

Evolve Marijuana Fund

SEED is an actively managed ETF that provides investors with exposure to a diversified portfolio of companies, both domestic and international, that are involved in the marijuana industry.

As at June 28, 2019



TICKER: SEED (Unhedged)

MACROECONOMIC HIGHLIGHTS:

- Canadian cannabis stocks ended higher during the first quarter in spite of significant volatility but lost ground in the second quarter as a result of softer-than-expected sales, supply chain issues, missed revenue targets, and problems associated with compliance and corporate governance at selected companies.
- The biggest decliner in the second quarter was CannTrust Holdings which ran into compliance problems with Health Canada for growing cannabis in unlicensed rooms. Aphria, Hexo Corp, Aurora Cannabis, Cronos Group and Canopy Growth Corp also experienced significant declines.ⁱ Canopy Growth, for instance, blamed rising expenses for a larger-than-expected loss in its fiscal fourth-quarter results announced in June.
- Industry consolidation which commenced last year, continued during the first half, evidenced by a spate of merger and acquisition transactions, as companies sought to build economies of scale. Among the largest transactions during the first half were Canopy's acquisition of 100% per cent of the shares of New York-based Acreage Holdings Inc., a multi-state cannabis operator that has dispensaries, cultivation sites and processing facilities located across the U.S. for \$3.4 billion.
- Aurora Cannabis Inc. also announced plans to acquire the remaining 48% of Hempco Food and Fiber Inc. that it does not already own through an exchange of shares;ⁱⁱ while in April Cannaccord Genuity Growth Corp., a special purpose acquisition company, completed its merger with Columbia Care, a New York-based vertically integrated cannabis business that operates in 14 U.S. states and territories, which subsequently became the first company listed on Canada's NEO exchange with a market capitalization of more than \$1 billion.
- In June, Ontario's Alcohol and Gaming Commission announced that it will hold a lottery on August 20 to grant licences to 50 more cannabis stores starting in October, of which eight will be located on First Nations reserves through a separate licensing process. However, applicants will have to first show they have their finances and retail space in place prior to being granted a licence.ⁱⁱⁱ



- According to Statistics Canada's most recent quarterly survey published in May, an increasing number of Canadians are using cannabis. At the same time, illegal use of cannabis is declining. During this period, an estimated 38% cent of Canadian cannabis users obtained cannabis from the black market in the first three months of 2019, as opposed to 51% in the first three months of 2018.
- However, a new report from accounting firm Deloitte predicted that Canadians are expected to increase their consumption of cannabis by up to 35%r cent and spend as much as \$7 billion on legal and illegal sales in 2019. Between \$500M and \$1B of those sales expected to be illegal.^{iv}
- Incidentally, Canada's second wave of recreational legalization of marijuana will permit cannabis edibles for legal sale no later than Oct. 17, 2019, according to Health Canada. However, given that federal licence holders, must give 60 days' notice to Health Canada of their intent to sell the new products, the earliest they could hit the shelves would be mid-December. The edibles industry is expected to be worth \$4.1 billion in Canada and the United States by 2022, according to a report by a marijuana market research company called The Arcview.
- A number of major licensed producers like Canopy Growth Corp., Quebec-based HEXO Corp. and CannTrust have already forged relationships with major companies in the food and beverage industries in order to prepare for the second wave of legalization. In June, Organigram Holdings Inc. announced an investment commitment of C\$15 million in a high capacity, high speed and fully automated chocolate line in anticipation of the legalization of adult use cannabis edibles. The production capacity of the plant is estimated to be around 4 million kilograms of premium chocolate cannabis edibles annually.^{vi}
- Increasing use of cannabis has resulted in most of Canada suffering from a supply shortage of cannabis. In an attempt to address the shortage of cannabis, Health Canada announced in May that it is changing the way it issues cannabis licences in a move that will likely alleviate a bottleneck that observers attribute to a long-running shortage of legal pot in the country. Effective immediately, the regulator said that new applicants seeking to produce, sell or process cannabis must already have a fully built facility. Previously, applicants were only required to make a paper submission. Health Canada said it is making these changes after reviewing its existing process where more than 70% of applicants whose paperwork was approved over the last three years failed to provide evidence of a having a cannabis facility that meets regulatory requirements.^{vii}
- In a move that removes uncertainty over changes in cannabis legislation due to a change in government, Conservative Leader, Andrew Scheer announced in June that legalized cannabis in Canada is here to stay, even if the Conservative Party is victorious in the country's federal elections this October.^{viii}





PERFORMANCE ATTRIBUTION:

- The portfolio held a 42% exposure by weight to five of Canada's largest cannabis stocks – Aphria Inc., Aurora Cannabis Inc., Cronos Group Inc, Tilray Inc., and Canopy Growth Corp, plus Charlotte's Web, a US company which is the world's leading CBD brand by market share. The portfolio also had a 34% exposure by weight in emerging cannabis companies and a 24% weight in ancillary cannabis-related securities. The best performing stock during the month of June was Tilray Inc. Class 2 Common shares, which also made the largest contribution to the ETFs return, followed by Charlotte's Web. Aurora Cannabis Inc., was the largest holding by weight.

SOURCES:

ⁱ <https://www.bnnbloomberg.ca/cannabis-canada-why-pot-stocks-saw-steep-declines-in-q2-1.1280464>

ⁱⁱ <https://ca.finance.yahoo.com/news/aurora-cannabis-buy-remaining-interest-133229821.html>

ⁱⁱⁱ <https://www.cbc.ca/news/canada/toronto/ontario-cannabis-stores-1.5198257>

^{iv} <https://www.cbc.ca/news/canada/ottawa/cannabis-market-canada-research-deloitte-1.4690533>

^v <https://globalnews.ca/news/5096541/marijuana-cannabis-edibles-canada/>

^{vi} <https://finance.yahoo.com/news/organigram-announces-investment-c-15m-113012324.html>

^{vii} <https://www.bnnbloomberg.ca/game-changer-health-canada-changes-cannabis-licensing-process-1.1255720>

^{viii} <https://www.bnnbloomberg.ca/cannabis-canada-why-pot-stocks-saw-steep-declines-in-q2-1.1280464>

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