Politecnico di Torino

Master of Science Degree in Engineering and Management (LM-31)

Academic Year 2023/2024

Graduation Session April 2024

Distress Investing in Italy: Assessing Turnaround Strategies and Financial Recovery – Pillarstone's Portfolio Case Study

Supervisor:
Prof. Enrico Luciano

Candidate:
Rayan Saliba

Abstract

This thesis aims to explore the realm of distress investing, characterized as an "alternative" investment strategy that targets companies experiencing financial distress. Such companies face significant challenges in sustaining their operations, lack the capacity for growth, and are unable to secure new financing due to their financial predicaments. By examining specific cases, this study showcases the investment tactics employed by Italian specialists in distress investing or restructuring. It specifically highlights the methodologies and mechanisms adopted for facilitating a corporate turnaround.

The work first provides a thorough exploration of distress investing, beginning with a literature review that establishes a foundational understanding of financial distress.
It lays the groundwork by defining financial distress and its differentiation from economic distress, followed by an investigation into its origins and common triggers.
It includes a focus on the predictive models and early warning indicators, scrutinizing their accuracy, limitations, and real-world applications.
Then, situates distress investing within the broader financial market context, discussing its impact, key players, and notable cases, while also delving into the associated methodologies and bankruptcy laws.
Moreover, it offers an in-depth look at turnaround strategies, their categorization, and the critical stages of corporate turnaround, supplemented by illustrative case studies.
Finally, it will weigh the risks and rewards of distress investing, analysing its potential profitability and the strategies employed to mitigate inherent risks.

Then it transitions into a detailed analysis of Pillarstone's investment portfolio. Pillarstone, established in 2015 by its management team in partnership with KKR & Co. Inc., aims to provide capital and professional expertise to reverse negative trends, stabilize, and accelerate the growth of underlying businesses.

The analysis employs a structured approach that includes a business and sector/market overview to understand the distress context, an initial asset analysis to identify operational and financial distress, a review of restructuring transactions encompassing financial manoeuvres and cash injections, an operational improvement analysis post-investment, and finally a divestment analysis or a current status overview for ongoing investments.

This methodology succinctly captures the essence of distress investing from identification to resolution, at least according to one leading Italian player which operates as a credit fund.

In conclusion, after analysing Pillarstone's approach, the thesis will summarize the findings and offer an opinion on the effectiveness of the investor's model as a credit fund, highlighting the nuanced outcomes of distress investing strategies.

Contents

Chapter 1: Understanding Financial Distress

1.1 Definition of Financial Distress:

Financial distress, a state wherein a company struggles to meet or has already failed to meet its financial obligations to creditors, has been a focal point of corporate finance research. Its causes, prediction methods, and implications on corporate governance and performance have been deeply explored across various industries and economies.

In their comprehensive analysis of financial distress, Whittaker et al. (1992) define it as a condition preceding bankruptcy but after financial viability has been compromised, often marked by operational funding challenges, meeting debt covenants, and sustaining liquidity. The delineation between financial distress and bankruptcy is critical, as the former does not necessarily lead to the latter due to possible intervention and recovery strategies.
Altman (1968), in his seminal work, underscores the importance of understanding financial distress not just as a prelude to bankruptcy but as a separate state where firms can still undertake successful turnaround strategies.

Nature of Financial Distress:

Distress investing operates cyclically, closely intertwined with the broader economic cycles. These cycles, typically comprising expansion and contraction phases, significantly influence investment strategies. During economic expansions, companies generally perform well, with fewer distressed assets available. In contrast, economic downturns, characterized by reduced consumer spending, declining corporate profits, and increased bankruptcies, create a fertile ground for distress investing.

In such downturns, distressed assets become more prevalent, offering opportunities for investors to acquire undervalued assets. These phases of economic contraction see increased activity in distress investing, as investors seek to capitalize on the lower asset prices and potential for high returns upon economic recovery. The work of Reinhart and Rogoff in "This Time is Different" (2009) delves into these patterns, illustrating how economic downturns have historically led to spikes in distress investing activities.

The impact of distress investing on market dynamics, particularly liquidity and asset pricing, is also substantial. Liquidity in financial markets refers to the ease and speed with which assets can be bought or sold without causing a significant impact on their prices. High liquidity indicates a stable market where assets can be quickly converted to cash, reflecting a high volume of trading activity. Conversely, low liquidity implies fewer buyers and sellers, potentially leading to more significant price fluctuations when trades occur. In distress investing, the acquisition of undervalued assets often injects liquidity into the market, as these assets are transferred from financially struggling entities to more stable investors or companies. This movement can increase the overall market's fluidity, making it easier for other participants to trade.

Asset pricing, on the other hand, involves determining the value of securities based on various factors, including risk, expected return, and underlying financial performance. It reflects

investors' perceptions and calculations of what a financial asset is worth, influenced by economic conditions, company performance, and market sentiment. Distress investing can influence this process in several ways. The restructuring processes typical in distress investing can lead to a re-evaluation of the underlying assets' value. This re-evaluation can affect not only the specific assets involved but can also have a broader impact on the market's perception of similar assets, thereby influencing their pricing.

In essence, distress investing plays a critical role in the financial markets by affecting liquidity and altering asset valuation paradigms, which are essential components in the functionality and efficiency of financial markets.

1.2: Main Causes

Several factors contribute to financial distress. Asquith et al. (1994) suggest that management's inability to respond to rapid market changes is a contributing factor, and this rigidity can stem from operational inefficiencies, a lack of strategic direction, or poor management decisions, amongst other factors. The usual causes are displayed below:

1. Macroeconomic Fluctuations:

Economic downturns significantly impact firms, particularly those in cyclical industries or with high leverage. These fluctuations can lead to reduced consumer spending, supply chain disruptions, and increased credit risk, directly affecting firms' revenues and profitability. For instance, the 2008 financial crisis severely impacted the banking and real estate sectors, leading to widespread financial distress (Reinhart & Rogoff, 2009). Companies with high leverage found themselves particularly vulnerable due to the tightened credit conditions and reduced cash flows.

2. Operational Inefficiencies:

Issues like poor supply chain management or outdated technology can lead to increased costs and decreased competitiveness. Operational inefficiencies often stem from outdated processes, ineffective management, or failure to adopt new technologies. A notable example can be seen in the case of Kodak, which struggled to adapt to the digital photography revolution, leading to its eventual bankruptcy in 2012 (Kotter, 2012). Inefficient supply chain management was also a contributing factor to the collapse of Toys "R" Us in 2017, where the company failed to adapt to the changing retail landscape (Mourdoukoutas, 2017).

3. Market Dynamics:

Rapid market changes, such as evolving consumer preferences or increased competition, can challenge a firm's profitability. The rise of e-commerce and digital platforms has significantly impacted traditional brick-and-mortar businesses. Blockbuster's decline in the face of streaming services like Netflix is a classic example of how changing market dynamics can lead to financial distress in firms that fail to adapt (McIntyre, 2010).

4. Regulatory Changes:

New regulations or legal requirements can impose additional costs or barriers to operations. The automotive industry, for instance, has faced challenges adapting to stricter environmental regulations, which have required significant investment in new technologies and altered production processes (Canis, 2011). Companies that are slow to comply with these regulations can face penalties, lost market share, or increased operational costs.

5. Management Failures:

Poor strategic decisions, lack of adaptability, or mismanagement of resources can lead to financial distress. Management failures often manifest in poor strategic decisions, a lack of vision, or inadequate responses to market changes. An example of this is the collapse of Enron in 2001, which was largely attributed to fraudulent practices and unethical leadership (Healy & Palepu, 2003).

CHAPTER 2: Predictive Models & Useful Ratios

2.1. Tools for predicting financial distress.

Predicting financial distress is of paramount importance for investors, creditors, and managers alike. The exploration of financial distress prediction, a subject extensively examined in academic literature, bridges the gap between theoretical research and practical application for industry professionals.

This thesis focuses on the quantitative methods of distress prediction, which have evolved significantly since their inception approximately eighty years ago. These methods serve as crucial tools for managers and stakeholders in understanding and navigating the complexities of business operations. The evolution of these models over time reveals both methodological and data differences, as well as notable similarities, particularly their reliance on balance sheet indicators within statistical analyses.

This discussion will categorize the most significant distress prediction methodologies into three distinct groups:

1. **Models Originating from Altman's Work**: The pioneering study by Edward I. Altman in 1968 is a cornerstone in distress prediction literature. Altman introduced the Z-Score model, a multivariate discriminant analysis-based tool for assessing the default probability of manufacturing companies. This model, with its linear formula incorporating key balance sheet indicators, set a benchmark and inspired subsequent research in the field.

2. **Corporate Crisis and Insolvency Code (C.C.I.I.)**: Developed by the National Council of Chartered Accountants and Accounting Experts (CNDCEC) and sanctioned by the Ministry of Economic Development, the C.C.I.I. utilizes a ratio-based approach to detect or foresee financial distress in companies. These ratios are derived from legislative decree n. 14, dated 12/01/2019.

3. **Practitioners' Approaches**: Specialists in financial distress and turnaround management often employ practical indicators sourced directly from balance sheet data. These indicators aim to provide a straightforward assessment of a company's financial health.

In delving into these methodologies, two models stand out due to their foundational impact in the literature:

- **Altman's Z-Score Model**: Altman's 1968 study introduced the Z-Score, a linear formula combining five key financial ratios to predict the likelihood of corporate bankruptcy. The model's threshold, or "cut-off point," identifies companies at risk of distress when their score falls below 2.67.

- **Merton's Distance to Default (DD) Model**: Introduced by Robert C. Merton in 1974, this model conceptualizes a company's equity as a call option on its assets. It uses the

market value of equity, its volatility, and other indices in a non-linear equation to determine the company's real value. The DD measures how many standard deviations a company's assets can lose in value before defaulting, offering a probabilistic approach to assessing default risk.

These models exemplify the ongoing development of quantitative methods for distress prediction, highlighting the integration of statistical rigor with practical balance sheet analysis.

More recent studies, such as those by Hillegeist et al. (2004), incorporate market-based variables and information from financial statements to increase predictive power, acknowledging that market perceptions of risk play a crucial role in anticipating financial distress. Additionally, Jones et al. (2017) advocate for the inclusion of non-financial indicators, such as customer satisfaction and employee engagement, in forecasting financial distress. They argue that these factors can provide early warning signs of internal issues before they manifest in financial outcomes.

2.2. Financial Ratios and their application

The utilization of financial ratios in assessing a company's health is grounded in the theoretical framework that these ratios capture key elements of a firm's financial status, such as liquidity, solvency, profitability, and operational efficiency. Beaver (1966) pioneered this approach by demonstrating the predictive power of specific ratios for bankruptcy, establishing a foundational role for financial ratios in corporate finance analysis. His work underscored the theoretical premise that variations in these ratios often precede financial distress, as they reflect underlying changes in cash flow patterns, asset management, and debt structure.

However, the application of financial ratios is not without limitations. Altman (1968), while extending Beaver's work through the development of the Z-score model, acknowledged inherent limitations in using historical data to predict future performance. This retrospective nature of financial ratios can result in delayed signals of distress, particularly in rapidly changing market conditions or industries subject to sudden technological disruptions. Furthermore, the reliance on financial ratios alone overlooks qualitative factors such as management competency, market position, and industry dynamics. As emphasized by Lev and Thiagarajan (1993), these limitations necessitate a holistic approach to financial analysis, combining quantitative financial ratios with qualitative assessments to form a more comprehensive view of a firm's financial health and its prospects.

Some of the industry’s most well-known ratios include:

1. Current Ratio

Formula:

$$Current\ Ratio\ = \frac{Current\ Assets}{Current\ Liabilities}$$

Origin & Usage: The current ratio's roots trace back to fundamental accounting principles, primarily serving as a liquidity indicator. Its usage spans across various industries to gauge a firm's short-term financial health.

Explanation: The current ratio serves as a fundamental measure of a company's liquidity and short-term financial health. It reveals the firm's ability to pay off its short-term liabilities with its short-term assets, including cash, accounts receivable, and inventory. A high current ratio indicates a good level of liquidity, suggesting the company can easily meet its short-term obligations. Conversely, a low ratio may signal potential liquidity problems, suggesting that the firm might struggle to meet its short-term debts. This ratio is particularly crucial in industries like manufacturing, where managing working capital efficiently is essential for smooth operation.

Industry Specifics: In manufacturing, efficient management of inventory and receivables is essential, making the current ratio a critical metric. A balanced range (1.5 to 2.5) suggests healthy liquidity without excess assets. In contrast, retail businesses often aim for a higher ratio due to the need to maintain substantial inventory levels to meet customer demands.

2. Debt-to-Equity Ratio

Formula:

$$Debt - to - Equity\ Ratio = \frac{Total\ Debt}{Total\ Equity}$$

Origin & Usage: Arising from financial analysis, this ratio is fundamental in assessing a company’s capital structure and financial leverage.

Explanation: This ratio is a critical indicator of a company's financial leverage and capital structure. It compares the company's total liabilities to its shareholder equity, providing insights into how much the company is financing its operations through debt versus its own funds. A high debt-to-equity ratio indicates that a company is primarily funded by debt, which can be risky if not managed properly, especially in volatile economic conditions. In contrast, a low ratio suggests a more conservative financial position, with less reliance on borrowed funds.

Industry Specifics: This ratio varies significantly across industries. In capital-intensive sectors like manufacturing or utilities, a higher ratio is common and reflects reliance on debt for heavy investments. In contrast, service-oriented industries might exhibit lower ratios, indicating less reliance on debt financing.

3. Inventory Turnover Ratio

Formula:

$$Inventory\ Turnover\ Ratio = \frac{Cost\ of\ Goods\ Sold}{Average\ Inventory}$$

Origin & Usage: Essential in retail and manufacturing, this ratio originated from the need to evaluate inventory management efficiency.

Explanation: The inventory turnover ratio is key in evaluating how efficiently a company manages and replenishes its inventory. It measures the speed at which a company sells and replaces its stock over a period, reflecting the efficiency of inventory management. A high inventory turnover ratio indicates that the company is selling its inventory quickly, which is generally positive as it suggests strong sales and efficient inventory control. In the retail sector, this ratio is crucial as it directly impacts profitability and cash flow.

Industry Specifics: Retail and wholesale businesses closely monitor this ratio for inventory management efficiency. High turnover indicates strong sales and effective inventory control. In contrast, industries with longer production cycles, like heavy machinery, might have lower turnover rates due to longer inventory holding periods.

4. Return on Equity (ROE)

Formula:

$$Return\ on\ Equity\ (ROE) = \frac{Net\ Income}{Total\ Equity}$$

Origin & Usage: Originating from fundamental financial analysis, ROE is a measure of profitability that calculates the return on shareholders' equity.

Explanation: ROE indicates how effectively a company uses the money invested by its shareholders to generate profits. A higher ROE implies efficient use of equity and higher profitability.

Industry Specifics: ROE is particularly relevant in capital-intensive industries such as finance and utilities, where efficient capital utilization is crucial.

5. Price-Earnings Ratio (P/E Ratio)

Formula:

$$Price - Earnings\ Ratio\ (P/E) = \frac{Market\ Price\ per\ Share}{Earnings\ per\ Share\ (EPS)}$$

Origin & Usage: A cornerstone of equity valuation, the P/E ratio is used to evaluate the price of a company's shares relative to its earnings.
Explanation: It assesses investor expectations and market valuation of a company. A high P/E ratio might indicate that the company's stock is overvalued, or investors expect high earnings growth in the future.

Industry Specifics: P/E ratios vary widely across industries, with tech companies often having higher P/Es due to greater growth expectations.

6. Debt Service Coverage Ratio (DSCR)

Formula:

$$Debt\ Service\ Coverage\ Ratio\ (DSCR) = \frac{Net\ Operating\ Income}{Total\ Debt\ Service}$$

Origin & Usage: Common in credit analysis and loan assessment, DSCR measures a company's ability to service its debt with its net operating income.

Explanation: It evaluates the cash flow available to pay current debt obligations. A higher DSCR indicates better ability to cover debt payments, reducing the risk of default.

Industry Specifics: This ratio is crucial for industries with high debt levels, such as real estate and infrastructure, where cash flow stability is key for debt servicing.

7. Interest Coverage Ratio

Formula:

$$Interest\ Coverage\ Ratio = \frac{EBIT}{Interest\ Expense}$$

Origin & Usage: Used widely in financial analysis to assess a company's ability to pay interest on its debt.

Explanation: This ratio assesses a company's ability to meet its interest obligations on outstanding debts. It's a measure of financial health, indicating whether a company's operating income is sufficient to cover its interest expenses. A higher ratio means that the company comfortably covers its interest obligations with earnings, indicating financial stability. A lower ratio, however, could signal financial distress, as it implies that the company may struggle to meet its interest payments, increasing the risk of default.

Industry Specifics: Industries with stable and predictable cash flows, like utilities, often maintain higher ratios, reflecting their ability to cover interest expenses easily. Conversely, sectors with volatile earnings, such as technology or consumer discretionary, might show lower or more fluctuating ratios.

8. EBITDA/Interest Coverage

Formula:

$$EBITDA/Interest\ Coverage = \frac{EBITDA}{Interest\ Expense}$$

Origin & Usage: Developed to provide a more comprehensive view of a company's financial health, including its ability to generate earnings before non-cash charges.

Explanation: Expanding on the traditional interest coverage ratio, the EBITDA/Interest Coverage ratio incorporates non-cash charges like depreciation and amortization into the calculation. This provides a broader view of a company's ability to generate income and cover its interest expenses. It's particularly useful for companies with significant investments in fixed assets, where depreciation can substantially impact earnings. A higher ratio indicates a strong ability to cover interest payments, signifying a robust financial position.

Industry Specifics: Industries with significant fixed assets and depreciation expenses, such as telecommunications and manufacturing, benefit from using this ratio. It offers a more accurate reflection of their ability to cover interest payments, considering non-cash expenses.

9. Free Cash Flow to Debt Ratio

Formula:

$$Free\ Cash\ Flow\ to\ Debt\ Ratio = \frac{Free\ Cash\ Flow}{Total\ Debt}$$

Origin & Usage: Emerged from the need to analyze a company's financial flexibility and solvency.

Explanation: This ratio evaluates a company's capacity to cover its total debt using its free cash flow. It's an important indicator of financial flexibility and solvency, revealing how much of the company's debt can be paid off with the cash it generates from operations, after accounting for capital expenditures. A higher ratio is preferable, as it suggests the company can effectively service its debt from its operational earnings, reducing financial risk.

Industry Specifics: This ratio is particularly relevant for industries undergoing rapid expansion or heavy investment, like technology or industrial manufacturing, where cash flow management is crucial for servicing debt.

10. Operating Cash Flow Ratio

Formula:

$$Operating\ Cash\ Flow\ Ratio = \frac{Operating\ Cash\ Flow}{Total\ Debts}$$

Origin & Usage: Developed to evaluate a firm's ability to generate enough cash from operations to cover its debts.

Explanation: The Operating Cash Flow Ratio measures the adequacy of cash flow generated from a company's business operations in relation to its total debts. This ratio is essential in

understanding whether a company's day-to-day operations generate enough cash to cover existing debts. It provides insights into the company's operational efficiency and financial health, with a higher ratio indicating a stronger ability to manage and service debt through operational income.

Industry Specifics: Sectors with high operational costs and lower margins, such as retail or hospitality, often scrutinize this ratio to ensure operational efficiency. Industries with larger capital expenditures, like oil and gas, also rely on this ratio to assess their ability to manage debt through operational earnings.

11. Quick Ratio (Acid-Test Ratio)

Formula:

$$Quick\ Ratio = \frac{Current\ Assets\ -\ Inventory}{Current\ Liabilities}$$

Origin & Usage: A liquidity measure developed to provide a more immediate view of a company's financial health, excluding inventory.

Explanation The Quick Ratio, or Acid-Test Ratio, offers a more immediate and conservative view of a company’s liquidity compared to the current ratio. By excluding inventory, which may not be quickly convertible to cash, this ratio focuses on the most liquid assets. It's a critical measure for companies in industries where inventory is less liquid or takes longer to convert into cash, providing a clearer picture of the firm's ability to meet short-term liabilities with its most liquid assets.

Industry Specifics: This ratio is crucial in industries where liquidity is paramount, and inventory is less liquid. Sectors like technology and consulting, which have minimal physical inventory, often exhibit higher quick ratios, reflecting stronger short-term financial health.

CHAPTER 3: Turnaround Strategies and Processes

3.1. Theoretical Foundation of Turnaround strategies:

Turnaround strategies in financially distressed firms are a critical aspect of corporate recovery efforts. Robbins and Pearce II (1992) categorize these strategies into two broad classifications: operational and strategic. Operational strategies involve immediate actions such as cost reduction, asset reduction, and revenue generation, whereas strategic strategies encompass the long-term repositioning of the firm in its market.

Bibeault (1982) provided an early and detailed exploration of turnaround strategies, emphasizing that the initial step in any turnaround is stabilizing the business. This involves rigorous cash flow management and the preservation of vital company functions. A critical analysis by Arogyaswamy et al. (1995) further supports this notion, suggesting that cost-cutting measures, while often necessary to address immediate financial concerns, must be carefully balanced with considerations for long-term strategic health. As for operational restructuring, Schendel et al. (1976) discuss the importance of efficiency and asset management. They suggest that distressed firms often need to streamline operations, divest non-core assets, and refocus on core business activities to recover performance. This view is supported by Robbins and Pearce II (1992), who argue for a retrenchment strategy focused on improving operational efficiency as a precursor to comprehensive strategic repositioning.

Financial restructuring is another cornerstone of the turnaround process. Gilson (1989) addresses the reconfiguration of the capital structure, advocating for debt restructuring negotiations and, if necessary, raising new equity to alleviate financial pressures. Gilson's analysis indicates that successful financial restructuring can provide the necessary foundation for operational and strategic turnaround efforts by securing the capital needed to invest in recovery activities.

Additionally, Sudarsanam and Lai (2001) discuss the psychological and managerial aspects of the turnaround process, noting that leadership changes often accompany or precipitate recovery strategies. They assert that new management can bring fresh perspectives, facilitate cultural shifts, and reinvigorate employee morale, contributing to the turnaround's success. Indirect factors also influence the turnaround process. Mayr's (2004) research highlights the impact of stakeholder relationships, particularly with creditors and suppliers, on the viability of turnaround efforts. Mayr posits that maintaining open lines of communication and negotiating terms can build the support necessary for a successful restructuring. Franks and Mayer (1996) emphasize the role of corporate governance in turnarounds, indicating that active and engaged boards can significantly influence the direction and outcome of recovery strategies. Their findings suggest that boards must balance the interests of shareholders and debt holders to navigate the company through the distress.

Corporate governance plays a pivotal role in navigating firms through financial distress, primarily by addressing the differing perspectives encapsulated in stewardship theory and agency conflicts. Stewardship theory posits that managers, as stewards of the company, are intrinsically

motivated to act in the best interests of the shareholders, optimizing company performance and value (Davis, Schoorman, & Donaldson, 1997). This theory suggests that when a firm faces financial distress, stewards will seek solutions aligned with shareholders' interests, aiming for long-term sustainability and recovery.

