TRAVELZOO INC
Form 10-Q
November 09, 2010

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

(Mark One)

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

For the quarterly period ended September 30, 2010

or

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

For the transition period from to

Commission File No.: 000-50171

TRAVELZOO INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**36-4415727**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. employer identification no.)*
590 Madison Avenue, 37th Floor New York, New York	**10022**
(Address of principal executive offices)	*(Zip code)*

Registrant s telephone number, including area code: **(212) 484-4900**

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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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

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

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

The number of shares of Travelzoo common stock outstanding as of November 5, 2010 was 16,443,828 shares.

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PART I FINANCIAL INFORMATION

Item 1. ***Financial Statements***

TRAVELZOO INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(In thousands, except par value)

	September 30, 2010	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 34,717	$ 19,776
Accounts receivable, less allowance for doubtful accounts of $531 and $501 as of September 30, 2010 and December 31, 2009, respectively	14,152	11,279
Prepaid income tax	1,781	6,061
Deposits	210	139
Prepaid expenses and other current assets	1,377	1,103
Deferred tax assets	966	966
Total current assets	53,203	39,324
Deposits, less current portion	319	381
Deferred tax assets, less current portion	52	52
Restricted cash	875	875
Property and equipment, net	3,822	4,089
Intangible assets, net	1,146	1,411
Total assets	$ 59,417	$ 46,132
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 7,331	$ 6,834
Accrued expenses	5,712	4,278
Deferred revenue	1,177	828
Income tax payable	500	
Deferred rent	211	134
Total current liabilities	14,931	12,074
Deferred tax liabilities long-term	597	533
Long-term tax liabilities	1,435	2,139
Deferred rent, less current portion	518	615
Commitments and contingencies		
Stockholders equity:		
Preferred stock, $0.01 par value per share (5,000 shares authorized; none issued)		
Common stock, $0.01 par value (40,000 shares authorized; 16,444 shares issued and outstanding as of September 30, 2010 and December 31, 2009)	164	164
Additional paid-in capital	6,410	4,772

Retained earnings		36,378		27,008
Accumulated other comprehensive loss		(1,016)		(1,173)
Total stockholders equity		41,936		30,771
Total liabilities and stockholders equity	$	59,417	$	46,132

See accompanying notes to unaudited condensed consolidated financial statements.

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TRAVELZOO INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Revenues	$ 27,693	$ 23,576	$ 84,317	$ 70,194
Cost of revenues	1,742	1,464	5,012	4,140
Gross profit	25,951	22,112	79,305	66,054
Operating expenses:				
Sales and marketing	13,630	13,437	42,671	37,450
General and administrative	6,616	6,395	19,833	18,420
Total operating expenses	20,246	19,832	62,504	55,870
Operating income from continuing operations	5,705	2,280	16,801	10,184
Other income and expense:				
Interest income and other income	45	8	132	40
Gain (loss) on foreign currency	20	320	(190)	17
Income from continuing operations before income taxes	5,770	2,608	16,743	10,241
Income taxes	2,120	1,308	7,373	5,292
Income from continuing operations, net of tax	3,650	1,300	9,370	4,949
Loss from discontinued operations, net of tax		(1,595)		(5,097)
Net income (loss)	$ 3,650	$ (295)	$ 9,370	$ (148)
Basic net income (loss) per share from:				
Continuing operations	$ 0.22	$ 0.08	$ 0.57	$ 0.30
Discontinued operations	$	$ (0.10)	$	$ (0.31)
Net income (loss) per share	$ 0.22	$ (0.02)	$ 0.57	$ (0.01)
Diluted net income (loss) per share from:				
Continuing operations	$ 0.22	$ 0.08	$ 0.57	$ 0.30
Discontinued operations	$	$ (0.10)	$	$ (0.31)
Net income (loss) per share	$ 0.22	$ (0.02)	$ 0.57	$ (0.01)
	16,444	16,444	16,444	16,396

Shares used in computing basic net income (loss) per share				
Shares used in computing diluted net income (loss) per share	16,453	16,452	16,453	16,413

See accompanying notes to unaudited condensed consolidated financial statements.

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TRAVELZOO INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Cash flows from operating activities:		
Net income (loss)	$ 9,370	$ (148)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	1,766	1,457
Deferred income tax	64	
Stock-based compensation	562	
Provision for losses on accounts receivable	106	302
Net foreign currency effect	190	(17)
Changes in operating assets and liabilities:		
Accounts receivable	(2,982)	(766)
Deposits	(109)	(75)
Prepaid income tax	4,280	
Prepaid expenses and other current assets	(278)	422
Accounts payable	594	1,600
Accrued expenses	1,416	(101)
Deferred revenue	348	153
Deferred rent	(20)	(127)
Income tax payable	496	
Other non-current liabilities	(704)	19
Net cash provided by operating activities	15,099	2,719
Cash flows from investing activities:		
Purchases of property and equipment	(1,142)	(1,608)
Purchases of intangible assets		(1,760)
Net cash used in investing activities	(1,142)	(3,368)
Cash flows from financing activities:		
Proceeds from exercise of stock options		2,158
Proceeds from sale of Asia Pacific business segment	1,073	
Net cash provided by financing activities	1,073	2,158
Effect of exchange rate changes on cash and cash equivalents	(89)	6
Net increase in cash and cash equivalents	14,941	1,515
Cash and cash equivalents at beginning of period	19,776	14,179

Cash and cash equivalents at end of period	$	34,717	$	15,694
Supplemental disclosure of cash flow information:				
Cash paid for income taxes, net	$	3,264	$	4,732

See accompanying notes to unaudited condensed consolidated financial statements.

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TRAVELZOO INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1: The Company and Basis of Presentation

Travelzoo Inc. (the Company or Travelzoo) is a global Internet media company. We inform over 21 million subscribers worldwide, as well as millions of website users, about the best travel and entertainment deals available from thousands of companies. Our deal experts source, research and test-book offers, recommending only those that meet Travelzoo s rigorous quality standards. We provide airlines, hotels, cruise lines, vacation packagers, and other travel and entertainment companies with a fast, flexible, and cost effective way to reach millions of consumers. Our revenues are generated primarily from advertising fees. Our publications and products include the *Travelzoo w*ebsites (www.travelzoo.com, www.travelzoo.ca, www.travelzoo.co.uk, www.travelzoo.de, www.travelzoo.es, www.travelzoo.fr, among others), the *Travelzoo Top 20* e-mail newsletter, the *Newsflash* e-mail alert service, the *SuperSearch* pay-per-click travel search tool, and the *Travelzoo Network*, a network of third-party websites that list travel deals published by Travelzoo. We also operate *Fly.com*, a travel search engine that allows users to quickly and easily find the best prices on flights from hundreds of airlines and online travel agencies. In August 2010, we launched *Local Deals*, a new service that allows our subscribers to purchase vouchers for deals from local businesses such as spas and restaurants. The vouchers are redeemable at the local businesses during the promotional period. We receive a percentage of the face value of the voucher from the local businesses.

Starting November 1, 2009, the *Travelzoo* websites in Asia Pacific (cn.travelzoo.com, www.travelzoo.co.jp, www.travelzoo.com.au, www.travelzoo.com.hk, www.travelzoo.com.tw, among others), the *Travelzoo Top 20* e-mail newsletters in Asia Pacific and the *Newsflash* e-mail alert service in Asia Pacific have been published by Travelzoo (Asia) Limited and Travelzoo Japan K.K., wholly owned subsidiaries of Azzurro Capital Inc., under a license agreement with the Company.

Travelzoo is controlled by Ralph Bartel, who held beneficially approximately 66.3% of the outstanding shares as of November 1, 2010.

The accompanying unaudited condensed consolidated financial statements have been prepared by the Company in accordance with the rules and regulations of the U.S. Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with generally accepted accounting principles in the United States of America have been condensed or omitted in accordance with such rules and regulations. In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the financial position of the Company, and its results of operations and cash flows. These condensed consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements and related notes as of and for the year ended December 31, 2009, included in the Company s Form 10-K filed with the SEC on March 16, 2010, and as amended on May 6, 2010.

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. 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 period.

The results of operations for the three and nine months ended September 30, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010 or any other future period, and the Company makes no representations related thereto.

Certain prior period amounts have been reclassified to conform to current year presentation. Specifically, as described in Note 15, Discontinued Operations , the Company has classified the financial results of its Asia Pacific operating segment as discontinued operations for all periods presented due to the sale of the assets of its Asia Pacific subsidiaries, which constituted the Company s Asia Pacific operating segment, to Travelzoo (Asia) Limited and Travelzoo Japan K.K., wholly-owned subsidiaries of Azzurro Capital Inc. The notes to the Company s unaudited condensed consolidated financial statements relate to continuing operations only, unless otherwise indicated.

The Company was formed as a result of a combination and merger of entities founded by the Company s majority stockholder, Ralph Bartel. In 1998, Mr. Bartel founded Travelzoo.com Corporation, a Bahamas corporation, which issued 5,155,874 shares via the

Internet to approximately 700,000 Netsurfer stockholders for no cash consideration, but subject to certain conditions as referred to below. In 1998, Mr. Bartel also founded Silicon Channels Corporation, a California corporation, to operate the *Travelzoo* website. During 2001, Travelzoo Inc. was formed as a subsidiary of Travelzoo.com Corporation, and Mr. Bartel contributed all of the outstanding shares of Silicon Channels Corporation to Travelzoo Inc. in exchange for 8,129,273 shares of Travelzoo Inc. and options to acquire an additional 2,158,349 shares at $1.00. Mr. Bartel exercised these options in January 2009.

