Trinity Alpha

DISTRESSED SECURITIES

A three pronged approach to invest in Distressed Securities

Executive Summary

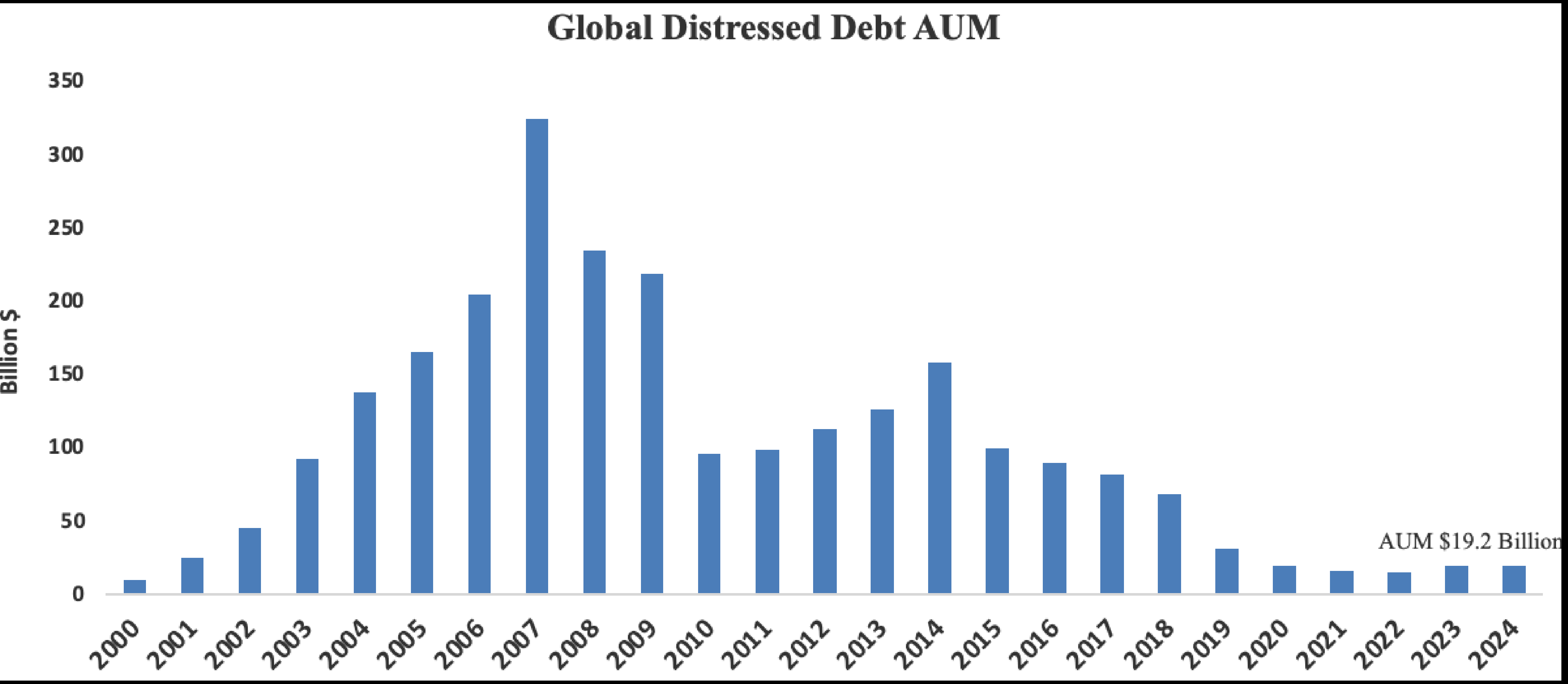
Trinity Alpha

- **Distressed Securities Strategy** – Investing in post-bankruptcy value extraction, debt-to-equity conversions, and capital structure arbitrage to capitalize on market inefficiencies.
- **Market Growth & Performance** – Distressed debt AUM, rising default rates, and hedge fund index growth confirm institutional opportunities in distressed investing.
- **Investment Execution** – Targeting mispriced assets, leveraging restructuring cycles, and strategically acquiring undervalued debt for high recovery potential.
- **Real-World Applications** - Applied successful strategies around the world.
- **Risk & Mitigation** – Credit, liquidity, regulatory, and market risks managed through diversification, hedging, and strategic risk-adjusted portfolio allocations.
- **Competitive Landscape** – Oaktree Capital, Apollo Global, and Baupost Group lead distressed investing, focusing on buyouts, debt restructuring, and arbitrage opportunities.
- **Market Timing & Outlook** – Rising interest rates, widening credit spreads, and forced liquidations create prime entry points for distressed securities investments.

