SONERA CORP
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SECURITIES AND EXCHANGE COMMISSION

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May 7, 2002

TELIA AB

(Name of Filer)

SONERA CORPORATION

(Subject Company)

0-30340

(Exchange Act File No. of Subject Company)

THE FOLLOWING IS TELIA AB S FIRST QUARTER REPORT PUBLISHED ON MAY 6, 2002.

First Quarter Report

January March, 2002

Telia AB (publ), SE-123 86 Farsta, Corp. Reg. No. 556103-4249, Registered office : Stockholm

Q1 in Brief

Group net sales increased 2 percent to MSEK 13,885 (13,592)
- Core business +9 percent

Underlying EBITDA increased to MSEK 3,381 (3,348)
- Core business +5 percent

Earnings after financial items climbed to MSEK 535 (502)
Capital expenditure (CAPEX) decreased to MSEK 2,022 (3,568)
The number of employees totaled 16,804 (29,936)
Telia and Sonera announced plans to merge

Review of Group Earnings

MSEK	Jan.-March 2002	Jan.-March 2001	Jan.-Dec. 2001
Net sales	13,885	13,592	57,196
Change in net sales (%)	2.2	5.7	5.8
Underlying EBITDA	3,381	3,348	12,915
Underlying EBITDA margin (%)	24.4	24.6	22.6
Operating income	709	811	5,460
Income after financial items	535	502	4,808
Net income	127	291	1,869
Basic and diluted earnings per share (SEK)	0.04	0.10	0.62
Investments	2,053	3,659	20,735
Of which CAPEX	2,022	3,568	17,713
Of which acquisitions	31	91	3,022

Comments from Marianne Nivert, President and CEO

We have seen a positive trend in our core businesses and we can already see the effects of the streamlining measures in Telia Internet Services and Telia International Carrier.

As already announced, we are stepping down our investments now, which will have a positive impact on cash flow.

In the planned merger, Telia and Sonera will together form a strong and successful telecommunications company in northern Europe, says Marianne Nivert.

Review of the Group

Sales and Earnings

The Telia Group s net sales increased 2 percent to MSEK 13,885 during the first quarter compared to the corresponding quarter 2001. Sales for comparable operations increased 9 percent.

Underlying EBITDA increased 1 percent to MSEK 3,381.

Telia s sales and earnings were affected by the divestiture of non-core operations carried out in 2001 as part of the Group s refine and focus efforts.

In the core businesses, which showed a stronger development than the Group as a whole, sales rose 9 percent and underlying EBITDA increased 5 percent.

Net Sales per Business Area[1)]

	Jan-Mar 2002 MSEK	Chg. %	Jan-Mar 2001 MSEK	Jan-Dec 2001 MSEK
Mobile	4,654	16.8	3,985	17,857
Internet Services	975	36.4	715	3,288
International Carrier	1,014	35.2	750	3,652
Networks	6,909	-1.7	7,027	29,159
Retail market	*5,827*	*-6.5*	*6,230*	*24,802*
Wholesale market	*1,082*	*35.8*	*797*	*4,357*
Group-wide	333	-70.1	1,115	3,240
Staff, support, programs & other	*73*	*43.1*	*51*	*168*
Holding	*260*	*-75.6*	*1,064*	*3,072*
Total	**13,885**	**2.2**	**13,592**	**57,196**
of which core business	*13,625*	*8.8*	*12,528*	*54,124*

1) For further information: www.telia.com, Investor Relations, Financial Information, External Net Sales per Business Area and Product Segment (specification).

Sales in Telia Mobile surged 17 percent to MSEK 4,654. Growth was particularly strong on the Norwegian market. The number of new mobile customers increased by 75,000 to 5,011,000 in the first quarter. Underlying EBITDA climbed 6 percent to MSEK 1,234. The margin fell from 26 to 24 percent, though this was an improvement compared to the fourth quarter of 2001.

Demand for broadband remained strong and led to a 36 percent jump in the sales of Telia Internet Services, to MSEK 975. Earnings improved by MSEK 180 as a result of the streamlining. Compared with the fourth quarter 2001, the improvement in earnings was MSEK 53. Telia is the leading broadband provider in Sweden and is the second leading provider in Denmark.

The carrier market continues to be characterized by weak growth and sustained price pressure. Telia International Carrier strengthened its market position and sales rose 35 percent to MSEK 1,014. Sales remained at approximately the same level compared with the fourth quarter 2001. Earnings improved during the period. Compared with the fourth quarter 2001, underlying EBITDA improved by MSEK 50.

Telia Networks increased its fixed network wholesale sales 24 percent for comparable operations. The increase largely compensated for reduced revenues on the Swedish retail market, where local carrier preselection was implemented on February 2, 2002.

Underlying EBITDA and Operating Income

MSEK	Jan-Mar 2002	Jan-Mar 2001	Jan-Dec 2001
Mobile	1,234	1,167	4,705
Internet Services	-170	-350	-970
International Carrier	-331	-265	-1,569
Networks	2,814	2,837	11,710
Group-wide	-166	-41	-961
Staff, support, programs & other	*-238*	*-238*	*-1,226*
Holding	*72*	*197*	*265*
Total underlying EBITDA	**3,381**	**3,348**	**12,915**
of which core business	*3,309*	*3,151*	*12,650*
Depreciation, amortization & write-downs	-2,707	-2,410	-13,975
Non-recurring items & pensions	23	30	384
Income from associated companies	12	-157	6,136
Operating income	**709**	**811**	**5,460**

Sales for Telia Networks as a whole fell 2 percent to MSEK 6,909. Sales for comparable operations fell 1 percent. Underlying EBITDA totaled MSEK 2,814, which is on the same level as the comparative quarter.

For Group-wide functions and projects (staff, support, programs & other), underlying EBITDA amounted to MSEK -238, which is on the same level as the corresponding quarter 2001.

Depreciation, amortization and write-downs increased to MSEK 2,707 (2,410). This is attributable to major investments made in 2001 in the buildout of broadband in Sweden, in capacity reinforcements in the Swedish fixed network and in the expansion of the international carrier network. Non-recurring items totaled MSEK 23 (30).

Income from Associated Companies

MSEK	Jan-Mar 2002	Jan-Mar 2001	Jan-Dec 2001
Core business	**23**	**-403**	**-2,103**
Baltic states (Mobile/Networks)	35	23	195
Netia (Networks)	0	-143	-2,464
Comsource/Eircom (Networks)	0	-204	126
Other	-12	-79	40
Holding	**-11**	**246**	**8,239**
Unisource/aucs	0	-49	-372
Telia Overseas	17	-2	2,794
Eniro		292	6,052
Other	-28	5	-235
Total	**12**	**-157**	**6,136**

Earnings from associated companies improved to MSEK 12 *(-157)*, despite non-recurring items in the comparative period in the form of capital gains and issue proceeds of MSEK 607. The improved performance is attributable to the divestiture in 2001 of associated companies that previously reported losses, such as Tess, Eircom and Scandinavia Online. The improvement is also because the earnings in Netia had no effect as the book value of Telia s holdings in the company was zero at the beginning of the year.

Operating income totaled MSEK 709 (811). Financial items declined to MSEK 174 (309). Earnings after financial items climbed to MSEK 535 (502). Net income totaled MSEK 127 (291).

Financial Position and Cash Flow

The Group s financial position remains good. Total assets decreased during the first quarter, chiefly attributable to the use of capital gains from the sale of businesses at the end of 2001 to amortize loans. The asset turnover rate and equity/assets ratio improved.

MSEK	March 31 2002	Dec. 31 2001	Dec. 31 2000
Interest coverage ratio (multiple)	2.0	3.0	7.3
Change in total assets (%)	-7.1	4.5	60.2
Asset turnover ratio (multiple)	0.47	0.46	0.54
Equity/assets ratio (%)	49.2	46.2	44.4
Capital employed	84,634	90,971	92,374
Operating capital	70,715	70,150	75,042
Net interest-bearing liability	11,908	10,661	20,235
Debt/equity ratio (multiple)	0.20	0.18	0.37

Operating cash flow was negative during the period (MSEK -865), but was greatly strengthened compared with the first quarter of the preceding year (MSEK -3,026). The improvement is a result of the planned decrease in the level of investment and a reduction in the seasonal increase in working capital.

Net indebtedness increased somewhat compared with year-end, the debt/equity ratio continues to be low compared to other operators with similar business.

Financial Risk Management

Foreign Exchange Risk

The Telia Group has a relatively limited operational need to net purchase foreign currency, primarily due to the settlement deficit in telephony traffic and import of materials.

Telia s general policy is normally to hedge the majority of known operational conversion exposure up to 12 months into the future. Given an operational net transaction exposure equal to that of 2001, and provided that no hedging measures were taken, there would be a negative impact on Group earnings of approximately MSEK 30 on an annual basis if the Swedish krona weakened one percent against the transaction currencies.

The Group is growing relatively robustly in other countries, which implies rising conversion exposure. Telia manages this in various ways, depending on the following factors: investment horizon, size of commitment, the country in which we are doing business, and the currency. With consideration given to fiscal effects, Telia normally hedges translation exposure that is relatively short-term, involves substantial amounts, and which is located in a country with a stable financial market or is denominated in a readily available currency. Telia does not hedge to the same extent exposure that is long-term or of lesser amounts in countries or currencies that are difficult to manage from a financial perspective. As of March 31, the Group had hedged conversion exposure equal to approximately MSEK 480.

Interest Rate Risk

Telia s financial policy provides guidelines for fixing interest rates on loan debt relative to the average life of the loan. The Group s policy is that the duration of loan debt should be from six months to four years. The Group arrived at this duration range by balancing the estimated ongoing cost of borrowing and the risk of significant negative impact on earnings should there be a sudden, major change in interest rates. The general principle is to optimize interest rate risk from an overall Group perspective.

Approximately GSEK 5 was used during the first quarter of 2002 to repay loans. As of March 31, the Group had interest-bearing liabilities of approximately GSEK 24 with duration of approximately two years.

Financing and Liquidity Risk

Telia is considered one of the most creditworthy telecommunications companies in Europe, which gives the Group good opportunities to finance operations using the financial markets.

