PARTY CITY CORP
Form 10-Q
February 13, 2001

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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 DECEMBER 30, 2000	COMMISSION FILE NUMBER 0-27826

PARTY CITY CORPORATION
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE	22--3033692
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
400 COMMONS WAY ROCKAWAY, NEW JERSEY	07866
(Address of Principal Executive Offices)	(Zip Code)

973-983-0888
(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 /X/ No: / /

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

As of February 8, 2001, there were outstanding 12,722,205 shares of Common Stock, $.01 par value per share.

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PARTY CITY CORPORATION AND SUBSIDIARY

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Part I. Financial Information

PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

PARTY CITY CORPORATION AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS)

	DECEMBER 30, 2000 (UNAUDITED)	JULY 1, 2000
ASSETS		
Current assets:		
Cash and cash equivalents	$ 31,961	$ 3,950
Merchandise inventory	50,404	42,030
Deferred income taxes	2,964	5,976
Other current assets	13,434	16,803
Total current assets	98,763	68,759
Property and equipment, net	41,332	41,447
Goodwill, net	14,251	14,844
Other assets	4,132	7,036
Total assets	$158,478	$132,086
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 42,471	$ 30,190
Accrued expenses	18,195	15,457
Advances under Loan Agreement	11	--

Senior Notes, current portion	5,103	5,103
Other current liabilities	2,045	2,940
Total current liabilities	67,825	53,690
Long-term liabilities:		
Deferred rent	8,012	7,503
Senior Notes	29,931	29,547
Other long-term liabilities	289	485
Commitments and contingencies		
Stockholders' equity:		
Common stock	127	127
Additional paid-in capital	37,968	37,968
Retained earnings	14,326	2,766
Total stockholders' equity	52,421	40,861
Total liabilities and stockholders' equity	$158,478	$132,086

See accompanying notes to consolidated financial statements.

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PARTY CITY CORPORATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

(IN THOUSANDS, EXCEPT PER SHARE DATA)

	QUARTER ENDED		S
	DECEMBER 30, 2000	JANUARY 1, 2000	DECEMB 200
	(Unaudited)		
Revenues:			
Net sales	$ 138,035	$ 130,769	$ 214
Royalty fees	5,464	5,277	8
Franchise fees	183	--	
Total revenues	143,682	136,046	223
Expenses:			
Cost of goods sold and occupancy costs	83,428	79,733	138
Company-owned stores operating and selling expense	29,364	25,651	49
Franchise expense	1,159	1,151	2
General and administrative expense	5,034	6,440	10
Total expenses	118,985	112,975	200
Income before interest and income taxes (benefit)	24,697	23,071	23
Interest expense	2,004	2,070	4
Income before income taxes (benefit)	22,693	21,001	18

Provision for income taxes (benefit)	8,782	(237)	7
Net income	$ 13,911	$ 21,238	$ 11
Basic income per share	$ 1.09	$ 1.69	$
Weighted average shares outstanding - basic	12,722	12,543	12
Diluted income per share	$ 0.78	$ 1.69	$
Weighted average shares outstanding - diluted	17,823	12,543	17

See accompanying notes to consolidated financial statements.

PARTY CITY CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS)

	SIX MONTH
	DECEMBER 30, 2000
	(Unaud
Cash flow from operating activities:	
Net income	$ 11,560
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization	5,172
Non-cash interest	841
Deferred rent	617
Provision for doubtful accounts	176
(Gain)/Loss on sale of stores to franchisees	(131)
Deferred tax asset	5,537
Changes in assets and liabilities:	
Merchandise inventory	(8,976)
Refundable income taxes	(83)
Other current assets	3,238
Other assets	(79)
Accounts payable	12,281
Accrued expenses	2,651
Other current liabilities	(895)
Other long term liabilities	(196)
Net cash provided by operating activities	31,713
Cash flow from investing activities:	
Purchases of property and equipment	(4,389)
Proceeds from sale of stores to franchisees	1,157
Stores acquired from franchisees	(516)

Disposals of property and equipment	35
Net cash provided by (used in) investing activities	(3,713)
Cash flow provided by financing activities:	
Net proceeds from Loan Agreement	11
Proceeds from issuance of stock in exchange for services	--
Proceeds from Senior Notes	--
Payment of Senior Note issuance costs	--
Tax effect of non-qualified stock options	--
Net proceeds from (payments on) Credit Agreement	--
Net cash provided from (used in) financing activities	11
Net increase (decrease) in cash and cash equivalents	28,011
Cash and cash equivalents, beginning of period	3,950
Cash and cash equivalents, end of period	$ 31,961
Supplemental disclosure of cash flow information:	
Income taxes paid	$ 1,494
Interest paid	3,357

See accompanying notes to consolidated financial statements.

