

CSS INDUSTRIES INC
Form 10-Q
February 06, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2012

or

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

For the transition period from _____ to _____

Commission file number 1-2661

CSS INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of
incorporation or organization)

13-1920657
(I.R.S. Employer
Identification No.)

1845 Walnut Street, Philadelphia, PA
(Address of principal executive offices)

19103
(Zip Code)

(215) 569-9900

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

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

As of February 1, 2013, there were 9,467,140 shares of common stock outstanding which excludes shares which may still be issued upon exercise of stock options or upon vesting of restricted stock unit grants.

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CSS INDUSTRIES, INC. AND SUBSIDIARIES

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(Unaudited)

(In thousands, except per share data)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2012	2011	2012	2011
Sales	\$ 116,020	\$ 129,240	\$ 310,572	\$ 323,534
Costs and expenses				
Cost of sales	78,407	87,662	214,930	227,758
Selling, general and administrative expenses	20,510	22,446	61,934	65,533
Disposition of product line, net	0	0	5,798	0
Interest (income) expense, net	(1)	73	(68)	227
Other expense, net	85	202	33	339
	99,001	110,383	282,627	293,857
Income from continuing operations before income taxes	17,019	18,857	27,945	29,677
Income tax expense	5,419	6,748	10,372	10,701
Income from continuing operations	11,600	12,109	17,573	18,976
Income (loss) from discontinued operations, net of tax	11	(1,131)	55	(82)
Net income	\$ 11,611	\$ 10,978	\$ 17,628	\$ 18,894
Net income (loss) per common share:				
Basic:				
Continuing operations	\$ 1.21	\$ 1.25	\$ 1.83	\$ 1.95
Discontinued operations	\$ 0.00	\$ (0.12)	\$ 0.01	\$ (0.01)
Total	\$ 1.22	\$ 1.13	\$ 1.84	\$ 1.94
Net income (loss) per common share:				
Diluted:				
Continuing operations	\$ 1.21	\$ 1.24	\$ 1.83	\$ 1.95
Discontinued operations	\$ 0.00	\$ (0.12)	\$ 0.01	\$ (0.01)
Total	\$ 1.22	\$ 1.13	\$ 1.84	\$ 1.94
Weighted average shares outstanding				
Basic	9,548	9,723	9,594	9,733
Diluted	9,554	9,732	9,597	9,739
Cash dividends per share of common stock	\$ 0.15	\$ 0.15	\$ 0.45	\$ 0.45

See notes to consolidated financial statements.

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(Unaudited)

(In thousands)

	December 31, 2012	March 31, 2012	December 31, 2011
<u>Assets</u>			
Current assets			
Cash and cash equivalents	\$ 53,347	\$ 66,135	\$ 10,489
Accounts receivable, net of allowances of \$3,408, \$1,764 and \$2,811	94,445	45,026	107,808
Inventories	66,087	71,671	74,005
Deferred income taxes	4,834	3,595	3,751
Other current assets	13,704	15,441	13,529
Current assets of discontinued operations	0	183	13,900
Total current assets	232,417	202,051	223,482
Property, plant and equipment, net	28,164	29,582	30,138
Deferred income taxes	195	1,184	4,633
Other assets			
Goodwill	14,522	17,233	17,233
Intangible assets, net	28,446	29,689	30,129
Other	7,046	6,825	9,316
Total other assets	50,014	53,747	56,678
Total assets	\$ 310,790	\$ 286,564	\$ 314,931
<u>Liabilities and Stockholders' Equity</u>			
Current liabilities			
Accrued customer programs	\$ 7,089	\$ 3,298	\$ 6,149
Other current liabilities	45,717	33,069	47,757
Current liabilities of discontinued operations	499	2,390	5,680
Total current liabilities	53,305	38,757	59,586
Long-term obligations	5,020	4,604	4,556
Stockholders' equity	252,465	243,203	250,789
Total liabilities and stockholders' equity	\$ 310,790	\$ 286,564	\$ 314,931

See notes to consolidated financial statements.

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CSS INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Nine Months Ended December 31,	
	2012	2011
Cash flows from operating activities:		
Net income	\$ 17,628	\$ 18,894
Adjustments to reconcile net income to net cash used for operating activities:		
Depreciation and amortization	5,757	5,878
Provision for accounts receivable allowances	4,027	3,928
Gain on sale of discontinued operations	0	(5,849)
Deferred tax (benefit) provision	(689)	4,521
Stock-based compensation expense	1,314	1,386
Loss (gain) on sale or disposal of assets	157	(776)
Reduction of goodwill from disposition of product line	2,711	0
Changes in assets and liabilities:		
Increase in accounts receivable	(53,546)	(69,325)
Decrease (increase) in inventory	4,617	(4,912)
Decrease in other assets	411	680
Increase in other accrued liabilities	17,270	11,485
Total adjustments	(17,971)	(52,984)
Net cash used for operating activities continuing operations	(343)	(34,090)
Net cash (used for) provided by operating activities discontinued operations	(1,709)	1,932
Net cash used for operating activities	(2,052)	(32,158)
Cash flows from investing activities:		
Purchase of property, plant and equipment	(3,269)	(2,489)
Proceeds from disposition of product line, net	1,758	0
Proceeds from sale of fixed assets	16	48
Net cash used for investing activities continuing operations	(1,495)	(2,441)
Net cash provided by investing activities discontinued operations	0	2,036
Net cash used for investing activities	(1,495)	(405)
Cash flows from financing activities:		
Payments on long-term obligations	0	(376)
Borrowings on credit facilities	0	74,270
Repayments on credit facilities	0	(74,270)
Dividends paid	(4,310)	(4,378)
Purchase of treasury stock	(4,864)	(742)
Proceeds from exercise of stock options	192	58
Payments for tax withholding on net restricted stock settlements	(253)	(60)

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Tax effect on stock awards	(6)	(27)
Net cash used for financing activities – continuing operations	(9,241)	(5,525)
Net decrease in cash and cash equivalents	(12,788)	(38,088)
Cash and cash equivalents at beginning of period	66,135	48,577
Cash and cash equivalents at end of period	\$ 53,347	\$ 10,489

See notes to consolidated financial statements.

