

PARTY CITY CORP  
Form DEF 14A  
October 18, 2002

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**SCHEDULE 14A INFORMATION**

**PROXY STATEMENT PURSUANT TO SECTION 14(A) OF THE SECURITIES  
EXCHANGE ACT OF 1934 (AMENDMENT NO.        )**

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

Preliminary Proxy Statement  Confidential, for Use of the Commission  
Only (as permitted by Rule 14a-6(e)(2))

Definitive Proxy  
Statement

Definitive Additional  
Materials

Soliciting Material  
Pursuant to  
Section 240.14a-11(c)  
or Section 240.14a-2.

**PARTY CITY CORPORATION**

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(Name of Registrant as Specified In Its Charter)

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(Name of Person(s) Filing Proxy Statement, if other than Registrant)

Payment of Filing Fee (Check the appropriate box):

No fee required.

Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-12.

(1) Title of each class of securities to which transaction applies:

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(2) Aggregate number of securities to which transaction applies:

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(3)

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Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11  
(Set forth the amount on which the filing fee is calculated and state how it was determined):

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(4) Proposed maximum aggregate value of transaction:

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(5) Total fee paid:

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Fee paid previously with preliminary materials.

Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

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(2) Form, Schedule or Registration Statement No.:

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(3) Filing Party:

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(4) Date Filed:

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**Party City Corporation**

**Notice of 2002 Annual Meeting of Stockholders**

**November 13, 2002**

TO THE STOCKHOLDERS:

NOTICE IS HEREBY GIVEN that the 2002 Annual Meeting of Stockholders of Party City Corporation, a Delaware corporation (the Company), will be held on Wednesday, November 13, 2002, at 9:00 a.m., Eastern Time, at The Peninsula New York, 700 Fifth Avenue, New York, New York 10019, for the following purposes:

1. To elect nine directors to the Board of Directors who shall serve until the 2003 Annual Meeting of Stockholders, or until their successors are elected and qualified; and
2. To transact such other business as may properly come before the Annual Meeting or any adjournment thereof.

The foregoing items are more fully described in the Proxy Statement accompanying this Notice.

Only stockholders of record at the close of business on October 7, 2002 are entitled to notice of and to vote at the Annual Meeting. A complete list of the stockholders entitled to vote at the Annual Meeting will be open to the examination of any stockholder, for any purpose germane to the Annual Meeting, during ordinary business hours for the ten day period ending immediately preceding the date of the Annual Meeting, at the Company's offices at 400 Commons Way, Rockaway, New Jersey 07866 and at The Peninsula New York. Attendance at the Annual Meeting will be limited to stockholders and guests of the Company.

**STOCKHOLDERS UNABLE TO ATTEND THE MEETING ARE URGED TO COMPLETE, DATE AND SIGN THE ENCLOSED PROXY AND RETURN IT IN THE ENCLOSED ENVELOPE. IF YOU ATTEND THE MEETING, YOU MAY REVOKE YOUR PROXY AND VOTE IN PERSON IF YOU WISH.**

By Order of the Board of Directors

By: /s/ JOSEPH J. ZEPF, ESQ.

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Joseph J. Zepf, Esq.  
*Secretary*

Rockaway, New Jersey  
October 18, 2002

**PLEASE MAIL YOUR PROXY PROMPTLY**

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**PARTY CITY CORPORATION**

**400 Commons Way  
Rockaway, New Jersey 07866**

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**PROXY STATEMENT**

**2002 ANNUAL MEETING OF STOCKHOLDERS**

**November 13, 2002**

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**INFORMATION CONCERNING SOLICITATION AND VOTING**

**General**

The enclosed Proxy is solicited on behalf of the Board of Directors of Party City Corporation (the "Company") for use at the 2002 Annual Meeting of Stockholders to be held on Wednesday, November 13, 2002, at 9:00 a.m., Eastern Time, or at any adjournment thereof (the "Annual Meeting"). The purposes of the Annual Meeting are set forth herein and in the accompanying Notice of 2002 Annual Meeting of Stockholders (the "Notice"). The Annual Meeting will be held at The Peninsula New York, 700 Fifth Avenue, New York, New York 10019. The Company's telephone number is (973) 983-0888.

This Proxy Statement and the accompanying Annual Report, Notice and Proxy are being mailed on or about October 18, 2002, to all stockholders entitled to vote at the Annual Meeting.

**Record Date**

Stockholders of record at the close of business on October 7, 2002 (the "Record Date"), are entitled to notice of and to vote at the Annual Meeting.

**Deadline for Receipt of Stockholder Proposals for 2003 Annual Meeting**

Proposals of stockholders of the Company which are intended to be presented at the Company's 2003 Annual Meeting of Stockholders must be received by the Company no later than June 20, 2003, and must otherwise be in compliance with the Company's Certificate of Incorporation and Bylaws and with applicable laws and regulations in order to be included in the Company's proxy statement and form of proxy relating to that meeting.

