

## Cannabis Business Blog

# Raising Money in Cannabis Businesses: Top Tips When Seeking Investment

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Raising money into any business can be stressful and time consuming, and requires compliance with a multitude of state and federal laws. Understanding the investment landscape and being prepared can make the process smoother and quicker.

**Details Matter.** From the type of entity you've formed to run your cannabis business to your capitalization structure, your business plan, and the agreements between the founders and the company, details matter to investors and play a role in the decision of whether to invest in a company. Having a business structure that facilitates investment and clean documentation are important first steps in attracting outside capital.

**Understand Your Valuation and Equity Stake.** The amount of money that will be invested and the portion of the company that will be sold are among the most fundamental terms of any offering. Founders typically value their company based on the potential value they believe it represents. Investors will typically value a company based on valuation methods that reflect current valuations and that apply risk premiums for startup capital transactions.

**State Regulations May Drive the Deal.** State regulations governing cannabis businesses will require disclosure and/or vetting of anyone investing money in your cannabis business. This can be a barrier to some investors who may not want to be identified on a license or who are unwilling to submit to state review. Communicating these requirements to investors early on can help avoid delays and surprises.

**Federal and State Securities Laws Apply.** Selling equity to investors or borrowing money from private lenders are types of securities transactions. A vast body of federal and state law regulates securities transactions (yes, federal securities laws still apply to cannabis businesses). Failing to comply with these laws can result in serious consequences, including, in certain circumstances, the right of the investors to rescind the transaction and receive their money back.

**Don't Over-Sell Your Investors (or Yourself).** More than one cannabis entrepreneur has been caught up in the excitement of this new market and the possibility of sky-high returns only to find out that the regulatory structure, significant competition within the industry and day-to-day business challenges make doing business in this industry more difficult than expected. It's important to be realistic when developing your business plan and to take a conservative approach when projecting returns so as not to over-sell your investors, or yourself, on the

returns the business will generate.

**Know What You're Asking For and Why.** Understanding what you're asking for and why you are asking for it will help you anticipate and answer the questions that investors are likely to ask. When putting together a term sheet or offering memo, think about these key questions:

1. How much capital are you asking for and how long will that capital last?
2. What will be your monthly burn rate?
3. Do you have detailed financial projections for the next two years?
4. What are the key assumptions underlying your projections?
5. What key cost components are there for the product or service?
6. What are the unit economics?
7. What are the likely gross margins?

The attorneys at [Garvey Schubert Barer's Cannabis Industry Group](#) have worked with both investors and companies in the cannabis industry on multiple equity and debt financing projects, and bring our extensive industry knowledge to bear when helping clients structure deals, evaluate term sheets and negotiate investment documents.

**Warning Regarding Federal Law:** The possession, distribution, and manufacturing of marijuana is illegal under federal law, regardless of state law which may, in some jurisdictions, decriminalize such activity under certain circumstances. Penalties for violating federal drug laws are very serious. For example, a conviction on a charge of conspiracy to sell drugs carries a mandatory minimum prison term of five years for a first offense and, depending on the quantity of marijuana involved, the fine for such a conviction could be as high as \$10 million. In addition, the federal government may seize, and seek the civil forfeiture of, the real or personal property used to facilitate the sale of marijuana as well as the money or other proceeds from the sale. Although the U.S. Department of Justice (DOJ) recently rescinded its guidance regarding prioritization of criminal prosecutions of individuals and entities operating in compliance with effective state regulatory systems, DOJ left in place long standing guidance to federal prosecutors regarding how to exercise this discretion. Individuals and companies are cautioned to consult with experienced attorneys regarding their exposure to potential criminal prosecution before establishing business operations in reliance upon the passage of state laws which may decriminalize such activity. Federal authority to prosecute violations of federal law as crimes or through seizures and forfeiture actions is not diminished by state law. Indeed, due to the federal government's jurisdiction over interstate commerce, when businesses provide services to marijuana producers, processors or distributors located in multiple states, they potentially face a higher level of scrutiny from federal authorities than do their customers with local operations.

**Tags:** cannabis business, company valuation, federal securities law, investments in cannabis businesses, state securities law