T2 Biosystems, Inc.
Form 10-K
March 14, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the year ended December 31, 2018

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: 001-36571

T2 Biosystems, Inc.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	20-4827488 (I.R.S. Employer Identification No.)
101 Hartwell Avenue, Lexington, MA (Address of principal executive offices)	02421 (Zip code)

Registrant's telephone number, including area code: 781-761-4646

Securities registered pursuant to Section 12(b) of the Act

Title of Each Class:	Name of Each Exchange on which Registered:
Common Stock, par value $0.001 per share	The NASDAQ Stock Market LLC (NASDAQ Global Market)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933, as amended. YES NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934, as amended. YES NO

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 every Interactive Data File required to be submitted 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 such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant’s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. Yes No

As of June 29, 2018, the last business day of the registrant’s most recently completed second fiscal quarter, the aggregate market value of the registrant’s common stock held by non-affiliates was approximately $286.6 million based on the closing price for the common stock of $7.74 on that date. Shares of common stock held by each executive officer, director, and their affiliated stockholders have been excluded from this calculation as such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of outstanding shares of the registrant’s common stock on March 8, 2019 was 44,320,048. The common stock is listed on the NASDAQ Global Market (trading symbol “TTOO”).

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant’s definitive Proxy Statement to be filed with the Securities and Exchange Commission within 120 days after the close of the fiscal year are incorporated by reference into Part III of this report.

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FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains forward-looking statements about us and our industry that involve substantial risks and uncertainties. We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in Section 27A of the Securities Act of 1933, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, or the Exchange Act. All statements other than statements of historical facts contained in this Annual Report on Form 10-K, including statements regarding our future results of operations and financial position, business strategy, prospective products and product candidates, their expected performance and impact on healthcare costs, marketing clearance from the U.S. Food and Drug Administration, or the FDA, regulatory clearance, reimbursement for our product candidates, research and development costs, timing of regulatory filings, timing and likelihood of success, plans and objectives of management for future operations and future results of anticipated products, are forward-looking statements. These statements involve known and unknown risks, uncertainties and other important factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements.

In some cases, you can identify forward-looking statements by terms such as “may,” “will,” “should,” “expect,” “plan,” “anticipate,” “could,” “intend,” “target,” “project,” “contemplate,” “believe,” “estimate,” “forecast,” “predict,” “potential” or “ negative of these terms or other similar expressions. The forward-looking statements in this Annual Report on Form 10-K are only predictions. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our business, financial condition and results of operations. These forward-looking statements speak only as of the date of this Annual Report on Form 10-K and are subject to a number of risks, uncertainties and assumptions described under the sections in this Annual Report on Form 10-K entitled “Item 1A.—Risk Factors”. These forward looking statements are subject to numerous risks, including, without limitation, the following:

- our status as an early stage company;

- our expectation to incur losses in the future;
- the market acceptance of our T2MR technology;
- our ability to timely and successfully develop and commercialize our existing products and future product candidates;
- the length and variability of our anticipated sales and adoption cycle;
- our limited sales history;
- our ability to gain the support of leading hospitals and key thought leaders and publish the results of our clinical trials in peer-reviewed journals;
- our ability to successfully manage our growth;
- our future capital needs and our ability to raise additional funds;
- the performance of our diagnostics;
- our ability to compete in the highly competitive diagnostics market;
- our ability to obtain marketing clearance from the FDA or regulatory clearance for new product candidates in the United States or any other jurisdiction;
- impacts of and delays caused by future federal government shutdowns;
- federal, state, and foreign regulatory requirements, including diagnostic product reimbursements and FDA regulation of our product candidates;
- our ability to protect and enforce our intellectual property rights, including our trade secret-protected proprietary rights in T2MR;
- our ability to recruit, train and retain key personnel;
- our dependence on third parties;
- our ability to continue as a going concern;
- manufacturing and other product risks;
- the impact of the adoption of new accounting standards; and
- the Tax Cuts and Jobs Act of 2017 (Tax Reform)

These forward-looking statements represent our estimates and assumptions only as of the date of this Annual Report on Form 10-K. Unless required by U.S. federal securities laws, we do not intend to update any of these forward-looking statements to reflect circumstances or events that occur after the statement is made or to conform these statements to actual results. The following discussion should be read in conjunction with the financial statements and notes thereto appearing elsewhere in this Annual Report on Form 10-K. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of various factors.

You should read the following discussion and analysis of our financial condition and results of operations together with our financial statements and related notes thereto included elsewhere in this Annual Report on Form 10-K. Some of the information contained in this discussion and analysis or set forth elsewhere in this Annual Report on Form 10-K, including information with respect to our plans and strategy for our business and related financing, includes forward-looking statements that involve risks and uncertainties. As a result of many factors, including those factors set forth in the "Item 1A.—Risk Factors" section of this Annual Report on Form 10-K, our actual results could differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis.

PART I.

Item 1. BUSINESS
Overview

We are an in vitro diagnostics company that has developed an innovative and proprietary technology platform that offers a rapid, sensitive and simple alternative to existing diagnostic methodologies. We are using our T2 Magnetic Resonance technology, or T2MR, to develop a broad set of applications aimed at lowering mortality rates, improving patient outcomes and reducing the cost of healthcare by helping medical professionals make targeted treatment decisions earlier. T2MR enables rapid detection of pathogens, biomarkers and other abnormalities in a variety of unpurified patient sample types, including whole blood, plasma, serum, saliva, sputum and urine, and can detect cellular targets at limits of detection as low as one colony forming unit per milliliter, or CFU/mL. Our initial development efforts target sepsis and Lyme disease, which are areas of significant unmet medical need in which existing therapies could be more effective with improved diagnostics.

On September 22, 2014, we received market clearance from the FDA for our first two products, the T2Dx instrument, or the T2Dx and the T2Candida Panel, or T2Candida, which have the ability to rapidly identify the five clinically relevant species of Candida, a fungal pathogen known to cause sepsis, directly from whole blood. On May 24, 2018, we received market clearance from the FDA for our T2Bacteria Panel, or T2Bacteria, which runs on the T2Dx and has the ability to rapidly identify five of the most common and deadly sepsis-causing bacteria (members of the ESKAPE pathogens) directly from whole blood. We have also developed and sell a research use only Candida auris assay for the rapid identification of Candida auris, a species of Candida that is highly drug resistant. Two additional diagnostic applications in development are called T2Carba Resistance+ and T2Lyme, which are focused on gram-negative bacterial sepsis infections and Lyme disease, respectively. Diagnostic applications for additional bacteria species and resistance markers are in development as part of a collaboration with CARB-X, a public-private partnership with the U.S. Department of Health and Human Services, or HHS, and the Wellcome Trust of London, focused on combatting antibiotic resistant bacteria. We anticipate that existing reimbursement codes will support our sepsis and Lyme disease product candidates, and that the anticipated economic savings associated with our sepsis products will be realized directly by hospitals. In the United States, we have built a direct sales force that is primarily targeting the top 1,200 hospitals with the highest concentration of patients at risk for sepsis-related infections. Internationally, we have primarily partnered with distributors that target large hospitals in their respective international markets.

Sepsis is one of the leading causes of death in the United States, claiming more lives annually than breast cancer, prostate cancer, and AIDS combined, and it is the most expensive hospital-treated condition. Most commonly afflicting immunocompromised, critical care, and elderly patients, sepsis is a severe inflammatory response to a bacterial or fungal infection with a mortality rate of approximately 30%. Based on data published by the HHS in 2017, the cost of sepsis was over $27 billion in the United States, building on data from 2013 demonstrating that sepsis was responsible for approximately 5% of the total aggregate costs associated with domestic hospital stays. Sepsis is typically caused by one or more of five Candida species or over 25 bacterial pathogens, and effective treatment requires the early detection and identification of these specific target pathogens in a patient's bloodstream. Today, sepsis is typically diagnosed through a series of blood cultures followed by post-blood culture species identification if a blood culture tests positive. These methods have substantial diagnostic limitations that lead to a high rate of false negative test results, a delay of up to several days in administration of targeted treatment, and the incurrence of unnecessary hospital expense. In addition, the Survey of Physicians' Perspectives and Knowledge About Diagnostic Tests for Bloodstream Infections in 2015 reported that negative blood culture results are only trusted by 36% of those physicians. Without the ability to rapidly identify pathogens, physicians typically start treatment of at-risk patients with broad-spectrum antibiotics and switch therapies every 12 to 24 hours if a patient is not responding. These drugs, which can be costly, are often ineffective and unnecessary and have contributed to the spread of antimicrobial resistance. The speed to getting the patient on the right targeted therapy is critical. According to a study published by Critical Care Medicine in 2006, in sepsis patients with documented hypotension, administration of effective antimicrobial therapy within the first hour of detection was associated with a survival rate of 79.9% and, over the ensuing six hours, each hour of delay in initiation of treatment was associated with an average decrease in survival of 7.6%.

Candida is the fourth leading hospital-acquired bloodstream infection, afflicting more than 135,000 patients per year in the United States, and the most lethal form of common bloodstream infections that cause sepsis, with an average mortality rate of approximately 40%. This high mortality rate is largely due to a delay in providing targeted therapy to the patient due to the elapsed time from Candida infection to positive diagnosis. According to a study published in Antimicrobial Agents and Chemotherapy, the Candida mortality rate can be reduced to 11% with the initiation of targeted therapy within 12 hours of presentation of symptoms. Additionally, a typical patient with a Candida infection averages 40 days in the hospital, including nine days in intensive care, resulting in an average cost per hospital stay of more than $130,000 per patient. In a study published in the American Journal of Respiratory and Critical Care Medicine, providing targeted antifungal therapy within 24 hours of the presentation of symptoms decreased the length of hospital stay by approximately ten days and decreased the average cost of care by approximately $30,000 per patient.

We believe our sepsis products, which include T2Candida and T2Bacteria, will redefine the standard of care in sepsis management while lowering healthcare costs by improving both the precision and the speed of detection of sepsis-causing pathogens. According to a study published in the Journal of Clinical Microbiology in 2010, targeted therapy for patients with bloodstream infections can be delayed up to 72 hours due to the wait time for blood culture results. In another study published in Clinical Infectious Diseases in 2012, the delayed administration of appropriate antifungal therapy was associated with higher mortality among patients with septic shock attributed to Candida infection and, on that basis, the study concluded that more rapid and accurate diagnostic techniques are needed.

Our pivotal clinical trial for T2Candida demonstrated that it can deliver actionable results in as few as three hours, with an average time to result during the trial of 4.2 hours, compared to the average time to result of one to six or more days typically required for blood-culture-based diagnostics and the pivotal clinical trial for T2Bacteria demonstrated that it can deliver actionable results in an average of 5.4 hours, compared to an average of 60 hours for detecting the same species by blood culture. We believe the speed of the T2Candida and T2Bacteria tests will enable physicians to potentially make treatment decisions and administer targeted treatment to patients in four to six hours versus 24 to 144 hours for blood culture. Furthermore, in April 2015, Future Microbiology published the results of an economic study regarding the use of T2Candida conducted by IMS Health, a healthcare economics agency. In that economic study, IMS demonstrated that an average hospital admitting 5,100 patients at risk for Candida infections could save approximately $5.8 million annually due to decreased hospital stays for patients, reduction in use of antifungal drugs and other associated savings. The economic study further showed T2Candida can potentially reduce the costs of care by $26,887 per Candida patient and that rapid detection of Candida reduces patient deaths by 60.6%. Results from a data analysis of T2Candida for the detection and monitoring of Candida infection and sepsis were published comparing aggregated results from the use of T2Candida to blood culture-based diagnostics for the detection of invasive candidiasis and candidemia. The analysis included samples acquired from more than 1,900 patients. Out of 55 prospective patient cases that were tested with T2Candida and blood culture and determined to be positive or likely to be positive for a Candida infection, T2Candida detected 96.4% of the patients (53 cases) compared to detection of 60% of the patients (33 cases) with blood culture.

In addition, due to the high mortality rate associated with Candida infections, physicians often will place patients on antifungal drugs while they await blood culture diagnostic results which generally take at least five days to generate a negative test result. Antifungal drugs are toxic and may result in side effects and can cost over $50 per day. The speed to result of T2Candida and T2Bacteria coupled with their superior sensitivity as compared to blood culture may help reduce the overuse of ineffective, or even unnecessary, antimicrobial therapy which may reduce side effects for patients, lower hospital costs and potentially counteract the growing resistance to antifungal therapy. The administration of inappropriate therapy is a driving force behind the spread of antimicrobial-resistant pathogens, which the United States Centers for Disease Control and Prevention, or the CDC, recently called “one of our most serious health threats.” The addition of the use of our products, T2Bacteria and T2Candida, which both run on the T2Dx instrument, with the standard of care for the management of patients suspected of sepsis, enables clinicians to potentially treat 90% of patients with sepsis pathogen infections with the right targeted therapy within the first twelve hours of development of the symptoms of disease. Currently, high risk patients are typically initially treated with broad spectrum antibiotic drugs that typically cover approximately 60% of patients with infections. Of the remaining 40% of patients, approximately 30% of the patients typically have a bacterial infection and 10% typically have Candida infections. T2Candida and T2Bacteria are designed to identify pathogens commonly not covered by broad spectrum antibiotic drugs.

Our Strategy

T2MR enables rapid and sensitive direct detection of a range of targets, and we believe it can be used in a variety of diagnostic applications that will improve patient outcomes and reduce healthcare costs. Our objective is to establish T2MR as a standard of care for clinical diagnostics. To achieve this objective, our strategy is to:

- Drive Commercial Adoption of Our Sepsis Products by Demonstrating Their Value to Physicians, Laboratory Directors and Hospitals. We expect our sepsis products to meaningfully improve patient outcomes while reducing costs to hospitals. We have established a targeted, direct sales force in the United States and have partnered with distributors internationally, all of whom are initially focused on educating physicians and demonstrating our clinical and economic value proposition to hospitals that have the highest populations of at-risk critical care and immunocompromised patients. We believe a sustained focus on these hospitals will drive adoption of the T2Dx, T2Candida, T2Bacteria, and future T2MR-based diagnostics. As a part of this effort, we will continue to work with thought leaders, conduct clinical and health economic studies and seek publication and presentation of these studies.
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Establish a Recurring, Consumables-Based Business Model. We are pursuing a consumables-based business model for our products by securing placements of the T2Dx at hospitals and driving utilization of our diagnostic panels starting with T2Candida and T2Bacteria. We believe this strategy will foster a sustainable and predictable business model with recurring revenue streams.

- Broaden Our Addressable Markets in Infectious Disease. Our product development pipeline includes additional diagnostic panels that provide near-term and complementary market expansion opportunities. We will expand our panels through partnerships similar to our agreement with Allergan, in which Allergan agreed to cover a portion of the costs of our development of certain additional products, including antibiotic resistance tests. We also are utilizing T2MR to address the challenges of providing rapid and sensitive diagnosis of Lyme disease and initiated a T2Lyme clinical trial in 2018.
- Broaden Our Addressable Markets Beyond Infectious Disease. We intend to expand our product offerings by applying T2MR to new applications beyond sepsis and Lyme disease. We plan to conduct internal development and to work with thought leaders, physicians, clinical researchers and business development partners to pursue new applications for T2MR. We believe the benefits of our proprietary technology, including the ability to rapidly and directly detect a broad range of targets, in a wide variety of sample types, will have potential applications within and outside of the in vitro diagnostics market, including environmental, food safety, industrial and veterinary applications.
- Drive International Expansion. We are commercializing T2Candida, T2Bacteria and the T2Dx internationally through distributors that target large hospitals in their respective markets. We intend to continue to expand in international markets through similar distribution channels. We have received CE marking for T2Candida, T2Bacteria and the T2Dx.

Our Technology Platform

T2 Magnetic Resonance Technology Overview

We have built an innovative and proprietary technology platform that offers a rapid, sensitive and simple alternative to existing diagnostic methodologies. T2MR is a miniaturized, magnetic resonance-based approach that measures how water molecules react in the presence of magnetic fields. Our proprietary platform is capable of detecting a variety of targets, including:

- molecular targets, such as DNA;
- immunodiagnostics targets, such as proteins; and
- a broad range of hemostasis measurements.

For molecular and immunodiagnostics targets, T2MR utilizes advances in the field of magnetic resonance by deploying particles with magnetic properties that enhance the magnetic resonance signals of specific targets. When particles coated with target-specific binding agents are added to a sample containing the target, the particles bind to and cluster around the target. This clustering changes the microscopic environment of water in that sample, which in turn alters the magnetic resonance signal, or the T2 relaxation signal that we measure, indicating the presence of the target.

We also believe T2MR is the first technology that can rapidly and accurately detect the presence of molecular targets within samples without the need for time- and labor-intensive purification or extraction of target molecules from the sample, such as that required by traditional polymerase chain reaction, or PCR, where 90% or more of the target can be lost. We can eliminate these steps because the T2 relaxation signal is not compromised or disrupted by the sample background, even the highly complex sample background that is present after a target amplification process, such as thermocycling. This enables T2MR’s low limit of detection, such as 1 CFU/mL, compared to the 100 to 1,000 CFU/mL typically required for PCR-based methods. More than 100 studies published in peer-reviewed journals have featured T2MR in a breadth of applications, including the direct detection and measurement of targets in various sample types, such as whole blood, plasma, serum, saliva, sputum and urine. We believe our T2MR technology will have potential applications within and outside of the in vitro diagnostics market, including environmental, food safety, industrial and veterinary applications.

Our Instruments

Utilizing T2MR, we have developed and received FDA marketing clearance for the T2Dx, a bench-top instrument for detecting pathogens associated with sepsis and Lyme disease, as well as other applications.

T2Dx

Our FDA-cleared T2Dx instrument is an easy-to-use, bench-top instrument that is capable of running a broad range of diagnostic tests and is fully automated from patient sample input to result, eliminating the need for manual work flow steps such as pipetting that can introduce risks of cross-contamination. To operate the system, a patient’s sample tube is snapped onto a disposable test cartridge, which is pre-loaded with all necessary reagents. The cartridge is then inserted into the T2Dx instrument, which automatically processes the sample and then delivers a diagnostic test result. Test results are displayed on screen and printed out.

By utilizing our proprietary T2MR technology for direct detection, the T2Dx instrument eliminates the need for sample purification and analyte extraction, which are necessary for other optical-detection devices. Eliminating these sample processing steps increases diagnostic sensitivity and accuracy, enables a broad menu of tests to be run on a single platform, and greatly reduces the complexity of the consumables. The T2Dx instrument incorporates a simple user interface and is designed to efficiently process up to seven specimens simultaneously.

The initial panels designed to run on the T2Dx are T2Candida and T2Bacteria, which are focused on identifying life-threatening pathogens associated with sepsis. In 2014 we received FDA market clearance for the T2Dx and T2Candida. In May 2018, we received FDA market clearance for T2Bacteria.