If a stockholder intends to present a stockholder proposal at the 2003 Annual Meeting in a manner other than the inclusion of the proposal in the Company's proxy statement and form of proxy relating to that meeting, unless the stockholder notifies the Company of such intention by August 28, 2003, the proxy holders named by the Company may exercise their discretionary voting authority on the matter in accordance with their best judgment.

**Voting Your Shares at the Annual Meeting**

If you want to vote your shares in person at the Annual Meeting and your shares are held of record by a broker, bank or other nominee, you will need to bring to the Annual Meeting a letter from the broker, bank or other nominee confirming your beneficial ownership of the shares. If you fail to bring such a letter, you will not be permitted to vote such shares at the Annual Meeting.

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**Revocability of Proxy**

Any proxy given by a record holder pursuant to this solicitation may be revoked by the person giving it at any time before its use by delivering to the Company a written notice of revocation or a duly executed proxy bearing a later date or by attending the Annual Meeting and voting in person. If your shares are held of record by a broker, bank or other nominee, you must contact the broker, bank or nominee for instructions on how to revoke your proxy.

Please note that merely attending the Annual Meeting without voting will not revoke your proxy. Also, as noted above, if you want to attend the Annual Meeting and vote in person and your shares of the Company's common stock are held of record by a broker, bank or other nominee, you will need to bring to the Annual Meeting a letter from the broker, bank or other nominee confirming your beneficial ownership of the shares.

**Independent Accountants**

The Company's independent accountants are Deloitte & Touche LLP. Representatives from Deloitte & Touche LLP are expected to be available at the Annual Meeting to respond to appropriate questions from stockholders.

**Solicitation**

The cost of solicitation will be borne by the Company. In addition, the Company may reimburse brokerage firms and other persons representing beneficial owners of shares for their expenses in forwarding solicitation materials to such beneficial owners. The Company has contracted with Georgeson Shareholder Communications, Inc. to solicit proxies. The anticipated cost of this service is expected to be approximately \$5,000. Proxies may also be solicited by the Company's directors, officers and employees, without additional compensation, personally or by telephone, facsimile, e-mail or telegram.

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**VOTING SECURITIES AND PRINCIPAL HOLDERS**

**Outstanding Shares**

The Company has only one class of stock outstanding, the Company's common stock, \$.01 par value per share (the "Common Stock"). At October 7, 2002, 16,699,747 shares of the Company's Common Stock were issued and outstanding.

**Voting Rights; Required Vote**

Under the Delaware General Corporation Law and the Company's Certificate of Incorporation and Bylaws, each stockholder will be entitled to one vote for each share of Common Stock held at the Record Date for all matters, including the election of directors. Holders of Common Stock have no cumulative voting rights in the election of directors. The presence, in person or by proxy, of stockholders holding a majority of the outstanding shares of Common Stock on the Record Date and entitled to vote is required in order to constitute a quorum for the Annual Meeting. The election of each director requires a plurality of the votes present at the Annual Meeting and entitled to vote.

Shares that are voted FOR, AGAINST, WITHHELD or ABSTAIN are treated as being present at the Annual Meeting for the purposes of establishing a quorum and are also treated as shares entitled to vote at the Annual Meeting with respect to such matter.

In addition, unless a broker's authority to vote on a particular matter is limited, shares held in street name that are not voted are counted for the purposes of establishing a quorum. However, a share that is held in street name that is not voted because the broker's authority to vote on that matter is limited and the broker did not receive a direction on how to vote the share on that matter from the beneficial owner (a "broker non-vote") is not considered entitled to vote and is thus not calculated as a vote cast at the Annual Meeting (either for or against the proposal). For the election of nominees, there cannot be any broker non-votes as a broker's authority to vote on such matters is not limited. Therefore, any abstention or vote withheld (including any abstention or vote withheld by a broker with respect to shares held in street name) will have the same effect as a vote against the election of the nominees.

Abstentions with respect to all other proposals which come before the Annual Meeting will have the effect of a vote against the proposals. Broker Non-Votes, however, will be treated as having not been voted for purposes of determining approval of such proposals and will not be counted as votes for or against such proposals.

**Voting of Proxies**

The shares of Common Stock represented by all properly executed proxies received in time for the Annual Meeting will be voted in accordance with the directions given by the stockholders. IF NO INSTRUCTIONS ARE GIVEN, THE SHARES WILL BE VOTED (i) FOR each of the nominees named herein as directors, or their respective substitutes as may be appointed by the Board of Directors; and (ii) at the discretion of the proxy holders with respect to any other matter properly brought before the Annual Meeting.