During January 2001, the Board of Directors of Travelzoo.com Corporation proposed that Travelzoo.com Corporation be merged with Travelzoo Inc. whereby Travelzoo Inc. would be the surviving entity. On March 15, 2002, the stockholders of Travelzoo.com Corporation approved the merger with Travelzoo Inc. On April 25, 2002, the certificate of merger was filed in Delaware upon which the merger became effective and Travelzoo.com Corporation ceased to exist. Each outstanding share of common stock of Travelzoo.com Corporation was converted into the right to receive one share of common stock of Travelzoo Inc. Under and subject to the terms of the merger agreement, stockholders were allowed a period of two years following the effective date of the merger to receive shares of Travelzoo Inc. The records of Travelzoo.com Corporation showed that, assuming all of the shares applied for by the Netsurfer stockholders were validly issued, there were 11,295,874 shares of Travelzoo.com Corporation outstanding. As of April 25, 2004, two years following the effective date of the merger, 7,180,342 shares of Travelzoo.com Corporation had been exchanged for shares of Travelzoo Inc. Prior to that date, the remaining shares which were available for issuance pursuant to the merger agreement were included in the issued and outstanding common stock of Travelzoo Inc. and included in the calculation of basic and diluted earnings per share. After April 25, 2004, the Company ceased issuing shares to the former stockholders of Travelzoo.com Corporation, and no additional shares are reserved for issuance to any former stockholders, because their right to receive shares has now expired. On April 25, 2004, the number of shares reported as outstanding was reduced from 19,425,147 to 15,309,615 to reflect actual shares issued as of the expiration date. Earnings per share calculations reflect this reduction of the number of shares reported as outstanding. As of September 30, 2010, there were 16,443,828 shares of common stock outstanding.

It is possible that claims may be asserted against the Company in the future by former stockholders of Travelzoo.com Corporation seeking to receive shares in the Company, whether based on a claim that the two-year deadline for exchanging their shares was unenforceable or otherwise. In addition, one or more jurisdictions, including the Bahamas or the State of Delaware, may assert rights to unclaimed shares of the Company under escheat statutes. As indicated below, the Company is currently the subject of an unclaimed property review by representatives of the State of Delaware. If such escheat claims are asserted, whether as a result of such unclaimed property review or otherwise, the Company intends to challenge the applicability of escheat rights, in that, among other reasons, the identity, residency, and eligibility of the holders in question cannot be determined. There were certain conditions applicable to the issuance of shares to the Netsurfer stockholders, including requirements that (i) they be at least 18 years of age, (ii) they be residents of the U.S. or Canada, and (iii) they not apply for shares more than once. The Netsurfer stockholders were required to confirm their compliance with these conditions, and were advised that failure to comply could result in cancellation of their shares in Travelzoo.com Corporation. Travelzoo.com Corporation was not able to verify that the applicants met the requirements referred to above at the time of their applications for issuance of shares. If claims are asserted by persons claiming to be former stockholders of Travelzoo.com Corporation, the Company intends to assert that their rights to receive their shares expired two years following the effective date of the merger, as provided in the merger agreement. The Company also expects to take the position, if escheat or similar claims are asserted in respect of the unissued shares in the future, that it is not required to issue such shares. Further, even if it were established that unissued shares were subject to escheat claims, the Company would assert that the claimant must establish that the original Netsurfer stockholders complied with the conditions to issuance of their shares. The Company is not able to predict the outcome of any future claims which might be asserted relating to the unissued shares. If such claims were asserted, and were fully successful, that could result in the Company being required to issue up to an additional approximately 4,067,000 shares of common stock for no additional payment.

Representatives of the State of Delaware are currently conducting an unclaimed property review of the Company. In response to information requests in this review, the Company has provided information concerning uncashed checks and other unclaimed property which may be in the custody of the Company. It is the Company s understanding that, if it holds unclaimed property of third parties whose addresses are unknown (and, in the case of the unclaimed shares referred to above, if it is established that the subscribers were entitled to such shares), that property may be subject to escheat to the State of Delaware, because it is the jurisdiction of incorporation of the Company. In the review, the Company has also been requested to provide, and has provided, information concerning the unissued shares referred to above. No escheat claims have been asserted in respect of any such unissued shares, but it is possible that such claims may be asserted as a result of the review. The Company is unable to predict the outcome of the unclaimed property review.

On October 15, 2004, the Company announced a program under which it would make cash payments to people who establish that they were former stockholders of Travelzoo.com Corporation, and who failed to submit requests to convert their shares into shares of Travelzoo Inc. within the required time period. The accompanying condensed consolidated financial statements include a charge in general and administrative expenses of $10,000 for these cash payments for the nine months ended September 30, 2010. The total cost of this program is not reliably estimable because it is based on the ultimate number of valid requests received and future levels of the Company s common stock price. The Company s common stock price affects the liability because the amount of cash payments under the program is based in part on the recent level of the stock price at the date valid requests are received. The Company does not know how many of the requests for shares originally received by Travelzoo.com Corporation in 1998 were valid, but the Company believes that only a portion of such requests were valid. As noted above, in order to receive payment under the program, a person is required to establish that such person validly held shares in Travelzoo.com Corporation. Assuming 100% of the requests from 1998 were valid, former stockholders of Travelzoo.com Corporation holding an additional approximately 4,067,000 shares had not submitted claims under the program as of September 30, 2010.

Note 2: Revenue Recognition

The Company s revenue consists primarily of advertising sales. Advertising revenues are principally derived from the sale of advertising in North America and Europe on the *Travelzoo* website, in the *Travelzoo Top 20* e-mail newsletter, in *Newsflash*, from *SuperSearch*, from the *Travelzoo Network*, and from *Fly.com*. The Company also generates revenue from the sale of vouchers through our *Local Deals* service.

The Company recognizes revenues in accordance with the SEC Staff Accounting Bulletin for revenue recognition. Advertising revenues are recognized in the period in which the advertisement is displayed, provided that evidence of an arrangement exists, the fees are fixed or determinable, and collection of the resulting receivable is reasonably assured.

Where collectibility is not reasonably assured, the revenue will be recognized upon cash collection, provided that the other criteria for revenue recognition have been met. The Company recognizes revenue for fixed-fee advertising arrangements ratably over the term of the insertion order as described below, with the exception of *Travelzoo Top 20* or *Newsflash* insertions, which are recognized upon delivery. The majority of insertion orders have terms that begin and end in a quarterly reporting period. In the cases where at the end of a quarterly reporting period the term of an insertion order is not complete, the Company recognizes revenue for the period by pro-rating the total arrangement fee to revenue and deferred revenue based on a measure of proportionate performance of its obligation under the insertion order. The Company measures proportionate performance by the number of placements delivered and undelivered as of the reporting date. The Company uses prices stated on its internal rate card, which represents stand-alone sales prices, for measuring the value of delivered and undelivered placements. The stand-alone price is the price that would be charged in the advertiser purchased only the individual insertion. Fees for variable-fee advertising arrangements are recognized based on the number of impressions displayed, number of clicks delivered, or number of referrals generated during the period.

Under these policies, no revenue is recognized unless persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collection is deemed reasonably assured. The Company evaluates each of these criteria as follows:

Evidence of an arrangement. The Company considers an insertion order signed by the client or its agency to be evidence of an arrangement.

Delivery. Delivery is considered to occur when the advertising has been displayed and, if applicable, the click-throughs have been delivered.

Fixed or determinable fee. The Company considers the fee to be fixed or determinable if the fee is not subject to refund or adjustment and payment terms are standard.

Collection is deemed reasonably assured. Collection is deemed reasonably assured if it is expected that the client will be able to pay amounts under the arrangement as payments become due. If it is determined that collection is not reasonably assured, then revenue is deferred and recognized upon cash collection. Collection is deemed not reasonably assured when a client is perceived to be in financial distress, which may be evidenced by weak industry conditions, a bankruptcy filing, or previously billed amounts that are past due.

Insertion orders that include fixed-fee advertising are invoiced upon acceptance of the insertion order and on the first day of each month over the term of the insertion order, with the exception of *Travelzoo Top 20* or *Newsflash* insertions, which are primarily invoiced upon delivery. Insertion orders that include variable-fee advertising are invoiced at the end of the month. The Company s standard terms state that in the event that Travelzoo fails to publish advertisements as specified in the insertion order, the liability of Travelzoo to the client shall be limited to, at Travelzoo s sole discretion, a pro rata refund of the advertising fee, the placement of the advertisements at a later time in a comparable position, or the extension of the term of the insertion order until the advertising is fully delivered. The Company believes that no significant obligations exist after the full delivery of advertising.

Revenue from advertising sold to clients through agencies is reported at the net amount billed to the agency.

Revenue from the sale of vouchers through our *Local Deals* service is reported on a net basis.

Note 3: Recent Accounting Standards

In June 2009, the FASB issued a new accounting standard that changes the consolidation model for variable interest entities. The new accounting standard requires a company to perform qualitative analysis when determining whether it must consolidate a variable interest entity and ongoing reassessments to determine if a company must consolidate a variable interest entity. The new accounting standard also requires a company to provide additional disclosures about the nature of restrictions on a consolidated variable interest entity s assets, its involvement with variable interest entities, any significant changes in risk exposure due to that involvement and how its involvement with a variable interest entity affects the company s financial statements. A company will also be required to disclose any significant judgments and assumptions made in determining whether it must consolidate a variable interest entity. Effective January 1, 2010, the Company adopted this new accounting standard. The adoption of this new accounting standard did not have an impact on the Company s consolidated results of operations or financial condition.

In October 2009, the FASB issued ASU 2009-13, a new accounting standard update for revenue recognition with multiple deliverables. The new accounting standard update defines when individual deliverables included in a multiple-element arrangement may be treated as separate units of accounting. The update primarily provides two significant changes: 1) it eliminates the need for objective and reliable evidence of the fair value for the undelivered element in order for a delivered item to be treated as a separate unit of accounting, and 2) it eliminates the residual method to allocate the arrangement consideration. In addition, the update also expands the disclosure requirements for revenue recognition. The new accounting standard update will be effective for the Company January 1, 2011, with early adoption permitted. The Company is currently assessing the future impact of this new accounting standard on its consolidated results of operations and financial condition.

