

LENOX GROUP INC  
Form 10-Q  
May 08, 2008

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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## **FORM 10-Q**

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

For the quarterly period ended: **March 29, 2008**

Commission File Number: 1-11908

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## **Lenox Group Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**13-3684956**

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

**One Village Place, 6436 City West Parkway, Eden Prairie, MN 55344**

(Address of principal executive offices)

(Zip Code)

**(952) 944-5600**

(Registrant's telephone number, including area code)

**Not Applicable**

(Former name, former address, and former fiscal year, if changed since last report)

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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 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  Smaller reporting company   
Non-accelerated filer  (Do not check if a smaller reporting company.)

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

As of May 5, 2008, 14,370,896 shares of the registrant's common stock, par value \$.01 per share, were outstanding.

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### PART I FINANCIAL INFORMATION

#### Item 1. Financial Statements

#### LENOX GROUP INC. AND SUBSIDIARIES

#### CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(In thousands)

#### ASSETS

|                             | March 29,<br>2008 | December 29,<br>2007 | March 31,<br>2007 |
|-----------------------------|-------------------|----------------------|-------------------|
| Current Assets:             |                   |                      |                   |
| Cash and cash equivalents   | \$ 448            | \$ 3,081             | \$ 277            |
| Accounts receivable, net    | 42,467            | 43,273               | 44,979            |
| Inventories                 | 92,708            | 84,415               | 96,210            |
| Deferred taxes              | 16,915            | 17,347               | 13,900            |
| Income tax receivable       | 9,634             | 10,114               | 13,235            |
| Other current assets        | 8,428             | 8,405                | 7,915             |
| Total current assets        | 170,600           | 166,635              | 176,516           |
|                             |                   |                      |                   |
| Property and equipment, net | 41,742            | 41,987               | 47,024            |
| Trademarks, net             | 119,941           | 119,941              | 119,439           |
| Other intangibles, net      | 11,491            | 11,984               | 13,562            |
| Marketable securities       | 74                | 71                   | 350               |
| Other assets                | 10,844            | 11,488               | 9,461             |
| Total Assets                | \$ 354,692        | \$ 352,106           | \$ 366,352        |

**LIABILITIES AND STOCKHOLDERS EQUITY**

|   |            |            |            |
|---|------------|------------|------------|
| Current liabilities:                      |            |            |            |
| Current portion of long-term debt         | \$ 1,250   | \$ 1,250   | \$ 1,250   |
| Borrowings on revolving credit facility   | 37,322     | 8,938      | 19,173     |
| Accounts payable                          | 28,087     | 31,836     | 32,132     |
| Accrued compensation and benefits payable | 8,253      | 8,727      | 7,450      |
| Severance and restructuring reserves      | 1,364      | 2,756      | 4,750      |
| Other current liabilities                 | 5,559      | 8,826      | 6,211      |
| Total current liabilities                 | 81,835     | 62,333     | 70,966     |
|   |            |            |            |
| Deferred compensation obligation          | 41         | 54         | 339        |
| Pension obligations                       | 14,052     | 15,788     | 28,329     |
| Postretirement obligations                | 1,355      | 1,585      | 15,695     |
| Deferred taxes                            | 20,081     | 25,531     | 20,562     |
| Long-term debt                            | 98,250     | 98,500     | 46,450     |
| Borrowings on revolving credit facility   |            |            | 42,178     |
| Deferred gain on sale-leaseback           | 3,502      | 3,570      | 3,776      |
| Other noncurrent liabilities              | 8,786      | 8,603      | 10,582     |
| Commitments and contingencies (Note 12)   |            |            |            |
| Stockholders' equity                      | 126,790    | 136,142    | 127,475    |
|   | \$ 354,692 | \$ 352,106 | \$ 366,352 |

See notes to condensed consolidated financial statements.

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**LENOX GROUP INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)**

(In thousands, except per share amounts)

|                                     | 13 Weeks<br>Ended<br>March 29,<br>2008 | 13 Weeks<br>Ended<br>March 31,<br>2007 |
|-------------------------------------|--|--|
| NET SALES                           | \$71,397                               | \$86,394                               |
| COST OF SALES                       | 34,595                                 | 49,780                                 |
| GROSS PROFIT                        | 36,802                                 | 36,614                                 |
|                                     |  |  |
| OPERATING EXPENSES                  |  |  |
| Selling, general and administrative | 46,117                                 | 53,248                                 |
| Restructuring charges               | 1,088                                  | 4,791                                  |

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|                                      |          |   |           |   |
|--------------------------------------|----------|---|-----------|---|
| OPERATING LOSS                       | (10,403  | ) | (21,425   | ) |
| OTHER EXPENSE (INCOME)               |          |   |           |   |
| Interest expense                     | 3,286    |   | 2,828     |   |
| Other, net                           | 104      |   | (13       | ) |
| LOSS BEFORE INCOME TAXES             | (13,793  | ) | (24,240   | ) |
| INCOME TAX BENEFIT                   | (4,742   | ) | (11,245   | ) |
| NET LOSS                             | \$(9,051 | ) | \$(12,995 | ) |
| NET LOSS PER SHARE BASIC             | \$(0.65  | ) | \$(0.94   | ) |
| NET LOSS PER SHARE ASSUMING DILUTION | \$(0.65  | ) | \$(0.94   | ) |
| WEIGHTED AVERAGE SHARES OUTSTANDING  |          |   |           |   |
| BASIC                                | 13,878   |   | 13,785    |   |
| ASSUMING DILUTION                    | 13,878   |   | 13,785    |   |

See notes to condensed consolidated financial statements.

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**LENOX GROUP INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

**(In thousands)**

|   | 13 Weeks Ended<br>March 29,<br>2008 |   | 13 Weeks Ended<br>March 31,<br>2007 |   |
|---|-------------------------------------|---|-------------------------------------|---|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>      |                                     |   |                                     |   |
| Net cash used in operating activities             | \$(28,203                           | ) | \$(10,717                           | ) |
| Net cash used in operating activities             | (28,203                             | ) | (10,717                             | ) |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>      |                                     |   |                                     |   |
| Purchases of property and equipment               | (2,791                              | ) | (1,944                              | ) |
| Proceeds from sale of assets                      | 245                                 |   | 19                                  |   |
| Acquisitions                                      |                                     |   | (212                                | ) |
| Net cash used by investing activities             | (2,546                              | ) | (2,137                              | ) |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>      |                                     |   |                                     |   |
| Payments of debt amendment and refinancing costs  |                                     |   | (204                                | ) |
| Excess tax benefits from stock-based compensation |                                     |   | (7                                  | ) |
| Borrowings on revolving credit facility           | 100,900                             |   | 56,673                              |   |
| Principal payments on revolving credit facility   | (72,516                             | ) | (42,832                             | ) |

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|  |               |          |               |          |
|--|---------------|----------|---------------|----------|
| Purchases of treasury stock                              | (12           | )        | (13           | )        |
| Principal payments on capital leases                     | (6            | )        | (5            | )        |
| Payments on long-term debt                               | (250          | )        | (1,356        | )        |
| Net cash provided by financing activities                | 28,116        |          | 12,256        |          |
| <b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>         | <b>(2,633</b> | <b>)</b> | <b>(598</b>   | <b>)</b> |
| <b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>  | <b>3,081</b>  |          | <b>875</b>    |          |
| <b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>        | <b>\$ 448</b> |          | <b>\$ 277</b> |          |
| <b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b> |               |          |               |          |
| Depreciation expense                                     | \$ 2,370      |          | \$ 3,243      |          |
| Intangible amortization expense                          | 493           |          | 573           |          |
| Accrued capital expenditure purchases                    | 624           |          | 142           |          |
| Cash paid (received) for:                                |               |          |               |          |
| Interest   | 2,866         |          | 2,253         |          |
| Income taxes   | (480          | )        | 9             |          |

See notes to condensed consolidated financial statements

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**LENOX GROUP INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**(In thousands, except per share amounts)**

**1. Basis of Presentation**

The Condensed Consolidated Balance Sheets as of March 29, 2008 and March 31, 2007, the Condensed Consolidated Statements of Operations for the 13 weeks ended March 29, 2008 and March 31, 2007 and the Condensed Consolidated Statements of Cash Flows for the 13 weeks ended March 29, 2008 and March 31, 2007 are unaudited. The Consolidated Balance Sheet as of December 29, 2007 was derived from audited consolidated financial statements, but does not include all disclosures required by Generally Accepted Accounting Principles in the United States of America.

