

CSS INDUSTRIES INC
Form 10-Q
February 03, 2010

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

(Mark One)

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

For the quarterly period ended December 31, 2009

or

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

For the transition period from _____ to _____

**Commission file number 1-2661
CSS INDUSTRIES, INC.**

(Exact name of registrant as specified in its charter)

Delaware

13-1920657

(State or other jurisdiction of incorporation or organization)

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

1845 Walnut Street, Philadelphia, PA

19103

(Address of principal executive offices)

(Zip Code)

(215) 569-9900

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such period that the registrant was required to submit and post such files).

Yes No

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

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

As of January 26, 2010, there were 9,668,306 shares of common stock outstanding which excludes shares which may still be issued upon exercise of stock options or upon vesting of restricted stock unit grants.

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

(In thousands, except per share data)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2009	2008	2009	2008
SALES	\$ 182,230	\$ 197,122	\$ 396,180	\$ 425,930
COSTS AND EXPENSES				
Cost of sales	136,661	147,967	295,356	315,134
Selling, general and administrative expenses	25,224	22,530	72,823	73,943
Interest expense, net	645	1,093	1,674	2,293
Other (income) expense, net	(86)	225	(337)	195
	162,444	171,815	369,516	391,565
INCOME BEFORE INCOME TAXES	19,786	25,307	26,664	34,365
INCOME TAX EXPENSE	7,086	8,895	9,562	11,945
NET INCOME	\$ 12,700	\$ 16,412	\$ 17,102	\$ 22,420
NET INCOME PER COMMON SHARE				
Basic	\$ 1.32	\$ 1.69	\$ 1.78	\$ 2.24
Diluted	\$ 1.31	\$ 1.68	\$ 1.77	\$ 2.22
WEIGHTED AVERAGE SHARES OUTSTANDING				
Basic	9,646	9,734	9,627	10,010
Diluted	9,682	9,796	9,671	10,120
CASH DIVIDENDS PER SHARE OF COMMON STOCK				
	\$.15	\$.15	\$.45	\$.45
COMPREHENSIVE INCOME				
Net income	\$ 12,700	\$ 16,412	\$ 17,102	\$ 22,420
Foreign currency translation adjustment				2

Comprehensive income	\$ 12,700	\$ 16,412	\$ 17,102	\$ 22,422
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See notes to consolidated financial statements.

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

(In thousands)

	December 31, 2009	March 31, 2009
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 4,619	\$ 2,179
Accounts receivable, net	152,536	43,741
Inventories	67,530	99,971
Deferred income taxes	6,609	5,758
Assets held for sale	1,363	1,363
Other current assets	11,986	15,295
Total current assets	244,643	168,307
PROPERTY, PLANT AND EQUIPMENT, NET	50,657	54,942
OTHER ASSETS		
Goodwill	49,258	49,258
Intangible assets, net	44,733	45,649
Other	3,936	4,103
Total other assets	97,927	99,010
Total assets	\$ 393,227	\$ 322,259
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES		
Notes payable	\$ 46,100	\$ 4,150
Current portion of long-term debt	497	10,479
Accrued customer programs	13,034	9,909
Other current liabilities	48,423	29,398
Total current liabilities	108,054	53,936
LONG-TERM DEBT, NET OF CURRENT PORTION	166	485

LONG-TERM OBLIGATIONS	4,646	4,376
DEFERRED INCOME TAXES	5,768	4,208
STOCKHOLDERS EQUITY	274,593	259,254
Total liabilities and stockholders equity	\$ 393,227	\$ 322,259

See notes to consolidated financial statements.

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

(In thousands)

	Nine Months Ended December 31,	
	2009	2008
Cash flows from operating activities:		
Net income	\$ 17,102	\$ 22,420
Adjustments to reconcile net income to net cash used for operating activities:		
Depreciation and amortization	9,160	10,101
Provision for doubtful accounts	174	206
Deferred tax provision	709	2,641
Loss (gain) on sale or disposal of assets	5	(771)
Share-based compensation expense	1,806	2,006
Changes in assets and liabilities, net of effects of acquisitions:		
Increase in accounts receivable	(108,969)	(105,465)
Decrease in inventory	32,566	12,751
Decrease in other assets	3,301	3,794
Increase in other liabilities	16,323	9,660
Increase in accrued taxes	6,190	5,172
Total adjustments	(38,735)	(59,905)
Net cash used for operating activities	(21,633)	(37,485)
Cash flows from investing activities:		
Purchase of a business	(225)	(10,599)
Final payment of purchase price for a business previously acquired		(2,700)
Purchase of property, plant and equipment	(3,606)	(10,731)
Proceeds from sale of assets	13	3,062
Net cash used for investing activities	(3,818)	(20,968)
Cash flows from financing activities:		
Payments on long-term obligations	(10,396)	(10,198)
Borrowings on notes payable	341,460	489,290
Repayments on notes payable	(299,510)	(421,890)
Payment of financing transaction costs		(621)
Dividends paid	(4,334)	(4,498)
Purchase of treasury stock		(16,687)
Proceeds from exercise of stock options	671	433

