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The Market Downturn

April 2020

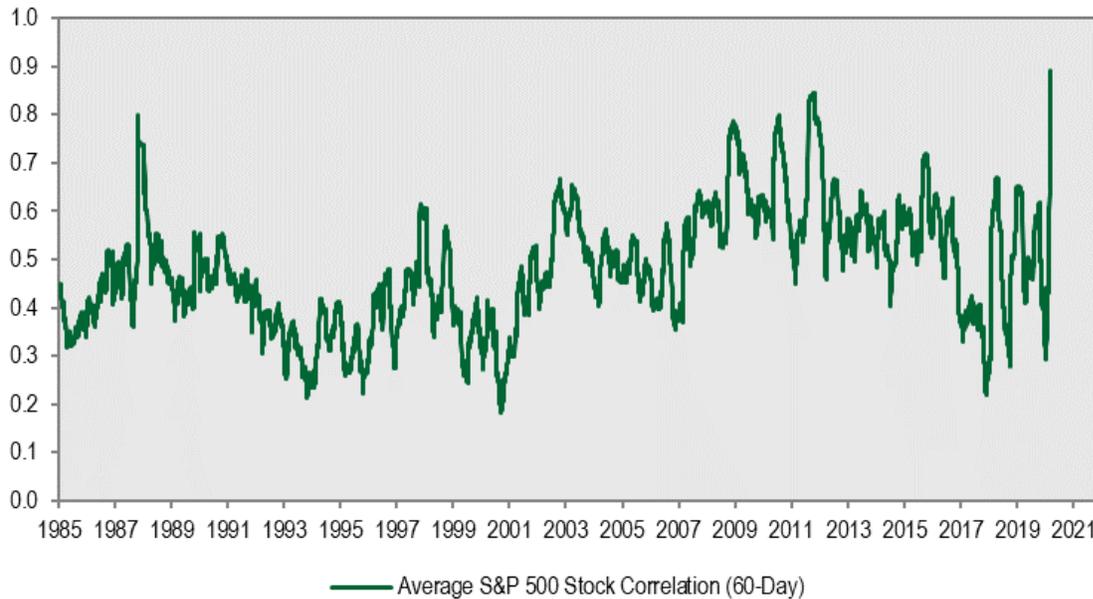
This is my third bear market as a portfolio manager, and while each has similarities, the pace of economic destruction in the US in the past six weeks has been unprecedented. This market crash was brought on by an exogenous event and was not the culmination of years of excess creating a 'bubble' like the crashes of 2001 and 2008. Because of this, I expect the recovery from this bear market will be comparably rapid once the conditions that created it begin to ameliorate. Certainly, the near-term economic devastation from shutting down the American economy will be apocalyptic, with negative economic numbers never before seen and severe company earnings reports. Companies will begin to report first quarter results over the next few weeks and the results will be weak as the effects of the virus began in mid-February. The forward guidance will be worse, if managements even try to estimate what 2020 results might look like.

We believe there are likely two broad scenarios for how these unfold. The end state for both is a combination of herd immunity and possibly a vaccine, which will relegate the COVID-19 virus to become more like what we saw with

SARS in 2003 and the H1N1 Swine flu in 2009. The first, and more pessimistic path, is that we don't get a medical breakthrough with an anti-viral and severe economic restrictions remain largely in place while we wait for the positive effects of herd immunity and eventually a vaccine. That scenario will be more difficult to manage as there will likely be a prolonged period of significant volatility as the market oscillates between despair over the economic destruction and periodic optimism over the decelerating rate of new case growth and the eventual end state of the virus. In that scenario, we will likely maintain a largely defensive posture while opportunistically building positions in companies with compelling prospects.

The second scenario is based on the success of an anti-viral like Hydroxychloroquine or Remdesivir, which meaningfully changes patient outcomes for those contracting the virus. If the threat of large-scale hospitalization and death is significantly reduced with the success of an antiviral, then the economy will largely get back to normal while waiting for ultimate resolution. This scenario could see an explosive recovery as the market will begin to discount the ultimate return to normality as well as the impact of the massive stimulus and liquidity injected into the economy by the government and Federal Reserve. In that scenario, I expect we will pivot to a much more aggressive posture.

Bear markets create significant opportunity in individual stocks as market selloffs are usually not discriminating and the vast majority of stocks head lower with the market. In fact, this bear market saw record high correlation of stock price returns as you can see in the chart below.



Source: Cornerstone Macro

Innovative companies continue their progress of creating and penetrating new markets as they move along their adoption curves and many of them have seen their share prices meaningfully compress. We continue to build our 'wish list' of companies that we believe will become multiples of their current size over the next several years and are selectively building positions in those where we find the risk and reward compelling while evaluating how the virus scenarios play out. The legal US cannabis industry is one area we are currently finding opportunity, which we discuss below.

