

DEPARTMENT 56 INC - 10-K

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

/X/ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 (Fee Required) For the fiscal year ended
December 29, 2001

OR

/ / TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 (No Fee Required)
For the transition period from . to

Commission file number 1-11908

DEPARTMENT 56, 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
(Address of
principal executive
offices)

55344
(Zip Code)

(952) 944-5600
(Registrant's telephone number, including area code)

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

| Title of each class | Name of each exchange on which registered |
|---|--|
| ----- Common Stock, par value \$.01 per share | ----- New York Stock Exchange |

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

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 /x/ No / /

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

The aggregate market value of the voting stock held by non-affiliates of the registrant was approximately \$166,731,061 as of March 18, 2002 (based on the closing price of consolidated trading in the Common Stock on that date as published in Yahoo! Finance). For purposes of this computation, shares held by affiliates and by directors and officers of the registrant have been excluded. Such exclusion of shares held by directors and officers is not intended, nor shall it be deemed, to be an admission that such persons are affiliates of the registrant.

Number of Shares of Common Stock, par value \$.01 per share, outstanding as of March 18, 2002: 12,936,682.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's definitive Proxy Statement for the 2002 Annual Meeting of Stockholders filed with the Securities and Exchange Commission concurrently with this Form 10-K (the "2002 Proxy Statement") are incorporated by reference in Part III.

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PART I

ITEM 1. BUSINESS

General:

Department 56, Inc. (including its direct and indirect subsidiaries, "Department 56" or "the Company") is a leading designer, distributor, wholesaler and retailer of fine quality collectibles and other giftware products sold through gift, home accessory, specialty retailers and department stores. The Company is best known for its Village Series of collectible, handcrafted, lighted ceramic and porcelain houses, buildings and related accessories in The Original Snow Village (r) Collection and The Heritage Village Collection (r) as well as its extensive line of holiday, special occasion and home decorative products, including its Snowbabies TM collectible porcelain figurines.

The Company was incorporated in Delaware in 1992 to hold the equity of a Minnesota corporation formed in 1984 under the name "Department 56, Inc.," which has since changed its name to "D 56, Inc." and has continued as the Company's principal operating subsidiary.

The Company seeks businesses that reinforce synergies, allows it to complement its internal product development and accelerates its penetration into new markets and new channels. In the third quarter of fiscal year 2001, the Company completed its acquisition of the business of Axis Corporation (the "Geppeddo Business" or "Geppeddo"), a designer and importer of porcelain and vinyl dolls, doll accessories and plush items sold through customized seasonal kiosks under the Geppeddo (r) brand. The Company believes opportunities exist to enhance and expand the selling season of Geppeddo through the addition of new products. The Company's focused, multi-faceted strategy is intended to position Department 56 as the premier giftware and collectibles company for the future.

The Company sells its products through several channels including approximately 13,600 wholesale customers, three Company-owned retail stores and approximately 370 seasonal stores and kiosks located throughout the U. S. and Canada.

Wholesale Operations:

The Company sells its products to retailers through its wholesale operations which consist of eight corporate showrooms and three independently operated wholesale showrooms, covering the major giftware market areas in the U.S. and Canada. In addition, the Company markets and sells through giftware trade shows throughout the U. S. and Canada.

The Company's domestic wholesale operations serve an extensive base of retailers primarily consisting of small, independent gift stores. The Company's principal customers (accounting for approximately 90% of its sales) are approximately 13,500 independent gift retailers across the United States. These retailers include approximately 1,550 independently owned Gold Key and Showcase Dealers, who receive special recognition and qualify for improved sales terms by satisfying certain requirements, such as maintaining the Company's products on display in an attractive setting for at least six months. Approximately 8% of the Company's sales are made to department stores and mail order houses. No single account represented more than 3% of the Company's sales in fiscal 2001. The Company provides volume discounts to its customers with respect to most of its products. The Company has generally had only limited sales outside the United States. International sales, which are made primarily in Canada, were less than 3% of the Company's sales in fiscal 2001.

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As part of the Company's strategy of selective distribution, only approximately 5,050 retailers receive the Company's Village Series and/or Snowbabies products (which the Company sometimes refers to as its "collectible" products and/or lines). Certain of the Company's limited edition and year of production lighted Village Series and Snowbabies products are sold on allocation. Under its allocation practice, the Company specifies certain items among its principal Village Series and Snowbabies product lines, which it does not allow customers to purchase in unlimited quantities. The Company periodically evaluates and adjusts its distribution network and reviews its policies with a view of optimizing both the Company's distribution strategy and the store-level operations of its independent retailers. While the Company remains committed to selective distribution for the Village Series and Snowbabies products, the Company plans to continue to seek complementary retailers (at times, with a less-than-full offering of the Company's product assortment) to maintain sufficient market presence to build consumer awareness, interest and trial of the Company's products.

Over the past two years, the Company's principal customers have decreased in number by approximately 4,000, or 23%. Similarly, customers who sell the Company's Village Series and/or Snowbabies products have decreased by approximately 850, or 14%. The Company believes the decrease in customers and related decrease in sales is due to several factors including: the problems experienced during the implementation of the Company's enterprise-wide computer system, and an overall weakness in the economy which has forced some of the Company's customers to go out of business. The Company has enacted programs to curb the decline in customers and wholesale sales experienced over the past two years including implementing new customer ordering and shipping programs. The Company is also strengthening its sales management team, working to refine its product development process, improving the gift and decorating appeal of its product, and broadening the seasonal coverage of its product lines to drive sales growth.

The Company continues to market and advertise its products to retailers principally through giftware trade shows, brochures and trade journals. The Company provides merchandising and product information to its customers distributing collectible products through its business-to-business Internet site ("WIN" TM or Web Information Network TM). The Company continues to expand

the use of WIN in order to develop greater merchandising effectiveness and operational efficiencies for its customers and the Company. The Company also extends its consumer advertising through use of cooperative advertising with its Gold Key Dealers using various media formats.

Retail Operations:

The Company sells its products to existing and potentially new consumers through its retail operations which include three retail stores located in tourist destinations at the Mall of America, outside Minneapolis, Minnesota; Aladdin Casino and Resort in Las Vegas, Nevada; and Downtown Disney (r) in Anaheim, California. During 2001, the Company also operated ten seasonal stores under the name "Holidays by Department 56" and through the Geppeddo business distributed Geppeddo (r) brand products through customized

seasonal kiosks located in approximately 360 major malls and shopping centers throughout the U.S. and Canada. The Company will continue to consider the addition of more corporate owned stores and continue to expand seasonal kiosks during fiscal 2002.

The Company markets and advertises to existing and potentially new consumers through seasonal advertisements in magazines and newspapers, brochures, point-of-sale information and booth presence at major collectibles expos. In addition, the Company publishes and sells Fifty-Six, TM a quarterly consumer magazine

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which contains product-related articles and description of its product lines, and maintains an interactive consumer information center on an Internet web site (www.department56.com). Department 56 maintains a toll-free telephone line for collector and consumer questions and participates in collector conventions. The Company also operates a collectors' club to which consumers of its Snowbabies product line may subscribe for exclusive product offerings and information.

Products:

Village Series Products - Department 56 is best known for its Village Series, which includes several different series of collectible, handcrafted, lighted ceramic and porcelain houses, buildings and related accessories that depict nostalgic scenes. The Company introduces new pieces, limited edition pieces, figurines and other accessories each year to complement and provide continuity to the collections. To allow for these new introductions and to keep each series appropriately balanced, the Company has traditionally retired a number of its existing pieces from production each year. Retirement decisions are based on management's judgment as to, among other things, expected consumer demand, whether a piece continues to fit the evolving design characteristics of a series, manufacturing considerations and, importantly, injecting an element of surprise. In 2001, to build upon the Company's success with its Halloween lighted pieces, the Company also introduced new lighted pieces and accessories for a variety of holidays and special days, including St. Patrick's Day, Easter and Fourth of July. The Company will continue to consider the introduction of new lighted pieces and accessories for other holidays and special day themes.

Village Accessories - Department 56 also produces a range of accessories for its Villages Series product, including figurines, vehicles, landscaping, lighting and other decorative items. The sale of accessories for its Village Series is an important part of the Company's strategy to encourage the continued purchase of its products. Accessories allow collectors and consumers to refresh their collections by changing their

displays and by creating personalized settings. Many of the accessories can be used interchangeably between the various series, although certain accessories are designed uniquely for specific series.

General Giftware - The Company offers a wide range of other decorative giftware and home accessory items including: the Company's Snowbabies and Snowbunnies (r) figurines; holiday and seasonal decorative items; as well as

tableware. Under the Geppeddo (r) brand, the Company also offers a range of porcelain and vinyl dolls, doll accessories and plush items. General Giftware product lines are product lines developed around either a seasonal or unique design theme. The Company generally introduces new products and refines its product offerings twice a year. The Company currently maintains an aggregate of approximately 3,800 stock keeping units, of which approximately 3,100 are General Giftware products.

