CSS INDUSTRIES INC
Form 10-Q
August 06, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2008

or

o **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)

Delaware	13-1920657
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1845 Walnut Street, Philadelphia, PA	19103
(Address of principal executive offices)	(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. þ Yes o 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. (Check one):

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

(Do not check if a smaller reporting company)

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

As of July 24, 2008, there were 10,076,231 shares of common stock outstanding which excludes shares which may still be issued upon exercise of stock options.

CSS INDUSTRIES, INC. AND SUBSIDIARIES
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CSS INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

(In thousands, except per share data)	Three Months Ended June 30, 2008	2007
SALES	$ 54,647	$ 46,802
COSTS AND EXPENSES		
Cost of sales	37,713	33,519
Selling, general and administrative expenses	23,550	20,683
Interest expense (income), net	284	(374)
Other income, net	(66)	(242)
	61,481	53,586
LOSS BEFORE INCOME TAXES	(6,834)	(6,784)
INCOME TAX BENEFIT	(2,338)	(2,357)
NET LOSS	$ (4,496)	$ (4,427)
BASIC AND DILUTED NET LOSS PER COMMON SHARE	$ (.44)	$ (.41)
WEIGHTED AVERAGE BASIC AND DILUTED SHARES OUTSTANDING	10,255	10,882
CASH DIVIDENDS PER SHARE OF COMMON STOCK	$ .15	$ .14
COMPREHENSIVE INCOME		
Net loss	$ (4,496)	$ (4,427)
Foreign currency translation adjustment	2	
Comprehensive income	$ (4,494)	$ (4,427)

See notes to consolidated financial statements.

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CSS INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

(In thousands)	June 30, 2008	March 31, 2008
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 7,213	$ 28,109
Accounts receivable, net	43,700	39,144
Inventories	143,387	105,532
Deferred income taxes	6,519	7,276
Assets held for sale	3,461	3,590
Other current assets	15,003	16,242
Total current assets	219,283	199,893
PROPERTY, PLANT AND EQUIPMENT, NET	51,695	50,632
OTHER ASSETS		
Goodwill	48,361	48,361
Intangible assets, net	42,401	42,454
Other	3,128	3,701
Total other assets	93,890	94,516
Total assets	$ 364,868	$ 345,041
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES		
Notes payable	$ 29,700	$
Current portion of long-term debt	10,249	10,246
Accrued customer programs	7,762	9,438
Other current liabilities	44,815	44,209
Total current liabilities	92,526	63,893
LONG-TERM DEBT, NET OF CURRENT PORTION	10,129	10,192

LONG-TERM OBLIGATIONS		6,235		6,121
DEFERRED INCOME TAXES		2,108		2,482
STOCKHOLDERS EQUITY		253,870		262,353
Total liabilities and stockholders equity	$	364,868	$	345,041

See notes to consolidated financial statements.

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CSS INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(In thousands)	Three Months Ended June 30, 2008	2007
Cash flows from operating activities:		
Net loss	$ (4,496)	$ (4,427)
Adjustments to reconcile net loss to net cash used for operating activities:		
Depreciation and amortization	3,418	3,296
Provision for doubtful accounts	52	240
Deferred tax provision (benefit)	383	(474)
Gain on sale of assets	(35)	
Compensation expense related to stock options	665	681
Changes in assets and liabilities, net of effects from purchase of a business:		
Increase in accounts receivable	(4,580)	(962)
Increase in inventory	(37,731)	(42,874)
Decrease (increase) in other assets	1,216	(893)
Increase in other liabilities	5,925	1,550
Decrease in accrued taxes	(4,313)	(2,230)
Total adjustments	(35,000)	(41,666)
Net cash used for operating activities	(39,496)	(46,093)
Cash flows from investing activities:		
Purchase of a business	(300)	
Final payment of purchase price for a business previously acquired	(2,700)	
Purchase of property, plant and equipment	(4,049)	(1,108)
Proceeds from sale of assets	102	
Net cash used for investing activities	(6,947)	(1,108)
Cash flows from financing activities:		
Payments on long-term obligations	(60)	(50)
Borrowings on notes payable	44,600	
Repayments on notes payable	(14,900)	
Dividends paid	(1,541)	(1,525)
Purchase of treasury stock	(2,637)	
Proceeds from exercise of stock options	79	1,739
Tax benefit realized for stock options exercised	4	249

Net cash provided by financing activities	25,545	413
Effect of exchange rate changes on cash	2	
Net decrease in cash and cash equivalents	(20,896)	(46,788)
Cash and cash equivalents at beginning of period	28,109	100,091
Cash and cash equivalents at end of period	$ 7,213	$ 53,303

See notes to consolidated financial statements.

