IPARTY CORP
Form 10-Q
August 13, 2001

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-QSB

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

For the quarterly period ended June 30, 2001

OR

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

For the transition period from ________________________ to _____________________

Commission File No. 0-25507

iPARTY CORP.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware | 13-4012236 |
| (State or other jurisdiction of incorporation of organization) | (IRS Employer Identification No.) |
| 1457 VFW Parkway West Roxbury, MA | 02132 |
| (Address of principal executive offices) | (Zip Code) |

Registrant's telephone number, including area code: (617) 323-0822

(Former name or former address, if changed since last report.)

Check whether the Issuer (1) 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 X No ___

Transitional small business disclosure format

Yes No X

On August 8, 2001 there were 13,574,095 shares of the Registrant's common stock, $.001 par value, issued and outstanding.

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iPARTY CORP.

Quarterly Report on Form 10-QSB

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iParty Corp.
Consolidated Balance Sheets

| | June 30, 2001 |
|---|---|
| ASSETS | (Unaudite |

| | |
|---|---|
| Current assets: | |
| Cash and cash equivalents | $ 3,354,18 |
| Cash, restricted | 155,56 |
| Accounts receivable | 522,35 |
| Inventory | 9,386,74 |
| Prepaid expenses and other current assets | 727,68 |
| Total current assets | 14,146,53 |
| Property and equipment, net | 786,37 |
| Other assets | 194,66 |
| Total assets | $ 15,127,58 |

LIABILITIES AND STOCKHOLDERS' EQUITY

| | |
|---|---|
| Current liabilities: | |
| Accounts payable | $ 3,324,01 |
| Accrued severance and restructuring expenses | 99,82 |
| Accrued expenses | 1,858,67 |
| Line of credit | 3,459,68 |
| Total current liabilities | 8,742,20 |
| Other liabilities: | 614,23 |
| Total liabilities | 9,356,44 |
| Commitments and contingencies | |
| Stockholders' equity: | |
| Preferred stock - $.001 par value; 10,000,000 shares authorized; Series A preferred stock - 1,000,000 shares authorized, issued and outstanding | 1,00 |
| Series B preferred stock - 1,413,352 authorized; 1,291,748 and 1,413,352 shares issued and outstanding as of June 30, 2001 and December 30, 2000, respectively | 1,29 |
| Series C preferred stock - 145,198 shares authorized, issued and outstanding | 14 |
| Series D preferred stock - 362,996 shares authorized, issued and outstanding | 36 |
| Series E preferred stock - 533,333 shares authorized, issued and outstanding | 53 |
| Series F preferred stock - 114,286 shares authorized, issued and outstanding | 11 |
| Common stock - $.001 par value; 150,000,000 shares authorized; 13,390,785 and 12,174,745 shares issued and outstanding as of June 30, 2001 and December 30, 2000, respectively | 13,39 |
| Additional paid in capital | 64,365,52 |
| Accumulated deficit | (58,611,22 |
| Total stockholders' equity | 5,771,13 |
| Total liabilities and stockholders' equity | $ 15,127,58 |

The accompanying Notes are an interal part of these Consolidated Fin
Statements



iParty Corp.
Consolidated Statements of Operations

| | For the three months ended June 30, 2001 (Unaudited) | For the three months ended June 30, 2000 (Unaudited) | For the six months June 30, 2001 (Unaudited) | ( |
|---|---|---|---|---|
| Revenues | $ 12,250,177 | $ 259,852 | $ 21,198,479 | $ |
| Operating costs: | | | | |
| Cost of products sold | 7,192,259 | 375,363 | 12,930,120 | |
| Amortization of partner warrant | -- | 377,744 | -- | |
| Marketing and sales | 3,652,970 | 2,563,555 | 6,907,395 | |
| Product and technology development | 565,032 | 1,664,788 | 1,092,472 | |
| General and administrative | 905,678 | 549,544 | 1,851,535 | |
| Restructuring income | (122,534) | -- | (122,534) | |
| Non-cash compensation expense | 114,138 | 88,777 | 199,628 | |
| Operating loss | (57,366) | (5,359,919) | (1,660,137) | ( |
| Interest income | 33,980 | 226,679 | 87,049 | |
| Interest Expense | (146,357) | -- | (279,904) | |
| Net loss | $ (169,743) | $ (5,133,240) | $ (1,852,992) | $( |
| Loss per share: | | | | |
| Basic and diluted | $ (0.01) | $ (0.46) | $ (0.14) | $ |
| Weighted Average Shares Outstanding: | | | | |
| Basic and diluted | 13,036,082 | 11,136,107 | 12,873,160 | |