In contrast, agency theory, as delineated by Jensen and Meckling (1976), underscores the inherent conflicts that arise when management's interests diverge from those of the shareholders, particularly in distressed situations. These conflicts can manifest in self-serving behaviors by managers, such as risk-aversion or short-term decision-making, which might not align with the best interests of the company or its shareholders. In financial distress scenarios, effective corporate governance is crucial in mitigating these agency conflicts, ensuring that management actions are closely aligned with shareholder interests. Strong governance frameworks can provide oversight, accountability, and mechanisms to reconcile these differing perspectives, thereby playing a critical role in the successful turnaround of financially distressed firms. This dichotomy between stewardship and agency perspectives emphasizes the importance of a robust corporate governance structure that can navigate these complex dynamics, ensuring that management decisions during distress are geared towards recovery and long-term value creation.

3.2. Stages of Turnaround:

The turnaround process for financially distressed firms involves a series of strategic, operational, and financial interventions designed to stabilize and rejuvenate the enterprise. This section delineates the sequential stages of a corporate turnaround, emphasizing the methodologies and mechanisms adopted, particularly within the context of Italian distress investing and restructuring expertise.

-Initial Assessment and Stabilization

Crisis Acknowledgment and Management Commitment: The first step involves recognizing the severity of the financial distress and securing a firm commitment from management to undertake necessary changes.

Financial Analysis and Viability Assessment: A thorough financial review to identify liquidity issues, debt obligations, and operational inefficiencies. This stage often requires external advisors to provide an unbiased assessment of the company's financial status and its capacity for recovery.

-Emergency Action and Efficiency Improvement

Cash Management and Cost Controls: Implementing stringent cash flow management techniques and identifying immediate cost reduction measures to halt financial hemorrhage.

Operational Restructuring: Streamlining operations by eliminating non-core assets, renegotiating supplier contracts, and improving production efficiency.

-Strategic Repositioning

Market and Competitor Analysis: Conducting a comprehensive market analysis to understand current positioning and identify potential areas for growth or retraction.
Business Model Revision: Revisiting the business model to align with market demands and competitive landscapes. This may include diversification, consolidation, or pivoting to new market segments.

-Financial Restructuring

Debt Restructuring: Negotiating with creditors to restructure existing debt, which may involve extensions, debt-for-equity swaps, or obtaining new financing under more favorable terms.

Capital Infusion: Securing new investments to support the restructuring plan, either through existing stakeholders or new investors, emphasizing the firm's potential post-turnaround viability.
Implementation and Monitoring

-Execution of the Turnaround Plan

Rolling out the restructuring strategies across the organization, ensuring alignment with overall objectives and maintaining agility to adapt to unforeseen challenges.

-Continuous Monitoring and Adjustment

Establishing key performance indicators (KPIs) to monitor the progress of the turnaround efforts, allowing for timely adjustments and interventions as needed.

-Return to Growth

Strategic Growth Initiatives: Once stability is restored, focusing on growth initiatives such as market expansion, product innovation, and strategic partnerships.

Long-term Financial Planning: Implementing robust financial planning and management practices to sustain growth and prevent future distress.

Conclusion and Lessons Learned

Evaluation of the Turnaround Process: Assessing the effectiveness of the turnaround strategies implemented, including a review of financial performance improvements, operational efficiencies gained, and strategic positioning achieved.

Incorporating Learnings into Future Strategy: Integrating the insights and lessons learned from the turnaround process into the company's strategic planning and corporate governance frameworks to build resilience against future disruptions.

Chapter 4: Distress Investing vs. other forms of Investments.

4.1. Size of the market in the Private Capital world

The private capital market, a critical component of the global financial ecosystem, encompasses a broad spectrum of investment vehicles, including private equity, venture capital, private debt, and distressed investing. This segment has witnessed significant growth over the past decade, fueled by investors' search for higher returns, diversification of investment portfolios, and access to a wider array of investment opportunities beyond traditional public markets.

Growth and Scale

The private capital market has expanded dramatically in size and scope, driven by substantial capital inflows from institutional investors, high-net-worth individuals, and family offices. According to recent data from Prequin, the global private capital market is estimated to manage assets exceeding $7 trillion, a figure that underscores the substantial weight of private investments in the broader financial landscape. This expansion is indicative of the market's resilience, its capacity to offer competitive returns, and its role in financing innovation, corporate growth, and infrastructure development.

Distress Investing within Private Capital

Distress investing, a niche yet integral component of the private capital domain, focuses on investments in companies experiencing financial difficulties or undergoing bankruptcy proceedings. This strategy capitalizes on the market's inefficiencies, aiming to unlock value through restructuring, operational improvements, or strategic realignments. Despite its challenges, distress investing presents unique opportunities for substantial returns, especially in economic downturns when distressed assets become more prevalent.

The size of the distress investing segment is influenced by economic cycles, with its market share expanding in periods of financial instability. During such times, distressed assets increase as companies face liquidity crunches, declining revenues, and operational challenges. The Global Financial Crisis of 2008 and the subsequent economic downturns have spotlighted the pivotal role of distress investing in providing liquidity, stabilizing distressed firms, and facilitating their turnaround. Current estimates suggest that distress investing, within the private capital framework, manages assets ranging from $200 billion to $300 billion, reflecting its significance amidst broader private capital strategies.

Market Dynamics and Future Prospects

The distress investing market is characterized by its cyclical nature, with its dynamics closely tied to global economic health, interest rate environments, and corporate default rates. The strategy thrives in challenging economic conditions, where the mispricing of assets offers lucrative opportunities for discerning investors. Looking ahead, the market is poised for continued growth, driven by economic uncertainties, transformations in various industries, and the ongoing impacts of global events on corporate health.

The convergence of technological advancements, regulatory changes, and evolving market conditions will likely shape the future trajectory of distress investing. Innovations in financial modeling, data analytics, and artificial intelligence are enhancing the identification, assessment, and management of distressed assets, enabling more sophisticated investment strategies. Moreover, the increasing emphasis on sustainability and corporate governance is influencing the selection and management of distress investments, aligning financial objectives with broader societal and environmental goals.

4.2. Investors in Distress Investing:

Investors specializing in distress investing typically fall into categories such as private equity firms, hedge funds, distressed debt investors, and private credit funds.

These investors seek opportunities to invest in companies facing financial challenges, with the aim of achieving returns through restructuring, turnaround, or recovery. Kraft, Kaplan, and Wright (2007) describe distressed debt investors as firms or individuals who purchase the debt of troubled companies at a significant discount with the expectation of profitable returns either through debt restructuring or the eventual recovery of the company.

Private equity firms, as discussed by Hotchkiss and Mooradian (1997), often acquire controlling interests in distressed companies, providing both capital infusion and management expertise to lead the turnaround process.

One prominent player in the field of distressed investing is KKR, a global investment firm that has a history of engaging in complex distressed situations. KKR's approach, as outlined by Moyer (2005), typically involves a combination of buying distressed debt and providing new financing, often taking a hands-on role in the management and strategic direction of the target company.

Pillarstone, a platform set up by investment firm KKR, exemplifies a strategic approach to distressed investments in Europe. Pillarstone partners with banks to manage and turn around the performance of their non-core and underperforming assets. As noted by Ayotte and Morrison (2009), such platforms are designed to operate across multiple jurisdictions, providing operational improvements, strategic realignment, and capital support.

Other influential firms include:

Oaktree Capital Management:

Founded in 1995 by Howard Marks and Bruce Karsh, Oaktree Capital Management has been a leading figure in distressed debt investing. The firm is known for its prudent and methodical approach to investing in distressed securities, focusing heavily on rigorous due diligence and fundamental analysis. Oaktree's strategies often involve buying the debt of companies experiencing financial or operational challenges at significant discounts, and then actively participating in the restructuring and turnaround processes. The firm's success is partly attributed

to Marks' investment philosophy, which emphasizes understanding market cycles and risk management.

Apollo Global Management:

Leon Black, Marc Rowan, and Joshua Harris founded Apollo Global Management in 1990. Apollo stands out for its aggressive approach to distressed investing, often seeking control positions in troubled companies and taking an active role in their operational and financial restructuring. Apollo's strategy includes buying distressed bonds and loans, as well as direct equity investments in troubled companies. They focus on a wide array of industries, demonstrating versatility and adaptability in their investment approach.

Alcentra:

Based in Europe, Alcentra is a global asset management firm focusing on sub-investment grade debt markets. The firm is known for its expertise in leveraged loans, high-yield bonds, and direct lending, often dealing with distressed and special situations. Alcentra employs a hands-on approach to restructuring distressed assets, working closely with management teams to improve operational and financial performance.

Cerberus Capital Management:

Founded in 1992 by Stephen Feinberg, Cerberus Capital Management is another major player in distressed investing, known for its focus on distressed securities, private equity, and real estate. Cerberus often takes an operationally focused approach, emphasizing the turnaround of its portfolio companies through hands-on management and operational improvements.

4.3 Methodologies Theory & Bankruptcy Laws differences between Geographies:

The methodologies of distress investing can vary by geography. In Europe, for instance, Gilson et al. (2000) note that bankruptcy laws and financial regulations can affect the strategies employed by distressed investors.

In comparing the bankruptcy systems of the UK and the US, the UK system is more pro-creditor, focusing on strict enforcement of debt contracts and prioritizing creditors' claims. The main bank plays a dominant role in restructuring or liquidating distressed firms, with an emphasis on collateral value and limited debt forgiveness. In contrast, the US system, particularly under Chapter 11, is more pro-debtor, allowing for reorganization and providing debtors with opportunities to retain control and restructure debts. The US approach aims for the rehabilitation of the business, offering more flexibility in protecting the debtor's interests. (Franks and Ossman, 2005)

In Asian markets, particularly in countries like Japan and South Korea, distressed investing is heavily influenced by cultural attitudes towards bankruptcy and corporate failure. These attitudes often emphasize the preservation of employment and avoidance of public disgrace, leading to a greater emphasis on corporate restructuring and rescue rather than liquidation (Peek and

Rosengren, 2005). This cultural backdrop can make stakeholder negotiations more complex, as preserving the social fabric and existing business relationships often takes precedence over purely financial considerations.

Additionally, in emerging markets like Brazil and India, distressed investing is shaped by evolving regulatory landscapes and varying levels of market transparency. A study by Claessens and Klapper (2003) highlights the challenges posed by less developed legal and financial systems, where enforcement of creditor rights can be inconsistent, and information asymmetries are more pronounced. These factors can lead to higher risk premiums and a greater focus on secured lending in distressed investing.

The result is a mosaic of distressed investing practices globally, where cultural nuances, regulatory frameworks, and market maturity collectively define the strategies and outcomes of distressed investments. As global financial markets continue to integrate, understanding these regional variations becomes crucial for investors engaging in cross-border distressed investing, necessitating a nuanced approach that considers both the financial and socio-cultural dimensions of each market.

Distressed investing also requires a deep understanding of the value drivers within different industries and the ability to influence management decisions and outcomes effectively. Thus, investors like KKR play a pivotal role in the restructuring landscape, employing varied strategies across different regulatory environments to manage risk and seek returns from distressed assets. Their influence shapes not just the futures of the companies they invest in, but also the broader trends in corporate restructuring and recovery.

Chapter 5: Risks and Rewards of Distress Investing

5.1: Results of Intervention Theory & Risk of Liquidation

The theory of intervention in distressed investing can be exemplified through landmark deals, each illustrating the complexity and impact of these strategies.

Chrysler Corporation Turnaround (1980s):

One of the most famous cases of corporate turnaround involved Chrysler Corporation in the 1980s. Facing severe financial difficulties, Chrysler's recovery was facilitated by a combination of substantial debt restructuring and significant government intervention. The U.S. government provided loan guarantees, while Chrysler underwent a drastic operational overhaul, including cost-cutting measures and a focus on developing new, more competitive automobile models. This intervention not only saved Chrysler from bankruptcy but also set a precedent for government involvement in corporate bailouts (Altman & Hotchkiss, 2006).

Energy Future Holdings (2007):

The acquisition of Energy Future Holdings (formerly TXU Corp) by KKR, TPG Capital, and Goldman Sachs Capital Partners in 2007 represented one of the largest leveraged buyouts at the time. This deal was significant not just for its scale but also for the complexity of its restructuring process. The investment strategy involved a significant reorganization of the company's debt and operational structure. However, the subsequent drop in natural gas prices and the increased regulatory scrutiny led to financial challenges, culminating in Energy Future Holdings filing for bankruptcy in 2014. This case highlights the risks inherent in large-scale leveraged buyouts in volatile market conditions (Gilson, 2010).

General Motors Restructuring (2009):

Another notable intervention was the restructuring of General Motors (GM) during the 2008-2009 financial crisis. Facing insolvency, GM received a government bailout and underwent a Chapter 11 bankruptcy process. This intervention involved significant financial support from the U.S. Treasury, operational restructuring, and a focus on innovation and emerging automotive technologies. GM's successful turnaround post-bankruptcy demonstrated the effectiveness of coordinated government support and strategic corporate restructuring in rescuing large, systemically important firms (Rattner, 2010).

Delta Air Lines (2006):

The company filed for bankruptcy in 2005, underwent a significant restructuring process that included cost reductions, debt renegotiation, and a refocus on core routes and services. By 2007, Delta had emerged from bankruptcy and later successfully merged with Northwest Airlines, illustrating a complete recovery and return to profitability.

IBM (Early 1990s):

Rappaport and Sirower (1999) detail how IBM, facing intense competition and changing technology markets, initiated a profound strategic and operational transformation that included divesting non-core businesses, cutting costs, and pivoting towards services and software. This shift eventually led IBM to regain its position as a leading technology company. The intervention's success is also influenced by the stakeholders involved. The active involvement of creditors, particularly those who convert debt to equity, may have provided the distressed firm with not only capital but also the oversight necessary for a successful turnaround.

These cases collectively illustrate the varying outcomes of distressed investing interventions. From successful turnarounds to complex bankruptcies, they underscore the importance of strategic planning, market conditions, and sometimes government involvement in determining the success of these interventions.

The results of these interventions are a subject of considerable interest, with outcomes ranging from successful turnarounds to complete liquidation.

The efficacy of these interventions is contingent on a multitude of factors, including the timing of the intervention, the strategies employed, and the prevailing economic conditions.

Gilson's (1990) empirical study on the outcomes of financially distressed firms indicates that successful restructuring, whether through formal bankruptcy processes or private workouts, often depends on the ability of the firm to realign its operations and financial structure with the changing market demands. The study also highlights that firms that emerge from distress frequently experience significant changes in their ownership structure, management teams, and business focus.

However, not all interventions lead to a positive outcome. Sutton and Callahan (1987) highlight that for every successful turnaround, there are instances where companies fail to adapt to market changes or achieve the operational efficiencies necessary for survival. In such cases, companies may enter a state of chronic distress or end up liquidating, as was the case with the retail chain Toys "R" Us, which declared bankruptcy in 2017 after a series of unsuccessful restructuring attempts. The phenomenon of company liquidations and failures, while a natural component of the market's self-regulatory mechanism, carries profound societal and economic implications.

The liquidation of a company, particularly a large one, reverberates beyond immediate financial losses to creditors and shareholders, often affecting employees, suppliers, customers, and the broader economy.
For employees, the immediate consequence is job loss, which extends to income insecurity and its attendant social issues. Towns and cities dependent on a single employer, for instance, can face significant social and economic challenges when that employer fails. The closure of steel mills in the United Kingdom during the 1980s serves as a historical example, significantly affecting the social fabric of entire communities (Froud et al., 1998). The ripple effects include reduced consumer spending, increased demands on social welfare systems, and potential long-term career setbacks for the displaced workforce.

Theory on Liquidation:

The liquidation of major firms can lead to economic stagnation in regional economies, particularly in areas where the firm is a significant employer or economic contributor. This often results in reduced consumer spending and can escalate to economic downturns in the affected regions. Additionally, increased demands are placed on social services, including unemployment benefits and community support programs, as a result of rising unemployment rates. The failure of large firms also has the potential to alter the dynamics within their respective industries, sometimes leading to decreased competition, higher prices, or reduced innovation.

A pertinent case study that illustrates these effects is the liquidation of Lehman Brothers in 2008. This event not only marked a significant milestone in the 2008 financial crisis but also highlighted the systemic risks posed by the failure of large-scale firms. Lehman Brothers' collapse had a domino effect, triggering a global credit crunch, substantial losses in financial markets, and contributing to a worldwide economic downturn. This case study is crucial in understanding the far-reaching consequences of corporate liquidations in the interconnected global economy.

The liquidation of firms, particularly those integral to a supply chain, can disrupt industry ecosystems. Suppliers and customers of the failed firm can find themselves facing sudden revenue shortfalls and operational challenges. An example of this was the bankruptcy of auto parts supplier Delphi Corporation in 2005, which sent shockwaves through the auto industry, affecting manufacturers and other suppliers (Berkovitz and White, 2009).

The broader economic impact of company failures can be substantial, particularly when it involves systemically important firms or sectors. Such failures can undermine investor and consumer confidence, leading to wider economic slowdowns or recessions. A case in point is the dot-com bubble burst in the early 2000s, where the failure of numerous internet startups contributed to a broader economic downturn and a significant loss in investor wealth (Lowenstein, 2004). Furthermore, company liquidations can have long-lasting effects on innovation and competitive dynamics within industries. The disappearance of key players can lead to reduced competition, potentially stifling innovation and leading to higher prices for consumers.

5.2. Risks and Challenges in Distress Investing:

Distress investing, while potentially providing large returns, also has its unique risks and challenges. Investors in this domain have to deal with financial instability, operational difficulties, and significant uncertainty. Understanding these risks is crucial for devising strategies that mitigate downsides while capitalizing on the opportunities presented by distressed assets.

Market and Economic Risks

Economic downturns, while increasing the availability of distressed assets, also heighten the risks associated with such investments. Market volatility can severely impact the recovery prospects of distressed entities, affecting their ability to return to profitability and sustainability. Interest rate fluctuations, inflationary pressures, and shifts in consumer behavior further compound these risks, undermining the viability of turnaround strategies.

Legal and Regulatory Challenges

Bankruptcy proceedings, creditor negotiations, and the restructuring process are governed by intricate legal frameworks that vary significantly across regions. Moreover, regulatory changes and government interventions, intended to stabilize economic conditions or protect certain stakeholders, can negatively impact the outcomes of distress investing strategies.

Operational and Financial Risks

Distressed companies often suffer from weakened management teams, eroded company cultures, and demoralized workforces. Rebuilding the organizational structure, instilling effective leadership, and revitalizing the company culture are essential yet challenging aspects of the operational turnaround.
The financial restructuring of distressed entities entails negotiating with creditors, securing new financing, and possibly restructuring equity. The ability to reach agreements that satisfy all parties is uncertain, and the failure to do so can lead to prolonged distress or liquidation. Additionally, the infusion of new capital carries the risk of insufficient returns if the company's recovery is slower or less successful than anticipated.

Asset Valuation and Exit Risks

Exiting a distressed investment typically requires finding a buyer willing to take on the asset at a valuation that provides a satisfactory return. Market conditions, the success of the turnaround strategy, and the availability of potential buyers all influence exit opportunities and returns.

Strategy-Specific Risks

Each turnaround strategy carries specific risks, such as the potential for total loss in the event of bankruptcy for debt investors or dilution for equity holders in restructuring scenarios. Additionally, investors employ various mitigation strategies. These include thorough due diligence, diversification across industries and geographic regions, active involvement in the management and restructuring of distressed entities and leveraging legal and financial expertise to navigate bankruptcy and regulatory complexities. Maintaining flexibility in investment approaches and exit strategies also allows investors to adapt to changing conditions and maximize the potential for successful outcomes.

Chapter 6: Pillarstone Portfolio Case

6.1. Pillarstone Introduction

Pillarstone is a platform created in 2015 through a collaboration between KKR and John Davison, aimed at partnering with European banks to address the challenge of non-core and underperforming assets on their balance sheets. As a pan-European initiative by KKR Credit, Pillarstone plays a crucial role in managing exposures to such assets, which amount to approximately €1.9 trillion, including €1.2 trillion in non-performing loans. These assets, being capital intensive, hinder the growth of banks, companies, and broader economies. By providing a solution to unlock bank lending and rebuild companies, Pillarstone contributes to the revitalization of local and national economies.

Supported by funds and accounts managed by KKR Credit and its affiliates, the Pillarstone platform leverages KKR's global resources and has immediate access to a large pool of long-term capital (8-10 years horizon).

Goals & Benefits to Stakeholders

Pillarstone's innovative approach offers numerous benefits to various stakeholders:

- **Banks:** It enables banks, which are not naturally inclined to own businesses, to participate in the financial upside as the performance and value of companies with non-performing loans improve.
- **Companies:** By offering long-term capital and operational expertise, Pillarstone supports companies in stabilizing, rebuilding, and growing.
- **Economies:** The platform aids in job protection and creation, bolsters local supply chains, and fosters the development of sustainable companies. On a macro level, it helps unblock credit supply chains, allowing banks to lend more freely, and enhances the financial system's resilience.

Pillarstone is focused on developing operating models that align the platform's interests with those of the banks. These models are tailored to the banks' preferences, whether they wish to retain ownership of the assets managed by Pillarstone or remove them from their balance sheets entirely. It's worth noting that Pillarstone's primary concern is not just acting as a distressed investor with new money, but also ensuring the repayment of bank debts, which is a crucial aspect of their operations.

To describe it in simple terms:

"These are situations in which we want to stay with the client, where we think the company can recover and we are not ready to sell the loan at a discount " says Giovanni Gilli, head of Intesa San Paolo's division for managing non-core assets. (sited on https://www.euromoney.com/reprints)

Pillarstone's Proposition with Key Stakeholders:

Partner Banks	**Government**	**Investors**
• ***Improved Recoveries of NPL*** • ***Partner that can invest New Capital, backed by KKR Credit Arm.*** • ***Cost Reduction*** • ***Reputational Management***	• ***''Stronger'' Banks*** • ***New Investment in troubled firms*** • ***Bring international investors into local market.*** • ***Improved turnaround outcomes.***	• ***Long term equity story with structural growth.*** • ***Proven investment team with unique blend of skills***
Regulators	**Companies**	**People**
• ***Improved turnaround focus*** • ***Reduced forbearance (temporary postponement of loan payments)*** • ***Greater strategic focus of Banks***	• *Experienced turnaround support* • *Focus on Future* • *New lending / Investment* • *Rapid decision making* • *''Patient Capital'' focused on value maximization*	• *Aligned incentives.* • *Entrepreneurial Culture* • *Lower regulatory burden*

Targets & Investing Model:

In its pursuit of viable investment opportunities, Pillarstone is discerning, focusing on businesses poised for recovery with a minimum debt threshold of €50 million. The acquisition of governance rights is a key part of their strategy to instigate essential changes within these companies.

Pillarstone's effectiveness is amplified through partnerships with banks that consolidate assets under its management, particularly noted in their dealings with an Italian portfolio. Such arrangements enable the firm to drive corporate transformations typically outside the purview of traditional banking institutions.

