In The News

After Bankruptcy Mr. Gatti's Plans Expansion

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Jay Ong was quoted in a recent Austin Business Journal article, which details how Austin founded chain Mr. Gatti's Pizza used the Chapter 11 Bankruptcy process to restructure its business.

It's been just over a year since the owner of Austin-born Mr. Gatti's Pizza filed for Chapter 11 bankruptcy. So what has the company been up to since then?

For one, the pizza chain emerged from bankruptcy on Nov. 18, said Travis Smith, vice president of marketing for Mr. Gatti's Pizza. Mr. Gatti's has resumed franchise sales, striking deals for "several new franchise locations," Smith said. He said the chain has "over a dozen qualified applicants in the pipeline" who are interested in opening a franchise.

"The system is performing well and we are forecasting strong growth for 2020 both from existing locations and new franchise sales," Smith said.

Mr. Gatti's Pizza hopes to add 20 franchise locations in 2020, he added.

Smith didn't elaborate on where those new franchises might crop up, though he did say that Austin remains an important market for the brand. Both current and potential franchisees are interested in developing new locations in Austin or relocating an existing location to the Austin market, Smith said.

A clear-eyed look at bankruptcy

Bankruptcy can be seen as a death knell for companies but that's not always the case. Especially with Chapter 11 bankruptcy, the protection can offer a business the flexibility needed to restructure while continuing operations. Generally, 20% to 25% of business that file for Chapter 11 survive, experts said.

Overall bankruptcy filings in the United States ticked up slightly in 2019. For the 12 months that ended Dec. 31, 2019, overall filings increased 0.2%, according to Administrative Office of the U.S. Courts. Business bankruptcy filings saw a more pronounced 2.5% increase over that span, ending a long stretch of annual decreases. For context, business bankruptcy filings in the U.S. dropped a total of 17.6% from 2014 to 2018, with decreases each year.

Travis County saw 93 business bankruptcies filed in the 12 months that ended Dec. 31, 2019, including 73 Chapter 7 bankruptcy filings.

Just last week, Trudy's Texas Star Inc., the parent company for four restaurants in Austin, filed for Chapter 11 bankruptcy protection with debt of about $4 million. Steve Sather of Barron & Newburger PC is representing Trudy's in the bankruptcy process.

"Trudy's has a lot that is attractive about it, and we're hoping that will make it a successful case," Sather said. "There are several avenues we're working on that aren't public yet."

Despite his optimism about the Trudy's case, Sather acknowledged that the "success rate is fairly low" with Chapter 11 bankruptcy. In order to beat the odds, business owners must first believe in the business and see a future for their company. From there, the ownership group must navigate the "emotionally taxing" process of bankruptcy reorganization, Sather said, keeping up with lawyers asking hundreds of questions while simultaneously keeping the business afloat.

That means communicating with vendors who might be uneasy about the future of the business partnership.

"The simplest thing is just showing your vendors that if they ship products for you post-bankruptcy, they're getting paid for it," Sather said. "The big picture of bankruptcy is to find a situation where everybody is better off than if the case just crashed and burned."

Bankruptcy expert Jay Ong, head of the Austin office ofMunsch Hardt Kopf & Harr PC, said bankruptcy cases can come in a "broad variety of shapes and sizes," with a wide variety of outcomes. That could include the sale of a business, obtaining new financing or a hybrid approach where certain aspects of the business are shed.

Ong said that one of the pitfalls of the bankruptcy process is that business owners view the protection as "a last-ditch resort," waiting too long to consult with a professional.

"If you get a call and the debtor starts consulting with you, and you find they are already in severe distress, a lot of times there would have been greater flexibility and potential to address their restructuring issues had they come to you at an earlier point in time," Ong said.

Sather agreed.

"One of the biggest mistakes that they make is waiting too long," Sather said. "If a business recognizes that it's in trouble and we have several months to plan, we can go in an organized fashion."

The stigma around bankruptcy is misguided, Ong said.

"It's been well established and accepted, at least within the bankruptcy system: Bankruptcy is a legitimate financial and restructuring tool that is provided for in federal law in order to try to maximize economic value for the debtor and people who are involved in it," Ong said.

Another difficult realization for a business owner facing bankruptcy is coming to grips with the role they played in bringing a company into financial duress.

"Any time you have a business failure, it's due in whole or in part to mistakes that you have made," Sather said. "If you don't acknowledge your own mistakes and look at them clear-eyed, you're never going to fix the problem. It takes a rare business owner to do it."

More on Mr. Gatti's

Mr. Gatti's was established in Austin in 1969. While it is now based in Fort Worth, Central Texas remains a critical market for the company — of its 70 locations, 17 are in the Austin metro, the most of any in Texas, according to the Mr. Gatti's website.

