IPARTY CORP
Form 10-Q
November 07, 2005

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 24, 2005

or

o TRANSITION REPORT PURSUANT SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number 0-25507

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iPARTY CORP.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**76-0547750** (I.R.S. Employer Identification No.)
270 Bridge Street, Suite 301, Dedham, Massachusetts (Address of principal executive offices)	**02026** (Zip Code)

(781) 329-3952

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes o No ý

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No ý

As of November 2, 2005, there were 22,189,147 shares of common stock, $.001 par value, outstanding.

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iPARTY CORP.

QUARTERLY REPORT ON FORM 10-Q

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

iPARTY CORP.

CONSOLIDATED BALANCE SHEETS

	Sep 24, 2005 (Unaudited)	Dec 25, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,001,298	$ 1,757,157
Restricted cash	451,798	561,407
Accounts receivable	945,417	700,961
Inventory, net	17,399,118	11,400,971
Prepaid expenses and other assets	809,662	476,046
Total current assets	20,607,293	14,896,542
Property and equipment, net	5,311,804	4,483,705
Other assets	102,775	99,690
Total assets	$ 26,021,872	$ 19,479,937
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 9,459,521	$ 3,421,195
Accrued expenses	3,036,100	2,615,835
Current portion of capital lease obligations	425,847	365,674
Borrowings under line of credit	9,519,470	5,257,690
Total current liabilities	22,440,938	11,660,394
Long-term liabilities:		
Capital lease obligations, net of current portion	555,150	796,693
Other liabilities	565,146	471,759
Total long-term liabilities	1,120,296	1,268,452
Commitments and contingencies		
Stockholders equity:		
Convertible preferred stock - $.001 par value; 10,000,000 shares authorized,		
Series B convertible preferred stock - 1,150,000 shares authorized; 501,402 and 507,460 shares issued and outstanding at September 24, 2005 and Dec 25, 2004, respectively (aggregate liquidation value of $10,028,039 at September 24, 2005)	7,460,861	7,551,002
Series C convertible preferred stock - 100,000 shares authorized, issued and outstanding (aggregate liquidation value of $2,000,000 at September 24, 2005)	1,492,000	1,492,000
Series D convertible preferred stock - 250,000 shares authorized, issued and outstanding (aggregate liquidation value of $5,000,000 at September 24, 2005)	3,652,500	3,652,500
Series E convertible preferred stock - 296,667 shares authorized, issued and outstanding (aggregate liquidation value of $1,112,500 at September 24, 2005)	1,112,500	1,112,500
Series F convertible preferred stock - 114,286 shares authorized, issued and outstanding (aggregate liquidation value of $500,000 at September 24, 2005)	500,000	500,000
Total convertible preferred stock	14,217,861	14,308,002

Common stock - $.001 par value; 150,000,000 shares authorized; 22,189,147 and 22,092,717 shares issued and outstanding at September 24, 2005 and Dec 25, 2004, respectively		22,189		22,093
Additional paid-in capital		50,570,243		50,448,100
Accumulated deficit		(62,349,655)		(58,227,104)
Total stockholders equity		2,460,638		6,551,091
Total liabilities and stockholders equity	$	26,021,872	$	19,479,937

The accompanying notes are an integral part of these Consolidated Financial Statements.

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iPARTY CORP.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	For the three months ended Sep 24, 2005	For the three months ended Sep 25, 2004	For the nine months ended Sep 24, 2005	For the nine months ended Sep 25, 2004
Revenues	$ 14,839,051	$ 13,157,546	$ 44,516,336	$ 40,554,000
Operating costs:				
Cost of products sold and occupancy costs	9,042,165	7,897,580	26,752,342	23,454,594
Marketing and sales	6,204,540	5,276,532	16,316,817	14,367,835
General and administrative	1,852,047	1,509,548	5,187,189	4,674,898
Operating loss	(2,259,701)	(1,526,114)	(3,740,012)	(1,943,327)
Other income		28,000		382,500
Loss before interest	(2,259,701)	(1,498,114)	(3,740,012)	(1,560,827)
Interest income	477	271	758	1,280
Interest expense	(151,437)	(77,580)	(383,298)	(148,900)
Net loss	$ (2,410,661)	$ (1,575,423)	$ (4,122,552)	$ (1,708,447)
Basic and diluted net loss per share	$ (0.11)	$ (0.07)	$ (0.19)	$ (0.08)
Weighted-average shares outstanding:				
Basic and diluted	22,147,063	22,019,408	22,123,289	21,123,511