Design and Production:

The Company has an ongoing program of new product development. Each year, the Company introduces new products in its existing product lines and also develops entirely new design concepts. The Company endeavors to develop new products which, although not necessarily similar to the products currently marketed by the Company, fit the Company's quality, creativity and productivity requirements.

Department 56 believes that its relationships with its manufacturers, and the quality of their craftsmanship, provide a competitive advantage and are a significant contributor to the Company's success. The Company imports most of its products from the Pacific Rim, primarily the People's Republic of China, Taiwan (Republic of China) and the Philippines. The Company also imports a small percentage of its products from

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India, and Europe (primarily Germany, Poland and Czechoslovakia). During fiscal 2001, the Company imported products from approximately 184 independent manufacturing sources, some of which are represented by independent trading companies. The Company's single largest manufacturing source represented approximately 23% of the Company's imports in fiscal 2001. The Company's emphasis on high-quality craftsmanship at affordable prices limits the sources from which the Company chooses to obtain products. The Company has long-standing relationships with the majority of its manufacturers (many for 20 years or more) and may purchase (typically on a year-to-year basis) a manufacturer's entire output for a year. As a result of these relationships, the Company has experienced a low turnover of its manufacturing sources.

The design and manufacture of the Company's Village Series products are complex processes. The path from initial conception of the design idea to market introduction typically takes approximately 12 months, although the Company continues to investigate processes intended to reduce this time. Products other than the Company's collectibles lines can generally be introduced within a few months after a decision is made to produce the product. The Company's Village Series products are principally composed of ceramic and porcelain clays and the Company's other products are designed in a variety of media, including paper mache, acrylic and resin.

Distribution and Systems:

The products sold by the Company to its retail customers in the United States and Canada are generally shipped by ocean freight from abroad and then by rail to the Company's distribution center located within the northwest quadrant of the Minneapolis/St. Paul metropolitan area. Similarly, the products sold by Geppeddo are shipped to a distribution

center in Salt Lake City, Utah. Shipments from the Company to its wholesale customers are handled primarily by United Parcel Service or commercial trucking lines.

The Company's systems maintain order processing from the time a product enters the Company's system through shipping and ultimate payment collection from its wholesale customers. The Company also uses handheld optical scanners and bar coded labels in accepting orders at wholesale showrooms throughout the United States. In addition, computer and communication software systems allow on-line information access between the Company's headquarters and its showrooms, and those systems generally provide direct linkage with the Company's field salesforce. These systems also provide a range of order and product information and ordering capabilities to customers subscribing to WIN.

The Company's retail systems also monitor and transmit to the Company on a daily basis the POS (point of sales) data for the Company's three retail stores and department totals for the ten seasonal stores.

Backlog and Seasonality:

The Company receives products, pays its suppliers and ships products throughout the year, although historically the majority of shipments have occurred in the second and third quarters of each year as retailers stock merchandise in anticipation of the winter holiday season. The Company continues to ship wholesale merchandise until mid-December each year. Accordingly, the Company's wholesale backlog typically is lowest at the beginning of January. As of December 29, 2001, Department 56 had unfilled wholesale orders of approximately \$4.7 million compared to \$4.6 million at December 30, 2000. All of the backlog is scheduled to be shipped to customers during the current fiscal year. Approximately 7% to 8% of

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the Company's total annual customer orders have been cancelled in each of the last three years for a number of reasons, including inventory shortages and customer credit considerations.

Department 56 historically experiences a significant seasonal pattern in its working capital requirements and operating results. During the first quarter of each of the last three years due to the timing of the wholesale trade shows early in the calendar year and retailers' desire for early product delivery of collectible products in particular, the Company has received approximately 61% to 68% of its annual wholesale orders for such year. The Company offers extended payment terms to many of its wholesale customers for seasonal merchandise. Accordingly, the Company collects a substantial portion of its accounts receivable for its wholesale customers in the fourth and first quarters. The Company can experience fluctuations in quarterly wholesale sales due to the timing of receipt of product from suppliers and subsequent shipment of product from the Company to wholesale customers, as well as the timing of orders placed by wholesale customers. Due to the seasonal pattern of shipping and accounts receivable collection, the Company generally has had greater working capital needs in its second and third quarters and has experienced greater cash availability in its fourth and first quarters. The Company typically finances its operations through net cash and marketable securities balances, internally generated cash flow and short-term seasonal borrowings. As a result of the Company's sales pattern, the Company has historically recorded a substantial portion of its wholesale revenues in its second and third quarters. In addition, the Company recognizes the majority of its retail sales in the fourth quarter during the peak holiday shopping season.

Trademarks and Other Proprietary Rights:

The Company owns 38 U.S. trademark registrations and has pending U.S. trademark applications with respect to certain of its logos and brand names. In addition, the Company from time to time registers selected trademarks in certain foreign countries.

Department 56 regards its trademarks and other proprietary rights as valuable assets and intends to maintain and renew its trademarks and their registrations and vigorously defend against infringement. The U.S. registrations for the Company's trademarks are currently scheduled to expire or be cancelled at various times between 2002 and 2011, but can be maintained and renewed provided that the marks are still in use for the goods and services covered by such registrations. The Company has historically renewed its trademarks and expects to continue to renew them in the future.

Competition:

Department 56 competes generally for the disposable income of consumers and, in particular, with other producers of fine quality collectibles, specialty giftware and home decorative accessory products. The collectibles area, in particular, is affected by changing consumer tastes and interests. The giftware industry is highly competitive, with a large number of both large and small participants. The Company's competitors distribute their products through independent gift retailers, department stores, mass market and specialty chain stores, televised home shopping networks, Internet commerce and mail order houses, or through direct response marketing. The Company believes that the principal elements of competition in the specialty giftware industry are product design and quality, product and brand-name loyalty, product display and price. The Company believes that its competitive position is enhanced by a variety of factors, including the innovativeness, quality and enduring themes of the Company's products, its reputation among retailers and consumers, its in-house design expertise, its sourcing and marketing capabilities and the pricing of its

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products. Some of the Company's competitors, however, have greater financial resources and a wider range of products than the Company.

Restrictions on Imports:

The Company does not own or operate any manufacturing facilities and imports most of its products from manufacturers in the Pacific Rim, primarily the People's Republic of China, Taiwan and the Philippines. The Company also imports a small percentage of its products from sources in India, and occasionally from sources in Europe (primarily Germany, Poland and Czechoslovakia).

The Company's ability to import products and thereby satisfy customer orders is affected by the availability of, and demand for, quality production capacity abroad. The Company competes with other importers of specialty giftware products for the limited number of foreign manufacturing sources which can produce detailed, high-quality products at affordable prices. Foreign manufacturing and procurement of imports is subject to the following inherent risks: fluctuations in currency exchange rates; economic and political instability; cost fluctuations and delays in transportation; restrictive actions by governments; nationalizations; the laws and policies of the U.S. affecting importation of goods (including duties, quota and taxes); and foreign trade and tax laws. The Company's costs could be adversely affected if the currencies of other countries in which the Company sources product appreciate significantly relative to the U.S. dollar. Moreover, the Company cannot predict what relevant political, legal or regulatory changes may occur or the type or amount of any financial impact on the Company such changes may have in the future.

The Company's products are subject to customs duties and regulations pertaining to the importation of goods, including requirements for the marking of certain information regarding the country of origin on the Company's products. In its ordinary course of business, the Company may be involved in disputes with the U.S. Customs Service regarding the amount of duty to be paid, the value of merchandise to be reported or other customs regulations with respect to certain of the Company's imports, which may result in the payment of additional duties and/or penalties, or which may result in the refund of duties to the Company.

In fiscal 2001, approximately 87% of the Company's imports were manufactured in the People's Republic of China ("China"), and the Company anticipates that such percentage will hold constant or increase for the foreseeable future. China has joined the World Trade Organization and been accorded permanent "Normal Trade Relations" status by the U.S. government.

However, various commercial and legal practices widespread in China, including the handling of intellectual properties, as well as certain political and military actions taken or suggested by China, are under review by the U.S. government. China, moreover, has been designated a Country of Particular Concern ("CPC") pursuant to the International Religious Freedom Act of 1998 ("IRFA"). The IRFA enumerates several specific retaliatory actions which may be taken by the U.S. government, none of which the Company believes would have a material impact on its business. The IRFA, however, also accords the President broad discretion in fashioning other or additional actions and, due to the breadth of the presidential powers under the IRFA, the Company is unable to predict what, if any, action the President could consider taking in the future.

Accordingly, the ability to continue to conduct business with vendors located in China is subject to political uncertainties, the financial impact of which the Company is unable to estimate. To the extent China may have its exports or transaction of business with U.S. persons subject to political retaliation, the cost of Chinese imports could increase significantly and/or the ability to import goods from China may be

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materially impaired. In such an event, there could be an adverse effect on the Company until alternative arrangements for the manufacture of its products were obtained on economic, production and operational terms at least as favorable as those currently in effect.