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CSS INDUSTRIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012

(Unaudited)

(1) **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Basis of Presentation

CSS Industries, Inc. (collectively with its subsidiaries, CSS or the Company) has prepared the consolidated financial statements included herein pursuant to the rules and regulations of the Securities and Exchange Commission. The Company has condensed or omitted certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States pursuant to such rules and regulations. In the opinion of management, the statements include all adjustments (which include normal recurring adjustments) required for a fair presentation of financial position, results of operations and cash flows for the interim periods presented. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2012. The results of operations for the interim periods are not necessarily indicative of the results for the full year.

On September 5, 2012, the Company and its Paper Magic Group, Inc. (PMG) subsidiary sold the Halloween portion of PMG's business and certain PMG assets relating to such business, including certain tangible and intangible assets associated with PMG's Halloween business, to Gemmy Industries (HK) Limited (Gemmy). PMG's remaining assets, including accounts receivable and inventory, were excluded from the sale. PMG retained the right and obligation to fulfill all customer orders for PMG Halloween products (such as Halloween masks, costumes, make-up and novelties) for the Halloween 2012 season. The inventory remaining after the Halloween 2012 season has been reduced to its estimated net realizable value. The purchase price of \$2,281,000 was paid to PMG at closing. The Company incurred \$523,000 of transaction costs (included within disposition of a product line further discussed in Note 2 to the condensed consolidated financial statements), yielding net proceeds of \$1,758,000.

On September 9, 2011, the Company and its Cleo Inc (Cleo) subsidiary sold the Christmas gift wrap portion of Cleo's business and certain Cleo assets relating to such business, including certain equipment, contract rights, customer lists, intellectual property and other intangible assets to Impact Innovations, Inc. (Impact). Cleo's remaining assets, including accounts receivable and inventory, were excluded from the sale. Various prior period amounts contained in these unaudited condensed consolidated financial statements include assets, liabilities and cash flows related to Cleo's Christmas gift wrap business which are presented as current assets and liabilities of discontinued operations. The results of operations for the three and nine month periods ended December 31, 2012 and 2011, as well as the accompanying notes, reflect the historical operations of Cleo's Christmas gift wrap business as discontinued operations. The discussions in this quarterly report are presented on the basis of continuing operations, unless otherwise noted.

The Company's fiscal year ends on March 31. References to a particular fiscal year refer to the fiscal year ending in March of that year. For example, fiscal 2013 refers to the fiscal year ending March 31, 2013.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and all of its subsidiaries. All significant intercompany transactions and accounts have been eliminated in consolidation.

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Nature of Business

CSS is a consumer products company primarily engaged in the design, manufacture, procurement, distribution and sale of seasonal and all occasion social expression products, principally to mass market retailers. These all occasion and seasonal products include decorative ribbons and bows, boxed greeting cards, gift tags, gift wrap, gift bags, gift boxes, gift card holders, decorative tissue paper, decorations, classroom exchange Valentines, floral accessories, Easter egg dyes and novelties, craft and educational products, stickers, memory books, stationery, journals, notecards, infant and wedding photo albums, scrapbooks, and other gift items that commemorate life's celebrations. The seasonal nature of CSS's business has historically resulted in lower sales levels and operating losses in the first and fourth quarters and comparatively higher sales levels and operating profits in the second and third quarters of the Company's fiscal year, which ends March 31, thereby causing significant fluctuations in the quarterly results of operations of the Company.

Foreign Currency Translation and Transactions

Translation adjustments are recorded in a separate component of stockholders' equity. Gains and losses on foreign currency transactions are not material and are included in other expense, net in the consolidated statements of operations.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Judgments and assessments of uncertainties are required in applying the Company's accounting policies in many areas. Such estimates pertain to revenue, the valuation of inventory and accounts receivable, the assessment of the recoverability of goodwill and other intangible and long-lived assets, income tax accounting, the valuation of stock-based awards and resolution of litigation and other proceedings. Actual results could differ from these estimates.

Impairment of Long-Lived Assets including Goodwill and Other Intangible Assets

The Financial Accounting Standards Board (FASB) issued updated authoritative guidance in September 2011 to amend previous guidance on the annual and interim testing of goodwill for impairment; the guidance became effective for the Company at the beginning of its 2013 fiscal year. The guidance provides entities with the option of first assessing qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If it is determined, on the basis of the qualitative factors, that the fair value of the reporting unit is more likely than not less than the carrying amount, the two step impairment test would still be required. The first step of the test compares the fair value of a reporting unit to its carrying amount, including goodwill, as of the date of the test. The Company uses a dual approach to determine the fair value of its reporting units including both a market approach and an income approach. We believe the use of multiple valuation techniques results in a more accurate indicator of the fair value of each reporting unit. If the carrying amount of the reporting unit exceeds its fair value, the second step is performed. The second step compares the carrying amount of the goodwill to the implied fair value of the goodwill. If the implied fair value of the goodwill is less than the carrying amount of the goodwill, an impairment loss would be reported. Annual impairment tests are performed by the Company in the fourth quarter of each year. The adoption of this updated authoritative guidance had no impact on the Company's Consolidated Financial Statements.

In connection with the sale of the Halloween portion of PMG's business on September 5, 2012, a portion of the goodwill associated with the PMG reporting unit was allocated to the business being sold. Such allocation was made on the basis of the fair value of the assets being sold relative to the overall fair value of the PMG reporting unit. This resulted in the Company recording a reduction of goodwill in the amount of \$2,711,000 for the PMG reporting unit. See Note 7 for further information on goodwill and other intangible assets.

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Other indefinite lived intangible assets consist primarily of tradenames which are also required to be tested annually. The fair value of the Company's tradenames is calculated using a relief from royalty payments methodology. Long-lived assets (including property, plant and equipment), except for goodwill and indefinite lived intangible assets, are reviewed for impairment when circumstances indicate the carrying value of an asset group may not be recoverable. If such asset group is considered to be impaired, the impairment to be recognized is the amount by which the carrying amount of the asset group exceeds the fair value of the asset group.

