IPARTY CORP
Form 10-Q
October 29, 2008

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

FORM 10-Q

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

For the Quarterly Period Ended September 27, 2008

OR

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

For the Transition Period from _______________ to _______________

Commission File Number 1-15611

iPARTY CORP.
(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	76-0547750 (I.R.S. Employer Identification No.)
270 Bridge Street, Suite 301, Dedham, Massachusetts (Address of Principal Executive Offices)	02026 (Zip Code)

(781) 329-3952
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

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

Large accelerated filer o Accelerated filer o

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

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

As of October 24, 2008 there were 22,731,667 shares of common stock, $.001 par value, outstanding.

iPARTY CORP.
QUARTERLY REPORT ON FORM 10-Q
TABLE OF CONTENTS

PART I - FINANCIAL INFORMATION

PART II - OTHER INFORMATION

PART I - FINANCIAL INFORMATION
Item 1. Financial Statements

iPARTY CORP.
CONSOLIDATED BALANCE SHEETS (unaudited)

	Sep 27, 2008	Dec 29, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 62,563	$ 71,532
Restricted cash	556,961	862,536
Accounts receivable	1,108,727	1,105,807
Inventory, net	17,391,470	13,639,531
Prepaid expenses and other assets	1,188,989	996,779
Total current assets	20,308,710	16,676,185
Property and equipment, net	3,965,581	4,360,123
Intangible assets, net	2,452,219	1,756,800
Other assets	195,081	183,978
Total assets	$ 26,921,591	$ 22,977,086
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 9,946,813	$ 4,723,370
Accrued expenses	2,668,414	2,503,752
Current portion of capital lease obligations	14,754	30,473
Current notes payable, net of discount $187,504	2,986,545	620,706
Borrowings under line of credit	4,320,714	2,613,511
Total current liabilities	19,937,240	10,491,812
Long-term liabilities:		
Capital lease obligations, net of current portion	-	9,213
Notes payable	600,000	3,271,632
Other liabilities	1,170,612	1,113,522
Total long-term liabilities	1,770,612	4,394,367
Commitments and contingencies		
Stockholders' equity:		
Convertible preferred stock - $.001 par value; 10,000,000 shares authorized,		
Series B convertible preferred stock - 1,150,000 shares authorized; 463,086 and 465,401 shares issued and outstanding at September 27, 2008 and December 29, 2007, respectively (aggregate liquidation value of $9,261,724 at September 27, 2008)	6,890,723	6,925,170
Series C convertible preferred stock - 100,000 shares authorized, issued and outstanding (aggregate liquidation value of $2,000,000 at September 27, 2008)	1,492,000	1,492,000
Series D convertible preferred stock - 250,000 shares authorized, issued and outstanding (aggregate liquidation value of $5,000,000 at September 27, 2008)	3,652,500	3,652,500
Series E convertible preferred stock - 296,666 shares authorized, issued and outstanding (aggregate liquidation value of $1,112,497 at September 27, 2008)	1,112,497	1,112,497
Series F convertible preferred stock - 114,286 shares authorized, issued and outstanding		

(aggregate liquidation value of $500,000 at September 27, 2008)	500,000	500,000
Total convertible preferred stock	13,647,720	13,682,167
Common stock - $.001 par value; 150,000,000 shares authorized; 22,731,667 and 22,700,655 shares issued and outstanding at September 27, 2008 and December 29, 2007, respectively	22,732	22,701
Additional paid-in capital	52,055,281	51,894,481
Accumulated deficit	(60,511,994)	(57,508,442)
Total stockholders' equity	5,213,739	8,090,907
Total liabilities and stockholders' equity	$ 26,921,591	$ 22,977,086

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

iPARTY CORP.
CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

	For the three months ended		For the nine months ended	
	Sep 27, 2008	Sep 29, 2007	Sep 27, 2008	Sep 29, 2007
Revenues	$ 17,742,315	$ 18,208,760	$ 53,990,071	$ 54,219,838
Operating costs:				
Cost of products sold and occupancy costs	10,629,144	10,679,713	32,225,078	31,687,361
Marketing and sales	6,677,703	6,620,424	18,703,915	18,286,196
General and administrative	1,580,277	1,828,865	5,490,076	5,700,919
Operating loss	(1,144,809)	(920,242)	(2,428,998)	(1,454,638)
Interest income	240	1,198	2,160	4,679
Interest expense	(178,061)	(214,614)	(576,714)	(674,417)
Net loss	$ (1,322,630)	$ (1,133,658)	$ (3,003,552)	$ (2,124,376)
Income loss per share:				
Basic and diluted	$ (0.06)	$ (0.05)	$ (0.13)	$ (0.09)
Weighted-average shares outstanding:				
Basic and diluted	22,730,295	22,642,280	22,719,425	22,626,550

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

iPARTY CORP.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	For the nine months ended	
	Sep 27, 2008	Sep 29, 2007
Operating activities:		
Net loss	$ (3,003,552)	$ (2,124,376)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and amortization	1,522,738	1,264,302
Deferred rent	57,090	138,490
Non cash stock based compensation expense	119,153	87,071
Non cash warrant expense	160,644	153,413
Changes in operating assets and liabilities:		
Accounts receivable	(2,920)	47,058
Inventory	(3,751,939)	(5,097,011)
Prepaid expenses and other assets	(77,449)	(469,127)
Accounts payable	5,223,443	5,486,523
Accrued expenses and other liabilities	164,662	(246,920)
Net cash provided by (used in) operating activities	411,870	(760,577)
Investing activities:		
Acquisition of retail stores and non-compete agreement	(1,350,000)	-
Purchase of property and equipment	(643,878)	(650,536)
Net cash used in investing activities	(1,993,878)	(650,536)
Financing activities:		
Net borrowings under line of credit	1,707,203	1,381,960
Principal payments on notes payable	(459,206)	(455,433)
Decrease in restricted cash	305,575	71,483
Principal payments on capital lease obligations	(24,932)	(338,220)
Deferred financing costs	44,399	51,951
Proceeds from exercise of stock options	-	4,583
Net cash provided by financing activities	1,573,039	716,324
Net decrease in cash and cash equivalents	(8,969)	(694,789)
Cash and cash equivalents, beginning of period	71,532	760,376
Cash and cash equivalents, end of period	$ 62,563	$ 65,587
Supplemental disclosure of non-cash financing activities:		
Conversion of Series B convertible preferred stock to common stock	$ 34,447	$ 44,640

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

iPARTY CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 27, 2008
(Unaudited)

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES:

Interim Financial Information

The interim consolidated financial statements as of September 27, 2008 have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") for interim financial reporting. These consolidated statements are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring adjustments and accruals) necessary to present fairly the consolidated balance sheets, consolidated operating results, and consolidated cash flows for the periods presented in accordance with U.S. generally accepted accounting principles. The consolidated balance sheet at December 29, 2007 has been derived from the audited consolidated financial statements at that date. Operating results for the Company on a quarterly basis may not be indicative of the results for the entire year due, in part, to the seasonality of the party goods industry. Historically, higher revenues and operating income have been experienced in the second and fourth fiscal quarters, while the Company has generated losses in the first and third quarters. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been omitted in accordance with the rules and regulations of the SEC. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements, and accompanying notes, included in the Company's Annual Report on Form 10-K, for the year ended December 29, 2007.

Principles of Consolidation

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

Revenue Recognition

Revenues include the selling price of party goods sold, net of returns and discounts, and are recognized at the point of sale. The Company estimates returns based upon historical return rates and such amounts have not been significant.

Concentrations

The Company purchases its inventory from a diverse group of vendors. Five suppliers account for approximately 43% of the Company's purchases of merchandise for the nine months ended September 27, 2008, but the Company does not believe that it is overly dependent upon any single source for its merchandise, often using more than one vendor for similar kinds of products. The Company entered into a Supply Agreement with its largest supplier on August 7, 2006. The Supply Agreement had a ramp-up period during 2006 and 2007 and, for five years beginning with calendar year 2008, requires the Company to purchase on an annual basis merchandise equal to the total number of stores open during such calendar year, multiplied by $180,000. The Supply Agreement provides for penalties in the event the Company fails to attain the annual purchase commitment that would require the Company to pay the difference between the purchases for that year and the annual purchase commitment for that year. Under the terms of the Supply Agreement, the annual purchase commitment for any individual year can be reduced for orders placed by the Company but not filled within a specified time period by the supplier. During 2008, the supplier experienced difficulty in filling completely certain orders sourced out of China. Accordingly, the supplier agreed to reduce the Company's purchase commitment for 2008 to 90% of the contractual minimum for that year. The Company is not aware of any reason or circumstance that would prevent the minimum purchase amount commitments, as adjusted, under the Supply Agreement from being met.