In April, the credit rating agency Standard & Poor s downgraded its credit rating for Telia AB to A+ for long-term borrowing and to A-1 for short-term borrowing. Standard & Poor s also put Telia s rating on its watch list for possible downgrading in light of the bid on Sonera Oyj. Telia s rating from the credit rating agency Moody s is the highest possible, P-1, for short-term borrowing. Telias s rating from Moody s for long-term borrowing is A1. Moody s has also posted Telia s rating on its watch list for possible downgrading.

Telia AB has a Revolving Credit Facility, i.e., confirmed loan commitments from a consortium of leading international banks, which constitutes a liquidity tool for the Group. At present, the loan commitment amounts to MUSD 1,000 or the equivalent value in certain other currencies. It was not utilized as of March 31.

Investments

In line with Telia s previously published focus, investments decreased 44 percent compared to the same quarter of 2001.

Investments by Class of Asset

MSEK	Jan-Mar 2002	Jan-Mar 2001	Jan-Dec 2001
Goodwill	4	29	448
Other intangible assets	59	52	1,316
Real estate	48	57	269
Machinery and equipment	1,915	3,459	16,128
Fixed networks	*354*	*422*	*7,022*
Mobile networks	*402*	*349*	*2,124*
Other machinery and equipment	*1,159*	*2,688*	*6,982*
Shares and participations	27	62	2,574
Total	**2,053**	**3,659**	**20,735**

The decrease is primarily attributable to the international carrier operations, where the buildout of the Viking Network is in its final stages. Telia s network investments are now focused on demand-driven capacity expansion.

Employees

The Group s refine and focus strategy, primarily the partial divestiture of Telefos and the sale of Orbiant, entailed a 33 percent reduction in the average number of full-time employees, to 16,671 during the first quarter compared with 24,979 for the full year 2001.

Telia and Sonera Announced Plans to Merge

On March 26, 2002, Telia and Sonera announced their plan to merge. The merger will create the leading telecommunications group in the Nordic and Baltic regions with combined preliminary pro-forma 2001 revenues of GSEK 83, underlying EBITDA of GSEK 20.8 and operating income of GSEK 11.4 and approximately 34,000 employees.

The home market for the combined group comprises 31 million people in the Nordic and Baltic countries. The combined entity is expected to have 8.1 million mobile customers and 7.6 million fixed line customers across the Nordic and Baltic regions. The associated companies of the combined group are expected to have 14.6 million mobile customers and 1.2 million fixed line customers.

Telia and Sonera expect significant cost and capital expenditure synergies as a result of the merger. Full cost synergies are expected to be derived in 2005 and are estimated at GSEK 2.7. Approximately 50 percent of the full amount is expected to be realized in 2003, and 75 percent in 2004. The capital expenditure synergies are expected to peak during 2004 at approximately MSEK 900. After 2005, continued capital expenditure synergies are expected to amount to MSEK 450 per year.

One-off costs (excluding transaction costs) resulting from the merger are expected to be limited in 2002 and total GSEK 2.3 in 2003. Telia and Sonera conservatively estimate pre-tax cash flow synergies to be approximately GSEK 2.7 per year after 2005.

The merger will be effected through an exchange offer to all shareholders of Sonera by Telia. Sonera shareholders will receive 1.51440 Telia shares in exchange for each Sonera share.

Pro-forma ownership of the new group will be 64 percent for current Telia shareholders and 36 percent for current Sonera shareholders, assuming 100 percent acceptance of the offer.

The merged company will have a primary listing on Stockholmsbörsen (Stockholm Exchange) and will seek secondary listings on the Helsinki Stock Exchange and in the United States.

Annual General Meeting Decisions

In accordance with the recommendation of Telia s Board of Directors, the Meeting of April 23, 2002 approved a dividend for 2001 of SEK 0.10 per share and an extra dividend of SEK 0.10 per share, totaling a dividend of SEK 0.20 per share.

Lars-Eric Petersson, Peter Augustsson, Carl Bennet, Ingvar Carlsson, Anders Igel, Lars Olofsson, Caroline Sundewall and Marianne Nivert were reelected members of the Board.

Financial Information

Semiannual Report Jan.-June Aug 6
Third Quarter Report Jan.-Sept. Nov 4

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Review of Business Areas

Telia Mobile

Customer growth, increased SMS usage and increased traffic per customer, primarily in Norway, contributed to a 17 percent surge in external net sales, to MSEK 4,654 in the first quarter compared to the corresponding quarter 2001.

Telia Mobile added 75,000 customers in the Nordic countries, for a total of 5,011,000, and the number of customers via service providers increased by 4,000 to 190,000.

MSEK	Jan-Mar 2002	Jan-Mar 2001	Jan-Dec 2001
Net sales	5,059	4,526	19,830
of which external	4,654	3,985	17,857
Underlying EBITDA	1,234	1,167	4,705
EBITDA margin (%)	24.4	25.8	23.7
Operating income	381	452	1,632
Investments	445	510	4,979
Mobile telephony, Sweden Net sales	2,734	2,669	11,546
of which external	2,446	2,247	10,047
Underlying EBITDA	1,206	1,194	5,132
EBITDA margin (%)	44.1	44.7	44.4
Investments	97	237	1,364
Mobile telephony, Norway Net sales	1,200	905	4,316
of which external	1,176	899	4,287
Underlying EBITDA	422	286	1,381
EBITDA margin (%)	35.2	31.6	32.0
Investments	212	124	1,057
Mobile telephony, Denmark Net sales	194	183	731
of which external	163	159	633
Underlying EBITDA	-128	-144	-602
EBITDA margin (%)	neg	neg	neg
Investments	36	49	1,565
Mobile telephony, Finland Net sales	216	142	666
of which external	215	137	648
Underlying EBITDA	-104	-71	-412
EBITDA margin (%)	neg	neg	neg
Investments	49	38	412
Business solutions, telephony Net sales	535	415	1,619
of which external	479	371	1,450
Underlying EBITDA	-21	33	-107
EBITDA margin (%)	neg	8.0	neg
Investments	0	1	18

Underlying EBITDA climbed 6 percent to MSEK 1,234. The margin was 24 percent (26).

Depreciation increased to MSEK 897 (741).

Earnings from associated companies in the Baltic states and Russia increased to MSEK 61 (42). The companies combined customer base increased during the quarter by 314,000 customers, to 2,351,000.

Operating income totaled MSEK 381 (452).

Investments in the first quarter totaled MSEK 445 (510). The investments primarily targeted expanding capacity in Sweden and Norway and the buildout of the GSM networks in Denmark and Finland.

A shared organization for the Nordic market was introduced on April 1 as a means to facilitate synergies.

Mobile telephony, Sweden

External sales rose by 9 percent to MSEK 2,446 for the Swedish operations.

Telia reduced its price for interconnect traffic on March 1, 2002 from SEK 1.18 to SEK 0.92, as ordered by the Swedish National Post and Telecom Agency (PTS). Telia has appealed the PTS decision to the county administrative court.

The number of GSM customers increased by 22,000 to 3,317,000, while the number of customers via service providers increased by 17,000 to 91,000. The surge in the number of customers via service providers is mainly due to the Halebop Mobile prepaid card initiative.

The average traffic volume per customer and month rose to 121 minutes (119).

During the first quarter, nearly 109 million SMS messages were sent, up 38 percent from the same quarter of 2001.

The average monthly revenue per customer (ARPU) fell to SEK 262 (273) due to reduced interconnect fees and an increased share of prepaid card customers. Reduced interconnect fees led to a 4 percent decline in the price level compared with the same quarter 2001, corresponding to revenues of slightly over MSEK 100.

Churn was 11 percent, which is on the same level as the same quarter of the preceding year.

Underlying EBITDA climbed 1 percent to MSEK 1,206 and the margin totaled 44.1 percent (44.7).

Telia began a collaboration with Microsoft and WM-data to develop solutions that will make it possible to access company intranets using a mobile phone.

A low-price GPRS offer, Telia Mobile Online Micro, was launched on the Swedish market for customers who use GPRS services sporadically and customers who want to try GPRS.

Using the Halebop portal, Telia was the first operator in Sweden to launch online games that can be played using a computer or a mobile phone with Java applications installed.

During the first quarter, the Swedish Competition Authority granted approval of Telia s and Tele2 s 3g network collaboration.

Mobile telephony, Norway

External net sales increased 31 percent to MSEK 1,176. The number of customers during the first quarter increased by 15,000 to 985,000, while the number of customers via service providers fell 13,000 to 99,000.

During the quarter, 166 million SMS messages were sent, up 57 percent from the same quarter of 2001.

The average traffic volume per customer per month increased to 144 (131) minutes and ARPU climbed to NOK 326 (292).

Underlying EBITDA climbed 48 percent to MSEK 422 and the margin was strengthened to 35.2 percent (31.6). The improvement is attributable to a combination of volume growth and cost management.

An agreement was signed with one of Norway s largest electronics chains, Expert, for the distribution of NetCom s products and services. There are approximately 300 Expert shops throughout Norway.

A new price structure was introduced for prepaid cards, which means that customers pay the same rate per minute regardless of where and when they make calls.

Mobile telephony, Denmark

External sales increased by 2 percent to MSEK 163. The increase was mainly attributable to customer growth. In the first quarter, the number of customers rose by 34,000 to 322,000.

Underlying EBITDA improved to MSEK -128 (-144).

The Choice household subscription was launched at the end of 2001, enabling customers to create their own service packages. A large part of new sales during the first quarter was attributable to Choice.

Telia Mobiz, a product that targets business customers, was launched during the quarter. The product combines a flat rate on traffic with a telephone lease offer.

Construction is underway on the GSM 900 network. At the end of the quarter, the network had a geographic footprint of 66 percent. The network is expected to attain full buildout as per the license provisions before the end of the year.

The new network will allow Telia to offer more attractive prices and nationwide services in Denmark.

Mobile telephony, Finland

In the Finnish market, external sales jumped 57 percent to MSEK 215 compared with the same quarter of 2001. The increase is attributable to customer growth and the resulting higher traffic.

Underlying EBITDA decreased to MSEK -104 (-71). Earnings were burdened by MSEK 16 in inventory write-downs. Earnings showed an improvement of MSEK 43 compared to the fourth quarter.

The number of customers rose by 6,000 to 245,000 during the first quarter.

An agreement was signed with Suomen 2G Oy for national roaming, enabling Telia to offer nationwide services in Finland.

An agreement was signed with Scandic Hotels Oy for the installation of HomeRun (wireless Internet access) at Scandic s hotels and conference facilities in Finland. With this, HomeRun is now available at 420 locations in the Nordic countries.