The accompanying Notes are an interal part of these Consolidated Fin
Statements

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iParty Corp.
Consolidated Statements of Cash Flows

Cash flows from operating activities:

Net loss

Adjustments to reconcile net loss to
net cash used in operating activities:
Depreciation and amortization
Non-cash compensation expense
Decrease (increase) in:
Accounts receivable
Inventory
Prepaid expenses and other current assets
Other assets
Increase (decrease) in:
Accounts payable
Accrued severance and restructuring expenses
Accrued expenses
Other liabilities

Net cash used in operating activities

Cash flows from investing activities:

Purchase of property and equipment
Purchase of marketable securities
Decrease in restricted cash

Net cash provided by (used in) investing activities

Cash flows from financing activities:

Net borrowings from line of credit,
Payments on capital lease obligations
Net cash provided by financing activities

Net decrease in cash and cash equivalents

Cash and cash equivalents, beginning of period

Cash and cash equivalents, end of period

Cash paid for:
Interest expense

Income taxes

Supplemental disclosure of non-cash financing activities:
Conversion of Series B preferred stock to common stock

Acquisition of assets under capital lease

The accompanying Notes are an interal part of these Consolidated Fin
Statements



iPARTY CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2001
(Unaudited)

1. THE COMPANY:

iParty LLC was created on December 11, 1997 to launch an Internet-based merchant of party goods and services and commenced operations in January 1998. On March 12, 1998, iParty Corp. was organized as a wholly owned subsidiary of iParty LLC and the net assets and operations of iParty LLC were transferred to iParty Corp. On April 9, 1998, StarGreetings, Inc. ("Star") was incorporated as a wholly owned subsidiary of iParty Corp. to develop and operate a personalized celebrity greeting service.

Effective July 2, 1998, iParty Corp. ("iParty" or the "Company") merged into WSI Acquisition Corp. ("WSI"), an inactive company. The merger was consummated through an exchange of shares that resulted in iParty LLC receiving 6,000,000 common shares or 54.5% of the outstanding shares of WSI. In connection with the merger and as a condition thereof, WSI sold, in two private placements, an aggregate of 4,585,000 shares of its common stock of which 3,624,043 shares were sold for $.01 per share and 960,957 shares, together with warrants to purchase 1,000,000 shares of Series A preferred stock, were sold for $1.00 per share or aggregate proceeds of $997,197 before related expenses. The merger was treated as a re-capitalization for accounting purposes and iParty's historic capital accounts were retroactively adjusted to reflect the 6,000,000 shares issued by WSI in the transaction. In addition, as WSI had no assets before the merger and the private placements, the 420,421 outstanding common shares of WSI were recorded at par value with a corresponding charge to additional paid-in capital. In connection with the merger, WSI changed its name to iParty Corp.

On August 3, 2000, iParty Retail Stores Corp. ("iParty Retail") was incorporated as a wholly owned subsidiary of iParty Corp. to operate a chain of retail stores selling party goods. On August 15, 2000, iParty Retail acquired inventory, fixed assets and the leases of 33 retail stores from The Big Party Corporation ("The Big Party") in consideration of cash and assumption of certain liabilities. The Big Party filed for bankruptcy protection during the second quarter of 2000 and the acquisition was approved by the United States Bankruptcy Court, District of Delaware.

The Company's efforts are devoted to the sale of party goods and services through retail stores and the Internet.

2. UNAUDITED INTERIM FINANCIAL INFORMATION:

The interim consolidated financial statements as of June 30, 2001 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 30, 2000 has been derived from the audited consolidated financial statements at that date. Operating results for the three and six months ended June 30, 2001 may not be indicative of the results for the year ending December 29, 2001. 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-KSB for the year ended December 30, 2000.

3. CREDIT ARRANGEMENT:

On August 1, 2000, the Company established a line of credit with a bank. The agreement permits maximum borrowings equal to the lesser of $7,500,000

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or the borrowing base, as defined. Interest on the line of credit for the first $5,000,000 borrowed ("Line Interest Rate") is payable at the greater of the bank's base rate (6.75% at June 30, 2001) plus 1% or 7.75%. Interest on the sub-line borrowing, money borrowed between $5,000,000 and $7,500,000, is payable at the bank rate plus 2%. The agreement also provides for a Commitment Fee of 1% or $75,000 and an Annual Facility Fee of 0.5% per annum of the maximum amount of the special sub-line. This agreement expires on July 31, 2003. As of June 30, 2001, the Company had $3,459,687 outstanding and an additional $2.4 million available under the line of credit

In March 2001, the Company and its lender modified the borrowing facility by adjusting certain covenants and other provisions based on the Company's operating plan for 2001. As of June 30, 2001, the Company was in compliance with the adjusted covenants.