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CSS INDUSTRIES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2008
(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, 2008. The results of operations for the interim periods are not necessarily indicative of the results for the full year.

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.

Nature of Business

CSS is a consumer products company primarily engaged in the design, manufacture, procurement, distribution and sale of seasonal and all occasion products, principally to mass market retailers. These products include gift wrap, gift bags, gift boxes, boxed greeting cards, gift tags, decorative tissue paper, decorations, classroom exchange Valentines, decorative ribbons and bows, Halloween masks, costumes, make-up and novelties, Easter egg dyes and novelties, craft products, educational products, memory books, stationery, journals, notecards, infant and wedding photo albums and scrapbooks, and other gift items that commemorate life s celebrations. The seasonal nature of CSS 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 charged or credited to a separate component of stockholders equity. Gains and losses on foreign currency transactions are not material and are included in other income, 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 the valuation of inventory and accounts receivable, the assessment of the recoverability of goodwill and other intangible assets, income tax accounting, the valuation of share-based awards and resolution of litigation and other proceedings. Actual results could differ from these estimates.

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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):

	June 30, 2008	March 31, 2008
Raw material	$ 25,584	$ 22,836
Work-in-process	29,370	29,827
Finished goods	88,433	52,869
	$ 143,387	$ 105,532

Assets Held for Sale

Assets held for sale in the amount of $3,461,000 represents two former manufacturing facilities and a distribution facility which the Company is in the process of selling. The Company expects to sell these facilities within the next 12 months for an amount greater than the current carrying value. The Company ceased depreciating these facilities at the time they were classified as held for sale.

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.

Net Loss Per Common Share

The following table sets forth the computation of basic and diluted net loss per common share for the three months ended June 30, 2008 and 2007 (in thousands, except per share data):

	Three Months Ended June 30, 2008	2007
Numerator:		
Net loss	$ (4,496)	$ (4,427)
Denominator:		
Weighted average shares outstanding for basic loss per common share	10,255	10,882
Effect of dilutive stock options		
Adjusted weighted average shares outstanding for diluted loss per common share	10,255	10,882

Basic and diluted net loss per common share	$	(.44)	$	(.41)

The effect of dilutive stock options is not reflected as they are anti-dilutive.

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Statements of Cash Flows

For purposes of the consolidated statements of cash flows, the Company considers all holdings of highly liquid debt instruments with a maturity at time of purchase of three months or less to be cash equivalents.

(2) STOCK-BASED COMPENSATION:

2004 Equity Compensation Plan

Under the terms of the 2004 Equity Compensation Plan (2004 Plan), the Human Resources Committee (Committee) of the Board of Directors 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. All options outstanding as of June 30, 2008 become exercisable at the rate of 25% per year commencing one year after the date of grant. The Company granted 54,000 stock options under the 2004 Plan during the first quarter of fiscal 2009.

During the first quarter of fiscal 2009, the Company granted 27,600 performance-vested restricted stock units (RSUs) which vest on the third anniversary of the date on which the award was granted, providing that certain performance metrics have been met during the performance period. During the first quarter of fiscal 2009, the Company also granted 26,550 time-vested RSUs which vest at a rate of 50% on each of the third and fourth anniversaries of the date on which the award was granted.

At June 30, 2008, there were 1,063,850 shares available for grant under the 2004 Plan.

2006 Stock Option Plan for Non-Employee Directors

Under the terms of the CSS Industries, Inc. 2006 Stock Option Plan for Non-Employee Directors (2006 Plan), non-qualified stock options to purchase up to 200,000 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 2006 Plan, options to purchase 4,000 shares of the Company s common stock will be granted automatically to each non-employee director on the last day that the Company s common stock is traded in each November until 2010. Each option will expire five years after the date the option is granted and commencing one year after the date of grant, options begin vesting and are exercisable at the rate of 25% per year. At June 30, 2008, there were 156,000 shares available for grant under the 2006 Plan.

