# Ninepoint Alternative Health Fund

November 2022 Commentary

## Introduction

In this month's commentary, we discuss; the implications of the US Mid Term elections, the significant impact that this season's flu has on healthcare names, in addition to the names within cannabis that are separating themselves from weaker operators. From a regulatory perspective, we also discuss the Lame Duck session of Congress and what might occur, while also looking at recent draft legislation for New York recreational sales, to begin in the coming months. We also discuss the Q3 results of some top ten holdings as well as discuss other names in the cannabis sector so that investors understand why we are underweighting certain names.


Investment Team

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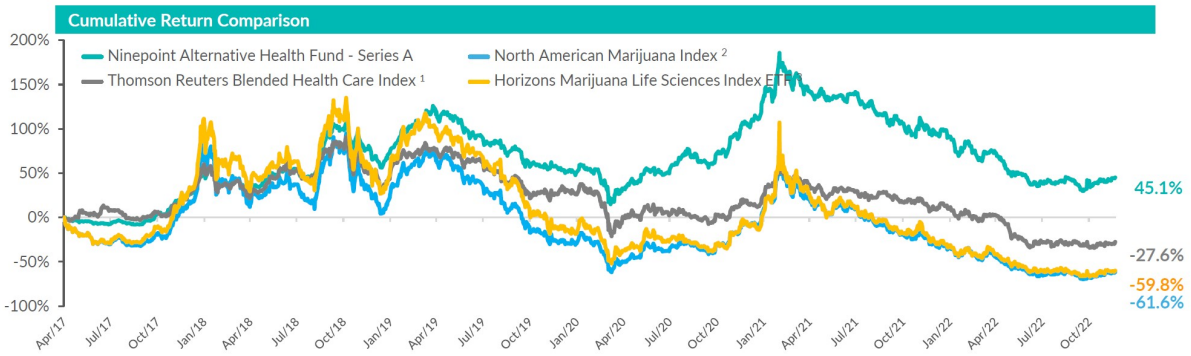
November was a sound month for equity markets as investors considered a pivot in US Fed policy towards a more considered interest rate environment. With that narrative, investors believe that interest rates are peaking and as a result, reduced fear led to strong equity returns. We are of the opinion that the Fed will continue to focus on curbing inflation, and raising rates regardless of the desires of equity market participants. As a result, we continue to be focused on our cannabis, healthcare and wellness which should generate stronger returns in the coming quarters based on fundamentals within each company and a macro environment that increasingly favours a focus on consumer staples and healthcare. We believe cannabis sits in the middle of both dynamics and as a result, should be considered for this next investment period.

# Ninepoint Alternative Health Fund

Cumulative Returns (As at November 30, 2022)




Inception date: March 26, 2017. Chart shows period between April 11, 2017 and November 30, 2022

| Period between April 11, 2017 and November 30, 2022 | Annualized Return | Annualized Std Dev | Downside Deviation | Sharpe Ratio | Sortino Ratio | Max Drawdown |
|---|---|---|---|---|---|---|
| Ninepoint Alternative Health Fund – Series A | 7.0% | 27.5% | 15.7% | 0.22 | 0.44 | -49.3% |
| Thomson Reuters Blended Health Care Index[1] | -5.7% | 36.6% | 21.4% | -0.18 | -0.27 | -58.7% |
| Horizons Marijuana Life Sciences Index ETF[3] | -15.3% | 60.7% | 32.9% | -0.27 | -0.46 | -84.6% |
| North American Marijuana Index[2] | -16.0% | 55.9% | 31.5% | -0.30 | -0.51 | -80.3% |

Performance and fund statistics are based on daily observations.
Effective April 23, 2018, Ninepoint Partners became the Manager of Ninepoint Alternative Health Fund (formerly UIT Alternative Health Fund)

1. 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.
2. For illustrative purposes only. North American Marijuana Index is computed by Ninepoint Partners LP based on publicly available index information.
3. HMMJ (Horizons Marijuana Life Sciences Index ETF) is computed by Ninepoint Partners LP based on publicly available index information.