Sepsis

Overview

Sepsis is an illness in which the body has a severe, inflammatory response to a bacterial or fungal infection. It is a life-threatening condition to which individuals with weakened immune systems or chronic illnesses are highly susceptible. Sepsis can lead to shock and organ failure, and is a leading cause of death in the United States with a mortality rate of approximately 30%, almost double the mortality rate of acute myocardial infarction, or heart attack. One out of every two hospital deaths in the United States is attributable to sepsis.

In 2016, HHS reported that sepsis is the most expensive hospital-treated condition in the United States, with an economic burden to hospitals exceeding $23 billion annually, almost double that of acute myocardial infarction. New data on the number of sepsis cases in the United States published by HHS in 2017 indicate that the economic burden now exceeds $27 billion. The high cost of treating sepsis is primarily driven by the extended hospitalization of patients. We believe there are many effective, targeted therapeutic choices that could reduce overall hospitalization costs if applied earlier, but clinicians need to more rapidly identify the specific sepsis-causing pathogens in order to make more informed, targeted treatment decisions. Today, the diagnostic standard to identify these pathogens is blood culture-based, despite typically requiring one to six or more days to generate species-specific results and despite blood cultures inherent low sensitivity of 50% to 65%.

The following table reflects key statistics from the 2016 HHS study regarding the five most expensive hospital-treated conditions:

Rank	Condition	U.S. hospital costs (in billions)	Percentage of total inpatient costs
1	Sepsis	$ 23.6	6.2 %
2	Osteoarthritis	16.5	4.3
3	Liveborn	13.3	3.5
4	Complication of device, implant or graft	12.4	3.3
5	Acute myocardial infarction (heart attack)	12.0	3.2

Over 1.6 million individuals are diagnosed with sepsis each year in the United States, 1.35 million of whom are at high risk for infection due to their suppressed immune system or their presence in critical care units. Virtually all of these patients are rapidly treated with broad-spectrum antibiotic drugs because there is no diagnostic manner for determining the type of infection. Of these 1.35 million patients with sepsis and at high risk for infection, approximately 40% do not respond to broad-spectrum antibiotic treatment. Of these patients that are non-responsive, approximately 25% of them have a Candida infection, with the remaining patients having a bacterial infection. Broad-spectrum antibiotics do not treat these Candida and bacterial infections; therefore more targeted drugs are required.

We estimate that approximately 15 million patients are tested for bloodstream infections in the United States annually. Of these, approximately 8.75 million are at high risk for a Sepsis infection, 90% of whom are at a high risk for a bacterial infection and 10% of whom are at a high risk for a Candida infection. Of these 8.75 million patients, 6.75 million patients present in in-patient settings and an additional 2.0 million present in emergency departments. We believe that our sepsis products have the potential to enable clinicians to make earlier therapeutic decisions that can reduce the mortality rate for sepsis by over 50% and save the hospitals an estimated $12 billion annually by testing all high risk patients with T2Candida and T2Bacteria.

Each year, over 30 million people worldwide are affected by sepsis with approximately six million mortalities, according to the World Health Organization, making sepsis a leading cause of death worldwide.

Limitations of Traditional In Vitro Diagnostics for Sepsis

The current standard for identifying bloodstream infections that cause sepsis requires a series of lengthy and labor-intensive analyses that begin with blood culture. Completing a blood culture requires a large volume of a patient’s blood, typically 20 mLs or more, which is obtained in two 10 mL draws and placed into two blood culture bottles containing nutrients formulated to grow fungi and bacteria. Before blood culture indicates if a patient is infected, pathogens typically must reach a concentration of 1,000,000 to 100,000,000 CFU/mL. This growth process typically takes one to six or more days because the pathogen’s initial concentration in the blood specimen is often less than 10 CFU/mL. A negative test result always requires a minimum of five days. A positive blood culture typically means that some pathogen is present, but additional steps must be performed to identify the specific pathogen in order to provide targeted therapy. These additional steps, which typically must be performed by a highly trained technician, may involve any of (i) a staining procedure for inspection on a microscope slide, (ii) PCR amplification and (iii) mass spectrometry. These steps require a preceding positive blood culture specimen because they need a high concentration of cells generated by the blood culture process for analysis.

For most PCR-based diagnostics, nucleic acid extraction of target cells from the sample is performed to remove inhibitory substances that may interfere with the amplification reaction. While PCR amplifies the target signal, this loss of target cells impairs the ability to detect, resulting in typical limits of detection of 100 to 1,000 CFU/mL, which is insufficient for species-specific sepsis diagnostics.

Blood culture-based diagnostics have substantial limitations, including:

- Time to Result Delays Targeted Treatment. Blood culture-based diagnostics typically require a minimum of one and as many as six or more days to identify a pathogen species, and blood culture always requires at least five days to generate a negative test result.
- Antimicrobial Therapy Can Cause False Negative Results. Antimicrobial therapies may be administered to a patient prior to taking a blood sample. As a result, the therapeutic agent is contained in the blood sample and its ability to stop or slow the growth of pathogens can delay or completely inhibit the growth of the pathogen during the blood culture process leading to time delays in detection or false negative results.
- Slow-Growing Pathogens Can Cause False Negative Results. Some sepsis pathogens grow slowly or not at all and can require up to five or more days to reach sufficient concentrations to be detected by blood culture-based diagnostics. Blood culture procedures are typically stopped after five days and declared negative. Often, pathogens that grow too slowly are not detected by blood culture during this time frame, leading to a false negative diagnosis. For example, C. glabrata, one of the most lethal species of Candida due to its growing resistance to antifungal therapy, often requires more than five days of growth to reach a detectable concentration, and therefore is frequently undetected by blood culture.
- Labor-Intensive Workflow Increases Costs and May Delay Targeted Treatment. Blood culture is only the first step in identifying a pathogen that causes sepsis. After a blood culture is determined to be positive, highly trained technicians are required to perform multiple post-culture procedures on the blood culture specimen to identify the specific pathogen. These additional procedures can be expensive and time-consuming and may delay targeted treatment.

Given the typical one-to-six day time to result for blood culture-based diagnostics, the first therapy for a patient at risk of sepsis is often broad-spectrum antibiotics, which treat some but not all bacteria types and do not address fungal infections. Some physicians may use first-line, antifungal therapy for patients at very high risk for fungal infection, or use antifungal therapy if the patient is not responding to broad-spectrum antibiotics while they are still awaiting the blood culture-based result. This therapeutic approach may still not treat the growing number of patients infected with the antimicrobial-resistant species nor may it be the best choice, as the type of therapy is dependent on the specific pathogen causing the infection, which is unknown.

This inefficient therapeutic approach has resulted in unnecessary treatment of a significant number of high-risk patients with expensive and often toxic therapies that can worsen a patient's condition. Such treatments may extend for many days while clinicians await blood culture-based diagnostic results. The overuse of ineffective, or even unnecessary, antimicrobial therapy is also a driving force behind the spread of antimicrobial-resistant pathogens, which the CDC recently called "one of our most serious health threats." The CDC has specifically noted increasing incidence of Candida infections due to azole- and echinocandin-resistant strains and considers it a "serious" threat level. According to the CDC, at least two million people in the United States acquire serious infections each year that are resistant to one or more of the antimicrobial therapies used to treat these patients. At least 23,000 of these people are estimated to die as a direct result of the resistant infections and many more may die from other conditions that are complicated by a resistant infection. Further, antimicrobial-resistant infections add considerable and avoidable costs to the already overburdened U.S. healthcare system, with the total economic cost estimated to be as high as $20 billion in excess of direct healthcare costs, with additional costs to society as high as $35 billion, due to lost productivity.

Our T2Direct Diagnostics

We believe T2MR delivers what no conventional technology currently available can: a rapid, sensitive and simple diagnostic platform to enable sepsis applications that can identify specific sepsis pathogens directly from an unpurified blood sample in hours instead of days at a level of accuracy equal to or better than blood culture-based diagnostics. The addition of the use of our products, T2Bacteria and T2Candida, with the standard of care for the management of patients suspected of sepsis enables clinicians to potentially treat 90% of patients with sepsis pathogen infections with the right targeted therapy within the first twelve hours of developing the symptoms of disease. Currently, high risk patients are typically initially treated with broad spectrum antibiotic drugs that typically cover approximately 60% of patients with infections. Of the remaining 40% of patients, approximately 30% of the patients have a bacterial infection and 10% have Candida infections. T2Candida and T2Bacteria are designed to identify pathogens commonly not covered by broad spectrum antibiotic drugs.

We believe our products provide a pathway for more rapid and targeted treatment of infections, potentially reducing the mortality rate by as much as 50% if a patient is treated within 12 hours of suspicion of infection and significantly reducing the cost burden of sepsis. Each year, approximately 250,000 patients in the United States die from sepsis. According to a study published by Critical Care Medicine in 2006, in sepsis patients with documented hypotension, administration of effective antimicrobial therapy within the first hour of detection was associated with a survival rate of 79.9% and, over the ensuing six hours, each hour of delay in initiation of treatment was associated with an average decrease in survival of 7.6%. According to such study, the survival rate for septic patients who remained untreated for greater than 36 hours was approximately 5%. The toll of sepsis on a patient's health can be severe: more than one-in-five patients die within two years as a consequence of sepsis. Sepsis is also the most prevalent and costly cause of hospital readmissions.

We believe the T2Direct Diagnostics addresses a significant unmet need in in vitro diagnostics by providing:

- Limits of Detection as Low as 1 CFU/mL. T2MR is the only technology currently available that can enable identification of sepsis pathogens directly from a patient's blood sample at limits of detection as low as 1 CFU/mL.

- Rapid and Specific Results in as Few as Three Hours. T2MR is the only technology that can enable species-specific results for pathogens associated with sepsis, directly from a patient's blood sample, without the need for blood culture, to deliver an actionable result in three hours.
- Accurate Results Even in the Presence of Antimicrobial Therapy. T2MR is the only technology that can reliably detect pathogens associated with sepsis, including slow-growing pathogens, such as C. glabrata, directly from a patient's blood sample, even in the presence of an antimicrobial therapy.
- Easy-to-Use Platform. T2MR eliminates the need for sample purification or extraction of target pathogens, enabling sample- to-result instruments that can be operated on-site by hospital staff, without the need for highly skilled technicians.

Our first U.S. Food and Drug Administration, or FDA-cleared products, the T2Dx and T2Candida, focus on the most lethal form of common blood stream infections that cause sepsis, Candida, which has an average mortality rate of approximately 40%. According to a 2005 report published in Antimicrobial Agents and Chemotherapy, this high mortality rate can be reduced to 11% with the initiation of targeted therapy within 12 hours of presentation of symptoms. Currently, a typical patient with a Candida infection averages 40 days in the hospital, including nine days in intensive care, resulting in an average cost per hospital stay of over $130,000 per patient. In a study published in the American Journal of Respiratory and Critical Care Medicine in 2009, providing targeted antifungal therapy within 24 hours of the presentation of symptoms decreased the length of hospital stay by approximately ten days and decreased the average cost of care by approximately $30,000 per patient. In addition, many hospitals initiate antifungal drugs, such as Caspofungin or Micafungin, while waiting for blood culture-based diagnostic results. We estimate this practice costs approximately $500 per patient and is currently in use for over 40% of high-risk patients on average and for all high-risk patients in some hospitals. A negative result from T2Candida can provide timely data allowing physicians to avoid unnecessary antifungal treatment and potentially reduce the treatment cost further.

We believe that by identifying the specific species of Candida, physicians can administer the most effective therapy, significantly improving patient outcomes and reducing hospital costs. We further believe that the adoption of the T2Dx and T2Candida can decrease both the high mortality rate and excessive costs of Candida infections because these products can enable clinicians to make earlier and more informed decisions by providing positive test results to direct therapy and negative test results to reduce the use of antifungal drugs.

T2Bacteria, a multiplex diagnostic panel that detects the major bacterial pathogens associated with sepsis that are frequently not covered by first-line antibiotics, is CE-Marked and available commercially in Europe and other countries that accept the CE mark, as well as available as a research-use-only product in the United States. T2Bacteria runs on the T2Dx, and addresses the same approximately 6.75 million symptomatic high-risk patients as T2Candida while also expanding our reach to an additional two million people presenting with symptoms of infection in the emergency room setting. We believe that these factors make the United States market opportunity for T2Bacteria over $1.0 billion, and that T2Bacteria has the potential to achieve similar performance capabilities and provide similar benefits as T2Candida.

To the extent that T2Bacteria is performed on an outpatient basis, third-party payors may separately reimburse our customers using existing CPT codes. By way of example, Medicare payment for outpatient clinical laboratory services is the lesser of the amount billed, the local fee for a geographic area, or the national limit established by the Centers for Medicare & Medicaid Services under the Clinical Laboratory Fee Schedule, or CLFS, on an annual basis. For 2017, the national limit for the series of CPT codes used to bill T2Bacteria is approximately $220. Effective January 1, 2018, CLFS rates are based on weighted median private payor rates as required by the Protecting Access to Medicare Act of 2014. We believe that additional state and federal healthcare reform measures will be adopted in the future, any of which could limit the amounts that federal and state governments will pay for healthcare products and services, which could result in reduced demand for our diagnostic products or additional pricing pressures.

Clinical Utility

T2Candida

DIRECT Clinical Trial—Clinical Infectious Disease

In 2013 and 2014, we conducted a pivotal clinical trial for our T2Dx Instrument and T2Candida, or the DIRECT trial. Our DIRECT trial consisted of two patient arms. The first arm, known as the Prospective Arm, consisted of 1,501 samples from patients with a possible infection. The second arm, known as the Contrived Arm, consisted of 300 samples, of which 250 patient specimens were labeled contrived because each contained a known quantity of Candida CFUs that were manually added to each sample, or spiked, at clinically relevant concentrations, while the remaining 50 patient specimens were specifically known not to contain Candida. The DIRECT trial was designed to evaluate the sensitivity and specificity of T2Candida on the T2Dx.

Sensitivity is the percent concordance, or the percentage of sample results that agree with a reference, or comparative, method for positive results. Specificity is the percent concordance to a reference method for negative results. If a sample does not agree with the result of a referenced method, it is considered discordant. In our clinical trial, the Prospective Arm was compared to blood culture and the Contrived Arm was compared to the known state, which means that it was in the known presence or absence of added Candida organisms.

The design of the DIRECT trial was reviewed by the FDA as part of pre-submission communications. The purpose of the DIRECT trial was to determine the clinical performance of T2Candida running on the T2Dx by identifying the following:

- clinical specificity of T2Candida results as compared to Candida negative blood culture results in specimens collected from patients in the Prospective Arm;
- clinical specificity of T2Candida results as compared to Candida negative samples collected from patients in the Contrived Arm;
- clinical sensitivity of T2Candida results as compared to the known Candida-positive specimens collected from patients in the Contrived Arm; and
- clinical sensitivity calculations of T2Candida results compared to the Candida-positive blood culture results in specimens collected from patients in the Prospective Arm.

50 known negative samples and 250 contrived samples (50 samples for each of the five Candida species included in the T2Candida Panel) were prepared and run in a blinded manner at the same clinical sites used for processing the prospective samples. The positive contrived samples were prepared by spiking clinical isolates into individual patient specimens at concentrations determined through publications and discussions with the FDA to be equivalent to the clinical state of patients who presented with symptoms of a Candida infection. 20% of the positive contrived samples were spiked at concentrations levels of less than 1 CFU/mL. The contrived samples were collected from patients referred for a diagnostic blood culture per routine standard of care — the same population of patients from whom prospective samples were collected. Unique isolates of the species were used for each patient sample, which means a total of 50 unique isolates were tested for each of the five species of Candida for a total of 250 unique isolates.

In addition to the pivotal clinical trial data that we submitted to the FDA, we also provided data from an analytical verification study to determine the limit of detection, or LoD, for each species identified by our T2Candida. The LoD was defined as the lowest concentration of Candida that can be detected in 95% of at least 20 samples tested at a single concentration.

The T2Candida Panel reports three results, where species are grouped together according to their responsiveness to therapy. Candida albicans and/or Candida tropicalis are reported as a single result, Candida parapsilosis is a single result, and Candida krusei and/or Candida glabrata are reported as a single result. Specificity and sensitivity are calculated for each reported result.

There are five relevant species of Candida, each of which were analyzed in the DIRECT trial. Each are listed in abbreviated form in the tables below. These species are Candida albicans, Candida tropicalis, Candida parapsilosis, Candida krusei, and Candida glabrata. The typical naming convention for a species is to abbreviate by using the first letter of the first word and the full second word; for example, Candida krusei is abbreviated as C. krusei. In the tables below, we also abbreviate each species name by the first letter of the second word; for example, Candida albicans and Candida tropicalis is A/T.

The following tables illustrate the results of the DIRECT trial. The primary sensitivity and specificity analysis is presented in Table A, followed by sub-analyses in Tables B and C. Additional data on the LoD and the time to results of T2Candida and the T2Dx are included in the remaining tables.

Table A

T2Candida Performance Characteristics

	Overall Sensitivity	Overall Specificity

Number of Tests (%) 234/257 (91.1%) 5114/5146 (99.4%)

Table B

Overall Sensitivity and Specificity by Test

		95% Confidence Interval		
Specificity:				
A/T (C. albicans/C. tropicalis)	1679/1697 (98.9%)	98.3 -	99.4	%
P (C. parapsilosis)	1736/1749 (99.3%)	98.7 -	99.6	%
K/G (C. krusei/C. glabrata)	1699/1700 (99.9%)	99.7 -	100.0	%
Total:	5114/5146 (99.4%)	0.8		0.6

Income before extraordinary item	4.3	3.2	4.0
Extraordinary item, net of taxes			0.6
Net income	4.3%	3.2%	4.6%

MANAGEMENT S DISCUSSION AND ANALYSIS

2012 COMPARED TO 2011

Net Sales

Net sales for the year were $486.8 million, an increase of 9.5% compared to net sales of $444.4 million in 2011. The increase was primarily the result of the inclusion of Creative Tops, which was acquired in November 2011.

Net sales for the Wholesale segment in 2012 were $464.8 million, an increase of $43.7 million, or 10.4%, as compared to net sales of $421.1 million in 2011. Net sales included $42.6 million from Creative Tops in 2012 compared to $6.7 million from Creative Tops in 2011. Net sales for the Company s Kitchenware product category in 2012 were $256.1 million, an increase of $40.4 million, or 18.7%, as compared to net sales of $215.7 million in 2011. The increase in the Company s Kitchenware product category was primarily attributable to the strength and expansion of certain brands and the introduction of new innovative styles and designs including the new Guy Fieri® line. The Kitchenware category also included $0.2 million of sales from the Fred® & Friends business acquired on December 20, 2012. Net sales for the Company s Tabletop product category in 2012 were $113.9 million, a decrease of $20.7 million, or 15.4%, as compared to net sales of $134.6 million for 2011. The Tabletop product category sales decrease was partially attributable to the absence, in the 2012 period, of sales of excess sterling silver finished goods inventory and a major rollout of dinnerware each of which occurred in the 2011 period. In addition, the category experienced weakness at the retail level. Net sales for the Company s Home Solutions products category in 2012 were $52.2 million, a decrease of $11.9 million, or 18.6%, as compared to net sales of $64.1 million in 2011. The decrease in sales for the Company s Home Solutions product category was due to weak consumer demand for this category.