In April 2002, an agreement was signed with Finnair for the installation of HomeRun in a number of the airline s business lounges.

Baltic states and Russia

The mobile operator companies in Russia and the Baltic states continued to report positive growth and the number of customers increased by 314,000 to 2,351,000. The greatest expansion was in the Russian operations.

Earnings from associated companies in the Baltic states and Russia improved to MSEK 61 (42).

Other mobile operations

Other operations, including mobile portals, paging, shops and radio contracting, increased net sales by 2 percent to MSEK 175, while underlying EBITDA fell MSEK 10 to MSEK 141.

In April 2002, an agreement was signed with Generic Mobile Systems ab for the transfer of the Minicall paging service. Generic will manage the service and the transfer is part of the streamlining efforts within Telia Mobile s operations.

Business solutions, telephony

Business customers are demanding greater mobility in their communications solutions. Most of today s business systems are set up for fixed telephony. To accelerate the development of business communications systems that integrate fixed and mobile voice communication, the Business Solutions telephony product area was moved from the business area Telia Networks to Telia Mobile on January 1, 2002. Work is underway to streamline the operations and develop system concepts that strengthen Telia s competitiveness on the business market.

Business Solutions posted external net sales of MSEK 479 for the first quarter, up 29 percent from the same period the preceding year. The sales growth is attributable to the fact that equipment previously sold on commission is now sold directly by Telia.

Underlying EBITDA decreased to MSEK -21 (33).

Sales of Centrex with mobile connections continued to be strong and the service was sold to additional municipalities in Sweden and to Lantmäteriverket (National Land Survey of Sweden).

Telia Internet Services

Continued strong demand on broadband access and increased sales of pay-per-view and digital TV subscriptions contributed to a 36 percent year on year increase in external sales to MSEK 975.

Earnings continued to improve during the period. Reduced development costs for Internet services, efficiency measures in the customer support function and improved cable television margins contributed to an improvement in underlying EBITDA of MSEK 180, to MSEK 170. Compared with the fourth quarter, the improvement in earnings was MSEK 53.

MSEK	Jan-Mar 2002	Jan-Mar 2001	Jan-Dec 2001
Net sales	982	719	3,305
of which external	975	715	3,288
Underlying EBITDA	-170	-350	-970
EBITDA margin (%)	neg	neg	neg
Operating income	-289	-442	-1,649
Investments	115	251	903
Sweden			
Net sales	826	619	2,817
of which external	819	615	2,802
Underlying EBITDA	-162	-323	-914
EBITDA margin (%)	neg	neg	neg
Investments	88	228	722

Depreciation totaled MSEK 109 (76) and referred mainly to the adaptation of cable television networks to broadband.

Losses in associated companies (the e-commerce company Marakanda) decreased to MSEK -9 (-15).

Operating income improved by MSEK 153 to MSEK -289. Earnings improved MSEK 272 compared with the fourth quarter.

Investments amounted to MSEK 115 (251).

Internet accesses

Internet accesses represent most of the business area s revenues. Sales increased 31 percent to MSEK 594 compared with the same quarter in the preceding year. The number of access customers jumped from 1,139,000 to 1,186,000.

Demand for broadband access remained strong in the household segment. The business segment also showed a strong increase in demand. During the first quarter, 50,000 paying broadband customers were added, bringing the total to 353,000. This indicates somewhat lower sales than during the fourth quarter, which was boosted by Christmas sales.

Telia is gradually refining its access offers. A new access service, Internet Cable with 1 Mbps speed, was launched during the quarter.

Dial-up Internet is still the dominating access form, but demand is slowing as customers switch to broadband.

Telia is the leading broadband provider in Sweden and is second on the Danish broadband market through the cable television company Telia Stofa. Telia has plans to offer broadband access over adsl in Denmark as well.

Internet Accesses ('000)	March 31, 2002	Change	Dec. 31, 2001
Sweden			
Dial-up access	740	-7	747
Broadband	288	+43	245
of which adsl/lan	233	+39	194
of which ProLane	3	0	3
of which cable TV	52	+4	48
Denmark			
Dial-up access	93	+4	89
Broadband via cable TV	65	+7	58
Total accesses	**1,186**	**+47**	**1,139**
of which dial-up access	833	-3	836
of which broadband	353	+50	303

Internet services

In addition to access, Telia offers Internet support services. Sales of Internet services rose to MSEK 31 (13). E-commerce solutions and security services are the primary drivers behind these revenues.

During the quarter, Telia launched RoamConnect, a service aimed at companies that makes it possible to connect to the Internet from abroad. For household customers, Telia launched Internet För Alla, a simplified way to connect to the Internet without passwords or subscriptions for which the user only pays for the time connected.

A shared brand was created for all of Telia Internet Services portals in Sweden and Denmark in order to generate synergies and economies of scale: (www.comhem.se (www.comhjemdk)).

Live broadcasts from MTV, MTV Live, were launched on the portal during the first quarter.

Work is underway on concentrating the product portfolio to access-related services, such as hosting, streaming, e-commerce, security and communications.

Cable television

Sales in the television operations rose 30 percent to MSEK 308 during the first quarter compared with the same quarter of 2001. The increased revenues are mainly attributable to higher average revenue from property owners, increased number of digital TV customers and increased pay-per-view sales. Profitability continued to improve during the period.

In Sweden, where most of the cable television network is digitized, the number of digital TV customers increased by 23,000 to 126,000. The number of cable television customers in Sweden was 1,389,000 at the end of the quarter.

In Denmark, 186,000 customers were connected directly via cable and 430,000 indirectly via parabolic antenna connections.

Telia International Carrier

External net sales rose to MSEK 1,014 for the international carrier operations, an increase of 35 percent compared to the same period of 2001. Sales of capacity and IP traffic nearly doubled, while telephony sales increased 17 percent.

Revenues remained at approximately the same level compared to the fourth quarter. This was due to reduced telephony revenues on the German market. Sales for IP traffic and capacity climbed 5 percent, however, despite continued price pressure.

MSEK	Jan-Mar 2002	Jan-Mar 2001	Jan-Dec 2001
Net sales	1,195	984	4,632
of which external	1,014	750	3,652
Underlying EBITDA	-331	-265	-1,569
EBITDA margin (%)	neg	neg	neg
Operating income	-528	-334	-5,159
Investments	173	1,132	5,037

At the end of 2001, the American portion of the network was lit up and the network began to generate revenues during the quarter. Moreover, there was an increase in orders received for IP traffic and capacity, which will have a positive effect on earnings at the end of the second quarter.

Underlying EBITDA totaled MSEK 331, which is an improvement of MSEK 57 compared with the fourth quarter 2001. The improved performance is attributable to the gradual move of traffic onto Telia s own infrastructure, reducing leased capacity costs.

Streamlining efforts are underway within International Carrier, including renegotiating agreements for operation and maintenance and reviewing facilities and costs for consultants. The measures are expected to yield effects starting in the second half of 2002.

Turbulence in the carrier market has continued in 2002. This turbulence has led to a shakeout of several players, which opens up opportunities for acquiring infrastructure at reasonable prices. In order to reduce leased capacity costs in England, Telia acquired a 1,500 kilometer long fiber and duct network in England during the first quarter. The network is equipped with 216 fibers and connects the 12 largest cities, seven of which with built-out fiber-optic intra-city networks that facilitate connecting customers to the Viking Network.

In Europe, the fiber-optic network was extended from 16,000 to 19,800 kilometers, while duct capacity grew from 10,500 to 11,900 kilometers. The Bordeaux-Marseille-Lyon-Paris routes were completed, among others.

Several additional network routes were lit up and at the end of the quarter, 90 percent of the European network was in traffic. Continued network expansion is underway in Russia, the Baltic states and Spain. Large parts of these investments are already complete.

Telia s investments decline as the network is completed and lit up. Investments dropped to MSEK 173 (1,132) during the first quarter. In addition to the network acquisition in England, investments were made in network construction in Eastern Europe and Spain and in equipment for bringing several network routes into service. Investments in 2002 are expected to total no more than MSEK 1,500.

Telia Networks

Telia Networks external net sales for the fixed network business decreased 2 percent to MSEK 6,909. Sales for comparable operations fell 1 percent.

Wholesale business showed continued growth while traffic revenues on the retail market continued to fall during the quarter.

The average price level was 1 percent higher than during the comparative quarter.

Underlying EBITDA totaled MSEK 2,814, which is on the same level as the corresponding quarter 2001. The margin was somewhat weakened.

MSEK	Jan-Mar 2002	Jan-Mar 2001	Jan-Dec 2001
Net sales	8,289	8,049	34,065
of which external	6,909	7,027	29,159
Underlying EBITDA	2,814	2,837	11,710
EBITDA margin (%)	33.9	35.2	34.4
Operating income	1,394	1,176	3,854
Investments	1,176	1,427	7,129
Sweden			
Net sales	7,857	7,612	32,085
of which external	6,602	6,680	27,707
Underlying EBITDA	2,767	2,851	11,701
EBITDA margin (%)	35.2	37.5	36.5
Investments	947	1,161	5,712

1) Changed purchasing routines affected sales. For further information: www.telia.com, Investor Relations, Financial Information.
The implementation of local carrier preselection in the Swedish market on February 2 reduced traffic revenues, which was partly compensated by increased interconnect traffic revenues. The net effect of local carrier preselection is estimated at MSEK -70 for the quarter.

Non-recurring items totaled MSEK -34 (-42).

Earnings from associated companies improved by MSEK 356 to MSEK -16. The improvement is attributable to the sale of Eircom, which previously burdened earnings, and to the fact that the book value of Netia fell to zero. The ongoing reconstruction of the company s capital structure will reduce Telia s participating interest in Netia from currently 48.1 percent to approximately 3 percent. Eircom was owned via the company Comsource, which was divested on April 18. The sale yields a second quarter capital gain of approximately MSEK 150 and reduces net indebtedness by approximately MSEK 900. Depreciation increased to MSEK 1,370 (1,247). Operating income increased to MSEK 1,394 (1,176).

Investments declined to MSEK 1,176 (1,427). Most of the investments referred to adsl expansion and capacity reinforcement of the Swedish fiber-optic backbone network and fiber-optic networks in larger cities and IP network expansion in Sweden and Denmark.