Leading the performance of the Fund this month included positions in both healthcare and cannabis as Astrazeneca (AZN) had a strong month +15.57%; followed by Trulieve Cannabis (TRUL) +10.58%; Green Thumb Industries (GTI) +9.27%; JAZZ Pharmaceuticals (JAZZ) +9.12% and Abbott Labs (ABT) + 8.73%.

This month we look at the implications of the mid-term elections, the potential passage of SAFE Banking for US cannabis operators as well as the strong demand for pharma and healthcare stocks during Q3 and Q4. We believe that the macro backdrop, with recessionary fears the leading names in our portfolio including healthcare, wellness and cannabis stand up well in this environment and should be considered to not only protect NAV but to grow investor NAVs into 2023.

**Post Mid-Term Election US Cannabis Market**

Two of the five potential states that could have voted in favour, approved legalizing adult use cannabis, making it 21 states and over 45% of the U.S. population with access to recreational cannabis. The two largest states, MD and MO, passed referendums for adult-use.

Other states that have large medical cannabis markets came away with election wins that could accelerate the passage of adult-use legalization through state legislatures. PA elected Democrat Josh Shapiro as Governor has a pro-cannabis position, and outspoken pro-cannabis PA Lt. Gov. John Fetterman was elected to the U.S. Senate to help shape federal reform. Gov. Shapiro defeated an anti-cannabis Republican, and the anticipation is that he will lead a job focussed PA adult-use legalization near-term through legislative action.

In Minnesota, with the Democrats taking control of the Senate for the first time since 2014, Governor Tim Waltz (D) is planning for cannabis legalization to pass in 2023.

**Lame Duck Session of Congress**

The period immediately after the mid-term elections that run until the end of the Congressional session at Christmas is the Lame Duck session of Congress, a time when significant horse trading takes place between

both parties, a way to essentially clean the decks and get ready for the next session of Congress that begins in January. This year, there are a few major pieces of legislation that are being negotiated and SAFE Banking has been discussed as potentially being attached to one or two must pass measures. To the date of writing, SAFE Banking, the bill that provides US cannabis companies with access to US financial services firms and credit card payment associations, has not been successfully attached to any legislation. Senate leadership on both sides of the aisle continues to use cannabis as a large bargaining chip, so we will continue to monitor the situation and will update investors in our annual commentary next month.

**New York Recreational Market Guidelines**

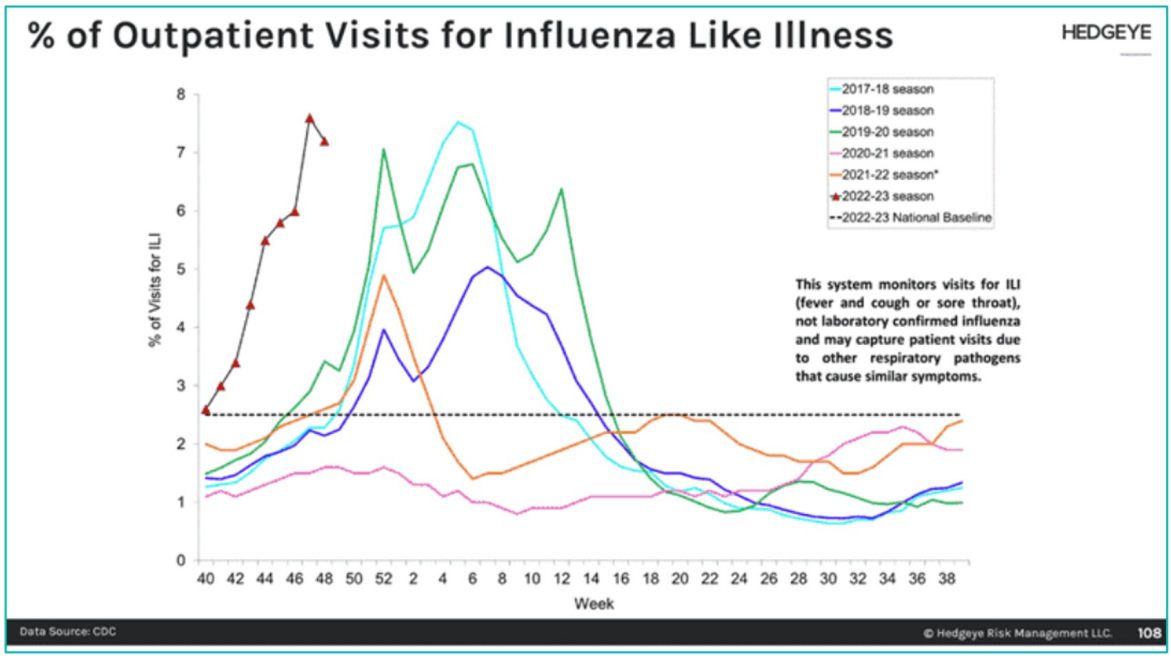
As a multi-year investor in the US cannabis market, we are disappointed that a set of state rules has been developed that are more challenging and less supportive for industry growth than the state of California, a state with one of the most dysfunctional regulatory regimes in the US. Our team would have thought that regulators on the east coast would have learned from California's mistakes, needlessly creating roadblocks to industry growth, jobs and state taxes. Several other states have adopted different paths. We were somewhat surprised to see New York's announcement.