Tax benefit realized for stock options exercised		5
Net cash provided by financing activities	27,891	35,834
Effect of exchange rate changes on cash		2
Net increase (decrease) in cash and cash equivalents	2,440	(22,617)
Cash and cash equivalents at beginning of period	2,179	28,109
Cash and cash equivalents at end of period	\$ 4,619	\$ 5,492

See notes to consolidated financial statements.

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CSS INDUSTRIES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009

(Unaudited)

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

Basis of Presentation -

CSS Industries, Inc. (collectively with its subsidiaries, CSS or the Company) has prepared the consolidated financial statements included herein pursuant to the rules and regulations of the Securities and Exchange Commission. The Company has condensed or omitted certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States pursuant to such rules and regulations. In the opinion of management, the statements include all adjustments (which include normal recurring adjustments) required for a fair presentation of financial position, results of operations and cash flows for the interim periods presented. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2009. The results of operations for the interim periods are not necessarily indicative of the results for the full year.

The Company's fiscal year ends on March 31. References to a particular year refer to the fiscal year ending in March of that year. For example fiscal 2010 refers to the year ending March 31, 2010.

Principles of Consolidation -

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

Nature of Business -

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

Foreign Currency Translation and Transactions -

Translation adjustments are charged or credited to a separate component of stockholders' equity. Gains and losses on foreign currency transactions are not material and are included in other (income) expense, net in the consolidated statements of operations.

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Use of Estimates -

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

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

Goodwill is subject to an assessment for impairment using a two-step fair value-based test, the first step of which must be performed at least annually, or more frequently if events or circumstances indicate that goodwill might be impaired. The first step of the test compares the fair value of a reporting unit to its carrying amount, including goodwill, as of the date of the test. The Company uses a dual approach to determine the fair value of its reporting units including both a market approach and an income approach. We believe the use of multiple valuation techniques results in a more accurate indicator of the fair value of each reporting unit. If the carrying amount of the reporting unit exceeds its fair value, the second step is performed. The second step compares the carrying amount of the goodwill to the implied fair value of the goodwill. If the implied fair value of the goodwill is less than the carrying amount of the goodwill, an impairment loss would be reported.

The Company determined that, due to the decline in fiscal 2010 earnings, a triggering event occurred which required testing for impairment of goodwill in the current fiscal quarter. The results of testing indicated that our C.R. Gibson reporting unit, acquired in fiscal year 2008, passed the first step of the test, and therefore no impairment of the goodwill associated with the reporting unit was recognized. However, the testing results also indicated that the fair value of such reporting unit as of the testing date was not substantially in excess of the carrying value of such reporting unit. Goodwill attributed to the CR. Gibson reporting unit totaled approximately \$17 million as of December 31, 2009. If the financial results of this reporting unit decline, or if certain economic factors that impact the assumptions in our valuation models change, such as market valuation multiples, borrowing costs and equity risk factors, an impairment of the goodwill associated with the C.R. Gibson reporting unit could be required in the future. The Company will perform its annual goodwill impairment assessment as of the fiscal year end.

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

Table of Contents**Inventories -**

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

	December 31, 2009	March 31, 2009
Raw material	\$ 11,443	\$ 17,533
Work-in-process	10,539	25,437
Finished goods	45,548	57,001
	\$ 67,530	\$ 99,971

Assets Held for Sale -

Assets held for sale in the amount of \$1,363,000 represents a former manufacturing facility which the Company is in the process of selling. The Company expects to sell this facility within the next 12 months for an amount greater than the current carrying value. The Company ceased depreciating this facility at the time it was classified as held for sale.

Revenue Recognition -

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

Net Income Per Common Share -

The following table sets forth the computation of basic and diluted net income per common share for the three and nine months ended December 31, 2009 and 2008 (in thousands, except per share data):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2009	2008	2009	2008
Numerator:				
Net income	\$ 12,700	\$ 16,412	\$ 17,102	\$ 22,420
Denominator:				
Weighted average shares outstanding for basic income per common share	9,646	9,734	9,627	10,010
Effect of dilutive stock options	36	62	44	110
Adjusted weighted average shares outstanding for diluted income per common share	9,682	9,796	9,671	10,120
Basic net income per common share	\$ 1.32	\$ 1.69	\$ 1.78	\$ 2.24
Diluted net income per common share	\$ 1.31	\$ 1.68	\$ 1.77	\$ 2.22

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.

