Ninepoint Alternative Health Fund

July 2019 Commentary

Investment Team

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Overview

July witnessed negative sentiment continuing to weigh on the cannabis sector as investors were concerned with announcements that involving regulatory issues both in Canada and the United States. In Canada, investors learned in early July about significant infractions at one of Canada's larger Licensed Producers, **CannTrust** (see below). From the US perspective, the review of mergers by the Department of Justice involving various US Multi-State Operators (MSO's) have also reduced short term demand for the sector.

Gains previously made in the cannabis sector in the early part of the year have been pared and investors are questioning the long term growth in the sector. It is during these times of weakness that the value of active management in an early stage industry like cannabis can be seen. If we look at the performance of the Fund, our actively managed approach has generated a solid 1 year return to July 31, 2019 of 27.4% (Series F). Over the same period, this compares to the passive approach found in ETF's like HMMJ that delivered 6.13%, down 33% from its peak in the Spring. We believe that given the due diligence we undertake on behalf of investors, our approach to reducing risk and diversifying our portfolio are key to generating solid risk adjusted returns.

Our portfolio focusses on those Canadian LP's that that are among the most profitable in the Canadian cannabis industry. One previous top ten holding that is missing this month is **Canopy Growth (WEED)**. Although we see the long term leadership of WEED with its capital strength and strategic partnership with **Constellation Brands (STZ)** near term we see weakness as part of the transition in the CEO position. We are concerned with the potential weak quarterly results coming up mid August and so we have reduced our position. The Fund's top holding is **Green Thumb Industries (GTII)** a US MSO that continues to grow organically, opening dispensaries in high barrier medical only states while also benefitting from increased adult use legalization especially in its home state of Illinois.

Since the start of the year we have oriented our cannabis holdings to US MSO's. In fact our cannabis weighting is approx. 60% weighted to US MSO's. Although listed on the CSE in Canada, and traded in Canadian dollars, it is important to note that these positions are key to our US exposure.

We believe there is significant value for investors as many of the MSO's operate with growing revenues and positive cash flows. It appears that the MSO's have been negatively affected by regulatory delays discussed below, but we see that as only temporary as many of the M&A transactions announced earlier this year should clear reviews in the Fall, creating a catalyst for growth. We also believe that US companies have a greater opportunity to use branding to promote different products without the regulatory burden that is present in Canada, and so we see value in select brands businesses within our portfolio, such as **Stanley Brothers/Charlottes Web (CWEB)** (see note below on **Kroger (KR)** retail distribution).

The opportunity to invest is looking similar to the Q418 sell off where the marijuana index was down 40-50% from its peak. Due to the meaningful correction we are experiencing, this creates a good entry point for any clients looking to add to their current position or any new clients who want exposure to a long term growth opportunity that haven't yet invested in the sector.

Topics Covered:
Canadian & US Regulatory Updates
Company Announcements
Quarterly Financial Results
Options Strategy

Regulatory Announcements: Canada
On July 8th **CannTrust Holdings Inc. (TRST)** shares plunged after the Cdn LP disclosed that Health Canada uncovered unlicensed growing rooms had been utilized at the company's main greenhouse, subsequent to which Health Canada put a sales freeze on all TRST inventory, pending further investigation.

The non-compliance order sent by Health Canada related to TRSTs Pelham, Ont. facility, for activities between October, 2018, and March. The unlicensed rooms represented roughly 40% of the 400,000 sq ft facility. This news took roughly half the company's share value away in one day. What was also significant was that the company's 70,000 patients are no longer able to access their medication and were forced to find alternative providers. In Denmark at Stenocare, where TRST has a JV to import medical products, Stenocare has halted shipments and put inventory of TRST product in a holding area pending further investigation. As the investigation continued it was learned that this unauthorized activity was known in the executive ranks and ultimately CEO Peter Aceto was terminated for cause. In addition, Chairman of the Board Eric Paul was asked to resign. The saga is ongoing as Health Canada and more recently the Ontario Securities Commission continue to review TRST to determine ultimate penalties that can include suspension or revocation of its license.

For our Fund, the portfolio implications were minimal. We had previously sold down our position after last quarter's weakened financial results in April. We held less than a 1% weight in the Fund before the Health Canada announcement July 8th.

Regulatory Announcements: U.S.
On July 22nd The FDA sent a warning letter to **Curaleaf (CURA)** involving language and claims being made on the company's website involving its CBD products. The FDA letter stated that CURA were not in compliance with the Food, Drug, and Cosmetics Act. Although we never want infractions to follow any of our portfolio holdings, we have spoken with management and they are cooperating with The FDA to remove the claims. This is not the first time that the FDA has sent letters of non-compliance involving claims involving hemp derived CBD products. We note CWEB has also been issued similar FDA warning letters, and after dealing with regulators, continues to market its CBD products.

