

DiamondRock Hospitality Co  
Form 10-Q  
April 30, 2012

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-Q

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

For the quarterly period ended March 23, 2012

OR

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

Commission file number 001-32514

DIAMONDROCK HOSPITALITY COMPANY

(Exact Name of Registrant as Specified in Its Charter)

Maryland

20-1180098

(State of Incorporation)

(I.R.S. Employer Identification No.)

3 Bethesda Metro Center, Suite 1500, Bethesda,

20814

Maryland

(Address of Principal Executive Offices)

(Zip Code)

(240) 744-1150

(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 shorter 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 definition 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   
(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).  Yes  No

The registrant had 167,918,292 shares of its \$0.01 par value common stock outstanding as of April 30, 2012.

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## PART I. FINANCIAL INFORMATION

## Item I. Financial Statements

## DIAMONDROCK HOSPITALITY COMPANY

## CONDENSED CONSOLIDATED BALANCE SHEETS

As of March 23, 2012 and December 31, 2011

(in thousands, except share and per share amounts)

|  | March 23, 2012<br>(Unaudited) | December 31, 2011 |
|--|-------------------------------|-------------------|
| <b>ASSETS</b>  |                               |                   |
| Property and equipment, at cost  | \$2,673,080                   | \$2,667,682       |
| Less: accumulated depreciation   | (453,882)                     | (433,178)         |
|  | 2,219,198                     | 2,234,504         |
| Assets held for sale   | —                             | 263,399           |
| Deferred financing costs, net  | 9,697                         | 5,869             |
| Restricted cash  | 56,099                        | 53,871            |
| Due from hotel managers  | 51,674                        | 50,728            |
| Note receivable  | 54,788                        | 54,788            |
| Favorable lease assets, net  | 43,054                        | 43,285            |
| Prepaid and other assets   | 67,372                        | 65,900            |
| Cash and cash equivalents  | 128,570                       | 26,291            |
| Total assets   | \$2,630,452                   | \$2,798,635       |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                               |                   |
| Liabilities:   |                               |                   |
| Mortgage debt  | \$903,331                     | \$762,933         |
| Mortgage debt of assets held for sale  | —                             | 180,000           |
| Senior unsecured credit facility   | —                             | 100,000           |
| Total debt   | 903,331                       | 1,042,933         |
| Deferred income related to key money, net  | 24,445                        | 24,593            |
| Unfavorable contract liabilities, net  | 81,483                        | 81,914            |
| Due to hotel managers  | 41,740                        | 41,676            |
| Liabilities of assets held for sale  | —                             | 3,805             |
| Dividends declared and unpaid  | 13,600                        | 13,594            |
| Accounts payable and accrued expenses  | 76,549                        | 87,963            |
| Total other liabilities  | 237,817                       | 253,545           |
| Stockholders' Equity:  |                               |                   |
| Preferred stock, \$0.01 par value; 10,000,000 shares authorized; no shares issued and outstanding  | —                             | —                 |
| Common stock, \$0.01 par value; 200,000,000 shares authorized; 167,918,292 and 167,502,359 shares issued and outstanding at March 23, 2012 and December 31, 2011, respectively | 1,679                         | 1,675             |
| Additional paid-in capital   | 1,706,490                     | 1,708,427         |
| Accumulated deficit  | (218,865)                     | (207,945)         |
| Total stockholders' equity   | 1,489,304                     | 1,502,157         |
| Total liabilities and stockholders' equity   | \$2,630,452                   | \$2,798,635       |

The accompanying notes are an integral part of these condensed consolidated financial statements.

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## DIAMONDROCK HOSPITALITY COMPANY

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

For the Fiscal Quarters Ended March 23, 2012 and March 25, 2011

(in thousands, except per share amounts)

|   | Fiscal Quarter Ended |                |            |            |            |  |
|---|----------------------|----------------|------------|------------|------------|--|
|   | March 23, 2012       | March 25, 2011 |            |            |            |  |
|   | (Unaudited)          | (Unaudited)    |            |            |            |  |
| Revenues:   |                      |                |            |            |            |  |
| Rooms   | \$83,388             | \$69,283       |            |            |            |  |
| Food and beverage   | 31,251               | 29,179         |            |            |            |  |
| Other   | 6,783                | 5,291          |            |            |            |  |
| Total revenues  | 121,422              | 103,753        |            |            |            |  |
| Operating Expenses:   |                      |                |            |            |            |  |
| Rooms   | 24,879               | 20,202         |            |            |            |  |
| Food and beverage   | 23,844               | 22,588         |            |            |            |  |
| Management fees   | 3,142                | 2,748          |            |            |            |  |
| Other hotel expenses  | 49,003               | 41,399         |            |            |            |  |
| Depreciation and amortization                                   | 20,518               | 18,549         |            |            |            |  |
| Hotel acquisition costs   | 33                   | 256            |            |            |            |  |
| Corporate expenses  | 4,483                | 4,074          |            |            |            |  |
| Total operating expenses  | 125,902              | 109,816        |            |            |            |  |
| Operating loss  | (4,480 )             | (6,063 )       |            |            |            |  |
| Other Expenses (Income):  |                      |                |            |            |            |  |
| Interest income   | (63 )                | (291 )         |            |            |            |  |
| Interest expense  | 11,468               | 8,818          |            |            |            |  |
| Gain on early extinguishment of debt                            | (144 )               | —              |            |            |            |  |
| Total other expenses  | 11,261               | 8,527          |            |            |            |  |
| Loss from continuing operations before income taxes             | (15,741 )            | (14,590 )      |            |            |            |  |
| Income tax benefit  | 5,774                | 3,727          |            |            |            |  |
| Loss from continuing operations                                 | (9,967 )             | (10,863 )      |            |            |            |  |
| Income (loss) from discontinued operations, net of income taxes | 12,582               | (181 )         |            |            |            |  |
| Net income (loss)   | \$2,615              | \$(11,044)     |            |            |            |  |
| Net sales   | \$ 498,253           | \$ 530,686     | \$ 525,494 | \$ 536,362 | \$ 539,349 |  |
| Income before income taxes                                      | 38,833               | 36,804         | 32,716     | 47,118     | 46,297     |  |
| Net income  | 25,358               | 23,889         | 21,841     | 30,692     | 29,850     |  |
| Net income per common share:                                    |                      |                |            |            |            |  |
| Basic   | \$ 2.36              | \$ 2.25        | \$ 2.08    | \$ 2.58    | \$ 2.54    |  |
| Diluted   | \$ 2.31              | \$ 2.19        | \$ 2.00    | \$ 2.45    | \$ 2.42    |  |

**Balance Sheet Data:**

|   |    |         |    |         |    |         |    |         |    |         |
|---|----|---------|----|---------|----|---------|----|---------|----|---------|
| Working capital                                 | \$ | 136,000 | \$ | 188,309 | \$ | 161,482 | \$ | 151,878 | \$ | 187,813 |
| Total assets                                    |    | 345,041 |    | 343,070 |    | 334,149 |    | 333,906 |    | 370,397 |
| Current portion of long-term debt               |    | 10,246  |    | 10,195  |    | 10,169  |    | 10,442  |    | 335     |
| Long-term debt                                  |    | 10,192  |    | 20,392  |    | 30,518  |    | 40,000  |    | 50,251  |
| Stockholders equity                             |    | 262,353 |    | 261,110 |    | 232,510 |    | 216,489 |    | 249,152 |
| <b>Cash dividends declared per common share</b> | \$ | .56     | \$ | .48     | \$ | .48     | \$ | .40     | \$ | .307    |

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.****Overview**

Approximately 70% of the Company's sales are attributable to seasonal (Christmas, Valentine's Day, Easter and Halloween) products, with the remainder being attributable to everyday products. Seasonal products are sold primarily to mass market retailers, and the Company has relatively high market shares in many of these categories. Most of these markets have shown little or no growth in recent years, and the Company continues to confront significant cost 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 has taken several measures to respond to cost and price pressures. CSS continually invests in product and packaging design and product knowledge to assure it can continue to provide unique added value to its customers. In addition, CSS maintains an office and showroom 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 domestically. In the last five fiscal years, the Company has closed five manufacturing plants and six warehouses totaling 1,344,000 square feet. Additionally, in fiscal 2007 the Company combined the management and back office support for its Memphis, Tennessee based Cleo gift wrap operation into its Berwick Offray ribbon and bow subsidiary. This action enhanced administrative efficiencies and provided incremental penetration of gift packaging products into broader everyday channels of distribution.

The Company's everyday craft, trim-a-package, stationery and memory product lines have higher inherent growth potential due to higher market growth rate. Further, the Company's everyday craft, trim-a-package, stationery and floral product lines have higher inherent growth potential due to CSS's relatively low current market share. The Company has established project teams and plans to pursue top line sales growth in these and other areas.

The seasonal nature of CSS's business results in low sales and operating losses in the first and fourth quarters and high sales levels and operating profits in the second and third quarters of the Company's fiscal year, thereby causing significant fluctuations in the quarterly results of operations of the Company.

Historically, significant growth at CSS has come through acquisitions. Management anticipates that it will continue to utilize acquisitions to stimulate further growth.

## **Litigation**

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.

## **Results of Operations**

### **Fiscal 2008 Compared to Fiscal 2007**

Consolidated sales for fiscal 2008 decreased 6% to \$498,253,000 from \$530,686,000 in fiscal 2007. The decrease in sales was primarily due to lower sales of products sold to warehouse clubs and lower sales of Christmas gift wrap, decorative tissue paper and gift bags and educational products. These sales reductions were partially offset by C.R. Gibson sales since its acquisition on December 3, 2007. Excluding sales from C.R. Gibson, sales declined 9% from prior year.

Cost of sales, as a percentage of sales, decreased to 72% in fiscal 2008 from 74% in fiscal 2007. The decrease in cost of sales was primarily due to improved efficiencies in the gift wrap, gift bag and tissue product lines resulting from the restructuring program announced in November 2006.

Selling, general and administrative ( SG&A ) expenses, as a percentage of sales, increased to 19% in fiscal 2008 from 18% in fiscal 2007. The increase in SG&A expenses, as a percentage of sales, is primarily attributable to the mix of expenses compared to the prior year resulting from the acquisition of the C.R. Gibson business on December 3, 2007.

Restructuring expenses were \$1,717,000 in fiscal 2008 and \$2,327,000 in fiscal 2007. The decrease in restructuring expenses was due to the absence of costs related to a restructuring program in the prior year to combine the operations of the Cleo and Berwick Offray subsidiaries, to close Cleo's Maysville, Kentucky production facility and to exit a non-material, non-core business which was partially offset by costs related to a restructuring program announced on January 4, 2008 to close the Company's two production facilities in Elysburg, Pennsylvania and a distribution center in Troy, Pennsylvania. See Note 4 to the consolidated financial statements for further discussion.

Interest expense, net decreased to \$974,000 in fiscal 2008 from \$2,285,000 in fiscal 2007. The decrease in interest expense, net was primarily due to lower average borrowing levels during fiscal 2008 compared to the prior year as a result of cash generated from operations, offset by the impact of cash utilized to purchase the C.R. Gibson business and to repurchase the Company's common stock and the impact of a lower rate of return on invested cash resulting from the Company's investment in a tax exempt municipal fund in the current year.

Income before income taxes was \$38,833,000, or 8% of sales, in fiscal 2008 and \$36,804,000, or 7% of sales, in fiscal 2007.

Income taxes, as a percentage of income before taxes, were 35% in fiscal 2008 and fiscal 2007. Reductions in the Company's effective tax rate from the Company's investment during fiscal 2008 in a federal tax exempt municipal fund and from a decrease in the Company's state effective tax rate were substantially offset by the non-recurrence of tax benefits recorded in fiscal 2007 related to decreases in foreign and state valuation allowances and state tax reserves.

Net income for the year ended March 31, 2008 increased 6% to \$25,358,000 from \$23,889,000 in fiscal 2007. The increase in net income was primarily attributable to current fiscal year cost savings and lower implementation expense associated with restructuring plans implemented in November 2006 and January 2008, incremental earnings contributed by the recently acquired C.R. Gibson business and reduced interest expense, net of the impact of reduced sales volume.



**Fiscal 2007 Compared to Fiscal 2006**

Consolidated sales for fiscal 2007 increased 1% to \$530,686,000 from \$525,494,000 in fiscal 2006. The increase in sales was primarily due to higher sales of Christmas gift wrap and boxed greeting cards, partially offset by lower sales of tissue, gift bags and ribbons and bows.

Cost of sales, as a percentage of sales, decreased to 74% in fiscal 2007 from 76% in fiscal 2006. The improvement in cost of sales was primarily due to improved manufacturing and distribution efficiencies achieved in the gift wrap, gift bag and tissue product lines and the impact of higher sales of gift wrap and boxed greeting cards, partially offset by incremental costs of \$706,000 associated with the restructuring program, which includes \$660,000 related to the write-down of inventory.

Selling, general and administrative ( SG&A ) expenses, as a percentage of sales, increased to 18% in fiscal 2007 from 17% in fiscal 2006. The increase in SG&A expenses, as a percentage of sales, was primarily due to incremental share-based compensation expense related to the adoption of SFAS No. 123R, Share-Based Payment, increased incentive compensation expense and incremental costs of \$909,000 associated with the restructuring program established in the current year.

Restructuring expenses were \$2,327,000 in fiscal 2007 and \$37,000 in fiscal 2006. The increase in restructuring expenses was due to the establishment of a restructuring program in fiscal 2007 to combine the operations of the Cleo and Berwick Offray subsidiaries, to close Cleo's Maysville, Kentucky production facility and to exit a non-material, non-core business. See Note 4 to the consolidated financial statements for further discussion.

Interest expense, net decreased to \$2,285,000 in fiscal 2007 from \$3,279,000 in fiscal 2006. The decrease in interest expense, net was primarily due to lower average borrowing levels during fiscal 2007 compared to the prior year and increased cash balances.

