

IPARTY CORP
Form 10-Q
November 08, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended September 24, 2011

OR

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

For the Transition Period from _____ to _____

Commission File Number 1-15611

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 No

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if smaller reporting company)

Smaller reporting company

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

As of October 27, 2011, there were 24,408,594 shares of common stock, \$.001 par value, outstanding.

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

(unaudited)

	Sept 24, 2011	Dec 25, 2010
ASSETS		
Current assets:		
Cash	\$ 74,650	\$ 62,650
Restricted cash	597,287	616,742
Accounts receivable	929,528	626,181
Inventories	21,486,972	14,950,933
Prepaid expenses and other assets	473,267	253,749
Deferred income tax asset	95,163	95,163
Total current assets	23,656,867	16,605,418
Property and equipment, net	2,907,002	3,000,798
Intangible assets, net	700,562	934,477
Other assets	223,974	264,179
Deferred income tax asset	476,354	476,354
Total assets	\$ 27,964,759	\$ 21,281,226
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and book overdrafts	\$ 10,544,820	\$ 4,572,147
Accrued expenses	2,475,238	2,254,049
Warrant liability	-	10,000
Current portion of capital lease obligations	6,921	9,228
Borrowings under line of credit	7,751,550	3,102,213
Total current liabilities	20,778,529	9,947,637
Long-term liabilities:		
Capital lease obligations, net of current portion	-	4,613
Deferred rent	1,504,226	1,517,157
Total long-term liabilities	1,504,226	1,521,770
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; 420,408 and 421,218 shares issued and outstanding, respectively at September 24, 2011 and December 25, 2010 (aggregate liquidation value of \$8,408,160 at September 24, 2011)	6,255,671	6,267,724

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Series C convertible preferred stock - 100,000 shares authorized, issued and outstanding		
(aggregate liquidation value of \$2,000,000 at September 24, 2011)	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, 2011)	3,652,500	3,652,500
Series E convertible preferred stock - 533,333 shares authorized; 296,666 shares issued and outstanding (aggregate liquidation value of \$1,112,497 at September 24, 2011)		
	1,112,497	1,112,497
Series F convertible preferred stock - 114,286 shares authorized, issued and outstanding		
(aggregate liquidation value of \$500,000 at September 24, 2011)	500,000	500,000
Total convertible preferred stock	13,012,668	13,024,721
Common stock - \$.001 par value; 150,000,000 shares authorized; 24,408,594 and 24,294,493 shares issued and outstanding at September 24, 2011 and December 25, 2010, respectively		
	24,409	24,294
Additional paid-in capital	52,940,746	52,760,302
Accumulated deficit	(60,295,819)	(55,997,498)
Total stockholders' equity	5,682,004	9,811,819
Total liabilities and stockholders' equity	\$ 27,964,759	\$ 21,281,226

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

iPARTY CORP.
CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)

	For the three months ended		For the nine months ended	
	Sept 24, 2011	Sept 25, 2010	Sept 24, 2011	Sept 25, 2010
Revenues	\$ 16,462,631	\$ 16,898,251	\$ 51,171,966	\$ 51,799,462
Operating costs:				
Cost of products sold and occupancy costs	10,813,669	10,676,032	32,234,434	32,114,729
Marketing and sales	6,329,882	6,371,234	17,426,635	16,894,562
General and administrative	1,667,689	1,726,532	5,177,499	5,245,660
Flood loss	393,036	-	393,036	-
Operating loss	(2,741,645)	(1,875,547)	(4,059,638)	(2,455,489)
Change in fair value of warrant liability	4,563	-	10,000	-
Interest income	16	12	56	46
Interest expense	(93,597)	(70,338)	(248,739)	(208,080)
Loss before income taxes	(2,830,663)	(1,945,873)	(4,298,321)	(2,663,523)
Income taxes	-	-	-	-
Net loss	\$(2,830,663)	\$(1,945,873)	\$(4,298,321)	\$(2,663,523)
Loss per share:				
Basic and diluted	\$(0.12)	\$(0.08)	\$(0.18)	\$(0.12)
Weighted-average shares outstanding:				
Basic and diluted	24,408,594	23,267,507	24,378,188	23,081,165