Pillarstone has a flexible approach, making money either through fees based on how well they recover debts or by buying up bad loans. They're also willing to change their deals to fit what banks need in terms of money and cash flow. This flexibility is key to how they help struggling businesses get back on their feet.

Investment Portfolio:

Year	*Company*	*Sector*	*Method of Entry*	*Time in Portfolio (in years)*	*Exit Year*
2015	***MAGICLAND***	*Entertainement Parks*	*Bought credits from Intesa & Unicredit*	*No exit yet*	*No exit yet*
2015	***CUKI***	*Packaging Manufacturing*	*Bought credits from Intesa & Unicredit*	*3 years*	*2018*
2015	***BURGO***	*Paper Manufacturing*	*Bought credits from Intesa & Unicredit*	*5 years*	*2020*
2015	***MANUCOR***	*Polipropylene Manufactuirng*	*Bought credits from Intesa & Unicredit*	*4 years*	*2019*
2015	***LEDIBERG***	*Notebooks manufacturing*	*Bought credits from Intesa & Unicredit*	*N/A*	*N/A*
2016	***PREMUDA***	*Maritime Transport*	*Bought credits from Intesa & Unicredit*	*No exit yet*	*No exit yet*
2016	***SIRTI***	*Telco Infrastructure*	*Bought credit from Intesa*	*No exit yet*	*No exit yet*
2016	***FOI & VITALI ELETTRODOTTI***	*Utilities Industry*	*Bought by SIRTI SpA*	*6 years*	*2022*
2017	***RIZZO-BOTTIGLIERI-DE CARLINI ARMATORI (RBD)***	*Maritime Transport*	*Bought credits from Banco di Napoli, Banca Mps*	*Less than 1 year*	*BANKRUPT*
2019	***WELLCOMM ENGINEERING***	*Cybersecurity*	*Bought by SIRTI SpA*	*Less than 1*	*No exit yet*

6.2. Research Methodology:

This chapter provides an overview of the methodology employed to conduct research aimed at exploring the asset portfolio of Italian distress investing operator Pillarstone and the investment strategies implemented on specific assets (companies) in their portfolios. The adopted methodology followed a series of phases to gather, organize, and analyze the necessary data for the completion of this study, specifically:

Mapping of the investments made by the firm was the first step to make. This phase included gathering information regarding current or past investments in their portfolios. Investment information was collected from operators' websites, while details about investments such as disinvestment year, investment mode, and invested amount were sourced from specialized online journalistic sources within private equity, venture capital, private debt, NPL, and similar domains.

Information Database:

Collection and storage of company financial statements upon completing the mapping phase, the collected investment and involved company information were utilized to develop a detailed Excel-format database.

The first phase focused on creating various sheets, each compiling the consolidated financial statements of different fiscal years of distressed companies obtained from AIDA. Considering the varying investment and disinvestment dates of the examined companies, it was deemed beneficial to retrieve all available financial statements from the AIDA source. These documents cover a period approximately from 2012, in some cases extending to 2022, while in others reaching up to 2021. These sheets hold crucial importance as they provide an overview of the operational and financial performances of distressed companies over an extended timeframe, including the period when they underwent restructuring by distress investing operators. Particularly, these sheets enable the evaluation of operator performances and the companies' restructuring process by examining whether and to what extent variations occurred in key indicators reflecting financial solidity and operational performance.

Analysis & Tools Used

The analytical process involved a deep dive into the annual reports up to three years preceding Pillarstone's investment. The objective was to pinpoint the specific pain points—whether financial, operational, or a combination of both—that necessitated intervention. Following this identification, a table was constructed to encapsulate the four primary restructuring levers as delineated in literature: managerial, financial, operational, and asset restructuring.

Advanced analytical tools were employed to visualize the data effectively. Excel was used for data management and initial analysis, while PowerPoint, enhanced with ThinkCell, facilitated the creation of dynamic tables and graphs. These visualizations tracked the trajectory of critical distress indicators such as EBITDA, net debt, equity, margins, and key financial ratios including debt-to-equity (D/E) and net debt to EBITDA. This multi-faceted approach ensured a thorough evaluation of the investments and the impact of Pillarstone’s strategic maneuvers on the revitalization of distressed assets.

Ultimately, our analysis aimed to discern whether the emphasis was truly on enhancing operational efficiency or if the focus leaned more towards debt repayment and servicing the debt obligations towards the banks, mainly Intesa San Paolo and UniCredit.

In the analysis of Pillarstone's investments, each strategy is categorized for a detailed understanding of the restructuring efforts:

- **Management Turnaround** refers to changes in management teams or strategies, often implemented to instil a fresh perspective or new leadership skills within the company.
- **Operational Turnaround** encompasses efforts to enhance operating efficiency through 'doing things right,' without altering the company's overarching strategy.
- **Portfolio Turnaround** is a strategic alteration of the company's asset portfolio, aiming to refocus the business by divesting non-core assets or acquiring strategically aligned ones to improve liquidity or efficiency.
- **Financial Turnaround** involves altering the firm's capital structure and can include activities like debt refinancing or restructuring, equity injections, or complete recapitalizations to stabilize the financial health of the firm.

This framework ensures a comprehensive analysis of Pillarstone's restructuring approaches across various dimensions of their investments.

	Management Turnaround	**Portfolio Turnaround**	**Operational turnaround**	**Financial Turnaround**
Sub-strategies	• CEO exchange. • Top management team exchange • BoD change	• Strategic asset retrenchment • M&A (usually with DIP financing)	• Liquidity Improvement • Cost retrenchment • CAPEX modifications • Human Capital strategies	• Debt Provision • Debt reduction • Swaps • DIP Financing

6.3. Portfolio Analysis

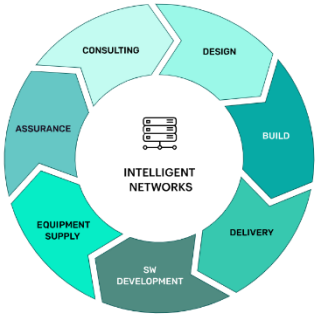
1. Business Sector & Industry

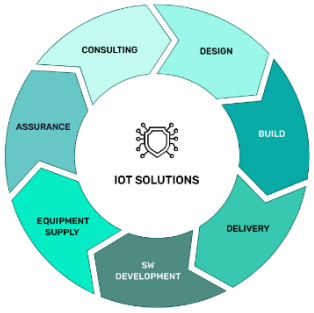
The telecommunications industry, marked by high market saturation in developed areas, necessitates the exploration of growth avenues either in emerging markets or via new technologies and services. This sector is propelled by rapid technological evolution, with advancements like 5G, the Internet of Things (IoT), and satellite technology significantly influencing companies' growth prospects and competitive positioning.
The industry demands substantial capital investment for infrastructure development, including network upgrades and expansion, making the assessment of capital expenditure and its impact on financial health vital.
Notably, the customer base in this sector often includes some of the largest companies in the country, such as Vodafone and TIM. However, this leads to limited customer differentiation, making firms more susceptible to the demands and changes in strategies of these major players.

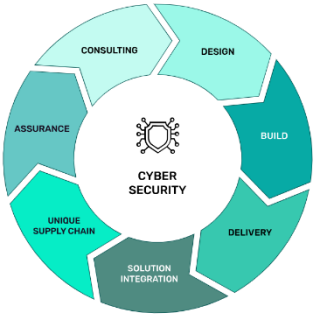
Sirti Group, with a legacy spanning over a century, has been at the forefront of connecting people and things innovatively and sustainably. The Group specializes in a broad concept of networks including:
Telecommunications, Energy, and Digital Solutions, serving a diverse clientele ranging from public entities to businesses requiring comprehensive project management capabilities.

In the telecommunications realm, the Telco Infrastructures Business Unit offers a complete suite of services encompassing the design, development, and maintenance of various network types. This unit is recognized for its involvement in major national projects like Ultra Broadband, positioning Sirti as a preferred partner for future infrastructure ventures funded by European initiatives.

Digital Solutions, another core business area, has emerged as a strategic player in system integration. Boasting a strong team with extensive certifications, the unit has been pivotal in the digital transformation of sectors such as Energy, Finance, and Public Administration, reflecting successful diversification strategies.







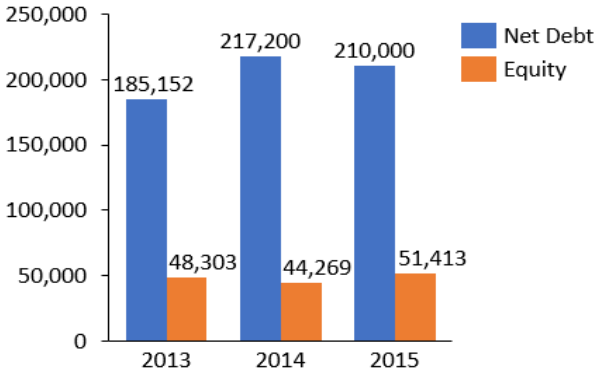
The Energy Business Unit, staffed with expert technicians, provides comprehensive services for energy transportation and distribution networks, demonstrating capabilities in network construction, maintenance, and energy efficiency solutions. (Through Terna S.p.A)

Historically, Sirti also held a **prominent position in transportation technology services**, encompassing signalling systems, telecommunications, and safety systems for various modes of transit. However, this business line was divested during the investment period, aligning with the strategic focus on core growth areas.
In simple terms, companies like Sirti in the transportation sector develop and implement technological services for metros and trains. This includes systems like Wi-Fi, signaling, telecommunications, and security systems to ensure efficient and safe operation.

2. Historical Operations Results, Financial Performance & Margins

2.1. Market Dynamics and Operational Performance:

In the years leading up to 2016, Sirti's revenue trajectory displayed modest growth, indicating relative stability in its operations. The absence of significant revenue distress suggests that, on the surface, the firm was maintaining its market position.
EBITDA figures during the same period showed an upward trend increasing 25% from 2013 to 2015. Although the growth rate may not have met all expectations, the consistent increase in EBITDA points to an improving operational margin and did not really show any signs of operational distress.



Despite the growth in revenue and EBITDA, the firm faced substantial operational challenges, particularly in generating sufficient cash flow. The cash flow from operations, for 3 out of the 4 years leading up to the acquisition, was inadequate to cover the capital expenditures, which are notably high in the telecommunications infrastructure sector.

Euro/000	2012	2013	2014	2015
Net Income	€ (6,077)	€ (41,502)	€ (1,948)	€ 6,489
Cash Flow from Operations	€ 4,549	€ 4,715	€ (23,458)	€ 15,494
CAPEX Expense	€ (8,987)	€ (8,987)	€ (8,386)	€ (7,039)

The insufficient cash flow from operations, as depicted by the financial data from 2012 to 2015, highlights that the firm was not able to cover its CAPEX, let alone make significant debt repayments.

2.2. Capital Structure & Debt Obligations:

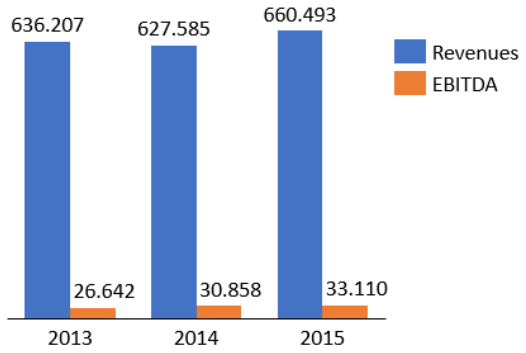
The shortfall in covering operational and capital costs led to a gradual increase in net debt. This rise was a necessity to finance ongoing operations and maintenance, which are critical in the telecom infrastructure domain. It reflects a situation where the firm had to increasingly rely on external financing to sustain its business model.

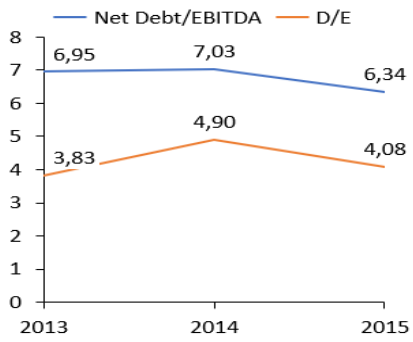
Prior to its acquisition in 2016, the company found itself in a challenging financial situation, though its operational performance was relatively stable compared to market norms. At this time, the firm was

	Credito concesso	Credito utilizzato al 31.12.2014	Tasso	Scadenza (***)
Term Loan Facility A	34.250	34.250	euribor + 1,00% (*)	30/06/2016
Term Loan Facility B	81.000	81.000	euribor + 1,00% (*)	30/06/2016
Term Loan Facility C	81.000	81.000	euribor + 1,00% (*)	30/06/2016
Revolving Credit Facility A e B	50.000	43.061	euribor + 1,00% (**)	30/06/2016
Totale	246.250	239.311		

burdened with various term loans and a revolving credit facility, all held by **Intesa San Paolo**. These financial obligations included Term Loan A of €34,250, Term Loan B and C each at €81,000, and a Revolving Credit of €43,061, all with an interest rate of Euribor plus 1%, and scheduled to be repaid by June 30, 2016.

The company's net debt was considerably high, as indicated by the following figures:





- In 2015, the Net Debt/EBITDA ratio was at 6.34, and the Debt-to-Equity (D/E) ratio stood at 4.08. Moreover, the Debt-Service Coverage Ratio (DSCR) remained low at 0.20 in 2015, indicating significant challenges in covering debt obligations with operating income.

The financial strain was exacerbated by the need to repay substantial principal amounts by the end of 2016. While the EBITDA was not exceptionally low, the net income frequently dipped into the negative territory.

In the period leading up to its acquisition, the company was compelled to renegotiate the terms of its loans, which were eventually acquired by **Pillarstone**. This renegotiation was a crucial step in addressing the company's financial challenges. Simultaneously, there was a concerted effort to strengthen the company's capital structure.

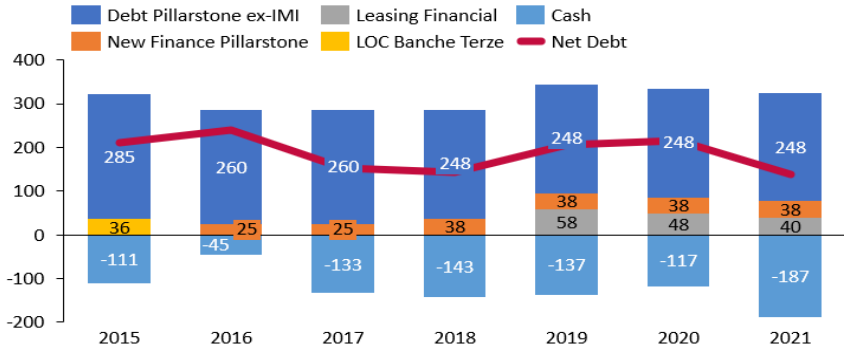
3. Investment Pillarstone & Turnaround Strategy:

In 2014, Sirti S.p.A. began a pivotal financial restructuring, which reached a key milestone in August 2016 with Pillarstone's entry. Addressing the financial strains evident since 2009, the restructuring under Article 67 of the Italian Bankruptcy Law aimed to reorganize the company's debts and strengthen its capital.

Pillarstone Italy S.P.V. was created to purchase Sirti's existing debt from Banca IMI and Intesa Sanpaolo, totaling **€286 million,** with a refinancing agreement maturing at the end of 2020. Concurrently, corporate governance was streamlined through PS Reti S.p.A (A firm set-up by Pillarstone)., consolidating ownership and simplifying decision-making. A strategic **capital increase of €25 million**, entirely underwritten by PS Reti through a **debt-to-equity conversion**, bolstered the company's capital structure. A provision for an additional capital increase, up to €12.5 million, was included to cater to strategic and financial needs.

Operational liquidity was secured by maintaining commercial lines and guarantees, amounting to €58.5 million and €104 million, respectively, vital for continued operations. Moreover, **super secured New Financing of €25 million**, the "Nuova Finanza," provided further flexibility, supporting the implementation of the Industrial Plan.

This table contains the strategies and actions taken by the firm to turnaround the economical state of the firm. Last column contains quantitative values & graphs depicting what was said and highlighting the development of the main KPIs.

Type of Restructuring	Strategies & Actions undertaken	Evolution of Main Financial Ratios throughout Investment Horizon:
Management & Governance Restructuring:	Following the acquisition, the company experienced a management overhaul. Key positions such as the CEO and Chairman were replaced, signifying a fresh direction under new leadership. Pillarstone had bought **100% of Sirti's share capital.** John Davison, ex-Pillarstone CEO was appointed as president of Sirti Group. Gaudenzio Gregori, CEO and Managing Partner of Pillarstone is on the board of directors as well as Andrea Nappa, a Partner at Pillarstone. The Board of Directors was not only replaced but also resized to a smaller cohort, streamlining the decision-making process. The reshaped board featured individuals with affiliations to KKR and Pillarstone, indicative of the acquiring fund's influence and strategic intent for the company's future.	**CONSIGLIO DI AMMINISTRAZIONE** *(1)* John Davison — *Presidente (a)* Roberto Loiola — *Amministratore Delegato (b)* Roberto Pisa — *Consigliere (c)* Andrea Nappa — *Consigliere* Gaudenzio Bonaldo Gregori — *Consigliere* Davide Benello — *Consigliere (d)*
Financial Restructuring:	**Capital Strengthening & Debt Restructuring** *During the investment period, Sirti's approach to managing its long-term debt was characterized by a strategy of postponement and restructuring, rather than repayment.* Key transformation in Capital Structure: • Debt/Equity swap of **€37.5 million** on Pillarstone's credit. • Super senior New Financing of **€37.5 million** by Pillarstone. • SPFs of **€50 million** to absorb accumulated negative NI, on Pillarstone's credit. • Repayment of credit lines of ≈**€36M** to a pool of Banks. (LOC Banche Terze) Main goal was to increase the liquidity position of the firm by matching the D/E swaps with new financing provided by Pillarstone to finance new acquisitions and CAPEX. Debt Paydown & Decrease in Interest Expense: No MLT debt paydown was done during this time horizon. Maturity of the principal payment was pushed back two times, until 2022, and will probably be pushed even further.	 **It's worth noting that from 2019 onwards, the firm started using the IFRS accounting method which meant adding Financial Leasing as a long-term financial debt that was paid back yearly, as seen in the graph above.

Operational & Asset Restructuring:

Performance Improvement:

Entrepreneurial turnaround Strategy

These asset restructuring actions are a testament to Sirti's commitment to a strategic refocus on high-margin business areas in Technology and core business strengths.

- **Divestures:**
  - Divestiture of the Transportation Business Unit in 2021 was a calculated move to concentrate on Sirti's core competencies offered limited synergies with the other business units.
- **Acquisitions & New Markets:**
  - Wellcomm Engineering, a significant player in the cybersecurity space, was acquired in 2019 strengthening the Digital Solutions Business Unit

Cash & NWC management:

- Thanks to the reputation of their customers (Telecom Italia, Vodafone, Wind…) Sirti was able to use pro-soluto tools which substantially improved the yearly net NWC.
- Sale of Transportation business unit in 2021 for €91M euros.
- Money raised was used to finance increasing CAPEX.

Revenue, EBITDA Growth

In executing its strategic plan, Sirti Group adeptly transitioned from a predominant focus on Telco Infrastructure to a diversified portfolio, notably strengthening its Digital Solutions segment.

Main observations regarding the top line:

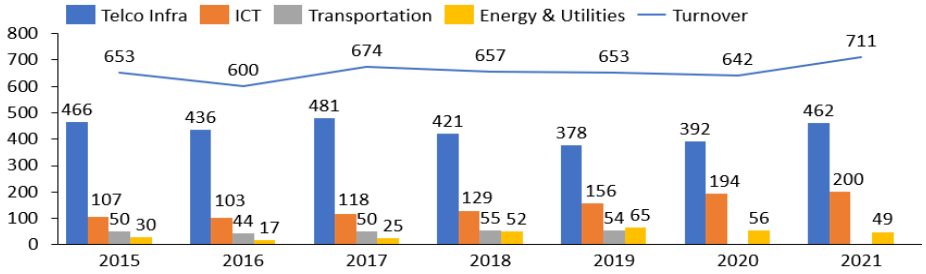
- Revenues reached a high of €711M in 2021.
- Digital Solution business segment grew at a CAGR of 11% from 2016 to 2021. Now makes up 29% of revenues, growing from 17% in 2016.
- Telco Infrastructure revenues remained volatile.

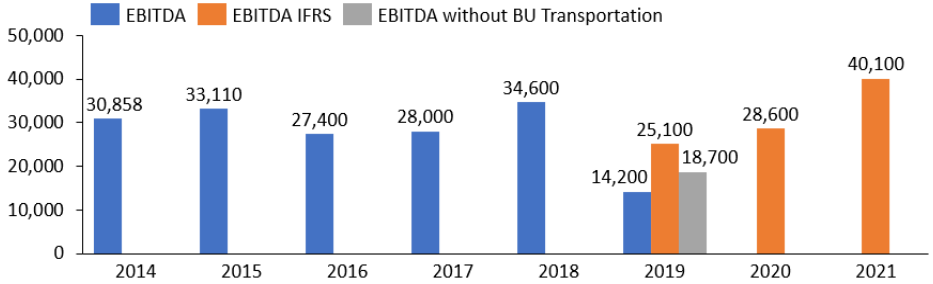
Sirti Group's strategy to diversify revenue was challenged by high fixed costs and volatile Telco Infrastructure segment earnings, limiting EBITDA growth and leading to huge, accumulated Losses.

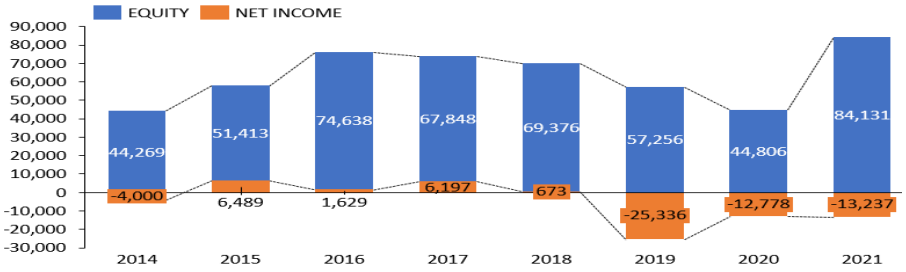
Main observations:

- Telco's revenue volatility hindered operational efficiency and margin enhancement, reflecting the sector's cost structure transformation difficulties.
- A higher 2019 EBITDA without the Transportation Business Unit. (+31%)
- Post-divestiture, Sirti's EBITDA in 2021 reached €40 million -, signalling improved financial health and a return to 2015-2016 performance levels (assuming non IFRS) with a more focused organizational structure.