Note 4: Financial Instruments

At September 30, 2010, restricted cash consisted of a certificate of deposit for $875,000 serving as collateral for a standby letter of credit for the security deposit of our corporate headquarters. Cash equivalents consist of highly liquid investments with remaining maturities of three months or less on the date of purchase held in money market funds. The Company believes that the carrying amounts of these financial assets are a reasonable estimate of their fair value. The fair value of these financial assets was determined using the following inputs at September 30, 2010 (in thousands):

		Fair Value Measurements at Reporting Date Using		
	Total	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Assets:				
Money market funds	$ 27,981	$ 27,981	$	$
Total	$ 27,981	$ 27,981	$	$

Note 5: Internal-Use Software and Website Development

The Company includes in fixed assets the capitalized cost of internal-use software and website development, including software used to upgrade and enhance its website and processes supporting the Company s business. Costs incurred in the planning stage and operating stage are expensed as incurred while costs incurred in the application development stage and infrastructure development stage are capitalized, assuming such costs are deemed to be recoverable.

As of September 30, 2010 and December 31, 2009, our capitalized internal-use software and website development costs, net of accumulated amortization, were $575,000 and $905,000, respectively. For the three months ended

September 30, 2010 and 2009, the Company recorded amortization of capitalized internal-use software and website development costs of $110,000 for each period. For the nine months ended September 30, 2010 and 2009, the Company recorded amortization of capitalized internal-use software and website development costs of $330,000 and $299,000, respectively.

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Note 6: Intangible Assets

Intangible assets consist of the following (in thousands):

	September 30, 2010	December 31, 2009
Internet domain names	$ 2,117	$ 2,117
Less accumulated amortization	971	706
Total	$ 1,146	$ 1,411

Intangible assets have a useful life of 5 years. For the three months ended September 30, 2010 and 2009, amortization expense was $89,000 for each period. For the nine months ended September 30, 2010 and 2009, amortization expense was $265,000 and $270,000, respectively.

Future expected amortization expense related to intangible assets at September 30, 2010 is as follows (in thousands):

2010	$ 89
2011	354
2012	352
2013	351
	$ 1,146

The expected amortization expense is an estimate. Actual amounts of amortization expense may differ from estimated amounts due to additional intangible asset acquisitions, impairment of intangible assets, accelerated amortization of intangible assets and other events.

Note 7: Certain Risks and Uncertainties

The Company s cash, cash equivalents and accounts receivable are potentially subject to concentration of credit risk. Cash and cash equivalents are placed with financial institutions that management believes are of high credit quality. The accounts receivable are derived from revenue earned from customers located in the U.S. and internationally.

The Company maintains an allowance for doubtful accounts based upon its historical experience, the age of the receivable and customer specific information. Determining appropriate allowances for these losses is an inherently uncertain process, and ultimate losses may vary from the current estimates. The allowance for doubtful accounts was $531,000 and $501,000 at September 30, 2010 and December 31, 2009, respectively.

Note 8: Stock-Based Compensation and Stock Options

In October 2001, the Company granted to each director fully vested and exercisable options to purchase 30,000 shares of common stock with an exercise price of $2.00 per share for their services as a director in 2000 and 2001. A total of 210,000 options were granted. The options expire in October 2011. 150,000 options were exercised during the year ended December 31, 2005, 17,275 options were exercised during the year ended December 31, 2006, and 30,000 options were exercised during the year ended December 31, 2008. As of September 30, 2010, 12,725 of these options are vested and remain outstanding.

In March 2002, the Company granted to each director options to purchase 5,000 shares of common stock with an exercise price of $3.00 per share that vested in connection with their services as a director in 2002. A total of 35,000 options were granted. The options expire in March 2012. In October 2002, 1,411 options were cancelled upon the resignation of a director, 23,589 options were exercised during the year ended December 31, 2004 and 5,000 options were exercised during the year ended December 31, 2008. As of September 30, 2010, 5,000 of these options are vested and remain outstanding.

In November 2009, the Company granted to one of its employees options to purchase 300,000 shares of common stock with an exercise price of $14.97. 75,000 options vest and become exercisable annually starting in July 1, 2011. The options expire in November 2019. As of September 30, 2010, none of the options were vested and 300,000 options were outstanding. Total stock-based compensation for the three and nine months ended September 30, 2010 was $187,000 and $562,000, respectively. The Company did not record any stock-based compensation for three and nine months ended September 30, 2009.

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As of September 30, 2010, there was approximately $2.8 million of unrecognized stock-based compensation expense related to outstanding stock options. This amount is expected to be recognized over 3.8 years. To the extent the actual forfeiture rate is different from what we have anticipated, stock-based compensation related to these options will be different from our expectations.

Note 9: Net Income Per Share

Basic net income per share is computed using the weighted-average number of common shares outstanding for the period. Diluted net income per share is computed by adjusting the weighted-average number of common shares outstanding for the effect of dilutive potential common shares outstanding during the period. Potential common shares included in the diluted calculation consist of incremental shares issuable upon the exercise of outstanding stock options calculated using the treasury stock method.

The following table sets forth the calculation of basic and diluted net income per share (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	**2009**	**2010**	**2009**
Net income (loss):				
Net income from continuing operations, net of tax	$ 3,650	$ 1,300	$ 9,370	$ 4,949
Net loss from discontinued operations, net of tax		(1,595)		(5,097)
Net income (loss)	$ 3,650	$ (295)	$ 9,370	$ (148)
Weighted average common shares	16,444	16,444	16,444	16,396
Dilutive potential common shares				
Stock options	9	8	9	17
Diluted weighted average common shares	16,453	16,452	16,453	16,413
Basic net income (loss) per share from:				
Continuing operations	$ 0.22	$ 0.08	$ 0.57	$ 0.30
Discontinued operations		(0.10)		(0.31)
Net income (loss)	$ 0.22	$ (0.02)	$ 0.57	$ (0.01)
Diluted net income (loss) per share from:				
Continuing operations	$ 0.22	$ 0.08	$ 0.57	$ 0.30
Discontinued operations		(0.10)		(0.31)
Net income (loss)	$ 0.22	$ (0.02)	$ 0.57	$ (0.01)

For the three and nine months ended September 30, 2010, options to purchase approximately 300,000 shares of common stock were not included in the calculation because the effect would have been anti-dilutive.

Note 10: Commitments and Contingencies

The Company leases office space in Canada, France, Germany, Spain, the U.K., and the U.S. under operating leases which expire between December 31, 2010 and January 31, 2014. The future minimum lease payments under these operating leases as of September 30, 2010 total $8.2 million. The future lease payments consist of $1,056,000 due in 2010, $3,062,000 due in 2011, $2,033,000 due in 2012, $1,924,000 due in 2013, and $161,000 due in 2014.

It is possible that claims may be asserted against the Company in the future by former stockholders of Travelzoo.com Corporation seeking to receive shares in the Company, whether based on a claim that the two-year deadline for exchanging their shares was unenforcew Roman" SIZE="2">) (18,347)

Net cash used for operating activities	(50,550)	(89,055)
Cash flows from investing activities:		
Purchase of property, plant and equipment	(1,921)	(1,881)
Proceeds from disposition of product line, net	1,758	0
Proceeds from sale of fixed assets	16	44

Net cash used for investing activities continuing operations

(147) (1,837)

Net cash provided by investing activities discontinued operations

0 2,059

Net cash (used for) provided by investing activities

(147) 222

Cash flows from financing activities:

Payments on long-term obligations

0 (339)

Borrowings on credit facilities

0 51,800

Repayments on credit facilities

0 (7,600)

Dividends paid

(2,878) (2,922)

Purchase of treasury stock

(2,650) 0

Proceeds from exercise of stock options

192 15

Payments for tax withholding on net restricted stock settlements

(253) (57)

Tax effect on stock awards

(6) (27)

Net cash (used for) provided by financing activities continuing operations

(5,595) 40,870

Net decrease in cash and cash equivalents

(56,292) (47,963)

Cash and cash equivalents at beginning of period	66,135	48,577
Cash and cash equivalents at end of period	$9,843	$614

See notes to consolidated financial statements.

CSS INDUSTRIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

(Unaudited)

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

CSS Industries, Inc. (collectively with its subsidiaries, CSS or the Company) has prepared the consolidated financial statements included herein pursuant to the rules and regulations of the Securities and Exchange Commission. The Company has condensed or omitted certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States pursuant to such rules and regulations. In the opinion of management, the statements include all adjustments (which include normal recurring adjustments) required for a fair presentation of financial position, results of operations and cash flows for the interim periods presented. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended March 31, 2012. The results of operations for the interim periods are not necessarily indicative of the results for the full year.

On September 5, 2012, the Company and its Paper Magic Group, Inc. (PMG) subsidiary sold the Halloween portion of PMG s business and certain PMG assets relating to such business, including certain tangible and intangible assets associated with PMG s Halloween business, to Gemmy Industries (HK) Limited (Gemmy). PMG s remaining assets, including accounts receivable and inventory, were excluded from the sale. PMG retained the right and obligation to fulfill all customer orders for PMG Halloween products (such as Halloween masks, costumes, make-up and novelties) for the Halloween 2012 season. The estimated inventory remaining after the Halloween 2012 season has been reduced to its estimated net realizable value. The purchase price of $2,281,000 was paid to PMG at closing. The Company incurred $523,000 of transaction costs (included within disposition of a product line further discussed in Note 2 to the condensed consolidated financial statements), yielding net proceeds of $1,758,000.

On September 9, 2011, the Company and its Cleo Inc (Cleo) subsidiary sold the Christmas gift wrap portion of Cleo s business and certain Cleo assets relating to such business, including certain equipment, contract rights, customer lists, intellectual property and other intangible assets to Impact Innovations, Inc. (Impact). Cleo s remaining assets, including accounts receivable and inventory, were excluded from the sale. Various prior period amounts contained in these unaudited condensed consolidated financial statements include assets, liabilities and cash flows related to Cleo s Christmas gift wrap business which are presented as current assets and liabilities of discontinued operations. The results of operations for the three- and six month periods ended September 30, 2012 and 2011, as well as the accompanying notes, reflect the historical operations of Cleo s Christmas gift wrap business as discontinued operations. The discussions in this quarterly report are presented on the basis of continuing operations, unless otherwise noted.