In the opinion of management, all adjustments necessary for a fair presentation of the consolidated financial statements are included. Adjustments consist only of normal recurring items, except for any discussed in the notes below. Interim results are not necessarily indicative of

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results for a full year. The condensed consolidated financial statements and notes are presented in accordance with instructions for Form 10-Q, and therefore, do not contain certain information included in our consolidated annual financial statements and notes. The condensed consolidated financial statements and notes appearing in this report should be read in conjunction with the consolidated audited financial statements and related notes included in the Annual Report on Form 10-K for the year ended December 29, 2007 ( 2007 Form 10-K ) filed by Lenox Group Inc. (the Company ) with the Securities and Exchange Commission ( SEC ).

### 2. New Accounting Standards

#### *Recently Adopted Accounting Standards*

In September 2006, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 became effective for our financial assets and liabilities on January 1, 2008. The FASB has deferred the implementation of the provisions of SFAS No. 157 relating to certain nonfinancial assets and liabilities until January 1, 2009. SFAS No. 157 did not materially affect how we determine fair value.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 permits companies to measure many financial instruments and certain other items at fair value. SFAS No. 159 became effective for us on January 1, 2008. We have not elected the fair value option for any of our existing financial instruments on the effective date and have not determined whether or not we will elect this option for any eligible financial instruments we acquire in the future.

#### *Recently Issued Accounting Standards*

In March 2008, the FASB issued Statement of Financial Accounting Standards No 161 ( SFAS 161 *Disclosures about Derivative Instruments and Hedging Activities*). SFAS 161 requires companies with derivative instruments to disclose information that should enable financial statement users to understand how and why a company uses derivative instruments, how derivative instruments and related hedged items are accounted for under FASB Statement No. 133 *Accounting for Derivative Instruments and Hedging Activities* and how derivative instruments and related hedged items affect a company's financial position, financial performance and cash flows. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. We are currently evaluating the impact, if any, that SFAS 161 will have on our consolidated financial statements.

In December 2007, the FASB issued Statement No. 141(R), *Business Combinations* ( SFAS 141R ). SFAS 141(R) established the principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. SFAS 141(R) also establishes rules for recognition and measurement of the goodwill acquired in the

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business combination and the gains from bargain purchases. SFAS No. 141R is effective for the Company in the first quarter of fiscal 2010. The Company is currently assessing the impact that SFAS No. 141R will have on its results of operations, financial position and cash flows.

### 3. Stock-Based Compensation

We recognize compensation for share-based awards over the requisite service period. This is the period of time between the grant date and the awards' stated vesting term. We recognize time-vesting compensation expense to operations over the applicable service periods and performance-vesting compensation expense over the applicable service period when it is probable the performance goals will be achieved.

Total share-based compensation expense (benefit) was \$249 and \$(922) for the 13 weeks ended March 29, 2008, and March 31, 2007, respectively. During the 13 weeks ended March 31, 2007, forfeiture of restricted stock with performance conditions that were not met resulted in a reduction of the associated expense.

The Company granted 255,000 restricted shares of common stock to executive officers, directors and employees during the 13 weeks ended March 29, 2008. Of these shares, 241,000 shares were performance-vesting and 14,000 shares were time-vesting. The weighted average price per share was \$1.75 which represents the market price of the Company's common stock on the date of the grant. The Company issued no restricted shares of common stock for the 13 weeks ended March 31, 2007. Total compensation expense (benefit) for non-vested restricted stock during the 13 weeks ended March 29, 2008, and March 31, 2007, was \$110 and \$(918), respectively.

During the 13 weeks ended March 29, 2008, 28,000 stock option awards were issued to directors. These stock option awards vest one year from the date of the grant and have an exercise price equal to the market price of the Company's common stock on the date of the grant. No option awards were granted during the thirteen weeks ended March 31, 2007. Total compensation expense (benefit) for stock option awards for the 13 weeks ended March 29, 2008 and March 31, 2007 was \$53 and \$(4), respectively.

The Company estimates the fair value of each stock option using the Black-Scholes option pricing model. Assumptions used were:

|                           |                |
|---------------------------|----------------|
|                           | 13 weeks       |
|                           | ended          |
|                           | March 29, 2008 |
| Risk-free interest rate   | 2.49           |
| Expected dividend yield   | 0.0%           |
| Expected stock volatility | 51.0%          |
| Expected life (in years)  | 6.0            |

The weighted average fair value of options granted during the 13 weeks ended March 29, 2008 was \$.90.

The Company recognized \$86 of share-based expense in the first quarter of 2008 related to directors compensation.



#### 4. Loss per Common Share

Net loss per common share is calculated by dividing net loss by the weighted average number of shares outstanding during the period. Net loss per common share assuming dilution reflects per share amounts that would have resulted had the Company's dilutive outstanding stock options been converted to common stock. Restricted stock is considered outstanding on the date the stock becomes vested when computing net income (loss) per common share basic. Restricted stock, to the extent it is probable that the stock will become vested, is considered outstanding on the grant date when computing net income (loss) per common share assuming dilution. Stock options and unvested restricted shares totaling 320 and 211 for the 13 weeks ended March 29, 2008 and March 31, 2007, respectively, were considered anti-dilutive and excluded from the computation of common equivalent shares because the Company reported a net loss.

#### 5. Severance and Restructuring Costs

During the first quarter of 2007, the Company engaged Carl Marks Advisory Group LLC to identify and implement business improvements and operational changes. Restructuring activities initiated during 2007 included the announcement of the planned closing of the Company's distribution center located in Rogers, MN in late 2007 (with distribution activities to be transferred to the Company's distribution center located in Hagerstown, MD), the sale of the Company's sterling silver product line and closure of the Company's sterling silver manufacturing facility located in Pomona, NJ and changes in and consolidation of our management and operations structure (described as general restructuring below). The Company incurred \$9,540 of severance and restructuring costs related to these activities in 2007. These costs were included in the restructuring charges in the Condensed Consolidated Statement of Operations for 2007. For the 13 weeks ended March 29, 2008, the Company incurred an additional \$1,088 of severance and restructuring costs related to these activities.

The table below shows a reconciliation of the severance and restructuring reserve activity through the first quarter of 2008:

|                            | Plant and Distribution<br>Center Closings |         | General Restructuring |       | Total Reserves |
|----------------------------|---|---------|-----------------------|-------|----------------|
|                            | Severance                                 | Other   | Severance             | Other |                |
| Balance, December 29, 2007 | \$704                                     | \$267   | \$1,745               | \$40  | \$2,756        |
| Costs incurred             | 10  | 1,058   | 20                    |       | 1,088          |
| Payments and other         | (339)                                     | (1,126) | (1,015)               |       | (2,480)        |
| Balance, March 29, 2008    | \$375                                     | \$199   | \$750                 | \$40  | \$1,364        |

The total estimated costs expected to be incurred related to the plant and distribution center closings and the general restructuring that were initiated during 2007, including costs incurred during the 13 weeks ended March 29, 2008, were as follows:

| Total costs<br>expected | Costs Incurred                   | Cumulative through<br>March 29, 2008 |
|-------------------------|----------------------------------|--------------------------------------|
|                         | 13 weeks ended<br>March 29, 2008 |                                      |

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|  |          |         |          |
|--|----------|---------|----------|
| Plant and Distribution Center Closings | \$3,528  | \$1,068 | \$3,528  |
| General Restructuring                  | 7,100    | 20      | 7,100    |
|  | \$10,628 | \$1,088 | \$10,628 |

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The additional costs incurred during the 13 weeks ended March 29, 2008 with respect to Plant and Distribution Center closings were principally severance and exit costs associated with the closure of the Company's Rogers Distribution Center. The additional general restructuring costs related primarily to severance costs related to retail store closings.