4. SEGMENT REPORTING:

SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information." establishes standards for the way business enterprises report information about operating segments in annual financial statements and requires that those enterprises report selected information about operating segments in interim financial reports issued to shareholders.

Operating segments represent components of the Company's business that are evaluated regularly by management in assessing the performance and resource allocation. The Company has determined that its reportable segments consist of retail operations and Internet operations.

The retail operations include the sales and related expenses from 33 retail stores located throughout New England and Florida with the highest concentration of 18 stores in Massachusetts; five are located in Connecticut, three in Rhode Island, three in New Hampshire, one in Maine and three in Florida.

The Internet operations include the sales and related expenses from the Internet and the Company's off line catalog.

The reporting segments follow the same accounting policies used for the Company's consolidated financial statements and are described in the Company's Form 10-KSB. Management evaluates a segment's performance based upon net revenue, operating income (loss) and net loss. Inter-segment transactions are uncommon and not material. Therefore, they have not been separately reflected in the financial table below. The totals of the reportable segments' revenues, net profits and assets agree with the Company's comparable amounts contained in the financial statements. Revenues from customers outside of the United States are not material. No one customer accounts for more than 10% of the Company's consolidated revenues.

The Company's financial data for segment reporting for the three and six months ended June 30, 2001 are as follows

| | Three months ended June 30, | | | |
|---|---|---|---|---|
| | 2001 | | | |
| | Internet | Retail | Total | Intern |
| Net revenue | $ 242,702 | $ 12,007,475 | $ 12,250,177 | $ |
| Operating Loss | $ (251,353) | $ 193,987 | $ (57,366) | $ (5 |
| Net loss | $ (222,982) | $ 53,239 | $ (169,743) | $ (5 |
| Total assets | $ 3,447,335 | $ 11,313,213 | $ 14,760,548 | $ 16 |

| | | | | |
|---|---|---|---|---|
| Deprec/amort | $ 120,598 | $ 27,860 | $ 148,458 | $ |
| Capital exp | $ -- | $ 115,521 | $ 115,521 | $ |



| | Six Months ended June 30 2001 | | | Six Mon |
|---|---|---|---|---|
| | Internet | Retail | Total | Internet |
| Net revenue | $ 489,504 | $ 20,708,975 | $ 21,198,479 | $ 406,685 |
| Operating Loss | $ (666,992) | $ (993,145) | $ (1,660,137) | $ (11,097,117) |
| Net loss | $ (593,404) | $(1,259,588) | $ (1,852,992) | $ (10,596,984) |
| Total assets | $ 3,447,335 | $ 11,313,213 | $ 15,127,580 | $ 16,343,053 |
| Deprec/amort | $ 241,196 | $ 42,128 | $ 286,324 | $ 1,498,952 |
| Capital exp | $ 2,025 | $ 124,321 | $ 126,346 | $ 337,458 |

5. ACQUISITION:

On August 15, 2000, the Company, through its wholly-owned subsidiary, iParty Retail, pursuant to an Asset Purchase Agreement, acquired certain assets from The Big Party. The Company acquired inventory, fixed assets and the leases of 33 retail stores from The Big Party in consideration of cash and assumption of certain liabilities. This transaction was accounted for as a purchase in accordance with APB No. 16, Accounting for Business Combinations and, accordingly, the results of The Big Party since August 15, 2000 have been included in the Company's statement of operations. The purchase price was allocated to the acquired assets as follows:

Purchase price:

| | |
|---|---|
| Cash paid | $ 3,975,000 |

| | |
|---|---|
| Payable to seller | 650,000 |
| Accrued transaction costs | 235,000 |
| Total purchase price | $ 4,860,000 |
| Net tangible assets acquired: | |
| Inventory | $ 4,860,000 |

In addition to acquiring inventory, iParty purchased leasehold improvements at the acquired stores. The fair value of the acquired inventory and leaseholds exceeded the purchase price. As a result, due to the fact that the purchase price approximated the fair value of the inventory, no value could be assigned to the long-term assets.