Income before income taxes was \$36,804,000, or 7% of sales, in fiscal 2007 and \$32,716,000, or 6% of sales, in fiscal 2006. Excluding costs relating to the restructuring program in fiscal 2007 and including the pro forma effect of stock option expense in the prior fiscal year for the Company's adoption of SFAS No. 123R, income before income taxes increased 36% to \$40,745,000 in fiscal 2007 from \$30,031,000 in fiscal 2006.

Income taxes, as a percentage of income before taxes, were 35% in fiscal 2007 and 33% in fiscal 2006. The increase in the effective tax rate was primarily due to a non-recurring, one-time favorable impact of the American Jobs Creation Act of 2004 of approximately \$430,000 relating to the repatriation of earnings from the Company's foreign affiliates that was recorded in the prior year. Also contributing to the increase was the non-deductibility for tax purposes of a portion of the share-based compensation expense recorded in fiscal 2007 as a result of the adoption of SFAS No. 123R.

Net income for the year ended March 31, 2007 increased 9% to \$23,889,000 from \$21,841,000 in fiscal 2006. Excluding costs relating to the restructuring program in fiscal 2007 and including the pro forma effect of stock option expense in the prior fiscal year for the Company's adoption of SFAS No. 123R, net income increased 35% to \$26,412,000 in fiscal 2007 from \$19,548,000 in fiscal 2006 and diluted earnings per share increased 33% to \$2.42 in fiscal 2007 compared to prior year diluted earnings per share of \$1.82.

**Reconciliation of Certain Non-GAAP Measures**

Management believes that presentation of results of operations adjusted for the affects of non-recurring costs related to a restructuring program in fiscal 2007 and the pro forma impact of recognizing stock option expense as if the

Company had adopted SFAS No. 123R, Share-Based Payment, in fiscal 2006, provides useful information to investors because it enhances comparability between the reporting periods.

|   | <b>Year Ended March 31, 2007</b>                |                   |   |
|---|---|-------------------|---|
|   | <b>Income<br/>Before<br/>Income<br/>Taxes</b>   | <b>Net Income</b> | <b>Diluted<br/>Earnings<br/>per Share</b> |
|   | <b>(In thousands, except per share amounts)</b> |                   |   |
| As Reported   | \$ 36,804                                       | \$ 23,889         | \$ 2.19                                   |
| - Restructuring expenses                                | 2,327   | 1,489             | .14                                       |
| - Inventory write-down due to facility closure          | 660   | 423               | .04                                       |
| - Other incremental costs related to restructuring plan | 954   | 611               | .06                                       |
| Non-GAAP Measurement                                    | \$ 40,745                                       | \$ 26,412         | \$ 2.42                                   |

|   | <b>Year Ended March 31, 2006</b>                |                   |   |
|---|---|-------------------|---|
|   | <b>Income<br/>Before<br/>Income<br/>Taxes</b>   | <b>Net Income</b> | <b>Diluted<br/>Earnings<br/>per Share</b> |
|   | <b>(In thousands, except per share amounts)</b> |                   |   |
| As Reported   | \$ 32,716                                       | \$ 21,841         | \$ 2.00                                   |
| - Restructuring expenses                                      | 37  | 25                |   |
| - Expensing stock options SFAS No. 123R adopted April 1, 2006 | (2,722)   | (2,318)           | (.18)                                     |
| Non-GAAP Measurement  | \$ 30,031                                       | \$ 19,548         | \$ 1.82                                   |

Diluted earnings per share for the year ended March 31, 2007 does not add due to rounding.

### **Liquidity and Capital Resources**

At March 31, 2008, the Company had working capital of \$136,000,000 and stockholders' equity of \$262,353,000. The increase in accounts receivable, net of reserves, to \$39,144,000 at March 31, 2008 from \$37,169,000 at March 31, 2007 was primarily the result of the acquisition of the C.R. Gibson business, net of improved collection experience in fiscal 2008. Inventories increased to \$105,532,000 from \$82,138,000 primarily due to finished goods inventory acquired in the C.R. Gibson acquisition and earlier purchases of commodity based raw materials such as paper and resin. These early purchases were made to avoid scheduled price increases. Capital expenditures increased to \$8,330,000 in fiscal 2008 from \$5,289,000 in fiscal 2007 primarily due to the ERP system integration project announced in October 2007. The increase in goodwill and intangible assets, net was also attributable to the acquisition of the C.R. Gibson business as more fully described in Note 2. Accounts payable increased to \$18,275,000 from \$12,212,000 primarily as a result of the acquisition of the C.R. Gibson business. The increase in long-term obligations was due to the reclassification of unrecognized tax benefits associated with the adoption of FIN 48 and is more fully described in Note 8. The increase in stockholders' equity was primarily attributed to the current year net income and

capital contributed upon exercise of employee stock options, partially offset by treasury repurchases and payments of cash dividends.

Under a stock repurchase program that had been previously authorized by the Company's Board of Directors, the Company repurchased 747,424 shares of the Company's common stock for \$25,449,000 in fiscal 2008 and 9,800 shares of the Company's common stock for \$323,000 in fiscal 2007. As of March 31, 2008, the Company had no shares remaining available for repurchase under the Board's authorization.

The Company relies primarily on cash generated from its operations and seasonal borrowings to meet its liquidity requirements. Historically, a significant portion of CSS revenues have been seasonal, with approximately 80% of sales recognized in the second and third quarters. As payment for sales of Christmas related products is usually not received until just before or just after the holiday selling season in accordance with general industry practice, short-term borrowing needs increase throughout the second and third quarters, peaking prior to Christmas and dropping thereafter. Seasonal financing requirements were met under a \$50,000,000 revolving credit facility with five banks and an accounts receivable securitization facility with an issuer of receivables-backed commercial paper. This facility has a funding limit of \$100,000,000 during peak seasonal periods and \$25,000,000 during off-

peak seasonal periods. In addition, the Company has outstanding \$20,000,000 of 4.48% senior notes due ratably in annual \$10,000,000 installments through December 2009. These financing facilities are available to fund the Company's seasonal borrowing needs and to provide the Company with sources of capital for general corporate purposes, including acquisitions as permitted under the revolving credit facility. At March 31, 2008, there were no borrowings outstanding under the revolving credit facility or the accounts receivable securitization and there were long-term borrowings of \$20,000,000 related to the senior notes. For information concerning these credit facilities, see Note 9 of the Notes to Consolidated Financial Statements.

Based on its current operating plan, the Company believes its sources of available capital are adequate to meet its ongoing cash needs for at least the next 12 months.

As of March 31, 2008, the Company's contractual obligations and commitments are as follows (in thousands):

| <b>Contractual Obligations</b> | <b>Less than 1<br/>Year</b> | <b>1-3<br/>Years</b> | <b>4-5<br/>Years</b> | <b>After 5<br/>Years</b> | <b>Total</b> |
|--------------------------------|-----------------------------|----------------------|----------------------|--------------------------|--------------|
| Short-term debt                | \$                          | \$                   | \$                   | \$                       | \$           |
| Capital lease obligations      | 246                         | 192                  |                      |                          | 438          |
| Operating leases               | 8,318                       | 10,059               | 2,161                | 759                      | 21,297       |
| Long-term debt(1)              | 10,762                      | 10,314               |                      |                          | 21,076       |
| Other long-term obligations(2) |                             | 422                  | 287                  | 2,587                    | 3,296        |
|                                | \$ 19,326                   | \$ 20,987            | \$ 2,448             | \$ 3,346                 | \$ 46,107    |

(1) Interest on long-term debt is based on amounts outstanding and on the fixed interest rate of 4.48%.

(2) Other long-term obligations consist primarily of postretirement medical liabilities and deferred compensation arrangements. Future timing of payments for other long-term obligations is estimated by management.

The above table excludes any potential uncertain income tax liabilities that may become payable upon examination of the Company's income tax returns by taxing authorities. Such amounts and periods of payment cannot be reliably estimated. See Note 8 to the consolidated financial statements for further explanation of the Company's uncertain tax positions.

As of March 31, 2008, the Company's other commitments are as follows (in thousands):

|                  | <b>Less than 1<br/>Year</b> | <b>1-3<br/>Years</b> | <b>4-5<br/>Years</b> | <b>After 5<br/>Years</b> | <b>Total</b> |
|------------------|-----------------------------|----------------------|----------------------|--------------------------|--------------|
| Letter of credit | \$ 3,883                    | \$                   | \$                   | \$                       | \$ 3,883     |

The Company has a reimbursement obligation to the issuer of a stand-by letter of credit that guarantees the funding of workers compensation claims. The Company has no financial guarantees or other arrangements with any third parties or related parties other than its subsidiaries.

In the ordinary course of business, the Company enters into arrangements with vendors to purchase merchandise in advance of expected delivery. These purchase orders do not contain any significant termination payments or other penalties if canceled.

### **Critical Accounting Policies**

In preparing our consolidated financial statements, management is required to make estimates and assumptions that, among other things, affect the reported amounts of assets, liabilities, revenue and expenses. These estimates and assumptions are most significant where they involve levels of subjectivity and judgment necessary to account for highly uncertain matters or matters susceptible to change, and where they can have a material impact on our financial condition and operating performance. Below are the most significant estimates and related assumptions used in the preparation of our consolidated financial statements. If actual results were to differ materially from the estimates made, the reported results could be materially affected.

### **Revenue**

Revenue is recognized from product sales when goods are shipped, title and risk of loss have been transferred to the customer and collection is reasonably assured. The Company records estimated reductions to revenue for customer programs, which may include special pricing agreements for specific customers, volume incentives and other promotions. In limited cases, the Company may provide the right to return product as part of its customer programs with certain customers. The Company also records estimated reductions to revenue, based primarily on historical experience, for customer returns and chargebacks that may arise as a result of shipping errors, product damaged in transit or for other reasons that become known subsequent to recognizing the revenue. These provisions are recorded in the period that the related sale is recognized and are reflected as a reduction from gross sales, and the related reserves are shown as a reduction of accounts receivable, except reserves for customer programs which are shown as a current liability. If the amount of actual customer returns and chargebacks were to increase or decrease significantly from the estimated amount, revisions to the estimated allowance would be required.

### **Accounts Receivable**

The Company offers seasonal dating programs related to certain seasonal product offerings pursuant to which customers that qualify for such programs are offered extended payment terms. While some customers are granted return rights as part of their sales program, customers generally do not have the right to return product except for reasons the Company believes are typical of our industry, including damaged goods, shipping errors or similar occurrences. The Company is generally not required to repurchase products from its customers, nor does the Company have any regular practice of doing so. In addition, the Company mitigates its exposure to bad debts by evaluating the creditworthiness of its major customers utilizing established credit limits and purchasing credit insurance when appropriate and available. Bad debt and returns and allowances reserves are recorded as an offset to accounts receivable while reserves for customer programs are recorded as accrued liabilities. The Company evaluates accounts receivable related reserves and accruals monthly by specifically reviewing customer's creditworthiness, historical recovery percentages and outstanding customer deductions and program arrangements.

### **Inventory Valuation**

Inventories are valued at the lower of cost or market. Cost is primarily determined by the first-in, first-out method although certain inventories are valued based on the last-in, first-out method. The Company writes down its inventory for estimated obsolescence in an amount equal to the difference between the cost of the inventory and the estimated market value based upon assumptions about future demand, market conditions, customer planograms and sales forecasts. Additional inventory write downs could result from unanticipated additional carryover of finished goods and raw materials, or from lower proceeds offered by parties in our traditional closeout channels.

### **Goodwill**

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 compares the fair value of a reporting unit to its carrying amount, including goodwill. For each of the reporting units, the estimated fair value is determined utilizing a multiple of earnings before interest, income taxes, depreciation and amortization. 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 goodwill is less than the carrying amount of the goodwill, an impairment loss would be reported.

### **Accounting for Income Taxes**

As part of the process of preparing our consolidated financial statements, we are required to estimate our actual current tax expense (state, federal and foreign), including the impact of permanent and temporary differences resulting from differing bases and treatment of items for tax and accounting purposes, such as the carrying value of intangibles, deductibility of expenses, depreciation of property, plant and equipment, and valuation of inventories. Temporary differences and operating loss and credit carryforwards result in deferred tax assets and liabilities, which



are included within our consolidated balance sheets. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income. Actual results could differ from this assessment if sufficient taxable income is not generated in future periods. To the extent we determine the need to establish a valuation allowance or increase such allowance in a period, we would record additional tax expense in the accompanying consolidated statements of operations. The management of the Company periodically estimates the probable tax obligations of the Company using historical experience in tax jurisdictions and informed judgments. There are inherent uncertainties related to the interpretation of tax regulations. The judgments and estimates made at a point in time may change based on the outcome of tax audits, as well as changes to or further interpretations of regulations. If such changes take place, there is a risk that the tax rate may increase or decrease in any period.

### **Share-Based Compensation**

Effective April 1, 2006, the Company adopted SFAS No. 123R, using the modified prospective transition method and began accounting for its share-based compensation using a fair-value based recognition method. Under the provisions of SFAS No. 123R, share-based compensation cost is estimated at the grant date based on the fair value of the award and is expensed ratably over the requisite service period of the award. Determining the appropriate fair-value model and calculating the fair value of share-based awards at the grant date requires considerable judgment, including estimating stock price volatility, and the expected option life.

The Company uses the Black-Scholes option valuation model to value employee stock awards. The Company estimates stock price volatility based on historical volatility of its common stock. Estimated option life assumptions are also derived from historical data. The Company recognizes compensation expense using the straight-line amortization method for share-based compensation awards with graded vesting. Had the Company used alternative valuation methodologies and assumptions, compensation cost for share-based payments could be significantly different.

### **Accounting Pronouncements**

See Note 14 to the Consolidated Financial Statements for information concerning recent accounting pronouncements and the impact of those standards.