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Net sales for the Retail Direct segment in 2012 were $22.0 million, a decrease of $1.3 million, or 5.6%, as compared to $23.3 million for 2011. The decrease was primarily attributable to a reduction in promotional activities in 2012.

Gross margin

Gross margin for 2012 was $176.8 million, or 36.3%, as compared to $162.4 million, or 36.5%, for the corresponding period in 2011.

Gross margin for the Wholesale segment was 34.8% for 2012 as compared to 34.9% for 2011.

Gross margin for the Retail Direct segment was 68.6% for 2012 as compared to 66.9% for 2011. The increase in gross margin reflects the mix in product sales, less promotional activities, a revised pricing strategy and more effective web design which favorably affected margins during the 2012 period.

Distribution expenses

Distribution expenses for 2012 were $44.0 million as compared to $43.9 million for 2011. Distribution expenses as a percentage of net sales were 9.0% in 2012 and 9.9% for 2011.

Distribution expenses as a percentage of sales shipped from the Company s warehouses located in the United States for the Wholesale segment were 8.9% for 2012 as compared to 9.4% for 2011. The percentage decrease resulted from significant improvements in labor management and other operating expense savings.

Distribution expenses as a percentage of net sales for the Retail Direct segment were 28.9% for 2012 compared to 29.8% for 2011. Retail Direct also benefitted from improved labor management and other operating expense savings.

Selling, general and administrative expenses

Selling, general and administrative expenses (SG&A) for 2012 were $104.3 million, an increase of $10.4 million, or 11.1%, as compared to $93.9 million for 2011. Excluding the expenses of Creative Tops, SG&A expenses for 2012 were $94.7 million, an increase of $1.9 million as compared to $92.8 million for 2011.

SG&A expenses for 2012 for the Wholesale segment were $82.4 million, an increase of $11.0 million, or 15.4%, as compared to $71.4 million in 2011. As a percentage of net sales, SG&A expenses were 17.7% for 2012 compared to 17.0% for 2011. The increase principally reflects higher expenses for Creative Tops to support its business expansion plan and an increase in employee related expenses.

SG&A expenses for 2012 for the Retail Direct segment were $8.3 million compared to $9.2 million for 2011. The decrease was primarily attributable to improved expense management.

Unallocated corporate expenses for 2012 and 2011 were $13.6 million and $13.3 million, respectively, due to an increase in compensation offset by a reduction in acquisition related expenses.

Intangible asset impairment

During the past twelve months, the Company s home décor products category has experienced a significant decline in sales. The Company believes the most significant factor was the reduction in retail space allocated to the category which has also contributed to pricing pressure. While the Company believes this market condition is not permanent, following a strategic review of the business, it has decided to re-brand a portion of the home décor products under the Mikasa® and Pfaltzgraff® trade names. As a result of these factors, the Company recorded an impairment charge of $1.1 million in its statement of operations which reduced the book value of its Elements® trade name.

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Interest expense

Interest expense for 2012 was $5.9 million as compared to $7.8 million for 2011. The decrease in interest expense was primarily attributable to lower average interest rates and lower average borrowings. The most significant factor in the rate reduction related to the retirement of the Company s 4.75% convertible senior notes (the Notes).

Loss on early retirement of debt

In June and July 2012, the Company repaid its second lien credit agreement (the Term Loan). In connection therewith, the Company wrote off debt issuance costs of $1.4 million.

Income tax provision

The income tax provision was $5.2 million in 2012 and $6.1 million in 2011. The Company s effective tax rate for 2012 was 25.9% as compared to 36.4% for 2011. The effective tax rate in 2012 reflects an income tax benefit for a non-cash adjustment to a deferred tax liability of $2.3 million related to the prior year. The effective tax rate for 2011 included a valuation allowance reversal related to various deferred tax assets, including net operating losses, for which a tax benefit was not previously recognized.

Equity in earnings

The Company s equity in earnings for 2012 and 2011 are as follows:

	Year Ended December 31, 2012	2011
	(in thousands)	
Equity in earnings of Grupo Vasconia:		
Equity earnings before bargain purchase gain, tax benefit and reduction in investment to fair value, net of tax	$ 3,015	$ 2,895
Bargain purchase gain in equity in earnings, net of tax	4,112	
Tax benefit recorded in equity in earnings[(1)]	1,116	
Reduction in investment to fair value, net of tax	(1,336)	
Equity in earnings of Grupo Vasconia	6,907	2,895
Equity in earnings (losses) of GSI	(727)	21
Equity in earnings (losses) of other investments	(99)	446
	$ 6,081	$ 3,362

Note:

(1) Income tax benefit related to the valuation allowance reversal for deferred taxes associated with the cumulative foreign currency translation adjustment.

Equity in earnings of Vasconia, net of taxes, was $6.9 million for 2012 and $2.9 million for 2011. Vasconia reported income from operations for 2012 of $14.6 million compared to $17.3 million for 2011 and net income of $34.2 million in 2012 compared to $11.4 million in 2011. The increase in net income is primarily due to a $22.9 million bargain purchase gain recognized by Vasconia on its purchase of Almexa, an aluminum mill and manufacturer of aluminum foil.

Equity in earnings for 2012 also includes a loss of $0.7 million from the Company s 40% equity interest in GSI and losses of $0.1 million related to other investments. Equity in earnings for 2011 includes income of $0.5 million derived from the Company s 50% joint venture investment in World Alliance Enterprises Limited which was dissolved in 2012.

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2011 COMPARED TO 2010

Net Sales

Net sales for the year were $444.4 million, an increase of 0.3% compared to net sales of $443.2 million in 2010.

Net sales for the Wholesale segment in 2011 were $421.1 million, an increase of $7.3 million, or 1.8%, as compared to net sales of $413.8 million in 2010. Net sales for the Wholesale segment include $6.7 million of net sales in 2011 from Creative Tops, which was acquired by the Company in November 2011.Net sales for the Company s Kitchenware product category in 2011 were $215.7 million, an increase of $7.2 million, or 3.5%, as compared to net sales of $208.5 million in 2010. The increase in the Company s Kitchenware product category was primarily attributable to increased volumes due, in part, to successful new programs and promotions during the year as compared to 2010. Net sales for the Company s Tabletop product category in 2011 were $134.6 million, an increase of $11.2 million, or 9.1%, as compared to net sales of $123.4 million for 2010. The Tabletop product category sales increase was primarily attributable to higher volumes related to new programs and the successful promotion of certain tabletop lines which increased sales by $7.7 million. The Tabletop product category also benefited from an increase of $3.5 million in net sales of excess silver finished goods and from silver products produced under manufacturing contracts. Net sales for the Company s Home Solutions products category in 2011 were $64.1 million, a decrease of $17.8 million, or 21.7%, as compared to net sales of $81.9 million in 2010. The decrease in sales for the Company s Home Solutions product category reflects lower volumes due, in part, to certain sales programs in 2010 not repeated in the 2011 period.

Net sales for the Retail Direct segment in 2011 were $23.3 million, a decrease of $6.1 million, or 20.7%, as compared to $29.4 million for 2010. The decrease in net sales was primarily attributable to a reduction in promotional activities and the Company s decision to terminate its print consumer catalog during the second quarter of 2011.

Gross margin

Gross margin for 2011 was $162.3 million as compared to $169.4 million for 2010. Gross margin as a percentage of net sales was 36.5% for 2011 as compared to 38.2% for 2010.

Gross margin as a percentage of net sales for the Wholesale segment was 34.9% for 2011 compared to 36.3% for 2010. The decrease in gross margin primarily reflected promotional allowances and changes in product mix. Wholesale gross profit declined by $3.5 million. This was primarily due to the weakness of the Company s Home Solutions category for which net sales and gross margin declined in 2011. The decline was partially offset in other product categories and from the inclusion of Creative Tops, since its acquisition.

Gross margin as a percentage of net sales for the Retail Direct segment increased to 66.9% in 2011 from 65.1% in 2010. The increase in gross margin primarily reflected reduced promotional activities which favorably affected margins during the 2011 period.

Distribution expenses

Distribution expenses for 2011 were $43.9 million as compared to $44.6 million for 2010. Distribution expenses as a percentage of net sales were 9.9% in 2011 and 10.1% for 2010.

Distribution expenses as a percentage of sales for the Wholesale segment shipped from the Company s warehouses located in the United States were 9.4% as compared to 9.6% for the corresponding period in 2010. The decrease resulted from reduced labor costs in the 2011 period from efficiencies associated with an inventory management system upgrade put in place in the 2010 period.

Distribution expenses as a percentage of net sales for the Retail Direct segment were 29.8% for 2011 compared to 29.2% for 2010. A substantial portion of distribution expenses are fixed and, therefore, cannot be reduced to offset a reduction in sales volumes.

Selling, general and administrative expenses

Selling, general and administrative expenses for 2011 were $93.9 million, a decrease of 1.2% compared to $95.0 million for 2010.

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SG&A for 2011 for the Wholesale segment were $71.4 million, an increase of $0.1 million or 0.1%, as compared to $71.3 million in 2010. As a percentage of net sales, SG&A expenses were 17.0% for 2011, as compared to 17.2 % for 2010. Excluding the expenses of Creative Tops, SG&A declined by $1.0 million. This decline in SG&A was the result of reductions of bad debt expense and certain office related expenses which substantially offset an increase in employee related and selling expenses.

SG&A expenses for 2011 for the Retail Direct segment were $9.2 million compared to $11.5 million for 2010. The decrease was primarily attributable to a decrease in employee, selling and office related expenses associated with the Company s decision to terminate its print consumer catalog.

Unallocated corporate expenses for 2011 and 2010 were $13.3 million and $12.2 million, respectively. The increase was primarily attributable to acquisition related expenses of $2.0 million, which was partially offset by a reduction in other professional fees.

Interest expense

Interest expense for 2011 was $7.8 million as compared to $9.4 million for 2010. The decrease in interest expense was primarily attributable to lower average interest rates and lower average borrowings. The most significant factor in the rate reduction related to the retirement of the Notes.

Loss on early retirement of debt

During 2010, the Company entered into a new revolving credit facility and Term Loan and repurchased $50.9 million principal amount of its convertible senior notes. In connection with these activities, the Company incurred a non-cash pre-tax charge of approximately $764,000 consisting primarily of the write-off of deferred financing costs and unamortized debt discount related to the Company s prior revolving credit facility and the Notes that were repurchased.

Income tax provision

The income tax provision was $6.1 million in 2011 and $4.6 million in 2010. The effective tax rates for the years ended December 31, 2011 and 2010 reflect taxes on income derived from U.S. sources and a reduction in valuation allowances related to the utilization of certain deferred tax assets during each year, for which a tax benefit was not previously recognized. The valuation allowance reversal in 2011 related to deferred tax assets for net operating losses which became realizable and deferred taxes for stock options, deferred rent and other temporary differences. The valuation allowance reversal reduced the effective tax rate by 8.2% and 19.8% in 2011 and 2010, respectively. The effective tax rates for 2011 and 2010 were 36.4% and 23.4% respectively.

Equity in earnings

Equity in earnings of Vasconia, net of taxes, was $2.9 million for 2011 and $2.7 million for 2010. Vasconia reported net income of $11.4 million in 2011 compared to $9.9 million in 2010. This increase in net income in 2011 compared to 2010 was primarily attributable to higher sales volumes in both the kitchenware products and aluminum products divisions.

Equity in earnings for 2011 also included equity income of $447,000 derived from the Company s 50% joint venture investment in World Alliance Enterprises Limited and equity income of $20,000 earned since December 9, 2011, the date of the Company s acquisition of a 40% equity interest in GSI.

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CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Management s Discussion and Analysis of Financial Condition and Results of Operations discusses the Company s consolidated financial statements which have been prepared in accordance with U.S. generally accepted accounting principles and with the instructions to Form 10-K and Article 10 of Regulation S-X. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the 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. On an on-going basis, management evaluates its estimates and judgments based on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. The Company evaluates these estimates including those related to revenue recognition, allowances for doubtful accounts, reserves for sales returns and allowances and customer chargebacks, inventory mark-down provisions, health insurance reserves, impairment of goodwill, tangible and intangible assets, stock option expense, accruals related to the Company s tax positions and tax valuation allowances. Actual results may differ from these estimates using different assumptions and under different conditions. The Company s significant accounting policies are more fully described in Note A of the Notes to the Consolidated Financial Statements included in Item 15. The Company believes that the following discussion addresses its most critical accounting policies, which are those that are most important to the portrayal of the Company s consolidated financial condition and results of operations and require management s most difficult, subjective and complex judgments.

Inventory

Inventory consists principally of finished goods sourced from third-party suppliers. Inventory also includes finished goods, work in process and raw materials related to the Company s manufacture of sterling silver products. Inventory is priced using the lower of cost (first-in, first-out basis) or market method. The Company estimates the selling price of its inventory on a product by product basis based on the current selling environment. If the estimated selling price is lower than the inventory s cost, the Company reduces the value of the inventory to its net realizable value.

Accounts Receivable

The Company periodically reviews the collectability of its accounts receivable and establishes allowances for estimated losses that could result from the inability of its customers to make required payments. A considerable amount of judgment is required to assess the ultimate realization of these receivables including assessing the initial and on-going creditworthiness of the Company s customers. The Company also maintains an allowance for anticipated customer deductions. The allowances for deductions are primarily based on contracts with customers. However, in certain cases the Company does not have a formal contract and, therefore, customer deductions are non-contractual. To evaluate the reasonableness of non-contractual customer deductions, the Company analyzes currently available information and historical trends of deductions. If the financial conditions of the Company s customers or general economic conditions were to deteriorate, resulting in an impairment of their ability to make payments or sell the Company s products at reasonable sales prices, or the Company s estimate of non-contractual deductions varied from actual deductions, revisions to allowances would be required, which could adversely affect the Company s financial condition. Historically, the Company s allowances have been appropriate and have not resulted in material unexpected charges.

Goodwill, intangible assets and long-lived assets

Goodwill and intangible assets deemed to have indefinite lives are not amortized but, instead, are subject to an annual impairment assessment. The Company first assesses qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment testing described in ASU Topic No. 350, Intangibles Goodwill and Other. The Company also evaluates qualitative factors to determine whether or not its indefinite lived intangibles have been impaired and then performs quantitative tests if required. These tests can include the royalty savings model or other valuation models.

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Long-lived assets, including intangible assets deemed to have finite lives, are reviewed for impairment whenever events or changes in circumstances indicate that such assets may have been impaired. Impairment indicators include, among other conditions, cash flow deficits, historic or anticipated declines in revenue or operating profit or material adverse changes in the business climate that indicate that the carrying amount of an asset may be impaired. When impairment indicators are present, the Company compares the carrying value of the assets to the estimated discounted future cash flows expected to be generated by the assets. If the assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. The Company considered indicators of impairment of its long-lived assets and determined that no such indicators were present at December 31, 2012.

Revenue recognition

The Company sells products wholesale, to retailers and distributors, and retail, directly to the consumer through the Company s Retail Direct operations. Wholesale sales and Retail Direct sales are recognized when title passes to the customer, which is primarily at the shipping point for Wholesale sales and upon delivery to the customer for Retail Direct sales. Shipping and handling fees that are billed to customers in sales transactions are recorded in net sales. Net sales exclude taxes that are collected from customers and remitted to the taxing authorities. Allowances and accruals for various sales incentives and promotions, which include cooperative advertising, buydowns, volume rebates and discounts, are reflected as reductions in net sales.

Employee stock options

The Company accounts for its stock options through measurement of compensation expense for all share-based compensation granted to employees and non-employee directors at fair value on the date of grant and recognition of compensation expense over the related service period for awards expected to vest. The Company uses the Black-Scholes option valuation model to estimate the fair value of its stock options. The Black-Scholes option valuation model requires the input of highly subjective assumptions including the expected stock price volatility of the Company s common stock and the risk-free interest rate. Changes in these subjective input assumptions can materially affect the fair value estimate of the Company s stock options on the date of the option grant. The Company historically has not issued options which would be variable awards.

Employee healthcare

In 2011, the Company commenced self-insuring certain portions of its health insurance plan. The Company maintains an estimated accrual for unpaid claims and claims incurred but not yet reported (IBNR). Although management believes that it uses the best information available to estimate IBNR, actual claims may vary significantly from estimated claims.

Income taxes

The Company applies the required provisions for financial statement recognition, measurement and disclosure of uncertain tax positions recognized in the Company s financial statements. Tax positions must meet a more-likely-than-not recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken. The valuation allowance is also calculated, established or maintained when it is more likely than not that all or a portion of deferred tax assets will not be realized.

Derivatives

The Company accounts for all derivative instruments on the balance sheet at fair value as either an asset or a liability. Changes in the fair value of derivatives that qualify as hedges and have been designated as part of a hedging relationship for accounting purposes have no net impact on earnings to the extent the derivative is considered perfectly effective in achieving offsetting changes in fair value or cash flows attributable to the risk being hedged, until the hedged item is recognized in earnings. For derivatives that do not qualify or are not designated as hedging instruments for accounting purposes, changes in fair value are recorded in operations.

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LIQUIDITY AND CAPITAL RESOURCES

The Company s principal sources of cash to fund liquidity needs are: (i) cash provided by operating activities and (ii) borrowings available under its revolving credit facility. The Company s primary uses of funds consist of working capital requirements, capital expenditures, acquisitions and investments and payments of principal and interest on its debt.

At December 31, 2012, the Company had cash and cash equivalents of $1.9 million compared to $3.0 million at December 31, 2011, working capital was $145.9 million at December 31, 2012 compared to $128.8 million at December 31, 2011 and the current ratio was 3.18 to 1 at December 31, 2012 compared to 2.84 to 1 at December 31, 2011.

Borrowings under the Company s revolving credit facility increased to $61.0 million at December 31, 2012 compared to $57.6 million at December 31, 2011. The increase in borrowings was primarily attributable to the acquisition of Fred® & Friends.

The Company believes that availability under the Revolving Credit Facility and cash flows from operations are sufficient to fund the Company s operations for the next twelve months. However, if circumstances were to adversely change, the Company may seek alternative sources of liquidity including debt and equity financing. However, there can be no assurance that any such alternative sources would be available or sufficient. The Company closely monitors the creditworthiness of its customers. Based upon the evaluation of changes in customers creditworthiness, the Company may modify credit limits and/or terms of sale. However, notwithstanding the Company s efforts to monitor its customers financial condition, the Company could be materially affected in the future.

