



AMERICAN
BANKRUPTCY
INSTITUTE

2019 Winter Leadership Conference

How Investors Evaluate Distressed Deals

Ronald E. Gold, Moderator

Frost Brown Todd LLC; Cincinnati

James Gansman

Rock Creek Advisors LLC; New York

Jennifer M. Meyerowitz

Summit Investment Management LLC; Atlanta

Leon Szlezinger

Jefferies; New York

Michael A. Teplitsky

Wynnchurch Capital; Rosemont, Ill.

Distressed Investing ABI Winter Leadership Conference 2019

Moderator:

Ron Gold - Frost Brown Todd

Panelists:

Jim Gansman - Rock Creek Advisors

Jennifer Meyerowitz – Summit Investment Advisors

Leon Szlezinger - Jeffries

Michael Teplitsky - WynChurch



Distressed Hotel Deals

Considerations for Distressed Hotel Deals

- 100% of the Time, we ask “What is the real estate worth?”
- There has to be some value add that we can bring to the table.
- End Game: Sell the Asset
- Where will asset stabilize?
- What is the worst case scenario?



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Considerations with Distressed Hotel Deals

Review STR Report

The STAR program is used by the **global** hotel industry as a vital revenue management tool.

The **report** benchmarks a hotel's performance against its competitive aggregate and local market. The STAR program tracks and delivers monthly, weekly and daily data



How much we will buy it for?
How much money will we have to put into it?
What it will perform at once stabilized?

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Other Considerations

- Negative Cash Flow?
- Timing to Ramp Up?
- How long til Sell Asset?
- Independent Operator or Brand Flag?
- Weekday Business in Area?
- Performance Projections
- Missed opportunities for income?
- Our Cost?
- Amount Putting In?
- Performance Once Stabilized?



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Landscape Today

- Not a lot of Asset Purchases
- More Note Purchases
- But, a lot of cash is out there



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JM1

Investment Considerations

Successful Distressed Investors

- ▼ Able to evaluate worst case scenarios.
- ▼ Know bankruptcy and not afraid to use the process.
- ▼ Messier the deal, the better
- ▼ Have expertise with various flags and brands.
- ▼ Have worked with repeat franchisors
- ▼ Allow borrower to stay involved.
- ▼ Not seeking Loan to Own



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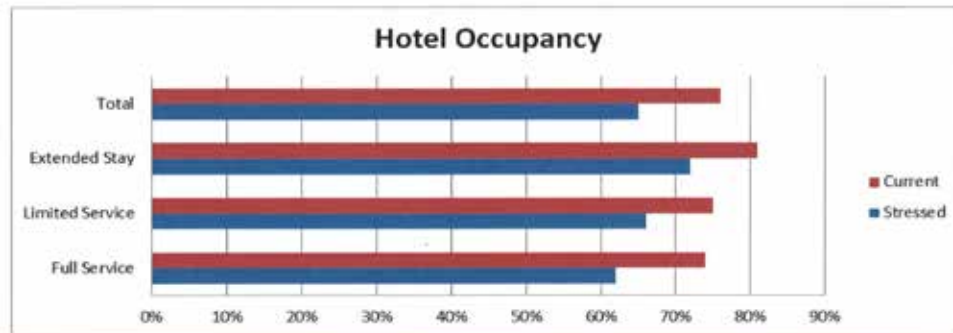
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JM1

Jennifer Meyerowitz, 10/2/2019

Underwriting

- ▼ Analyze Rev Par – Revenue per Available Room occupancy and rate
- ▼ Competition
- ▼ Land Values
- ▼ Need for Hotel in Area
- ▼ Sales in Region



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Typical Scenario

- Hotel property with X number of rooms
- In danger of losing their flag
- Unpaid franchise fees
- Behind in real estate taxes
- Have not put in any capital improvements

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Distressed Hotel Deal

**How much we
need to put into
the asset?**

**How long until it
turns around and
we can sell it?**



"After watching the clock for 25 years, it's only right
we send you off to retirement with a watch."

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Distressed Real Estate Deals

Distressed Real Estate Includes:

- ▼Commercial & Residential Real Estate
- ▼Agricultural Deals
- ▼Restaurants
- ▼Retail
- ▼Among Others



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Considerations for Distressed Real Estate Deals

- High Returns, but also high risk – many ways to lose investment
- Messy Real Estate Deals
 - ▼Property might be in need of repairs
 - ▼Property might have environmental damage
 - ▼Property that does not have clean title

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DO YOUR RESEARCH

- ▼Comprehensively review asset
- ▼Conduct title searches
- ▼Review history of permits and zoning
- ▼Review bankruptcy petitions filed
- ▼Conduct municipal searches
- ▼Get an environmental indemnification
- ▼View the Property
- ▼If a construction deal, get third party inspectors to ensure construction up to par and milestones reached



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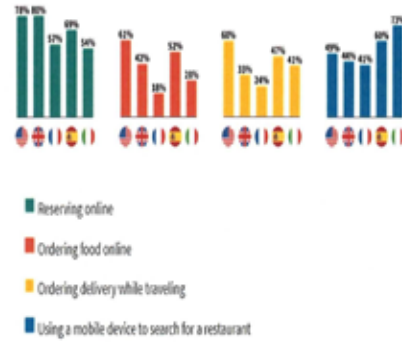
Distressed Restaurant Deals

Considerations for Distressed Restaurant Deals

■ Issues to Consider for Restaurant Deals:

- ▼ Labor Laws
- ▼ Overhead is critical
- ▼ Product freshness
- ▼ Brand Awareness
- ▼ Technological Advances
- ▼ Whimsical dining trends

Reservations Online and Mobile Use



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Distressed Retail Deals

Retail Apocalypse

American retailers have announced plans to close almost 8,200 stores

U.S. Retail Apocalypse Intensifies in 2019

Chains that are closing the most U.S. stores, by brand



* refers to the brand or brands, not all brands by parent company
Source: Business Insider

statista



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Why Retail Distress?