Employees:

As of March 6, 2002, the Company had 353 full-time employees in the United States, eight in Canada and one in Taiwan. Of the total workforce, approximately 100 are engaged in wholesale sales representation throughout North America and 38 are associated with the Company's retail operations. The Company's 59 U.S.-based warehouse, shipping and receiving personnel employed as of that date are represented by Local Union No. 638 of the Teamsters under a contract that expires on December 31, 2004. The Company believes that its labor relations are good and has never experienced a work stoppage.

Environmental Matters:

The Company is subject to various federal, state and local laws and regulations governing the use, discharge and disposal of hazardous materials. Compliance with current laws and regulations has not had and is not expected to have a material adverse effect on the Company's financial condition. It is possible, however, that environmental issues may arise in the future that the Company cannot currently predict.

ITEM 2. PROPERTIES

The Company owns or leases buildings that contain approximately 688,800 square feet of floor space, as identified in the following table. The Company's primary corporate showroom, executive offices and creative center are located in Eden Prairie, Minnesota. The office building in Eden Prairie, Minnesota is owned by the Company and the remainder of the Company's facilities are leased. In addition, the Company leases space for approximately 370 seasonal stores and kiosks located throughout the U.S. and Canada during the peak holiday shopping season.

| Facility | Location | Lease Expiration Date | Approximate Number of Square Feet |
|---|-----------------------|-----------------------------|---|
| Executive Offices, Creative Center and Primary Corporate Showroom | Eden Prairie, MN | Company-owned facility | 66,400 |
| Warehouse and Distribution Facility | Rogers, MN | 6-30-2010 | 333,700 |
| Offices, Warehouse and Distribution Facility | Salt Lake City, UT | 6-30-2002 | 54,400 |
| Showroom | Atlanta, GA | 12-31-2006 | 12,946 |
| Showroom | Chicago, IL | 11-30-2006 | 7,480 |
| Showroom | Dallas, TX | 1-31-2007 | 9,143 |
| Showroom | Los Angeles, CA | 12-31-2002 | 6,600 |
| Showroom | New York, NY | 12-31-2005 | 10,300 |
| Showroom | Fairfax, VA | 12-31-2003 | 4,300 |
| Showroom | Bedford, MA | 6-30-2004 | 1,800 |
| Showroom | Columbus, OH | 5-31-2009 | 2,485 |
| Retail Store | Bloomington, MN | 4-30-2009 | 10,200 |
| Retail Store | Las Vegas, NV | 10-31-2010 | 3,100 |
| Retail Store | Anaheim, CA | 3-31-2012 | 6,250 |

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ITEM 3. LEGAL PROCEEDINGS

On September 14, 2000, Arthur Andersen LLP filed a lawsuit against the Company in The Fourth Judicial District, State of Minnesota alleging breach of contract in connection with computer system implementation work and seeking \$0.6 million plus interest and legal costs. On March 1, 2001, the Company filed suit in The Circuit Court of Baltimore City, State of Maryland against Andersen Worldwide Societe Cooperative and W. Robert Grafton alleging fraud, conspiracy, tortuous conduct and breach of contract in connection with the computer systems implementation work solicited and performed by Arthur Andersen LLP. On July 12, 2001, the Company dismissed all claims brought against W. Robert Grafton. On March 1, 2002, the Company received net proceeds (before taxes) of \$11.0 million in settlement of all parties' claims.

On March 5 and March 9, 2001 lawsuits seeking unspecified compensatory damages were filed against the Company and its Chairwoman and Chief Executive Officer Susan E. Engel, in the United States District Court for the District of Minnesota purportedly on behalf of the class of persons who purchased Department 56 common stock during the period February 24, 1999 through April 26, 2000. The purported class action lawsuits allege the Company and its Chairwoman violated federal securities laws by making a series of false and misleading statements concerning the Company's financial statements. On August 29, 2001, the Court consolidated all the actions into In Re Department 56, Inc. Securities Litigation. Oral arguments are scheduled to be heard in connection with the Company's Motion to Dismiss on March 22, 2002. The Company has tendered a claim for coverage to the underwriters of its Directors and Officers Liability Insurance, and believes that such insurance will respond to the coverage claim net of a \$250,000 deductible. The Company intends to defend this lawsuit vigorously, but the Company is unable to predict the outcome of these proceedings or to reasonably estimate the impact, if any, that the ultimate resolution of these matters will have on the Company's results of operations, financial position or cash flows.

In the ordinary course of its business, the Company is involved in various additional legal proceedings, claims and governmental audits, in addition to the above lawsuits. The Company believes it has meritorious defenses to all proceedings, claims and audits. While management cannot predict the eventual outcome of these proceedings, 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.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of the Company's security holders during the last quarter of the year ended December 29, 2001.

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PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Department 56's common stock is currently traded on the New York Stock Exchange (NYSE) under the symbol "DFS." The table below sets forth the high and low sales prices as reported by the NYSE.

| | High | Low |
|----------------|-------|-------|
| ----- | | |
| FISCAL 2001 | | |
| First quarter | 13.06 | 8.01 |
| Second quarter | 8.98 | 7.41 |
| Third quarter | 11.10 | 6.20 |
| Fourth quarter | 9.71 | 5.90 |
| FISCAL 2000 | | |
| First quarter | 23.69 | 12.88 |
| Second quarter | 15.69 | 7.44 |
| Third quarter | 14.94 | 8.75 |
| Fourth quarter | 15.88 | 10.00 |

The Company has not declared or paid dividends on its Common Stock. The

Company does not anticipate paying dividends in the foreseeable future. As a holding company, the ability of the Company to pay cash dividends will depend upon the receipt of dividends or other payments from its subsidiaries.

As of March 18, 2002, the number of holders of record of the Company's Common Stock was 984.

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ITEM 6. SELECTED FINANCIAL DATA

FIVE-YEAR SUMMARY (In thousands, except per share amounts)
YEARS ENDED DECEMBER 29, 2001, DECEMBER 30, 2000, JANUARY 1, 2000,
JANUARY 2, 1999, AND JANUARY 3, 1998

The following selected consolidated financial data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations, and the Consolidated Financial Statements and related Notes thereto, included elsewhere herein.

| | December 29, 2001 | December 30, 2000 | January 1, 2000 | January 2, 1999 | January 3, 1998 |
|--|-------------------------|-------------------------|-----------------------|-----------------------|--------------------|
| ----- | | | | | |
| STATEMENTS OF INCOME | | | | | |
| Net sales | \$ 200,447 | \$ 234,058 | \$255,528 | \$251,153 | \$ 225,566 |
| Cost of sales | 89,845 | 109,522 | 113,475 | 108,570 | 100,110 |
| | ----- | ----- | ----- | ----- | ----- |
| Gross profit | 110,602 | 124,536 | 142,053 | 142,583 | 125,456 |
| Operating expenses: | | | | | |
| Selling, general and administrative | 68,589 | 74,166 | 61,542 | 56,648 | 49,772 |
| Amortization of goodwill, trademarks and other intangibles | 5,189 | 5,486 | 5,145 | 4,926 | 4,577 |
| | ----- | ----- | ----- | ----- | ----- |
| Total operating expenses | 73,778 | 79,652 | 66,687 | 61,574 | 54,349 |
| | ----- | ----- | ----- | ----- | ----- |
| Income from operations | 36,824 | 44,884 | 75,366 | 81,009 | 71,107 |
| Other expense (income): | | | | | |
| Interest expense | 7,036 | 11,729 | 6,719 | 4,817 | 4,362 |
| Gain on sale of aircraft ² | - | - | - | - | (2,882) |
| Impairment and equity in losses of minority investment ³ | 3,304 | 427 | - | - | - |
| Other, net | (662) | (809) | (153) | (397) | (1,086) |
| | ----- | ----- | ----- | ----- | ----- |
| Income before income taxes | 27,146 | 33,537 | 68,800 | 76,589 | 70,713 |
| Provision for income taxes | 11,184 | 12,744 | 26,144 | 30,073 | 27,932 |
| | ----- | ----- | ----- | ----- | ----- |
| Net income | \$ 15,962 | \$ 20,793 | \$ 42,656 | \$ 46,516 | \$ 42,781 |
| | ----- | ----- | ----- | ----- | ----- |
| Net income per | | | | | |

| | | | | | | | | | | |
|---|----|---------|----|---------|----|---------|----|---------|----|---------|
| common share - basic | \$ | 1.24 | \$ | 1.47 | \$ | 2.48 | \$ | 2.49 | \$ | 2.06 |
| Net income per common share - assuming dilution | \$ | 1.24 | \$ | 1.47 | \$ | 2.45 | \$ | 2.45 | \$ | 2.05 |
| BALANCE SHEET DATA | | | | | | | | | | |
| Working capital | \$ | 62,894 | \$ | 65,581 | \$ | 32,289 | \$ | 29,276 | \$ | 40,857 |
| Total assets | | 279,821 | | 277,808 | | 287,108 | | 233,283 | | 259,695 |
| Total debt | | 85,000 | | 105,000 | | 102,500 | | 20,000 | | 40,000 |
| Total stockholders' equity ⁴ | | 156,747 | | 140,575 | | 152,924 | | 178,735 | | 186,655 |