These costs are allocable to reportable segments as follows:

|           | Total costs<br>expected | Costs Incurred<br>13 weeks ended<br>March 29, 2008 | Cumulative through<br>March 29, 2008 |
|-----------|-------------------------|--|--------------------------------------|
| Wholesale | \$542                   | \$   | \$542                                |
| Retail    | 1,213                   | 15   | 1,213                                |
| Direct    | 218                     | 5  | 218                                  |
| Corporate | 8,655                   | 1,068  | 8,655                                |
|           | \$10,628                | \$1,088  | \$10,628                             |

**6. Concentrations**

At March 29, 2008, one customer accounted for approximately 15% of the Company's total accounts receivable. For the 13 weeks ended March 29, 2008, this same customer accounted for approximately 14% of the Company's total net sales.

**7. Inventories**

Inventories were comprised of:

|                   |                      |                   |
|-------------------|----------------------|-------------------|
| March 29,<br>2008 | December 29,<br>2007 | March 31,<br>2007 |
|-------------------|----------------------|-------------------|

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|                   |          |          |          |
|-------------------|----------|----------|----------|
| Raw materials     | \$2,628  | \$2,655  | \$2,964  |
| Work-in-process   | 3,209    | 3,925    | 4,865    |
| Finished goods    | 86,871   | 77,835   | 88,381   |
| Total inventories | \$92,708 | \$84,415 | \$96,210 |

The Company terminated its precious metals consignment arrangement in the second quarter of 2007, at which time the Company purchased the remaining outstanding silver inventory balance at a cost of \$4,617. The Company sold its sterling silver product line and its entire related sterling silver inventory during the third quarter of 2007.

**8. Comprehensive Loss**

Comprehensive loss and its components, net of tax, were as follows:

|   | 13 weeks ended    |                   |
|---|-------------------|-------------------|
|   | March 29,<br>2008 | March 31,<br>2007 |
| Net loss  | \$ (9,051 )       | \$ (12,995 )      |
| Changes in cumulative foreign currency translation adjustment | 2                 | (14 )             |
| Adjustment to pension and postretirement plan liabilities     | (503 )            | (319 )            |
| Comprehensive loss  | \$ (9,552 )       | \$ (13,328 )      |

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**9. Trademarks and Other Intangible Assets**

Intangible assets, other than goodwill, are comprised of the following:

|  | March 29, 2008        |                          |            | December 29, 2007     |                          |            | March 31, 2007        |                          |            |
|--|-----------------------|--------------------------|------------|-----------------------|--------------------------|------------|-----------------------|--------------------------|------------|
|  | Gross carrying amount | Accumulated amortization | Net        | Gross carrying amount | Accumulated amortization | Net        | Gross carrying amount | Accumulated amortization | Net        |
| <b>Finite-life intangible assets</b>     |                       |                          |            |                       |                          |            |                       |                          |            |
| Customer relationships                   | \$ 15,300             | \$ (4,267 )              | \$ 11,033  | \$ 15,300             | \$ (3,854 )              | \$ 11,446  | \$ 15,300             | \$ (2,615 )              | \$ 12,685  |
| Favorable lease interests                | 2,542                 | (2,284 )                 | 258        | 2,542                 | (2,238 )                 | 304        | 2,542                 | (2,005 )                 | 537        |
| Non-compete agreements                   | 2,705                 | (2,505 )                 | 200        | 2,705                 | (2,471 )                 | 234        | 2,705                 | (2,365 )                 | 340        |
| <b>Indefinite-life intangible assets</b> |                       |                          |            |                       |                          |            |                       |                          |            |
| Trademarks                               | 20,547                | (9,056 )                 | 11,491     | 20,547                | (8,563 )                 | 11,984     | 20,547                | (6,985 )                 | 13,562     |
| Trademarks                               | 124,080               | (4,139 )                 | 119,941    | 124,080               | (4,139 )                 | 119,941    | 123,578               | (4,139 )                 | 119,439    |
| <b>Total Intangibles</b>                 | \$ 144,627            | \$ (13,195 )             | \$ 131,432 | \$ 144,627            | \$ (12,702 )             | \$ 131,925 | \$ 144,125            | \$ (11,124 )             | \$ 133,001 |

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During 2007, finalization of the purchase price allocation related to the Willitts acquisition resulted in an increase of \$127 to indefinite-lived trademarks and a decrease of \$127 to tangible assets. During 2007, the Company also paid or accrued additional earnout payments to Willitts for achieving certain performance thresholds. These earnout payments resulted in an increase in indefinite-lived trademarks of \$1,022.

During the second quarter of 2007, as part of the sale of certain of the Gorham sterling silver assets, the Company evaluated the Gorham trademark. Based on the results of this evaluation, the Company determined that \$647 of indefinite-life trademarks were to be included as part of the sale transaction that took place in the third quarter.

Intangible asset amortization expense for the 13 weeks ended March 29, 2008 was \$493 compared to \$573 for the 13 weeks ended March 31, 2007.

Expected future amortization expense for finite-lived intangible assets is as follows:

|                  |           |
|------------------|-----------|
| 2008 (full year) | \$ 1,938  |
| 2009             | 1,846     |
| 2010             | 1,560     |
| 2011             | 1,242     |
| Thereafter       | 5,398     |
|                  | \$ 11,984 |

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

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### 10. Debt

Debt and the average interest rate on debt outstanding are summarized as follows:

| March 29,<br>2008 |         | December 29,<br>2007 |         | March 31,<br>2007 |         |
|-------------------|---------|----------------------|---------|-------------------|---------|
| Total             | Current | Total                | Current | Total             | Current |

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|   |            |           | Non<br>current |            |           | Non<br>current |            |           | Non<br>current |
|---|------------|-----------|----------------|------------|-----------|----------------|------------|-----------|----------------|
| Revolving credit facility 7.50%   | \$ 37,322  | \$ 37,322 | \$             | \$ 8,938   | \$ 8,938  | \$             | \$ 61,351  | \$ 19,173 | \$ 42,178      |
| Note payable to Maryland Department of Business and Economic Development 3% | 150        |           | 150            | 150        |           | 150            | 150        | 150       |                |
| Note payable to the County Commissioners of Washington County, Maryland 0%  | 100        |           | 100            | 100        |           | 100            | 100        | 100       |                |
| Term loan facility 7.75%  | 99,250     | 1,250     | 98,000         | 99,500     | 1,250     | 98,250         | 47,450     | 1,000     | 46,450         |
| Total debt  | \$ 136,822 | \$ 38,572 | \$ 98,250      | \$ 108,688 | \$ 10,188 | \$ 98,500      | \$ 109,051 | \$ 20,423 | \$ 88,628      |

The note payable to the Maryland Department of Business and Economic Development is a conditional promissory note that accrues interest at 3% per year. The principal and interest payments were deferred until December 31, 2008 and thereafter are subject to multiple maturity dates determined by the Company's employment levels at the Hagerstown, MD distribution facility. The Company is also required to make a minimum capital investment to the distribution facility by December 31, 2008 in order to maintain this deferral status. The Company expects to meet the amended terms to allow for deferral of principal and interest payments through its next fiscal year. Accordingly, the note was classified as noncurrent long-term debt as of March 29, 2008.

The note payable to the County Commissioners of Washington County, Maryland is a conditional grant agreement that bears no interest charges. The principal payments were deferred until December 31, 2008 and thereafter are subject to multiple maturity dates determined by the Company's employment levels at the Hagerstown, MD distribution facility. The Company is also required to make a minimum capital investment to the distribution facility by December 31, 2008 in order to maintain this deferral status. The Company expects to meet the amended terms to allow for deferral of principal payments through its next fiscal year. Accordingly, the note was classified as noncurrent long-term debt as of March 29, 2008.

On February 9, 2007, the Company entered into waivers and amendments to its revolving credit facility and term loan credit facility (the credit facilities) in connection with the Company's noncompliance with certain financial covenants under the credit facilities for the period ended December 30, 2006. Pursuant to the waivers and amendments, the lenders granted the Company a limited waiver of noncompliance through and including April 30, 2007, and temporarily amended the agreements to adjust the leverage ratio and interest coverage ratio levels for the first quarter of 2007. In addition, the amendment to the term loan facility increased the applicable margin for loans by 0.25% per annum. As consideration for the amendments, the Company paid amendment fees of \$0.2 million.