**Security Ownership of Certain Beneficial Owners and Management**

The following table sets forth information regarding the beneficial ownership of the Common Stock, as of October 7, 2002, for individuals or entities in the following categories: (i) each of the Company's Directors; (ii) each executive officer of the Company named in the Summary Compensation Table (each, a "Named Executive Officer"); (iii) each person known by the Company to be a beneficial owner of more than 5% of the Common Stock; and (iv) all Directors and Named Executive Officers as a group. For purposes of this table, a person is deemed to have beneficial ownership of any shares that such person has the right to acquire within 60 days after the date of this Proxy Statement. For purposes of calculating the percentage of outstanding shares held by each person named below, any shares that such person has the right to acquire within 60 days after the date of this Proxy Statement are deemed to be outstanding, but not for the purposes of calculating the percentage ownership of any other person.



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Unless indicated otherwise, each of the stockholders has sole voting and investment power with respect to the shares beneficially owned.

**BENEFICIAL OWNERSHIP OF COMMON STOCK BY  
DIRECTORS, OFFICERS AND KNOWN 5% OR GREATER STOCKHOLDERS**

Name of Beneficial Owner	Shares Beneficially Owned	
	Number	Percent
Special Value Investment Management, LLC Accounts and Tennenbaum & Co., LLC 11100 Santa Monica Boulevard, Suite 210 Los Angeles, California 90025	5,547,781(1)	28.9%
Steven Mandell P.O. Box 85 New Vernon, New Jersey 07976	1,207,878(2)(3)	7.2%
Craig Enterprises, Inc. 11355 North Torrey Pines Road La Jolla, California 92037	1,121,802(4)	6.7%
Pequot Capital Management	985,200(5)	5.9%
Ralph D. Dillon	579,665(6)	3.4%
Jack Futterman	1,039,500(3)(7)	6.0%
Michael A. Gatto	13,166(8)	*
Richard H. Griner	0	*
L.R. Jalenak, Jr.	87,298(9)	*
Howard Levkowitz	5,471,913(1)(10)	28.5%
Nancy Pedot	18,333(11)	*
Walter Salmon	15,666(12)	*
James Shea	275,150(13)	1.6%
Michael E. Tennenbaum	5,569,114(1)(14)	29.0%
Andrew Bailen	69,000(15)	*
Warren Jeffery	0	*
Linda M. Siluk	15,125(16)	*
Thomas E. Larson	59,875(17)	*
All Directors and Named Officers as a group (14 persons)	13,057,137	38.8%

\* Less than 1%

- (1) The shares of Common Stock are owned of record by the Special Value Investment Management, LLC ( SVIM ) Accounts and Tennenbaum & Co., LLC ( TCO ) as follows: 2,496,000 shares subject to outstanding warrants to purchase Common Stock which are exercisable within the next 60 days are owned by Special Value Bond Fund, LLC ( SVBF ); 2,594,720 shares of Common Stock are owned by Special Value Absolute Return Fund, LLC ( SVAR ); 318,000 shares of Common Stock are owned by Special Value Bond Fund II, LLC ( SVBF II ); 25,000 shares of Common Stock are owned by a separate account managed by SVIM; and 114,061 shares of Common Stock are owned by TCO.

The managing member of SVBF is SVIM/MSM, LLC ( SVIM/MSM ) and the managing member of SVBF II is SVIM/MSM II, LLC ( SVIM/MSM II ). The managing member of both SVIM/MSM and SVIM/MSM II is TCO. The managing member of SVAR is SVAR/MM, LLC ( SVAR/MM ), and the managing member of SVAR/MM is SVIM. The managing member of SVIM is TCO. The managing member of TCO is Michael E. Tennenbaum.

SVIM is the investment advisor to SVBF, SVBF II, SVAR and the separate account. SVIM, SVIM/MSM, TCO and Mr. Tennenbaum share voting and dispositive power for the 2,496,000 shares subject to outstanding warrants to purchase Common Stock. SVIM, SVIM/MSM II, TCO and Mr. Tennenbaum share voting and dispositive power for the 318,000 shares. SVIM, SVAR/MM, TCO



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and Mr. Tennenbaum share voting and dispositive power for the 2,594,720 shares. SVIM, TCO and Mr. Tennenbaum share voting and dispositive power for the 25,000 shares. TCO and Mr. Tennenbaum have sole voting and dispositive power for the 114,061 shares (See also footnotes 10 and 14).