Several streamlining measures are underway that are expected to have an impact towards the end of the year. Customer service is being concentrated from its current 31 locations to 13 centers. Sales of unprofitable products have stopped and these products will be discontinued.

Ongoing efficiency efforts had a positive effect on both sales and profitability in Denmark during the quarter.

Retail market

Sales fell 7 percent to MSEK 5,827 on the retail market. Sales for comparable operations fell 5 percent. The decline is due to falling traffic revenues in Sweden, which is mainly attributable to the implementation of local carrier preselection. First quarter traffic revenues dropped 13 percent to MSEK 2,218.

Subscription sales in Sweden increased 4 percent to MSEK 1,914 due to the price increase for consumers that took effect in March 2001.

The number of telephone subscriptions dropped by 21,000 to 5,642,000, mainly due to new, young customers opting to use mobile telephony rather than fixed line subscriptions. After a long period of growth, the number of ISDN channels is also on the decline. The number of ISDN channels fell by 1,000 to 921,000 during the first quarter, mainly due to household customers switching from ISDN to ADSL/LAN. ISDN continues to grow in the business customer segment.

Sales of data communications and other IT services amounted to MSEK 594, which is on a level with the preceding year. The market was characterized by heavy price pressure and Telia has chosen to forgo business with insufficient margins.

Sales for customer premises equipment surged 76 percent to MSEK 201. This growth is chiefly attributable to the fact that equipment previously sold on commission is now sold directly by Telia.

Sales of network capacity fell 19 percent due to increased competition and that a number of customers switched to more refined products.

Telia Networks launched a new conferencing service, Telia TeleMöte Webb, during the quarter.

Sales in the Danish retail market increased 15 percent to MSEK 177 during the first quarter.

Wholesale market

The wholesale business grew steadily. Sales climbed 36 percent to MSEK 1,082. Sales for comparable operations increased 24 percent.

Interconnect traffic sales in Sweden increased 26 percent to MSEK 545.

First quarter deliveries of ADSL/LAN connections totaled 59,000, of which 22,000 were to service providers outside Telia. As the period drew to a close, there were 309,000 customers connected to Telia s broadband network through ADSL/LAN solutions.

Sales of network capacity totaled MSEK 283, which is on the same level as the comparative quarter.

Several new services for storage and distribution were launched during the quarter, including Application Hosting and Content Distribution. These services enable service providers to offer Video on Demand, Games on Demand and other types of interactive broadband service to end-customers. The acquisition of the infrastructure company PowerCom in 2001 resulted in a 90 percent increase in sales in the Danish wholesale business, totaling MSEK 127 in the first quarter.

Business Unit Telia Holding

Telia Holding (formerly Telia Equity) is responsible for the Group s financial investments.

Telia Holding comprises a number of consolidated businesses, including Finans/Credit leasing operations, Sergel Kredittjänster, Division Satellit, Division Offentlig Telecom, Promotor, Telia Business Innovation, Overseas and Suntel, as well as several associated companies, including Slottsbacken, Drutt Corp, Telefos, AUCS, Infonet Services and COOP Bank.

Extensive divestitures in 2001 resulted in reduced first quarter net sales and underlying EBITDA, but an increased EBITDA margin.

External net sales in comparable operations increased to MSEK 260 (222) and underlying EBITDA decreased to MSEK 72 (113). The largest sales increases were in Finans/Credit, Sergel Kredittjänster and Suntel, while sales in Promotor dropped due to weaker demand for consulting services.

MSEK	**Jan-Mar 2002**	**Jan-Mar 2001**	**Jan-Dec 2001**
Net sales	462	3,785	10,680
of which external	260	1,064	3,072
Underlying EBITDA	72	197	265
EBITDA margin (%)	15.6	5.2	2.5
Operating income	-128	102	7,403
Investments	118	374	2,744

The increase in underlying EBITDA was primarily attributable to Suntel, while earnings decreased in Finans/Credit. A significant part of Finans/Credit s leasing operations is financial leasing that is reported under financial revenues and expenses. After financial items, Finans/Credit achieved earnings on a par with 2001.

Depreciation totaled MSEK 119 (255). The decrease is a consequence of divestitures in 2001.

Earnings from associated companies totaled MSEK -10 (189). The decrease is attributable to the effect of capital gains and issue proceeds of MSEK 607 during the comparative quarter. Excluding non-recurring items, Telia Holding had substantial earnings growth due to the divestiture of operations that burdened earnings in 2001. During the first quarter 2002, positive earnings were reported by companies including Telefos totaling MSEK 38, and negative earnings from companies including Infonet Inc. (MSEK -34) and COOP Bank (MSEK -12).

Non-recurring items totaled MSEK -72 (-29), and consisted mainly of restructuring and disposal costs.

Operating income totaled MSEK -128 (102). Investments totaled MSEK 118, and included MSEK 91 in Finans/Credit s leasing operations and MSEK 27 in the fixed network operator Suntel.

During the quarter, Telia signed an agreement for the sale of Telia s 26 percent holding in the Indian mobile operator Bahrti Mobile Ltd. The transaction is expected to be completed later in the year.

Parent Company

The parent company Telia AB, which is domiciled in Stockholm, comprises the Group s Swedish operations in development and operation of fixed networks and basic production of network services. The parent company also includes Group executive management functions, certain support units and the Group s internal banking operations.

Net sales for the period were MSEK 5,824 (5,640), of which MSEK 4,824 (4,857) was invoiced to subsidiaries. Earnings before appropriations and taxes declined to MSEK 262 (372), partly due to Group contributions to subsidiaries.

Earnings after appropriations and taxes were MSEK 152 (658). Equity was MSEK 33,448 (33,296 at year-end), and retained earnings MSEK 9,966 (9,814).

The balance sheet total decreased to MSEK 80,124 (82,796 at year-end). Cash flow from operating activities was MSEK -449 (-544), while operating cash flow was MSEK -6,765 (-3,669). Net borrowings expanded, to MSEK 5,262 (3,858 at year-end). Cash and cash equivalents totaled MSEK 2,083 (8,068 at year-end). The equity/assets ratio (including the equity component of untaxed reserves) improved to 56.0 percent (54.0 percent at year-end).

Total investments for the period amounted to MSEK 998 (2,499), including MSEK 930 (1,041) in tangible fixed assets, primarily fixed telephony installations. Other investments totaling MSEK 68 (1,458) were primarily attributable to capital infusions in subsidiaries and associated companies. Of the capital infusions to subsidiaries, MSEK 40 was provided through debt conversion.

The number of employees as of March 31 was 3,318 (3,150 at year-end).

Outlook 2002

After our refine and focus efforts, Telia is focusing on developing and streamlining the four core businesses. We expect to see positive effects from these initiatives during the second half of 2002.

Our level of investment is expected to be significantly lower in 2002.

We expect slightly slower growth in mobile communications due to the high penetration in Sweden combined with the fledgling state of mobile data services.

Stockholm, May 6, 2002

Marianne Nivert
President and CEO

Auditors Review Report

We have made a review of this first quarter report in accordance with recommendations issued by the Swedish Institute of Authorized Public Accountants. A review is substantially limited in scope in comparison to an audit. Nothing has come to our attention that indicates that this first quarter report fails to comply with the requirements of the Swedish Securities Exchange Act and International Accounting Standards (IAS).

Stockholm, May 6, 2002

Ernst & Young AB	*Gunnar Widhagen* Authorized Public Accountant	*Filip Cassel* Authorized Public Accountant
Torsten Lyth Authorized Public Accountant		

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Consolidated Income Statements

MSEK	Jan.-Mar. 2002	Jan.-Mar. 2001	Apr. 2001- Mar. 2002	Jan.-Dec. 2001	Jan.-Dec. 2000
Net sales	13,885	13,592	57,489	57,196	54,064
Costs of production	-8,831	-8,638	-40,628	-40,435	-33,028
Gross income	**5,054**	**4,954**	**16,861**	**16,761**	**21,036**
Sales, administrative, and R&D expenses	-4,318	-4,131	-18,130	-17,943	-16,326
Other operating revenues and expenses, net	-39	145	322	506	8,493
Income from associated companies	12	-157	6,305	6,136	-1,197
Operating income	**709**	**811**	**5,358**	**5,460**	**12,006**
Net financial revenues and expenses	-174	-309	-517	-652	-289
Income after financial items	**535**	**502**	**4,841**	**4,808**	**11,717**
Income taxes	-397	-208	-3,106	-2,917	-1,447
Minority interests	-11	-3	-30	-22	8
Net income	**127**	**291**	**1,705**	**1,869**	**10,278**
Earnings per share, basic (SEK)	0.04	0.10	0.57	0.62	3.50
diluted (SEK)	0.04	0.10	0.57	0.62	3.50

Quarterly Data

MSEK	2002 Q 1	2001 Q 4	Q 3	Q 2	Q 1	2000 Q 4	Q 3	Q 2	Q1
Net sales	13,885	14,970	14,431	14,203	13,592	14,540	13,487	13,180	12,857
Underlying EBITDA	3,381	3,133	3,420	3,014	3,348	3,790	3,180	2,857	3,260
Non-recurring items & pensions	23	322	-239	271	30	6,937	-116	201	1,316
Income from associates	12	3,746	2,339	208	-157	-370	-759	-710	642
EBITDA	3,416	7,201	5,520	3,493	3,221	10,357	2,305	2,348	5,218
Depreciation and write-downs	-2,707	-6,285	-2,775	-2,505	-2,410	-2,427	-2,099	-1,860	-1,836
Operating income	709	916	2,745	988	811	7,930	206	488	3,382
Income after financial items	535	906	2,491	909	502	7,658	267	356	3,436
Net income	127	-572	1,900	250	291	7,408	172	308	2,390
Earnings per share, basic (SEK)	0.04	-0.19	0.63	0.08	0.10	2.47	0.06	0.10	0.84
diluted (SEK)	0.04	-0.19	0.63	0.08	0.10	2.47	0.06	0.10	0.84
Investments	2,053	5,157	5,965	5,954	3,659	10,311	16,745	16,042	4,644
of which CAPEX	2,022	4,849	5,630	3,666	3,568	7,185	3,369	3,841	2,185
of which acquisitions	31	308	335	2,288	91	3,126	13,376	12,201	2,459