Table of Contents**(2) RECENT ACCOUNTING PRONOUNCEMENTS***Accounting Standards Codification*

In June 2009, the Financial Accounting Standards Board (FASB) issued authoritative guidance which replaced the previous hierarchy of Generally Accepted Accounting Principles (GAAP) and establishes the FASB Codification as the single source of authoritative GAAP recognized by the FASB to be applied to nongovernmental entities and rules and interpretive releases of the SEC as authoritative GAAP for SEC registrants. The FASB Codification superseded all the existing non-SEC accounting and reporting standards upon its effective date, and on and after its effective date, the FASB will not issue new standards in the form of Statements, FASB Staff Positions or Emerging Issues Task Force Abstracts. This guidance was effective for the Company in the second quarter of fiscal 2010. The adoption of this guidance did not have an impact on the Company's financial position or results of operations.

Subsequent Events

In May 2009, the FASB issued authoritative guidance which establishes general standards of accounting for, and disclosure of, events that occur after the balance sheet date, but before financial statements are issued or are available to be issued. This guidance was effective for the Company as of June 30, 2009. The adoption of this guidance did not have an impact on the Company's financial position or results of operations. The Company evaluated subsequent events through the date the accompanying consolidated financial statements were issued, which was February 3, 2010.

Fair Value of Financial Instruments Disclosure

In April 2009, the FASB revised the authoritative guidance which requires disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. The Company adopted the updated guidance effective June 30, 2009. Other than the required disclosures (see Note 9), the adoption of the updated guidance had no impact on the Company's consolidated financial statements.

Business Combinations

In December 2007, the FASB revised the authoritative guidance for business combinations which 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 method. 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.

In April 2009, the FASB revised the authoritative guidance related to the initial recognition and measurement, subsequent measurement and accounting, and disclosures for assets and liabilities arising from contingencies in business combinations. This guidance became effective for all business acquisitions occurring on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company adopted the updated guidance for business combinations with an acquisition date on or after April 1, 2009.

(3) SHARE-BASED COMPENSATION*2004 Equity Compensation Plan*

Under the terms of the Company's 2004 Equity Compensation Plan (2004 Plan), the Human Resources Committee (Committee) of the Board of Directors may grant incentive stock options, non-qualified stock options, restricted stock grants, stock appreciation rights, stock bonuses and other awards to officers and other employees. Grants under the 2004 Plan may be made through August 3, 2014. The term of each grant is at the discretion of the Committee, but in no event greater than ten years from the date of grant. The Committee has discretion to determine the date or dates on which granted options become exercisable. All options outstanding as of December 31, 2009 become exercisable at the rate of 25% per year commencing one year after the date of grant. Outstanding performance-vested restricted stock units (RSUs) vest on the third anniversary of the date on which the award was granted, provided that certain performance metrics have been met during the performance period, and outstanding time-vested RSUs vest at the rate of 50% of the shares underlying the grant on each of the third and fourth anniversaries of the date on which the award was granted. At December 31, 2009, 1,082,469 shares were available for grant under the 2004 Plan.

Table of Contents*2006 Stock Option Plan for Non-Employee Directors*

Under the terms of the CSS Industries, Inc. 2006 Stock Option Plan for Non-Employee Directors (2006 Plan), non-qualified stock options are available for grant to non-employee directors at exercise prices of not less than fair market value of the underlying common stock on the date of grant. Under the 2006 Plan, options to purchase 4,000 shares of the Company's common stock are granted automatically to each non-employee director on the last day that the Company's common stock is traded in November from 2006 to 2010. Each option will expire five years after the date the option is granted and commencing one year after the date of grant, options begin vesting and are exercisable at the rate of 25% per year. At December 31, 2009, 108,000 shares were available for grant under the 2006 Plan.

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

	For the Nine Months Ended December 31,	
	2009	2008
Expected dividend yield at time of grant	2.98%	2.47%
Expected stock price volatility	54%	37%
Risk-free interest rate	2.92%	3.04%
Expected life of option (in years)	4.2	4.4

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

The weighted average fair value of stock options granted during the nine months ended December 31, 2009 and 2008 was \$7.40 and \$7.08, respectively. The weighted average fair value of restricted stock units granted during the nine months ended December 31, 2009 and 2008 was \$16.70 and \$27.28, respectively.

