

SMARTER PERSPECTIVE: CANNABIS

Cannabis Industry Financing: Challenges, ABL Opportunities, and the Path Forward

By Jason Gomes

February 2025 The cannabis industry has witnessed a significant transformation over the past decade, driven by the growing acceptance of marijuana for both medical and recreational use across various localities, particularly in North America. Legal markets are expanding, consumer demand continues to rise, and the social stigma surrounding cannabis is slowly deteriorating.

Despite the potential for profitability, however, the cannabis sector continues to face several challenges when it comes to financing. First and foremost, access to capital remains one of the most significant hurdles for businesses in this rapidly evolving industry. In the U.S., the legalization of cannabis at the federal level would be a game-changer for the industry, as it would most certainly unlock a greater degree of access to traditional banking services, reduce investor concerns, and further open up the U.S. stock market to cannabis companies. Federal legalization would also lead to the creation of more clearly defined regulatory guidelines for cannabis businesses, making it easier for investors to navigate the market.

Another important factor relates to sustainability, which is increasingly becoming a key focus for investors in the cannabis sector. Businesses that

prioritize eco-friendly practices, such as energy-efficient cultivation methods or sustainable packaging materials, will likely attract investment from impact investors and environmental, social, and governance (ESG) focused investment funds. In the long term, we expect that businesses that choose to align with sustainability goals may gain a greater competitive advantage in securing financing.

Additionally, on a global basis, as more countries legalize cannabis for medical and recreational use, new markets

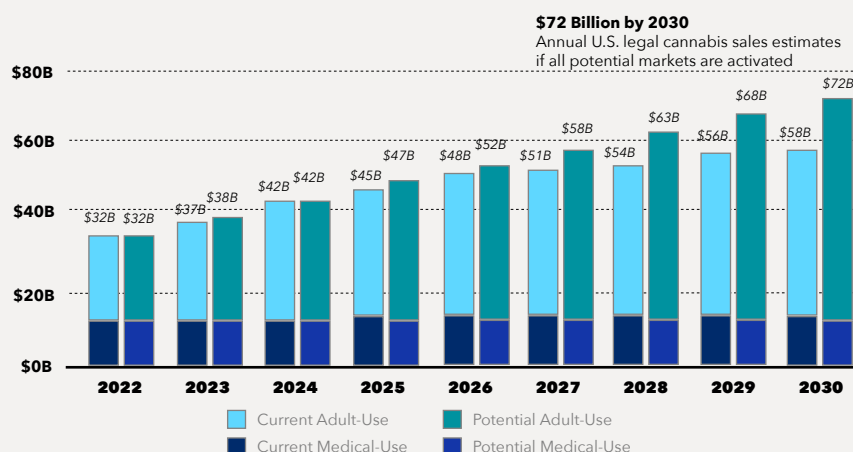
that are primed for investment are emerging. Cannabis businesses that can expand internationally stand to benefit from a broad influx of new capital. Importantly, European markets are currently experiencing rapid growth, and companies that establish a foothold early on in that region could be ideally poised for long-term success.

Traditional and Alternative Financing

While initial skepticism surrounded the sector, more investors are now recognizing the long-term potential of

Projected U.S. Legal Cannabis Sales

Currently legal states vs. expected by 2030



Source: New Frontier Data

Note: Historically, states which legalize adult-use cannabis beyond existing medical markets experience declines in patient participation.