On April 20, 2007, the Company completed the refinancing of its credit facilities by entering into amended and restated revolving and term loan facilities. The amended and restated revolving credit facility, which expires on April 20, 2012, provides for borrowings up to \$175 million, which may be in the form of letters of credit and revolving credit loans to be used for working capital and general corporate purposes. The amended and restated term loan facility, which expires on April 20, 2013, provides for term loans in the aggregate principal amount of up to \$100 million. The Company used the proceeds of the amended and restated term loan facility to refinance the \$47.4 million of term debt outstanding and \$42.2 million of the revolver debt outstanding at April 20, 2007, to pay \$1.2 million of accrued interest and fees payable under the existing credit facilities and to pay \$9.2 million of fees and expenses in connection with the refinancing.

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Total fees and expenses incurred by the Company in connection with the refinancing were \$9.7 million (inclusive of the \$9.2 million paid out of the proceeds of the amended and restated term loan facility), of which \$7.0 million was capitalized and \$2.7 million was included as loss on refinancing of debt during the second quarter of 2007 in accordance with EITF 98-14, *Debtor's Accounting for Changes in Line-of-Credit or Revolving-Debt Arrangements* ( EITF 98-14 ), and EITF 96-19, *Debtor's Accounting for a Modification or Exchange of Debt Instruments* ( EITF 98-19 ). Based on these same criteria, the Company recognized an additional \$3.2 million loss on refinancing of debt during the second quarter of 2007 to write-off portions of the previously capitalized loan costs.

Borrowings under the amended and restated revolving credit facility are subject to certain borrowing base limitations, and the Company's borrowing capacity fluctuates during the year based upon accounts receivable and inventory levels. As of March 29, 2008, the Company's borrowing capacity under the amended and restated revolving credit facility was \$67.6 million, of which \$21.1 million was available for additional borrowings or letters of credit at such date.

The amended and restated credit facilities are secured by a first-priority lien on substantially all of the real and personal property of the Company. In addition, the Company has pledged the common stock of its subsidiaries, direct and indirect, as collateral under the amended and restated credit facilities, and the Company and its material subsidiaries, direct and indirect, have guaranteed repayment of amounts borrowed under the amended and restated credit facilities.

The amended and restated revolving credit facility allows the Company to choose between two interest rate options in connection with its revolving credit loans. The interest rate options are the Alternate Base Rate (as defined) or the Adjusted LIBOR Rate (as defined) plus an applicable margin. The applicable margin ranges from 0% to 0.5% for Alternate Base Rate loans and from 1.75% to 2.25% for Adjusted LIBOR Rate loans. The amended and restated revolving credit facility also provides for commitment fees of 0.375% per annum on the daily average of the unused commitment.

The amended and restated term loan facility allows the Company to choose between two interest rate options in connection with its loans under the facility. The interest rate options are the Alternate Base Rate (as defined) or the Adjusted LIBOR Rate (as defined) plus an applicable margin. The applicable margin is 3.5% for Alternate Base Rate loans and 4.5% for Adjusted LIBOR Rate loans.

Under the amended and restated term loan facility, the Company is also obligated to make mandatory prepayments if certain events occur in the future such as certain asset sales, additional debt issuances, common and preferred stock issuances, and excess cash flow generation. Such prepayments will be applied to the term loan until it is paid in full, except for prepayments occurring upon the sale of designated revolving loan collateral, which will be applied to the revolving loan.

The amended and restated credit facilities contain customary financial conditions and covenants, including restrictions on additional indebtedness, liens, investments, capital expenditures, issuances of capital stock and dividends. The amended and restated credit facilities also require maintenance of minimum levels of fixed charge coverage and maximum levels of leverage, in each case at the end of each fiscal quarter. The minimum fixed charge coverage ratio (as defined within the credit facility agreements) requires the Company to maintain a minimum ratio of Consolidated EBITDA (as defined within the credit facility agreements) to Consolidated Fixed Charges (as defined within the credit facility agreements) over a 12-month period ending on each fiscal quarter. The maximum leverage ratio (as defined within the term credit facility agreement) requires the Company to maintain a maximum ratio of debt (as measured at the end of each fiscal quarter) to Consolidated EBITDA over a 12-month period ending on each fiscal quarter.

## 11. Benefit Plans

During the quarter ended September 29, 2007, the Company announced that it is discontinuing post-65 retiree medical and life insurance coverage for all current participants (except for eight retirees and their dependents which have individual agreements with the Company) effective September 1, 2007. In accordance with SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, the Company accounted for this discontinuation as a negative plan amendment, remeasured its obligation as of August 31, 2007, and reflected a negative prior service cost which is being amortized into net periodic benefit cost pursuant to the Company's historical accounting policy.

Components of net periodic benefit cost for the 13 weeks ended March 29, 2008 and March 31, 2007 were as follows:

|                                    | 13 weeks ended    |                   |                                     |                   |
|------------------------------------|-------------------|-------------------|-------------------------------------|-------------------|
|                                    | Pension Benefits  |                   | Medical and Life Insurance Benefits |                   |
|                                    | March 29,<br>2008 | March 31,<br>2007 | March 29,<br>2008                   | March 31,<br>2007 |
| Service cost                       | \$ 113            | \$                | \$                                  | \$                |
| Interest cost                      | 2,386             | 2,263             | 26                                  | 237               |
| Expected return on assets          | (2,870 )          | (2,667 )          |                                     |                   |
| Amortization of prior service cost |                   |                   | (345 )                              | (175 )            |
| Amortization of gain               | (444 )            | (298 )            | (41 )                               | (41 )             |
| Net periodic benefit cost          | \$ (815 )         | \$ (702 )         | \$ (360 )                           | \$ 21             |

## 12. Commitments and Contingencies

### *Legal Proceedings*

(A) In Re Tableware Antitrust Litigation In August 2004, plaintiffs purporting to represent a class of consumers who purchased tableware sold in the United States filed suit against Federated Department Stores, the May Department Stores Company, Waterford Wedgwood U.S.A. and Lenox, Incorporated ( "Lenox" ) in United States District Court for the Northern District of California. In November 2004, plaintiffs filed a consolidated amended complaint alleging that, for the period beginning at least as early as May 1, 2001, through the filing of the amended complaint on November 12, 2004, defendants violated Section 1 of the Sherman Act by conspiring to fix prices and to boycott sales to Bed, Bath & Beyond (hereinafter the "Action" ). Plaintiffs sought to recover an undisclosed amount of damages, trebled in accordance with antitrust laws, as well as costs, attorney's fees and injunctive relief.

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On February 22, 2007, without admitting any violation of any statute or law or any liability or wrongdoing whatsoever, Lenox entered into a settlement agreement with the plaintiff class representatives. Pursuant to the terms of the settlement agreement, Lenox has paid \$500 in return for which Lenox and its affiliates were completely released from any and all claims, demands and actions concerning the Action and any claims that could have been alleged in the Action. The court approved the settlement agreement by opinion and order dated November 25, 2007, by which the Action was dismissed with prejudice.

(B) Curiale v. Lenox Group Inc. On April 12, 2007, Amanda Curiale filed a complaint in the United States District Court for the Eastern District of Pennsylvania, which is a purported class action alleging that the Company willfully violated the Federal Fair and Accurate Credit Transactions Act ( FACTA ) by continuing to print after December 1, 2006 the expiration dates on receipts provided to debit card and credit cardholders transacting business with the Company (hereinafter the FACTA Litigation ). The Company understands that similar complaints have been filed against a large number of retailers. The plaintiff seeks, on behalf of herself and the class, statutory damages of not less than one hundred dollars and not more than one thousand dollars for each violation, as well as unspecified punitive damages, costs and attorneys' fees and a permanent injunction from further engaging in violations of FACTA.