Accounts receivable primarily represent amounts due from credit card companies and vendors for inventory rebates. Management does not provide for doubtful accounts as such amounts have not been significant to date; the Company does not require collateral.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Cash and Cash Equivalents and Restricted Cash

The Company considers all highly liquid investments with an original maturity date of three months or less to be cash equivalents. Cash equivalents consist primarily of store cash funds and daily store receipts in transit to our concentration bank and are carried at cost.

The Company uses controlled disbursement banking arrangements as part of its cash management program. Outstanding checks, which were included in accounts payable, totaled $1,099,796 at September 27, 2008 and $329,756 at December 29, 2007. The increase in outstanding checks as of September 27, 2008 is due to the timing of payments made in September 2008 compared to the timing of payments made in December 2007.

Restricted cash represents funds on deposit established for the benefit of and under the control of Wells Fargo Retail Finance II, LLC, the Company's lender under its line of credit, and constitutes collateral for amounts outstanding under the Company's line of credit.

Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, accounts receivable and accounts payable approximate fair value because of the short-term nature of these instruments. The fair value of borrowings under the Company's line of credit approximates carrying value because the debt bears interest at a variable market rate. The fair value of the capital lease obligations approximates the carrying value. The fair value of the notes payable approximates the carrying value since the majority of the principal bears interest at a variable market rate. The fair value of the warrants issued in 2006 was determined by using the Black-Scholes model (volatility of 108%, interest of 4.73% and expected life of five years). The fair value of the warrants issued in 2008 was also determined by using the Black-Scholes model (volatility of 101%, risk free rate of 3.21% and expected life of five years).

Inventories

Inventories consist of party supplies and are valued at the lower of moving weighted-average cost or market. Inventory has been reduced by an allowance for obsolete and excess inventory, which is based on management's review of inventories on hand compared to estimated future sales. The Company records vendor rebates, discounts and certain other adjustments to inventory, including freight costs, and these amounts are recognized in the income statement as the related goods are sold.

The activity in the allowance for obsolete and excess inventory is as follows:

	Nine months ended Sep 27, 2008	Twelve months ended Dec 29, 2007
Beginning balance	$ 969,859	$ 1,079,814
Increases to reserve	265,000	263,847
Write-offs against reserve	(381,358)	(373,802)
Ending balance	$ 853,501	$ 969,859

6

Income Taxes

The Company adopted the provisions of Financial Accounting Standards Board ("FASB") Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 ("FIN 48") on December 31, 2006. At the adoption date and as of September 27, 2008, the Company had no material unrecognized tax benefits and upon adoption on December 31, 2006 no adjustments to liabilities, retained earnings or operations were required.

Net Loss per Share

Net loss per basic share is computed by dividing net loss available to common shareholders by the weighted-average number of common shares outstanding. The common share equivalents of Series B-F preferred stock are required to be included in the calculation of net loss per basic share in accordance with EITF Consensus 03-6, Participating Securities and the Two-Class Method under SFAS No. 128, which supersedes EITF Topic D-95, Effect of Participating Convertible Securities on the Computation of Basic Earnings Per Share. Since the preferred stockholders are entitled to participate in dividends when and if declared by the Board of Directors on the same basis as if the shares of Series B-F preferred stock were converted to common stock, the application of EITF 03-6 has no effect on the amount of loss per basic share of common stock. For periods with net losses, the Company does not allocate losses to Series B-F preferred stock.

Net loss per diluted share under EITF 03-6 is computed by dividing net loss by the weighted average number of common shares outstanding, plus the common share equivalents of Series B-F preferred stock on an as if-converted basis, plus the common share equivalents of the "in the money" stock options and warrants as computed by the treasury method. For the periods with net losses, the Company excludes those common share equivalents since their impact would be anti-dilutive.

As of September 27, 2008, there were 27,277,567 potential additional common share equivalents outstanding, which were not included in the calculation of diluted net loss per share for the nine months then ended because their effect would be anti-dilutive. These included 15,478,916 shares upon the conversion of immediately convertible preferred stock, 2,083,334 shares upon the exercise of a warrant with an exercise price of $0.475 per share, 528,210 shares upon the exercise of warrants with a weighted average exercise price of $3.79 per share, 100,000 shares upon the exercise of warrants with a weighted average exercise price of $1.50 per share and 9,087,107 shares upon the exercise of stock options with a weighted average exercise price of $0.55 per share.

Stock option compensation expense

On January 1, 2006, the Company adopted the Financial Accounting Standards Board ("FASB") Statement No. 123(R), Share-Based Payments, using the modified prospective method. Under this method, stock based compensation expense is recognized for new grants beginning in 2006 and any unvested grants prior to the adoption of Statement No. 123(R). Prior to fiscal 2006, the Company accounted for share-based payments to employees using the Accounting Principles Board ("APB") Opinion No. 25, Accounting for Stock Issued to Employees, and the disclosure-only provisions of Statement No. 123, Accounting for Stock-Based Compensation. Because the Company granted stock options to employees at exercise prices equal to fair market value on the date of grant, no stock based compensation cost was recognized for option grants in periods prior to fiscal 2006.

Under Statement No. 123(R), the Company uses the Black-Scholes option pricing model to determine the fair value of stock based compensation. The Black-Scholes model requires the Company to make several subjective assumptions, including the estimated length of time employees will retain their vested stock options before exercising them ("expected term"), and the estimated volatility of the Company's common stock price over the expected term, which is based on historical volatility of the Company's common stock over a time period equal to the expected term. The Black-Scholes model also requires a risk-free interest rate, which is based on the U.S. Treasury yield curve in effect at the time of the grant, and the dividend yield on the Company's common stock, which is assumed to be zero since the Company does not pay dividends and has no current plans to do so in the future. Changes in these assumptions can materially affect the estimate of fair value of stock based compensation and consequently, the related expense recognized on the consolidated statement of operations. Under the modified prospective method, stock based compensation expense is recognized for new grants beginning in the fiscal year ended December 30, 2006 and any unvested grants prior to the adoption of Statement No. 123(R). The Company recognizes stock based compensation expense on a straight-line basis over the vesting period of each grant.

The stock based compensation expense recognized by the Company was:

	For the three months ended		For the nine months ended	
	Sep 27, 2008	Sep 29, 2007	Sep 27, 2008	Sep 29, 2007
Stock Based Compensation Expense	$ 38,204	$ 56,633	$ 119,153	$ 87,071

Stock based compensation expense is included in general and administrative expense and had no impact on cash flow from operations and cash flow from financing activities for the nine months ended September 27, 2008.

On September 26, 2007, the Board of Directors, acting on the recommendation of the Compensation Committee, extended the expiration date on options to purchase 970,087 shares of the Company's common stock held by a former officer for an additional six months following his termination date, making the expiration date August 15, 2008. As a result, additional stock based compensation of $14,569, representing the change in the fair value of these options immediately before and after this modification, was recorded as of September 26, 2007 as required by Statement No. 123(R). The options covered by this extension were not exercised, and so expired on August 15, 2008.

Under the Company's Amended and Restated 1998 Incentive and Nonqualified Stock Option Plan (the "1998 Plan") options to acquire 11,000,000 shares of common stock may be granted to officers, directors, key employees and consultants. The exercise price for qualified incentive options cannot be less than the fair market value of the stock on the grant date and the exercise price of nonqualified options can be fixed by the Board. Options to purchase the Company's common stock under the 1998 Plan have been granted to employees, directors and consultants of the Company at fair market value at the date of grant. Generally, the options become exercisable over periods of up to four years, and expire ten years from the date of grant.