Causes of Retail Distress

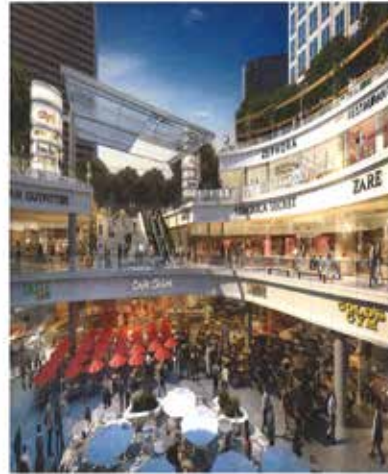
- The "Amazon" Effect
- Over-leveraged
- E-Commerce has grown
- Growth of super discounters
- Changes in Consumer Spending Trends



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Changes to Shopping Mall Complex

- Trends:
 - Landlords are considering unorthodox and non-retail uses when Big Box tenants vacate
 - Malls focusing on experiences
- Considerations
 - Zoning
 - Exclusive Use and Use Restrictions
 - Ground Leases v. Fee Ownership
 - Access Issues Related to Anchor Closures
 - Environmental
 - Taxes



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Other Uses for Distressed Shopping Malls

Repurposing Shopping Malls



- Medical Centers
- Office Space
- Hotels
- Apartments
- Theatres
- Gyms
- Entertainment:
Bowling Alleys,
Arcades, Billiards

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General Investing Considerations

- Select sound and closely related comps
 - Clearly understand operations, valuations, analysts reports
 - Understand the capital investments
 - Do not rely on one method in preparing a forecast
 - Look at size the market
 - Is there a second act for this business after it is fixed?
 - Is the overall sector growing?
 - Is there industry excess capacity
 - Can labor availability support growth
-

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Selling Technology Company Assets

Technology for this discussion includes

- E-commerce
 - Retail
 - Online Auction
 - Portals
- Software
 - Licensing
 - Internal use development



What are we selling?

People

- Deals vary but essentially one of the primary assets is typically key technology staff
 - Programmers
 - Designers
 - Web Developers
- Retention is key
 - The employee's understanding of the code is invaluable, the loss of institutional knowledge could be worth 20% of value.
- Brands, URLs, Custom code, Trademarks, Copyrights, Patents
 - These can provide market delineation and recognition, continual downstream revenue and protection from competitors



Intellectual Property Diligence

Confirm the IP is protected and marketable

- Obtain listings of patents and applications along with the patent type and expiration.
 - Has it been defended in any court proceedings?
 - Have any revenue generating royalty agreements been executed for the patent?
 - Do the Royalty agreements have termination dates?
- Are customer lists transferable, what is company privacy policy?
- Obtain listing of URLs, Trademarks and Copyrights along with registration numbers and renewal dates.
 - Are there measurable indications of market awareness for the TM and CR? NPS information?
 - Are there customer files that are sellable/rentable?
- Understand if technology is custom and protected.
 - Is it easily replicated? Current programming code used?
 - How does it help set the user apart from competitors?
- If the sale is part of bankruptcy proceeding note section 363 rules regarding IP sales and section 365(n) assumption of licensing contracts



The Sale Process

- Understand prior to the sale process how the IP can attain maximum value
 - Better sold in total or piecemeal?
- Search your database for potential strategic acquirers
 - Does this fortify a larger player in the market's barrier to entry?
 - Are the competitors who can use this as a synergistic addition to help them acquire further market share?
- Are there financial acquirers?
 - Entities who would add the IP to their stable and generate revenue through licensing?
 - Patent aggregators who have interest?
 - Financials with multiple holdings that could benefit from the IP?
- As this process will involve rigorous review from potential acquirers be certain all IP has appropriate documentation, valid registrations and complete history of any agreements associated with it.





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Distressed Investing in the Healthcare Sector



December 2019

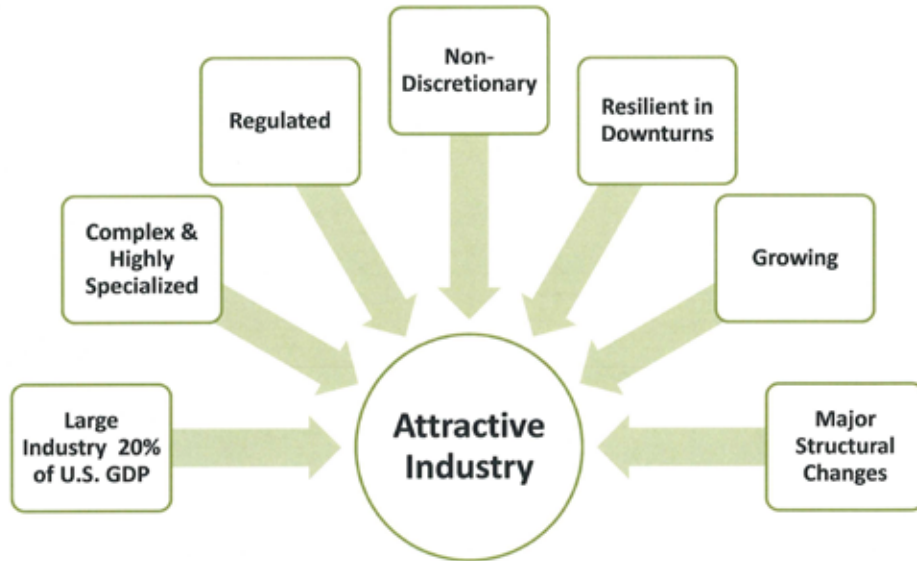
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Wynnchurch Capital – Healthcare – Attractive Sector