The Company s fiscal year ends on March 31. References to a particular fiscal year refer to the fiscal year ending in March of that year. For example, fiscal 2013 refers to the fiscal year ending March 31, 2013.

Principles of Consolidation

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

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Nature of Business

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

Foreign Currency Translation and Transactions

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

Use of Estimates

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

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

The Financial Accounting Standards Board (FASB) issued updated authoritative guidance in September 2011 to amend previous guidance on the annual and interim testing of goodwill for impairment; the guidance became effective for the Company at the beginning of its 2013 fiscal year. The guidance provides entities with the option of first assessing 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. If it is determined, on the basis of the qualitative factors, that the fair value of the reporting unit is more likely than not less than the carrying amount, the two step impairment test would still be required. The first step of the test compares the fair value of a reporting unit to its carrying amount, including goodwill, as of the date of the test. The Company uses a dual approach to determine the fair value of its reporting units including both a market approach and an income approach. We believe the use of multiple valuation techniques results in a more accurate indicator of the fair value of each reporting unit. If the carrying amount of the reporting unit exceeds its fair value, the second step is performed. The second step compares the carrying amount of the goodwill to the implied fair value of the goodwill. If the implied fair value of the goodwill is less than the carrying amount of the goodwill, an impairment loss would be reported. Annual impairment tests are performed by the Company in the fourth quarter of each year. The adoption of this updated authoritative guidance had no impact on the Company s Consolidated Financial Statements.

In connection with the sale of the Halloween portion of PMG s business on September 5, 2012, a portion of the goodwill associated with the PMG reporting unit was allocated to the business being sold. Such allocation was made on the basis of the fair value of the assets being sold relative to the overall fair value of the PMG reporting unit. This resulted in the Company recording a reduction of goodwill in the amount of $2,711,000 for the PMG reporting unit. See Note 7 for further information on goodwill and other intangible assets.

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

Inventories

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

	September 30, 2012	March 31, 2012	September 30, 2011
Raw material	$ 10,162	$ 9,194	$ 10,232
Work-in-process	11,047	15,470	12,906
Finished goods	63,968	47,007	68,204
	$ 85,177	$ 71,671	$ 91,342

Property, Plant and Equipment

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

	September 30, 2012	March 31, 2012	September 30, 2011
Land	$ 2,508	$ 2,508	$ 2,508
Buildings, leasehold interests and improvements	36,902	37,064	37,645
Machinery, equipment and other	100,206	101,076	101,525
	139,616	140,648	141,678
Less Accumulated depreciation and amortization	(111,335)	(111,066)	(110,728)
Net property, plant and equipment	$ 28,281	$ 29,582	$ 30,950

Depreciation expense was $1,492,000 and $1,576,000 for the quarters ended September 30, 2012 and 2011, respectively, and was $3,050,000 and $3,194,000 for the six months ended September 30, 2012 and 2011, respectively.

Revenue Recognition

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

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Net Income Per Common Share

The following table sets forth the computation of basic and diluted net income per common share for the three and six months ended September 30, 2012 and 2011 (in thousands, except per share data):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2012	2011	2012	2011
Numerator:				
Income from continuing operations	$ 6,840	$ 10,314	$ 5,973	$ 6,867
Loss from discontinued operations, net of tax	81	5,171	44	1,049
Net income	$ 6,921	$ 15,485	$ 6,017	$ 7,916
Denominator:				
Weighted average shares outstanding for basic income per common share	9,592	9,741	9,617	9,738
Effect of dilutive stock options	29	6	3	5
Adjusted weighted average share outstanding for diluted income per common share	9,621	9,747	9,620	9,743
Basic:				
Continuing operations	$ 0.71	$ 1.06	$ 0.62	$ 0.71
Discontinued operations	$ 0.01	$ 0.53	$ 0	$ 0.11
Total (1)	$ 0.72	$ 1.59	$ 0.63	$ 0.81
Diluted:				
Continuing operations	$ 0.71	$ 1.06	$ 0.62	$ 0.70
Discontinued operations	$ 0.01	$ 0.53	$ 0	$ 0.11
Total (1)	$ 0.72	$ 1.59	$ 0.63	$ 0.81

(1) Total net income per share for certain periods does not foot due to rounding.

Options on 264,000 shares and 665,000 shares of common stock were not included in computing diluted net income per common share for the six months ended September 30, 2012 and 2011, respectively, because their effects were antidilutive.

(2) DISPOSITION OF PRODUCT LINE

On September 5, 2012, the Company and its PMG subsidiary sold the Halloween portion of PMG s business and certain PMG assets relating to such business, including certain tangible and intangible assets associated with the Halloween portion of PMG s business, to Gemmy. PMG s remaining assets, including accounts receivable and inventory, were excluded from the sale. PMG retained the right and obligation to fulfill all customer orders for PMG Halloween products (such as Halloween masks, costumes, make-up and novelties) for the Halloween 2012 season. The estimated inventory remaining after the Halloween 2012 season has been reduced to its estimated net realizable value. The purchase price of $2,281,000 was paid to PMG at closing. In connection with the sale, the Company recorded charges of $5,368,000 during the second quarter of fiscal 2013 consisting of severance of 49 employees of

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$1,282,000, facility closure costs of $1,375,000, professional fees and other costs of $1,341,000 ($523,000 were costs of the transaction) and a non-cash write-down of assets of $1,370,000. Additionally, a portion of the goodwill associated with the PMG reporting unit was allocated to the business being sold. Such allocation was made on the basis of the fair value of the assets being sold relative to the overall fair value of the PMG reporting unit. This resulted in the Company recording a reduction of goodwill in the amount of $2,711,000 for the PMG reporting unit. There was also a non-cash charge of $966,000 related to the write-down of inventory to net realizable value which was recorded in costs of sales. Net sales of the Halloween business were $19,089,000 and $20,482,000 in the three months ended September 30, 2012 and 2011, respectively, and were $27,930,000 and $27,672,000 in the six months ended September 30, 2012 and 2011, respectively.

During the quarter ended September 30, 2012, the Company made payments and other adjustments of $869,000 primarily for professional fees and costs related to severance. As of September 30, 2012, $2,537,000 of the remaining liability was classified in current liabilities and $592,000 was classified in long-term obligations in the accompanying condensed consolidated balance sheet and will be paid through December 2015.

(3) DISCONTINUED OPERATIONS AND RELATED RESTRUCTURING CHARGES

On May 24, 2011, the Company approved a plan to close its Cleo manufacturing facility located in Memphis, Tennessee. The Company exited the Memphis facility in December 2011. In connection with this restructuring plan which was completed by March 31, 2012, the Company recorded restructuring charges of $6,749,000 during fiscal 2012 primarily related to severance of 433 employees and facility closure costs. Additionally, there was a non-cash reduction of $177,000 related to severance that was less than originally estimated, which was included in restructuring expenses in fiscal 2012. During the three and six months ended September 30, 2012, the Company made payments of $187,000 and $612,000, respectively, primarily for costs related to severance. Additionally, there was a reduction in the restructuring accrual of $63,000 and $92,000 during the three and six months ended September 30, 2012, respectively, for costs that were less than originally estimated. As of September 30, 2012, the remaining liability of $126,000 was classified in current liabilities of discontinued operations in the accompanying condensed consolidated balance sheet and will be paid through fiscal 2013.

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

	Employee Termination Costs	Facility and Other Costs	Total
Restructuring reserve as of March 31, 2012	$ 750	$ 80	$ 830
Cash paid	(585)	(27)	(612)
Non-cash reductions	(45)	(47)	(92)
Restructuring reserve as of September 30, 2012	$ 120	$ 6	$ 126

On September 9, 2011, the Company sold the Cleo Christmas gift wrap business and certain Cleo assets to Impact. Impact acquired the Christmas gift wrap portion of Cleo s business and certain of Cleo s assets relating to such business, including certain equipment, contract rights, customer lists, intellectual property and other intangible assets. Cleo s remaining assets, including accounts receivable and inventory, were excluded from the sale. Cleo retained the right and obligation to fulfill all customer orders for Cleo Christmas gift wrap products for Christmas 2011. The purchase price was $7,500,000, of which $2,000,000 was paid to Cleo in cash at closing. The remainder of the purchase price was paid through the issuance by Impact of an unsecured subordinated promissory note, which provides for quarterly payments of interest at 7% and principal payments as follows: $500,000 on March 1, 2012; $2,500,000 on March 1, 2013; and all remaining principal and interest on March 1, 2014. All interest payments to date and the $500,000 principal payment due on March 1, 2012 were paid when due. As of September 30, 2012, $2,500,000 of this note receivable was recorded in other current assets and $2,500,000 of this note receivable was recorded in other long term assets in the accompanying condensed consolidated balance sheet.

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As a result of the sale of its Cleo Christmas gift wrap business, the Company has reported these operations, including operating income of the business and all exit activities, as discontinued operations, as shown in the following table (in thousands):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2012	2011	2012	2011
Operating income (loss) (A)	$ 56	$ 2,436	$ (30)	$ (861)
Exit costs	63	(1,157)	92	(4,199)
Exit costs equipment sale	0	825	0	825
Gain on sale of business to Impact	0	5,849	0	5,849
Discontinued operations, before income taxes	119	7,953	62	1,614
Income tax expense	38	2,782	18	565
Discontinued operations, net of tax	$ 81	$ 5,171	$ 44	$ 1,049

(A) During the quarter ended June 30, 2011, the Company recorded a write down of inventory to net realizable value of $2,498,000, which was included in cost of sales of the discontinued operations. During the quarter ended September 30, 2011, the Company was able to sell certain of the inventory written down during the quarter ended June 30, 2011 for amounts greater than its adjusted carrying value resulting in higher gross profit of $563,000 of the discontinued operations for the quarter ended September 30, 2011.

