on the company. But to me, that's been my secret weapon. And then I can always go back when I have questions and I need to get the refresh old mind, get things turned in there again. The notes can really be helpful. I just have to figure out a system of organizing, all because it's become a bird's nest and I hate it.

Dave [00:32:14]:

Right? Yeah. So maybe moving past the MDA and thinking about, like, the financial sections and the footnotes, those are really kind of the two major sections that are left. Like, what does that look like for you? Is it kind of all over the map, which I'm guessing, or is it more structured or organized?

Andrew [00:32:37]:

Yeah, it's all over the map. Looking for things that catch my eye, big numbers. And then I'm going to go dig in the footnotes, which is the sections after the financial statements, going to go digging those when I want to figure something out, probably scan through most of that. Most of the time. A lot of times. Skipping over to derivatives, unless I'm looking at the bank, the sections I find myself coming back to a lot in the notes would be the segment information, which is usually near the back, and then geographic information, which Netflix was kind of provide us with that at the top, but a lot of companies put it at the bottom. So those are the two places I find myself coming back to a lot.

Dave [00:33:19]:

Yeah. Yeah. I look at the segment information a lot. I will sometimes skim, I generally try to skim through revenue recognition. So I kind of understand maybe how the business recognizes, you know, the money they take in. It depends on the business. But a lot of times I'll look at that, just that I won't spend like hours scouring it, but I'll just kind of briefly go through that. I'll also look at the goodwill and the PP and e to see if they've had any revisions on the goodwill or impairments that I think are coming.

Dave [00:33:51]:

So you have some, you know, heads up on that. This could be a big problem for the company. I'll look at the PP and E or the product placement and our property plant and equipment. Sorry. Basically investments into hard assets. I'll look at that stuff to see if that's growing, where it's growing, how it's growing. Some of it will depend on whether the company is acquisitive or not. So if a company acquires a lot of other businesses, a lot of that PPE or goodwill will get added in those sections.

Dave [00:34:19]:

And so that's, that could be a place to kind of see any sort of discrepancies or things that could be potential problems down the road. And then the other sections besides those I look at would be any sort of debt situation. So I will look at the debt schedules, see kind of what their schedule is for the debt. In other words, just because you see a big number doesn't necessarily mean something. A company I was looking at a couple days ago, Moody's, I was looking at Moody's a few days ago, and they, they have some debt, not tons, but the thing that jumped out at me when I looked at that little particular section is that over the next three years, they only owe $700 million in debt payments. So they have two out of the next three years they dont have any debt payments. And im like, huh. So, I mean, that could be good.

Dave [00:35:10]:

I mean, if they struggle, then they have extra free cash flow because they dont have that payment that they have, or it also, if they find it an attractive investment, it means they have some room to wiggle. They can either take on additional debt or they could have potential cash flow that they could use for it. So sometimes that can be a revealing feature. Likewise, you can also see that they got a big, big debt payment coming up, and so that's something you want to know, whether the, a, they're going to make it, or b, if they have to refinance that and at what cost. So those are all things that have a bearing on the future performance of the business. So I guess those are kinds of the places I tend to look. Any other thoughts on that?

Andrew [00:35:48]:

I love those, especially the debt. I mean, that's like, now you're talking about, like, a salty caramel, right?

Dave [00:35:54]:

That's your love. Yeah.

Andrew [00:35:57]:

That's really, really getting into it.

Dave [00:35:59]:

Yeah. So I guess once, once you're kind of past those sections, what else, I guess, really is left to look at with the ten k. Yeah.

Andrew [00:36:12]:

You just got to fill in whatever gaps you left.

Dave [00:36:16]:

Yeah.

Andrew [00:36:16]:

And, I mean, I think it also depends on why you're reading it. If you're, you know, I'll read something because I'm thinking about maybe investing in it. And then once I get too many red flags that give me something feeling not so great in my stomach, then I'm out. You know, I have the notes for next time if I need to go back to it, but I'm out. I'm on to the next one.

Dave [00:36:40]:

Right.

Andrew [00:36:40]:

But if I'm, you know, looking at Texas instruments, and so I'm reading Qualcomm to try to get information about Texas instruments, then I'm reading Qualcomm's ten k, probably more completely, because I'm just trying to gather as much information rather than trying to make a yay or nay investment decision on them. Yeah. How about you? What other holes can we fill?