The program includes 277 cultivation licenses, 33 processor licenses and 36 social equity retail licenses. At this stage though, initial guidelines are not as friendly towards the original ten license holders that were each allowed to have cultivation along with four medical dispensaries. The assumption was that these coveted ten license holders would be able to provide wholesale to the under supplied legal market for an initial period at least until new licensees were ready to compete. However, that has not materialized. The initial draft of the legislation states that medical incumbents (called Registered Organizations, or ROs, in state parlance) will be allowed to add four additional medical stores (to their existing four) and co-locate recreational services in three of those eight stores. But they will not be able to offer recreational retail services until three years after the first sale of recreational sales in the state. Essentially the legislation provides new social equity retail licensees with a 3-year window before ROs can begin sales. In addition, there are space requirements within RO dispensaries to allocate to independent NY farmers and processors.

Generally, we see the New York legislative proposals and guidelines as needlessly hampering the legal market from excelling as the state has no legal supply and will need to rely on incumbent RO's to allow the market to open. The regulations then hamper the growth of the original license holders. Unfortunately, these regulations will do little to curb the illicit market, which will negatively impact the success of legal operators in NY. Given the way other states have rolled out their own rules, it appears that the New York legislation will end subject to court battles.

**FLU & RSV UPDATE**

Flu season is upon us and given the previous two years of lockdowns and travel restrictions and working from home, we have been relatively spared from this annual outbreak while the world dealt with COVID-19. However, this fall, the Centers for Disease Control estimate that over 13 million Americans have been treated for illnesses related to the flu. With multiple respiratory viruses circulating, the CDC suggests the cumulative hospitalization rate is the highest it has been since 2010-11. It's important to note that this year's flu test rate is over 24%, whereas previous peak rates of flu tests were approximately 3.6%. The spread is being felt most dramatically in NYC while it stretches to at least a dozen states in the southeast.



Data Source: CDC

Not surprisingly there is a shortage of antibiotics like amoxicillin and according to the American Society of Health-Systems Pharmacists, there is a shortage of Tamiflu and albuterol. And now the children's Tylenol shortage that we have witnessed here in Canada has carried over to the U.S.

We bring this situation to our investors as a way to feature one of the Fund's newer holdings, Perrigo (PRGO). We have been adding to our position since the early summer. PRGO is a leading global consumer products manufacturer of the private label over the counter pharmaceuticals with 70% of its sales emanating from the US healthcare system. Its products range from cough, cold and flu medication to various types of infant formula can be found.

