

DISTRESSED CREDIT

Investment Strategies

DISTRESSED CREDIT – Overview



Definition of Distressed Credit

Distressed credit refers to debt instruments issued by companies or entities experiencing financial difficulties or are at risk of defaulting on their obligations.



Distressed Credit Investment Strategies

Investors in distressed credit may employ various strategies, such as purchasing discounted debt, providing debtor-in-possession financing, or participating in debt restructuring processes.



Characteristics of Distressed Credit

Distressed credit investments typically offer higher yields compared to investment-grade debt, but also carry greater risks, such as higher default probability and potential for principal loss.



Evaluation of Distressed Credit Opportunities

Careful analysis of the issuer's financial condition, industry dynamics, and restructuring potential is essential when evaluating distressed credit investment opportunities.

Distressed credit investing requires precise collateral valuation and understanding of legal processes as prolonged processes can sharply impact IRR. Skilled assessment of recovery scenarios and exit strategies is essential to balance risk and reward.

INVESTMENT PROCESS

● Phase 1: Identification

Analyze the credit market to identify potential distressed opportunities

● Phase 3: Valuation

Develop a comprehensive valuation model to determine the intrinsic worth of the asset

● Phase 5: Restructuring

Actively engage with the borrower to restructure the debt and improve the asset's performance

● Phase 2: Evaluation

Conduct in-depth research and due diligence on the target investment

● Phase 4: Acquisition

Negotiate and execute the purchase of the distressed credit instrument

● Phase 6: Exit

Monitor the investment and identify the optimal time and strategy to exit the position

DISTRESSED CREDIT – Main Strategies

- **Loan-to-Own**

Investors purchase distressed debt with the intent of converting their debt position into an equity stake in the company, often through a bankruptcy or restructuring process.

- **Debt Exchanges**

Investors exchange existing debt for new debt instruments, often at a discount, to improve the company's capital structure and provide liquidity.

- **Distressed Debt Purchases**

Investors acquire discounted debt instruments in the secondary market, aiming to profit from a potential recovery in the company's financial health.

- **Litigation and Workout Strategies**

Investors pursue legal and negotiation strategies to maximize the value of their distressed debt investments, such as initiating bankruptcy proceedings or participating in debt restructuring negotiations.

- **Hedging and Arbitrage**

Investors employ various hedging techniques and arbitrage strategies to manage the risks associated with distressed credit investments, such as using credit default swaps or relative value trades.

DISTRESSED CREDIT – Risks

- **Limited Liquidity**

Distressed assets may have limited secondary market liquidity, making it difficult to exit positions quickly.

- **High Volatility**

Prices of distressed securities can be highly volatile, subject to market sentiment and restructuring outcomes.

- **Operational Risks**

Investing in distressed companies may require active involvement in operational turnaround, which carries additional risks.

- **Legal Complexities**

Distressed credit investing often involves navigating complex legal and regulatory environments related to bankruptcy and restructuring.

- **Information Asymmetry**

Investors may face challenges in obtaining accurate and timely information about the financial condition of distressed issuers.

CASE STUDY: JC PENNEY

By 2020, JC Penney was burdened with significant debt, declining sales, and fierce competition from online retailers, which led to its Chapter 11 bankruptcy filing. Distressed debt investors, seeing potential in the company's real estate assets and established customer base, began acquiring its discounted debt, anticipating a profitable restructuring.

Throughout the bankruptcy process, JC Penney restructured its operations and financial commitments. A key turning point was the company's acquisition by Simon Property Group and Brookfield Asset Management, two major commercial property owners. This acquisition enabled JC Penney to continue operating while reducing debt, renegotiating leases, and streamlining its store portfolio. The focus shifted to making the company leaner and more responsive to shifting retail trends, which was crucial for survival.

The restructuring provided value to distressed debt investors who initially bought JC Penney's bonds at a discount. As JC Penney stabilized and resumed operations under new ownership, the restructured debt increased in value, creating a viable exit strategy for investors. This case underscores how distressed debt investment in retail can hinge on real estate value, operational restructuring and strategic partnerships to drive a successful turnaround.

DISTRESSED CREDIT – Valuation Techniques

Discounted Cash Flow Analysis

Projecting future cash flows and discounting them back to present value to determine the intrinsic value of a distressed asset.

Comparable Company Analysis

Comparing the valuation metrics of the distressed company to those of comparable, financially healthy companies.

Asset-Based Valuation

Estimating the value of a distressed company's assets, such as real estate, equipment, and inventory, to determine the liquidation value.

Event-Driven Valuation

Analyzing the potential impact of specific events, such as restructuring, bankruptcy or M&A on the value of a distressed asset.

Sum-of-the-Parts Valuation

Valuing each of a distressed company's business segments or assets separately and then aggregating the values to determine the overall worth.

Key Components of Distressed Credit Investing



Credit Quality and Risk Assessment

Collateral and Recovery Potential

Capital Structure Positioning

Asset Management
& Workout Strategy

REGULATORY AND LEGAL CONSIDERATIONS



Licensing and registration requirements

Investors in distressed credit must ensure they comply with relevant licensing and registration requirements, such as being registered as an investment advisor or broker-dealer.