- 1 The years ended January 2, 1999, January 1, 2000, December 30, 2000 and December 29, 2001 were 52-week periods, and the year ended January 3, 1998 was a 53-week period.
- 2 During December 1997, the Company exercised its purchase option under an aircraft lease agreement and subsequently sold the aircraft at its appraised value to a former officer of the Company for \$8,567, recognizing a gain of \$2,882.
- 3 During 2001, the Company recognized a \$3.0 million impairment of the Company's minority investment in 2-Day Designs, Inc. given continued deterioration in the U.S. home furnishings market. The impairment charge taken reduced the carrying value of the Company's minority investment to zero.
- 4 The Company has not declared or paid dividends on its Common Stock. The Company does not anticipate paying dividends in the foreseeable future. As a holding company, the ability of the Company to pay cash dividends will depend upon the receipt of dividends or other payments from its subsidiaries.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(In millions, except per share amounts)

The following discussion of the results of operations and financial condition should be read in conjunction with the Department 56, Inc. Consolidated Financial Statements and related Notes thereto, included elsewhere herein.

| | 2001 | | 2000 | | 1999 | |
|--|----------------------|------|----------------------|------|----------------------|------|
| | Percent of Net Sales | | Percent of Net Sales | | Percent of Net Sales | |
| | Dollars | | Dollars | | Dollars | |
| Net sales | \$ 200.4 | 100% | \$ 234.1 | 100% | \$ 255.5 | 100% |
| Gross profit | 110.6 | 55 | 124.5 | 53 | 142.1 | 56 |
| Selling, general and administrative expenses | 68.6 | 34 | 74.2 | 32 | 61.5 | 24 |
| Amortization of | | | | | | |

| | | | | | | |
|---|------|----|------|----|------|----|
| goodwill, trademarks and other intangibles | 5.2 | 3 | 5.5 | 2 | 5.2 | 2 |
| Income from operations | 36.8 | 18 | 44.9 | 19 | 75.4 | 29 |
| Interest expense | 7.0 | 4 | 11.7 | 5 | 6.7 | 3 |
| Other, net | 2.6 | 1 | (.4) | - | (.2) | - |
| Income before income taxes | 27.1 | 14 | 33.5 | 14 | 68.8 | 27 |
| Provision for income taxes | 11.2 | 6 | 12.7 | 5 | 26.1 | 10 |
| Net income | 16.0 | 8 | 20.8 | 9 | 42.7 | 17 |
| Net income per common share assuming dilution | 1.24 | | 1.47 | | 2.45 | |

COMPARISON OF RESULTS OF OPERATIONS 2001 TO 2000

Net Sales

Net sales decreased \$33.7 million, or 14%, from \$234.1 million in 2000 to \$200.4 million in 2001. The decrease in sales was principally due to a decrease in wholesale sales to independent gift retailers ("wholesale customers"), partially offset by an increase in retail sales. The Company has enacted programs to curb the decline in wholesale sales experienced over the past two years including implementing new customer ordering and shipping programs. The Company is also strengthening its sales management team, working to refine its product development process, improving the gift and decorating appeal of its product, and broadening the seasonal coverage of its product lines in order to drive sales growth.

Wholesale sales decreased \$50.1 million, or 22%, from \$231.2 million in 2000 to \$181.1 million in 2001. This decrease was due to lower volume sales to existing wholesale customers as well as sales to fewer wholesale customers in 2001 than in 2000. The decrease in customers was principally due to the problems experienced during the implementation of the Company's enterprise-wide computer system and an overall weakness in the economy which has forced some of the Company's customers to go out of business. The decrease in sales was partially offset by the impact of a customer appreciation discount that the Company offered on orders taken during the first quarter of 2000 and higher charges for product claims in 2000. Product claims have returned to normal levels during 2001. Wholesale sales of the Company's Village Series products decreased \$39.9 million, or 27%, while sales of General Giftware products decreased \$10.2 million, or 13% between the two periods. Village Series products represented 61% of the Company's sales during 2001 versus 65% during 2000.

Retail sales increased \$16.5 million from \$2.9 million in 2000 to \$19.4 million in 2001 principally due to the Company's acquisition of Geppeddo during the third quarter of 2001 (see Note 8 to the Consolidated

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Financial Statements). Geppeddo is a designer and specialty retailer of porcelain dolls, doll accessories and plush items, which are marketed under the brand name Geppeddo. (r) Retail sales also increased due to the Company opening its third "full-line" Department 56-branded retail store as well as testing ten Department 56-branded seasonal stores during the peak holiday shopping season.

Gross Profit

Gross profit as a percentage of net sales was 53% and 55% in 2000 and 2001,

respectively. Excluding the impact of the customer appreciation discount and the higher charges for product claims, gross profit as a percent of sales would have been approximately 56% in 2000. The decrease in gross profit as a percentage of net sales during 2001 compared to this adjusted gross profit as a percentage of net sales for 2000 was primarily the result of higher charges recorded to provide for excess inventories and a shift in product mix toward general giftware as noted above.

Selling, General and Administrative Expenses

Selling, general and administrative expenses decreased \$5.6 million, or 8%, between 2000 and 2001. Selling, general and administrative expenses as a percentage of net sales was approximately 32% in 2000 and 34% in 2001. In 2000, the Company recorded higher than normal bad debt costs as a result of the problems experienced during the implementation of the Company's new enterprise-wide computer system beginning in early 1999, as previously communicated. Excluding the impact on net sales of the customer appreciation discount and the higher charges for product claims and the impact on selling, general and administrative expense from higher bad debt costs, selling, general and administrative expenses as a percentage of net sales would have been approximately 28% in 2000.

The increase in selling, general and administrative expenses as a percentage of net sales in 2001 compared to the adjusted percentage in 2000 is principally due to an increase in retail store operations resulting from the acquisition of Geppeddo, the Company opening its third retail store, consumer research and the testing of ten seasonal stores during the peak holiday shopping season. Retail net sales, which have higher selling, general and administrative expenses as a percentage of net sales than wholesale net sales, represented 10% of total net sales in 2001 compared to 1% in 2000. Selling, general and administrative expense as a percentage of net sales was also higher in 2001 due to the decrease in wholesale sales. Many of the Company's wholesale operating expenses such as rent and labor do not vary directly with net sales. As a result, wholesale operating expenses were not reduced proportionately with the decrease in wholesale net sales.

Income from Operations

Income from operations decreased \$8.1 million, or 18%, from 2000 to 2001 due to the factors described above. Operating margins decreased from 19% of net sales in 2000 to 18% of net sales in 2001. Excluding the impact of the customer appreciation discount and the higher charges for product claims and bad debts, income from operations would have been approximately 26% of net sales in 2000.

Interest Expense

Interest expense decreased \$4.7 million, or 40%, between 2000 and 2001 principally due to decreased borrowings under the Company's credit facilities as a result of improved cash collections, lower inventory balances, and higher cash balances at the beginning of 2001. Interest expense also decreased due to lower interest rates paid by the Company in 2001.

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Other, net

Other expense increased \$3.0 million from 2000 to 2001 principally due to a \$3.0 million impairment of the Company's minority investment in 2-Day Designs, Inc. given continued deterioration in the U.S. home furnishings market. The impairment charge recorded reduces the carrying value of the Company's minority investment to zero. The Company has not guaranteed any

debt obligations of 2-Day Designs, Inc.

Provision for Income Taxes

The effective income tax rate was 38% and 41% during 2000 and 2001, respectively. The effective income tax rate in 2001 was higher primarily because the Company recognized no tax benefit associated with its impairment charge of 2-Day Designs, Inc. (see Note 5 to the Consolidated Financial Statements). This increase was partially offset by a \$1.0 million tax benefit that the Company recorded related to prior year tax accruals that were no longer needed.

COMPARISON OF RESULTS OF OPERATIONS 2000 TO 1999

Net Sales

Net sales decreased \$21.4 million, or 8%, from \$255.5 million in 1999 to \$234.1 million in 2000. The decrease in sales was principally due to a decrease in sales volume of approximately \$12.6 million, or 5%, the impact of a customer appreciation discount that the Company offered on orders taken during the first quarter of 2000 of approximately \$6.3 million, or 2%, and an increase in the amount provided for product claims. The increase in the amount provided for product claims was primarily the result of a \$6.5 million charge taken during the first quarter of 2000. The offer of the customer appreciation discount to affirm returning customer relationships and the \$6.5 million charge taken for returned product were each a result of the problems experienced during the implementation of the Company's new enterprise-wide information system beginning in early 1999, as previously communicated. Sales of Village Series products decreased \$17.9 million, or 11%, while sales of General Giftware products decreased \$3.5 million, or 4% between the two periods. Village Series products represented 65% of the Company's sales in 2000 versus 67% in 1999.

