Ninepoint Alternative Health Fund

February 2020 Commentary

Investment Team

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The month of February began with the major North American equity indices reaching all-time highs. But by the middle of the month a dramatic change to the forecasts for global economic growth occurred with the implications of the coronavirus (COVID19) just beginning to be understood. What started as a health risk, a virus in China, has now reached over 100 countries and over 100,000 positive tests around the world. What has driven major equity indices down since mid-month are the economic implications of a global supply chain that is undergoing an abrupt interruption. Initially, North America's reliance on Chinese components was exposed from semiconductors to auto parts. COVID19 precautions are now reducing North American interests in the movies, air travel, cruises and entertainment such as concerts. The implications on quarterly earnings of North American equities will be significant, yet are still uncertain.

During February the U.S. health care and pharma industries also witnessed significant pressure from the Democratic Primaries having given rise to policy initiatives that have challenged some larger health care names. As Democratic front runner Sen. Bernie Sanders gained traction with early delegate gains, his rhetoric about nationalized healthcare affected names in the space. This is not the first time that the Dem's have made these pronouncements. In fact one year ago, Sen. Elizabeth Warren made similar statements causing similar gyrations, only to have the equities rebound strongly once cooler heads prevailed. And that is how we are analyzing our portfolio, with strong resilient names that will stand the test.

UnitedHealth Group Inc: UNH

Source: Refinitiv

We believe that any health-care related legislation will need to have private market involvement to have any chance of passing the U.S. House and Senate. UNH is well positioned to benefit from an expansion of medical insurance in the U.S. with its industry leading position. As a result, we chose to hold the position through these periods of weakness, both last year and more recently. Each time the stock has recovered and has been a solid position during the recent market downturn.

All major North American indices suffered negative performance as the DOW was -10% for the month; the SP500 generated a return of -9.75% while the SPTSX was partially buoyed by precious metals ending the month -6.42%. The Fund return for the month was -10% similar to the broad US indices, outperforming the cannabis focused funds and ETFs that produced returns of -16%.

The Portfolio Team believes that the strength of our portfolio is based on a diversified health care approach. Our primary focus is the cannabis sector, including Cdn, US and European operations. The portfolio also includes US large cap pharma, US healthcare, and other health related companies. With this type of portfolio over the last three years we have been able to provide growth while reducing risk and volatility for investors.

We believe strongly that the market is currently not valuing the strength in the underlying operations of many of our key holdings, offering a great entry point for investors. As an example, the US cannabis industry continues to grow both in terms of the number of states legalizing for medical and recreational usage, as well as the number of patients and clients increasingly using products as alternatives to more traditional health solutions. This growth is showing up in the financial results, with many of the U.S. cannabis companies posting impressive sales and in some limited licence states, such as Illinois, producers are able to make very high margins due to production limitations.

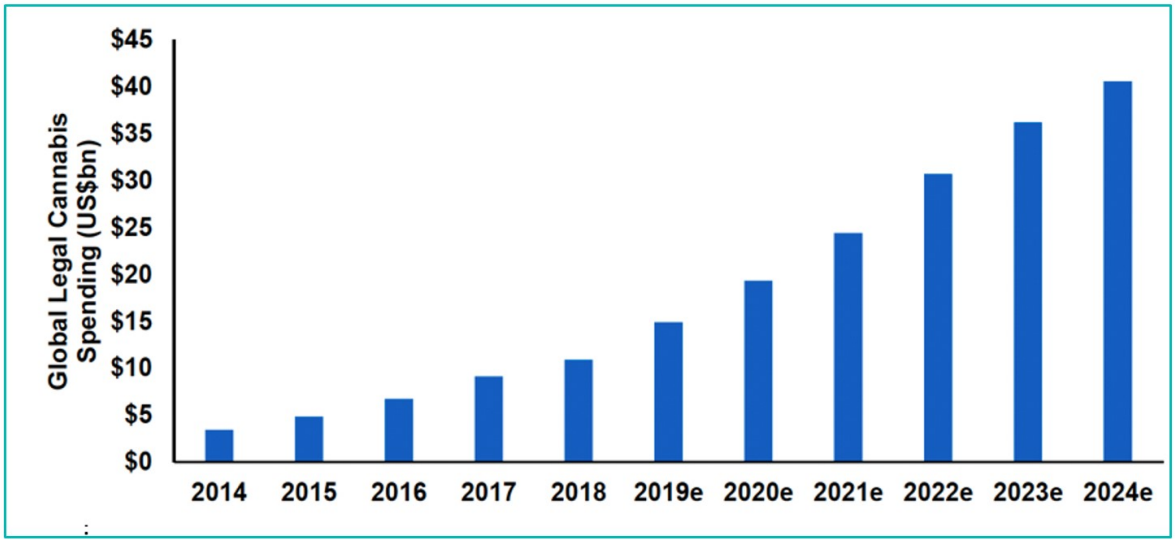
Often we hear that “the cannabis sector” is weakening or “the cannabis names are not making money”. The cannabis sector is not one homogenous group. It is true that some of the largest Cdn LPs are currently “right-sizing” attempting to improve operational efficiencies to improve financial