Euro/000	2016	2017	2018	2019	2020	2021
CAPEX	€ 14,700	€ 21,000	€ 11,800	€ 22,900	€ 27,700	€ 15,400
CAPEX/Sales	2.41%	3.07%	1.76%	3.45%	4.31%	2.11%
Net WC		€ 128,000	€ 13,121	€ (16,695)	€ 47,465	€ (7,456)
FCFE	€ (65,254)	€ 92,377	€ 5,406	€ (1,289)	€ (21,002)	€ 68,210
					Cumulated FCFE	€ 78,448.00



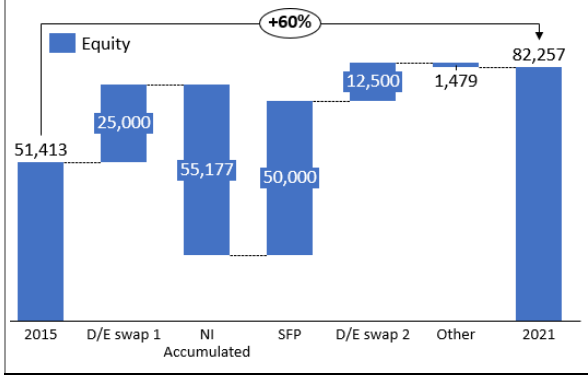
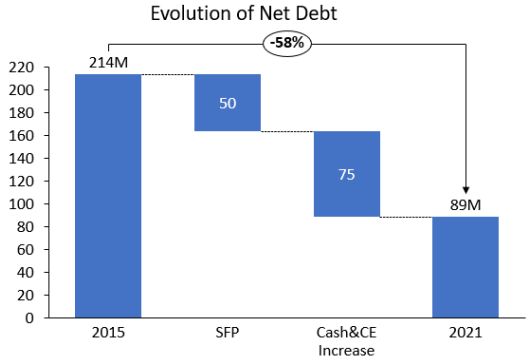




4. Exit & Overview of Asset:

4.1. Exit:
Pillarstone has not exited yet.

4.2. Status Quo

Equity Evolution		Debt Evolution	
	• 100% of the value increase in equity came from the financial manoeuvres did by Pillarstone. They covered the huge €50 million accumulated losses as well.		•As mentioned earlier, there was no debt pay-down. •Value of net debt was decreased due to the issuance of SFPs and increase in cash which came mainly from the sale of BU Transportation.

Capital Structure & Operational Improvement:

YEAR	2015	2021
Net Debt/ EBITDA	6.34x	2.28x
D/E	4.08x	1.09x
EBITDA	33,110	40,100
EBITDA Margin	4.49%	5.49%

Euro/000

- By divesting non-core assets and acquiring companies aligned with future growth trajectories, Sirti Group effectively shifted part of its focus towards high-margin digital solutions industry.
- No real improvement in operations has been visible until now, even though the EBITDA growth (mostly due to new IFRS accounting) suggests otherwise. The main positive from the intervention for now is a new organizational structure potentially able to increase profits and improve margins.
- The path forward for Sirti Group is marked by strategic opportunities, particularly in the Business Unit (BU) Digital Solutions, which promises a healthy increase in revenues with relatively lower CAPEX and cash requirements. The focus on expanding this BU is a strategic response to the evolving market demand for digital services, which are not only more profitable but also require less intensive capital investment compared to traditional infrastructure projects.

1. Business & Industry Overview

1.1. Burgo Group & Subsidiaries

The Burgo Group is the industrial holding company of a group operating in the production and distribution of paper for the graphics sector, speciality papers (for example for food use) and containerboard, as well as in the production and sale of fibrous raw materials (chemical pulp, mechanical pulp, deinked pulp) and energy.
The firm's paper revenues have always been the highest compared to the other stream of revenues like Cellulose and Energy.

Initially, upon entry the parent company Burgo Group initially held:

100% of the share capital of:

- Burgo Ardennes S.A. (BE)
- Burgo Distribution S.r.l.
- Burgo Energia S.r.l.
- Mossini S.r.l.
- Gever S.p.A.

- **90%** of **Burgo Factor** S.p.A.

Additionally, the Burgo Group also had full control over the companies that perform sales and distribution activities abroad, which include:

- Burgo Benelux SA (B)
- Burgo France SARL (F)
- Burgo UK Ltd (UK)

Through Burgo Ardennes SA (100% ownership), it controlled:

- Burgo Iberica Papel SA (E)

Through Burgo Ardennes SA (89.8%) and Burgo Group S.p.A. (10.2%), it controls:

- S.E.F.E. Sarl (F)

Moreover, the Burgo Group holds stakes in the following subsidiaries:

- Burgo Central Europe (D)
- Burgo North America Inc. (USA)
- Burgo Polska Sp.z o.o. (PL)

This structured breakdown indicates the Burgo Group's extensive network of subsidiaries, reflecting its strategic control over sales and distribution in various international markets.

The group's main area of business was **Paper Production**, most specifically **Graphic Paper**. They also produce and sell Cellulose & Wood pulp and Deink.

Graphic Paper is sold in different ways, with very different finish, grade, printing method and application. Different types of paper are generally suited for different purposes based on their quality, weight, texture, and the printing technology they are designed to work with:

1. **Fine Papers**: High-quality papers, often used for formal correspondence and presentations.
2. **Publication Papers**: Designed for print publications, like magazines and newsletters.
3. **Inkjet & Laser Papers**: Optimized for use with inkjet or laser printers, providing good print quality for both text and images.
4. **Thin Papers**: Lightweight papers, often used for items like Bible pages or dictionary pages.
5. **Recycled Papers**: Made from post-consumer waste, environmentally friendly but can vary in quality.
6. **Office Papers**: Standard papers used for everyday printing and copying in an office environment.

Finally, the Group produces electricity and steam and, through the subsidiary **Burgo Energia**, also operates as a wholesaler and trader. In the electricity sector, Burgo Energia operates in the following markets: end consumer, GME (day ahead and infraday markets - MGP and MI), the EEX (futures market for French, German and Italian electricity), the IDEX (futures market for German and Italian electricity), the French, Swiss and German spot markets, bilateral trading (Over the Counter - OTC), and on bidding platforms to acquire transport capacity through interconnections with other countries for imports and exports. In this context, the subsidiary Burgo Energia manages the excess and gaps for the Group's plant.

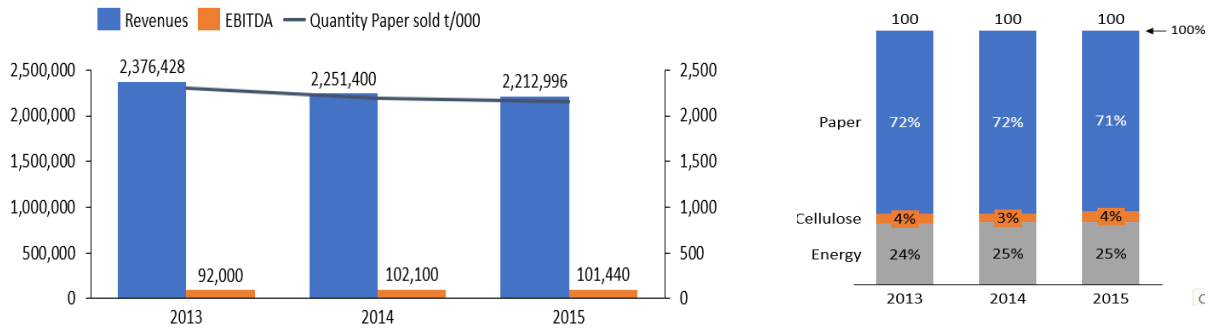
1.2. Shareholding Structure & Control Pre-entry:

As of the close of 2014, the shareholding structure was characterized by Holding Gruppo Marchi spa and its subsidiary Palladio Zannini Industrie Grafiche Cartotecniche spa possessing a combined majority of 50.59%. Mediobanca spa was the next significant shareholder with 22.12%, followed by Société de Participation Financière Italmobiliare sa and Allegro (sub-fund of Generali Financial Holdings FCP-F1S) each holding 11.68%. Unicredit spa had a 3.83% stake, and a marginal 0.10% was held by minority shareholders.

Key corporate decisions, as outlined in Article XIX of the company's bylaws, require the assent of 70% of serving directors for the passage of resolutions. No single shareholder or coalition of shareholders held this supermajority, affirming that Burgo Group spa operates autonomously and is not governed by any external business entity.

2. Historical Operations Results, Financial Performance & Margins

2.1. Market Dynamics and Operational Performance:



From 2013 to 2015, Burgo Group encountered a noticeable downturn in its financial performance, marked by a 6.8% decline in total sales. This downturn is particularly pronounced in the Graphic Paper Sales, where we observed a reduction in quantity sold from 2,306 thousand tonnes in 2013 to 2,152 thousand tonnes in 2015. One should mention that External Factors, such as a decline in Graphic Paper demand due to switch in consumer preference is one of the reasons that lead the firm down this path.

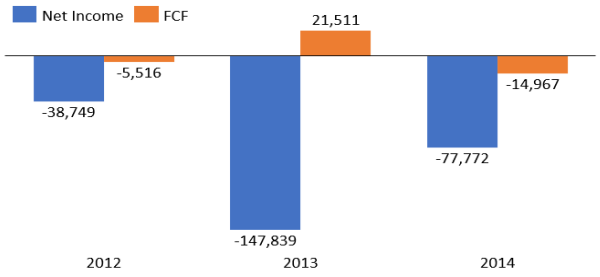
The declining sales volume has exerted pressure on the company's financial health, leading to an unsatisfactory net income. The main problem lies in the inadequacy of the EBITDA, which falls short of covering depreciation and amortization (D&A) expenses, not to mention other operational costs. As it can be seen in the table above, D&A has been consistently higher than EBITDA over the years prior to Pillarstone's entry.

Euro/000	2013	2014	2015
EBITDA	€ 92,000	€ 102,100	€ 101,400
D&A / EBITDA	1.94	1.18	1.05

Between 2012 and 2014, Burgo Group faced significant financial challenges, with net income deeply entrenched in negative territory. This period of financial distress directly correlates with the operational difficulties highlighted previously, particularly within the Graphic Paper segment. The downturn in sales

and market demand for graphic paper significantly impacted profitability, leading to substantial losses and a need for cash.

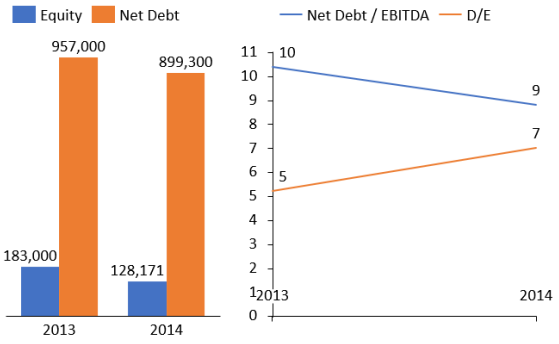
The Free Cash Flow (FCF) metric, crucial for assessing the firm's liquidity and its ability to meet debt obligations, presents a nuanced picture. Calculated as Net Income adjusted for changes in Net Working Capital (NWC), Capital Expenditures (CAPEX), and Depreciation & Amortization (D&A), FCF has shown variability over the same period. Despite these fluctuations, the overarching concern is that FCF levels have been largely insufficient to comfortably support the company's existing capital structure and debt service requirements. It's also important to mention that CAPEX needs for businesses like Burgo's are relatively high and demand a big amount of CF per year to keep up with the maintenance, as seen in the table below.



YEAR	2012	2013	2014
CAPEX/Sales	2%	2.1%	1.9%
CAPEX	€45M	€49M	€42M

2.2. Capital Structure & Debt Obligations:

In 2014, just before the entry of Pillarstone, Burgo Group's financial statements reflected a substantial financial burden.
The company's current financial liabilities stood at €330.677 million. Within this figure, the company had access to committed credit lines amounting to €447 million, which were approximately 70% utilized, and additional revolving credit lines valued at €60 million, which were fully drawn.
The long-term financial liabilities MLT were reported at €759.767 million. As highlighted by the ratios in the graph on the right, the company was now overleveraged and needed a different capital structure to sustain the firm's activities.



Additionally, due to the high amount of debt, the Interest Coverage Ratio, using EBITDA as nominator, averaged at 1.575 in the last 2 years pre-entry. This further showcases the dire need of capital structure rebalancing.

Euro/000	2013	2014
Current Financial Liab	€ 61,174	€ 62,016
Interest Coverage Ratio	1.50	1.65
DSCR	0.02	0.07

3. Investment Pillarstone & Turnaround Strategy:

In the years leading up to 2015, the Burgo Group faced a critical period characterized by declining market trends and escalating financial challenges. These factors set the stage for Pillarstone's strategic entry.

In December 2015, A few days after the implementation of the securitization programs implemented about Lediberg, Cuki, Magicland and Manucor, the Pillarstone platform acquired a portfolio of receivables and quasi-equity instruments (convertible debt) vis-à-vis Burgo, an Italian company active in the production of, inter alia, graphic and specialty papers. These credits were held by UniCredit and Intesa San Paolo.
For this transaction as well, Pillarstone's team made use of, among other things, the tools provided by the Italian law no. 130 of 1999 to implement a securitization program aimed at acquiring instruments with a total nominal value more than Euro 190 million.
A pivotal change occurred in the ownership structure of the Burgo Group with the entrance of Pillarstone, a private credit fund. This strategic move was orchestrated through the acquisition of Convertible Participatory Financial Instruments (SPFs), for a nominal value of 54M euros, which were previously debt obligations held by the banks (mainly Intesa & UniCredit) and converted into equity instruments, granting Pillarstone a significant control over the firm.

This table contains the strategies and actions taken by the firm to turnaround the economical state of the firm. Last column contains quantitative values & graphs depicting what was said and highlighting the development of the main KPIs.

<table>
<tr><th>Type of Restructuring</th><th>Strategies & Actions undertaken</th><th>Evolution of Main Financial Ratios throughout Investment Horizon:</th></tr>
<tr><td>Management & Governance Restructuring:</td><td>The strategic redirection of the company was manifested through a significant shift in its executive leadership. Following the acquisition by the fund, a pivotal change was effected at the helm of the company's management. Mr. Ignazio Capuano was appointed CEO, succeeding Mr. Paolo Mattei. This transition in chief executive leadership, while retaining the consistent oversight of Chairperson Mr. Alberto Marchi, suggests a deliberate move by the fund to inject fresh perspective and leadership to steer the company through its restructuring phase.
The timing of the change in CEO post-acquisition indicates a likely intervention by the fund to align the company's strategic direction with its operational goals to successfully implement the industrial plan Burgo2020.

As SPFs holders, Pillarstone, have certain administrative rights, including (i) the right to appoint one member of the board of directors under Article 2351, paragraph 5, of the Italian Civil Code; (ii) the right to express approval for the appointment of an additional 3 directors; and (iii) the right to express approval for the appointment of an effective statutory auditor.</td><td>• Pre-acquisition

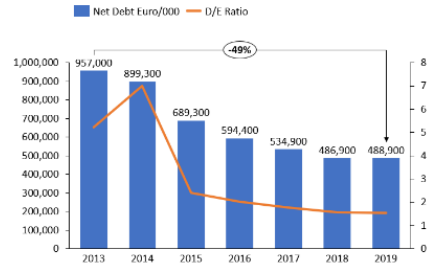
<table><tr><th></th><th>Categoria A</th><th>Categoria B</th></tr><tr><td>Mediobanca S.p.A.</td><td></td><td>130.374.542</td></tr><tr><td>Unicredit S.p.A.</td><td>43.997.525</td><td></td></tr><tr><td>Banco Popolare S.c.</td><td>15.528.538</td><td></td></tr><tr><td>Intesa Sanpaolo S.p.A.</td><td>10.099.395</td><td></td></tr><tr><td></td><td>69.625.458</td><td>130.374.542</td></tr></table>
• Post-acquisition

<table><tr><th></th><th>Categoria A</th><th>Categoria B</th></tr><tr><td>Mediobanca S.p.A.</td><td></td><td>130.374.542</td></tr><tr><td>Pillarstone SPV S.r.l.</td><td>54.096.920</td><td></td></tr><tr><td>Banco Popolare S.c.</td><td>15.528.538</td><td></td></tr><tr><td></td><td>69.625.458</td><td>130.374.542</td></tr></table></td></tr>
<tr><td>Financial Restructuring:</td><td>Capital Structure Rebalancing:

<u>Key transformation in Capital Structure:</u>
• Conversion of €200 million of the Group's debt into participatory financial instruments (SFP) (Unicredit portion bought by Pillarstone).
• An additional €100 million of debt being transformed into a loan with the potential for future conversion into SFP, aimed at further bolstering the company's capital structure. No impact on Net Debt value.
• Reclassification of revolving credit lines worth €60 million from Current Financial Liabilities to MLT.

<u>Debt Restructuring:</u>
Remaining MLT's maturity payment postponed to 2022 (with possibility to postpone again)

<u>Less Reliance on Commercial Credit Lines:</u>
Concurrently, the company markedly reduced its dependency on credit lines, with total financial obligations contracting from €287 million in 2015 to a mere €49 million in 2019, thanks to huge CF generation during the tenure. (covered below)

<u>Debt Paydown & Decrease in Interest Expense:</u>
This recapitalization, coupled with the firm's robust operational performance and positive cash flows, facilitated a deliberate paydown of long-term liabilities amounting to €37 million between 2016 and 2019. Plus, the decrease in MLT debt and commercial lines during the investment lead to a substantial drop in yearly Interest Expense, increasing liquidity and income of the firm.</td><td> 

• -47% Decrease in Net Debt since take-over.
• Net Debt/Equity decreased to approx. 1.5 in 2019.
• MLT debt of 551M in 2019 euros while current financial liabilities decreased primarily.

<table><tr><td>Year</td><td>2014</td><td>2015</td><td>2016</td><td>2017</td><td>2018</td><td>2019</td></tr><tr><td>Financial Interest Expense</td><td>61M</td><td>53M</td><td>35M</td><td>31M</td><td>30M</td><td>30M</td></tr></table></td></tr>
</table>

Operational & Asset Restructuring:

Performance Improvement:

Product Portfolio Restructuring

Retrenchment Phase: Repositioning from declining Graphic Paper segment to Cardboard, Writing Paper & Speciality Paper.

- The transition was financed thanks to careful cash management by the firm.
  -No debt re-payments in 2015 and 2016.
  -CAPEX Management: decrease in CAPEX during first two years of holding.
  -Divesting multiple non-strategic assets generating 87.5M euros, including Burgo Energia exiting consumer gas & energy market in 2018.
  -Positive NWC throughout the investment horizon.

- Investments & Modifications
  High CAPEX investments between 17'-19', from which the main modifications:
  -The cessation of the outdated line 8 at Verzuolo signalled a strategic withdrawal from the coated paper with wood (CM) segment and coated wood-free paper (CWF), & conversion of the Toscano plant into specialty papers.
  -At Avezzano, significant investments laid the groundwork for containerboard production, catapulting the group into a leading position within this market niche.
  - Research and development of new products in line with market trends, such as high-quality coated papers and an expanded portfolio in natural papers and specialty segments.

EBITDA & Net Income Growth:

This refocusing Business Plan worked, with a strategy increasingly focussed on business with greater added value, such as special paper and cellulose, and those with prospects for increased demand such as cardboard.

Main observations, showcasing the important of cost reductions as seen in the Literature (D'Aveni 1989)

-Shifted sales focus to higher-margin products like Specialty Paper and Cardboard, maintaining comparable absolute paper sales figures from 2014 to 2019 but with a restructured, more profitable product mix. This is highlighted by an Operative Result Margin increasing 5% between 2015 (26%) and 2018 (31%).
-Exited the volatile energy market, reducing energy revenue from €534M in 2014 to approximately €98M in 2019, a strategic move to mitigate the negative impact of methane and energy cost fluctuations on profit margins.
-Downsizing the size of the personal leading to a decrease of 10% of the workforce (approx. 300 job) decreasing personnel expenses by 7%

Achieved a 32% increase in EBITDA, amounting to a €32M improvement from 2015 to 2019, reflecting a stronger operational performance driven by the strategic adjustments.

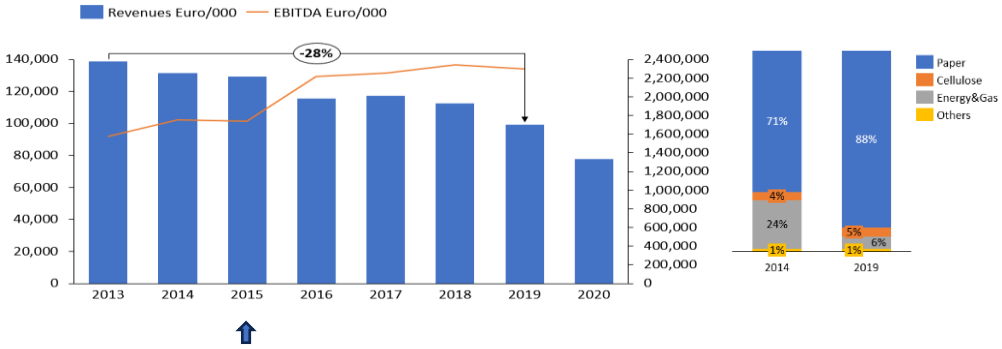
Since the takeover, the firm's net income has consistently been positive, driven by:

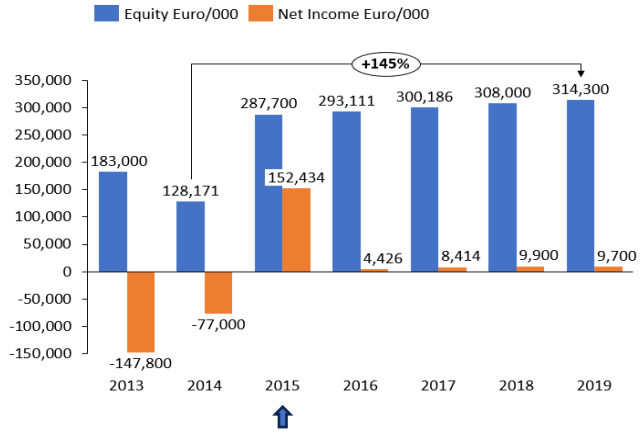
- A €200 million gain in 2015 from converting long-term debt to equity during restructuring.
- Reduced interest expenses from a healthier capital structure.
- Improved operating margins due to increased business efficiency.

These factors have contributed to a steady annual increase in equity value starting in 2016.

YEAR	2014	2015	2016	2017	2018	2019
CAPEX/Sales	1.9%	1.7%	1.8%	2.9%	4.0%	5.6%
CAPEX	€42M	€37M	€40.5M	€58.2M	€76.8M	€94.4M
ΔNWC	€32.7M	€(4.0)M	€45.5M	€21.91M	€15.71M	€0.128M
FCFE	€27.608M	€25.608M	€132.568M	€69.35M	€33.52M	€19.28M
					Cumulative FCFE	280.326

Majority of the Free Cash Flow to Equity (FCFE) was used to pay back the short-term liabilities (credit lines) , decreasing them of approx. 250M euros.