Inventories

The Company records inventory when title is transferred, which occurs upon receipt or prior to receipt dependent on supplier shipping terms. The Company adjusts unsaleable and slow-moving inventory to its estimated net realizable value. Substantially all of the Company's inventories are stated at the lower of first-in, first-out (FIFO) cost or market. The remaining portion of the inventory is valued at the lower of last-in, first-out (LIFO) cost or market. Inventories consisted of the following (in thousands):

	December 31, 2012	March 31, 2012	December 31, 2011
Raw material	\$ 9,665	\$ 9,194	\$ 9,593
Work-in-process	11,351	15,470	11,731
Finished goods	45,071	47,007	52,681
	\$ 66,087	\$ 71,671	\$ 74,005

Property, Plant and Equipment

Property, plant and equipment are stated at cost and include the following (in thousands):

	December 31, 2012	March 31, 2012	December 31, 2011
Land	\$ 2,508	\$ 2,508	\$ 2,508
Buildings, leasehold interests and improvements	37,185	37,064	37,103
Machinery, equipment and other	101,172	101,076	101,644
	140,865	140,648	141,255
Less Accumulated depreciation and amortization	(112,701)	(111,066)	(111,117)
Net property, plant and equipment	\$ 28,164	\$ 29,582	\$ 30,138

Depreciation expense was \$1,464,000 and \$1,405,000 for the quarters ended December 31, 2012 and 2011, respectively, and was \$4,514,000 and \$4,599,000 for the nine months ended December 31, 2012 and 2011, respectively.

Income Tax Valuation Allowance

During the quarter ended December 31, 2012, the Company released valuation allowances of \$775,000 related to state net operating loss carryforwards which resulted in a tax benefit for the quarter. There was no such reversal of valuation allowances in the comparable quarter ended December 31, 2011.

Revenue Recognition

The Company recognizes revenue from product sales when the goods are shipped, title and risk of loss have been transferred to the customer and collection is reasonably assured. Provisions for returns, allowances, rebates to customers and other adjustments are provided in the same period that the related sales are recorded.

Table of Contents**Net Income Per Common Share**

The following table sets forth the computation of basic and diluted net income per common share for the three and nine months ended December 31, 2012 and 2011 (in thousands, except per share data):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2012	2011	2012	2011
Numerator:				
Income from continuing operations	\$ 11,600	\$ 12,109	\$ 17,573	\$ 18,976
Income (loss) from discontinued operations, net of tax	11	(1,131)	55	(82)
Net income	\$ 11,611	\$ 10,978	\$ 17,628	\$ 18,894
Denominator:				
Weighted average shares outstanding for basic income per common share	9,548	9,723	9,594	9,733
Effect of dilutive stock options	6	9	3	6
Adjusted weighted average share outstanding for diluted income per common share	9,554	9,732	9,597	9,739
Basic:				
Continuing operations	\$ 1.21	\$ 1.25	\$ 1.83	\$ 1.95
Discontinued operations	\$ 0.00	\$ (0.12)	\$ 0.01	\$ (0.01)
Total (1)	\$ 1.22	\$ 1.13	\$ 1.84	\$ 1.94
Diluted:				
Continuing operations	\$ 1.21	\$ 1.24	\$ 1.83	\$ 1.95
Discontinued operations	\$ 0.00	\$ (0.12)	\$ 0.01	\$ (0.01)
Total (1)	\$ 1.22	\$ 1.13	\$ 1.84	\$ 1.94

(1) Total net income per share for certain periods does not foot due to rounding.

Options on 151,000 shares and 385,000 shares of common stock were not included in computing diluted net income per common share for the nine months ended December 31, 2012 and 2011, respectively, because their effects were antidilutive.

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On September 5, 2012, the Company and its PMG subsidiary sold the Halloween portion of PMG's business and certain PMG assets relating to such business, including certain tangible and intangible assets associated with the Halloween portion of PMG's business, to Gemmy. PMG's remaining Halloween assets, including accounts receivable and inventory, were excluded from the sale. PMG retained the right and obligation to fulfill all customer orders for PMG Halloween products (such as Halloween masks, costumes, make-up and novelties) for the Halloween 2012 season. The inventory remaining after the Halloween 2012 season has been reduced to its estimated net realizable value. The purchase price of \$2,281,000 was paid to PMG at closing. In connection with the sale, the Company recorded charges of \$5,368,000 during the second quarter of fiscal 2013 consisting of severance of 49 employees of \$1,282,000, facility closure costs of \$1,375,000, professional fees and other costs of \$1,341,000 (\$523,000 were costs of the transaction) and a non-cash write-down of assets of \$1,370,000. Additionally, a portion of the goodwill associated with the PMG reporting unit was allocated to the business being sold. Such allocation was made on the basis of the fair value of the assets being sold relative to the overall fair value of the PMG reporting unit. This resulted in the Company recording a reduction of goodwill in the amount of \$2,711,000 for the PMG reporting unit. There was also a non-cash charge of \$966,000 related to the write-down of inventory to net realizable value which was recorded in cost of sales. Net sales of the Halloween business were \$1,415,000 and \$1,046,000 in the three months ended December 31, 2012 and 2011, respectively, and were \$29,345,000 and \$28,718,000 in the nine months ended December 31, 2012 and 2011, respectively.

During the three and nine months ended December 31, 2012, the Company made payments related to the restructuring of \$630,000 and \$1,417,000, respectively, and other adjustments of \$82,000 in the second quarter of fiscal 2013. As of December 31, 2012, \$2,037,000 of the remaining liability was classified in current liabilities and \$462,000 was classified in long-term obligations in the accompanying condensed consolidated balance sheet and will be paid through December 2015.