Condensed Consolidated Balance Sheets

MSEK	March 31, 2002	March 31, 2001	Dec. 31, 2001	Dec. 31, 2000
Assets				
Intangible fixed assets	26,479	26,351	26,816	25,198
Tangible fixed assets	46,477	45,686	47,314	43,807
Financial fixed assets	20,420	23,576	20,784	22,335
Total fixed assets	*93,376*	*95,613*	*94,914*	*91,340*
Inventories, etc.	537	796	636	773
Receivables	22,227	29,291	23,521	29,072
Short-term investments	1,684	76	7,602	178
Cash and bank	1,297	1,286	1,518	1,352
Total current assets	*25,745*	*31,449*	*33,277*	*31,375*
Total assets	**119,121**	**127,062**	**128,191**	**122,715**
Equity and liabilities Equity	59,350	58,298	59,885	55,988
Minority shares	208	522	204	320
Provisions for pensions	2,219	3,609	2,358	3,525
Other provisions	10,452	7,602	10,749	7,826
Total provisions	*12,671*	*11,211*	*13,107*	*11,351*
Long-term loans	21,613	26,149	25,193	20,876
Short-term loans	1,994	12,315	3,931	13,166
Non-interest-bearing liabilities	23,285	18,567	25,871	21,014
Total liabilities	*46,892*	*57,031*	*54,995*	*55,056*
Total equity and liabilities	**119,121**	**127,062**	**128,191**	**122,715**

Condensed Consolidated Cash Flow Statements and Changes in Net-interest-bearing Liability

MSEK	Jan.-Mar. 2002	Jan.-Mar. 2001	Apr. 2001-Mar. 2002	Jan.-Dec. 2001	Jan.-Dec. 2000
Cash flow before change in working capital	2,682	2,661	10,293	10,272	9,589
Change in working capital	-1,808	-2,175	511	144	563
Cash flow from operating activities	**874**	**486**	**10,804**	**10,416**	**10,152**
Cash flow from investing activities	-1,739	-3,512	5,405	3,632	-37,121
Operating cash flow	**-865**	**-3,026**	**16,209**	**14,048**	**-26,969**
Cash flow from financing activities	-5,277	2,862	-14,747	-6,608	26,818
Cash flow for the period	**-6,142**	**-164**	**1,462**	**7,440**	**-151**
Cash and cash equivalents, opening balance	**8,923**	**1,437**	**1,296**	**1,437**	**1,575**
Cash flow for the period	-6,142	-164	1,462	7,440	-151
Exchange rate differences in cash and cash equivalents	-20	23	3	46	13
Cash and cash equivalents, closing balance	**2,761**	**1,296**	**2,761**	**8,923**	**1,437**

Net interest-bearing liability, opening balance	**10,661**	**20,235**	**24,425**	**20,235**	**7,527**
Change in net borrowing	1,386	4,106	-11,127	-8,407	12,429
Change in pension provisions	-139	84	-1,390	-1,167	279
Net interest-bearing liability, closing balance	**11,908**	**24,425**	**11,908**	**10,661**	**20,235**

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Condensed Consolidated Statements of Changes in Shareholders Equity

MSEK	March 31, 2002	March 31, 2001	Dec. 31, 2001	Dec. 31, 2000
Opening balance	**59,885**	**55,988**	**55,988**	**32,893**
Change of accounting principles (IAS 39)		-342	-342	
Adjusted opening balance	*59,885*	*55,646*	*55,646*	*32,893*
Dividend			-1,501	-1,470
New share issue				12,750
Underwriting expenses after tax posted directly to equity			-16	-231
Transactions with outside parties		-6	-155	-82
Share of earnings in companies previously outside the Group				29
Differences arising from translation of foreign operations	-713	2,767	4,268	2,127
Fair value measurement of securities available for sale	-13	2	143	
Gains/losses on instruments used to hedge cash flow	49	-87	114	
Differences after tax on forward contracts used for equity hedge	15	-315	-483	-306
Net income for the period	127	291	1,869	10,278
Closing balance	**59,350**	**58,298**	**59,885**	**55,988**

Business Area Breakdown

January-March, 2002 or March 31, 2002

MSEK	Mobile	Internet Services	International Carrier	Networks	Group-wide	of which Holding	Group
Net sales	5,059	982	1,195	8,289	-1,640	*462*	**13,885**
External net sales	4,654	975	1,014	6,909	333	*260*	**13,885**
Underlying EBITDA	1,234	-170	-331	2,814	-166	*72*	**3,381**
Depreciation, amortization & write-downs	-897	-109	-197	-1,370	-134	*-119*	**-2,707**
Non-recurring items & pensions	-16	-1	0	-34	74	*-71*	**23**
Income from associates	60	-9	0	-16	-23	*-10*	**12**
Operating income	381	-289	-528	1,394	-249	*-128*	**709**
Operating capital	36,141	1,289	8,919	30,914	-6,548	*485*	**70,715**
Equity participations in associates	3,078	27	0	3,349	3,096	*3,094*	**9,550**
Investments	445	115	173	1,176	144	*118*	**2,053**
of which CAPEX	445	100	173	1,173	131	*106*	**2,022**
Number of employees	4,656	1,464	806	7,511	2,367	*1,550*	**16,804**
Average number of full-time employees	4,665	1,394	797	7,485	2,330	*1,527*	**16,671**

January-March, 2001 or March 31, 2001 (restated)

MSEK	**Mobile**	**Internet Services**	**International Carrier**	**Networks**	**Group-wide**	**of which Holding**	**Group**
Net sales	4,526	719	984	8,049	-686	*3,785*	**13,592**
External net sales	3,985	715	750	7,027	1,115	*1,064*	**13,592**
Underlying EBITDA	1,167	-350	-265	2,837	-41	*197*	**3,348**
Depreciation, amortization & write-downs	-741	-76	-69	-1,247	-277	*-255*	**-2,410**
Non-recurring items & pensions	-16	-1	0	-42	89	*-29*	**30**
Income from associates	42	-15	0	-372	188	*189*	**-157**
Operating income	452	-442	-334	1,176	-41	*102*	**811**
Operating capital	34,394	1,232	8,726	31,500	6,630	*9,600*	**82,482**
Equity participations in associates	2,216	5	1	5,631	5,952	*5,952*	**13,805**
Investments	510	251	1,132	1,427	339	*374*	**3,659**
of which CAPEX	507	236	1,111	1,413	301	*336*	**3,568**
Number of employees	5,171	1,178	626	7,740	15,221	*14,424*	**29,936**
Average number of full-time employees	4,904	1,134	606	7,465	14,535	*13,731*	**28,644**

January-December, 2001 or December 31, 2001 (restated)

MSEK	**Mobile**	**Internet Services**	**International Carrier**	**Networks**	**Group-wide**	**of which Holding**	**Group**
Net sales	19,830	3,305	4,632	34,065	-4,636	*10,680*	**57,196**
External net sales	17,857	3,288	3,652	29,159	3,240	*3,072*	**57,196**
Underlying EBITDA	4,705	-970	-1,569	11,710	-961	*265*	**12,915**
Depreciation, amortization & write-downs	-3,385	-606	-3,589	-5,422	-973	*-886*	**-13,975**
Non-recurring items & pensions	-49	-28	-1	-71	533	*-209*	**384**
Income from associates	361	-45	0	-2,363	8,183	*8,233*	**6,136**
Operating income	1,632	-1,649	-5,159	3,854	6,782	*7,403*	**5,460**
Operating capital	36,499	1,401	8,652	30,795	-7,197	*287*	**70,150**
Equity participations in associates	3,061	22	0	3,488	3,356	*3,356*	**9,927**
Investments	4,979	903	5,037	7,129	2,687	*2,744*	**20,735**
of which CAPEX	4,341	836	5,037	6,767	732	*788*	**17,713**
Number of employees	4,813	1,369	777	7,910	2,280	*1,576*	**17,149**
Average number of full-time employees	4,857	1,257	671	7,693	10,501	*9,729*	**24,979**

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Geographic Segment Breakdown

January-March, 2002 or March 31, 2002

MSEK	Sweden	Other Nordic countries	Baltic Region	Rest of Europe	Rest of world	Group
External net sales	11,033	2,142	54	457	199	**13,885**
Depreciation, amortization & write-downs	-1,754	-792	-7	-101	-53	**-2,707**
Income from associated companies	-16	0	45	0	-17	**12**
Operating income	1,543	-529	33	-207	-131	**709**
Operating capital	24,942	34,353	5,538	6,210	-328	**70,715**
Equity participations in associates	587	-2	5,411	1,337	2,217	**9,550**
Investments	1,302	587	15	152	-3	**2,053**
of which CAPEX	1,273	585	15	152	-3	**2,022**
Number of employees	13,058	2,695	192	356	503	**16,804**
Average number of full-time employees	12,911					

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

	Number of Stock Options	Weighted Average Exercise Price	Price Range	Average Remaining Life (Years)	Aggregate Intrinsic Value
Outstanding - December 25, 2010	9,023,357	$ 0.38	$ 0.07 - $ 1.33		
Granted	817,100	0.28	0.28 - 0.28		
Expired/forfeited	(2,029,397)	$ 0.25	$ 0.20 - $ 0.69		
Exercised	(103,250)	$ 0.24	$ 0.20 - $ 0.25		
Outstanding - June 25, 2011	7,707,810	$ 0.41	$ 0.07 - $ 1.33	5.2	$ 202,447
Exercisable - June 25, 2011	5,920,557	$ 0.45	$ 0.07 - $ 1.33	4.8	$ 167,447
Available for grant - June 25, 2011	1,743,439				

The following table summarizes information for options outstanding and exercisable at June 25, 2011:

	Outstanding			Exercisable	
Price Range	Number of Stock Options	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price	Number of Stock Options	Weighted Average Exercise Price
$ 0.07 - $ 0.20	1,308,860	7.7	$ 0.11	1,098,863	$ 0.11
0.21 - 0.30	2,322,320	6.1	0.28	858,509	0.28
0.31 - 0.50	2,269,422	4.6	0.39	2,155,977	0.39
0.51 - 1.00	1,768,908	3.1	0.81	1,768,908	0.81

1.01	-	1.33	38,300	2.4		1.13	38,300		1.13
Total			7,707,810	5.2	$	0.41	5,920,557	$	0.45

The remaining unrecognized stock-based compensation expense related to unvested awards at June 25, 2011 was $340,503 and the period of time over which this expense will be recognized is 3.07 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

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, defined in the Fair Value Measurements section below.