The US Department of Justice & The Hart-Scott-Rodino Antitrust Act Reviews of U.S. Cannabis Transactions
During the first half of this year, many US M&A transactions entered a review process within The

Hart-Scott-Rodino ("HSR")Antitrust Improvements Act of 1976. The HSR Act requires large companies to file a report before completing a merger or acquisition taking place within the United States. Enacted by President Ford as a set of amendments to existing U.S. antitrust laws, the HSR Act requires parties to notify the Federal Trade Commission and Department of Justice (DOJ) of large mergers and acquisitions so that regulators can determine if markets will be controlled unfairly by the proposed merger under review.

The process requires a "premerger notification" to be filed, then allowing the DOJ to have 30 days to require further information to clarify certain elements of the businesses involved. The DOJ can come back to the parties requesting further information. The preparation and timing of a subsequent response to the DOJ's inquiry is up to the merger participants. The issuance of second requests is a statutory tool used by the DOJ to investigate pending transactions. Once merger participants have completed the subsequent response, it is forwarded to the DOJ for review, once again allowing the DOJ 30 days to respond. No response from the DOJ during the 30 days provides a clear path for the merger to be completed. Given the time involved in the preparation of communications with the DOJ, we believe that many of the US MSO's have been under a more critical watch than normal. Investors may have interpreted this review as the DOJ blocking such transactions. We believe the first M&A transactions will be approved by late September and will be seen as a positive catalyst for investors to re-enter the US space particularly since some investors may believe that the DOJ reviews are more far-ranging than the anti-trust focus.

Company Announcements:
Curaleaf-Grassroots
Given the discussion above involving large US M&A transactions, CURA announced another strategic acquisition with an agreement to purchase GR Companies, Inc. (Grassroots), in a stock and cash deal valued at ~$875m, expected to close in early 2020. This transaction will be the second HSR reviewed transaction that CURA is involved in this year, with its deal to acquire the Select CBD brand of California back in the Spring already in process with the DOJ.
Grassroots is one of the industry's largest private MSOs, operating in 11 states with 61 dispensary licenses (20 stores open currently) and 17 production licenses. The expanded CURA will end up with a total of 131 dispensary licenses (68 open currently), 20 cultivation sites and 26 processing facilities.

The transaction adds key states to CURA's national footprint including Michigan and Illinois (states that both recently became legal for adult recreational purposes) as well as Pennsylvania, a key limited license medical only state. In addition, the transaction adds Arkansas, North Dakota, Oklahoma, and Vermont and builds on CURA's existing businesses in Connecticut, Maryland and Ohio. In addition, in Nevada, with Grassroots' existing 7 retail licenses that will enable CURA to further leverage its previously acquired Acres cultivation platform.

This transaction will also attract the attention of the Department of Justice within its HSR Antitrust legislation. Management is confident that the Grassroots transaction will close, as will its previously announced SELECT CBD transaction with no major issues. The CFO of CURA has stated that the previously announced Select acquisition, would close during Q4 2019.

Cronos- Lord Jones
On August 2nd **Cronos Group (CRON)** announced a definitive agreement to acquire four of Redwood Holding Group, LLC's operating subsidiaries (collectively, "Redwood"). Redwood manufactures, markets and distributes hemp-derived cannabidiol (CBD) infused skincare and other

consumer products online and through retail and hospitality partner channels in the United States under the brand, **Lord Jones™**. Lord Jones manufactures and distributes CBD infused products with a focus on high end clientele that is looking for a unique hand crafted products. All products are CBD infused and range from bath salts to red raspberry summer gumdrops, to body oils, tinctures and gel caps.

CWEB announced it will begin distributing products through Kroger and its affiliated locations. Ultimately, CWEB products will be sold through 1,350 Kroger locations in 22 states. While the initial agreement stipulates only CWEB's topical products will be sold, once the FDA improves clarity around regulations concerning ingestible products, we anticipate greater retailer acceptance of these products. Notably, the agreement increases CWEB's distribution footprint to 8,000 locations in the US, which firmly entrenches the company's position as the leading player within the CBD market.

Quarterly Financials:

Top Ten holding **Organigram (OGI)** announced Q3FY19 revenues of $24.8m, down 8% QoQ, below consensus of $29.7m. Selling volumes were helped by growth in Alberta and Atlantic Canada, but this was more than offset by lower re-orders in Ontario which did not match the pipeline fill in Q2 when Ontario opened its original 25 dispensaries. In addition, there was a delay in timing of shipments to Quebec with revenues occurring subsequent to quarter end.

Organigram's cash costs of cultivation came in at $0.95/g, up from $0.65/g in the prior quarter still amongst the lowest production costs of all Canadian LPs. Q3 adjusted gross margin declined to 50% from 60% in the prior quarter due to a temporary decrease in yield per plant.

Organigram reported adjusted EBITDA of $7.7m, below our expectation of $14.4m and consensus of $12.6m. The company's EBITDA margin was 31% based on net revenues. The difference vs our expectation comes from lower than expected revenue.
Current annualized capacity is approximately 61,000 kg with the Moncton NB production facility Phase 4 expansion on track for completion by the end of December. Once ramped up, that will take annualized capacity to 113,000 kg.