PARTY CITY CORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The consolidated financial statements contained in this Quarterly Report on Form 10-Q, except for the July 1, 2000 consolidated balance sheet, are unaudited. In the opinion of management, the accompanying consolidated financial statements contain all adjustments (consisting only of normal recurring accruals) necessary to present fairly the financial position of the Company as of December 30, 2000, and the results of operations for the quarters and six months ended December 30, 2000 and January 1, 2000 and cash flows for the six months ended December 30, 2000 and January 1, 2000. 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 year.

The consolidated financial statements contained in this Quarterly Report on Form 10-Q should be read in conjunction with the Company's audited consolidated financial statements for the year ended July 1, 2000, included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission. All significant intercompany accounts and transactions have been eliminated. The July 1, 2000 consolidated balance sheet amounts have been derived from the Company's audited consolidated financial statements.

2. LITIGATION

Securities Litigation

The Company has been named as a defendant in twelve class action complaints. The Company's former Chief Executive Officer and former Chief

Financial Officer and Executive Vice President of Operations have also been named as defendants. The complaints have all been filed in the United States District Court for the District of New Jersey. The complaints were filed as class actions on behalf of persons who purchased or acquired Party City common stock during various time periods between February 1998 and March 19, 1999. In October 1999, plaintiffs filed an amended class action complaint and in February 2000, plaintiffs filed a second amended complaint.

The second amended complaint alleges, among other things, violations of sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, and seeks unspecified damages. The plaintiffs allege that defendants issued a series of false and misleading statements and failed to disclose material facts concerning, among other things, the Company's financial condition, adequacy of internal controls and compliance with certain loan covenants. The plaintiffs further allege that because of the issuance of a series of false and misleading statements and/or failure to disclose material facts, the price of Party City common stock was artificially inflated.

Defendants have moved to dismiss the second amended complaint on the ground that it fails to state a cause of action. The Court has not yet issued a decision with respect to the motion to dismiss. Because this case is in its early stages, no opinion can be expressed as to its likely outcome.

Other

On April 23, 1999, plaintiff Emil Asch, Inc. ("Emil Asch") filed a complaint in the United States District Court for the Eastern District of New York against the Company and co-defendants Amscan, Inc., Hallmark, Inc., and Rubie's Costume. The complaint alleges five claims which pertain to price discrimination under the Robinson-Patman Act, unfair competition, tortious interference with contractual relations, and false and deceptive advertising. Plaintiff seeks damages of $2 million, as well as treble and punitive damages for certain counts.

On February 3, 2000, Emil Asch amended its complaint by adding Ron's: The Party Store, Inc., as an additional plaintiff to the suit. The amended complaint asserts the same causes of action against the same defendants and seeks the same damages that were sought in the original complaint. The Company has answered the amended complaint, and discovery is proceeding. At this point, no opinion can be expressed as to the likely outcome of the litigation.

Although the Company's management is unable to express a view on the likely outcome of these litigations because they are in their early stages, they could have a material adverse effect on the Company's business and results of operations.

In addition to the foregoing, the Company is from time to time involved in ordinary, routine litigation incidental to the conduct of its business. The Company is aware of no other material existing or threatened litigation to which it is or may be a party.

3. SEGMENT INFORMATION

The following table contains key financial information of the Company's business segments (in thousands):