The Company granted options for the purchase of an aggregate of 200,000 shares of common stock to a key employee and each of the four independent members of the Board of Directors on June 4, 2008 at an exercise price of $0.29 per share. Similarly, the Company granted options for the purchase of an aggregate of 1,350,000 shares of common stock to key employees and each of the four independent members of the Board of Directors on June 6, 2007 at an exercise price of $0.42 per share. The weighted-average fair market value using the Black-Scholes option pricing model of the options granted on June 4, 2008 was $0.22 per share, and was $0.33 per share for the options granted on June 6, 2007. The fair market value of the stock options at the date of the grant was estimated using the Black-Scholes option-pricing model with the following weighted average assumptions:

	For the three months ended		For the nine months ended	
	Sep 27, 2008	Sep 29, 2007	Sep 27, 2008	Sep 29, 2007
Risk-free interest rate	N/A	N/A	3.21%	4.94%
Expected volatility	N/A	N/A	101.2%	102.6%
Weighted average expected life (in years)	N/A	N/A	5.0	5.0
Expected dividends	N/A	N/A	0.00%	0.00%

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

	Number of Stock Options	Weighted Average Exercise Price	Price Range			Weighted Average Remaining Life (Years)	Aggregate Intrinsic Value
Outstanding - December 29, 2007	10,130,594	$ 0.59	$ 0.13	-	$ 4.25		
Granted	200,000	0.29	0.29	-	0.29		
Expired/Forfeited	(1,243,487)	0.82	0.20	-	2.50		
Exercised	-	-	-	-	-		
Outstanding - September 27, 2008	9,087,107	$ 0.55	$ 0.13	-	$ 4.25	4.3	$ 7,400
Exercisable - September 27, 2008	8,046,494	$ 0.57	$ 0.13	-	$ 4.25	3.7	$ 7,400
Available for grant - September 27, 2008	1,477,632						

The following table summarizes information for options outstanding and exercisable at September 27, 2008:

Price Range			Outstanding Number of Stock Options	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price	Exercisable Number of Stock Options	Weighted Average Exercise Price
$ 0.13	-	$ 0.20	137,750	2.9	$ 0.18	137,750	$ 0.18
0.21	-	0.30	3,414,252	2.9	0.25	3,239,252	0.25
0.31	-	0.50	2,468,027	6.5	0.39	1,606,673	0.37
0.51	-	1.00	2,678,778	4.6	0.77	2,674,519	0.77
1.01	-	3.50	288,300	1.6	2.51	288,300	2.51
3.51	-	4.25	100,000	1.2	4.14	100,000	4.14
Total			9,087,107	4.3	$ 0.55	8,046,494	$ 0.57

The remaining unrecognized stock based compensation expense related to unvested awards at September 27, 2008, was $285,788 and the period of time over which this expense will be recognized is 3.75 years.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and are depreciated on the straight-line method over the estimated useful lives of the assets. Expenditures for maintenance and repairs are charged to operations as incurred. A listing of the estimated useful life of the various categories of property and equipment is as follows:

Asset Classification	Estimated Useful Life

Leasehold improvements	Lesser of term of lease or 10 years
Furniture and fixtures	7 years
Computer hardware and software	3 years
Equipment	5 years

Intangible Assets

On August 15, 2007, the Company entered into an Asset Purchase Agreement to purchase two franchised Party City Corporation retail stores in Lincoln, Rhode Island and Warwick, Rhode Island, in exchange for aggregate consideration of $1,350,000 plus up to $400,000 for associated inventory. On January 2, 2008, the Company completed the purchase of the two stores. The aggregate consideration paid was $1,350,000 plus approximately $195,000 for associated inventory. Funding for the purchase was obtained from the Company's existing line of credit with Wells Fargo Retail Finance II, LLC. The stores were converted into iParty stores immediately following the closing of the transaction.

Intangible assets consist primarily of (i) the values of two non-compete agreements acquired in conjunction with the purchase of retail stores in 2006 and 2008, and (ii) the values of retail store leases acquired in those transactions. These assets have been accounted for at fair value as of their respective acquisition dates using significant other observable inputs, or Level 2 criteria, specified by SFAS No. 157 (see Fair Value Measurements section below).

The first non-compete agreement, from Party City Corporation and its affiliates, covers Massachusetts, Maine, New Hampshire, Vermont, Rhode Island, and Windsor and New London counties in Connecticut, and expires in 2011. The second non-compete agreement was acquired in connection with the Company's purchase in January 2008 of the two party supply stores in Lincoln and Warwick, Rhode Island described above. It covers Rhode Island for five years from the date of closing and within a certain distance from the Company's stores in the rest of New England for three years. Both non-compete agreements have an estimated life of 60 months and are subject to certain terms and conditions in their respective acquisition agreements.

The occupancy valuations relate to acquired retail store leases for stores in Peabody, Massachusetts (estimated life of 90 months), Lincoln, Rhode Island (estimated life of 79 months) and Warwick, Rhode Island (estimated life of 96 months). Intangible assets also include legal and other transaction costs incurred related to the purchase of the Peabody, Lincoln and Warwick stores.

Intangible assets as of September 27, 2008 and December 29, 2007 were:

	Sep 27, 2008	Dec 29, 2007
Non-compete agreements	$ 2,358,540	1,688,346
Occupancy valuations	944,716	449,716
Other	157,855	182,048
Intangible assets	3,461,111	2,320,110
Less: accumulated amortization	(1,008,892)	(563,310)
Intangible assets, net	$ 2,452,219	$ 1,756,800

Amortization expense for these intangible assets was:

	For the three months ended		For the nine months ended	
	Sep 27, 2008	Sep 29, 2007	Sep 27, 2008	Sep 29, 2007
Amortization expense	$ 130,427	$ 104,392	$ 445,581	$ 333,382

The amortization expense for the non-compete agreements and other intangible assets is included in general and administrative expense in the Consolidated Statement of Operations. The amortization expense for occupancy valuation is included in cost of products sold and occupancy costs in the Consolidated Statement of Operations.

Future amortization expense related to these intangible assets as of September 27, 2008 is:

Year		Amount
2008	$	148,527
2009		697,108
2010		672,108
2011		467,412
2012		242,438
Thereafter		224,626
Total	$	2,452,219

Accounting for the Impairment of Long-Lived Assets

In accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the Company reviews each store for impairment indicators whenever events and changes in circumstances suggest that the carrying amounts may not be recoverable from estimated future store cash flows. The Company's review considers store operating results, future sales growth and cash flows. During the third quarter of 2007, the Company decided to close its stores in North Providence, Rhode Island and Auburn, Massachusetts at the end of their lease terms, which expired on January 31, 2008. No material impairment costs were incurred as a result of that decision. As of September 27, 2008, the Company does not believe that any of its assets are impaired.

Notes Payable

Notes payable consist of three notes entered into in fiscal 2006.

The "Highbridge Note" is a subordinated note in the stated principal amount of $2,500,000 that bears interest at the rate of prime plus one percent. The note matures on September 15, 2009. Interest only is payable quarterly in arrears and the entire principal balance is due at the maturity date. The original discount associated with the warrant issued in conjunction with the Highbridge Note (original discount amount $613,651) is being amortized using the effective interest method over the life of the note payable. The note payable balance of $2,312,496 as of September 27, 2008 is presented net of the remaining unamortized discount.

The "Amscan Note" is a subordinated promissory note in the original principal amount of $1,819,373, with a balance as of September 27, 2008 of $674,049. The note bears interest at the rate of 11.0% per annum and is payable in thirty-six (36) equal monthly installments of principal and interest of $59,562 beginning on November 1, 2006, and on the first day of each month thereafter until October 1, 2009, when the entire remaining principal balance and all accrued interest are due and payable.

The "Party City Note" is a subordinated promissory note in the principal amount of $600,000. The note bears interest at the rate of 12.25% per annum and is payable by quarterly interest-only payments over four years, with the full principal amount due at the note's maturity on August 7, 2010.

On August 7, 2006, the Company entered into a Supply Agreement with Amscan Inc. ("Amscan"), the largest supplier in the party goods industry. The Supply Agreement with Amscan gives the Company the right to receive certain additional rebates and more favorable pricing terms over the term of the agreement than generally were available to the Company under its previous terms with Amscan. The right to receive additional rebates, and the amount of such rebates, are subject to the Company's achievement of increased levels of purchases and other factors provided for in the Supply Agreement. In exchange, the Supply Agreement obligates the Company to purchase increased levels of merchandise from Amscan until 2012. The Supply Agreement provided for an initial ramp-up period during 2006 and 2007 and, beginning with calendar year 2008, requires the Company to purchase on an annual basis merchandise equal to the total number of its stores open during such calendar year, multiplied by $180,000 until 2012. The Supply Agreement provides for penalties in the event the Company fails to attain the annual purchase commitment. Under the terms of the Supply Agreement, the annual purchase commitment for any individual year can be reduced for orders placed by the Company but not filled by the supplier within a specified time period. During 2008, the supplier experienced difficulty in filling completely certain orders sourced out of China. Accordingly, the supplier agreed to reduce the Company's purchase commitment for 2008 to 90% of the contractual minimum for that year.

The Supply Agreement also provided for Amscan to extend, until October 31, 2006, approximately $1,150,000 of certain currently due amounts owed by the Company to Amscan which would otherwise have been payable on August 8, 2006 (the "extended payables") and gave the Company the right, at its option, to convert the extended payables into a subordinated promissory note. On October 24, 2006, the Company converted $1,143,896 of extended payables originally due to Amscan as of August 8, 2006 as well as an additional $675,477 of payables due to Amscan as of September 28, 2006 into a single subordinated promissory note in the total principal amount of $1,819,373, which is the Amscan Note defined above.