performance. At the same time there are Cdn LPs with low costs/gram, generating positive cash flow and growing their product offerings. In this select group we are invested in names such as **Village Farms International (VFF)** and **Organigram Holdings (OGI)**.

There are also strong operators in several US states, both in medical only as well as recreational states. With over 35 states now legal, representing over 200 million people, there are multi-state operators growing revenues on a quarterly basis and generating increasing cash flows. Leading names in the Fund include **Green Thumb Industries (GTII)** and **Trulieve Cannabis Corp (TRUL)**. With these core cannabis holdings we believe we have fundamentally strong businesses that will continue to lead the US cannabis sector.

As we look for opportunities in this new growing sector, it is important to focus on the long term. Over the next five to ten years global growth of the legal cannabis industry is forecast to grow at a compound annual growth rate of 25%. As investors we must not get distracted by short term volatility. The long term growth of the sector is still intact.

Global Cannabis Spending to Grow at approx. 25% CAGR (2018-2024)



Source: Arcview Market Research

Topics Covered

1. Regulatory Updates
2. Company Announcements
3. Quarterly Financial Results
4. Options Strategy

1. Regulatory Updates

Canada

Health Canada released cannabis sales data for December that marks the third consecutive month that the Canadian recreational market has posted a record sales high, increasing by 8% m/m and generating C$146.3M. Ontario, Alberta, and Quebec – all posted healthy m/m revenue growth of 7%, 8%, and 12%, respectively and each occupy a ~23% share of the national market. The monthly figure is important as it takes the monthly run rate to $1.75 billion annually, and that is before

consideration for new Cannabis 2.0 products that hit store shelves in January.

At the provincial level, nationwide there are now 800 stores, with roughly 400 of stores opened and licensed in Alberta. Beginning in April, the Province of Ontario will begin to license 20 stores/month in an effort to open up the Ontario adult use market. Already in early March, the provincial regulator has received over 400 applications. Ontario will be central to the growth of the Canadian adult use market as the province has roughly 40% of the population of the country, yet has limited points of sale, with only 27 stores open, and a total of 100 stores open or licensed.

Health Canada released information on cultivation that shows the amount of outdoor cannabis canopy (cultivation) has exceeded indoor licensing in Canada with roughly 19 million sq ft approved for outdoor growing versus 13 million sq ft of indoor cultivation. This is interesting from the standpoint of lowering average cost/gram, while it also has implications on quality of flower available for sale. Premium prices are available to those providers that are able to produce consistent quality, high THC content. With the growth in outdoor cultivation we see competition at the lower end of the market, but continue to see large opportunities for quality premium THC strains.

The U.S.

The legalization of cannabis in many states for medical and recreational purposes has led to a surge in interest in using it to treat a variety of long-term health conditions and symptoms. Among new users are a large proportion of older adults. The proportion of adults 65 years and older who reported using marijuana increased in the past year sharply to 4.2% of people over 65, according to a study published last week in the journal JAMA Internal Medicine.