	QUARTER ENDED		SIX MONTHS ENDED	
	DECEMBER 30, 2000	JANUARY 1, 2000	DECEMBER 30, 2000	JANUARY 2000
	(UNAUDITED)		(UNAUDITED)	
RETAIL				
Net revenue	$ 138,035	$ 130,769	$ 214,888	$ 198,5
Operating earnings	25,243	25,385	26,885	22,4
Identifiable assets	145,393	130,058	145,393	130,0
Depreciation/amortization	1,920	2,077	3,836	4,2
Capital expenditures	1,636	429	2,323	7
FRANCHISING				
Net revenue	$ 5,647	$ 5,277	$ 8,882	$ 7,9
Operating earnings	4,488	4,126	6,469	5,6
Identifiable assets	2,480	2,400	2,480	2,4
Depreciation/amortization	--	--	--	
Capital expenditures	--	--	--	
CORPORATE/OTHER				
Net revenue	$ --	$ --	$ --	$
Operating loss	5,034	6,440	10,211	14,8
Identifiable assets	10,605	9,014	10,605	9,0
Depreciation/amortization	718	557	1,336	1,0
Capital expenditures	975	553	2,353	1,0
CONSOLIDATED TOTALS				
Net revenue	$ 143,682	$ 136,046	$ 223,770	$ 206,4
Operating income	24,697	23,071	23,143	13,2
Interest expense	2,004	2,070	4,286	4,5
Income before income taxes (benefit)	22,693	21,001	18,857	8,7
Provision for income taxes (benefit)	8,782	(237)	7,297	(2
Net income	$ 13,911	$ 21,238	$ 11,560	$ 8,9
Identifiable assets	$ 158,478	$ 141,472	$ 158,478	$ 141,4
Depreciation/amortization	2,638	2,634	5,172	5,3
Capital expenditures	2,611	982	4,676	1,7

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4. 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		SIX MONTHS ENDED	
	DECEMBER 30,	JANUARY 1,	DECEMBER 30,	JANUARY 1

	2000	2000	2000	2000
	(UNAUDITED)		(UNAUDITED)	
Net income	$ 13,911	$ 21,238	$ 11,560	$ 8,979
Average common shares outstanding	12,722	12,543	12,722	12,499
Income per share - basic	$ 1.09	$ 1.69	$ 0.91	$ 0.72
Dilutive effect of stock options	283	(a)	258	(a)
Dilutive effect of warrants	4,818	(a)	4,701	(a)
Average common and common equivalents outstanding	17,823	12,543	17,681	12,499
Income per share - diluted	$ 0.78	$ 1.69	$ 0.65	$ 0.72

Options to purchase 804,814 common shares at prices ranging from $3.70 to $31.13 per share were outstanding at December 30, 2000 but were not included in the above calculation because the average market price exceeded the exercise price of the options.

(a) Options to purchase 1,273,876 common shares at prices ranging from $2.00 to $32.50 per share and warrants to purchase 6,880,000 common shares at $1.07 (as amended) per share were outstanding at January 1, 2000, but were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive.

5. FRANCHISE ADDITIONS

In October 2000, the Company signed an agreement with The Party Supermarket, Inc. ("Party Supermarket") whereby Party Supermarket would become a franchisee of the Company. Under that agreement, Party Supermarket purchased three stores in Florida from the Company for approximately $1.2 million. The Company estimates that Party Supermarket will operate 21 stores as franchise stores after their conversion to the Party City concept.

6. DEBT

At December 30, 2000, the aggregate maturities of long-term debt are as follows:

Fiscal year ending June/July:	
2001	$ 5,103
2002	14,655
2003	7,655
2004	10,207
	37,620
Less: Unamortized debt discount	(2,586)
	$35,034

On January 31, 2001, the Company paid $5.1 million of debt on its required payment date.

The Company has a Loan and Security Agreement (the "Loan Agreement") with Congress Financial Corporation ("Congress"), as lender. Under the terms of the Loan Agreement, the

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Company may from time to time borrow amounts based on a percentage of its eligible inventory, up to a maximum of $40 million at any time outstanding. Advances drawn under the Loan Agreement bear interest, at the Company's option, (i) at the adjusted Eurodollar rate plus the applicable margin, which was 2.75% per annum (subject to possible reduction to an interest rate as low as 2.25% from and after June 30, 2001, based on the Company's pre-tax income and excess availability) or (ii) at the rate of 3/4% per annum above the prime rate, totaling 10.25% at December 30, 2000. The term of the Loan Agreement is three years, and is secured by a lien on substantially all of the assets of the Company. At February 8, 2001, there was no balance outstanding and $27.4 million was available to be borrowed under the Loan Agreement.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

SELECTED FINANCIAL DATA
(in thousands, except per share and store data)

	QUARTER ENDED		SIX MONT
	DECEMBER 30, 2000	JANUARY 1, 2000	DECEMBER 30, 2000
	(UNAUDITED)		(UNAU
STATEMENT OF OPERATIONS DATA			
Total revenue	$ 143,682	$ 136,046	$ 223,770
Company-owned stores			
Net sales	$ 138,035	$ 130,769	$ 214,888
Cost of goods sold and occupancy costs	83,428	79,733	138,890
Gross profit	54,607	51,036	75,998
Store operating and selling expense	29,364	25,651	49,113
Company-owned stores profit contribution	25,243	25,385	26,885
Franchise stores:			
Royalty fees	5,464	5,277	8,273
Franchise fees	183	--	609
Total franchise revenues	5,647	5,277	8,882
Total franchise expense	1,159	1,151	2,413
Franchise profit contribution	4,488	4,126	6,469
General and administrative expense:			
Special charges (a)	--	1,394	--