Gross Profit

Gross profit as a percentage of net sales was 56% and 53% in 1999 and 2000, respectively. Excluding the impact of the customer appreciation discount and the increase in the amount provided for product claims, gross profit as a percent of sales would have been approximately 56% during both 1999 and 2000.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased \$12.6 million, or 21%, between 1999 and 2000. The increase is principally due to an increase in the amount provided for bad debts, an increase in depreciation and expenses related to the Company's continued investment in its business-to-business internet site and its new distribution center, an increase in expenses related to the Company's launching of its new business-to-business extranet, and an increase in other administrative expenses. The increase in the provision for bad debts was primarily due to a \$5.5 million charge taken during the first quarter of 2000 as a result of the problems experienced during the implementation of the Company's new enterprise-wide information system beginning in early 1999, as previously communicated. These increases were principally offset by a decrease in marketing expense, a decrease in commission expense, and acquisition costs existing in 1999 but

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not in 2000. Selling, general and administrative expenses as a percentage of sales was 24% and 32% during 1999 and 2000, respectively. Excluding the impact of the customer appreciation discount and increased provisions for returned product and bad debts, selling, general and administrative

expenses as a percentage of sales would have been approximately 28% in 2000.

Income from Operations

Income from operations decreased \$30.5 million, or 40%, from 1999 to 2000 due to the factors described above. Operating margins decreased from 29% of net sales in 1999 to 19% of net sales in 2000. Excluding the impact of the customer appreciation discount and the increased provisions for product claims and bad debts, income from operations would have been 26% of net sales in 2000.

Interest Expense

Interest expense increased \$5.0 million, or 75%, between 1999 and 2000 principally due to increased borrowings under the Company's credit facilities in 2000 and increased interest rates paid by the Company. Additional borrowings were required as a result of slower cash collections and share repurchases.

Provision for Income Taxes

The effective income tax rate was 38.0% during 1999 and 2000.

SEASONALITY

Historically, due to the timing of wholesale trade shows early in the calendar year, the Company has received the majority of its total annual wholesale customer orders during the first quarter of each year. The Company entered 61% and 68% of its total net annual wholesale customer orders during 2001 and 2000, respectively, during the first quarter of each of those years. Cancellations of total annual wholesale customer orders were approximately 8% and 7% in 2001 and 2000, respectively. Orders not shipped in a particular year, net of cancellations, are carried into backlog for the following year and have historically been orders for Spring and Easter products. The Company's backlog of wholesale customer orders was \$4.7 million and \$4.6 million at December 29, 2001 and December 30, 2000, respectively.

The Company receives products, pays its suppliers and ships products throughout the year, although historically the majority of wholesale shipments occur in the second and third quarters as retailers stock merchandise in anticipation of the holiday season. As a result of this seasonal pattern, the Company generally records its highest wholesale sales during the second and third quarters of each year. However, the Company can experience fluctuations in quarterly wholesale 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 wholesale customers, as well as the timing of orders placed by wholesale customers. In addition, the Company recognizes the majority of its retail sales in the fourth quarter during the peak holiday shopping season. 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.

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| 2001 | | | | | 2000 | | | | |
|------|------|------|------|-------|------|------|------|------|-------|
| 1st | 2nd | 3rd | 4th | | 1st | 2nd | 3rd | 4th | |
| Qtr. | Qtr. | Qtr. | Qtr. | Total | Qtr. | Qtr. | Qtr. | Qtr. | Total |

| | | | | | | | | | | |
|---|---------|--------|--------|--------|---------|---------|--------|--------|--------|---------|
| Wholesale customer orders entered ¹ | \$110.4 | \$50.7 | \$20.3 | \$ 1.0 | \$182.4 | \$162.4 | \$48.1 | \$28.8 | \$ 0.4 | \$239.7 |
| Net sales - wholesale | 28.7 | 54.3 | 58.5 | 39.5 | 181.0 | 42.8 | 59.7 | 71.5 | 57.2 | 231.2 |
| Net sales - retail | 0.4 | 0.9 | 1.6 | 16.5 | 19.4 | 0.2 | 0.3 | 0.5 | 1.9 | 2.9 |
| Net sales - total | 29.1 | 55.2 | 60.1 | 56.0 | 200.4 | 43.0 | 60.0 | 72.0 | 59.1 | 234.1 |
| Gross profit | 15.8 | 31.3 | 33.0 | 30.5 | 110.6 | 21.4 | 33.5 | 40.3 | 29.3 | 124.5 |
| Selling, general and administrative expenses | 14.8 | 15.3 | 16.6 | 21.9 | 68.6 | 23.2 | 16.1 | 16.2 | 18.7 | 74.2 |
| Amortization of goodwill, trademarks and other intangibles | 1.4 | 1.3 | 1.3 | 1.2 | 5.2 | 1.4 | 1.4 | 1.4 | 1.4 | 5.5 |
| (Loss) income from operations | (0.4) | 14.7 | 15.2 | 7.4 | 36.8 | (3.1) | 16.1 | 22.7 | 9.2 | 44.9 |
| Net (loss) income | (1.4) | 8.0 | 6.5 | 2.9 | 16.0 | (3.2) | 8.3 | 12.0 | 3.6 | 20.8 |
| Net (loss) income per common share assuming dilution ² | (.11) | .62 | .50 | .22 | 1.24 | (0.21) | 0.58 | 0.85 | 0.28 | 1.47 |

1 Customer orders entered are orders received and approved by the Company, net of any cancellation for various reasons including credit considerations, inventory shortages, and customer requests.

2 See Note 11 to the Consolidated Financial Statements.

LIQUIDITY AND CAPITAL RESOURCES

Net cash provided by operating activities decreased \$4.7 million, or 8%, from \$61.6 million in 2000 to \$56.9 million in 2001 principally due to the decrease in net sales which resulted in a decrease in net income in 2001 and higher cash collections in 2000 as a result of the higher than normal accounts receivable balances at the end of 1999. This decrease was partially offset by an increase in cash due to lower inventory and higher payable balances in 2001.

Consistent with customary practice in the giftware industry, the Company offers extended accounts receivable terms to many of its wholesale customers. This practice has typically created significant working capital requirements in the second and third quarters for which the Company has generally financed with internally generated cash flow and seasonal borrowings. The Company's cash and cash equivalents balances peak during the first quarter of the subsequent year, following the collection of accounts receivable with extended payment terms due in November and December.

Accounts receivable, net of reserves, which principally consists of wholesale trade receivables, decreased by 36%, from \$37.0 million at December 30, 2000 to \$23.6 million at December 29, 2001. The decrease in accounts receivable was principally due to a decrease in wholesale sales from 2000 to 2001 and improved cash collections. Management believes there is adequate provision for any doubtful accounts receivable and product claims that may arise.

Inventories decreased from \$15.7 million at December 30, 2000 to \$11.2 million at December 29, 2001. The decrease in inventories was principally due to additional write-downs related to excess inventories and the Company's initiative to reduce inventory levels through better inventory planning and more efficient product flow through the Company's distribution center. The decrease in inventory was partially offset by \$2.8 million of additional inventory on hand at the end of 2001 as a result of the Geppeddo acquisition.

Capital expenditures were \$2.9 million, \$7.1 million and \$16.3 million in 2001, 2000 and 1999, respectively. Capital expenditures in 2000 and 1999 included \$3.3 million and \$7.7 million, respectively, for information systems principally related to the Company's implementation of its integrated computer systems. The Company expects capital expenditures in 2002 to be at or below its 2002 depreciation.

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During the third quarter of 2001, the Company completed its \$9.7 million acquisition of Geppeddo, a privately held designer, importer and specialty retailer based in Salt Lake City whose products, primarily porcelain dolls, doll accessories and plush items, are marketed under the brand name Geppeddo. (r) The Geppeddo business operates customized kiosks located in approximately 360 major malls and shopping centers throughout the United States and Canada during the peak holiday shopping season. The acquisition gives the Company additional differentiated and branded products, and access to a new channel of distribution. The high quality and creativity of Geppeddo's products and strength of the Geppeddo (r) brand complement the reputation of Department 56 for quality, branded product lines. The Company sees the potential to expand upon this brand and distribution channel with new concepts designed to enhance and lengthen the selling season of the acquired business. The founders and entire management team of the acquired business are continuing in their positions. Revenue generated by Geppeddo in 2001 was approximately \$12.0 million since the acquisition date. The selling shareholders of the acquired business have the ability to earn up to an additional \$12.0 million of cash consideration if certain pre-specified financial performance measures are attained as measured annually over a three-year period concluding February 29, 2004.

