CSS INDUSTRIES INC
Form 10-Q
November 04, 2010

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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 September 30, 2010

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 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). o 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.

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

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 November 3, 2010, there were 9,702,446 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
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

(In thousands, except per share data)

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Six Months Ended September 30, 2010	Six Months Ended September 30, 2009
SALES	$ 159,945	$ 160,273	$ 213,233	$ 213,950
COSTS AND EXPENSES				
Cost of sales	120,731	119,630	160,286	158,695
Selling, general and administrative expenses	25,629	26,238	48,022	47,599
Interest expense, net	384	661	593	1,029
Other (income) expense, net	(19)	(138)	49	(251)
	146,725	146,391	208,950	207,072
INCOME BEFORE INCOME TAXES	13,220	13,882	4,283	6,878
INCOME TAX EXPENSE	4,755	4,990	1,555	2,476
NET INCOME	$ 8,465	$ 8,892	$ 2,728	$ 4,402
NET INCOME PER COMMON SHARE				
Basic	$ .87	$ .92	$ .28	$ .46
Diluted	$ .87	$ .92	$ .28	$ .46
WEIGHTED AVERAGE SHARES OUTSTANDING				
Basic	9,696	9,628	9,690	9,617
Diluted	9,702	9,683	9,702	9,666
CASH DIVIDENDS PER SHARE OF COMMON STOCK	$ .15	$ .15	$ .30	$ .30

See notes to consolidated financial statements.

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CSS INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

	September 30, 2010 (Unaudited)	March 31, 2010 (Audited)	September 30, 2009 (Unaudited)
ASSETS			
CURRENT ASSETS			
Cash and cash equivalents	$ 2,086	$ 27,217	$ 2,830
Accounts receivable, net of allowances of $3,439, $4,742 and $3,908	140,538	45,711	132,212
Inventories	122,095	78,851	122,422
Deferred income taxes	5,890	6,165	6,227
Assets held for sale	1,323	1,363	1,363
Other current assets	13,194	15,986	16,370
Total current assets	285,126	175,293	281,424
PROPERTY, PLANT AND EQUIPMENT, NET	47,575	47,786	52,691
DEFERRED INCOME TAXES	5,000	5,439	
OTHER ASSETS			
Goodwill	17,233	17,233	49,258
Intangible assets, net	32,394	32,027	44,996
Other	3,913	3,984	3,971
Total other assets	53,540	53,244	98,225
Total assets	$ 391,241	$ 281,762	$ 432,340
LIABILITIES AND STOCKHOLDERS EQUITY			
CURRENT LIABILITIES			
Short-term debt	$ 55,690	$	$ 69,000
Current portion of long-term debt	264	481	10,517
Accrued customer programs	10,111	8,380	9,655
Other current liabilities	83,799	35,535	71,405

Total current liabilities		149,864		44,396		160,577
LONG-TERM DEBT, NET OF CURRENT PORTION				66		264
LONG-TERM OBLIGATIONS		7,240		4,255		4,568
DEFERRED INCOME TAXES						4,399
STOCKHOLDERS EQUITY		234,137		233,045		262,532
Total liabilities and stockholders equity	$	391,241	$	281,762	$	432,340

See notes to consolidated financial statements.

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

(In thousands)

	Six Months Ended September 30, 2010	Six Months Ended September 30, 2009
Cash flows from operating activities:		
Net income	$ 2,728	$ 4,402
Adjustments to reconcile net income to net cash used for operating activities:		
Depreciation and amortization	5,832	6,264
Provision for doubtful accounts	82	81
Deferred tax provision (benefit)	714	(278)
Loss on sale or disposal of assets	3	5
Share-based compensation expense	966	1,212
Changes in assets and liabilities, net of effects of acquisition:		
Increase in accounts receivable	(94,909)	(88,552)
Increase in inventory	(43,244)	(22,325)
Increase in other assets	2,865	(3,670)
Increase in other accrued liabilities	49,405	44,695
Total adjustments	(78,286)	(62,568)
Net cash used for operating activities	(75,558)	(58,166)
Cash flows from investing activities:		
Purchase of a business		(225)
Purchase of property, plant and equipment	(2,350)	(3,132)
Proceeds from sale of assets		1
Net cash used for investing activities	(2,350)	(3,356)
Cash flows from financing activities:		
Payments on long-term obligations	(311)	(277)
Borrowings on notes payable	189,955	225,100
Repayments on notes payable	(134,265)	(160,250)
Dividends paid	(2,907)	(2,886)
Proceeds from exercise of stock options	289	486
Tax benefit realized for stock options exercised	16	
Net cash provided by financing activities	52,777	62,173

Effect of exchange rate changes on cash				
Net (decrease) increase in cash and cash equivalents		(25,131)		651
Cash and cash equivalents at beginning of period		27,217		2,179
Cash and cash equivalents at end of period	$	2,086	$	2,830

See notes to consolidated financial statements.

CSS INDUSTRIES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2010
(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, 2010. The results of operations for the interim periods are not necessarily indicative of the results for the full year.

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 2011 refers to the fiscal year ending March 31, 2011.

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 social expression products, principally to mass market retailers. These seasonal and all occasion products include gift wrap, gift bags, gift boxes, gift card holders, boxed greeting cards, gift tags, decorative tissue paper, decorations, classroom exchange Valentines, decorative ribbons and bows, floral accessories, Halloween masks, costumes, make-up and novelties, 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 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) expense, net in the consolidated statements of operations.

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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.

Impairment of Long-Lived Assets including Goodwill and Other Intangible Assets -
Goodwill is subject to an assessment for impairment using a two-step fair value-based test, the first step of which must be performed at least annually, or more frequently if events or circumstances indicate that goodwill might be impaired. 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.