Unaudited pro forma results of operations for the three and six months ended June 30, 2000 as if iParty and The Big Party had been combined as of January 1, 2000 follow. The pro forma results include estimates and assumptions which management believes are reasonable. The pro forma financial information is not necessarily indicative of the operating results that would have occurred had the acquisition occurred as of the dates indicated, nor are they necessarily indicative of future operating results.

| | Three months ended June 30, | | S |
|---|---|---|---|
| | | (Proforma) | |
| | 2001 | 2000 | 20 |
| Revenue | $ 12,250,177 | $ 11,631,918 | |
| Operating loss | $ (57,366) | $ (6,958,613) | |
| Net loss | $ (169,743) | $ (6,360,734) | |
| Loss per share: | | | |
| Basic and diluted | $ (0.01) | $ (0.57) | |
| Weighted average shares: | | | |
| Basic and diluted | 13,036,082 | 11,136,107 | |



6. EARNINGS PER SHARE:

The Company has computed net income (loss) per share in accordance with SFAS No. 128, Earnings per Share. Under the provisions of SFAS No. 128, basic net income (loss) per common share ("Basic EPS") is computed by dividing net income (loss) by the weighted average number of common shares outstanding. Diluted net income (loss) per common share ("Diluted EPS") is computed by dividing net income (loss) by the weighted average number of common shares and dilutive common share equivalents then outstanding using the treasury-stock method.

As of June 30, 2001 and June 30, 2000, 49,289,411 and 32,579,193 potential common shares were outstanding, respectively, but not included in earnings per share calculation as their effect would have been anti-dilutive.

7. RESTRUCTURING COSTS:

In fiscal 2000, the Company decided to close its New York City headquarters and transfer this operation to its Boston, Massachusetts location. As part of operating expenses, the Company recorded $1,093,328 of restructuring expenses related to this facility closure in 2000. These costs were primarily related to severance for a group of employees and other exit costs related to closing the New York facility.

| | Severance | Other | Total |
|---|---|---|---|
| Balance at December 30, 2000 | $ 406,874 | $ 368,263 | $ 775, |
| Amounts paid in 2001 | $(406,874) | $(145,901) | $(552, |
| Excess of amounts provided | $ - | $(122,534) | $(122, |
| Balance at June 30 2001 | $ - | $ 99,828 | $ 99 |

During the quarter ended June 30, 2001, due to the substantial completion of the actions of the 2000 restructuring plan, the Company reevaluated its 2000 restructuring accrual. As a result of this review certain costs associated with the close of the New York City headquarters were no longer required. This resulted from the elimination of certain planned actions as well as the Company successfully negotiating certain closing costs. As such, the Company has recognized a restructuring credit of $122,534, which affected the Internet segment. This credit is reflected in "Restructuring income" in the Consolidated Statements of Operations.

The remainder of the reserve represents exit costs related to closing and vacating the facility. Such costs are expected to be incurred during the second half of 2001.

8. COMMITMENTS AND CONTINGENCIES:

Legal proceedings:

The Company is a defendant in one lawsuit that is being handled in the ordinary course of business. Pursuant to an Asset Purchase Agreement dated August 2, 2000, as amended, the Company purchased from The Big Party Corporation, Debtor and Debtor-in-Possession, 33 retail locations and the assets located therein, including inventory. The Company and The Big Party are in disagreement concerning the value and amount due on account of the inventory and The Big Party is claiming that $625,568 is due. In addition, the parties set up a $100,000 escrow of funds paid under the agreement as security for rental payments and other adjustments due, and the parties are in discussions concerning the portion thereof which belongs to the Company. The Big Party filed a complaint with the U.S. Bankruptcy Court for the District of Delaware in January 2001 seeking payment of $625,568 on account of the inventory. The Company is disputing the amount claimed and intends to file an answer and a possible counterclaim for amounts due on account of the escrow referred to above. The Company is also in negotiations with The Big Party seeking to reach an agreeable compromise. This matter is in the preliminary stages. In the opinion of the management of the Company, the Company is adequately reserved and this should not result in final judgement or settlement that would have a material adverse effect on the Company's financial condition or results of operations.

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Safe Harbor Statement:

Certain statements in this Form 10-QSB, including information set forth under Item 2 "Management's Discussion and Analysis" constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 (the "Act"). The words "anticipates," "believes," "estimates," "expects," "plans," "intends" and other similar expressions are intended to identify these forward-looking statements, but are not the exclusive means of identifying them. We desire to avail ourselves of certain "safe harbor" provisions of the Act and are therefore including this special note to enable us to do so. Forward-looking statements included in this Form 10-QSB or hereafter included in other publicly available documents filed with the Securities and Exchange Commission, reports to our stockholders and other publicly available statements issued or released by us involve known and unknown risks, uncertainties, and other factors which could cause our actual results, performance (financial or operating) or achievements to differ from the future results, performance (financial or operating) achievements expressed or implied by such forward looking statements. Such future results are based upon our best estimates based upon current conditions and the most recent results of operations. Various risks, uncertainties and contingencies could cause our actual results, performance or achievements to differ materially from those expressed in, or implied by, these statements, including, but not limited to, the following: the success or failure of our efforts to implement our business strategy; our inability to obtain additional financing, if required; third-party suppliers failure to fulfill their obligations to us; intense competition; the failure of our systems or those of our third-party suppliers; and government regulation of the Internet.