On August 7, 2006, the Company also entered into and simultaneously closed an Asset Purchase Agreement with Party City, an affiliate of Amscan, pursuant to which the Company acquired a Party City retail party goods store in Peabody, Massachusetts and received a five-year non-competition covenant from Party City, for aggregate consideration of $2,450,000, payable by a subordinated note in the principal amount of $600,000, which is the Party City Note defined above, and $1,850,000 in cash.

Stockholders' Equity

During the nine months ended September 27, 2008, there were no exercises of stock options, and 31,012 shares of common stock were issued upon conversion of 2,315 shares of Series B convertible preferred stock.

Fair Value Measurements

Effective December 30, 2007, the Company adopted SFAS No. 157, Fair Value Measurements. SFAS No. 157 defines fair value as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS No. 157 also describes three levels of inputs that may be used to measure the fair value:

Level 1 – quoted prices in active markets for identical assets or liabilities

Level 2 – observable inputs other than quoted prices in active markets for identical assets or liabilities

Level 3 – unobservable inputs in which there is little or no market data available, which require the reporting entity to develop its own assumptions

The adoption of SFAS No. 157 had no effect on the Company's financial statements and related disclosures since the Company does not have financial assets or liabilities on a recurring basis that are subject to the provisions of SFAS No. 157.

Reclassifications

Certain prior year balances have been reclassified to conform to current year presentation.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the unaudited Consolidated Financial Statements and related Notes included in Item 1 of this Quarterly Report on Form 10-Q and the audited Consolidated Financial Statements and related Notes and Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations", contained in our Annual Report on Form 10-K for the fiscal year ended December 29, 2007.

Certain statements in this Quarterly Report on Form 10-Q, particularly statements contained in this Item 2, "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 o 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 Quarterly Report on Form 10-Q or hereafter included in other publicly available documents filed with the Securities and Exchange Commission ("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 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, the forward-looking statements contained in this Quarterly Report on Form 10-Q. These include, but are not limited to, those described below under the heading "Factors That May Affect Future Results" and in Part II, Item 1A, "Risk Factors" as well as under Item 1A, "Risk Factors" of our most recently filed Annual Report on Form 10-K for the year ended December 29, 2007.

Overview

We believe we are a leading brand in the party industry in the markets we serve and a leading resource in those markets for consumers seeking party goods, party planning advice and relevant information. We are a party goods retailer operating stores throughout New England, where 45 of our 50 retail stores are located. We also license the name "iparty.com" (at www.iparty.com) to a third party in exchange for royalties, which to date have not been significant.

Our 50 retail stores are located predominantly in New England with 25 stores in Massachusetts, 7 in Connecticut, 6 in New Hampshire, 3 in Rhode Island, 3 in Maine and 1 in Vermont. We also operate 5 stores in Florida. Our stores range in size from approximately 8,000 square feet to 20,300 square feet and average approximately 10,200 square feet in size. We lease our properties, typically for 10 years and usually with options from our landlords to renew our leases for an additional 5 or 10 years.

The following table shows the number of stores in operation (not including temporary stores):

	For the nine months ended	
	Sep 27, 2008	Sep 29, 2007
Beginning of period	50	50
Openings / Acquisitions	2	-
Closings	(2)	-

End of period	50	50

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 driven by the following holiday and party events: Halloween, Christmas, Easter, Valentine's Day, New Year's, Independence Day, St. Patrick's Day, Thanksgiving, Hanukkah and professional sports playoff events. We also focus our business closely on lifetime events such as anniversaries, graduations, birthdays, and bridal or baby showers.

In addition to the stores discussed in the paragraphs above, we opened two temporary Halloween stores in the greater Boston area in September of 2008. These stores feature a strategically selected assortment of Halloween related merchandise and are expected to remain open only through early November.

Trends and Quarterly Summary

Our business has a seasonal pattern. In the past three years, we have realized approximately 36.5% of our annual revenues in our fourth quarter, which includes Halloween and Christmas, and approximately 23.8% of our revenues in the second quarter, which includes school graduations. Also, during the past three years, we have had net income in our second and fourth quarters and generated losses in our first and third quarters.

For the third quarter of 2008, our consolidated revenues were $17.7 million, compared to $18.2 million for the third quarter in 2007. The decrease in third quarter revenues from the year-ago period included a 4.2% decrease in comparable store sales from stores open more than one year. The decrease in consolidated revenue was primarily due to decreased customer traffic during the quarter partly offset by an improvement in the average transaction size. Consolidated gross profit margin was 40.1% for the third quarter of 2008 compared to a margin of 41.3% for the same period in 2007. The decline in gross margins was substantially due to increases in occupancy costs as well as the decreased leveraging of those costs related to lower sales. The consolidated net loss for the third quarter of 2008 was $1,322,630, or $0.06 per share, compared to a consolidated net loss of $1,133,658, or $0.05 per share, for the third quarter in 2007.

Acquisition and Growth Strategy

We operate in a largely un-branded market that has many small businesses. As a result, we have considered, and may continue to consider, growing our business through acquisitions of other entities, expanding or relocating existing stores, and opening new stores, including temporary stores. Any determination to make an acquisition, or open or expand a store will be based upon a variety of factors, including, without limitation, the purchase price or required investment , other financial terms of the transaction, and the extent to which any such acquisition, expansion, relocation or store opening would enhance our operating results and financial position.

On August 15, 2007, we entered into an Asset Purchase Agreement to purchase two franchised Party City Corporation retail stores in Lincoln, Rhode Island and Warwick, Rhode Island, in exchange for aggregate consideration of $1,350,000 plus up to $400,000 for associated inventory. On January 2, 2008, we completed the purchase of the two stores. The aggregate consideration paid was $1,350,000 plus approximately $195,000 for associated inventory. The consideration paid for the assets acquired in the transaction was allocated based upon an independent appraisal to the following, based on their fair values on the date of purchase:

	Fair Value at Jan 2, 2008
Non-compete agreement	$ 781,000
Occupancy valuation	495,000
Equipment and other	74,000
	$ 1,350,000

Funding for the purchase was obtained from our existing line of credit with Wells Fargo Retail Finance. The stores were converted into iParty stores immediately following the closing of the transaction.

Results of Operations

Fiscal year 2008 has 52 weeks and ends on December 27, 2008. Fiscal year 2007 had 52 weeks and ended on December 29, 2007.

The third quarter of fiscal year 2008 had 13 weeks and ended on September 27, 2008. The third quarter of fiscal year 2007 had 13 weeks and ended on September 29, 2007.

Three Months Ended September 27, 2008 Compared to Three Months Ended September 29, 2007

Revenues

Revenues include the selling price of party goods sold, net of returns and discounts, and are recognized at the point of sale. Our consolidated revenues for the third quarter of fiscal 2008 were $17,742,315, a decrease of $466,445, or 2.6% from the third quarter of the prior fiscal year.

	For the three months ended	
	Sep 27, 2008	Sep 29, 2007
Revenues	$ 17,742,315	$ 18,208,760
Increase (decrease) in revenues	-2.6%	5.6%

Sales for the third quarter of fiscal 2008 included sales from 48 comparable stores (defined as stores open for at least one full year), two stores that were acquired in January 2008 and two temporary Halloween stores opened in mid-September 2008. Comparable store sales for the quarter decreased by 4.2%.

Cost of products sold and occupancy costs

Cost of products sold and occupancy costs consist of the cost of merchandise sold to customers and the occupancy costs for our stores. Our cost of products sold and occupancy costs for the third quarter of fiscal 2008 were $10,629,144, or 59.9% of revenues, a decrease of $50,569 and an increase of 1.2 percentage points, as a percentage of revenues, from the third quarter of the prior fiscal year.

	For the three months ended	
	Sep 27, 2008	Sep 29, 2007
Cost of products sold and occupancy costs	$ 10,629,144	$ 10,679,713
Percentage of revenues	59.9%	58.7%

As a percentage of revenues, the increase in cost of products sold and occupancy costs was primarily attributable to increases in occupancy costs as well as the decreased leveraging of those costs related to lower sales in the third quarter of 2008 compared to the third quarter of the prior fiscal year.

Marketing and sales expense

Marketing and sales expense consists primarily of advertising and promotional expenditures, all store payroll and related expenses for personnel engaged in marketing and selling activities and other non-payroll expenses associated with operating our stores. Our consolidated marketing and sales expense for the third quarter of fiscal 2008 was $6,677,703, or 37.6% of revenues, an increase of $57,279 or an increase of 1.2 percentage points, as a percentage of revenues, from the third quarter of the prior fiscal year.