The following table presents the carrying values of the major accounts of discontinued operations that are included in the condensed consolidated balance sheet (in thousands):

	September 30, 2012	March 31, 2012	September 30, 2011
Accounts receivable, net	$ 0	$ 78	$ 23,543
Inventories	126	105	13,837
Other current assets	0	0	481
Total assets attributable to discontinued operations	$ 126	$ 183	$ 37,861
Customer programs	$ 254	$ 237	$ 1,095
Restructuring reserve	126	830	1,698
Other current liabilities	344	1,323	6,592
Total liabilities associated with discontinued operations	$ 724	$ 2,390	$ 9,385

(4) BUSINESS RESTRUCTURING

On March 27, 2012, the Company combined the operations of its Berwick Offray LLC (Berwick Offray) and PMG subsidiaries in order to drive sales growth by providing stronger management oversight and by reallocating sales and marketing resources in a more strategic manner. Involuntary termination benefits offered to terminated employees were in accordance with the applicable terms of the Company s applicable pre-existing severance plans. As part of the restructuring plan, the Company recorded a restructuring reserve of $706,000 related to employee severance charges in the fourth quarter of fiscal 2012. During the three and six months ended September 30, 2012, the Company made payments of $159,000 and $344,000, respectively, for costs related to severance. Additionally, there was a reduction in the restructuring accrual of $11,000 during the six months ended September 30, 2012 for costs that were less than originally estimated. The remaining liability of $235,000 and $590,000 is classified in other current liabilities in the accompanying condensed consolidated balance sheet as of September 30, 2012 and March 31, 2012, respectively. This amount will be paid in fiscal 2013.

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(5) STOCK-BASED COMPENSATION

2004 Equity Compensation Plan

Under the terms of the Company s 2004 Equity Compensation Plan (2004 Plan), the Human Resources Committee (Committee) of the Board of Directors (Board) may grant incentive stock options, non-qualified stock options, restricted stock grants, stock appreciation rights, stock bonuses and other awards to officers and other employees. Grants under the 2004 Plan may be made through August 3, 2014. The term of each grant is at the discretion of the Committee, but in no event greater than ten years from the date of grant. The Committee has discretion to determine the date or dates on which granted options become exercisable. Service-based options outstanding as of September 30, 2012 become exercisable at the rate of 25% per year commencing one year after the date of grant. Market-based stock options outstanding as of such date will become exercisable only if certain market conditions and service requirements are satisfied, and the date(s) on which they become exercisable will depend on the period in which such market conditions and service requirements are met, if at all. Market-based restricted stock units (RSUs) outstanding at September 30, 2012 will vest only if certain market conditions and service requirements have been met, and the date(s) on which they vest will depend on the period in which such market conditions and service requirements are met, if at all. Subject to limited exceptions, service-based RSUs outstanding as of September 30, 2012 vest at the rate of 50% of the shares underlying the grant on each of the third and fourth anniversaries of the grant date.

On May 24, 2011, our Board approved an amendment to the 2004 Plan to reduce the number of shares of the Company s common stock authorized for issuance under the 2004 Plan by 500,000 shares. As a result of this reduction, the 2004 Plan now provides that 1,500,000 shares of the Company s common stock may be issued as grants under the 2004 Plan. Prior to this amendment, the 2004 Plan provided that 2,000,000 shares of the Company s common stock could be issued as grants under the 2004 Plan. At September 30, 2012, 762,370 shares were available for grant under the 2004 Plan.

The fair value of each market-based stock option and each market-based RSU granted under the above plan for the six months ended September 30, 2012 and 2011 was estimated on the date of grant using Monte Carlo simulation. The fair value of each service-based RSU granted during the six months ended September 30, 2011 was estimated on the day of grant based on the closing price of the Company s common stock reduced by the present value of the expected dividend stream during the vesting period using the risk-free interest rate. There were no service-based RSUs granted during the six months ended September 30, 2012.

The weighted average fair value of stock options granted during the six months ended September 30, 2012 and 2011 was $7.27 and $6.88, respectively. The weighted average fair value of restricted stock units granted during the six months ended September 30, 2012 and 2011 was $14.78 and $16.25.

2011 Stock Option Plan for Non-Employee Directors

Under the terms of the Company s 2011 Stock Option Plan for Non-Employee Directors (2011 Plan), non-qualified stock options to purchase up to 150,000 shares of common stock are available for grant to non-employee directors at exercise prices of not less than fair market value of the underlying common stock on the date of grant. Under the 2011 Plan, options to purchase 4,000 shares of the Company s common stock are granted automatically to each non-employee director on the last day that the Company s common stock is traded in November of each year from 2011 to 2015. Each option will expire five years after the date the option is granted and options may be exercised at the rate of 25% per year commencing one year after the date of grant. At September 30, 2012, 134,000 shares were available for grant under the 2011 Plan.

As of September 30, 2012, there was $1,589,000 of total unrecognized compensation cost related to non-vested stock option awards granted under the Company s equity incentive plans which is expected to be recognized over a weighted average period of 2.9 years. As of September 30, 2012, there was $2,105,000 of total unrecognized compensation cost related to non-vested RSUs granted under the Company s equity incentive plans which is expected to be recognized over a weighted average period of 2.5 years.

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Compensation cost related to stock options and RSUs recognized in operating results (included in selling, general and administrative expenses) was $504,000 and $493,000 in the quarters ended September 30, 2012 and 2011, respectively, and was $914,000 and $956,000 for the six months ended September 30, 2012 and 2011, respectively.

(6) DERIVATIVE FINANCIAL INSTRUMENTS

The Company enters into foreign currency forward contracts in order to reduce the impact of certain foreign currency fluctuations on sales denominated in a foreign currency. Derivatives are not used for trading or speculative activities. Firmly committed transactions and the related receivables may be hedged with forward exchange contracts. Gains and losses arising from foreign currency forward contracts are recorded in other (income) expense, net as offsets of gains and losses resulting from the underlying hedged transactions. A realized loss of $6,000 was recorded in the three- and six months ended September 30, 2012. A realized gain of $85,000 was recorded in the three- and six months ended September 30, 2011. As of September 30, 2012 and 2011, the notional amount of open foreign currency forward contracts was $5,131,000 and $7,281,000, respectively. The related unrealized loss was $91,000 at September 30, 2012 and the related unrealized gain was $366,000 at September 30, 2011. The Company believes that it does not have significant counterparty credit risks as of September 30, 2012.

The following table shows the fair value of the foreign currency forward contracts designated as hedging instruments and included in the Company s condensed consolidated balance sheet as of September 30, 2012 and 2011 (in thousands):

	Fair Value of Derivative Instruments		
		Fair Value	
	Balance Sheet Location	September 30, 2012	September 30, 2011
Foreign currency foreign contracts	Other current liabilities	$ 91	$ 0
Foreign currency forward contracts	Other current assets	0	366

(7) GOODWILL AND INTANGIBLES

The Company performs an annual impairment test of the carrying amount of goodwill and indefinite-lived intangible assets in the fourth quarter of its fiscal year. Additionally, the Company would perform its impairment testing at an interim date if events or circumstances indicate that goodwill or intangibles might be impaired. In connection with the sale of the Halloween portion of PMG s business on September 5, 2012, a portion of the goodwill associated with the PMG reporting unit was allocated to the business being sold. Such allocation was made on the basis of the fair value of the assets being sold relative to the overall fair value of the PMG reporting unit. This resulted in the Company recording a reduction of goodwill in the amount of $2,711,000 for the PMG reporting unit. As the sale of the Halloween portion of PMG s business was a triggering event, the Company performed an interim impairment test on the goodwill remaining in the PMG reporting unit after the reduction in goodwill associated with the sale of the Halloween portion of PMG s business was recorded. The Company determined that no impairment existed for the remainder of the goodwill of the PMG reporting unit.

The change in the carrying amount of goodwill for the six months ended September 30, 2012 is as follows (in thousands):

Balance as of March 31, 2012	$ 17,233
Reduction related to disposition of product line	(2,711)
Balance as of September 30, 2012	$ 14,522

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

	September 30, 2012		March 31, 2012		September 30, 2011	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Tradenames and trademarks	$ 12,793	$ 0	$ 12,793	$ 0	$ 12,793	$ 0
Customer relationships	22,057	7,109	22,057	6,358	22,057	5,608
Non-compete	200	200	200	200	200	192
Trademarks	403	228	403	213	403	198
Patents	1,301	357	1,301	294	1,337	239
	$ 36,754	$ 7,894	$ 36,754	$ 7,065	$ 36,790	$ 6,237

Amortization expense related to intangible assets was $415,000 and $427,000 for the quarters ended September 30, 2012 and 2011, respectively, and was $829,000 and $855,000 for the six months ended September 30, 2012 and 2011, respectively. Based on the current composition of intangibles, amortization expense for the remainder of fiscal 2013 and each of the succeeding four years is projected to be as follows (in thousands):

Remainder of fiscal 2013	$ 829
Fiscal 2014	1,658
Fiscal 2015	1,639
Fiscal 2016	1,638
Fiscal 2017	1,638

(8) TREASURY STOCK TRANSACTIONS

Under a stock repurchase program authorized by the Company s Board of Directors, the Company repurchased 140,183 shares of the Company s common stock for $2,650,000 during the six months ended September 30, 2012. There were no repurchases of the Company s common stock by the Company during the six months ended September 30, 2011. On July 31, 2012, the Company announced that its Board of Directors had authorized the repurchase of up to an additional 500,000 shares of the Company s common stock. As of September 30, 2012, the Company had 584,607 shares remaining available for repurchase under the Board s authorization.

