# Ninepoint Alternative Health Fund

## April 2019 Commentary


Investment Team

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The month of April saw weakness for the healthcare sector in general while cannabis companies were generally flat from the beginning to month end. Mid-month witnessed significant weakness in the broader healthcare sector as US healthcare policy pronouncements by leading Democrats for President issued policy papers outlining universal healthcare coverage plans, that worried investors. In terms of the cannabis sector, many analysts in Canada and the U.S. reduced their equity price targets with reduced revenue and earnings estimates for the larger Canadian LPs reflecting less than anticipated dispensary openings, reduced cultivation and lack of SKUs available for purchase.

This recently revised near term market outlook for Canadian LP's from many analyst's supports our thesis from early January, (see 2019 Outlook) positioning the fund for relative strength in the US cannabis market. Factors such as more states adding dispensaries; more states considering adult recreational legislation, and hemp based CBD products being marketed throughout the US, all provide a sound base upon which to invest.

**Topics Covered:**
*Market Updates*
*Private Company Investment Completes RTO*
*US M&A Transactions*
*Quarterly & Annual Financial Results*
*Options Strategy*

**Market Updates:**
April 1st witnessed the opening of Ontario's first licensed cannabis dispensaries, however in the early days of April just 9 of 25 licensed retailers opened. The award as Ontario's first storefront went to The Hunny Pot Cannabis Co. on Queen St West.

In a sign of increased market acceptance of the cannabis sector, **Canopy Growth (WEED)** was added to the S&P/TSX 60 replacing Goldcorp Inc. (G) prior to the open of trading April 18th. Concurrent with the replacement, Goldcorp will be dropped from the S&P/TSX Composite Index. The reason G was replaced was that Newmont Mining Corp. (NEM) acquired Goldcorp in a transaction pending final conditions.

Also noteworthy was the announcement by **CannTrust (TRST)** of the acquisition of 81 acres of land, to advance its outdoor cannabis cultivation operation in British Columbia. As legislation in Canada begins to allow outdoor cultivation, we anticipate similar announcements utilizing large tracts of land in select rural areas.

**Private Investment Completes RTO**

One of the Funds' key differentiators is its ability to invest in private companies, well before a public listing is achieved. Often that results in entering a name at an advantageous entry point. On April 29th, a private holding in the Fund, **Columbia Care Inc. (CCHW)** went public on the NEO exchange. CCHW is a pharmaceutical quality medical cannabis multi-state operator (MSO) with operations in 14 U.S. states and territories plus operations in Malta. Currently, CCHW has 35 licenses with a total of 54 facilities operational or in development. The company's listing was facilitated via an acquisition by Canaccord Genuity Growth Corp., a special purpose acquisition company, or SPAC, with a valuation of about $1.4 billion. Our investment includes shares at USD $6.90 (approx.. $9.30 Cdn)

**US M&A:**

A wave of consolidation has been changing the US cannabis industry over the last 8 weeks, with large MSO's buying unique companies in a race to build a national presence. **Creso Labs Inc. (CL)** and **Harvest Health & Recreation Inc. (HARV)** each announced deals worth more than $800 million in the last two months with a primary goal in these transactions being the ability to build brands in the growing cannabis market.

Middle of the month saw the first cross boarder transaction between a Canadian cannabis company and a U.S. MSO. **Canopy Growth (WEED)** signed a definitive arrangement granting WEED a 7 year option to acquire all of the shares of **Acreage Holdings (ACRG)**. The 7 year right is to facilitate the closing of the transaction at such time as cannabis production and sale becomes federally legal in the United States. ACRG shareholders will receive an immediate payment of US$300 million or approximately US$2.55 per ACRG share, in addition, upon the exercise of the right, holders will receive 0.5818 of a common share of WEED for each ACRG share owned. The total transaction is valued at US$3.4 billion on a fully-diluted basis, representing a premium of 41.7% over the 30-day volume weighted average price of the ACRG. Before the deal was announced, ACRG was trading at a multiple of 13.5 times 2020 EV/EBITDA. Given that WEED trades at over 80 times EV/EBITDA, picking up a major asset at a discount to its trading value is accretive. Aside from being the first transaction where a Canadian cannabis company buys a US Cannabis company, with cannabis still illegal federally in the US, there are several noteworthy points to consider;

WEED trades on the NYSE, so it has reportedly signed off on the transaction, which means that the SEC has essentially blessed the transaction as well;

ACRG is a company with a very well-known Board of Directors (Former Prime Minister Mulroney, Gov William Weld, Former Speaker of the House John Boehner), our belief is that this group was instrumental in getting this deal done.

