Alternative Health Fund Commentary

June 2019 commentary

The second quarter of 2019 was a challenging quarter for the cannabis sector as investors were generally disappointed with earnings releases of the large well-known names, sending many investors to the sidelines. During Q2, we witnessed decreases in the share prices of **Aphria (APHA)** -26.08% **Canopy Growth (CGC,WEED)** -8.56%, **Aurora Cannabis (ACB)** -15.13% , and **Tilray (TLRY)** -28.94%, predominantly based on lack of top line growth an absence of positive cash flow.

Investment Team

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Our portfolio tends to focus on Canadian names that may not be the largest, but many are among the most profitable in the Canadian cannabis industry. The Fund's top holding continue to be **Organigram (OGI)** that was -6.33% in the quarter yet is Canada's most profitable cannabis company, and has been generating positive cash flow for the last four quarters. Also among our top holdings is **Village Farms (VFF)** -19.95% in the quarter yet based on the efficiencies at its Delta BC greenhouse generates positive cash flow within its Pure Sun Farms JV and has already established itself in the US hemp cultivation business. Another area of the cannabis industry that has been an interesting area for the Fund has been the oil extractors, with the Fund holding both **Valens Grow Works (VGW)** +44.10% and **Medipharm (LABS)** +55.09%, both generating strong positive performance in the quarter.

Since the start of the year we have oriented our cannabis holdings to US names. Despite stronger financial results than Canadian LPs, the US names were also weak during Q2.. We believe investors are not valuing some of the US multi-state operators (MSO's) properly, with valuations perhaps being impacted by a combination of spill-over selling from weak Canadian LP financial metrics and shares being sold from some early investors. With the US MSO's posting strong revenue growth and trading at a discount to the large Canadian LP's, we see great opportunities south of the border. 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.

The pause in the market offers a great time to invest in the right names. We believe this is a good time to be invested. The Fund is up 17% YTD, with key names in the sector down substantially, offering great entry points for our team. Its important to note that investors remain interested in the significant growth and shareholder returns that are ahead, but with that opportunity comes risk and volatility. Our Fund offers significant upside while reducing the volatility of an investment in the cannabis sector.

It is worth noting the benefits of our actively managed strategy and some of the tools we use as we invested in the cannabis sector. Given the early stage nature of the industry and the equity growth that has been generated, it is often challenging to make these decisions but in order to preserve

gains, we often *take profits*, reducing the positions we have in some great companies. Taking profit sounds like a simple strategy but is often difficult to execute when the prospects for higher returns are present. Taking profit doesn't mean that we don't re-buy, but we will wait for a new entry point once some weakness has crept into the market and buy back. We are also patient with re-investing, often holding double digit cash positions, waiting for an appropriate entry point for a new name. Our option strategy also helps us gain advantageous entry points with our put writing. It can also add value during those periods when some stocks are not trending in a particular direction due to a lack of near term catalysts. Finally, a key differentiator of our Fund is that we take select positions in private companies that offer compelling valuations before they go public, offering significant longer term returns for the Fund. As a result, we believe our outperformance since inception in March 2017 is based on an investment strategy that offers more than merely investing in the largest well known names.

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

Regulatory Updates:
Canada

Slow Down on Edibles Roll-out
On June 14th, Health Canada announced guidelines for cannabis edibles, moving the October 17th start date to mid-December before products from the rollout of Cannabis 2.0 can be sold. There is a 3 step process for Licensed Producers (LP's) before the first sales can occur:

1. LPs must amend their existing sales license to be able to sell Cannabis 2.0 products; the application period opening on July 15th, 2019. This does not prevent producers from manufacturing and building up inventory of these products currently.

2. On Oct. 17, 2019, the regulations surrounding Cannabis 2.0 products come into effect. As of this date, Health Canada will accept notice applications from LPs detailing the Cannabis 2.0 products those LPs intend to sell.

3. There is a a 60-day period from the date which an LP sends a notice application to Health Canada (October 17, 2019), to when that LPs may begin selling their Cannabis 2.0 products (assuming there was no objection from Health Canada.) This means that first days for product sales can be no earlier than December 17th, 2019.

Another regulatory hurdle that has been established for edibles is a dosage limit of 10mg per package. This is very different from US edible products as many states have a 100mg limit with products sub-divided into 5mg or 10mg pieces within an individual package. (see below). In Canada legal packages will essentially be 1 square of a US cannabis chocolate bar, or two chocolate covered mints within a can. Aside from limiting how much individuals can purchase at any one time, it will result in increased expenses related to packaging that will likely be borne by consumers. We anticipate a slower ramp up in sales for Cdn LPs as well as reduced margin expectations as value added products will be delayed getting to market.