(9) COMMITMENTS AND CONTINGENCIES

CSS and its subsidiaries are involved in ordinary, routine legal proceedings that are not considered by management to be material. In the opinion of Company counsel and management, the ultimate liabilities resulting from such legal proceedings will not materially affect the consolidated financial position of the Company or its results of operations or cash flows.

(10) FAIR VALUE MEASUREMENTS

Recurring Fair Value Measurements

The Company uses certain derivative financial instruments as part of its risk management strategy to reduce foreign currency risk. The Company recorded all derivatives on the condensed consolidated balance sheet at fair value based on quotes obtained from financial institutions as of September 30, 2012.

The Company maintains a Nonqualified Supplemental Executive Retirement Plan for highly compensated employees and invests assets to mirror the obligations under this Plan. The invested funds are maintained at a third party financial institution in the name of CSS and are invested in publicly traded mutual funds. The

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Company maintains separate accounts for each participant to reflect deferred contribution amounts and the related gains or losses on such deferred amounts. The investments are included in other current assets and the related liability is recorded as deferred compensation and included in other long-term obligations in the condensed consolidated balance sheets. The fair value of the investments is based on the market price of the mutual funds as of September 30, 2012.

The Company maintains two life insurance policies in connection with deferred compensation arrangements with two former executives. The cash surrender value of the policies is recorded in other long-term assets in the condensed consolidated balance sheets and is based on quotes obtained from the insurance company as of September 30, 2012.

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

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

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

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

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

The following table presents the Company s fair value hierarchy for those financial assets and liabilities measured at fair value on a recurring basis in its condensed consolidated balance sheet as of September 30, 2012 and 2011 (in thousands):

		Fair Value Measurements at September 30, 2012 Using		
	September 30, 2012	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Marketable securities	$ 638	$ 638	$ 0	$ 0
Cash surrender value of life insurance policies	930	0	930	0
Total assets	$ 1,568	$ 638	$ 930	$ 0
Liabilities				
Deferred compensation plans	$ 638	$ 638	$ 0	$ 0
Foreign exchange contracts	91	0	91	0
Total liabilities	$ 729	$ 638	$ 91	$ 0

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	September 30, 2011	Fair Value Measurements at September 30, 2011 Using Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Marketable securities	$ 571	$ 571	$ 0	$ 0
Cash surrender value of life insurance policies	903	0	903	0
Foreign exchange contracts	366	0	366	0
Total assets	$ 1,840	$ 571	$ 1,269	$ 0
Liabilities				
Deferred compensation plans	$ 571	$ 571	$ 0	$ 0
Total liabilities	$ 571	$ 571	$ 0	$ 0

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

The carrying value of the Company s note receivable (included in other current assets and other assets in the condensed consolidated balance sheet) is a reasonable estimate of its fair value as the terms of the note reflect market conditions for similar entities.

Nonrecurring Fair Value Measurements

The Company s nonfinancial assets which are measured at fair value on a nonrecurring basis include property, plant and equipment, goodwill, intangible assets and certain other assets. These assets are not measured at fair value on a recurring basis; however, they are subject to fair value adjustments in certain circumstances, such as when there is evidence that impairment may exist. In making the assessment of impairment, recoverability of assets to be held and used is measured by a comparison of the carrying amount of the asset group to future net cash flows estimated by the Company to be generated by such assets. If such asset group is considered to be impaired, the impairment to be recognized is the amount by which the carrying amount of the asset group exceeds the fair value of the asset group. Assets to be disposed of are recorded at the lower of their carrying value or estimated net realizable value.

Goodwill and indefinite-lived intangibles are subject to impairment testing on an annual basis, or sooner if circumstances indicate a condition of impairment may exist. The valuation uses assumptions such as interest and discount rates, growth projections and other assumptions of future business conditions. These valuation methods require a significant degree of management judgment concerning the use of internal and external data. In the event these methods indicate that fair value is less than the carrying value, the asset is recorded at fair value as determined by the valuation models. Accordingly, these fair value measurements fall in Level 3 of the fair value hierarchy.

In connection with the sale of the Halloween portion of PMG s business on September 5, 2012, a portion of the goodwill associated with the PMG reporting unit was allocated to the business being sold. Such allocation was made on the basis of the fair value of the assets being sold relative to the overall fair value of the PMG reporting unit. This resulted in the Company recording a reduction of goodwill in the amount of $2,711,000 for the PMG reporting unit. As the sale of the Halloween portion of PMG s business was a triggering event, the Company performed an interim impairment test on the goodwill remaining in the PMG reporting unit after the reduction in goodwill associated with the sale of the Halloween portion of PMG s business was recorded. The Company determined that no impairment existed for the remainder of the goodwill of the PMG reporting unit. There were no other indications or circumstances indicating that an impairment might exist in regard to the Company s other nonfinancial assets which are measured at fair value on a nonrecurring basis as of September 30, 2012.

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(11) RECENT ACCOUNTING PRONOUNCEMENTS

In June 2011, the FASB issued ASU 2011-05, Presentation of Comprehensive Income (ASU 2011-05) which requires an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This standard eliminates the option to report other comprehensive income and its components in the statement of changes in equity. In December 2011, the FASB issued ASU 2011-12, Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 (ASU 2011-12). The amendments in ASU 2011-12 defer the requirement to present reclassification adjustments for each component of accumulated other comprehensive income in both net income and other comprehensive income on the face of the financial statements. The amendments in ASU 2011-12 are effective at the same time as ASU 2011-05 so that entities will not be required to comply with the presentation requirements in ASU 2011-05 that ASU 2011-12 is deferring. The amendments in ASU 2011-12 are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. As this standard impacts presentation only, the adoption of ASU 2011-05, as amended by ASU 2011-12, did not an impact the Company s financial condition, results of operations and cash flows.

In September 2011, the FASB issued ASU 2011-08, Testing Goodwill for Impairment (ASU 2011-08), which amends existing guidance by giving an entity the option 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. If this is the case, a more detailed two-step goodwill impairment test will need to be performed which is used to identify potential goodwill impairments and to measure the amount of goodwill impairment losses to be recognized, if any. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The adoption of ASU 2011-08 did not have a material impact on the Company s financial condition, results of operations and cash flows.

In December 2011, the FASB issued ASU 2011-11, Disclosures about Offsetting Assets and Liabilities (ASU 2011-11). This update is intended to improve the comparability of statements of financial position prepared in accordance with U.S. GAAP and IFRS, requiring both gross and net presentation of offsetting assets and liabilities. The new requirements are effective for fiscal years beginning on or after January 1, 2013, and for interim periods within those fiscal years. As this guidance only affects disclosures, the adoption of this standard will not have an impact on the Company s financial condition, results of operations and cash flows.

In July 2012, the FASB issued ASU 2012-02, Testing Indefinite-Lived Intangible Assets for Impairment (ASU 2012-02), which amends existing guidance by giving an entity the option to first assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired. If this is the case, a more detailed fair value calculation will need to be performed which is used to identify potential impairments and to measure the amount of impairment losses to be recognized, if any. To perform a qualitative assessment, an entity must identify and evaluate changes in economic, industry and entity-specific events and circumstances that could affect the significant inputs used to determine the fair value of an indefinite-lived intangible asset. ASU 2012-02 is effective for annual and interim impairment tests performed by the Company for fiscal years beginning after September 15, 2012, with early adoption permitted. The Company will adopt the provisions of ASU 2012-02 effective April 1, 2013. The Company does not expect the adoption of ASU 2012-02 to have a material impact on the Company s future indefinite-lived intangibles impairment tests.

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CSS INDUSTRIES, INC. AND SUBSIDIARIES

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL

CONDITION AND RESULTS OF OPERATIONS

STRATEGIC OVERVIEW

Approximately 54% of the Company s prior year sales were attributable to all occasion products with the remainder attributable to seasonal (Christmas, Valentine s Day, Easter and Halloween) products.

Seasonal products are sold primarily to mass market retailers, and the Company has relatively high market share in many of these categories. Most of these markets have shown little growth and in some cases have declined in recent years, and the Company continues to confront significant price pressure as its competitors source certain products from overseas and its customers increase direct sourcing from overseas factories. Increasing customer concentration has augmented their bargaining power, which has also contributed to price pressure. The Company believes that its all occasion craft, gift card holder, stickers, stationery and memory product lines have higher inherent growth potential due to higher market growth rates. Further, the Company s all occasion craft, gift card holder, stickers, stationery and floral product lines have higher inherent growth potential due to CSS relatively low current market share. The Company continues to pursue sales growth in these and other areas. Historically, significant revenue growth at CSS has come through acquisitions. Management anticipates that it will continue to consider acquisitions as a strategy to stimulate further growth.

The Company has taken several measures to respond to sales volume, cost and price pressures. The Company believes it continues to have strong core Christmas product offerings which has allowed it to compete effectively in this competitive market. In addition, the Company is aggressively pursuing new product initiatives related to seasonal, craft and all occasion products, including new licensed and non-licensed product offerings. CSS continually invests in product and packaging design and product knowledge to assure that it can continue to provide unique added value to its customers. In addition, CSS maintains a showroom in Hong Kong as well as a purchasing office to be able to provide alternatively sourced products at competitive prices. CSS continually evaluates the efficiency and productivity of its North American production and distribution facilities and of its back office operations to maintain its competitiveness. In the last nine fiscal years, the Company has closed six manufacturing plants and seven warehouses totaling 2,680,000 square feet. Additionally, in the last four fiscal years, the Company has combined the operations of its Berwick Offray LLC (Berwick Offray) and Paper Magic Group, Inc. (PMG) subsidiaries in order to drive sales growth by providing stronger management oversight and by reallocating sales and marketing resources in a more strategic manner; consolidated its human resources, accounts receivable, accounts payable and payroll functions into a combined back office operation; and completed the implementation of a phase of the Company s enterprise resource planning systems standardization project.