The first non-compete agreement, from Party City and its affiliates, originally covered Massachusetts, Maine, New Hampshire, Vermont, Rhode Island, and Windsor and New London counties in Connecticut, and was to expire in 2011. This non-compete agreement had an original estimated life of 60 months. On December 30, 2010, the Company executed an agreement with Party City to take over its leased location in Manchester, Connecticut. Under that agreement, the term of the earlier non-compete agreement was extended to December 31, 2013 and the non-compete area was amended to include a three mile radius around the Manchester, Connecticut store. The other 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. This 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. The second non-compete agreement has an estimated life of 60 months. Both non-compete agreements 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 as of June 25, 2011 and December 25, 2010 were:

		June 25, 2011			December 25, 2010	
Non-compete agreements	$	2,358,540		$	2,358,540	
Occupancy valuations		944,716			944,716	
Other		157,855			157,855	
Intangible assets		3,461,111			3,461,111	
Less: accumulated amortization		(2,685,039	)		(2,526,634	)
Intangible assets, net	$	776,072		$	934,477	

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Amortization expense for these intangible assets was:

	For the three months ended		For the six months ended	
	June 25, 2011	June 26, 2010	June 25, 2011	June 26, 2010
Amortization expense	$ 79,202	$ 168,027	$ 158,405	$ 336,054

Non-compete agreements are amortized based on the pattern of their expected cash flow benefits over the terms of the agreements. As a consequence of the December 30, 2010 amendment of the Party City non-compete agreement, the remaining unamortized asset associated with that agreement will be amortized over its remaining term, as amended. Occupancy valuations are amortized on a straight line basis over the terms of the related leases ranging from 79 to 96 months. The non-compete agreement amortization expense is included in general and administrative expense on the Consolidated Statements of Operations. The occupancy valuation amortization expense is included in cost of products sold and occupancy costs.

Future amortization expense related to these intangible assets as of June 25, 2011 is:

Year	Amount
2011	$ 149,172
2012	320,541
2013	208,761
2014	59,848
2015	37,750
Total	$ 776,072

Accounting for the Impairment 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. As of June 25, 2011, the Company has not identified any indicators of impairment based on its review of each of its stores' operations and, accordingly, does not believe that any of its remaining long-lived assets are impaired.

Note Payable

On August 7, 2006, 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 (the "Party City Note"), and $1,850,000 in cash. The promissory note to Party City (the "Party City Note") matured on August 6, 2010, at which time the Company paid the full principal amount of $600,000 plus all accrued interest.

Line of Credit

On July 1, 2009, the Company and its wholly-owned subsidiary, iParty Retail Stores Corp., as borrowers (together, the "Borrowers"), and Wells Fargo, as administrative agent, collateral agent, swing line lender and lender, entered into a Second Amended and Restated Credit Agreement (the "Agreement").

The Agreement amended and restated the previous revolving credit facility with Wells Fargo, continued the revolving line of credit with Wells Fargo in the amount of up to $12,500,000 and extended the maturity date of the revolving line of credit for three years to July 2, 2012. In addition, the Agreement included an option whereby the Borrowers could increase the revolving line of credit up to a maximum level of $15,000,000, at any time until July 2, 2011, which the Company did not exercise. The amount of credit that is available from time to time under the Agreement is determined as a percentage of the value of eligible inventory plus a percentage of the value of eligible credit card receivables, as reduced by certain reserve amounts that may be required by Wells Fargo.

Borrowings under the Agreement will generally accrue interest at a margin ranging from 3.00% to 3.50% (determined according to the average daily excess availability during the fiscal quarter immediately preceding the adjustment date) over, at the Borrowers' election, either the London Interbank Offered Rate ("LIBOR") or a base rate determined by Wells Fargo from time to time. The credit facility also provides for letters of credit and includes an unused line fee of 0.5% on the unused portion of the revolving credit line.

The obligations of the Borrowers under the Agreement and the other loan documents are secured by a lien on substantially all of the personal property of the Borrowers.

The Agreement has financial covenants that are limited to minimum availability and capital expenditures and contains a number of restrictive covenants, such as incurrence, payment or entry into certain indebtedness, liens, investments, acquisitions, mergers, dispositions and dividends. The Agreement contains events of default customary for credit facilities of this type. Upon an event of default that is not cured or waived within any applicable cure periods, in addition to other remedies that may be available to Wells Fargo, the obligations under the Agreement may be accelerated, outstanding letters of credit may be required to be cash collateralized and the lenders may exercise remedies to collect the balance due, including to foreclose on the collateral. Should the Agreement be prepaid or the maturity accelerated for any reason, the Borrowers would be responsible for an early termination fee in the amount of 0.50% of the revolving credit facility ceiling for the remainder of the term.

The line includes a financial covenant requiring the Company to maintain a minimum availability under the line of 7.50% of the credit limit. At the current credit limit of $12,500,000, the minimum availability is $937,500. The Agreement also has a covenant that requires the Company to limit its capital expenditures to within 110% of those amounts included in its business plan, which may be updated from time to time. For the six months ended June 25, 2011 and for the year ended December 25, 2010, the Company was in compliance with all debt covenants. The line generally prohibits the payment of any dividends or other distributions to any of the Company's classes of capital stock.

The amounts outstanding under the line as of June 25, 2011 and December 25, 2010 were $4,581,877 and $3,102,213, respectively. The interest rate on these borrowings was 5.2% at June 25, 2011 and 6.3% at December 25, 2010. The outstanding balances under the line are classified as current liabilities in the accompanying consolidated balance sheets since the Company is required to apply daily lock box receipts to reduce the amount outstanding. At June 25, 2011, the Company had $4,939,802 of additional availability under the line.

Stockholders' Equity

During the six months ended June 25, 2011, 103,250 shares of common stock were issued upon the exercise of stock options, and there were no exercises of warrants or conversions of Series B convertible preferred stock.

Fair Value Measurements

The Company follows the provisions of ASC 820, Fair Value Measurements and Disclosures. ASC 820 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. ASC 820 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 only assets and liabilities subject to fair value measurement standards at June 25, 2011 and December 25, 2010 are cash and restricted cash which are based on Level 1 inputs and the warrant liability which is based on Level 2 inputs.

2. SUBSEQUENT EVENTS

The Company has evaluated subsequent events as required by ASC 855, Subsequent Events, and has determined that there were no subsequent events requiring disclosure in these interim consolidated financial statements.

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 25, 2010.

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 our 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 our most recently filed Annual Report on Form 10-K for the fiscal year ended December 25, 2010 and our other periodic reports filed with the SEC. We assume no obligation to update these forward looking statements contained in this report, whether as a result of new information, future events or otherwise.

Overview

We are a party goods retailer operating stores throughout New England, where 48 of our 53 retail stores are located, and in Florida in addition to an online e-commerce site. We believe we are a leading brand in the party industry in the retail markets we serve and a leading resource in those markets for consumers seeking party goods, party planning advice and information.

Our 53 retail stores are located predominantly in New England with 8 stores in Connecticut, 6 in New Hampshire, 3 in Rhode Island, 3 in Maine, 1 in Vermont, and 27 in Massachusetts. We also operate 5 stores in Florida. In July 2011, we re-launched our newly redesigned e-commerce site with a full assortment of costume and related merchandise for purchase and shipping via the internet. We also use our internet site to highlight the changing store product assortment and feature sales flyers, promotions and coupons to increase customer visits to our retail stores.

During the 2010 Halloween season, we operated eleven temporary Halloween stores. This was more than double the number of temporary stores we operated in 2009. In December 2010, we opened a new store in the South Bay Center, Boston, Massachusetts and entered into an agreement to take over an additional store from a competitor in Manchester, Connecticut in the first quarter of 2011, which has now opened.

Our stores range in size from approximately 8,000 square feet to 20,295 square feet and average approximately 10,150 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.

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

	For the six months ended	
	June 25, 2011	June 26, 2010
Beginning of period	52	51
Openings / Acquisitions	1	-
Closings	-	-
End of period	53	51

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

Trends and Quarterly Summary

Our business has a seasonal pattern. In the past three years, we have realized an average of approximately 35.2% of our annual revenues in our fourth quarter, which includes Halloween and Christmas, and an average of approximately 24.8% of our revenues in the second quarter, which includes school graduations, and often the Easter holiday. Also, during these past three years, we have had net income in our second and fourth quarters and generated losses in our first and third quarters.

Second Quarter Summary

For the second quarter of 2011, our consolidated revenues were $19.6 million, compared to $20.1 million for the second quarter of 2010. The decrease in second quarter revenues from the year-ago period included a 5.6% decrease in comparable store sales (sales from stores open more than one year). The decrease in consolidated revenue was primarily due to the decrease in sales from novelty wrist bands, which experienced a brief period of strong popularity in the spring and summer of 2011, that were not replaced by another novelty item or popular licensed goods in 2011, and the effect on the business from the slow economic recovery and spike in gas prices during the first half of 2011. Partially offsetting the lack of replacement sales were increased sales from our new stores in the South Bay Center, Boston, and in Manchester, Connecticut and improved performance in some of our seasonal categories. Consolidated gross profit margin was 39.7% for the second quarter of 2011 compared to a margin of 40.7% for the same period in 2010. The lower gross profit margin was primarily due to decreased leveraging of occupancy costs based on the decline in same store sales, which was partly offset by increased product selling margins. The consolidated net profit for the second quarter of 2011 was $43 thousand, or $0.00 per share, compared to $767 thousand, or $0.02 per share, for the second quarter of 2010.

Acquisition and Growth Strategy

Our growth strategy for 2011 and beyond includes expanding and targeting the temporary Halloween store aspect of our business, opening new stores, relocating or consolidating existing stores, reviewing potential acquisition of other entities, and developing our e-commerce site. In March 2011, we took over Party City's Manchester, Connecticut store. In addition, we anticipate opening up to eleven temporary Halloween stores in 2011. Any determination whether to open a new or temporary store or make an acquisition is based upon a variety of factors, including, without limitation, the purchase price and other financial terms of the transaction, our liquidity and ability to finance the transaction, the business prospects, geographical location and the extent to which any new or temporary store or acquisition would enhance our business.

We did not complete any acquisitions in 2010, although we did open eleven temporary Halloween stores and one new store during the fourth quarter of that year.

Results of Operations

Fiscal year 2011 has 53 weeks and ends on December 31, 2011. Fiscal year 2010 had 52 weeks and ended on December 25, 2010.