### **Forward-Looking and Cautionary Statements**

This report includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements regarding expected future benefits and costs from the Company's restructuring plan involving the closure of its facilities in Elysburg, Pennsylvania and Troy, Pennsylvania; continued use of acquisitions to stimulate further growth; the expected future impact of changes in accounting principles; the anticipated effects of measures taken by the Company to respond to cost and price pressures; and the Company's anticipation that quarterly cash dividends will continue to be paid in the future. Forward-looking statements are based on the beliefs of the Company's management as well as assumptions made by and information currently available to the Company's management as to future events and financial performance with respect to the Company's operations. Forward-looking statements speak only as of the date made. The Company undertakes no obligation to update any forward-looking statements to reflect the events or circumstances arising after the date as of which they were made. Actual events or results may differ materially from those discussed in forward-looking statements as a result of various factors, including without limitation, general market conditions; increased competition; increased operating costs, including labor-related and energy costs and costs relating to the imposition or retrospective application of duties on imported products; currency risks and other risks associated with international markets; risks associated with acquisitions, including acquisition integration costs; risks associated with the restructuring plan to close the Company's facilities in Elysburg, Pennsylvania and Troy, Pennsylvania, including the risk that the restructuring related savings and/or costs

may exceed the presently expected amounts and the risk that the closures will adversely affect the Company's ability to fulfill its customer's orders on time; risks associated with the Company's ERP systems standardization project, including the risk that the cost of the project will exceed expectations, the risk that the expected benefits of the project will not be realized and the risk that implementation of the project will interfere with and adversely affect the Company's operations and financial performance; the risk that customers may become insolvent; costs of compliance with governmental regulations

and government investigations; liability associated with non-compliance with governmental regulations, including regulations pertaining to the environment, Federal and state employment laws, and import and export controls and customs laws, and other factors described more fully elsewhere in this annual report on Form 10-K and in the Company's previous filings with the Securities and Exchange Commission. As a result of these factors, readers are cautioned not to place undue reliance on any forward-looking statements included herein or that may be made elsewhere from time to time by, or on behalf of, the Company.

**Item 7A. *Quantitative and Qualitative Disclosures About Market Risk.***

The Company's activities expose it to a variety of market risks, including the effects of changes in interest rates and foreign currency exchange rates. These financial exposures are actively monitored and, where considered appropriate, managed by the Company as described below.

***Interest Rate Risk***

The Company's primary market risk exposure with regard to financial instruments is to changes in interest rates. Pursuant to the Company's variable rate lines of credit, a change in either the lender's base rate or LIBOR would affect the rate at which the Company could borrow funds thereunder. Based on average borrowings under these credit facilities of \$12,323,000 for the year ended March 31, 2008, a 1% increase or decrease in floating interest rates would have increased or decreased annual interest expense by approximately \$123,000. Based on an average cash balance of \$36,023,000 for the year ended March 31, 2008, a 1% increase or decrease in interest rates would have increased or decreased annual interest income by approximately \$360,000.

***Foreign Currency Risk***

Approximately 4% of the Company's sales in fiscal 2008 were denominated in a foreign currency. The Company considers its risk exposure with regard to foreign currency fluctuations insignificant as it enters into foreign currency forward contracts to hedge the majority of firmly committed transactions and related receivables that are denominated in a foreign currency. The Company has designated its foreign currency forward contracts as fair value hedges. The gains or losses on the fair value hedges are recognized in earnings and generally offset the transaction gains or losses on the foreign denominated assets that they are intended to hedge.

**Item 8. *Financial Statements and Supplementary Data.***

**CSS INDUSTRIES, INC. AND SUBSIDIARIES**

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**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders  
CSS Industries, Inc.:

We have audited the accompanying consolidated balance sheets of CSS Industries, Inc. and subsidiaries as of March 31, 2008 and 2007, and the related consolidated statements of operations and comprehensive income, stockholders' equity and cash flows for each of the years in the three-year period ended March 31, 2008. In connection with our audits of the consolidated financial statements, we also have audited the financial statement schedule. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of CSS Industries, Inc. and subsidiaries as of March 31, 2008 and 2007, and the results of their operations and their cash flows for each of the years in the three-year period ended March 31, 2008, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in notes 1 and 6 to the consolidated financial statements, effective April 1, 2006, CSS Industries, Inc. adopted Statement of Financial Accounting Standards No. 123R, *Share-Based Payment*, applying the modified prospective method. As discussed in notes 1 and 8 to the consolidated financial statements, effective April 1, 2007, CSS Industries, Inc. adopted the provisions of Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of CSS Industries, Inc.'s internal control over financial reporting as of March 31, 2008, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated June 2, 2008 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

June 2, 2008

**CSS INDUSTRIES, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

|   | <b>March 31,</b>  |                   |
|---|---|-------------------|
|   | <b>2008</b>   | <b>2007</b>       |
|   | <b>(In thousands, except share and per share amounts)</b> |                   |
| <b>ASSETS</b>   |   |                   |
| <b>CURRENT ASSETS</b>   |   |                   |
| Cash and cash equivalents   | \$ 28,109   | \$ 100,091        |
| Accounts receivable, net of allowances of \$5,291 and \$4,850           | 39,144  | 37,169            |
| Inventories   | 105,532   | 82,138            |
| Deferred income taxes   | 7,276   | 8,645             |
| Assets held for sale  | 3,590   | 2,564             |
| Other current assets  | 16,242  | 13,665            |
| <b>Total current assets</b>   | <b>199,893</b>  | <b>244,272</b>    |
| <b>PROPERTY, PLANT AND EQUIPMENT</b>                                    |   |                   |
| Land  | 2,619   | 2,739             |
| Buildings, leasehold interests and improvements                         | 47,135  | 55,352            |
| Machinery, equipment and other  | 126,904   | 124,164           |
|   | 176,658   | 182,255           |
| Less Accumulated depreciation   | (126,026)   | (123,358)         |
| <b>Net property, plant and equipment</b>                                | <b>50,632</b>   | <b>58,897</b>     |
| <b>OTHER ASSETS</b>   |   |                   |
| Goodwill  | 48,361  | 30,952            |
| Intangible assets, net of accumulated amortization of \$1,093 and \$619 | 42,454  | 4,328             |
| Other   | 3,701   | 4,621             |
| <b>Total other assets</b>   | <b>94,516</b>   | <b>39,901</b>     |
| <b>Total assets</b>   | <b>\$ 345,041</b>   | <b>\$ 343,070</b> |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>                              |   |                   |
| <b>CURRENT LIABILITIES</b>  |   |                   |
| Note payable  | \$  | \$                |
| Current portion of long-term debt                                       | 10,246  | 10,195            |
| Accounts payable  | 18,275  | 12,212            |
| Accrued income taxes  | 822   | 444               |
| Accrued payroll and other compensation                                  | 11,526  | 10,687            |

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|  |            |            |
|--|------------|------------|
| Accrued customer programs  | 9,438      | 10,290     |
| Accrued other expenses   | 13,586     | 12,135     |
| Total current liabilities  | 63,893     | 55,963     |
| LONG-TERM DEBT, NET OF CURRENT PORTION   | 10,192     | 20,392     |
| OTHER LONG-TERM OBLIGATIONS  | 6,121      | 3,221      |
| DEFERRED INCOME TAXES  | 2,482      | 2,384      |
| COMMITMENTS AND CONTINGENCIES (Notes 10 and 12)  |            |            |
| STOCKHOLDERS EQUITY  |            |            |
| Preferred stock, Class 2, \$.01 par, 1,000,000 shares authorized, no shares issued                         |            |            |
| Common stock, \$.10 par, 25,000,000 shares authorized, 14,703,084 shares issued at March 31, 2008 and 2007 | 1,470      | 1,470      |
| Additional paid-in capital   | 44,150     | 40,680     |
| Retained earnings  | 342,688    | 325,246    |
| Accumulated other comprehensive loss, net of tax   | (90)       | (1)        |
| Common stock in treasury, 4,437,325 and 3,857,571 shares, at cost  | (125,865)  | (106,285)  |
| Total stockholders equity  | 262,353    | 261,110    |
| Total liabilities and stockholders equity  | \$ 345,041 | \$ 343,070 |

See notes to consolidated financial statements.

## CSS INDUSTRIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

|  | <b>For the Years Ended March 31,</b>            |             |             |
|--|---|-------------|-------------|
|  | <b>2008</b>                                     | <b>2007</b> | <b>2006</b> |
|  | <b>(In thousands, except per share amounts)</b> |             |             |
| NET SALES  | \$ 498,253                                      | \$ 530,686  | \$ 525,494  |
| <b>COSTS AND EXPENSES</b>  |   |             |             |
| Cost of sales  | 360,708   | 394,045     | 399,605     |
| Selling, general and administrative expenses                           | 96,703  | 96,125      | 90,211      |
| Restructuring expenses   | 1,717   | 2,327       | 37          |
| Interest expense, net of interest income of \$1,163, \$1,295 and \$474 | 974   | 2,285       | 3,279       |
| Other income, net  | (682)   | (900)       | (354)       |
|  | 459,420   | 493,882     | 492,778     |
| INCOME BEFORE INCOME TAXES   | 38,833  | 36,804      | 32,716      |
| INCOME TAX PROVISION   | 13,475  | 12,915      | 10,875      |
| NET INCOME   | \$ 25,358                                       | \$ 23,889   | \$ 21,841   |
| <b>NET INCOME PER COMMON SHARE</b>                                     |   |             |             |
| Basic  | \$ 2.36   | \$ 2.25     | \$ 2.08     |
| Diluted  | \$ 2.31   | \$ 2.19     | \$ 2.00     |
| <b>COMPREHENSIVE INCOME</b>  |   |             |             |
| Net income   | \$ 25,358                                       | \$ 23,889   | \$ 21,841   |
| Foreign currency translation adjustment                                | 2   | 1           |             |
| Postretirement medical plan, net of tax                                | (91)  |             |             |
| Comprehensive income   | \$ 25,269                                       | \$ 23,890   | \$ 21,841   |

See notes to consolidated financial statements.



## CSS INDUSTRIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

|   | <b>For the Years Ended March 31,</b> |             |             |
|---|--------------------------------------|-------------|-------------|
|   | <b>2008</b>                          | <b>2007</b> | <b>2006</b> |
|   | <b>(In thousands)</b>                |             |             |
| Cash flows from operating activities:   |                                      |             |             |
| Net income  | \$ 25,358                            | \$ 23,889   | \$ 21,841   |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                      |             |             |
| Depreciation and amortization   | 13,218                               | 14,335      | 14,499      |
| Provision for doubtful accounts   | 5                                    | 26          | 399         |
| Asset impairments   | 1,222                                | 422         |             |
| Deferred tax provision (benefit)  | 2,622                                | (3,621)     | (1,512)     |
| (Gain) loss on sale or disposal of assets   | (386)                                | (418)       | 153         |
| Compensation expense related to stock options                                     | 2,830                                | 2,825       | 172         |
| Changes in assets and liabilities, net of effects of acquisition:                 |                                      |             |             |
| Decrease (increase) in accounts receivable  | 9,204                                | (1,613)     | 1,292       |
| (Increase) decrease in inventories  | (10,737)                             | 21,632      | (1,903)     |
| (Increase) decrease in other assets   | (1,274)                              | 4,575       | (4,778)     |
| Decrease in accounts payable  | (196)                                | (2,282)     | (843)       |
| Increase (decrease) in accrued income taxes                                       | 3,493                                | (3,466)     | 2,790       |
| Decrease in accrued expenses and other long-term obligations                      | (3,665)                              | (957)       | (4,510)     |
| Net cash provided by operating activities   | 41,694                               | 55,347      | 27,600      |
| Cash flows from investing activities:   |                                      |             |             |
| Purchase of a business, net of cash received of \$2                               | (71,145)                             |             |             |
| Purchase of property, plant and equipment   | (8,330)                              | (5,289)     | (9,515)     |
| Proceeds from sale of assets  | 3,092                                | 732         | 361         |
| Net cash used for investing activities  | (76,383)                             | (4,557)     | (9,154)     |
| Cash flows from financing activities:   |                                      |             |             |
| Payments on long-term debt obligations  | (10,149)                             | (10,241)    | (10,484)    |
| Borrowings on notes payable   | 186,900                              | 172,360     | 243,845     |
| Payments on notes payable   | (186,900)                            | (172,360)   | (243,845)   |
| Dividends paid  | (5,983)                              | (5,100)     | (5,040)     |
| Purchase of treasury stock  | (25,449)                             | (323)       | (7,167)     |
| Proceeds from exercise of stock options   | 3,936                                | 5,486       | 4,568       |
| Tax benefit realized for stock options exercised                                  | 350                                  | 1,822       |             |
| Net cash used for financing activities  | (37,295)                             | (8,356)     | (18,123)    |
| Effect of exchange rate changes on cash and cash equivalents                      | 2                                    | 1           |             |

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|  |           |            |           |
|--|-----------|------------|-----------|
| Net (decrease) increase in cash and cash equivalents | (71,982)  | 42,435     | 323       |
| Cash and cash equivalents at beginning of period     | 100,091   | 57,656     | 57,333    |
| Cash and cash equivalents at end of period           | \$ 28,109 | \$ 100,091 | \$ 57,656 |

See notes to consolidated financial statements.

