

PARTY CITY CORP  
Form 10-Q  
May 13, 2003

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**SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

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**Form 10-Q**

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

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For The Quarterly Period Ended  
March 29, 2003

Commission File Number  
0-27826

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**PARTY CITY CORPORATION**

*(Exact name of registrant as specified in its charter)*

**Delaware**  
*(State or other jurisdiction of  
incorporation or organization)*

**22-3033692**  
*(I.R.S. Employer  
Identification No.)*

**400 Commons Way**  
**Rockaway, New Jersey**  
*(Address of Principal Executive Offices)*

**07866**  
*(Zip Code)*

**973-983-0888**  
**(Registrant's telephone number, including area code)**

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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 x No: o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes x No: o

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date:

As of May 9, 2003, there were outstanding 16,432,086 shares of  
Common Stock, \$.01 par value.

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**Table of Contents****PART 1. FINANCIAL INFORMATION****Item 1. Financial Statements**

**PARTY CITY CORPORATION AND SUBSIDIARY  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(in thousands, except share information)**

	March 29, 2003	March 30, 2002	June 29, 2002
	(Unaudited)	(Unaudited)	(1)
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalents	\$ 3,036	\$ 7,455	\$ 3,467
Merchandise inventory	76,156	60,952	55,867
Deferred income taxes	6,957	5,031	5,827
Other current assets, net	13,862	13,349	11,789
	<u>100,011</u>	<u>86,787</u>	<u>76,950</u>
Total current assets	100,011	86,787	76,950
Property and equipment, net	53,432	46,024	49,356
Goodwill	19,172	14,206	18,016
Other assets	4,152	5,901	4,732
	<u>176,767</u>	<u>152,918</u>	<u>149,054</u>
Total assets	\$ 176,767	\$ 152,918	\$ 149,054
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>			
Current liabilities:			
Accounts payable	\$ 48,913	\$ 40,846	\$ 35,499
Accrued expenses and other current liabilities	21,139	23,191	26,744
Advances under Loan Agreement	18,637		
Senior Notes, current portion		7,655	
	<u>88,689</u>	<u>71,692</u>	<u>62,243</u>
Total current liabilities	88,689	71,692	62,243
Deferred rent and other long-term liabilities	10,759	9,725	10,297
Senior Notes		8,759	8,915
Commitments and contingencies			
Stockholders' equity:			
Common stock \$0.01 par value; 25,000,000 shares authorized; 17,177,151, 13,289,767 and 16,239,081 shares issued, respectively	172	133	162
Additional paid-in capital	41,662	38,654	39,347
Retained earnings	41,425	25,784	29,919
Treasury stock, at cost (747,012 shares at March 29, 2003 and 284,000 shares at March 30, 2002 and June 29, 2002, respectively)	(5,940)	(1,829)	(1,829)
	<u>77,319</u>	<u>62,742</u>	<u>67,599</u>
Total stockholders' equity	77,319	62,742	67,599
	<u>\$ 176,767</u>	<u>\$ 152,918</u>	<u>\$ 149,054</u>
Total liabilities and stockholders' equity	\$ 176,767	\$ 152,918	\$ 149,054

(1) The June 29, 2002 condensed consolidated balance sheet was derived from the Company's audited condensed consolidated financial statements.

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See accompanying notes to condensed consolidated financial statements.

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**PARTY CITY CORPORATION AND SUBSIDIARY**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(in thousands, except per share data)  
(Unaudited)