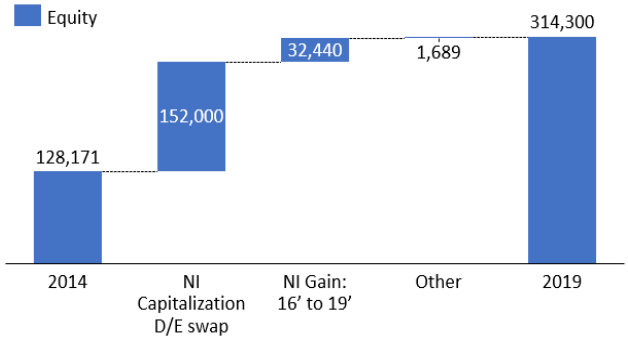
4. Exit & Review of Value Creation:

4.1. Exit:

In a significant shift in ownership, the turnaround fund QuattroR acquired a majority stake in the Burgo Group, marking the exit of Pillarstone in 2020. Pillarstone sold the equity instruments it had acquired in 2015 as part of Burgo Group's debt restructuring plan. These instruments, which were originally part of a conversion of €200 million of medium and long-term debt into equity under Article 67 of the Bankruptcy Law, had been a key component in the financial stabilization of Burgo Group. The sale by Pillarstone concludes its engagement with the company, transitioning the stake to QuattroR, who is set to support Burgo Group's strategic repositioning and growth.

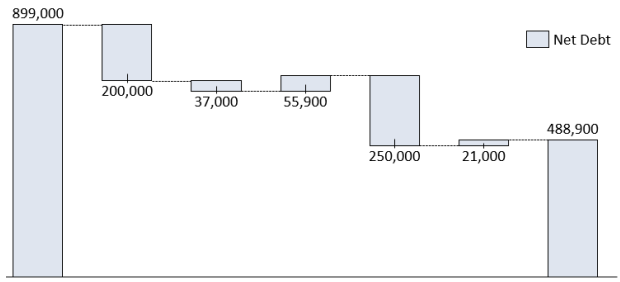
4.2. Value Creation:

Equity Evolution



- Equity value increased 145% between 2014 and 2019. Most of it (85%) comes from the D/E swap done by Pillarstone upon entry, the remaining 15% increase was done thanks to a positive income throughout the investment horizon.

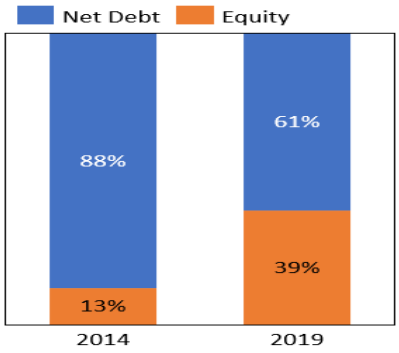
Debt Evolution



- Decrease in Net Debt value of 45% between 2014 and 2019. The swap is responsible for 45% of that decrease while a big chunk of this decrease came from the debt pay-down and reduced credit line exposure by the firm amounting to 53% of the value change.

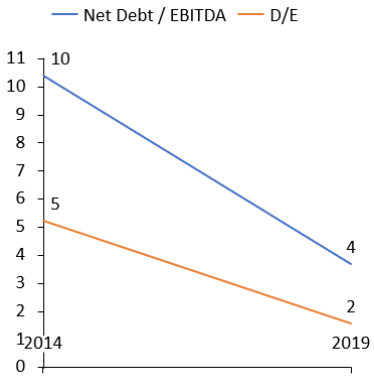
New Capital Structure & Operations

Capital Structure



- A healthier capital structure with a D/E value of 1.56, within the acceptable range for a manufacturing company. (less than 2)

Financial Ratios



- EBITDA increase of 32M euros with a decrease of 410M euros in Net Debt improved the ND/EBITDA ratio from 10.4x to 3.67x, still below the normal healthy range, but at that rate the firm should be decreasing it further in the future.

Operational Performance

Euro	2014	2019
EBITDA	102M	134M
EBITDA Margin vs Sales	4.6%	7.9%
Interest Coverage Ratio	1.65x	4.42x

- The firm successfully undertook a strategic repositioning where it divested its Energy business & decreased its exposure to the graphic paper market, a market in decline. This lead to healthier margins with an increase in EBITDA, able to withstand the new capital structure and the CAPEX needs of the firm.

This case showcases the importance of retrenchment and repositioning strategies as a core solution for turnaround as argued by most of the Literature (Ramanujam & Grant, 1989, Slatter 1984).

Returns for the main Stakeholders:

I) Pillarstone:
Brief overview of the investment operation involving Pillarstone and Intesa San Paolo, and the returns for both. The goal in this part is to calculate the NPV of the investment made by Pillarstone to manage the debt and showcase the returns of the bank.

Assumptions for Pillarstone's Investment Strategy:

- **Debt Acquisition:** Pillarstone acquires bad debt from banks, but instead of paying cash, they set a value for the debt at 40% of its original value. They issue notes from their credit fund to the bank in return for the debt. **Recovered principal and interest debt under the 40% threshold goes automatically to the bank.**
- **Management Fees:** Pillarstone earns yearly management fees of **1%** on the entire value of the debt they manage.
- **Commission on Recovery:** If Pillarstone recovers more than the 40% threshold they initially set for the debt, they earn a commission of 7% on the excess recovery.
- **Risk and Returns:** While Pillarstone's direct financial risk might be low if they haven't invested their own capital, they face operational, reputational, and regulatory risks. Their returns are primarily driven by their ability to effectively manage and recover value from the bad debt, as well as the performance of their credit fund.
- **Super Senior Loans (New Money):** Sometimes Pillarstone adds super senior loans (New Money) and expects to receive at least a 12% return, acting similarly to private equity firms. In that case, no senior debt was added. **No new money was added in that case.**

***Please note that the assumptions pertaining to the valuation of the debt acquired and disposed of were established based on logical reasoning and informed estimates, not on official figures.*

AUM Fees	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
Bank MLT Debt (Value in 2015)	€ 54,096,000	€ 54,096,000	€ 54,096,000	€ 54,096,000	€ 54,096,000	€ 54,096,000
Returns	-	€ 540,960	€ 540,960	€ 540,960	€ 540,960	€ 540,960

Total return on fees	€ 2,704,800

II) Intesa San Paolo & Unicredit:

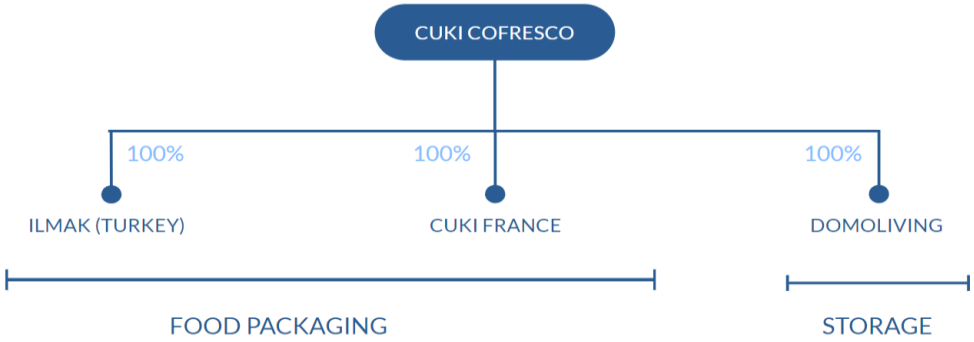
No debt was repaid. But the firm was left in the hands of QuattroR after it purchased the SFPs for a value of 29M euros, approx. 50% of the nominal value of the quasi-equity instruments, way higher than in 2015, where high leverage led to a negative value of equity.

1. Business & Industry Overview

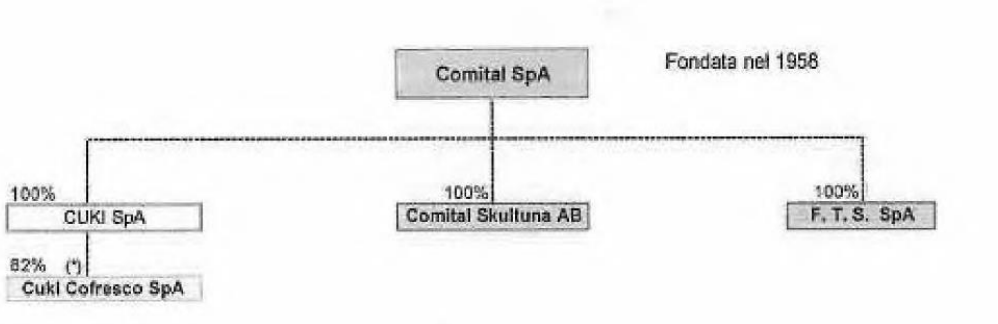
Food conservation is a crucial part of the food-industry production cycle: **for over sixty years** Cuki have been investing in this sector, in terms of **technological research**, **integrated industrial system** and **production diversification** according to market's demands.

Cuki's offer includes **Cuki and Domopak** cling film, aluminium foil, baking paper and food containers; as well as **Domopak Spazzy** bin-liners, made with recycled, recyclable or plant-based material and **Domopak Living** products for the care and organisation of homespace.

Today, **Cuki Cofresco S.r.l.** (directly and indirectly owned by Melitta Group Management GmbH & Co. KG) **controls the following activities and companies** from its managerial and commercial headquarters in Volpiano:



In the FMCG sector, Cuki Cofresco operates in a market that is worth 372 million euros. The company is the brand leader in all the markets in which it operates, with over 33% of the market share.
Pre-acquisition, the organizational structure of the firm looked like this:

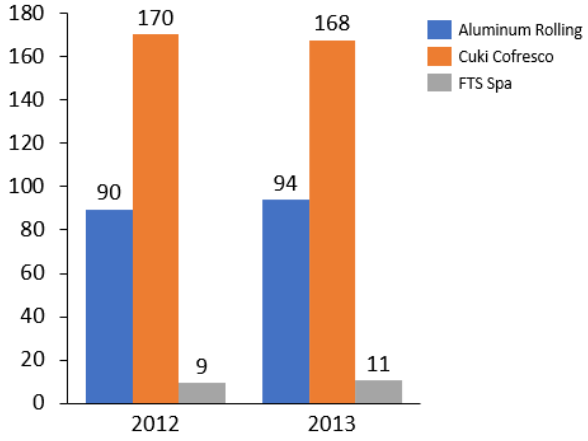


2. Historical Operations Results, Financial Performance & Margins

2.1. Market Dynamics and Operational Performance

The years prior to Pillarstone's entry in 2015, were quite eventful. In 2013, the group, at the time called ''Gruppo Comital'' operated under a completely different structure, which was the following:
It used to operate three main lines of business:

- Aluminium Lamination under the Comital brand.
- Food Packaging via Cuki Cofresco.
- Special Fibers and Fabrics through FTS Spa.



Euro/000	2012	2013
Cuki Cofresco		
EBITDA	13,850	14,221
Margin vs. Cuki Cofresco Sales	7.90%	8.40%
FTS Spa		
EBITDA	210	(145)
Margin vs. FTS Sales	2.40%	-1.3%
Comital SpA & Skultuna (Aluminum Rolling)		
EBITDA	1,120	551
Margin vs. Comital Sales	1%	0.40%
TOTAL EBITDA	15,180	14,627

In the years preceding 2014 and 2015, Cuki Cofresco significantly bolstered the firm's EBITDA, consistently delivering robust margins averaging 8.15%. This segment not only contributed the lion's share to EBITDA but also dominated revenue generation. On the other hand, the Aluminum Rolling segment, under Comital SpA, including its Swedish subsidiary, confronted challenges. Despite being the second-largest revenue contributor, it struggled with slim margins averaging just 0.7%, a consequence of Europe's saturated Aluminum Market and resultant excess production capacity. FTS, in contrast, had a minimal impact on the financials.

2.2. Capital Structure & Debt Obligations:

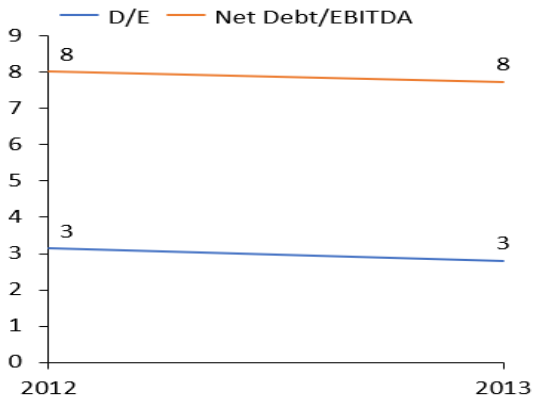
Before the acquisition, the firm's financial structure was marked by:

- **Long-Term Debt**: Annual long-term debt payments of €10.5 million through 2020, against a backdrop of high leverage with a net debt to EBITDA ratio averaging 7.6. Below is the MLT Debt schedule pre-acquisition.

MLT Debt Schedule Pre-Acquisition

Euro/000	2015	2016	2017	2018	2019	2020
Debito Consolidato	10,616	10,616	10,616	10,616	10,616	10,616
Debito Hedging	1058	1058	1058	1058		

- **Short-Term Debt**: Immediate liabilities included €30 million in credit lines due, €15M in Disposal Lines and a €10 million portion of longer-term debt, with a DSCR of 0.15 indicating significant risk in covering short-term liabilities.



Euro/000	2012	2013	2014
DSCR	0.10	0.19	-0.03
Interest Coverage Ratio	2.33x	2.60x	4.34x
Financial Interest	6,512	5,617	3,688
Current Financial Liabilities	54,554	57,418	55,239

The firm's capacity to continue meeting its long-term debt obligations was in question due to escalating short-term debts leading to a D/E ratio of 3, below industry standards.

This combined financial outlook—short-term pressure without immediate long-term relief and compounded by weak operational performance—suggested that the company was overleveraged and vulnerable before the investment.

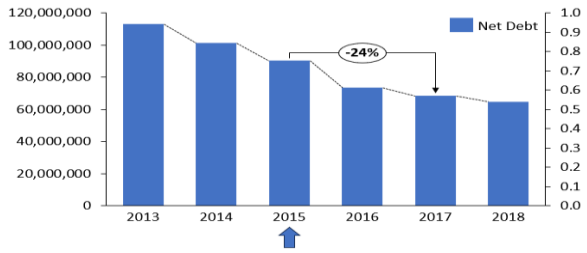
3. Investment Pillarstone & Turnaround Strategy:

In 2015, Pillarstone's acquisition of debt and Participatory Financial Instruments (SFPs) from the Cuki Group marked a critical juncture. By assuming both a creditor stance and control over the SFPs—a financial mechanism established during a 2009 restructuring—Pillarstone significantly bolstered its influence on the company's strategic decisions. This included pivotal actions such as asset sales and guiding the overarching industrial plan. The presence of tag/drag along clauses further cemented Pillarstone's role in the event of a sale, embedding their authority deep within the Cuki Group's decision-making framework.
Introducing the pivotal phase of operational and strategic turnaround, the industrial plan was meticulously designed to enhance the development of strategic activities while simultaneously focusing on a significant reduction of invested capital. This strategy primarily targeted the repayment of consolidated debt and aimed at the gradual reduction of short-term financial exposure, laying the groundwork for sustainable refinancing efforts.
The strategic initiative for this transformation began in 2014, slightly ahead of Pillarstone's formal involvement with the company. This early start underscores the proactive approach taken to steer the company towards a robust turnaround even before the official entry of Pillarstone.

This table contains the strategies and actions taken by the firm to turnaround the economical state of the firm. Last column contains quantitative values & graphs depicting what was said and highlighting the development of the main KPIs.

<table>
<tr><th>Type of Restructuring</th><th>Strategies & Actions undertaken</th><th>Evolution of Main Financial Ratios throughout Investment Horizon:</th></tr>
<tr><td>Management & Governance Restructuring:</td><td>• Contrarily to most of the turnaround cases, the main Shareholder and CEO, Corrado Ariaudo remained at the top of the firm. There was not enough information to judge whether an overhaul of the boards of directors was done.
• Through taking on the role of creditor and gaining control of the SFPs, Pillarstone enhanced its sway over strategic company decisions. This enabled Pillarstone to direct significant moves, including the sale of assets and the steering of the comprehensive industrial strategy.</td><td>Shareholders of Cuki (Unchanged)
<table><tr><td>Aholding Srl (Corrado Ariaudo)</td><td>90.33%</td></tr><tr><td>Giovanni Linari</td><td>7.78%</td></tr><tr><td>Famiglia Gualco</td><td>1.74%</td></tr><tr><td>Others</td><td>0.15%</td></tr></table></td></tr>
<tr><td>Financial Restructuring:</td><td>Debt Restructuring:

<u>Main components of the Debt Restructuring:</u>
• Ex-Nuova Finanza current Liability was reclassified from Current Liabilities that was supposed to be paid by 2016, to an MLT debt, with a new debt schedule with a big bullet payment of 25k in 2020 decreasing the ST Financial Liabilities -44.7% instantly. The new schedule can be seen in the table on the right.
• Modifying the interest rates on the debt: decrease from interest of 6 month + 80 basis points to 6-month Euribor + 40-70 Basis Points.
• No Capital Injection was done neither debt write-offs.

<u>Debt Paydown & Decrease in Interest Expense:</u>
The aggressive asset retrenchment done by the firm, as will be seen in the next section, permitted the firm to follow the Debt Schedule initially agreed on where the original Debito Consolidato was reduced of approx. 30M euro and the ''Debito Hedging'' was fully paid off.</td><td>MLT Debt Schedule Post-Acquisition
<table><tr><th>Euro/000</th><th>2016</th><th>2017</th><th>2018</th><th>2019</th><th>2020</th></tr><tr><td>Debito Consolidato</td><td>10,616</td><td>10,616</td><td>10,616</td><td>10,616</td><td>10,616</td></tr><tr><td>Debito Hedging</td><td>2117</td><td>1058</td><td></td><td></td><td></td></tr><tr><td>Ex Nuova Finanza</td><td>1,000</td><td>1,000</td><td>1,000</td><td>1,000</td><td>25,000</td></tr></table> 
</td></tr>
</table>

Operational & Asset Restructuring:

Performance Improvement:

Scaling back the business

During the investment horizon, Cuki Group's primary strategy focused on divesting non-core assets to streamline operations and reinvest in its central product line—Packaging.

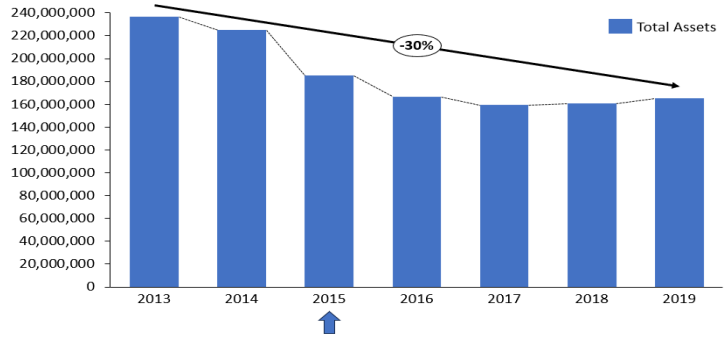
- Divestures & CF Management:
  -As mentioned in the first part, Aluminium Rolling business segment was unprofitable and negatively affecting the bottom line. This lead to the sale of Comital SpA and the liquidation of the Swedish Subsidiary Comital Skultuna AB between 2014 and 2015. Payments were made until 2017.
  -Sale of FTS SpA, hence exiting the Special Fibers market.
  The table on the right highlights the CF received from these activities, reinforcing the liquidity of the firm.

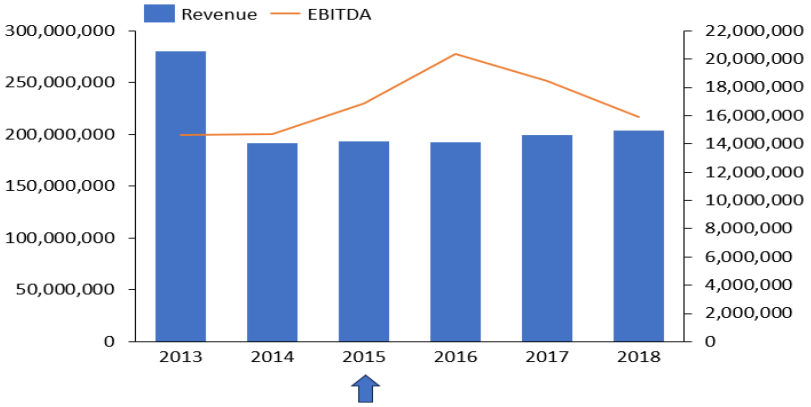
- Acquisitions & New Markets:
  After an initial period of cost entrenchment on the CAPEX level, Cuki Group started investing again in CAPEX and acquiring new plants, positioning Cuki Cofresco to reinforce its market leadership in Italy with products like Coki and Domopak and to expand its professional reach across European markets.
  Main activities:
  -Acquiring full ownership of Turkish subsidiary Ilmak A3.
  -Establishment of a joint venture in Poland Alfatec Sp.Zoo, increasing reach to Eastern Europe Markets. (50% stake)
  -Established a French subsidiary Cuki France SAS, and an online sales platform to expand its market reach and digital presence.

Revenue, EBITDA Growth

-During the period of operational restructuring, the company witnessed a notable increase in revenue, escalating from €187.5 million to €198 million, marking an approximate 5.6% rise.
-EBITDA improved post-acquisition, climbing to €18 million from the previous €14.7 million, which translated into an enhanced margin of around 8%, compared to the earlier 7%.
-Cuki Cofresco gained market share and increased sales, with an EBITDA averaging €19 million.

Year	2015	2016	2017
CAPEX	€2.5M	€6.1M	€5.5M
CAPEX/Sales	1.29%	3.16%	2.75%
CF from Divesting Assets	€16M	€11.6M	€11M





Euro/000	2012	2013	2014	2015	2016	2017
Cuki Cofresco						
EBITDA	13,850	14,221	14,767	15,305	20,177	17,903
Margin vs. Cuki Cofresco Sales	7.90%	8.40%	8.70%	9.30%	11.10%	9.60%
Ilmak A3						
EBITDA	-	-	162	356	53	788
TOTAL EBITDA	14,900	14,600	16,000	16,600	20,100	18,458

Does not consider Holding expenses etc.

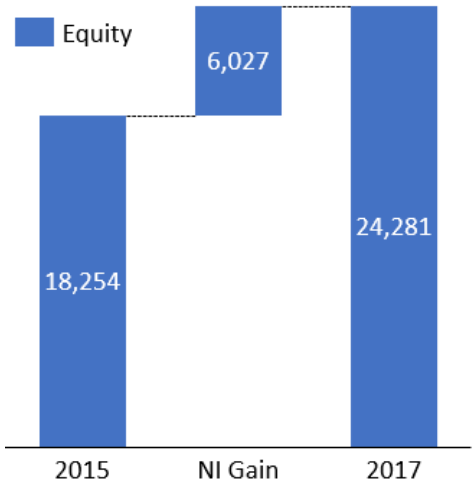
4. Exit & Review of Value Creation:

4.1. Exit:

In July 2018, in the culmination of a strategic move within the food packaging sector, Melitta Group Management executed the acquisition of 100% of Cuki SPA (exercising the tag along clause), positioning itself as a market leader in Italy. This acquisition was not just a transfer of ownership but also came with a comprehensive refinancing of Cuki's existing debt, mostly held by Pillarstone, indicating a strong financial restructuring aimed at optimizing the operational efficiency and financial health of the acquired entity.