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

iPARTY CORP.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	For the nine months ended	
	Sept 24, 2011	Sept 25, 2010
Operating activities:		
Net loss	\$(4,298,321)	\$(2,663,523)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	898,672	818,489
Amortization	297,858	568,025
Deferred rent	(12,931)	(17,926)
Non-cash stock-based compensation expense	151,576	206,711
Loss on disposal of assets	34,432	-
Non-cash warrant expense	(7,173)	(1,925)
Change in fair value of warrants	(10,000)	-
Changes in operating assets and liabilities:		
Accounts receivable	(303,347)	(241,665)
Inventories	(6,536,039)	(7,461,483)
Prepaid expenses and other assets	(243,256)	(216,050)
Accounts payable and book overdrafts	5,972,673	7,595,689
Accrued expenses	221,189	(63,423)
Net cash used in operating activities	(3,834,667)	(1,477,081)
Investing activity:		
Purchase of property and equipment	(839,308)	(985,920)
Net cash used in investing activity	(839,308)	(985,920)
Financing activities:		
Net borrowings under line of credit	4,649,337	2,602,482
Principal payments on notes payable	-	(600,000)
Decrease in restricted cash	19,455	479,340
Principal payments on capital lease obligations	(6,920)	(6,921)
Proceeds from exercise of stock options	24,103	-
Net cash provided by financing activities	4,685,975	2,474,901
Net increase in cash	12,000	11,900
Cash beginning of period	62,650	61,050
Cash end of period	\$74,650	\$72,950
Supplemental disclosure of non-cash financing activities:		

Conversion of Series B convertible preferred stock to common stock	\$ 12,053	\$ 520,800
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The accompanying notes are an integral part of these Consolidated Financial Statements.

iPARTY CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 24, 2011
(Unaudited)

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES:

Interim Financial Information

The interim consolidated financial statements as of September 24, 2011 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 U.S. generally accepted accounting principles. The consolidated balance sheet at December 25, 2010 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, while the Company has generated losses in the first and third quarters. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. 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 25, 2010.

Principles of Consolidation

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

Revenue 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 to date.

Concentrations

The Company purchases its inventory from a diverse group of vendors. Seven suppliers accounted for approximately 49.8% of the Company's purchases of merchandise for the nine months ended September 24, 2011, but the Company does not believe that it is overly dependent upon any single source for its merchandise, often using more than one vendor for similar kinds of products. The Company entered into a Supply Agreement with its largest supplier, Amscan, Inc. ("Amscan") on August 7, 2006. Beginning with calendar year 2008, the Supply Agreement requires the Company to purchase on an annual basis merchandise equal to the total number of stores open, excluding temporary stores, during such calendar year, multiplied by \$180,000. The Supply Agreement provides for penalties in the event the Company fails to attain the annual purchase commitment that would require the Company to pay the difference between the purchases for that year and the annual purchase commitment for that year. Under the terms of the Supply Agreement, the annual purchase commitment for any individual year can be reduced for orders placed by the Company but not filled within a specified time period by the supplier. The Company's purchases for 2009 fell short of the required annual commitment by approximately \$368,000. The supplier agreed to allow the Company to roll over

any shortfall for the year 2009 into future years' requirements. The Company's purchases in 2010 exceeded the minimum purchase requirements for that year in addition to the 2009 shortfall. The Company is not aware of any reason that would prevent it from meeting the minimum purchase requirements during the remaining term of the Supply Agreement, which was extended until December 31, 2013 from the original expiration date of December 31, 2012. In addition, on December 30, 2010, the Company agreed with Party City Corporation ("Party City"), an affiliate of Amscan, to take over one Party City leased location in Manchester, Connecticut on March 1, 2011. As part of the store takeover, the Company entered into an amendment to that certain Asset Purchase Agreement dated August 7, 2006 with Party City to extend the term of the non-compete provisions with Party City and its affiliates contained in the Asset Purchase Agreement from August 7, 2011 until December 31, 2013 and to include the Manchester, Connecticut location as part of the restricted area in the non-compete provisions.

Accounts Receivable

Accounts receivable primarily represent amounts due from credit card companies and from 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 consolidated 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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Cash and Restricted Cash

The Company uses controlled disbursement banking arrangements as part of its cash management program. Outstanding checks, which were included in accounts payable and book overdrafts, totaled \$1,221,702 at September 24, 2011 and \$180,055 at December 25, 2010.

Restricted cash represents funds on deposit established for the benefit of and under the control of Wells Fargo Bank, National Association (successor by merger to Wells Fargo Retail Finance, LLC) ("Wells Fargo"), the Company's lender under its line of credit, and constitutes collateral for amounts outstanding under this line.