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

	For the Three Months Ended June 30,	
	2008	2007
Expected dividend yield at time of grant	2.18%	1.59%
Expected stock price volatility	36%	29%
Risk-free interest rate	3.50%	4.80%
Expected life of option (in years)	4.2	4.2

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.

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The weighted average fair value of stock options granted during the three months ended June 30, 2008 and 2007 was $7.70 and $9.43, respectively. The weighted average fair value of restricted stock units granted during the three months ended June 30, 2008 was $27.57.

As of June 30, 2008, there was $4,416,000 of total unrecognized compensation cost related to non-vested equity awards granted under the Company s equity incentive plans which is expected to be recognized over a weighted average period of 1.2 years.

Compensation cost related to stock options and RSUs recognized in operating results (included in selling, general and administrative expenses) was $665,000 and $681,000 for the three months ended June 30, 2008 and 2007, respectively.

(3) DERIVATIVE FINANCIAL INSTRUMENTS:

The Company enters into foreign currency forward contracts in order to reduce the impact of certain foreign currency fluctuations. Firmly committed transactions and the related receivables and payables may be hedged with forward exchange contracts. Gains and losses arising from foreign currency forward contracts are recognized in income or expense as offsets of gains and losses resulting from the underlying hedged transactions. As of June 30, 2008, the notional amount of open foreign currency forward contracts was $11,256,000 and the related unrealized gain was $170,000. There were no open foreign currency forward contracts as of March 31, 2008.

(4) BUSINESS ACQUISITION:

On May 19, 2008, a subsidiary of the Company completed the acquisition of substantially all of the business and assets of iota (iota) for approximately $300,000 in cash and a note payable to the seller in the amount of $100,000. The purchase price is subject to adjustment, based on future sales volume through fiscal 2014, up to a maximum of $2,000,000. In addition, the seller retains a 50% interest in royalty income associated with the sale by third parties of licensed iota products through the fifth anniversary of the closing date. iota is a leading designer, manufacturer and marketer of stationery products such as notecards, gift wrap, journals, and stationery kits. The acquisition was accounted for as a purchase and the excess of cost over fair market value of the net tangible assets acquired of $275,000 was recorded as trademarks, not subject to amortization, and included in intangible assets in the accompanying condensed consolidated balance sheet. No goodwill was recorded in this transaction.

On December 3, 2007, the Company completed the acquisition of substantially all of the business and assets of C.R. Gibson, Inc. (C.R. Gibson), through a newly-formed subsidiary, C.R. Gibson, LLC, for approximately $73,847,000 in cash, including transaction costs of approximately $200,000. In the first quarter of fiscal 2009, $2,700,000 of the purchase price was paid as settlement of an obligation assumed as contemplated in the Asset Purchase Agreement. C.R. Gibson, headquartered in Nashville, Tennessee, is a designer, marketer and distributor of memory books, stationery, journals, notecards, infant and wedding photo albums and scrapbooks, and other gift items that commemorate life s celebrations. As of June 30, 2008, a portion of the purchase price is being held in escrow for certain indemnification obligations. The acquisition was accounted for as a purchase and the excess of cost over the fair market value of the net tangible and identifiable intangible assets acquired of $17,409,000 was recorded as goodwill in the accompanying condensed consolidated balance sheet. For tax purposes, goodwill resulting from this acquisition is deductible.