## CSS INDUSTRIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

|  | Preferred<br>Stock<br>Shares | Preferred<br>Stock<br>Amount | Additional             |                        | Accumulated<br>Other |                      | Common Stock          |                       | Total        |            |
|--|------------------------------|------------------------------|------------------------|------------------------|----------------------|----------------------|-----------------------|-----------------------|--------------|------------|
|  |                              |                              | Common Stock<br>Shares | Common Stock<br>Amount | Paid-in<br>Capital   | Retained<br>Earnings | Comprehensive<br>Loss | in Treasury<br>Shares |              | Amount     |
| (In thousands, except share and per share amounts)   |                              |                              |                        |                        |                      |                      |                       |                       |              |            |
| BALANCE,<br>APRIL 1, 2005  |                              | \$                           | 14,703,084             | \$ 1,470               | \$ 34,214            | \$ 303,022           | \$ (2)                | (4,321,380)           | \$ (122,215) | \$ 216,489 |
| Tax benefit<br>associated with<br>exercise of<br>stock options<br>compensation<br>expense<br>related to stock<br>options |                              |                              |                        | 1,647                  |                      |                      |                       |                       |              | 1,647      |
| Issuance of<br>common stock<br>upon exercise<br>of stock<br>options  |                              |                              |                        | 172                    |                      |                      |                       |                       |              | 172        |
| Increase in<br>treasury shares   |                              |                              |                        |                        |                      | (5,944)              |                       | 322,896               | 10,512       | 4,568      |
| Cash dividends<br>(\$0.48 per<br>common<br>share)  |                              |                              |                        |                        |                      |                      |                       | (218,100)             | (7,167)      | (7,167)    |
| Net income   |                              |                              |                        |                        |                      | 21,841               |                       |                       |              | 21,841     |
| BALANCE,<br>MARCH 31,<br>2006  |                              |                              | 14,703,084             | 1,470                  | 36,033               | 313,879              | (2)                   | (4,216,584)           | (118,870)    | 232,510    |
| Tax benefit<br>associated with<br>exercise of<br>stock options<br>compensation<br>expense<br>related to stock<br>options |                              |                              |                        |                        | 1,822                |                      |                       |                       |              | 1,822      |
| Issuance of<br>common stock<br>upon exercise   |                              |                              |                        | 2,825                  |                      | (7,422)              |                       | 368,813               | 12,908       | 5,486      |

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|                  |               |          |           |            |         |             |              |       |            |
|------------------|---------------|----------|-----------|------------|---------|-------------|--------------|-------|------------|
| of stock         |               |          |           |            |         |             |              |       |            |
| ptions           |               |          |           |            |         |             |              |       |            |
| increase in      |               |          |           |            |         |             |              |       |            |
| treasury shares  |               |          |           |            |         | (9,800)     | (323)        | (323) |            |
| foreign          |               |          |           |            |         |             |              |       |            |
| currency         |               |          |           |            |         |             |              |       |            |
| translation      |               |          |           |            |         |             |              |       |            |
| adjustment       |               |          |           |            | 1       |             |              |       | 1          |
| cash dividends   |               |          |           |            |         |             |              |       |            |
| \$.48 per        |               |          |           |            |         |             |              |       |            |
| common           |               |          |           |            |         |             |              |       |            |
| share)           |               |          |           | (5,100)    |         |             |              |       | (5,100)    |
| net income       |               |          |           | 23,889     |         |             |              |       | 23,889     |
|                  |               |          |           |            |         |             |              |       |            |
| BALANCE,         |               |          |           |            |         |             |              |       |            |
| MARCH 31,        |               |          |           |            |         |             |              |       |            |
| 2007             | 14,703,084    | 1,470    | 40,680    | 325,246    | (1)     | (3,857,571) | (106,285)    |       | 261,110    |
| tax benefit      |               |          |           |            |         |             |              |       |            |
| associated with  |               |          |           |            |         |             |              |       |            |
| exercise of      |               |          |           |            |         |             |              |       |            |
| stock options    |               |          | 640       |            |         |             |              |       | 640        |
| compensation     |               |          |           |            |         |             |              |       |            |
| expense          |               |          |           |            |         |             |              |       |            |
| related to stock |               |          |           |            |         |             |              |       |            |
| ptions           |               |          | 2,830     |            |         |             |              |       | 2,830      |
| issuance of      |               |          |           |            |         |             |              |       |            |
| common stock     |               |          |           |            |         |             |              |       |            |
| upon exercise    |               |          |           |            |         |             |              |       |            |
| of stock         |               |          |           |            |         |             |              |       |            |
| ptions           |               |          |           | (1,933)    |         | 167,670     | 5,869        |       | 3,936      |
| increase in      |               |          |           |            |         |             |              |       |            |
| treasury shares  |               |          |           |            |         | (747,424)   | (25,449)     |       | (25,449)   |
| foreign          |               |          |           |            |         |             |              |       |            |
| currency         |               |          |           |            |         |             |              |       |            |
| translation      |               |          |           |            |         |             |              |       |            |
| adjustment       |               |          |           |            | 2       |             |              |       | 2          |
| cash dividends   |               |          |           |            |         |             |              |       |            |
| \$.56 per        |               |          |           |            |         |             |              |       |            |
| common           |               |          |           |            |         |             |              |       |            |
| share)           |               |          |           | (5,983)    |         |             |              |       | (5,983)    |
| postretirement   |               |          |           |            |         |             |              |       |            |
| medical plan,    |               |          |           |            |         |             |              |       |            |
| net of tax       |               |          |           |            | (91)    |             |              |       | (91)       |
| net income       |               |          |           | 25,358     |         |             |              |       | 25,358     |
|                  |               |          |           |            |         |             |              |       |            |
| BALANCE,         |               |          |           |            |         |             |              |       |            |
| MARCH 31,        |               |          |           |            |         |             |              |       |            |
| 2008             | \$ 14,703,084 | \$ 1,470 | \$ 44,150 | \$ 342,688 | \$ (90) | (4,437,325) | \$ (125,865) |       | \$ 262,353 |

See notes to consolidated financial statements.



**CSS INDUSTRIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 31, 2008**

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

***Principles of Consolidation***

The consolidated financial statements include the accounts of CSS Industries, Inc. ( CSS or the Company ) and all of its subsidiaries. All significant intercompany transactions and accounts have been eliminated in consolidation.

***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.

***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. CSS' product breadth provides its retail customers the opportunity to use a single vendor for much of their seasonal product requirements. A substantial portion of CSS' products are manufactured, packaged and/or warehoused in eleven facilities located in the United States, with the remainder purchased primarily from manufacturers in Asia and Mexico. The Company's products are sold to its customers by national and regional account sales managers, sales representatives, product specialists and by a network of independent manufacturers' representatives.

The Company's operating subsidiaries include Paper Magic Group, Inc. ( Paper Magic ), BOC Design Group (consisting of Berwick Offray LLC ( Berwick Offray ) and Cleo Inc ( Cleo )) and C.R. Gibson, LLC ( C.R. Gibson ). The C.R. Gibson business was acquired on December 3, 2007. In fiscal 2007, the Company combined the operations of its Cleo and Berwick Offray subsidiaries in order to improve profitability and efficiency through the elimination of redundant back office functions and certain management positions. Approximately 725 of its 2,200 employees (increasing to approximately 3,300 as seasonal employees are added) are represented by labor unions. The collective bargaining agreement with the labor union representing the production and maintenance employees in Memphis, Tennessee remains in effect until December 31, 2010. The collective bargaining agreement with the labor union representing the production and maintenance employees in Hagerstown, Maryland remains in effect until December 31, 2009.

***Reclassification***

The Company has reclassified \$2,129,000 from accrued payroll and other compensation to accrued other expenses at March 31, 2007 in the accompanying consolidated balance sheet to conform with the current year presentation.

***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

**CSS INDUSTRIES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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.

***Accounts Receivable***

The Company offers seasonal dating programs related to certain seasonal product offerings pursuant to which customers that qualify for such programs are offered extended payment terms. With some exceptions, customers do not have the right to return product except for reasons the Company believes are typical of our industry, including damaged goods, shipping errors or similar occurrences. The Company generally is not required to repurchase products from its customers, nor does the Company have any regular practice of doing so. In addition, the Company mitigates its exposure to bad debts by evaluating the creditworthiness of its major customers utilizing established credit limits and purchasing credit insurance when appropriate and available. Bad debt and returns and allowances reserves are recorded as an offset to accounts receivable while reserves for customer programs are recorded as accrued liabilities. The Company evaluates accounts receivable related reserves and accruals monthly by specifically reviewing customer's creditworthiness, historical recovery percentages and outstanding customer deductions and program arrangements.

***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 unsalable 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, which was \$838,000 and \$955,000 at March 31, 2008 and 2007, respectively. Had all inventories been valued at the lower of FIFO cost or market, inventories would have been greater by \$761,000 and \$818,000 at March 31, 2008 and 2007, respectively. Inventories consisted of the following (in thousands):

|                 | <b>March 31,</b>  |                  |
|-----------------|-------------------|------------------|
|                 | <b>2008</b>       | <b>2007</b>      |
| Raw material    | \$ 22,836         | \$ 14,442        |
| Work-in-process | 29,827            | 31,283           |
| Finished goods  | 52,869            | 36,413           |
|                 | <b>\$ 105,532</b> | <b>\$ 82,138</b> |

***Assets Held for Sale***

Assets held for sale in the amount of \$3,590,000 at March 31, 2008 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. Assets held for sale in the amount of



\$2,564,000 at March 31, 2007 represented two former manufacturing facilities which were both sold in the fourth quarter of fiscal 2008 resulting in a pre-tax gain of approximately \$342,000 which is classified in other income, net. The Company ceased depreciating all of these facilities at the time they were classified as held for sale.

**CSS INDUSTRIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Property, Plant and Equipment***

Property, plant and equipment are stated at cost. Depreciation is provided generally on the straight-line method and is based on estimated useful lives or terms of leases as follows:

|   |                        |
|---|------------------------|
| Buildings, leasehold interests and improvements | Lease term to 45 years |
| Machinery, equipment and other                  | 3 to 15 years          |

When property is retired or otherwise disposed of, the related cost and accumulated depreciation and amortization are eliminated from the consolidated balance sheet. Any gain or loss from the disposition of property, plant and equipment is included in other income, net. Maintenance and repairs are expensed as incurred while improvements are capitalized and depreciated over their estimated useful lives. Depreciation expense was \$12,604,000, \$14,101,000 and \$14,264,000 for the years ended March 31, 2008, 2007 and 2006, respectively.

***Impairment of Long-Lived Assets***

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. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets to future net cash flows estimated by the Company to be generated by such assets. 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. Assets to be disposed of are recorded at the lower of their carrying value or estimated net realizable value.

***Goodwill and Intangible Assets***

When a company is acquired, the difference between the fair value of its net assets, including intangibles, and the purchase price is recorded as goodwill. In the fourth quarter of fiscal 2008, 2007 and 2006, the Company performed the required annual impairment test of the carrying amount of goodwill and indefinite lived assets and determined that no impairment existed. Other intangible assets with definite useful lives are required to continue to be amortized over their respective estimated useful lives.

At March 31, 2008, in addition to goodwill, the Company had \$23,790,000 of other intangible assets relating to tradenames that are not subject to amortization, \$18,480,000 relating to customer lists, which is net of accumulated amortization of \$420,000, and being amortized over 15 years and \$184,000 of other intangible assets, which is net of accumulated amortization of \$673,000, relating primarily to a covenant not to compete, that is being amortized over four years (see Note 3).

***Derivative Financial Instruments***

The Company uses certain derivative financial instruments as part of its risk management strategy to reduce foreign currency risk. Derivatives are not used for trading or speculative activities.

The Company recognizes all derivatives on the consolidated balance sheet at fair value. On the date the derivative instrument is entered into, the Company generally designates the derivative as either (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ( fair value hedge ), or (2) a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability ( cash flow hedge ). Changes in the fair value of a derivative that is designated as, and meets all the required criteria for, a fair value hedge, along with the gain or loss on the hedged asset or liability that is attributable to the hedged risk, are recorded in current period earnings. Changes in the fair value of a derivative that is designated as, and meets all the required criteria for, a cash flow hedge are recorded in accumulated other comprehensive loss and reclassified into earnings as the underlying hedged item affects earnings. The portion of the change in fair value of a derivative associated with hedge ineffectiveness or the component of a derivative instrument excluded from the assessment of hedge effectiveness is recorded currently in earnings. Also, changes in the entire fair value of a

**CSS INDUSTRIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

derivative that is not designated as a hedge are recorded immediately in earnings. The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. This process includes relating all derivatives that are designated as fair value or cash flow hedges to specific assets and liabilities on the consolidated balance sheet or to specific firm commitments or forecasted transactions.

The Company also formally assesses, both at the inception of the hedge and on an ongoing basis, whether each derivative is highly effective in offsetting changes in fair values or cash flows of the hedged item. If it is determined that a derivative is not highly effective as a hedge or if a derivative ceases to be a highly effective hedge, the Company will discontinue hedge accounting prospectively.

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. There were no open forward exchange contracts as of March 31, 2008. The notional amount of open forward exchange contracts as of March 31, 2007 was \$294,000 and the related gain was not material.

***Income Taxes***

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences and carryforwards are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Effective April 1, 2007, the Company adopted the provisions of FASB Interpretation No. ( FIN ) 48, Accounting for Uncertainty in Income Taxes, which clarifies the accounting for uncertain tax positions. FIN 48 requires that the Company recognize in its consolidated financial statements the impact of a tax position if that position is more likely than not of being sustained on the technical merits of the position. See Note 8 to consolidated financial statements for further discussion.

***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.

***Product Development Costs***

Product development costs consist of purchases of outside artwork, printing plates, cylinders, catalogs and samples. The Company typically begins to incur product development costs approximately 18 to 20 months before the applicable holiday event and amortizes the costs monthly over the selling season, which is generally within two to

four months of the holiday event. The expense of certain product development costs that are related to the manufacturing process are recorded in cost of sales while the portion that relates to creative and selling efforts are recorded in selling, general and administrative expenses.

Product development costs capitalized as of March 31, 2008 and 2007 were \$6,316,000 and \$5,647,000, respectively, and are included in other current assets in the consolidated financial statements. Product development expense of \$9,194,000, \$7,887,000 and \$7,384,000 was recognized in the years ended March 31, 2008, 2007 and 2006, respectively.

## CSS INDUSTRIES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

*Shipping and Handling Costs*

Shipping and handling costs are reported in cost of sales in the consolidated statements of operations.

*Stock-Based Compensation*

Effective April 1, 2006, the Company adopted Statement of Financial Accounting Standards ( SFAS ) No. 123R, Share-Based Payment, using the modified prospective transition method, and began accounting for its share-based compensation using a fair-value based recognition method. Under the provisions of SFAS No. 123R, share-based compensation cost is estimated at the grant date based on a fair-value model. Calculating the fair value of share-based awards at the grant date requires considerable judgment, including estimating stock price volatility and expected option life.

The Company uses the Black-Scholes option valuation model to value employee stock awards. The Company estimates stock price volatility based on historical volatility of its common stock. Estimated option life assumptions are also derived from historical data. The Company recognizes compensation expense using the straight-line amortization method for share-based compensation awards with graded vesting. Had the Company used alternative valuation methodologies and assumptions, compensation cost for share-based payments could be significantly different.