Large & Less-Cyclical Market



WC WYNNCHURCH | CAPITAL

Source: Moody's, April 2019

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Wynnchurch Capital – Healthcare – Industry Challenges

Mature Industry, Undergoing Change



Amended Regulations & Proposed Rules

- Major political changes and new laws
- Pricing transparency & increased focus on compliance
- Declining reimbursement
- Laws & reimbursement policies vary state-to-state



Revenue Pressure

- Little or no control over pricing
- Medicare/Medicaid programs & insurance companies dictate reimbursement
- Increased competition
- Frequent billing mistakes lead to high denial rates and delayed cash collections



High Fixed Costs

- For 48 of the past 49 years, costs have grown faster than the CPI
- Historically fragmented & inefficient value chain
- Labor shortage
- Little ability to negotiate pricing with suppliers

WC WYNNCHURCH | CAPITAL

Source: FTT, LEK, BofA, DebtWire, BM&B

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Wynnchurch Capital – Healthcare – Industry Challenges (continued)

Headline Noise from Washington



Affordable Care Act (ACA) appeal process



Opioids



Drug pricing



Surprise billing & dialysis report



Medicare for All

The New York Times

Is America's Health Care System a Fixer-Upper or a Teardown?



Source: New York Times, September 15, 2019; BAM, Quarterly Outlook Report, 2019 Company/Regulatory/Legislative Update, July 24, 2019

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Wynnchurch Capital – Healthcare – Industry Challenges (continued)

Biggest Challenges at Facility-Based Companies

Many Challenged Models



Small & Rural Hospitals



Senior Housing



Alternate Site & Unaffiliated Providers



Skilled Nursing



Equipment & Supplies



Services & Distribution

"Technology is out pacing old brick and motor facilities."



Wynnchurch Target Attributes

- More value-add
- Focused on payor mix
- Need limited pricing risk
- Switching costs
- Differentiation
- Outsourcing trends

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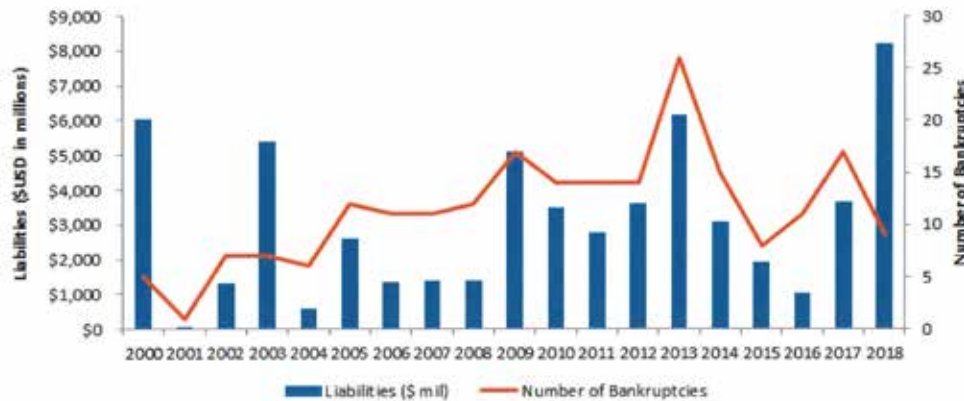
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Wynnchurch Capital – Healthcare – Distressed M&A Activity

Healthcare Bankruptcies Already Increasing



Healthcare Bankruptcies by Count and Total Liabilities



Source: FTI, TheDeal Pipeline (through August 27, 2018)

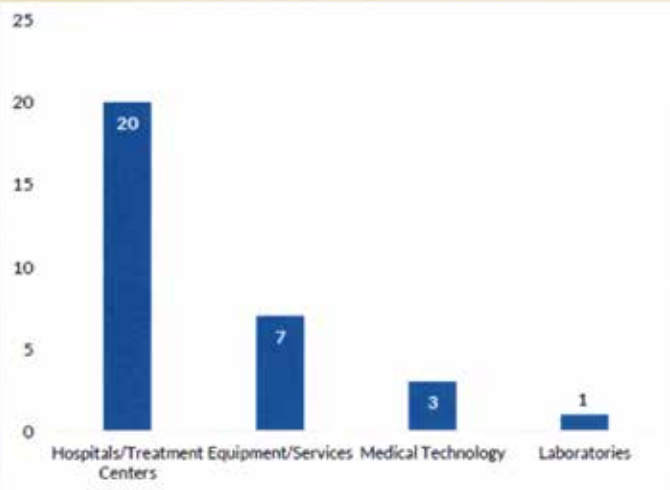
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Wynnchurch Capital – Healthcare – Distressed M&A Activity (continued)

Bankruptcy Themes

Recent Healthcare Bankruptcies by Sub-Sector



Top Bank Creditors



Top Strategic Creditors



Source: DebtWise, Healthcare: 2016-2018 Restructuring Insights

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Wynnchurch Capital – Healthcare – Distressed M&A Activity (continued)

Classic Private Equity Playbook

Turnaround Investors Can Dramatically Help Improve the Healthcare Sector

Operational Improvement Opportunity	Strategy Development Opportunity
<ul style="list-style-type: none"> • Deploy superior continuing improvement manufacturing techniques • Bring scale & efficiency to various physician specialties • Improve access to care and quality of patient experience • Utilize new ERP systems to optimize revenues, reduce costs, and improve supply chain 	<ul style="list-style-type: none"> • Opportunity to back market-aggregating health systems that can: <ul style="list-style-type: none"> • scale operations • reduce costs across geographies • coordinate patient care • increase quality outcomes

Wynnchurch Capital – Healthcare – Distressed M&A Activity (continued)



Wynnchurch – Healthcare Case Study (December 2018)

Wynnchurch Capital – Restructuring of American Medical Depot (“AMD”)

