

IPARTY CORP
Form 10-K
March 29, 2013

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

FORM 10-K

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

For The Fiscal Year Ended December 29, 2012

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 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
(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)

Securities Registered pursuant to Section 12(b) of the Act:

Title of Each Class

Name of Each Exchange on Which
Registered

COMMON STOCK, \$.001 PAR
VALUE

NYSE MKT

Securities Registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 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 (229.405 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or 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 a 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

On June 29, 2012, the aggregate market value of the voting common equity of the registrant (consisting of common stock, \$.001 par value (the "common stock")) held by nonaffiliates of the registrant was approximately \$3,944,508 based on the closing price for such common stock on said date as reported by the NYSE MKT. On March 12, 2013 there were 24,431,204 shares of common stock, \$.001 par value, issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement for the 2013 Annual Stockholders' Meeting, which we plan to file with the SEC no later than 120 days after the end of our fiscal year ended December 29, 2012, are incorporated by reference into Part III of this Annual Report on Form 10-K.

Special Note on Forward-Looking Statements

Certain statements in this Annual Report on Form 10-K, particularly statements contained in Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” constitute “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. The words “anticipate”, “believe”, “estimate”, “expect”, “plan”, “intend” and other similar expressions are intended to identify these forward-looking statements, but are not the exclusive means of identifying them. Forward-looking statements included in this Annual Report on Form 10-K or hereafter included in other publicly available documents filed with the SEC, 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) or achievements expressed or implied by such forward-looking statements. Such future results are based upon our best estimates based upon current conditions and our most recent results of operations. Our forward-looking statements speak only as of the date of this document, and we do not intend to update these statements to reflect events or circumstances that occur after that date.

Various risks, uncertainties and contingencies could cause our actual results, performance or achievements to differ materially from those expressed in, or implied by, the forward-looking statements contained in this Annual Report on Form 10-K. These include those listed below in Part I, Item 1A, “Risk Factors.”

PART I

ITEM 1. BUSINESS

General

We are a party goods retailer operating stores throughout New England, where 49 of our 54 retail stores are located, and in Florida in addition to an online e-commerce site. We believe we are a leading brand in the party industry in the retail markets we serve and a leading resource in those markets for consumers seeking party goods, party planning advice and information.

Our 54 retail stores are located predominantly in New England with 7 stores in Connecticut, 7 in New Hampshire, 3 in Rhode Island, 3 in Maine, 1 in Vermont, and 28 in Massachusetts. We also operate 5 stores in Florida. Among our retail store locations are our new Plaistow, New Hampshire and Waltham, Massachusetts stores, which we opened in the third quarter and fourth quarter, respectively, of our 2012 fiscal year.

In July 2011, we re-launched our newly redesigned e-commerce site with a full assortment of costume and related merchandise for purchase and shipping via the Internet. In 2012, we expanded the product offerings on the e-commerce site to include adult birthday, kids birthday, graduation and other merchandise categories. We also use our Internet site to highlight the changing store product assortment and feature sales flyers, promotions and coupons to increase customer visits to our retail stores.

In addition to our retail store locations and e-commerce site, we also operate a number of temporary Halloween stores during the Halloween season. During the 2012 and 2011 Halloween seasons, we operated ten and eleven temporary stores, respectively.

Our stores range in size from approximately 7,000 square feet to 20,521 square feet and average approximately 10,300 square feet.

We lease our properties, typically for 10 years and usually with options from our landlords to renew our leases for one or more additional 5 or 10 year terms.

Our stores feature over 20,000 products ranging from paper party goods, Halloween costumes, greeting cards and balloons to more unique merchandise such as piñatas, tiny toys, masquerade and Hawaiian Luau items. Our sales are primarily driven by the following holiday and party events: Halloween, Christmas, Easter, Valentine's Day, New Year's, Independence Day, St. Patrick's Day, Thanksgiving, Chanukah and sports championships. We also focus our business closely on lifetime events such as anniversaries, graduations, birthdays, and bridal and baby showers.

