

CSS INDUSTRIES INC
Form 10-Q
August 01, 2018
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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 June 30, 2018

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 shorter period that the registrant was required to submit and post such files). Yes No

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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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 July 27, 2018, there were 9,119,746 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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CSS INDUSTRIES, INC. AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
 (Unaudited)

(In thousands, except per share data)

	Three Months Ended June 30,	
	2018	2017
Net sales	\$64,127	\$48,324
Cost of sales	52,480	36,512
Gross profit	11,647	11,812
Selling, general and administrative expenses	28,929	20,696
Impairment of goodwill	1,390	—
Operating income (loss)	(18,672)	(8,884)
Interest expense (income), net	262	(54)
Other expense (income), net	(117)	(159)
Income (loss) before income taxes	(18,817)	(8,671)
Income tax expense (benefit)	(341)	(1,607)
Net income (loss)	\$(18,476)	\$(7,064)
Weighted average basic and diluted shares outstanding	9,120	9,089
Basic and diluted net income (loss) per common share	\$(2.03)	\$(0.78)
Cash dividends per share of common stock	\$0.20	\$0.20
Comprehensive income (loss):		
Net income (loss)	\$(18,476)	\$(7,064)
Foreign currency translation adjustment	(720)	308
Fair value of interest rate swap agreements	265	—
Comprehensive income (loss)	\$(18,931)	\$(6,756)
See notes to consolidated financial statements.		

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CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share amounts)

	June 30, 2018 (Unaudited)	March 31, 2018 (Audited)	June 30, 2017 (Unaudited)
Assets			
Current assets:			
Cash and cash equivalents	\$ 33,103	\$ 58,560	\$ 49,695
Accounts receivable, net of allowances of \$1,640, \$1,576 and \$1,124	51,908	63,083	42,753
Inventories	117,944	102,436	115,348
Prepaid expenses and other current assets	12,851	11,962	14,099
Total current assets	215,806	236,041	221,895
Property, plant and equipment, net	53,133	52,126	35,474
Deferred income taxes	10,560	10,439	—
Goodwill	—	—	19,916
Intangible assets, net	57,794	57,029	43,038
Other assets	9,828	9,553	8,172
Total assets	\$ 347,121	\$ 365,188	\$ 328,495
Liabilities and Stockholders' Equity			
Current liabilities:			
Current portion of long-term debt	\$ 229	\$ 228	\$ 223
Accounts payable	25,751	20,581	14,076
Accrued payroll and other compensation	9,994	11,496	7,107
Accrued customer programs	13,937	12,284	4,934
Accrued other liabilities	11,387	14,751	7,638
Total current liabilities	61,298	59,340	33,978
Long-term debt, net of current portion	40,170	40,228	399
Deferred income taxes	1,500	1,639	4,413
Other long-term obligations	10,745	10,286	3,809
Total liabilities	113,713	111,493	42,599
Commitments and contingencies			
Stockholders' equity:			
Preferred stock, Class 2, \$.01 par, 1,000,000 shares authorized, no shares issued	—	—	—
Common stock, \$.10 par, 25,000,000 shares authorized, 14,703,084 shares issued at June 30, 2018, March 31, 2018 and June 30, 2017	1,470	1,470	1,470
Additional paid-in capital	59,348	58,877	57,221
Retained earnings	318,785	339,088	374,750
Accumulated other comprehensive income (loss), net of tax	708	1,163	245
Common stock in treasury, 5,583,338 shares at June 30, 2018 and March 31, 2018 and 5,608,690 shares at June 30, 2017, at cost	(146,903)	(146,903)	(147,790)
Total stockholders' equity	233,408	253,695	285,896
Total liabilities and stockholders' equity	\$ 347,121	\$ 365,188	\$ 328,495
See notes to consolidated financial statements.			