Company	Challenges	Restructuring & Turnaround
<ul style="list-style-type: none"> • AMD is a leading distributor of medical products, equipment, and services • Unique supply chain capabilities • Prime vendor to U.S. Department of Defense (DoD) and U.S. Department of Veterans Affairs (VA) 	<ul style="list-style-type: none"> • Awarded 6 Regions under VA’s Medical Surgical Prime Vendor contract in 2016 • Secured a \$85 million loan from Senior Lender in 2017 • Contract delays in 2016-2017 caused need for recapitalization 	<ul style="list-style-type: none"> • Wynnchurch provided financing to AMD in 2018 to refinance Senior Debt • Partnered with Management and SOLIC Capital • Unique opportunity to support growth of supply chain market leader • Growing Alternate Site Care segment (i.e. all sites of care outside the hospital)



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Distressed Investing in the Healthcare Sector



December 2019

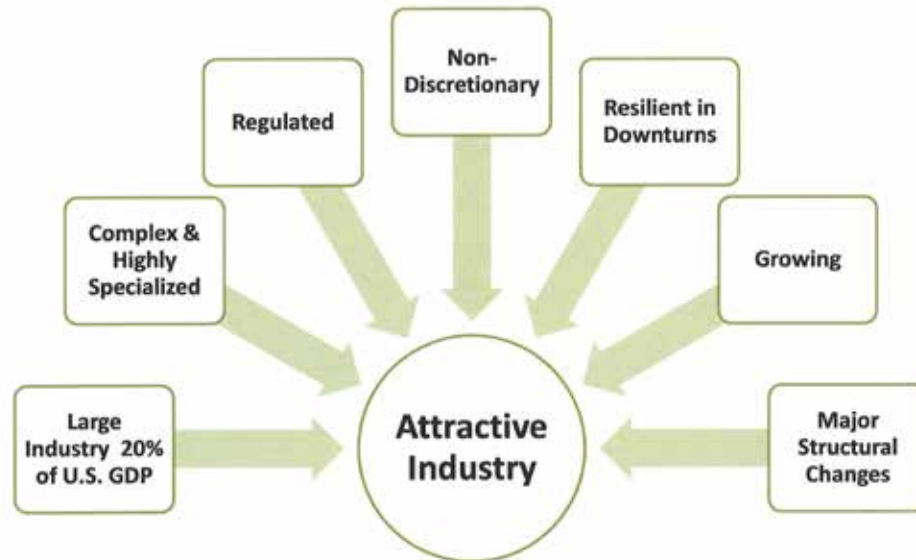
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Source: Moody's, April 2019

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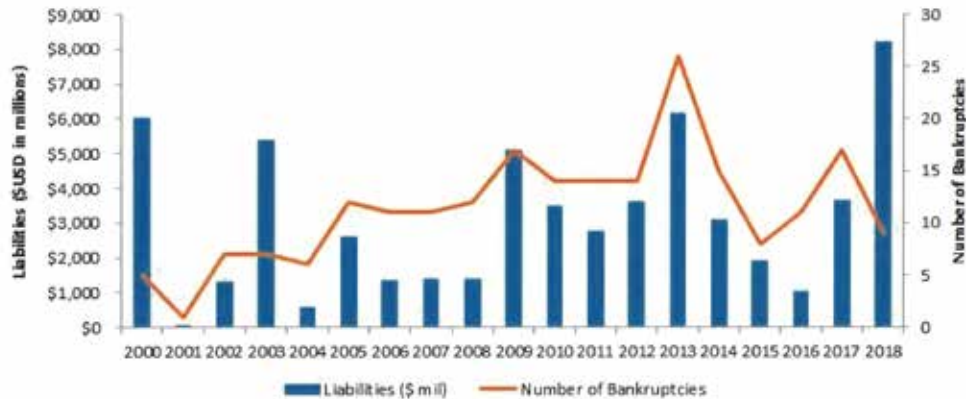
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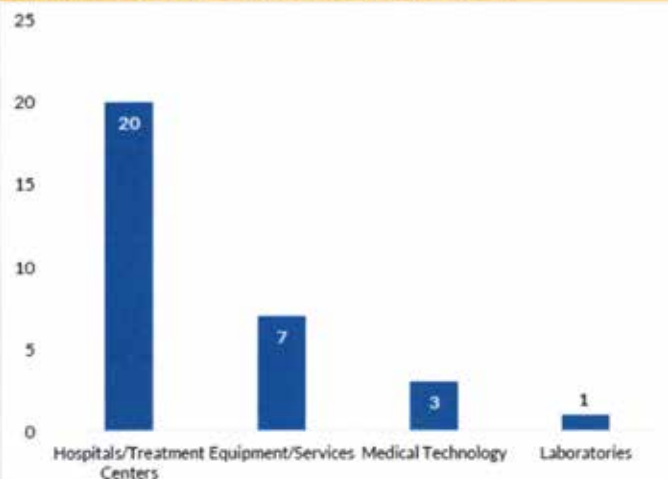
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Preliminary Draft – Subject to Material Change

Investing in the Energy Markets
'How Investors Evaluate Distressed Deals' Panel



October 2019 / Highly Confidential

Jefferies LLC
Member SIPC

October 2019

Jefferies

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Oil & Gas

October 2019

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Themes in Oil & Gas

- 1 **Macro Outlook Remains Uncertain**
 - Commodity volatility is near all-time highs
 - Heightened scrutiny of operators from public investors
- 2 **Asset / Technical Environment Also Challenging**
 - Unfavorable results from new drilling techniques
 - Investors focused on high-quality, simple plays with predictable cash flow
- 3 **Exit Opportunities in Today's Environment Are Limited...**
 - M&A activity near historical lows
 - Public capital markets are closed for most issuers
- 4 **... However, Attractive Opportunities For Investors Exist**
 - Opportunity for *deep value buys* – assets once sold at high multiples and lower embedded return now trade at substantial discount to NAV
 - Stressed / distressed E&P high yield could be an attractive value play