Regulatory Updates: US

Texas Legalization: Hemp

On June 10, Texas House Bill 1325 was signed into law by Governor Greg Abbott. The law goes into effect September 1, 2019 and legalizes hemp and hemp-derived extracts like CBD oil as long as they contain no more than 0.3% THC. This is a major change for a large populated state. It is also meaningful for one of the Fund's top holdings, Village Farms, that has 5 million sq ft of vegetable greenhouses that are poised to be converted to hemp cultivation this year.

Texas Legalization: Cannabis

On June 14, Texas Governor Greg Abbbot signed Bill 3703, expanding access to medical cannabis from one to eight conditions. This announcement significantly increases the addressable medical patient market while significantly easing access, removing the burden of requiring two separate doctor approvals. Under the previous Texas rules, the addressable market was ~**35,000** patients. Under the newly approved Medical Cannabis Program, the addressable market could increase to ~**1,300,000** patients. The new law, which is now effective, contains the following three key provisions that, together, are expected to increase legal access to low-level THC medical cannabis products:

1. Expands the range of medical conditions that physicians may recommend low-level THC cannabis products (containing up to 0.5 percent THC). In addition to intractable epilepsy, the following additional chronic conditions now qualify for cannabis recommendation:

- **All forms of epilepsy**
- **Terminal Cancer**
- **Amyotrophic Lateral Sclerosis (ALS)**
- **Incurable neurological disease**
- **Parkinson's Disease**
- **Multiple Sclerosis**
- **Autism**
- **Seizure disorders**

2. Enables a patient to gain access to medical cannabis products based on the recommendation of a single licensed specialty physician.

3. Authorizes the Texas Department of Public Safety to oversee approval, regulation and administration of cannabis dispensaries.

Company Announcements

Changing of the Guard

On July 3, a major change in the leadership of the largest and most well-known Canadian cannabis producer, **Canopy Growth (WEED, CGC)**, announced the departure of its founder and CEO Bruce Linton. To our management team, Bruce's exit is symbolic of a transition for the industry, from its entrepreneurial beginnings to its current opportunity to become a significant consumer goods products (CPG) based industry. Our view is that Bruce is a pioneer, a visionary and Canopy under his leadership is credited with many firsts in the industry including; the first major strategic investor into the industry in **Constellation Brands (STX)**, and the first Cdn mover into the US cannabis sector with its recent deal with **Acreage Holdings (ACRG)**.

Despite is strategic and marketing leadership, WEED has had its challenges which we discuss below with its Q419 financial results. The financial performance of WEED has been its weakness for many quarters, with challenges in cultivation costs, having amongst the highest cost per gram in the industry; low capacity utilization in it various cultivation facilities as well as G&A expenses which have escalated. However as the industry leader, investors have generally given it a free pass looking more towards anticipated long term expansion. We see the transition as potentially positive as it represents a new opportunity for WEED, bringing in leadership that will be more focussed on profitability and the roll out of its various consumer products with the assistance and capital backing of STZ.

Valens Grow Works (VGW) is a new top ten holding in the Fund, providing extraction services and product development to Canadian marijuana licensed producers. VGW operates out of its 25,000 sq. ft. facility in Kelowna, that has annual extraction capacity of 240,000 kgs of production from dried cannabis and hemp material. It is our opinion that value-added products derived from cannabis extracts could represent 50% or more of cannabis industry sales in Canada. Currently, extraction is a bottle neck for many LP's and the opportunity for VGW and other extractors is to provide outsourced value added extraction and white label services that offer higher margin opportunities. We are excited by the prospects for extractors, and particularly VGW as it continues to add contracted volumes at good margins with new and existing customers.

During the month, VGW announced that it expanded an additional option to a previous contract for manufacturing services to the binding multi-year agreement previously announced February 26, 2019 with Tilray Inc. (TLRY). Under the initial two-year term of the expanded Agreement, VGW will extract on a fee for service basis a minimum annual quantity of 60,000kg of dried cannabis and hemp biomass, up 300% from the 15,000kg annual commitment outlined in the original agreement. In addition, the Company may provide contract manufacturing services for tincture bottles and gel caps, with the option to offer contract manufacturing services for other product formats such as vaporizer cartridges and topicals as Health Canada regulations allow.

Later in the month, the company announced a major increase to its extraction capacity, adding 185,000kgs to its capacity as it ramped up its hydrocarbon extraction lines, competitive in our view as vape pen cartridges are made using this extraction method and are estimated to be a significant portion of the market. Its important to note that VGW is the only extractor in Canada with hydrocarbon extraction capacity. Another portion of the added capacity is ethanol which is ideal for hemp extraction, an area of increased focus in the Canadian industry as a potential low-cost source of CBD.