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Item 2. Management's Discussion and Analysis

Overview:

The Company intends to become the premier multi-channel party supply resource with distribution on-line, through catalogs and in retail stores.

The Company's web site was launched in February 1999. On October 12, 1999, the Company launched the new iParty.com site, a destination for party goods and party planning. From Pokemon costumes to birthday party packs to fog machines, an online party magazine to party safety tips, iParty.com presents consumers with what it believes to be a sophisticated, yet fun and easy-to-navigate online party resource. Offering convenience and an extensive assortment of merchandise, the Company believes iParty.com is refocusing the party goods industry back to the needs of the consumer. At the click of a mouse, party givers can enjoy one-stop shopping and easy-to-find pricing while purchasing all their party needs for birthday bashes, Super Bowl and Halloween parties and more.

In April 2000, the Company launched its catalogue operation, specializing in the seasonal party needs of the consumer.

On August 15, 2000 iParty Retail Stores Corp. purchased assets consisting of 33 store leases, fixtures and inventory from The Big Party Corporation. This enabled the Company to set up retail operations and to become a multi-channel outlet for party supplies.

Results of Operations:

Three months ended June 30, 2001 compared to three months ended June 30, 2000

Revenue includes the selling price of party goods sold, net of returns and discounts, as well as outbound shipping and handling charges. Revenue is recognized at the time of sale for retail sales and at the time products are shipped to customers for Internet sales. Consolidated revenue for the three months ended June 30, 2001 and 2000 were $12,250,177 and $259,852 respectively. For the three months ended June 30, 2001 revenue from retail stores totaled $12,007,475 and revenue from the Internet totaled $242,702. For the three months ended June 30, 2000 revenue from the retail stores totaled $0 and revenue from the Internet totaled $259,852. The 7% decrease in Internet sales is due to decreased traffic and revenue from new customers compared to the three months ended June 30, 2000. During the period ended June 30, 2000, the Company aggressively acquired new customers with several coupon promotions. Although these promotions were successful in acquiring new customers, they resulted in a negative gross margin of 44% for the quarter.

Cost of products sold consists of the cost of merchandise sold to customers, store rent, warehousing costs, and outbound shipping and handling costs charged to the Company by its fulfillment partner, Taymark. Consolidated cost of products sold for the three months ended June 30, 2001 and 2000 was $7,192,259 or 59% of revenue and $375,363 or 144% of revenue respectively. For the three months ended June 30, 2001 cost of products sold from the retail stores totaled $7,022,264 or 58% of revenue and cost of products sold from the Internet totaled $169,995 or 70% of revenue. For the three months ended June 30, 2000 cost of products sold from the retail stores totaled $0 and cost of products sold from the Internet totaled $375,363 or 144% of revenue. During the period ended June 30, 2000, the Company aggressively acquired new customers with several coupon promotions. Although these promotions were successful in acquiring new customers, they resulted in a negative gross margin of 44% for the quarter.

Amortization of fulfillment partner warrant expense consists of the amortization of the estimated fair value of the warrant issued to Taymark to provide inventory and fulfillment services to deliver merchandise ordered on the site, or directly through a toll-free telephone number, directly to consumers. On July 8, 1999, the Company entered into a product fulfillment agreement with Taymark. The initial term of the agreement runs through December 31, 2002. The agreement contains certain restrictions on competition by the direct marketer. As additional consideration for such restrictions and services, the Company issued a warrant to purchase 3,000,000 shares of common stock at an exercise price of $3.75. The warrant expires on October 1, 2002. The estimated fair value of the warrant on the date of issue was approximately $5.3 million as determined using the Black-Scholes option pricing model. On December 30, 2000 it was determined that the Company had not met certain purchase requirements for the year as outlined in the agreement with Taymark. As a result of this shortfall, the restrictions on competition by Taymark as outlined in the agreement were lifted rendering the remaining unamortized value of the warrant worthless. Therefore, the remaining balance of $3,021,954 was charged to expense. For the three months ended June 30, 2001 and 2000 amortization of fulfillment partner warrant expense was $0 and $377,744, respectively.