- (2) Includes 250,600 shares owned of record by The Mandell Family Limited Partnership of which Mr. Mandell is the General Partner and 700,000 shares subject to an immediately exercisable option to purchase such shares held by Mr. Futterman. (See also footnote 3).
- (3) Includes 700,000 shares of Common Stock owned by Mr. Mandell for which Mr. Futterman has an immediately exercisable option to purchase pursuant to an Option Agreement, dated as of June 8, 1999, by and between Messrs. Mandell and Futterman.
- (4) As reported by Craig Enterprises, Inc. on its Amendment to Schedule 13G filed with the Securities and Exchange Commission on April 23, 1999 which indicates that Craig Enterprises, Inc. owns 1,107,000 shares of Common Stock. Also includes, 14,802 shares of Common Stock distributed to an affiliate of Craig Enterprises, Inc. by SVBF pursuant to the exercise of its warrant not reflected in such Amendment to Schedule 13G.
- (5) As reported by Pequot Capital Management, Inc. on its Form 13F filed with the Securities and Exchange Commission on August 14, 2002.
- (6) Includes 361,665 shares of Common Stock subject to outstanding options which are exercisable within the next 60 days.
- (7) Includes 738,000 shares of Common Stock subject to outstanding options which are exercisable within the next 60 days. Also includes 1,500 shares of Common Stock transferred to the Jack Futterman Trust, of which Mr. Futterman is the investment advisor.
- (8) Includes 11,666 shares of Common Stock subject to outstanding options which are exercisable within the next 60 days.
- (9) Includes 21,333 shares of Common Stock subject to outstanding options which are exercisable within the next 60 days.
- (10) As a member of the Investment Committee of SVIM, Mr. Levkowitz shares voting and dispositive power for the following: 2,496,000 shares subject to outstanding warrants to purchase Common Stock which are exercisable within the next 60 days owned by SVBF; 2,594,720 shares of Common Stock owned by SVAR; 318,000 shares of Common Stock owned by SVBF II; and 25,000 shares of Common Stock owned by a separate account managed by SVIM (See footnote 1). Also includes 13,527 shares of Common Stock owned by Mr. Levkowitz and 24,666 shares of Common Stock subject to outstanding options which are exercisable within the next 60 days that are owned by Mr. Levkowitz.
- (11) Includes 18,333 shares of Common Stock subject to outstanding options which are exercisable within the next 60 days.
- (12) Includes 11,666 shares of Common Stock subject to outstanding options which are exercisable within the next 60 days.
- (13) Includes 212,500 shares of Common Stock subject to outstanding options which are exercisable within the next 60 days.
- (14) As the managing member of TCO, Mr. Tennenbaum shares voting and dispositive power for all of the shares of Common Stock owned of record by the SVIM Accounts and TCO (See footnote 1). Also includes 21,333 shares of Common Stock subject to outstanding options which are exercisable within the next 60 days that are owned by Mr. Tennenbaum.
- (15) Includes 55,000 shares of Common Stock subject to outstanding options which are exercisable within the next 60 days.
- (16) Includes 12,125 shares of Common Stock subject to outstanding options which are exercisable within the next 60 days.
- (17) Includes 56,375 shares of Common Stock subject to outstanding options which are exercisable within the next 60 days.

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During the fiscal year ended June 29, 2002, the Board of Directors was comprised of ten directors, consisting of the nine nominees and Jack Futterman. Mr. Futterman is not standing for reelection and is ending his service as a Director on November 13, 2002. The Board of Directors intends to reduce the size of the Board of Directors to nine directors thereafter.

Unless otherwise instructed, the proxy holders will vote the proxies received by them for the nine nominees. In the event that any nominee is unable or declines to serve as a director at the time of the Annual Meeting, the proxies will be voted for any nominee who shall be designated by the present Board of Directors to fill the vacancy. In the event that additional persons are nominated for election as directors, the proxy holders intend to vote all proxies received by them in such a manner as will ensure the election of as many of the nominees listed below as possible. It is not expected that any nominee will be unable or will decline to serve as a director. The names of the nine nominees, their ages, the respective years in which each first became a Director of the Company, and their respective principal occupations during the past five years are as follows:

<u>Name of Nominee</u>	<u>Age</u>	<u>Position with the Company</u>	<u>Served as a Director Since</u>
Ralph D. Dillon(1)	62	Non-Executive Chairman of the Board of Directors	1999
Michael A. Gatto(2)(3)(4)	35	Director	2001
Richard H. Griner	59	Director	2002
L.R. Jalenak, Jr.(3)(6)	72	Director	2000
Howard Levkowitz(5)(7)(8)	35	Director	1999
Nancy Pedot(7)(9)	50	Director	2000
Walter J. Salmon(5)(7)(9)	71	Director	2001
James Shea	57	Director and Chief Executive Officer	2001
Michael E. Tennenbaum(10)	67	Vice Chairman of the Board of Directors	2000

- (1) Chairman of Strategic Planning Committee.
- (2) Member of Nominating and Governance Committee.
- (3) Member of Compensation Committee.
- (4) Chairman of Finance Committee.
- (5) Member of Finance Committee.
- (6) Chairman of Audit Committee.
- (7) Member of Audit Committee.
- (8) Chairman of Nominating and Governance Committee.
- (9) Member of Strategic Planning Committee.
- (10) Chairman of Compensation Committee.