	For the three months ended	
	Sep 27, 2008	Sep 29, 2007
Marketing and sales	$ 6,677,703	$ 6,620,424
Percentage of revenues	37.6%	36.4%

As a percentage of revenues, the increase in marketing and sales expense was primarily attributable to decreased leveraging of store payroll and fringe benefit costs related to lower sales in the third quarter of 2008 compared to the third quarter of the prior year.

General and administrative expense

General and administrative (“G&A”) expense consists of payroll and related expenses for executive, merchandising, finance and administrative personnel, as well as information technology, professional fees and other general corporate expenses. Our consolidated G&A expense for the third quarter of fiscal 2008 was $1,580,277, or 8.9% of revenues, a decrease of $248,588 or a decrease of 1.1 percentage points, as a percentage of revenues, from the third quarter of the prior fiscal year.

	For the three months ended	
	Sep 27, 2008	Sep 29, 2007
General and administrative	$ 1,580,277	$ 1,828,865
Percentage of revenues	8.9%	10.0%

As a percentage of revenues, the decrease in general and administrative expense from the third quarter of the prior fiscal year was primarily attributable to lower incentive based compensation.

Operating loss

Our operating loss for the third quarter of fiscal 2008 was $1,144,809, or 6.5% of revenues, compared to an operating loss of $920,242, or 5.1% of revenues for the third quarter of the prior fiscal year.

Interest expense

Our interest expense in the third quarter of fiscal 2008 was $178,061, a decrease of $36,553 from the third quarter of the prior fiscal year. The decrease in the third quarter of fiscal 2008 was primarily due to a lower effective rate on our Highbridge Note and lower interest expense on our Amscan Note due to amortization of that indebtedness.

Income taxes

We have not provided for income taxes for the third quarter of fiscal 2008 or fiscal 2007 due to the availability of net operating loss (NOL) carryforwards to eliminate federal taxable income during those periods. No benefit has been recognized with respect to NOL carryforwards due to the uncertainty of future taxable income.

At the end of fiscal 2007, we had estimated federal net operating loss carryforwards of approximately $21.2 million, which begin to expire in 2018. In accordance with Section 382 of the Internal Revenue Code, the use of these carryforwards will be subject to annual limitations based upon certain ownership changes of our stock that have occurred or that may occur.

Net loss

Our net loss in the third quarter of fiscal 2008 was $1,322,630, or $0.06 per basic and diluted share, compared to a net loss of $1,133,658, or $0.05 per basic and diluted share, in the third quarter of the prior fiscal year. The increase in net loss was mainly attributable to the decrease in sales and increase in occupancy costs discussed above.

Nine Months Ended September 27, 2008 Compared to Nine Months Ended September 29, 2007

Revenues

Revenues include the selling price of party goods sold, net of returns and discounts, and are recognized at the point of sale. Our consolidated revenues for the first nine months of fiscal 2008 were $53,990,071, a decrease of $229,767 or 0.4% from the first nine months of the prior fiscal year.

	For the nine months ended	
	Sep 27, 2008	Sep 29, 2007
Revenues	$ 53,990,071	$ 54,219,838
Increase (decrease) in revenues	-0.4%	9.8%

Sales for the first nine months of fiscal 2008 included sales from 48 comparable stores (defined as stores open for at least one full year) two stores that were acquired in January 2008 and two temporary Halloween stores opened in mid-September 2008. Comparable store sales for the first nine months decreased by 1.9%.

Cost of products sold and occupancy costs

Cost of products sold and occupancy costs consist of the cost of merchandise sold to customers and the occupancy costs for our stores. Our cost of products sold and occupancy costs for the first nine months of fiscal 2008 were $32,225,078, or 59.7% of revenues, an increase of $537,717 or an increase of 1.3 percentage points, as a percentage of revenues, from the first nine months of the prior fiscal year.

	For the nine months ended	
	Sep 27, 2008	Sep 29, 2007
Cost of products sold and occupancy costs	$ 32,225,078	$ 31,687,361
Percentage of revenues	59.7%	58.4%

As a percentage of revenues, the increase in cost of products sold and occupancy costs was primarily attributable to clearance markdowns of seasonal product in the first quarter of 2008, taken to clear out excess holiday inventories, and to increases in rent and other store occupancy costs. The excess holiday inventories were caused by sluggish sales in December 2007, due in part to unusually inclement weather in New England.

Marketing and sales expense

Marketing and sales expense consists primarily of advertising and promotional expenditures, all store payroll and related expenses for personnel engaged in marketing and selling activities and other non-payroll expenses associated with operating our stores. Our consolidated marketing and sales expense for the first nine months of fiscal 2008 was $18,703,915, or 34.6% of revenues, an increase of $417,719 or an increase of 0.9 percentage points, as a percentage of revenues, from the first nine months of the prior fiscal year.

	For the nine months ended	
	Sep 27, 2008	Sep 29, 2007
Marketing and sales	$ 18,703,915	$ 18,286,196
Percentage of revenues	34.6%	33.7%

As a percentage of revenues, the increase in marketing and sales expense was primarily attributable to increased store payroll expenses, plus store opening costs associated with the two Rhode Island stores acquired on January 2, 2008 and two temporary Halloween stores opened in September 2008.

General and administrative expense

General and administrative ("G&A") expense consists of payroll and related expenses for executive, merchandising, finance and administrative personnel, as well as information technology, professional fees and other general corporate expenses. Our consolidated G&A expense for the first nine months of fiscal 2008 was $5,490,076, or 10.2% of revenues, a decrease of $210,843 or a decrease of 0.3 percentage points, as a percentage of revenues, from the first nine months of the prior fiscal year.

	For the nine months ended	
	Sep 27, 2008	Sep 29, 2007
General and administrative	$ 5,490,076	$ 5,700,919
Percentage of revenues	10.2%	10.5%

As a percentage of revenues, the decrease in general and administrative expense from the first nine months of the prior fiscal year was primarily attributable to the reduction in recruitment fees and incentive based compensation.

Operating loss

Our operating loss for the first nine months of fiscal 2008 was $2,428,998, or 4.5% of revenues, compared to an operating loss of $1,454,638, or 2.7% of revenues for the first nine months of the prior fiscal year.

Interest expense

Our interest expense in the first nine months of fiscal 2008 was $576,714, a decrease of $97,703 from the first nine months of the prior fiscal year. The decrease in the first nine months of fiscal 2008 was primarily due to a lower effective rate on our Highbridge Note and lower interest expense on our Amscan Note, due to amortization of that indebtedness.

Income taxes

We have not provided for income taxes for the first nine months of fiscal 2008 or fiscal 2007 due to availability of net operating loss (NOL) carryforwards to eliminate federal taxable income during those periods. No benefit has been recognized with respect to NOL carryforwards due to the uncertainty of future taxable income.

At the end of fiscal 2007, we had estimated federal net operating loss carryforwards of approximately $21.2 million, which begin to expire in 2018. In accordance with Section 382 of the Internal Revenue Code, the use of these carryforwards will be subject to annual limitations based upon certain ownership changes of our stock that have occurred or that may occur.

Net Loss

Our net loss in the first nine months of fiscal 2008 was $3,003,552, or $0.13 per basic and diluted share, compared to a net loss of $2,124,376, or $0.09 per basic and diluted share, in the first nine months of the prior fiscal year. The increase in net loss was mainly attributable to the decrease in sales and increase in occupancy costs and store opening costs discussed above.

Liquidity and Capital Resources

Our primary uses of cash are:

- purchases of inventory, including purchases under our Supply Agreement with Amscan, as described more fully below;
- occupancy expenses of our stores;
- employee salaries; and
- new store openings, including acquisitions.

Our primary sources of cash are:

- cash from operating activities; and
- debt, including our line of credit and notes payable.

Our prospective cash flows are subject to certain trends, events and uncertainties, including demands for capital to support growth, improve our infrastructure, respond to economic conditions, and meet contractual commitments. We expect our capital expenditures for the remainder of 2008 to include amounts for continued improvements of existing stores and for relocating an existing store.