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Successful Business Models in the Current Environment

Key Points	Pillar	Commentary
<ul style="list-style-type: none"> Investors have rewarded businesses for delivering return on capital Traditional benchmarks (production growth, single well IRRs) are secondary to future distributions / buybacks 	Scale	<ul style="list-style-type: none"> Investors unlikely to evaluate businesses that are perceived as "sub-scale" Differentiated ownership (i.e. larger, long-term holders) for businesses with larger and more liquid market capitalizations
	Free Cash Flow	<ul style="list-style-type: none"> Many companies have targeted 2019 as the inflection point for generating positive free cash flow – few are actually there today
	Balance Sheet	<ul style="list-style-type: none"> Investors typically seeking leverage multiples between 1.0x – 2.0x and a fully-funded business plan (no external capital requirement)
	Asset-Level Returns	<ul style="list-style-type: none"> Combination of single well returns and depth of "Tier 1" inventory; however, investors have focused on delivering growth within cash flow as benchmark on asset quality
	Return Capital to Shareholders	<ul style="list-style-type: none"> Combination of dividends and share repurchases, each driving to higher absolute return for shareholders

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A&D Market Participation by Sector – Who's Buying?



Source: PLS as of September 13, 2019

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Post Major Price Correction, Oil Prices “Snap Back” Due to Limited Supply



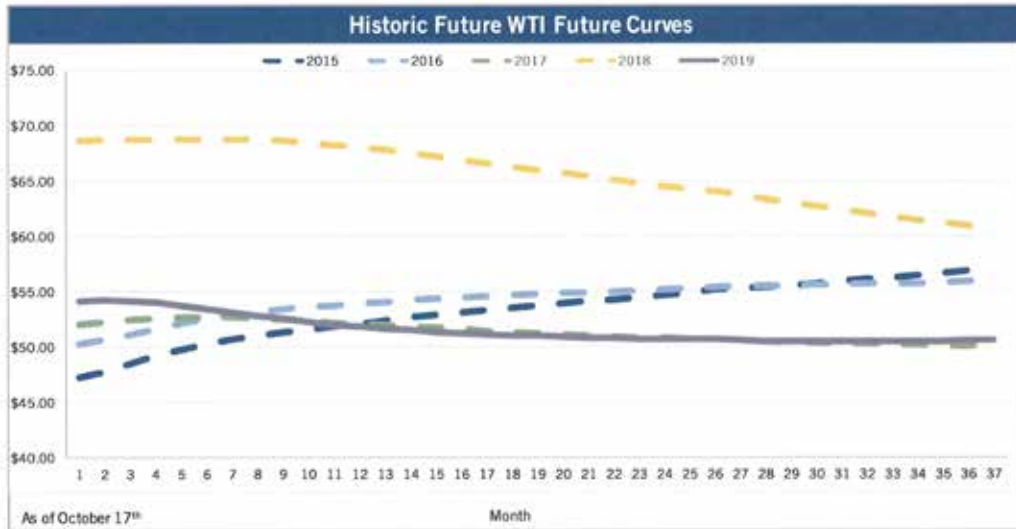
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Historical Future Curves



- Futures Curve trading similar to 2017 levels, slightly steeper drop reflective of today's pessimism
- Despite an immaterial ~\$5/bbl. difference between today's curve and 2016, Multiples (EV / forward EBITDA) have fallen drastically

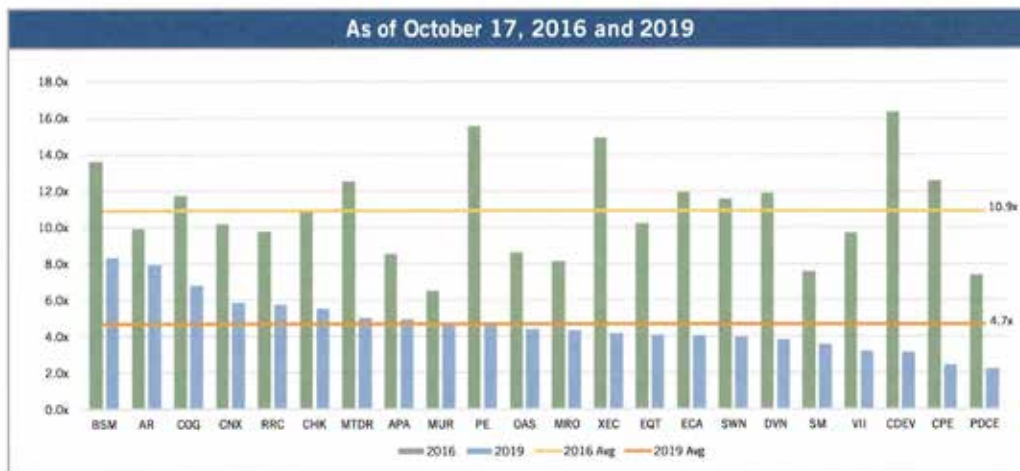
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NTM Projected EV / EBITDA



- 2016 multiples traded ~6 turns higher than present day levels
 - Investors and strategics viewed downturn as an opportunistic time to invest
 - Optimism was growing due to talks of increased efficiencies, by way of new technologies and new drilling techniques
- Investors are no longer interested in growth through leverage and acquisitions
 - Investor sentiment focused on companies that can produce steady cash flows, amid low oil price environment