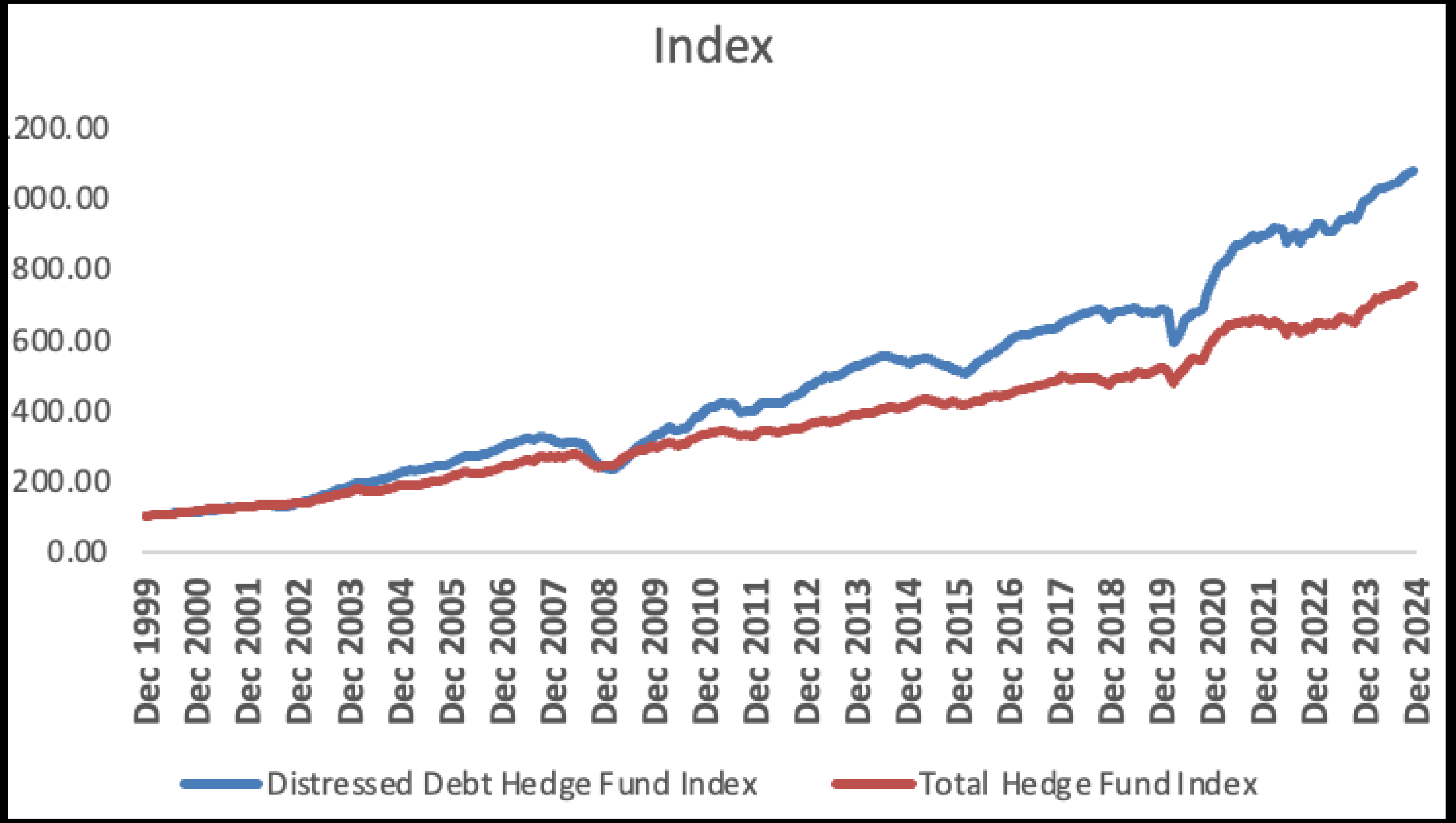
Why Distressed Securities

Performance, Market Size & Growth

Barclay Hedge Global Distressed Debt Securities AUM



Eurekahedge Distressed Debt Hedge Fund Index



Distressed debt strategies, historically linked to economic cycles and default rates, are now presenting compelling opportunities. Speculation about potential U.S. interest rate cuts has led to distressed debt trading at attractive discounts. This environment offers pension funds a chance to achieve strong risk-adjusted returns by investing in distressed debt at favorable prices.

Sources : Eureka Hedge, 2025

Real-World Examples of Distressed Investing Success

The Canada Pension Plan Investment Board (CCPIB) acquired a portfolio of non-performing loans from Spanish banks during the European debt crisis and in NPA's in Indian Banks

Ares Management launched a $7 billion fund aimed at providing capital to companies in complex or distressed situations in UK & China

Facing financial difficulties, offshore drilling company Seadrill underwent a debt-to-equity swap, allowing creditors to convert debt holdings into equity stakes

Oaktree Capital Management invested in the distressed debt of Pierre Foods, facilitating a restructuring process that converted debt into equity, enabling the company to emerge from bankruptcy

Key Characteristics & Description

The Trinity Alpha strategy combines three investment strategies to capitalize on distressed securities.

Debt-to-Equity conversions:

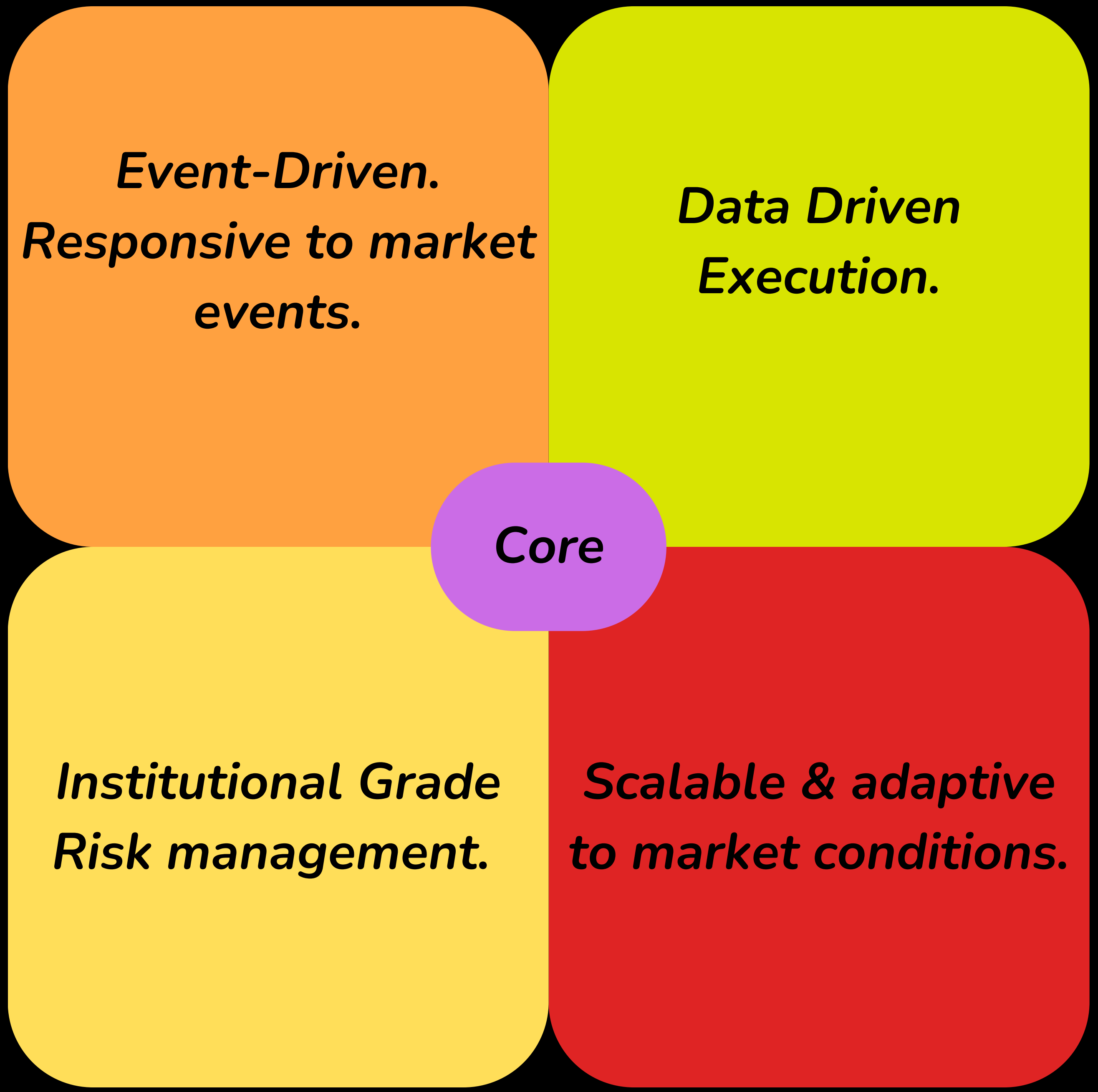
- Objective: Convert debt positions into equity stakes during corporate restructurings.
- Approach: Utilize convertible bonds and negotiable debt-for-equity swaps.