Marketing and sales expenses consist primarily of advertising, public relations and promotional expenditures, and all related payroll and related expenses for personnel engaged in marketing and selling activities, including store payroll. Consolidated marketing and sales expenses for the three months ended June 30, 2001 and 2000 were $3,652,970 and $2,563,555 respectively. For the three months ended June 30, 2001, marketing and sales expenses for retail stores totaled $3,650,397 and marketing and sales expenses for the Internet totaled $2,573. For the three months ended June 30, 2000 marketing and sales expenses for retail stores totaled $0 and marketing and sales expenses for the Internet totaled $2,563,555. Included in the marketing and sales expenses for the Internet for 2000 was $135,000 resulting from the amortization of the Margaritaville warrant. The decrease in marketing spending for the Internet was related to lower cost per acquisition in 2001.

Product and technology development expenses consist principally of payroll and related expenses for product development, editorial, systems and operations personnel and consultants, and systems infrastructure related to the Company's Internet site. Product and technology development expenses for the three months ended June 30, 2001 and 2000 were $565,032 and $1,664,788, respectively. The decrease in product and technology development expenses is due to the transition from a site development phase in 2000 to a site maintenance phase in 2001.

General and administrative ("G&A") expenses consist of payroll and related expenses for executive, finance and administrative personnel, professional fees and other general corporate expenses. Consolidated G&A expenses for the three months ended June 30, 2001 and 2000 were $905,678 and $549,544, respectively. The increase in G&A expenses is due to the additional staff required to manage the retail stores.

Restructuring income consists of the excess of amounts provided to close our New York office over actual expenses incurred. During the quarter ended June 30, 2001, due to the substantial completion of the actions of the 2000 restructuring plan, the Company reevaluated its 2000 restructuring accrual. As a result of this review certain costs associated with the close of the New York City headquarters were no longer required. This resulted from the elimination of certain planned actions as well as the Company successfully negotiating certain closing costs. As such, the Company has recognized a restructuring credit of $122,534, which affected the Internet segment. This credit is reflected in "Restructuring income" in the Consolidated Statements of Operations.

The non-cash compensation expenses consist of the amortization of stock options granted to consultants related to the Internet operation. Non-cash compensation expenses for the three months ended June 30, 2001 and 2000 was $114,138 and $88,777, respectively.

Interest income on cash and cash equivalents for the three months ended June 30, 2001 and 2000, was $33,980 and $226,679, respectively. The decrease in interest income is due to higher cash and investment balance in 2000 resulting from the Company's financing activities, principally the private placement of Series B, C, and D Convertible Preferred Stock completed in 1999.

Interest expense for the three months ended June 30, 2001 and 2000, was $146,357 and $0, respectively. The interest expense in 2001 was related to the iParty Retail line of credit.

Six months ended June 30, 2001 compared to six months ended June 30, 2000:

Revenue includes the selling price of party goods sold, net of returns and discounts, as well as outbound shipping and handling charges. Revenue is

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recognized at the time of sale for retail sales and at the time products are shipped to customers for Internet sales. Consolidated revenue for the six months ended June 30, 2001 and 2000 were $21,198,479 and $406,685, respectively, For the six months ended June 30, 2001 revenue from retail stores totaled $20,708,975 and revenue from the Internet totaled $489,504. For the six months ended June 30, 2000 revenue from the retail stores totaled $0 and revenue from the Internet totaled $406,685. The 20% increase in Internet sales is due to increased traffic and revenue from repeat customers.

Cost of products sold consists of the cost of merchandise sold to customers, store rent, warehousing costs, and outbound shipping and handling costs charged to the Company by its fulfillment partner, Taymark. Consolidated cost of products sold for the six months ended June 30, 2001 and 2000 was $12,930,120 or 61% of revenue and $492,720 or 121% of revenue respectively. For the six months ended June 30, 2001 cost of products sold from retail stores totaled $12,551,261 or 61% of revenue and cost of products sold from the Internet totaled $378,859 or 77% of revenue. For the six months ended June 30, 2000 cost of products sold from the retail stores totaled $0 and cost of products sold from the Internet totaled $492,720 or 121% of revenue.