Our business has a seasonal pattern. In the past three years, we have realized an average of approximately 35.7% of our annual revenues in the fourth quarter, which includes Halloween and Christmas, and an average of approximately 24.6% of our annual revenues in the second quarter, which includes school graduations, and often the Easter holiday. Also, during these past three years, we have had net income in the second and fourth quarters and generated losses in the first and third quarters.

Our executive offices are located at 270 Bridge Street, Suite 301, Dedham, Massachusetts, 02026. Our phone number is (781) 329-3952. Our website is located at www.iparty.com. The information contained on our website does not constitute a part of this Annual Report, or any other report we file with or furnish to the SEC.

Where a reference is made in this Annual Report to a particular year or years, it is a reference to our fiscal year, unless the context indicates otherwise. For example, "2012" refers to our 52-week fiscal year ended December 29, 2012, "2011" refers to our 53-week fiscal year ended December 31, 2011, and "2010" refers to our 52-week fiscal year ended December 25, 2010.

Merger Agreement

On March 1, 2013, iParty Corp., a Delaware corporation (the "Company"), entered into an Agreement and Plan of Merger (the "Merger Agreement") by and among the Company, Party City Holdings Inc., a Delaware corporation ("Party City"), and Confetti Merger Sub, Inc., a Delaware corporation and wholly-owned subsidiary of Party City ("Merger Sub"). Pursuant to the terms of the Merger Agreement, Merger Sub will be merged with and into the Company, with the Company being the surviving corporation, becoming a wholly-owned subsidiary of Party City (the "Merger") and (i) each share of Common Stock of the Company (the "Common Stock") will be converted into the right to receive \$0.45; (ii) each share of Series B Convertible Preferred Stock of the Company (the "Series B Stock") will be converted into the right to receive 100% of its liquidation preference of \$20.00 per share; (iii) each share of Series C Convertible Preferred Stock of the Company (the "Series C Stock") will be converted into the right to receive 100% of its liquidation preference of \$20.00 per share; (iv) each share of Series D Convertible Preferred Stock of the Company (the "Series D Stock") will be converted into the right to receive 100% of its liquidation preference of \$20.00 per share; (v) each share of Series E Convertible Preferred Stock of the Company (the "Series E Stock") will be converted into the right to receive the greater of: (A) 100% of its liquidation preference of \$3.75 per share and (B) \$0.45 per each Series E Common Equivalent Share, which is currently set at 10.359 shares of Common Stock for each share of Series E Stock or \$4.66 per share of Series E Stock, and; (vi) each share of Series F Convertible Preferred Stock of the Company (the "Series F Stock", and collectively with the Series B Stock, Series C Stock, Series D Stock and Series E Stock, the "Preferred Stock") will be converted into the right to receive the greater of (A) 100% of its liquidation preference of \$4.375 per share and (B) \$0.45 per each Series F Common Equivalent Share, which is currently set at 10.367 shares of Common Stock for each share of Series F Stock or \$4.67 per share of Series F Stock (collectively, the "Merger Consideration"), in each case, payable net to the selling stockholders in cash, without interest thereon, and less any required withholding taxes.

In addition, at the effective time, each outstanding and unexercised option under the Company's equity incentive plans (the "CompanyOptions") will become fully vested, and will be terminated and converted into the right to receive a cash payment equal to (i) the positive difference, if any, between \$0.45 and their respective exercise prices multiplied by (ii) the total number of shares of Common Stock subject to such option or other right.