Post-Bankruptcy value extraction:

1. **Objective**: Acquire distressed debt during bankruptcy, and profit from asset recovery post-restructuring.
2. **Approach**: Focus will be on senior secured debt with high recovery rate.

Capital structure arbitrage:

1. **Objective**: Exploit mis-pricing between different securities of the same company
2. **Approach**: Long-Short strategies between undervalued debt and overvalued equity.



Sources : Altman, E. I., & Hotchkiss, E. (2010). Corporate Financial Distress and Bankruptcy: Predict and Avoid Bankruptcy, Analyze and Invest in Distressed Debt.

Advanced Strategy Execution Debt-to-Equity Conversions

Rationale

Debt-to-equity swaps allow investors to convert debt holdings into equity, gaining control of the company and restructuring operations to unlock value.

Debt Restructuring: A Strategic Approach towards Financial Stability

Debt restructuring is a financial strategy used by companies facing distress to modify their existing debt obligations, making them more manageable and sustainable. Companies that have low Altman Z-Scores, indicating a higher risk of bankruptcy, often turn to debt restructuring as a proactive measure to avoid insolvency.

Financial Distress Prediction Models – Altman Z – Score

$$Z = 1.2(X_1) + 1.4(X_2) + 3.3(X_3) + 0.6(X_4) + 1.0(X_5)$$

X_1 = Working Capital / Total Assets

Measures liquidity by comparing working capital to total assets.

X_2 = Retained Earnings / Total Assets

Represents the portion of earnings reinvested in the company, indicating profitability and stability.

X_3 = EBIT / Total Assets

Reflects operating efficiency and profitability by showing earnings before interest and taxes as a proportion of total assets.

X_4 = Market Value of Equity / Total Liabilities

Measures leverage and investor confidence by comparing market capitalization to total liabilities.

X_5 = Sales / Total Assets

Assesses asset turnover and revenue generation efficiency.

Z-Score Interpretation:

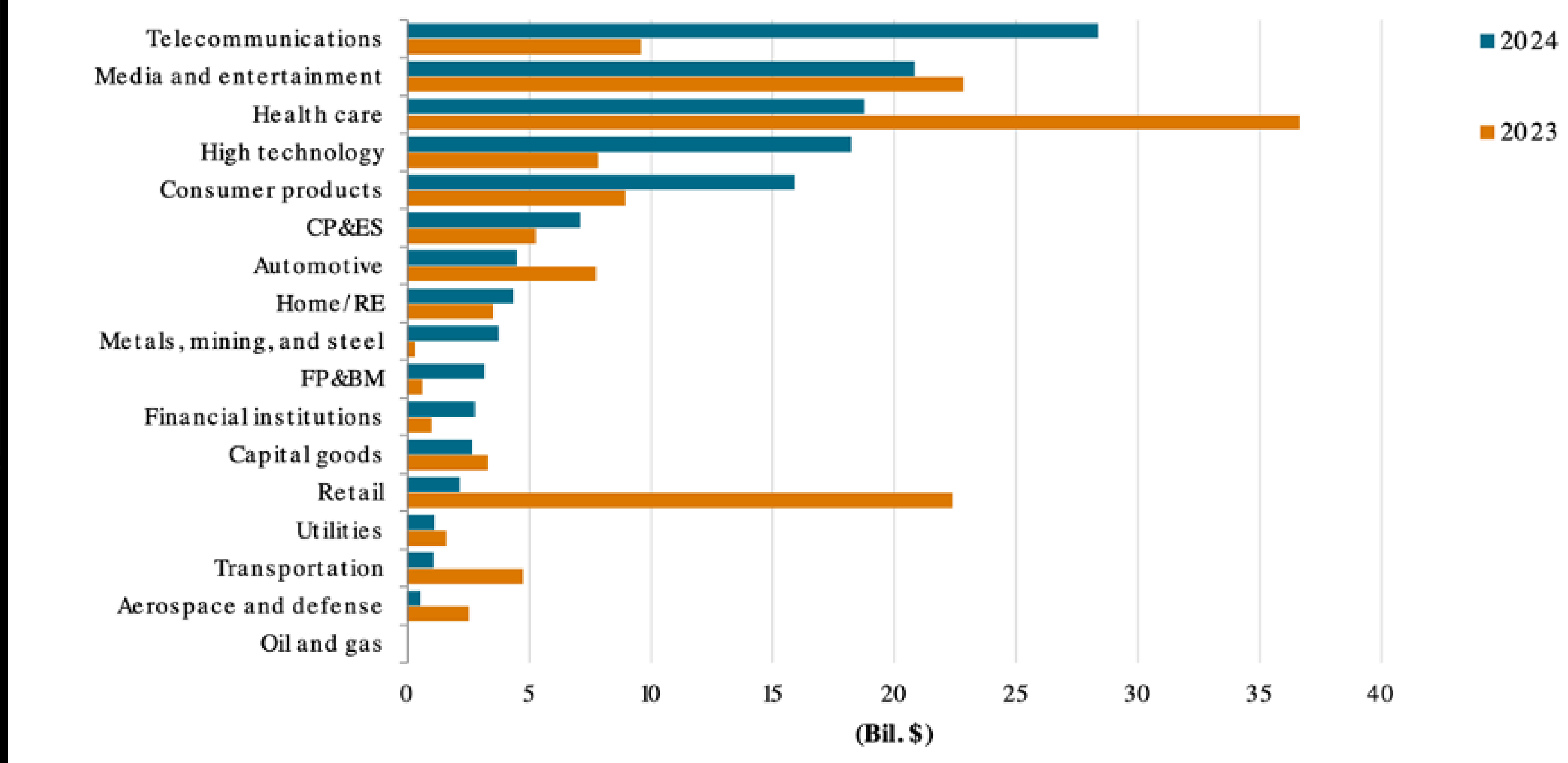
$Z > 2.99$ → Safe Zone (Company is financially stable)

$1.81 < Z < 2.99$ → Gray Zone (Financial distress is possible)

$Z < 1.81$ → Distress Zone (High risk of bankruptcy)