Based on our current operating plan, we believe that anticipated revenues from operations and borrowings available under our existing line of credit will be sufficient to fund our operations, working capital requirements and capital expenditures through the next twelve months. In the event that our operating plan changes due to changes in our strategic plans, lower-than-expected revenues, unanticipated expenses, increased competition, unfavorable economic conditions or other unforeseen circumstances, including the continued turmoil and tightening of the credit markets, and further weakening of consumer confidence and spending, our liquidity may be negatively impacted. If so, we could be required to adjust our expenditures for the remainder of 2008 and for 2009 to conserve working capital or raise additional capital, possibly including debt or equity financing, to fund operations and our growth strategy and to refinance our outstanding debt. There can be no assurance, that, should we seek or require additional financing, such financing will be available, if at all, on terms and conditions acceptable to us, which could adversely affect our results of operations, liquidity and growth strategy.

In September 2009, the Highbridge Note in the principal amount of $2,500,000, as defined below, is due and payable in full. In January 2010, our line of credit with Wells Fargo, as discussed more fully below, expires by its terms. We expect to pay off the Highbridge Note from the availability under our existing line of credit and available cash flow. We are in preliminary discussions with Wells Fargo to extend our line of credit beyond January 2010. While we believe we have a positive and long term relationship with Wells Fargo, given the current state of the credit markets and the weak economy, we may not be able to extend our existing line of credit on terms more favorable or substantially the same as the existing line, making it more expensive to borrow money. If we are unable to use our bank line of credit or available cash to pay off the Highbridge note when due, or if there is a material increase in the cost to do so, we would need to secure alternative financing, which may not be available on commercially reasonable terms or at all, and could result in a materially adverse effect on our results of operations and financial position.

Our operating activities provided $411,870 in the first nine months of fiscal 2008 compared to use of $760,577 in the first nine months of the prior fiscal year, an increase of $1,172,447. The increase in cash provided by operating activities was primarily due to lower inventory purchases during the first nine months of 2008 as compared to the first nine months of 2007.

We used $1,993,878 in investing activities in the first nine months of fiscal 2008 compared to $650,536 in the first nine months of the prior fiscal year, an increase of $1,343,342. The cash invested in the first nine months of fiscal

2008 was primarily due to the acquisition in January 2008 of two retail stores located in Rhode Island and the related non-compete agreement (see discussion below). The cash invested in the first nine months of fiscal 2007 was primarily due to fixture and equipment improvements in our existing retail stores, plus the implementation of a new human resource information and payroll system.

Our financing activities provided $1,573,039 in the first nine months of fiscal 2008 compared to $716,324 in the first nine months of the prior fiscal year, an increase of $856,715. The increase was primarily related to increased borrowings on our line of credit and lower principal payments on capital lease obligations during the first nine months of 2008 as compared to the first nine months of 2007.

As mentioned above, on January 2, 2008, we completed the purchase of two franchised Party City Corporation ("Party City") retail stores in Lincoln, Rhode Island and Warwick, Rhode Island. The purchase was made pursuant to the Asset Purchase Agreement entered into on August 15, 2007 (the "Asset Purchase Agreement"). The aggregate consideration for the assets purchased and related non-competition covenants was $1,350,000, plus approximately $195,000 for associated inventory, paid in cash at closing, on terms and conditions specified in the Asset Purchase Agreement. Funding for the purchase was obtained from our existing line of credit with Wells Fargo Retail Finance II, LLC ("Wells Fargo"). Both locations were converted into iParty stores immediately following the closing.

We have a line of credit (the "line") with Wells Fargo, which expires on January 2, 2010. The maximum loan amount available under the line of credit with Wells Fargo is $12,500,000, which may be increased up to a maximum level of $15,000,000, upon 15 days written notice, as long as we are in compliance with all debt covenants and the other provisions of the loan agreement. The agreement permits us, at our option, to use the London Interbank Offered Rate ("LIBOR") for certain of our borrowings rather than the bank's base rate. Borrowings under our line of credit are secured by our inventory and accounts receivable. We borrow against these assets at agreed upon advance rates, which vary at different times of the year.

Our inventory consists of party supplies which are valued at the lower of weighted-average cost or market and are reduced by an allowance for obsolete and excess inventory and are further reduced or increased by other adjustments, including vendor rebates and discounts and freight costs. Our line of credit availability calculation allows us to borrow against "acceptable inventory at cost", which is based on our inventory at cost and applies adjustments that our lender has approved, which may be different than adjustments we use for valuing our inventory in our financial statements, such as the adjustment to reserve for inventory shortage. The amount of "acceptable inventory at cost" was approximately $18,361,931 at September 27, 2008.

Our accounts receivable consist primarily of credit card receivables and vendor rebate receivables. Our line of credit availability calculation allows us to borrow against "eligible credit card receivables", which are the credit card receivables for the previous two to three days of business. The amount of "eligible credit card receivables" was approximately $293,432 at September 27, 2008.

Our total borrowing base is determined by adding the "acceptable inventory at cost" times an agreed upon advance rate plus the "eligible credit card receivables" times an agreed upon advance rate but not to exceed our established credit limit, which was $12,500,000 at September 27, 2008. Under the terms of our line of credit, our $12,500,000 credit limit was further reduced by (1) a minimum availability block, (2) customer deposits, (3) gift certificates, (4) merchandise credits and (5) outstanding letters of credit. The amounts outstanding under our line were $4,320,714 at September 27, 2008 and $2,544,679 as of September 29, 2007, an increase of $1,776,035. Our additional availability was $7,349,993 at September 27, 2008 and $9,115,830 at September 29, 2007. The increase in the amount outstanding under our line of credit was due primarily to the cash borrowed for the acquisition of the two Rhode Island stores in the first quarter of 2008.

The outstanding balances under our line are classified as current liabilities in the accompanying consolidated balance sheets since we are required to apply daily lock-box receipts to reduce the amount outstanding.

Our line of credit includes a number of covenants, including a financial covenant requiring us to maintain a minimum availability under the line of 5% of the credit limit. The agreement also has a covenant that requires us to limit our capital expenditures to within 110% of those amounts included in our business plan, which may be updated from time to time. At September 27, 2008, we were in compliance with these financial covenants.

On January 17, 2006, we amended our line to allow for a $500,000 term loan, which increased our borrowing base, but was contained within the $12.5 million credit limit. The interest rate on the term loan was the bank's prime rate plus 125 basis points. During the time the term loan remained outstanding, the interest rate on the line of credit was the bank's base rate plus 75 basis points. The term loan had an amended maturity date of October 31, 2007. We repaid the term loan on March 2, 2007.

Our Supply Agreement with Amscan gives us the right to receive certain additional rebates and more favorable pricing terms over the term of the agreement than generally were available to us under our previous terms with Amscan. The right to receive additional rebates, and the amount of such rebates, are subject to our achievement of increased levels of purchases and other factors provided for in the Supply Agreement. In exchange, the Supply Agreement obligates us to purchase increased levels of merchandise from Amscan until 2012. The Supply Agreement provided for a ramp-up period during 2006 and 2007 and, for five years beginning with calendar year 2008, requires us to purchase on an annual basis merchandise equal to the total number of our stores open during such calendar year, multiplied by $180,000. The Supply Agreement provides for penalties in the event we fail to attain the annual purchase commitment that would require us to pay to Amscan the difference between the purchases for that year and the annual purchase commitment for that year. Under the terms of the Supply Agreement, the annual purchase commitment for any individual year can be reduced for orders placed by the Company but not filled by the supplier. During 2008, the supplier experienced difficulty in fulfilling certain of our orders sourced out of China. Accordingly, the supplier agreed to reduce the Company's purchase commitment for 2008 to 90% of the contractual minimum for that year. Although we do not expect to incur any penalties under this supply agreement, as adjusted, if they were to occur, there could be a material adverse effect on our uses and sources of cash.

The Supply Agreement also provided for Amscan to extend, until October 31, 2006, approximately $1,150,000 of certain currently due amounts owed by us to Amscan which would otherwise have been payable by us on August 8, 2006 (the "extended payables") and gave us the right, at our option, to convert the extended payables into a subordinated promissory note.

On October 24, 2006, we elected to convert $1,143,896 of extended payables originally due to Amscan as of August 8, 2006 as well as an additional $675,477 of payables due to Amscan as of September 28, 2006 into a single subordinated promissory note in the total principal amount of $1,819,373 ("the Amscan Note"). The Amscan Note bears interest at the rate of 11.0% per annum and is payable in thirty-six (36) equal monthly installments of principal and interest of $59,562 commencing on November 1, 2006, and on the first day of each month thereafter until October 1, 2009, when the entire remaining principal balance and all accrued interest is due and payable.