Amortization of fulfillment partner warrant expense consists of the amortization of the estimated fair value of the warrant issued to Taymark to provide inventory and fulfillment services to deliver merchandise ordered on the site, or directly through a toll-free telephone number, directly to consumers. On July 8, 1999, the Company entered into a product fulfillment agreement with Taymark. The initial term of the agreement runs through December 31, 2002. The agreement contains certain restrictions on competition by the direct marketer. As additional consideration for such restrictions and services, the Company issued a warrant to Taymark to purchase 3,000,000 shares of common stock at an exercise price of $3.75. The warrant expires on October 1, 2002. The estimated fair value of the warrant on the date of issue was approximately $5.3 million as determined using the Black-Scholes option pricing model. On December 30, 2000 it was determined that the Company had not met certain purchase requirements for the year as outlined in the agreement with Taymark. As a result of this shortfall, the restrictions on competition by Taymark as outlined in the agreement were lifted rendering the remaining unamortized value of the warrant worthless. Therefore, the remaining balance of $3,021,954 was charged to expense. For the six months ended June 30, 2001 and 2000 amortization of fulfillment partner warrant expense was $0 and $755,488, respectively.

Marketing and sales expenses consist primarily of advertising, public relations and promotional expenditures, and all related payroll and related expenses for personnel engaged in marketing and selling activities, including store payroll. Consolidated marketing and sales expenses for the six months ended June 30, 2001 and 2000 were $6,907,395 and $4,979,563, respectively. For the six months ended June 30, 2001, marketing and sales expenses for retail stores totaled $6,870,837 and marketing and sales expenses for the Internet totaled $36,558. For the six months ended June 30, 2000 marketing and sales expenses for retail stores totaled $0 and marketing and sales expenses for the Internet totaled $4,979,563. Included in the marketing and sales expenses for the Internet for 2000 was $270,000 resulting from the amortization of the Margaritaville warrant. The decrease in marketing spending for the Internet was related to lower cost per acquisition in 2001.

Product and technology development expenses consist principally of payroll and related expenses for product development, editorial, systems and operations personnel and consultants, and systems infrastructure related to the Company's Internet site. Product and technology development expenses for the six months ended June 30, 2001 and 2000 were $1,092,472 and $3,562,532, respectively. The decrease in product and technology development expenses is due to the transition from a site development phase in 2000 to a site maintenance phase in 2001.

General and administrative ("G&A") expenses consist of payroll and related expenses for executive, finance and administrative personnel, professional fees and other general corporate expenses. Consolidated G&A expenses for the six months ended June 30, 2001 and 2000 were $1,851,535 and $1,078,453 respectively. The increase in G&A expenses is due to the additional staff required to manage the retail stores.

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Restructuring income consists of the excess of amounts provided to close our New York office over actual expenses incurred. During the quarter ended June 30, 2001, due to the substantial completion of the actions of the 2000 restructuring plan, the Company reevaluated its 2000 restructuring accrual. As a result of this review certain costs associated with the close of the New York City headquarters were no longer required. This resulted from the elimination of certain planned actions as well as the Company successfully negotiating certain closing costs. As such, the Company has recognized a restructuring credit of $122,534, which affected the Internet segment. This credit is reflected in "Restructuring income" in the Consolidated Statements of Operations.

The non-cash compensation expense consists of the amortization of stock options granted to consultants related to the Internet operation. Non-cash compensation expense for the six months ended June 30, 2001 and 2000 was $199,628 and $634,596, respectively. In February 2000, certain employees exercised stock options on a cash-less basis resulting in $460,000 of non-cash compensation.

Interest income on cash and cash equivalents for the six months ended June 30, 2001 and 2000, was $87,049 and $500,133, respectively. The decrease in interest income is due to higher cash and investment balance in 2000 resulting from the Company's financing activities, principally the private placement of Series B, C, and D Convertible Preferred Stock completed in 1999.

Interest expense for the six months ended June 30, 2001 and 2000, was $279,904 and $0, respectively. The interest expense in 2001 was related to the iParty Retail line of credit.

Liquidity and Capital Resources:

The Company used cash in operating activities for the six months ended June 30, 2001 and 2000 totaling $2,537,370 and $7,173,606, respectively. In addition, the Company invested cash in property and equipment, including web site development expenditures for the six months ended June 30, 2001 and 2000 totaling $126,346 and $337,458, respectively. The Company also used $658,897 of its bank line to fund our working capital and capital expenditures in the six months ended June 30, 2001.