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, except for goodwill and indefinite lived intangible assets, are reviewed for impairment when circumstances indicate the carrying value of an asset may not be recoverable. If such assets are considered to be impaired, the impairment to be recognized is the amount by which the carrying amount of the assets exceeds the fair value of the assets.

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):

	September 30, 2010	March 31, 2010	September 30, 2009
Raw material	$ 17,128	$ 12,696	$ 16,008
Work-in-process	16,763	20,881	18,419
Finished goods	88,204	45,274	87,995
	$ 122,095	$ 78,851	$ 122,422

Assets Held for Sale -
Assets held for sale in the amount of $1,323,000 at September 30, 2010 and $1,363,000 as of March 31, 2010 and September 30, 2009, represents a former manufacturing facility which the Company is in the process of selling. The Company expects to sell this facility within the next 12 months for an amount greater than the current carrying value. The Company ceased depreciating this facility at the time it was classified as held for sale.

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Property, Plant and Equipment -

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

	September 30, 2010	March 31, 2010	September 30, 2009
Land	$ 2,508	$ 2,508	$ 2,608
Buildings, leasehold interests and improvements	46,656	45,165	46,161
Machinery, equipment and other	147,197	147,305	146,420
	196,361	194,978	195,189
Less Accumulated depreciation	(148,786)	(147,192)	(142,498)
Net property, plant and equipment	$ 47,575	$ 47,786	$ 52,691

In conjunction with negotiating certain lease extensions during the first quarter of fiscal 2011, the Company identified a previously unrecognized asset retirement obligation at one of its leased facilities. The Company believes that this obligation existed since the adoption of Financial Accounting Standards Board (FASB) No. 143, Asset Retirement Obligations, which was later codified as ASC 420-20, which became effective for the Company beginning in fiscal 2004. The Company calculated the historical impact as if it had appropriately adopted the standard in fiscal 2004, and the impact was not material to any individual period from fiscal 2004 through fiscal 2010. The impact of recording the asset retirement obligation resulted in an asset and a liability, each in the amount of $1,704,000, as of April 1, 2003. Additionally, as of April 1, 2010, a reduction in income of $1,326,000 was recorded related to depreciation and accretion from fiscal 2004 through fiscal 2010 in the amount of $712,000 and $614,000, respectively. During the six months ended September 30, 2010, the impact of the asset retirement obligation included $51,000 of depreciation expense and $54,000 of accretion expense. Accretion expense was recorded as a component of depreciation and amortization. The asset retirement obligation of $2,372,000 is included in other long-term obligations at September 30, 2010.

Additionally, during the first quarter of fiscal 2011, the Company determined that the useful lives used to amortize leasehold improvements at the same leased facility from fiscal 2006 to fiscal 2010 did not follow the guidance in the codification referenced above. Leasehold improvements were being amortized through the lease end date without consideration of lease renewal periods that were reasonably assured. The Company calculated the historical impact as if it had used the proper useful life of the assets, and such impact was not material to any individual period from fiscal 2006 through fiscal 2010. The impact of adjusting the leasehold improvement amortization periods resulted in additional net book value of $1,293,000 as of April 1, 2010 that was recorded as a reduction of depreciation expense in the first quarter of fiscal 2011.

The correction of these items did not have a material impact on the Company s consolidated statement of cash flows. Management evaluated the quantitative and qualitative impact of the corrections on previously reported periods as well as the three months ended June 30, 2010 and the six months ended September 30, 2010. Based upon this evaluation, management concluded that these adjustments were not material to the Company s consolidated financial statements.

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.

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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 six months ended September 30, 2010 and 2009 (in thousands, except per share data):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2010	2009	2010	2009
Numerator:				
Net income	$ 8,465	$ 8,892	$ 2,728	$ 4,402
Denominator:				
Weighted average shares outstanding for basic income per common share	9,696	9,628	9,690	9,617
Effect of dilutive stock options	6	55	12	49
Adjusted weighted average shares outstanding for diluted income per common share	9,702	9,683	9,702	9,666
Basic net income per common share	$ .87	$ .92	$ .28	$ .46
Diluted net income per common share	$ .87	$ .92	$ .28	$ .46

(2) SHARE-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 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 September 30, 2010 become exercisable at the rate of 25% per year commencing one year after the date of grant. Outstanding time-vested restricted stock units (RSUs) generally vest at the rate of 50% of the shares underlying the grant on each of the third and fourth anniversaries of the date on which the award was granted. At September 30, 2010, 1,197,749 shares were 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 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 are granted automatically to each non-employee director on the last day that the Company s common stock is traded in November from 2006 to 2010. Each option will expire five years after the date the option is granted, and options vest and become exercisable at the rate of 25% per year on each of the first four anniversaries of the grant date. At September 30, 2010, 118,000 shares were available for grant under the 2006 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 Six Months Ended September 30,

	2010	2009
Expected dividend yield at time of grant	3.11%	2.90%
Expected stock price volatility	55%	55%
Risk-free interest rate	2.63%	3.22%
Expected life of option (in years)	4.7	4.0

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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.

The weighted average fair value of stock options granted during the six months ended September 30, 2010 and 2009 was $6.99 and $7.72, respectively. The weighted average fair value of restricted stock units granted during the six months ended September 30, 2010 and 2009 was $16.94 and $16.64, respectively.

As of September 30, 2010, there was $1,829,000 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 2.5 years. As of September 30, 2010, there was $2,201,000 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 2.7 years.

Compensation cost related to stock options and RSUs recognized in operating results (included in selling, general and administrative expenses) was $505,000 and $623,000 in the quarters ended September 30, 2010 and 2009, respectively, and was $966,000 and $1,212,000 for the six months ended September