In leading retailers, including Walmart, Sam's Club, Costco, CVS, Kroger, Walgreens, Target. These stores/chains sell store brand products under their own labels to caregivers across the US. Typically we would see a bump in sales from annual flu demand during Q3 as pharmacies stock up for the flu season that begins in early Q4. This year PRGO's Q4 is set for the cough & cold season as orders are already in and production is maximized, especially for liquid medicines. A larger or longer cough & cold season extends the strength in demand for its wide range of products to at least Q1 as retailers have had to reorder more inventory.

**Q3 US MSO Results**

Our view is to focus on those cannabis operators that are able to generate efficient pre-tax cash flows rather than focus on a rising tide lifts all boat mentality. As a result, operational efficiency in production and retail distribution is paramount. Given the current state of equity markets, it's important to focus on strong execution.

**1.** Trulieve Cannabis (TRUL) announced revenues that were shy of estimates however given strong execution and operational efficiencies met consensus adjusted EBITDA estimates. Revenues declined 6% QoQ, however, they grew 34% YoY to $301 million vs consensus of $306 million, with 94% of revenue from its own distribution or vertical sales. Verticality is a growing trend amongst US MSO's and TRUL is a leader. Verticality is taking place in the US as a way to enhance margins by controlling all aspects of cultivation, production, branding and self-distribution. FL was hit by Hurricane Ian during the quarter and many MSO's witnessed 1 week plus of shutdowns and evacuations. With 24% of all dispensaries in the state of FL, TRUL continues to garner ~45% of the FL flower market by volume and a ~41% share of all THC sold, while facing competitive promotional campaigns from MSO's trying to take market share. TRUL continues to grow outside its base in FL, with the

company opening 11 locations during Q3 to now have 32% of its dispensaries now outside FL, with a total of 178 dispensaries in 11 states. TRUL continues to be a leader in production efficiency with a gross margin of 56%, with a gross profit of $168 million vs a gross profit of $184 million and a gross margin of 58% in the second quarter. The company generated adjusted EBITDA of $99 million*, or 33% margin and ended the quarter with $114 million in cash. Another reason we continue to be positive on TRUL is that in addition to its strong margin showing, we anticipate further enhanced cash flows for 2023 as we expect a significant decline in capital investments in 2023 following a multi-year investment cycle to support future growth.

**2.** Verano (VRNO) released 22-Q3 financial results driven by strength in the newly opened recreational market of New Jersey with revenues of $228 million, increasing 2% QoQ and 10% YoY. In addition, the company increased production scale and efficiency as gross margin improved significantly to $123 million or 54% of revenues vs 44% in Q2 while adjusted EBITDA reached $82 million to 36% vs 34% in Q2. VRNO continues to execute on its growth and integration strategies from the last 2 years of acquisitions. The team opened 11 new MÜV retail dispensaries in FL, a total of 61 giving it the second largest footprint in this lucrative and vertically integrated state. We emphasize the forced vertical integration of FL as a factor in maintaining strong margins, with FL law preventing wholesale, and only allowing licensees to cultivate and sell their own products. In addition to the strong showing in FL, Q3 saw VRNO open 2 new Zen Leaf dispensaries in WV, and 1 in PA; and opened its 3rd New Jersey Zen Leaf dispensary, Neptune on the Jersey Shore.

**3.** Terrascend (TER) Q3 results generated revenues of $67 million reflecting the strong growth emanating from the New Jersey recreational market in addition to improved execution coming from Michigan and Pennsylvania. Retail revenues were $53.4 million while wholesale was $13.6 million, with an overall growth of 3.4% QoQ and 36.4% YoY. Retail sales are the engine of growth for TER with 11% growth QoQ, up 114% YoY. There were challenges in the PA and MI markets, however, what is noteworthy are the operational improvements in those state markets that support better cash flows in future quarters. Wholesale operations were down 19% in the quarter as most MSO's increased their own verticality to combat share of wallet issues and inflationary pressures. Gross profit came in a 36.3% while adjusted EBITDA improved to 17% of sales or $11.3 million better than 9% or $5.8 million in Q2.