CANNABIS

The cannabis industry today reminds me to some extent of when I first started as an analyst at Salomon Brothers in 1997 following the gaming industry. In the mid 1990's, different US states were legalizing casino gambling, with no federal oversight, and the young industry was volatile but growing rapidly. Similar to cannabis today, casino gaming was then coming out of the shadows and into the mainstream. Today, casino gambling is legal in 30 states and is a fairly mature industry. Cannabis, while still a Schedule 1 illegal drug at the federal level, is now legal in 33 states for medical use and in 11 states for adult (recreational) use. We believe the cannabis industry is at the very beginning of its life cycle, offering some compelling early-stage

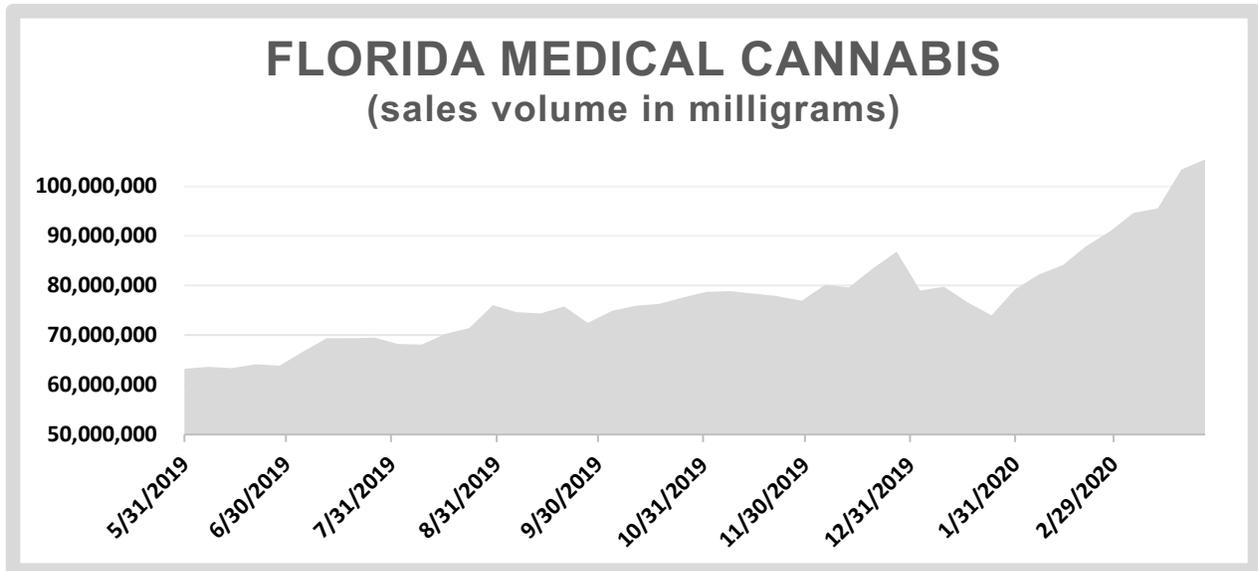


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investment opportunities. We've made two investments related to cannabis, Trulieve Cannabis Corp and Innovative Industrial Properties, Inc.

Trulieve is a vertically integrated cannabis company based in Florida with 45 locations in its home Florida market, which is a medical use only state. Trulieve manages all aspects of its cannabis business from "seed to sale". It grows its own plants, creates derived products, and distributes and sells in its own licensed stores. Despite having only 19% of the Florida retail distribution, Trulieve captures nearly 50% of the market largely because of its strong branding and excellent management team. The company is in the early stages of establishing a presence in Massachusetts, Connecticut and California, focusing on states with a limited number of available licenses and large medical patient population. The company is growing quickly, with sales growing to \$79.4 million for the quarter ending in December 2019, an increase of 122% compared to the previous year. In contrast to much of its competition, Trulieve has an attractive balance sheet and is the most profitable public cannabis company in the US, with EBITDA margins of 56% in the last quarter.

As a regulated industry, the State of Florida publishes weekly sales figures, giving us the ability to monitor the company's progress nearly real time. Below is a chart showing the sales trend in Florida over the past year. The demand trends in Florida so far remain unaffected by COVID-19.



Innovative Industrial Properties (IIPR) is our other cannabis related investment. Founded in 2016, IIPR is the only publicly traded Real Estate Investment Trust (REIT) serving the cannabis industry. The company typically acquires properties from licensed operators and leases them back to the companies over 10 to 20- year terms. The company works predominately with the



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largest operators in the industry, many of whom are multi-state operators like Trulieve. The initial rent typically yields 10% to 16% of the total investment and escalates 3% to 4.5% per annum. Because cannabis is still a Schedule 1 illegal drug at the federal level, the operators have limited access to the banking system, making them reliant on alternative capital sources like IIPR, which also allows IIPR to make attractive returns. The founder of IIPR is Alan Gold, who was also the founder of Biomed Realty Trust, a healthcare focused REIT that was sold to Blackstone in early 2016 for \$7.7 billion. Several of the senior managers at IIPR worked with Mr. Gold at Biomed. As a REIT, IIPR pays a healthy dividend, currently \$1.00 per quarter, equating to roughly a 5.6% yield at recent share prices. Given the pace of growth and acquisition of new properties, we expect that dividend to at least double over the next eighteen months.

The GrowthLine Team

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