In 2012, Wal-Mart Stores, Inc. (including Sam s Club and Asda Superstore) accounted for 16% of the Company s net sales. A material reduction of product orders by Wal-Mart Stores, Inc. could have significant adverse effects on the Company s business and operating results and ultimately the Company s liquidity, including the loss of predictability and volume production efficiencies associated with such a large customer.

Revolving Credit Facility

The Company had a $150.0 million secured credit agreement (the Revolving Credit Facility), maturing on October 28, 2016, with a bank group led by JPMorgan Chase Bank, N.A. On July 27, 2012, the Company amended the Revolving Credit Facility to increase the lenders commitment to $175.0 million and to, among other things, extend the maturity date to July 27, 2017 and increase the expansion option which permits the Company, subject to certain conditions including the consent of the Senior Secured Term Loan (defined below) lenders, to increase the maximum borrowing commitment from $175.0 million to $225.0 million.

At December 31, 2012, borrowings outstanding under the Revolving Credit Facility were $61.0 million and open letters of credit were $1.2 million.

Borrowings under the Revolving Credit Facility bear interest, at the Company s option, at one of the following rates: (i) the Alternate Base Rate, defined as the greater of the Prime Rate, Federal Funds Rate plus 0.5% or the Adjusted LIBO Rate plus 1.0%, plus a margin of 1.0% to 1.75%, or (ii) the Eurodollar Rate, defined as the Adjusted LIBO Rate plus a margin of 2.0% to 2.75%. The respective margins are based upon availability. Interest rates on outstanding borrowings at December 31, 2012 ranged from 2.50% to 4.50%. In addition, the Company pays a commitment fee of 0.375% to 0.50% on the unused portion of the Revolving Credit Facility. Availability under the Revolving Credit Facility was approximately $77.7 million, or 44%, of the total loan commitment at December 31, 2012.

The Company classifies a portion of the Revolving Credit Facility as a current liability if the Company s intent and ability is to repay the loan from cash flows from operations which are expected to occur within the year. Repayments and borrowings under the facility can vary significantly from planned levels based on cash flow needs and general economic conditions. The Company expects that it will continue to borrow and repay funds, subject to availability, under the facility based on working capital and other corporate needs.

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Senior Secured Term Loan

The Company has a $35.0 million senior secured credit agreement (the Senior Secured Term Loan), which matures on July 27, 2018, with JPMorgan Chase Bank, N.A.

The Senior Secured Term Loan bears interest, at the Company s option, at the Alternate Base Rate (as defined) plus 4.00%, or the Adjusted LIBOR Rate (as defined) plus 5.00%. The interest rate on outstanding borrowings at December 31, 2012 was 5.25%.

The Senior Secured Term Loan provides that for any four consecutive fiscal quarters ending after July 27, 2012, (x) if at any time EBITDA (as defined) is less than $34.0 million but equal to or greater than $30.0 million, the ratio of Indebtedness (as defined) to EBITDA shall not exceed 3.0 to 1.0 and (y) EBITDA shall not be less than $30.0 million at any time. Capital expenditures are limited and for the year ending December 31, 2012, such limit is $7.5 million. The Senior Secured Term Loan provides for other customary restrictions and events of default. Restrictions include limitations on additional indebtedness, acquisitions, investments and payment of dividends, among others. Further, the Senior Secured Term Loan provides that the Company shall maintain a minimum fixed charge coverage ratio of 1.10 to 1.00 for any four consecutive fiscal quarters ending after July 27, 2012. The Company was in compliance with the financial covenants of the Senior Secured Term Loan and the Revolving Credit Facility at December 31, 2012.

The Company s Consolidated EBITDA for the four quarters ended December 31, 2012 was $41.2 million, as follows:

	Consolidated EBITDA for the four quarters ended December 31, 2012 (in thousands)
Three months ended December 31, 2012	$ 17,868
Three months ended September 30, 2012	11,568
Three months ended June 30, 2012	5,584
Three months ended March 31, 2012	6,222
Total for the four quarters	$ 41,242

Capital expenditures for the year ended December 31, 2012 were $5.0 million.

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Non-GAAP financial measure

Consolidated EBITDA is a non-GAAP financial measure within the meaning of Regulation G promulgated by the Securities and Exchange Commission. This measure is provided because management of the Company uses this financial measure in evaluating the Company s on-going financial results and trends. Management uses this non-GAAP information as an indicator of business performance. The following is a reconciliation of net income as reported to Consolidated EBITDA for the three and twelve months ended December 31, 2012 and 2011:

	Three Months Ended December 31,		Year Ended December 31,	
	2012	2011	2012	2011
	(in thousands)			
Net income as reported	$ 15,154	$ 5,419	$ 20,947	$ 14,066
Subtract out:				
Undistributed equity earnings, net	(4,464)	(925)	(5,665)	(2,896)
Add back:				
Income tax provision	2,596	3,513	5,208	6,122
Interest expense	1,254	1,951	5,898	7,758
Depreciation and amortization	2,446	2,336	9,324	8,397
Stock compensation expense	662	690	2,793	2,795
Loss on early retirement of debt			1,363	
Intangible asset impairment			1,069	
Permitted acquisition related expenses	220	1,358	305	1,856
Consolidated EBITDA	$ 17,868	$ 14,342	$ 41,242	$ 38,098

Term Loan

In June 2012, the Company repaid $10.0 million of the principal owing under its second lien credit agreement (the Term Loan). In July 2012, the Company utilized the proceeds of the Senior Secured Term Loan to repay the remaining $30.0 million of the then outstanding Term Loan. The loss on early retirement of debt in the accompanying consolidated statements of operations of $1.4 million represents a write-off of unamortized debt issuance costs related to the repayment of the Term Loan.

Dividends

In March 2011, the Company determined that it would resume paying cash dividends on its outstanding shares of common stock which were suspended in February 2009. The Board of Directors declared a dividend of $0.025 per share payable on May 16, 2011, August 16, 2011, November 29, 2011, February 15, 2012, May 15, 2012, August 15, 2012, November 15, 2012 and February 15, 2013.

Operating activities

Net cash provided by operating activities was $22.7 million in 2012 as compared to net cash provided by operating activities of $12.2 million in 2011. The increase was primarily attributable to a decrease in inventory, a decrease in payments of accounts payable, accrued expenses and other liabilities and income taxes and an increase in net income offset by an increase in accounts receivable.

Investing activities

Net cash used in investing activities was $22.2 million in 2012 as compared to $30.6 million in 2011. The decrease in cash used in investing activities principally related to: i) cash consideration of $14.5 million paid in 2012 for the acquisition of Fred® and Friends, ii) cash consideration of $2.6 million paid in 2012 for the investment in GSI, iii) additional cash consideration of $0.2 million paid in 2012 for the investment in the joint venture to distribute Mikasa® products as compared to i) cash consideration of $20.6 million paid in 2011 for the acquisition of Creative Tops, ii) cash consideration of $5.0 million paid in 2011 for the investment in GSI, iii) an investment in Housewares Corporation of Asia of $0.1 million in 2011.

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Financing activities

Net cash used in financing activities was $2.2 million in 2012 as compared to net cash provided by financing activities of $17.9 million in 2011. The Company had net borrowings of $3.3 million from its Revolving Credit Facility in 2012 as compared to net borrowings of $43.5 million in 2011. The proceeds from the 2012 borrowings were principally used to finance a portion of the Fred® & Friends acquisition. The proceeds from the 2011 borrowings were principally used to: i) finance the Creative Tops acquisition, ii) finance the Company s investment in GSI, iii) retire the Notes and iv) pay acquisition related costs of $2.0 million.

Contractual obligations

As of December 31, 2012, the Company s contractual obligations were as follows (in thousands):

		Payment due by period			
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Operating leases	$ 91,254	$ 14,818	$ 29,293	$ 23,323	$ 23,820
Short-term debt	11,375	11,375			
Long-term debt	84,593		33,570	43,149	7,874
Interest on debt	15,240	4,166	6,996	3,912	166
Minimum royalty payments	21,839	6,423	12,625	1,022	1,769
Post retirement benefits	5,900	143	258	613	4,886
Total	$ 230,201	$ 36,925	$ 82,742	$ 72,019	$ 38,515

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Market risk represents the risk of loss that may impact the consolidated financial position, results of operations or cash flows of the Company. The Company is exposed to market risk associated with changes in interest rates and foreign currency exchange rates. The Company s Revolving Credit Facility and Senior Secured Term Loan bear interest at variable rates; and, therefore, the Company is subject to increases and decreases in interest expense resulting from fluctuations in interest rates. The Company entered into an interest rate swap agreement in August 2012 to manage interest rate exposure in connection with its variable interest rate borrowings. The Company has foreign operations through its acquisitions, investments and strategic alliances which have operations in the United Kingdom, Mexico, Canada, Brazil, Hong Kong and China; therefore, the Company is subject to increases and decreases in its investments resulting from the impact of fluctuations in foreign currency exchange rates.

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Item 8. Financial Statements and Supplementary Data

The Company s Consolidated Financial Statements as of and for the year ended December 31, 2012 in Item 15 commencing on page F-1 are incorporated herein by reference.

The following tables set forth certain unaudited consolidated quarterly statement of operations data for the eight quarters ended December 31, 2012. This information is unaudited, but in the opinion of management, it has been prepared substantially on the same basis as the audited consolidated financial statements appearing elsewhere in this Annual Report on Form 10-K and all necessary adjustments, consisting only of normal recurring adjustments, have been included in the amounts stated below to present fairly the unaudited consolidated quarterly results of operations. The consolidated quarterly data should be read in conjunction with the Company s audited consolidated financial statements and the notes to such statements appearing elsewhere in this Annual Report. The results of operations for any quarter are not necessarily indicative of the results of operations for any future period:

	Year ended December 31, 2012			
	First quarter	Second quarter	Third quarter	Fourth quarter(1)
	(in thousands, except per share data)			
Net sales	$ 109,041	$ 94,939	$ 128,050	$ 154,812
Gross profit	40,460	35,374	44,909	56,045
Income from operations	3,232	2,153	7,411	14,539
Net income	1,344	559	3,890	15,154
Basic income per common share	0.11	0.04	0.31	1.21
Diluted income per common share	0.11	0.04	0.30	1.19

	Year ended December 31, 2011			
	First quarter	Second quarter	Third quarter	Fourth quarter
	(in thousands, except per share data)			
Net sales	$ 91,773	$ 90,371	$ 124,663	$ 137,611
Gross profit	33,390	34,046	44,239	50,685
Income (loss) from operations	(23)	4,351	10,298	9,958
Net income (loss)	(949)	2,063	7,533	5,419
Basic income (loss) per common share	(0.08)	0.17	0.62	0.45
Diluted income (loss) per common share	(0.08)	0.17	0.60	0.43

Note:

(1) The fourth quarter ended December 31, 2012 reflects an income tax benefit for a non-cash adjustment to a deferred tax liability of $2.3 million related to the prior year fourth quarter.

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

None

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Item 9A. Controls and Procedures

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

The Chief Executive Officer and the Chief Financial Officer of the Company (its principal executive officer and principal financial officer, respectively) have concluded, based on their evaluation as of December 31, 2012, that the Company s controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports filed by it under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by the Company in such reports is accumulated and communicated to the Company s management, including the Chief Executive Officer and Chief Financial Officer of the Company, as appropriate to allow timely decisions regarding required disclosure.

(b) **Changes in Internal Controls**

There were no changes in the Company s internal control over financial reporting that occurred during the Company s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

Management s Report on Internal Control over Financial Reporting

Management of the Company is responsible for establishing and maintaining effective internal control over financial reporting and for performing an assessment of the effectiveness of internal control over financial reporting as of December 31, 2012. Internal control over financial reporting is defined in Rule 13a-15(f) or 15d-15(f) promulgated under the Exchange Act as a process designed by, or under the supervision of, the Company s principle executive and principal financial officers and effected by the Company s Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

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 the preparation of financial statements in accordance with U.S. 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.

All internal control systems, no matter how well designed, have inherent limitations. Because of the inherent limitations, internal control over financial reporting may not prevent or detect misstatements. 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 the degree of compliance with the policies or procedures may deteriorate. Accordingly, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Management performed an assessment of the effectiveness of the Company s internal control over financial reporting as of December 31, 2012 using the criteria set forth in the Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management has determined that the Company s internal control over financial reporting as of December 31, 2012 is effective.

The effectiveness of the Company s internal control over financial reporting as of December 31, 2012 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report.

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Lifetime Brands, Inc.

We have audited Lifetime Brands Inc. s internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Lifetime Brands 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 accompanying Management 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, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and 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, Lifetime Brands, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012 based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Lifetime Brands, Inc. as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2012 of Lifetime Brands, Inc. and our report dated March 15, 2013 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Jericho, New York

March 15, 2013

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Item 9B. Other Information

Not applicable

PART III

Items 10, 11, 12, 13 and 14

The information required under these items is contained in the Company s 2013 Proxy Statement, which will be filed with the Securities and Exchange Commission within 120 days after the close of the Company s fiscal year covered by this Annual Report on Form 10-K and is herein incorporated by reference.

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PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) See Financial Statements and Financial Statement Schedule on page F-1.

(b) Exhibits*:

Exhibit No.	Description
3.1	Second Restated Certificate of Incorporation of the Company (incorporated by reference to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2005)**
3.2	Amended and Restated By-Laws of the Company (incorporated by reference to the Registrant s Form 8-K dated November 5, 2007)**
4.1	Indenture dated as of June 27, 2006, Lifetime Brands, Inc. as issuer, and HSBC Bank USA, National Association as trustee, $75,000,000 4.75% Convertible Senior Notes due 2011 (incorporated by reference to the Registrant s registration statement No. 333-137575 on Form S-3)**
10.1	License agreement dated December 14, 1989 between the Company and Farberware, Inc. (incorporated by reference to the Registrant s registration statement No. 33-40154 on Form S-1)**
10.2	Evan Miller employment agreement dated July 1, 2003 (incorporated by reference to the Registrant s Form 10-Q dated September 30, 2003)**
10.3	Employment agreement dated May 2, 2006 between Lifetime Brands, Inc. and Jeffrey Siegel (incorporated by reference to the Registrant s Form 8-K dated May 8, 2006)**
10.4	Lease agreement dated as of May 10, 2006 between AG Metropolitan Endo, L.L.C and Lifetime Brands, Inc. for the property located at 1000 Stewart Avenue in Garden City, New York (incorporated by reference to the Registrant s Form 8-K dated May 15, 2006)**
10.5	Amended 2000 Long-Term Incentive Plan (incorporated by reference to the Registrant s Form 8-K dated June 9, 2006)**
10.6	Amended 2000 Incentive Bonus Compensation Plan (incorporated by reference to the Registrant s Form 8-K dated June 9, 2006)**
10.7	First Amendment to the Lease Agreement dated as of May 10, 2006 between AG Metropolitan Endo, L.L.C and Lifetime Brands, Inc. for the property located at 1000 Stewart Avenue in Garden City, New York (incorporated by reference to the Registrant s Form 10-Q dated September 30, 2006)**
10.8	Employment agreement dated June 28, 2007 between Lifetime Brands, Inc. and Laurence Winoker (incorporated by reference to the Registrant s Form 8-K dated July 3, 2007)**
10.9	Shares Subscription Agreement by and among Lifetime Brands, Inc., Ekco, S.A.B. and Mr. José Ramón Elizondo Anaya and Mr. Miguel Ángel Huerta Pando, dated as of June 8, 2007 (incorporated by reference to the Registrant s Form 8-K dated June 11, 2007)**

10.10	Lease Agreement between Granite Sierra Park LP and Lifetime Brands, Inc. dated June 29, 2007 (incorporated by reference to the Registrant s Form 8-K dated July 6, 2007)**
10.11	Evan Miller Amendment of Employment Agreement dated June 29, 2007 (incorporated by reference to the Registrant s Form 8-K dated July 3, 2007)**
10.12	Amendment No.1 dated September 5, 2007 to the Shares Subscription Agreement by and among Lifetime Brands, Inc., Ekco, S.A.B. and Mr. José Ramón Elizondo Anaya and Mr. Miguel Ángel Huerta Pando, dated as of June 8, 2007 (incorporated by reference to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2008)**
10.13	Amendment to the Lifetime Brands, Inc. 2000 Long-Term Incentive Plan dated November 1, 2007 (incorporated by reference to the Registrant s Form 8-K dated November 5, 2007)**
10.14	Amendment No. 2 to Second Amended and Restated Credit Agreement by and among Lifetime Brands, Inc., Lenders party hereto, Citibank, N.A. and Wachovia Bank, National Association, as Co-Documentation Agents, JP Morgan Chase Bank, N.A., as Syndication Agent, and HSBC Bank USA, National Association, as Administrative Agent (incorporated by reference to the Registrant s Form 8-K/A dated April 22, 2008)**
10.15	Asset Purchase Agreement between Mikasa, Inc. and Lifetime Brands, Inc. dated June, 6 2008 (incorporated by reference to the Registrant s Form 10-Q dated June 30, 2008)**
10.16	Amendment No. 2 dated September 25, 2008 to the Shares Subscription Agreement by and among Lifetime Brands, Inc., Ekco, S.A.B. and Mr. José Ramón Elizondo Anaya and Mr. Miguel Ángel Huerta Pando, dated as of June 8, 2007 (incorporated by reference to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2008)**
10.17	Amendment to the Company s Second Amended and Restated Credit Agreement, Amendment No. 3, dated September 29, 2008 (incorporated by reference to the Registrant s Form 8-K dated September 30, 2008)**
10.18	Forbearance Agreement and Amendment No. 4, dated as of February 12, 2009, by and among Lifetime Brands, Inc., the several financial institutions parties thereto and HSBC Bank USA, National Association, as Administrative Agent for the Lenders (incorporated by reference to the Registrant s Form 8-K dated February 19, 2009)**
10.19	Amendment to Forbearance Agreement and Amendment No. 4, dated as of March 6, 2009, by and among Lifetime Brands, Inc., the several financial institutions parties thereto and HSBC Bank USA, National Association, as Administrative Agent for the Lenders (incorporated by reference to the Registrant s Form 8-K dated March 10, 2009)**
10.20	Waiver and Amendment No. 5 to Second Amended and Restated Credit Agreement, dated as of March 31, 2009, by and among Lifetime Brands, Inc., the several financial institutions parties thereto and HSBC Bank USA, National Association, as Administrative Agent for the Lenders (incorporated by reference to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2008)**
10.21	Amendment of the Lifetime Brands, Inc. 2000 Long-Term Incentive Plan dated June 11, 2009 (incorporated by reference to the Registrant s Form 8-K dated June 12, 2009)**
10.22	Amended and Restated Employment Agreement, dated August 10, 2009 by and between Lifetime Brands, Inc. and Ronald Shiftan (incorporated by reference to the Registrant s Form 8-K dated August 12, 2009)**
10.23	Amendment of Employment Agreement, dated August 10, 2009 by and between Lifetime Brands, Inc. and Jeffrey Siegel (incorporated by reference to the Registrant s Form 8-K dated August 12, 2009)**