During January 2000, the Company completed a \$4.0 million strategic minority investment in 2-Day Designs, Inc., a manufacturer and marketer of high quality accent furniture and wooden accessories sold primarily through furniture, home furnishings, and catalog retailers principally in the United States. The transaction was accounted for under the equity method of accounting. During the quarter ended September 29, 2001, the Company recognized a \$3.0 million impairment of the Company's minority investment in 2-Day Designs, Inc. given continued deterioration in the U.S. home furnishings market. The impairment charge recorded reduced the carrying value of the Company's minority investment to zero. The Company has not guaranteed any debt obligations of 2-Day Designs, Inc.

During 1999, the Company acquired substantially all of the assets of the independent sales representative organizations that represented the Company's products in Massachusetts and several other eastern states, Minnesota and several other midwestern states, and Texas and several surrounding southern states. The cost of these acquisitions was \$4.0 million.

In April 1999, the Company executed a lease for a new distribution center in Minnesota. The lease provides for a 10-year term, with options to renew the lease, as well as to expand and/or acquire the facility. During 2000, the Company consolidated its two existing distribution centers and storage facility into the new distribution center. Estimated costs of \$0.9 million were recorded in 1999 related to noncancelable lease contracts associated

with the existing rented facilities.

In 2000, the Company repurchased 2.4 million shares at an average price of \$14 per share. No shares were repurchased in 2001. Since January 1997, the Company has repurchased a total of 9.2 million shares. The Company had no remaining authorization from the Board of Directors to repurchase any additional shares at the end of 2001.

The Company's credit agreement provides for a revolving credit facility and a term loan facility. The revolving credit facility provides for borrowings of up to \$100 million including letters of credit. The letters of credit are issued primarily in connection with inventory purchases. The credit agreement contains numerous financial and operating covenants, including restrictions on incurring indebtedness and liens, selling property and paying dividends. In addition, the Company is required to satisfy consolidated net worth, interest coverage ratio and leverage ratio tests, in each case at the end of each fiscal quarter. None of

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these restrictions are expected to have a material adverse effect on the Company's ability to operate in the future.

During the first quarter of 2000, the Company borrowed an additional \$90 million of term debt under its term loan facility which brought the total outstanding term debt to \$150 million as of April 1, 2000. During the second quarter of 2000, the Company prepaid \$45 million of term debt which cannot be reborrowed and included the \$22.5 million payment due March 2001. During the first quarter of 2001, the Company prepaid \$20 million of term debt under its term loan facility. As of December 29, 2001, the total term debt outstanding was \$85 million. The Company's remaining term debt requires annual amortization payments of \$0.9 million, \$32.4 million, and \$51.7 due March 2002, 2003, and 2004, respectively. The Company's borrowing capacity under the revolving credit facility as of December 29, 2001 was \$30.0 million and will fluctuate during 2002 based on accounts receivable and inventory levels.

The Company believes that its internally generated cash flow and seasonal borrowings under the revolving credit facility will be adequate to fund operations and capital expenditures for the next 12 months.

CREDIT, RETURN AND OTHER CRITICAL ACCOUNTING POLICIES

The Company has credit policies that establish specific criteria related to creditworthiness that its customers must meet prior to the shipment of product to the customer. The Company periodically makes limited and selective exceptions to its policy of not shipping to customers with overdue balances when the particular customer has met specific criteria which are indicative of a wherewithal to pay their past due and future balances.

The Company does not accept returns from wholesale customers without its prior authorization. Returns are typically accepted only for damaged or defective goods, or for pricing or shipping discrepancies. The Company reserves the right to refuse authorization of any returns and to discard any unauthorized returns. If the Company accepts an unauthorized return or if a return is the result of a customer error, the wholesale customer may be subject to a 20% handling charge. The Company reserves the right to cancel open orders or backorders for those wholesale customers who abuse or excessively use return privileges.

The Company believes that the selection and application of its accounting policies are appropriately reasoned. The following are the accounting policies that management believes require the most difficult, subjective or

complex judgments about matters that are inherently uncertain.

Sales Returns - An allowance is established for expenses and losses related to possible returns of product. The amount of the allowances is based on historical ratios of returns to sales, the historical average length of time between the sale and the return, and other factors. Changes in customers' behavior versus historical experience or changes in the Company's return policies are among the factors that would result in materially different amounts for this item.

Inventory Valuation - Inventory is written down for estimated surplus and discontinued inventory items. The amount of the reserve is determined by analyzing historical and projected sales information, plans for discontinued products and other factors. Changes in sales volumes due to unexpected economic or competitive conditions are among the factors that would result in materially different amounts for this item.

Allowance for Doubtful Accounts - An allowance is established for estimated uncollectible accounts receivable. The required allowance is determined by reviewing customer accounts and making estimates of

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amounts that may be uncollectible. Factors considered in determining the amount of the reserve include the age of the receivable, the financial condition of the customer, general business, economic and political conditions, and other relevant facts and circumstances. Unexpected changes in the aforementioned factors would result in materially different amounts for this item.

RECENT DEVELOPMENTS

On March 1, 2002, the Company received net proceeds (before taxes) of \$11.0 million in settlement of its litigation with Andersen Worldwide Societe Cooperative and W. Robert Grafton. See discussion in Legal Proceedings under Item 3.

RECENT ACCOUNTING PRONOUNCEMENTS

On June 29, 2001, the Financial Accounting Standards Board (FASB) approved for issuance Statement of Financial Accounting Standard (SFAS) No. 141, Business Combinations, and SFAS No. 142, Goodwill and Intangible Assets. Major provisions of these Statements are as follows: all business combinations initiated after June 30, 2001 must use the purchase method of accounting; the pooling of interest method of accounting is prohibited except for transactions initiated before July 1, 2001; intangible assets acquired in a business combination must be recorded separately from goodwill if they arise from contractual or other legal rights or are separable from the acquired entity and can be sold, transferred, licensed, rented or exchanged, either individually or as part of a related contract, asset or liability; goodwill and intangible assets with indefinite lives are not amortized but are tested for impairment annually, except in certain circumstances, and whenever there is an impairment indicator; all acquired goodwill must be assigned to reporting units for purposes of impairment testing and segment reporting. In general, impairment testing will entail a comparison of the fair value of a reporting unit with its carrying value including goodwill. These statements are effective for fiscal years beginning after December 15, 2001, at which time goodwill will no longer be subject to amortization.

As of December 29, 2001, the Company had net goodwill of \$138.6 million. Goodwill amortization expense recorded during fiscal year 2001 was \$4.4 million.

Based on a preliminary review of the new standard, management believes the Company will record a goodwill impairment charge upon adoption, and that the amount of such charge will likely be significant in relation to the Company's unamortized goodwill balance. However, the Company has not completed its evaluation to determine the exact amount of such a charge. Such impairment charge will be recorded as a cumulative effect of a change in accounting principle and therefore will not affect operating income. Also, the Company believes this charge will not meaningfully affect the financial covenant calculations under the Company's credit agreement.

See Note 1 to the Consolidated Financial Statements for a more complete discussion of new accounting standards.

FOREIGN EXCHANGE

Approximately 97% of the Company's sales in 2001 were denominated in United States dollars and, as a result, were not subject to changes in exchange rates. Approximately 3% of the Company's sales were denominated in foreign currencies which were subject to changes in exchange rates.

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The Company imports its product from manufacturers located in the Pacific Rim, principally China. Although the Company generally pays for its product in United States dollars, the cost of such product may fluctuate with the value of the Chinese currency because the purchase price paid to the Company's vendors in United States dollars would be worth more or less in the Chinese currency. As a result, the Company's costs could be adversely affected if the Chinese currency appreciates significantly relative to the United States dollar. Conversely, its costs would be favorably affected if the Chinese currency depreciates significantly relative to the United States dollar. In addition, the Company purchased less than 2% of its product from Taiwan (Republic of China) in 2001. These purchases were denominated in New Taiwan Dollars and were subject to changes in exchange rates.

The Company, from time to time, will enter into foreign exchange contracts or build foreign currency deposits as a partial hedge against currency fluctuations. The Company did not enter into any foreign exchange contracts nor have any foreign exchange contracts outstanding in fiscal 2000 and 2001.

EFFECT OF INFLATION

The Company continually attempts to minimize any effect of inflation on earnings by controlling its operating costs and selling prices. During the past few years, the rate of inflation has been low and has not had a material impact on the Company's results of operations.

FACTORS AFFECTING FUTURE EARNINGS

On February 20, 2002, the Company issued a press release stating in relevant part: "The Company intends to provide an outlook for fiscal 2002 in conjunction with its release of first quarter 2002 financial results in April. Information on its wholesale orders received during the first quarter of 2002 will also be disclosed at that time. For the last several years the Company has released wholesale order information in February in conjunction with its reporting of prior year results. However, as described below, the Company has implemented certain customer ordering programs that management believes will materially change the timing of customer orders. As a result, the comparability of customer orders to prior year levels through mid-February does not provide a sufficiently accurate guideline for the Company to provide investors with an outlook for 2002 at this time."