The opportunity for WEED is to help grow a US company that hasn't opened a significant number of stores (23 dispensaries open vs 73 licenses) relative to other MSO's yet has a big footprint in terms of states where it holds licenses In order to buildout this footprint Acreage will require significant capital, something WEED has easy access to. This transaction helps establish WEED's position in the U.S. - Constellation Brands did not invest $5 billion CDN in WEED for access to the Canadian Market.

In March (HARV) announced the acquisition of private company Verano in an all-stock transaction valued at US$850 million. In April, HARV announced an agreement to acquire CannaPharmacy, Inc.

owner/operator of cannabis licenses in 4 states including Pennsylvania, Delaware, New Jersey and Maryland. Total consideration of the transaction was not disclosed. However upon closing HARV will hold licenses that will allow it to operate up to 213 facilities, including 130 retail dispensaries. The transaction builds HARV's east coast strength as it operates throughout the northeast in OH, PA, MD, MJ, MA, and MI. This transaction continues HARV's recent streak of acquisitions that includes Verano, CBx, and Falcon highlighting a solid M&A track record. This series of transactions, along with its recent $500 million financing announcement suggests to us that HARV will remain active building out its national presence and should reward investors with increased earnings from continuing operations.

On May 1st **Curaleaf Holdings Inc. (CURA)** remained busy on its M&A plans, after its Nevada acquisition of Acres in March, CURA announced the acquisition of the cannabis business of Cura Partners Inc., a manufacturer of oil for vape pens, in an all share transaction valued at approx. $950 million USD. That transaction is the largest acquisition so far between two U.S. cannabis companies. Cura, based in Portland, Oregon, sells its "Select" branded products in more than 900 dispensaries, including dispensaries in California. Cura total revenue was $117 millionUSD in 2018, with the majority of that revenue being in the cannabis business that was acquired. Acquiring the Select brand gives CURA a popular west coast brand it can sell at its dispensaries throughout the U.S. as well as adding the brand to its suite of brands for distribution outside the Curaleaf dispensary network. Cura currently operates 44 dispensaries in 12 states, including New York and Massachusetts. The combined CURA and Select businesses had revenue in 2018 of $200 millionUSD, operates in 15 states with 900 wholesale locations and 44 dispensaries growing to 70 stores by year end where customers and patients can find their products. In addition, by combining well-known brands, CURA maintains strong brand awareness on both the east coast (FLA, MD,NJ,NY,CT,MA,ME) and west coast (CA, OR, NV, AZ).

**Quarterly Financials**

**Cdn LP's**

Top Ten holding **Organigram Holdings (OGI)** announced Q219 quarterly financial statements on April 15th, with record net revenue of $26.9 million in the quarter, more than double it's net revenue from Q119. Adjusted gross margin was very strong at 60% or $16.0 million while adjusted EBITDA was 49% or $13.3 million. Adjusted EBITDA of $13.3 million beat consensus of $8 million. OGI continues to lead all Canadian LP's in terms of having the lowest cost of cultivation at $0.65 ($0.56 previous) and "all-in" cost of cultivation of $0.85 ($0.74 previous). This is the 3rd consecutive quarter of positive EBITDA, and this quarter exceeded both analysts' estimates and company guidance.

Many of OGI's peers are cash flow negative and some are expected to have negative cash flow for a significant period of time. It is also noteworthy that OGI's high margins are being achieved within indoor cultivation facilities, typically associated with higher cost operations. OGI is now only one of three LP's that have supply agreements with all ten provinces, having recently signed an agreement with the Société Québécoise du cannabis (SQDC). Further solidifying OGI and its operational plans were two significant announcements; first its equity listing to NASDAQ announced April 26th as well as the announcement post quarter end that it had secured debt financing from a Canadian Schedule I Chartered Bank of $140 MM which includes a term loan and revolving debt for general working capital and corporate purposes.