Other general and administrative expenses	5,034	5,046	10,211
	5,034	6,440	10,211
Income before interest and income taxes (benefit)	24,697	23,071	23,143
Interest expense, net	2,004	2,070	4,286
Income before income taxes (benefit)	22,693	21,001	18,857
Provision for income taxes (benefit)	8,782	(237)	7,297
Net income	$ 13,911	$ 21,238	$ 11,560
Basic earnings per share	$ 1.09	$ 1.69	$ 0.91
Diluted earnings per share	$ 0.78	$ 1.69	$ 0.65
Weighted average shares outstanding -- Basic	12,722	12,543	12,722
Weighted average shares outstanding -- Diluted	17,823	12,543	17,681
EBITDA (b)	27,335	27,100	28,315
Depreciation and amortization	2,638	2,634	5,172

(a) Special charges in fiscal 2000 relate to consulting services, accounting fees, bank fees, legal fees and other expenses related to the Company's default on its Credit Agreement and related financial transactions. The Company engaged the services of a crisis management consulting firm and numerous other professionals to advise management during the complex negotiations with the bank, vendors and potential investors

(b) The Company's definition of EBITDA is earnings before interest, taxes, depreciation and amortization, and exclusive of special charges, as defined above.

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	QUARTER ENDED		SI
	DECEMBER 30, 2000	JANUARY 1, 2000	DECEMBER 2000
	(Unaudited)		
STORE DATA:			
COMPANY-OWNED:			
Stores open at beginning of period	198	199	1
Stores opened	--	--	
Stores closed	--	(1)	
Stores acquired from franchisees	--	--	
Stores sold to franchisees	(3)	--	
Stores open at end of period	195	198	1
FRANCHISE:			
Stores open at beginning of period	228	207	2
Stores opened	28	--	
Stores closed	--	(1)	
Stores sold to Company	--	--	
Stores acquired from Company	3	--	

Stores open at end of period	259	206	2
Total stores chainwide	454	404	4
Increase in Company-owned same store sales	6.0%	3.9%	9
Increase in franchise same store sales	0.4%	12.1%	2
Average sales per Company-owned store	$ 707.9	$ 661.8	$ 1,102
BALANCE SHEET DATA:			
Working capital	$ 30,938	$ 21,629	$ 30,9
Total assets	158,478	141,472	158,4
Bank borrowings and other debt, net of discount	35,045	36,325	35,0
Capital lease obligation	536	880	5
Stockholders' equity	52,421	47,668	52,4

QUARTER ENDED DECEMBER 30, 2000 COMPARED TO QUARTER ENDED JANUARY 1, 2000

Retail. Net sales from Company-owned stores increased 5.6% to $138.0 million for the second quarter from $130.8 million for the second quarter of the prior fiscal year. Same store sales increased 6.0% in the second quarter. Gross profit reflects the cost of goods sold and store occupancy costs, including rent, common area maintenance, real estate taxes, repair and maintenance, depreciation and utilities. Gross profit for the second quarter increased 7.0% to $54.6 million from $51.0 million for the second quarter of the prior fiscal year. The increase was primarily due to increased sales volume. Gross margin was 39.6% for the second quarter compared with 39.0% for the second quarter of the prior fiscal year. The increase in gross margin is related primarily to an increase in vendor discounts and rebates in the second quarter which were achieved based on increased sales volume.

Store operating and selling expenses increased 14.5% to $29.4 million for the second quarter from $25.7 million in the second quarter of the prior fiscal year. The increase in store operating expenses is attributable primarily to increased payroll expenses of $1.3 million, increased advertising expense of $1.6 million and increased supplies expense of $589,000. Store operating and selling expenses were 21.3% and 19.6% of sales for the second quarter of fiscal 2001 and fiscal 2000, respectively. Company-owned stores recorded a contribution of $25.2 million for the second quarter compared to $25.4 million for the second quarter of the prior fiscal year.