As of December 31, 2009, there was \$2,161,000 of total unrecognized compensation cost related to non-vested stock option awards granted under the Company's equity incentive plans which is expected to be recognized over a weighted average period of 2.2 years. As of December 31, 2009, there was \$1,678,000 of total unrecognized compensation cost related to non-vested RSUs granted under the Company's equity incentive plans which is expected to be recognized over a weighted average period of 2.7 years.

Compensation cost related to stock options and RSUs recognized in operating results (included in selling, general and administrative expenses) was \$594,000 and \$616,000 in the quarters ended December 31, 2009 and 2008, respectively, and was \$1,806,000 and \$2,006,000 for the nine months ended December 31, 2009 and 2008, respectively.

(4) DERIVATIVE FINANCIAL INSTRUMENTS

The Company enters into foreign currency forward contracts in order to reduce the impact of certain foreign currency fluctuations on sales denominated in a foreign currency. Derivatives are not used for trading or speculative activities. Firmly committed transactions and the related receivables may be hedged with forward exchange contracts. Gains and losses arising from foreign currency forward contracts are recorded in other (income) expense, net as offsets of gains and losses resulting from the underlying hedged transactions. Realized losses of \$328,000 and \$419,000 were recorded in the quarter and nine months ended December 31, 2009. Realized gains of \$1,108,000 and \$1,292,000 were recorded in the quarter and nine months ended December 31, 2008. As of December 31, 2009, the notional amount of open foreign currency forward contracts was \$6,733,000 and the related unrealized loss was \$5,000. There were no open foreign currency forward contracts as of March 31, 2009. We believe we do not have significant counterparty credit risk as of December 31, 2009.

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The following table shows the fair value of the foreign currency forward contracts designated as hedging instruments and included in the Company's condensed consolidated balance sheet as of December 31, 2009 (in thousands):

	Fair Value of Derivative Instruments Balance Sheet	
	Location	Fair Value
Foreign currency forward contracts	Other current liabilities	\$ 5

(5) BUSINESS RESTRUCTURING

On January 4, 2008, the Company announced a restructuring plan to close the Company's Elysburg, Pennsylvania production facilities and its Troy, Pennsylvania distribution facility. This restructuring was undertaken as the Company has increasingly shifted from domestically manufactured to foreign sourced boxed greeting cards and gift tags. Under the restructuring plan, both facilities were closed as of March 31, 2008. As part of the restructuring plan, the Company recorded a restructuring reserve of \$628,000, including severance related to 75 employees. During fiscal 2009, there was an increase in the restructuring reserve in the amount of \$426,000 primarily related to the ratable recognition of retention bonuses for employees providing service until their termination date. During the nine months ended December 31, 2009, the Company made payments of \$55,000 for costs related to severance. There were no payments made during the quarter ended December 31, 2009. The Company expects to incur additional period expenses related to this restructuring program of approximately \$39,000 during the remainder of fiscal 2010. Selected information relating to the aforementioned restructuring follows (in thousands):

Restructuring reserve as of March 31, 2009	\$ 55
Cash paid - fiscal 2010	(55)
Restructuring reserve as of December 31, 2009	\$

(6) GOODWILL AND INTANGIBLES

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

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

	December 31, 2009		March 31, 2009	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Tradenames and trademarks	\$ 25,083	\$	\$ 25,083	\$
Customer relationships	22,057	2,983	21,957	1,860
Non-compete	200	104	500	367
Trademarks	403	145	403	123
Patents	266	44	89	33
	\$ 48,009	\$ 3,276	\$ 48,032	\$ 2,383

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Amortization expense related to intangible assets was \$401,000 and \$386,000 for the quarters ended December 31, 2009 and 2008, respectively, and was \$1,193,000 and \$1,077,000 for the nine months ended December 31, 2009 and 2008, respectively. Based on the current composition of intangibles, amortization expense for the remainder of fiscal 2010 and each of the succeeding four years is projected to be as follows (in thousands):

Fiscal 2010	\$ 405
Fiscal 2011	1,612
Fiscal 2012	1,595
Fiscal 2013	1,562
Fiscal 2014	1,550

(7) ACCOUNTS RECEIVABLE SECURITIZATION FACILITY

On May 8, 2009, the Company entered into an extension of its accounts receivable securitization facility through May 7, 2010, although it may terminate prior to such date in the event of termination of the commitments of the facility's back-up purchasers. This facility has a funding limit of \$75,000,000 during peak seasonal periods and \$25,000,000 during off-peak seasonal periods. Financing costs for amounts funded under this facility are based on a variable commercial paper rate plus 1.5%, and commitment fees of 0.5% per annum on the unused commitment are also payable under the facility. In addition, if the daily amount outstanding is less than 50% of the seasonally adjusted funding limit, an additional commitment fee of 0.25% per annum will also be payable under the facility.