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

	Three Months Ended June 30,	
	2018	2017
Cash flows from operating activities:		
Net income (loss)	\$(18,476)	\$(7,064)
Adjustments to reconcile net income (loss) to net cash used for operating activities:		
Depreciation and amortization	3,297	2,126
Amortization of inventory step-up	5,043	3,185
Accretion of asset retirement obligation	31	—
Accretion of investment discount	—	(69)
Impairment of goodwill	1,390	—
Provision for accounts receivable allowances	733	526
Deferred tax (benefit) provision	(218)	(56)
Share-based compensation expense	471	283
Loss on sale or disposal of assets	2	—
Changes in assets and liabilities, net of effects of purchase of a business:		
Accounts receivable	10,709	5,562
Inventories	(20,312)	(13,156)
Prepaid expenses and other assets	(1,445)	(4,323)
Accounts payable	4,995	(99)
Accrued expenses and long-term obligations	(1,624)	(2,239)
Total adjustments	3,072	(8,260)
Net cash used for operating activities	(15,404)	(15,324)
Cash flows from investing activities:		
Maturities of investment securities	—	20,000
Final payment of purchase price for a business previously acquired	(2,500)	—
Purchase of a business	(2,500)	—
Purchase of property, plant and equipment	(3,159)	(901)
Net cash (used for) provided by investing activities	(8,159)	19,099
Cash flows from financing activities:		
Payments on long-term debt	(57)	(54)
Dividends paid	(1,824)	(1,819)
Proceeds from exercise of stock options, net of tax withholdings	—	37
Net cash used for financing activities	(1,881)	(1,836)
Effect of exchange rate changes on cash	(13)	63
Net (decrease) increase in cash and cash equivalents	(25,457)	2,002
Cash and cash equivalents at beginning of period	58,560	47,693
Cash and cash equivalents at end of period	\$33,103	\$49,695
See notes to consolidated financial statements.		

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CSS INDUSTRIES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(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, 2018. 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 2019” refers to the fiscal year ending March 31, 2019.

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 creative consumer products company, focused on the seasonal, gift and craft categories. For these design-driven categories, the Company engages in the creative development, manufacture, procurement, distribution and sale of our products with an omni-channel approach focused primarily on mass market retailers.

Seasonal The seasonal category includes gift packaging items such as ribbons, bows, greeting cards, wrapping paper, bags, boxes, tags and gift card holders, in addition to specific holiday-themed decorations, accessories, and activities, such as Easter egg dyes and novelties and Valentine's Day classroom exchange cards. These products are sold to mass market retailers, and production forecasts for these products are generally known well in advance of shipment.

Gift The gift category includes products designed to celebrate certain life events or special occasions such as weddings, birthdays, anniversaries, graduations, or the birth of a child. Products include ribbons and bows, floral accessories, infant products, journals, gift card holders, all occasion boxed greeting cards, memory books, scrapbooks, stationery, stickers and other items that commemorate life's celebrations. Products in this category are primarily sold to mass market and specialty retailers, floral and packaging wholesalers and distributors, and are generally ordered on a replenishment basis throughout the year.

Craft The craft category includes ribbons, trims, buttons, sewing patterns, knitting needles, needle arts and kids crafts. These products are sold to mass market and specialty retailers, and are generally ordered on a replenishment basis throughout the year.

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

The Company's foreign subsidiaries generally use the local currency as the functional currency. The Company translates all assets and liabilities at period end exchange rates and all income and expense accounts at average rates during the period. Translation adjustments are recorded in accumulated other comprehensive income (loss) in stockholders’ equity. Gains and losses on foreign currency transactions (denominated in currencies other than the local currency) are not material and are included in other expense (income), net in the consolidated statements of operations.

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Use of Estimates

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

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 net realizable value. The remaining portion of the inventory is valued at the lower of last-in, first-out (LIFO) cost or net realizable value. Inventories consisted of the following (in thousands):

	June 30, 2018	March 31, 2018	June 30, 2017
Raw material	\$ 13,207	\$ 11,602	\$ 12,129
Work-in-process	16,495	17,809	19,198
Finished goods	88,242	73,025	84,021
	\$ 117,944	\$ 102,436	\$ 115,348