The press release further stated: "During 2001 the Company performed extensive research within its core customer base of gift and collectible stores. In response to this feedback, the Company has designed and implemented new ordering, sales, marketing and operational programs designed to improve the quality of service to its customers. One of the significant objectives of these programs is to guarantee customers a specific time frame for delivery of product based upon the month in which the customer orders. These programs will alter the timing of customer orders within the first quarter and, to a lesser extent, throughout the year."

Over the past two years, the Company's principal customers have decreased by approximately 4,000, or 23%. Similarly, customers who sell the Company's Village Series and/or Snowbabies products have decreased by approximately 850, or 14%. The Company believes the decrease in customers and related decrease in sales is due to several factors including: the problems experienced during the implementation of the Company's enterprise-wide computer system, and an overall weakness in the economy which has forced some of the Company's customers to go out of business. The Company has enacted programs to curb the decline in customers and wholesale sales experienced over the past two years including implementing new customer

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ordering and shipping programs. The Company is also strengthening its sales management team, working to refine its product development process, improving the gift and decorating appeal of its product, and broadening the seasonal coverage of its product lines to drive sales growth.

The federal securities laws provide "safe harbor" status to certain statements that go beyond historical information and may provide an indication of future results. Any conclusions or expectations expressed in, or drawn from, the statements in the press release or throughout this annual report concerning matters that are not historical corporate financial results are "forward-looking statements" that involve risks and uncertainties.

The Company's sales, gross margin, earnings and earnings per share can be significantly impacted by many factors including consumer acceptance of new products; product development efforts; identification and retention of sculpting and other talent; shift in product mix; completion of third-party product manufacturing; retailer reorders and order cancellations; the volume, number, mix and timing of retailers' orders, retailer inventory policies, and the Company's ability to forecast and fulfill changes in anticipated product demand; control of operating expenses; collection of accounts receivable; changes in freight rates; changes in foreign exchange rates, corporate cash flow application, including share repurchases; cost of debt capital; functionality of information, operating and distribution systems; identification, completion and results of acquisitions, investments, and other strategic business initiatives; capital expenditures and depreciation, and the timing thereof; grants of stock options or other equity equivalents; actual or deemed exercises of stock options; industry, general economic, regulatory, transportation, and international trade and monetary conditions; and actions of competitors. 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.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's market risks relate primarily to changes in interest rates and currency exchange rates. The first component of the Company's interest rate risk relates to its debt outstanding. At December 29, 2001, the Company had \$85.0 million outstanding under its credit facility, which

bears interest at variable rates. Because this facility carries a variable interest rate, the Company's results of operations and cash flows will be exposed to changes in interest rates. Based on December 29, 2001 borrowing levels, a 1% increase or decrease in current market interest rates would have an impact of approximately \$0.9 million.

The second component of the Company's interest rate risk involves the short-term investment of excess cash. Excess cash flow is typically invested in high-quality fixed income securities issued by banks, corporations and the U.S. government; municipal securities; and overnight repurchase agreements backed by U.S. government securities. These securities are classified as cash equivalents on the Company's balance sheet. At December 29, 2001, the Company's cash balance was approximately \$48.1 million. Earnings from cash equivalents were approximately \$0.7 million for the fifty-two weeks ended December 29, 2001. Based on the December 29, 2001 cash balance, a 1% increase or decrease in current market interest rates would have an impact of approximately \$0.4 million.

Approximately 3% of the Company's sales and less than 2% of the Company's product purchases in fiscal year 2001 were denominated in a foreign currency. Based on these sales and product purchases, a 10% increase or decrease in the foreign currency exchange rates would have an impact of less than \$1 million.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

See Consolidated Financial Statements on page F-1 herein.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information required by this Item is included in the 2002 Proxy Statement in the sections captioned "Item 1 - Election of Directors - Nominees for Terms Ending at the 2003 Annual Meeting of Stockholders" and "Biographical Information Regarding Executive Officers," and such information is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

Information required by this Item is included in the 2002 Proxy Statement in the section captioned "Further Information Concerning the Board of the Directors and Committees - Compensation Committee Interlocks and Insider Participation" and "- Director Compensation" and in the section captioned "Compensation of Executive Officers" (other than the subsection thereof captioned "Compensation Committee and Stock Incentive Committee Report on Executive Compensation" and "Performance Graph"), and such information (other than the subsections thereof captioned "Compensation Committee Report on Executive Compensation" and "Performance Graph") is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Information required by this Item is included in the 2002 Proxy Statement in the section captioned "Security Ownership of Certain Beneficial Owners and Management," and such information is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

None.

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PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

The Exhibits, and other documents filed as part of this Annual Report on Form 10-K, including those exhibits which are incorporated by reference herein, are:

| | Page |
|--|------|
| (a) 1. Financial Statements | |
| Independent Auditors' Report | F-1 |
| Consolidated Balance Sheets as of December 29, 2001 and December 30, 2000 | F-2 |
| For the years ended December 29, 2001, December 30, 2000, and January 1, 2000: | |
| Consolidated Statements of Income | F-3 |
| Consolidated Statements of Cash Flows | F-4 |
| Consolidated Statements of Stockholders' Equity | F-5 |
| Notes to Consolidated Financial Statements | F-6 |
| 2. Financial Statement Schedule | |
| II. Valuation and Qualifying Accounts | S-1 |
| All other schedules have been omitted because they are not applicable. | |
| 3. Exhibits | |

Exhibits required in connection with this Annual Report on Form 10-K are listed below.

| Exhibit | Description |
|---------|---|
| 3.1 | Restated Certificate of Incorporation of the Company. (Incorporated herein by reference to Exhibit 3.1 of Registrant's Quarterly Report on Form 10-Q for the quarter ended July 3, 1993. SEC File No. 1-11908.) |
| 3.2 | Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock of the Company. (Incorporated herein by reference to Exhibit 1.1 of Registrant's Amendment No. 1, dated May 12, 1997, to Registration Statement on Form 8-A, dated April 23, 1997. SEC File No. 1-11908.) |
| 3.3 | Restated By-Laws of the Company. (Incorporated herein by reference to Exhibit 3.2 of Registrant's Registration Statement on Form S-1, No. 33-61514 and to Exhibits 1 and 2 of Registrant's Current Report on Form 8-K dated February 15, 1996. SEC File No. 1-11908.) |
| 4.1 | Specimen Form of Company's Common Stock Certificate. (Incorporated herein by reference to |

- Exhibit 4.1 of Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1994. SEC File No. 1-11908.)
- 4.2 Rights Agreement (including Exhibits A, B and C thereto), dated as of April 23, 1997, between the Company and ChaseMellon Shareholder Services, L.L.C., as Rights Agent. (Incorporated herein by reference to Exhibit 1 of Registrant's Registration Statement on Form 8-A, dated April 23, 1997. SEC File No. 1-11908.)
 - 4.3 First Amendment, dated as of March 13, 1998, to Rights Agreement between the Company and ChaseMellon Shareholder Services, L.L.C., as Rights Agent. (Incorporated herein by reference to Exhibit 1 to Registrant's Amendment No. 2, dated March 16, 1998, to Registration Statement on Form 8-A, dated April 23, 1997. SEC File No. 1-11908.)
 - 4.4 Amendment No. 2 to Rights Agreement, dated as of February 25, 1999, between the Company and ChaseMellon Shareholder Services, L.L.C., as Rights Agent. (Incorporated herein by reference to Exhibit 99.2 of Registrant's Current Report on Form 8-K dated February 26, 1999. SEC File No. 1-11908.)
 - 10.1 Department 56, Inc. 1992 Stock Option Plan. (Incorporated herein by reference to Exhibit 10.1 of Registrant's Registration Statement on Form S-1, No. 33-61514.)
 - 10.2 Form of Stock Option Agreement in connection with the 1992 Stock Option Plan. (Incorporated herein by reference to Exhibit 10.2 of Registrant's Registration Statement on Form S-1, No. 33-61514.)
 - 10.3 Form of Outside Directors Stock Option Agreement. (Incorporated herein by reference to Exhibit 10.3 of Registrant's Annual Report on Form 10-K for the fiscal year ended January 3, 1998. SEC File No. 1-11908.)

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- 10.4 Lease Agreement dated April 14, 1999 between D 56, Inc. and Ryan Companies US, Inc. pertaining to the Rogers warehouse and distribution facility. (Incorporated herein by reference to Exhibit 10.4 of Registrant's Annual Report on Form 10-K for the fiscal year ended January 1, 2000. SEC File No. 1-11908.)
 - 10.5 Guaranty of Lease dated April 14, 1999 between the Company and Ryan Companies US, Inc. pertaining to the Rogers warehouse and distribution facility. (Incorporated herein by reference to Exhibit 10.5 of Registrant's Annual Report on Form 10-K for the fiscal year ended January 1, 2000. SEC File No. 1-11908.)
 - 10.6 Credit Agreement, dated as of March 19, 1999 among the Company, the Banks parties thereto, ABN Amro Bank N.V. and The First National Bank of Chicago, as documentation agents, U.S. Bank National

Association, as managing agent, and The Chase Manhattan Bank, as administrative agent.
(Incorporated herein by reference to Exhibit 10.7 of Registrant's Annual Report on Form 10-K for the fiscal year ended January 2, 1999. SEC File No. 1-11908.)