(8) 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.

(9) FAIR VALUE MEASUREMENTS:

The Company uses certain derivative financial instruments as part of its risk management strategy to reduce foreign currency risk. The Company recorded all derivatives on the consolidated condensed balance sheet at fair value based on quotes obtained from financial institutions as of December 31, 2009. There were no foreign currency contracts outstanding as of March 31, 2009.

The Company maintains a Nonqualified Supplemental Executive Retirement Plan for highly compensated employees and invests assets to mirror the obligations under this Plan. The invested funds are maintained at a third party financial institution in the name of CSS and are invested in publicly traded mutual funds. The Company maintains separate accounts for each participant to reflect deferred contribution amounts and the related gains or losses on such deferred amounts. The investments are included in other current assets and the related liability is recorded as deferred compensation and included in other long-term obligations in the consolidated condensed balance sheets. The fair value of the investments is based on the market price of the mutual funds as of December 31, 2009 and March 31, 2009.

The Company maintains two life insurance policies in connection with deferred compensation arrangements with two former executives. The cash surrender value of the policies is recorded in other long-term assets in the consolidated condensed balance sheets and is based on quotes obtained from the insurance company as of December 31, 2009 and March 31, 2009.

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

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

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

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

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

The following table presents the Company's fair value hierarchy for those financial assets and liabilities measured at fair value on a recurring basis in its consolidated condensed balance sheet as of December 31, 2009 and March 31, 2009 (in thousands):

	Fair Value Measurements at December 31, 2009 Using			
	December 31, 2009	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Marketable securities	\$ 795	\$ 795	\$	\$
Cash surrender value of life insurance policies	867		867	
Total assets	\$ 1,662	\$ 795	\$ 867	\$
Liabilities				
Deferred compensation plans	\$ 795	\$ 795	\$	\$
Foreign exchange contracts	5		5	
Total liabilities	\$ 800	\$ 795	\$ 5	\$

	Fair Value Measurements at March 31, 2009 Using			
	March 31, 2009	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Marketable securities	\$ 628	\$ 628	\$	\$
Cash surrender value of life insurance policies	837		837	
Total assets	\$ 1,465	\$ 628	\$ 837	\$

Liabilities					
Deferred compensation plans	\$	628	\$	628	\$
Total liabilities	\$	628	\$	628	\$

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Cash and cash equivalents, accounts receivable, accounts payable and accrued expenses are reflected at carrying value in the consolidated condensed balance sheets as such amounts are a reasonable estimate of their fair values due to the short-term nature of these instruments.

The carrying value of the Company's short-term borrowings is a reasonable estimate of its fair value as borrowings under the Company's credit facilities have variable rates that reflect currently available terms and conditions for similar debt.

The fair value of long-term debt instruments is estimated using a discounted cash flow analysis. As of December 31, 2009, the carrying amount and estimated fair value of long-term debt was \$663,000. As of March 31, 2009, the carrying amount of long-term debt was \$10,964,000 and the fair value was estimated to be \$10,950,000.

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CSS INDUSTRIES, INC. AND SUBSIDIARIES

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

STRATEGIC OVERVIEW

Approximately 63% of the Company's prior year sales were attributable to seasonal (Christmas, Valentine's Day, Easter and Halloween) products, with the remainder attributable to all occasion products. Seasonal products are sold primarily to mass market retailers, and the Company has relatively high market share in many of these categories. Most of these markets have shown little growth and in some cases have declined in recent years, and the Company continues to confront significant price pressure as its competitors source certain products from overseas and its customers increase direct sourcing from overseas factories. Increasing customer concentration has augmented their bargaining power, which has also contributed to price pressure. In recent fiscal years, the Company experienced lower sales in its gift wrap, boxed greeting card, ribbons and bow, gift tissue and gift bag lines. In addition, both seasonal and all occasion sales declines were further exacerbated as the current economic downturn deepened in the fall of calendar 2008 and continues into the current fiscal year as we have experienced slowness or reductions in order patterns by our customers.