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**Ralph D. Dillon** has been the Non-Executive Chairman of the Board of Directors since December 10, 1999 and has been a Director of the Company since October 1, 1999. Prior to becoming a Director of the Company, Mr. Dillon served as Chief Executive Officer of Cost Plus, Inc. ( Cost Plus ), a specialty retailer of casual home living and entertainment products, from September 1990 to February 1998, President of Cost Plus from September 1990 to August 1995 and Chairman of the Board of Cost Plus from August 1995 to February 1998. He also served as a Director of Cost Plus from September 1990 to May 1999 and has served as an advisor to the Chief Executive Officer of Cost Plus. Mr. Dillon holds his current seat on the Board of Directors of the Company and is being nominated for re-election in connection with the investment and

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restructuring of the Company's obligations which occurred on August 17, 1999 (which transactions are described below in "Certain Relationships and Related Party Transactions").

**Michael A. Gatto** has been a Director of the Company since February 20, 2001. From April, 2002 to the present Mr. Gatto has been an executive director with Silverpoint Capital. He was previously a Vice President in the Special Situations Investing Group of Goldman, Sachs & Co. from 1998 to 2001, a Principal of Stroble & Associates, a financial consulting firm, from 1997 to 1998 and a Corporate Finance Associate in the Retail Industry Group of Citibank, N.A. from 1992 to 1997.

**Richard H. Griner** has been a Director of the Company since September 6, 2002. From April 2001 to the present Mr. Griner has been the President of Omni Fitness, Inc., the specialty fitness equipment chain. Prior to joining Omni Fitness, Mr. Griner served from 1996 to 2000 as President and Chief Operating Officer of Trend-Lines, Inc. and from 1986 to 1995 as Senior Vice President of Operations for Family Dollar Stores, Inc.

**L.R. Jalenak, Jr.** has been a Director of the Company since February 17, 2000. Prior to becoming a Director of the Company, Mr. Jalenak was Chairman of the Board of Cleo Inc, a manufacturer of Christmas wrapping paper and related products, from 1990 until his retirement in December 1993. From 1977 to 1990, he was President of Cleo Inc. Mr. Jalenak also serves as a Director of Perrigo Company. He is also a trustee of First Funds, a mutual fund company and Commissioner of Memphis Light, Gas and Water Division, a Memphis utility company.

**Howard Levkowitz** has been a Director of the Company since August 17, 1999. Mr. Levkowitz has been a Partner in Special Value Investment Management, LLC, an investment management company focused on special situation investments, since 1999 and since 1997, has been a principal of Tennenbaum & Co., LLC (with which Special Value Investment Management, LLC is affiliated). He was an attorney with Dewey Ballantine LLP from 1993 to 1997. Mr. Levkowitz holds his current seat on the Board of Directors of the Company and is being nominated for re-election in connection with the investment and restructuring of the Company's obligations which occurred on August 17, 1999 (which transactions are described below in "Certain Relationships and Related Transactions").

**Nancy Pedot** has been a Director of the Company since November 27, 2000. Between 1989 and 1993, Ms. Pedot served in various executive positions with The Gymboree Corporation, a designer, manufacturer and retailer of children's apparel and accessories that operates a chain of more than 500 stores. She joined Gymboree in 1989 as Senior Vice President of Merchandising and in 1994 was named President and CEO. Ms. Pedot left Gymboree in 1997 to devote more time to her family and to pursue personal interests. Ms. Pedot also serves on the boards of directors of several not-for-profit entities.

**Walter J. Salmon** has been a Director of the Company since July 25, 2001. Mr. Salmon is presently the Stanley Roth, Sr., Professor of Retailing, Emeritus, at the Harvard University Graduate School of Business Administration. He has been a member of the Harvard Business School faculty since 1956. Professor Salmon presently serves on the boards of The Neiman Marcus Group, PetsMart, Inc., Harrah's Entertainment, Inc., Cole National Corporation, Luby's, Inc. and the Harvard Business School Publishing Company.

**James Shea** has been a Director of the Company since October 1, 2001. Mr. Shea has been the Company's Chief Executive Officer since December 10, 1999. From November 1995 until his appointment as Chief Executive Officer of the Company, Mr. Shea held positions as Senior Vice President for Merchandise and Marketing, Executive Vice President and, most recently, President, of Lechters, Inc., a chain of over 500 houseware specialty stores located nationwide. Prior to that, Mr. Shea held various executive positions with the May Department Stores Company and Target Corporation.