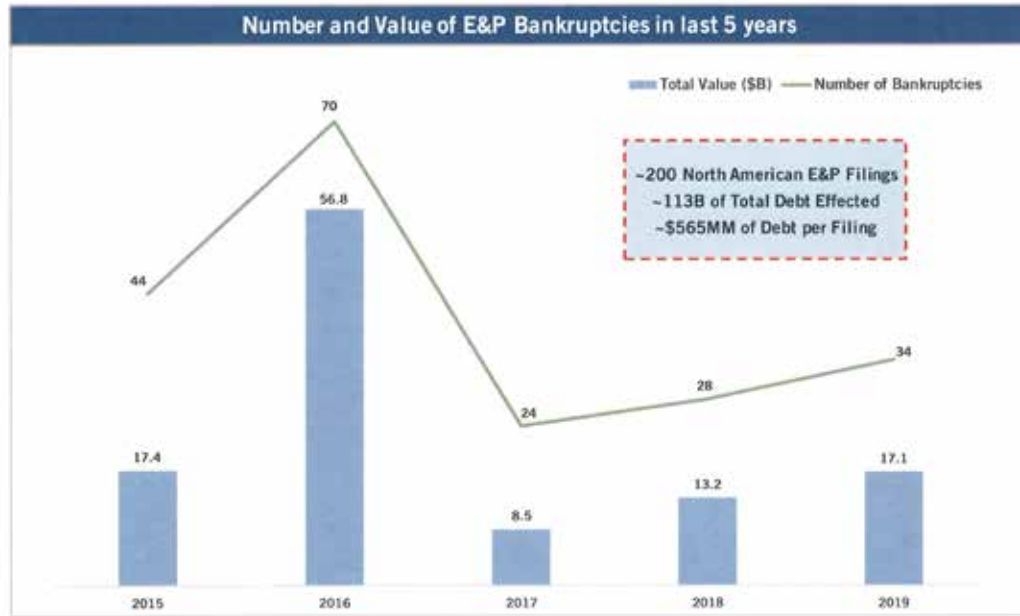
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Upstream Bankruptcy Review



Source: Haynes & Boone September 30, 2019 Bankruptcy Monitor.

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Coal

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2019 WINTER LEADERSHIP CONFERENCE

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Key Considerations for Investing in Coal

Met vs. Thermal Exposure	<ul style="list-style-type: none"> Both U.S. met and thermal coal producers are experiencing significant challenges Thermal producers have been negatively impacted by increasing competition from alternative fuel sources (natural gas and renewables) and mounting ESG pressures, resulting in declining domestic demand and pricing for coal <ul style="list-style-type: none"> Even low cost producers have seen margins almost entirely eroded by the declining pricing environment Negative pressures for thermal producers have been compounded by a collapsing seaborne thermal market, flooding domestic market with coal that was intended to go export and setting up 2020 to be a very challenging year, particularly for ILB and NAPP producers Met producers experienced a resurgence in 2017 and 2018 due to significantly higher benchmark pricing and cleaner balance sheets as a result of recent restructuring efforts <ul style="list-style-type: none"> However, benchmark pricing has significantly declined in 2019 driven by the ongoing U.S. / China trade war and global macroeconomic uncertainty, weakening demand for met coal by the global steelmakers As a result, U.S. producers have recently announced shutdowns for a number of met coal mines that are no longer profitable in the current pricing environment
Forecasting Cash Flow	<ul style="list-style-type: none"> Investors evaluating coal mine opportunities need to forecast the financials for the mine in order to estimate returns. This can be complex and will include evaluating capital expenditures over a long period as well as pricing <ul style="list-style-type: none"> In diligence, investors will typically look to life-of-mine analyses in order to determine whether owning the asset will ultimately result in an enhanced cash recovery if they were to run the mine as opposed to pursuing an immediate sale Understanding market/pricing expectations and where the company's mine(s) sit on the cost curve is critical

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Key Considerations for Investing in Coal (cont'd)

Market Liquidity	<ul style="list-style-type: none"> As a secured lender in a chapter 11 process with the potential to own the debtor's assets, distressed investors must pay attention to market liquidity, which could determine the speed at which the lender is able to crystallize a return on investment In the coal industry, which has been effectively deemed a 'falling knife' by industry players, understanding the i) ability to and ii) timing associated with marketing the contemplated asset is crucial Investors must take into account that (i) current lack of available capital to coal strategics impacts the universe of potential buyers and (ii) private equity is largely unwilling to invest in coal
Asset Valuation	<ul style="list-style-type: none"> Valuation should not be limited to an analysis of the company as a whole only <ul style="list-style-type: none"> In bankruptcy, buyers can use their position in the debtors' secured debt to credit bid for individual assets in their collateral package at a discount Comparable valuations (at the asset level) can be obtained from certain specialty valuation firms, or a discounted cash flow model can be used to value the asset Supply-demand dynamics in the industry are critical to pricing coal assets

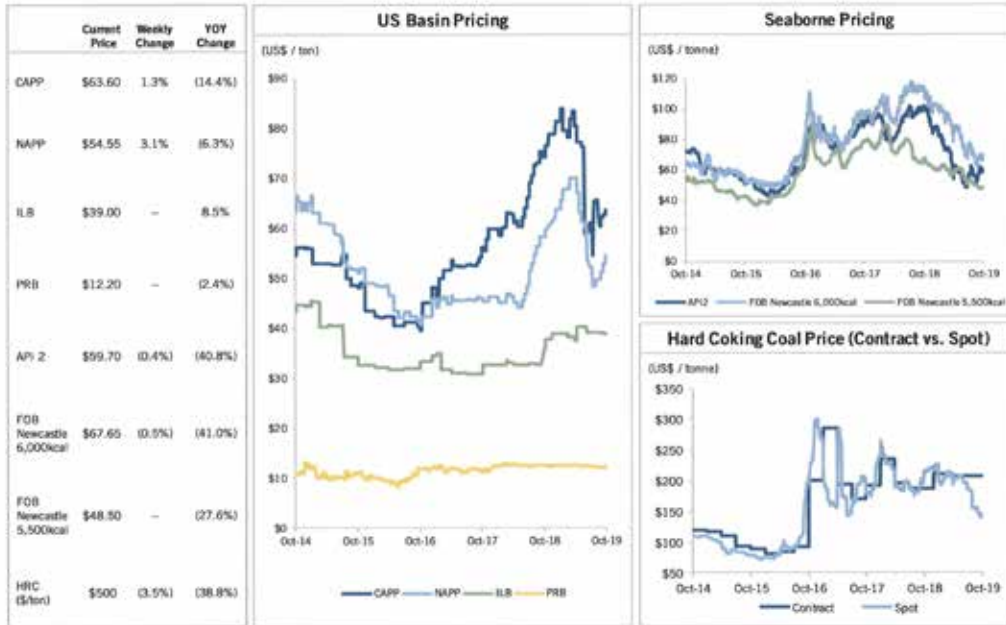
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Coal Pricing Update / Market Volatility