Selected information relating to the aforementioned restructuring follows (in thousands):

	Employee Termination Costs	Facility Costs	Professional Fees and Other Costs	Total
Initial restructuring reserve	\$ 1,282	\$ 1,375	\$ 1,341	\$ 3,998
Cash paid	(495)	(152)	(770)	(1,417)
Non-cash adjustments	(56)	9	(35)	(82)
Restructuring reserve as of December 31, 2012	\$ 731	\$ 1,232	\$ 536	\$ 2,499

(3) DISCONTINUED OPERATIONS AND RELATED RESTRUCTURING CHARGES

On May 24, 2011, the Company approved a plan to close its Cleo manufacturing facility located in Memphis, Tennessee. The Company exited the Memphis facility in December 2011. In connection with this restructuring plan, which was completed by March 31, 2012, the Company recorded restructuring charges of \$6,749,000 during fiscal 2012 primarily related to severance of 433 employees and facility closure costs. Additionally, there was a non-cash reduction of \$177,000 related to severance that was less than originally estimated, which was included in restructuring expenses in fiscal 2012. During the three and nine months ended December 31, 2012, the Company made payments of \$81,000 and \$693,000, respectively, primarily for costs related to severance. Additionally, there was a reduction in the restructuring accrual of \$92,000 during the nine months ended December 31, 2012 for costs that were less than originally estimated. As of December 31, 2012, the remaining liability of \$45,000 was classified in current liabilities of discontinued operations in the accompanying condensed consolidated balance sheet and will be paid through fiscal 2013.

Selected information relating to the aforementioned restructuring follows (in thousands):

	Employee Termination Costs	Facility and Other Costs	Total
Restructuring reserve as of March 31, 2012	\$ 750	\$ 80	\$ 830

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Cash paid	(663)	(30)	(693)
Non-cash adjustments	(45)	(47)	(92)
Restructuring reserve as of December 31, 2012	\$ 42	\$ 3	\$ 45

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On September 9, 2011, the Company sold the Cleo Christmas gift wrap business and certain Cleo assets to Impact. Impact acquired the Christmas gift wrap portion of Cleo's business and certain of Cleo's assets relating to such business, including certain equipment, contract rights, customer lists, intellectual property and other intangible assets. Cleo's remaining assets, including accounts receivable and inventory, were excluded from the sale. Cleo retained the right and obligation to fulfill all customer orders for Cleo Christmas gift wrap products for Christmas 2011. The purchase price was \$7,500,000, of which \$2,000,000 was paid to Cleo in cash at closing. The remainder of the purchase price was paid through the issuance by Impact of an unsecured subordinated promissory note, which provides for quarterly payments of interest at 7% and principal payments as follows: \$500,000 on March 1, 2012; \$2,500,000 on March 1, 2013; and all remaining principal and interest on March 1, 2014. All interest payments to date and the \$500,000 principal payment due on March 1, 2012 were paid when due. As of December 31, 2012, \$2,500,000 of this note receivable was recorded in other current assets and \$2,500,000 of this note receivable was recorded in other long term assets in the accompanying condensed consolidated balance sheet. The Company subsequently received a \$2,500,000 principal payment on January 23, 2013 in advance of the March 1, 2013 due date.

As a result of the sale of its Cleo Christmas gift wrap business, the Company has reported these operations, including operating income (loss) of the business and all exit activities, as discontinued operations, as shown in the following table (in thousands):

	Three Months Ended		Nine Months Ended	
	December 31, 2012	2011	December 31, 2012	2011
Operating income (loss) (A)	\$ 22	\$ 544	\$ (8)	\$ (317)
Exit costs	0	(2,286)	92	(6,485)
Exit costs - equipment sale	0	0	0	825
Gain on sale of business to Impact	0	0	0	5,849
Discontinued operations, before income taxes	22	(1,742)	84	(128)
Income tax expense (benefit)	11	(611)	29	(46)
Discontinued operations, net of tax	\$ 11	\$ (1,131)	\$ 55	\$ (82)

(A) During the quarter ended June 30, 2011, the Company recorded a write down of inventory to net realizable value of \$2,498,000, which was included in cost of sales of the discontinued operations. During the quarter ended September 30, 2011, the Company was able to sell certain of the inventory written down during the quarter ended June 30, 2011 for amounts greater than its adjusted carrying value resulting in higher gross profit of \$563,000 of the discontinued operations for the quarter ended September 30, 2011.

The following table presents the carrying values of the major accounts of discontinued operations that are included in the condensed consolidated balance sheet (in thousands):

	December 31, 2012	March 31, 2012	December 31, 2011
Accounts receivable, net	\$ 0	\$ 78	\$ 13,543
Inventories	0	105	131
Other current assets	0	0	226
Total assets attributable to discontinued operations	\$ 0	\$ 183	\$ 13,900
Accrued customer programs	\$ 179	\$ 237	\$ 701
Restructuring reserve	45	830	1,738
Other current liabilities	275	1,323	3,241
Total liabilities associated with discontinued operations	\$ 499	\$ 2,390	\$ 5,680

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On March 27, 2012, the Company combined the operations of its Berwick Offray LLC (Berwick Offray) and PMG subsidiaries in order to drive sales growth by providing stronger management oversight and by reallocating sales and marketing resources in a more strategic manner. Involuntary termination benefits offered to terminated employees were in accordance with the applicable terms of the Company's applicable pre-existing severance plans. As part of the restructuring plan, the Company recorded a restructuring reserve of \$706,000 related to employee severance charges in the fourth quarter of fiscal 2012. Also during the fourth quarter of fiscal 2012, the Company made payments of \$117,000 for costs related to severance. During the three and nine months ended December 31, 2012, the Company made payments of \$103,000 and \$447,000, respectively, for costs related to severance. Additionally, there was a reduction in the restructuring accrual of \$11,000 during the nine months ended December 31, 2012 for costs that were less than originally estimated. The remaining liability of \$132,000 and \$590,000 is classified in other current liabilities in the accompanying condensed consolidated balance sheet as of December 31, 2012 and March 31, 2012, respectively. This amount will be paid in fiscal 2013.