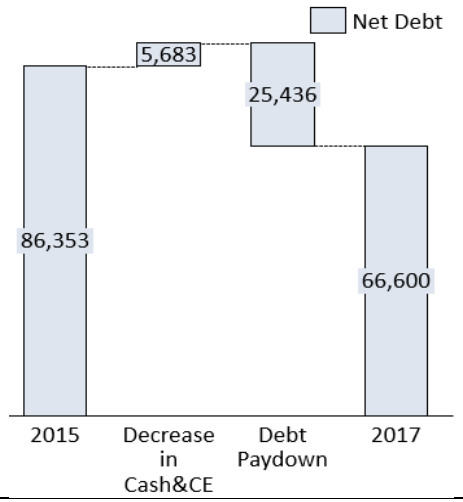
4.2. Value Creation:

Equity Evolution



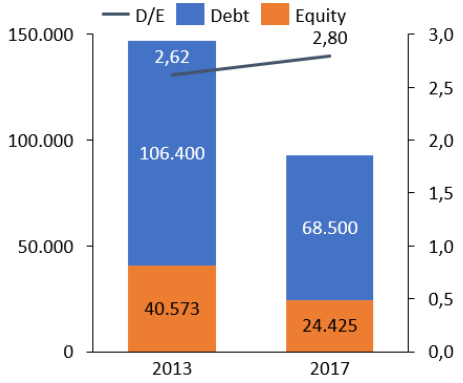
- Net Income was positive during these 2-3 years of tenure, increasing the value of equity. Despite the financial statements reflecting substantial extraordinary expenses, primarily due to one-off adjustments, impairments, and corrections on receivables and investments, the firm managed to remain profitable.

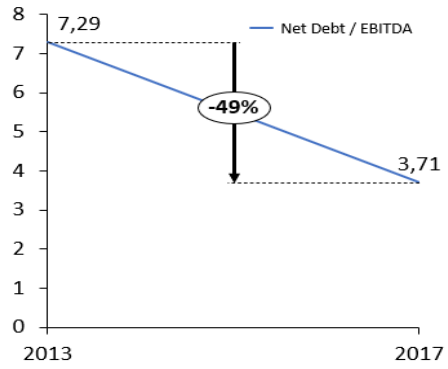
Debt Evolution



- Net Debt was reduced thanks to debt paydown, following the MLT schedule post-acquisition. The industrial plan was successfully implemented, scaling back the business size to improve the financial position of the firm and focus on its core business through Cuki Cofresco.

Capital Structure & Operational Improvement:





- Cuki Group scaled back the business and decreased the capital invested in the firm, leaving the D/E relatively unchanged, but with way less interest expenses, improving the firm's profitability.

Euro/000	2013	2017
EBITDA	14,600	18,458
EBITDA Margin vs Sales	5.22%	9.25%
Interest Coverage Ratio	2.6x	6.49x

- The divesture of unprofitable lines of businesses and refocusing on core business through Cuki Cofresco paid off with an 26% increase in EBITDA throughout the investment horizon.
- A substantial increase in the interest coverage ratio indicating the healthiness of the improved capital structure.
- Firm positioned itself as market leader in Italy for packaging.

Returns for Fund&Banks:

I) Pillarstone:

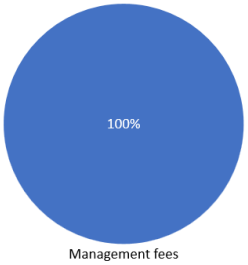
Brief overview of the investment operation involving Pillarstone and Intesa San Paolo, and the returns for both. The goal in this part is to calculate the NPV of the investment made by Pillarstone to manage the debt and showcase the returns of the bank.

Assumptions for Pillarstone's Investment Strategy:

- **Debt Acquisition:** Pillarstone acquires bad debt from banks, but instead of paying cash, they set a value for the debt at 40% of its original value. They issue notes from their credit fund to the bank in return for the debt. **Recovered principal and interest debt under the 40% threshold goes automatically to the bank.**
- **Management Fees:** Pillarstone earns yearly management fees of **1%** on the entire value of the debt they manage.
- **Commission on Recovery:** If Pillarstone recovers more than the 40% threshold they initially set for the debt, they earn a commission of 7% on the excess recovery.
- **Risk and Returns:** While Pillarstone's direct financial risk might be low if they haven't invested their own capital, they face operational, reputational, and regulatory risks. Their returns are primarily driven by their ability to effectively manage and recover value from the bad debt, as well as the performance of their credit fund.
- **Super Senior Loans (New Money):** Sometimes Pillarstone adds super senior loans (New Money) and expects to receive at least a 12% return, acting similarly to private equity firms. In that case, no senior debt was added.

***Please note that the assumptions pertaining to the valuation of the debt acquired and disposed of were established based on logical reasoning and informed estimates, not on official figures.*

Debt amount recovered	**€ 26,250,000.0**			
40% Threshold	**€ 31,520,800.0**			
	2015	**2016**	**2017**	**2018**
Returns from AuM				
Nominal debt value	€ 78,802,000	€ 78,802,000	€ 68,502,000	€ 58,506,000
AuM fees @1%	€ 78,802.00	€ 788,020.00	€ 685,020.00	€ 292,530.00
Commission on debt paydown @7%	-	-	-	-



Total Return in fees	**€ 1,844,372.00**

- With the assumptions made, and thanks to the CF that the firm received during the aggressive asset retrenchment phase, they were able to pay back a big amount of debt, in a relatively small amount of time (2.5 years). 100% of the money made from Pillarstone's side came from management fees.

II) Intesa San Paolo:

Debt paid back	**2015**	**2016**	**2017**	**2018 (until exit in July)**
Debt value paid back yearly	-	€ 10,300,000	€ 10,300,000	€ 5,650,000

For Intesa San Paolo, this intervention of the credit fund was probably the most successful. They received around 40% of the debt the firm owed them.

1. Business Sector & Industry

Manucor, an Italian company with a robust global footprint, excels in manufacturing polypropylene films for the flexible packaging and labeling sectors. Renowned for their innovative approach, they offer comprehensive solutions tailored to the evolving needs of today's competitive market. Main sectors they serve are **food packaging, labels, and adhesive tapes.**

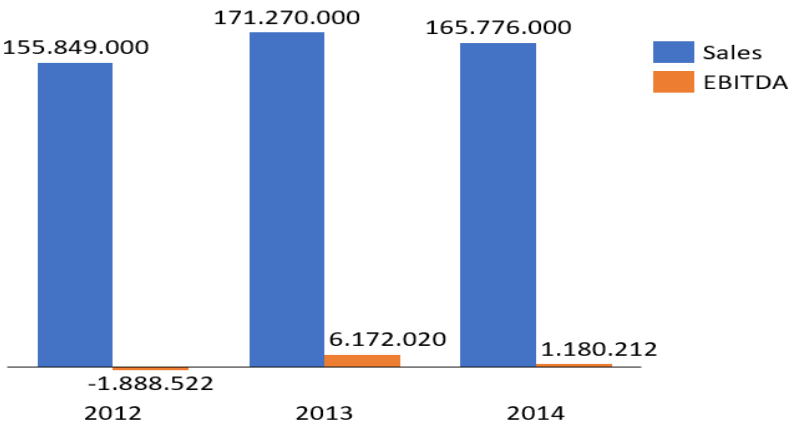
Manucor specializes in food packaging products offering flexible packaging films with varied applications and functionalities. Their products serve various food sectors, including baked goods, snacks, confectionery, ice cream, and frozen foods. They provide films with different appearances like transparent, white, metallized, and matte. Functionally, these materials offer features like heat sealing, high barrier properties for freshness, thermal resistance, and different sealing capabilities, tailored for specific packaging needs.

On another hand, Manucor's labeling products range covers a broad spectrum of applications and functionalities for various markets. They offer a selection of films that include high gloss, matte, transparent, and white cavitated films suitable for self-adhesive labeling, and premium roll-fed wrap-around labels. These films are designed to cater to different functionalities such as high barrier properties, thermal resistance, and various sealing capabilities. Their innovative films also meet high safety and quality standards required for labeling applications across different industries.

Operating from their facility in Italy, with an annual production capacity of 100,000 tons, Manucor serves customers in 35 countries through its export network.

2. Historical Operations Results, Financial Performance & Margins

2.1. Market Dynamics and Operational Performance



In the period leading up to the investment, Manucor demonstrated a mixed financial performance characterized by relatively high sales and some growth over time yet faced significant challenges in profitability. The company's EBITDA was notably weak for three consecutive years up to 2015 with an average margin of 1% , insufficient to cover depreciation and amortization expenses, resulting in negative net income annually.

	2012	2013	2014
First Margin %	26%	25.80%	25.30%
D&A/EBITDA	-3.82	1.30	6.88

The situation was compounded by a **declining gross margin percentage**, calculated as (Sales - COGS) / Sales. This downward trend was attributed to several factors, mainly:

- Heavy reliance on the Italian market
- Challenging financial situation with high debt levels. This financial strain hindered Manucor's ability to obtain Letters of Credit for purchasing key raw materials, such as resins, from more cost-effective international suppliers.
- Operations in markets with inherently low margins.
- Bad liquidity position pushing the firm to propose big discounts for earlier payments.

Complicating matters, the company struggled with poor operating cash flows, which were inadequate to meet its capital expenditure requirements or to repay debt to improve its debt-to-equity ratio and reduce interest expenses, as seen in the table below.

	2012	2013	2014
CF from operations	€ 6,174,000	€ 3,751,000	€ (509,000)
CAPEX	€ (4,085,000)	€ (5,624,000)	€ (2,374,000)

As Manucor approached the investment, it had already initiated negotiations with its creditor, Intesa San Paolo, to restructure some debt as a response to its financial difficulties. This move marked the beginning of a more in-depth examination of the firm's financial structure, setting the stage for further analysis in the subsequent section.

2.2. Capital Structure & Debt Obligations:

	2012	2013	2014
Debt	€ 65,025,000	€ 65,975,000	€ 53,917,000
Equity	€ 2,717,000	€ (233,592)	€ 5,843,805
D/E	23.93	-282.44	9.23
Net Debt/EBITDA	//	10.54	44.85

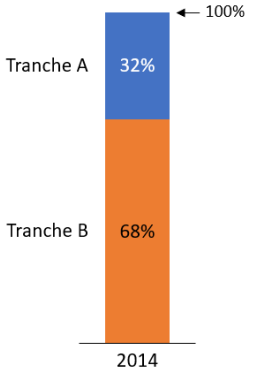
Before the investment, Manucor's financial structure was heavily reliant on medium-to-long-term (MLT) debt, exclusively held by **Intesa San Paolo**. The debt levels were notably high in relation to the firm's operational capacity, as evidenced by a the incredibly high Net Debt/EBITDA ratio for the years of 2013 & 2014.

Prior to 2014, the outstanding debt amounted to €65 million, which was subsequently reduced by €15 million through a debt-to-equity swap involving the issuance of Participatory Financial Instruments (SPFs) called ‘’SPF 1”.

The restructured debt was then organized into two tranches:

- **Tranche A**: Valued at €15 million, this portion was set to be converted into a loan through the issuance and subscription of Series 2 Participatory Financial Instruments by the bank, or ‘’SPF 2” contingent on the company's net equity falling below €10 million as per an approved financial statement. If the conditions for conversion were not met, this tranche would be repaid according to a predefined schedule.

- **Tranche B**: Amounting to €31,386,670, this tranche was slated for repayment based on a specified plan.



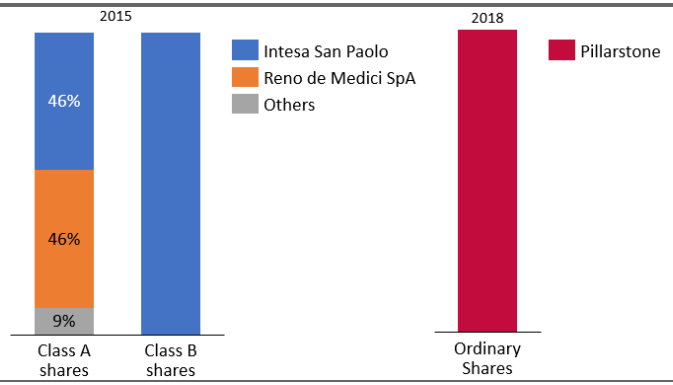
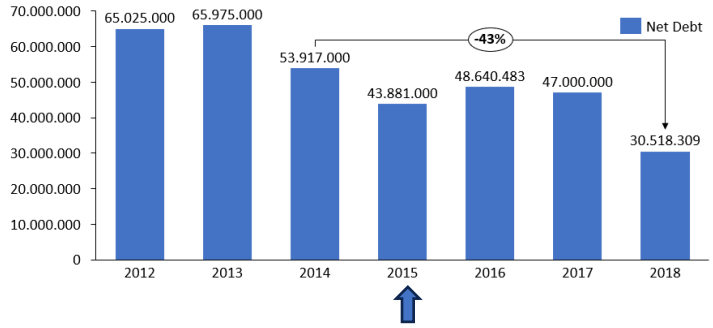
Manucor initially committed to repaying its exposure through 15 semi-annual instalments starting from June 30, 2016, and concluding on June 30, 2023. The applicable interest rate was set at the Euribor 6-month rate plus an annual spread.
Before Pillarstone’s entry, the firm issued additional SPF’s for a value of 4.2M euros decreasing tranche A to 10.8M euro, leaving the outstanding debt at a value of 42M euros approximately.

3. Investment Pillarstone & Turnaround Strategy:

Pillarstone bought Manucor's long-term loans from Intesa Sanpaolo in 2015 as Italian banks sought to push soured debt off their balance sheets following a deep recession.

On November 20, 2015, Intesa Sanpaolo communicated the assignment of the credit held against the Company (Senior Loan) totaling €42,230,475.2 to Pillarstone. On December 22, 2015, Intesa Sanpaolo, the shareholder, announced that by notarial deed dated December 10, 2015, they had transferred to them as well 15,000,000 SFP Series 1 and 4,156,195 SFP Series 2 that were in their ownership, issued in 2014 and 2015 respectively.

This table contains the strategies and actions taken by the firm to turnaround the economical state of the firm. Last column contains quantitative values & graphs depicting what was said and highlighting the development of the main KPIs.

Type of Restructuring	Strategies & Actions undertaken	Evolution of Main Financial Ratios throughout Investment Horizon:
Management & Governance Restructuring:	• Pillarstone set up PS Film SpA which ended up owning 100% of the share capital of Manucor SpA. This was probably done knowing the firm will eventually be sold to a bigger player in the market or a new entrant and wanted to have full power over the decision of when and how to sell. • Andrea Nappa, partner at Pillarstone, was added to the board of directors for the years 2018 and 2019.	
Financial Restructuring:	**Debt Restructuring:** Initially, 1-2 years prior to acquisition by Pillarstone, **Intesa San Paolo (the sole MLT creditor)** owned 65M euro worth of bank credit towards Manacor. A big chunk of this debt was **progressively** transformed to quasi-equity instruments. <u>Main components of the Debt Restructuring:</u> • Prior to entry, D/E swap of 15M euros. • Tranche A swapped into ''SPF 2'' worth 15M euros. • New ''SPF 3'' worth 5M euros issued. • **Debt issued worth approx. 5.6M euro from Pillarstone. (considered MLT).** • Cancellation and subscription of new capital shares to Pillarstone ; paid with an offset of 6M in MLT debt. **Overall, 41M euros, or 63% of MLT debt was swapped into equity.** This was used to reduce leverage, acquire share capital & improve liquidity. <u>Debt Paydown & Renegotiation</u> **No debt repayment was made.** Due to bad operations, leading to missing payments on the MLT debt, the firm decided to agree on a bullet payment on the 31st of December 2022 for the remaining portion of credit. Interest rate remained **unchanged** at 6 month-EURIBOR + 200 basis points.	

Operational & Asset Restructuring:

Performance Improvement:

Industrial strategy

Initial industrial strategy aimed at increasing sales & profitability:

- Increase sales & maximize production capacity.
- Reduction of COGS (aka improve Gross Margin) by increasing diversification in suppliers.
- Increase use of credit lines to decrease reliance on ''purchase discounts''.
- Change in product mix: produce and sell more of ''specialty products'' like Labelling with higher margin.

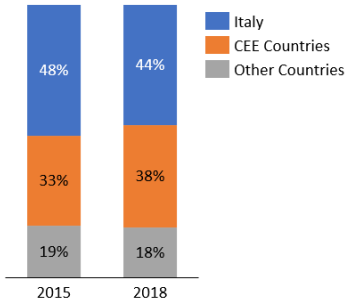
Main actions undertaken:

- Transformation of multiple production lines – started supplying the Labelling segment instead of BOPP films. Increased **Labels' share of revenue by approx. 20%**
- Reduce dependence on Italian market – increase sales all over Europe.

Revenue, EBITDA Growth

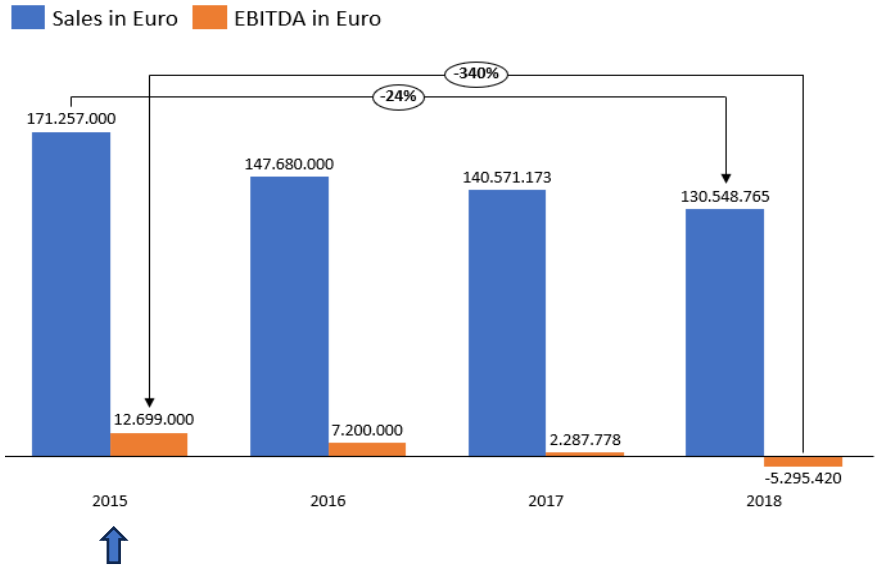
Initial plan was not followed due to multiple factors which lead to a deterioration of the margins:

- Significant Revenue Decline: The company experienced a substantial 24% drop in revenues, primarily due to a contraction in the Italian market, whereas sales in other European markets remained relatively stable.
- EBITDA Deterioration: EBITDA performance consistently deteriorated over the investment period, ultimately turning negative a few months before the exit strategy was implemented.
- Gross Margin Stagnation: Contrary to the objectives, there was no improvement in the Gross Margin. **This was largely due to a supply shortage of polypropylene**, which led to increased costs. Additionally, the price of resin, a key material, also surged, further impacting costs adversely.



Segment	2015	2018
BOPP film for Plastic Packaging	81.4%	60.18%
Ribbons	10.6%	12.24%
Labels	8%	27.58%

Year	2015	2016	2017	2018
GROSS MARGIN %	31.80%	33%	30.23%	24.89%



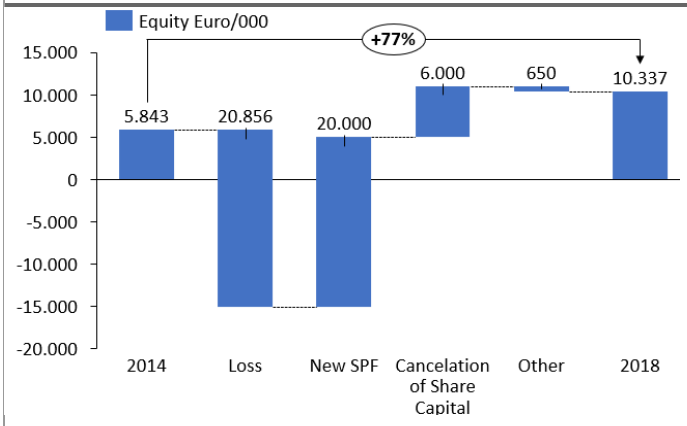
4. Exit & Review of Value Creation:

4.1. Exit:

The exit of Pillarstone from Manucor was finalized in mid-2019, through a strategic transaction where they sold 100% of the share capital and debt exposure to Sibur Holding. Sibur is an international company headquartered in Russia, renowned for its involvement in both the production of resins and polypropylene films.

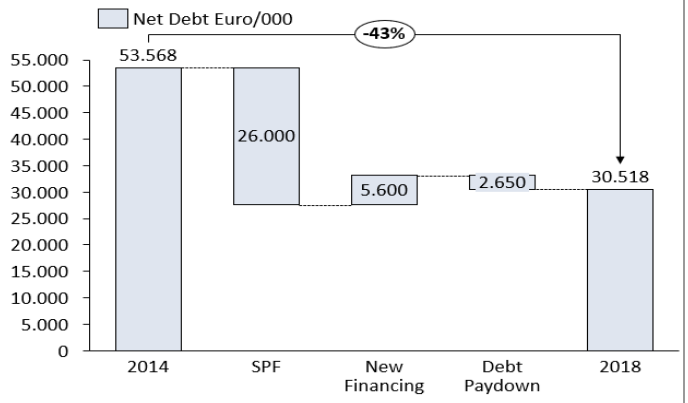
4.2. Value Creation:

Equity Evolution



- Equity value increased 77% during the investment tenure.
- 99% of that value was due to D/E swaps. Operation wise the company accounted for 20.8M euros of losses, pushing the firm to covert its credit into quasi-equity tools.

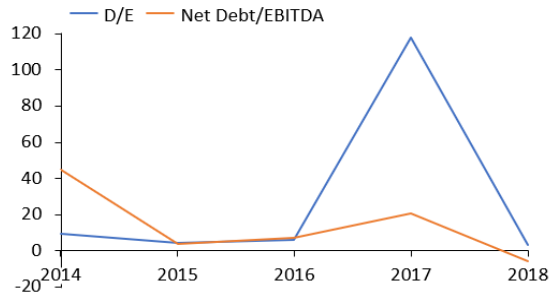
Debt Evolution



- Net Debt decreased of 40%.
- Only one scheduled debt repayment was made (2.6M euros).
- Most of the debt decrease was due to swaps into equity, as already mentioned.

Capital Structure & Operational Improvement:

	2015	2016	2017	2018
Sales	€ 171,257,000	€ 147,680,000	€ 140,571,173	€ 130,548,765
EBITDA	€ 12,699,000	€ 7,200,000	€ 2,287,778	€ (5,295,420)
Net Income	€ 1,273,739	€ (3,237,676)	€ (7,663,069)	€ (11,229,420)
CF from operations	€ 12,156,000	€ (1,143,000)	€ 4,164,000	€ (1,466,000)



- Overall, there was clearly no real improvements made on the operational side as depicted by the NetDebt/EBITDA line.
- Most of the CFs came from the extra money the fund put in the business. The core business (sale of BOPP film and labelling) remained unprofitable as highlighted by the negative accumulated losses of close to 21M euros.
- The firm was eventually sold to a competitor in the market, who will integrate its customer base. It is unclear whether this was the goal of the fund all along.