Source: Bloomberg, Wall Street Research
Note: Market data as of October 4, 2019. CAPP (12,000 BTU, 13.5% ash, <1% sulfur), NAPP (12,500 BTU, 7%-9% ash, 2%-3% sulfur), ILB (11,800 BTU, max 2% sulfur, 8%-9% ash), PRB (10,800 BTU, <2% sulfur, 5.5% ash).
HCC type and HRC price forecasts are from Jefferies Research.

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Distressed Investing in the Healthcare Sector



December 2019

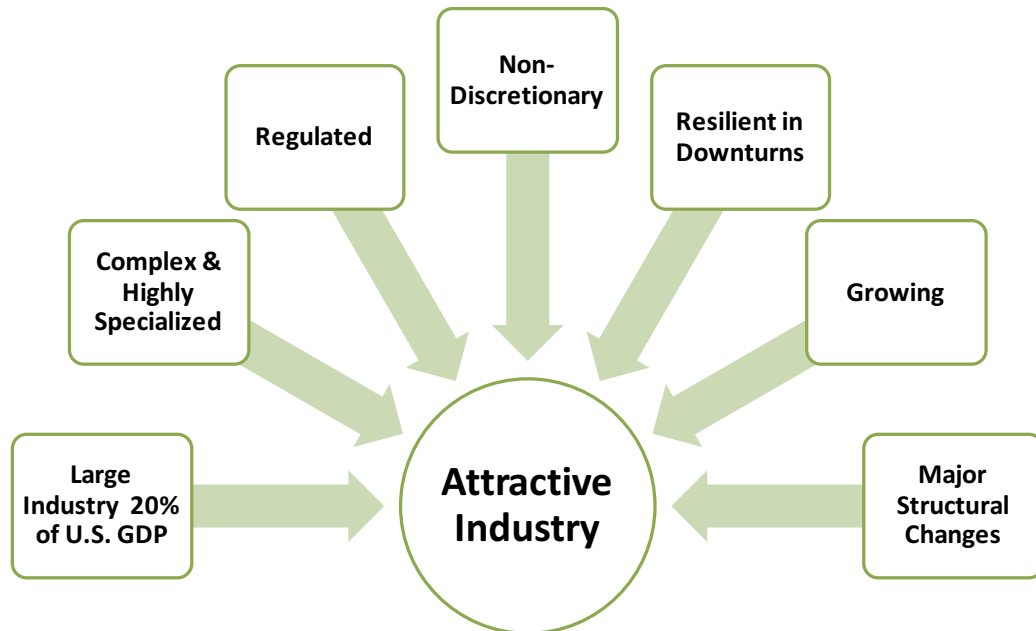
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- Labor shortage
- Little ability to negotiate pricing with suppliers

Source: FTI, LEK, BofA, DebtWire, BAML

Wynnchurch Capital – Healthcare – Industry Challenges (continued)

Headline Noise from Washington



1. Affordable Care Act (ACA) appeal process



1. Opioids



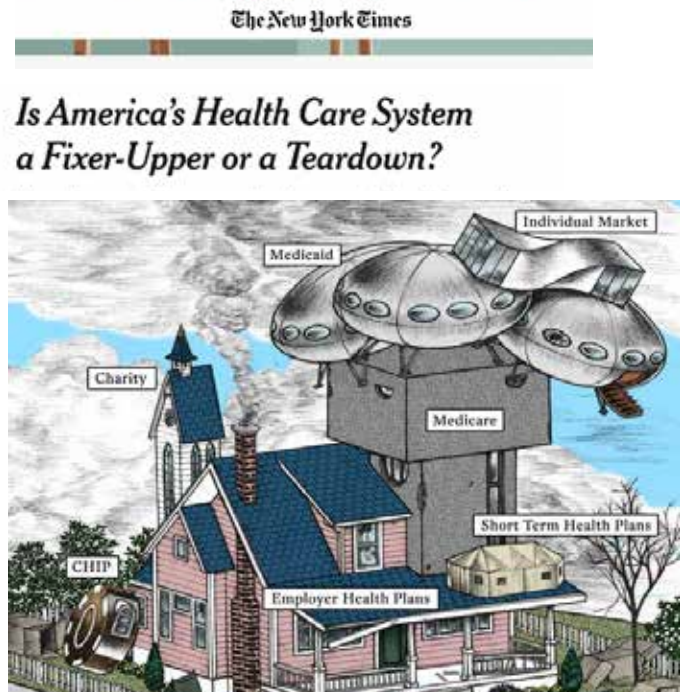
1. Drug pricing



1. Surprise billing & dialysis report



1. Medicare for All



Source: New York Times, September 19, 2019; BAMl, Quarterly Outlook Report, 2Q19 Company/Regulatory/Legislative Update, July 24, 2019

Wynnchurch Capital – Healthcare – Industry Challenges (continued)

