Ninepoint Alternative Health Fund

November 2018 Commentary

Markets during the Month:

The month of November saw continued market weakness in the cannabis sector. Many large cap names were under pressure based on valuation and other concerns. Investors are re-examining the multiples upon which many companies are trading given the opening of the recreational market in Canada and a supply shortage that was not anticipated. It is becoming apparent that some companies are not able to meet provincial supply agreements leaving opportunities for other entrants to gain market share.

Investment Team

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Further strain on the market is seen in the significant difference between the earnings multiples that the larger >$1 billion market cap names trade at relative to those Cdn listed LP's that have a market cap of <$1 billion. The larger LPs trade at an average of 60 times 2020 EBITDA while Cdn sub $1 billion market cap LPs trade at an average of 6.9 times. In addition, there are US operations, many multi-state operators with market caps >$1 billion USD yet they trade on average at 9.5X 2020 EBITDA. We believe that increasingly earnings will matter and investors are no longer looking at the sector in a uniform manner.

The Ninepoint Alternative Health Fund is Canada's first actively managed mutual fund that focusses in the cannabis sector. Although the markets have been volatile of late, we are proud that as of month end November 30th, the Fund was up 28% YTD vs the marijuana index which is -6.03% YTD. We believe that our actively managed approach, coupled with our wider portfolio allocation involving select US healthcare providers and large cap pharma adds growth while lowering volatility to the Funds' returns.

Subsequent to month end, a short seller report on Aphria Inc. (APHA:TSX,NYSE) from Quintessential Capital Management provided evidence detailing concerns it had with the company's LATAM acquisition that took place earlier this year. As a result of the negative report, APHA stock traded down approximately 30% the day the short report was released, Monday December 3rd.

The concerns surround the value of the assets acquired, who APHA acquired the assets from and whether the companies were in fact operating as they had represented to investors. In addition, although disclosed at the time of the acquisition, a group of APHA directors and senior management had a combined 2% interest in Scythian Biosciences (SCYB), the entity selling the assets to APHA. There was also heightened investor concern surrounding APHA's international acquisitions due to the company's previous purchase of Nuuvera, early in 2018. However, since that time, APHA announced several steps that it took to both disclose related party interests as well as avoid conflicts.

The Board of Directors of APHA received a fairness opinion from Cormark Securities that, as of July

16, 2018, and subject to the assumptions, limitations and qualifications on which such opinions are based, the consideration to be offered by APHA in respect of the Transaction was fair from a financial point of view.

A response from APHA early Tuesday December 4th reiterated management's support for the due diligence undertaken, however it fell short of what market participants needed which was a detailed response challenging all of the short report allegations. At that point we decided to step back from the company as there was too much uncertainty with its global operations. While we reiterate our view that APHA's Canadian operations are quality assets (and represent the vast majority of the company's value), with low cost and high volume cultivation capacity, we are concerned that the company will be unable to gain traction at this point given the cloud of controversy involving the noted international expansion.

Risk management is an important part of our portfolio process. One aspect of risk management is managing individual position size. It is important to note that our APHA position was less than 4% of the Fund relative to the passive ETF, HMMJ which maintained a 7.32% weight (as of December 4th). This is not the only cannabis company to have been the focus of an unwanted short report. Several companies have had short reports released on them including Tilray (TLRY), Cronos Group (CRON) and Aurora Cannabis (ACB). The sector is vulnerable to these reports because of its early stage, and that so much of the value in the market cap of these companies is based on future growth rather than current earnings.

MJBiz

Turning to other events during the month, the annual MJBiz conference took place at the Las Vegas Convention Center. As we have been adding US exposure to the Fund over the past several months, we were very interested to note that attendance records were set this year amid strong ongoing growth in the global cannabis industry. More than 27,000 people attended the conference, a 52% increase from 2017. More than 1,000 companies exhibited at the event. Putting that in perspective, almost as many businesses were added to the 2018 show (at 315 new exhibits), than the total number of companies at the MG biz in 2016 (321 exhibits).

Also interesting was the number of exhibits spanning all sub categories within the industry including legal, technology, marketing, extraction machinery, manufacturers, and cultivation equipment providers. Roughly 13% of conference attendees were from outside United States with 70% of the non-US audience emanating from Canada. In total 70 countries were represented at MJ biz.