During the period beginning on the date of the Merger Agreement and ending at 11:59 p.m. (Eastern Time) on March 31, 2013 (the "Go-Shop Period"), we may initiate, solicit and encourage, whether publicly or otherwise, any acquisition proposals from third parties, and provide non-public information to and engage in discussions or negotiations with third parties with respect to alternative acquisition proposals. Starting at 12:00 a.m. (Eastern Time) on April 1, 2013 (the "No-Shop Period Start Date"), we will become subject to customary "no-shop" restrictions on our ability to solicit

acquisition proposals from third parties and to provide non-public information to and engage in discussions or negotiations with third parties regarding alternative acquisition proposals, except that we may continue to engage in the aforementioned activities until 11:59 p.m. (Eastern Time) on April 10, 2013 (the “Go-Shop Extension Period”) with certain third parties from whom the Company has received an acquisition proposal during the Go-Shop Period that our Board of Directors has determined constitutes or could reasonably be expected to lead to a superior proposal and with whom the Company is then having discussions or negotiations.

The Merger Agreement contains certain termination rights for us and Party City, including if the Merger is not consummated by 12:00 a.m. (Eastern Time) on August 1, 2013. Upon termination of the Merger Agreement under specified circumstances, we will be required to pay Party City a termination fee and/or expenses that are reasonably documented and actually incurred, in an amount that is reasonable in the circumstances of the transaction, and that, in any event, does not exceed \$750,000 or \$1,000,000 (depending upon the circumstances of termination). If the termination fee becomes payable as a result of (i) the Company terminating the Merger Agreement in order to enter into a definitive acquisition agreement with respect to a superior proposal or (ii) by Party City terminating the Merger Agreement as a result of our entry into such an agreement or our Board changing its recommendation with respect to the Merger, the amount of the termination fee will be \$1,750,000, provided however that if the Merger Agreement is terminated prior to the end of the Go Shop Period (March 31, 2013) or during the Go Shop Extension Period (April 10, 2013), the amount of the termination fee (with certain exceptions) will be \$1,000,000. The Company may be required to pay a termination fee and/or Party City expenses in certain other circumstances as more fully described in the Merger Agreement.

The Merger Agreement has customary representations and warranties and covenants, including without limitation covenants regarding: (i) the conduct of our business prior to the consummation of the Merger, (ii) the calling and holding of a meeting of our stockholders for the purpose of obtaining the company stockholder approval of the Merger Agreement and the other transactions contemplated thereby, including the Merger and (iii) the use of commercially reasonable efforts to cause the Merger to be consummated.

The consummation of the Merger is subject to customary conditions to closing, including the approval of our stockholders. The Merger is expected to close in our second fiscal quarter.

Additional information about the Merger Agreement is set forth in our current report on Form 8-K filed with the SEC on March 1, 2013.

Organization

While we are currently a party goods retail chain operating 54 stores and an e-commerce site, when we were first incorporated as iParty Corp. (“iParty”) on March 12, 1998, we were an Internet-based merchant of party goods and services.

In August 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”), a privately-held company, which was operating under bankruptcy protection, in exchange for cash and the assumption of certain liabilities. We have subsequently opened an additional 22 stores, acquired four stores, and closed 5 stores.

Capital Structure

Our capital structure currently consists of Common Stock and five outstanding series of Preferred Stock. We have also issued warrants convertible into Common Stock, none of which is currently outstanding, and have stock option plans that offer a broad range of equity grants to attract and retain executive officers and key employees.

Our common stock has a par value of \$0.001 per share. We have 150,000,000 shares of Common Stock authorized, 24,431,204 of which were issued and outstanding as of December 29, 2012. These shares are listed on the NYSE MKT and trade under the symbol “IPT”.

As noted above, we have five outstanding series of Preferred Stock. On January 13, 2004, all 1,000,000 shares of our Series A Convertible Preferred Stock were converted into 1,000,000 shares of Common Stock. As of December 29, 2012, we had a total of 1,179,610 shares of Preferred Stock outstanding which were convertible into 14,499,077 shares of Common Stock on that date based on the following conversion rates as of such date: (i) each share of Series B Stock is presently convertible into 12.920 shares of Common Stock; (ii) each share of Series C Stock is presently convertible into 13.158 shares of Common Stock; (iii) each share of Series D Stock is presently convertible into 14.065 shares of Common Stock; (iv) each share of Series E Stock is presently convertible into 10.359 shares of Common Stock; and (v) each share of Series F Stock is presently convertible into 10.367 shares of Common Stock. Our Preferred Stock is presented on our consolidated balance sheet at its carrying value, which was \$12,986,628 at December 29, 2012.