The accompanying notes are an integral part of these Consolidated Financial Statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the nine months ended Sep 24, 2005	Sep 25, 2004
Operating activities:		
Net loss	$ (4,122,552)	$ (1,708,447)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	785,693	406,576
Deferred rent	93,387	38,723
Changes in operating assets and liabilities:		
Accounts receivable	(244,456)	(350,294)
Inventory	(5,998,147)	(5,548,275)
Prepaid expenses and other assets	56,431	29,682
Accounts payable	6,038,326	4,697,756
Accrued expenses and other liabilities	45,830	143,980
Net cash used in operating activities	(3,345,488)	(2,290,299)
Investing activities:		
Purchase of property and equipment	(1,480,824)	(1,648,300)
Net cash used in investing activities	(1,480,824)	(1,648,300)
Financing activities:		
Net borrowings under line of credit	4,261,780	2,499,908
Increase (decrease) in restricted cash	109,609	(59,031)
Principal payments on capital lease obligations	(314,338)	(72,995)
Deferred financing costs	9,804	(32,921)
Proceeds from exercise of stock options	3,598	4,529
Net cash provided by financing activities	4,070,453	2,339,490
Net decrease in cash and cash equivalents	(755,859)	(1,599,109)
Cash and cash equivalents, beginning of period	1,757,157	2,442,471
Cash and cash equivalents, end of period	$ 1,001,298	$ 843,362
Supplemental disclosure of non-cash financing activities:		
Conversion of Series A convertible preferred stock to common stock	$	$ 1,000,000
Conversion of Series B convertible preferred stock to common stock	90,141	1,541,869
Conversion of Series E convertible preferred stock to common stock		347,895
Total conversion of convertible preferred stock to common stock	$ 90,141	$ 2,889,764
Acquisition of assets under capital lease	$ 132,968	$ 891,465

The accompanying notes are an integral part of these Consolidated Financial Statements.

iPARTY CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 24, 2005

(Unaudited)

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES:

Interim Financial Information

The interim consolidated financial statements as of September 24, 2005 have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC) for interim financial reporting. These consolidated statements are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring adjustments and accruals) necessary to present fairly the consolidated balance sheets, consolidated operating results, and consolidated cash flows for the periods presented in accordance with generally accepted accounting principles. The consolidated balance sheet at December 25, 2004 has been derived from the audited consolidated financial statements at that date. Operating results for the Company on a quarterly basis may not be indicative of the results for the entire year due, in part, to the seasonality of the party goods industry. Historically, higher revenues and operating income have been experienced in the second and fourth fiscal quarters. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted in accordance with the rules and regulations of the SEC. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements, and accompanying notes, included in the Company s Annual Report on Form 10-K, as amended, for the year ended December 25, 2004.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries after elimination of all significant intercompany transactions and balances.

Revenues Recognition

Revenues include the selling price of party goods sold, net of returns and discounts, and are recognized at the point of sale. The Company estimates returns based upon historical return rates and such amounts have not been significant.

Concentrations

The Company purchases its inventory from a diverse group of vendors and is not overly dependent upon any single source for its merchandise, often using more than one vendor for similar kinds of products.

Accounts receivable primarily represent amounts due from credit card companies and vendors for inventory rebates. Management does not provide for doubtful accounts as such amounts have not been significant to date; the Company does not require collateral.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Cash and Cash Equivalents and Restricted Cash

The Company considers all highly liquid investments with an original maturity date of three months or less to be cash equivalents. Cash equivalents consist primarily of money market accounts and are carried at cost plus accrued interest, which approximates fair value.

The Company uses controlled disbursement banking arrangements as part of its cash management program. Outstanding checks, which were included in accounts payable, totaled $1,071,143 at September 24, 2005 and $950,156 at December 25, 2004. The Company had sufficient funds available to fund the outstanding checks when they were presented for payment.

Restricted cash represents money deposited in blocked accounts established for the benefit of and under the control of Wells Fargo Retail Finance II, LLC, the Company s lender under its line of credit, and constitutes collateral for amounts outstanding under the Company s line of credit.

Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, accounts receivable and accounts payable approximate fair value because of the short-term nature of these instruments. The fair value of borrowings under its line of credit approximates carrying value because the debt bears interest at a variable market rate.

