

CSS INDUSTRIES INC
Form 10-Q
October 25, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2016

or

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

For the transition period from _____ to _____
Commission file number 1-2661

CSS INDUSTRIES, INC.
(Exact name of registrant as specified in its charter)

Delaware 13-1920657
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)
450 Plymouth Road, Suite 300, Plymouth Meeting, PA 19462
(Address of principal executive offices) (Zip
Code)

(610) 729-3959
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such period that the registrant was required to submit and post such files). Yes No

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

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

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

As of October 21, 2016, there were 9,077,782 shares of common stock outstanding which excludes shares which may still be issued upon exercise of stock options or upon vesting of restricted stock unit grants.

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CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share data)

	Three Months Ended		Six Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Sales	\$101,291	\$111,477	\$146,609	\$155,705
Costs and expenses				
Cost of sales	69,691	73,686	102,712	105,472
Selling, general and administrative expenses	20,921	20,100	38,495	37,400
Interest income, net	(4) (10) (93) (82
Other (income) expense, net	(387) 48	(478) —
	90,221	93,824	140,636	142,790
Income before income taxes	11,070	17,653	5,973	12,915
Income tax expense	4,078	6,424	2,267	4,754
Net income	\$6,992	\$11,229	\$3,706	\$8,161
Net income per common share:				
Basic	\$0.77	\$1.23	\$0.41	\$0.88
Diluted	\$0.77	\$1.22	\$0.41	\$0.87
Weighted average shares outstanding:				
Basic	9,076	9,148	9,065	9,245
Diluted	9,107	9,237	9,111	9,345
Cash dividends per share of common stock	\$0.20	\$0.18	\$0.40	\$0.36

See notes to consolidated financial statements.

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CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

(Unaudited)

	September 30, 2016	March 31, 2016	September 30, 2015
Assets			
Current assets			
Cash and cash equivalents	\$ 30,241	\$ 19,927	\$ 27,745
Short-term investments	—	59,806	24,929
Accounts receivable, net of allowances of \$1,524, \$1,363 and \$1,375	91,577	45,144	95,080
Inventories	93,701	73,022	79,265
Other current assets	12,741	12,792	10,587
Total current assets	228,260	210,691	237,606
Property, plant and equipment, net	27,204	27,053	25,769
Deferred income taxes	2,363	3,193	4,413
Other assets			
Goodwill	19,677	19,974	15,820
Intangible assets, net	41,160	42,183	31,770
Other	6,657	6,832	5,810
Total other assets	67,494	68,989	53,400
Total assets	\$ 325,321	\$ 309,926	\$ 321,188
Liabilities and Stockholders' Equity			
Current liabilities			
Accounts payable	\$ 27,790	\$ 14,463	\$ 27,165
Accrued payroll and other compensation	7,070	9,016	7,368
Accrued customer programs	3,622	3,275	3,920
Accrued income taxes	551	—	3,173
Other current liabilities	9,823	7,051	9,641
Total current liabilities	48,856	33,805	51,267
Long-term obligations	4,590	4,631	4,295
Stockholders' equity	271,875	271,490	265,626
Total liabilities and stockholders' equity	\$ 325,321	\$ 309,926	\$ 321,188
See notes to consolidated financial statements.			

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

	Six Months Ended	
	September 30,	
	2016	2015
Cash flows from operating activities:		
Net income	\$3,706	\$8,161
Adjustments to reconcile net income to net cash used for operating activities:		
Depreciation and amortization	4,270	4,102
Accretion of investment discount	(194)	(160)
Provision for accounts receivable allowances	2,553	1,530
Deferred tax provision	799	745
Share-based compensation expense	688	867
Gain on bargain purchase	(376)	—
Loss on sale of assets	43	—
Changes in assets and liabilities:		
Accounts receivable	(48,987)	(54,558)
Inventory	(19,815)	(13,774)
Other assets	(48)	(293)
Accounts payable	13,652	13,942
Other accrued liabilities	1,683	2,077
Total adjustments	(45,732)	(45,522)
Net cash used for operating activities	(42,026)	(37,361)
Cash flows from investing activities:		
Maturities of investment securities	60,000	70,000
Purchase of held-to-maturity investment securities	—	(24,924)
Purchase of a business	(1,125)	—
Purchase of property, plant and equipment	(2,831)	(2,817)
Purchase of intangibles	(100)	—
Proceeds from sale of fixed assets	311	23
Net cash provided by investing activities	56,255	42,282
Cash flows from financing activities:		
Dividends paid	(3,634)	(3,321)
Purchase of treasury stock	—	(10,000)
Exercise of stock options, net of tax withholdings	(32)	—
Payments for tax withholding on net restricted stock settlements	(527)	(518)
Tax effect on stock awards	278	234
Net cash used for financing activities	(3,915)	(13,605)
Net increase (decrease) in cash and cash equivalents	10,314	(8,684)
Cash and cash equivalents at beginning of period	19,927	36,429
Cash and cash equivalents at end of period	\$30,241	\$27,745
See notes to consolidated financial statements.		