**Michael E. Tennenbaum** has been a Director of the Company since October 5, 2000 and has been the Vice Chairman of the Board of Directors since October 1, 2002. Mr. Tennenbaum has been the Managing Member of Tennenbaum & Co., LLC since its inception in June 1996. Tennenbaum & Co., LLC is the Managing Member of Special Value Investment Management, LLC, an investment management company focused on special situation investments. From February 1993 until June 1996, Mr. Tennenbaum was a Senior Managing Director of Bear, Stearns & Co., Inc. and also held the position of Vice Chairman, Investment

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Banking. Mr. Tennenbaum currently is Chairman of the board of directors of Pemco Aviation Group, Inc., and is also a director of various privately-held companies.

### **Recommendation and Vote**

The election of each nominee as a Director requires a plurality of the votes present at the Annual Meeting and entitled to vote.

**The Board unanimously recommends a vote FOR the nominees.**

### **Section 16(a) Beneficial Ownership Reporting Compliance**

Section 16(a) of the Securities Exchange Act of 1934, as amended (the Exchange Act ) requires the Company's directors and executive officers, and persons who have beneficial ownership of more than ten percent (10%) of the Common Stock of the Company, to file reports of ownership and changes of ownership with the Securities and Exchange Commission and the NASDAQ. Copies of all filed reports are required to be furnished to the Company pursuant to Section 16(a). Based solely on the reports received by the Company and on written representations from reporting persons, the Company believes that the directors, executive officers and greater than ten percent (10%) beneficial owners complied with all Section 16(a) filing requirements during the fiscal year ended June 29, 2002 except as follows: Mr. Andrew Bailen, through inadvertence, failed to file a Form 4 upon purchasing 3,500 shares of Company Common Stock on September 19, 2001. A Form 4 reporting Mr. Bailen's purchase was promptly filed by Mr. Bailen after the oversight was discovered. The Company believes that all holdings and transactions of Mr. Bailen have been promptly and timely disclosed in the Company's annual reports.

### **Certain Relationships and Related Party Transactions**

On August 17, 1999, the Company received \$30 million in financing from a group of investors (the Investors ) led by TCO. Under securities purchase agreements with the Investors, the Company issued (i) \$10 million of its 12.5% Secured Notes due 2003 (the A Notes ); (ii) \$5 million of its 13.0% Secured Notes due 2003 (the B Notes ); (iii) \$5 million of its 13.0% Secured Notes due 2002 (the C Notes ); (iv) \$10 million of its 14.0% Secured Notes due 2004 (the D Notes ); and (v) warrants (the Warrants ) to purchase 6,880,000 shares of the Company's Common Stock at an initial exercise price of \$3.00 per share. Then on January 14, 2002, the Company received \$7 million from the sale of 14.0% Senior Secured Notes due 2002 (the E Notes ), and together with the A Notes, B Notes, C Notes and D Notes, the Notes ) to certain of the Investors and the Company also agreed to amend and restate the terms of the Warrants. The amended and restated warrants provide for an exercise price of \$1.07 per share and were issued upon surrender of the Warrants which had an exercise price of \$3.00 per share. For more information see Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources, in the Company's Form 10-K for the fiscal year ended June 29, 2002, which was filed on September 27, 2002.

During the fiscal year ended June 29, 2002, the Company made regularly scheduled principal and interest payments on the Notes. In addition, the Company prepaid the A Notes, B Notes and E Notes, which included the following prepayments to SVBF and SVBF II: (i) \$464,250 of E Notes in September 2001; (ii) \$1,392,750 of E Notes in December 2001; (iii) \$1,275,913 of A Notes in December 2001; (iv) \$1,275,913 of A Notes in June 2002; and (v) \$2,551,826 of B Notes in June 2002. Messrs. Tennenbaum and Levkowitz, each of whom is a Director of the Company and a nominee for Director at the 2002 Annual Meeting, are principals of SVIM, which, in turn, is the Investment Manager of SVBF and SVBF II, and Mr. Tennenbaum is the Managing Member of TCO, which is the Managing Member of SVIM.

Messrs. Jason Craig and Steven Craig, sons of Mr. Sidney Craig, President of Craig Enterprises, Inc., own and operate six and five Party City franchised stores, respectively, located in California. Pursuant to the terms of their respective franchise agreements with the Company, during the fiscal year ended June 29, 2002 Mr. Jason Craig paid the Company \$783,700 and Mr. Steven Craig paid the Company \$623,296. Craig Enterprises, Inc. owns 1,121,802 shares of Common Stock; 1,107,000 shares of Common Stock as reported in

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the Amendment to Schedule 13G filed by Craig Enterprises, Inc. with the Securities and Exchange Commission on April 23, 1999 and 14,802 shares of Common Stock distributed to an affiliate of Craig Enterprises, Inc. by SVBF pursuant to the exercise of its warrant not reflected in the Amendment to Schedule 13G.