*Net Income Per Common Share*

The following table sets forth the computation of basic net income per common share and diluted net income per common share for the years ended March 31, 2008, 2007 and 2006.

|  | <b>For the Years Ended March 31,</b>            |             |             |
|--|---|-------------|-------------|
|  | <b>2008</b>                                     | <b>2007</b> | <b>2006</b> |
|  | <b>(In thousands, except per share amounts)</b> |             |             |
| Numerator:   |   |             |             |
| Net income   | \$ 25,358                                       | \$ 23,889   | \$ 21,841   |
| Denominator:   |   |             |             |
| Weighted average shares outstanding for basic income per common share            | 10,732  | 10,622      | 10,482      |
| Effect of dilutive stock options   | 261   | 297         | 453         |
| Adjusted weighted average shares outstanding for diluted income per common share | 10,993  | 10,919      | 10,935      |
| Basic net income per common share  | \$ 2.36   | \$ 2.25     | \$ 2.08     |
| Diluted net income per common share  | \$ 2.31   | \$ 2.19     | \$ 2.00     |

Options on 232,000 shares, 58,000 shares and 643,000 shares of common stock were not included in computing diluted net income per common share for the years ended March 31, 2008, 2007 and 2006, respectively, because their effects were antidilutive.

***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.

**CSS INDUSTRIES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Supplemental Schedule of Cash Flow Information**

|   | <b>For the Years Ended March 31,</b> |             |             |
|---|--------------------------------------|-------------|-------------|
|   | <b>2008</b>                          | <b>2007</b> | <b>2006</b> |
|   | <b>(In thousands)</b>                |             |             |
| Cash paid during the year for:                  |                                      |             |             |
| Interest  | \$ 2,413                             | \$ 3,780    | \$ 3,971    |
| Income taxes                                    | \$ 8,445                             | \$ 17,874   | \$ 9,579    |
| Details of acquisitions:                        |                                      |             |             |
| Fair value of assets acquired                   | \$ 82,442                            | \$          | \$          |
| Liabilities assumed                             | 8,595                                |             |             |
| Net assets acquired                             | 73,847                               |             |             |
| Amount due seller for purchase price adjustment | 2,700                                |             |             |
| Cash paid                                       | 71,147                               |             |             |
| Less cash acquired                              | 2                                    |             |             |
| Net cash paid for acquisitions                  | \$ 71,145                            | \$          | \$          |

**(2) BUSINESS ACQUISITION**

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. Subsequent to March 31, 2008, \$2,700,000 of the purchase price was paid as settlement of the closing net asset value adjustment 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. At March 31, 2008, a portion of the purchase price is being held in escrow for certain indemnification obligations including, but not limited to, the post closing net asset value adjustment which was settled subsequent to year end. The acquisition was accounted for as a purchase and the preliminary estimated 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 consolidated balance sheet. For tax purposes, goodwill resulting from this acquisition is deductible.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition (in thousands):



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|                               |           |
|-------------------------------|-----------|
| Current assets                | \$ 25,470 |
| Property, plant and equipment | 963       |
| Intangible assets             | 38,600    |
| Goodwill                      | 17,409    |
| Total assets acquired         | 82,442    |
| Current liabilities           | 8,595     |
| Total liabilities assumed     | 8,595     |
| Net assets acquired           | \$ 73,847 |

**CSS INDUSTRIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The unaudited consolidated results of operations of the Company including C.R. Gibson on a pro forma basis, as though the transaction had been consummated at the beginning of the respective periods, were as follows (in thousands, except per share data):

|                          | <b>Years Ended March 31,</b> |             |
|--------------------------|------------------------------|-------------|
|                          | <b>2008</b>                  | <b>2007</b> |
| Net sales                | \$ 536,192                   | \$ 582,494  |
| Net income               | 24,537                       | 23,883      |
| Income per common share: |                              |             |
| Basic                    | \$ 2.29                      | \$ 2.25     |
| Diluted                  | \$ 2.23                      | \$ 2.19     |

Pro forma adjustments included in the above reflect the effect of purchase accounting adjustments on interest, depreciation, amortization and tax expense. Included in the above pro forma results are approximately \$2,100,000 and \$3,150,000 for the year ended March 31, 2008 and 2007, respectively, of charges from C.R. Gibson's previous parent company that the Company does not expect to incur in the future.

**(3) GOODWILL AND OTHER INTANGIBLE ASSETS**

Goodwill and other indefinite lived intangible assets are subject to fair-value based impairment tests performed, at a minimum, on an annual basis. The Company performs its annual assessment of impairment in the fourth fiscal quarter. These impairment tests are conducted on each reporting unit of the Company, and may require two steps. For goodwill, the initial step is designed to identify potential impairment by comparing an estimate of the fair value for each applicable reporting unit to its respective carrying value. For those reporting units where the carrying value exceeds its fair value, a second step is performed to measure the amount of goodwill impairment, if any. With respect to indefinite lived intangible assets, the impairment test is performed by comparing the fair value of the intangible to its carrying value. In the fourth quarter of fiscal 2008, 2007 and 2006, the Company performed the required annual impairment test of the carrying amount of goodwill and indefinite lived intangible assets and determined that no impairment existed.

The change in the carrying amount of goodwill for the year ended March 31, 2008 is as follows (in thousands):

|                              |           |
|------------------------------|-----------|
| Balance as of March 31, 2007 | \$ 30,952 |
| Acquisition of C.R. Gibson   | 17,409    |
| Balance as of March 31, 2008 | \$ 48,361 |

With the acquisition of the C.R. Gibson business, the Company recorded intangible assets relating to tradenames that are not subject to amortization in the amount of \$19,500,000. Additionally, the Company recorded \$18,900,000 relating to customer lists which are being amortized over 15 years and \$200,000 relating to a covenant not to compete

that is being amortized over four years.

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

|                             | <b>March 31,</b> |                 |
|-----------------------------|------------------|-----------------|
|                             | <b>2008</b>      | <b>2007</b>     |
| Tradenames                  | \$ 23,790        | \$ 4,290        |
| Customer relationships, net | 18,480           |                 |
| Non-compete, net            | 184              | 38              |
|                             | <b>\$ 42,454</b> | <b>\$ 4,328</b> |

**CSS INDUSTRIES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Accumulated amortization at March 31, 2008 and 2007 was \$1,093,000 and \$619,000, respectively, and amortization expense was \$474,000 for fiscal 2008, \$94,000 for fiscal 2007 and \$94,000 for fiscal 2006. The estimated amortization expense for the next five fiscal years is as follows (in thousands):

|             |          |
|-------------|----------|
| Fiscal 2009 | \$ 1,310 |
| Fiscal 2010 | 1,310    |
| Fiscal 2011 | 1,310    |
| Fiscal 2012 | 1,293    |
| Fiscal 2013 | 1,260    |
|             | \$ 6,483 |

**(4) BUSINESS RESTRUCTURING**

On November 27, 2006, the Board of Directors of the Company approved a restructuring plan to combine the operations of its Cleo Inc ( Cleo ) and Berwick Offray LLC ( Berwick Offray ) subsidiaries, to close Cleo's Maysville, Kentucky production facility and to exit a non-material, non-core business. This restructuring was undertaken in order to improve profitability and efficiency through the elimination of 1) redundant back office functions, 2) certain senior management positions and 3) excess manufacturing capacity, and was substantially completed by December 31, 2007. As part of the restructuring plan, the Company recorded a restructuring reserve of \$1,323,000, including severance related to 29 employees. Also, in connection with the restructuring plan, the Company recorded an impairment of property, plant and equipment at the affected facilities of \$422,000. During fiscal 2007, there was an increase in the restructuring reserve in the amount of \$582,000 primarily related to the ratable recognition of retention bonuses for employees providing service until their termination date. During fiscal 2008, there was a reduction in the restructuring accrual of \$133,000 primarily for costs related to severance that were less than originally estimated. During the year ended March 31, 2008, the Company made payments of \$1,323,000, primarily related to severance. The Company expects to incur additional charges related to other restructuring costs of approximately \$60,000 during fiscal 2009.

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

|  | <b>Termination<br/>Costs</b> | <b>Other<br/>Costs</b> | <b>Total</b> |
|--|------------------------------|------------------------|--------------|
| Initial accrual                            | \$ 1,200                     | \$ 123                 | \$ 1,323     |
| Additional charges fiscal 2007             | 457                          | 125                    | 582          |
| Cash paid fiscal 2007                      | (304)                        | (145)                  | (449)        |
| Restructuring reserve as of March 31, 2007 | 1,353                        | 103                    | 1,456        |
| Cash paid fiscal 2008                      | (1,168)                      | (155)                  | (1,323)      |
| Non cash adjustments fiscal 2008           | (185)                        | 52                     | (133)        |



**CSS INDUSTRIES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

balance sheet and will be paid in fiscal 2009. The Company expects to incur additional period expenses related to this restructuring program of approximately \$1,750,000 during fiscal 2009 and fiscal 2010.

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

|  | <b>Termination<br/>Costs</b> | <b>Other<br/>Costs</b> | <b>Total</b> |
|--|------------------------------|------------------------|--------------|
| Initial accrual                            | \$ 355                       | \$ 273                 | \$ 628       |
| Cash paid - fiscal 2008                    | (46)                         | (263)                  | (309)        |
| Restructuring reserve as of March 31, 2008 | \$ 309                       | \$ 10                  | \$ 319       |

**(5) TREASURY STOCK TRANSACTIONS**

Under a stock repurchase program that had been previously authorized by the Company's Board of Directors, the Company repurchased 747,424 shares of the Company's common stock for \$25,449,000 in fiscal 2008, 9,800 shares of the Company's common stock for \$323,000 in fiscal 2007 and 218,100 shares for \$7,167,000 in fiscal 2006. As of March 31, 2008, the Company had no shares remaining available for repurchase under the Board's authorization.

**(6) STOCK OPTION PLANS**

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 March 31, 2008 become exercisable at the rate of 25% per year commencing one year after the date of grant. At March 31, 2008, 1,168,350 shares were available for grant under the 2004 Plan.

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 the 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 commencing one year after the date of grant, options begin vesting and are exercisable at the rate of 25% per year. At March 31, 2008, 156,000 shares were available for grant under the 2006 Plan.

Prior to April 1, 2006, the Company accounted for its equity incentive plans under the recognition and measurement provisions of Accounting Principles Board ( APB ) Opinion No. 25, Accounting for Stock Issued to Employees, and

related Interpretations, as permitted by SFAS No. 123, Accounting for Stock-Based Compensation. Effective April 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123R, Share-Based Payment, using the modified prospective transition method. Under that transition method, stock compensation cost recognized in fiscal 2008 and fiscal 2007 includes: (a) compensation cost for all share-based payments granted prior to, but not vested as of April 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, (b) compensation cost for all share-based payments granted subsequent to April 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123R, and (c) compensation cost for all share-based payments modified, repurchased, or cancelled subsequent to April 1, 2006. Compensation cost is recognized on a straight-line basis over the vesting period during which employees perform related services. In accordance with the modified prospective transition method, the consolidated financial statements for fiscal 2006 have not been restated to reflect the impact of SFAS No. 123R.

**CSS INDUSTRIES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company issues treasury shares for stock option exercises. Prior to the adoption of SFAS No. 123R, the Company presented all tax benefits of deductions resulting from share-based payment arrangements as operating cash flows in the consolidated statements of cash flows. SFAS No. 123R requires that the cash flows resulting from the tax benefits from tax deductions in excess of the compensation cost recognized for those share awards (referred to as excess tax benefits) be classified as financing cash flows.

Compensation cost related to stock options recognized in operating results (included in selling, general and administrative expenses) was \$2,830,000 and \$2,825,000 in the year ended March 31, 2008 and 2007, respectively, and the associated future income tax benefit recognized was \$775,000 and \$666,000 in the years ended March 31, 2008 and 2007, respectively.

The following table illustrates the effect on net income and net income per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to options granted under the Company's stock option plans for the year ended March 31, 2006:

|   | <b>(In thousands, except<br/>per share data)</b> |         |
|---|--|---------|
| Net income, as reported   | \$   | 21,841  |
| Add: Total stock-based employee compensation expense included in the determination of net income, net of related tax effects                |  | 111     |
| Deduct: Total stock-based employee compensation expense determined under fair-value based method for all awards, net of related tax effects |  | (2,429) |
| Pro forma net income  | \$   | 19,523  |
| Net income per share:   |  |         |
| Basic as reported   | \$   | 2.08    |
| Basic pro forma   | \$   | 1.86    |
| Diluted as reported   | \$   | 2.00    |
| Diluted pro forma   | \$   | 1.82    |

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 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:

| <b>For the Years Ended<br/>March 31,</b> |             |             |
|--|-------------|-------------|
| <b>2008</b>                              | <b>2007</b> | <b>2006</b> |



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|  |       |       |       |
|--|-------|-------|-------|
| Expected dividend yield at time of grant | 1.64% | 1.60% | 1.44% |
| Expected stock price volatility          | 30%   | 25%   | 35%   |
| Risk-free interest rate                  | 4.20% | 4.91% | 4.10% |
| Expected life of option (in years)       | 4.3   | 4.7   | 4.9   |

## CSS INDUSTRIES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Transactions from April 1, 2005 through March 31, 2008 under the above plans (and their predecessor plans) were as follows:

|  | <b>Number<br/>of Shares</b> | <b>Option Price<br/>per Share<br/>(In thousands)</b> |       | <b>Weighted<br/>Average<br/>Price</b> | <b>Weighted<br/>Average<br/>Life<br/>Remaining</b> | <b>Aggregate<br/>Intrinsic<br/>Value</b> |
|--|-----------------------------|--|-------|---------------------------------------|--|--|
| Options outstanding at April 1, 2005     | 1,847,016                   | \$ 12.71   | 35.00 | \$ 21.35                              | 5.5 years  |  |
| Granted                                  | 362,100                     | 29.66  | 36.60 | 33.52                                 |  |  |
| Exercised                                | (394,733)                   | 12.71  | 34.12 | 17.85                                 |  |  |
| Forfeited/canceled                       | (76,777)                    | 16.70  | 34.12 | 29.06                                 |  |  |
| Options outstanding at March 31,<br>2006 | 1,737,606                   | 12.71  | 36.60 | 24.35                                 | 4.7 years  |  |
| Granted                                  | 399,100                     | 27.60  | 36.10 | 30.15                                 |  |  |
| Exercised                                | (451,600)                   | 12.71  | 35.00 | 17.84                                 |  |  |
| Forfeited/canceled                       | (176,996)                   | 16.70  | 35.00 | 32.00                                 |  |  |
| Options outstanding at March 31,<br>2007 | 1,508,110                   | 12.71  | 36.60 | 26.94                                 | 3.9 years  |  |
| Granted                                  | 234,000                     | 29.69  | 39.58 | 34.41                                 |  |  |
| Exercised                                | (175,245)                   | 13.21  | 35.98 | 24.17                                 |  |  |
| Forfeited/canceled                       | (43,775)                    | 18.50  | 34.12 | 29.14                                 |  |  |
| Options outstanding at March 31,<br>2008 | 1,523,090                   | \$ 12.71   | 39.58 | \$ 28.34                              | 3.2 years  | \$ 9,628                                 |
| Options exercisable at March 31, 2008    | 837,090                     | \$ 12.71   | 36.60 | \$ 24.92                              | 3.0 years  | \$ 8,009                                 |

The weighted average fair value of options granted during fiscal 2008, 2007 and 2006 was \$9.30, \$7.87 and \$9.78 per share, respectively.