10.24	Waiver to the Second Amended and Restated Credit Agreement, dated as of October 13, 2009, by and among Lifetime Brands, Inc., the several financial institutions parties thereto and HSBC Bank USA, National Association, as Administrative Agent and Co-Collateral Agent for the Lenders (incorporated by reference to the Registrant s Form 8-K dated October 16, 2009)**
10.25	Amendment No. 6 to Second Amended and Restated Credit Agreement, dated as of October 30, 2009, by and among Lifetime Brands, Inc., the several financial institutions parties thereto and HSBC Bank USA, National Association, as Administrative Agent for the Lenders (incorporated by reference to the Registrant s Form 8-K dated November 2, 2009)**
10.26	Termination of Lease and Sublease Agreement dated December 1, 2009 by and between Crispus Attucks Association of York, Pennsylvania, Inc. and Lifetime Brands, Inc. (incorporated by reference to the Registrant s Form 8-K dated December 2, 2009)**
10.27	Amendment No. 7 to Second Amended and Restated Credit Agreement by and among Lifetime Brands, Inc., Lenders party hereto, Citibank, N.A. and Wachovia Bank, National Association, as Co-Documentation Agents, JP Morgan Chase Bank, N.A., as Syndication Agent, and HSBC Bank USA, National Association, as Administrative Agent (incorporated by reference to the Registrant s Form 8-K dated February 12, 2010)**
10.28	Amendment to Employment Agreement, dated March 8, 2010, between Lifetime Brands, Inc. and Laurence Winoker (incorporated by reference to the Registrant s Form 8-K dated March 10, 2010)**
10.29	Amended and Restated Executive Employment Agreement, dated March 8, 2010, between Lifetime Brands, Inc. and Craig Phillips (incorporated by reference to the Registrant s Form 8-K dated March 10, 2010)**
10.30	Credit Agreement, dated as of June 9, 2010, among Lifetime Brands, Inc., JPMorgan Chase Bank, N.A., as administrative agent and a co-collateral agent, and HSBC Business Credit (USA) Inc., as syndication agent and a co-collateral agent, with exhibits (incorporated by reference to the Registrant s Form 8-K dated June 15, 2010)**
10.31	Second Lien Credit Agreement, dated as of June 9, 2010, among Lifetime Brands, Inc. and Citibank, N.A., as administrative agent and collateral agent, with exhibits (incorporated by reference to the Registrant s Form 8-K dated June 15, 2010)**
10.32	Second Amendment of Employment Agreement, dated November 9, 2010, by and between Lifetime Brands, Inc. and Jeffrey Siegel (incorporated by reference to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2010)**
10.33	Amendment of Amended and Restated Employment Agreement, dated November 9, 2010, by and between Lifetime Brands, Inc. and Ronald Shiftan (incorporated by reference to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2010)**
10.34	Amendment No. 1 to the Second Lien Credit Agreement, dated as of March 9, 2011, among Lifetime Brands, Inc. and Citibank, N.A., as administrative agent and collateral agent (incorporated by reference to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2010)**
10.35	Employment Agreement, dated March 4, 2011, by and between Lifetime Brands, Inc. and Jeffrey Siegel (incorporated by reference to the Registrant s Form 8-K dated March 8, 2011)**
10.36	Amended and Restated Credit Agreement, dated as of October 28, 2011, by and among Lifetime Brands, Inc., the Foreign Subsidiary Borrowers parties thereto, the Other Loan Parties hereto, the Lenders party hereto JP Morgan Chase Bank, N.A., as Administrative Agent and a Co-Collateral Agent, and HSBC Bank USA, National Association, as Syndication Agent and a Co-Collateral Agent (incorporated by reference to the Registrant s Form 8-K dated November 3, 2011)**
10.37	Amendment No. 2 of the Second Lien Credit Agreement, dated as of October 28, 2011, by and among Lifetime Brands, Inc. and Citibank, N.A., as administrative agent and collateral agent, with exhibits (incorporated by reference to the Registrant s Form 8-K dated November 3, 2011)**

10.38	Share Purchase Agreement, dated November 4, 2011, by and among Lifetime Brands, Inc. and Creative Tops Holding Limited and Creative Tops Far East Limited (incorporated by reference to the Registrant s Form 8-K dated November 8, 2011)**
10.39	Amendment of Employment Agreement, dated April 12, 2012, between Lifetime Brands, Inc. and Laurence Winoker (incorporated by reference to the Registrant s Form 8-K dated April 16, 2012)**
10.40	First Amendment to Employment Agreement, dated April 30, 2012, between Lifetime Brands, Inc. and Jeffrey Siegel (incorporated by reference to the Registrant s Form 8-K dated April 30, 2012)**
10.41	Amendment No. 2 to Amended and Restated Credit Agreement, dated as of July 27, 2012, by and among Lifetime Brands, Inc., the financial institutions party hereto as Lenders and JPMorgan Chase Bank, N.A., as Administrative Agent (incorporated by reference to the Registrant s Form 8-K dated August 2, 2012)**
10.42	Senior Secured Credit Agreement, dated as of July 27, 2012, among Lifetime Brands, Inc., the Subsidiary Guarantors, the Lenders and JPMorgan Chase Bank, N.A., as Administrative Agent and Collateral Agent (incorporated by reference to the Registrant s Form 8-K dated August 2, 2012)**
10.43	Second Amended and Restated Employment Agreement, dated as of December 20, 2012, by and between Lifetime Brands, Inc. and Ronald Shiftan (incorporated by reference to the Registrant s Form 8-K dated December 21, 2012)**
14.1	Code of Ethics dated February 28, 2013 (incorporated by reference to the Registrant s Form 8-K dated March 6, 2013)**
18.1	Letter from Ernst & Young LLP stating an acceptable change in accounting method for the impairment of goodwill dated October 28, 2008 (incorporated by reference to the Registrant s Form 10-Q dated September, 30 2008)**
21.1	Subsidiaries of the registrant***
23.1	Consent of Ernst & Young LLP***
23.2	Consent of Castillo Miranda Y Compañía, S.C.***
31.1	Certification by Jeffrey Siegel, Chief Executive Officer and President, pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities and Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002***
31.2	Certification by Laurence Winoker, Senior Vice President Finance, Treasurer and Chief Financial Officer, pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities and Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002***
32.1	Certification by Jeffrey Siegel, Chief Executive Officer and President, and Laurence Winoker, Senior Vice President Finance, Treasurer and Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002****
99.1	Grupo Vasconia, S.A.B. (formerly Ekco, S.A.B.), Report of Independent Registered Accounting Firm***
99.2	Grupo Vasconia, S.A.B. (formerly Ekco, S.A.B.), separate financial statements and Report of Independent Registered Accounting Firm (incorporated by reference to the Registrant s Annual Report on Form 10-K/A for the year ended December 31, 2011)
101	Interactive data files pursuant to Rule 405 of Regulation S-T. The following materials from Lifetime Brands, Inc. s Annual Report on Form 10-K for the year ended December 31, 2012 formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Stockholders Equity, (v) the Consolidated Statements of Cash Flows and (vi) Notes to the Consolidated Financial Statements.

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Notes to exhibits:

The Company will furnish a copy of any of the exhibits listed above upon payment of $5.00 per exhibit to cover the cost of the Company furnishing the exhibit.

** Incorporated by reference.
*** Filed herewith.
**** This exhibit is being furnished pursuant to Item 601(b)(32) of SEC Regulation S-K and is not deemed filed with the Securities and Exchange Commission and is not incorporated by reference in any filing of the Company under the Securities Act of 1933 or the Securities Exchange Act of 1934.

(c) Financial Statement Schedules the response to this portion of Item 15 is submitted as a separate section of this report.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Lifetime Brands, Inc.

/s/ Jeffrey Siegel
Jeffrey Siegel
Chairman of the Board of Directors,
Chief Executive Officer, President and Director

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

Signature	Title	Date
/s/ Jeffrey Siegel Jeffrey Siegel	Chairman of the Board of Directors, Chief Executive Officer, President and Director	March 15, 2013
/s/ Ronald Shiftan Ronald Shiftan	Vice Chairman of the Board of Directors, Chief Operating Officer and Director	March 15, 2013
/s/ Laurence Winoker Laurence Winoker	Senior Vice President Finance, Treasurer and Chief Financial Officer (Principal Financial and Accounting Officer)	March 15, 2013
/s/ Craig Phillips Craig Phillips	Senior Vice-President Distribution and Director	March 15, 2013
/s/ David Dangoor David Dangoor	Director	March 15, 2013
/s/ Michael Jeary Michael Jeary	Director	March 15, 2013
/s/ John Koegel John Koegel	Director	March 15, 2013
/s/ Cherrie Nanninga Cherrie Nanninga	Director	March 15, 2013
/s/ Michael Regan	Director	March 15, 2013

Michael Regan		
/s/ William Westerfield	Director	March 15, 2013
William Westerfield		

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Item 15

LIFETIME BRANDS, INC.

LIST OF FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULE

The following consolidated financial statements of Lifetime Brands, Inc. are filed as part of this report under Item 8 *Financial Statements and Supplementary Data.*

The following consolidated financial statement schedule of Lifetime Brands, Inc. required pursuant to Item 15(a) is submitted herewith:

All other financial schedules are not required under the related instructions or are inapplicable, and therefore have been omitted.

The unaudited supplementary data regarding quarterly results of operations are incorporated by reference to the information set forth in Item 8 *Financial Statements and Supplementary Data*.

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Lifetime Brands, Inc.

We have audited the accompanying consolidated balance sheets of Lifetime Brands, Inc. (the Company) as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2012. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits. We did not audit the financial statements of Grupo Vasconia, S.A.B. and Subsidiaries (a corporation in which the Company has a 30% interest), which statements have been audited by other auditors whose report has been furnished to us, and our opinion on the consolidated financial statements, insofar as it relates to the amounts included for Grupo Vasconia, S.A.B. and Subsidiaries, is based solely on the report of the other auditors. In the consolidated financial statements, the Company s investment in Grupo Vasconia, S.A.B. and Subsidiaries is stated at $36.4 million and $26.3 million at December 31, 2012 and 2011, respectively, and the Company s equity in the net income of Grupo Vasconia, S.A.B. and Subsidiaries is stated at $6.9 million for the year ended December 31, 2012, $2.9 million for the year ended December 31, 2011 and $2.7 million for the year ended December 31, 2010.

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 and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Lifetime Brands, Inc. at December 31, 2012 and 2011, and the consolidated results of its operations, comprehensive income and its cash flows for each of the three years in the period ended December 31, 2012, 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 financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Lifetime Brands, Inc. s internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 15, 2013 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Jericho, New York

March 15, 2013

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LIFETIME BRANDS, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands except share data)

	December 31, 2012	December 31, 2011
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 1,871	$ 2,972
Accounts receivable, less allowances of $3,996 at December 31, 2012 and $4,602 at December 31, 2011	97,369	77,749
Inventory (Note M)	104,584	110,337
Prepaid expenses and other current assets	5,393	5,264
Deferred income taxes (Note I)	3,542	2,475
TOTAL CURRENT ASSETS	212,759	198,797
PROPERTY AND EQUIPMENT, net (Note M)	31,646	34,324
INVESTMENTS (Note C)	43,685	34,515
INTANGIBLE ASSETS, net (Note D)	57,842	46,937
OTHER ASSETS	2,865	4,172
TOTAL ASSETS	$ 348,797	$ 318,745
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES		
Revolving Credit Facility (Note E)	$ 7,000	$ 15,000
Current maturity of Senior Secured Term Loan (Note E)	4,375	
Accounts payable	18,555	18,985
Accrued expenses (Note M)	33,354	33,877
Income taxes payable (Note I)	3,615	2,100
TOTAL CURRENT LIABILITIES	66,899	69,962
DEFERRED RENT & OTHER LONG-TERM LIABILITIES (Note M)	21,565	14,598
DEFERRED INCOME TAXES (Note I)	3,510	5,385
REVOLVING CREDIT FACILITY (Note E)	53,968	42,625
SENIOR SECURED TERM LOAN (Note E)	30,625	
TERM LOAN (Note E)		40,000
STOCKHOLDERS EQUITY		
Preferred stock, $.01 par value, shares authorized: 100 shares of Series A and 2,000,000 shares of Series B; none issued and outstanding		
Common stock, $.01 par value, shares authorized: 25,000,000; shares issued and outstanding: 12,754,467 at December 31, 2012 and 12,430,893 at December 31, 2011	128	124
Paid-in capital	142,489	137,467
Retained earnings	33,849	14,465
Accumulated other comprehensive loss (Note M)	(4,236)	(5,881)
TOTAL STOCKHOLDERS EQUITY	172,230	146,175
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 348,797	$ 318,745

See notes to consolidated financial statements.

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LIFETIME BRANDS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands except per share data)

	Year Ended December 31,		
	2012	**2011**	**2010**
Net sales	$ 486,842	$ 444,418	$ 443,171
Cost of sales	310,054	282,058	273,774
Gross margin	176,788	162,360	169,397
Distribution expenses	44,046	43,882	44,570
Selling, general and administrative expenses	104,338	93,894	95,044
Intangible asset impairment (Note D)	1,069		
Income from operations	27,335	24,584	29,783
Interest expense (Note E)	(5,898)	(7,758)	(9,351)
Loss on early retirement of debt (Note E)	(1,363)		(764)
Income before income taxes, equity in earnings and extraordinary item	20,074	16,826	19,668
Income tax provision (Note I)	(5,208)	(6,122)	(4,602)
Equity in earnings, net of taxes (Note C)	6,081	3,362	2,718
Income before extraordinary item	20,947	14,066	17,784
Extraordinary item, net of taxes			2,477
NET INCOME	$ 20,947	$ 14,066	$ 20,261
Basic income per common share before extraordinary item (Note H)	$ 1.67	$ 1.16	$ 1.48
Basic income per common share of extraordinary item (Note H)			0.20
BASIC INCOME PER COMMON SHARE (NOTE H)	$ 1.67	$ 1.16	$ 1.68
Diluted income per common share before extraordinary item (Note H)	$ 1.64	$ 1.12	$ 1.44
Diluted income per common share of extraordinary item (Note H)			0.20
DILUTED INCOME PER COMMON SHARE (NOTE H)	$ 1.64	$ 1.12	$ 1.64

See notes to consolidated financial statements.

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LIFETIME BRANDS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

	Year ended December 31,		
	2012	**2011**	**2010**
Net income	$ 20,947	$ 14,066	$ 20,261
Other comprehensive income (loss), net of tax:			
Translation adjustment (Note M)	3,077	(704)	1,088
Deferred gains (losses) on cash flow hedges (Notes F & M):			
Fair value adjustment, net of tax of $182 in 2012 and $36 in 2010	(272)		57
Hedge de-designation, net of tax of $216 in 2010			342
Interest rate swap termination, net of tax of $95 in 2010			150
Total deferred gains (losses) on cash flow hedges	(272)		549
Effect of retirement benefit obligations (Note M):			
Net loss arising from retirement benefit obligations, net of tax of $791 in 2012	(1,187)		
Less: amortization of loss included in net income, net of tax of $18 in 2012	27		
Total effects of retirement benefit obligations	(1,160)		
Other comprehensive income (loss), net of tax	1,645	(704)	1,637
Comprehensive income	$ 22,592	$ 13,362	$ 21,898

See notes to consolidated financial statements.

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LIFETIME BRANDS, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(in thousands)

	Common stock Shares	Common stock Amount	Paid-in capital	Retained earnings (accumulated deficit)	Accumulated other comprehensive loss	Total
BALANCE AT DECEMBER 31, 2009	12,015	$ 120	$ 129,655	$ (18,949)	$ (6,814)	$ 104,012
Comprehensive income:						
Net income				20,261		20,261
Grupo Vasconia, S.A.B. translation adjustment (Note C)					1,088	1,088
Derivative hedge de-designation					342	342
Derivative fair value adjustment					57	57
Interest rate swap termination					150	150
Total comprehensive income						21,898
Convertible Senior Note repurchase			(2,366)			(2,366)
Tax effect on Convertible Senior Note repurchase			836			836
Shares issued to directors (Note G)	10		150			150
Stock compensation expense (Note G)			2,778			2,778
Tax benefit on exercise of stock options			124			124
Exercise of stock options	40	1	173			174
BALANCE AT DECEMBER 31, 2010	12,065	121	131,350	1,312	(5,177)	127,606
Comprehensive income:						
Net income				14,066		14,066
Translation adjustment					(704)	(704)
Total comprehensive income						13,362
Shares issued to directors (Note G)	21		183			183
Stock compensation expense (Note G)			2,612			2,612
Issuance of 255,908 shares of common stock for acquisition of Creative Tops	256	3	3,097			3,100
Exercise of stock options	89		225			225
Dividends (Note G)				(913)		(913)
BALANCE AT DECEMBER 31, 2011	12,431	124	137,467	14,465	(5,881)	146,175
Comprehensive income:						
Net income				20,947		20,947
Translation adjustment					3,077	3,077
Derivative fair value adjustment (Note F)					(272)	(272)
Effect of retirement benefit obligations					(1,160)	(1,160)
Total comprehensive income						22,592
Shares issued to directors (Note G)	23		267			267
Stock compensation expense (Note G)			2,526			2,526
Issuance of 143,568 shares of common stock for acquisition of Fred® & Friends (Note B)	144	1	1,506			1,507

Tax benefit on exercise of stock options				150					150
Exercise of stock options	156		3	573					576
Dividends (Note G)						(1,563)			(1,563)
BALANCE AT DECEMBER 31, 2012	12,754	$	128	$ 142,489	$	33,849	$	(4,236)	$ 172,230

See notes to consolidated financial statements.