On August 7, 2006, we also entered into and simultaneously closed an Asset Purchase Agreement with Party City, an affiliate of Amscan, pursuant to which we acquired a Party City retail party goods store in Peabody, Massachusetts and received a five-year non-competition covenant from Party City, for aggregate consideration of $2,450,000, payable by a subordinated note in the principal amount of $600,000, which will bear interest at the rate of 12.25% per annum (the "Party City Note") and $1,850,000 in cash. The Party City Note is payable by quarterly interest-only payments over four years, with the full principal amount due at the note's maturity on August 7, 2010.

On September 15, 2006, we entered into a Securities Purchase Agreement pursuant to which we raised $2.5 million through a combination of subordinated debt and warrants issued to Highbridge International LLC ("Highbridge"), an institutional accredited investor. Under the terms of the financing, we issued Highbridge a three-year $2.5 million subordinated note (the "Highbridge Note") that bears interest at an interest rate of prime plus one percent. The Highbridge Note matures on September 15, 2009. In addition, we issued Highbridge a warrant (the "Highbridge Warrant") exercisable for 2,083,334 shares of our common stock at an exercise price of $0.475 per share, or 125% of the closing price of our common stock on the day immediately prior to the closing of the transaction. We allocated approximately $613,651 of value to the Highbridge Warrant using the Black-Scholes model with volatility of 108%, interest of 4.73% and expected life of five years. The Highbridge Warrant is being amortized using the effective interest method over the life of the Highbridge Note. The agreements entered into in connection with the financing provide for certain restrictions and covenants consistent with Highbridge's status as a subordinated lender, and also grant Highbridge resale registration rights with respect to the shares of common stock underlying the Highbridge Warrant.

The issuance of the Highbridge Warrant triggered certain anti-dilution provisions of our Series B, C, and D convertible preferred stock. As a result, the outstanding shares of these three series of preferred stock are now convertible into an aggregate of 442,354 additional shares of common stock. The issuance of the Highbridge Warrant, however, did not trigger the anti-dilution provisions of our Series E or F convertible preferred stock.

Contractual obligations at September 27, 2008 were as follows:

	Payments Due By Period				
	Within 1 Year	Within 2 - 3 Years	Within 4 - 5 Years	After 5 Years	Total
Line of credit	$ 4,325,729	$ -	$ -	$ -	$ 4,325,729
Capital lease obligations	16,704	-	-	-	16,704
Notes payable	3,461,024	662,626	-	-	4,123,650
Supply agreement	8,403,155	18,000,000	11,250,000	-	37,653,155
Operating leases (including retail space leases)	6,641,171	15,792,371	10,556,677	9,357,627	42,347,846
Total contractual obligations	$ 22,847,783	$ 34,454,997	$ 21,806,677	$ 9,357,627	$ 88,467,084

In addition, at September 27, 2008, we had outstanding purchase orders, exclusive of the amounts to which the Company is obligated under the Amscan supply agreement, totaling approximately $4,640,711 for the acquisition of inventory and non-inventory items that are scheduled for delivery after September 27, 2008.

Seasonality

Due to the seasonality of our business, sales and operating income are typically higher in our second and fourth quarters. Our business is highly dependent upon sales of graduation and summer merchandise in the second quarter and sales of Halloween and Christmas merchandise in the fourth quarter. We have historically operated at a loss during the first and third quarters.

Geographic Concentration

As of September 27, 2008, we operated a total of 50 stores, 45 of which are located in New England, plus two temporary Halloween stores, located in Massachusetts. As a result, a severe or prolonged regional recession or regional changes in demographics, employment levels, population, weather patterns, real estate market conditions, consumer confidence and spending patterns or other factors specific to the New England region may adversely affect us more than a company that is more geographically diverse.

Effects of Inflation

While we do not view the effects of inflation as having a direct material effect upon our business, we believe that volatility in oil and gasoline prices impacts the cost of producing petroleum-based/plastic products, which are a key raw material in much of our merchandise, and also impacts prices to ship products made overseas in foreign countries, such as China, which includes much of our merchandise. Volatile oil and gasoline prices also impact our freight costs, and consumer confidence and spending patterns. These and other issues directly or indirectly affecting our vendors, our customers and us could adversely affect our business and financial performance.

Factors That May Affect Future Results

Our business is subject to certain risks that could materially affect our financial condition, results of operations, and the value of our common stock. These risks include, but are not limited to, the ones described herein under Item 1A, "Risk Factors" of our Annual Report on Form 10-K for the fiscal year ended December 29, 2007, and Part II, Item 1A, "Risk Factors" contained in our Quarterly Reports on Form 10-Q, including this one, and in our periodic reports filed with the Commission. Additional risks and uncertainties that we are unaware of, or that we may currently deem immaterial, may become important factors that harm our business, financial condition, results of operations, or the value of our common stock.

Critical Accounting Policies and Estimates

Our financial statements are based on the application of significant accounting policies, many of which require our management to make significant estimates and assumptions (see Note 2 to our consolidated financial statements). We believe the following accounting policies to be those most important to the portrayal of our financial condition and those that require the most subjective judgment. If actual results differ significantly from management's estimates and projections, there could be a material effect on our financial statements.

Inventory and Related Allowance for Obsolete and Excess Inventory

Our inventory consists of party supplies and is valued at the lower of moving weighted-average cost or market. We record vendor rebates, discounts and certain other adjustments to inventory, including freight costs, and we recognize these amounts in the income statement as the related goods are sold.

During each interim reporting period, we estimate the impact on cost of products sold associated with inventory shortage. The actual inventory shortage is determined upon reconciliation of the annual physical inventory, which occurs shortly before and after our year end, and an adjustment to cost of products sold is recorded at the end of the fourth quarter to recognize the difference between the estimated and actual inventory shortage for the full year. The adjustment in the fourth quarter of 2007 included an estimated reduction of $123,249 to the cost of products sold during the previous three quarters.

We also make adjustments to reduce the value of our inventory for an allowance for obsolete and excess inventory, which is based on our review of inventories on hand compared to estimated future sales. We conduct reviews periodically throughout the year on each stock keeping unit ("SKU"). As we identify obsolete and excess inventory, we take immediate measures to reduce our inventory risk on these items and we adjust our allowance accordingly. Thus, actual results could differ from our estimates.

Revenue Recognition

Revenues include the selling price of party goods sold, net of returns and discounts, and are recognized at the point of sale. We estimate returns based upon historical return rates and such amounts have not been significant to date.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and are depreciated on the straight-line method over the estimated useful lives of the assets. Expenditures for maintenance and repairs are charged to operations as incurred.

Intangible Assets

Intangible assets consist primarily of the values of two non-compete agreements acquired in conjunction with the purchase of retail stores in 2006 and 2008, and the values of retail store leases acquired in those transactions.

The first non-compete agreement, from Party City Corporation and its affiliates, covers Massachusetts, Maine, New Hampshire, Vermont, Rhode Island, and Windsor and New London counties in Connecticut, and expires in 2011. The second non-compete agreement was acquired in connection with the Company's purchase in January 2008 of two franchised party supply stores in Lincoln and Warwick, Rhode Island. The acquired Rhode Island stores had been operated as Party City franchise stores, and were converted to iParty stores immediately following the closing. The second non-compete agreement covers Rhode Island for five years from the date of closing and within a certain distance from the Company's stores in the rest of New England for three years. Both non-compete agreements have an estimated life of 60 months and are subject to certain terms and conditions in their respective acquisition agreements.

The occupancy valuations related to acquired retail store leases are for stores in Peabody, Massachusetts (estimated life of 90 months), Lincoln, Rhode Island (estimated life of 79 months) and Warwick, Rhode Island (estimated life of 96 months). Intangible assets also include legal and other transaction costs incurred related to the purchase of the Peabody, Lincoln and Warwick stores.

Non-compete agreements are amortized based on the pattern of their expected cash flow benefits. Occupancy valuations are amortized over the terms of the related leases.

Impairment of Long-Lived Assets

In accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, we perform a review of each store for impairment indicators whenever events and changes in circumstances suggest that the carrying amounts may not be recoverable from estimated future store cash flows. Our review considers store operating results, future sales growth and cash flows. The conclusion regarding impairment may differ from current estimates if underlying assumptions or business strategies change. As of December 29, 2007, we planned to close two stores in early January 2008, at the end of their lease terms. These two stores were closed as planned. No impairment charges were required for these stores, as the assets related to them have been fully amortized, except for immaterial amounts, and no liability existed for future lease costs. We are not aware of any impairment indicators for any of our remaining stores at September 27, 2008.