On October 7, 2011, our Board of Directors adopted a new shareholder rights plan (the “Rights Plan”). The Rights Plan replaced the prior shareholder rights plan which expired on November 9, 2011. Under the Rights Plan each share of our capital stock outstanding at the close of business on November 9, 2011 and each share of our capital stock issued subsequent to that date has a right associated with it, such that each share of our Common Stock is entitled to one right and each share of our Preferred Stock is entitled to such number of rights equal to the number of shares of Common Stock into which it is convertible. The rights will become exercisable only in the event that, with certain exceptions, an acquiring party accumulates 10 percent or more of our voting stock or if a party announces an offer to acquire 15 percent or more of our voting stock, without the prior approval of the Board of Directors of the Company. The rights expire on November 9, 2021. When exercisable, each right entitles the holder to purchase from us one one-hundredth of a share of a new series of Series H Junior Preferred Stock at an initial purchase price of \$2.00, subject to adjustment. In addition, upon the occurrence of certain events, holders of the rights will be entitled to purchase either iParty Corp. stock or shares in an “acquiring entity” at half of market value. We generally will be entitled to redeem the rights at \$0.001 per right at any time until the tenth day following the acquisition by any person or group of 10 percent or more of our outstanding voting stock. Until a right is exercised, the holder of a right will have no rights as a stockholder of iParty solely by virtue of being a rights holder, including, without limitation, the right to vote or receive dividends. On March 1, 2013, we amended our Rights Plan with the purpose and intent of rendering the Rights Plan inapplicable to the Merger Agreement, the Merger, and any other transaction with Party City and its affiliates contemplated by the Merger Agreement, and to cause the Rights Plan to terminate immediately prior to the effective time of the Merger.

The holders of our Preferred Stock have a liquidation preference senior to the holders of our Common Stock. In the event of liquidation, which is defined in our Restated Certificate of Incorporation to include a merger, acquisition, or a similar transaction involving the acquisition of our Company, our holders of Preferred Stock would be entitled to receive an amount for their shares of Preferred Stock as a liquidation value, which was \$16,985,657 at December 29, 2012. This amount is in excess of the carrying value of the Preferred Stock due to amounts allocated to warrants, which were issued in connection with the original issuances of our Preferred Stock. The difference of approximately \$4.0 million will be accreted when and if a liquidation event occurs. The holders of our Preferred Stock are also entitled to convert their shares into Common Stock at specified conversion prices and have anti-dilution protection in the event we issue Common Stock or certain rights, including option grants in excess of certain amounts, to purchase or convert into Common Stock, at a price below the applicable conversion prices for the Preferred Stock.

The holders of Preferred Stock are entitled to participate in dividends when and if declared by our Board of Directors.

We have also issued warrants in connection with the issuance of certain Preferred Stock, certain licensing, marketing and financing arrangements, and certain investor relations services, each of which is no longer outstanding. On September 15, 2011, a warrant for 2,083,334 shares of our Common Stock with an exercise price of \$0.475 expired unexercised. Upon the expiration of this warrant, the conversion prices of the Series B, C, and D Preferred Stock were recomputed to reflect the reversal of the anti-dilution adjustment calculated at the warrant’s issuance in 2006. As a result, the outstanding shares of these three series of Preferred Stock are now convertible into approximately 385,514 fewer shares of Common Stock, which adjustment is reflected in the conversion ratios above.

At December 29, 2012, we had warrants outstanding with a weighted average exercise price of \$1.50, which were exercisable for 100,000 shares of our Common Stock. On February 28, 2013, these warrants expired unexercised.

