

IPARTY CORP
Form 10-Q
November 09, 2004

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 25, 2004

OR

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

For the Transition Period from to

Commission File Number 0-25507

iPARTY CORP.

(Exact Name of Registrant as Specified in Its Charter)

Edgar Filing: IPARTY CORP - Form 10-Q

DELAWARE
(State or Other Jurisdiction of
Incorporation or Organization)

76-0547750
(IRS 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 No

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

As of November 1, 2004, there were 22,087,331 shares of iParty Corp.'s common stock outstanding.

iParty Corp.

Quarterly Report on Form 10-Q

Table of Contents

<u>PART I</u>	<u>FINANCIAL INFORMATION</u>
<u>Item 1.</u>	<u>Financial Statements (Unaudited)</u> <u>Consolidated Balance Sheets – September 25, 2004 and December 27, 2003</u> <u>Consolidated Statements of Operations – Three months and nine months ended</u> <u>September 25, 2004 and September 27, 2003</u> <u>Consolidated Statements of Cash Flows – Nine months ended September 25, 2004 and</u> <u>September 27, 2003</u> <u>Notes to Consolidated Financial Statements</u>
<u>Item 2.</u>	<u>Management’s Discussion and Analysis of Financial Condition and Results of</u> <u>Operations</u>
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures about Market Risk</u>
<u>Item 4.</u>	<u>Controls and Procedures</u>
<u>PART II</u>	<u>OTHER INFORMATION</u>
<u>Item 1.</u>	<u>Legal Proceedings</u>
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>
<u>Item 3.</u>	<u>Defaults upon Senior Securities</u>
<u>Item 4.</u>	<u>Submission of Matters to a Vote of Security Holders</u>
<u>Item 5.</u>	<u>Other Information</u>
<u>Item 6.</u>	<u>Exhibits and Reports on Form 8-K</u>
<u>SIGNATURES</u>	
<u>EXHIBIT INDEX</u>	
<u>Ex. 31.1</u>	<u>Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley</u> <u>Act</u>
<u>Ex. 31.2</u>	<u>Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley</u> <u>Act</u>
<u>Ex. 32.1</u>	<u>Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350</u>
<u>Ex. 32.2</u>	<u>Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350</u>

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

iPARTY CORP.

CONSOLIDATED BALANCE SHEETS

	Sep 25, 2004 (Unaudited)	Dec 27, 2003
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 843,362	\$ 2,442,471
Restricted cash	592,315	533,284
Accounts receivable	838,228	487,934
Inventory, net	14,971,738	9,423,463
Prepaid expenses and other assets	833,949	483,925
Total current assets	18,079,592	13,371,077
Property and equipment, net	4,129,013	1,694,140
Other assets	106,737	86,763
Total assets	\$ 22,315,342	\$ 15,151,980
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 7,793,604	\$ 3,095,848
Accrued expenses	3,119,325	2,306,902
Current portion of capital lease obligations	241,433	29,220
Borrowings under line of credit	6,260,579	3,760,671
Total current liabilities	17,414,941	9,192,641
Long-term liabilities:		
Capital lease obligations, net of current portion	606,517	260
Other liabilities	444,932	406,209
Total long-term liabilities	1,051,449	406,469
Commitments and contingencies		
Stockholders' equity:		
Convertible preferred stock - \$.001 par value; 10,000,000 shares authorized,		
Series A convertible preferred stock - 1,000,000 shares authorized; 0 and 1,000,000 shares issued and outstanding at September 25, 2004 and Dec 27, 2003, respectively (aggregate liquidation value of \$0 at September 25, 2004)		1,000,000
Series B convertible preferred stock - 1,150,000 shares authorized; 507,460 and 611,080 shares issued and outstanding at September 25, 2004 and Dec 27, 2003, respectively (aggregate liquidation value of \$10,149,200 at September 25, 2004)	7,551,002	9,092,870
Series C convertible preferred stock - 100,000 shares authorized, issued and outstanding (aggregate liquidation value of \$2,000,000 at September 25, 2004)	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 25, 2004)	3,652,500	3,652,500
Series E convertible preferred stock - 533,333 shares authorized; 296,667 and 389,439 shares issued and outstanding at September 25, 2004 and Dec 27, 2003, respectively (aggregate	1,112,500	1,460,396