In connection with the acquisitions of substantially all of the net assets and business of The McCall Pattern Company ("McCall") on December 13, 2016, Simplicity Creative Group ("Simplicity") on November 3, 2017 and Fitlosophy, Inc. ("Fitlosophy") on June 1, 2018, the Company recorded a step-up to fair value of the inventory acquired of \$21,773,000, \$10,214,000, and \$312,000, respectively, at the date of such acquisition. This was a result of the inventory acquired being marked up to an estimated net selling price in purchase accounting and is recognized through cost of sales as the inventory is sold. The amount of step-up to fair value of the acquired inventory remaining as of June 30, 2018, March 31, 2018 and June 30, 2017 was \$5,923,000, \$10,683,000 and \$15,071,000, respectively. The Company expects the acquired McCall inventory to be sold through the second quarter of fiscal 2019, the acquired Simplicity inventory to be sold through the first quarter of fiscal 2020, and the acquired Fitlosophy inventory to be sold through the third quarter of fiscal 2019.

Property, Plant and Equipment

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

	June 30, 2018	March 31, 2018	June 30, 2017
Land	\$7,025	\$7,100	\$5,882
Buildings, leasehold interests and improvements	45,348	45,164	40,798
Machinery, equipment and other	106,292	104,497	90,713
	158,665	156,761	137,393
Less - Accumulated depreciation and amortization	(105,532)	(104,635)	(101,919)
Net property, plant and equipment	\$53,133	\$52,126	\$35,474

Depreciation expense was \$2,030,000 and \$1,285,000 for the quarters ended June 30, 2018 and 2017, 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.

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. As of June 30, 2018, the Company assessed its segment and reporting

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unit structure and determined the Company has a single reporting unit. 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, an impairment loss would be reported. During the three months ended June 30, 2018, the Company impaired goodwill of \$1,390,000 associated with the acquisition of Fitlosophy acquired on June 1, 2018. See Note 2 for further discussion.

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 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 three months ended June 30, 2018, there were no such events or circumstances. See Note 5 for further information on other intangible assets.

Revenue Recognition

Revenue from the sale of the Company's products is recognized when control of the promised goods is transferred to customers, in the amount that reflects the consideration the Company expects to be entitled to in exchange for those goods. Revenue is recognized using the five-step model identified in Accounting Standards Codification 606, "Revenue from Contracts with Customers." These steps are: (i) identify the contract with the customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue as the performance obligations are satisfied.

The Company's contracts with customers include one performance obligation under the revenue recognition standard. For most product sales, the performance obligation is the delivery of a specified product, and is satisfied at the point in time when control of the product has transferred to the customer, which takes place when title and risk of loss transfer in accordance with the applicable shipping terms, typically either at shipping point or at delivery to a specified destination. The Company has certain limited products, primarily sewing patterns, that are on consignment at mass market retailers. The Company recognizes revenue on these products as they are sold to end consumers as recorded at point-of-sale terminals, which is the point in time when control of the product is transferred to the customer.

Revenue is recognized based on the consideration specified in a contract with the customer, and is measured as the amount of consideration to which the Company expects to be entitled in exchange for transferring the goods. When applicable, the transaction price includes estimates of variable consideration to the extent it is probable that a significant reversal of revenue recognized will not occur. Variable consideration consists of estimated reductions to the transaction price and revenue for customer programs, which may include special pricing arrangements for specific customers, volume incentives and other promotions. The Company has significant historical experience with customer programs and estimates the expected consideration considering historical trends. The Company adjusts its estimate of variable consideration at least quarterly or when facts and circumstances used in the estimation process may change. In limited cases, the Company may provide the right to return product to certain customers. The Company also records estimated reductions to revenue, based primarily on known claims, for customer returns and chargebacks that may arise as a result of shipping errors, product damaged in transit or for other reasons that become known subsequent to recognizing the revenue. These provisions are recorded in the period that the related sale is recognized and are reflected as a reduction from gross sales. The related reserves are included in accrued customer programs in the consolidated balance sheet. If the amount of actual customer returns and chargebacks were to increase or decrease from the estimated amount, revisions to the estimated reserve would be recorded.

The Company treats shipping and handling activities that occur after the customer has obtained control of a good as an activity to fulfill the promise to transfer the product. Costs related to shipping of product are recorded as incurred and classified in cost of sales in the consolidated statements of operations and comprehensive income (loss).