On September 5, 2012, the Company and its PMG subsidiary sold the Halloween portion of PMG s business and certain PMG assets relating to such business, including certain tangible and intangible assets associated with PMG s Halloween business, to Gemmy Industries (HK) Limited (Gemmy). PMG s remaining assets, including accounts receivable and inventory, were excluded from the sale. PMG retained the right and obligation to fulfill all customer orders for PMG Halloween products (such as Halloween masks, costumes, make-up and novelties) for the Halloween 2012 season. The purchase price of $2,281,000 was paid to PMG at closing.

On September 9, 2011, the Company and its Cleo Inc (Cleo) subsidiary sold the Christmas gift wrap portion of Cleo s business and certain of Cleo s assets relating to such business, including certain equipment, contract rights, customer lists, intellectual property and other intangible assets to Impact Innovations, Inc. (Impact). Cleo s remaining assets, including accounts receivable and inventory, were excluded from the sale. Cleo retained the right and obligation to fulfill all customer orders for Cleo Christmas gift wrap products for Christmas 2011. The purchase price was $7,500,000, of which $2,000,000 was paid to Cleo in cash at closing. The remainder of the purchase price was paid through the issuance by Impact of an unsecured subordinated promissory note, which provides for quarterly payments of interest at 7% and principal payments as follows: $500,000 on March 1, 2012;

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$2,500,000 on March 1, 2013; and all remaining principal and interest on March 1, 2014. All interest payments to date and the $500,000 principal payment due on March 1, 2012 were paid when due. The results of operations for the three and six month periods ended September 30, 2012 and 2011 reflect the historical operations of the Cleo Christmas gift wrap business as discontinued operations and the discussion herein is presented on the basis of continuing operations, unless otherwise stated.

CRITICAL ACCOUNTING POLICIES

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

The significant accounting policies of the Company are described in the notes to the consolidated financial statements included in the Annual Report on Form 10-K for the fiscal year ended March 31, 2012. Judgments and estimates of uncertainties are required in applying the Company s accounting policies in many areas. Following are some of the areas requiring significant judgments and estimates: revenue; the assessment of the recoverability of goodwill and other intangible and long-lived assets; the valuation of inventory and accounts receivable; income tax accounting; the valuation of stock-based awards and resolution of litigation and other proceedings. There have been no material changes to the critical accounting policies affecting the application of those accounting policies as noted in the Company s annual report on Form 10-K for the fiscal year ended March 31, 2012.

RESULTS OF OPERATIONS

Seasonality

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

Six Months Ended September 30, 2012 Compared to Six Months Ended September 30, 2011

Sales of $194,552,000 for the six months ended September 30, 2012 were comparable to sales of $194,294,000 in the six months ended September 30, 2011 as higher sales of all occasion products and Christmas ribbons and bows were substantially offset by lower sales of Christmas boxed greeting cards compared to the prior year.

Cost of sales, as a percentage of sales, decreased to 70% in the six months ended September 30, 2012 compared to 72% in the six months ended September 30, 2011. This favorable decrease was primarily due to lower commodity costs and other input costs as well as the mix of product shipped compared to the prior year, partially offset by a write-down of inventory to net realizable value of $966,000 related to the sale of the Halloween portion of PMG s business.

Selling, general and administrative (SG&A) expenses of $41,424,000 in the six months ended September 30, 2012 decreased from $43,087,000 in the six months ended September 30, 2011 primarily due to reduced payroll and related costs.

Disposition of product line, net of $5,798,000 recorded in the six months ended September 30, 2012 primarily relates to costs associated with the sale of the Halloween portion of PMG s business, including severance of $1,282,000, facility closure costs of $1,375,000, professional fees of $1,341,000, a write-down of assets of $1,370,000 and a reduction of goodwill of $2,711,000. These costs were offset by proceeds received from the sale of $2,281,000. The Company incurred $523,000 of transaction costs, which is included in the aforementioned professional fees, yielding net proceeds of $1,758,000. A portion of the goodwill associated with the PMG reporting unit was required to be allocated to the business being sold. Such allocation was made on the basis of the fair value of the assets being sold relative to the overall fair value of the PMG reporting unit. See Note 2 to the condensed consolidated financial statements for further discussion.

Interest income, net was $67,000 in the six months ended September 30, 2012 compared to interest expense, net of $154,000 in the six months ended September 30, 2011. The change was primarily due to lower borrowings levels compared to the prior year and interest income received on the note receivable from Impact (issued by Impact as part of its purchase of the Cleo Christmas wrap business on September 9, 2011).

Income from continuing operations before income taxes for the six months ended September 30, 2012 was $10,926,000 compared to $10,820,000 for the six months ended September 30, 2011 as improved margins and lower SG&A expenses in the current year were offset by the impact of the charges related to the sale of the Halloween portion of PMG s business.

Income taxes, as a percentage of income before taxes, were 45% and 37% in the six months ended September 30, 2012 and 2011, respectively. The increase in income taxes in the six months ended September 30, 2012 was primarily attributable to a portion of the goodwill reduction being non-deductible for tax purposes.

Income from discontinued operations, net of tax of $44,000 for the six months ended September 30, 2012 reflects pre-tax income of $62,000 related to the Cleo Christmas gift wrap business which was sold on September 9, 2011. Income from discontinued operations, net of tax of $1,049,000 for the six months ended September 30, 2011 includes a pre-tax operating loss of the Cleo Christmas gift wrap business of $861,000; a pre-tax gain of $5,849,000 related to the sale of the Cleo Christmas gift wrap business and certain of Cleo s assets to Impact; pre-tax proceeds of $825,000 related to the sale of the remaining equipment located in Cleo s former Memphis, Tennessee manufacturing facility to a third party; and pre-tax exit costs of $4,199,000 consisting primarily of staff termination costs and a non-cash write down of inventory to net realizable value.

Three Months Ended September 30, 2012 Compared to Three Months Ended September 30, 2011

Sales for the three months ended September 30, 2012 decreased 4% to $133,485,000 from $139,725,000 in the three months ended September 30, 2011 primarily due to lower sales of Christmas and all occasion boxed greeting cards, partially offset by higher sales of Christmas ribbons and bows compared to the same quarter in the prior year.

Cost of sales, as a percentage of sales, decreased to 69% in the three months ended September 30, 2012 compared to 71% in the three months ended September 30, 2011 primarily due to lower commodity costs and other input costs as well as the mix of product shipped compared to the prior year, partially offset by a write-down of inventory to net realizable value of $966,000 related to the sale of the Halloween portion of PMG s business.

SG&A expenses of $22,854,000 in the three months ended September 30, 2012 decreased from $23,528,000 in the three months ended September 30, 2011 primarily due to reduced payroll and related costs.

Disposition of a product line, net of $5,798,000 recorded in the three months ended September 30, 2012 primarily relates to costs associated with the sale of the Halloween portion of PMG s business, including severance of $1,282,000, facility closure costs of $1,375,000, professional fees of $1,341,000, a write-down of assets of $1,370,000 and a reduction of goodwill of $2,711,000. These costs were offset by proceeds received from the sale of $2,281,000. A portion of the goodwill associated with the PMG reporting unit was required to be allocated to the business being sold. Such allocation was made on the basis of the fair value of the assets being sold relative to the overall fair value of the PMG reporting unit. See Note 2 to the condensed consolidated financial statements for further discussion.

Interest income, net was $14,000 in the three months ended September 30, 2012 compared to interest expense, net of $111,000 in the three months ended September 30, 2011. The change was primarily due to lower borrowing levels compared to the same quarter in the prior year and interest income received on the note receivable from Impact (issued by Impact as part of its purchase of the Cleo Christmas wrap business on September 9, 2011).

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Income from continuing operations before income taxes for the three months ended September 30, 2012 was $12,259,000 compared to $16,304,000 in 2011 as favorable margins and lower SG&A expenses compared to the same quarter in the prior year were offset by the impact of the charges related to the sale of the Halloween portion of PMG s business, which were recorded in the second quarter of fiscal 2012.

Income taxes, as a percentage of income before taxes, were 44% and 37% in the three months ended September 30, 2012 and 2011, respectively. The increase in income taxes in the three months ended September 30, 2012 was primarily attributable to a portion of the goodwill reduction being non-deductible for tax purposes.

Income from discontinued operations, net of tax for the three months ended September 30, 2012 reflects pre-tax income of $119,000 related to the Cleo Christmas gift wrap business. Income from discontinued operations, net of tax for the three months ended September 30, 2011 includes pre-tax operating income of the Christmas gift wrap business of $2,436,000; a pre-tax gain of $5,849,000 related to the sale of the Cleo Christmas gift wrap business and certain of Cleo s assets to Impact; pre-tax proceeds of $825,000 related to the sale of the remaining equipment located in Cleo s former Memphis, Tennessee manufacturing facility to a third party; and pre-tax exit costs of $1,157,000 consisting primarily of building occupancy costs.

LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2012, the Company had working capital of $170,867,000 and stockholders equity of $244,247,000. The increase in accounts receivable from March 31, 2012 reflected seasonal billings of current year Halloween and Christmas accounts receivable, net of current year collections. The increase in inventories and other current liabilities from March 31, 2012 was primarily a result of the normal seasonal inventory build necessary for the fiscal 2013 shipping season. Also contributing to the increase in other current liabilities is the reserve of $2,537,000 related to the sale of the Halloween portion of PMG s business during the second quarter of fiscal 2012. The decrease in goodwill is due to the reduction of $2,711,000 related to the sale of the Halloween portion of PMG s business. The increase in stockholders equity from March 31, 2012 was primarily attributable to year-to-date net income, partially offset by treasury stock repurchases and payments of cash dividends.