The total intrinsic value of options exercised during the years ended March 31, 2008, 2007 and 2006 was \$2,512,000, \$6,639,000 and \$6,051,000, respectively. As of March 31, 2008, there was \$4,665,000 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 1.2 years.

**(7) RETIREMENT BENEFIT PLANS**

***Profit Sharing Plans***

The Company and its subsidiaries maintain defined contribution profit sharing and 401(k) plans covering substantially all of their employees as of March 31, 2008. Annual contributions under the plans are determined by the Board of Directors of the Company or each subsidiary, as appropriate. Consolidated expense related to the plans for the years ended March 31, 2008, 2007 and 2006 was \$2,884,000, \$2,710,000 and \$2,112,000, respectively.

***Pension Plan***

The Company's Cleo subsidiary administered a defined benefit pension plan covering substantially all salaried employees of Crystal Creative Products, Inc. ( Crystal ) at the time of Cleo's acquisition of Crystal in October 2002. The plan was frozen on November 2, 2002 and terminated September 30, 2003. After the plan was frozen, benefits were provided to eligible employees by allowing them to participate in an existing defined contribution profit sharing and 401(k) plan. In the first quarter of fiscal 2006, the Company received the Internal Revenue Service approval letter regarding termination of the plan. As of March 31, 2006, the Company made all payments and purchased annuities in accordance with the provisions of the plan. During fiscal 2006, the Company recorded a charge of \$72,000 related to the incremental cost of annuities that were purchased in fiscal 2006. During the first quarter of fiscal 2007, the Company transferred the surplus in the defined benefit plan of \$3,156,000 to a separate investment account which will be used to fund future contributions to the existing defined contribution profit

**CSS INDUSTRIES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

sharing and 401(k) plan. As of March 31, 2008, the remaining \$1,498,000 of the surplus was classified in other current assets in the accompanying consolidated balance sheet.

***Postretirement Medical Plan***

The Company's Cleo subsidiary administers a postretirement medical plan covering certain persons who were employees or former employees of Crystal at the time of Cleo's acquisition of Crystal in October 2002. The plan is unfunded and was frozen to new participants prior to Crystal's acquisition by the Company.

The following table provides a reconciliation of the benefit obligation for the postretirement medical plan (in thousands):

|   | <b>2008</b> | <b>2007</b> |
|---|-------------|-------------|
| Benefit obligation at beginning of year                         | \$ 825      | \$ 938      |
| Interest cost   | 48          | 55          |
| Actuarial loss (gain) and other adjustments                     | 212         | (119)       |
| Benefits paid   | (48)        | (49)        |
| Benefit obligation recognized in the consolidated balance sheet | \$ 1,037    | \$ 825      |

The net loss recognized in other comprehensive income at March 31, 2008 was \$91,000, net of tax, and the actuarial loss expected to be amortized from accumulated other comprehensive income into net periodic benefit cost during fiscal 2009 is approximately \$3,000.

The assumptions used to develop the net periodic benefit cost and benefit obligation for the postretirement medical plan as of and for the years ended March 31, 2008, 2007 and 2006 were a discount rate of 6% and assumed health care cost trend rates of 15% (16% for 2007 and 17% for 2006) trending down to an ultimate rate of 5% in 2018.

Net periodic pension and postretirement medical costs were \$48,000, \$55,000 and \$121,000 for the years ended March 31, 2008, 2007 and 2006, respectively.

**(8) INCOME TAXES**

Income from operations before income tax expense was as follows (in thousands):

|               | <b>For the Years Ended March 31,</b> |             |             |
|---------------|--------------------------------------|-------------|-------------|
|               | <b>2008</b>                          | <b>2007</b> | <b>2006</b> |
| United States | \$ 22,281                            | \$ 20,957   | \$ 22,684   |
| Foreign       | 16,552                               | 15,847      | 10,032      |

\$ 38,833    \$ 36,804    \$ 32,716

**CSS INDUSTRIES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table summarizes the provision for U.S. federal, state and foreign taxes on income (in thousands):

|           | <b>For the Years Ended March 31,</b> |             |             |
|-----------|--------------------------------------|-------------|-------------|
|           | <b>2008</b>                          | <b>2007</b> | <b>2006</b> |
| Current:  |                                      |             |             |
| Federal   | \$ 8,147                             | \$ 12,679   | \$ 9,967    |
| State     | (311)                                | 899         | 659         |
| Foreign   | 3,017                                | 2,958       | 1,761       |
|           | 10,853                               | 16,536      | 12,387      |
| Deferred: |                                      |             |             |
| Federal   | 2,344                                | (3,172)     | (1,738)     |
| State     | 278                                  | (449)       | 226         |
|           | 2,622                                | (3,621)     | (1,512)     |
|           | \$ 13,475                            | \$ 12,915   | \$ 10,875   |

The differences between the statutory and effective federal income tax rates on income before income taxes were as follows:

|   | <b>For the Years Ended</b> |             |             |
|---|----------------------------|-------------|-------------|
|   | <b>March 31,</b>           |             |             |
|   | <b>2008</b>                | <b>2007</b> | <b>2006</b> |
| U.S. federal statutory rate                     | 35.0%                      | 35.0%       | 35.0%       |
| State income taxes, less federal benefit        | .8                         | 1.7         | 2.0         |
| Tax exempt interest                             | (.7)                       |             |             |
| Changes in tax reserves and valuation allowance | .1                         | (1.6)       | (1.3)       |
| Foreign dividend repatriation                   |                            |             | (1.3)       |
| Other, net                                      | (.5)                       |             | (1.2)       |
|   | 34.7%                      | 35.1%       | 33.2%       |

The Company receives distributions from its foreign operations and, therefore, does not assume that the income from operations of its foreign subsidiaries will be permanently reinvested.

Income tax benefits related to the exercise of stock options reduced current taxes payable and increased additional paid-in capital by \$640,000 in fiscal 2008, \$1,822,000 in fiscal 2007 and \$1,647,000 in fiscal 2006.

## CSS INDUSTRIES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Deferred taxes are recorded based upon differences between the financial statement and tax bases of assets and liabilities and available net operating loss and credit carryforwards. The following temporary differences gave rise to net deferred income tax assets (liabilities) as of March 31, 2008 and 2007 (in thousands):

|   | March 31, |          |
|---|-----------|----------|
|   | 2008      | 2007     |
| Deferred income tax assets:                       |           |          |
| Accounts receivable                               | \$ 324    | \$ 259   |
| Inventories                                       | 3,886     | 4,138    |
| Accrued expenses                                  | 5,265     | 5,750    |
| State net operating loss and credit carryforwards | 11,522    | 11,672   |
| Stock based compensation                          | 1,433     | 666      |
|   | 22,430    | 22,485   |
| Valuation allowance                               | (11,389)  | (11,543) |
|   | 11,041    | 10,942   |
| Deferred income tax liabilities:                  |           |          |
| Property, plant and equipment                     | 1,221     | 2,039    |
| Intangibles                                       | 1,607     | 473      |
| Unremitted earnings of foreign subsidiaries       | 2,205     | 221      |
| Other   | 1,214     | 1,948    |
|   | 6,247     | 4,681    |
| Net deferred income tax asset                     | \$ 4,794  | \$ 6,261 |

At March 31, 2008 and 2007, the Company had potential state income tax benefits of \$11,522,000 and \$11,672,000, respectively, from net operating loss and credit carryforwards that expire in various years through 2028. At March 31, 2008 and 2007, the Company provided valuation allowances of \$11,389,000 and \$11,543,000, respectively. The valuation allowance reflects management's assessment of the portion of the deferred tax asset that more likely than not will not be realized through future taxable earnings or implementation of tax planning strategies.

Due to developments during fiscal 2007, the Company decreased its state income tax reserves by \$305,000 and its state and foreign valuation allowances by \$290,000.

Effective April 1, 2007, the Company adopted the provisions of FASB Interpretation No. (FIN) 48, Accounting for Uncertainty in Income Taxes, which clarifies the accounting for uncertainty in income taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation requires that the Company recognize in the



financial statements the impact of a tax position, if that position is more likely than not of being sustained on audit, based solely on the technical merits of the position. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods and disclosure. The

**CSS INDUSTRIES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

implementation of FIN 48 did not result in an adjustment to the Company's April 1, 2007 balance of retained earnings. A reconciliation of the beginning and ending amount of gross unrecognized tax benefits is as follows (in thousands):

|  |          |
|--|----------|
| Gross unrecognized tax benefits upon adoption at April 1, 2007             | \$ 2,169 |
| Additions based on tax positions related to the current year               | 84       |
| Additions for tax positions of prior years                                 | 196      |
| Reductions for tax positions of prior years                                | (403)    |
| Reductions relating to settlements with taxing authorities                 | (23)     |
| Reductions as a result of a lapse of the applicable statute of limitations | (36)     |
| Gross unrecognized tax benefits at March 31, 2008                          | \$ 1,987 |

The total amount of gross unrecognized tax benefits at March 31, 2008 of \$1,987,000 was classified in other long-term obligations in the accompanying consolidated balance sheet and the amount that would favorably affect the effective tax rate in future periods, if recognized, is \$1,363,000.

Consistent with the Company's historical financial reporting, the Company recognizes potential accrued interest and/or penalties related to unrecognized tax benefits in income tax expense in the consolidated statements of operations. Approximately \$838,000 of interest and penalties are accrued at March 31, 2008, \$145,000, of which was recorded during the current year.

The Company is subject to U.S. federal income tax as well as income tax in multiple state and foreign jurisdictions. The statute of limitations for the Company's federal tax return has expired for all years through March 31, 2004. The Company's March 31, 2005 through March 31, 2007 federal tax returns are currently under examination by the Internal Revenue Service. State and foreign income tax returns remain open back to March 31, 2002 in major jurisdictions in which the Company operates.

**(9) LONG-TERM DEBT AND CREDIT ARRANGEMENTS**

Long-term debt consisted of the following (in thousands):

|  | <b>March 31,</b> |             |
|--|------------------|-------------|
|  | <b>2008</b>      | <b>2007</b> |
| 4.48% Senior Notes due December 13, 2009 | \$ 20,000        | \$ 30,000   |
| Other                                    | 438              | 587         |
|  | 20,438           | 30,587      |
| Less current portion                     | (10,246)         | (10,195)    |
|  | \$ 10,192        | \$ 20,392   |

On December 13, 2002, the Company issued \$50,000,000 of 4.48% Senior Notes due December 13, 2009 (the Senior Notes ). The Senior Notes are to be paid ratably over five years, beginning at the end of the third year of the seven year term of the agreement. The note purchase agreement contains various financial covenants, the most restrictive of which pertain to net worth, the ratio of operating cash flow to fixed charges and the ratio of debt to capitalization. The Company is in compliance with all covenants as of March 31, 2008.

The Company also has a \$50,000,000 unsecured revolving credit facility with five banks which expires on April 23, 2009. The loan agreement contains provisions to increase or reduce the interest pricing spread based on the achievement of certain benchmarks related to the ratio of earnings to interest expense. At the Company's option, interest on the facility accrues at (1) the greater of the prime rate minus 0.5% or the Federal Funds Rate, or (2) LIBOR plus .75%. The revolving credit facility provides for commitment fees of 0.225% per annum on the daily

**CSS INDUSTRIES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

average of the unused commitment. The loan agreement also contains various financial covenants, the most restrictive of which pertain to net worth, the ratio of operating cash flow to fixed charges, the ratio of debt to capitalization and limitations on capital expenditures. As of March 31, 2008 and 2007, no amounts were outstanding under this revolving credit facility. The Company is in compliance with all financial debt covenants as of March 31, 2008.

On April 23, 2004, the Company entered into an extension of its accounts receivable securitization facility through July 25, 2009, although the facility is subject to earlier termination in the event of termination of the commitments of the facility's back-up purchasers. The agreement permits the sale (and repurchase) of an undivided interest in an accounts receivable pool. The facility has a funding limit of \$100,000,000 during peak seasonal periods and \$25,000,000 during off-peak seasonal periods. Under this arrangement, the Company sells, on an ongoing basis and without recourse, its trade accounts receivable to a wholly-owned special purpose subsidiary (the SPS), which in turn has the option to sell, on an ongoing basis and without recourse, to a commercial paper issuer an undivided percentage interest in the pool of accounts receivable. Under the agreement, new trade receivables are automatically sold to the SPS and became a part of the receivables pool. Interest on amounts financed under this facility are based on a variable commercial paper rate plus 0.375% and commitment fees of 0.225% per annum on the daily average of the unused commitment are also payable under the facility. This arrangement is accounted for as a financing transaction. As of March 31, 2008 and 2007, no amounts were outstanding under this arrangement.