Payment terms with customers vary by customer, but generally range from 30 to 90 days. Certain seasonal revenues have extended payment terms in accordance with general industry practice. Since the term between invoicing and expected payment is less than one year, the Company does not adjust the transaction price for the effects of a financing component.

Sales commissions are earned and are recognized as expense as the related revenue is recognized at a point in time. These costs are recorded in selling, general and administrative expenses. Taxes collected from customers are excluded from revenue and credited directly to obligations to the appropriate governmental agencies.

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The Company operates as a single reporting segment, engaged in the creative development, manufacture, procurement, distribution, and sale of seasonal, gift, and craft products, primarily to mass market retailers in the United States. The following represents our net sales disaggregated by product category:

	Three Months Ended June 30,	
	2018	2017
Seasonal	\$4,799	\$4,642
Gift	24,040	25,139
Craft	35,288	18,543
Total	\$64,127	\$48,324

Net Income (Loss) Per Common Share

Due to the Company's net losses in the first quarter of fiscal 2019 and 2018, potentially dilutive securities of 552,000 shares and 561,000 shares as of June 30, 2018 and 2017, respectively, consisting of outstanding stock options and unearned restricted stock units, were excluded from the diluted net income (loss) per common share calculation due to their antidilutive effect.

(2) ACQUISITION

On June 1, 2018, a subsidiary of the Company completed the acquisition of substantially all of the business and net assets of Fitlosophy for \$2,500,000 in cash and transaction costs of approximately \$25,000, which are included in selling, general and administrative expenses in the three months ended June 30, 2018. In addition to the \$2,500,000 paid at closing, the Company may pay up to an additional \$10,500,000 of contingent earn-out consideration, in cash, if net sales of certain products meet or exceed five different thresholds during the period from the acquisition date through March 31, 2023. The contingent consideration payments will be paid, if at all, generally within 20 days after the end of each rolling twelve-month measurement period (quarterly starting June 30, 2018 through March 31, 2023). The estimated fair value of the contingent earn-out consideration is \$1,600,000, which is included in accrued other liabilities in the consolidated balance sheet as of June 30, 2018. The estimated fair value of the contingent earn-out consideration was determined using a Monte Carlo simulation discounted to a present value. The following table summarizes the estimated purchase price at the date of acquisition (in thousands):

Cash	\$2,500
Contingent earn-out consideration	1,600
Estimated purchase price	\$4,100

Fitlosophy is devoted to creating, marketing, and distributing innovative products that inspire people to develop healthy habits by focusing on effective goal-setting through journaling. Products include a complete line of fitness and wellness planning products all sold under the fitlosophy™, live life fit™ and fitbook™ brands. The acquisition was accounted for using the acquisition method and the excess of cost over the fair market value of the net tangible and identifiable intangible assets acquired of \$1,390,000 was recorded as goodwill. This goodwill was deemed impaired as a result of the continued discrepancy between the Company's stockholders' equity balance and its market capitalization and, therefore, was expensed during the quarter ended June 30, 2018.

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

Accounts receivable	\$389
Inventory	452
Other assets	5
Total current assets	846
Intangible assets	2,032
Goodwill	1,390
Total assets acquired	4,268
Current liabilities	(168)
Net assets acquired	\$4,100

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Our consolidated statements of operations include the operating results of Fitlosophy from the acquisition date through June 30, 2018. Pro forma results of operations for this acquisition have not been presented as the financial impact to our consolidated results of operations is not material.

(3) SHARE-BASED COMPENSATION

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. 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. 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. Service-based stock options outstanding as of June 30, 2018 become exercisable at the rate of 25% per year commencing one year after the date of grant. Market-based stock options outstanding as of June 30, 2018 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 either: 1) 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 or 2) the rate of 25% of the shares underlying the grant on each of the first four anniversaries of the date on which the award was granted. Service-based RSUs granted to directors and outstanding as of June 30, 2018 vested on July 30, 2018. Market-based and performance-based RSUs outstanding at June 30, 2018 will vest only if certain market or performance conditions and service requirements have been met, and the date(s) on which they vest will depend on the period in which such market or performance conditions and service requirements are met, if at all, except that vesting and redemption are accelerated upon a change of control. At June 30, 2018, there were 588,440 shares available for grant under the 2013 Plan.