The second quarter of fiscal year 2011 had 13 weeks and ended on June 25, 2011. The second quarter of fiscal year 2010 had 13 weeks and ended on June 26, 2010.

Three Months Ended June 25, 2011 Compared to Three Months Ended June 26, 2010

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 second quarter of fiscal 2011 were $19,617,207, a decrease of $447,625, or 2.2% from the second quarter of the prior fiscal year. The decrease was primarily due to decreased sales transactions in our comparable stores in the second quarter of 2011 compared to the second quarter of 2010, driven largely by the decrease in sales of $806,500 related to novelty wrist bands in 2011 compared to 2010. This decrease was partly offset by additional sales in our new stores in South Bay Center, Boston and in Manchester, Connecticut and improved sales in some of our seasonal categories.

	For the three months ended	
	June 25, 2011	June 26, 2010
Revenues	$ 19,617,207	$ 20,064,832
Increase (decrease) in revenues	-2.2 %	2.5 %

Comparable store sales for the quarter decreased by 5.6% compared to the prior year's period. The decrease in comparable store sales was primarily the result of a significant decrease in sales of novelty wrist bands, as discussed above.

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 second quarter of fiscal 2011 were $11,819,894, or 60.3% of revenues, a decrease of $84,034, and an increase of 1.0 percentage points as a percentage of revenues, from the second quarter of the prior fiscal year.

	For the three months ended	
	June 25, 2011	June 26, 2010
Cost of products sold and occupancy costs	$ 11,819,894	$ 11,903,928
Percentage of revenues	60.3 %	59.3 %

As a percentage of revenues, cost of products sold and occupancy costs increased due to decreased leveraging in the second quarter of 2011 of occupancy costs against the decreased same store sales. The decreased leveraging was partly offset by an improvement in product selling margin in the second quarter of 2011 compared to the second quarter of 2010.

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 second quarter of fiscal 2011 was $5,960,011, or 30.4% of revenues, an increase of $373,450 and an increase of 2.6 percentage points, as a percentage of revenues, from the second quarter of the prior fiscal year. The increase in marketing and sales expense was primarily due to the increase in payroll costs resulting from the additional stores in 2011 compared to 2010 and from increased promotional activities.

	For the three months ended			
	June 25, 2011		June 26, 2010	
Marketing and sales	$ 5,960,011		$ 5,586,561	
Percentage of revenues	30.4	%	27.8	%

As a percentage of revenues, the increase in marketing and sales expense was primarily due to lower same store sales that decreased leveraging of payroll and advertising expenses in the second quarter of 2011 compared to the second quarter of 2010, and to a lesser extent due to slightly higher payroll costs.

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 second quarter of fiscal 2011 was flat at $1,726,609, or 8.8% of revenues, an increase of 0.2 percentage points, as a percentage of revenues, from the second quarter of the prior fiscal year.

	For the three months ended			
	June 25, 2011		June 26, 2010	
General and administrative	$ 1,726,609		$ 1,735,314	
Percentage of revenues	8.8	%	8.6	%

The increase in general and administrative expense as a percentage of revenues from the second quarter of the prior fiscal year was primarily due to decreased leveraging of those expenses against lower same store sales in the second quarter of 2011 compared to the second quarter of 2010.

Operating income

Our operating income for the second quarter of fiscal 2011 was $110,693, or 0.6% of revenues, as compared to $839,029, or 4.2% of revenues for the second quarter of the prior fiscal year.

Interest expense

Our interest expense in the second quarter of fiscal 2011 was $81,937, an increase of $10,374 from the second quarter of the prior fiscal year. The increase in the second quarter of fiscal 2011 as compared to the prior period was primarily due to higher average debt balances in the second quarter 2011 compared to the same period in 2010.

Income taxes

We have not provided for income taxes for the second quarter of fiscal 2011 or fiscal 2010 due to the availability of net operating loss (NOL) carryforwards to eliminate federal taxable income on an annual basis, and to the likelihood that additional reductions in our deferred tax asset valuation allowance in 2011 will offset expected levels of state tax expense. No benefit has been recognized with respect to current losses or NOL carryforwards in these periods due to the uncertainty of future taxable income beyond 2011, the assessment of which depends largely on our operating results during our fourth quarter. We continue to believe we will be able to realize the deferred tax asset of $571,517 based on estimated 2011 taxable income.

At the end of 2010, we had estimated net operating loss carryforwards of approximately $16.4 million, which begin to expire in 2019. In accordance with Section 382 of the Internal Revenue Code, the use of these carryforwards may be subject to annual limitations based upon certain ownership changes of our stock that may have occurred or that may occur.

Net income

Our net income in the second quarter of fiscal 2011 was $43,253, or $0.00 per basic and diluted share, compared to a $767,484, or $0.02 per basic and diluted share, in the second quarter of the prior fiscal year.

Six months Ended June 25, 2011 Compared to Six months Ended June 26, 2010

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 six months of fiscal 2011 were $34,709,335, a decrease of $191,876, or 0.5% from the first six months of the prior fiscal year. The decrease was primarily due to decreased sales transactions in our comparable stores in the first six months of 2011 compared to the first six months of 2010, driven largely by the decrease in sales from novelty wrist bands in 2011 compared to 2010. This decrease was partly offset by additional sales in our new stores in South Bay Center, Boston and in Manchester, Connecticut.

	For the six months ended					
	June 25, 2011			June 26, 2010		
Revenues	$	34,709,335		$	34,901,211	
Increase (decrease) in revenues		-0.5	%		2.2	%

Comparable store sales for the six months decreased by 3.7% as compared to the prior year period.

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 six months of fiscal 2011 were $21,420,765, or 61.7% of revenues, a decrease of $17,932 from the first six months of the prior fiscal year.

	For the six months ended			
	June 25, 2011		June 26, 2010	
Cost of products sold and occupancy costs	$	21,420,765	$	21,438,697

Percentage of revenues	61.7	%	61.4	%

As a percentage of revenues, cost of products sold and occupancy costs were 0.3 percentage points higher in the first six months of 2011 compared to the first six months of 2010, mainly due to decreased leveraging of relatively flat occupancy costs against the decrease in same store sales. The effect of this leveraging shortfall was partly offset by better product selling margins.

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 six months of fiscal 2011 was $11,096,753, or 32.0% of revenues, an increase of $573,425 or 1.8 percentage points, as a percentage of revenues, from the first six months of the prior fiscal year.

	For the six months ended			
	June 25, 2011		June 26, 2010	
Marketing and sales	$ 11,096,753		$ 10,523,328	
Percentage of revenues	32.0	%	30.2	%

As a percentage of revenues, the increase in marketing and sales expense was substantially due to decreased leveraging of payroll and other store costs against the decrease in same store sales for the period, and to a lesser extent due to slightly higher payroll costs.

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 six months of fiscal 2011 was $3,509,810, or 10.1% of revenues, a decrease of $9,318 from the first six months of the prior fiscal year.

	For the six months ended			
	June 25, 2011		June 26, 2010	
General and administrative	$ 3,509,810		$ 3,519,128	
Percentage of revenues	10.1	%	10.1	%

The slight decrease in general and administrative expense was primarily due to a decrease in amortization cost for our non-compete agreement with Party City of approximately $178 thousand, and by a decrease in executive incentive bonus expense of approximately $87 thousand, substantially offset by increases in payroll and other administrative expenses in the first six months of 2011 compared to the six months of 2010.

Operating loss

Our operating loss for the first six months of fiscal 2011 was $1,317,993, or 3.8% of revenues, as compared to an operating loss of $579,942, or 1.7% of revenues for the first six months of the prior fiscal year.

Interest expense

Our interest expense in the first six months of fiscal 2011 was $155,142, an increase of $17,400 from the first six months of the prior fiscal year. The increase in the first six months of fiscal 2011 as compared to the prior period was primarily due to higher average debt balances in the first six months of 2011 compared to the same period in 2010.

Income taxes

We have not provided for income taxes for the first six months of fiscal 2011or fiscal 2010 due to losses in the six month period ended June 25, 2011 and in the six month period ended June 26, 2010 and the availability of net operating loss (NOL) carryforwards to eliminate federal taxable income on an annual basis. No benefit has been recognized with respect to current losses or NOL carryforwards in these periods due to the uncertainty of future taxable income beyond 2011, the assessment of which depends largely on our operating results during our fourth quarter. We continue to believe we will be able to realize the deferred tax asset of $571,517 based on estimated 2011 taxable income.

At the end of 2010, we had estimated federal net operating loss carryforwards of approximately $16.4 million, which begin to expire in 2019. In accordance with Section 382 of the Internal Revenue Code, the use of these carryforwards may be subject to annual limitations based upon certain ownership changes of our stock that may have occurred or that may occur.

Net loss

Our net loss in the first six months of fiscal 2011 was $1,467,658, or $0.06 per basic and diluted share, compared to a net loss of $717,650, or $0.03 per basic and diluted share, in the first six months of the prior fiscal year.

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 and temporary store openings, including acquisitions.

Our primary sources of cash are:

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

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. Based on our current operating plan, we believe that anticipated revenues from operations and borrowings available under our 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, declines in consumer confidence and spending, or other unforeseen circumstances, our liquidity may be negatively impacted. If so, we could be required to adjust our expenditures to conserve working capital or raise additional capital, possibly including debt or equity financing to fund operations and our business strategy. Given the current state of the debt and equity markets and our existing capital structure, this could be difficult and expensive, and we might not be able to do so on terms acceptable to us.

Line of Credit

On July 1, 2009, we entered into a Second Amended and Restated Credit Agreement (the “line”) with Wells Fargo Retail Finance, LLC (now Wells Fargo Bank, National Association) (“Wells Fargo”), which amended and restated the previous revolving credit facility with Wells Fargo. The line is a three year commitment maturing on July 2, 2012, with a revolving line of credit in the amount of up to $12,500,000. The line included an option whereby we could increase the revolving line of credit up to a maximum level of $15,000,000 at any time prior to July 2, 2011. We did not exercise this option. The amount of credit that is available from time to time under the Agreement is determined as a percentage of the value of eligible inventory plus a percentage of the value of eligible credit card receivables, reduced by certain reserve amounts that may be required by Wells Fargo.