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CSS INDUSTRIES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2016

(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, 2016. The results of operations for the interim periods are not necessarily indicative of the results for the full year.

The Company's fiscal year ends on March 31. References to a particular fiscal year refer to the fiscal year ending in March of that year. For example, "fiscal 2017" refers to the fiscal year ending March 31, 2017.

Principles of Consolidation

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

Nature of Business

CSS is a consumer products company primarily engaged in the design, manufacture, procurement, distribution and sale of all occasion and seasonal social expression products, principally to mass market retailers. These all occasion and seasonal products include decorative ribbons and bows, classroom exchange Valentines, infant products, journals, buttons, boxed greeting cards, gift tags, gift card holders, gift bags, gift wrap, decorations, floral accessories, craft and educational products, Easter egg dyes and novelties, memory books, scrapbooks, stickers, stationery, and other 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.

The Company's principal operating subsidiaries include Berwick Offray LLC ("Berwick Offray"), Paper Magic Group, Inc. ("Paper Magic") and C.R. Gibson, LLC ("C.R. Gibson").

Reclassification

Certain prior period amounts have been reclassified to conform with the current year classification.

Foreign Currency Translation and Transactions

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

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 recognition, 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 share-based awards and resolution of litigation and other proceedings. Actual results could differ from these estimates.

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Short-Term Investments

The Company categorized and accounted for its short-term investment holdings as held-to-maturity securities. This categorization was based upon the Company's positive intent and ability to hold these securities until maturity. There were no short-term investments at September 30, 2016. Short-term investments at March 31, 2016 consisted of commercial paper with an amortized cost of \$59,806,000 and matured in the first half of fiscal 2017. Short-term investments at September 30, 2015 consisted of commercial paper with an amortized cost of \$24,929,000 and matured in fiscal 2016. Held-to-maturity securities are recorded at amortized cost which approximated fair value at March 31, 2016 and September 30, 2015.

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, 2016	March 31, 2016	September 30, 2015
Raw material	\$ 10,919	\$ 11,392	\$ 11,376
Work-in-process	14,474	17,745	13,603
Finished goods	68,308	43,885	54,286
	\$ 93,701	\$ 73,022	\$ 79,265

Property, Plant and Equipment

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

	September 30, 2016	March 31, 2016	September 30, 2015
Land	\$ 2,508	\$ 2,508	\$ 2,508
Buildings, leasehold interests and improvements	34,612	34,317	33,754
Machinery, equipment and other	89,630	87,675	86,722
	126,750	124,500	122,984
Less - Accumulated depreciation and amortization	(99,546)	(97,447)	(97,215)
Net property, plant and equipment	\$ 27,204	\$ 27,053	\$ 25,769

Depreciation expense was \$1,290,000 and \$1,419,000 for the quarters ended September 30, 2016 and 2015, respectively, and was \$2,647,000 and \$2,824,000 for the six months ended September 30, 2016 and 2015, respectively.

Long-Lived Assets including Goodwill and Other Intangible Assets

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. During the six months ended September 30, 2016, there were no such events or circumstances.

The Company uses a dual approach to determine the fair value of its reporting units, including both a market approach and an income approach. The Company believes the use of multiple valuation techniques results in a more accurate indicator of the fair value of each reporting unit. 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. If the carrying amount of the reporting unit exceeds its fair value, the second step is performed. The second step compares the carrying amount of the goodwill to the implied fair value of the goodwill. If the implied fair value of the goodwill is less than the carrying amount of the goodwill, an impairment loss would be reported.

Other indefinite-lived intangible assets consist primarily of tradenames, which are also required to be tested annually for impairment. 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 events or circumstances indicate the carrying value of an asset

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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. During the six months ended September 30, 2016, there were no such events or circumstances. See Note 5 for further information on other intangible assets.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences and carryforwards are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The Company records a valuation allowance to reduce deferred tax assets to the amount that is more likely than not to be realized.

The Company recognizes the impact of an uncertain tax position if it is more likely than not that such position will be sustained on audit, based solely on the technical merits of the position.

Revenue Recognition

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

Net Income Per Common Share

The following table sets forth the computation of basic and diluted net income per common share for the three- and six months ended September 30, 2016 and 2015 (in thousands, except per share data):

	Three Months Ended September 30, 2016		Six Months Ended September 30, 2015	
Numerator:				
Net income	\$6,992	\$11,229	\$3,706	\$8,161
Denominator:				
Weighted average shares outstanding for basic net income per common share	9,076	9,148	9,065	9,245
Effect of dilutive stock options	31	89	46	100
Adjusted weighted average shares outstanding for diluted net income per common share	9,107	9,237	9,111	9,345
Basic net income per common share	\$0.77	\$1.23	\$0.41	\$0.88
Diluted net income per common share	\$0.77	\$1.22	\$0.41	\$0.87

The Company has excluded 508,000 shares and 258,000 shares, consisting of outstanding stock options and unearned restricted stock units, in computing diluted net income per common share for the three- and six months ended September 30, 2016 and 2015, respectively, because their effects were antidilutive.

