How Interest Rates Are Changing Veterinary Practice Decisions

Nate: So, a hot topic that's been in many of our discussions with clients over the last, really, last couple of years, as the world has somewhat normalized after the pandemic, has been the interest rate arena, and how that, in fact, impacts business owners and individuals. It's something that comes up pretty regularly. And I guess you know, as a starting point there's probably some, some easy ways to help manage this, both on the cash side of things and also on the debt side of things. So I'm curious, Andy, what what you've been seeing, and what have you been talking about with clients?

Andy: It's been a real fascinating topic, because, you know, we could go in all different directions with this. Obviously, those of you that have a line of credit, you know, for a while there, you kept getting notices from the bank. It's felt like almost weekly, monthly, that you're the prime rate of interest was just skyrocketing, right? And it was affecting your, your line of credit, and they're required to notify you, right every time that interest rate goes up. Those you with mortgages with HELOCs, home equity lines of credit, those of you financing vehicles of all type, whether personally in the practice. You know, one area that was fascinating to me was how interest rates have affected the M & A world, the mergers and acquisitions, the buying and selling of practices. I've been telling prospective buyers and prospective sellers for a couple of years now that the cost of financing that has occurred in the last couple of years has really suppressed values a bit, because there's a give and take, right? If I'm going to pay x for this practice, and I can finance it cheaply, I'm a bit more willing to give in to a higher valuation, but if I know the onerous task of financing that what it's going to cost me, I'm not as willing to give into that higher valuation. So to me, that probably has been the biggest, big picture effect on what it's done to the buying and selling of practices.

Nate: Yeah, and to your point, private equity specifically, we saw from our vantage a huge uptick over, call it, the last 10 years, right, in private equity acquisitions. And those are folks that that deal in this on a daily, monthly, yearly basis. And we've seen a drastic scale back as folks try, or as those entities try to kind of grapple with the idea that the cost of capital is just higher, and yet they've also got all these other operations that they've acquired that they've kind of got to stabilize now and service that debt. So that is something that really, really seemed to put the brakes on an emerging trend that seemed to be going up and up and up for a long time. And this does also impact, you know, the typical like owner-to-owner sale, you know, one partner buying out the other, or adding another partner that was an associate and they want to graduate to shareholdership. It is absolutely at the front of mind for folks looking at any kind of succession planning, and is certainly a challenge, challenge to work through. And for me, maybe the most interesting item that's come out of this is as a, as a simple agreement, I would say we commonly saw things based on a prime rate, right? Some sort of prime rate plus some buffer so that the seller could, you know, have some worthy investment return on it, and prime has done some interesting things in the last recent period of time. So what we've seen more folks actually go away from any prime language and keeping it to a slightly modified structure to maybe changing that wording to say the cost of capital to the corporation, or basically taking this to a bank, shopping it, and then determining what that rate would be based on the bank's assessment, and then using that as kind of a base rate rather than the prime rate.

Andy: Yeah, totally agree. A couple other things that I've seen trending. Little more seller financing, okay, a little bit more willing. Like, okay, it's going to be hard to go to the bank and finance this, but I still want to get a fair value for my practice. How about I finance some of this, and I undercut the banks a little bit to make this a little more cost effective for both of us. That's number one, little more selling, fine seller, financing. The other one that's been really interesting is: buy-sell agreements. Like you said, some of these buy-sell agreements really old, okay? And drafted, and so now you get, you get to the point where it's time to buy out your partner, right? And the accountant or the finance person does the calculation, and you get the amortization schedule, and it's like, what or the next five to seven years I'm going to pay out how much in interest? Well, can I, can I just lump sum the buyout now? Can I buy them out right now? And I've seen more of that where typically that has not happened. It's, let's, let's comply with the contract. Let's do it over time. But I've seen more willing to front load that to offset the cost of interest that they would pay over time.

Nate: It's been fascinating, and it's impacted pretty much every aspect of practices' operations, too, right? There used, there was a long period of time, not too long ago, where you didn't really see money market accounts on balance sheets, especially high yield ones, and with interest rates doing what they've been, that's been a great solution to maybe, say, short term CDs as a way to keep cash liquid and still get a decent return on your investment. And you know, depending upon the timing of when business debt was, was opened, trying to stick to those amortization schedules at those low rates as long as folks can, rather than maybe trying to be aggressive with that debt. This might have happened in a higher interest rate environment, because now those are at a bargain, at least for a period of time, and they're until they're refinanced.

Andy: Yeah, I'm glad you touched on the money market accounts, because there are still times where we will talk to a new client, and we will see very healthy balances in cash, because this industry, almost more so than any others, you are very conservative with the cash, and there's been some very high cash balances coming out of the pandemic, right, the last, last five years. And what we'll ask is, who do you bank with, and what interest are you earning on that cash balance? And you know, as well as I do, there are a lot of clients that did not make the move to that money market account, you know, and lost out on a lot of interest from the bank. And to me, I shame on the bank to not reach out proactively and get, get clients into an interest earning account, but also just bad advice out there to not have had that question proactively asked from their advisor years ago, when they could have, for the first time, at least in our career, seen interest incomes higher than ever.

Nate: That's right. I think looking at kind of next steps and really trying to position yourself well for the current climate. And right there's some talks of interest rates going down, but really the first and easiest step is talking to your institution and seeing what options you have, depending upon the institution. Those high yield rates are a little bit all over the place, and some of them just simply don't have that offering, but they have shorter term CDs available, so should be worth considering, you know, continuing to evaluate your debts and seeing if it makes sense to continue with those or strategize around those. And even if you're not playing, planning on an ownership transition, it's worthwhile to revisit your buy-sell agreements and the language in those to make sure that they still make sense, and maybe they're a little bit more high interest rate proof for the coming whatever time horizon is that we might be in this same climate for, for probably a while, at least to some degree.

Andy: Shop around, okay? There's many different options out there. Talk to your advisors. If you're purchasing, you know, expensive equipment, vendors are offering financing. You know, maybe you get that one year zero interest. Maybe you get, you know, a lower interest rate than the bank can, but think outside the box, be flexible, be creative, and see what you can to leverage the still high-interest rate environment that we're in.