Income Taxes

Historically, we have not recognized an income tax benefit for our losses. Accordingly, we record a valuation allowance against our deferred tax assets because of the uncertainty of future taxable income and the realizability of the deferred tax assets. In determining if a valuation allowance against our deferred tax asset is appropriate, we consider both positive and negative evidence. The positive evidence that we considered included: (1) we were profitable in 2007 and 2006, (2) we have achieved positive comparable store sales growth for the last six years and (3) we had improved merchandise margins in 2007. The negative evidence that we considered included: (1) we realized a net loss in 2005, (2) our merchandise margins decreased in 2006 and 2005, (3) our future profitability is vulnerable to certain risks, including (a) the risk that we may not be able to generate significant taxable income to fully utilize our net operating loss carryforwards of approximately $21.2 million, (b) the risk of unseasonable weather and other factors in a single geographic region, New England, where our stores are concentrated, (c) the risk of being so dependent upon a single season, Halloween, for a significant amount of annual sales and profitability, (d) the risk of fluctuating prices for petroleum products, which are a key raw material for much of our merchandise and which affect our freight costs and those of our suppliers and affect our customers' spending levels and patterns, (e) the costs of opening or acquiring new stores will put pressure on our profit margins until these stores reach maturity, and (f) the expected costs of increased regulatory compliance, including, without limitation, those associated with Section 404 of the Sarbanes-Oxley Act, will have a negative impact on our profitability.

The negative evidence is strong enough for us to conclude that the level of our future profitability is uncertain at this time. We believe that it is prudent for us to maintain a valuation allowance until we have a longer track record of profitability and we can reduce our exposure to the risks described above. Should we determine that we will be able to realize our deferred tax assets in the future, an adjustment to our deferred tax assets would increase income in the period we made such a determination.

We adopted the provisions of Financial Accounting Standards Board ("FASB") Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 ("FIN48") on December 31, 2006. At the adoption date and as of September 27, 2008, we had no material unrecognized tax benefits and no adjustments to liabilities, retained earnings or operations were required.

Stock Option Compensation Expense

On January 1, 2006, we adopted Statement No. 123(R) using the modified prospective method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of Statement No. 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of Statement No. 123 for all awards granted to employees prior to the effective date of Statement No. 123(R) that remain unvested on the effective date. Prior to January 1, 2006, we accounted for our stock option compensation agreements with employees under the provisions of Accounting Principles Board ("APB") Opinion No. 25, Accounting for Stock Issued to Employees and the disclosure-only provisions of Statement No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation – Transition and Disclosure, an amendment of Financial Accounting Standards Board ("FASB") Statement No. 123.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Our actual results could differ from our estimates.

New Accounting Pronouncements

No new accounting pronouncements were issued during the quarter ended September 27, 2008 that are expected to have a material impact on our financial position or results of operations.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

There has been no material change in our market risk exposure since the filing of our Annual Report on Form 10-K.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures. The Chief Executive Officer and the Chief Financial Officer of iParty (its principal executive officer and principal financial officer, respectively) have concluded, based on their evaluation as of September 27, 2008, the end of the fiscal quarter to which this report relates, that iParty's disclosure controls and procedures: are effective to ensure that information required to be disclosed by iParty in the reports filed or submitted by it under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms; and include controls and procedures designed to ensure that information required to be disclosed by iParty in such reports is accumulated and communicated to iParty's management, including the Chief Executive Officer and the Chief Financial Officer, to allow timely decisions regarding required disclosure. iParty’s disclosure controls and procedures were designed to provide a reasonable level of assurance of reaching iParty’s disclosure requirements and are effective in reaching that level of assurance.

(b) Changes in Internal Controls. No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended) occurred during the fiscal quarter ended September 27, 2008 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

The Company is not a party to any material pending legal proceedings, other than ordinary routine matters incidental to its business, which we do not expect, individually or in the aggregate, to have a material effect on its financial position or results of operations.

Item 1A. Risk Factors

Other than as described in the risk factors below, there have been no material changes to the risk factors disclosed in the “Risk Factors” section of our Annual Report on Form 10-K for the year ended December 27, 2007, as filed with the SEC on March 13, 2008.

The U.S. consumer has been experiencing rising unemployment, increasing mortgage foreclosures, higher food and gas prices, credit market turmoil, and a significant decline in the stock market. This has contributed to a loss in consumer confidence and a decline in consumer spending that could lead to reduced consumer demand for our products, which represent relatively discretionary spending. Such a reduction in demand for our products, if it occurs, could have an adverse effect on our liquidity and profitability.

Since purchases of our merchandise are dependent upon discretionary spending by our customers, our financial performance is sensitive to changes in overall economic conditions that affect consumer spending. Consumer spending habits are affected by, among other things, prevailing economic conditions, levels of employment, salaries and wage rates, consumer confidence and consumer perception of economic conditions. A general or perceived slowdown in the U.S economy, or uncertainty as to the economic outlook, which the U.S. and world economy may be experiencing, could reduce discretionary spending or cause a shift in consumer discretionary spending to other products. Any of these factors may cause us to delay acquiring or opening new stores, may result in lower net sales and may also result in excess inventories, which could, in turn, lead to increased merchandise markdowns and related costs associated with higher levels of inventory and adversely affect our liquidity and profitability.

Our failure to generate sufficient cash to meet our liquidity needs may affect our ability to service our indebtedness and grow our business.

Our business requires access to capital to support growth, improve our infrastructure, respond to economic conditions, and meet contractual commitments. In the event that our current operating plan or long term goals change due to changes in our strategic plans, lower-than-expected revenues, unanticipated expenses, increased competition, unfavorable economic conditions, other risk factors discussed in this report, or other unforeseen circumstances, our liquidity may be negatively impacted. Our ability to make payments on and to refinance our indebtedness, principally the amounts borrowed under our bank line of credit and notes payable, and to fund any capital expenditures for systems upgrades and new store openings, if any, we may make in the future will depend in large part on our current and future ability to generate cash. This, to a certain extent, is subject to general economic, financial, competitive and other factors that are beyond our control. We cannot assure you that our business will generate sufficient cash flow from operations in the future, that our currently anticipated growth in revenues and cash flow will be realized on schedule, or that future borrowings will be available to us under our line of credit in an amount sufficient to enable us to service indebtedness, undertake store openings and replace and upgrade our technology systems to grow our business, or to fund other liquidity needs. If we need to refinance all or a portion of our indebtedness from other sources, we cannot assure you that we will be able to do so on terms and conditions acceptable to us. If so, our ability, among other things, to proceed with our acquisition and grown strategy would be negatively affected.

We currently have three notes payable outstanding with principal balances totaling $3,586,545 at September 27, 2008. The principal amount of one of these notes is paid monthly in installments. The principal amounts of the other two notes are due in full in the amounts of $2,500,000 and $600,000 on September 15, 2009 and August 7, 2010, respectively. We expect to pay off the note due September 2009 from the availability under our bank line of credit and available cash flow. We are in preliminary discussion with Wells Fargo to extend our bank line of credit beyond its current expiration date of January 2010, three months after the September 2009 note becomes due and payable. While we believe we have a positive and long term relationship with Wells Fargo, given the adverse events in the credit markets and the weak economy, which is negatively impacting consumer spending and preferences, we may not be able to extend the existing bank line of credit on terms more favorable or substantially the same as the existing line. If the terms are less favorable than the existing line, our results of operations and liquidity may be adversely affected. If we need to refinance all or a portion of our indebtedness from other sources, we cannot assure you that we will be able to do so on commercially reasonable terms. In addition, to the extent we use our existing line of credit to refinance the debt, we could have less room available for working capital and acquisition needs, which could adversely impact our results of operations, liquidity and growth opportunities. Our existing bank line of credit with Wells Fargo allows us to borrow up to $12,500,000 with an option to increase that limit up to $15 million and matures on January 2, 2010. As of September 27, 2008, there was $4,320,714 outstanding under our line of credit with additional availability of $7,349,993. Borrowings under our line of credit are secured by our inventory and accounts receivable. We borrow against these assets at agreed upon advance rates, which vary at different times of the year.

Item 2. Unregistered Sales of Equity and Securities and Use of Proceeds

Not applicable

Item 3. Defaults upon Senior Securities

Not applicable.

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

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

The exhibits listed in the Exhibit Index immediately preceding the exhibits are filed as part of this Quarterly Report on Form 10-Q and are incorporated herein by reference.

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.

iPARTY CORP.

By:	/s/ SAL PERISANO Sal Perisano Chairman of the Board and Chief Executive Officer (Principal Executive Officer)
By:	/s/ DAVID ROBERTSON David Robertson Chief Financial Officer (Principal Financial and Accounting Officer)

Dated: October 29, 2008

EXHIBIT INDEX

EXHIBIT NUMBER	DESCRIPTION
Ex. 31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act
Ex. 31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act
Ex. 32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350
Ex. 32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350