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Mantras Ambulance Services, Inc. Case 1: A Seller-Side Business Valuation Case

Janet R. Jones, University of Minnesota – Duluth
Paul D. Hutchison, University of North Texas
Amy F. Holmes, Trinity University

Introduction

"Guess what mom, I'm pregnant!" Marie Wade's youngest daughter, Kelley, shared the good news that her mom was going to be a grandmother for the second time! Marie was very happy for her daughter, but at the same time, she felt a pang of guilt and reflected on her inability to spend more time with her children and grandchildren. As her business had grown over the years, she found it required more and more of her time on a daily basis.

Marie thought to herself that it was 2017, where had all the time gone. All her children were grown, and she had a lot of grandchildren, with more on the way! This was where she wanted to spend her time. Thus, she thought to herself that she would love to retire, have more time for family, and pursue other interests, but she had not established a succession plan for the business. Neither Kelley, nor her brother and sisters had any interest in operating the company. Marie realized it was time to get serious about planning for the future of the business and her retirement from the daily operations of Mantras. "It's time for a change" she thought as she turned to her computer to check her email that day. By a strange twist of fate, the first line of one of her emails was "Would you be interested in selling your business?" She was intrigued and decided to open the email and begin to consider the possibility of selling her business.

Company Background

In 1986, Marie Wade was a Registered Nurse (R.N.) working long hours at a local hospital with two small children at home. Many patients at the hospital required medical transports to other facilities, and there was not a reliable, timely transport service to meet the growing demand. Marie identified this opportunity, and prepared a business plan to start a for-profit ambulance company. Her calculations showed that if she had at least one transport a day on average, she could replace her hospital salary. The high end of her projections indicated that she had the potential to make even more money with additional daily transport calls.

Marie went to a local bank armed with her business plan and budget. She met with a loan officer who assisted her in getting a $40,000 loan. With those funds, she purchased a used ambulance and the necessary supplies, got licensed by the state to operate her business, set up an office in her home, and started Mantras Ambulance Services, Inc. After some limited marketing—

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personal visits to healthcare facilities in the region and word of mouth among healthcare providers—the business grew rapidly, and she realized that one transport a day was a much too conservative estimate—the demand was far greater!

Initially, Mantras' offered one service—transporting stable patients from one healthcare facility to another. Within five years, the business had grown from a single ambulance, operating out of Marie's home with one full-time employee, to a new business location that utilized five ambulances and a full-time staff of 25 employees. Over the years, the company continued to grow and expanded its operations by offering different types of transport services, such as wheelchair van services, emergency response services, and medi-taxi services. After being in business for over 30 years, the company had 18 vehicles and a staff of over 75 employees.

Company Financial Information

Mantras reported $302,237 in net income for 2016 (see Table 1) and had reported modest earnings almost every year of operation. Marie attributed this accomplishment primarily to her fear of large amounts of debt. She believed that by keeping fixed financing costs to a minimum, she could allow for additional business flexibility and keep her company afloat in lean years.

Table 1: Mantras Ambulance Services, Inc. Income Statement

	2016	2015	2014
Income			
Sales Revenue	$4,300,578	$4,074,979	$4,059,430
Interest Income	1,656	1,879	1,752
Investment Income	63,145	46,586	36,472
Total Income	$4,365,379	$4,123,444	$4,097,654
Expenses			
Wages & Benefits	2,626,005	2,530,015	2,488,838
Vehicles Expense	846,791	720,452	775,115
Rent	195,000	195,000	195,000
Selling, General, & Administrative	278,585	310,444	256,108
Depreciation	60,165	57,632	55,555
Interest	3,260	4,120	375
Total Expenses	$4,009,806	$3,817,663	$3,770,991
Income Before Taxes	355,573	305,781	326,663
Provision for Income Tax	53,336	45,867	48,999
Net Income	$ 302,237	$ 259,914	$ 277,664

With Marie's debt-adverse strategy in mind, she had amassed a large cash and investment balance to finance a building expansion (see Table 2), as the company had reached capacity and outgrown its current building. Other material assets shown on the balance sheet included net accounts receivable; prepaid income taxes; and property, plant, and equipment. The investments, both short-term and long-term, were primarily funds Marie had accumulated over the years for the company to directly fund the purchase of a new building and expand its operations in the future. Accounts Receivable was primarily made up of payments processed, but not yet received from insurance companies and the federal government. Prepaid taxes were income taxes paid in advance. Property, plant, and equipment were comprised of ambulances, wheelchair vans, automobiles, medical equipment, and office equipment, net of accumulated depreciation.