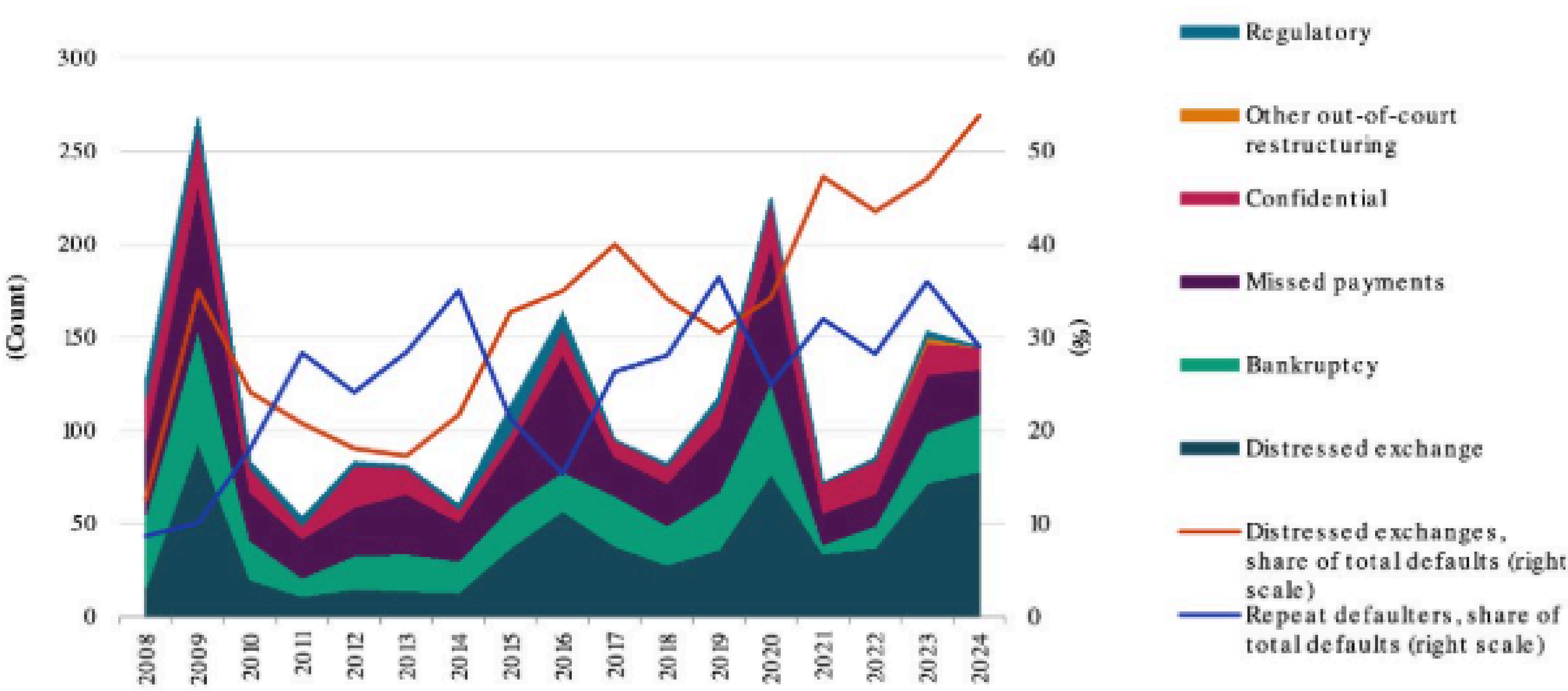
Advanced Strategy Execution Debt-to-Equity Conversions

The telecommunications sector led by cumulative defaulted debt in 2024



Data as of Dec. 31, 2024. Defaulted debt is the volume of debt upon which the issuer defaulted at issue level. CP&ES--Chemicals, packaging, and environmental services. Home/RE--Homebuilders/real estate companies. FP&BM--Forest products and building material. Retail--Retail and restaurants. Source: S&P Global Ratings Credit Research & Insights.

The percentage of distressed exchanges rose to its highest level since 2009



Data as of Dec. 31, 2024. Data has been updated to reflect confidential issuers.

Industries with high default levels (telecom, media, healthcare) may benefit from converting debt into equity to regain financial stability.

The increase in distressed exchanges highlights the growing preference for restructuring over liquidation, reinforcing the relevance of debt-to-equity conversions as a strategic move.

Advanced Strategy Execution - Post-Bankruptcy Value Extraction

Rationale

- Companies emerging from bankruptcy often experience significant mis-pricing due to uncertainty of the outcome.
- Debt holders/Investors can capitalize on stock price recoveries, which can offer significant alpha opportunities
- Investors can also take advantage of mis-pricing in newly issued equity & distressed debt instruments.

Execution

Step 1: Screening for High potential targets

- Firms emerging from chapter 11 with clear restricting plans.
- High asset recovery rates, strong creditor backing.
- Sectors; preference for essential industries.

Step 2: Strategic entry

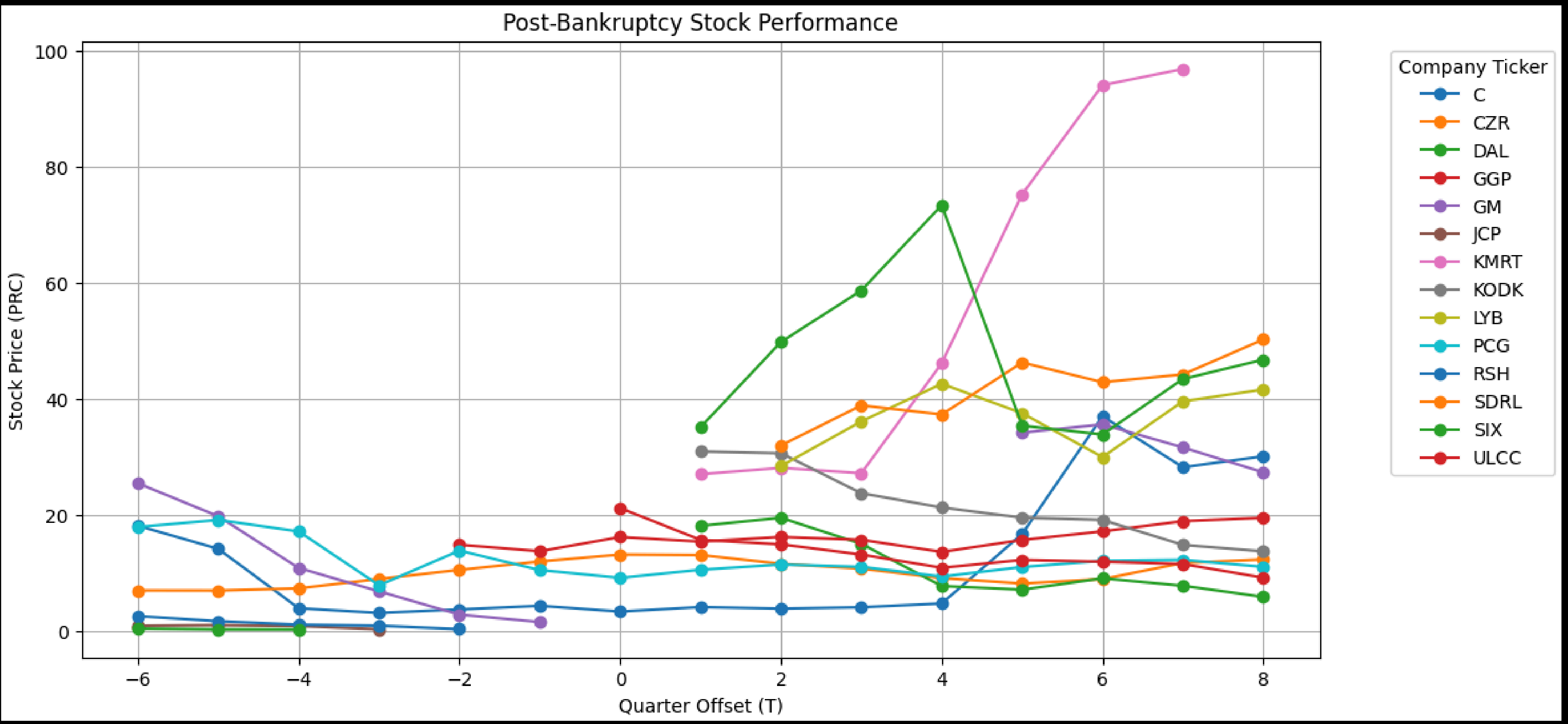
- Target discounted securities.
- Utilize data-driven entry signals example abnormal volume, insider buying.
- Deploy capital in tranches