There have been more than 500 filings in the bankruptcy case of Sovrano LLC, the parent company of Mr. Gatti's, since it filed for bankruptcy on Jan. 4, 2019, with liabilities between $10 million and $50 million. Sovrano, which bought Mr. Gatti's in June 2015 from Austin's Blue Sage Capital, is an affiliate of Fort Worth-based private equity firm FundCorp Inc., according to Dallas Business Journal.

Several other FundCorp companies also filed for bankruptcy protection in January 2019: Mr Gatti's LP, Gatti's Great Pizza Inc. and several limited liability companies tied to Gigi's Cupcakes.

A federal bankruptcy judge on Oct. 18 approved an amended Chapter 11 reorganization plan for Mr. Gatti's. In addition to a robust expansion plan, Mr. Gatti's is also emerging from Chapter 11 with a new corporate name: Mr. Gatti's Pizza LLC. The restaurant chain is still controlled by the same ownership group behind Sovrano LLC, but all operations have now been consolidated under the new entity.

Smith indicated optimism is high now that the brand has resumed franchise sales.

"Mr. Gatti's found itself in Chapter 11 due to a lender issue and not as a result of poor sales," Smith said. "Strong communication with our dedicated and committed franchisees has been critical throughout the process."

The plan lays out many steps for Mr. Gatti's to settle up with creditors. For example, the company is supposed to pay $141,622.48 to Harbert Rainier Southpark Meadows, the landlord of its Gattitown location in the Southpark Meadows shopping center in South Austin. The initial payment was to be $60,000 with the rest paid out in 12 monthly installments of $6,801.87, beginning Jan. 1, 2020.

The Southpark Meadows location is one of only two corporate-owned Mr. Gatti's restaurants, which speaks to the brand's vision moving forward.

"Our goal is definitely to be a franchisor," Smith said. "I think there's a lot of pent-up demand for the brand. You can't sell [franchises] when you're in bankruptcy."

While Mr. Gatti's seems to be on sounder financial footing, Sovrano is still in bankruptcy court, at least for now.

In late January, a bankruptcy court judge approved compensation for a handful of companies working for Sovrano on the bankruptcy case, including accountants, restructuring experts and lawyers. From Jan. 17 through Jan. 29, those awards totaled nearly $1.8 million, according to court records.

Bankruptcies are up; here are some to mind

Mr. Gatti's Pizza is one of dozens of local businesses that grapple with bankruptcy every year.

A total of 573 business bankruptcy filings were recorded in the Western District of Texas by the Administrative Office of the U.S. Courts in 2019, compared to 511 filings in 2018.

Here are a few notable recent bankruptcies in the Austin area:

- Celis Brewery is still working through the Chapter 11 bankruptcy process after filing in July 2019. A confirmation hearing regarding its third amended Chapter 11 plan is scheduled to take place Feb. 20.
- Real estate firm World Class Holdings has used bankruptcy as a legal tool multiple times as it grapples with lenders over a handful of Austin properties.
- 360 Mortgage Group LLC filed for Chapter 11 protection in November, the latest step in a year-long shuttering of the company.

There are many different possible outcomes to bankruptcy. Austin-born sandwich chain Schlotzsky's filed for Chapter 11 bankruptcy in San Antonio in August 2004, was bought on the courthouse steps that year by Bobby Cox Cos. Inc. for $28.5 million and was later purchased by Atlanta-based Focus Brands Inc. in 2006. As of April 2019, when the chain rebranded as Schlotzsky's Austin Eatery, it had more than 370 stores across the U.S., down from more than 750 in 2001.

Ong said there are many ways to resolve bankruptcy but there has been a recent uptick in the number of bankrupt companies that seek asset sales. Those sale plans typically require companies to obtain enough breathing room to "find the time and opportunity to market the assets so that you could get the maximum reasonable price that you can," Ong said.

Sather noted that really big bankruptcies typically follow one of two models: "Either they sell the company to a new owner or they wipe out the existing shareholders and recapitalize by converting the creditors into equity owners."

Take the case of Jones Energy, which was acquired by Oklahoma City-based Revolution Resources in December after declaring for Chapter 11 bankruptcy in April with more than $1 billion in debt.

Firefly Aerospace Inc. is another example of a company that emerged from bankruptcy with new owners, and it has risen to near the top of its field.

The company filed for Chapter 7 bankruptcy in April 2017, when it went by Firefly Systems Inc. But the Cedar Park-based rocket maker got out of bankruptcy in August of that year after its assets were bought at auction by California-based asset management firm Noosphere Ventures. It's now one of eight companies competing for hundreds of millions of dollars worth of U.S. Air Force contracts, and in December won the "Turnaround of the Year" award from space-industry publication Space News.

The full article can also be viewed by clicking here.

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