(2) BUSINESS ACQUISITION

On July 8, 2016, a subsidiary of the Company completed the acquisition of substantially all of the assets and business of Lawrence Schiff Silk Mills, Inc. ("Schiff") for \$1,125,000 in cash. Schiff was a leading U.S. manufacturer and distributor of narrow woven ribbon prior to its April 2016 Chapter 11 bankruptcy filing. The acquisition was accounted for using the acquisition method and resulted in a bargain purchase due to the fair value of the net assets acquired of approximately \$1,501,000 exceeding the amount paid.

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The following table summarizes the preliminary fair values of the net assets acquired at the date of acquisition (in thousands):

Inventory	\$865
Property, plant and equipment	350
Intangible assets	500
Total assets acquired	1,715
Deferred tax liability	(214)
Net assets acquired	\$1,501

In connection with this bargain purchase, the Company recorded a gain of approximately \$376,000 which is included in other (income) expense, net in the consolidated statements of operations in the quarter ended September 30, 2016.

(3) SHARE-BASED COMPENSATION**2013 Equity Compensation Plan**

Under the terms of the Company's 2013 Equity Compensation Plan ("2013 Plan"), the Company may grant incentive stock options, non-qualified stock options, stock units, restricted stock grants, stock appreciation rights, stock bonus awards and dividend equivalents to officers and other employees and non-employee directors. Grants under the 2013 Plan may be made through July 29, 2023. The term of each grant is at the discretion of the Company, but in no event greater than ten years from the date of grant, and at the date of grant the Company has discretion to determine the date or dates on which granted options become exercisable. Under the 2013 Plan, a committee of the Company's Board of Directors (the "Board") approves grants to officers and other employees, and the Board approves grants to non-employee directors. Service-based stock options outstanding as of September 30, 2016 become exercisable at the rate of 25% per year commencing one year after the date of grant. Market-based stock options outstanding as of September 30, 2016 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, except that vesting and exercisability are accelerated upon a change of control.

Outstanding service-based restricted stock units ("RSUs") granted to employees vest at the rate of 50% of the shares underlying the grant at each of the third and fourth anniversaries of the date on which the award was granted.

Service-based RSUs granted to directors and outstanding as of September 30, 2016 vest on July 31, 2017.

Market-based RSUs outstanding at September 30, 2016 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, except that vesting and redemption are accelerated upon a change of control. At September 30, 2016, there were 640,338 shares available for grant under the 2013 Plan.

The fair value of each stock option and market-based RSU granted under the above plan was estimated on the date of grant using either a Black-Scholes option pricing model (service-based awards) or a Monte Carlo simulation model (market-based awards) with the following average assumptions:

	Stock Options		RSUs	
	Six Months		Six Months	
	Ended		Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Risk-free interest rate	1.66 %	1.96 %	1.20 %	1.29 %
Volatility	35.12%	36.90%	33.08%	36.86%
Dividend yield	2.91 %	2.59 %	2.99 %	2.60 %
Expected life of option (in years)	4.75	4.75		

The fair value of each service-based RSU granted to employees 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. The fair value of each service-based RSU granted to directors, for which dividend equivalents are paid upon vesting of the underlying awards, was estimated on the day of grant based on the closing price of the Company's common stock.

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During the six months ended September 30, 2016 and 2015, the Company granted 151,350 and 134,100 stock options, respectively, with a weighted average fair value of \$6.25 and \$7.35, respectively. During the six months ended September 30, 2016 and 2015, the Company granted 66,602 and 44,100 RSUs, respectively, with a weighted average

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fair value of \$21.47 and \$18.46, respectively. As of September 30, 2016, there were 566,825 and 179,687 outstanding stock options and RSUs, respectively.

As of September 30, 2016, there was \$1,727,000 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, 2016, there was \$2,013,000 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 2.2 years.

On August 11, 2015, the Company granted 10,000 RSUs to the new Chair of the Company's Board of Directors. The RSUs will become vested and convertible into a lump sum cash payment equal to the then fair market value of corresponding shares of common stock of the Company if, and only to the extent that, certain service-based vesting conditions and other terms and conditions are satisfied by August 15, 2017, or upon occurrence of a change of control. The RSUs are classified as liability awards because they will be paid in cash upon vesting. The RSU award liability is measured at its fair market value at the end of each reporting period and, therefore, will fluctuate based on the performance of the Company's stock. The total amount accrued related to this grant as of September 30, 2016 was \$144,000 and is included in accrued payroll and other compensation in the condensed consolidated balance sheet. The total amount accrued related to this grant as of September 30, 2015 was \$17,000 and is included in long-term obligations in the condensed consolidated balance sheet. During the six months ended September 30, 2016 and 2015, dividend equivalents of \$4,000 and \$2,000 were paid in cash related to this liability classified award and were charged to selling, general and administrative expenses.

Compensation cost related to stock options and RSUs (inclusive of the liability classified awards described above) recognized in operating results (included in selling, general and administrative expenses) was \$307,000 and \$410,000 in the quarters ended September 30, 2016 and 2015, respectively, and \$749,000 and \$867,000 in the six months ended September 30, 2016 and 2015, respectively.