The weighted average interest rate under the revolving credit facilities for the years ended March 31, 2008, 2007 and 2006, was 7.43%, 7.04% and 5.24%, respectively. The average and peak borrowings were \$12,323,000 and \$81,000,000, respectively, for the year ended March 31, 2008 and \$28,547,000 and \$79,800,000, respectively, for the year ended March 31, 2007. Additionally, outstanding letters of credit under the revolving credit facilities totaled \$3,883,000 at March 31, 2008 and 2007. These letters of credit guarantee funding of workers compensation claims.

The Company leases certain computer equipment under a capital lease. The future minimum annual lease payments, including interest, associated with the capital lease obligations are as follows (in thousands):

|   |        |
|---|--------|
| 2009  | \$ 261 |
| 2010  | 196    |
| Total minimum lease obligations                   | 457    |
| Less amount representing interest                 | (19)   |
| Present value of future minimum lease obligations | \$ 438 |

Long-term debt, including capital lease obligations, matures as follows (in thousands):

|       |           |
|-------|-----------|
| 2009  | \$ 10,246 |
| 2010  | 10,192    |
| Total | \$ 20,438 |



**CSS INDUSTRIES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(10) OPERATING LEASES**

The Company maintains various lease arrangements for property and equipment. The future minimum rental payments associated with all noncancelable lease obligations are as follows (in thousands):

|            |           |
|------------|-----------|
| 2009       | \$ 8,318  |
| 2010       | 6,314     |
| 2011       | 3,745     |
| 2012       | 1,239     |
| 2013       | 922       |
| Thereafter | 759       |
| Total      | \$ 21,297 |

Rent expense was \$8,405,000, \$8,507,000 and \$9,044,000 for the years ended March 31, 2008, 2007 and 2006, respectively.

**(11) FAIR VALUE OF FINANCIAL INSTRUMENTS**

The estimated fair value of financial instruments has been determined by the Company using available market information and appropriate methodologies. The estimates presented herein are not necessarily indicative of the amounts that the Company could realize in a current market exchange. Certain of these financial instruments are with major financial institutions and expose the Company to market and credit risks and may at times be concentrated with certain counterparties or groups of counterparties. The creditworthiness of counterparties is continually reviewed, and full performance is anticipated.

The assumptions used to estimate the fair value of each class of financial instruments are set forth below:

**Cash and cash equivalents, accounts receivable and accounts payable** The carrying amounts of these items are a reasonable estimate of their fair values at March 31, 2008 and 2007.

**Short-term borrowings** Borrowings under the revolving credit facility have variable rates that reflect currently available terms and conditions for similar debt. The carrying amount of this debt is a reasonable estimate of its fair value.

**Foreign currency contracts** The fair value is based on quotes obtained from financial institutions. There were no foreign currency contracts outstanding as of March 31, 2008 and the fair value of foreign currency contracts was immaterial as of March 31, 2007.

**Long-term debt** The fair value of long-term debt instruments is estimated using a discounted cash flow analysis. As of March 31, 2008, the carrying amount of long-term debt was \$20,438,000 and the fair value was estimated to be \$20,557,000. As of March 31, 2007, the carrying amount of long-term debt was \$30,587,000

and the fair value was estimated to be \$29,995,000.

**(12) 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.

**CSS INDUSTRIES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(13) SEGMENT DISCLOSURE**

The Company operates in a single reporting segment, the design, manufacture, procurement, distribution and sale of non-durable everyday and seasonal social expression products, primarily to mass market retailers in the United States and Canada.

The Company's detail of revenues from its various products is as follows (in thousands):

|                | <b>For the Years Ended March 31,</b> |             |             |
|----------------|--------------------------------------|-------------|-------------|
|                | <b>2008</b>                          | <b>2007</b> | <b>2006</b> |
| Christmas      | \$ 285,848                           | \$ 346,866  | \$ 323,380  |
| All occasion   | 151,410                              | 127,163     | 143,307     |
| Other seasonal | 60,995                               | 56,657      | 58,807      |
| Total          | \$ 498,253                           | \$ 530,686  | \$ 525,494  |

One customer accounted for sales of \$133,456,000, or 27% of total sales in fiscal 2008, \$144,464,000, or 27% of total sales in fiscal 2007 and \$144,202,000, or 27% of total sales in fiscal 2006. One other customer accounted for sales of \$59,907,000, or 12% of total sales in fiscal 2008, \$58,742,000, or 11% of total sales in fiscal 2007 and \$60,751,000, or 12% of total sales in fiscal 2006.

**(14) RECENT ACCOUNTING PRONOUNCEMENTS**

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 establishes a framework for measuring fair value in accordance with accounting principles generally accepted in the United States, and expands disclosure about such fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 (April 1, 2008 for the Company). The adoption of SFAS No. 157 is not expected to have a significant effect on the Company's consolidated financial position or results of operations.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. SFAS No. 159 permits companies to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing companies with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007 (fiscal 2009 for the Company). Companies are not allowed to adopt SFAS No. 159 on a retrospective basis unless they choose early adoption. SFAS No. 159 is not expected to have a significant effect on the Company's consolidated financial position or results of operations.

In March 2007, the FASB ratified Emerging Issues Task Force Issue No. 06-10, Accounting for Collateral Assignment Split-Dollar Life Insurance Agreements (EITF 06-10). EITF 06-10 provides guidance for determining a liability for the postretirement benefit obligation as well as recognition and measurement of the associated asset on the



basis of the terms of the collateral assignment agreement. EITF 06-10 is effective for fiscal years beginning after December 15, 2007 (fiscal 2009 for the Company). The Company will adopt EITF 06-10 on April 1, 2008 and the net reduction to equity is expected to be approximately \$566,000.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations, 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 years beginning after December 15, 2008 (fiscal 2010 for the Company) and will apply prospectively to business combinations completed on or after April 1, 2009.

**CSS INDUSTRIES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* an amendment of FASB Statement No. 133. This statement requires enhanced disclosures about an entity's derivative and hedging activities, with the intent to provide users of financial statements with an enhanced understanding of (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* and its related interpretations and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. SFAS No. 161 is effective for fiscal years beginning after November 15, 2008 (fiscal 2010 for the Company). The Company is currently evaluating the impact of the adoption of SFAS No. 161 will have on its consolidated financial statements.

**(15) QUARTERLY FINANCIAL DATA (UNAUDITED)**

| <b>2008</b>                         | <b>Quarters</b>                                 |               |              |               |
|-------------------------------------|---|---------------|--------------|---------------|
|                                     | <b>First</b>                                    | <b>Second</b> | <b>Third</b> | <b>Fourth</b> |
|                                     | <b>(In thousands, except per share amounts)</b> |               |              |               |
| Net sales                           | \$ 46,802                                       | \$ 172,882    | \$ 222,170   | \$ 56,399     |
| Gross profit                        | \$ 13,283                                       | \$ 46,199     | \$ 61,382    | \$ 16,681     |
| Net (loss) income                   | \$ (4,427)                                      | \$ 13,535     | \$ 22,854    | \$ (6,604)    |
| Net (loss) income per common share: |   |               |              |               |
| Basic(1)                            | \$ (.41)  | \$ 1.25       | \$ 2.12      | \$ (.63)      |
| Diluted(1)                          | \$ (.41)  | \$ 1.22       | \$ 2.07      | \$ (.63)      |

| <b>2007</b>                         | <b>Quarters</b>                                 |               |              |               |
|-------------------------------------|---|---------------|--------------|---------------|
|                                     | <b>First</b>                                    | <b>Second</b> | <b>Third</b> | <b>Fourth</b> |
|                                     | <b>(In thousands, except per share amounts)</b> |               |              |               |
| Net sales                           | \$ 47,533                                       | \$ 173,830    | \$ 264,065   | \$ 45,258     |
| Gross profit                        | \$ 13,470                                       | \$ 44,827     | \$ 66,370    | \$ 11,974     |
| Net (loss) income                   | \$ (5,507)                                      | \$ 11,703     | \$ 23,290    | \$ (5,597)    |
| Net (loss) income per common share: |   |               |              |               |
| Basic(1)                            | \$ (.52)  | \$ 1.11       | \$ 2.19      | \$ (.52)      |
| Diluted(1)                          | \$ (.52)  | \$ 1.08       | \$ 2.13      | \$ (.52)      |

- (1) Net (loss) income per common share amounts for each quarter are required to be computed independently and may not equal the amount computed for the total year.

Fourth quarter net income of fiscal 2008 included expenses of approximately \$2,132,000 related to a restructuring plan approved on January 4, 2008 to close the Company's Elysburg, Pennsylvania production facilities and its Troy, Pennsylvania distribution facility.

Included in net income in the third and fourth quarters of fiscal 2007 were costs of approximately \$1,663,000 and \$860,000, respectively, related to a restructuring plan to combine the operations of its Cleo and Berwick Offray subsidiaries, to close Cleo's Maysville, Kentucky production facility and to exit a non-material, non-core business.

The seasonal nature of CSS's business has historically resulted in comparatively lower sales 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, thereby causing significant fluctuations in the quarterly results of operations of the Company.

**Item 9. *Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.***

None.

**Item 9A. *Controls and Procedures.***

**(a) *Evaluation of Disclosure Controls and Procedures.***

The Company's management, with the participation of the Company's President and Chief Executive Officer and Vice President Finance and Chief Financial Officer, evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Securities Exchange Act of 1934 ( Exchange Act ) Rules 13a-15(e) or 15d-15(e)) as of the end of the period covered by this report as required by paragraph (b) of Exchange Act Rules 13a-15 or 15d-15. Based upon that evaluation, the President and Chief Executive Officer and Vice President Finance and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in providing reasonable assurance that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and procedures.

**(b) *Management's Report on Internal Control over Financial Reporting.***

Management is responsible for establishing and maintaining adequate internal control over financial reporting of the Company. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

The Company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Company acquired substantially all of the business and assets of C.R. Gibson, Inc. ( C.R. Gibson ) on December 3, 2007, and management excluded C.R. Gibson's internal control over financial reporting from its assessment of the effectiveness of the Company's internal control over financial reporting as of March 31, 2008. The Company's consolidated financial statements included total assets of \$80,326,000 and total revenues of \$17,825,000 associated with the C.R. Gibson business as of and for the year ended March 31, 2008.

Management conducted an evaluation of the effectiveness of internal control over financial reporting based on the framework in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that the Company's internal control over financial reporting was effective as of March 31, 2008. Management's assessment of the effectiveness of the

Company's internal control over financial reporting as of March 31, 2008 has been audited by KPMG LLP, an independent registered public accounting firm, as stated in their report which is included herein.

**(c) Changes in Internal Control over Financial Reporting.**

There was no change in the Company's internal control over financial reporting that occurred during the fourth quarter of fiscal year 2008 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**(d) Report of Independent Registered Public Accounting Firm.**

The Board of Directors and Stockholders of  
CSS Industries, Inc.:

We have audited CSS Industries, Inc.'s internal control over financial reporting as of March 31, 2008, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). CSS Industries Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, CSS Industries, Inc. maintained, in all material respects, effective internal control over financial reporting as of March 31, 2008, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

CSS Industries, Inc. acquired substantially all of the business and assets of C.R. Gibson, Inc. (C.R. Gibson) on December 3, 2007, and management excluded from its assessment of the effectiveness of CSS Industries Inc.'s internal control over financial reporting as of March 31, 2008, C.R. Gibson's internal control over financial reporting associated with total assets of \$80,326,000 and total revenues of \$17,825,000 included in the consolidated financial statements of CSS Industries, Inc. and subsidiaries as of and for the year ended March 31, 2008. Our audit of internal control over financial reporting of CSS Industries, Inc. also excluded an evaluation of the internal control over financial reporting of C.R. Gibson.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of CSS Industries, Inc. and subsidiaries as of March 31, 2008 and 2007, and the related consolidated statements of operations and comprehensive income, stockholders' equity and cash flows for each of the years in the three-year period ended March 31, 2008, and our report dated June 2, 2008 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

June 2, 2008

**Item 9B. *Other Information.***

None.

**Part III**

**Item 10. *Directors, Executive Officers and Corporate Governance.***

See Election of Directors, Our Executive Officers, Section 16(a) Beneficial Ownership Reporting Compliance, Code of Ethics and Internal Disclosure Procedures (Employees) and Code of Business Conduct and Ethics (Board), Board Committees; Committee Membership; Committee Meetings and Audit Committee in the Proxy Statement for the 2008 Annual Meeting of Stockholders of the Company, which is incorporated herein by reference.

**Item 11. *Executive Compensation.***

See Executive Compensation, Human Resources Committee Interlocks and Insider Participation, Director Compensation and Human Resources Committee Report in the Proxy Statement for the 2008 Annual Meeting of Stockholders of the Company, which is incorporated herein by reference.

**Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.***

See Ownership of CSS Common Stock and Securities Authorized for Issuance Under CSS Equity Compensation Plans in the Proxy Statement for the 2008 Annual Meeting of Stockholders of the Company, which is incorporated herein by reference.

**Item 13. *Certain Relationships and Related Transactions, and Director Independence.***

See Board Independence and Related Party Transactions in the Proxy Statement for the 2008 Annual Meeting of Stockholders of the Company, which is incorporated herein by reference.

**Item 14. *Principal Accounting Fees and Services.***

See Our Independent Registered Public Accounting Firm, Their Fees and Their Attendance at the Annual Meeting in the Proxy Statement for the 2008 Annual Meeting of Stockholders of the Company, which is incorporated herein by reference.