The Company has taken several measures to respond to sales volume, cost and price pressures. The Company believes it continues to have strong core Christmas product offerings which has helped us to maintain market share in this competitive market. In addition, we are aggressively pursuing new product initiatives related to seasonal, craft and all occasion products, including new licensed and non-licensed product offerings. CSS continually invests in product and packaging design and product knowledge to assure 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. In the last five fiscal years, the Company has closed five manufacturing plants and five warehouses totaling 1,209,000 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. In fiscal 2009, the Company initiated the consolidation of its human resources, accounts receivable, accounts payable and payroll functions into a combined back office operation, which was substantially completed in the first quarter of fiscal 2010. Also completed in the first quarter of fiscal 2010 was the implementation of the first phase of integrating the Company's enterprise resource planning systems standardization project.

In recent months, our domestically-manufactured narrow woven ribbon product lines have experienced significant price pressure and the prospect of reduced future sales volume due to competition from low-priced imports from Taiwan and China. Based on its belief that these products may be imported from Taiwan and China at less-than-fair-value and that the imports of these products from China may benefit from governmental subsidies, our Berwick Offray company filed a petition in July 2009 with the U.S. International Trade Commission (ITC) and the U.S. Department of Commerce (Commerce Department) seeking the imposition of antidumping duties on narrow woven ribbon imported from Taiwan and China, and seeking the imposition of countervailing duties on narrow woven ribbon imported from China. We expect that the proceedings before the ITC and Commerce Department will conclude by not later than October 2010. If the petition is successful, duties potentially may be imposed on import shipments that arrived in the U.S. from and after as early as September 15, 2009 for countervailing duties, and from and after as early as approximately mid-December 2009 for antidumping duties. The potential impact of these proceedings is not determinable at this time, but management believes that any impact will not have a material effect on the Company's consolidated results of operations or financial condition.

The Company's Halloween product line and all occasion, gift card holder, stationery and infant product lines have higher inherent growth potential due to higher market growth rates. Further, the Company's various all occasion product lines have higher inherent growth potential due to CSS's relatively low current market share. The Company continues to pursue sales growth in these and other areas.

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

CRITICAL ACCOUNTING POLICIES

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

The significant accounting policies of the Company are described in the notes to the consolidated financial statements included in the Annual Report on Form 10-K for the fiscal year ended March 31, 2009. Judgments and estimates of uncertainties are required in applying the Company's accounting policies in many areas. Following are some of the areas requiring significant judgments and estimates: revenue; cash flow and valuation assumptions in performing asset impairment tests of long-lived assets and goodwill; valuation reserves for inventory and accounts receivable; income tax accounting and the valuation of share-based awards. Refer to Impairment of Long-Lived Assets including Goodwill and Other Intangible Assets in Note 1 to the consolidated financial statements for information on the goodwill recoverability test completed in the third quarter of fiscal 2010. There have been no material changes to the critical accounting policies affecting the application of those accounting policies as noted in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2009.

RESULTS OF OPERATIONS

Seasonality

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

Nine Months Ended December 31, 2009 Compared to Nine Months Ended December 31, 2008

Sales for the nine months ended December 31, 2009 decreased 7% to \$396,180,000 from \$425,930,000 in the nine months ended December 31, 2008 primarily due to reduced customer purchases following weak retail sales in the preceding Christmas selling season. Sales of all occasion products in the current fiscal year have also been negatively impacted by the current economic downturn as retailers replenishment rates were lower than expected. Partially offsetting these declines were sales of businesses acquired since the beginning of last fiscal year, growth in our baby memory products business and improved Halloween sales. Excluding sales of businesses acquired since the beginning of last fiscal year, sales declined 9%.

Cost of sales, as a percentage of sales, was 75% in 2009 and 74% in 2008. The increase was primarily due to lower gross margins on domestically produced Christmas products resulting from competitive pricing pressures and manufacturing inefficiencies, some of which were compounded by difficulties encountered from the implementation of a phase of our enterprise resource planning systems standardization project, partially offset by improved margins on imported seasonal products.

Selling, general and administrative (SG&A) expenses decreased \$1,120,000, or 2%, from the prior year period primarily related to the benefit of initiatives implemented by the Company to reduce spending, including the impact of a reduction in workforce initiated in March 2009.

Interest expense, net of \$1,674,000 in 2009 decreased from interest expense, net of \$2,293,000 in 2008 due to lower borrowing levels during the nine months ended December 31, 2009 compared to the same period in the prior year.

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Income taxes, as a percentage of income before taxes, were 36% in 2009 and 35% in 2008. The increase in the effective tax rate was primarily due to recognition in the second and third quarters of fiscal 2009 of the favorable settlement of an outstanding tax audit and the lapse of an applicable statute of limitations.