(4) DERIVATIVE FINANCIAL INSTRUMENTS

The Company enters into foreign currency forward contracts in order to reduce the impact of certain foreign currency fluctuations on sales denominated in a foreign currency. Derivatives are not used for trading or speculative activities. Firmly committed transactions and the related receivables may be hedged with forward exchange contracts. Gains and losses arising from foreign currency forward contracts are recorded in other (income) expense, net as offsets of gains and losses resulting from the underlying hedged transactions. A realized gain of \$12,000 and \$14,000 was recorded in the three- and six months ended September 30, 2016, respectively. A realized gain of \$9,000 was recorded in the three- and six months ended September 30, 2015. As of September 30, 2016 and 2015, the notional amount of open foreign currency forward contracts was \$1,564,000 and \$1,656,000, respectively. The related unrealized gain was \$14,000 and \$97,000 at September 30, 2016 and 2015, respectively. The Company believes it does not have significant counterparty credit risks as of September 30, 2016.

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 (in thousands):

		Fair Value of Derivative Instruments	
		Fair Value September 30, 2016	Fair Value September 30, 2015
	Balance Sheet Location		
Foreign currency forward contracts	Other current assets	\$ 14	\$ 97

(5) INTANGIBLE ASSETS

On September 30, 2016, the Company sold a manufacturing facility that was acquired as part of the acquisition of substantially all of the assets and business of Blumenthal Lansing Company, LLC ("Blumenthal") on February 2, 2016. As the proceeds received from the sale of the building were in excess of the estimated fair value of the building recorded in the transaction, the Company recorded an adjustment to increase property, plant and equipment and reduce

goodwill, in the amount of approximately \$297,000, in order to properly reflect the fair value of the building as of the acquisition date.

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The following table shows the change in goodwill for the six months ended September 30, 2016 (in thousands):

Balance at March 31, 2016	\$19,974
Decrease in goodwill - Blumenthal (297)	
Balance at September 30, 2016	\$19,677

With the acquisition of substantially all of the assets and business of Schiff on July 8, 2016, the Company recorded intangible assets of \$500,000 relating to customer lists which are being amortized over the estimated useful life of five years. Additionally, in an unrelated transaction, the Company recorded customer lists of \$100,000 which were acquired during the second quarter of fiscal 2017 and are being amortized over two years.

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

	September 30, 2016		March 31, 2016		September 30, 2015	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Tradenames and trademarks	\$15,553	\$ —	\$15,553	\$ —	\$12,953	\$ —
Customer relationships	39,757	14,940	39,157	13,444	29,957	12,183
Patents	1,164	767	1,164	708	1,164	650
Trademarks	403	348	403	333	403	318
Non-compete	530	192	530	139	530	86
	\$57,407	\$ 16,247	\$56,807	\$ 14,624	\$45,007	\$ 13,237

Amortization expense related to intangible assets was \$820,000 and \$639,000 for the quarters ended September 30, 2016 and 2015, respectively, and was \$1,623,000 and \$1,278,000 for the six months ended September 30, 2016 and 2015. Based on the current composition of intangibles, amortization expense for the remainder of fiscal 2017 and each of the succeeding four years is projected to be as follows (in thousands):

Remainder of fiscal 2017	\$1,681
Fiscal 2018	3,362
Fiscal 2019	3,305
Fiscal 2020	3,244
Fiscal 2021	3,056

(6) TREASURY STOCK TRANSACTIONS

Under a stock repurchase program authorized by the Company's Board, the Company repurchased 352,789 shares of the Company's common stock for approximately \$10,000,000 during the six months ended September 30, 2015. There were no repurchases of the Company's common stock by the Company during the six months ended September 30, 2016. As of September 30, 2016, the Company had 303,166 shares remaining available for repurchase under the Board's authorizations.

(7) 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.

(8) 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, 2016.

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The Company maintains a Nonqualified Supplemental Executive Retirement Plan ("SERP") for qualified 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. There have been no contributions provided under the SERP since fiscal 2007 and there are four employees who maintain account balances as of September 30, 2016. The Company maintains separate accounts for each participant to reflect deferred contribution amounts and the related gains or losses on such deferred amounts. The investments are included in other current assets and the related liability is recorded as deferred compensation and included in long-term obligations in the condensed consolidated balance sheet. The fair value of the investments is based on the market price of the mutual funds as of September 30, 2016.

