Ninepoint-UIT Alternative Health Fund

June 2018 Commentary

On June 7th, Canada's Senate approved Bill C-45, (The Cannabis Act) with amendments, sending it back to the House of Commons with suggested edits. There was some discussion and negotiation between houses of government, but by June 18th both levels of government had signed the Bill into law. On that historic day, Canada becamef the first G-7 country to legalize cannabis for recreational adult usage. Subsequent to the passing of the Bill into law, the Prime Minister announced that October 17th 2018 would be the date when government approved retail locations across Canada will be open for sale.

Investment Team

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Capital markets welcomed several significant offerings during the month. Canopy Growth Corporation (TSX: WEED) announced a $400 million convertible debenture offering that was upsized and closed for C$500 million of 4.25% convertible senior notes due 2023. Aphria Inc. (TSX:APH) announced a bought deal for gross proceeds close to C$260 million. Also noteworthy was the filing from Tilray Inc., a Canadian licensed producer, that announced the filing of a registration statement with the U.S. Securities and Exchange Commission for an initial public offering (IPO) of shares in the United States. Tilray intends to list on the Nasdaq but does not intend to list on any stock exchange in Canada. Tilray's filing is notable as it will be the first Cannabis company to complete an IPO on a U.S. exchange.

On June 25th, news from the U.S. Food & Drug Administration (FDA) was significant for the global cannabis sector as G.W. Pharma, a UK based biopharmaceutical company received the first "DIN" (Drug Identification Number) for a botanical cannabis based drug, Epidiolex, a drug to help control seizures in specific types of epilepsy. This is significant for many reasons. First, GW Pharma has been able to attain a DIN which opens the drug to group benefits and health insurance plans, at no additional cost relative to other medicines. In addition, with a DIN, doctors can rely on the drug's efficacy and will reduce concerns about prescribing medical cannabis. In addition and perhaps most impactful for the sector, with Epidiolex receiving a DIN, the U.S. Drug Enforcement Agency (DEA) could de-schedule marijuana from a Schedule 1 Controlled Narcotic, allowing more research, clinical trials and medical applications to continue.

With respect to our portfolio, and in speaking with investors recently, a common discussion point revolves around valuations in the sector. More specifically, some investors are concerned and questioning how these companies are valued and why they are valued at such rich multiples. There is no question, parts of the sector are fully valued given what information is known to date. But not all companies are being given the premium valuation that some of the market leaders are attracting. That is, in our opinion, an opportunity for active management to add value. With financial analysis and due diligence, we have constructed a portfolio that offers opportunity for growth in the sector, while also managing volatility and reducing risk for investors.

One of the financial metrics we use, in our analysis of Licensed Producers (LP's) is a multiple of EV/EBITDA, enterprise value to earnings before interest, taxes and depreciation. With high earnings growth rates anticipated in the sector, part of our analysis involves looking forward and valuing the company on future earnings, that is once the market is more mature and the rapid build out of capacity produces revenues and earnings. The EV/EBITDA ratio compares a company's value, including debt and liabilities, to its earnings that have been adjusted for a number of items including interest and depreciation in order to get a better picture of the companies true earnings generation potential. We believe that a multiple of EV/EBITDA is a good tool to use to analyse the effectiveness of a management team's focus.

While investors focus in the sector is clearly on future earnings, it is important to note that there are some companies in the sector that currently have positive earnings. We believe there is value in owning those companies that are building out future production in a profitable and efficient manner. They are efficient in deploying capital, building out capacity while generating revenue and watching bottom line results. Conversely, there are some companies focussing on "planned capacity", yet very little in the way of current production. That is where active management can provide value, selecting those companies which may fall below the radar yet are operating profitably.

Inherent in analyzing companies operating in high growth sectors is determining whether the money being spent on the build out is being deployed efficiently such that it will generate a solid return. For example, is the company more like an "Amazon", that had a long and costly build-out with low margins but over time created a virtually unassailable market position. Conversely is it a company that has a long and costly build out more like a "Barrick", one that strove to be the biggest gold mining company in the world, with less focus on efficiency and/or profitability.

We believe there are some inconsistencies with respect to the valuation metrics in the market and that is where we can build a portfolio positioned to outperform on a risk adjusted basis. The largest companies in the sector as measured by market cap are trading at significantly higher multiples of forecasted 2020 EV/EBITDA, with Aurora Cannabis (TSX: ACB) trading at ~22x, Canopy Growth (TSX:WEED) at 20x and Cronos Group (CRON) at 19x. But those higher metrics are not flowing through to all names in the sector.

CannTrust (TSX:TRST), a company with one of the highest patient growth rates and the highest percentage of oils/extracts to overall sales in the sector has been trading at a multiple of 8x, while Aphria (TSX:APH) a company with a record of ten consecutive quarters of profitability is trading at ~13x. At the same time, Organigram (TSX:OGI) which is a low cost indoor producer and in the top five of all LP's in terms of current annual capacity is at 11x. That illustrates a variance in market perception, and allows us to do further work to decide which companies we believe can deliver value to investors and which ones we have reservations about. Our reservations about a company can result from a market risk, execution risk or simply a lack of current profitability.

New names within our portfolio include Green Thumb Industries (CSE:GTII), and CannaRoyalty (CNSX: CRZ). Cannaroyalty is a manufacturer, distributor, and provider of capital to cannabis companies in both Canada and the US, with the majority of its operations in California, focusing on downstream consumer products markets. In addition to a number of wholly owned brands, CRZ holds equity interests or royalty streams in a total of 19 different businesses.

GTII is an Illinois based company that manufactures and sells branded cannabis products including flower, concentrates, edibles, and topicals. The company also owns and operates a multi-state chain of dispensaries operating under the RISE™ banner. Headquartered in Chicago, GTII has seven manufacturing facilities and licenses for 50 retail locations across seven highly regulated U.S. markets including Illinois, Maryland, Pennsylvania, Massachusetts, Nevada, Florida, in addition to recently securing five dispensary licenses in the State of Ohio.

The sector is evolving with new entrants in both the domestic and international markets. Utilizing our actively managed approach we are able to invest when we see new opportunities arise. We are pleased to announce our Fund has delivered a return of 9.37% for the first six months of 2018 while our one year return is 65.52% and 40.86% annualized since inception in March of 2017. The Ninepoint-UIT Alternative Health Fund is Canada’s first actively managed mutual fund with a focus in the cannabis sector and remains open to new investors and is available for purchase on a daily basis.

Until next month,

The Alternative Health Fund Team

Compounded Returns[1]

	1MTH	YTD	3MTH	6MTH	1YR	INCEPTION
FUND	4.3	9.4	13.9	9.4	65.5	40.9
INDEX	4.4	7.5	13.5	7.5	35.5	36.7

[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 June 29, 2018. 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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