**MediPharm (LABS)** announced Q418 results that beat analyst estimates. Revenues in Q4 were

$10.2 million putting LABS within the top 10 of all Canadian cannabis companies for Q4/18. LABS adj. EBITDA of $2.1 million was well ahead of estimates. Impressive gross margins at 39% while the company controlled SG&A expenses below estimates by $0.8 million allowed the company to generate positive pre-tax cash flow for the quarter, only weeks after receiving its sales license. We anticipate further upside on LABS as the company continues to sign sales agreements both in Canada and internationally. In addition, offering extract solutions in a B2B environment can lead to enhanced margins in future quarters. We also believe that its current valuation at 7 times 2020 EV/EBITDA offers a good entry point relative to other mid-level Canadian LP's that trade at higher valuation metrics yet do not have LABS positive cash flow capability.

**Aphria Inc (APH)** announced Q319 results that provided growth in top line revenue, however results were disappointing relative to analyst estimates. Net revenue was $73.6 million vs consensus estimates of $85 million. Revenue shortfalls were experienced due to supply shortages from the company's transition related to different growing methods as well as temporary packaging and distribution challenges. Gross margin came in at a very low 18%, compared to 48% in the previous quarter. Cash costs to produce came in at $1.48 per gram vs $1.34 from the previous quarter. "All-in" cost of goods sold per gram of $3.76 increased from $2.60 in the previous quarter. Adj. EBITDA of ($14.4) million was a miss on the negative side vs consensus estimates of ($5.8) million. APH's low volumes in the recreational market were surprising and disappointed investors.

**US MSO Q418 & Full Year Results (all results in USD)**
The Fund has been rewarded in our support of US MSO's as April witnessed Q418 and full year financial results that exceeded analyst estimates while providing strong guidance for fiscal 2019.

**Trulieve (TRUL)** reported strong Q4/18 results with both revenues and EBITDA ahead of consensus estimates. TRUL, a medically focused operator and the leader in Florida generated full year revenue of $102.8 million, a year-over-year increase of 419%. Equally impressive is that TRUL announced adjusted EBITDA of $45.6 million, or 44.4% for the year. During Q4 TRUL reported revenues of $35.9 million, up 27% QoQ, and above consensus estimates of $32.4 million. Quarterly EBITDA of $15.2 million also beat consensus estimates of $13.8million. The results illustrate how TRUL continues to expand its leadership position in Fla while maintaining solid profitability. TRUL still generates over 50% of all medical sales in FLA, and 65% of all milligrams of cannabis sold which is impressive given rising competition as peers opened 23 new stores during Q4. Same Store Sales (SSS) was up 343% YoY, a significant achievement in any retail focused business. TRUL released 2019 guidance calling for revenues of $214m, up 108% YoY, with guidance on EBITDA of $92million, up 102% YoY. TRUL currently trades at 11.6x 2020 EV/EBITDA, a significant discount to the Cdn LP avg multiple of 41x and US peer group at 13x

**Harvest Health and Recreation (HARV)** released Q4 and full year 2018 results. HARV reported Q4/18 revenues of $17 million, up an 52% QoQ, while gross margin was 42%, or $7.2 million while adjusted EBITDA was $2.6 million. For the 12 months ended December 31, revenues were $47.0 million, an increase of 106%, compared to $22.8 million for the same period in 2017. Gross margin was 52%, excluding the impact of biological assets, or $24.6 million. Adjusted EBITDA totaled $10.3 million for the 12 months ended December 31, 2018, compared to $6.0 million for the same period in 2017. During the management call to discuss its financial results, HARV raised its 2019 guidance for proforma revenue and EBITDA which due to recent M&A activity have increased to a range of ~$350–400 million for revenues with ~$70–80million for EBITDA. Growth in 2019 should be driven by its operations that now include X states, and continued store rollout with plans to triple its retail network from 21 stores open currently to ~60 by the end of the year.