The fair value of each stock option granted under the above plan during the first quarter of fiscal 2018 was estimated on the date of grant using a Black-Scholes option pricing model with assumptions of a risk-free interest rate of 2.21%, volatility of 34.45%, dividend yield of 2.90% and expected life of 6.25 years. There were no stock options granted during the first quarter of fiscal 2019.

The fair value of each performance-based and 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. There were no market-based RSUs granted during the first quarter of fiscal 2019 or 2018.

During the three months ended June 30, 2017, the Company granted 119,000 stock options with a weighted average fair value of \$7.42. During the three months ended June 30, 2018 and 2017, the Company granted 157,803 and 54,360 RSUs, respectively, with a weighted average fair value of \$14.50 and \$25.21, respectively. As of June 30, 2018, there were 435,600 and 316,083 outstanding stock options and RSUs, respectively.

As of June 30, 2018, there was \$1,215,000 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 2.3 years. As of June 30, 2018, there was \$3,820,000 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.

On August 11, 2015, the Company granted 10,000 RSUs to the Chair of the Company's Board of Directors. The RSUs vested on August 15, 2017 and were converted into a lump sum cash payment of approximately \$266,000 which represented the fair market value of corresponding shares of common stock of the Company. Prior to vesting, the RSUs were classified as liability awards because they were to be paid in cash upon vesting. The RSU award liability

was measured at its fair market value at the end of each reporting period. The total amount accrued related to this grant as of June 30, 2017 was \$245,000 and is included in accrued payroll and other compensation in the consolidated balance sheet.

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 \$471,000 and \$319,000 in the quarters ended June 30, 2018 and 2017, respectively.

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(4) DERIVATIVE FINANCIAL INSTRUMENTS

Foreign Currency Forward Contracts

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 expense (income), net as offsets of gains and losses resulting from the underlying hedged transactions. A realized gain of \$5,000 was recorded in the three months ended June 30, 2018 and a realized loss of \$19,000 was recorded in the three months ended June 30, 2017. As of June 30, 2018 and 2017, the notional amount of open foreign currency forward contracts was \$805,000 and \$1,636,000, respectively. The related unrealized loss was \$2,000 and \$35,000 at June 30, 2018 and 2017, respectively. The Company believes it does not have significant counterparty credit risks as of June 30, 2018.

Interest Rate Swap Agreement

On February 1, 2018, the Company entered into an interest rate swap agreement with a term of five years to manage its exposure to interest rate movements by effectively converting a portion of its anticipated working capital debt from variable to fixed rates. The notional amount of the interest rate swap contract subject to fixed rates was \$40,000,000 and fixed interest rate payments were at a weighted average rate of 2.575% during the first quarter of fiscal 2019. Interest rate differentials paid under this agreement were recognized as adjustments to interest expense and were \$78,000 for the quarter ended June 30, 2018. There were no interest rate swap arrangements in place during the first quarter of fiscal 2018.

The following table shows the fair value of the foreign currency forward contracts and interest rate swap agreement designated as hedging instruments and included in the Company's consolidated balance sheet (in thousands):

	Balance Sheet Location	Fair Value of Derivative Instruments June 30, 2018	June 30, 2017
Foreign currency forward contracts	Accrued other liabilities	\$ 2	\$ 35
Interest rate swap agreement	Other assets	238	—

(5) INTANGIBLE ASSETS

The change in the carrying amount of goodwill during the three months ended June 30, 2018 is as follows (in thousands):

Balance as of March 31, 2018	\$	—
Acquisition of Fitlosophy		1,390
Impairment charge		(1,390)
Balance as of June 30, 2018	\$	—

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

	June 30, 2018		March 31, 2018		June 30, 2017	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Tradenames and trademarks	\$24,353	\$ —	\$24,353	\$ —	\$19,953	\$ —
Customer relationships	48,657	20,976	48,657	19,976	39,757	17,273
Favorable lease contracts	3,882	478	3,882	299	—	—
Trademarks	2,435	425	403	393	403	370
Patents	1,164	971	1,164	941	1,164	855
Non-compete	530	377	530	351	530	271

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\$81,021 \$ 23,227 \$78,989 \$ 21,960 \$61,807 \$ 18,769

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With the acquisition of substantially all of the business and net assets of Fitlosophy on June 1, 2018, the Company recorded intangible assets of \$2,032,000 relating to tradenames which are being amortized over the estimated useful life of seven years.