### **Board of Directors Meetings and Committees**

The Board of Directors met six times during the fiscal year ended June 29, 2002.

The Compensation Committee, comprised of Messrs. Gatto, Jalenak and Tennenbaum, met three times during the fiscal year ended June 29, 2002. In addition to its other responsibilities, the Compensation Committee is responsible for the administration of the Company's 1999 Stock Incentive Plan and for the grant of stock options and other awards under such plan, as well as the administration of the Management Stock Purchase Plan (the Management Plan) and grants thereunder.

The Audit Committee, which during the fiscal year ended June 29, 2002 was comprised of Ms. Pedot and Messrs. Futterman, Jalenak, Levkowitz and Salmon, is responsible for recommending independent auditors, reviewing with the independent auditors the scope and results of the audit engagement and establishing and monitoring the Company's financial policies and control procedures. The Audit Committee met eight times during the Company's fiscal year ended June 29, 2002.

The Nominating and Governance Committee is responsible for recommending persons to be nominees for the Company's Board of Directors. This Committee does not consider nominees recommended by the Company's stockholders. The Nominating and Governance Committee met three times during the fiscal year ended June 29, 2002. During the fiscal year ended June 29, 2002, the Nominating and Governance Committee was comprised of Messrs. Futterman, Gatto and Levkowitz.

The Finance Committee assists the Board in advising and overseeing the Company's financial initiatives and financial matters. The Finance Committee met once during the fiscal year ended June 29, 2002. The Finance Committee is comprised of Messrs. Gatto, Levkowitz and Salmon.

The Strategic Planning Committee assists the Board in facilitating the strategic planning process. The Strategic Planning Committee is comprised of Ms. Pedot and Messrs. Dillon and Salmon. The Strategic Planning Committee met once during the fiscal year ended June 29, 2002.

In addition to meeting, the Compensation Committee and the Nominating and Governance Committee, as well as the full Board of Directors, acted by unanimous written consent on numerous occasions during the Company's fiscal year ended June 29, 2002.

All Directors are elected at each annual meeting of stockholders and hold office until the election and qualification of their successors at the next annual meeting of stockholders. All of the Directors attended at least 75% of the combined number of Board meetings and meetings of committees of which they were members that were held during the fiscal year ended June 29, 2002.

All executive officers of the Company are elected annually by, and serve at the discretion of, the Board of Directors, although the employment of Messrs. Shea and Bailen by the Company is subject to the provisions of their respective employment agreements.

### **Resignations**

In September 2002, Thomas E. Larson, former Chief Financial Officer of the Company, resigned his position.



**Table of Contents****EXECUTIVE OFFICERS OF THE COMPANY**

Name	Age	Position(s)
James Shea	57	Director and Chief Executive Officer
Andrew Bailen	46	Executive Vice President of Merchandising/ Marketing
Linda M. Siluk	45	Senior Vice President and Chief Financial Officer
Warren Jeffery	53	Senior Vice President of Operations

All executive officers are chosen by the Company's Board of Directors and serve at the Board's discretion. Set forth below is information concerning the business experience of the executive officers of the Company.

**James Shea** was appointed Chief Executive Officer on December 10, 1999. He has been a director of the Company since October 1, 2001. From November 1995 until his appointment as Chief Executive Officer of the Company, Mr. Shea held positions as Senior Vice President for Merchandise and Marketing, Executive Vice President and, most recently, President, of Lechters, Inc., a chain of over 500 houseware specialty stores located nationwide. Prior to that, Mr. Shea held various executive positions with the May Department Stores Company and Target Corporation.

**Andrew Bailen** was appointed Executive Vice President of Merchandising/ Marketing of the Company on August 8, 2000. From January 1999 until his appointment, Mr. Bailen was the Chief Executive Officer of Net Connections, Inc., an Internet advertising firm. From February 1998 to December 1998, Mr. Bailen was Executive Vice President/ Chief Operating Officer of Hollywood.com and from February 1995 to October 1997, Vice President of Merchandising and Senior Vice President/ General Merchandise Manager-Retail of Blockbuster Entertainment Group. Prior to that, he held a variety of executive positions with Greenman Brothers Inc. and KayBee Toys.

**Linda M. Siluk** was appointed Senior Vice President and Chief Financial Officer on August 26, 2002. She had previously been the Company's Vice President of Finance since September 14, 1998. Prior to joining the Company in September 1998, Ms. Siluk had been the Chief Financial Officer of Federated Merchandising Group, a division of Federated Department Stores, Inc. from December 1994 to April 1998. From October 1985 until December 1994, Ms. Siluk held positions as Senior Vice President, Finance and Logistics for Macy Product Development and Vice President Finance for Macy Corporate Buying Office, both positions in a division of R.H. Macy & Co., Inc.