State Demand Continues to Grow

The State of **Illinois** launched legal recreational cannabis sales January 1, with total sales of $62 million in the first month of the year, with $40 million attributed to the recreational market. Fund holdings that have significant operations in ILL include **GTII** and **Curaleaf Holdings Inc (CURA)** through its acquisition of Grassroots. In **Nevada**, retail sales over 11 months of 2019 total $640 million, up 10% from 2018, with NV potentially reaching $700 million in annual sales by the end of December. In NV, **CURA** and **GTII** have vertically integrated operations. In **California**, despite increased tax and regulatory burden, sales from three quarters of retail sales puts the state on pace to reach $2 billion in annual sales in 2019. Finally, the State of **Florida**, which continues to be a medical only state continues to grow with over 315,000 registered patients, which represents a penetration rate of approx.. 1.5%, half the rate of mature medical markets. In addition, Florida just past new regulations during the first week of March to allow for edibles to be sold through medical dispensaries, once again adding to the forecast revenue to be generated from this medical only state. In Fl as stated earlier, both **TRUL** and **CURA** have operations that are among the leading companies in the state.

In Connecticut, its State Congress has introduced a legalization bill after the Gov. called for the measure in his budget address, marking another Northeastern US state pushing to liberalize its cannabis laws. This comes as NJ and NY governments renew their efforts to pass legalization with **New York** Gov. Cuomo including it as part of his annual budget and NJ putting the question to voters on the Nov. 2020 ballot.

Utah officially launched its medical cannabis program on March 1. The state legalized medical

cannabis in November 2018 through a ballot and has approved 14 dispensaries, two of which will be operated by **Columbia Care (CCHW)** and **CURA**. The state has also approved 8 cultivators that include Tryke Companies, which was recently acquired by **Cresco Labs (CL)**.

Jobs Growth in US Cannabis Industry
Recently we have read announcements about job cuts in Canada with leading LP's such as HEXO, Aurora, Tilray and Canopy all making cuts to their workforces. Yet in the US, one of the fastest-growing sources of jobs in the U.S. is the cannabis sector. The sector employed 243,700 people at the beginning of 2020, up 15% from a year ago and nearly double the number of jobs in 2017, according to data from cannabis information firm Leafly.

2. Company News

One of the main news stories of the last few weeks was the announcement from **Canopy Growth (WEED)** and its new leadership team that it is shutting its two largest BC based greenhouses (in Delta and Aldergrove) and will not commission a third greenhouse in southern Ontario. The company expects to record a $700-800 million charge in the next quarter (FQ4/20) as a result of the announcement. The announcement was not a surprise to our team as it was anticipated that WEED needed to "right-size" operations and new CEO David Klein discussed a 90 day review of all operations during the Q320 conference call. The closure significantly reduces WEED's cultivation footprint, reducing its full capacity cultivation by 60%. The two BC Tweed facilities make up a total footprint of 3M sf and could have likely produced between 250,000 and 300,000 kg of biomass annually. The shutting down of the greenhouses will also be felt by 500 staff in BC who have been let go.

After months of discord in a public dispute over capital commitments for its joint venture, **VFF** and **Emerald Health Therapeutics (EMH)** announced that they have entered into a settlement agreement in order to settle all outstanding disputes with respect to the Pure Sun Farms (PSF) joint venture. The net result is that VFF's ownership of PSF has increased to 57.5% from 50%. The dispute revolves primarily around EMH owing PSF capital to maintain a take-or-pay contract for 40% of the production from PSF. EMH was unable to fulfill this obligation in Q3 and Q4 resulting in a substantial payable to PSF.

PSF releases EMH from all liability arising from its take-or-pay contract for 2019 (40% of production) and cancels its supply agreement with EMH that stipulated that EMH must take 25% of PSF product in 2020, 2021 and 2022. Furthermore, VFF has made an $8 million equity contribution to PSF, thus increasing its ownership to 57.4%

This settlement not only opens-up the potential to pursue more traditional financing arrangements but also removes confusion on behalf of investors in terms of who owns PSF.

OGI announced that it completed the first shipments of its 2nd vaporizer product (Edison Vape Pens powered by Feather) and its 1st edible product (Edison Bytes). OGI launches the vapes through its exclusive agreement with the **Feather Company Ltd. (Private)**.

With regards to Edison Bytes, this marks OGI's first edible product release, and builds on OGI's management team that has extensive experience in chocolate consumer packaged goods, specifically its SVP of Operations who formerly was an executive at Ganong.

The brand took home a number of awards at the recent Leafly Readers' Choice Awards, an event that

recognized “best-in-class products, producers, places, and personalities in Canada’s legal cannabis industry”. OGI’s honours include having the top THC-Dominant Flower, the top Pre-Roll, the top THC Oil, and the top CBD Oil products in Canada. This further supports our view that OGI is one of our favorite Canadian names.

