Financing Considerations in Emerging Hemp Businesses

Hemp-related business opportunities are exploding, particularly in Kentucky. Interested private equity backed investors will discover that the Commonwealth is at the national forefront in progressive legislation and support for the nascent industry, which by many measures is enjoying wide-spread and growing consumer demand.

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Industrial hemp is not marijuana. While "hemp" and marijuana are derived from the same plant species, they are treated very differently under the laws. Hemp is specifically legal, thanks to the 2018 Farm Bill. Under this federal law and most states' laws, growing, processing and selling hemp-derived products is lawful so long as the products do not contain a concentration greater than 0.3% of THC, the chemical component that produces the infamous "high." Marijuana, which remains illegal at the federal level and in most states, has THC at higher concentration levels.

It is important for investors in this new legal industry to recognize that the industrial hemp marketplace involves much more than simply growing one of the three types of hemp plants. It includes businesses involved in transportation, warehousing, processing, manufacturing, distribution, financing and wholesale and retail sales.

Like every start-up business enterprise, developing the right mix of financing is essential to success. Traditional banks typically will be part of the mix due to their ability to offer depository accounts, loans and treasury management services, including credit card acceptance processing. However, despite passage of the 2018 Farm Bill, not all banks are accepting hemp-related businesses as customers. For B2C companies, close attention must be devoted to credit card payment services, which are proving problematic nationwide for retailers in this space.

Private equity buyers and financiers must understand the specific legal and regulatory scheme applicable to each business. This is a highly regulated industry and licensure varies depending upon where the business touches the stream of commerce. For example, CBD product producers and sellers are subject to different requirements than businesses using hemp in fiber production. It is

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noteworthy that important "business uncertainty" exists for those who manufacture or sell ingestible-type hemp products, as the Food and Drug Administration has only recently begun its investigation into whether it will exercise regulatory jurisdiction.

As with any emerging industry, there is little institutional history or past-practice formulas to rely upon in valuing a hemp business or its assets. This fact can be a source of reticence when interacting with traditional banks. Investor-owners must remember that hemp in the field is subject to all the laws of nature, just like all farm crops, but that crop insurance is currently unavailable. An additional financial risk is that hemp, whether in the field, at the warehouse or on a store shelf, can immediately become valueless if it tests "hot" because of an impermissible THC concentration.

The future appears bright for hemp-related businesses whose owners and investors can navigate these uncharted waters. Frost Brown Todd is uniquely positioned to advise PE firms interested in investing in this emerging industry. The firm and its government relations subsidiary have taken leadership roles in the creation and guidance of the hemp industry over the past decade, including presently serving as legal counsel for the U.S. Hemp Roundtable, the nation's leading business advocate for the industry. The firm's banking lawyers have worked with banks and hemp-related businesses in resolving the issues necessary to opening the Commonwealth's traditional banking infrastructure. Frost Brown Todd's M&A attorneys and PE industry team work closely with the firm's hemp industry group in connection with assisting clients entering or operating in within the growing hemp industry.

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