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LIFETIME BRANDS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Year ended December 31,		
	2012	**2011**	**2010**
OPERATING ACTIVITIES			
Net income	$ 20,947	$ 14,066	$ 20,261
Adjustments to reconcile net income to net cash provided by operating activities:			
Extraordinary gain			(2,477)
Provision for doubtful accounts	123	(24)	376
Depreciation and amortization	9,324	8,397	9,810
Amortization of debt discount		543	1,802
Deferred rent	(668)	(133)	306
Deferred income taxes	(3,011)	(1,218)	(2,691)
Stock compensation expense	2,793	2,795	2,928
Undistributed equity earnings	(5,665)	(2,896)	(2,321)
Intangible asset impairment (Note C)	1,069		
Loss on early retirement of debt (Note E)	1,363		764
Changes in operating assets and liabilities (excluding the effects of business acquisitions)			
Accounts receivable	(14,741)	3,297	(11,619)
Inventory	9,694	(5,365)	3,996
Prepaid expenses, other current assets and other assets	120	1,120	3,981
Accounts payable, accrued expenses and other liabilities	(166)	(4,673)	628
Income taxes payable	1,515	(3,722)	4,356
NET CASH PROVIDED BY OPERATING ACTIVITIES	22,697	12,187	30,100
INVESTING ACTIVITIES			
Purchases of property and equipment	(4,955)	(4,959)	(2,864)
Equity investments	(2,765)	(5,123)	
Business acquisition, net of cash acquired	(14,500)	(20,584)	
Net proceeds from sale of property	27	31	70
NET CASH USED IN INVESTING ACTIVITIES	(22,193)	(30,635)	(2,794)
FINANCING ACTIVITIES			
Repayments of prior credit facility, net			(24,601)
Proceeds from Revolving Credit Facility, net (Note E)	3,343	43,525	14,100
Proceeds from Senior Secured Term Loan (Note E)	35,000		
Proceeds (repayments) of Term Loan (Note E)	(40,000)		40,000
Repurchase of 4.75% convertible senior notes		(24,100)	(51,028)
Financing Costs		(761)	(3,248)
Cash dividends paid (Note G)	(1,249)	(913)	
Payment of capital lease obligations		(78)	(158)
Proceeds from the exercise of stock options	577	225	174
Excess tax benefits from exercise of stock options	150		124
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	(2,179)	17,898	(24,637)
Effect of foreign exchange on cash	574	171	

INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(1,101)	(379)	2,669
Cash and cash equivalents at beginning of year	2,972	3,351	682
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 1,871	$ 2,972	$ 3,351

See notes to consolidated financial statements

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LIFETIME BRANDS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

NOTE A SIGNIFICANT ACCOUNTING POLICIES

Organization and business

Lifetime Brands, Inc. (the Company) designs, sources and sells branded kitchenware, tabletop and other products used in the home and markets its products under a number of brand names and trademarks, which are either owned or licensed by the Company or through retailers private labels. The Company markets and sells its products principally on a wholesale basis to retailers. The Company also markets and sells a limited selection of its products directly to consumers through its Pfaltzgraff®, Mikasa®, Housewares Deals® and Lifetime Sterling® Internet websites.

Principles of consolidation

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

Foreign Currency

All foreign subsidiaries use the local currency of their respective countries as their functional currency. Assets and liabilities are translated into U.S. dollars at exchange rates prevailing at the balance sheet dates. Revenues, costs and expenses are translated into U.S. dollars at average exchange rates for the relevant period. Gains and losses resulting from translation are recorded as a component of accumulated other comprehensive gain (loss). Gains and losses from foreign currency transactions are recognized in selling, general and administrative expenses in the consolidated statements of operations. Foreign currency gain/loss was a $415,000 loss in 2012, a $28,000 gain in 2011 and a $62,000 gain in 2010.

Revenue recognition

Wholesale sales and Retail Direct sales are recognized when title passes to the customer, which is primarily at the shipping point for Wholesale sales and upon delivery to the customer for Retail Direct sales. Shipping and handling fees that are billed to customers in sales transactions are included in net sales and amounted to $1.4 million, $1.4 million and $1.9 million for the years ended December 31, 2012, 2011 and 2010, respectively. Net sales exclude taxes that are collected from customers and remitted to the taxing authorities.

The Company offers various sales incentives and promotional programs to its customers from time to time in the normal course of business. These incentives and promotions typically include arrangements such as cooperative advertising, buydowns, volume rebates and discounts. These arrangements and an estimate of sales returns are reflected as reductions in net sales in the Company s consolidated statements of operations.

Distribution expenses

Distribution expenses consist primarily of warehousing expenses and freight-out expenses. Freight-out expenses were $8.5 million, $7.5 million and $8.2 million for the years ended December 31, 2012, 2011 and 2010, respectively. Handling costs of products sold are included in cost of sales.

Advertising expenses

Advertising expenses are expensed as incurred and are included in selling, general and administrative expenses. Advertising expenses were $775,000, $702,000 and $775,000 for the years ended December 31, 2012, 2011 and 2010, respectively.

Accounts receivable

The Company periodically reviews the collectability of its accounts receivable and establishes allowances for estimated losses that could result from the inability of its customers to make required payments. A considerable amount of judgment is required to assess the ultimate realization of these receivables including assessing the initial and on-going creditworthiness of the Company s customers. The Company also maintains an allowance for anticipated customer deductions. The allowances for deductions are primarily based on contracts with customers.

LIFETIME BRANDS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

NOTE A SIGNIFICANT ACCOUNTING POLICIES (continued)

However, in certain cases the Company does not have a formal contract and, therefore, customer deductions are non-contractual. To evaluate the reasonableness of non-contractual customer deductions, the Company analyzes currently available information and historical trends of deductions.

Inventory

Inventory consists principally of finished goods sourced from third-party suppliers. Inventory also includes finished goods, work in process and raw materials related to the Company s manufacture of sterling silver products. Inventory is priced using the lower of cost (first-in, first-out basis) or market method. The Company estimates the selling price of its inventory on a product by product basis based on the current selling environment. If the estimated selling price is lower than the inventory s cost, the Company reduces the value of the inventory to its net realizable value.

Property and equipment

Property and equipment is stated at cost. Property and equipment, other than leasehold improvements, is depreciated using the straight-line method over the estimated useful lives of the assets. Building and improvements are being depreciated over 30 years and machinery, furniture and equipment over periods ranging from 3 to 10 years. Leasehold improvements are amortized over the term of the lease or the estimated useful lives of the improvements, whichever is shorter. Advances paid towards the acquisition of property and equipment and the cost of property and equipment not ready for use before the end of the period are classified as construction in progress.

Cash equivalents

The Company considers all highly liquid instruments with a maturity of three months or less when purchased to be cash equivalents.

Use of estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Amounts subject to estimates include judgments related to revenue recognition, allowances for doubtful accounts, reserves for sales returns and allowances and customer chargebacks, inventory mark-down provisions, impairment of tangible and intangible assets, stock option expense, estimates for unpaid healthcare claims, derivative valuations, accruals related to the Company s tax provision and tax valuation allowances.

Concentration of credit risk

The Company s cash and cash equivalents are potentially subject to concentration of credit risk. The Company maintains cash with several financial institutions that, in some cases, is in excess of Federal Deposit Insurance Corporation insurance limits.

Concentrations of credit risk with respect to trade accounts receivable are limited due to the large number of entities comprising the Company s customer base.

During the years ended December 31, 2012, 2011 and 2010, Wal-Mart Stores, Inc. (including Sam s Club and Asda Superstore, in the United Kingdom) accounted for 16%, 15%, and 15% of net sales, respectively. Sales to Wal-Mart Stores, Inc. are included in the Company s Wholesale segment. No other customer accounted for 10% or more of the Company s sales during these periods.

LIFETIME BRANDS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

NOTE A SIGNIFICANT ACCOUNTING POLICIES (continued)

Fair value measurements

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic No. 820, *Fair Value Measurements and Disclosures*, provides enhanced guidance for using fair value to measure assets and liabilities and establishes a common definition of fair value, provides a framework for measuring fair value under U.S. generally accepted accounting principles and expands disclosure requirements about fair value measurements. Fair value measurements included in the Company s consolidated financial statements relate to the Company s annual goodwill and other intangible asset impairment tests and derivatives, described in Notes D and F, respectively.

Fair value of financial instruments

The Company determined the carrying amounts of cash and cash equivalents, accounts receivable and accounts payable are reasonable estimates of their fair values because of their short-term nature. The Company determined that the carrying amounts of borrowings outstanding under its revolving credit facility and senior secured term loan approximate fair value since such borrowings bear interest at variable market rates.

Derivatives

The Company accounts for derivative instruments in accordance with ASC Topic No. 815, *Derivatives and Hedging*. ASC Topic No. 815 requires that all derivative instruments be recognized on the balance sheet at fair value as either an asset or liability. Changes in the fair value of derivatives that qualify as hedges and have been designated as part of a hedging relationship for accounting purposes have no net impact on earnings to the extent the derivative is considered highly effective in achieving offsetting changes in fair value or cash flows attributable to the risk being hedged, until the hedge item is recognized in earnings. If the derivative which is designated as part of a hedging relationship is considered ineffective in achieving offsetting changes in fair value or cash flows attributable to the risk being hedged, the changes in fair value are recorded in operations. For derivatives that do not qualify or are not designated as hedging instruments for accounting purposes, changes in fair value are recorded in operations.

Goodwill, intangible assets and long-lived assets

Goodwill and intangible assets deemed to have indefinite lives are not amortized but, instead, are subject to an annual impairment assessment. The Company first assesses qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment testing described in ASU Topic No. 350, Intangibles Goodwill and Other. The Company also evaluates qualitative factors to determine whether or not its indefinite lived intangibles have been impaired and then performs quantitative tests if required. These tests can include the royalty savings model or other valuation models.

Long-lived assets, including intangible assets deemed to have finite lives, are reviewed for impairment whenever events or changes in circumstances indicate that such amounts may have been impaired. Impairment indicators include, among other conditions, cash flow deficits, historic or anticipated declines in revenue or operating profit or material adverse changes in the business climate that indicate that the carrying amount of an asset may be impaired. When impairment indicators are present, the Company compares the carrying value of the asset to the estimated discounted future cash flows expected to be generated by the assets. If the assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets.

LIFETIME BRANDS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

NOTE A SIGNIFICANT ACCOUNTING POLICIES (continued)

Income taxes

The Company accounts for income taxes using the asset and liability method. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. The Company accounts for foreign income taxes based upon anticipated reinvestment of profits into respective foreign tax jurisdictions.

The Company applies the authoritative guidance for the financial statement recognition, measurement and disclosure of uncertain tax positions recognized in the Company s financial statements. In accordance with this guidance, tax positions must meet a more-likely-than-not recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position. A valuation allowance is required to be established or maintained when it is more likely than not that all or a portion of deferred tax assets will not be realized.

Stock options

The Company measures compensation expense for all share-based compensation granted to employees and non-employee directors at fair value on the date of grant and recognizes compensation expense over the related service period for awards expected to vest. The Company uses the Black-Scholes option valuation model to estimate the fair value of its stock options. The Black-Scholes option valuation model requires the input of highly subjective assumptions including the expected stock price volatility of the Company s common stock and the risk free interest rate.

Employee Healthcare

In 2011, the Company commenced self-insurance of certain portions of its health insurance plan. The Company maintains an estimated accrual for unpaid claims and claims incurred but not yet reported (IBNR). Although management believes that it uses the best information available to estimate IBNR, actual claims may vary significantly from estimated claims.

New Accounting Pronouncements

In July 2012, the FASB issued ASU No. 2012-02, *Intangibles Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment*, which permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the quantitative impairment test described in ASC Topic No. 350, Intangibles Goodwill and Other. The amendments in this update are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The Company has determined that the adoption of this guidance will not have a material impact on the Company s consolidated financial position, results of operations or cash flows.

In January 2013, the FASB issued ASU No. 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income,* which requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under GAAP to be reclassified in their entirety to net income (e.g., net periodic pension benefit cost), an entity is required to cross-reference to other disclosures required under GAAP that provide additional detail about those amounts. The amendments in this update are effective prospectively for reporting periods beginning after December 15, 2012. The Company has determined that the adoption of this guidance will not have a material impact on the Company s consolidated financial position, results of operations or cash flows.

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LIFETIME BRANDS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

NOTE B ACQUISITIONS

Fred® & Friends

On December 20, 2012, the Company acquired the Fred® & Friends (F&F) business from Easy Aces, Inc., a Rhode Island corporation, for $21.4 million consideration, comprised of $14.5 million cash, 143,568 shares of common stock with a value of $1.5 million and $5.4 million of contingent consideration. F&F, which reported net sales of approximately $16.6 million for the year ended December 31, 2011, designs and distributes novelty housewares under the Fred® brand directly to retailers throughout the United States and Canada. The assets, liabilities and operating results of F&F have been reflected in the Company s consolidated financial statements in accordance with ASC Topic No. 805, *Business Combinations*, commencing from the acquisition date and did not significantly impact the Company s consolidated financial results for the year ended December 31, 2012.

The purchase price has been determined as follows (in thousands):

Cash paid	$ 14,500
Common stock issued	1,507
Value of contingent consideration	5,370
Total purchase price	$ 21,377

The cash portion of the purchase price was funded by borrowings under the Company s credit facility (Revolving Credit Facility). The value of contingent consideration is comprised of the present value of estimated contingent payments of $4.0 million related to the attainment of certain gross contribution targets for the years 2013 through 2016 and the present value of the contractual holdback amount of $1.4 million, which serves as security for payments in satisfaction of any claim. The maximum undiscounted deferred and contingent consideration to be paid under the agreement is $7.7 million.

The purchase price has been preliminarily allocated based on management s estimate of the fair value of the assets acquired and liabilities assumed, as follows (in thousands):

	Purchase Price Allocation
Accounts receivable[1]	$ 5,003
Inventory	3,941
Other assets	360
Other liabilities	(1,519)
Goodwill and other intangibles	13,592
Total allocated value	$ 21,377

Note:

(1) The fair value of accounts receivable approximated the gross contractual amounts receivable.

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LIFETIME BRANDS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

NOTE B ACQUISITIONS (continued)

On the basis of estimated fair values, the excess of the purchase price over the net assets acquired of $13.6 million has been allocated as follows: $7.2 million for customer relationships, $3.9 million for trade names and $2.5 million for goodwill. The goodwill recognized results from such factors as an assembled workforce and the value of other synergies expected from combining operations with the Company. The total amount of goodwill is expected to be deductible for tax purposes. All of the goodwill and other intangibles are included in the Wholesale segment. Customer relationships and trade names are amortized on a straight-line basis over their estimated useful lives (see Note D).

Creative Tops

On November 4, 2011, the Company acquired 100% of the share capital of each of Creative Tops Holdings Limited and Creative Tops Far East Limited (collectively, Creative Tops), for £14.8 million ($23.7 million) of consideration, comprised of cash in the amount of £12.9 million ($20.6 million) and 255,908 shares of common stock with a value of £1.9 million ($3.1 million). Creative Tops, which reported net sales of approximately £26.3 million ($42.3 million) for its fiscal year ended March 31, 2011, is a leading UK-based supplier of private label and branded tabletop and kitchenware products. The purpose of this acquisition was to expand the Company s sale of products into Europe including growth in the sales of the traditional products of Creative Tops and new branded product offerings. The assets, liabilities and operating results of Creative Tops are reflected in the Company s consolidated financial statements in accordance with ASC Topic No. 805, *Business Combinations*, commencing from the acquisition date and did not significantly impact the Company s consolidated financial results for the year ended December 31, 2011.

The purchase price was determined as follows (in thousands):

Cash paid, net of cash acquired	$ 20,584
Common stock issued	3,100
Total purchase price	$ 23,684

The cash portion of the purchase price was funded by borrowings under the Revolving Credit Facility. Cash paid is reflected net of cash acquired of £0.1 million ($0.2 million).

The purchase price was allocated based on management s estimate of the fair value of the assets acquired and liabilities assumed, as follows (in thousands):

	Purchase Price Allocation
Accounts receivable(1)	$ 8,559
Inventory	5,228
Other current assets	508
Property and equipment	844

Goodwill and other intangibles	16,892
Accounts payable	(1,250)
Accrued expenses	(2,351)
Other liabilities	(1,191)
Deferred tax liability	(3,555)
Total allocated value	$ 23,684

(1) The fair value of accounts receivable approximated the gross contractual amounts receivable.

LIFETIME BRANDS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

NOTE B ACQUISITIONS (continued)

On the basis of estimated fair values, the excess of the purchase price over the net assets acquired of $13.3 million was allocated as follows: $10.6 million for customer relationships, $3.6 million for trade names, $2.7 million for non-tax-deductible goodwill, net of a deferred tax liability related to amortizable intangibles of $3.6 million. The goodwill recognized results from such factors as an assembled workforce and the value of other synergies expected from combining operations with the Company. Customer relationships and trade names are amortized on a straight-line basis over their estimated useful lives (see Note D).

NOTE C EQUITY INVESTMENTS

The Company owns approximately 30% of the outstanding capital stock of Grupo Vasconia, S.A.B. (Vasconia). The investment is accounted for using the equity method of accounting. Accordingly, the Company has recorded its proportionate share of Vasconia s net income (reduced for amortization expense related to the customer relationships acquired) for the years ended December 31, 2012, 2011 and 2010 in the accompanying consolidated statements of operations. The value of the Company s investment balance has been translated from Mexican Pesos (MXN) to U.S. Dollars (USD) using the spot rate of MXN 12.97 and MXN 13.95 at December 31, 2012 and 2011, respectively. The Company s proportionate share of Vasconia s net income has been translated from MXN to USD using the average exchange rates of MXN 12.94 to 13.51, MXN 11.74 to 13.62 and MXN 12.37 to 12.79 during the years ended December 31, 2012, 2011 and 2010, respectively. The effect of the translation of the Company s investment resulted in an increase (decrease) of the investment of $2.7 million, $(0.5) million and $1.1 million during the years ended December 31, 2012, 2011 and 2010, respectively. These translation effects are recorded in accumulated other comprehensive loss. The Company received cash dividends of $416,000, $466,000 and $398,000 from Vasconia during the years ended December 31, 2012, 2011 and 2010, respectively. Included in prepaid expenses and other currents assets at December 31, 2012 and 2011 are amounts due from Vasconia of $71,000 and $216,000, respectively.

Summarized income statement information for the years ended December 31, 2012, 2011 and 2010, as well as summarized balance sheet information as of December 31, 2012 and 2011, for Vasconia in USD and MXN is as follows:

	Year Ended December 31,					
	2012		2011		2010	
	(in thousands)					
Income Statement	USD	MXN	USD	MXN	USD	MXN
Net Sales	$ 168,712	$ 2,224,256	$ 132,310	$ 1,647,479	$ 113,454	$ 1,430,528
Gross Profit	38,134	497,413	38,143	476,501	32,451	409,263
Income from operations	14,614	192,182	17,254	216,715	15,122	190,862
Net Income	34,172	443,630	11,395	142,698	9,910	125,115

	December 31,			
	2012		2011	
	(in thousands)			
Balance Sheet	USD	MXN	USD	MXN
Current assets	$ 106,953	$ 1,386,731	$ 54,262	$ 756,792
Non-current assets	75,511	979,059	42,904	598,382
Current liabilities	29,282	379,663	14,645	204,254
Non-current liabilities	44,405	575,746	7,310	101,953

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LIFETIME BRANDS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE C EQUITY INVESTMENTS (continued)

The Company recorded equity in earnings of Vasconia, net of taxes, of $6.9 million, $2.9 million and $2.7 million for the years ended December 31, 2012, 2011 and 2010, respectively. Equity in earnings of Vasconia in 2012 includes $4.1 million related to the Company s portion of a bargain purchase gain recognized by Vasconia on its purchase of Almexa, an aluminum mill and manufacturer of aluminum foil, a $1.1 million tax benefit realized in the period and the reduction of the investment to fair value of $1.3 million, net of tax.