Franchising. Franchise revenue is composed of the initial franchise fees that are recorded as revenue when the store opens, and ongoing royalty fees, generally 4.0% of the store's net sales. Franchise fees, recognized on 28 store openings were $183,000 for the second quarter. No franchise stores opened during

the second quarter of the last fiscal year. Royalty fees increased 3.5% to $5.5 million in the second quarter from $5.3 million in the second quarter of the prior fiscal year primarily due to an increase in the number of stores and a same store sales increase of 0.4% for the franchise stores in the second quarter.

Expenses directly related to franchise revenue were $1.2 million for the second quarter. As a percentage of franchise revenue, franchise expenses were 20.5% and 21.8% for the second quarter of fiscal 2001 and fiscal 2000, respectively.

Franchise profit contribution increased 8.8% to $4.5 million for the second quarter from $4.1 million for the second quarter of the last fiscal year. The increase in franchise profit contribution is due to higher revenues from the increased number of franchise stores.

General and Administrative Expenses. General and administrative expenses decreased 21.8% to $5.0 million in the second quarter from $6.4 million in the second quarter of the last fiscal year. This decrease is attributable in part to $1.4 million in special charges relating to consulting, accounting, banking and other expenses resulting from the Company's refinancing arrangements in the second quarter of the last fiscal year. Exclusive of the $1.4 million in special charges discussed above, general and administrative expenses were 3.6% and 3.9% of sales for the second quarter of fiscal 2001 and fiscal 2000, respectively.

Interest Expense. Interest expense decreased 3.2% to $2.0 million for the second quarter from $2.1 million in the second quarter of the last fiscal year. The decreased expense is primarily attributable to lower average borrowings outstanding.

Income Taxes. Taxes of $8.8 million were recorded in the second quarter of fiscal 2001, compared to a benefit of $237,000 in the second quarter of the previous fiscal year. The effective income tax rate was 38.7% in the second quarter compared to a 1.1% benefit recorded in the second quarter of the prior fiscal year. The disproportionate tax benefit recorded in the prior fiscal year was primarily due to reduced valuation allowances against deferred tax assets and the use of previous federal and state net operating losses.

Net Income. As a result of the above factors, net income for the second quarter was $13.9 million, or $0.78 per diluted share, as compared to net income of $21.2 million, or $1.69 per basic and diluted share in second quarter of the last fiscal year. The calculation of fully diluted earnings per share in the second quarter includes the effect of warrants outstanding which were not dilutive in the second quarter of the prior year.

SIX MONTHS ENDED DECEMBER 30, 2000 COMPARED TO SIX MONTHS ENDED JANUARY 1, 2000

Retail. Net sales from Company-owned stores increased 8.2% to $214.9 million for the six months ended December 30, 2000, from $198.6 million for the six months ended January 1, 2000. This increase is the result of the maturing of stores opened in the 1998 period plus same-store sales increases due to better in-stock positions. Same store sales increased 9.7% in the six-month period ended December 30, 2000. Gross profit reflects the cost of goods sold and store occupancy costs including rent, common area maintenance, real estate taxes, repair and maintenance, depreciation and utilities. Gross profit for the six-month period ended December 30, 2000 increased 11.5% to $76.0 million from $68.1 million for the six-month period ended January 1, 2000. The increase was primarily due to increased sales volume. Gross margin was 35.4% for the six months ended December 30, 2000 compared with 34.3% for the six months ended January 1, 2000. The increase in gross margin is related primarily to an increase in vendor discounts and rebates in the six month period ended December 30, 2000 compared to the comparable period in the prior fiscal year which were achieved based on increased sales volume.

Store operating and selling expenses increased 7.5% to $49.1 million for the six-month period ended December 30, 2000 from $45.7 million in the six-month period ended January 1, 2000. The increase in store operating expenses is attributable primarily to increased payroll expenses of $1.5 million, increased advertising expense of $1.2 million and increased supplies expense of $527,000. Store operating and selling expenses were 22.9% and 23.0% of sales for the six-month periods ended December 30, 2000 and

January 1, 2000, respectively. Company-owned stores recorded a profit contribution of $26.9 million for the six-month period ended December 30, 2000, compared to a contribution of $22.5 million for the comparable period in the previous fiscal year. The increased contribution was primarily the result of improved margin and increased sales.

Franchising. Franchise revenue is composed of the initial franchise fees that are recorded as revenue when the store opens and ongoing royalty fees, generally 4% of the store's net sales. Franchise fees recognized on 46 store openings were $609,000 for the six-month period ended December 30, 2000, compared to $322,000 for the comparable period in the prior fiscal year, which represents 12 store openings. Royalty fees increased 9.0% to $8.3 million in the six month period ended December 30, 2000 from $7.6 million in the comparable period in the prior fiscal year due primarily to an increase in the number of franchise stores and same-store sales increases of 2.4%.