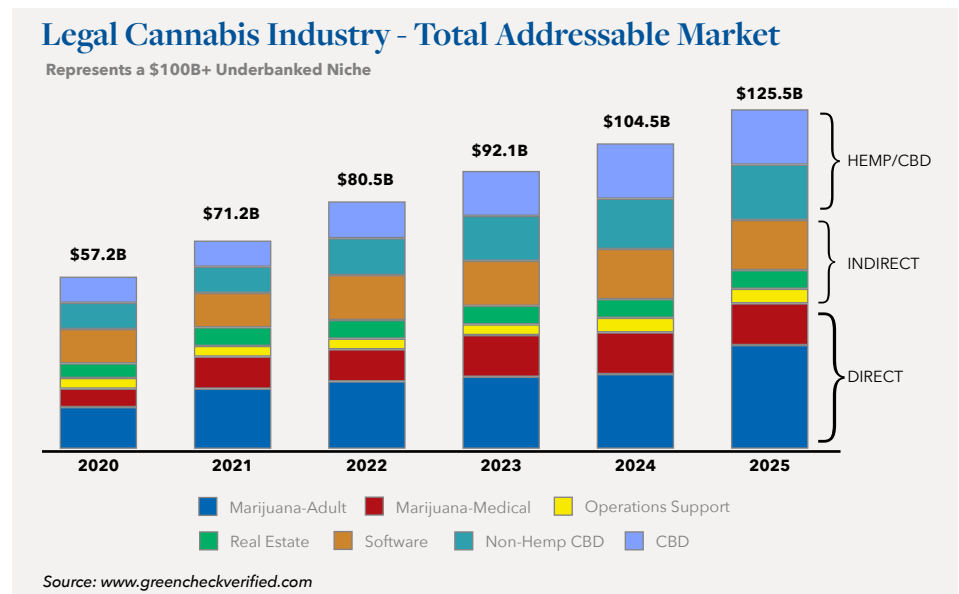
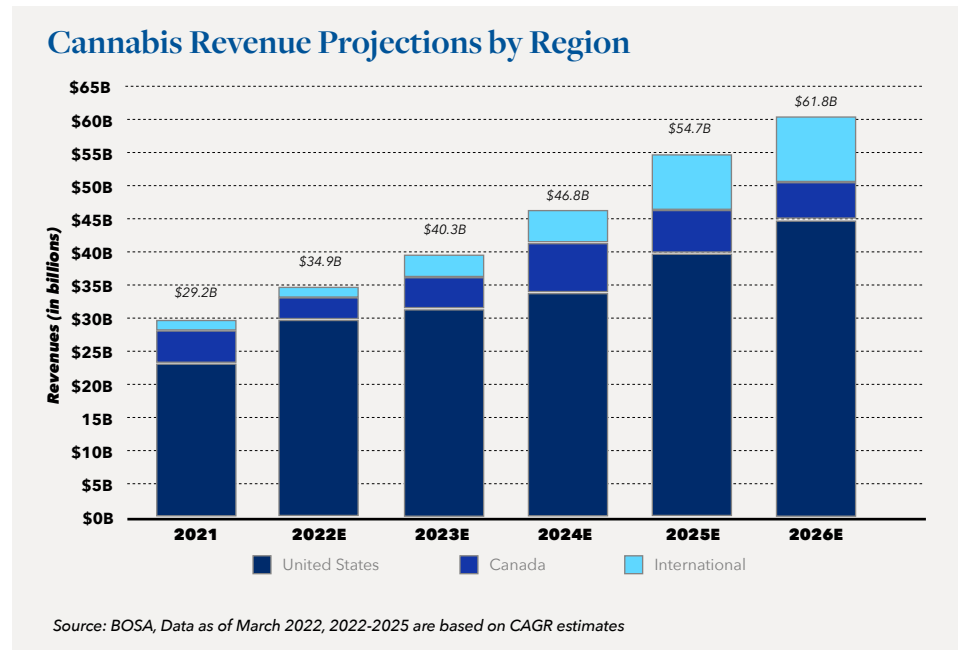
cannabis firms, particularly as markets mature and consumer demand stabilizes. Private equity (PE) firms and venture capitalists are among those who are increasingly looking to capitalize on the cannabis industry's rapid growth.

