Reading a 10-K for Credit

A one-hour field workflow for pulling credit-relevant information out of an annual report. Companion download to Module 3 — Corporate Credit Analysis.

The mindset

An equity analyst reads a 10-K asking *how good can this get?* A credit analyst asks *how bad can this get, and who absorbs it first?* You are not valuing the upside — you are hunting for the scenarios in which you don't get paid, and for the honesty of the numbers you'll feed into every ratio and model in the track. The statements are the claim; the footnotes are the evidence.

The one-hour workflow (in this order)

Step	Where	What you're extracting	Time
1	Auditor's opinion	Going-concern language, qualified opinions, critical audit matters, a change of auditor. Two minutes that can end the analysis early.	2 min
2	Cash flow statement	Cash from operations vs. net income (persistent gaps = earnings quality problem), capex burden, whether debt is being repaid or rolled, dividends/buybacks funded by borrowing.	10 min
3	Balance sheet	Debt levels and where they sit (which entity, secured vs. unsecured), liquidity position, intangibles as a share of equity, working-capital swings.	8 min
4	Income statement	Margin trend, interest expense (for coverage), one-offs that keep recurring. Read it last of the three — it's the most managed statement.	5 min
5	The eight footnotes	Below — this is where most of the hour goes.	25 min
6	MD&A; — liquidity section	Management's own maturity table, revolver availability, covenant headroom discussion.	5 min
7	Ratio worksheet	Fill in the last page of this guide while everything is fresh.	5 min

The eight footnotes that matter

1. Debt

The single most important footnote for a lender. Extract: the full maturity ladder (when does refinancing risk concentrate?), fixed vs. floating mix, secured vs. unsecured split, and the covenant package — which ratios, tested when, with how much headroom. A firm that renegotiated covenants recently told you where the pain threshold is.

2. Leases

IFRS 16 / ASC 842 put operating leases on the balance sheet, but the footnote still matters: discount-rate assumptions, renewal options excluded from the liability, and variable lease payments that behave like fixed charges. For retailers and airlines, this footnote *is* the capital structure.

3. Commitments & contingencies

Litigation, guarantees, purchase obligations, environmental liabilities. These are claims that can jump the queue in distress. Anything described as “reasonably possible” with an estimable range goes straight into your downside case.

4. Pensions & other post-retirement benefits

The funded status is effectively debt owed to the workforce. Check the discount rate and expected-return assumptions — aggressive assumptions understate the deficit. In a downturn the deficit widens exactly when the sponsor is weakest (wrong-way risk on your own balance sheet).

5. Related-party transactions

Loans to insiders, sales to affiliates, assets leased from entities the CEO controls. Usually empty. When it isn't, it reprices the Character C from the Five Cs — and occasionally the entire analysis.

6. Segments

Consolidated numbers hide which business actually earns the cash and which burns it. Match segment profitability against where the debt sits (structural subordination: are you lending to the holding company while the cash is generated — and trapped — in subsidiaries?).

7. Revenue recognition

Read for change: a new policy, growing contract assets vs. receivables, lengthening days sales outstanding. Aggressive recognition inflates every coverage and profitability ratio you'll compute — and it inflates X■ and X■ in the Altman Z, in the flattering direction.

8. Subsequent events

Filed up to ~90 days after fiscal year-end, the 10-K sometimes buries the real news here: a facility drawn in full, an acquisition, a covenant waiver obtained after the balance-sheet date. The most time-sensitive paragraph in the document.

Red flags checklist

- Cash from operations persistently below net income (earnings without cash)
- Receivables or inventory growing much faster than revenue
- Revolver drawn near year-end, or growing reliance on short-term funding
- Covenant amendments, waivers, or a shrinking headroom discussion in MD&A;
- Auditor change, material weakness in controls, or expanding critical audit matters
- Serial “one-time” restructuring charges (three in a row is a business model)
- Capitalizing costs peers expense (development costs, customer acquisition)
- Growing gap between adjusted EBITDA and any number the auditor signed
- Related-party footnote with actual content
- Maturity wall inside 24 months with no committed refinancing

Ratio worksheet

Fill this in while the filing is open. Two prior years give you trend; the Altman block feeds the calculator at rodoslay.com/tools.

Ratio	Formula	FY–2	FY–1	FY	Reading
Interest coverage	EBIT / interest expense				< 2× strained; < 1× unsustainable
Cash coverage	(EBITDA – capex) / interest				the honest version
Leverage	Total debt / EBITDA				> 4–5× is high yield territory
Balance-sheet leverage	Total liabilities / total assets				compare to sector norm
Cash flow to debt	CFO / total debt				Beaver's best single predictor
Current ratio	Current assets / current liabilities				level matters less than trend
Quick ratio	(Current assets – inventory) / current liabilities				
Return on assets	EBIT / total assets				Altman's heaviest-weighted input
DSO trend	receivables × 365 / revenue				lengthening = quality flag

Altman Z inputs (from this filing)

Input	Where in the 10-K	Value
Total assets	Balance sheet	
Total liabilities	Balance sheet	
Current assets / current liabilities	Balance sheet	
Retained earnings	Balance sheet — equity section	
EBIT	Income statement (operating income)	
Sales	Income statement (revenue)	
Market value of equity	Shares outstanding (cover page) × price	
Book value of equity	Balance sheet — total equity	

Enter these into the Altman calculator at rodoslay.com/tools — it computes Z, Z′ and Z″ with zone interpretations, and the disagreements between the three variants are as instructive as the scores.