Q3 was the first full quarter of adult-use contribution from New Jersey's Maplewood and Phillipsburg dispensaries in addition to a partial contribution from its state-maximum 3rd location in Lodi that opened at the end of July. Management estimates that each store could achieve at least a $40M/year run rate (with $50-$60M/year a possibility) with Lodi expected to become the strongest performer in NJ. A standout in TER is its exclusive distribution relationship in PA, MI and NJ with Cookies, the biggest global brand in the cannabis industry. As the exclusive cultivator, TER is able to grow its wholesale business as its competitors in these states want the Cookies brand on their shelves. We see long term benefits to this relationship.

Third quarter '22 results reflect a challenging transitional period for Cresco Labs (CL) with revenue of $210 million, down 2% year-over-year. A read through on CL operations though, highlights price compression in various state markets where competitors are increasingly focussed on vertical integration, reducing their demand for CL's wholesale business. In addition, CL was negatively impacted by its exit from 3rd party distribution in California, where the company had previously focussed considerable capital and effort to build its brands since 2020. The company took the quarter to close certain under-performing facilities while also working on the divestment of duplicative assets and licenses related to the acquisition of Columbia Care (CCHW), the closing anticipated in Q1-23. During this period of reduced demand from third party dispensaries, CL wholesale revenue in the quarter came in at $93 million, maintaining CL's position as the No. 1 wholesaler in U.S. cannabis. CL retail dispensary revenue increased 11% year-over-year, to $118 million. Gross profit was $100 million or 47% of revenue while Q3-22 adjusted EBITDA was $42 million, or 20% of revenue. Despite the challenging economic environment, the company was able to generate $26 million in operating cash flow in the quarter. With consumer's generally stretched during this inflationary period, and the increased focus on verticality from its competitors, we are cautiously optimistic on the further divestiture of assets and licenses prior to the closing of CCHW transaction, with a reduced weighting in this name relative to other US multi-state operators (MSO's).

**4.** Curaleaf (CURA) generated revenue in Q3 of $340 million, with the growth of 1% QoQ and 7% over Q3-21. The biggest contributor in Q3 was the New Jersey market which grew 21% in the quarter, with management remarking that 2 of its dispensaries in the state, (a maximum of 3) are on pace to generate $80 million for the year. Its 3rd store has just recently opened and is expected to also generate solid results. Outside the growth in New Jersey, several core markets had challenges in Q3. Management noted the effects of Hurricane Ian were a drag on sales and profitability in Florida, while other key markets for CURA; PA and CO also experienced softness.

CURA dispensary based retail revenue came in at $260 million vs $225 million a year earlier, however, wholesale revenues were down 14%. Company gross profit was $165 million, margins falling 360bp QoQ to 48.5% while adjusted EBITDA margins came in at $84 million, 25% margin, down 2.5% QoQ. From meetings with management, it appears that the company is in the middle of a rationalization phase and is considering shedding certain under-performing assets in slow markets. With a new President and new CFO, we remain cautious as the combination of macro headwinds and previous overbuilding is putting pressure on the company's ability to grow profitably.

**5.** Jamieson Wellness (JWEL) released Q3-22 results that that saw revenue increasing 24% to $138.9 million in Q3-22 vs $112.4 million in Q3-21 driven by 31.8% growth in the Jamieson Brands segment. The company witnessed organic growth of 12% in its domestic (Canadian) branded business and nearly 30% growth in its China business segment. Gross profit reached $48.5 million yet decreased by 400 bps to 40% as the Youtheory acquisition in the US assisted the top line but has a lower margin mix. Adjusted EBITDA increased 16% to $29.5 million while net earnings were $10.9 million. Youtheory is a brand that can grow in multiple channels in the U.S. and JWEL believes it can leverage its CPG relationships to drive more product listings, leading to quick up-take for certain retail partners. JWEL continues to gain traction operationally with organic growth in the range of high single digits while holding an above 25% market share in Canada, which is 2 times greater than the next largest competitor. The other initiatives that are keys to the future of JWEL include its expansion into the US and China. Despite its strength, the stock is trading near a two-year low and is at a five year low of 11x forward EBITDA.