(5) STOCK-BASED COMPENSATION*2004 Equity Compensation Plan*

Under the terms of the Company's 2004 Equity Compensation Plan (2004 Plan), the Human Resources Committee (Committee) of the Board of Directors (Board) may grant incentive stock options, non-qualified stock options, restricted stock grants, stock appreciation rights, stock bonuses and other awards to officers and other employees. Grants under the 2004 Plan may be made through August 3, 2014. The term of each grant is at the discretion of the Committee, but in no event greater than ten years from the date of grant. The Committee has discretion to determine the date or dates on which granted options become exercisable. Service-based options outstanding as of December 31, 2012 become exercisable at the rate of 25% per year commencing one year after the date of grant. Market-based stock options outstanding as of such date will become exercisable only if certain market conditions and service requirements are satisfied, and the date(s) on which they become exercisable will depend on the period in which such market conditions and service requirements are met, if at all. Market-based restricted stock units (RSUs) outstanding at December 31, 2012 will vest only if certain market conditions and service requirements have been met, and the date(s) on which they vest will depend on the period in which such market conditions and service requirements are met, if at all. Subject to limited exceptions, service-based RSUs outstanding as of December 31, 2012 vest at the rate of 50% of the shares underlying the grant on each of the third and fourth anniversaries of the grant date.

On May 24, 2011, our Board approved an amendment to the 2004 Plan to reduce the number of shares of the Company's common stock authorized for issuance under the 2004 Plan by 500,000 shares. As a result of this reduction, the 2004 Plan now provides that 1,500,000 shares of the Company's common stock may be issued as grants under the 2004 Plan. Prior to this amendment, the 2004 Plan provided that 2,000,000 shares of the Company's common stock could be issued as grants under the 2004 Plan. At December 31, 2012, 771,623 shares were available for grant under the 2004 Plan.

The fair value of each market-based stock option and each market-based RSU granted under the above plan for the nine months ended December 31, 2012 and 2011 was estimated on the date of grant using Monte Carlo simulation. The fair value of each service-based RSU granted during the nine months ended December 31, 2011 was estimated on the day of grant based on the closing price of the Company's common stock reduced by the present value of the expected dividend stream during the vesting period using the risk-free interest rate.

The weighted average fair value of stock options granted during the nine months ended December 31, 2012 and 2011 was \$7.30 and \$6.87, respectively. The weighted average fair value of restricted stock units granted during the nine months ended December 31, 2012 and 2011 was \$14.78 and \$16.25.

Table of Contents*2011 Stock Option Plan for Non-Employee Directors*

Under the terms of the Company's 2011 Stock Option Plan for Non-Employee Directors (2011 Plan), non-qualified stock options to purchase up to 150,000 shares of common stock are available for grant to non-employee directors at exercise prices of not less than fair market value of the underlying common stock on the date of grant. Under the 2011 Plan, options to purchase 4,000 shares of the Company's common stock are granted automatically to each non-employee director on the last day that the Company's common stock is traded in November of each year from 2011 to 2015. Each option will expire five years after the date the option is granted and options may be exercised at the rate of 25% per year commencing one year after the date of grant. At December 31, 2012, 114,000 shares were available for grant under the 2011 Plan.

The fair value of each stock option granted under the above plans was estimated on the date of grant using the Black-Scholes option pricing model with the following average assumptions:

	For the Nine Months Ended December 31,	
	2012	2011
Expected dividend yield at time of grant	2.92%	3.21%
Expected stock price volatility	54%	54%
Risk-free interest rate	0.61%	2.14%
Expected life of option (in years)	5.0	5.1

Expected volatilities are based on historical volatility of the Company's common stock. The expected life of the option is estimated using historical data pertaining to option exercises and employee terminations. The risk-free interest rate is based on U.S. Treasury yields in effect at the time of grant.

As of December 31, 2012, there was \$1,463,000 of total unrecognized compensation cost related to non-vested stock option awards granted under the Company's equity incentive plans which is expected to be recognized over a weighted average period of 2.3 years. As of December 31, 2012, there was \$1,747,000 of total unrecognized compensation cost related to non-vested RSUs granted under the Company's equity incentive plans which is expected to be recognized over a weighted average period of 2.3 years.

Compensation cost related to stock options and RSUs recognized in operating results (included in selling, general and administrative expenses) was \$400,000 and \$430,000 in the quarters ended December 31, 2012 and 2011, respectively, and was \$1,314,000 and \$1,386,000 for the nine months ended December 31, 2012 and 2011, respectively.

(6) DERIVATIVE FINANCIAL INSTRUMENTS

The Company enters into foreign currency forward contracts in order to reduce the impact of certain foreign currency fluctuations on sales denominated in a foreign currency. Derivatives are not used for trading or speculative activities. Firmly committed transactions and the related receivables may be hedged with forward exchange contracts. Gains and losses arising from foreign currency forward contracts are recorded in other expense, net as offsets of gains and losses resulting from the underlying hedged transactions. Realized losses of \$50,000 and \$56,000 were recorded in the three and nine months ended December 31, 2012. Realized gains of \$38,000 and \$123,000 were recorded in the three and nine months ended December 31, 2011. As of December 31, 2012 and 2011, the notional amount of open foreign currency forward contracts was \$5,230,000 and \$3,599,000, respectively. The related unrealized loss was \$13,000 at December 31, 2012 and the related unrealized gain was \$17,000 at December 31, 2011. The Company believes that it does not have significant counterparty credit risks as of December 31, 2012.

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The following table shows the fair value of the foreign currency forward contracts designated as hedging instruments and included in the Company's condensed consolidated balance sheet as of December 31, 2012 and 2011 (in thousands):

	Fair Value of Derivative Instruments		
	Balance Sheet	Fair Value	
		Location	December 31, 2012
Foreign currency forward contracts	Other current liabilities	\$ 13	\$ 0
Foreign currency forward contracts	Other current assets	0	17

(7) GOODWILL AND INTANGIBLES

The Company performs an annual impairment test of the carrying amount of goodwill and indefinite-lived intangible assets in the fourth quarter of its fiscal year. Additionally, the Company would perform its impairment testing at an interim date if events or circumstances indicate that goodwill or intangibles might be impaired. In connection with the sale of the Halloween portion of PMG's business on September 5, 2012, a portion of the goodwill associated with the PMG reporting unit was allocated to the business being sold. Such allocation was made on the basis of the fair value of the assets being sold relative to the overall fair value of the PMG reporting unit. This resulted in the Company recording a reduction of goodwill in the amount of \$2,711,000 for the PMG reporting unit. As the sale of the Halloween portion of PMG's business was a triggering event, the Company performed an interim impairment test on the goodwill remaining in the PMG reporting unit after the reduction in goodwill associated with the sale of the Halloween portion of PMG's business was recorded. The Company determined that no impairment existed for the remainder of the goodwill of the PMG reporting unit.