Expenses directly related to franchise revenue increased 6.1% to $2.4 million for the six-month period ended December 30, 2000 from $2.3 million for the comparable quarter. As a percentage of franchise revenue, franchise expenses were 27.2% and 28.7% for the six-month periods ended December 30, 2000 and January 1, 2000, respectively.

Franchise profit contribution increased 14.7% to $6.5 million for the six-month period ended December 30, 2000 from $5.6 million for the six-month period ended January 1, 2000. The increase in franchise profit contribution is due to higher revenues from the increased number of franchise stores and same store sales increases.

General and Administrative. General and administrative expenses decreased 31.3% to $10.2 million in the six-month period ended December 30, 2000 from $14.9 million in the six-month period ended January 1, 2000. This decrease is primarily attributable to $6.3 million in special charges relating to consulting, accounting, banking and other expenses resulting from the Company's refinancing arrangements recorded in the six-month period ended January 1, 2000. Exclusive of the $6.3 million in special charges discussed above, general and administrative expenses were 4.8% and 4.3% of sales for the six-month periods ended December 30, 2000 and January 1, 2000, respectively.

Interest Expense. Interest expense decreased 4.8% to $4.3 million for the six-month period ended December 30, 2000 from $4.5 million in the six-month period ended January 1, 2000. The decreased expense is primarily attributable to lower average borrowings because of improved liquidity.

Income Taxes (Benefit). Taxes of $7.3 million were recorded in the six-month period ended December 30, 2000 compared to a benefit of $237,000 in the six-month period ended January 1, 2000. The effective income tax rate was 38.7% in the six-month period ended December 30, 2000 compared to a 2.7% benefit recorded in the six-month period ended January 1, 2000. The disproportionate tax benefit recorded in the prior fiscal year was primarily due to reduced valuation allowances against deferred tax assets and the use of previous federal and state net operating losses.

Net Income. As a result of the above factors, net income for the six-month period ended December 30, 2000 was $11.6 million, or $0.65 per diluted share, compared to a net income of $9.0 million, or $0.72 per basic and diluted share in the six-month period ended January 1, 2000.

LIQUIDITY AND CAPITAL RESOURCES

For the six-month period ended December 30, 2000, cash provided by operating activities increased 169% to $31.7 million, compared to $11.8 million for the six-month period ended January 1, 2000. The increase in cash provided by operating activities was primarily attributable to a $12.3 million increase in accounts payable, a $2.7 million increase in accrued expenses and net income of $11.6 million offset by a $9.0 million increase in inventory.

Cash used in investing activities for the six months ended December 30, 2000 was $3.7 million compared to cash provided by investing activities of $8.1 million in the comparable period in the last fiscal

year. The change in cash used in investing activities was primarily attributable to the sales of stores to franchisees in the second quarter of fiscal 2000, one store acquisition in the first quarter of fiscal 2001 and increased investment in property and equipment in the first six months of fiscal 2001 compared to the first six months of the prior fiscal year.

Cash provided by financing activities was $11,000 for the six months ended December 30, 2000, compared to cash used in financing activities of $20.3 million in the comparable period in the previous fiscal year.

The Company has a Loan and Security Agreement (the "Loan Agreement") with Congress Financial Corporation ("Congress"), as lender. Under the terms of the Loan Agreement, the Company may from time to time borrow amounts based on a percentage of its eligible inventory, up to a maximum of $40 million at any time outstanding. Advances drawn under the Loan Agreement bear interest, at the Company's option, (i) at the adjusted Eurodollar rate plus the applicable margin, which was 2.75% per annum (subject to possible reduction to an interest rate as low as 2.25% from and after June 30, 2001, based on the Company's pre-tax income and excess availability) or (ii) at the rate of 3/4% per annum above the prime rate, totaling 10.25% at December 30, 2000. The term of the Loan Agreement is three years, and is secured by a lien on substantially all of the assets of the Company. At February 8, 2001, there was no balance outstanding and $27.4 million was available to be borrowed under the Loan Agreement.

Company management currently believes that the cash generated by operations, together with the borrowing availability under the Loan Agreement, will be sufficient to meet the Company's working capital needs for the next twelve months as well as the principal payment of $14.7 million due in January 2002. A required payment of $5.1 million was made on January 31, 2001. The Company's current liquidity position is strong and will support continued reduction in principal balance.