Step 3: Exit strategy

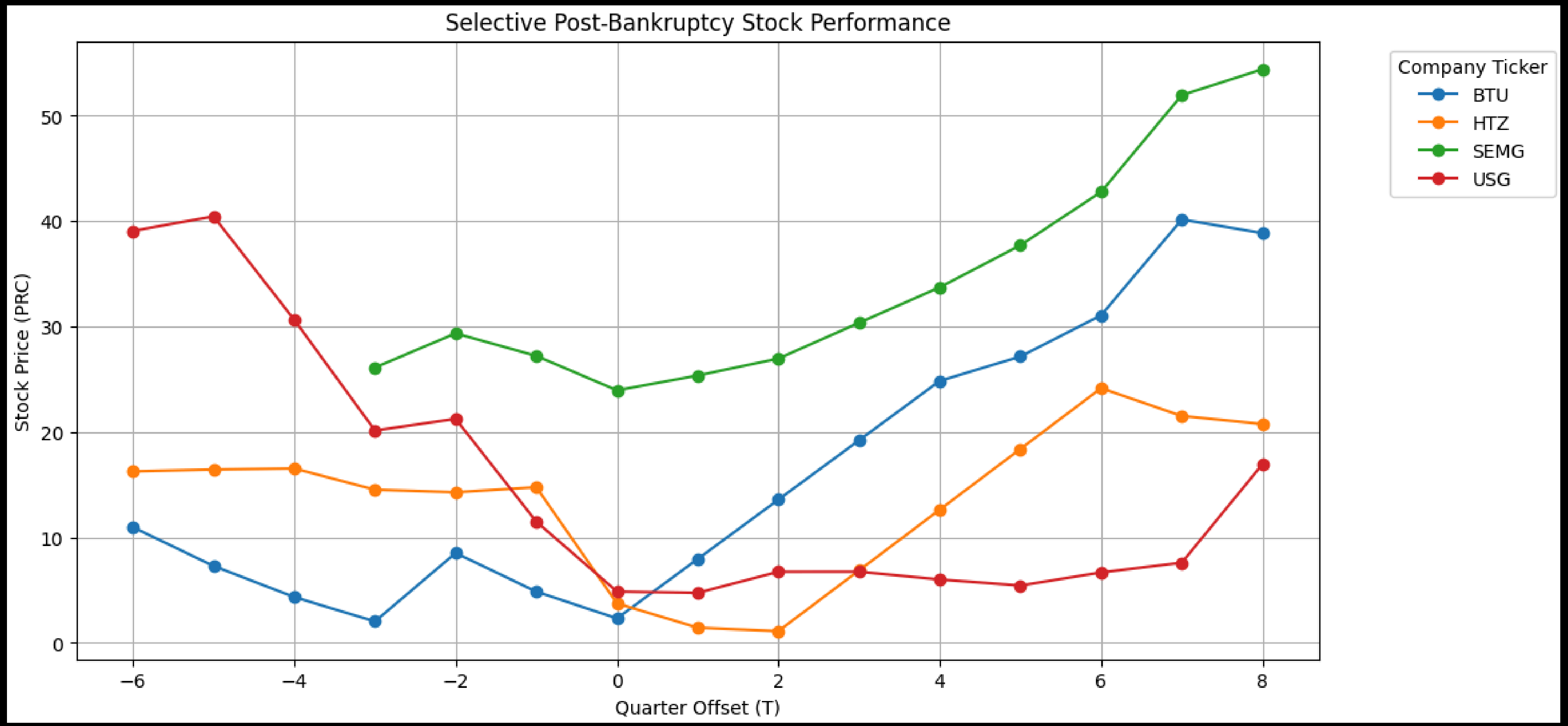
- Sell into strength at key appreciation point.
- Monitor liquidity trends at the most opportune exit.

Advanced Strategy Execution - Post-Bankruptcy Value Extraction

Pre-Selection Data



Post filtering and selective stocks



Here we analyze in three formats Pre-Emergence Phase (T < 0), Emergence quarter (T = 0)(turning point where companies exit bankruptcy), Post-Emergence Phase (T > 0 To T = +8)(Here divergence occurs). Companies exhibit diverse recoveries, through filtering with our strategy, we can have selective, profitable firms that have higher chanced of emerging into profitability long or short term . This validates our Post-Bankruptcy Value Extraction strategy, where targeting mispriced equities post-restructuring offers alpha opportunities. However, strategic entry and precise exit timing are critical, as not all companies recover.

Advanced Strategy Execution - Capital Structure Arbitrage

Rationale

- Companies often have misaligned pricing between their equity and debt, creating arbitrage opportunities.
- Market inefficiencies can cause a firm's stocks to be overpriced while its bonds remain undervalued.
- Investors can capitalize on these discrepancies by implementing a long-short arbitrage strategy, profiting as the mispricing corrects.

Execution

Step 1: Identifying mispricing

- Analysis of bonds vs equity implied volatility to detect mismatches.
- Keeping track of CDS spreads, bond ratings & historical volatility as signals.
- Focus on distressed firms where debt holders fear default, yet equity remains high.

Step 2: Arbitrage Entry

- Long on undervalued bonds while shorting overvalued equity.
- Monitor earnings report, rating agencies and market sentiment.