Net income for the nine months ended December 31, 2009 was \$17,102,000, or \$1.77 per diluted share compared to \$22,420,000, or \$2.22 per diluted share in 2008. The decrease in net income was primarily the result of reduced Christmas sales volume and lower gross margins on domestically produced Christmas products. Partially offsetting these negative factors were improved gross margins related to imported seasonal products, reduced SG&A expenses primarily related to the impact of cost saving initiatives, and lower interest expense.

Three Months Ended December 31, 2009 Compared to Three Months Ended December 31, 2008

Sales for the three months ended December 31, 2009 decreased 8% to \$182,230,000 from \$197,122,000 in the three months ended December 31, 2008 primarily due to reduced customer purchases following weak retail sales in the preceding Christmas selling season. Partially offsetting this decline was the impact of sales of a business acquired since the beginning of last year's third quarter and improved all occasion sales. Excluding sales of a business acquired since the beginning of last year's third quarter, sales declined 9%.

Cost of sales, as a percentage of sales, was 75% in 2009 and 2008. Substantially offsetting improved gross margins on imported seasonal products were lower margins on domestically produced Christmas products resulting from competitive pricing pressures and manufacturing inefficiencies, some of which were compounded by difficulties encountered from the implementation of a phase of our enterprise resource planning systems standardization project.

SG&A expenses increased \$2,694,000, or 12%, from the prior year period primarily due to lower incentive compensation expenses recorded in the same quarter in the prior year.

Interest expense, net of \$645,000 in 2009 decreased from interest expense, net of \$1,093,000 in 2008 due to lower borrowing levels during the three months ended December 31, 2009 compared to the same period in the prior year.

Income taxes, as a percentage of income before taxes, were 36% in 2009 and 35% in 2008. The increase in the effective tax rate was primarily due to the absence of a benefit recorded in the third quarter of fiscal 2009 following the lapse of an applicable statute of limitations.

Net income for the three months ended December 31, 2009 was \$12,700,000, or \$1.31 per diluted share compared to \$16,412,000, or \$1.68 per diluted share in 2008. The decrease in net income for the quarter ended December 31, 2009 was primarily the result of lower Christmas sales volume and lower margins on domestically produced Christmas products and higher SG&A expenses, partially offset by improved gross margins on imported seasonal products.

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2009, the Company had working capital of \$136,589,000 and stockholders' equity of \$274,593,000. The increase in accounts receivable from March 31, 2009 reflected seasonal billings of current year Christmas accounts receivables, net of current year collections. The decrease in inventories from March 31, 2009 reflects the normal seasonal shipments during the fiscal 2010 shipping season and improved inventory management. The increase in other current liabilities was primarily due to higher accounts payable and increased accruals for income taxes, sales commissions and royalties. The increase in stockholders' equity from March 31, 2009 was primarily attributable to year-to-date net income, partially offset by payments of cash dividends.

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The Company relies primarily on cash generated from its operations and seasonal borrowings to meet its liquidity requirements. Historically, a significant portion of the Company's revenues have been seasonal with approximately 75% 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 are met under a \$110,000,000 revolving credit facility with four banks and an accounts receivable securitization facility with an issuer of receivables-backed commercial paper. This facility has a funding limit of \$75,000,000 during peak seasonal periods and \$25,000,000 during off-peak seasonal periods. 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. The Company made its final repayment of 4.48% senior notes in December 2009. At December 31, 2009, the Company's borrowings consisted of \$46,100,000 outstanding under the Company's short-term credit facilities and the Company has approximately \$611,000 of capital leases outstanding. Based on its current operating plan, the Company believes its sources of available capital are adequate to meet its future cash needs for at least the next 12 months.

As of December 31, 2009, the Company's letter of credit commitments are as follows (in thousands):

	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years	Total
Letters of credit	\$ 4,920				\$ 4,920

The Company has a reimbursement obligation with respect to stand-by letters of credit that guarantee the funding of workers compensation claims and guarantee the funding of obligations to certain vendors. The Company has no financial guarantees 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 cancelled.

LABOR RELATIONS

With the exception of the bargaining units at the gift wrap facilities in Memphis, Tennessee and the ribbon manufacturing facilities in Hagerstown, Maryland, which totaled approximately 630 employees as of December 31, 2009, CSS employees are not represented by labor unions. Because of the seasonal nature of certain of its businesses, the number of production employees fluctuates during the year. The collective bargaining agreement with the labor union representing Cleo's production and maintenance employees at the Cleo gift wrap plant and warehouses in Memphis, Tennessee remains in effect until December 31, 2010. The collective bargaining agreement with the labor union representing the Hagerstown-based production and maintenance employees remains in effect until December 31, 2011.

ACCOUNTING PRONOUNCEMENTS

See Note 2 to the consolidated financial statements for information concerning recent accounting pronouncements and the impact of those standards.