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 the Company's line of credit approximates the carrying value because the debt bears interest at a variable market rate. The fair value of the capital lease obligations approximates the carrying value. The fair value at December 25, 2010 of the warrants issued in 2006 was determined by using the Black-Scholes model (implied volatility of 40%, risk free rate of 0.2388% and expected life of 0.7233 years) after considering a probability weighted scenario in which the warrant exercise price adjustment scenario was deemed remote. These warrants expired on September 15, 2011. The fair value at September 24, 2011 of the warrants issued in 2008 was determined by using the Black-Scholes model (implied volatility of 80%, risk free rate of 0.23% and expected life of 1.43 years).

Inventories

Inventories consist of party supplies and are valued at the lower of moving weighted-average cost or market which approximates FIFO (first-in, first-out). The Company records vendor rebates, discounts and certain other adjustments to inventories, including freight costs, and these amounts are recognized in the income statement as the related goods are sold.

Net Loss per Share

Net loss per basic share is computed by dividing net loss available to common shareholders by the weighted-average number of common shares outstanding. The common share equivalents of Series B-F preferred stock are required to be included in the calculation of net loss per basic share in accordance with Accounting Standards Codification (ASC)

260-10-45, Earnings Per Share – Other Presentation Matters. Since the preferred stockholders are entitled to participate in dividends when and if declared by the Board of Directors on the same basis as if the shares of Series B-F preferred stock were converted to common stock, the application of ASC 260-10-45 has no effect on the amount of net income per basic share of common stock. For periods with net losses, the Company does not allocate losses to Series B-F preferred stock.

Net income (loss) per diluted share under ASC 260-10-45 is computed by dividing net income (loss) by the weighted-average number of common shares outstanding plus, if dilutive, the common share equivalents of Series B-F preferred stock on an as if-converted basis, 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.

The following table sets forth the computation of net loss per basic and diluted share available to common stockholders:

	For the three months ended		For the nine months ended	
	Sept 24, 2011	Sept 25, 2010	Sept 24, 2011	Sept 25, 2010
Common shares	\$(2,830,663)	\$(1,945,873)	\$(4,298,321)	\$(2,663,523)
Convertible preferred Series B-F	-	-	-	-
Net loss	\$(2,830,663)	\$(1,945,873)	\$(4,298,321)	\$(2,663,523)
Net loss per share				
Basic and diluted	\$(0.12)	\$(0.08)	\$(0.18)	\$(0.12)
Weighted-average shares outstanding:				
Common shares - basic	24,408,594	23,267,507	24,378,188	23,081,165
Common share equivalents of Series B-F convertible preferred stock	-	-	-	-
If - converted weighted-average shares outstanding	24,408,594	23,267,507	24,378,188	23,081,165

The common stock equivalents of Series B-F preferred stock calculated on an if converted basis totaled 14,847,891 and 14,891,744 shares for the three months ended and 14,934,797 and 15,135,195 shares for the nine months ended September 24, 2011 and September 25, 2010, respectively. These share amounts have been excluded from net loss per share since their impact would have been anti-dilutive.

The common share equivalents of “out of the money” stock options and warrants which were also excluded from the computation of net loss per diluted share available to common stockholders were 5,544,605 and 1,488,889 in the third quarter of 2011 and 4,595,365 and 2,183,334 in the third quarter of 2010, respectively. The common share equivalents of “out of the money” stock options and warrants which were excluded from the computation of net loss per diluted share available to common stockholders were 5,750,805 and 2,114,653 for the nine months ended September 24, 2011 and 4,256,847 and 2,183,334 for the nine months ended September 25, 2010, respectively.

Stock-Based Compensation Expense

The Company uses the Black-Scholes option pricing model to determine the fair value of stock-based compensation. The Black-Scholes model requires the Company to make several subjective assumptions, including the estimated length of time employees will retain their vested stock options before exercising them (“expected term”), and the estimated volatility of the Company’s common stock price over the expected term, which is based on historical volatility of the Company’s common stock over a time period equal to the expected term. The Black-Scholes model also requires a risk-free interest rate, which is based on the U.S. Treasury yield curve in effect at the time of the grant, and the dividend yield on the Company’s common stock, which is assumed to be zero since the Company does not pay dividends and has no current plans to do so in the future. Changes in these assumptions can materially affect the

estimate of fair value of stock-based compensation and consequently, the related expense recognized in the consolidated statements of operations. The Company recognizes stock-based compensation expense on a straight-line basis over the vesting period of each grant.