	Quarter ended		Nine months ended	
	March 29, 2003	March 30, 2002	March 29, 2003	March 30, 2002
<b>Revenues:</b>				
Net sales	\$ 95,846	\$ 86,252	\$ 348,618	\$ 309,026
Royalty fees	3,607	3,652	13,757	13,031
Franchise fees	80	200	355	543
<b>Total revenues</b>	<b>99,533</b>	<b>90,104</b>	<b>362,730</b>	<b>322,600</b>
<b>Expenses:</b>				
Cost of goods sold and occupancy costs	70,164	60,816	230,563	202,411
Company-owned stores operating and selling expense	23,196	20,031	81,182	69,724
Franchise expense	1,755	1,612	4,963	4,826
General and administrative expense	7,223	6,707	22,928	19,409
<b>Total expenses</b>	<b>102,338</b>	<b>89,166</b>	<b>339,636</b>	<b>296,370</b>
Operating (loss) income	(2,805)	938	23,094	26,230
Interest expense, net	208	1,099	3,917	4,508
(Loss) income before income taxes	(3,013)	(161)	19,177	21,722
(Benefit) provision for income taxes	(1,205)	(65)	7,671	8,665
Net (loss) income	\$ (1,808)	\$ (96)	\$ 11,506	\$ 13,057
Basic (loss) earnings per share	\$ (0.11)	\$ (0.01)	\$ 0.69	\$ 1.01
Weighted average shares outstanding basic	16,653	12,982	16,617	12,909
Diluted (loss) earnings per share	\$ (0.11)	\$ (0.01)	\$ 0.58	\$ 0.69
Weighted average shares outstanding diluted	16,653	12,982	19,757	18,972

See accompanying notes to condensed consolidated financial statements.

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**PARTY CITY CORPORATION AND SUBSIDIARY**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands)

	Nine months ended	
	March 29, 2003	March 30, 2002
	(Unaudited)	
Cash flow from operating activities:		
Net income	\$ 11,506	\$ 13,057
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	11,092	8,944
Deferred taxes	(349)	462
Non-cash interest	1,584	1,128
Deferred rent and other long-term liabilities	463	1,024
Equity based compensation	799	257
Provision for doubtful accounts	(460)	59
Changes in assets and liabilities:		
Merchandise inventory	(19,882)	(12,620)
Other current assets and other assets	(1,677)	(1,242)
Accounts payable, accrued expenses and other current liabilities	7,810	9,858
	<u>10,886</u>	<u>20,927</u>
Cash flow from investment activities:		
Purchases of property and equipment	(15,023)	(8,493)
Stores acquired	(1,758)	(1,504)
Proceeds from disposals of property and equipment	144	—
	<u>(16,637)</u>	<u>(9,997)</u>
Cash flow from financing activities:		
Payments of Senior Notes	(10,207)	(11,655)
Net proceeds from Loan Agreement	18,637	—
Proceeds from exercise of stock options and warrants	1,525	167
Payment of financing costs	(524)	—
Purchase of treasury stock	(4,111)	(1,829)
	<u>5,320</u>	<u>(13,317)</u>
Net decrease in cash and cash equivalents	(431)	(2,387)
Cash and cash equivalents, beginning of period	3,467	9,842
	<u>\$ 3,036</u>	<u>\$ 7,455</u>
Supplemental disclosure of cash flow information:		
Income taxes paid	\$ 9,476	\$ 9,785
Interest paid	\$ 2,758	\$ 4,098
Supplemental disclosure of non-cash financing activity:		
Issuance of shares under management stock plan	\$ 288	\$ —
Issuance of warrants	\$ 245	\$ 642

See accompanying notes to condensed consolidated financial statements.





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**PARTY CITY CORPORATION AND SUBSIDIARY**

**NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS**

**1. BASIS OF PRESENTATION**

The condensed consolidated financial statements, except for the June 29, 2002 consolidated balance sheet, are unaudited. In the opinion of management, the accompanying condensed consolidated financial statements contain all adjustments (consisting only of normal recurring accruals) necessary to present fairly the financial position of the Company as of March 29, 2003 and March 30, 2002 and the results of operations for the respective three and nine months then ended and cash flows for nine months then ended. Because of the seasonality of the party goods industry, operating results of the Company on a quarterly basis may not be indicative of operating results for the full fiscal year.

These condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements for the fiscal year ended June 29, 2002, which are included in the Company's Annual Report on Form 10-K with respect to such period filed with the Securities and Exchange Commission on September 27, 2002. All significant intercompany accounts and transactions have been eliminated. The June 29, 2002 condensed consolidated balance sheet amounts are derived from the Company's audited consolidated financial statements.