Inventories

Inventories consist of party supplies and are valued at the lower of moving weighted-average cost or market. Inventory has been reduced by an allowance for obsolete and excess inventory, which is based on management s review of inventories on hand compared to estimated future sales. The activity in the allowance for obsolete and excess inventory is as follows:

	Sep 24, 2005	Dec 25, 2004
Beginning balance	$ 1,296,855	$ 1,400,262
Increases to reserve	196,477	200,000
Write-offs against reserve	(368,375)	(303,407)
Ending balance	$ 1,124,975	$ 1,296,855

The Company records vendor rebates, discounts and certain other adjustments to inventory, including freight costs, and these amounts are recognized in the income statement as the related goods are sold.

Net Income (Loss) per Share

Net income per basic share is computed by dividing net income by the weighted-average number of common shares outstanding plus the common share equivalents of all outstanding Series B, C, D, E and F convertible preferred stock. The common share equivalents of Series B, C, D, E and F convertible preferred stock are included in the calculation of net income per basic share in accordance with EITF Topic D-95, Effect of Participating Convertible Securities on the Computation of Basic Earnings Per Share, since these convertible preferred stockholders are entitled to participate in dividends when and if declared by the Board of Directors. For the periods with net losses, the Company excludes those common share equivalents since their impact would be anti-dilutive.

Net income per diluted share is computed by dividing net income by the weighted-average number of common shares outstanding, plus the common share equivalents of all outstanding Series B, C, D, E and F convertible preferred stock, plus the common share equivalents of the in the money stock options and warrants as computed by the treasury method. For the periods with net losses, the Company excludes those common share equivalents since their impact would be anti-dilutive.

On August 26, 2005, a total of 5,723,512 warrants issued in connection with the issuance of Series B and Series C convertible preferred stock which were exercisable for 9,157,619 shares of common stock expired.

On September 10, 2005, a total of 929,929 warrants issued in connection with the issuance of Series E convertible preferred stock which were exercisable for 1,487,886 shares of common stock expired.

As of September 24, 2005, there were 28,273,403 potential additional common share equivalents outstanding, which were not included in the calculation of basic and diluted net loss per share because their effect would be anti-dilutive. These included 15,535,370 shares upon the conversion of immediately convertible preferred stock, 2,365,711 shares upon the exercise of warrants with a weighted-average exercise price of $1.90 and 10,372,322 shares upon the exercise of stock options with a weighted-average exercise price of $0.95.

Stock Option Compensation Expense

The Company accounts for its stock option compensation agreements with employees under the provisions of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*. The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*.

In response to FAS No. 123R, on September 21, 2005, our Board of Directors approved an acceleration of the vesting of certain unvested and out-of-the-money stock options previously awarded to employees and officers with exercise prices equal to or greater than $0.69 per share. Options held by non-employee directors were excluded from the vesting acceleration. As a result, options to purchase approximately 1.0 million shares of iParty stock became exercisable immediately. Based upon our closing stock price of $0.46 on September 21, 2005, none of these options had economic value on the date of acceleration.

In making the decision to accelerate these options, the Company s Board of Directors considered the interest of the stockholders as it will reduce the company s reported compensation expense in future periods following the effectiveness of FAS No. 123R. The future stock option expense that was eliminated was approximately $508,000 on a pre-tax basis and is reflected in the pro forma footnote disclosure for the three and nine months ended September 24, 2005.

The Company has computed the value of options using the Black-Scholes option pricing model prescribed by SFAS No. 123. The weighted-average fair value of the options granted was $0.36 per share during the third quarter of fiscal 2005 and $0.59 per share during the third quarter of fiscal 2004, using the following assumptions: no dividend yield, volatility of 109% in 2005 and 117% in 2004, a risk-free interest rate of 4.01% in the third quarter of fiscal 2005 and 3.26% in the third quarter of fiscal 2004 and an expected life of five years from the date of the grant. If compensation cost for the Company s stock option plan been determined based upon the fair value at the grant date for awards under the plan consistent with the methodology prescribed under SFAS 123, the Company s net loss and net loss per share would have been the following pro forma amounts:

	For the three months ended				**For the nine months ended**			
		Sep 24, 2005		**Sep 25, 2004**		**Sep 24, 2005**		**Sep 25, 2004**
Net income (loss):								
Reported	$	(2,410,661)	$	(1,575,423)	$	(4,122,552)	$	(1,708,447)
Stock option compensation expense		(717,743)		(117,460)		(927,744)		(652,745)
Pro forma	$	(3,128,404)	$	(1,692,883)	$	(5,050,296)	$	(2,361,192)
Net income (loss) per share:								
Reported								