5. Returns for fund & Bank

I) Pillarstone:

Brief overview of the investment operation involving Pillarstone and Intesa San Paolo, and the returns for both. The goal in this part is to calculate the NPV of the investment made by Pillarstone to manage the debt and evaluate the performance on the **New Money of 5.6M euros** that they invested in 2018.

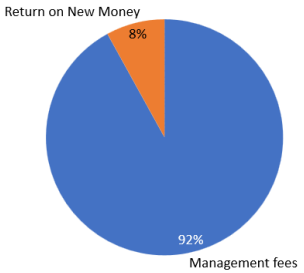
For the return on AuM fees

- **Debt Acquisition:** Pillarstone acquires bad debt from banks, but instead of paying cash, they set a value for the debt at 40% of its original value. They issue notes from their credit fund to the bank in return for the debt. **Recovered principal and interest debt under the 40% threshold goes automatically to the bank.**
- **Management Fees:** Pillarstone earns yearly management fees of **1%** on the entire value of the debt they manage.
- **Commission on Recovery:** If Pillarstone recovers more than the 40% threshold they initially set for the debt, they earn a commission of 7% on the excess recovery.
- **Risk and Returns:** While Pillarstone's direct financial risk might be low if they haven't invested their own capital, they face operational, reputational, and regulatory risks. Their returns are primarily driven by their ability to effectively manage and recover value from the bad debt, as well as the performance of their credit fund.

Super Senior Loans (New Money): Sometimes Pillarstone adds super senior loans (New Money) and expects to receive at least a 12% return, acting similarly to private equity firms. In that case, Pillarstone invested 5.6M euros in 2018.
Returns for the new money was discounted using 12% as a threshold for these types of risky investments.

Debt amount recovered	€ 2,650,000
40% Threshold	€ 16,800,000.0

	2015	2016	2017	2018	2019
Returns from AuM					
Nominal debt + SFPs	€ 42,000,000	€ 39,400,000	€ 39,400,000	€ 39,400,000	€ 39,400,000
AuM fees @1%	-	€ 394,000.00	€ 394,000.00	€ 394,000.00	€ 197,000.00
Commission of debt paydown @7%	-	-	-	-	-



	2015	2016	2017	2018	2019
Return on New Money					
New Money debt				€ (5,650,000.00)	

Cash Inflow during exit					€ 5,766,549.00
NPV @ 12%				($447,585.30)	

- **IRR** on **new money** of approx. **2%**, very far from the **hypothetical 12%** that this kind of funds usually expect from a similar risky investment.

Total returns fees+interest	**€ 1,495,549.00**

II) Intesa San Paolo:

In 2016, the bank received a cash payment of €2.65 million, aligning with the initial expectations set forth in the Industrial Plan. Subsequently, due to operational challenges, no further payments were made to the bank. However, a potential upside exists as, at the time of exit, the bank held approximately €22 million in debt towards Manucor. With Manucor's acquisition by a larger entity, there is a possibility that the bank will recover a portion of its outstanding funds in the future, thanks to potential revenue and cost synergies that could arise from the acquisition.

1-Business Sector & Industry

Magic Land, situated in the enchanting outskirts of Rome, Italy, stands as a testament to the world of amusement and entertainment. This vibrant amusement park is a haven for thrill-seekers and families alike, offering a diverse array of attractions that cater to all age groups. From adrenaline-pumping roller coasters to whimsical children's rides, Magic Land provides an immersive experience that transports visitors into a realm of magic and adventure.
The park is not just about rides; it also hosts spectacular shows, interactive experiences, and seasonal events that add to its allure. With its commitment to safety, innovation, and guest satisfaction, Magic Land has established itself as a key player in the amusement park industry, attracting visitors from both local and international destinations.

The entertainment sector, particularly the amusement park industry, has experienced a dynamic evolution over the years. From 2012 to approximately 2018, the industry witnessed a mixed trajectory. The overall entertainment market showed signs of recovery, with increases in attendance, box office revenue, audience spending, and turnover. This positive trend indicated a growing appetite for leisure and recreational activities among consumers.

However, the amusement park sector faced its unique challenges during this period. Despite a rise in the volume of visitors, the industry grappled with a decline in average ticket prices, which pointed to a competitive and price-sensitive market. The decrease in ticket prices, while boosting attendance, put pressure on the revenue margins of amusement parks. This scenario highlighted the need for parks like Magic Land to continuously innovate and enhance their offerings to attract and retain visitors in a fluctuating market environment.

As the industry moves forward, amusement parks are increasingly focusing on creating unique and memorable experiences through technological advancements, thematic attractions, and personalized services. The goal is to not only drive footfall but also to ensure sustainable growth in a rapidly evolving entertainment landscape.

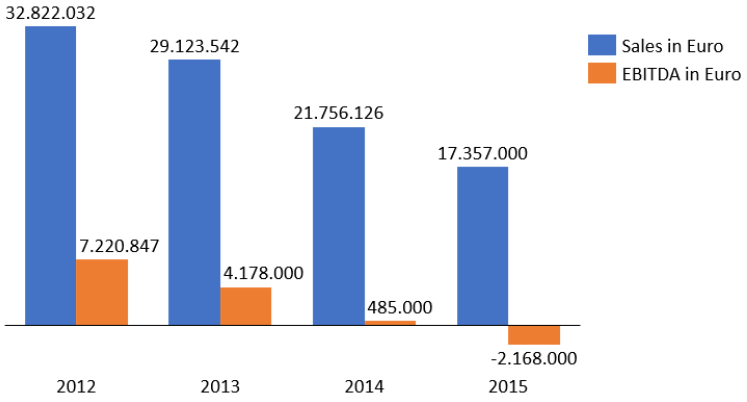
2. Historical Operations Results, Financial Performance & Margins

2.1. Market Performance and operational dynamics

Magic Land generates its income through a variety of revenue streams, each contributing to the overall financial health of the park. Understanding these revenue streams is crucial for analysing the park's business model. The primary sources of revenue for Magic Land include:

1. **Entrance Tickets:** The sale of entrance tickets forms the backbone of Magic Land's revenue. These tickets grant access to the park and its array of attractions, rides, and shows.
2. **Catering Services:** Magic Land offers a range of catering services within the park, including restaurants, food stalls, and snack bars.
3. **Merchandise Sales:** The park capitalizes on branded merchandise sales, which include souvenirs, apparel, toys, and other themed items.
4. **Other Operating Revenues:** In addition to the main revenue streams, Magic Land may also earn income from other sources such as parking fees, rental of equipment or facilities for events etc.

The 2012 season was the first full opening season of Rainbow Magicland Park. Initially, it was fully owned by **Alfa Park**, an entertainment company that had multiple investments in the industry.



Rainbow Magic land started off relatively well, with an EBITDA margin of 22% in 2012. Profitability quickly eroded due to an aggressive decrease in revenues between the years of 2013 and 2015, reducing revenues 40%, leading to a negative EBITDA value of -2.16M euros in 2015.

Below are the suspected reasons that may have contributed to this situation:

- **Adverse Weather Conditions:** The park, being an open-air venue, likely suffered from reduced operational days due to unfavourable weather, particularly during the crucial summer season when attendance is typically at its peak.
- **Fluctuating Tourist Attendance:** While there was an increase in tourist numbers in Italy, it does not necessarily translate to increased attendance at Magic Land. Factors influencing tourist attraction choices could include marketing, accessibility, and reputation.
- **Family Consumption Trends:** *Data from Studio Confturismo-Confcommercio* indicates that families in Italy were spending less on vacations compared to those in France and Spain, possibly reflecting economic pressures or changing preferences that affect discretionary spending on entertainment.
- **Market Trends Among Competitors:** With 80% of the 165 amusement facilities in Italy experiencing a downturn in turnover, and 60% operating at a loss, the trend within the industry suggests a broader market challenge affecting all players.

- **Intense Competition and Price Wars:** Competition, especially from smaller players on the brink of closure, may have led to aggressive pricing strategies. These competitors, attempting to stay afloat, could undercut prices, forcing a market-wide margin compression.

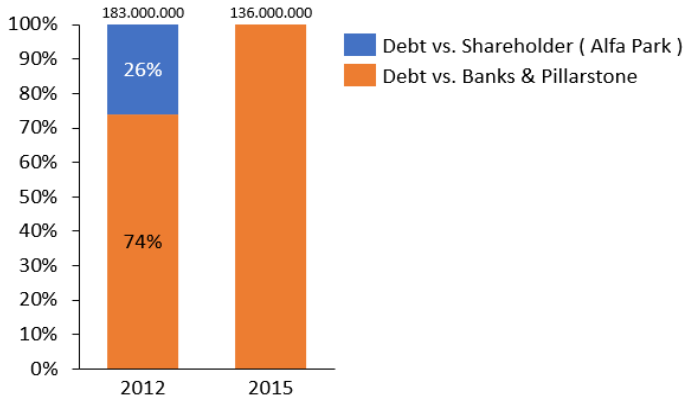
In summary, Magic Land faced significant challenges due to its **inability to differentiate itself amidst fierce competition and a decline in consumer spending**. High costs and a lack of unique offerings led to reduced revenues, leaving the park in a precarious financial position and underscoring the need for strategic change.

Euro	2012	2013	2014	2015
CF Operations		€ 26,331,000	€ 14,673,000	€ 11,015,000
FCFE		€ (12,372,000)	€ 1,478,000	€ (1,069,000)
Capex/SALES	-19.98%	-9.87%	-5.53%	-5.06%
Net CAPEX	€ (6,559,000)	€ (2,874,000)	€ (1,203,000)	€ (878,000)

The firm was not short on cash. Despite deteriorating margins, they were able to cover most of the debt repayments during that period, with the cash obtained through operations. This is due to the nature of the business where most of the payments are made in advance, prior to booking, or in cash directly at the gate. However, **this cash generation was not enough to pay back debt and cover high level of CAPEX that was needed to upgrade the offering compete again on the market and adopt a growth strategy again.** Pillarstone's intervention was needed.

2.2. Capital Structure & Debt Obligations

Creditors (2012)	Type & Value	Interest Rate
Banks (Unicredit , Monte dei paschi di Siena..)	1-Project Financ-ing (mortgage): 135M euro 2-Unsecured Loan : 5M euros	N/A
Shareholder (Alfa Park S.r.l)	47.7M euros	Non-interest-bearing loan



As already mentioned, the firm had a marked decline in revenue over the period from 2012 to 2015. This contraction, when evaluated in conjunction with an unbalanced capital structure, exerted a pronounced negative impact on net income.

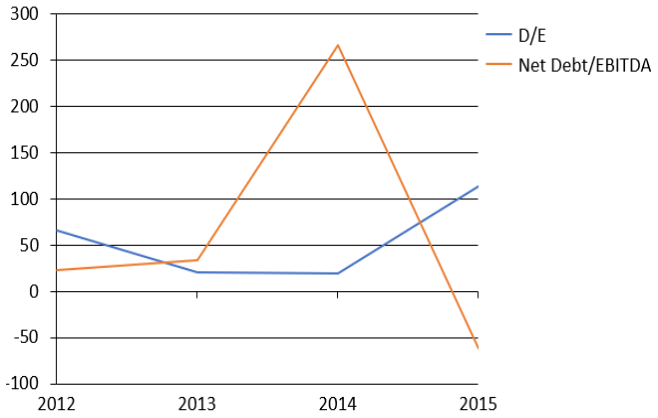
Euro	2012	2013	2014	2015
DSCR (12 month)	-66.19%	-152.21%	-282.42%	-235.60%
Interest Coverage Ratio	0.89x	0.54x	0.06x	-0.32x
Financial Interest	€ 8,045,000	€ 7,629,000	€ 7,059,000	€ 6,743,000

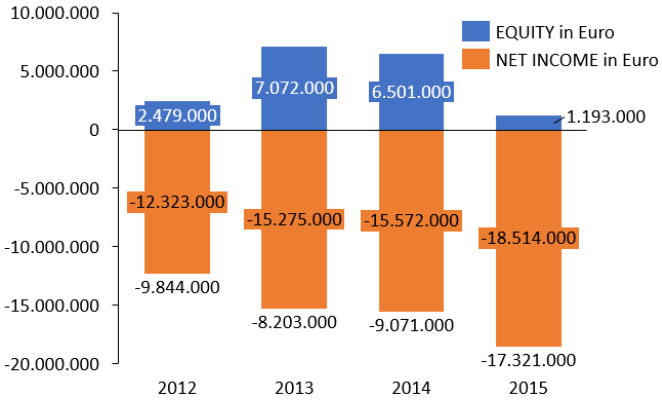
A critical analysis of the financial data reveals that the elevated interest expenses, as depicted in the accompanying table 3, were a substantial burden. This financial strain is evidenced by the consistently low

EBITDA, which failed to surpass interest expenses throughout the observed period. Consequently, this led to an Interest Coverage Ratio persistently below the threshold of 1.

A similar trend is observed in the Debt Service Coverage Ratio (DSCR) over a 12-month period, which remained in negative territory, further underscoring the company's inability to cover debt service requirements through its operating income. **These indicators collectively paint a picture of a firm that was not only challenged operationally but was also encumbered by a debt load that was unsustainable given its profitability.**

The financial trajectory of the firm over the period from 2012 to 2015 was characterized by a series of accumulated losses surpassing 60 million euros. This downward spiral was notably attenuated through a substantial debt-to-equity (D/E) swap, which involved converting the entirety of Alfa Park's debt obligations (47.7M) towards Magic Land into equity.



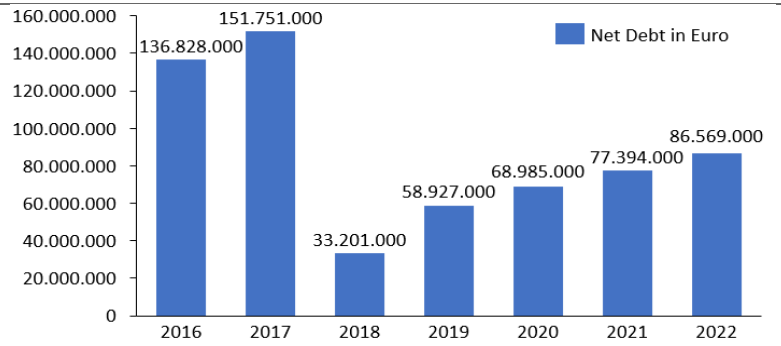
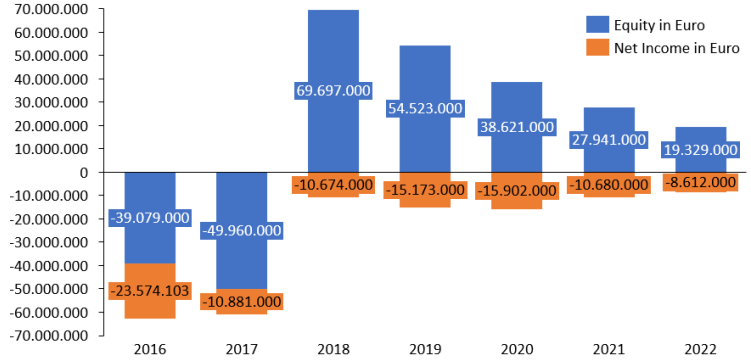


The D/E ratio throughout this period exhibited significant fluctuations, largely attributable to a consistent annual diminution in equity value, as seen in graph. Moreover, in this period, the company's Net Debt-to-EBITDA ratio turned negative due to declining operations, reflecting a situation where conventional financial ratios become less relevant. This is particularly true for a firm with negative EBITDA, as it challenges the meaningfulness of leverage and solvency metrics like D/E and Net Debt/EBITDA, which assume positive earnings.

3. Investment Pillarstone & Turnaround Strategy:

In November 2015, marking a pivotal moment for Magic Land, Pillarstone Italy SPV Srl undertook a significant transaction **with UniCredit SpA**.
On the 20th of November, with effectiveness from the 23rd, Pillarstone Italy **acquired the rights to debts** originating from a certified restructuring agreement, valued at **76 million euros**. This acquisition was the initial step Pillarstone took towards influencing Magic Land's trajectory. However, the anticipated turnaround did not manifest immediately; substantial negotiations with existing creditors and the arrangement for fresh capital injection were met with complications. It was not until two to three years later that tangible transformations began to materialize within Magic Land, a narrative that will be further elaborated in the subsequent sections of this analysis.

This table contains the strategies and actions taken by the firm to turnaround the economical state of the firm. Last column contains quantitative values & graphs depicting what was said and highlighting the development of the main KPIs.

Type of Restructuring	Strategies & Actions undertaken	Evolution of Main Financial Ratios throughout Investment Horizon:
Management & Governance Restructuring:	In 2015, Pillarstone's investment in Magic Land was marked by the purchase of distressed debt from UniCredit, kickstarting a complex turnaround strategy. The initial phase involved navigating tough negotiations with creditors, which delayed substantive financial and managerial changes for nearly three years. In 2018, a key managerial transformation was implemented, marked by a €10 million reduction in share capital from Alfa Park, originally sole shareholder. It was followed by the creation of new share classes and a capital increase, granting Pillarstone through PS Parchi S.p.A. nearly complete economic control with selective voting rights. **This restructuring also brought a new Board of Directors with strong Pillarstone ties, including both Gaudenzio Bonaldo Gregori and Raimondi Bonfati, co-founders of Pillarstone.**	///
Financial Restructuring:	**Capital Strengthening & Debt Restructuring** *Between 2015 and 2018, in the lead-up to a significant financial restructuring, a series of manoeuvres were undertaken to address the operational and cash flow challenges:* • **Extension of terms for Project Financing and Unsecured Loan**. New maturity: December 31, 2025, and introducing a new repayment schedule with nine increasing instalments starting from 2017. • A **grace period** was instituted from January 1, 2014, to December 31, 2016, during which no bank debt repayments were made, and leasing instalments did not accrue capital portions. • Repayment plans were introduced for accrued interest on loans and derivatives up to 2016, with plans extending from 2017 for loans and from 2024 for derivatives interest accrued during 2014-2018. • Cancellation of derivative contracts, **decreasing interest expenses by 30%. (Table 4)** Net debt still increased by about 13% due to accrued interest and the addition of the derivative contracts as MLT debt vs. Banks. *The approval of the restructuring agreement faced a challenge from Unipol Banca, one of the creditors, leading to court hearings and delays. To resolve this, Pillarstone engaged in negotiations to acquire Unipol Banca's loans and leasing contracts, successfully integrating these financial credits into its strategy upon Unipol Banca's withdrawal of opposition.* **Debt Restructuring Agreement of 2018 :**	 

- Conversion of 82.5% of Bank debt into SFP1 and SFP2, worth 129.7M euros
- Write off 8.5M euros in accrued interest.
- **New Money** of 20.6M euros, by Pillarstone, maturity on 31st of December 2024.
- Shareholders are now PS Parchi S.p.A (51%) & Pillarstone Italy SPV (49%)

The residual MLT debt, fully owned by Pillarstone:

- MLT debt of 21.1M euros, bullet payment on the 31st of December 2024.
- MLT debt for leasing (bought from Unipol), for approx. 13.8M euros to be re-paid bullet also on the 31st of December 2024 along with interest.

	2016	2017	2018	2019	2020	2021	2022
Financial Interest	€ 6,478,000	€ 4,768,000	€ 2,022,000	€ 2,947,000	€ 2,892,000	€ 2,944,000	€ 2,916,000

Operational & Asset Restructuring:

Performance Improvement:

As already mentioned, the industrial strategy plan aimed to address the low retention rates by investing in park attractiveness and differentiation.

Pillarstone's new money intervention arrived in December 2018, leading to three very bad years in operation from 2016-2018. The CAPEX investments started in 2019, as can be seen in table 4.

Main new attractions:

- New attractions for teenagers (Magic Splash aquatic themed, Gran Teatro , Music Hall…). Main goal was to increase time of stay in the park.
- Capitalizing on the increase in time of stay, new cafes and merchandise were created, increasing revenues from catering&merchandising services.

Due to COVID restrictions, most of these investments were available to use in 2021.

Cash Management

- **CAPEX Management: Substantial cut in capital expenditures from 2016 to 2018 to manage cash outflows amidst operational challenges.**
- **Interest Payment Strategy:** Utilization of Payment-In-Kind (PIK) loans from Pillarstone, allowing deferment of cash interest payments and conserving liquidity + accrued leasing fees.
- **Investment and Supplier Management:** Allocation of new funds in 2019 for strategic investments while prioritizing the settlement of outstanding supplier payments.

Revenue, EBITDA Growth

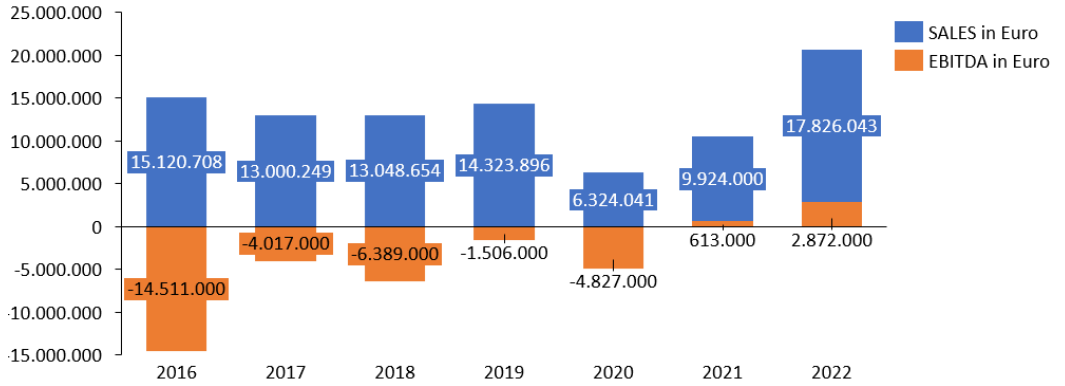
Main observation regarding the top line:

- Constant decrease pre-investments.
- Growth of 18% (vs. 2016 levels) post-covid in 2022.
- Record number of visitors & spending per family since 2016.

The evolution of EBITDA for the company in question was markedly influenced by timing and external factors (COVID).

Main observations regarding EBITDA:

- Positive EBITDA for both 2021-2022
- Positive trend in EBITDA growth in the past 3 years.