The Valens Company (VLNS) announced its first international shipments of white label products to Australia, the initial shipment containing three SKUs of tinctures, totaling over 3,000 units, which are expected to be shipped in Q2, pending receipt of necessary import and export permits.

Cresco Labs (CL) one of the leading Multi-State Operators (MSO’s) based in Illinois announced that co-founder, Joe Caltabiano, resigned as President of the Company, effective immediately.
Mr. Caltabiano’s management responsibilities will be taken up by CEO and Co-founder Charlie Bachtell as well as other members of the Company’s leadership team. Mr. Caltabiano will continue to serve on the board of Cresco.

3. Financial Reports

During the month, financial results from various producers were presented to the market. What is important to review are the revenue growth rates, margins and capital available for the companies to continue to grow. We note that although some of the largest cannabis producers are generating hundreds of millions in revenues, challenges lie in their ability to reach positive cash flow. At the same time, other companies in the sector are showing strength in revenue growth and cash flow strength. We believe that those that can continue to grow while generating positive cash flow will attract supporters and provide solid returns for investors.

VLNS reported strong FQ4/19 and full year results with revenues in Q4 ramping up to reach $30.6 million, an 86% increase from Q3 of $16.5 million, and beating consensus of $28.1 million. Gross margin was strong at 73.8%, while Adj. EBITDA reached $17.7 million or 57.7% of revenues. Net income for the quarter reached $4.5 million, and the company finished the fiscal year with $58.7 million of cash and short-term investments on the balance sheet.

Aurora Cannabis (ACB) reported weaker than anticipated FQ2/20 financial results with revenues of $56 million, decreasing 25% from the previous quarter. Also cause for concern was that adult-use sales declined 24% to $22.9 million which included return provisions. Gross margin was down to 41% from 56% in the previous quarter while cash cost to produce per gram increased to $0.88 from $0.85 in the previous quarter. Adj. EBITDA was $(80.2) million while SG&A expenses increased 23% QoQ to $99.9 million. ACB management has stated that it intends to to get this level to $40 - $45 million per quarter exiting FQ4/20. Also concerning was the material intangible, PP&E and goodwill impairments that the Company will be taking in the range of C$900 million to C$1.0 billion in FQ2 in what the Company stated were related to operations in South America and Denmark given limited near/medium-term growth drivers.

WEED reported Q320 financials with stronger than anticipated net revenue of $123.8 million that was well above consensus expectations of $105 million. Revenues were up 13% sequentially QoQ adjusted for prior quarter sales returns and after two quarters with significant provisions and returns against revenues, no returns were recognized in the quarter. Gross margin did improve to 34% beating consensus of 29%, however margins are lower than the rates that are required to generate positive cash flow. In addition, adj. EBITDA was $(92) million which although beat consensus is still

well below break-even which is a stated goal of the company's new management team. As stated earlier the Company disclosed that it has already begun a 90 day review of all operations and have begun to implement tighter cost controls across the organization.

4. Options Strategy

During February the Fund continued using its option strategy to enhance risk adjusted returns. With the above average volatility in the cannabis and health care sectors, we are able to generate significant option premium, while lowering the overall volatility of the Fund relative to its underlying benchmark. Since inception of the option writing program in September 2018, the Fund has generated significant income from option premium of over $2.65 million.

During the month we used our option strategy to assist in rebalancing the portfolio in favor of names we prefer while generating $41,000 in option income. We continue 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)**, **Aphria Inc. APHA**, and **Innovative Industrial Properties Inc (IIPR)**.

During these extremely volatile times in the equity markets, we can profit from volatility while building in downside protection on select entry points. We believe that having the ability to hold cash, while exhibiting a view on specific names reduces volatility and yet still generates upside opportunities for the fund.

Charles Taerk & Douglas Waterson

Portfolio Team
Ninepoint Alternative Health Fund

Compounded Returns[1]

	1MTH	YTD	3MTH	6MTH	1YR	INCEPTION
FUND	-10.01	-9.67	-12.53	-19.85	-32.03	16.79
INDEX	-12.29	-14.32	-11.87	-19.34	-35.03	2.52

Statistical Analysis

	FUND	INDEX
Cumulative Returns	49.00%	6.58%
Standard Deviation	29.81	31.94
Sharpe Ratio	0.52	0.04

[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 February 28, 2020. 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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