The Company relies primarily on cash generated from its operations and seasonal borrowings to meet its liquidity requirements. Historically, a significant portion of the Company s revenues have been seasonal, primarily Christmas related, with approximately 70% of sales recognized in the second and third quarters. As payment for sales of Christmas related products is usually not received until just before or just after the holiday selling season in accordance with general industry practice, short-term borrowing needs increase in the second and third quarters, peaking prior to Christmas and dropping thereafter. However, the sale of the Christmas gift wrap portion of Cleo s business has decreased the Company s seasonal borrowing needs and the sale of the Halloween portion of PMG s business will decrease the Company s future seasonal borrowing needs. Seasonal financing requirements are met under a revolving credit facility with two banks. Reflecting the seasonality of the Company s business, the maximum credit available at any one time under the credit facility (Commitment Level) adjusts to $50,000,000 from February to June (Low Commitment Period), $100,000,000 from July to October (Medium Commitment Period) and $150,000,000 from November to January (High Commitment Period) in each respective year over the term of the facility. The Company has the option to increase the Commitment Level during part of any Low Commitment Period from $50,000,000 to an amount not less than $62,500,000 and not in excess of $125,000,000; provided, however, that the Commitment Level must remain at $50,000,000 for at least three consecutive months during each Low Commitment Period. The Company has the option to increase the Commitment Level during all or part of any Medium Commitment Period from $100,000,000 to an amount not in excess $125,000,000. Fifteen days prior written notice is required for the Company to exercise an option to increase the Commitment Level with respect to a particular Low Commitment Period or Medium Commitment Period. The Company may exercise an option to increase the Commitment Level no more than three times each calendar year. This facility is due to expire on March 17, 2016. This financing facility is available to fund the Company s seasonal borrowing needs and to provide the Company with sources of capital for general corporate purposes, including acquisitions as permitted under the revolving credit facility. At September 30, 2012, there were no borrowings outstanding under the Company s revolving credit facility. The Company is in compliance with all financial debt covenants as of September 30, 2012. Based on its current operating plan, the Company believes its sources of available capital are adequate to meet its future cash needs for at least the next 12 months.

As of September 30, 2012, the Company s letter of credit commitments are as follows (in thousands):

	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years	Total
Letters of credit	$ 2,493	0	0	0	$ 2,493

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

As of September 30, 2012, the Company is committed to purchase approximately $289,000 of electric power from a vendor through December 31, 2012. The Company believes the minimum commodity purchases under this agreement are well within the Company s annual commodity requirements. The Company is also committed to pay guaranteed minimum royalties attributable to sales of certain licensed products. Reference is made to contractual obligations included in the Company s annual report on Form 10-K for the fiscal year ended March 31, 2012. There have been no significant changes to contractual obligations.

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

LABOR RELATIONS

With the exception of the bargaining unit at the ribbon manufacturing facility in Hagerstown, Maryland, which totaled approximately 98 employees as of September 30, 2012, CSS employees are not represented by labor unions. Because of the seasonal nature of certain of its businesses, the number of production employees fluctuates during the year. The collective bargaining agreement with the labor union representing the Hagerstown-based production and maintenance employees remains in effect until December 31, 2014.

ACCOUNTING PRONOUNCEMENTS

See Note 11 to the consolidated financial statements for information concerning recent accounting pronouncements and the impact of those standards.

FORWARD-LOOKING STATEMENTS

This report includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements regarding the Company s estimated future cash expenditures for restructuring charges; the continued consideration by management of acquisitions and other initiatives to stimulate growth; aggressively pursuing new product initiatives, pursuing sales growth within certain identified product categories, driving sales growth by providing stronger management oversight and by reallocating sales and marketing resources in a more strategic manner; the expected future impact of legal proceedings; the anticipated effects of measures taken by the Company to respond to sales volume, cost and price pressures; the expected reduction of the Company s seasonal borrowing needs due to the sale of the Cleo Christmas gift wrap business and PMG Halloween business; the expected amount and timing of future amortization expense; and the Company s belief that its sources of available capital are adequate to meet its future cash needs for at least the next 12 months. Forward-looking statements are based on the beliefs of the Company s management as well as assumptions made by and information currently available to the Company s management as to future events and financial performance with respect to the Company s operations. Forward-looking statements speak only as of the date made. The Company undertakes no obligation to update any forward-looking statements to reflect the events or circumstances arising after the date as of which they were made. Actual events or results may differ materially from those discussed in forward-looking statements as a result of various factors, including without limitation, general market and economic conditions; increased competition (including competition from foreign products which may be imported at less than fair value and from foreign products which may benefit from foreign governmental subsidies); difficulties entering new

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markets and/or developing new products that drive incremental sales; increased operating costs, including labor-related and energy costs and costs relating to the imposition or retrospective application of duties on imported products; currency risks and other risks associated with international markets; difficulties identifying and evaluating suitable acquisition opportunities; risks associated with acquisitions, including realization of intangible assets and recoverability of long-lived assets, and acquisition integration costs and the risk that the Company may not be able to integrate and derive the expected benefits from such acquisitions; risks associated with the combination of the operations of Berwick Offray and PMG; risks associated with the Company s sale of the Halloween portion of its PMG business during the second quarter of fiscal 2013; risks associated with the Company s restructuring activities, including the risk that the cost of such activities will exceed expectations, the risk that the expected benefits of such activities will not be realized, and the risk that implementation of such activities will interfere with and adversely affect the Company s operations, sales and financial performance; the risk that customers may become insolvent, may delay payments or may impose deductions or penalties on amounts owed to the Company; costs of compliance with governmental regulations and government investigations; liability associated with non-compliance with governmental regulations, including regulations pertaining to the environment, Federal and state employment laws, and import and export controls and customs laws; and other factors described more fully in the Company s annual report on Form 10-K for the fiscal year ended March 31, 2012 and elsewhere in the Company s filings with the Securities and Exchange Commission. As a result of these factors, readers are cautioned not to place undue reliance on any forward-looking statements included herein or that may be made elsewhere from time to time by, or on behalf of, the Company.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company s activities expose it to a variety of market risks, including the effects of changes in interest rates and foreign currency exchange rates. The Company actively monitors these exposures and, where considered appropriate, manages this risk. The Company manages its exposure to foreign currency fluctuations by entering into foreign currency forward contracts to hedge the majority of firmly committed transactions and related receivables that are denominated in a foreign currency. The Company does not enter into contracts for trading purposes and does not use leveraged instruments. The market risks associated with debt obligations and other significant instruments as of September 30, 2012 have not materially changed from March 31, 2012 (see Item 7A of the Company s Annual Report on Form 10-K for the fiscal year ended March 31, 2012).

ITEM 4. CONTROLS AND PROCEDURES

(a) *Evaluation of Disclosure Controls and Procedures.* As of the end of the period covered by this report, the Company s management, with the participation of the Company s President and Chief Executive Officer and Vice President Finance and Chief Financial Officer, evaluated the effectiveness of the Company s disclosure controls and procedures in accordance with Rule 13a-15 of the Securities Exchange Act of 1934 (the Exchange Act). Based upon that evaluation, the President and Chief Executive Officer and Vice President Finance and Chief Financial Officer concluded that the Company s disclosure controls and procedures are effective in providing reasonable assurance that information required to be disclosed by the Company in reports that it files under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms and (ii) accumulated and communicated to our management, including the President and Chief Executive Officer and Vice President Finance and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure.

(b) *Changes in Internal Controls*. There was no change in the Company s internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) as promulgated by the Securities and Exchange Commission under the Exchange Act) during the second quarter of fiscal year 2013 that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

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CSS INDUSTRIES, INC. AND SUBSIDIARIES

PART II OTHER INFORMATION

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

Share Repurchase Program

A total of 38,477 shares were repurchased at an average price of $18.89 in the second quarter of fiscal 2013. As of September 30, 2012, there remained an outstanding authorization to repurchase 584,607 shares of outstanding CSS common stock as represented in the table below.

	Total Number of Shares Purchased (1)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Program (2)	Maximum Number of Shares that May Yet Be Purchased Under the Program (2)
July 1 through July 31, 2012	20,121	$ 18.86	20,121	602,963
August 1 through August 31, 2012	14,519	18.90	14,519	588,444
September 1 through September 30, 2012	3,837	19.02	3,837	584,607
Total Second Quarter	38,477	$ 18.89	38,477	584,607

(1) All share repurchases were effected in open-market transactions and in accordance with the safe harbor provisions of Rule 10b-18 of the Exchange Act.

(2) On October 23, 2008 and July 31, 2012, the Company announced that its Board of Directors had authorized the repurchase of up to 500,000 and 500,000 shares, respectively, of the Company s common stock (the Repurchase Program). As of September 30, 2012, the Company repurchased an aggregate of 415,393 shares pursuant to this Repurchase Program. An expiration date has not been established for the Repurchase Program.

Item 6. Exhibits

*Exhibit 3.1 Bylaws of the Company, as amended to date (as last amended September 25, 2012).

*Exhibit 31.1 Certification of the Chief Executive Officer of CSS Industries, Inc. required by Rule 13a-14(a) under the Securities Exchange Act of 1934.

*Exhibit 31.2 Certification of the Chief Financial Officer of CSS Industries, Inc. required by Rule 13a-14(a) under the Securities Exchange Act of 1934.

*Exhibit 32.1 Certification of the Chief Executive Officer of CSS Industries, Inc. required by Rule 13a-14(b) under the Securities Exchange Act of 1934 and 18 U. S. C. Section 1350.

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

**101.INS XBRL Instance Document.

**101.SCH XBRL Schema Document.

**101.CAL XBRL Taxonomy Extension Calculation Linkbase Document.

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**101.LAB	XBRL Taxonomy Extension Label Linkbase Document.
**101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.
**101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.

* Filed with this Quarterly Report on Form 10-Q.

** Furnished with this Quarterly Report on Form 10-Q.

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SIGNATURES

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

	CSS INDUSTRIES, INC. (Registrant)
Date: November 7, 2012	By: /s/ Christopher J. Munyan Christopher J. Munyan President and Chief Executive Officer (principal executive officer)
Date: November 7, 2012	By: /s/ Vincent A. Paccapaniccia Vincent A. Paccapaniccia Vice President Finance and Chief Financial Officer (principal financial and accounting officer)

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