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The stock-based compensation expense recognized by the Company was:

	For the three months ended		For the nine months ended	
	Sept 24, 2011	Sept 25, 2010	Sept 24, 2011	Sept 25, 2010
Stock-based compensation expense	\$ 39,506	\$ 94,182	\$ 151,576	\$ 206,711

Stock-based compensation expense is included in general and administrative expense and had no impact on cash flow from operations and cash flow from financing activities for the three months ended September 24, 2011 or September 25, 2010 or for the nine month periods then ended.

On May 27, 2009, the Company's stockholders approved a new equity incentive plan entitled the 2009 Stock Incentive Plan (the "2009 Plan"). The Company no longer grants equity awards under its former equity incentive plan, the Amended and Restated 1998 Incentive and Nonqualified Stock Option Plan (the "1998 Plan" and with the 2009 Plan, the "Plans").

Under the Company's Plans, options to acquire shares of common stock may be granted to officers, directors, key employees and consultants. Under the 2009 Plan, the exercise price for qualified incentive options and non-qualified options cannot be less than the fair market value of the stock on the grant date, as determined by the Company's Board of Directors. In addition, under the 2009 Plan, other stock-based and performance awards may be granted to officers, directors, key employees and consultants, including stock appreciation rights, restricted stock, and restricted stock units. Under the Plans, a combined total of 11,000,000 shares of common stock or other stock based awards may be granted. To date, the Company has only issued options for shares under its Plans, which have been granted to employees, directors and consultants of the Company at fair market value at the date of grant. Of the options that have been issued, options for 1,548,751 shares have been exercised and options for 7,571,510 shares remain outstanding at September 24, 2011. Generally, employee options become exercisable over periods of up to four years, and expire ten years from the date of grant.

At the annual Board of Directors meetings following the Company's annual stockholders meetings, the Company granted options to its key employees, including its CEO and CFO, and independent directors as follows: (i) 817,100 options for the purchase of shares of common stock on June 10, 2011 at an exercise price of \$0.28 per share, and (ii) 502,320 options for the purchase of shares of common stock on June 2, 2010 at an exercise price of \$0.30 per share. Also, the Company granted options for the purchase of an aggregate of 165,000 shares of common stock to key employees on March 11, 2010 at an exercise price of \$0.41 per share. The fair value using the Black-Scholes option pricing model of the options granted on June 10, 2011 was \$0.23 per share, \$0.25 per share for the options granted on June 2, 2010, and \$0.34 per share for the options granted on March 11, 2010. The exercise prices for each of the option grants made in 2010 and 2011 was equal to the grant date closing price of the Company's common stock as reported on the NYSE Amex.

On April 1, 2010, in accordance with the related provisions of new employment contracts executed as of that date, options to purchase 720,000 shares of common stock granted on May 27, 2009 to the Company's Chief Executive Officer and Senior Vice President – Merchandising and Marketing were accelerated and became fully vested. The acceleration of the options resulted in immediate recognition of expense in the amount of \$48,204. In addition, on July 1, 2010, the Company granted options for the purchase of 675,000 shares of common stock to these two executives, pursuant to their new employment contracts, at an exercise price of \$0.27 per share. One third of each of these executives' options vested on July 1, 2010, the grant date, with the remaining options vesting as to one third on each of the next two grant date anniversaries. The fair value using the Black-Scholes option pricing model of the July 1, 2010 executive options was \$0.22 per share.

The weighted average fair value of the options at the date of the grant was estimated using the Black-Scholes option-pricing model with the following weighted average assumptions:

	For the three months ended			For the nine months ended		
	Sept 24, 2011	Sept 25, 2010		Sept 24, 2011	Sept 25, 2010	
Risk-free interest rate	N/A	1.80	%	0.76	2.00	%
Expected volatility	N/A	110.39	%	114.23	109.16	%
Weighted average expected life (in years)	N/A	5.75		5.27	6.00	
Expected dividends	N/A	0.00	%	0.00	0.00	%

A summary of the Company's stock options is as follows:

	Number of Stock Options	Weighted Average Exercise Price	Price Range	Weighted Average Remaining Life (Years)	Aggregate Intrinsic Value
Outstanding - December 25, 2010	9,023,357	\$ 0.38	\$ 0.07 - \$ 1.33		
Granted	817,100	0.28	- 0.28		
Expired/forfeited	(2,165,697)	0.26	0.20		