These firms are interested in companies at the cutting edge of cannabis innovation, including cannabis tech, biotech, and consumer goods. Their typical focus is on businesses that they believe hold the most potential to scale quickly and generate high returns on investment. Cannabis businesses, however, typically face certain challenges accessing the types of traditional financing needed to accelerate this type of scale. As a result, alternative financing models such as those shown below are gaining increased traction in this market:

- **Debt Financing:** In response to the lack of available equity capital, some cannabis businesses have turned to high-interest debt financing. While this can be a more expensive option, it allows companies to maintain control without relinquishing equity.
- **Revenue-Based Financing:** This model offers cannabis companies funding in exchange for a percentage of their future revenue, providing an alternative to equity-based financing. This arrangement can be appealing to businesses that want to avoid diluting their ownership stake.
- **Cannabis REITs:** Real estate investment trusts (REITs) that focus on cannabis-related properties such as cultivation facilities and dispensaries, are becoming an attractive option for investors. Cannabis REITs offer a way to invest in the cannabis sector indirectly through real estate, while providing liquidity to cannabis operators.

An Opportunity: Asset-Based Lending in the Cannabis Industry

As the cannabis industry continues to expand, it faces a unique set of challenges, one of the most significant being access to traditional financing. As referenced above, due to the regulatory



environment surrounding cannabis in many countries, including the United States, these businesses are often excluded from the traditional banking and lending systems, preventing them from establishing credit lines and even checking accounts. However, one niche form of financing that has gained traction among cannabis businesses in recent years is Asset-Based Lending (ABL).

In contrast to unsecured loans, ABL financing offers businesses a way to secure capital based on the value of

their property, equipment, accounts receivable, or inventory assets (a portion of which it should be noted may face shelf-life limitations) rather than their creditworthiness or business performance alone. Understandably, this form of lending is particularly attractive to companies such as cannabis businesses that possess valuable tangible assets but limited access to the traditional lines of credit needed to grow, expand operations, or cover day-to-day expenses.





This restrictive environment has also led many cannabis companies to seek alternative sources of capital that, unfortunately, often come at a steep price. Some cannabis firms, for example, have turned to private investors or high-net-worth individuals willing to take on higher risks in exchange for potentially higher returns. While these investors may provide much-needed financing, their expectations can be demanding, and the terms can be less favorable than traditional financing options.

ABLs, on the other hand, are increasingly recognizing an opportunity to bridge this gap by offering alternative lending solutions that are not encumbered by federal regulation. This, in turn, has led to the rise of specialized cannabis lending firms and private lenders willing to work with cannabis businesses by offering ABL services with comparatively beneficial terms.

ABL loans also provide more flexibility than most conventional loans. Cannabis businesses can, for example, use the funds for a variety of purposes such as inventory procurement, operational expenses, and even expansion- all while still continuing to use their assets as collateral. While traditional loans often involve a lengthy approval process and the cannabis sector, due to its regulatory complexity, can experience even longer approval processes, asset-based lending is typically quicker to secure because

decisions are based directly on the value of the assets being appraised or valued. This speed allows cannabis businesses to access funds when they need them most, without waiting for protracted approval processes.

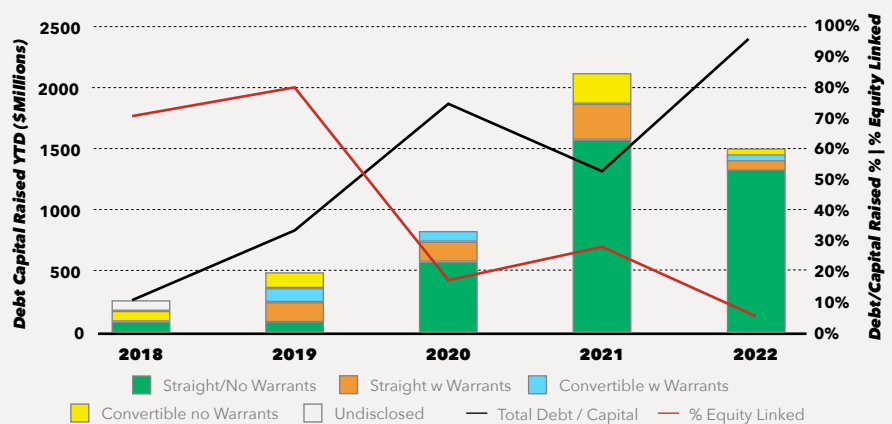
Challenges and Risks of Asset-Based Lending in the Cannabis Industry

Despite its benefits, asset-based lending in the cannabis industry comes with its own set of challenges and risks that both lenders and borrowers must understand. One of the main challenges is accurately valuing the assets that are being used as collateral. Cannabis companies often face challenges in accurately

determining the value of their inventory or real estate, especially given the volatile nature of the cannabis market. This represents a potential risk to both lenders and borrowers, especially in times of market fluctuations.