Biggest Challenges at Facility-Based Companies

Many Challenged Models



Small & Rural Hospitals



Senior Housing



Alternate Site & Unaffiliated Providers



Skilled Nursing



Equipment & Supplies



Services & Distribution



Wynnchurch Target Attributes

- More value-add
- Focused on payor mix
- Need limited pricing risk
- Switching costs
- Differentiation
- Outsourcing trends

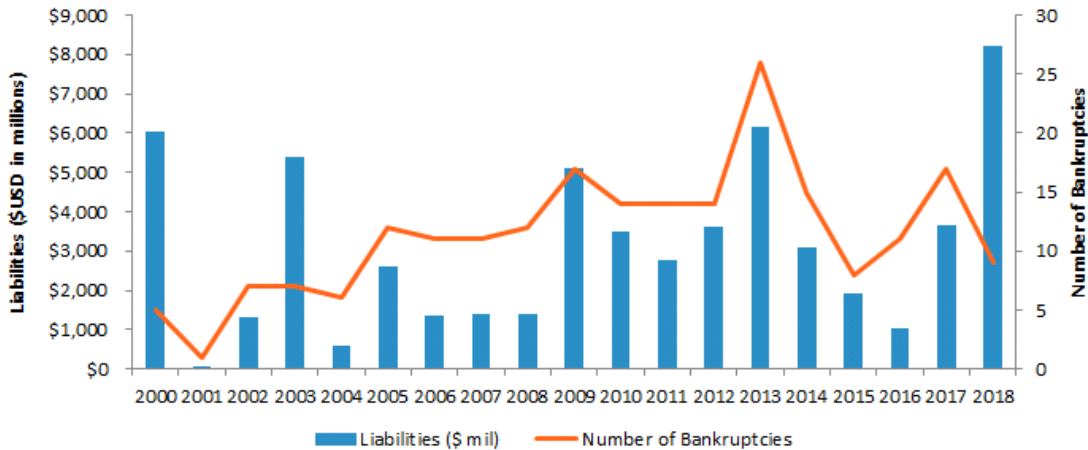
"Technology is out pacing old brick and motor facilities."

Wynnchurch Capital – Healthcare – Distressed M&A Activity

Healthcare Bankruptcies Already Increasing



Healthcare Bankruptcies by Count and Total Liabilities

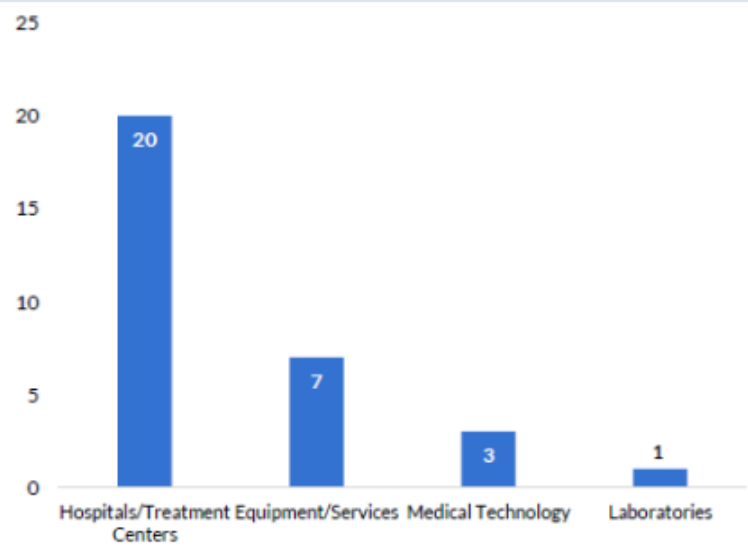


Source: FTI, TheDeal Pipeline (through August 27, 2018)

Wynnchurch Capital – Healthcare – Distressed M&A Activity (continued)

Bankruptcy Themes

Recent Healthcare Bankruptcies by Sub-Sector



Top Bank Creditors



Top Strategic Creditors



Source: DebtWire, Healthcare: 2016-2018 Restructuring Insights

Wynnchurch Capital – Healthcare – Distressed M&A Activity (continued)

Classic Private Equity Playbook

Turnaround Investors Can Dramatically Help Improve the Healthcare Sector

1. Operational Improvement Opportunity	Strategy Development Opportunity
<ul style="list-style-type: none"> • Deploy superior continuing improvement manufacturing techniques • Bring scale & efficiency to various physician specialties • Improve access to care and quality of patient experience • Utilize new ERP systems to optimize revenues, reduce costs, and improve supply chain 	<ul style="list-style-type: none"> • Opportunity to back market-aggregating health systems that can: <ul style="list-style-type: none"> • scale operations • reduce costs across geographies • coordinate patient care • increase quality outcomes

Wynnchurch Capital – Healthcare – Distressed M&A Activity (continued)



Wynnchurch – Healthcare Case Study (December 2018)

Wynnchurch Capital – Restructuring of American Medical Depot (“AMD”)

Company	Challenges	Restructuring & Turnaround
<ul style="list-style-type: none"> • AMD is a leading distributor of medical products, equipment, and services • Unique supply chain capabilities • Prime vendor to U.S. Department of Defense (DoD) and U.S. Department of Veterans Affairs (VA) 	<ul style="list-style-type: none"> • Awarded 6 Regions under VA’s Medical Surgical Prime Vendor contract in 2016 • Secured a \$85 million loan from Senior Lender in 2017 • Contract delays in 2016-2017 caused need for recapitalization 	<ul style="list-style-type: none"> • Wynnchurch provided financing to AMD in 2018 to refinance Senior Debt • Partnered with Management and SOLIC Capital • Unique opportunity to support growth of supply chain market leader • Growing Alternate Site Care segment (i.e. all sites of care outside the hospital)