Table of Contents**FORWARD-LOOKING STATEMENTS**

This report includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements regarding continued use of acquisitions to stimulate further growth; the expected future impact of legal proceedings and changes in accounting principles; the anticipated effects of measures taken by the Company to respond to sales volume, cost and price pressures; and strengthened product lines and new product initiatives. 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 and economic conditions; increased competition (including competition from foreign products which may be imported at less than fair value and from foreign products which may benefit from foreign governmental subsidies); 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 and the risk that the Company may not be able to integrate and derive the expected benefits from such acquisitions; risks associated with the Company's enterprise resource planning 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, may delay payments or may impose deductions or penalties on amounts owed to the Company; 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 in the Company's annual report on Form 10-K for the fiscal year ended March 31, 2009 and elsewhere in the Company's 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 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to the impact of interest rate changes and manages this exposure through the use of variable-rate debt. The Company is also exposed to foreign currency fluctuations which it manages by entering 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 does not enter into contracts for trading purposes and does not use leveraged instruments. The market risks associated with debt obligations and other significant instruments as of December 31, 2009 have not materially changed from March 31, 2009 (see Item 7A of the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2009).

ITEM 4. CONTROLS AND PROCEDURES

- (a) *Evaluation of Disclosure Controls and Procedures.* As of the end of the period covered by this report, 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 in accordance with Rule 13a-15 of the Securities Exchange Act of 1934 (the Exchange Act). 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 under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.
- (b) *Changes in Internal Controls.* There was no change in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) as promulgated by the Securities and Exchange Commission under the

Exchange Act) during the third quarter of fiscal year 2010 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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CSS INDUSTRIES, INC. AND SUBSIDIARIES

PART II OTHER INFORMATION

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

Unregistered Sales of Equity Securities

On November 18, 2009, CSS issued 6,000 shares of its common stock (\$.10 par value) to a member of the Board of Directors of CSS, upon such director's exercise of stock options previously granted to such director pursuant to CSS 1995 Stock Option Plan for Non-Employee Directors (the 1995 Plan). The aggregate purchase price for these 6,000 shares of CSS common stock was \$85,500, which was paid in cash.

On November 24, 2009, CSS issued 6,000 shares of its common stock (\$.10 par value) to a member of the Board of Directors of CSS, upon such director's exercise of stock options previously granted to such director under the 1995 Plan. The aggregate purchase price for these 6,000 shares of CSS common stock was \$85,500, which was paid in cash.

On November 30, 2009, CSS issued options to purchase 24,000 shares of its common stock (\$.10 par value) to the non-employee members of the Board of Directors of CSS pursuant to CSS 2006 Stock Option Plan for Non-Employee Directors (the 2006 Plan). The 2006 Plan provides for the automatic issuance of an option to purchase 4,000 shares of CSS common stock to each non-employee director of CSS on the last trading day of November of each year from 2006 to 2010. In accordance with the automatic grant provisions of the 2006 Plan, each of the options granted on November 30, 2009: (i) has an exercise price of \$18.55 per share, the closing price for shares of CSS common stock on the date of the grant; (ii) becomes exercisable in four equal installments, commencing on the first anniversary of the date of grant and annually thereafter; and (iii) expires five years after the date of grant. No consideration is required to be paid to the Company in connection with the issuance of options under the 2006 Plan, and none was received.

The options granted pursuant to the 1995 Plan and the 2006 Plan were not registered under the Securities Act of 1933, as amended (the Securities Act), and the shares of CSS common stock issued upon exercise of the aforementioned options issued under the 1995 Plan were not registered under the Securities Act. CSS believes that the issuance of the options, and the issuance of the aforementioned shares of CSS common stock in connection with the exercise of options, was exempt from registration under (a) Section 4(2) of the Securities Act as transactions not involving any public offering and such securities having been acquired for investment and not with a view to distribution, or (b) Rule 701 under the Securities Act as transactions made pursuant to a written compensatory benefit plan or pursuant to a written contract relating to compensation. All recipients had adequate access to information about CSS. CSS did not engage an underwriter in connection with the foregoing stock option grants and stock issuances.

Item 6. Exhibits

- | | |
|--------------|---|
| Exhibit 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. |
| Exhibit 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. |
| Exhibit 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. |
| Exhibit 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. |

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CSS INDUSTRIES, INC.

(Registrant)

Date: February 3, 2010

By: /s/ Christopher J. Munyan
Christopher J. Munyan
President and Chief Executive Officer
(principal executive officer)

Date: February 3, 2010

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