In May 2009, our stockholders approved our 2009 Stock Incentive Plan (the “2009 Plan”). The 2009 Stock Incentive Plan replaced our Amended and Restated 1998 Incentive and Non-Qualified Plan (the “1998 Plan”) and no new awards will be issued under the 1998 Plan. Under our 2009 Stock Incentive Plan, at the time of stockholder approval, we were authorized to grant options, stock appreciation rights, restricted stock, restricted stock units and other equity grants for the purchase of up to 1,322,894 shares of our Common Stock plus any shares that expire, terminate or are cancelled without being exercised under the 1998 Plan (which could have increased the pool under the 2009 Plan by 9,241,845). At December 29, 2012, we have options outstanding only under the 1998 Plan and the 2009 Plan that were exercisable for the purchase of 6,627,301 shares of Common Stock and options outstanding that were not yet exercisable for the purchase of 1,004,444 shares of our Common Stock.

The following chart summarizes our capital structure at December 29, 2012:

	Number of Shares/ Warrants/ Options Outstanding	Conversion/ Exercise Ratios	Total Common Shares Issued and Issuable (1)	Weighted Average Exercise Price per Common Share Issuable	Liquidation Value
Common stock	24,431,204		24,431,204		\$-
Series B convertible preferred stock	418,658	12.920	5,409,061		8,373,160
Series C convertible preferred stock	100,000	13.158	1,315,800		2,000,000
Series D convertible preferred stock	250,000	14.065	3,516,250		5,000,000
Series E convertible preferred stock	296,666	10.359	3,073,163		1,112,497
Series F convertible preferred stock	114,286	10.367	1,184,803		500,000
Total convertible preferred stock	1,179,610		14,499,077		16,985,657
Warrants	100,000	1.000	100,000	1.500	-
Stock options	7,631,745	1.000	7,631,745	0.390	-
Totals			46,662,026		\$16,985,657

(1) Includes Common Stock outstanding and Common Stock issuable upon conversion of Preferred Stock and exercise of outstanding warrants and stock options.

Competition

The party supplies retailing business is highly competitive and fragmented. We compete with a variety of smaller and larger retailers, including single owner-operated party supply stores, specialty party supplies retailers, discount department stores, retail drug store chains, general mass merchants and supermarkets, as well as catalog, Internet merchants and temporary seasonal stores, especially Halloween stores.

Our success depends in part on our ability to be competitive against many different competitors in each local market area we serve and on the Internet. If we fail to anticipate evolving innovations and product offerings from our competitors and fail to offer products that appeal to the changing needs and preferences of our customers in the various markets we serve, demand for our products could decline and our operating results would be adversely affected. While the competitive importance of product quality, price, service and innovation varies from product to

product, price is a factor, and we experience pricing pressures from competitors in our markets.

Barriers to entry are minimal. New competitors can open new or temporary stores and launch new catalogs and Internet sites at a relatively low cost. However, we believe that the costs to remain competitive over the longer term in the party supplies retailing business can be significant. These costs include the hiring of human resources with industry knowledge and the marketing costs associated with building a widely recognized brand.

Seasonality

Our business has a seasonal pattern. In the past three years, we have realized an average of approximately 35.7% of our annual revenues in our fourth quarter, which includes Halloween and Christmas, and an average of approximately 24.6% of our annual revenues in the second quarter, which includes school graduations, and often the Easter holiday. Also, during these past three years, we have had net income in our second and fourth quarters and generated losses in our first and third quarters.

Suppliers and Inventory

The products we sell are sourced from a wide variety of third-party vendors. Many of the products that we offer for sale, such as paper-based party goods, Halloween masks and costumes, are manufactured overseas in foreign countries such as China. Global sourcing of many of the products we sell is thus an important factor in our financial performance.

The following represents suppliers from whom we purchased at least 5% of our merchandise in either 2012 or 2011:

Supplier	Products supplied	2012
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