Our team attended the conference and also visited several operations and dispensaries around Las Vegas. This was important to view as some of our portfolio holdings have dispensaries in LV. In addition, the visit gave us an opportunity to analyze dispensaries as Canada is at the beginning of its recreational rollout with few dispensaries. It was educational to understand the different strategies to address the growing recreational market. We continue to believe that a number of US based cannabis names are underappreciated by investors given the size of the US market, and that these investments represent a significant opportunity for the Fund.

What was interesting to observe was the number of dispensaries that catered to very different sub-markets within the city and how each storefront offered a different value proposition, with different product offerings. There are stores that cater to those more knowledgeable purchasers enabling customers to go into a store, get in line and purchase what they want. We visited one of three Essence dispensaries. Recently, Green Thumb Industries (GTII:CSE) purchased 100% of Integral

Associates which owns the Essence branded stores in a cash and stock transaction valued at $290m. The state of Nevada is legal for recreational as well as medical cannabis use, with annual combined revenue estimates of $575 million throughout Nevada. Essence is a vertically-integrated operator of three dispensaries in Las Vegas, plus 95,000 sq.ft. of production across two facilities. Its brands are estimated to have distribution in 70% of Nevada retail stores, while the dispensaries build GTI's NV store count to five, and provides exposure to the high-volume Las Vegas area. The location at the end of the LV strip has a non-descript store front, an approx. 1,200 sq ft floor plate, yet has a very steady and knowledgeable clientele. People visiting the location come in and immediately know the strain, dosage and amount they wish to purchase. With Nevada being legal for both recreational and medical, it's also important to note that each dispensary has a separate area that caters to medical patients relative to the line for recreational customers.

We also visited dispensaries that offered more of an educational opportunity, catering to those customers who were less knowledgeable and needed to understand the different products, the different active ingredients of each product. The Source, owned by Green Growth Brands (GGB:CSE) stood out as a chain of dispensaries that offers a welcoming location with a well displayed array of products and a very knowledgeable staff to help consumers understand the different health benefits or the different effects of each product. GGB acquired the NV based dispensary chain and will use it as a prototype of further acquisitions in the south west. We believe that GGB has a leadership team with a wealth of retail experience that will lead the US market.

A final store visit included those stores that focus almost exclusively on the tourist market. Planet 13 (PLTH:CSE) is approximately 1000 steps from the front door of the Wynn Hotel, making it the closest dispensary to the strip and the high-end casinos. The company opened Phase 1 of its 40,000 sq ft Superstore on November 1st, and is already servicing an average of 1,300 customers/day, meeting management run-rate estimates.

The company has also developed its location to be the most spectacular dispensary to cater to the Las Vegas strip and the 45-55 million tourists that visit sin-city each year. PLTH is a high-end, high touch dispensary, with knowledgeable staff able to assist in selecting the right edible, drink, or topical cream. In addition to the 12,000 sq ft store that opened November 1, further expansion includes a consumption lounge that is planned to open once Clark County laws are passed enabling public consumption. PLTH is unique in that it has enough space to house not only the 15,000 $ft.^2$ retail space, but also includes the 20,000 $ft.^2$ lounge and 5,000 $ft.^2$ outdoor patio, available for consumption. As a result of the unique construction and infrastructure in place, we believe that PLTH is well ahead of any competition that intends to cater to the high-end tourist visiting Las Vegas.