Edgar Filing: IPARTY CORP - Form 10-Q

liquidation value of \$1,112,500 at September 25, 2004)

Series F convertible preferred stock - 114,286 shares authorized, issued and outstanding (aggregate liquidation value of \$500,000 at September 25, 2004)	500,000	500,000
Total convertible preferred stock	14,308,002	17,197,766
Common stock - \$.001 par value; 150,000,000 shares authorized; 22,087,331 and 18,780,204 shares issued and outstanding at September 25, 2004 and Dec 27, 2003, respectively	22,087	18,780
Additional paid-in capital	50,445,607	47,554,621
Accumulated deficit	(60,926,744)	(59,218,297)
Total stockholders' equity	3,848,952	5,552,870
Total liabilities and stockholders' equity	\$ 22,315,342	\$ 15,151,980

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

iPARTY CORP.

CONSOLIDATED STATEMENTS OF OPERATIONS

	For the three months ended		For the nine months ended	
	Sep 25, 2004	Sep 27, 2003	Sep 25, 2004	Sep 27, 2003
Revenues	\$ 13,157,546	\$ 11,878,460	\$ 40,554,000	\$ 35,971,592
Operating costs:				
Cost of products sold	7,897,580	7,060,170	23,454,594	21,151,729
Marketing and sales	5,276,532	4,507,919	14,367,835	12,712,371
General and administrative	1,509,548	1,279,623	4,674,898	3,780,542
Operating loss	(1,526,114)	(969,252)	(1,943,327)	(1,673,050)
Other income	28,000		382,500	
Loss before interest and income taxes	(1,498,114)	(969,252)	(1,560,827)	(1,673,050)
Interest income	271	273	1,280	1,261
Interest expense	(77,580)	(65,748)	(148,900)	(175,427)
Loss before income taxes	(1,575,423)	(1,034,727)	(1,708,447)	(1,847,216)
Income taxes				
Net loss	\$ (1,575,423)	\$ (1,034,727)	\$ (1,708,447)	\$ (1,847,216)
Basic and diluted net loss per share	\$ (0.07)	\$ (0.06)	\$ (0.08)	\$ (0.11)
Weighted-average shares outstanding:				
Basic and diluted	22,019,408	17,687,448	21,123,511	17,354,107

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

iPARTY CORP.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the nine months ended	
	Sep 25, 2004	Sep 27, 2003
Operating activities:		
Net loss	\$ (1,708,447)	\$ (1,847,216)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	406,576	386,022
Deferred rent	38,723	5,691
Changes in operating assets and liabilities:		
Accounts receivable	(350,294)	(100,463)
Inventory	(5,548,275)	(3,452,354)
Prepaid expenses and other assets	29,682	(33,501)
Accounts payable	4,697,756	3,517,920
Accrued expenses and other liabilities	143,980	(65,546)
Net cash used in operating activities	(2,290,299)	(1,589,447)
Investing activities:		
Purchase of property and equipment	(1,648,300)	(714,292)
Net cash used in investing activities	(1,648,300)	(714,292)
Financing activities:		
Net borrowings under line of credit	2,499,908	2,746,453
Increase in restricted cash	(59,031)	(281,837)
Principal payments on capital lease obligations	(72,995)	(167,772)
Deferred financing costs	(32,921)	39,220
Proceeds from exercise of stock options	4,529	1,760
Net cash provided by financing activities	2,339,490	2,337,824
Net increase (decrease) in cash and cash equivalents	(1,599,109)	34,085
Cash and cash equivalents, beginning of period	2,442,471	2,326,343
Cash and cash equivalents, end of period	\$ 843,362	\$ 2,360,428
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	1,541,869	761,276
Conversion of Series E convertible preferred stock to common stock	347,895	289,604
Total conversion of convertible preferred stock to common stock	\$ 2,889,764	\$ 1,050,880
Acquisition of assets under capital lease	\$ 891,465	\$

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

iPARTY CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 25, 2004

(Unaudited)

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES:

Interim Financial Information

The interim consolidated financial statements as of September 25, 2004 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 27, 2003 has been derived from the audited consolidated financial statements at that date. Operating results for the three months and nine months ended September 25, 2004 and September 27, 2003 may not be indicative of the results for the entire year due, in part, to the seasonality of the Company's business. 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 for the year ended December 27, 2003.