The change in the carrying amount of goodwill for the nine months ended December 31, 2012 is as follows (in thousands):

Balance as of March 31, 2012	\$ 17,233
Reduction related to disposition of product line	(2,711)
Balance as of December 31, 2012	\$ 14,522

The gross carrying amount and accumulated amortization of other intangible assets is as follows (in thousands):

	December 31, 2012		March 31, 2012		December 31, 2011	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Tradenames and trademarks	\$ 12,793	\$ 0	\$ 12,793	\$ 0	\$ 12,793	\$ 0
Customer relationships	22,057	7,484	22,057	6,358	22,057	5,984
Non-compete	0	0	200	200	200	200
Trademarks	403	235	403	213	403	205
Patents	1,301	389	1,301	294	1,337	272
	\$ 36,554	\$ 8,108	\$ 36,754	\$ 7,065	\$ 36,790	\$ 6,661

Amortization expense related to intangible assets was \$414,000 and \$424,000 for the quarters ended December 31, 2012 and 2011, respectively, and was \$1,243,000 and \$1,279,000 for the nine months ended December 31, 2012 and 2011, respectively. Based on the current composition of intangibles, amortization expense for the remainder of fiscal 2013 and each of the succeeding four years is projected to be as follows (in thousands):

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Remainder of fiscal 2013	\$ 415
Fiscal 2014	1,658
Fiscal 2015	1,639
Fiscal 2016	1,638
Fiscal 2017	1,638

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(8) **TREASURY STOCK TRANSACTIONS**

On December 11, 2012, the Company purchased, under the Company's stock repurchase program, an aggregate 80,000 shares of its common stock from a trust established by a director of the Company. The terms of the purchase were negotiated on behalf of the Company by a Special Committee of the Board of Directors consisting of four independent, disinterested directors. The price of \$20.00 per share was less than the fair market value of a share of the Company's common stock on the date of the transaction. The Special Committee unanimously authorized the purchase. The total amount of this transaction was \$1,600,000.

Under a stock repurchase program authorized by the Company's Board of Directors, the Company repurchased 251,180 shares (inclusive of the 80,000 shares described above) of the Company's common stock for \$4,864,000 (inclusive of the \$1,600,000 described above) during the nine months ended December 31, 2012 and repurchased 40,523 shares of the Company's common stock for \$742,000 during the nine months ended December 31, 2011. On July 31, 2012, the Company announced that its Board of Directors had authorized the repurchase of up to an additional 500,000 shares of the Company's common stock. As of December 31, 2012, the Company had 473,610 shares remaining available for repurchase under the Board's authorization.

(9) **COMMITMENTS AND CONTINGENCIES**

CSS and its subsidiaries are involved in ordinary, routine legal proceedings that are not considered by management to be material. In the opinion of Company counsel and management, the ultimate liabilities resulting from such legal proceedings will not materially affect the consolidated financial position of the Company or its results of operations or cash flows.

(10) **FAIR VALUE MEASUREMENTS**

Recurring Fair Value Measurements

The Company uses certain derivative financial instruments as part of its risk management strategy to reduce foreign currency risk. The Company recorded all derivatives on the condensed consolidated balance sheet at fair value based on quotes obtained from financial institutions as of December 31, 2012.

The Company maintains a Nonqualified Supplemental Executive Retirement Plan for highly compensated employees and invests assets to mirror the obligations under this Plan. The invested funds are maintained at a third party financial institution in the name of CSS and are invested in publicly traded mutual funds. The Company maintains separate accounts for each participant to reflect deferred contribution amounts and the related gains or losses on such deferred amounts. The investments are included in other current assets and the related liability is recorded as deferred compensation and included in other long-term obligations in the condensed consolidated balance sheets. The fair value of the investments is based on the market price of the mutual funds as of December 31, 2012.

The Company maintains two life insurance policies in connection with deferred compensation arrangements with two former executives. The cash surrender value of the policies is recorded in other long-term assets in the condensed consolidated balance sheets and is based on quotes obtained from the insurance company as of December 31, 2012.

To increase consistency and comparability in fair value measurements, the Financial Accounting Standards Board (FASB) established a fair value hierarchy that prioritizes the inputs to valuation techniques, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the financial assets and liabilities fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument.

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The Company's recurring assets and liabilities recorded on the condensed consolidated balance sheet are categorized based on the inputs to the valuation techniques as follows:

Level 1 Financial assets and liabilities whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market that the Company has the ability to access.

Level 2 Financial assets and liabilities whose values are based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability. Examples of Level 2 inputs include quoted prices for identical or similar assets or liabilities in non-active markets and pricing models whose inputs are observable for substantially the full term of the asset or liability.

Level 3 Financial assets and liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement.

The following table presents the Company's fair value hierarchy for those financial assets and liabilities measured at fair value on a recurring basis in its condensed consolidated balance sheet as of December 31, 2012 and 2011 (in thousands):

	Fair Value Measurements at December 31, 2012 Using			
	December 31, 2012	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Marketable securities	\$ 633	\$ 633	\$ 0	\$ 0
Cash surrender value of life insurance policies	937	0	937	0
Total assets	\$ 1,570	\$ 633	\$ 937	\$ 0
Liabilities				
Deferred compensation plans	\$ 633	\$ 633	\$ 0	\$ 0
Foreign exchange contracts	13	0	13	0
Total liabilities	\$ 646	\$ 633	\$ 13	\$ 0

	Fair Value Measurements at December 31, 2011 Using			
	December 31, 2011	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Marketable securities	\$ 617	\$ 617	\$ 0	\$ 0
Cash surrender value of life insurance policies	910	0	910	0
Foreign exchange contracts	17	0	17	0
Total assets	\$ 1,544	\$ 617	\$ 927	\$ 0
Liabilities				
Deferred compensation plans	\$ 617	\$ 617	\$ 0	\$ 0

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Total liabilities	\$	617	\$	617	\$	0	\$	0
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Cash and cash equivalents, accounts receivable, accounts payable and accrued expenses (included in other current liabilities in the condensed consolidated balance sheet) are reflected at carrying value in the condensed consolidated balance sheets as such amounts are a reasonable estimate of their fair values due to the short-term nature of these instruments.