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, 2016. 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, 2016 and March 31, 2016 (in thousands):

	September 30, 2016	September 30, 2016	Fair Value Measurements at September 30, 2016 Using Quoted Prices In Active Markets	Significant Observable Inputs (Level 2)	Other Significant Unobservable Inputs (Level 3)
Assets					
Marketable securities	\$ 296	\$ 296	\$ —	\$ —	\$ —
Foreign exchange contracts	14	—	14	—	—
Cash surrender value of life insurance policies	1,166	—	1,166	—	—
Total assets	\$ 1,476	\$ 296	\$ 1,180	\$ —	\$ —
Liabilities					
Deferred compensation plans	\$ 296	\$ 296	\$ —	\$ —	\$ —
Total liabilities	\$ 296	\$ 296	\$ —	\$ —	\$ —

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	Fair Value Measurements at March 31, 2016 Using Quoted Prices In Active Markets for Identical Assets (Level 1)				
	March 31, 2016	Significant Observable Inputs (Level 2)	Other Significant Unobservable Inputs (Level 3)		
Assets					
Marketable securities	\$278	\$278	\$ —	\$	—
Cash surrender value of life insurance policies	1,153	—	1,153	—	—
Total assets	\$1,431	\$278	\$ 1,153	\$	—
Liabilities					
Deferred compensation plans	\$278	\$278	\$ —	\$	—
Total liabilities	\$278	\$278	\$ —	\$	—

Cash and cash equivalents, accounts receivable, accounts payable and accrued expenses 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. Short-term investments included held-to-maturity securities that were recorded at amortized cost, which approximates fair value (Level 2), because their short-term maturity results in the interest rates on these securities approximating current market interest rates.

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 an 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.

As discussed in Note 2, the Company acquired substantially all of the assets and business of Schiff on July 8, 2016 and determined that the aggregate preliminary fair value of acquired intangible assets, consisting of customer relationships, was \$500,000. The Company estimated the fair value of the acquired intangible assets using discounted cash flow techniques which included an estimate of future cash flows discounted to present value with an appropriate risk-adjusted discount rate (Level 3). As discussed in Note 5, the Company acquired certain customer lists in the amount of \$100,000 during the second quarter of fiscal 2016. The Company estimated the fair value of the acquired customer lists as the amount paid to acquire such customer lists (Level 2).

Goodwill and indefinite-lived intangibles are subject to impairment testing on an annual basis, or sooner if events or circumstances indicate a condition of impairment may exist. Impairment testing is conducted through valuation methods that are based on assumptions for matters such as interest and discount rates, growth projections and other future business conditions (Level 3). 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. As of September 30, 2016, the Company believes that no impairments exist.

(9) RECENT ACCOUNTING PRONOUNCEMENTS

In August 2016, the FASB issued Accounting Standards Update ("ASU") 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments" ("ASU 2016-15"). ASU 2016-15 clarifies and provides guidance on eight cash flow classification issues and is intended to reduce existing diversity in practice in

how certain cash receipts and cash payments are presented and classified in the statement of cash flows. ASU 2016-15 is effective for annual periods beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The Company does not anticipate that this guidance will have a material impact on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, "Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting" ("ASU 2016-09"). ASU 2016-09 simplifies several aspects of accounting for share-based payment award transactions, including income tax consequences, classification of awards as either liability or equity, and classification on the statement of cash flows. The standard is effective for annual periods beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted.

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The Company is currently evaluating the impact the adoption of ASU 2016-09 will have on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)" ("ASU 2016-02"). ASU 2016-02 requires lessees to record a right-of-use asset and lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative periods presented in the financial statements, with certain practical expedients available. The standard also requires certain quantitative and qualitative disclosures. The Company is currently evaluating the effect that ASU 2016-02 will have on its consolidated financial statements and related disclosures.

In November 2015, the FASB issued ASU 2015-17, "Balance Sheet Classification of Deferred Taxes" ("ASU 2015-17"), which requires entities to present all deferred tax liabilities and assets as noncurrent on the balance sheet instead of separating deferred taxes into current and noncurrent amounts. The Company adopted ASU 2015-17 on a retrospective basis in the fourth quarter of fiscal 2016. The adoption of ASU 2015-17 resulted in a \$4,652,000 reduction in current deferred tax assets, a \$4,413,000 increase in noncurrent deferred tax assets, and a \$239,000 reduction in noncurrent deferred tax liabilities as of September 30, 2015.

In September 2015, the FASB issued ASU 2015-16, "Simplifying the Accounting for Measurement-Period Adjustments" ("ASU 2015-16"). ASU 2015-16 eliminates the requirement for an acquirer in a business combination to account for measurement-period adjustments retrospectively. This guidance was effective for the Company beginning April 1, 2016 and will be applied prospectively to adjustments arising after that date. There was no impact of adopting this standard at the date of adoption.

In July 2015, the FASB issued ASU 2015-11, "Simplifying the Measurement of Inventory" ("ASU 2015-11"). ASU 2015-11 amends the guidelines for the measurement of inventory from lower of cost or market to the lower of cost and net realizable value (NRV). NRV is defined as the estimated selling prices in the ordinary course of business less reasonably predictable costs of completion, disposal, and transportation. Under existing standards, inventory is measured at lower of cost or market, which requires the consideration of replacement cost, NRV and NRV less an amount that approximates a normal profit margin. This ASU eliminates the requirement to determine and consider replacement cost or NRV less a normal profit margin for inventory measurement. The new standard is effective prospectively for fiscal years beginning after December 15, 2016, with early adoption permitted. The Company is currently evaluating the effect that ASU 2015-11 will have on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers" ("ASU 2014-09"). ASU 2014-09 provides a single model for entities to use in accounting for revenue arising from contracts with customers and will supersede most current revenue recognition guidance. The new standard also requires expanded disclosures regarding the qualitative and quantitative information about the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The new guidance is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early application is permitted for fiscal years beginning after December 15, 2016. The standard permits the use of either a full retrospective or a modified retrospective approach. The Company is evaluating the method by which it will adopt ASU 2014-09 and the impact it will have on its consolidated financial statements and related disclosures.