Basic and diluted:	$	(0.11)	$	(0.07)	$	(0.19)	$	(0.08)
Pro forma								
Basic and diluted:	$	(0.14)	$	(0.08)	$	(0.23)	$	(0.11)

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and are depreciated on the straight-line method over the estimated useful lives of the assets. Expenditures for maintenance and repairs are charged to operations as incurred. A listing of the estimated useful life of the various categories of property and equipment is as follows:

Asset Classification	**Estimated Useful Life**
Leasehold improvements	Lesser of term of lease or 10 years
Furniture and fixtures	7 years
Computer hardware and software	3 years
Equipment	5 years

Accounting for the Impairment of Long-Lived Assets

In accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the Company reviews each store for impairment indicators whenever events and changes in circumstances suggest that the carrying amounts may not be recoverable from estimated future store cash flows. Our review considers store operating results, future sales growth and cash flows.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

This information should be read in conjunction with the unaudited consolidated financial statements and related notes included in Item 1 of this Quarterly Report on Form 10-Q and the audited consolidated financial statements and related notes and Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, contained in our Annual Report on Form 10-K, as amended, for the fiscal year ended December 25, 2004.

Forward Looking Statements

This Quarterly Report on Form 10-Q, including this discussion and analysis by management, contains or incorporates forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements are based on current expectations, estimates, forecasts and projections about the industry and markets in which we operate and our management s beliefs and assumptions. In addition, other written or oral statements that constitute forward-looking statements may be made by or on our behalf. Words such as expect , anticipate , intend , plan , believe , seek , estimate , va of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. We have included important factors in the cautionary statements below under the heading Factors That May Affect Future Results that we believe could cause our actual results to differ materially from the forward-looking statements we make. We do not intend to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

Overview

We believe we are a leading brand in the party industry in the markets we serve and a leading resource in those markets for consumers seeking party goods, party planning advice and party-related information. We are a party goods retailer operating stores throughout New England, where 45 of our 50 retail stores are located. Our other five stores are located in Florida. We also license the name iparty.com (at www.iparty.com) to a third party in exchange for royalties from Internet sales, which to date have not been significant.

The following table shows the number of stores in operation:

	For the three months ended		For the nine months ended	
	Sep 24, 2005	Sep 25, 2004	Sep 24, 2005	Sep 25, 2004
Beginning of period	45	40	44	38
Openings	5	2	6	4
Closings				
End of period	50	42	50	42

Our stores feature over 20,000 products ranging from greeting cards and balloons to more unique merchandise such as piñatas, tiny toys, masquerade and Hawaiian Luau items. Our sales are driven by the following events: Halloween, Christmas, Easter, Valentine s Day, New Year s, Independence Day, St. Patrick s Day, Thanksgiving and Chanukah. We also focus our business closely on lifetime events such as anniversaries, graduations, birthdays, and bridal or baby showers. The following table shows a summary of our revenues and the increase in revenues from the prior year periods:

	For the three months ended		For the nine months ended	
	Sep 24, 2005	Sep 25, 2004	Sep 24, 2005	Sep 25, 2004
Revenues	$ 14,839,051	$ 13,157,546	$ 44,516,336	$ 40,554,000
Increase in revenues	12.8%	10.8%	9.8%	12.7%

Our business has a seasonal pattern. In the past three years we have realized over one-third of our annual revenues in our fourth quarter, which includes Halloween and Christmas, and approximately 25% of our revenues in the second quarter, which includes school graduations. Also, during the past three years, we have had net income in our second and fourth quarters and generated losses in our first and third quarters.

Results of Operations

Fiscal year 2005 has 53 weeks and ends on December 31, 2005. Fiscal year 2004 had 52 weeks and ended on December 25, 2004.

The third quarter of fiscal year 2005 had 13 weeks and ended on September 24, 2005. The third quarter of fiscal year 2004 had 13 weeks and ended on September 25, 2004.

Three Months Ended September 24, 2005 Compared to Three Months Ended September 25, 2004

Revenues

Our consolidated revenues for the third quarter of fiscal 2005 were $14,839,051, an increase of $1,681,505, or 12.8% from the third quarter of the prior fiscal year. Revenues include the selling price of party goods sold, net of returns and discounts, and are recognized at the point of sale.

Sales for the third quarter of fiscal 2005 included sales from eight new stores that opened subsequent to the third quarter of 2004, as well as an increase of 2.5% in comparable store sales. Comparable store sales are defined as sales from those stores open for at least one full year. The increase in comparable store sales was mostly driven by higher sales of Boston Red Sox related merchandise which we feel was