Bankruptcy and insolvency considerations

Investing in distressed credit often requires understanding the bankruptcy and insolvency processes, including the rights and obligations of different creditor classes.



Compliance with securities laws

Distressed credit investing involves navigating complex securities laws and regulations, including restrictions on insider trading, disclosure requirements and anti-fraud provisions.



Regulatory oversight and reporting

Distressed credit investors may be subject to regulatory oversight and reporting requirements, such as filing periodic reports or disclosing positions to regulators.

Deeply understanding the legal and regulatory landscape is crucial for successful distressed credit investing, as investors must ensure compliance with a wide range of rules and regulations to mitigate risks and avoid potential penalties or liabilities.

THE FUTURE OF DISTRESSED CREDIT INVESTING

Emerging Distressed Credit Opportunities

Analyze the growing sectors and industries presenting attractive distressed credit investment opportunities, such as the impact of black swan events (e.g. COVID-19) on certain industries and supply chain disruptions.

Regulatory and Policy Shifts

Explore how changes in government policies, regulations, and interventions are shaping the distressed credit landscape, including the potential impact of central bank actions and stimulus programs.

Evolving Distressed Debt Strategies

Discuss the latest trends in distressed debt investment strategies, including the rise of alternative credit structures, the increased use of data analytics, and the integration of environmental, social, and governance (ESG) considerations.

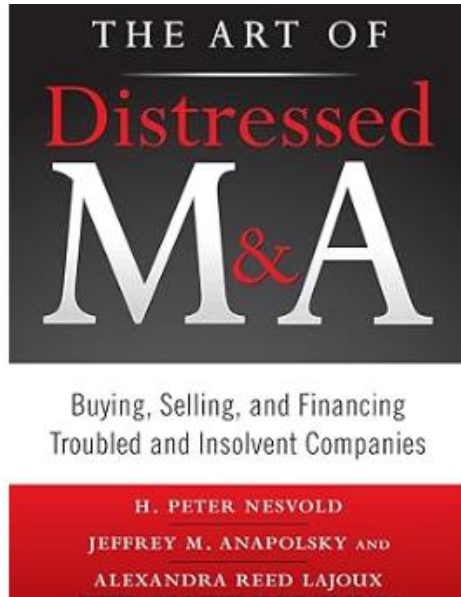
Global Distressed Credit Hotspots

Identify key global regions and markets that are expected to witness a surge in distressed credit opportunities, such as emerging markets, commodity-dependent economies, and sectors impacted by geopolitical tensions.

Challenges and Risks in Distressed Investing

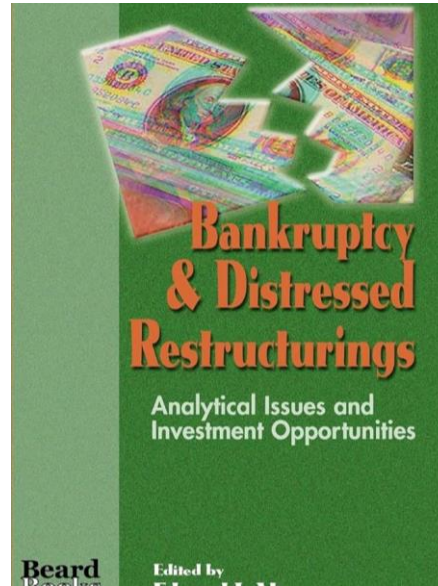
Explore the potential challenges and risks associated with distressed credit investing, including legal and bankruptcy complexities, valuation uncertainties, and the impact of macroeconomic factors on portfolio performance.

RELEVANT RESOURCES



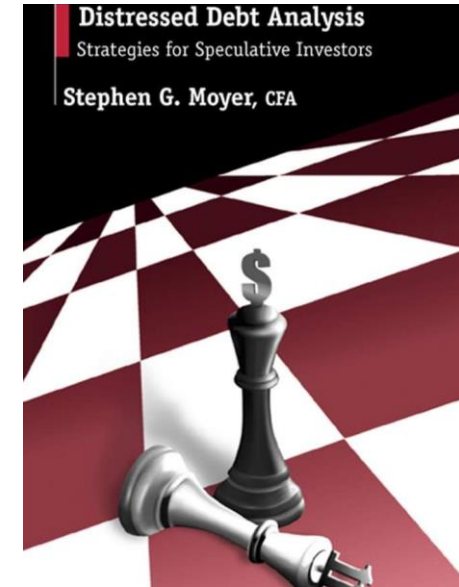
The Art of Distressed M&A

Provides insights on the unique complexities of buying, selling, and financing troubled companies.



Bankruptcy and Distressed Restructurings

A comprehensive guide to the legal, financial, and strategic aspects of distressed investing.



Distressed Debt Analysis

A detailed examination of the processes and analytical techniques used in distressed credit investing.

Private Equity

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