

Alternative Financing Options in the Cannabis Industry

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The recent developments in Canadian cannabis policy and legislation have sparked significant investment in licensed cannabis producers. Until recently, equity financing has been the primary form of financing, with Canadian cannabis companies raising approximately \$1 billion over the past twelve months.

However, the industry has yet to see significant debt financing for a variety of reasons, including concerns from lenders regarding (i) potential reputational risks; (ii) a borrower's non-compliance with applicable law, which can result in the revocation of the borrower's license; (iii) restrictions on the ability to grant security over a license to produce (because transferability of the license is restricted by Health Canada); and (iv) limitations on enforcement of collateral (because directors, officers and other personnel are required to have security clearance from Health Canada). All of this means that if a borrower defaults on a loan, a successful liquidation process may be difficult or impossible. In addition, even if available, debt financing can be prohibitively expensive in the cannabis industry.

As the cannabis industry continues to grow, the difficulties with debt financing have prompted the resort to alternative financing models. Licensed producers and pre-licensed applicants are not keen to continuously dilute existing shareholders by additional equity rounds. The capital intensive nature of developing a cannabis business has demanded recourse to innovative solutions.

The evolution has been modeled after the mining industry, using streaming and royalty transactions to finance growth opportunities. In a typical streaming transaction, a purchaser provides an upfront deposit to a cannabis company in exchange for the right to a percentage of future production at a discounted price. The upfront deposit provides immediate funding which can be used for infrastructure development and other capital expenditures. Similarly, a royalty transaction provides an immediate capital infusion for the cannabis company in exchange for future payments based on financial or operating metrics, such as grams of cannabis produced.

The complications of royalty and streaming transactions in the cannabis industry are quite unique. Difficulties with respect to collateral and enforcement remain and there are additional considerations with respect to the group of persons who are permitted to possess, purchase and sell cannabis products. As a result of the industry's idiosyncrasies, there are significant legal implications for entities that are considering alternative forms of investment.

For a cannabis company, the benefits of these transactions, aside from access to capital, include the fact that payment obligations are generally dependent upon production. Depending on the structure of the

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agreement, obligations under a streaming agreement may not be considered debt on the cannabis company's balance sheet

Some of the major cannabis industry players are hoping to service this alternative financing market and also provide licensed producers and pre-licensed applicants seasoned business guidance from financing partners that have established operations in the industry. Canopy Growth Corporation, for instance, announced its new cannabis industry strategic growth platform, Canopy Rivers Corporation, and completed a private placement offering for gross proceeds of approximately \$36 million. Cannabis Wheaton Income Corp., another company that is entering this market, also completed a private placement offering for funds to be used in connection with financing various streaming agreements.

These financiers aim to create a non-dilutive method to foster the cannabis ecosystem of both boutique and commercial scale operators. As a result, consumers benefit from a more diverse collection of producers and products and the growth of alternative financing options may influence large institutional lenders to reconsider their approach to the cannabis industry.

We Can Help

For more information about alternative financing transactions in the Cannabis industry and our experience at the forefront of streaming and royalty transactions across a wide variety of industries, please contact Cathy Mercer, Jonathan Sherman or another member of our firm's Cannabis Group.

This article was written with the helpful contribution of Jesse Tepperman (Summer Student).

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