The Company continues to pursue the expansion plans detailed in its 10-K which include, but are not limited to opening more stores, increasing franchised stores and exploring acquisition opportunities.

ACCOUNTING AND REPORTING CHANGES

In November 1999, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 101, "Revenue Recognition." This bulleting sets forth the SEC Staff's position regarding the point at which it is appropriate for a Registrant to recognize revenue. The Staff believes that revenue is realizable and earned when all of the following criteria are met: persuasive evidence of an arrangement exists; delivery has occurred or service has been rendered; the seller's price to the buyer is fixed or determinable; and collectibility is reasonably assured. The Company uses the above criteria to determine whether revenue can be recognized, and therefore believes that the issuance of this bulletin does not have a material impact on its financial statements.

FORWARD-LOOKING STATEMENTS

This Form 10-Q (including the information incorporated herein by reference) contains forward-looking statements within the meaning of The Private Securities Litigation Reform Act of 1995. The statements are made a number of times throughout the document and may be identified by forward-looking terminology as "estimate", "project", "expect", "believe", "may", "will", "intend" or similar statements or variations of such terms. Such forward-looking statements involve certain risks and uncertainties, and include, among others, the following: levels of sales, store traffic, acceptance of product offerings, competitive pressures from other party supplies retailers, availability of qualified personnel, availability of suitable future store locations, schedules of store expansion plans and year 2000 readiness issues relating to the Company's internal systems and those of third parties and other factors. As a result of the foregoing risks and uncertainties, actual results and performance may differ materially from that projected or suggested herein. Additional information concerning certain risks and uncertainties that could cause actual results to differ materially from that projected or suggested may be identified from time to time in the Company's Securities and Exchange Commission filings and the Company's public announcements.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Securities Litigation

The Company has been named as a defendant in twelve class action complaints. The Company's former Chief Executive Officer and former Chief Financial Officer and Executive Vice President of Operations have also been named as defendants. The complaints have all been filed in the United States District Court for the District of New Jersey. The complaints were filed as class actions on behalf of persons who purchased or acquired Party City common stock during various time periods between February 1998 and March 19, 1999. In October 1999, plaintiffs filed an amended class action complaint and in February 2000, plaintiffs filed a second amended complaint.

The second amended complaint alleges, among other things, violations of sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, and seeks unspecified damages. The plaintiffs allege that defendants issued a series of false and misleading statements and failed to disclose material facts concerning, among other things, the Company's financial condition, adequacy of internal controls and compliance with certain loan covenants. The plaintiffs further allege that because of the issuance of a series of false and misleading statements and/or failure to disclose material facts, the price of Party City common stock was artificially inflated.

Defendants have moved to dismiss the second amended complaint on the ground that it fails to state a cause of action. The Court has not yet issued a decision with respect to the motion to dismiss. Because this case is in its early stages, no opinion can be expressed as to its likely outcome.

Other

On April 23, 1999, plaintiff Emil Asch, Inc. ("Emil Asch") filed a complaint in the United States District Court for the Eastern District of New York against the Company and co-defendants Amscan, Inc., Hallmark, Inc., and Rubie's Costume. The complaint alleges five claims which pertain to price discrimination under the Robinson-Patman Act, unfair competition, tortious interference with contractual relations, and false and deceptive advertising. Plaintiff seeks damages of $2 million, as well as treble and punitive damages for certain counts.

On February 3, 2000, Emil Asch amended its complaint by adding Ron's: The Party Store, Inc., as an additional plaintiff to the suit. The amended complaint asserts the same causes of action against the same defendants and seeks the same damages that were sought in the original complaint. The Company has answered the amended complaint, and discovery is proceeding. At this point, no opinion can be expressed as to the likely outcome of the litigation.

Although the Company's management is unable to express a view on the likely outcome of these litigations because they are in their early stages, they could have a material adverse effect on the Company's business and results of operations.

In addition to the foregoing, the Company is from time to time involved in ordinary, routine litigation incidental to the conduct of its business. The Company is aware of no other material existing or threatened litigation to which it is or may be a party.