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On September 20, 2007, the parties held an all-day mediation session and reached a tentative settlement which is subject to the parties signing a definitive settlement agreement and court approval. Under the terms of the settlement, Lenox denies all claims as to liability, damages, penalties, interest, fees, restitution and all other forms of relief sought in the FACTA Litigation. Pursuant to the terms of the proposed settlement, the Company will pay approximately \$128 for attorney's fees and costs, a charitable contribution and a plaintiff's incentive fee, and will provide participating claimants with a coupon off a future purchase or a free product through Company-operated retail stores. In return, the Company and its affiliates will be completely released from any and all claims, demands and actions concerning the FACTA Litigation and any claims that could have been alleged in the FACTA litigation.

(C) Period Design, Inc. v. D56, Inc. ( D56 ) D56 is a subsidiary of the Company. Plaintiff alleges a breach of contract claim and seeks compensatory damages based upon D56's alleged failure to pay royalties alleged to be due Period Design, Inc. on various products marketed and sold by D56, together with pre-judgment interest thereon. The matter was tried before the Minnesota State District Court (Hennepin County) from February 17 through February 28, 2008. The parties are in the process of filing post-trial submissions, and anticipate a decision by the Court in late May 2008. The Company believes that it has adequately accrued for liabilities related to this case.

In addition to the above actions, the Company is involved in various legal proceedings, claims and governmental audits in the ordinary course of its business. The Company believes it has meritorious defenses to all proceedings, claims and audits. Management believes the impact, if any, of these legal proceedings would not be material to the results of operations, financial position or cash flows of the Company.



### 13. Segments of the Company and Related Information

The Company has three reportable segments – Wholesale, Retail and Direct. Although the product produced and sold for each segment is similar, the types of customers for the product and the methods used to distribute the product are different. The segmentation of these operations also reflects how the Company’s chief executive officer currently reviews the results of these operations. Operating income (loss) for each operating segment includes specifically identifiable operating costs such as cost of sales and selling expenses. General and administrative expenses are generally not allocated to specific operating segments and are therefore reflected in the Corporate category. Other components of the statement of operations, which are classified below operating income (loss), are also not allocated by segment. In addition, the Company does not account for or report assets, capital expenditures or certain depreciation and amortization by segment. All transactions between operating segments have been eliminated and are not included in the following table.

|                          | 13 WEEKS<br>ENDED<br>MARCH 29,<br>2008 |   | % of net<br>sales | 13 WEEKS<br>ENDED<br>MARCH 31,<br>2007 |   | % of net<br>sales |
|--------------------------|--|---|-------------------|--|---|-------------------|
| <b>WHOLESALE:</b>        |  |   |                   |  |   |                   |
| Net sales                | \$44,810                               |   | 100               | \$50,295                               |   | 100               |
| Gross profit             | 20,719                                 |   | 46                | 18,630                                 |   | 37                |
| Selling expenses         | 8,795                                  |   | 20                | 8,233                                  |   | 16                |
| Restructuring charges    |  |   |                   | 601                                    |   | 1                 |
| Operating income         | 11,924                                 |   | 27                | 9,796                                  |   | 20                |
| <b>RETAIL:</b>           |  |   |                   |  |   |                   |
| Net sales                | \$9,194                                |   | 100               | \$16,353                               |   | 100               |
| Gross profit             | 4,356                                  |   | 47                | 4,726                                  |   | 29                |
| Selling expenses         | 6,655                                  |   | 72                | 8,094                                  |   | 50                |
| Restructuring charges    | 15                                     |   |                   | 353                                    |   | 2                 |
| Operating loss           | (2,314                                 | ) | (25               | (3,721                                 | ) | (23               |
| <b>DIRECT:</b>           |  |   |                   |  |   |                   |
| Net sales                | \$17,187                               |   | 100               | \$19,124                               |   | 100               |
| Gross profit             | 11,521                                 |   | 67                | 12,637                                 |   | 66                |
| Selling expenses         | 9,184                                  |   | 53                | 11,193                                 |   | 59                |
| Restructuring charges    | 5                                      |   |                   |  |   |                   |
| Operating income         | 2,332                                  |   | 14                | 1,444                                  |   | 8                 |
| <b>CORPORATE:</b>        |  |   |                   |  |   |                   |
| Unallocated net sales    | \$206                                  |   |                   | \$622                                  |   |                   |
| Unallocated G&A expenses | 21,483                                 |   |                   | 25,729                                 |   |                   |
| Restructuring charges    | 1,068                                  |   |                   | 3,837                                  |   |                   |
| Operating loss           | (22,345                                | ) |                   | (28,944                                | ) |                   |
| <b>CONSOLIDATED:</b>     |  |   |                   |  |   |                   |
| Net sales                | \$71,397                               |   | 100               | \$86,394                               |   | 100               |
| Operating loss           | (10,403                                | ) | (15               | (21,425                                | ) | (25               |

**14. Subsequent events**

On May 8, 2008, the Company was notified by the NYSE Regulation Inc. that the common stock of Lenox Group Inc. will be suspended prior to the market opening on Friday, May 16, 2008 because the Company had fallen below the New York Stock Exchange's continued listing standard regarding average global market capitalization over a consecutive 30 day trading period of not less than \$25 million. The NYSE has submitted an application to the U.S. Securities and Exchange Commission to delist the issue, which we expect to occur following completion of standard procedures.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**RESULTS OF OPERATIONS**

This Item should be read in conjunction with the Condensed Consolidated Financial Statements and the related notes, particularly Note 13, presented earlier in this Quarterly Report on Form 10-Q. Other components of the Condensed Consolidated Statement of Operations which are classified below Operating Income (i.e. interest expense, income tax expense (benefit), etc.) are not allocated by segment and are discussed separately.

*Comparison of Results of Operations for the Quarter Ended March 29, 2008 to the Quarter Ended March 31, 2007.*

Wholesale

Net sales decreased \$5.5 million, or 11%, in the first quarter of 2008, compared with the same period in 2007. The decrease is reflective of the current retail environment as well as a reduction in liquidation sales versus last year. Gorham sales decreased in part due to the sale of the sterling silver product line that occurred in 2007. Sales of Department 56 branded product increased year-over-year due to our decision to bring in inventory earlier than last year to fill orders that were not shipped until the second quarter of 2007.

Gross profit increased \$2.1 million in the first quarter of 2008 as compared to the first quarter of 2007. Gross profit as a percentage of net sales was 46% and 37% in the first quarter of 2008 and 2007, respectively. The increase in gross profit dollars and gross profit percentage was due primarily to a mix of higher gross margin products sold in the first quarter of 2008 as well as sourcing and Kinston factory improvements. Sales in the prior year's comparable quarter also included significant liquidation merchandise.

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Selling expenses were 20% of net sales in the first quarter of 2008 compared to 16% in the first quarter of 2007. The higher rate reflects slightly higher selling and advertising expense on a lower sales base.

Results in the first quarter of 2008 benefited by not recording any restructuring expense compared to \$0.6 million in 2007.

Operating income increased in the first quarter of 2008 by \$2.1 million as compared to the comparable period in 2007, primarily due to the improvement in gross margin as described above.

### Retail

Net sales decreased \$7.2 million, or 44%, in the first quarter of 2008 compared with the same period in 2007. This decrease was primarily due to the negative impact of a 38% reduction in same store sales. Sales in 2007 were driven by excessive sales price reductions to liquidate excess merchandise. A more normalized mix of first quality, go-forward and excess merchandise in 2008, resulted in lower sales with improved margins. In addition, the soft retail economic environment and lower outlet mall and store traffic were significant factors in the same store sales decrease. An average of five fewer retail stores in the first quarter of 2008 as compared to the comparable prior year period, also contributed to the decrease.

Gross profit decreased only \$0.4 million in the first quarter of 2008 compared to the first quarter of 2007 despite the significant sales volume decrease. Gross profit as a percentage of net sales was 47% in the first quarter of 2008 versus 29% in the first quarter of 2007. The increase in gross profit percentage was primarily due to a heavier mix of high gross margin first quality and go-forward merchandise sold in the first quarter of 2008 as compared to lower gross margin excess merchandise sold in the first quarter of 2007.