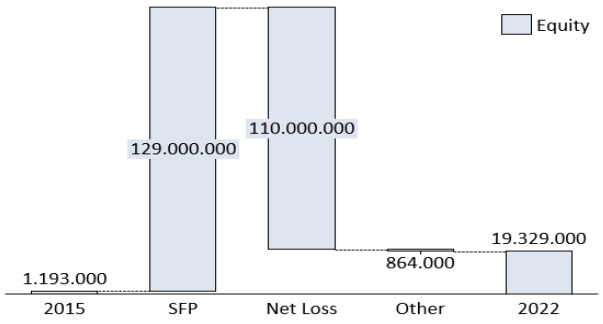
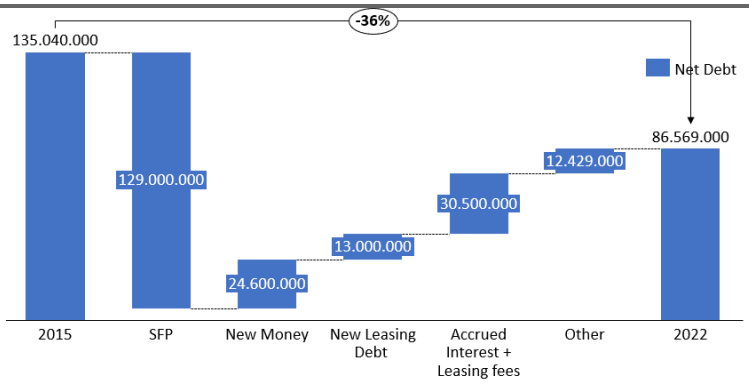
Euro	2016	2017	2018	2019	2020	2021	2022
CF Operations	€ 3,121,000	€ (10,487,000)	N/A	€ (16,169,000)	€ (5,500,000)	€ (4,854,000)	€ (3,480,000)
FCFE	€ 4,379,000	€ (1,256,000)	**€ 17,378,000**	€ (17,457,000)	€ (2,953,000)	€ 2,771,000	€ (2,016,000)
Net CAPEX	€ (500,000)	€ (6,280)	€ (733,741)	**€ (6,611,000)**	€ (1,619,000)	€ (925,000)	€ (2,800,000)
CAPEX/SALES	3.31%	0.05%	5.62%	**46.15%**	25.60%	9.32%	15.71%

4. Exit & Overview of Asset:

4.1. Exit:

Pillarstone has not exited yet.

4.2. Status Quo

Equity Evolution	Debt Evolution
	
• No value creation through operations. • Huge loss of 110M euros was covered through issuing SFPs, offsetting the credit on the balance sheet.	• No debt paydown was made. • 100% of the value decrease was made thanks to the huge swap into SFPs made by Pillarstone & other banks. • Due to low cash availability and focus on growing the park, interest kept on increasing throughout the investment horizon.

Capital Structure & Operational Improvement:

Euro

YEAR	2015	2022
Net Debt/ EBITDA	-62x	30.14x
D/E	113.19x	4.48x
EBITDA	(2,168,000)	2,872,000
Interest Coverage Ratio	-0.32x	0.98x

- From 2012 to 2019, revenue significantly decreased due to non-differentiated product offerings and potential pricing strategy issues. Infusion of new capital was strategically utilized to enhance the park's attractions and improve product offerings.
- Delays in investment execution meant new attractions were only operational from 2020, coinciding with the COVID-19 pandemic's adverse impact on the industry and the park's profitability.
- A recovery was observed in 2021 and 2022 with EBITDA growth, signalling the beginning of positive returns on recent investments and a rebound from the pandemic's disruption.
- The park's current EBITDA is more aligned with its capital structure, featuring manageable interest expenses, with a 0.98 ICR.

The summary indicates that substantial operational value creation has not been realized yet, with future performance being critical to generate sufficient cash flow and EBITDA for debt repayment. Further extension of debt terms may be anticipated to accommodate this growth trajectory.

7. Conclusions:

7.1. Main conclusion from the study:

The work provided an analysis of the world of distress investing, focusing specifically on Pillarstone, rather than the entire Italian landscape. However, it still delved into both the theoretical and empirical aspects of investment in financially distressed companies.

The first part of the thesis established a solid theoretical foundation for the topic, analysing existing literature on distress investing and providing a clear definition of financial distress. It also examined models for predicting financial crisis, indicators of financial soundness, and investors' motivations for tackling the risk associated with distressed companies. Furthermore, it also clarified who the operators specialized in distress investing are, outlining their organizational structures and strategies employed to obtain returns from investments in troubled companies. This section was very useful as it offered a comprehensive framework for how investors approach the sector.

The detailed analysis of Pillarstone revealed several trends and dynamics relevant to the Italian context. For example, they operate in a wide range of industrial sectors, demonstrating considerable diversification. This includes manufacturing industries, consumer goods production, logistics, Entertainment and more. Such diversification underscores the flexibility of these investors in dealing with distressed companies in different sectors. Moreover, they tend to diversify their portfolio not only through different sectors but also based on the level of financial distress of the involved companies.

Although ideally, investments in distress investing should have a short duration, data collection revealed that reality is more complex. The duration can vary considerably, sometimes extending beyond 5 years, and this variability is often linked to the effectiveness of the restructuring operations. However, it should also be said that the Covid-19 pandemic could have lengthened the duration of investments by about two years, compared to what might have more likely occurred in a historical period devoid of such an exceptional event. This was visible in the case of Magic Land where the entertainment sector was affected the most due to lockdowns.

A common feature that emerges from investments in distress investing is the purchase of equity shares of the involved companies. Sometimes this occurs immediately if the investment involves the injection of new financial resources, other times it occurs later, after the purchase of impaired loans, which are only later converted into capital, the case of Pillarstone most of the times.

This approach, namely holding equity and typically most of it and control of the companies, provides operators with the ability to concretely influence their restructuring.

Pillarstone Portfolio Analysis Results

Main initial causes of distress					
	Sirti Group	**Manucor S.p.A**	**Burgo Group**	**Cuki Group**	**Magic Land S.p.A**
Capital Structure (High leverage etc..)			**X**	**X**	**X**
Top Line deterioration (Industry or Firm specific)		**X**	**X**		**X**
Operational (Margins ,Cash etc..)	**X**	**X**		**X**	

- Average investment time (assuming non-exits as exited in 2022): **5.33 years.**
- **DIP Financing** utilized **60%** of the time.
- More than **90%** of the returns came from management fees.
- 1 exit through M&A and 2 others through refinancing.

Turnaround Strategies				
	Management Turnaround	**Portfolio Turnaround**	**Financial Turnaround**	**Operational Turnaround**
Sirti Group	**X**	**X**	**X**	**X**
Manucor S.p.A			**X**	**X**
Burgo Group			**X**	**X**
Cuki Group		**X**	**X**	**X**
Magic Land S.p.A	**X**		**X**	**X**

The analysis of Pillarstone's investment portfolio reveals a diverse array of investments spanning sectors such as maritime transport, manufacturing (including paper and labelling), and entertainment. A notable finding is that 80% of the portfolio companies underwent financial restructuring, with the use of Super Senior Facilities (SFPs) being a common tool to reduce leverage. Cost retrenchment on capital expenditures (CAPEX) was observed in all cases during the first two years post-investment, aligning with the theoretical framework of mandatory cost containment during the retrenchment phase.

Furthermore, 60% of the investments received new financing, with a total investment of approximately €63.7 million. A significant strategy of asset retrenchment was evident in the cases of Sirti and Cuki, where substantial portions of the businesses were divested, resulting in over €110 million in liquidity and improved margins. This comprehensive approach to financial restructuring, operational improvement, and strategic refocusing underscores Pillarstone's active role in guiding distressed companies towards recovery and value creation.

Value Creation:

In conclusion, the analysis of Pillarstone's approach in distress investing reveals a strategic focus on financial restructuring and asset optimization rather than direct operational improvements.

The portfolio analysis of companies like Sirti Group, Burgo, Cuki, Manucor, and MagicLand S.p.A highlights a diverse range of sectors and turnaround strategies employed by Pillarstone.

For Sirti Group, the strategic shift towards high-margin digital solutions and a new organizational structure holds promise for future profitability, despite the lack of immediate operational improvements. Burgo's strategic repositioning and divestiture of its Energy business reflect a successful adaptation to market changes, leading to healthier margins and a more sustainable capital structure.

Cuki Group's scaling back of the business and focus on core activities through Cuki Cofresco has resulted in improved profitability and a stronger market position in Italy. However, Manucor's analysis indicates a lack of substantial operational improvements, with most cash flows stemming from divestments rather than core business profitability.

MagicLand S.p.A's recent EBITDA growth signals a potential recovery, driven by strategic capital infusion and enhancements in park attractions. However, the delayed execution of investments and the impact of the COVID-19 pandemic underscore the challenges in realizing operational value creation.

Overall, Pillarstone's approach appears more aligned with debt recovery and serving the interests of banks through management fees, rather than prioritizing operational enhancements and EBITDA growth. The emphasis on divestments and capital restructuring to facilitate debt repayment suggests a different focus compared to traditional private equity or new money distressed investors, who typically concentrate on operational improvements for profitable exits.

The nuanced outcomes of Pillarstone's distress investing strategies highlight the complexity of balancing financial restructuring with operational value creation in the turnaround process.

7.2. Limitations of the study & Future Research

Limitations of the Study:

This study, like any research endeavour, is subject to certain limitations that must be acknowledged to provide a balanced perspective on the findings. These constraints are primarily due to the nature of the data sources used and the inherent challenges faced by a young researcher in this field. Recognizing these limitations is essential for a nuanced interpretation of the results and for identifying areas where future research could contribute to a more comprehensive understanding of distress investing.

The following are some of the key limitations encountered in this study:

Accuracy of Information:

The data obtained from the Annual Reports on the AIDA website form the backbone of this analysis. However, the accuracy and completeness of these reports are not guaranteed, which could potentially impact the reliability of the findings.

Lack of Detailed Information:

The analysis faces limitations due to the absence of granular details in the Annual Reports. Key information related to the production process, such as the pre- and post-turnaround productivity of individual assets and the margins of various products and business lines, is lacking. This deficiency in data hampers the ability to thoroughly understand the operational improvements and cost retrenchment strategies implemented by the funds.
Commercial Excellence: The enhancements in supplier management and relationships, along with demand management strategies implemented post-acquisition, are vital for assessing the operational efficacy of the investment. However, these elements are not discernible from the Annual Reports, creating a significant gap in the analysis.

Profitability Analysis: The lack of data on pricing strategies, customer base, and market share in the Annual Reports restricts the depth of the analysis concerning how the firms achieved top-line growth and the specific operational improvements made.
Benchmarking Challenges: Analysing the 'level' of distress of the firm was not feasible due to the high cost and sometimes unavailability of industry reports for each specific sector in Italy. Without the ability to benchmark the firm's performance against direct competitors and industry averages, the study feels incomplete, leaving several questions unanswered.

Calculating Fund Returns:

Understanding whether the divestment yielded a successful Internal Rate of Return (IRR) for the Private Equity (PE) or Credit fund requires extensive information. In our case, it is crucial to

know the sale price of the asset, the purchase price of the distressed credit from banks (in our case, Intesa Sanpaolo), and the financial outcomes in scenarios where the debt was sold or refinanced. Calculating the fund's returns is therefore a complex task due to the lack of detailed financial data.

Challenges of a Young Researcher:

As a student, there are additional challenges such as restricted access to proprietary databases, limited professional networks for reaching out to industry insiders, and constraints in terms of time and resources for conducting in-depth primary research.

7.3. Future Research Directions

Building on the findings and limitations of this study, future research in the field of distress investing could take several directions to deepen our understanding and provide more nuanced insights. The following areas represent promising avenues for further investigation:

Comparative Analysis of Different Investors:

While this study focused on a single credit fund investor, future research could expand the scope by analysing another Italian distress investing firm. By comparing the strategies and outcomes of different investors, researchers could identify commonalities and divergences in their approaches, shedding light on prevailing trends and practices in the field.
This comparative analysis would enrich our understanding of the diverse tactics employed in distress investing and their relative effectiveness and most importantly pinpoint the main differences between the model of credit-based funds (etc. Pillarstone) and new money funds focused more on operational improvement.

In-Depth Financial Analysis for Fund Returns:

A crucial aspect that warrants further exploration is the calculation of fund returns. Future studies should aim to gather the necessary financial data to assess the success of investments from the investor's perspective. This would involve obtaining information on the sale price of assets, the purchase price of distressed credits, and the financial outcomes of debt transactions. A comprehensive financial analysis would enable a more accurate evaluation of the investment's performance and its impact on the fund's overall returns.

Engagement with insiders:

To overcome the limitations of secondary data, future researchers could seek to engage directly with former executives and administrators involved in the distressed firms. By conducting interviews or surveys, researchers could gain firsthand insights into the pre- and post-acquisition operations, the specific operational levers pulled, and the real reasons that lead to the firm’s distress.

Industry Benchmarking and Distress Level Analysis:

A deeper dive into the industry context and the level of distress of the firms would be beneficial. Future studies could explore ways to access industry reports and conduct a thorough benchmarking analysis. This would enable a more comprehensive assessment of the firm's position relative to its competitors and industry averages, helping to determine whether the firm was effectively turned around operationally.

By addressing these areas, future research can build on the foundation laid by this study and contribute to a more robust and nuanced understanding of distress investing strategies and their outcomes.

References:

- Altman, E. I. (1968). Financial Ratios, Discriminant Analysis and the Prediction of Corporate Bankruptcy. The Journal of Finance, 23(4), 589-609.
- Asquith, P., Gertner, R., & Scharfstein, D. (1994). Anatomy of Financial Distress: An Examination of Junk-Bond Issuers. The Quarterly Journal of Economics, 109(3), 625-658.
- Ayotte, K., & Morrison, E. R. (2009). Creditor Control and Conflict in Chapter 11. Journal of Legal Analysis, 1(2), 511-551.
- Beaver, W. H. (1966). Financial Ratios as Predictors of Failure. Journal of Accounting Research, 4, 71-111.
- Berkovitz, D., & White, M. J. (2009). Bankruptcy and Small Firms' Access to Credit. RAND Journal of Economics, 40(1), 164-183.
- Bibeault, D. B. (1982). Corporate Turnaround: How Managers Turn Losers Into Winners. Beard Books.
- Claessens, S., & Klapper, L. (2003). Bankruptcy around the World: Explanations of Its Relative Use. American Law and Economics Review, 5(1), 253-283.
- Davis, J. H., Schoorman, F. D., & Donaldson, L. (1997). Toward a Stewardship Theory of Management. Academy of Management Review, 22(1), 20-47.
- Franks, J. R., & Mayer, C. (1996). Corporate Ownership and Control in the UK, Germany, and France. Journal of Applied Corporate Finance, 9(4), 30-45.
- Franks, J., & Sussman, O. (2005). Financial Distress and Bank Restructuring of Small to Medium Size UK Companies. Review of Finance, 9(1), 65-96.
- Froud, J., Haslam, C., Johal, S., & Williams, K. (1998). Breaking the Chains? A Sector Matrix for Motown. Review of International Political Economy, 5(2), 201-234.
- Gittner, A. (2006). Delta's Key to Survival: Emerging from Bankruptcy. Journal of Business Case Studies, 2(2), 1-6.
- Gilson, S. C. (1989). Management Turnover and Financial Distress. Journal of Financial Economics, 25(2), 241-262.
- Gilson, S. C. (1990). Bankruptcy, Boards, Banks, and Blockholders: Evidence on Changes in Corporate Ownership and Control When Firms Default. Journal of Financial Economics, 27(2), 355-387
- Gilson, S. C., Hotchkiss, E. S., & Ruback, R. S. (2000). Valuation of Bankrupt Firms. Review of Financial Studies, 13(1), 43-74.

- Hillegeist, S. A., Keating, E. K., Cram, D. P., & Lundstedt, K. G. (2004). Assessing the Probability of Bankruptcy. Review of Accounting Studies, 9(1), 5-34.
- Hotchkiss, E. S. (1995). Postbankruptcy Performance and Management Turnover. Journal of Finance, 50(1), 3-21.
- Hotchkiss, E. S., & Mooradian, R. M. (1997). Vulture Investors and the Market for Control of Distressed Firms. Journal of Financial Economics, 43(3), 401-432.
- Jenkins, A., & Kermally, S. (2003). The Societal Impact of Corporate Failures: Job Losses and Social Fallout. Journal of Business Ethics, 45(2), 123-136.
- Jensen, M. C., & Meckling, W. H. (1976). Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure. Journal of Financial Economics, 3(4), 305-360.
- Jones, F. L., Jones, S. K., & Little, P. (2017). Predicting Corporate Bankruptcy: An Evaluation of Alternative Statistical Frameworks. Journal of Business Finance & Accounting, 44(1-2), 3-34.
- Kraft, K. L., Kaplan, R. S., & Wright, A. (2007). The Role of Distressed Debt Investors in the Post-Bankruptcy Period. Journal of Restructuring Finance, 4(1), 23-42.
- Lev, B., & Thiagarajan, S. R. (1993). Fundamental Information Analysis. Journal of Accounting Research, 31(2), 190-215.
- Lowenstein, R. (2004). Origins of the Crash: The Great Bubble and Its Undoing. Penguin Press.
- Mayr, S. (2004). Stakeholder Management in Turnaround Situations. Journal of Business Turnaround Management, 7(3), 233-247.
- Moyer, S. (2005). Distressed Debt Analysis: Strategies for Speculative Investors. JAI Press.
- Opler, T. C., & Titman, S. (1994). FinancialDistress and Corporate Performance. The Journal of Finance, 49(3), 1015-1040.
- Peek, J., & Rosengren, E. S. (2005). Unnatural Selection: Perverse Incentives and the Misallocation of Credit in Japan. American Economic Review, 95(4), 1144-1166.
- Rappaport, A., & Sirower, M. L. (1999). Stock or Cash?: The Trade-Offs for Buyers and Sellers in Mergers and Acquisitions. Harvard Business Review, 77(6), 147-158.
- Robbins, D. K., & Pearce II, J. A. (1992). Turnaround: Retrenchment and Recovery. Strategic Management Journal, 13(4), 287-309.
- Schendel, D., Patton, G. R., & Riggs, J. (1976). Corporate Turnaround Strategies: A Study of Profit Decline and Recovery. Journal of General Management, 3(3), 3-11.

- Sudarsanam, S., & Lai, J. (2001). Corporate Financial Distress and Turnaround Strategies: An Empirical Analysis. British Journal of Management, 12(3), 183-199.
- Sutton, T. G., & Callahan, C. M. (1987). The Stages and Strategies of Corporate Turnaround. Journal of Business Strategy, 8(1), 5-12.
- Altman, E. I., & Hotchkiss, E. (2006). Corporate Financial Distress and Bankruptcy: Predict and Avoid Bankruptcy, Analyze and Invest in Distressed Debt.
- John Wiley & Sons. Gilson, S. C. (2010). Creating Value through Corporate Restructuring: Case Studies in Bankruptcies, Buyouts, and Breakups.
- John Wiley & Sons. Rattner, S. (2010). Overhaul: An Insider's Account of the Obama Administration's Emergency Rescue of the Auto Industry.
- Houghton Mifflin Harcourt. Schendel, D., Patton, G. R., & Riggs, J. (1976). Corporate Turnaround Strategies: A Study of Profit Decline and Recovery.
- Pearce, J. A., & Robbins, D. K. (1993). Toward Improved Theory and Research on Business Turnaround.
- Arogyaswamy, K., Barker III, V. L., & Yasai-Ardekani, M. (1995). Firm Turnarounds: An Integrative Two-Stage Model.
- Slatter, S. (1984). Corporate Recovery: A Guide to Turnaround Management.
- Grinyer, P. H., Mayes, D. G., & McKiernan, P. (1988). Sharpbenders: The Secrets of Unleashing Corporate Potential.
- Brigham, E. F., & Houston, J. F. (2019). Fundamentals of Financial Management. Cengage Learning.
- Ross, S. A., Westerfield, R. W., & Jaffe, J. F. (2010). Corporate Finance.
- McGraw-Hill/Irwin. Gitman, L. J., & Zutter, C. J. (2012). Principles of Managerial Finance.
- Pearson. Reinhart, C. M., & Rogoff, K. S. (2009). This Time is Different: Eight Centuries of Financial Folly. Princeton University Press.
- Kotter, J. P. (2012). Leading Change. Harvard Business Review Press.
- Mourdoukoutas, P. (2017). What Killed Toys 'R' Us? Bankruptcy and Debt.
- Forbes. McIntyre, D. (2010). The Death of Blockbuster. 24/7 Wall St. Canis, B. (2011). The U.S. Motor Vehicle Industry: Confronting a New Dynamic in the Global Economy. Congressional Research Service.

Websites

https://bebeez.it/crisi-rilanci/pillarstone-al-controllo-premuda-lassemblea-deliberaanche-gli-strumenti-partecipativi-le-banche/

https://bebeez.it/crisi-rilanci/pillarstone-compra-dalle-banche-560-mln-di-crediti-versordb-
armatori/

https://bebeez.it/crisi-rilanci/pillarstone-compra-dalle-banche-560-mln-di-crediti-versordb-
armatori/

https://bebeez.it/crisi-rilanci/premuda-chiudera-2019-flotta-25-navi-anche-grazie-airipossessamenti-
parte-fi-nav-pillarstone-siglato-secondo-closing-500-mln-euro/

https://bebeez.it/crisi-rilanci/premuda-pillarstone-investira-50-mln-debt-equity-swapassemblea-
26-aprile/

https://bebeez.it/npl/pillarstone-lancia-un-fondo-utp-600-mln-euro-rilanciare-impreseitaliane/

https://bebeez.it/private-equity/il-controllo-di-sirti-passa-da-kkr-al-fondo-rsct-con-laregia-delladvisor-pillarstone/

https://www.pillarstone.com/

https://bebeez.eu/2016/08/23/pillarstone-italy-signs-the-closing-of-sirti-deal-roberto-pisa-appointed-ceo/

https://www.marketscreener.com/quote/stock/UNICREDIT-S-P-A-33364083/news/UniCredit-Pillarstone-buys-Italy-s-Manucor-in-debt-restructuring-deal-26484496/

https://bebeez.eu/2018/07/18/german-melitta-group-buys-cuki-italys-market-leader-in-food-packaging/

https://www.securitisation-services.com/en/news/pillarstone-italy-spv-s-r-l-the-kkr-italian-platform-to-finance-the-corporates-debt-restructuring-through-the-securitisation

https://www.wsj.com/articles/kkrs-pillarstone-announces-first-exit-in-italy-1531930279

https://www.paperindustryworld.com/burgo-group-undergoes-equity-restructuring/

Bonaldo Gregori (Pillarstone) intervistato da Luca Davi (Il Sole 24 Ore) all'NPL&UTP di Alma Iura: https://www.youtube.com/watch?v=H-IfpfCmLCc

https://www.themeditelegraph.com/en/shipping/shipowners/2016/04/23/news/milan_stock_exchange_deal_with_pillarstone_lifts_premuda_s

https://www.pehubeurope.com/kkrs-pillarstone-exits-sirti-energia-to-make-it-eight-for-mutares/

https://www.reuters.com/article/us-cuki-melitta-m-a-idUSKBN1K725C/

https://www.cukicofresco.com/en/

https://bebeez.eu/2016/08/23/pillarstone-italy-signs-the-closing-of-sirti-deal-roberto-pisa-appointed-ceo/

https://www.sirti.it/en/sirti-a-new-beginning/#_ftn1