**Cresco Labs (CL)** also reported Q418 and full year 2018 financial results that illustrated profitability and continued growth for 2019. Revenues in Q4 were $17.0 million, up 411% YOY and 33% QOQ. Fourth quarter adjusted EBITDA2 was $13.7 million, compared to an adjusted EBITDA loss of $3.1 million in Q417. For the year revenue was $43.3 million, up 294% from the prior year. As of fiscal year-end, the company had a working capital position of $172.7 million with zero debt on the balance sheet. The Company is operational in seven U.S. states, with binding transactions pending in New York, Massachusetts, and Florida. As mentioned above, on March 25, 2019, the Company received approval to enter into the State of Michigan.

Finally, non-cannabis Top Ten Fund holding **Pfizer (PFE)** posted stronger-than-anticipated Q119 earnings and provided enhanced guidance to its full-year profit forecast. Earnings for the three months ending in March came in at $0.68/share, a 15.25% increase from the same period last year and well ahead of consensus estimates. Revenues, were up 1.64% at $13.118 billion and came in ahead of analysts' forecasts of $13.01 billion. The share price received solid support as management raised the mid-point of its full-year adjusted earnings forecast to a range of $2.83 to $2.93 per share, and confirmed its previous guidance for full-year revenues in the range of $52 billion to $54 billion.

**Option Strategy:**
During April the Fund continued using its option strategy to enhance risk adjusted returns. With the extreme volatility in the cannabis sector, we are able to generate significant option premium, while lowering the overall volatility of the fund. Where we believe we are being well compensated through the premium income earned, we are writing cash secured puts on specific names we would like to own to increase our exposure to such names in the Fund; we are writing covered calls on names we feel have richer valuations; and we are writing short straddles (puts and calls written on the same name with similar strike prices) and short strangles (puts and calls written on the same name but with different strike prices) on names we feel will trade range bound. Depending on the strike price chosen, all three strategies are neutral to slightly bullish strategies that allow us to generate option premium or enter and exit positions at more attractive prices during periods of elevated volatility.
During the month we used our option strategy to assist in rebalancing the portfolio in favor of names we prefer post legalization while generating an impressive $161,000 in option income. We wrote covered call options out of the money at strike prices we would be happy to sell and redeploy the funds into other positions. Examples of such trades included CRON and WEED. We were able to write cash secured puts out of the money at strike prices that offered opportunities to increase our exposure, at more attractive prices, to names already in the Fund including WEED, VFF, and APH. Since inception of the option writing program in September 2018, the Fund has generated significant income from option premium of approximately $1.40 million. We will continue to look for such attractive opportunities given the above average volatility in the sector and we continue to believe that option writing can add incremental value going forward.
We continue to see unique opportunities for investment in the global cannabis sector as well as the broader alternative health care space, with the rapidly evolving global medical, health and wellness markets continuing to open new markets and new delivery methods offering compelling investment opportunities for growth oriented investors. Our actively managed approach allows the Fund to invest in a broad universe of companies that include both public companies and select private companies that are focused on go public transactions.

The Ninepoint Alternative Health Fund, launched in March of 2017 is Canada’s first actively

managed mutual fund with a focus in the cannabis sector and remains open to new investors, available for purchase on a daily basis. Utilizing our actively managed approach we are able to invest when we see new opportunities arise. Many catalysts are on the horizon and we continue to see solid returns for the alternative health space in the coming months and years.

**Charles Taerk & Douglas Waterson**
Portfolio Team
Ninepoint Alternative Health Fund

## Compounded Returns[1]

| | 1MTH | YTD | 3MTH | 6MTH | 1YR | INCEPTION |
|---|---|---|---|---|---|---|
| Fund | 0.14 | 32.01 | 10.55 | 18.98 | 61.22 | 61.88 |
| Index | 0.15 | 29.86 | 4.25 | 11.81 | 35.66 | 35.25 |

[1] All returns and fund details are a) based on Series F units; b) net of fees; c) annualized if period is greater than one year; d) as at April 30, 2019. The index is 70% Thomson Reuters Canada Health Care Total Return Index and 30% Thomson Reuters United States Healthcare Total Return Index and is computed by Ninepoint Partners LP based on publicly available index information.

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