Selling expenses decreased \$1.4 million in the first quarter of 2008 compared to the same period in 2007, primarily as a result of fewer stores. Selling expenses increased as a percentage of net sales from 50% in the first quarter of 2007 to 72% in the first quarter of 2008. The higher expense rate reflects reduced operating expenses on a significantly smaller sales base.

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2008 results benefited by recording minimal restructuring expense in the quarter, compared to \$0.4 million in 2007, related to the closure of one retail store.

Operating loss was \$1.4 million less in the first quarter of 2008 as compared to the first quarter of 2007 due to the gross margin improvements.

### Direct

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Net sales decreased \$1.9 million or 10% in the first quarter of 2008 as compared to the same period in 2007. The decrease was primarily due to a planned decline in the direct mail business as a result of a decision to reduce promotion frequency to increase customer response rates to direct mail advertising campaigns. Lower catalog sales also contributed to the decrease. An increase in internet sales partially offset the decrease in sales.

Gross profit decreased \$1.1 million in the first quarter of 2008 as compared to the first quarter of 2007, due to the decrease in sales volume. Gross profit as a percentage of sales was 67% and 66% in the first quarter of 2008 and 2007, respectively. This increase in gross profit as a percentage of sales was primarily due to an improvement in merchandise mix.

Selling expenses decreased by \$2.0 million or 18% in the first quarter of 2008 compared to the same period in 2007. As a result, selling expense as a percentage of net sales decreased six percentage points from 59% in 2007 to 53% in 2008. This decrease in selling expense in 2008 as a percentage of net sales was primarily due to a planned decrease in advertising spending to eliminate programs with low customer response rates.

Operating income increased by \$0.9 million or 62% in the first quarter of 2008 compared to the same period in 2007 due primarily to lower selling expenses partially offset by the decrease in sales volume.

### Corporate

Net sales of \$0.2 million represents revenue from the licensing of the Lenox brand and were \$0.4 million lower in the first quarter of 2008 compared to the same period in 2007, which was largely timing related.

General and administrative expenses decreased by \$4.2 million or 17% in the first quarter of 2008 as compared to the same period in 2007. This decrease was primarily due to \$2.7 million in lower base and incentive compensation and \$0.5 million in pension and post retirement expense savings. An additional decrease of \$2.2 million resulted principally from reduced distribution costs, primarily the result of the Rogers warehouse closure, decreased variable costs due to the sales volume decline, lower executive management costs and various other cost reductions. These decreases were partially offset by a \$1.2 million increase in equity compensation expense in the first quarter of 2008 as compared to the first quarter of 2007. The first quarter of 2007 benefited from a reversal of equity compensation expense related to certain performance shares which did not re-occur in the first quarter of 2008.

Restructuring charges of \$1.1 million in the first quarter of 2008 were principally related to the closure of the Rogers, MN distribution center. Restructuring charges of \$3.8 million in 2007 were comprised of \$3.0 million in workforce and management severance expense and \$0.8 million associated with facility closures.

### Provision for Income Taxes

The effective income tax rate was 34% in the first quarter of 2008 compared to 46% in the first quarter of 2007. The higher 2007 effective income tax rate was principally due to the reversal of \$1.8 million of tax accruals as a result of the expiration of the applicable statute of limitations. The effective rate in 2008 was further reduced by the impact of the changes in the current year State tax positions.

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## SEASONALITY

The Company's business is highly seasonal. It has historically recorded its highest Wholesale segment sales during the third and fourth quarters of each year as Wholesale customers stock merchandise in anticipation of the holiday season. In addition, the Company records its highest Retail and Direct segment sales in the fourth quarter during the peak holiday shopping season. However, the Company can experience fluctuations in quarterly sales and related net income compared with the prior year due to the timing of receipt of product from suppliers and subsequent shipment of product from the Company to customers, as well as the timing of orders placed by customers. Due to the seasonality of segment sales as indicated above, the Company has historically operated at a loss during the first nine months of the fiscal year. The Company is not managed to maximize quarter-to-quarter results, but rather to achieve annual objectives designed to achieve long-term growth consistent with the Company's business strategy.

## LIQUIDITY AND CAPITAL RESOURCES

The Company's primary sources of cash are the funds generated from operations and its revolving credit facility, which is available for working capital and investment needs.

Consistent with customary practice in the giftware industry, the Company offers extended payment terms to some of its Wholesale customers. This practice has created significant working capital requirements as the Company uses cash to source inventory, but does not receive cash from its customers until the fourth quarter and early first quarter of the subsequent year, when the extended payment terms come due. Similarly, the Company's Retail and Direct segments create working capital requirements during the first nine months of the year with revenue and cash collections peaking during the holiday season in the fourth quarter and early first quarter of the subsequent year. The Company finances these working capital requirements with seasonal borrowings under its revolving credit facility. Cash collected in the fourth quarter and first quarter of the subsequent year is used to repay the seasonal borrowings.

The timing of cash payments to suppliers of inventory, the ability to ship inventory to its customers, and the timing of cash receipts from its customers will impact the Company's borrowing base capacity. The Company monitors accounts receivable, inventory levels and shipment of products on a routine basis to ensure adequate borrowing base capacity exists to fund its current working capital needs.

The Company believes its current cash and liquidity available under its amended and restated revolving credit facility will be sufficient to finance working capital needs, capital expenditures and contractual obligations for the remainder of fiscal 2008, based on current forecasted levels of operations.

## Cash Flows from Operations

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In the first three months of 2008, operations consumed \$28.2 million in cash compared to \$10.7 million in the first three months of 2007. The operating cash flow in the first three months of both years reflects the seasonal working capital requirements of the business as noted above. The \$17.5 million increase in cash used in operating activities was principally due to higher working capital requirements in the first three months of 2008 compared to the same period in 2007. In 2007, the liquidation of excess merchandise provided cash. This liquidation event was not repeated in 2008 resulting in an increase in working capital. Lower cash collections from outstanding accounts receivable in the first quarter of 2008 compared to the first quarter of 2007, as a result of lower sales, also contributed to the year-on-year increase in working capital.

### **Cash Flows from Investing Activities**

In the first three months of 2008, the Company used \$2.5 million of net cash in investing activities, due principally to capital investments in distribution and manufacturing operations, as well as technology infrastructure. For the first three months of 2007, investing activities used \$2.1 million in cash related principally to capital investment.

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### **Cash Flows from Financing Activities**

The Company had net borrowings of \$28.4 million under its revolving credit facility to fund operations in the first three months of 2008 compared to borrowings of \$13.8 million for the same period in 2007. The \$14.6 million increase in borrowings resulted principally from higher working capital needs as discussed above.

On February 9, 2007, the Company entered into waivers and amendments to its revolving credit facility and term loan credit facility (the credit facilities) in connection with the Company's noncompliance with certain financial covenants under the credit facilities for the period ended December 30, 2006. Pursuant to the waivers and amendments, the lenders granted the Company a limited waiver of noncompliance through and including April 30, 2007, and temporarily amended the agreements to adjust the leverage ratio and interest coverage ratio levels for the first quarter of 2007. In addition, the amendment to the term loan facility increased the applicable margin for loans by 0.25% per annum. As consideration for the amendments, the Company paid amendment fees of \$0.2 million.

On April 20, 2007, the Company completed the refinancing of its credit facilities by entering into amended and restated revolving and term loan facilities. The amended and restated revolving credit facility, which expires on April 20, 2012, provides for borrowings up to \$175 million, which may be in the form of letters of credit and revolving credit loans to be used for working capital and general corporate purposes. The amended and restated term loan facility, which expires on April 20, 2013, provides for term loans in the aggregate principal amount of up to \$100 million. The Company used the proceeds of the amended and restated term loan facility to refinance the \$47.4 million of term debt outstanding and \$42.2 million of the revolver debt outstanding at April 20, 2007, to pay \$1.2 million of accrued interest and fees payable under the existing credit facilities and to pay \$9.2 million of fees and expenses in connection with the refinancing.