The Farm Bill

As the month ended news from the US Congress was encouraging with reports that Republicans and Democrats had reached a tentative agreement with respect to the Farm Bill. The 2018 legislation was held up due to mid-term elections, however now that Congress is back in session, there is support to finalize the Bill. Amongst other areas, the Farm Bill will legalize farming of hemp plants as well as extraction of hemp oil in addition to its sale at the federal level. As our readers are aware from previous discussions with our team, hemp is a source of CBD, the non-psychoactive chemical compound that is also found in cannabis plants. Legalizing hemp is a progressive necessary next step in federal legalization of cannabis in the US as the Controlled Substances Act states that given similar genetics hemp and cannabis are both Schedule I controlled narcotics (despite the fact that hemp has only trace amounts of THC and cannot produce a psychoactive effect). This should be taken as a positive for the industry with specific Canadian implications. Legalization of hemp could mean that under the right circumstances, Canadian companies can cultivate in the US. Already, Canopy has made a strategic investment in ebbu, a Colorado hemp cultivation and research based business. In addition, Village Farms (VFF), a 30 year old public company focused in vegetable farming has over 5 million sq ft of greenhouses in Texas that could convert a portion of that facility to hemp cultivation in a relatively short period of time. VFF is part of the Pure Sun Farms JV with Emerald Health Therapeutics in Canada, and has already converted 1 million sq ft of its Delta BC farm to cannabis cultivation. The Texas opportunity would be to the benefit of VFF and could be operational within twelve months of a legalization announcement. Further supporting our view on VFF is the announcement in October that VFF became the first large greenhouse grower to be accepted as a member of the board of the U.S. Hemp Roundtable, a coalition of dozens of companies and major national grassroots organizations advocating for the full and permanent legalization of hemp in the United States.

As mentioned at the beginning of our commentary, we continued to see weaker equity prices throughout most of the month. Yes, this was part of a more volatile North American equity sell off however there was significant downside in the cannabis sector as many licensed producers announced weaker than anticipated quarterly results.

Select Quarterly Financial Reports

In our opinion, this was the first set of quarterly results where market participants punished financial underperformance. In previous quarters, there were instances where some of the largest well followed companies generated lackluster revenues or significant cost increases that investors had not anticipated. Yet in the past, there was mild negative reaction. This month when some of the leading companies announced significantly higher losses than anticipated, there was significant selling pressure. We believe going forward that investors will increasingly focus their attention on individual results rather than taking a sector approach. The cannabis sector is no different than any other sector, all companies are not the same and all stocks are not created equally. We have stated before that this is not a homogenous group of companies, there are unique opportunities and unique efficiencies that certain companies offer investors. Our job as portfolio managers is to find those unique opportunities and provide differentiated performance.

A stand out performer in Canada during the quarter ended September 30 was CannTrust Holdings, (TRST). Revenues came in at $12.6m, up 39% QoQ, ahead of consensus estimates of $11m. TRST reported Q3/18 adjusted EBITDA of $0.6m better than consensus of negative -$1.9m. with medical patient counts expanding to 53,000, from ~45,000 in Q2/18. TRST is the only Canadian LP to report positive EBITDA for the September quarter and the only one to report a QoQ increase in EBITDA for the period, as other LPs generally spent heavily leading up to the recreational market. The solid results were driven by prudent SG&A expense allocation as revenue growth outpaced SG&A growth in a quarter when the company launched marketing campaigns to support its four new recreational brands. The company has also just begun the formal process for obtaining a NYSE listing, which should significantly broaden the investor audience, and warrant a meaningful multiple lift given where US-listed issuers trade. We continue to believe that TRST has further short term growth prospects. We continue to view TRST as one of a handful of companies with the right combination of low cost, large scale production capacity matched with demonstrated strength in developing and commercializing higher value pharma focused products. Potential catalysts include the NYSE listing, as well as strategic partnerships with major players from the food and cosmetic industries.

GTII reported mixed Q3 results with revenues coming in at $17m, in line with our $17m forecast, and up 26% QoQ driven by good growth in retail sales (SSS up 50%+ YoY) and wholesale shipments (up 20% QoQ). We estimate adj. EBITDA came in at a loss of –$1m slightly below our $0.6m forecast, due to higher than expected SG&A as GTII ramped up in new states. The company is making progress in its new markets (OH, NY, FL). All five dispensary locations in OH have been selected and the first store opening is targeted for Jan. 2019. Leases in NY have been executed and the first store in FLA is scheduled to open in late Jan 2019. GTII has already signed leases for nine FLA stores. In Nevada, the company's acquisition of Integral Associates (mentioned above) was valued at 11x current EBITDA while the peer group trades at 28x next year's EBITDA which we see as an accretive purchase. GTII still has cash of $173M on the balance sheet with minimal debt levels(<$8M) making the company well positioned to support additional acquisitions and organic growth.