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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

The strategy of CSS is to build on existing relationships with craft, seasonal and celebrations customers by expanding and diversifying its product lines and thereby growing presence in the largest retailers in North America. This will include acquiring companies which fit into appropriate acquisition parameters. We actively meet with craft, seasonal and celebrations companies to review and assess potential acquisition targets.

Approximately 61% of the Company's annual sales are attributable to all occasion products with the remainder attributable to seasonal (Christmas, Valentine's Day and Easter) 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. The Company continues to confront significant price pressure as its competitors source certain products from overseas and its customers increase direct sourcing from overseas factories. Increasing customer concentration has augmented their bargaining power, which has also contributed to price pressure. In recent fiscal years, the Company has experienced lower sales in Christmas boxed greeting cards and gift tags.

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 pursuing new product initiatives related to craft, all occasion and seasonal 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 purchasing office in Hong Kong to be able to provide foreign-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.

On July 8, 2016, a subsidiary of the Company completed the acquisition of substantially all of the assets of Lawrence Schiff Silk Mills, Inc. ("Schiff") for approximately \$1,125,000 in cash. Schiff was a leading U.S. manufacturer and distributor of narrow woven ribbon prior to its April 2016 Chapter 11 bankruptcy filing. The acquisition was accounted for using the acquisition method and resulted in a bargain purchase due to the fair value of the net assets acquired of approximately \$1,501,000 exceeding the amount paid. In connection with this bargain purchase, the Company recorded a gain of approximately \$376,000 which is included in other (income) expense, net in the consolidated statements of operations in the quarter ended September 30, 2016.

On February 2, 2016, a subsidiary of the Company completed the acquisition of substantially all of the business and assets of Blumenthal Lansing Company, LLC ("Blumenthal") for approximately \$19,626,000 in cash, including transaction costs of approximately \$81,000. The Company also incurred costs of approximately \$1,028,000 in fiscal 2016, primarily related to severance. Blumenthal was the leading provider of buttons to the sewing and craft markets in the United States, selling to mass market retailers and wholesale distributors that service independent retail stores. As of September 30, 2016, a portion of the purchase price is being held in escrow for certain post-closing adjustments and indemnification obligations. The acquisition was accounted for as a purchase, and \$3,778,000, which is the excess of cost over fair value of the net tangible and identifiable intangible assets acquired, was recorded as goodwill in the accompanying condensed consolidated balance sheet. For tax purposes, goodwill resulting from this acquisition is deductible.

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, 2016. 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 share-based awards and resolution of litigation and other proceedings. There have been no material changes to the critical accounting policies affecting the

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application of those accounting policies as noted in the Company's annual report on Form 10-K for the fiscal year ended March 31, 2016.

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, 2016 Compared to Six Months Ended September 30, 2015

Sales for the six months ended September 30, 2016 decreased 6% to \$146,609,000 from \$155,705,000 in the six months ended September 30, 2015 partially due to lower sales of Christmas products of \$6,142,000, some of which is related to timing as a portion of our known Christmas 2016 sales volume is with retailers who have requested that product shipments occur during our third quarter, compared to product shipments that occurred during our second quarter in the prior year. The remaining sales decline is primarily attributable to a portion of our craft and floral ribbon sales volume, which in the prior year had shipped in our second quarter, now expected to ship in the last six months of fiscal 2017. These sales declines were partially offset by incremental sales of buttons of \$5,657,000 related to the acquisition of substantially all of the business and assets of Blumenthal on February 2, 2016.

Cost of sales, as a percentage of sales, increased to 70% in the six months ended September 30, 2016 from 68% in the six months ended September 30, 2015 primarily due to the mix of product shipped in the current year compared to the prior year, and higher distribution and freight costs of \$1,703,000 related to inefficiencies of two warehouse consolidation projects. The warehouse consolidation projects, which were substantially completed as of September 30, 2016, involved the closing of a distribution facility in El Paso, Texas in the fourth quarter of fiscal 2016 and the closing of a manufacturing and distribution facility in Lansing, Iowa, which was acquired as part of the Blumenthal acquisition, in the second quarter of fiscal 2017. The Company consolidated the distribution operations of the two closed facilities into the Company's existing distribution facilities in Florence, Alabama.

Selling, general and administrative expenses of \$38,495,000 in the six months ended September 30, 2016 increased from \$37,400,000 in the six months ended September 30, 2015 primarily due to incremental costs related to the Blumenthal acquisition of \$1,641,000; higher legal and professional fees of \$537,000 primarily relating to the Company's participation in "sunset" review proceedings conducted by the U.S. Department of Commerce and the U.S. International Trade Commission in connection with the fifth anniversary of the initiation of trade remedies on certain imported narrow woven ribbon products, which proceedings concluded in the Company's favor in August 2016 ("Sunset Review"); and higher product development costs of \$419,000. Partially offsetting these increases were lower incentive compensation of \$978,000 and lower severance of \$251,000.