Also, although some states have legalized cannabis, the federal government still classifies marijuana as a "Schedule I controlled substance." This ongoing regulatory uncertainty makes some lenders hesitant to offer asset-based loans to cannabis businesses, even when those loans are secured by valuable assets. In Canada, while cannabis is fully legalized, businesses still face challenges in navigating the

U.S. Cultivation & Retail Sector Debt By Type



Source: Viridian Capital Advisors

regulatory landscape, with restrictions that impact the flow of capital into the sector. Lastly here, asset-based loans tend to come with higher interest rates when compared with traditional loans due to the increased risks associated with regulatory and legal hurdles. For cannabis businesses, this means that the cost of capital may be higher, with more stringent terms than companies in more traditional industries would experience.

The Future of Asset-Based Lending in Cannabis

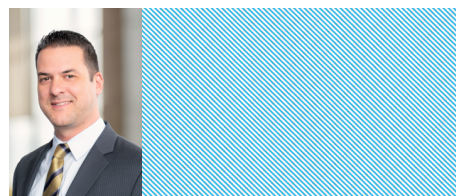
Looking forward, we expect that asset-based lending will likely continue to grow as an important part of the cannabis industry's financing landscape, especially as the sector matures. As more states legalize cannabis and the industry becomes more mainstream, it is expected that more ABLs will enter the space, expanding access to these loans. Additionally, as the cannabis industry grows, lenders are likely to innovate in the types of collateral that can be used for asset-based loans. This may ultimately include more creative solutions for companies with unique needs or assets, such as intellectual property or future receivables.

In the U.S., asset-based lending has the potential to establish itself as a reliable source of financing for cannabis businesses seeking access to capital in an industry still heavily constrained by regulatory challenges. While there are obstacles for ABLs—such as the complexity of securing timely and highly accurate appraisals of the tangible assets associated with these businesses, regulatory uncertainty, and high interest rates—ABLs can add thoroughly vetted cannabis companies to their high-performing portfolios while providing a much-needed pathway to liquidity, growth and sustainability for those businesses.



Hilco Valuation Services is the world's leading provider of asset appraisals with a proven, decades-long track record of providing the most accurate appraisals across all asset categories. The scope of the valuations we deliver ranges from a single asset in one domestic location to millions of assets located around the world.

Even when working within a highly complex and relatively new market such as cannabis, we are able to affirm current asset value through proprietary market data sourced from the collective worldwide asset disposition and acquisition experiences of Hilco Global over time. In contrast to the aged data relied upon by most others in the industry, access to this cumulative, real-time information ensures delivery of the most reliable valuations for our clients. We encourage both ABLs and businesses in this space to reach out to our team to discuss up-to-the-minute insights on the constantly changing cannabis market environment. We are here to help.



JASON GOMES IS A VALUATION DIRECTOR AT HILCO VALUATION SERVICES

He has more than 10 years of experience as an Asset Based Lending & Inventory Valuation Professional specializing in a wide range of Consumer, Industrial, and Wholesale Businesses, including the cigarette & tobacco, vaping and cannabis industries. Jason has worked on hundreds of client transactions over the years involving chemicals, fabrics, food manufacturing & distribution, flooring, housing & building materials, HVAC, packaging, pet food, pharmaceuticals, plastics/resins, and others. Prior to joining Hilco, Jason held a similar valuation role within B. Riley Financial. He is a graduate of Boston University. Contact Jason at 857.403.3093 or jgomes@hilcoglobal.com.