

Cannabis Firms Explore Alternatives Amid Slow Capital Market

Cannabis Sector Faces Slow Capital Raises Amid High Debt Financing Costs

The cannabis sector has experienced a significant slowdown in capital raises over the past year, with experts attributing the sluggish activity in part to the high cost of debt financing. This challenge has made it increasingly difficult for cannabis businesses to secure the funding needed for expansion and operations.

One company navigating this tough financial landscape is Cannect Wellness, which recently secured a new round of funding to fuel its growth.

Cannect Wellness Expands with Latest Funding Round

Cannect Wellness, a cannabis company based in Illinois, raised \$7.5 million in its latest funding round, bringing its total equity financing to \$14.5 million. The funds will be used to expand its operations and product offerings, adding edibles, pre-rolls, and solventless concentrates to its existing range of flower, live resin, and concentrates.

The initial \$7.5 million raised during the company's first funding round was used to construct a 22,000-square-foot facility in Franklin Park, Illinois, and launch its first products across marijuana retail stores in the state. The second round will help increase production capacity and double the size of the company's team, which currently has 26 members.

While Cannect Wellness is focused on growing within the Illinois market, it has no immediate plans to expand into other regulated markets. The company aims to deepen its presence in the state by launching new brands and cultivating additional cannabis strains.

Challenges in Securing Capital in the Cannabis Industry

Cannect Wellness' recent funding round attracted a diverse group of investors, including both new and existing backers. However, like many businesses in the cannabis sector, the company faces challenges in securing traditional financing due to the federal prohibition of marijuana.

The lack of access to conventional bank loans, coupled with the unavailability of Small Business Administration (SBA) loans for cannabis companies, has left many businesses struggling to find alternative funding sources. According to Tracy Gallegos, a cannabis law expert, raising capital in the industry has become increasingly difficult as investors and lenders have grown cautious.

The complexity of operating a cannabis business and the high costs associated with running a compliant and successful operation have caused investors to take a more careful approach. In many cases, potential lenders and investors are requiring companies to undergo corporate restructuring and provide extensive documentation—creating hurdles for early-stage cannabis companies.

This cautious approach has been particularly evident in markets like California, where numerous cannabis businesses have shut down due to financial strain. As Gallegos explains, this trend has contributed to the slowdown in fundraising activity across the industry.

Impact of High Debt Financing Costs

Debt financing has become a costly option for many cannabis businesses, with high interest rates making it less attractive. Cannect Wellness' co-founder, Gabe Singal, noted that while some of the company's investors were eager to contribute more capital, Cannect has aimed to limit its debt due to the expense.

In many cases, companies are seeking funding from personal networks or turning to self-financing to avoid the high costs of debt. With interest rates expected to decrease by the end of 2024, experts believe debt financing may become more appealing again in the future.

The Role of Large Companies in Capital Raises

Despite the overall slowdown in capital raises, some larger companies in the cannabis industry have continued to secure significant funding. According to Frank Colombo, managing director of Viridian Capital Advisors, capital raises in 2024 have seen a 226% increase, primarily due to large debt issuances of over \$100 million.

Cultivation and retail operations have accounted for 50% of these capital raises, driven in part by the potential federal rescheduling of marijuana. Colombo also noted that 86% of capital raised in 2024 has been for public companies, with the vast majority of these funds coming from debt rather than equity raises.

Outlook for the Cannabis Industry

As the cannabis industry faces ongoing financial challenges, companies like Cannect Wellness are focused on strategic expansion and limiting debt. While capital raises have slowed across the sector, there is optimism that decreasing interest rates could revitalize debt financing opportunities in the near future.

With the possibility of federal marijuana rescheduling and the continued growth of the market, large companies are expected to play a key role in driving capital investment. However, smaller and newer cannabis businesses may continue to face difficulties in raising funds until the financial landscape becomes more favorable.

Email: info@cannabisriskmanager.com | Phone: +415-226-4060

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