Total fees and expenses incurred by the Company in connection with the refinancing were \$9.7 million (inclusive of the \$9.2 million paid out of the proceeds of the amended and restated term loan facility), of which \$7.0 million was capitalized and \$2.7 million was included as loss on

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refinancing of debt during the second quarter of 2007 in accordance with EITF 98-14, *Debtor's Accounting for Changes in Line-of-Credit or Revolving-Debt Arrangements* ( EITF 98-14 ), and EITF 96-19, *Debtor's Accounting for a Modification or Exchange of Debt Instruments* ( EITF 96-19 ). Based on these same criteria, the Company recognized an additional \$3.2 million of loss on early extinguishment of debt during the second quarter of 2007 to write-off portions of the previously capitalized loan costs.

Borrowings under the amended and restated revolving credit facility are subject to certain borrowing base limitations, and the Company's borrowing capacity fluctuates during the year based upon accounts receivable and inventory levels. As of March 29, 2008, the Company's borrowing capacity under the amended and restated revolving credit facility was \$67.6 million, of which \$21.1 million was available for additional borrowings or letters of credit at such date.

The amended and restated credit facilities are secured by a first-priority lien on substantially all of the real and personal property of the Company. In addition, the Company has pledged the common stock of its subsidiaries, direct and indirect, as collateral under the amended and restated credit facilities, and the Company and its material subsidiaries, direct and indirect, have guaranteed repayment of amounts borrowed under the amended and restated credit facilities.

The amended and restated revolving credit facility allows the Company to choose between two interest rate options in connection with its revolving credit loans. The interest rate options are the Alternate Base Rate (as defined) or the Adjusted LIBOR Rate (as defined) plus an applicable margin. The applicable margin ranges from 0% to 0.5% for Alternate Base Rate loans and from 1.75% to 2.25% for Adjusted LIBOR Rate loans. The amended and restated revolving credit facility also provides for commitment fees of 0.375% per annum on the daily average of the unused commitment.

The amended and restated term loan facility allows the Company to choose between two interest rate options in connection with its loans under the facility. The interest rate options are the Alternate Base Rate (as defined) or the Adjusted LIBOR Rate (as defined) plus an applicable margin. The applicable margin is 3.5% for Alternate Base Rate loans and 4.5% for Adjusted LIBOR Rate loans.

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Under the amended and restated term loan facility, the Company is also obligated to make mandatory prepayments if certain events occur in the future such as certain asset sales, additional debt issuances, common and preferred stock issuances, and excess cash flow generation. Such prepayments will be applied to the term loan until it is paid in full, except for prepayments occurring upon the sale of designated revolving loan collateral, which will be applied to the revolving loan.

The amended and restated credit facilities contain customary financial conditions and covenants, including restrictions on additional indebtedness, liens, investments, capital expenditures, issuances of capital stock and dividends. The amended and restated credit facilities also require maintenance of minimum levels of fixed charge coverage and maximum levels of leverage, in each case at the end of each fiscal quarter. The Company was in compliance with all financial covenants as of March 29, 2008.

**OFF-BALANCE SHEET ARRANGEMENTS**

The Company does not have off-balance sheet arrangements.

**CONTRACTUAL OBLIGATIONS**

As of March 29, 2008, the Company is obligated to make cash payments in connection with its debt obligations, operating leases, purchase commitments, capital leases, environmental remediation costs and royalty guarantees in the amounts listed below. The contractual obligation table below excludes the Company's FIN 48 liabilities of \$1,308 because the Company cannot make a reasonable estimate of the timing of the related cash payment. The Company has no unrecorded obligations other than the items noted in the following table:

|  | Payments due (in thousands) |           |           |           |          |            | Total      |
|--|-----------------------------|-----------|-----------|-----------|----------|------------|------------|
|  | 2008 (Q2-Q4)                | 2009      | 2010      | 2011      | 2012     | Thereafter |            |
| Revolving Credit Facility <sup>1,2</sup> | \$ 37,322                   | \$        | \$        | \$        | \$       | \$         | \$ 37,322  |
| Long-term Debt <sup>2</sup>              | 1,000                       | 1,000     | 1,000     | 1,000     | 750      | 94,750     | 99,500     |
| Operating Leases                         | 10,474                      | 13,259    | 11,809    | 10,367    | 8,852    | 44,314     | 99,075     |
| Purchase Commitments <sup>3</sup>        | 37,724                      |           |           |           |          |            | 37,724     |
| Capital leases                           | 4                           |           |           |           |          |            | 4          |
| Environmental Costs <sup>4</sup>         | 293                         | 214       | 209       | 205       | 290      | 973        | 2,184      |
| Royalty Guarantees <sup>5</sup>          | 126                         | 262       | 223       | 25        |          |            | 636        |
| Total                                    | \$ 86,943                   | \$ 14,735 | \$ 13,241 | \$ 11,597 | \$ 9,892 | \$ 140,037 | \$ 276,445 |

<sup>1</sup> The Company's borrowings under the revolving credit facility are classified as current liabilities on the Consolidated Balance Sheets in accordance with Emerging Issues Task Force Issue No. 95-22, *Balance Sheet Classification of Borrowings Outstanding under Revolving Credit Agreements That Include both a Subjective Acceleration Clause and a Lock-Box Arrangement*.

<sup>2</sup> In addition to the principal payments on debt included in the summary of significant contractual obligations, the Company will incur interest expense on outstanding variable rate debt. All amounts outstanding under the revolving and term loan credit facilities are variable interest rate debt with weighted average interest rates as of March 29, 2008 of 5.12 % and 7.75 %, respectively.

<sup>3</sup> The Company is committed to pay suppliers of product under the terms of open purchase orders issued in the normal course of business.

<sup>4</sup> The Company is responsible for the cleanup and/or monitoring of two environmental sites located in New Jersey.

<sup>5</sup> The Company is committed to pay licensors under the terms of license agreements entered into in the normal course of business.

Other than noted in the above table, there were no other material changes in contractual obligations from those disclosed in the Company's 2007 Form 10-K.

**CRITICAL ACCOUNTING POLICIES**

There were no material changes in the Company's critical accounting policies from those described in the Company's 2007 Annual report of Form 10-K.



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## FORWARD-LOOKING STATEMENTS

Any conclusions or expectations expressed in, or drawn from, the statements in this filing concerning matters that are not historical corporate financial results are forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, that involve risks and uncertainties. These statements are based on management's estimates, assumptions and projections as of today and are not guarantees of future performance. Such risks and uncertainties that could affect performance include, but are not limited to, the ability of the Company to: (1) integrate certain Lenox and Department 56 operations, including the consolidation and transfer of all financial responsibilities and controls into one company-wide finance department to be located in the Company's Bristol, Pennsylvania offices; (2) achieve revenue or cost synergies; (3) generate cash flow to pay off outstanding debt and remain in compliance with the terms of its new credit facilities; (4) successfully complete its operational improvements, including improving inventory management and making the supply chain more efficient; (5) retain key employees; (6) maintain and develop cost effective relationships with foreign manufacturing sources; (7) maintain the confidence of and service effectively key wholesale customers; (8) manage currency exchange risk and interest rate changes on the Company's variable debt; (9) identify, hire and retain quality designers, sculptors and artistic talent to design and develop products which appeal to changing consumer preferences; (10) successfully implement a strategic alternative; (11) forecast and react to consumer demand in a challenging economic environment; and (12) manage litigation risk in a cost effective manner. Actual results may vary materially from forward-looking statements and the assumptions on which they are based. The Company undertakes no obligation to update or publish in the future any forward-looking statements. Also, please read the bases, assumptions and factors set out in Part II, Item 1A of this Form 10-Q and in Item 1A in the Company's 2007 Form 10-K filed under the Securities Exchange Act of 1934, all of which is incorporated herein by reference and applicable to the forward-looking statements set forth herein.

### Item 3. Quantitative and Qualitative Disclosures about Market Risk

There has been no significant change in the Company's exposure to market risk since the end of fiscal 2007. The Company's market risks relate primarily to changes in interest rates and currency exchange rates. See Item 7A in the Company's 2007 Form 10-K for a discussion of these market risks.