**Warren Jeffery** was appointed Senior Vice President of Operations on August 26, 2002. He had previously been the Company's Vice President of Operations since January 2002. Prior to joining the Company, Mr. Jeffery had been the Senior Vice President of Pharmacy Management at McKesson Medication Management from June 2001 to January 2002. He previously held various executive positions including Executive Vice President Merchandising, Marketing and Logistics, Senior Vice President Store Operations and Vice President of Store Operations and Loss Prevention at Phar-Mor Inc., from February 1993 through October 2000.

**Table of Contents****COMPENSATION OF EXECUTIVE OFFICERS AND DIRECTORS****Executive Compensation**

The following table sets forth a summary of the compensation paid by the Company for services rendered in all capacities to the Company during the Company's fiscal year 2002, 2001 and 2000 to each of the Named Executive Officers:

**Summary Compensation Table**

Name and Principal Position	Fiscal year(1)	Period Compensation			Long-Term Compensation	
		Salary	Bonus(2)	Other Annual Compensation	Restricted Stock Awards(3)	# Securities Underlying Stock Options
James Shea Chief Executive Officer	2002	\$ 378,634	\$ 122,257	\$ 60,703(4)	\$ 183,385	75,000
	2001	356,191	34,920	73,222(5)	227,500	
	2000	192,500				200,000
Andrew Bailen Executive Vice President	2002	283,654	184,000	20,461(6)	46,000	40,000
	2001	243,269	165,001	116,909(7)		100,000
	2000					
Linda M. Siluk Senior Vice President, Chief Financial Officer	2002	198,760	100,000	8,629(8)		17,000
	2001	189,248	71,543	7,425(9)		
	2000	178,077	18,000			5,000
Warren Jeffery Senior Vice President	2002	105,577	80,342	68,342(10)		50,000
	2001					
	2000					
Thomas E. Larson(11) Former SVP & CFO	2002	258,750	31,604	45,311(12)	126,363	23,000
	2001	257,739	38,818	51,763(13)	155,245	
	2000	250,000	125,000			

- (1) The Company's fiscal year end is the Saturday nearest to June 30.
- (2) Amounts in this column do not include any portion of the Named Executive Officers' respective bonuses foregone under the Management Plan.
- (3) Amounts in this column represent a portion of the Named Executive Officers' respective bonuses foregone pursuant to the Management Plan. The Management Plan provides for a mechanism through which certain executive officers of the Company may forego all or a portion of their annual bonus such that it may be used to purchase restricted stock units linked on a one-to-one basis to the value of the Company's Common Stock. Depending on the amount of the annual bonus foregone by an eligible executive officer who participates in the Management Plan, the Company offers the restricted stock units at a 20% to 25% discount.
- (4) This amount includes \$12,130 in automobile allowances, and \$48,393 representing the value of the discount applicable to the purchase of restricted stock units under the Management Plan.
- (5) This amount includes \$8,517 in automobile allowances and \$64,705 representing the value of the discount applicable to the purchase of restricted stock units under the Management Plan.
- (6) This amount includes \$8,960 in automobile allowances, \$11,501 representing the value of the discount applicable to the purchase of restricted stock units under the Management Plan.

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- (7) This amount includes \$6,750 in automotive allowances, \$99,847 for moving expenses and \$10,312 representing the value of the discount applicable to the purchase of restricted stock units under the Management Plan.
- (8) This amount includes \$8,100 in automobile allowances and \$529 representing the value of the discount applicable to the purchase of restricted stock units under the Employee Plan.
- (9) This amount includes \$7,425 in automobile allowances.
- (10) This amount includes \$3,894 in automobile allowances and \$64,448 for moving expenses.
- (11) Mr. Larson was the Company's Senior Vice President and Chief Financial Officer from June 18, 1999 until September 3, 2002. Mr. Larson resigned as Senior Vice President and Chief Financial Officer on September 3, 2002.
- (12) This amount includes \$8,640 in automobile allowances, \$34,540 representing the value of the discount applicable to the purchase of restricted stock units under the Management Plan, and \$1,131 representing the value of the discount applicable to the purchase of restricted stock units under the Employee Plan.
- (13) This amount includes \$8,100 in automobile allowances and \$43,663 representing the value of the discount applicable to the purchase of restricted stock units under the Management Plan.

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**OPTION GRANTS DURING THE FISCAL YEAR ENDED JUNE 29, 2002**

The following table presents information regarding grants of options to purchase shares of the Company's Common Stock for each of the Named Executive Officers receiving option grants during the fiscal year ended June 29, 2002:

Name	Individual Grants				Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term
	Number of Securities Underlying Options Granted	Percent of Total Options Granted to Employees in Fiscal Year	Exercise Price Per Share(1)	Expiration Date	