As a result of recording the bargain purchase gain and a corresponding increase in the investment, the Company determined it was necessary to perform an impairment test on its investment in Vasconia as of December 31, 2012. The test involved the assessment of the fair value of the Company s investment in Vasconia based on Level 1 quoted prices in active markets. The result of the assessment of the Company s investment in Vasconia indicated that the carrying amount of the investment exceeded its fair value and, therefore, was required to be reduced by $1.3 million, net of tax, to its fair value. As of December 31, 2012, the carrying value of the Company s investment in Vasconia was $36.4 million.

The Company owns a 40% equity interest in GS Internacional S/A (GSI), a leading wholesale distributor of branded housewares products in Brazil, which the Company acquired in December 2011. The Company recorded equity in losses of GSI, net of taxes, of $727,000 for the year ended December 31, 2012. The operating results of GSI were not significant during the period of December 9, 2011 through December 31, 2011. As of December 31, 2012, the carrying value of the Company s investment in GSI was $6.8 million.

The Company, together with Vasconia and unaffiliated partners, formed Housewares Corporation of Asia Limited (HCA), a Hong Kong-based company, to supply direct import kitchenware products to retailers in North, Central and South America. The Company initially invested $105,000 for a 40% equity interest in this entity during 2011. The operating results of HCA were not significant through December 31, 2012. As of December 31, 2012, the carrying value of the Company s investment in HCA was $0.1 million.

In February 2012, the Company entered into Grand Venture Holdings Limited (Grand Venture), a joint venture with Manweal Development Limited (Manweal), a Chinese corporation, to distribute Mikasa® products in China, which included an initial investment of $500,000. The Company and Manweal each own 50% of Grand Venture and have rights and obligations proportionate to their ownership percentage. The Company accounts for its investment in Grand Venture using the equity method of accounting and has recorded its proportionate share of Grand Venture s net loss as equity in earnings in the Company s consolidated statements of operations. The Company recorded equity in losses of the joint venture of $125,000 for the year ended December 31, 2012. As of December 31, 2012, the carrying value of the Company s investment in Grand Venture was $0.4 million.

The Company evaluated the disclosure requirements of ASC Topic No. 860, *Transfers and Servicing*, and determined that at December 31, 2012, the Company did not have a controlling voting interest or variable interest in any of its investments and therefore continued accounting for the investments using the equity method of accounting.

LIFETIME BRANDS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

NOTE D GOODWILL AND INTANGIBLE ASSETS

The Company s intangible assets, all of which are included in the Wholesale segment, consist of the following (in thousands):

	Year Ended December 31, 2012			2011		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Goodwill	5,085		5,085	2,673		2,673
Indefinite-lived intangible assets:						
Trade names	18,364		18,364	19,433		19,433
Finite-lived intangible assets:						
Licenses	15,847	(7,096)	8,751	15,847	(6,641)	9,206
Trade names	10,056	(1,800)	8,256	6,116	(1,400)	4,716
Customer relationships	18,406	(1,409)	16,997	11,166	(681)	10,485
Patents	584	(195)	389	584	(160)	424
Total	68,342	(10,500)	57,842	55,819	(8,882)	46,937

The Company performed its 2012 annual impairment tests for its indefinite-lived intangible assets as of October 1, 2012. The test involved the assessment of the fair market value of the Company s indefinite-lived intangible assets based on Level 2 observable inputs, using a discounted cash flow approach, assuming a discount rate of 12.5%-14.0% and an annual growth rate of 2.0%-4.0%. The result of the assessment of the Company s indefinite-lived intangibles indicated that the carrying amount of the Elements® trade name exceeded its fair value.

During 2012, the Company s home décor products line experienced a significant decline in sales. The Company believes the most significant factor was the reduction in retail space allocated to the category which has also contributed to pricing pressure. While the Company believes this market condition is not permanent, following a strategic review of the business, it has decided to re-brand a portion of the home décor products under the Mikasa® and Pfaltzgraff® trade names. As a result of these factors, the Company recorded an impairment charge of $1.1 million in its statement of operations in the third quarter of 2012 which reduced the book value of its Elements® trade name.

In addition, the Company assessed the carrying value of its goodwill, which arose from recent acquisitions, and determined based on qualitative factors that no impairment existed as of December 31, 2012.

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LIFETIME BRANDS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

NOTE D GOODWILL AND INTANGIBLE ASSETS (continued)

A summary of the activities related to the Company s intangible assets for the year ended December 31, 2012 consists of the following (in thousands):

	Intangible Assets	Goodwill	Total Intangible Assets and Goodwill
Goodwill and Intangible Assets, December 31, 2010	$ 30,818	$	$ 30,818
Acquisition of trade names	3,639		3,639
Acquisition of customer relationships	10,580		10,580
Goodwill from Creative Tops acquisition		2,673	2,673
Amortization	(773)		(773)
Goodwill and Intangible Assets, December 31, 2011	44,264	2,673	46,937
Acquisition of trade names	3,940		3,940
Acquisition of customer relationships	7,240		7,240
Goodwill from F&F acquisition		2,412	2,412
Impairment of Elements® trade name	(1,069)		(1,069)
Amortization	(1,618)		(1,618)
Goodwill and Intangible Assets, December 31, 2012	$ 52,757	$ 5,085	$ 57,842

The weighted-average amortization periods for the Company s finite-lived intangible assets as of December 31, 2012 are as follows:

	Years
Trade names	15
Licenses	33
Customer relationships	14
Patents	17

Estimated amortization expense for each of the five succeeding fiscal years is as follows (in thousands):

Year ending December 31,	
2013	$ 2,692
2014	2,692
2015	2,688
2016	2,685

2017	2,552

Amortization expense for the years ended December 31, 2012, 2011 and 2010 was $1.6 million, $0.8 million and $0.7 million, respectively.

LIFETIME BRANDS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

NOTE E DEBT

Revolving Credit Facility

The Company had a $150.0 million secured credit agreement (the Revolving Credit Facility), maturing on October 28, 2016, with a bank group led by JPMorgan Chase Bank, N.A. On July 27, 2012, the Company amended the Revolving Credit Facility to increase the lenders commitment to $175.0 million and to, among other things, extend the maturity date to July 27, 2017 and increase the expansion option which permits the Company, subject to certain conditions including the consent of the Senior Secured Term Loan (defined below) lenders, to increase the maximum borrowing commitment to $225.0 million.

Borrowings under the Revolving Credit Facility are secured by a first lien priority security interest in all of the assets of the Company and its domestic subsidiaries, including a pledge of the Company s outstanding shares of stock in its subsidiaries (limited, in the case of its foreign subsidiaries, to 65.0% of the Company s equity interests), except regarding the Company s shares in its wholly-owned subsidiary LTB de Mexico, S.A. de C.V. (LTB de Mexico), which in turn holds the Company s interest in Vasconia. Availability under the Revolving Credit Facility is subject to a borrowing base calculation equal to the sum of (i) 85.0% of eligible domestic accounts receivable, (ii) 85.0% of the net orderly liquidation value of eligible domestic inventory and (iii) the lesser of 50.0% of the orderly liquidation value of eligible trademarks and $25.0 million less reserves. The borrowing base is also subject to reserves that may be established by the administrative agent in its permitted discretion.

Borrowings under the Revolving Credit Facility bear interest, at the Company s option, at one of the following rates: (i) the Alternate Base Rate, defined as the greater of the Prime Rate, Federal Funds Rate plus 0.5% or the Adjusted LIBOR Rate plus 1.0%, plus a margin of 1.0% to 1.75%, or (ii) the Eurodollar Rate, defined as the Adjusted LIBOR Rate plus a margin of 2.0% to 2.75%. The respective margins are based upon availability. Interest rates on outstanding borrowings at December 31, 2012 ranged from 2.5% to 4.5%. In addition, the Company pays a commitment fee of 0.375% to 0.50% on the unused portion of the Revolving Credit Facility.

The Revolving Credit Facility provides for customary restrictions and events of default. Restrictions include limitations on additional indebtedness, acquisitions, investments and payment of dividends, among others. Furthermore, if availability under the Revolving Credit Facility is less than $20.0 million, the Company will be required to maintain a minimum fixed charge coverage ratio of 1.10 to 1.00, which covenant would remain effective until availability is at least $23.5 million for a period of three consecutive months.

At December 31, 2012, the Company had $1.2 million of open letters of credit and $61.0 million of borrowings outstanding under the Revolving Credit Facility. Availability under the Revolving Credit Facility was approximately $77.7 million, or 44%, of the total loan commitment at December 31, 2012.

The Company classifies a portion of the Revolving Credit Facility as a current liability if the Company s intent and ability is to repay the loan from cash flows from operations which are expected to occur within the year. Repayments and borrowings under the facility can vary significantly from planned levels based on cash flow needs and general economic conditions. The Company expects that it will continue to borrow and repay funds, subject to availability, under the facility based on working capital and other corporate needs.

Senior Secured Term Loan

On July 27, 2012, the Company entered into a $35.0 million senior secured credit agreement (the Senior Secured Term Loan), which matures on July 27, 2018, with JPMorgan Chase Bank, N.A.

The Senior Secured Term Loan bears interest, at the Company s option, at the Alternate Base Rate (as defined) plus 4.00%, or the Adjusted LIBO Rate (as defined) plus 5.00%. The interest rate on outstanding borrowings at December 31, 2012 was 5.25%.

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LIFETIME BRANDS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

NOTE E DEBT (continued)

The Senior Secured Term Loan provides that for any four consecutive fiscal quarters, (x) if EBITDA (as defined) is less than $34.0 million but equal to or greater than $30.0 million, the ratio of Indebtedness (as defined) to EBITDA shall not exceed 3.0 to 1.0 and (y) EBITDA shall not be less than $30.0 million. Capital expenditures are limited and for the year ended December 31, 2012, such limit is $7.5 million. The Senior Secured Term Loan provides for other customary restrictions and events of default. Restrictions include limitations on additional indebtedness, acquisitions, investments and payment of dividends, among others. Further, the Senior Secured Term Loan provides that the Company shall maintain a minimum fixed charge coverage ratio of 1.10 to 1.00 for any four consecutive fiscal quarters. The Company was in compliance with the financial covenants of the Senior Secured Term Loan and Revolving Credit Facility at December 31, 2012.

Term Loan

In June 2012, the Company repaid $10.0 million of the outstanding principal of its second lien credit agreement (the Term Loan). In July 2012, the Company utilized the proceeds of the Senior Secured Term Loan to repay the remaining $30.0 million of the then outstanding Term Loan. The loss on early retirement of debt in the accompanying condensed consolidated statements of operations of $1.4 million represents a write-off of unamortized debt issuance costs related to the repayment of the Term Loan.

NOTE F DERIVATIVES

On August 20, 2012, the Company entered into an interest rate swap agreement with a notional amount of $35.0 million to manage interest rate exposure in connection with its variable interest rate borrowings. The hedge period in the agreement commences in March 2013 and expires in June 2018. The interest rate swap agreement was designated as a cash flow hedge under ASC Topic No. 815. The effective portion of the fair value gain or loss on this agreement is recorded as a component of accumulated other comprehensive loss. The effect of recording this derivative at fair value resulted in an unrealized loss of $272,000, net of taxes, for the year ended December 31, 2012. No amounts recorded in accumulated other comprehensive loss are expected to be reclassified to interest expense in the next twelve months.

The fair value of the derivative has been obtained from the counterparty to the agreement and was based on Level 2 observable inputs using proprietary models and estimates about relevant future market conditions. The aggregate fair value of the Company s derivative instruments was a liability of $454,000 at December 31, 2012 and is included in other long-term liabilities.

NOTE G CAPITAL STOCK

Long-term incentive plan

In June 2012, the shareholders of the Company approved an amendment to the Company s 2000 Long-Term Incentive Plan (the Plan) to increase the shares available for grant by 700,000 shares to 4,200,000 shares. These shares of the Company s common stock are available for grants to directors, officers, employees, consultants and service providers and affiliates in the form of stock options or other equity-based awards. The Plan authorizes the Board of Directors of the Company, or a duly appointed committee thereof, to issue incentive stock options, non-qualified options and other stock-based awards. Options that have been granted under the Plan expire over a range of five to ten years from the date of grant and vest over a range of up to five years from the date of grant. As of December 31, 2012, there were 756,832 shares available for the grant of awards.

Cash dividends

The Company did not pay cash dividends on its outstanding shares of common stock during the year ended December 31, 2010. In March 2011, the Company resumed the declaration of cash dividends on its outstanding shares of common stock.

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LIFETIME BRANDS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

NOTE G CAPITAL STOCK (continued)

Dividends declared in 2012 and 2011 are as follows:

Dividend per share	Date declared	Date of record	Payment date
$0.025	March 4, 2011	May 2, 2011	May 16, 2011
$0.025	June 27, 2011	August 2, 2011	August 16, 2011
$0.025	November 4, 2011	November 18, 2011	November 29, 2011
$0.025	January 11, 2012	February 1, 2012	February 15, 2012
$0.025	March 6, 2012	May 1, 2012	May 15, 2012
$0.025	June 13, 2012	August 1, 2012	August 15, 2012
$0.025	July 31, 2012	November 1, 2012	November 15, 2012
$0.025	November 2, 2012	February 1, 2013	February 15, 2013

On March 12, 2013, the Board of Directors declared a quarterly dividend of $0.03125 per share payable on May 15, 2013 to shareholders of record on May 1, 2013.

Preferred stock

The Company is authorized to issue 100 shares of Series A Preferred Stock and 2,000,000 shares of Series B Preferred Stock, none of which is issued or outstanding at December 31, 2012.

Restricted stock

In 2012, 2011 and 2010, the Company issued an aggregate of 23,394, 21,400 and 10,020 restricted shares, respectively, of the Company s common stock to its non-employee directors representing payment of a portion of their annual retainer. The total fair value of the restricted shares, based on the number of shares granted and the quoted market price of the Company s common stock on the date of grant was $270,000 in 2012, $230,000 in 2011 and $150,000 in 2010. For all restricted stock grants, the restriction lapses one year from the date of grant and the stock is expensed over the one year period.

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LIFETIME BRANDS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

NOTE G CAPITAL STOCK (continued)

Stock options

A summary of the Company s stock option activity and related information for the three years ended December 31, 2012, is as follows:

	Options	Weighted-average exercise price	Weighted-average remaining contractual life (years)	Aggregate intrinsic value
Options outstanding at December 31, 2009	1,786,667	$ 12.14		
Grants	573,000	13.12		
Exercises	(39,250)	4.44		
Cancellations	(101,217)	13.65		
Options outstanding at December 31, 2010	2,219,200	12.46		
Grants	391,500	11.20		
Exercises	(123,500)	5.19		
Cancellations	(11,450)	13.29		
Options outstanding at December 31, 2011	2,475,750	12.62		
Grants	305,000	11.64		
Exercises	(199,823)	5.47		
Cancellations	(52,750)	12.82		
Options outstanding at December 31, 2012	2,528,177	13.06	6.13	$ 4,525,905
Options exercisable at December 31, 2012	1,616,052	14.19	4.96	$ 3,813,485

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value that would have been received by the option holders had all option holders exercised their stock options on December 31, 2012. The intrinsic value is calculated for each in-the-money stock option as the difference between the closing price of the Company s common stock on December 31, 2012 and the exercise price.

The total intrinsic values of stock options exercised for the years ended December 31, 2012, 2011 and 2010 were $1,182,000, $830,400 and $389,100, respectively. The intrinsic value of a stock option that is exercised is calculated at the date of exercise.

The Company recognized stock compensation expense of $2.8 million, $2.8 million and $2.9 million for the years ended December 31, 2012, 2011 and 2010, respectively. The stock compensation expense recognized each year is equal to the grant date fair value of stock options vested during the year. Total unrecognized compensation cost related to unvested stock options at December 31, 2012, before the effect of income taxes, was $4.1 million and is expected to be recognized over a weighted-average period of 1.77 years.

The Company values stock options using the Black-Scholes option valuation model. The Black-Scholes option valuation model, as well as other available models, was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. The Black-Scholes option valuation model requires the input of highly subjective assumptions including the expected stock price volatility and risk-free interest rate. Because the Company s stock options have characteristics significantly different from those of traded options, changes in the subjective input assumptions can materially affect the fair value estimate of the Company s stock options. The weighted-average per share grant date fair value of stock options granted during the years ended December 31, 2012, 2011 and 2010 was $6.05, $5.69 and $7.96, respectively.

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LIFETIME BRANDS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

NOTE G CAPITAL STOCK (continued)

The fair value for these stock options was estimated at the date of grant using the following weighted-average assumptions:

	2012	2011	2010
Historical volatility	61%	60%	73%
Expected term (years)	6.0	5.6	5.0
Risk-free interest rate	1.10%	1.96%	2.18%
Expected dividend yield	0.86%	0.89%	0.00%

NOTE H INCOME PER COMMON SHARE

Basic income per common share has been computed by dividing net income by the weighted-average number of shares of the Company s common stock outstanding. Diluted income per common share adjusts net income and basic income per common share for the effect of all potentially dilutive shares of the Company s common stock. The calculations of basic and diluted income per common share for the years ended December 31, 2011, 2010 and 2009 are as follows:

	2012	2011	2010
	(in thousands - except per share amounts)		
Income before extraordinary item	$ 20,947	$ 14,066	$ 17,784
Extraordinary item, net of taxes			2,477
Net income Basic and Diluted	$ 20,947	$ 14,066	$ 20,261
Weighted-average shares outstanding Basic	12,511	12,128	12,036
Effect of dilutive securities:			
Stock options	299	401	340
Weighted-average shares outstanding Diluted	12,810	12,529	12,376
Basic income per common share before extraordinary item	$ 1.67	$ 1.16	$ 1.48
Basic income per common share of extraordinary item			0.20
Basic income per common share	$ 1.67	$ 1.16	$ 1.68
Diluted income per common share before extraordinary item	$ 1.64	$ 1.12	$ 1.44
Diluted income per common share of extraordinary item			0.20
Diluted income per common share	$ 1.64	$ 1.12	$ 1.64

The computations of diluted income per common share for the years ended December 31, 2012, 2011 and 2010 excludes options to purchase 1,450,200, 1,600,413 and 1,060,588 shares of the Company s common stock, respectively. The computations of diluted income per common share for the years ended December 31, 2011 and 2010 also exclude options to purchase 462,192 and 2,678,571 shares, respectively, of the Company s common stock that were issuable upon the conversion of the Company s 4.75% convertible senior notes and related interest expense, which were retired in July 2011. The above shares were excluded due to their antidilutive effect.