Step 3: Exit strategy

- Close positions as spread converge.
- Forced liquidation and re-ratings for final exit strategy.

Sources : Hull, J. C. (2021). Options, Futures, and Other Derivatives.

Addressing Risks

High credit (default) risk and its consequences - possible issues arising from bankruptcy, liquidation/restructuring and recovery.

Liquidity risk when dealing with distressed securuties.

Work with experts when needed to navigate complex financial/legal situations (legal/regulatory risk).

Diversification can offset concentration risk. Any company is capable of entering distress from idiosyncratic reasons.

Unexpected market movements can cause significant losses on positions.

Be aware of the risks associated with short-selling. These include: potentially 'unlimited' (extreme) losses, significant costs, risk of short squeezes etc.

Active due diligence is essential, as well as understanding market timing.

Hedging risk when required, such as for Capital Structure Arbitrage

Addressing Risks

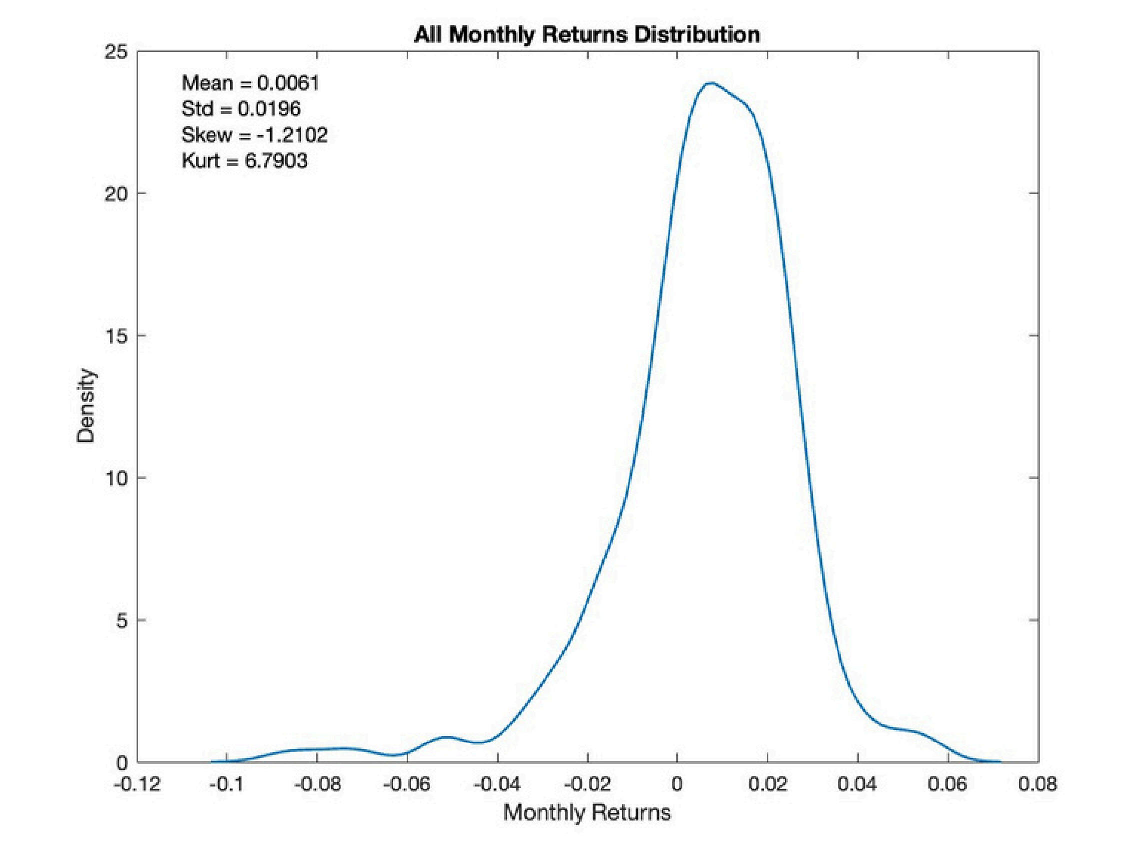


Figure 1

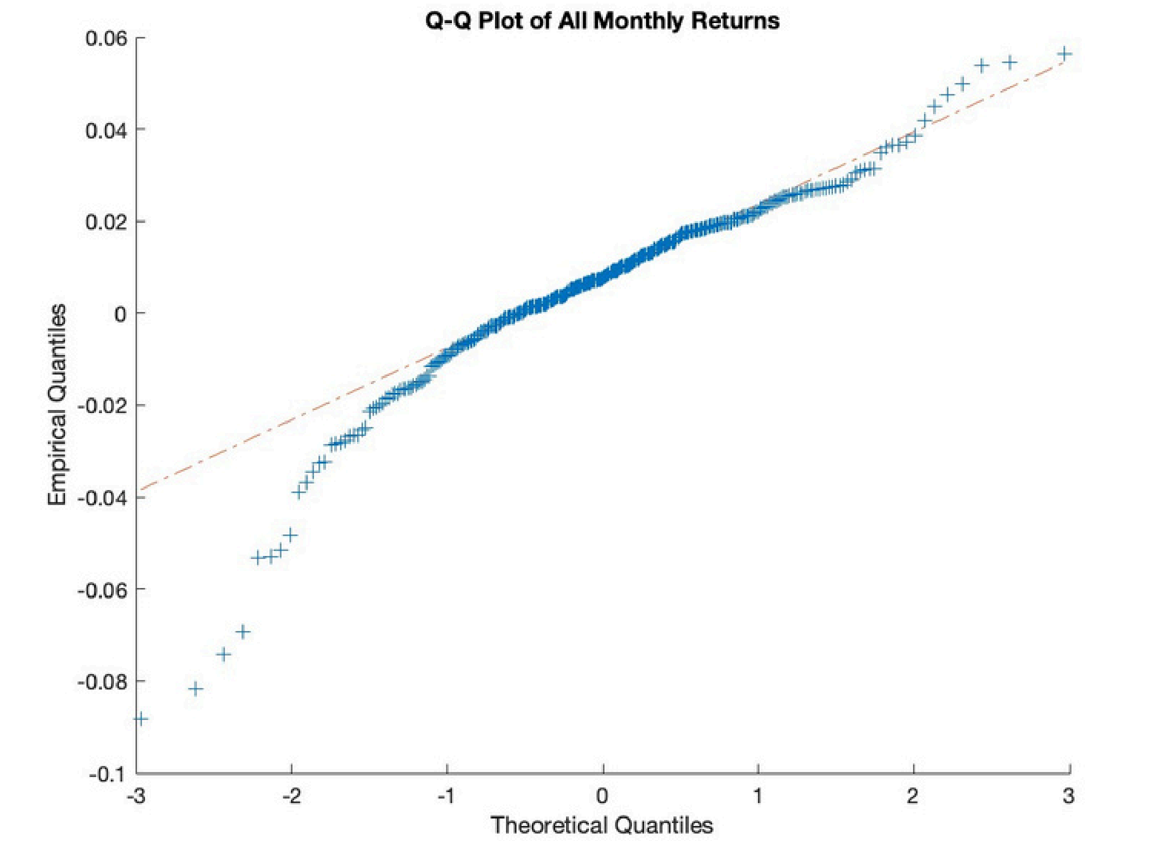


Figure 2

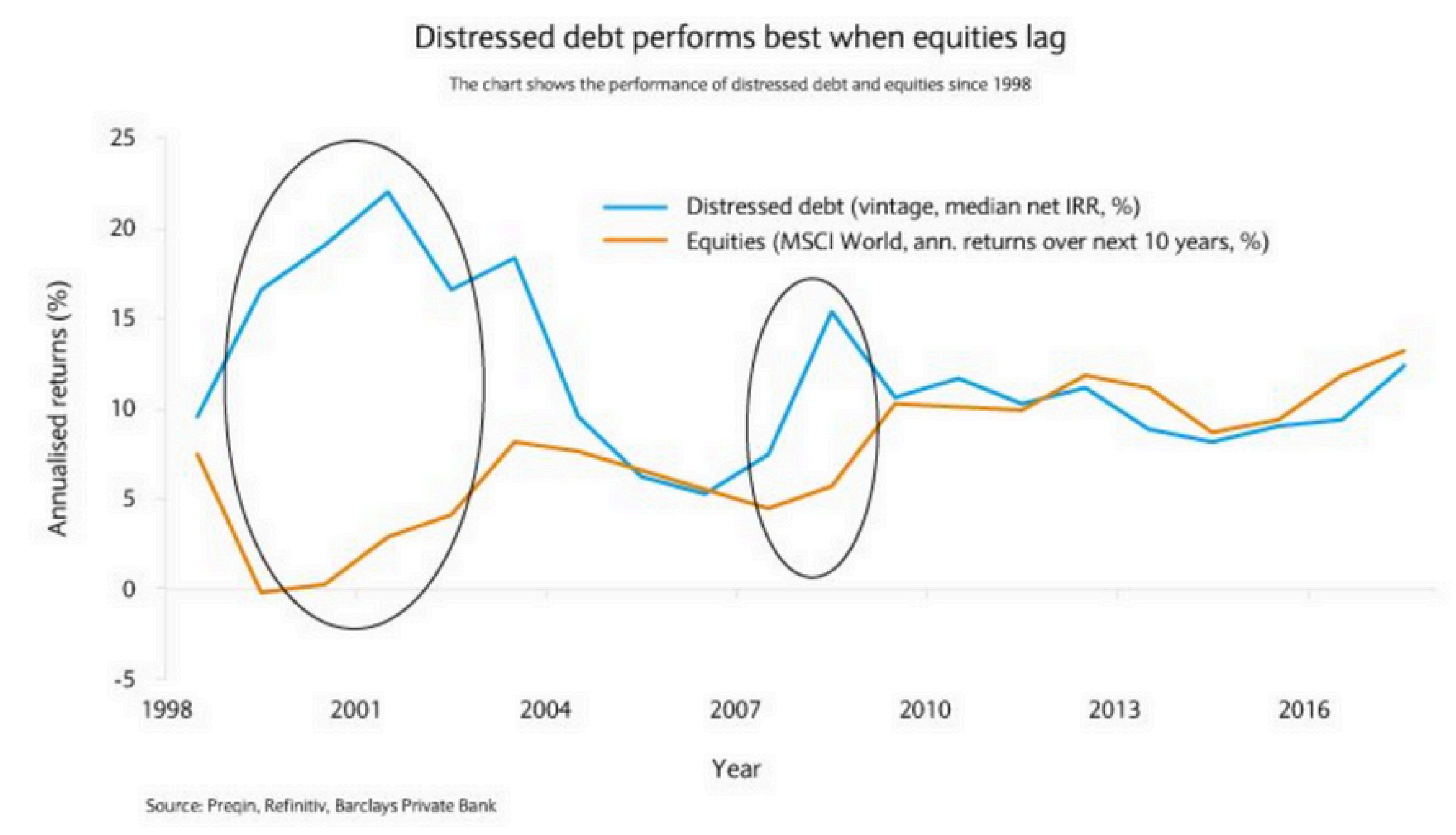


Figure 3

Investing in distressed debt hedge funds presents both unique opportunities and significant risks that investors must carefully consider. Our analysis of monthly returns from 1997 to 2024, covering 2 funds from Barclay Hedge in the distressed securities market, highlights several key statistical characteristics that provide insights into the risk profile of this asset class.

===== Stats for Single-Column Monthly Returns (1997-2024) =====
Mean: 0.0061
Std Dev: 0.0196
Skewness: -1.2102
Kurtosis: 6.7903
JB test => REJECT normality (p=0.0010)