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The carrying value of the Company's note receivable (included in other current assets and other assets in the condensed consolidated balance sheet) is a reasonable estimate of its fair value as the terms of the note reflect market conditions for similar entities.

Nonrecurring Fair Value Measurements

The Company's nonfinancial assets which are measured at fair value on a nonrecurring basis include property, plant and equipment, goodwill, intangible assets and certain other assets. These assets are not measured at fair value on a recurring basis; however, they are subject to fair value adjustments in certain circumstances, such as when there is evidence that impairment may exist. In making the assessment of impairment, recoverability of assets to be held and used is measured by a comparison of the carrying amount of the asset group to future net cash flows estimated by the Company to be generated by such assets. If such asset group is considered to be impaired, the impairment to be recognized is the amount by which the carrying amount of the asset group exceeds the fair value of the asset group. Assets to be disposed of are recorded at the lower of their carrying value or estimated net realizable value.

Goodwill and indefinite-lived intangibles are subject to impairment testing on an annual basis, or sooner if circumstances indicate a condition of impairment may exist. The valuations use assumptions such as interest and discount rates, growth projections and other assumptions of future business conditions. These valuation methods require a significant degree of management judgment concerning the use of internal and external data. In the event these methods indicate that fair value is less than the carrying value, the asset is recorded at fair value as determined by the valuation models. Accordingly, these fair value measurements fall in Level 3 of the fair value hierarchy.

In connection with the sale of the Halloween portion of PMG's business on September 5, 2012, a portion of the goodwill associated with the PMG reporting unit was allocated to the business being sold. Such allocation was made on the basis of the fair value of the assets being sold relative to the overall fair value of the PMG reporting unit. This resulted in the Company recording a reduction of goodwill in the amount of \$2,711,000 for the PMG reporting unit. As the sale of the Halloween portion of PMG's business was a triggering event, the Company performed an interim impairment test on the goodwill remaining in the PMG reporting unit after the reduction in goodwill associated with the sale of the Halloween portion of PMG's business was recorded. The Company determined that no impairment existed for the remainder of the goodwill of the PMG reporting unit. There were no other indications or circumstances indicating that an impairment might exist in regard to the Company's other nonfinancial assets which are measured at fair value on a nonrecurring basis as of December 31, 2012.

(11) **RECENT ACCOUNTING PRONOUNCEMENTS**

In June 2011, the FASB issued ASU 2011-05, Presentation of Comprehensive Income (ASU 2011-05) which requires an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This standard eliminates the option to report other comprehensive income and its components in the statement of changes in equity. In December 2011, the FASB issued ASU 2011-12, Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 (ASU 2011-12). The amendments in ASU 2011-12 defer the requirement to present reclassification adjustments for each component of accumulated other comprehensive income in both net income and other comprehensive income on the face of the financial statements. The amendments in ASU 2011-12 are effective at the same time as ASU 2011-05 so that entities will not be required to comply with the presentation requirements in ASU 2011-05 that ASU 2011-12 is deferring. The amendments in ASU 2011-12 are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. As this standard impacts presentation only, the adoption of ASU 2011-05, as amended by ASU 2011-12, did not impact the Company's financial condition, results of operations and cash flows.

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In September 2011, the FASB issued ASU 2011-08, *Testing Goodwill for Impairment* (ASU 2011-08), which amends existing guidance by giving an entity the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If this is the case, a more detailed two-step goodwill impairment test will need to be performed which is used to identify potential goodwill impairments and to measure the amount of goodwill impairment losses to be recognized, if any. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The adoption of ASU 2011-08 did not have a material impact on the Company's financial condition, results of operations and cash flows.

In December 2011, the FASB issued ASU 2011-11, *Disclosures about Offsetting Assets and Liabilities* (ASU 2011-11). This update is intended to improve the comparability of statements of financial position prepared in accordance with U.S. GAAP and International Financial Reporting Standards, requiring both gross and net presentation of offsetting assets and liabilities. The new requirements are effective for fiscal years beginning on or after January 1, 2013, and for interim periods within those fiscal years. As this guidance only affects disclosures, the adoption of this standard will not have an impact on the Company's financial condition, results of operations and cash flows.

In July 2012, the FASB issued ASU 2012-02, *Testing Indefinite-Lived Intangible Assets for Impairment* (ASU 2012-02), which amends existing guidance by giving an entity the option to first assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired. If this is the case, a more detailed fair value calculation will need to be performed which is used to identify potential impairments and to measure the amount of impairment losses to be recognized, if any. To perform a qualitative assessment, an entity must identify and evaluate changes in economic, industry and entity-specific events and circumstances that could affect the significant inputs used to determine the fair value of an indefinite-lived intangible asset. ASU 2012-02 is effective for annual and interim impairment tests performed by the Company for fiscal years beginning after September 15, 2012, with early adoption permitted. The Company will adopt the provisions of ASU 2012-02 effective April 1, 2013. The Company does not expect the adoption of ASU 2012-02 to have a material impact on the Company's future indefinite-lived intangibles impairment tests.

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CSS INDUSTRIES, INC. AND SUBSIDIARIES

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL

CONDITION AND RESULTS OF OPERATIONS

STRATEGIC OVERVIEW

Approximately 54% of the Company's prior year sales were attributable to all occasion products with the remainder attributable to seasonal (Christmas, Valentine's Day, Easter and Halloween) products.