Table 2: Mantras Ambulance Services, Inc. Balance Sheet

	2016	2015	2014
Assets			
Current Assets			
Cash	$ 271,000	$ 459,605	$ 383,537
Accounts Receivable, net	86,590	53,245	31,525
Short-Term Investments	350,000	296,000	311,000
Prepaid Income Taxes	25,942	55,638	75,693
Total Current Assets	733,532	864,488	801,755
Property, Plant, and Equipment, net	340,000	265,000	208,000
Long-Term Investments	450,000	250,000	150,000
Total Assets	$1,523,532	$1,379,488	$1,159,755
Liabilities			
Current Liabilities			
Accounts Payable	$ 85,317	$ 105,964	$ 92,560
Salaries and Bonus Payable	36,472	28,033	20,155
Current Portion of Long Term Debt	30,025	29,140	28,280
Total Current Liabilities	151,814	163,137	140,995
Long Term Debt			
Note Payable - Car Loan	62,816	92,841	121,981
Total Liabilities	214,630	255,978	262,976
Stockholders' equity			
Common Stock and Paid-In Capital	45,000	45,000	45,000
Retained Earnings	1,263,902	1,078,510	851,779
Total Stockholders' Equity	1,308,902	1,123,510	896,779
Total Liabilities and Stockholders' Equity	$1,523,532	$1,379,488	$1,159,755

As Marie did not like financing costs, she expanded the business slowly by reinvesting company profits. However, she decided to take advantage of the auto industry's incentives to purchase new vehicles at the end of 2014. She purchased 3 new vehicles with a five-year note valued at $150,261 at a 3% interest rate. Retained earnings had grown over the years, with Marie taking some dividends in profitable years.

Valuing the Company

Although Marie was very knowledgeable of business operations and the accounting involved in her business, she was not knowledgeable in business valuation. She had an idea of a price she would accept for the company, but this value was based mostly on the amount she thought she needed to retire. It was not founded on financial analysis. She did not want to begin negotiations with a buyer to sell her company without some knowledge of the estimated value of her business. Immediately, she knew who she could trust to give her some sound advice on business valuation, her company's CPA, Sarah Washington. For the past 10 years, Marie had been using Sarah's accounting firm to prepare Mantra's annual income tax return, and she felt that she really understood her business and financial situation. Thus, Marie decided it was time to enlist Sarah's help in approximating the value of her business before she started any type of sales negotiation. She immediately set up an appointment with Sarah.

"I have done a few valuations in the past, but I am not a certified valuation expert and cannot give you an exact valuation for your business" Sarah informed Marie. Marie understood this and simply wanted a rough approximation of the company's value to begin negotiations. Thus, it was agreed that Sarah would gladly assist Marie as a business advisor with prior knowledge of the company. Sarah told Marie that business valuation was more of an art than a science. There was rarely one value for a company, but rather a range of acceptable values, based on the underlying assumptions and various approaches to business valuation (American Institute of Certified Public Accountants, 2015; American Society of Appraisers, 2009; Gabehart & Brinkley, 2002; Cruise, 2012; Easton et al., 2015; Palepu & Healey, 2013.) She also suggested that if Marie was serious about selling the business, she should consider hiring a certified valuation expert to maximize her return on this important business decision (American Institute of Certified Public Accountants, 2015).

Sarah reviewed the company's most recent financial statements (see Tables 1 and 2 above) and said she would have a few questions for Marie that would need to be answered before she could get started. Sarah had extensive experience with investment opportunities and prior involvement with clients that completed mergers and acquisitions. She knew that ratio analysis was very useful in comparing the financial performance and balance sheet strength of a company over time and to industry norms (Kieso, Weygandt, & Warfield, 2013; Needles & Powers, 2014; and Spiceland et al., 2016). She jotted down some notes regarding analysis needed to estimate a cost of equity and cost of debt, and determine appropriate growth rates and potential discount rates for Mantras.

After receiving the list of Sarah's questions, Marie used her company's accounting system to easily gather information and provide answers (see Table 3).

Table 3: Sarah's Questions and Marie's Responses

Sarah's Questions	Marie's Responses
1. How much was distributed to the owner (Marie) through gross salary and dividends over the past three years?	$270,000 and $148,756 in 2016. $228,000 and $ 64,965 in 2015. $200,000 and $132,761 in 2014.
2. What was Henry Johnson's gross salary for the last three years? (Henry was Marie's brother-in-law, and served as the Transportation and Maintenance Coordinator for Mantras. Marie indicated that he would probably leave the company if there was a change in ownership. This position would not require replacement due to improvements in technology that had automated this function.)	$44,758 in 2016. $41,170 in 2015. $39,968 in 2014.
3. How much were expenses and any related party benefits (e.g., payroll taxes, healthcare insurance, professional football tickets, company use of vehicles, etc.) for Marie and Henry during the past three years?	$56,226 in 2016. $54,267 in 2015. $52,122 in 2014.
4. Were there any one-time expenses or charges in the last three years, amounts that you would not expect to continue into the future?	$0 in 2016. $45,000 in 2015 (legal settlement included in SGA). $0 in 2014.

Conclusion

With Sarah's offer of assistance, Marie started feeling confident that she could evaluate her options with a greater understanding of the process to negotiate a reasonable price for the sale of her business yet not sell the business for less than she deserved for all of her years of hard work. She was cautiously optimistic as she looked forward to spending more time with her family and enjoying her retirement years. Maybe it was time for her to focus more on family than on the business that she had built over many years.

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