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

Edgar Filing: IPARTY CORP - Form 10-Q

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 \$768,145 at September 25, 2004 and \$989,816 at December 27, 2003. 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. The fair value of capital lease obligations for point-of-sale equipment and software approximates carrying value because the obligations were incurred during the third quarter of fiscal 2004 at prevailing interest rates for such leases.

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 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.

Edgar Filing: IPARTY CORP - Form 10-Q

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 A, 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 January 13, 2004, all 1,000,000 shares of Series A convertible stock were converted into 1,000,000 shares of common stock. As of September 25, 2004, there were 38,832,488 potential additional common share equivalents outstanding, which were not included in the above calculation because their effect would be anti-dilutive. These include 15,613,425 shares upon the conversion of immediately convertible preferred stock, 13,561,216 shares upon the exercise of warrants with a weighted-average exercise price of \$1.43 and 9,657,847 shares upon the exercise of stock options with a weighted-average exercise price of \$0.97.

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*.

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 \$0.59 per share during the third quarter of fiscal 2004 and \$0.33 per share during the third quarter of fiscal 2003, using the following assumptions: no dividend yield, volatility of 117% in 2004 and 119% to 121% in 2003, a risk-free interest rate of 3.26% in the third quarter of fiscal 2004 and 2.49% to 3.51% in the third quarter of fiscal 2003 and an expected life of five years from the date of the grant. Had 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 25, 2004	Sep 27, 2003	Sep 25, 2004	Sep 27, 2003
Net loss:				
Reported	\$ (1,575,423)	\$ (1,034,727)	\$ (1,708,447)	\$ (1,847,216)
Stock option compensation expense	(117,460)	(144,324)	(652,745)	(361,517)
Pro forma	\$ (1,692,883)	\$ (1,179,051)	\$ (2,361,192)	\$ (2,208,733)
Basic and diluted net loss per share:				
Reported	\$ (0.07)	\$ (0.06)	\$ (0.08)	\$ (0.11)
Pro forma	\$ (0.08)	\$ (0.07)	\$ (0.11)	\$ (0.13)

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. At the beginning of fiscal 2004 the Company adopted a new policy for estimating the useful life of fixed assets which extended the useful life of equipment, furniture and fixtures and point-of-sale specific computer hardware and software. Changing the estimated life of the assets in these categories as of the beginning of the year reduced depreciation expense for the third quarter and first nine months of fiscal 2004 by approximately \$31,840 and \$100,753, respectively. The net loss per share on the basic and diluted would have been \$.07 for the third quarter and \$.09 for the nine months of fiscal 2004 if this change in estimating the useful life of fixed assets had not been adopted. 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
Computer hardware and software	3 years
Equipment	5 years
Furniture and fixtures	7 years
Computer hardware and software under capital leases	3 years
Point-of-sale specific computer hardware and software under capital leases	5 years
Leasehold improvements	Lesser of term of lease or 10 years

Edgar Filing: IPARTY CORP - Form 10-Q

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 performs an impairment review quarterly.

Reclassifications

Certain reclassifications have been made to prior year's amounts to conform to the current year presentation.

Item 2. Management's Discussion and Analysis

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, contained in our Annual Report on Form 10-K for the fiscal year ended December 27, 2003.

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, vary, or 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 40 of our 44 retail stores are located. Our other four stores are located in Florida. Two new stores were opened during the third quarter, in Citrus Park (Tampa), Florida and Augusta, Maine. Two new stores were opened subsequent to the end of the third quarter, in Sturbridge, Massachusetts and Plymouth, Massachusetts. 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 at September 25, 2004 and September 27, 2003.