As mentioned earlier, there was significant selling pressure in the cannabis sector as many licensed producers announced weaker than anticipated quarterly results. Canopy Growth (WEED:TSX) (CGC:NYSE) announced Q2FY19 revenues of $23.3m for the quarter, down 10% QoQ and below consensus estimates of $53m. Sales volumes, predominantly medical market focussed, were down 18% QoQ, the first time in 2 years that the company experienced negative QoQ sequential reductions. During the quarter, Canopy produced at an annual run-rate of ~60,000 kg/year and had ~50,000 kg in inventory. We would expect that this inventory has been supplying the company's adult-use shipments beginning October. The company indicated that its products represented ~30% of supplied provinces' SKU listings and that will be verified in the next quarterly release. To that end, management noted that shipments during Nov. 1-12 were double the volumes shipped during Oct. 17-31.

Adjusted gross margin was reported at 28%, down significantly QoQ. Adjusted EBITDA came in at ($67m), lower than consensus of ($31m). The company's SG&A was up over 100% QoQ to $78m, higher than forecasted of $49m. This was a disappointing quarter with metrics coming below expectations on several fronts including a decline in sales volumes which was unusual given the launch of recreational market at the same time its peers group continued to grow their top line. Another concern is the low gross margin recorded, which is the lowest in the last two years. On a positive note, we are encouraged by the news that WEED/CGC doubled its daily shipping volumes in the beginning of November compared to the second half of October.

Aurora Cannabis (ACB:NYSE and TSX) reported Q1/FY19 results ended September 30, again a quarter that largely reflected the medical market. For the quarter, the company had revenues of $29.7M up 50% QoQ. Despite strong revenue growth, the company reported significantly higher G&A and sales & marketing expenses during the quarter, totaling C$65.3M. SGA expenses were up 75.1% from the previous quarter. Aurora reported an Adj. EBITDA loss of ($48.6M) compared to consensus estimate of ($26.8M). We still have concerns with several acquisitions announced this past year (including MedReleaf, Anandia Labs, ICC Labs, Agropro and HotHouse). Aurora is currently in the process of integrating a variety of new platforms into its business and we believe investors should focus on the company's efforts to integrate these assets.

For both Canopy and Aurora, both companies incurred significantly elevated costs associated with their recreational market launches with no revenue contribution in their respective quarters. We would expect to see the noted cash losses to be significantly mitigated in subsequent quarters, as the full recreational market contribution grows over the next 6-9 months.

Options Strategy:

During November, 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. We are writing cash secured puts on specific names we would like to own to increase our exposure to such names in the Fund, while writing covered calls on names we feel have stretched 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 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 all the while generating approximately $200,000 in option income. As a result of the elevated volatility and anxious market sentiment since October 17th we were able to write covered call options out of the money at strike prices that we believe are closer to values that better represent our belief in the companies while still maintaining a cautious but bullish market sentiment. We continue to write puts on core holdings we wanted to further add to, such as TRST, HEXO Corp, (HEXO:TSX), and covered strangles on names such as WEED, CGC and GW Pharma (GWPH) and HEXO we felt would trade range bound and from which we could receive above average premiums.

Although financial results and irregularities have been confined to a few select names in the sector, the entire cannabis sector including Canadian and US focused companies have sold off indiscriminately. We continue to see solid opportunities to invest. Our analysis continues to show undervalued yet compelling opportunities in select US operations. By example, the total market cap of all CSE listed US cannabis companies during the week of Dec 4 is approx. $12.5 billion, while the market cap of Canopy Growth alone is $14.3 billion. When we view calendar 2018 top line revenue a gap exists as the US listed companies estimate top line revenues of $630 million vs an estimate of Canopy revenues for its fiscal 2019 year at $250 million. That is not to say that Canopy is overvalued, rather we believe that selling pressure has given investors an opportunity to Invest at better valuations across a wide list of names.

As the year ends, we see this weakness as an opportunity to add to select positions. We wish everyone a happy holiday season and look forward to strong markets in the new year.

Until next month,

The Alternative Health Fund Team

Compounded Returns[1]

	1MTH	YTD	3MTH	6MTH	1YR	INCEPTION
FUND	-1.9	27.9	-0.2	21.9	48.2	62.6
INDEX	-1.2	11.8	-8.8	8.5	27.3	37.5

[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 November 30, 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.

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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