EXCLUSIVE FOR INSIDERS

THE LEAD

MSOs collapsing under COVID? Insiders remain optimistic, hopeful the industry can come out stronger.

As the United States' economy took a deep breath earlier this year in the face of the pandemic, it's become more apparent how tenuous the finances were of some prominent multi-state operators.

Case in point, iAnthus, whose fortunes have tumbled like a house of cards in the wake of scandal after scandal: failure to pay interest on debts, allegations of mismanagement, cease trade orders and a federal class action lawsuit.

Despite the financial woes hastened by the pandemic, some insiders remain hopeful for those companies able to survive the current challenges and become leaner, more competitive operations.

Treading water

Fruqan Mouzon of McElroy, Deutsch, Mulvaney & Carpenter, said "the iAnthus debacle is bad for the industry."

"It is a cautionary tale for anyone entering the business," Mouzon said. "Be careful not to overextend, focus on revenue generation/profitability (rather than immediate expansion) and, most importantly, maintain the utmost integrity and always endeavor not to mislead the public or investors in any way."

Jonathan Boguchwal of CLB Partners said the downfall of iAnthus demonstrated that some highly touted companies were nothing more than an illusion.

“With the industry in general what we are learning over the past year, and certainly the last five months, is that some companies everyone raved about or were seen as can't miss in the industry may have been a bit of smoke and mirrors,” he said. “COVID accelerated a lot of issues that require liquidity to handle and that has been a challenge for many companies as they grew.”

Who else is impacted?

iAnthus isn’t the only cannabis company to face significant headwinds. Before the announced restructuring of Canopy Growth’s option to buy Acreage Holdings, Acreage accepted a steep loan for $15 million at 60%.

“If you believe everything you read, Medmen, certainly,” Mouzon said. “It appears other companies like High Times, Acreage and Harvest Health & Recreation are struggling. The common issue could be an unfocused emphasis on expansion for the sake of expansion over profitability and targeted growth, but I’m not one to say. All I can say is I am rooting for these companies to succeed. Financial success is good for all of us who provide professional services to the industry.”

For **Mike McQueeny**, co-chair of Genova Burns cannabis law practice, what this means is the larger the company, the larger the fall.

“I think about this in the context of some of these troubled MSOs — just because you’re a bigger company with a lot of sales doesn’t mean that you’re not leveraged to the hilt,” McQueeny said. “Ultimately, what several of these same medical and adult-use states are unfortunately finding, is that the larger the entity sometimes means the larger the fall. When balance sheets go bad, it's not just one state’s patient population that suffers, but all of them.”

Survival strategies

With challenging times facing them now and in the future, companies have had to tighten their belts even further and find whatever liquidity they can.

“Most of these MSOs are becoming tighter on expenditures,” McQueeny said. “If you’re one of those newer startups seeking to get into the cannabis space, now is the best time to go hunting for talented partners with experience in some of these bigger MSOs, because we’ve also seen a flurry of terminations of high-ranking employees and officers within these organizations.”

Sale-leaseback agreements as we’ve seen with numerous companies including Curaleaf, Acreage and Columbia Care have also proved to be a reliable solution for the short-term.

“Real estate, if you own it, is one of the easiest assets to readily transfer, as the parties can provide a legally clean mechanism for ultimately receiving payments that are only indirectly tied to cannabis,” McQueeny said. “There are other inventive ways to structure lending, but from a nuts and bolts perspective, that’s the easiest mechanism to interest a lender.”

Boguchwal said while sale-leaseback agreements provide immediate capital they don’t always solve the long-term issues facing a company.

“You must have a stable business plan and a good working relationship with your new ‘partner,” he said. “There are other business sectors that regulators keep a watchful eye on these types of arrangements as they can cause issues down the road, but each should be judged on their own merit and the plan laid out.”

Lessons learned

One of the biggest lessons learned from iAnthus, according to McQueeny, is that “when you look at the complicated deal structure ultimately agreed to by iAnthus, you learn loud and clear how different cannabis legalization is as compared to what activists would like it to be.”

“The people marching just this weekend in Newark were not marching so that secured creditors would be provided preferential equity,” McQueeny said. “I think what this deal tells us, unfortunately, is that this industry is more beholden to the lenders than it is to the patients. Without meaningful reform at the federal level that permits these cannabis entities to seek out traditional lending and other tax related relief, this will continue to be an industry for the biggest operators who are, in turn, subject to the greatest risks in economic downturns.

Other factors such as the expense of running operations to the lack of protection for cannabis companies under bankruptcy law also contributed to the company's downfall, McQueeny said.

"Those protections aren't available (for cannabis companies) because a federally illegal business is not provided refuge in a federal bankruptcy court," he said.

Tara Sargente, founder of Blazin' Bakery and executive director of the New Jersey CannaBusiness Association, said cannabis companies need to reevaluate their companies from the bottom up.

"Most companies would benefit from a shift from looking at things at 30,000 feet and instead reevaluate the foundations they are built on," Sargente said. "We need to inject more passion, humanity and culture back into the industry to win over the public and eliminate the black market."

She continued: "Expanding a bit more naturally as well as being inclusive of industry veterans is a great start. Blending 25 years of our country's hard-learned medical marijuana wisdom with the business acumen of new players could prove promising and truly exciting. New Jersey has the population. By keeping a laser focus on patient care and providing diverse quality products at competitive prices, there is no reason we shouldn't grow a healthy sustainable industry."

— Justin Zaremba