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Cannabis M&A Flares As Players Bet On US Legalization

By **Chelsea Naso**

Law360 (October 17, 2019, 3:50 PM EDT) -- Cannabis companies are snapping each other up in the U.S. despite regulatory challenges as they try to build market share ahead of anticipated federal legalization of marijuana, seeking to become either industry leaders or attractive targets for large acquirers looking to enter the market.

A handful of larger cannabis combinations made headlines earlier this year — including Massachusetts-based Curaleaf Holdings Inc.'s **$948.8 million deal** for private equity-backed Cura Partners, which Curaleaf followed with an **$875 million deal** for Grassroots two months later.

But smaller deals have been inked steadily among cannabis companies from all areas of the industry, with businesses looking to build out a platform that is well-poised to tap into the growth opportunities that will be presented if the U.S. legalizes cannabis. And deal-making is showing no signs of slowing.

"We're probably at the middle of the second inning in a long ball game. It's fast, it is. Who would have thought six years ago we would have been talking about cannabis M&A?" said Josh Mann, president of Cannabis One, a U.S. cannabis distributor and branding company whose most recent deals include a July takeover of Green Lady IP Inc.

Companies have cropped up on different points along the supply chain and different areas of the industry, like manufacturing or retail, but many are finding that going it alone is too difficult and costly and are looking to find more scale where possible.

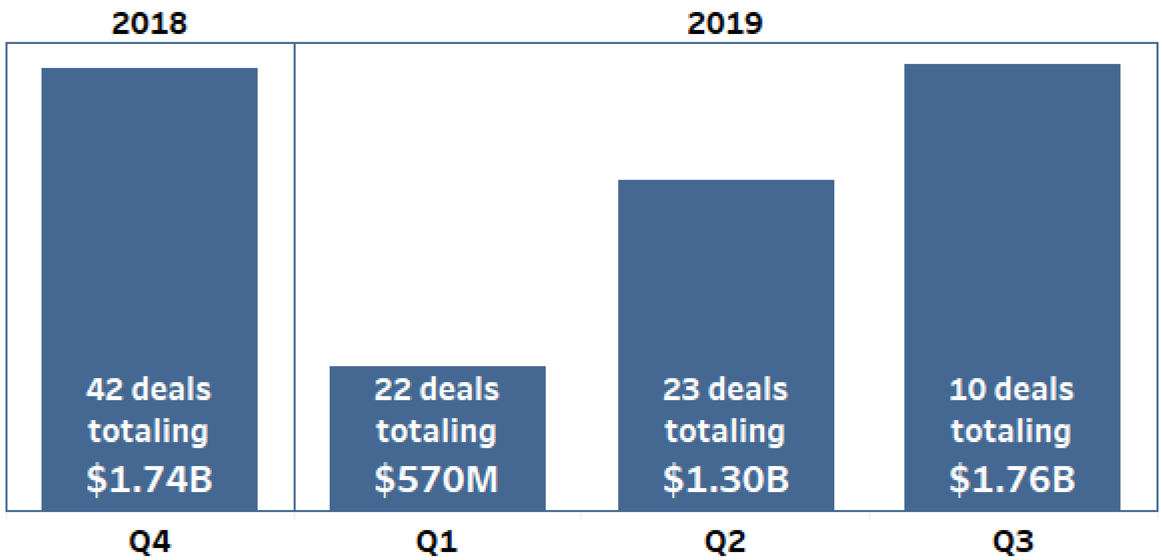
"This is definitely an industry that is ripe for consolidation," said Sam Dibble, a Baker Botts LLP partner. "It's not an industry that can sustain being as fractured as it is. It's going to trend toward larger players."

U.S. cannabis mergers and acquisitions reached $1.76 billion across 10 deals during the third quarter of 2019, marking a steady uptick in deal value since a first-quarter dip, according to data tracked by Mergermarket.

For the 12 months ending at the wrap of the third quarter, there was $5.37 billion in deal value across 97 transactions, including deals that fell below Mergermarket's normal $5 million threshold for tracking.

U.S. Cannabis M&A Climbs Throughout 2019

Deal activity is continuing to flow in the U.S. cannabis industry.



Source: Mergermarket

While the race to become a large player in the cannabis industry is an expensive and risky endeavor, many believe the payout will be great for a few key companies. For some, the competition is to become a brand synonymous with the sector.

"I think the rewards will be massive if you can create the next Mars Bar or the Evian of CBD water. There is no brand that is that relevant yet. And that's a pretty big opportunity that everyone is chasing," Mann said.

"That's primarily our focus, where we really want to be the Cannabis One house of brands, where all of our underlying brands become the brands of the industry," said Cannabis One CEO Jeff Mascio.

Becoming a well-known brand or building a strong platform of either brands or services also serves another goal for companies vying to create the major acquisition targets of the top players in neighboring industries that are somewhat sidelined until U.S. legalization.

"In anticipating to legalize marijuana federally, the larger U.S. companies in the space believe that their primary goal is to get as big as they can as quickly as they can because when U.S. legalization happens, big pharma, big alcohol, big tobacco will enter the space much as they have already in Canada. And everybody expects they will enter the space by buying the biggest players," said David Feldman, a Duane Morris LLP partner.

There's an understanding in the industry that regardless of why a company wants to grow, those who are not prepared to ride the wave of M&A that is expected to follow U.S. legalization will be left behind.

"At some point, I do envision the restrictions at the federal level will be removed or referred to the states," said Dibble of Baker Botts. "When that happens, and this is allowed to operate more like a nationwide business or interstate business, that's when the consolidation will really accelerate and the branding will become more critical."

The current race to do deals is hindered by the fact that marijuana is still illegal at the U.S. federal level. And while many in the industry are confident that legalization is a question of when, and not if, the current prohibition has led to a number of hurdles along the way.

For one, banks have not been able to participate in the industry, which in turn creates another challenge for financing M&A activity. A bill to approve a federal safe harbor for banks is **working its way** through Congress, but banks are not currently shielded from legal liability for serving legitimate cannabis companies.

The federal illegality of cannabis also hinders many of the industry's companies from landing the tax benefits that other U.S. businesses enjoy, adding yet another layer of complexity.

And each state that has legalized medical or adult use of cannabis has implemented its own set of regulations, with the municipalities within those states sometimes adopting additional or more stringent rules.

That means that to get a deal done, the list of needed regulatory approvals and licensing matters is particularly long. There needs to be a green light at the state and local level, and potentially antitrust approval at the federal level.

"The biggest challenge other than money … is getting all the necessary regulatory approvals," said Joshua Horn, who co-chairs Fox Rothschild LLP's cannabis practice.

"Each state is different. It's a truncated system because you don't have uniform laws," said William Bogot, a Fox Rothschild partner.

Another challenge to M&A that is unique to the cannabis industry is that many of the target companies were not set up with an acquisition in mind. That means that their financial record keeping and other corporate practices might make due diligence particularly difficult.

"Given that it's a new industry and people were scrambling to organize or maybe get a license, and a lot of the folks especially on the Main Street side are first time entrepreneurs, it hasn't had all of the corporate formalities," said Shawn Stigler, co-leader of Michael Best & Friedrich LLP's cannabis practice.

That makes the merger situation more difficult than what attorneys might be used to when dealing with a company set up by a venture capitalist or other investor.

"The structure of the company can be, you know, a little messy, for lack of a better word," Stigler said.

But the challenges overall are not expected to calm the hunger for M&A.

"I continue to think that M&A is an incredible opportunity," said Andrew Apfelberg, a Greenberg Glusker Fields Claman & Machtinger LLP partner.

--Editing by Jill Coffey and Breda Lund.