**2. RECENT ACCOUNTING STANDARDS**

In June 2002, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 146, Accounting for Costs Associated with Exit or Disposal Activities (SFAS No. 146), replacing Emerging Issues Task Force (EITF) Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred instead of at the date an entity commits to an exit plan. This statement also established that fair value is the objective for the initial measurement of the liability. SFAS No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002. The Company has adopted this statement and it did not have a material impact on its financial position or the results of operations.

In November 2002, the FASB issued FASB Interpretation (FIN) No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (FIN 45). FIN 45 requires that upon issuance of a guarantee, a guarantor must recognize a liability for the fair value of an obligation assumed under a guarantee. FIN 45 also requires additional disclosures by a guarantor in its interim and annual financial statements about the obligations associated with guarantees issued. The recognition provisions of FIN 45 will be effective for any guarantees that are issued or modified after December 31, 2002. The disclosure requirement is effective for the Company's current quarter (see Note 10). The Company has adopted this statement and it did not have a material impact on its financial position or the results of operations.

In November 2002, the EITF reached a consensus on issues raised in EITF 02-16, Accounting by a Reseller for Cash Consideration Received from a Vendor (EITF 02-16). This EITF issue addresses the timing of recognition for rebates that are earned by resellers based on specified levels of purchases or over specified periods. This guidance, related to timing of recognition, is to be applied prospectively to new rebate arrangements entered into in fiscal periods beginning after January 1, 2003. This EITF issue also addresses the classification of cash consideration received from vendors in a reseller's statement of operations. The guidance related to income statement classification is to be applied in annual and interim financial statements for periods beginning after January 1, 2003. The Company has adopted this application and it did not have a material impact on its financial position or the results of operations.

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation (SFAS No. 148). SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of FASB Statement No. 123, Accounting For Stock-Based Compensation (SFAS 123) to require more prominent and more frequent disclosures in financial statements about the effects of stock-based compensation. The Company has adopted the disclosure provisions of SFAS 148 as of December 31, 2002 (see Note 4).

**Table of Contents****PARTY CITY CORPORATION AND SUBSIDIARY****NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)****3. EARNINGS PER SHARE**

The following table sets forth the computations of basic and diluted earnings per share (in thousands, except per share amounts):

	Quarter ended		Nine months ended	
	March 29, 2003	March 30, 2002	March 29, 2003	March 30, 2002
Net (loss) income	(\$ 1,808)	(\$ 96)	\$ 11,506	\$ 13,057
Earnings (loss) per share basic	(\$ 0.11)	(\$ 0.01)	\$ 0.69	\$ 1.01
Earnings (loss) per share diluted	(\$ 0.11)	(\$ 0.01)	\$ 0.58	\$ 0.69
Weighted average common shares outstanding	16,653	12,982	16,617	12,909
Dilutive effect of warrants	(a)	(b)	(c) 2,359	(c) 5,461
Dilutive effect of stock options	(a)	(b)	692	532
Restricted stock units	(d)	(d)	89	70
Weighted average common and common equivalent shares outstanding	16,653	12,982	19,757	18,972

- (a) Options to purchase 1,652,825 common shares at prices ranging from \$2.00 to \$32.50 per share and warrants to purchase 2,496,000 common shares at \$1.07 per share were outstanding at March 29, 2003 but were not included in the computation of dilutive loss per share for the quarter ended March 29, 2003 because to do so would have been anti-dilutive.
- (b) Options to purchase 1,009,888 common shares at prices ranging from \$2.00 to \$32.50 per share and warrants to purchase 6,280,000 common shares at \$1.07 per share were outstanding at March 30, 2002 but were not included in the computation of dilutive loss per share for the quarter ended March 30, 2002 because to do so would have been anti-dilutive.
- (c) Options to purchase 649,879 common shares at prices ranging from \$12.53 to \$32.50 and options to purchase 578,541 common shares at prices ranging from \$7.00 to \$32.50 were outstanding but were not included in the computation of dilutive earnings per share for the nine months ended March 29, 2003 and March 30, 2002, respectively, because to do so would have been anti-dilutive.