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LIFETIME BRANDS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

NOTE I INCOME TAXES

The components of income before income taxes, equity in earnings and extraordinary item are as follows:

	Year Ended December 31, 2012	2011	2010
		(in thousands)	
Domestic	$ 20,609	$ 16,178	$ 20,867
Foreign	(535)	648	(1,199)
Total income before income taxes, equity in earnings and extraordinary income	$ 20,074	$ 16,826	$ 19,668

The provision (benefit) for income taxes (before equity in earnings) consists of:

	Year Ended December 31, 2012	2011	2010
		(in thousands)	
Current:			
Federal	$ 6,691	$ 4,657	$ 4,269
State and local	761	2,063	1,437
Foreign	503	618	565
Deferred	(2,747)	(1,216)	(1,669)
Income tax provision	$ 5,208	$ 6,122	$ 4,602

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company s deferred income tax assets are as follows:

	December 31, 2012	2011
	(in thousands)	
Deferred income tax assets:		
Deferred rent expense	$ 4,407	$ 3,038
Translation adjustment	1,116	2,205
Stock options	3,660	2,743
Inventory	1,381	1,624
Operating loss carry-forward	1,797	2,120
Accounts receivable allowances	106	270
Accrued compensation	669	580

Other	1,915	674
Total deferred income tax assets	$ 15,051	$ 13,254

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LIFETIME BRANDS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

NOTE I INCOME TAXES (continued)

Significant components of the Company s net deferred income tax asset (liability) are as follows:

	December 31, 2012	December 31, 2011
	(in thousands)	
Deferred income tax liabilities:		
Depreciation and amortization	$ (5,945)	$ (4,867)
Intangibles	(4,645)	(6,679)
Equity in earnings	(3,080)	(998)
Other	(167)	(535)
Total deferred income tax liabilities	(13,837)	(13,079)
Net deferred income tax asset	1,214	175
Valuation allowance	(1,182)	(3,085)
Net deferred income tax asset (liability)	$ 32	$ (2,910)

The Company has generated various state net operating loss carryforwards of which $18.7 million remains at December 31, 2012 that begin to expire in 2014. The Company has net operating losses in foreign jurisdictions of $2.1 million at December 31, 2012 that begin to expire in 2016. As of December 31, 2011, management had determined that it was more likely than not that certain deferred tax assets would be realized and the corresponding valuation allowance had been released based on the Company s ability to utilize deferred tax assets currently and the expected future use of temporary differences in the carryback periods. In 2012, the Company recorded an income tax benefit for a non-cash adjustment to a deferred tax liability of $2.3 million related to the prior year. Additionally, the Company recorded a reduction in its valuation allowance of $1.9 million of which $1.1 million related to a portion of the translation adjustment deferred tax asset in connection with the equity method investee, Vasconia. The valuation allowance which remains as of December 31, 2012 relates to certain state net operating losses.

The provision for income taxes (before equity in earnings) differs from the amounts computed by applying the applicable federal statutory rates as follows:

	Year Ended December 31, 2012	2011	2010
Provision for federal income taxes at the statutory rate	35.0%	35.0%	35.0%
Increases (decreases):			
State and local income taxes, net of Federal income tax benefit	3.2	6.4	5.6
Foreign rate differences	(1.8)		
Non-deductible stock options		0.1	1.2
Non-deductible expenses	1.2	3.4	0.1

Valuation allowance		(8.2)	(19.8)
Reduction of deferred tax liabilities related to the prior year	(11.6)		
Other	(0.1)	(0.3)	1.3
Provision for income taxes	25.9%	36.4%	23.4%

LIFETIME BRANDS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

NOTE I INCOME TAXES (continued)

The estimated values of the Company s gross uncertain tax positions at December 31, 2012, 2011 and 2010 are liabilities of $301,000, $134,000 and $356,000, respectively, and consist of the following:

	Year Ended December 31, 2012	2011	2010
		(in thousands)	
Balance at January 1	$ (134)	$ (356)	$ (335)
Additions based on tax positions related to the current year			
Additions for tax positions of prior years	(167)	(76)	(200)
Reductions for tax position of prior years			
Settlements		298	179
Balance at December 31	$ (301)	$ (134)	$ (356)

The Company had approximately $39,000 and $34,000, net of federal tax benefit, accrued at December 31, 2012 and 2011, respectively, for the payment of interest. The Company s policy for recording interest and penalties is to record such items as a component of income taxes.

If the Company s tax positions are ultimately sustained, the Company s liability, including interest, would be reduced by $301,000, all of which would impact the Company s tax provision. On a quarterly basis, the Company evaluates its tax positions and revises its estimates accordingly. The Company believes that it is reasonably possible that $301,000 of its tax positions will be resolved within the next twelve months.

The Company has identified the following jurisdictions as major tax jurisdictions: U.S. Federal, California, Massachusetts, Pennsylvania, New York, New Jersey and the United Kingdom. The Company is no longer subject to U.S. Federal income tax examinations for the years prior to 2009. At December 31, 2012, the periods subject to examination for the Company s major state jurisdictions are the years ended 2008 through 2011.

NOTE J BUSINESS SEGMENTS

Segment information

The Company operates in two reportable business segments: the Wholesale segment, the Company s primary business segment, in which the Company designs, markets and distributes products to retailers and distributors, and the Retail Direct segment, in which the Company markets and sells a limited selection of its products directly to consumers through its Pfaltzgraff®, Mikasa®, Housewares Deals® and Lifetime Sterling® Internet websites. The operating results of Creative Tops and Fred® & Friends since the dates of the acquisitions are included in the Wholesale segment.

The Company has segmented its operations to reflect the manner in which management reviews and evaluates the results of its operations. While both segments distribute similar products, the segments have been distinct due to the different methods the Company uses to sell, market and distribute the products. Management evaluated the performance of the Wholesale and Retail Direct segments based on net sales and income (loss) from operations through December 31, 2012. Such measures give recognition to specifically identifiable operating costs such as cost of sales, distribution expenses and selling, general and administrative expenses. Certain general and administrative expenses, such as senior executive salaries and benefits, stock compensation, director fees and accounting, legal and consulting fees, are not allocated to the specific segments and are reflected as unallocated corporate expenses. Assets in each segment consist of assets used in its operations and acquired intangible assets. Assets in the unallocated corporate category consist of cash and tax related assets that are not allocated to the segments.

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LIFETIME BRANDS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

NOTE J BUSINESS SEGMENTS (continued)

	Year Ended December 31,		
	2012	2011	2010
		(in thousands)	
Net sales:			
Wholesale	$ 464,862	$ 421,119	$ 413,809
Retail Direct	21,980	23,299	29,362
Total net sales	$ 486,842	$ 444,418	$ 443,171
Income from operations:			
Wholesale[1]	$ 40,530	$ 38,410	$ 42,997
Retail Direct	463	(524)	(1,018)
Unallocated corporate expenses	(13,658)	(13,302)	(12,196)
Total income from operations	$ 27,335	$ 24,584	$ 29,783
Depreciation and amortization:			
Wholesale	$ 9,074	$ 8,183	$ 9,719
Retail Direct	250	214	91
Total depreciation and amortization	$ 9,324	$ 8,397	$ 9,810
Assets:			
Wholesale	$ 342,872	$ 317,435	$ 271,670
Retail Direct	512	813	1,441
Unallocated/ corporate/ other	5,413	497	4,475
Total assets	$ 348,797	$ 318,745	$ 277,586
Capital expenditures:			
Wholesale	$ 4,897	$ 4,730	$ 2,541
Retail Direct	58	229	323
Total capital expenditures	$ 4,955	$ 4,959	$ 2,864

Note:

(1) In 2012, income from operations for the Wholesale segment includes $1.1 million of intangible asset impairment.

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LIFETIME BRANDS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

NOTE J BUSINESS SEGMENTS (continued)

Geographical information

The following table sets forth net sales and long-lived assets by the major geographic locations (in thousands):

	Year ended December 31, 2012	2011
Net sales:		
United States	$ 430,758	$ 426,405
International	56,084	18,013
Total	$ 486,842	$ 444,418
Long-lived assets at period-end:		
United States	$ 133,841	$ 118,803
International	2,197	1,145
Total	$ 136,038	$ 119,948

Product category information net sales

The following table sets forth net sales by major product categories included within the Company s Wholesale operating segment:

	Year Ended December 31,		
	2012	2011	2010
		(in thousands)	
Category:			
Kitchenware	$ 256,154	$ 215,707	$ 208,491
Tabletop	113,911	134,652	123,432
Home Solutions	52,176	64,099	81,886
Creative Tops	42,621	6,661	
Total	$ 464,862	$ 421,119	$ 413,809

The product categories, which incorporate a 2011 change to establish a Home Solutions products category and the additional revenue source from Creative Tops, reflect a refined alignment of the products into the sources of revenue which the Company analyzes. The revenue source categories disclosed in 2010 have been reclassified to conform to current year presentation for comparative purposes.

NOTE K COMMITMENTS AND CONTINGENCIES

Operating leases

The Company has lease agreements for its corporate headquarters, distribution centers, showrooms and sales offices that expire through 2025. These leases generally provide for, among other things, annual base rent escalations and additional rent for real estate taxes and other costs.

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LIFETIME BRANDS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

NOTE K COMMITMENTS AND CONTINGENCIES (continued)

Future minimum payments under non-cancelable operating leases are as follows (in thousands):

Year Ending December 31,	
2013	$ 14,818
2014	14,850
2015	14,443
2016	13,349
2017	9,974
Thereafter	23,820
Total	$ 91,254

Rent and related expenses under operating leases were $14.8 million, $13.3 million and $13.3 million for the years ended December 31, 2012, 2011 and 2010, respectively. There was no sublease rental income in 2012. Sublease rental income was $70,000 and $82,000 for the years ended December 31, 2011 and 2010, respectively.

Royalties

The Company has license agreements that require the payment of royalties on sales of licensed products which expire through 2023. Future minimum royalties payable under these agreements are as follows (in thousands):

Year ending December 31,	
2013	$ 6,423
2014	6,251
2015	6,374
2016	472
2017	550
Thereafter	1,769
Total	$ 21,839

Legal proceedings

Wallace Silversmiths de Puerto Rico, Ltd. (Wallace de Puerto Rico), a wholly-owned subsidiary of the Company, operates a manufacturing facility in San Germán, Puerto Rico that is leased from the Puerto Rico Industrial Development Company (PRIDCO). In March 2008, the United States Environmental Protection Agency (the EPA) announced that the San Germán Ground Water Contamination site in Puerto Rico (the Site) had been added to the Superfund National Priorities List due to contamination present in the local drinking water supply.

In May 2008, Wallace de Puerto Rico received from the EPA a Notice of Potential Liability and Request for Information Pursuant to 42 U.S.C. Sections 9607(a) and 9604(e) of the Comprehensive Environmental Response, Compensation, Liability Act. The Company responded to the EPA s Request for Information on behalf of Wallace de Puerto Rico. In July 2011, Wallace de Puerto Rico received a letter from the EPA requesting access to the property that it leases from PRIDCO, and the Company granted such access. In February, 2013, the EPA requested access to conduct further environmental investigation at the property during May 2013.

The Company is not aware of any determination by the EPA that any remedial action is required for the Site, and, accordingly, is not able to estimate the extent of any possible liability.

LIFETIME BRANDS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

NOTE K COMMITMENTS AND CONTINGENCIES (continued)

The Company is, from time to time, involved in other legal proceedings. The Company believes that other current litigation is routine in nature and incidental to the conduct of the Company s business and that none of this litigation, individually or collectively, would have a material adverse effect on the Company s consolidated financial position, results of operations or cash flows.

NOTE L RETIREMENT PLANS

401(k) plan

The Company maintains a defined contribution retirement plan for eligible employees under Section 401(k) of the Internal Revenue Code. Participants can make voluntary contributions up to the Internal Revenue Service limit of $17,000 ($22,500 for employees 50 years or over) for 2012. Effective January 1, 2009, the Company suspended its matching contribution as an expense savings measure. The Company s U.K.-based subsidiary, Creative Tops, also maintains a defined contribution pension plan.

Retirement benefit obligations

The Company assumed retirement benefit obligations, which are paid to certain former executives of an acquired business. The obligations under these agreements are unfunded and amounted to $5.9 million at December 31, 2012 and $3.4 million at December 31, 2011.

The discount rate used to calculate the retirement benefit obligations was 3.60% at December 31, 2012 and 4.50% at December 31, 2011. The retirement benefit obligations are included in accrued expenses and deferred rent & other long-term liabilities.

The Company expects to recognize $90,000 of the actuarial losses included in accumulated other comprehensive loss in net periodic benefit cost in 2013.

Future retirement benefit payments are as follows (in thousands):

Year ending December 31,	
2013	$ 143
2014	134
2015	124
2016	247
2017	366
2018-2022	1,734
Total	$ 2,748

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LIFETIME BRANDS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

NOTE M OTHER

Inventory

The components of inventory are as follows:

	December 31, 2012	December 31, 2011
	(in thousands)	
Finished goods	$ 101,021	$ 107,471
Work in process	2,046	1,683
Raw materials	1,517	1,183
Total	$ 104,584	$ 110,337

Property and equipment

Property and equipment consist of:

	December 31, 2012	December 31, 2011
	(in thousands)	
Machinery, furniture and equipment	$ 75,896	$ 70,037
Leasehold improvements	26,334	25,050
Building and improvements	1,604	1,604
Construction in progress	920	1,900
Land	100	100
	104,854	98,691
Less: accumulated depreciation and amortization	(73,208)	(64,367)
Total	$ 31,646	$ 34,324

Depreciation and amortization expense on property and equipment for the years ended December 31, 2012, 2011 and 2010 was $7.8 million, $7.5 million and $8.2 million, respectively.

Included in machinery, furniture and equipment at each of December 31, 2012 and 2011 is $2.1 million related to assets recorded under capital leases. Included in accumulated depreciation and amortization at each of December 31, 2012 and 2011 is $1.9 million related to assets recorded under capital leases.

LIFETIME BRANDS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

NOTE M OTHER (continued)

Accrued expenses

Accrued expenses consist of:

	December 31, 2012	December 31, 2011
	(in thousands)	
Customer allowances and rebates	$ 10,595	$ 10,422
Compensation and benefits	7,824	7,950
Interest	401	441
Vendor invoices	5,355	1,984
Royalties	2,259	2,181
Commissions	1,089	1,093
Freight	1,122	1,419
Contingent consideration related to GSI investment		2,622
Contingent consideration related to F&F acquisition	730	
Working capital excess related to F&F acquisition	845	
Other	3,134	5,765
Total	$ 33,354	$ 33,877

Deferred rent & other long-term liabilities

Deferred rent & other long-term liabilities consist of:

	December 31, 2012	December 31, 2011
	(in thousands)	
Deferred rent liability	$ 10,719	$ 11,354
Retirement benefit obligations	5,752	3,244
Contingent consideration related to F&F acquisition	4,640	
Derivative liability	454	
Total	$ 21,565	$ 14,598

Extraordinary item

In December 2010, the Company paid $2.5 million to ARC International SA for all outstanding consideration remaining due or payable related to its 2008 acquisition of the business and certain assets of Mikasa®, Inc. As a result of the payment of this amount to ARC, the Company adjusted the remaining book value of the acquired Mikasa® intangible assets, including the trade name and associated deferred tax liability, to zero and the negative goodwill balance to approximately $2.5 million. Concurrently, the remaining balance of negative goodwill was eliminated resulting in an extraordinary gain in the amount of $2.5 million in 2010.

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LIFETIME BRANDS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

NOTE M OTHER (continued)

Supplemental cash flow information

	Year Ended December 31,		
	2012	2011	2010
		(in thousands)	
Supplemental disclosure of cash flow information:			
Cash paid for interest	$ 5,498	$ 6,877	$ 6,893
Cash paid for taxes	6,067	10,331	1,198
Non-cash investing activities:			
Translation adjustment	$ 3,077	$ (704)	$ 1,088

Components of accumulated other comprehensive loss, net

	Year Ended December 31,		
	2012	2011	2010
		(in thousands)	
Accumulated translation adjustment:			
Balance at beginning of year	$ (5,881)	$ (5,177)	$ (6,265)
Translation adjustment during period	3,077	(704)	1,088
Balance at end of year	$ (2,804)	$ (5,881)	$ (5,177)
Accumulated effect of retirement benefit obligations:			
Balance at beginning of year	$	$	$
Net loss arising from retirement benefit obligations, net of tax	(1,187)		
Amounts reclassified from accumulated other comprehensive loss:			
Amortization of loss, net of tax(1)	27		
Balance at end of year	$ (1,160)	$	$
Accumulated deferred gains (losses) on cash flow hedges:			
Balance at beginning of year	$	$	$ (549)
Derivative fair value adjustment, net of tax	(272)		57
Amounts reclassified from accumulated other comprehensive loss:			
Hedge de-designation, net of tax(2)			342
Interest rate swap termination, net of tax			150
Balance at end of year	$ (272)	$	$

Notes:

(1) Amount is recorded in selling, general and administrative expenses on the consolidated statements of operations.

(2) Amount is recorded in interest expense on the consolidated statements of operations.

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Item 15(a)

LIFETIME BRANDS, INC.

SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS

(in thousands)

COL. A	COL. B	COL. C Additions		COL. D	COL. E
Description	Balance at beginning of period	Due to acquisitions	Charged to costs and expenses	Deductions	Balance at end of period
Year ended December 31, 2012					
Deducted from asset accounts:					
Allowance for doubtful accounts	$ 328	$ 67	$ 181	$ (215)(a)	$ 361
Reserve for sales returns and allowances	4,274	179	6,660(c)	(7,478)(b)	3,635
	$ 4,602	$ 246	$ 6,841	$ (7,693)	$ 3,996
Year ended December 31, 2011					
Deducted from asset accounts:					
Allowance for doubtful Accounts	$ 1,057	$	$ 63	$ (792)(a)	$ 328
Reserve for sales returns and allowances	11,554		3,378(c)	(10,658)(b)	4,274
	$ 12,611	$	$ 3,441	$ (11,450)	$ 4,602
Year ended December 31, 2010					
Deducted from asset accounts:					
Allowance for doubtful accounts	$ 1,433	$	$ 1,456	$ (1,832)(a)	$ 1,057
Reserve for sales returns and allowances	15,124		661(c)	(4,231)(b)	11,554
	$ 16,557	$	$ 2,117	$ (6,063)	$ 12,611

(a) Uncollectible accounts written off, net of recoveries.
(b) Allowances granted.
(c) Charged to net sales.