6**.** SunOpta (STKL) generated an overall revenue increase of 15.7% to $229.7 in Q3-22 with broad based growth in plant-based milk led by a 68% increase in oat milk. Plant-based volumes grew 7% QoQ for the quarter driven by oat milk demand. The company's retail channel witnessed sales growth of 16% while the foodservice channel grew by 30%. An important driver for STKL is the efficient utilization of its increased capacity for oat milk production, resulting in its ability to meet soaring demand in oat milk sales that grew 68% in Q3, outpacing the overall alt milk category's 29% growth in Q3 with new products or new customers accounting for 15% of the revenue growth.

Statistics from Insights Sales Data and the Plant Based Foods Association show that approx. 62% of American households are buying plant based products, and STKL has been able to lever its production facility and private label business to provide retailers including Albertson's, CostCo, Walmart, Starbucks, Whole Foods, Jamba, IHOP Kroger, Dollar General and Sams Club with plant based products. For STKL, oat milk is now the company's largest plant-based milk although both almond and soy milks also saw sales growth. Gross margin increased 190 basis points to 13.7% from 11.8% in the third quarter of the prior year, despite approximately 140 basis points of margin dilution in pass-through pricing to cover cost inflation. Bottom line, in a quarter that saw many companies miss estimates, STKL reported Q3 EPS of $.02 vs. consensus estimate of -$.01 while management also raised the low-end of its guidance for both revenues and EBITDA.

## Options Strategy

Since the inception of the option writing program in September 2018, the Fund has generated significant income from options premium of approximately $4.53 million. We will continue to utilize our options 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.

Our current interpretation of cross asset volatility indicators and daily trading volume metrics indicate to us, for the time being, we will be selective traders of our preferred option trades, especially on decelerating volume and deteriorating fundamentals. We need to see lower levels of trending volatility and accelerating volume signaling to us a healthier investing environment.

Volatility spikes are trending and as such we have been quite selective on our trades, tilted more towards large cap, lower beta health care to execute on, for now.

During the month we used our options strategy to assist in rebalancing the portfolio in favor of names we prefer while generating approximately $53,000 in options income. We continue to write covered calls on names we feel are range bound near term and from which we could receive above average premiums. We also 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 AstraZeneca PLC (AZN), Abbott Laboratories (ABT), UnitedHealth Group Inc. (UNH), Merck & Co Inc. (MRK), Perrigo Company PLC (PRGO), Eli Lilly and Co (LLY) and Tilray Brands Inc. (TLRY).

The **Ninepoint Alternative Health Fund**, launched in March of 2017 is Canada's first actively managed mutual fund with a focus on the cannabis sector and remains open to new investors, available for purchase daily.

**Charles Taerk & Douglas Waterson**
The Portfolio Team
Faircourt Asset Management
Sub-Advisor to the Ninepoint Alternative Health Fund

## Ninepoint Alternative Health Fund - Compounded Returns[1] as of November 30, 2022 (Series F NPP5421) | Inception Date - August 8, 2017

| | MTD | YTD | 3MTH | 6MTH | 1YR | 3YR | 5YR | INCEPTION(ANNUALIZED) |
|---|---|---|---|---|---|---|---|---|
| FUND | 1.5% | -26.1% | 1.1% | -1.9% | -26.1% | -1.8% | 4.6% | 9.4% |
| TR CAN/US HEALTH CARE BLENDED INDEX | 1.9% | -35.3% | 2.4% | -5.3% | -33.5% | -16.9% | -9.9% | -6.6% |

## Statistical Analysis

| | FUND | TR CAN/US HEALTH CARE BLENDED INDEX |
|---|---|---|
| Cumulative Returns | 61.0% | -30.6% |
| Standard Deviation | 28.0% | 30.3% |
| Sharpe Ratio | 0.3 | -0.2 |

[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, 2022. 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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