### Item 4. Controls and Procedures

#### Disclosure Controls and Procedures

Lenox Group Inc. management is responsible for establishing and maintaining effective disclosure controls and procedures, as defined under Rule 13a-15(e) of the Securities Exchange Act of 1934. As of the end of the period covered by this report, the Company performed an

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evaluation, under the supervision and with the participation of the Company's management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures. Based upon, and as of the date of that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures were effective to ensure that information required to be disclosed by the Company in the reports that it files or submits to the Securities and Exchange Commission under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

### Internal Controls Over Financial Reporting

No changes were made to the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) during the last fiscal quarter that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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## **PART II OTHER INFORMATION**

### **Item 1. Legal Proceedings**

(A) In Re Tableware Antitrust Litigation In August 2004, plaintiffs purporting to represent a class of consumers who purchased tableware sold in the United States filed suit against Federated Department Stores, the May Department Stores Company, Waterford Wedgwood U.S.A. and Lenox, Incorporated ( "Lenox" ) in United States District Court for the Northern District of California. In November 2004, plaintiffs filed a consolidated amended complaint alleging that, for the period beginning at least as early as May 1, 2001, through the filing of the amended complaint on November 12, 2004, defendants violated Section 1 of the Sherman Act by conspiring to fix prices and to boycott sales to Bed, Bath & Beyond (hereinafter the "Action" ). Plaintiffs sought to recover an undisclosed amount of damages, trebled in accordance with antitrust laws, as well as costs, attorney's fees and injunctive relief.

On February 22, 2007, without admitting any violation of any statute or law or any liability or wrongdoing whatsoever, Lenox entered into a settlement agreement with the plaintiff class representatives. Pursuant to the terms of the settlement agreement, Lenox has paid \$500 in return for which Lenox and its affiliates were completely released from any and all claims, demands and actions concerning the Action and any claims that could have been alleged in the Action. The court approved the settlement agreement by opinion and order dated November 25, 2007, by which the Action was dismissed with prejudice.

(B) Curiale v. Lenox Group Inc. On April 12, 2007, Amanda Curiale filed a complaint in the United States District Court for the Eastern District of Pennsylvania, which is a purported class action alleging that the Company willfully violated the Federal Fair and Accurate Credit Transactions Act ( FACTA ) by continuing to print after December 1, 2006 the expiration dates on receipts provided to debit card and credit cardholders transacting business with the Company (hereinafter the FACTA Litigation ). The Company understands that similar complaints have been filed against a large number of retailers. The plaintiff seeks, on behalf of herself and the class, statutory damages of not less than one hundred dollars and not more than one thousand dollars for each violation, as well as unspecified punitive damages, costs and attorneys' fees and a permanent injunction from further engaging in violations of FACTA.

On September 20, 2007, the parties held an all-day mediation session and reached a tentative settlement which is subject to the parties signing a definitive settlement agreement and court approval. Under the terms of the settlement, Lenox denies all claims as to liability, damages, penalties, interest, fees, restitution and all other forms of relief sought in the FACTA Litigation. Pursuant to the terms of the proposed settlement, the Company will pay approximately \$128 for attorney's fees and costs, a charitable contribution and a plaintiff's incentive fee, and will provide participating claimants with a coupon off a future purchase or a free product through Company-operated retail stores. In return, the Company and its affiliates will be completely released from any and all claims, demands and actions concerning the FACTA Litigation and any claims that could have been alleged in the FACTA litigation.

(C) Period Design, Inc. v. D56, Inc. ( D56 ) D56 is a subsidiary of the Company. Plaintiff alleges a breach of contract claim and seeks compensatory damages based upon D56's alleged failure to pay royalties alleged to be due Period Design, Inc. on various products marketed and sold by D56, together with pre-judgment interest thereon. The matter was tried before the Minnesota State District Court (Hennepin County) from February 17 through February 28, 2008. The parties are in the process of filing post-trial submissions, and anticipate a decision by the Court in late May 2008. The Company believes that it has adequately accrued for liabilities related to this case.

In addition to the above actions, the Company is involved in various legal proceedings, claims and governmental audits in the ordinary course of its business. The Company believes it has meritorious defenses to all proceedings, claims and audits. Management believes the impact, if any, of these legal proceedings would not be material to the results of operations, financial position or cash flows of the Company.

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#### **Item 1A. Risk Factors**

In addition to the risk discussed below and other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A of the Company's 2007 Form 10-K, which could have a material impact on the Company's business, financial condition or results of operations. The risks described below and in the Company's 2007 Form 10-K are not the only risks facing the Company. Additional risks and uncertainties not presently known to the Company or that the Company currently believes to be immaterial may also adversely affect the Company's business, financial condition or results of operations.

*If the common stock of Lenox Group Inc. is delisted from the NYSE, it could affect its market price and tradability and reduce our ability to raise capital.*

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As a result of our inability to meet an average global market capitalization standard to maintain the listing of our common stock on the NYSE, our common stock will be suspended from trading on the NYSE effective May 16, 2008. An application has been submitted by the NYSE to the U.S. Securities and Exchange Commission to delist our common stock from the NYSE. If delisting occurs, it could be more difficult to buy or sell our common stock and the price of our stock could decline. Delisting could also affect our ability to raise capital

### Item 4. Submission of Matters to a Vote of Security Holders

None

### Item 6. Exhibits

- 3.1 Restated Certificate of Incorporation of the Company. (Incorporated herein by reference to Exhibit 3.1 of the Company's Annual Report on Form 10-K for the fiscal year ended December 31 2005. SEC File No. 1-11908.)
- 3.2 Certificate of Designations of Series A Junior Participating Preferred Stock (Incorporated herein by reference to Exhibit A of Exhibit 4.1 of the Company's Current Report on Form 8-K, filed January 14, 2008, SEC File No. 1-11908)
- 3.3 Restated By-Laws of the Company. (Incorporated herein by reference to Exhibit 3.3 of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005. SEC File No. 1-11908).
- 4.1 Specimen Form of Company's Common Stock Certificate (Incorporated herein by reference to Exhibit 4.1 of the Company's Annual Report on Form 10-K for the fiscal year ended December 29, 2007, SEC File No. 1-11908).
- 4.2 Rights Agreement, dated as of January 14, 2008 between Lenox Group Inc. and Wells Fargo Bank, National Association, as Rights Agent, including the form of Certificate of Designations of Series A Junior Participating Preferred Stock, the forms of Right Certificate, Assignment and Election to Purchase, and the Summary of Rights attached thereto as Exhibits A, B and C, respectively. (Incorporated herein by reference to Exhibit 4.1 of the Company's Current Report on Form 8-K, filed on January 14, 2008, SEC File No. 1-11908.)
- 10.1 Amendment No. 3 dated January 28, 2008 to the Consulting Agreement dated January 4, 2007, by and between the Company and Carl Marks Advisory Group LLC. (Incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed on January 31, 2008, SEC File No. 1-11908).
- 10.2 Form of Retention Agreement. (Incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K, filed on January 31, 2008, SEC File No. 1-11908).
- 10.3 Form of Amendment No. 1 to the Letter Agreement dated as of November 9, 2007, by and between the Company and Fred Spivak. (Incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K, filed on January 31, 2008, SEC File No. 1-11908).
- 10.4 Form of Amendment to Restricted Stock Agreement for Directors (Incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed on March 28, 2008, SEC File No. 1-11908).

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- 11.1 Computation of net loss per share.\*
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.\*
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.\*
- 32.1 Officer Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.\*

\* Filed herewith

Management contract or compensatory plan

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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.

LENOX GROUP INC.

Date: May 8, 2008

/s/ Marc L. Pfefferle  
Marc L. Pfefferle  
Chief Executive Officer  
(Principal Executive Officer)

Date: May 8, 2008

/s/ Fred Spivak  
Fred Spivak  
Chief Financial Officer  
Chief Operating Officer  
(Principal Financial Officer)

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**EXHIBIT INDEX**

| <b><u>Exhibit<br/>Number</u></b> | <b><u>Description</u></b>  |
|----------------------------------|--|
| 11.1                             | Computation of net loss per share  |
| 31.1                             | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2                             | Certification of Chief Financial Officer pursuant to Section 302of the Sarbanes-Oxley Act of 2002  |
| 32.1                             | Officer Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002                    |

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