Session 6: Post Class tests

1. If you wanted to measure the capacity of a business to increase profits as it scales up, which of the following measures of profitability would you look at?
    a. Gross margins
    b. Operating margins
    c. Net margins
    d. Difference between gross and operating margins
    e. Difference between operating and net margins
    f. Difference between gross and net margins
2. The return on equity and the return on invested capital are designed to measure the quality of investments made by a company and both are computed using book value measures for equity and invested capital in the denominator. Why do we use book values (rather than market values) in this computation?
    a. Because book values are less volatile than market values
    b. Because book values more accurately reflect the values of assets than market values
    c. Because book values are more likely to reflect the capital invested in existing assets and projects
    d. Because you may not be able to get the market value of equity and/or the market value of debt for most companies
    e. None of the above
3. If you wanted a debt ratio that would be an indicator of default risk in a company, which of the following would you use? Explain why.
    a. Total Debt/ (Total Debt + Equity)
    b. Long Term Debt/ (Long Term Debt + Equity)
    c. Short Term Debt/ (Short Term Debt + Equity)
    d. Total Debt/ EBITDA
    e. Long Term Debt/ EBITDA
    f. Short Term Debt/ EBITDA
4. If you are computing an interest coverage ratio for a company with <u>volatile earnings</u> and <u>rising debt</u>, with the intent to measure its buffer against default, which of the following would you use?
    a. Current year's EBIT/ Current year's interest expense
    b. Average EBIT over time/ Current year's interest expense
    c. Average EBIT over time/ Average interest expense over time
    d. Current year's EBIT/ Average interest expense over time
5. Turnover ratios are measures of investment efficiency, but often have to be read in conjunction with operating margins. Rank the following from most efficient to least investment-efficient companies:
    a. High sales to capital and low operating margins
    b. Low sales to capital and low operating margins
    c. High sales to capital and high operating margins
    d. Low sales to capital and high operating margins