PAX Labs, a leading consumer technology brand in cannabis, announced that is partnering with four Canadian cannabis producers to supply the Canadian market with PAX designed vaporizers. The four LP's are **APH**, **ACB**, **OGI** and **FIRE**. Using cannabis oils through a vaporizer is widely expected to emerge as one of the most popular formats in the legal Canadian marijuana market given its popularity in American states.

Subsequent to its PAX Labs agreement, top Fund holding **Organigram (OGI)** signed an exclusive agreement with Feather Company Ltd., a manufacturer of disposable vaporizer pens and accessories, to license technology for adult-use customers. OGI has an exclusive license to Feather's proprietary vaporizer pen technology and form factor. The relationship will also allow OGI to represent Feather across Canada. These agreements continue to build what we believe is OGI's leadership in the Canadian market, offering a wide variety of formats and dosage delivery systems to meet the needs of medical patients and recreational adult users, one of only a select number of LPs that has agreements to sell in all ten provinces.

Grocery Chain Kroger Adds CBD Topicals in Stores Across 17 States

The Kroger Co. (KR) one of the latest retailers in the US and the largest supermarket chain by revenue, announced that it will introduce CBD in its stores. The Cincinnati-based grocery store chain with over 2,700 stores said that, effective immediately, it will begin carrying topical products containing cannabidiol (CBD) in its stores in 17 states. The products Kroger will carry contain no THC.

Green Growth Brands continues to accelerate its branded CBD products strategy, this morning announcing an arrangement with Brookfield Properties Shopping Centers for 70 "prime shop locations" to place its CBD kiosks. These 70 locations are part of GGB's target of 280 locations open by the end of 2019. To date, GGB has open 40+ "Seventh Sense" CBD kiosks, with 280 kiosks expected open by year-end from roughly 44 today.

<u>Quarterly Financial Results:</u>

Canopy Growth Q419 & Fiscal 2019 Results:

As a result of limited product availability during the quarter caused by expansion work at several of the company's greenhouse facilities, Q4FY19 cannabis revenue was extremely disappointing for Canada's largest LP. Q4FY19 net cannabis revenue was $70m, down from $76m in the prior quarter and below our estimate of $90 million. The company continued to experience depressed gross margins of a mere 16% while some of its competitors experience gross margins in the mid 50% range. With WEED continuing to have build-out issues, financials were weighed down by under-utilized facilities and non-cultivation facilities. The biggest concern is the path to profitability which remains uncertain. The company's SG&A was up 31% QoQ to $126m, higher than quarterly revenue. Bottom line was a $100 million EBITDA loss in the quarter where consensus was at -$75 million underscoring continued ramp and distribution difficulties for the WEED across the industry.

HEXO Inc (HEXO) also reported Q3/FY19 results that were below expectations. Net revenue of $13.0m, roughly stable QoQ, was below consensus of $14.7m. EBITDA came in at a loss of –$9.2 million, widening from –$6.1 million in Q2/FY19, and lower than consensus of –$7.5million, primarily driven by higher than expected SG&A. With Health Canada's delay of edibles, we would also note that the company's previous guidance on revenues of $400 million would be in doubt for the current fiscal year given ~25% of FY20 sales are expected to stem from these product forms.

Synopsis on Canadian LP Results:
It is instructive to review the most recent quarters for the larger LPs, in terms gross margins and EBITDA. The following table highlights such statistics. Important consideration needs to be given to those LP's that have large EBITDA losses, as it may take longer to reach profitability.

	March Quarter KGs Sold	Gross Margin	EBITDA
WEED	9,326	16%	($111.2M)
ACB	9,160	55%	($34.4M)
OGI	**5,000**	**60.70%**	**$13.3M**
PSF (VFF)	**4,000**	**69%**	**$8.6M**
TRST	3,014	45.70%	($4.5M)
TLRY	3,012	23.40%	($16.2M)
APHA	2,637	43%	($16.0M)
FIRE	2,000	42.80%	($7.3M)
CRON	1,111	53.80%	($92M)

Option Strategy:
During June 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 $1.69 million.

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 $100,000 in option income. 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)** and VFF. We continue to write covered strangles on names we feel are range bound near term and from which we could receive above average premiums. Examples of such trades included WEED and **Planet Fitness (PLNT)**. 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.

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.

Compounded Returns[1]

	1MTH	YTD	3MTH	6MTH	1YR	INCEPTION
FUND	-4.42	17.57	-10.82	17.57	26.21	46.18
INDEX	3.05	21.02	-6.67	21.02	9.66	26.89

Statistical Analysis

	FUND	INDEX
Cumulative Returns	105.62	57.02
Standard Deviation	31.72	33.78
Sharpe Ratio	1.42	0.77

[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 28, 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; Concentration 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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