Amortization expense related to intangible assets was \$1,267,000 and \$841,000 for the quarters ended June 30, 2018 and 2017, respectively. Based on the current composition of intangibles, amortization expense for the remainder of fiscal 2019 and each of the succeeding four years is projected to be as follows (in thousands):

Remainder of fiscal 2019	\$3,887
Fiscal 2020	5,041
Fiscal 2021	4,554
Fiscal 2022	4,458
Fiscal 2023	3,741

(6) LONG-TERM DEBT

As of June 30, 2018 and March 31, 2018, there was \$40,000,000 outstanding under the Company's revolving credit facility and there were no amounts outstanding as of June 30, 2017. The Company has classified this debt as long-term because of its intent and ability to maintain the debt outstanding for greater than one year.

The Company leases certain equipment under capital leases which is classified in the accompanying balance sheet as follows (in thousands):

	June 30, 2018	March 31, 2018	June 30, 2017
Current portion of long-term debt	\$ 73	\$ 74	\$ 76
Long-term debt, net of current portion	102	120	175
	\$ 175	\$ 194	\$ 251

The Company also finances certain equipment which is classified in the accompanying balance sheet as follows (in thousands):

	June 30, 2018	March 31, 2018	June 30, 2017
Current portion of long-term debt	\$ 156	\$ 154	\$ 147
Long-term debt, net of current portion	68	108	224
	\$ 224	\$ 262	\$ 371

(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 interest rate risk and foreign currency risk. The Company recorded all derivatives on the consolidated balance sheet at fair value based on quotes obtained from financial institutions as of June 30, 2018 and March 31, 2018.

The Company maintains a Nonqualified Supplemental Executive Retirement Plan ("SERP") for qualified employees. There have been no contributions provided under the SERP since fiscal 2007 and there are three employees, and one former employee, who maintain account balances as of June 30, 2018. The Company also maintains a nonqualified Deferred Compensation Plan ("Deferred Comp Plan") for qualified employees. The Deferred Comp Plan provides eligible key employees with the opportunity to elect to defer up to 50% of their eligible compensation under the Deferred Comp Plan. The Company may make matching or discretionary contributions, at the discretion of the Board. All compensation deferred under the SERP and Deferred Comp Plan is held by the Company. The Company maintains separate accounts for each participant to reflect deferred contribution amounts and the related gains or losses on such

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deferred amounts. A participant's account is notionally invested in one or more investment funds and the value of the account is determined with respect to such investment allocations. The related liability is recorded as deferred compensation and included in other long-term obligations in the consolidated balance sheet as of June 30, 2018 and March 31, 2018.

In connection with the above SERP and Deferred Comp Plan, the Company has invested in company-owned life insurance policies. The Company also maintains two life insurance policies in connection with deferred compensation arrangements with two former executives. The cash surrender value of the policies is recorded in other long-term assets in the consolidated balance sheets and is based on quotes obtained from the insurance company as of June 30, 2018 and March 31, 2018.

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 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 consolidated balance sheet as of June 30, 2018 and March 31, 2018 (in thousands):

	Fair Value Measurements at June 30, 2018			
	Using			
	Quoted Prices In			
	Active			
	June	Markets	Significant	Other
	30,	for	Observable	Significant
	2018	Identical	Inputs (Level 2)	Unobservable
		Assets		Inputs (Level 3)
		(Level		
		1)		
Assets				
Marketable securities	\$ 366	\$ 366	\$	— \$
Cash surrender value of life insurance policies	2,031	—	2,031	—
Interest rate swap agreement	238	—	238	—
Total assets	\$			