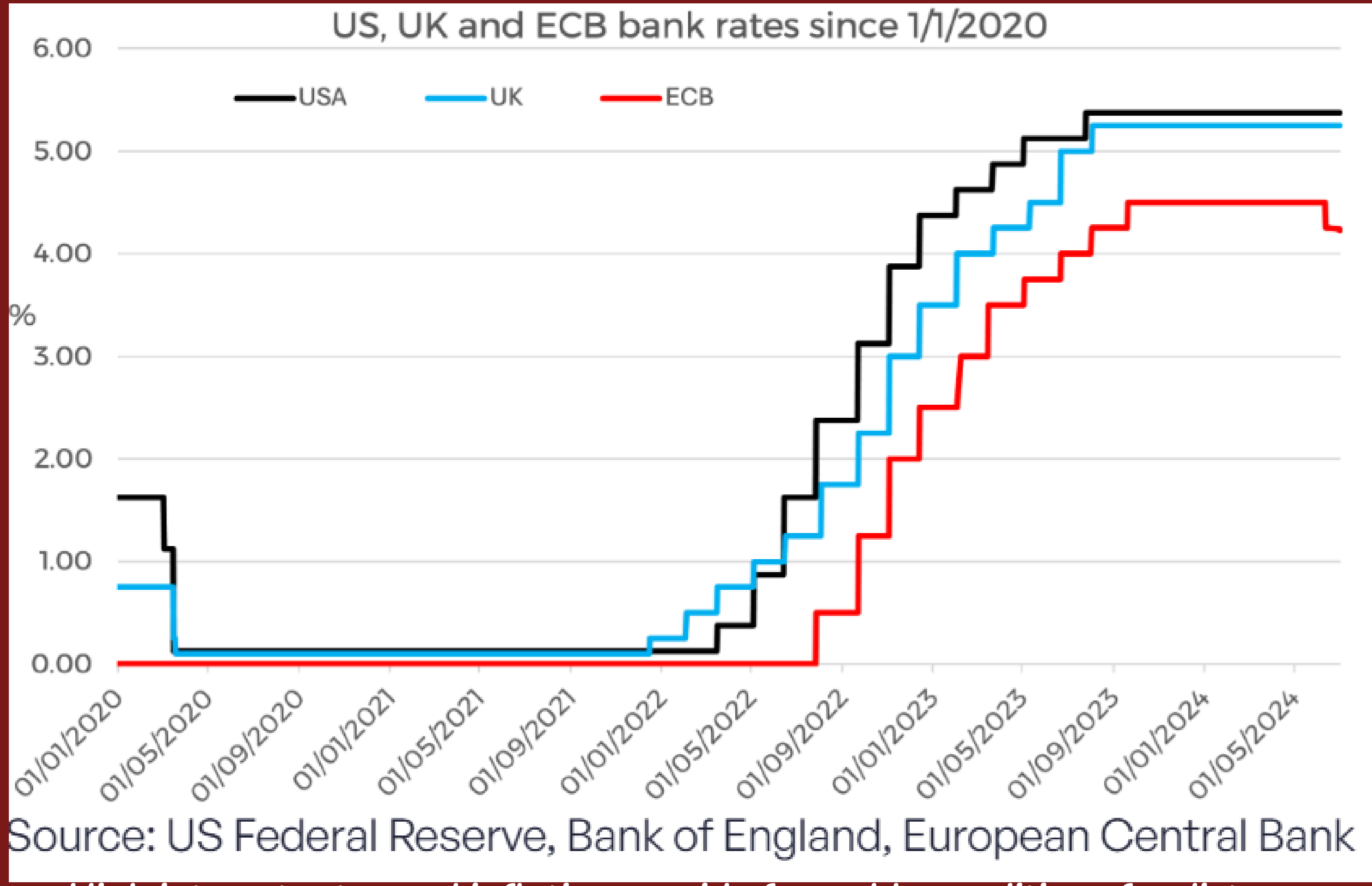
Importantly, as shown in the above chart (Figure 3), distressed debt returns tend to exhibit a negative correlation to equities during periods of market stress. This suggests that distressed debt can act as a hedge, performing best when equity markets struggle. However, correlation is dynamic, and while historically low to negative, it may shift depending on macroeconomic conditions and credit cycles.

Our analysis of two distressed debt hedge funds from 1997 to 2024 provides key insights into the opportunities and risks of this strategy. These funds generated an average monthly return of 0.61% (~7.5% annually) with a 1.96% standard deviation, demonstrating the potential for strong long-term returns.

However, the negative skewness (-1.21) and high kurtosis (6.79) suggest that while returns are generally stable, the strategy is prone to occasional large drawdowns. The rejection of normality in the Jarque-Bera test confirms that risk models must account for fat tails and extreme events.

Importantly, the low to negative correlation with equities, particularly in downturns, highlights distressed debt's potential role as a portfolio diversifier. These findings support the case for launching a fund that capitalizes on market dislocations while actively managing downside risks.

Trends & Developments



High interest rates and inflation provide favorable conditions for distress.

- **Emerging markets like Sri Lanka, Ethiopia, Ukraine, Argentina, Ghana and Zambia face recent debt restructuring, negotiations or crisis.**
- **Growing ESG focus means more considerations in restructuring, financing, and compliance.**
- **Most UK insolvencies (Jan 2024–2025) were in construction, trade, and hospitality (The Gazette, Feb. 2025).**

ESG integration in distressed investing enhances long-term value by prioritizing sustainability and governance reforms. Green restructuring focuses on decarbonization, making bankrupt firms ESG-compliant post-recovery, while adding sustainable credit recovery channels capital into distressed firms with strong ESG risk frameworks. Socially responsible turnarounds emphasize fair labor policies and diversity ultimately leading to governance-driven value creation strengthens ethical leadership. We can involve ESG-linked bonds provide financing tied to sustainability goals, ensuring accountability and resilience in post-bankruptcy recoveries. The steps surrounding ESG would also bring in other firms adding more value creation.

Sources : Antunes, Wanke, Fonesca, Tan (2023). ESG Risk Scores Influence Financial Distress. Evidence from a Dynamic NDEA Approach

Portfolio Benefits

Volatility

Distressed securities offer uncorrelated returns, reducing overall portfolio volatility and acting as a hedge during market downturns.

Diversify

Trinity Alpha enhances portfolio diversification, blending event-driven strategies that outperform traditional equities and fixed income in distressed cycles.

Scalability

Institutional scalability allows pension funds to capitalize on market dislocations, optimizing risk-adjusted returns while maintaining capital preservation.

Growth

Distressed debt funds are poised for a strong 2025, with private credit market showing resilience amidst changing conditions. Although interest rate cuts may impact returns in 2025, the asset class's expansion into diverse lending forms and its adaptability suggest sustained growth.

Hedge Fund Competitors

Oaktree Capital
California, USA

AUM $183 Billion

Leading distressed debt investor.

Apollo Global
New York, USA

AUM $600 Billion

Management Specializing in distressed buyouts.

Baupost Group
Massachusetts, USA

AUM $30 Billion

Focused on deep value distressed investing.

Avenue Capital Group
New York, USA

AUM $12.6 Billion

Distressed debt and equity securities, private equity

Crescent Capital Group
California USA

AUM $41 Billion

Below investment grade credit markets, including leveraged loans, high-yield bonds.

Monarch Alternative Capital
New York, USA

AUM $15 Billion

Distressed debt and opportunistic credit,

Market Outlook & Why Now

Outlook

- **Structural Shifts in Credit Markets** - The post-pandemic credit cycle has accelerated deleveraging trends, leading to forced liquidations of overleveraged firms.
- **ESG-Driven Restructuring & Green Turnarounds** - Firms with ESG commitments are accessing cheaper refinancing and outperforming traditional distressed assets.
- **Private Credit Expansion** - Private credit funds are stepping in, making distressed debt strategies more lucrative for institutional investors.
- **Prediction & Opportunistic Entry** - Quantitative hedge funds are leveraging AI & machine learning to preempt financial distress

Market Conditions
Rising rates and uncertainty create prime distressed investing conditions.

Opportunities in Credit Cycles
Widening spreads

Now

Risk-Adjusted Returns
Distressed securities offer diversification

Institutional Pension funds can capitalize on forced liquidations

Final Persuasion

Distressed securities offer pension funds a rare opportunity to achieve high, uncorrelated returns. Act now before market conditions normalize. Partner with our Trinity Alpha to execute these institutional-grade strategies.

THANK YOU

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