Management explained that there was some abnormally strong sales volume in the previous quarter with a big ramp up in Ontario as the first 25 dispensaries came online in April. OGI management is expecting another major pipeline fill in August/September as new stores get ready to open in Ontario as the government has announced its intention to allow up to 50 additional dispensaries to open in October. In ON, the purchases are centralized and the provincial buyer then rations out product to dispensaries that currently are limited to 25 kg/store/week to ensure stability of supply.

During the month Top Ten holding **Valens Gro Works (VGW)** released its Q219 financials which beat estimates on all counts including revenue and EBITDA, while processing a record amount of dried cannabis and hemp biomass. The company also executed several processing agreements. Q2FY19 revenues came in at $8.8million, up 296% QoQ and above consensus of $6.9m. The ramp up of VGW's tolling business resulted in meaningful gross margin expansion to 58%, up ~2000bps QoQ and above estimates of 56%. The sequential improvement was primarily driven by lower dried flower purchases in the quarter as tolling accounted for a large majority of the revenue. VGW reported adjusted EBITDA of $2.0m, from a loss of $2.0m in the prior quarter, above consensus of $0.9m.

GW Pharma, the company that developed Epidiolex, the only botanical cannabis based drug approved by the FDA reported results for the quarter ended June 30, 2019, with US$72.0mm in revenue compared to consensus of US$47mm. EPS for the quarter came in at US$0.21/sh, better than consensus estimate of US$0.01/sh. Epidiolex demand in the US continues to grow. Since the November 2018 launch, ~12,000 patients have received prescriptions and over 2,500 physicians have generated prescriptions for Epidiolex. GW added ~4,400 new patients during the quarter, an increase of ~58% from Q1/19.

GW has a solid drug development pipeline and is progressing through several clinical trials, that should provide the Company with strong growth opportunities over the mid to long term. To date, GW has reported positive results in the Phase 3 Tuberous Sclerosis Complex (TSC) trial and commenced the Phase 3 trial in Rett syndrome, in addition to other drug investigations.

Q4 APHA Announcement
Aphria Inc. (APHA) reported FQ419 financial results that came in ahead of consensus on virtually all metrics. The company realized ~C$129M of net revenue that is split between its domestic cannabis business and its German pharmaceutical distribution business. Excluding German distribution revenues of C$99.2M, APHA had growth in its cannabis revenues, which increased sequentially by ~85%, to C$28.6M. In addition, adjusted EBITDA in FQ4 was positive at C$0.2M, vs. consensus estimates forecasting a loss. Along with its FQ4/19 results, APHA also provided FY2020 guidance which includes net revenue of C$650M to C$700M (at a roughly 50/50 split between cannabis sales and pharma distribution) and Adj. EBITDA of C$88M to C $95M.

Option Strategy:
During July the Fund continued using its option strategy to enhance risk adjusted returns. With the above average 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 also write 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. Since inception of the option writing program in September 2018, the Fund has generated significant income from option premium of approximately $1.87 million. We will continue to utilize our option program to look for attractive opportunities given the above average volatility in the sector as we strongly believe that option writing can continue to add incremental value going forward.

During the month we used our option strategy to assist in rebalancing the portfolio in favor of names we prefer while generating an impressive $184,000 in option income. We continue to write covered calls and strangles on names we feel are range bound near term and from which we could receive above average premiums. Examples of such trades include **Planet Fitness (PLNT).** During the month, 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 **GW Pharma (GWPH)**, **Jamieson Wellness (JWEL)**, and **Village Farms (VFF)** with cash secured puts on VFF having been especially rewarding. We have been able to take advantage of both the recent price correction and elevated volatility to write cash secured puts on our Village Farms positive outlook. Explained below is the summary of our trades on Village Farms for the month of July.

VFF is a top ten holding and we continue to be positive on VFF. We use both outright buys and options to add to our holdings. On July 16th VFF was trading at USD $9.32 and we wrote a 31 day cash covered put by selling an August 16th expiry at the volatility level of 86% with strike price USD$9.00 and earning USD$0.80. That equates to a strike yield of 8.90% for 31 days outstanding or the equivalent of 100% for a year. The breakeven for being assigned would be USD$8.20 or 12% lower than the reference point when the trade was placed.

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 generate industry leading risk adjusted returns.

Charles Taerk & Douglas Waterson
Portfolio Team
Ninepoint Alternative Health Fund

Compounded Returns[1]

	1MTH	YTD	3MTH	6MTH	IYR	INCEPTION
Fund	-4.2	12.7	-14.6	-5.6	27.4	97.1
Index	-8.44	10.81	-14.67	-11.04	5.09	43.77

Statistical Analysis[1]

	FUND	INDEX
Cumulative Return (Since Inception)	40.6%	20.13%
Standard Deviation	12.65%	17.21%
Sharpe Ratio	1.25	0.56

[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 July 31, 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.

The Fund is generally exposed to the following risks. See the prospectus of the Fund for a description of these

risks: Cannabis sector risk • Currency risk • Cybersecurity risk • Derivatives risk • Exchange traded fund risk • Foreign investment risk • Inflation risk • Market risk • Regulatory risk • Securities lending, repurchase and reverse repurchase transactions risk • Series risk • Specific issuer risk • Sub-adviser risk • Tax risk

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