## Part IV

### Item 15. *Exhibits, Financial Statement Schedules.*

(a) Following is a list of documents filed as part of this report:

#### 1. Financial Statements

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets March 31, 2008 and 2007

Consolidated Statements of Operations and Comprehensive Income for the years ended March 31, 2008, 2007 and 2006

Consolidated Statements of Cash Flows for the years ended March 31, 2008, 2007 and 2006

Consolidated Statements of Stockholders Equity for the years ended March 31, 2008, 2007 and 2006

Notes to Consolidated Financial Statements

#### 2. Financial Statement Schedules

Schedule II Valuation and Qualifying Accounts

#### 3. Exhibits required by Item 601 of Regulation S-K, Including Those Incorporated by Reference

##### Articles of Incorporation and By-Laws

- 3.1 Restated Certificate of Incorporation filed December 5, 1990 (incorporated by reference to Exhibit 3.1 to the Registrant's Annual Report on Form 10-K for the fiscal year ended March 31, 2006).
- 3.2 Amendment to Restated Certificate of Incorporation filed May 8, 1992 (incorporated by reference to Exhibit 3.2 to the Registrant's Annual Report on Form 10-K for the fiscal year ended March 31, 2006).
- 3.3 Certificate eliminating Class 2, Series A, \$1.35 Preferred stock filed September 27, 1991 (incorporated by reference to Exhibit 3.3 to the Registrant's Annual Report on Form 10-K for the fiscal year ended March 31, 2006).
- 3.4 Certificate eliminating Class 1, Series B, Convertible Preferred Stock filed January 28, 1993 (incorporated by reference to Exhibit 3.4 to the Registrant's Annual Report on Form 10-K for the fiscal year ended March 31, 2006).
- 3.5 Amendment to Restated Certificate of Incorporation filed August 4, 2004 (incorporated by reference to Exhibit 3.1 to the Registrant's Quarterly Report on Form 10-Q dated November 8, 2004).
- 3.6 Restated Certificate of Incorporation, as amended to date (as last amended August 4, 2004) (incorporated by reference to Exhibit 3.2 to the Registrant's Quarterly Report on Form 10-Q dated November 8, 2004)
- 3.7 By-laws of the Company, as amended to date (as last amended August 2, 2007) (incorporated by reference to Exhibit 3.1 to the Registrant's Quarterly Report on Form 10-Q dated October 25, 2007).

##### Material Contracts

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- 10.1 Receivables Purchase Agreement among CSS Funding LLC, CSS Industries, Inc., Market Street Funding Corporation and PNC Bank, National Association, dated as of April 30, 2001 (incorporated by reference to Exhibit 10.9 to the Registrant's Annual Report on Form 10-K/A for the fiscal year ended March 31, 2002).
- 10.2 Purchase and Sale Agreement between Various Entities Listed on Schedule I, as the Originators, CSS Industries, Inc. and CSS Funding LLC, dated as of April 30, 2001 (incorporated by reference to Exhibit 10.10 to the Registrant's Annual Report on Form 10-K/A for the fiscal year ended March 31, 2002).
- 10.3 First Amendment to Receivables Purchase Agreement dated as of August 24, 2001 (incorporated by reference to Exhibit 10.12 to the Registrant's Annual Report on Form 10-K/A for the fiscal year ended March 31, 2002).
- 10.4 First Amendment to Purchase and Sale Agreement dated as of August 24, 2001 (incorporated by reference to Exhibit 10.13 to the Registrant's Annual Report on Form 10-K/A for the fiscal year ended March 31, 2002).
- 10.5 \$50,000,000 4.48% Senior Notes due December 13, 2009 Note Purchase Agreement dated December 12, 2002 (incorporated by reference to Exhibit 10.17 to the Registrant's Annual Report on Form 10-K for the fiscal year ended March 31, 2003).

- 10.6 Amended and Restated Loan Agreement dated April 23, 2004 (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q dated November 8, 2004).
- 10.7 Second Amendment to Purchase and Sale Agreement dated as of July 29, 2003 (incorporated by reference to Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q dated November 8, 2004).
- 10.8 Third Amendment to Purchase and Sale Agreement dated June 1, 2004 (incorporated by reference to Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q dated November 8, 2004).
- 10.9 Second Amendment to Receivables Purchase Agreement dated as of July 29, 2003 (incorporated by reference to Exhibit 10.4 to the Registrant's Quarterly Report on Form 10-Q dated November 8, 2004).
- 10.10 Third Amendment to Receivables Purchase Agreement dated as of April 26, 2004 (incorporated by reference to Exhibit 10.5 to the Registrant's Quarterly Report on Form 10-Q dated November 8, 2004).
- 10.11 Fourth Amendment to Receivables Purchase Agreement dated June 1, 2004 (incorporated by reference to Exhibit 10.6 to the Registrant's Quarterly Report on Form 10-Q dated November 8, 2004).
- 10.12 First Amendment to Note Purchase Agreements dated October 27, 2004 (incorporated by reference to Exhibit 10.8 to the Registrant's Quarterly Report on Form 10-Q dated November 8, 2004).
- 10.13 Amendment to Amended and Restated Loan Agreement dated January 27, 2005 (incorporated by reference to Exhibit 10.17 to the Registrant's Annual Report on Form 10-K for the fiscal year ended March 31, 2005).
- 10.14 Asset Purchase Agreement dated as of October 31, 2007, among CSS Industries, Inc., Delta Acquisition, LLC, C.R. Gibson, Inc. and the shareholders of C.R. Gibson, Inc. (incorporated by reference to Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed on December 7, 2007).
- 10.15 Closing letter dated November 30, 2007 by and among Delta Acquisition, LLC, CSS Industries, Inc. and C.R. Gibson, Inc., on behalf of itself and its shareholders (incorporated by reference to Exhibit 2.2 to the Registrant's Current Report on Form 8-K filed on December 7, 2007).
- 10.16 Fifth Amendment to Receivables Purchase Agreement dated as of August 1, 2007 (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q dated January 31, 2008).

Management Contracts, Compensatory Plans or Arrangements

- 10.17 CSS Industries, Inc. 1995 Stock Option Plan for Non-Employee Directors (incorporated by reference to Exhibit 10.2 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1996).
- 10.18 CSS Industries, Inc. 2000 Stock Option Plan for Non-Employee Directors (incorporated by reference to Exhibit 10.14 to the Registrant's Annual Report on Form 10-K/A for the fiscal year ended March 31, 2002).
- 10.19 CSS Industries, Inc. Non-Qualified Supplemental Executive Retirement Plan Guidelines, dated January 25, 1994 (incorporated by reference to Exhibit 10.19 to the Registrant's Annual Report on Form 10-K for the fiscal year ended March 31, 2006).
- 10.20 Amendment 1998-1 to the Non-Qualified Supplemental Executive Retirement Plan Covering Officer-Employees of CSS Industries, Inc., dated November 13, 1998 (incorporated by reference to Exhibit 10.20 to the Registrant's Annual Report on Form 10-K for the fiscal year ended March 31, 2006).
- 10.21 Berwick Industries, Inc. Non-Qualified Supplemental Executive Retirement Plan, dated November 18, 1996 (incorporated by reference to Exhibit 10.26 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1996).
- 10.22 Amendment 1998-1 to the Non-Qualified Supplemental Executive Retirement Plan Covering Officer-Employees of Berwick Industries, Inc. and its Subsidiaries in the United States, dated November 18, 1998 (incorporated by reference to Exhibit 10.22 to the Registrant's Annual Report on Form 10-K for the fiscal year ended March 31, 2006).
- 10.23 The Paper Magic Group, Inc. Non-Qualified Supplemental Executive Retirement Plan, dated December 5, 1996 (incorporated by reference to Exhibit 10.27 to the Registrant's Annual Report on

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Form 10-K for the fiscal year ended December 31, 1996).

- 10.24 Amendment 1998-1 to the Non-Qualified Supplemental Executive Retirement Plan Covering Officer-Employees of The Paper Magic Group, Inc. and its Subsidiaries in the United States, dated November 23, 1998 (incorporated by reference to Exhibit 10.24 to the Registrant's Annual Report on Form 10-K for the fiscal year ended March 31, 2006).

- 10.25 Cleo Inc Non-Qualified Supplemental Executive Retirement Plan dated November 26, 1996 (incorporated by reference to Exhibit 10.18 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1998).
- 10.26 Amendment 1998-1 to the Non-Qualified Supplemental Executive Retirement Plan Covering Officer-Employees of Cleo Inc and its Subsidiaries in the United States, dated November 23, 1998 (incorporated by reference to Exhibit 10.26 to the Registrant's Annual Report on Form 10-K for the fiscal year ended March 31, 2006).
- 10.27 CSS Industries, Inc. 1994 Equity Compensation Plan (as last amended August 7, 2002) (incorporated by reference to Exhibit 10.29 to the Registrant's Annual Report on Form 10-K for the fiscal year ended March 31, 2004).
- 10.28 CSS Industries, Inc. 2004 Equity Compensation Plan (incorporated by reference to Exhibit 10.7 to the Registrant's Quarterly Report on Form 10-Q dated November 8, 2004).
- 10.29 Employment Agreement dated as of July 11, 2005 between CSS Industries, Inc. and William G. Kiesling (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q dated November 9, 2005).
- 10.30 Employment Agreement dated as of May 12, 2006 between CSS Industries, Inc. and Christopher J. Munyan (incorporated by reference to Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q dated August 9, 2006).
- 10.31 CSS Industries, Inc. Severance Pay Plan for Senior Management and Summary Plan Description (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q dated February 2, 2007).
- 10.32 CSS Industries, Inc. 2006 Stock Option Plan for Non-Employee Directors (incorporated by reference to Exhibit 10.34 to the Registrant's Annual Report on Form 10-K for the fiscal year ended March 31, 2007).
- 10.33 Amendment 2006-1 to the Non-Qualified Supplemental Executive Retirement Plan Covering Officer-Employees of CSS Industries, Inc. (incorporated by reference to Exhibit 10.35 to the Registrant's Annual Report on Form 10-K for the fiscal year ended March 31, 2007).
- 10.34 CSS Industries, Inc. Management Incentive Program (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q dated August 3, 2007).
- 10.35 CSS Industries, Inc. FY 2008 Management Incentive Program Criteria for CSS Industries, Inc. (incorporated by reference to Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q dated August 3, 2007).
- 10.36 CSS Industries, Inc. FY 2008 Management Incentive Program Criteria for BOC Design Group (incorporated by Reference to Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q dated August 3, 2007).
- 10.37 CSS Industries, Inc. FY 2008 Management Incentive Program Criteria for Paper Magic Group, Inc. (incorporated by reference to Exhibit 10.4 to the Registrant's Quarterly Report on Form 10-Q dated August 3, 2007).

Other

- \*21. List of Significant Subsidiaries of the Registrant.
- \*23. Consent of Independent Registered Public Accounting Firm.
- \*31.1 Certification of the Chief Executive Officer of CSS Industries, Inc. required by Rule 13a-14(a) under the Securities Exchange Act of 1934.
- \*31.2 Certification of the Chief Financial Officer of CSS Industries, Inc. required by Rule 13a-14(a) under the Securities Exchange Act of 1934.
- \*32.1 Certification of the Chief Executive Officer of CSS Industries, Inc. required by Rule 13a-14(b) under the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.

\*32.2 Certification of the Chief Financial Officer of CSS Industries, Inc. required by Rule 13a-14(b) under the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.

\* Filed or furnished with this Annual Report on Form 10-K.

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## CSS INDUSTRIES, INC. AND SUBSIDIARIES

SCHEDULE II  
VALUATION AND QUALIFYING ACCOUNTS

| Column A                       | Column<br>B                                | Column C<br>Additions                  |   | Column D    | Column<br>E                    |
|--------------------------------|--|--|---|-------------|--------------------------------|
|                                | Balance<br>at<br>Beginning<br>of<br>Period | Charged<br>to Costs<br>and<br>Expenses | Charged<br>to Other<br>Accounts<br>(In thousands) | Deductions  | Balance<br>at End of<br>Period |
| Year ended March 31, 2008      |  |  |   |             |                                |
| Accounts receivable allowances | \$ 4,850                                   | \$ 4,542                               | \$ 997(d)   | \$ 5,098(a) | \$ 5,291                       |
| Accrued restructuring expenses | 1,456                                      | 628                                    |   | 1,765(b)    | 319                            |
| Year ended March 31, 2007      |  |  |   |             |                                |
| Accounts receivable allowances | \$ 4,119                                   | \$ 4,086                               | \$  | \$ 3,355(a) | \$ 4,850                       |
| Accrued restructuring expenses | 4  | 1,905                                  |   | 453(c)      | 1,456                          |
| Year ended March 31, 2006      |  |  |   |             |                                |
| Accounts receivable allowances | \$ 5,428                                   | \$ 3,326                               | \$  | \$ 4,635(a) | \$ 4,119                       |
| Accrued restructuring expenses | 599  | 37                                     |   | 632(b)      | 4                              |

## Notes:

- (a) Includes amounts written off as uncollectible, net of recoveries.
- (b) Includes payments and non cash reductions.
- (c) Includes payments.
- (d) Balance at acquisition of C.R. Gibson.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Annual Report to be signed on behalf of the undersigned thereunto duly authorized.

CSS INDUSTRIES, INC.

Registrant

By /s/ Christopher J. Munyan

Christopher J. Munyan, President and  
Chief Executive Officer  
(principal executive officer)

Dated: June 2, 2008

Pursuant to the requirements of the Securities Exchange Act of 1934, this Annual Report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/ Christopher J. Munyan  
Christopher J. Munyan, President and  
Chief Executive Officer  
(principal executive officer and a director)

Dated: June 2, 2008

/s/ Clifford E. Pietrafitta  
Clifford E. Pietrafitta, Vice President Finance and  
Chief Financial Officer  
(principal financial and accounting officer)

Dated: June 2, 2008

/s/ Jack Farber  
Jack Farber, Director

Dated: June 2, 2008

/s/ Scott A. Beaumont  
Scott A. Beaumont, Director

Dated: June 2, 2008

/s/ James H. Bromley  
James H. Bromley, Director

Dated: June 2, 2008



/s/ John J. Gavin  
John J. Gavin, Director

Dated: June 2, 2008

/s/ Leonard E. Grossman  
Leonard E. Grossman, Director

Dated: June 2, 2008

/s/ James E. Ksansnak  
James E. Ksansnak, Director

Dated: June 2, 2008

/s/ Rebecca C. Matthias  
Rebecca C. Matthias, Director

Dated: June 2, 2008