Interest income, net of \$93,000 in the six months ended September 30, 2016 increased from \$82,000 in the six months ended September 30, 2015 primarily due to higher rates of return on invested balances compared to the same quarter in the prior year.

Other income of \$478,000 in the six months ended September 30, 2016 compared to \$0 in the six months ended September 30, 2015 primarily due to the gain on bargain purchase of \$376,000 related to the acquisition of substantially all of the assets and business of Schiff on July 8, 2016. The acquisition was accounted for using the acquisition method and resulted in a bargain purchase due to the fair value of the net assets acquired of approximately \$1,501,000 exceeding the amount paid of \$1,125,000. There was no such gain recorded in the six months ended September 30, 2015. Also contributing to the increase were favorable foreign currency transactions recorded in the current year compared to the prior year.

Income taxes, as a percentage of income before income taxes, were 38% and 37% in the six months ended September 30, 2016 and 2015, respectively. The increase in income taxes, as a percentage of income before taxes, was primarily attributable to differences between the financial statement bases and tax bases of assets acquired in the Schiff acquisition in the current fiscal year.

Net income for the six months ended September 30, 2016 was \$3,706,000, or \$0.41 per diluted share compared to \$8,161,000, or \$0.87 per diluted share for the comparable period in 2015.

Three Months Ended September 30, 2016 Compared to Three Months Ended September 30, 2015

Sales for the three months ended September 30, 2016 decreased 9% to \$101,291,000 from \$111,477,000 in the three months ended September 30, 2015 partially due to lower sales of Christmas products of \$5,818,000, some of which is related to timing as a portion of our known Christmas 2016 sales volume is with retailers who have requested that product shipments occur during our third quarter, compared to product shipments that occurred during our second quarter in the prior year. The remaining sales decline is primarily attributable to a portion of our craft and floral ribbon sales volume, which in the prior year

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had shipped in our second quarter, now expected to ship in the last six months of fiscal 2017. These sales declines were partially offset by incremental sales of buttons of \$2,549,000 related to the acquisition of substantially all of the business and assets of Blumenthal on February 2, 2016.

Cost of sales, as a percentage of sales, increased to 69% in the three months ended September 30, 2016 from 66% in the three months ended September 30, 2015 primarily due to the mix of product shipped in the current year compared to the prior year, and higher distribution and freight costs of \$1,032,000 related to inefficiencies of two warehouse consolidation projects.

Selling, general and administrative expenses of \$20,921,000 in the three months ended September 30, 2016 increased from \$20,100,000 in the three months ended September 30, 2015 primarily due to incremental expenses related to the Blumenthal acquisition of \$784,000; higher product development costs of \$320,000; and higher legal and professional fees of \$383,000, partially relating to the Company's participation in the Sunset Review. Partially offsetting these increases was lower incentive compensation of \$916,000.

Interest income, net of \$4,000 in the three months ended September 30, 2016 decreased from \$10,000 in the three months ended September 30, 2015 primarily due to lower average balances of funds invested in short-term investments compared to the prior year.

Other income, net of \$387,000 in the three months ended September 30, 2016 compared to other expense, net of \$48,000 in the three months ended September 30, 2015. The increase in other income, net was primarily due to the gain on bargain purchase of \$376,000 related to the acquisition of substantially all of the assets and business of Schiff on July 8, 2016. There was no such gain recorded in the three months ended September 30, 2015.

Income taxes, as a percentage of income before income taxes, were 37% and 36% in the three months ended September 30, 2016 and 2015, respectively. The increase in income taxes, as a percentage of income before taxes, was primarily attributable to differences between the financial statement bases and tax bases of assets acquired in the Schiff acquisition during the second quarter of fiscal 2017.

Net income for the three months ended September 30, 2016 was \$6,992,000, or \$0.77 per diluted share compared to \$11,229,000, or \$1.22 per diluted share for the comparable period in 2015.

LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2016, the Company had working capital of \$179,404,000 and stockholders' equity of \$271,875,000. Operating activities used net cash of \$42,026,000 during the six months ended September 30, 2016 compared to \$37,361,000 in the six months ended September 30, 2015. Net cash used for operating activities during the six months ended September 30, 2016 reflected our working capital requirements which resulted in an increase in accounts receivable of \$48,987,000 primarily reflecting seasonal billings of current year Christmas accounts receivable, net of current year collections; an increase in inventory of \$19,815,000 and an increase in accounts payable of \$13,652,000 due to the normal seasonal inventory build for the fiscal 2017 shipping season, as well as higher inventory related to the Blumenthal and Schiff acquisitions, and higher levels of finished goods inventory to support new all occasion customer reset programs; and an increase in other accrued liabilities of \$1,683,000. Included in net income for the six months ended September 30, 2016 were non-cash charges for depreciation and amortization of \$4,270,000, provision for accounts receivable allowances of \$2,553,000, deferred tax provision of \$799,000, share-based compensation of \$688,000 and gain on bargain purchase of \$376,000. Net cash used for operating activities during the six months ended September 30, 2015 reflected our working capital requirements which resulted in an increase in accounts receivable of \$54,558,000 primarily reflecting seasonal billings of current year Christmas accounts receivable, net of current year collections; an increase in inventory of \$13,774,000 and an increase in accounts payable of \$13,942,000 due to the normal seasonal inventory build for the fiscal 2016 shipping season; and an increase in other accrued liabilities of \$2,077,000. Included in net income for the six months ended September 30, 2015 were non-cash charges for depreciation and amortization of \$4,102,000, provision for accounts receivable allowances of \$1,530,000, share-based compensation of \$867,000 and a deferred tax provision of \$745,000.

Our investing activities provided net cash of \$56,255,000 in the six months ended September 30, 2016, consisting of the proceeds from held-to-maturity securities of \$60,000,000, partially offset by capital expenditures of \$2,831,000 and the purchase of a business of \$1,125,000. In the six months ended September 30, 2015, our investing activities provided net cash of \$42,282,000, consisting primarily of the proceeds from held-to-maturity securities of

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\$70,000,000, partially offset by purchases of held-to-maturity securities of \$24,924,000 and capital expenditures of \$2,817,000.

Our financing activities used net cash of \$3,915,000 in the six months ended September 30, 2016, consisting primarily of payments of cash dividends of \$3,634,000. In the six months ended September 30, 2015, financing activities used net cash of \$13,605,000, consisting primarily of purchases of treasury stock of \$10,000,000 and payments of cash dividends of \$3,321,000.

Under a stock repurchase program authorized by the Company's Board of Directors, the Company repurchased 352,789 shares of the Company's common stock for \$10,000,000 during the six months ended September 30, 2015. There were no

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repurchases of the Company's common stock by the Company during the six months ended September 30, 2016. As of September 30, 2016, the Company had 303,166 shares remaining available for repurchase under the Board's authorization.

The Company relies primarily on cash generated from its operations and, if needed, seasonal borrowings under its revolving credit facility to meet its liquidity requirements throughout the year. Historically, a significant portion of the Company's revenues have been seasonal, primarily Christmas related, with approximately 68% 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, working capital has historically increased in the second and third quarters, peaking prior to Christmas and dropping thereafter. Seasonal financing requirements are available 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 of \$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 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. This facility is due to expire on March 16, 2020. At September 30, 2016, there were no borrowings outstanding under the Company's revolving credit facility, and the Company did not borrow any amount under the facility during the six months ended September 30, 2016. The Company is in compliance with all financial debt covenants as of September 30, 2016. 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, 2016, 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
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Letters of credit \$	1,136	—	—	—	\$1,136
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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 with respect to certain obligations of its subsidiaries.

As of September 30, 2016, the Company is 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, 2016. There have been no significant changes to such 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 83 employees as of September 30, 2016, 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, 2017.

ACCOUNTING PRONOUNCEMENTS

See Note 9 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 product shipments expected to take place in the second half of fiscal 2017; the Company’s strategy to grow its presence in the largest retailers in North America by expanding and diversifying the Company’s product lines, including through acquisitions; pursuing new product initiatives within certain identified product categories; the expected

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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 amount and timing of future amortization expense and future compensation expense relating to non-vested outstanding stock options and RSUs; 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: uncertainties associated with forecasting future shipment volumes, including the risk that future shipments may fall short of management's current estimates; 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 markets and/or developing new and complementary products that drive incremental sales; information technology risks, such as cyber attacks and data breaches; 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 Company's warehouse consolidation projects, including the risk that expected efficiencies from the projects may not be realized in the timeframe currently anticipated by the Company; 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, customs laws and consumer product safety regulations; and other factors described more fully in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2016 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 these risks. 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, 2016 have not materially changed from March 31, 2016 (see Item 7A of the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2016).

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 Interim 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 Interim 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 Interim 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 2017 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 6. Exhibits

- *10.1 CSS Industries, Inc. Change of Control Severance Pay Plan for Executive Management (as amended through August 1, 2016).
- *10.2 Summary of Sales Commission Arrangement for Carey Edwards adopted August 1, 2016.
- 10.3 CSS Industries, Inc. 2013 Equity Compensation Plan, as amended and restated effective August 2, 2016 (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on August 5, 2016).
- *10.4 Form of Grant Instrument for Restricted Stock Units granted to Non-Employee Directors on August 2, 2016 under the Company's 2013 Equity Compensation Plan.
- *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.
- *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.

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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: October 25, 2016 By: /s/ Christopher J. Munyan
Christopher J. Munyan
President and Chief Executive Officer
(principal executive officer)

Date: October 25, 2016 By: /s/ David F. McHugh
David F. McHugh
Vice President – Finance and Interim Chief Financial Officer
(principal financial and accounting officer)