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(5) BUSINESS RESTRUCTURING:

On January 4, 2008, the Company announced a restructuring plan to close the Company s Elysburg, Pennsylvania production facilities and its Troy, Pennsylvania distribution facility. This restructuring was undertaken as the Company has increasingly shifted from domestically manufactured to foreign sourced boxed greeting cards and gift tags. Under the restructuring plan, both facilities were closed as of March 31, 2008. As part of the restructuring plan, the Company recorded a restructuring reserve of $628,000, including severance related to 75 employees. Also, in connection with the restructuring plan, the Company recorded an impairment of property, plant and equipment at the affected facilities of $1,222,000, which was included in restructuring expenses in the fourth quarter of fiscal 2008. During the quarter ended June 30, 2008, the Company made payments of $238,000 primarily for costs related to severance. The Company increased the restructuring reserve by $101,000 during the quarter ended June 30, 2008 primarily related to the ratable recognition of retention bonuses for employees providing service until their termination. As of June 30, 2008, the remaining liability of $182,000 was classified as a current liability in the accompanying consolidated balance sheet and will be paid in fiscal 2009. The Company expects to incur additional period expenses related to this restructuring program of approximately $1,614,000 during the remainder of fiscal 2009 and fiscal 2010.

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

	Termination Costs	Other Costs	Total
Restructuring reserve as of March 31, 2008	$ 309	$ 10	$ 319
Cash paid fiscal 2009	(238)		(238)
Charges to expense fiscal 2009	101		101
Restructuring reserve as of June 30, 2008	$ 172	$ 10	$ 182

(6) GOODWILL AND INTANGIBLES:

The Company performs the required annual impairment test of the carrying amount of goodwill and indefinite-lived intangible assets in the fourth quarter of its fiscal year.

With the acquisition of iota, the Company recorded intangible assets relating to trademarks that are not subject to amortization in the amount of $275,000.

Included in intangible assets, net in the accompanying condensed consolidated balance sheets are the following acquired intangible assets (in thousands):

	June 30, 2008	March 31, 2008
Tradenames	$ 23,790	$ 23,790
Customer relationships, net	18,165	18,480
Trademarks	275	
Non-compete, net	171	184
	$ 42,401	$ 42,454

Amortization expense related to intangible assets was $328,000 and $15,000 for the quarters ended June 30, 2008 and 2007, respectively. Based on the current composition of intangibles, amortization expense for the remainder of fiscal 2009 and each of the succeeding four years is projected to be as follows (in thousands):

Fiscal 2009	$ 982

Fiscal 2010		1,310
Fiscal 2011		1,310
Fiscal 2012		1,293
Fiscal 2013		1,260
Total	$	6,155

(7) COMMITMENTS AND CONTINGENCIES:

CSS and its subsidiaries are also 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.

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(8) ACCOUNTING PRONOUNCEMENTS:

In May 2008, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 162, The Hierarchy of Generally Accepted Accounting Principles. SFAS No. 162 identifies, within the accounting literature established by the FASB, the sources and hierarchy of the accounting principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with Generally Accepted Accounting Principles. SFAS No. 162 is effective 60 days following the Securities and Exchange Commission s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. The Company does not believe that the adoption of SFAS No. 162 will have a significant effect on its financial position or results of operations.

In April 2008, the FASB issued FASB Staff Position (FSP) No. 142-3, Determination of the Useful Life of Intangible Assets. FSP No. 142-3 amends the factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of recognized intangible assets under FASB Statement No. 142, Goodwill and Other Intangible Assets. This new guidance applies prospectively to intangible assets that are acquired individually or with a group of other assets in business combinations and asset acquisitions. FSP No. 142-3 is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008. Early adoption is prohibited. The Company does not believe that the adoption of FSP No. 142-3 will have a significant effect on its financial position or results of operations.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities. SFAS No. 161 requires companies with derivative instruments to disclose information that should enable financial-statement users to understand how and why a company uses derivative instruments, how derivative instruments and related hedged items are accounted for under FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, and how derivative instruments and related hedged items affect a company s financial position, financial performance and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company is currently evaluating the impact of adopting SFAS No. 161 on the consolidation financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations (SFAS No. 141R), which replaces SFAS No. 141. The statement retains the purchase method of accounting for acquisitions, but requires a number of changes, including changes in the way assets and liabilities are recognized in the purchase accounting. It also changes the recognition of assets acquired and liabilities assumed arising from contingencies, requires the capitalization of in-process research and development at fair value, and requires the expensing of acquisition-related costs as incurred. SFAS No. 141R is effective for fiscal year beginning after December 15, 2008 (fiscal 2010 for the Company) and will apply prospectively to business combinations completed on or after April 1, 2009.