Seasonal products are sold primarily to mass market retailers, and the Company has relatively high market share in many of these categories. Most of these markets have shown little growth and in some cases have declined in recent years, and the Company continues to confront significant price pressure as its competitors source certain products from overseas and its customers increase direct sourcing from overseas factories. Increasing customer concentration has augmented their bargaining power, which has also contributed to price pressure. The Company believes that its all occasion craft, gift card holder, stickers, stationery and memory product lines have higher inherent growth potential due to higher market growth rates. Further, the Company's all occasion craft, gift card holder, stickers, stationery and floral product lines have higher inherent growth potential due to CSS's relatively low current market share. The Company continues to pursue sales growth in these and other areas. Historically, significant revenue growth at CSS has come through acquisitions. Management anticipates that it will continue to consider acquisitions as a strategy to stimulate further growth.

The Company has taken several measures to respond to sales volume, cost and price pressures. The Company believes it continues to have strong core Christmas product offerings which has allowed it to compete effectively in this competitive market. In addition, the Company is aggressively pursuing new product initiatives related to seasonal, craft and all occasion products, including new licensed and non-licensed product offerings. CSS continually invests in product and packaging design and product knowledge to assure that it can continue to provide unique added value to its customers. In addition, CSS maintains a purchasing office in Hong Kong to be able to provide alternatively sourced products at competitive prices. CSS continually evaluates the efficiency and productivity of its North American production and distribution facilities and of its back office operations to maintain its competitiveness. In the last nine fiscal years, the Company has closed six manufacturing plants and seven warehouses totaling 2,680,000 square feet. Additionally, in the last four fiscal years, the Company has combined the operations of its Berwick Offray LLC (Berwick Offray) and Paper Magic Group, Inc. (PMG) subsidiaries in order to drive sales growth by providing stronger management oversight and by reallocating sales and marketing resources in a more strategic manner; consolidated its human resources, accounts receivable, accounts payable and payroll functions into a combined back office operation; and completed the implementation of a phase of the Company's enterprise resource planning systems standardization project.

On September 5, 2012, the Company and its PMG subsidiary sold the Halloween portion of PMG's business and certain PMG assets relating to such business, including certain tangible and intangible assets associated with PMG's Halloween business, to Gemmy Industries (HK) Limited (Gemmy). PMG's remaining Halloween assets, including accounts receivable and inventory, were excluded from the sale. PMG retained the right and obligation to fulfill all customer orders for PMG Halloween products (such as Halloween masks, costumes, make-up and novelties) for the Halloween 2012 season. The purchase price of \$2,281,000 was paid to PMG at closing.

On September 9, 2011, the Company and its Cleo Inc (Cleo) subsidiary sold the Christmas gift wrap portion of Cleo's business and certain of Cleo's assets relating to such business, including certain equipment, contract rights, customer lists, intellectual property and other intangible assets to Impact Innovations, Inc. (Impact). Cleo's remaining assets, including accounts receivable and inventory, were excluded from the sale. Cleo retained the right and obligation to fulfill all customer orders for Cleo Christmas gift wrap products for Christmas 2011. The purchase price was \$7,500,000, of which \$2,000,000 was paid to Cleo in cash at closing. The remainder of the purchase price was paid through the issuance by Impact of an unsecured subordinated promissory note, which provides for quarterly payments of interest at 7% and principal payments as follows: \$500,000 on March 1, 2012; \$2,500,000 on March 1, 2013; and all remaining principal and interest on March 1, 2014. All interest payments to date and the \$500,000 principal payment due on March 1, 2012 were paid when due. Subsequent to the quarter ended December 31, 2012, the Company also received a \$2,500,000 principal payment on January 23, 2013 in advance of the March 1, 2013 due date. The results of operations for the three and nine month periods ended December 31, 2012 and 2011 reflect the historical operations of the Cleo Christmas gift wrap business as discontinued operations and the discussion herein is presented on the basis of continuing operations, unless otherwise stated.

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CRITICAL ACCOUNTING POLICIES

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

The significant accounting policies of the Company are described in the notes to the consolidated financial statements included in the Annual Report on Form 10-K for the fiscal year ended March 31, 2012. Judgments and estimates of uncertainties are required in applying the Company's accounting policies in many areas. Following are some of the areas requiring significant judgments and estimates: revenue; the assessment of the recoverability of goodwill and other intangible and long-lived assets; the valuation of inventory and accounts receivable; income tax accounting; the valuation of stock-based awards and resolution of litigation and other proceedings. There have been no material changes to the critical accounting policies affecting the application of those accounting policies as noted in the Company's annual report on Form 10-K for the fiscal year ended March 31, 2012.

RESULTS OF OPERATIONS

Seasonality

The seasonal nature of CSS's business has historically resulted in lower sales levels and operating losses in the first and fourth quarters and comparatively higher sales levels and operating profits in the second and third quarters of the Company's fiscal year, which ends March 31, thereby causing significant fluctuations in the quarterly results of operations of the Company.

Nine Months Ended December 31, 2012 Compared to Nine Months Ended December 31, 2011

Sales for the nine months ended December 31, 2012 decreased 4% to \$310,572,000 from \$323,534,000 in the nine months ended December 31, 2011 primarily due to lower sales of Christmas boxed greeting cards, ribbons and bows, partially offset by the earlier timing of Valentine shipments compared to the prior year and higher sales of gift card holders.

Cost of sales, as a percentage of sales, decreased to 69% in the nine months ended December 31, 2012 compared to 70% in the nine months ended December 31, 2011. This favorable decrease was primarily due to manufacturing efficiencies and lower commodity and freight costs compared to the prior year, partially offset by a write-down of inventory to net realizable value of \$966,000 related to the sale of the Halloween portion of PMG's business.

Selling, general and administrative (SG&A) expenses of \$61,934,000 in the nine months ended December 31, 2012 decreased from \$65,533,000 in the nine months ended December 31, 2011 primarily due to reduced payroll and related costs.

Disposition of product line, net of \$5,798,000 recorded in the nine months ended December 31, 2012 primarily relates to costs as