THRASIO RESTRUCTURING

Distressed Capital Structure, Recovery Analysis, and Pricing Under Stress

PRIVATE CREDIT DIVISION

Division Head: Ettore Cerreti
Analysts: Luca Brancaleoni, Tristan Buckley
Bocconi Students for Alternative Investments

Executive Summary

This semester's Private Credit Division project is a concept-led analysis of private credit secondaries under stress, anchored in what actually occurred in Thrasio's restructuring and using that real-world context to explain how secondary credit investors think about structure, outcomes, and downside protection.

Rather than building a full technical model, the project's emphasis is on the mechanics of a distressed capital structure, understanding how stakeholder incentives shift in distress, why documentation and seniority matter, and how value is ultimately allocated when a company restructures.

The report then deliberately pivots from the historical record to an alternative, decision-focused scenario designed for learning: Thrasio seeks to sell a first-lien term loan in the secondary market. The scenario is not presented as "what happened," but as a thought experiment: if a senior instrument is sold during a restructuring process, what does a buyer underwrite and how do they price it?

The point is to highlight that secondary pricing in distressed credit is driven less by headline yield and more by expected recovery, timing, and process risk. The end product is a practical analysis of distressed private credit outcomes and of how secondary transactions can be evaluated when a stressed borrower considers selling senior secured debt.

IRR & Pricing Analysis

The model highlights a clear divergence between base-case and downside returns, reinforcing that pricing in credit secondaries is fundamentally driven by downside protection rather than headline yield.

In the base case, the investment generates an annual IRR of 26.1%, driven by a combination of coupon income and pull-to-par, as the loan is purchased at 75 and repaid at 100. This reflects the traditional credit return profile, where contractual cash flows dominate and the entry discount enhances returns through capital appreciation.

The downside case presents a markedly different outcome. Under the assumed default in quarter 5, a 55% recovery rate, and a four-quarter recovery lag, the investment generates a negative annual IRR of -5.6%. Despite receiving four quarters of coupon payments, the early cessation of cash flows and delayed recovery significantly impair returns. In stressed scenarios, returns are no longer driven by coupon income, but instead by recovery dynamics and timing.

Impact of Purchase Price

The sensitivity analysis shows that purchase price is the most critical determinant of returns. At higher entry prices, the investment fails to compensate for downside risk, with IRRs remaining negative. For instance, purchasing at 85 results in a downside IRR of -11.3%, whereas lowering the entry price to 65 increases IRR to 1.6%.

This highlights that the entry price serves as the primary margin of safety. Investors must demand a sufficient discount to par to offset uncertainty around default and recovery outcomes. Even relatively small changes in purchase price materially affect returns, reinforcing the importance of disciplined pricing in secondary transactions.

Impact of Recovery Rate

Recovery assumptions also play a central role in determining investment outcomes. At lower recovery levels, returns are significantly negative, with a 40% recovery resulting in an IRR of -17.4%. As recovery rates increase, returns improve substantially, turning positive at approximately 70%, where IRR reaches 4.6%.

This sensitivity underscores the importance of accurate credit underwriting. Since recovery values are uncertain and often negotiated during restructuring, small misjudgments can materially impact realized returns.

Impact of Default Timing

The timing of default has a meaningful effect on performance. Earlier defaults reduce the number of coupon payments received, leading to more negative returns. For example, a default in quarter

3 results in an IRR of -11.9%, whereas delaying the default to quarter 11 increases IRR to 4.4%.

This reflects the dual role of time in credit investments: additional time allows for more income generation, but also increases exposure to uncertainty. Investors benefit from delayed default as it extends the period of contractual cash flows.

Impact of Recovery Lag

Recovery timing is another key driver of returns. Longer recovery lags reduce IRR because of the time value of money. The analysis shows that changing the lag assumption moves downside IRR within a roughly -3% to -7% range, with returns remaining negative in all cases.

This demonstrates that even when recovery values are unchanged, delays in receiving cash flows can significantly erode returns, making timing nearly as important as recovery magnitude.

Break-even Analysis and Pricing Implications

The model further highlights the pricing required to achieve acceptable returns under downside conditions. To break even at a 0% IRR, the implied purchase price is approximately 67.1% of par, compared with the current assumption of 75%. Alternatively, maintaining the purchase price at 75% would require a recovery rate of approximately 63.1% to achieve break-even returns.

However, break-even is not a sufficient threshold for investment. To generate a modest positive return and preserve an adequate margin of safety under stressed conditions, a more appropriate entry price is around 65% of par, or lower. At that level, the downside case begins to produce a slightly positive IRR of roughly 1% to 2%, providing compensation for default risk and recovery uncertainty.

This pricing recommendation depends on several key assumptions. The analysis assumes a 55% recovery rate, which appears reasonable but leaves limited room for error. If recovery outcomes are weaker, returns deteriorate significantly, reinforcing the need for a lower entry price. Conversely, justifying a higher purchase price such as 75% would require recovery levels to increase materially to roughly 63% or higher, which may not be consistently achievable in practice.

In addition, the model assumes a four-quarter recovery lag, which has a meaningful impact on returns because of the time value of money. Longer recovery periods would further reduce IRR and strengthen the case for a discounted entry price. The downside scenario also assumes default in quarter 5; earlier defaults materially reduce returns by limiting coupon income and again highlight the importance of downside protection at entry.

Overall, while base-case returns appear attractive, they are not the primary driver of investment decisions in credit secondaries. Instead, returns are highly sensitive to downside assumptions, particularly recovery values and timing. Pricing discipline is therefore critical, and acquiring the asset at around 65% of par rather than 75% is necessary to ensure sufficient downside protection and acceptable risk-adjusted returns.

Conclusion

Overall, the analysis demonstrates that credit secondaries investing is inherently downside-driven. While base-case returns appear attractive, they are highly sensitive to default risk. The key to generating attractive returns lies in acquiring assets at a sufficient discount, ensuring that recovery outcomes provide adequate compensation for the risks taken.