ITEM 2. CHANGES IN SECURITIES

None

ITEM 3. DEFAULTS UNDER SENIOR SECURITIES AND USE OF PROCEEDS

None

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The Company's 2000 Annual Meeting of Stockholders was held on Wednesday, November 15, 2000 for the following purposes:

1. To elect six directors to the Board of Directors who shall serve until the 2001 Annual Meeting of Stockholders, or until their successors are elected and qualified. ("Proposal 1")

2. To approve an amendment and restatement of the Company's 1999 Stock Incentive Plan increasing the number of shares of the Company's common stock issuable pursuant to options and awards granted under the Plan from 500,000 to 2,000,000. ("Proposal 2")

The voting as to each Proposal was as follows:

PROPOSAL 1

Name	For	Withheld
Ralph Dillon	10,585,057	32,954
Jack Futterman	8,918,831	1,699,180
L. R. Jalenak, Jr.	10,562,962	55,049
Howard Levkowitz	10,584,512	33,499
Edward Mule	10,591,312	26,699

Michael Tennenbaum	10,593,662	24,349

PROPOSAL 2

For	Against	Abstain
3,475,270	336,209	31,708

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) The exhibits required to be filed as part of this report on Form 10-Q are listed in the attached Exhibit Index.

(b) Reports on Form 8-K: Report on Form 8-K dated October 10, 2000 Report of Form 8-K dated November 29, 2000

EXHIBIT INDEX

Exhibit No.

3.1(1) -- Certificate of Incorporation of the Company.

3.2(4) -- Bylaws of the Company, as amended.

4.1(1) -- Specimen stock certificate evidencing the Common Stock.

4.2(5) -- Form of Amended and Restated Warrant.

4.3(2) -- Form of A Note.

4.4(2) -- Form of B Note.

4.5(2) -- Form of C Note.

4.6(2) -- Form of D Note.

4.7(5) -- Form of E Note.

4.8(2) -- Form of Securities Purchase Agreement, dated as of August 16, 1999, by and between the Company and each of the Investors.

4.9(5) -- First Amendment to Securities Purchase Agreement, dated as of January 14, 2000, by and between the Company and each of the Investors.

10.1(1) -- Form of Unit Franchise Agreement entered into by the Company and franchisees.

10.2	--	Amended and Restated Stock Option Plan of the Company.
10.3(3)	--	Option Agreement, dated as of June 8, 1999, between Steven Mandell and Jack Futterman.
10.4(3)	--	Stock Pledge Agreement, dated as of June 8, 1999, between Steven Mandell and Jack Futterman.
10.5(3)	--	Employment Agreement, dated as of June 8, 1999, between the Company and Jack Futterman.
10.6(2)	--	Investor Rights Agreement, dated as of August 16, 1999, by and among the Company, the Investors and Jack Futterman.
10.7(2)	--	Standstill and Forbearance Agreement, dated as of August 16, 1999, by and among the Company, PNC Bank, National Association, as Agent, and the Banks.
10.8(2)	--	Vendor Forbearance and Standstill Agreement, dated as of August 16, 1999, by and among the Company and the Trade Vendors.
10.9(5)	--	Loan and Security Agreement, dated January 14, 2000, by and between the Company and Congress Financial Corporation.
10.10	--	Description of oral consulting agreement between the Company and Ralph Dillon.
10.11	--	Employment Agreement of James Shea, dated as of December 10, 1999, by and between the Company and James Shea.
10.12	--	Employment Agreement of Andrew Bailen, dated as of August 7, 2000, by and between the Company and Andrew Bailen.
10.13	--	Employment Agreement of Gordon Keil, dated as of April 12, 2000, by and between the Company and Gordon Keil.
10.14	--	Employment Agreement of Thomas Larson, dated as of June 18, 1999, by and between the Company and Thomas Larson.

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21.1	--	Subsidiaries. The wholly owned subsidiary of the Company is Party City Michigan, Inc. incorporated on October 23, 1997, in the State of Delaware. This subsidiary does business under the name Party City Michigan, Inc.

Notes

1. Incorporated by reference to the Company's Registration Statement as amended on Form S-1 Number 333-350 as filed with the Commission on January 18, 1996.

2. Incorporated by reference to the Company's Current Report on Form 8-K as filed with the Commission on August 25, 1999.

3. Incorporated by reference to Amendment No. 1 to Schedule 13D as filed

with the Commission on June 30, 1999.

4. Incorporated by reference to the Company's Current Report on Form 8-K as filed with the Commission on February 17, 2000.

5. Incorporated by reference to the Company's Current Report on Form 8-K as filed with the Commission on January 19, 2000.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PARTY CITY CORPORATION

By /s/ James Shea
James Shea
Chief Executive Officer

By /s/ Thomas E. Larson
Thomas E. Larson
Chief Financial Officer

By /s/ Linda M. Siluk
Linda M. Siluk
Chief Accounting Officer

Date: February 12, 2001