To date, the Company has raised an aggregate of $32.9 million in equity financing. On August 1, 2000, the Company established a line of credit with a bank. The agreement permits maximum borrowings equal to the lesser of $7,500,000 or the borrowing base, as defined. Interest on the line of credit for the first $5,000,000 borrowed ("Line Interest Rate") is payable at the greater of the bank's base rate (6.75% at June 30, 2001) plus 1% or 7.75%. Interest on the sub-line borrowing, money borrowed between $5,000,000 and $7,500,000, is payable at the bank rate plus 2%. The agreement also provides for a Commitment Fee of 1% or $75,000 and an Annual Facility Fee of 0.5% per annum of the maximum amount of the special sub-line. This agreement expires on July 31, 2003. As of June 30, 2001, the Company had $3,459,687 outstanding under the line of credit.

In March 2001, the Company and its lender modified the borrowing facility by adjusting certain covenants and other provisions based on the Company's operating plan for 2001. As of June 30, 2001, the Company was in compliance with the adjusted covenants.

The Company believes, based on currently proposed plans and assumptions relating to its operations, that the net proceeds from the financings and related interest income, together with anticipated revenues from operations and the line of credit, will be sufficient to fund its operations and working capital requirements for at least twelve months. In the event that the Company's plans or assumptions change or prove inaccurate (due to unanticipated expenses, increased competition, unfavorable economic conditions, or other unforeseen circumstances) the Company could be required to seek additional financing sooner than currently expected. There can be no assurance that such additional funding will be available to the Company, or if available, that the terms of such additional financing will be acceptable.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings

The Company is a defendant in one lawsuit that is being handled in the ordinary course of business. Pursuant to an Asset Purchase Agreement dated August 2, 2000, as amended, the Company purchased from The Big Party Corporation, Debtor and Debtor-in-Possession, 33 retail locations and the assets located therein, including inventory. The Company and The Big Party are in disagreement concerning the value and amount due on account of the inventory and The Big Party is claiming that $625,568 is due. In addition, the parties set up a $100,000 escrow of funds paid under the agreement as security for rental payments and other adjustments due, and the parties are in discussions concerning the portion thereof which belongs to the Company. The Big Party filed a complaint with the U.S. Bankruptcy Court for the District of Delaware in January 2001 seeking payment of $625,568 on account of the inventory. The Company is disputing the amount claimed and intends to file an answer and a possible counterclaim for amounts due on account of the escrow referred to above. The Company is also in negotiations with The Big Party seeking to reach an agreeable compromise. This matter is in the preliminary stages. In the opinion of the management of the Company, the Company is adequately reserved and this should not result in final judgement or settlement that would have a material adverse effect on the Company's financial condition or results of operations.

Item 4. Submission of Matters to a vote of Security Holders

On June 18, 2001 the Company held its Annual Meeting of Stockholders. The stockholders elected five (5) Director's to the Company's Board of Directors. Set forth below are (i) the names of the persons elected to serve on the Company's Board of Directors until the 2002 Annual Meeting of Stockholders and until their successors are duly elected and qualified and (ii) the results of the voting for the nominees.

| Name | For | % For | Against | % Withheld |
|---|---|---|---|---|
| Sal Perisano | 24,363,502 | 99.8% | 48,205 | 0.02% |
| Robert H. Lessin | 24,360,352 | 99.8% | 51,355 | 0.02% |
| Stuart G. Moldaw | 24,361,877 | 99.8% | 49,830 | 0.02% |
| Lorenzo Roccia | 24,365,502 | 99.8% | 48,205 | 0.02% |
| Christina Weaver | 3,629,960 | 100.0% | 0 | 0.00% |

The stockholders also approved an amendment to the Company's Restated Certificate of Incorporation to effect an increase in the number of authorized shares of Common Stock from 50,000,000 to 150,000,000.

| For | % For | Against | % Against |
|---|---|---|---|
| 23,587,312 | 96.6% | 791,525 | 3.2% |

The stockholders also approved an amendment to the 1998 Incentive and Nonqualified Stock Option Plan to effect an increase in the number of shares authorized for issuance from 7,000,000 to 11,000,000.

| For | % For | Against | % Against |
|---|---|---|---|
| 20,031,792 | 95.4% | 916,657 | 4.4% |

The stockholders also ratified the appointment of Arthur Andersen LLP as independent public accountants for the fiscal year ended December 29, 2001

| For | % For | Against | % Against |
|---|---|---|---|
| 24,371,997 | 99.1% | 22,355 | 0.1% |

Item 6. Exhibits:

(a) Exhibit 27.1 Financial Data Schedule

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SIGNATURES

In accordance with requirements of the Securities Exchange Act, the

Company has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

iPARTY CORP.

Dated: August 10, 2001

By: /s/ Sal Perisano
Sal Perisano
Chief Executive Officer

By: /s/ Patrick Farrell
Patrick Farrell
President & Chief Financial Officer