Dave [00:37:05]:

I think the last item that I try to go through before I would potentially move on to a new company is work through my checklist. Now that I've worked through the company, this is the part where ill start analyzing how is their returns on capital been? How are they investing? What kinds of investments are they having? Are they seeing revenue growth? Are the margins growing or expanding or contracting? Just any of those kinds of things I will start to look at. And if it passes that filter, I have a checklist of, like, 30 or 40 questions that ill try to go through. Some are super fast, and some take a little bit longer, but excel and. And Finchat can be very helpful in speeding those things along. The last thing that I would do would be to maybe start to dig into the proxy and look and see what the management structure is, how long they've been there, how they get paid, how much they get paid, is that relative to others in the industry? Who do they think are their competitors? And then I can start looking from there into other competitors, like you were talking about, Texas Instruments and Qualcomm. I will do that with, with companies, too, because a lot of times they'll list companies you don't think are obvious competitors. And that can be very helpful, too, because you can glean some pretty interesting insights from reading about other companies in the same field that you may not have thought about when you're looking at your primary source.

Andrew [00:38:31]:

So once that's all done, you've gone through the checklist. You just checked off the last number. Time to buy, what's going on?

Dave [00:38:38]:

No. Then it's time to go through trying to figure out what a fair value is for the company and then trying to, you know, to your point, fill in any gaps that I think are missing. If there's something about the industry that maybe I don't feel like I'm quite getting, then that's when I'll start to turn to other sources, like looking at other blog posts that other people have written, other companies maybe watching a YouTube video or two about the business, something that's maybe not related directly to the company, but that can give me maybe another insider angle that I'm not thinking of. Or I talk to Andrew and he tells me, no. What about you? After you go through all this process, does that mean you're done and, you know, it's time to hit the buy button?

Andrew [00:39:22]:

Yeah, no, I'm just getting started. So definitely in like information gather mode. And this is probably just particular to me, but I'm like mister Market. In two or three days, I go from very bullish to very bearish. And then I come back and I'm bullish and I'm bearish and then I'm probably ready to buy it.

Dave [00:39:43]:

So.

Andrew [00:39:43]:

Or it gets kicked down the can and, you know, we're on to the next one.

Dave [00:39:48]:

Right.

Andrew [00:39:48]:

Of course. I'm getting your feedback and trying to just think deeply about it and trying to see if there's, is there an angle that other people aren't seeing? And I think for some stocks, that's worked out really well for me.

Dave [00:40:01]:

I think that last little part of trying to think about what it is that you're trying to learn about, I think is probably an underrated discussion. It's an un discussed topic, at least as far as related to its importance. I think a lot of people focus so much on the gathering of information, that they don't focus on the assimilating and thinking through the information, because I think that can be where you can really start to have some serious insights.

Andrew [00:40:31]:

Hmm. Yeah. Where do you get this?

Dave [00:40:35]:

I don't know yet. I'm still trying to figure out where the spigot of knowledge comes from. I think that's one of the things that sets Warren Buffett apart from the rest of us mortals, is that he not only spends a lot of time accumulating knowledge, but I think he also just spends a lot of time leaning back in his chair thinking. And I think in this day and age, I'm going to get on a soapbox for a moment. In this day and age, with access to so much information via computers, tvs, cell phones, everywhere, I think we don't spend enough time thinking. We spend so much time with our faces in a screen, consuming information that we don't think. And you know, how many of us all raise our hands have had these great intuitions or insights. When you're in a shower or when you're on an airplane and your phone's on airplane mode, or you're driving and you're just listening to the radio and you zone off and you all of a sudden have this brilliant insight, is it because we're thinking? And so I think sometimes we neglect that part of investing.

Dave [00:41:37]:

It's just sitting, being bored, and, you know, letting your brain wander. And you can come up, I think, with some pretty great insights if you do that a little bit. So I'm off the soapbox now.

Andrew [00:41:48]:

That's 100% agree that the shower, the gym, lots of different places.

Dave [00:41:55]:

Yes. Yeah. All right. Well. All right, folks. Well, with that, that will wrap up our discussion today on how to work through a ten k. I think you've learned over the last half an hour, 45 minutes that this is a very important document and it's very critical to understanding a business and becoming a better investor. And we will do these back to basics episodes every Thursday for a little while.

Dave [00:42:19]:

We got quite a bit of content we want to work through. So come back every Thursday and you can learn a foundational part of investing. So with that, we'll go ahead and sign us off. You guys go out there and invest with a margin of safety. Emphasis on the safety. Have a great week, and we'll talk to you all next week. Bye.