Borrowings under the line generally accrue interest at a margin ranging from 3.00% to 3.50% (determined according to the average daily excess availability during the fiscal quarter immediately preceding the adjustment date) over, at our election, either the London Interbank Offered Rate (“LIBOR”) or a base rate determined by Wells Fargo from time to time. The line also provides for letters of credit for up to a sublimit of $2 million to be used in connection with inventory purchases and includes an unused line fee on the unused portion of the revolving credit line. The line also provided for a closing fee of $125,000, which was paid to Wells Fargo at closing. Our obligations under the line continue to be secured by a lien on substantially all of our personal property.

Our inventory consists of party supplies which are valued at the lower of weighted-average cost or market, which approximates FIFO (first-in, first-out) and are reduced or increased by 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 $17,810,239 at June 25, 2011.

Our accounts receivable consist primarily of credit card receivables and vendor rebates receivable. 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 $380,274 at June 25, 2011.

Our total borrowing base is determined by adding the “acceptable inventory at cost” times an agreed upon advance rate, which is seasonally adjusted by month, plus the “eligible credit card receivables” times an agreed upon advance rate but not to exceed our established credit limit, of $12,500,000, 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 $4,581,877 at June 25, 2011 and $3,102,213 at December 25, 2010, an increase of $1,479,664. Our additional availability was $4,939,802 at June 25, 2011 and $3,672,581 at December 25, 2010.

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

The line has financial covenants that are limited to minimum availability and capital expenditures and contains various restrictive covenants, such as incurrence, payment or entry into certain indebtedness, liens, investments, acquisitions, mergers, dispositions and dividends. Under the line, we are required to maintain a minimum availability of 7.5% of the credit limit and 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 June 25, 2011, we were in compliance with these financial covenants.

The line contains events of default customary for credit facilities of this type. Upon an event of default that is not cured or waived within any applicable cure periods, in addition to other remedies that may be available to Wells Fargo, the obligations under the line may be accelerated, outstanding letters of credit may be required to be cash collateralized and the lenders may exercise remedies to collect the balance due, including to foreclose on the collateral. Should the line be prepaid or the maturity accelerated during the remaining term for any reason, we would be responsible for an early termination fee in the amount of 0.50% of the revolving credit facility, or $62,500.

Supply Agreement with Amscan

Our Supply Agreement with Amscan gives us the right to receive more favorable pricing terms over the term of the agreement than generally were available to us under our previous terms with Amscan. In exchange, the Supply

Agreement obligates us to purchase increased levels of merchandise from Amscan. Beginning with calendar year 2008, the Supply Agreement requires us to purchase on an annual basis merchandise equal to the total number of our stores, excluding temporary stores, open during such calendar year, multiplied by $180,000. On December 30, 2010, we amended our Supply Agreement with Amscan to extend it until December 31, 2013 from the original expiration date of December 31, 2012.

The Supply Agreement provides for penalties in the event we fail to attain the annual purchase commitment that would require us to pay 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 us but not filled by the supplier. Our purchases for 2009 fell short of the annual commitment by approximately $368,000, which unfilled commitment was rolled into the remaining term of the Supply Agreement. Our purchases for 2010 exceeded the minimum purchase amount commitments plus the 2009 shortfall of $368,000. We are not aware of any reason that would prevent it from meeting the minimum purchase requirements for the remainder of the term of the Supply Agreement. Although we do not expect to incur any penalties under this Supply Agreement, if they were to occur, there could be a material adverse effect on our uses and sources of cash.

Operating, Investing and Financing Activities

Our operating activities used $756,717 during the six months ended June 25, 2011 compared to providing $1,095,152 during the six months ended June 26, 2010, an increase in cash used of $1,851,869. The increase in cash used in operating activities was primarily due to an increase in net loss and a greater increase in inventory in the first half of 2011 compared to the first half of 2010, due in part to the addition of two new stores and early purchases of Halloween inventory as we prepare for the upcoming Halloween season.

We used $695,607 in investing activity during the first six months of 2011 compared to $321,759 during the first six months of 2010, an increase of $373,848. The cash invested in 2011 was primarily for fixtures and equipment for our new Manchester, Connecticut store as well as existing store improvements. The cash invested in 2010 was primarily due to the new store opening in Boston, Massachusetts, point of sale register updates in our retail stores and other store improvements.

Financing activities provided $1,417,324 during the first six months of 2011 compared to using $721,404 during the first six months of 2010, an increase of $2,138,728. The increase was primarily due to increased net borrowings on the line of credit during the first half of 2011 compared to the first half of 2010, during which we reduced our borrowings under the line.

Contractual Obligations

Contractual obligations at June 25, 2011 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	$ 4,588,852	$ -	$ -	$ -	$ 4,588,852
Capital lease obligations	11,400	-	-	-	11,400
Supply agreement	8,778,479	14,040,000	-	-	22,818,479
Operating leases (including retail space leases)	9,657,106	15,888,920	10,087,726	10,486,727	46,120,479
Total contractual obligations	$ 23,035,837	$ 29,928,920	$ 10,087,726	$ 10,486,727	$ 73,539,210

In addition, at June 25, 2011, we had outstanding purchase orders totaling approximately $8,889,160 for the acquisition of inventory and non-inventory items that were scheduled for delivery after June 25, 2011.

Seasonality

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

Geographic Concentration

As of June 25, 2011, we operated a total of 53 stores, 48 of which are located in New England and 5 of which are located in Florida. 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 or in Florida 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 of shipping 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, 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.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangement that has or is reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources, that is material to investors.

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 under Item 1A, “Risk Factors” of our Annual Report on Form 10-K for the fiscal year ended December 25, 2010, and Part II, Item 1A, “Risk Factors” contained in our Quarterly Reports on Form 10-Q, including this one, and in our other 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

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 for the fiscal year ended December 25, 2010 included in Item 8 of our Annual Report on Form 10-K for that fiscal year, as filed with the SEC on March 24, 2011). We believe the following accounting policies to be those most important to the portrayal of our financial condition and operating results 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.

Inventories

Our inventories consist of party supplies and are valued at the lower of moving weighted-average cost or market which approximates FIFO (first-in, first-out). 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 2010 included a reduction of $20,226 to the cost of products sold during the previous three quarters. The adjustment in the fourth quarter of 2009 included a reduction of $142,010 to the cost of products sold during the previous three quarters.

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.

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 and its affiliates, covers Massachusetts, Maine, New Hampshire, Vermont, Rhode Island, and Windsor and New London counties in Connecticut. This non-compete agreement had an original estimated life of 60 months. The expiration date of this non-compete agreement was extended from August 7, 2011 to December 31, 2013 in conjunction with our agreement with Party City to take over their location in Manchester, Connecticut. In addition, the restricted trade area under the non-compete agreement was amended to include the trade area around the Manchester, Connecticut location.

The other non-compete agreement was acquired in connection with our 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. The second non-compete agreement has an estimated life of 60 months. Both non-compete agreements 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 on a straight line basis over the terms of the related leases.

Impairment of Long-Lived Assets

In connection with our ongoing long-lived asset assessment, 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. We are not aware of any impairment indicators for any of our remaining stores at June 25, 2011.

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 four of the last six years, including 2010, 2009, 2007 and 2006, (2) we have achieved positive comparable store sales growth for six out of the last eight years, (3) we were able to significantly reduce store and headquarters operating expenses in 2009, and (4) we were able to use federal net operating loss deductions in each tax year from 2002 through 2009, and expect to do so for tax year 2010. The negative evidence that we considered included (1) we realized a net loss in 2005 and 2008, (2) our merchandise margins decreased in five of the last six years, including 2010, 2009, 2008, 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 $16.4 million at December 25, 2010, (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 and (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, (4) the risk that costs of opening or acquiring new stores will put pressure on our profit margins until these stores reach maturity, (5) the expected increasing costs of regulatory compliance which will likely have a negative impact on our profitability, and (6) the risk a renewed slowdown or continued slow recovery in the U.S economy could dampen or reduce discretionary spending or cause a shift in consumer discretionary spending to other products.

The positive evidence was strong enough at the end of fiscal 2010 for us to conclude that we would realize sufficient levels of taxable income in 2011 to support the release of a portion of the related reserves in fiscal 2010. However, we believe that it is prudent for us to maintain a valuation allowance against our remaining deferred tax assets until we have a longer history 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 in which we made such a determination.

Stock Option Compensation Expense

We use the Black-Scholes option pricing model to determine the fair value of stock-based compensation. The Black-Scholes model requires us 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 our common stock price over the expected term, which is based on historical volatility of our 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 our common stock, which is assumed to be zero since we do not pay dividends and have 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 in the Consolidated Statements of Operations. We recognize stock based compensation expense on a straight-line basis over the vesting period of each grant.

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 June 25, 2011 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 for the period ended December 25, 2010, which was filed with the SEC on March 24, 2011.

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 June 25, 2011, 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 June 25, 2011 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

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

Item 1A. Risk Factors

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 fiscal year ended December 25, 2010, as filed with the SEC on March 24, 2011.

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

Not applicable

Item 3. Defaults upon Senior Securities

Not applicable

Item 4. (Removed and Reserved)

Item 5. Other Information

On August 8, 2011, the Company and Mr. Robertson, the Company's chief financial officer, amended his employment offer letter to provide that if Mr. Robertson terminates his employment with the Company for good reason, which is defined as a material breach of the Company's obligations under the offer letter that is not cured within the applicable time period, then Mr. Robertson will be entitled to receive six months of severance to be paid in accordance with the Company's normal payroll practices and the continuation of his health benefits for such six month period.

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: August 9, 2011

EXHIBIT INDEX

EXHIBIT NUMBER	DESCRIPTION
Ex. 10.1	Compensation Arrangements with Independent Directors*
Ex. 10.2	Written Summary of Renewed One Year Part time Consulting Arrangement with Mr. Vassalluzzo*
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
Ex. 101.INS	XBRL Instance Document**
Ex. 101.SCH	XBRL Taxonomy Extension Schema Document**
Ex. 101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document**
Ex. 101.DEF	XBRL Taxonomy Extension Definition Linkbase Document**
Ex. 101.LAB	XBRL Taxonomy Extension Label Linkbase Document**
Ex. 101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document**

*Management contract or compensatory plan or arrangement.

**In accordance with Regulation S-T, XBRL (Extensible Business Reporting Language) related information in Exhibit No. (101) to this Quarterly Report on Form 10-Q shall be deemed "furnished" and not "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities of that section, and shall not be incorporated by reference into any registration statement pursuant to the Securities Act of 1933, as amended.