- 10.7 First Amendment to the Credit Agreement, dated as of January 27, 2000 among the Company, the Banks parties thereto, ABN Amro Bank N.V. and Bank One NA, as documentation agents, U.S. Bank National Association, as managing agent, and The Chase Manhattan Bank, as administrative agent.
(Incorporated herein by reference to Exhibit 10.7 of Registrant's Annual Report on Form 10-K for the fiscal year ended January 1, 2000. SEC File No. 1-11908.)
- 10.8 Guarantee and Collateral Assignment, dated as of March 19, 1999, by the Company and certain of its direct or indirect subsidiaries in favor of The Chase Manhattan Bank. (Incorporated herein by reference to Exhibit 10.8 of Registrant's Annual Report on Form 10-K for the fiscal year ended January 2, 1999. SEC File No. 1-11908.)
- 10.9 Form of Indemnification Agreement between the Company and its directors and executive officers.
(Incorporated herein by reference to Exhibit 10.24 of Registrant's Registration Statement on Form S-1, No. 33-61514.)
- 10.10 Department 56, Inc. 1993 Stock Incentive Plan.*
- 10.11 Department 56, Inc. 1995 Stock Incentive Plan.*
- 10.12 Department 56, Inc. 1997 Stock Incentive Plan.*
- 10.13 Form of Executive Stock Option Agreement in connection with Department 56, Inc. 1993 Stock Incentive Plan, Department 56, Inc. 1995 Stock Incentive Plan, and Department 56, Inc. 1997 Stock Incentive Plan. (Incorporated herein by reference to Exhibit 10.13 of Registrant's Annual Report on Form 10-K for the fiscal year ended January 1, 2000. SEC File No. 1-11908.)
- 10.14 Form of Performance - Accelerated Vesting Stock Option Agreement in connection with Department 56, Inc. 1993, 1995 and 1997 Stock Incentive Plans.
(Incorporated herein by reference to Exhibit 10.14 of Registrant's Annual Report on Form 10-K for the fiscal year ended January 1, 2000. SEC File No. 1-11908.)
- 10.15 Forms of Letter Agreement between the Company and its executive officers.*
- 10.16 Form of Department 56, Inc. Restricted Stock Agreement.*
- 10.17 Form of Department 56, Inc. 2001 Non-Officer Stock Option Plan.*
- 10.18 Department 56, Inc. Annual Cash Incentive Program.*
- 10.19 Asset Purchase Agreement By and Among Department 56, Inc., Axis Holdings Corporation, Axis Corporation, All Shareholders of Axis Corporation, and Kirk Willey in the Capacity of Shareholders' Representative.*
- 21.1 Subsidiaries of the Company.*
- 23.1 Independent Auditors' Consent.*

Management contract or compensatory plan.

* Filed herewith.

(b) Reports on Form 8-K

The Company filed Form 8-K dated October 19, 2001 containing a press release and financial statements.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DEPARTMENT 56, INC.

Date: March 28, 2002

By: /s/ SUSAN E. ENGEL

Susan E. Engel
Chairwoman of the Board
and Chief Executive
Officer

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

| Signature | Capacity in which signed | Date |
|------------------------|----------------------------------|----------------|
| /s/ SUSAN E. ENGEL | Chairwoman of the Board and | March 28, 2002 |
| ----- | Chief Executive Officer | |
| Susan E. Engel | (Principal Executive Officer) | |
| /s/ GREGG A. PETERS | Managing Director of Finance and | March 28, 2002 |
| ----- | Principal Accounting Officer | |
| Gregg A. Peters | (Principal Accounting Officer) | |
| /s/ JAMES E. BLOOM | | March 28, 2002 |
| ----- | Director | |
| James E. Bloom | | |
| /s/ MICHAEL R. FRANCIS | | March 28, 2002 |
| ----- | Director | |
| Michael R. Francis | | |
| /s/ STEWART M. KASEN | | March 28, 2002 |
| ----- | Director | |

Stewart M. Kasen

/s/ GARY S.
MATTHEWS

March 28,
2002

----- Director
Gary S. Matthews

/s/ STEVEN G.
ROTHMEIER

March 28,
2002

----- Director
Steven G. Rothmeier

/s/ VIN WEBER

March 28,
2002

----- Director
Vin Weber

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INDEPENDENT AUDITORS' REPORT

Board of Directors and Stockholders of
Department 56, Inc.:

We have audited the consolidated balance sheets of Department 56, Inc. and subsidiaries (the Company) as of December 29, 2001 and December 30, 2000 and the related consolidated statements of income, cash flows, and stockholders' equity for the years ended December 29, 2001, December 30, 2000, and January 1, 2000. Our audit also included the financial statement schedule listed in the Index at Item 14. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 29, 2001 and December 30, 2000 and the results of its operations and cash flows for the years ended December 29, 2001, December 30, 2000, and January 1, 2000 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

Deloitte & Touche LLP

Minneapolis, Minnesota
February 22, 2002

(March 1, 2002 as to the first paragraph of Legal Proceedings of Note 6)

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DEPARTMENT 56, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)

AS OF DECEMBER 29, 2001 AND DECEMBER 30, 2000

| | 2001 | 2000 |
|--|------------|------------|
| ----- | | |
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 48,088 | \$ 23,698 |
| Accounts receivable, net of allowances of \$11,942 and \$19,591, respectively | 23,584 | 36,994 |
| Inventories | 11,151 | 15,650 |
| Deferred taxes | 7,318 | 10,104 |
| Other current assets | 4,010 | 3,638 |
| | ----- | ----- |
| Total current assets | 94,151 | 90,084 |
| PROPERTY AND EQUIPMENT, net | 29,749 | 31,796 |
| GOODWILL, net of accumulated amortization of \$38,708 and \$34,402, respectively | 138,640 | 135,034 |
| TRADEMARKS AND OTHER INTANGIBLES, net of accumulated amortization of \$5,787 and \$5,030, respectively | 15,323 | 15,575 |
| OTHER ASSETS | 1,958 | 5,319 |
| | ----- | ----- |
| | \$ 279,821 | \$ 277,808 |
| | ----- | ----- |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Current portion of long-term debt | \$ 900 | \$ - |
| Accounts payable | 10,811 | 7,866 |
| Accrued compensation and benefits | 7,428 | 6,402 |
| Income taxes payable | 8,626 | 6,795 |
| Other current liabilities | 3,492 | 3,440 |
| | ----- | ----- |
| Total current liabilities | 31,257 | 24,503 |
| DEFERRED TAXES | 7,717 | 7,730 |
| LONG-TERM DEBT | 84,100 | 105,000 |
| COMMITMENTS AND CONTINGENCIES | | |
| (Note 6) | | |
| STOCKHOLDERS' EQUITY: | | |
| Preferred stock, \$.01 par value; authorized 20,000 shares; no shares issued | | |

| | | |
|---|------------|------------|
| Common stock, \$.01 par value; authorized 100,000 shares; issued 22,063 and 21,990 shares, respectively | 221 | 220 |
| Additional paid-in capital | 50,655 | 50,019 |
| Unearned compensation - restricted shares | (427) | - |
| Treasury stock, at cost; 9,166 shares | (216,636) | (216,636) |
| Retained earnings | 322,934 | 306,972 |
| | ----- | ----- |
| Total stockholders' equity | 156,747 | 140,575 |
| | ----- | ----- |
| | \$ 279,821 | \$ 277,808 |
| | ----- | ----- |

See notes to consolidated financial statements.

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DEPARTMENT 56, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share amounts)

YEARS ENDED DECEMBER 29, 2001, DECEMBER 30, 2000, AND JANUARY 1, 2000

| | 2001 | 2000 | 1999 |
|--|------------|------------|------------|
| | ----- | ----- | ----- |
| NET SALES | \$ 200,447 | \$ 234,058 | \$ 255,528 |
| COST OF SALES | 89,845 | 109,522 | 113,475 |
| | ----- | ----- | ----- |
| Gross profit | 110,602 | 124,536 | 142,053 |
| OPERATING EXPENSES: | | | |
| Selling, general and administrative | 68,589 | 74,166 | 61,542 |
| Amortization of goodwill, trademarks and other intangibles | 5,189 | 5,486 | 5,145 |
| | ----- | ----- | ----- |
| Total operating expenses | 73,778 | 79,652 | 66,687 |
| | ----- | ----- | ----- |
| INCOME FROM OPERATIONS | 36,824 | 44,884 | 75,366 |
| OTHER EXPENSE (INCOME): | | | |
| Interest expense | 7,036 | 11,729 | 6,719 |
| Impairment and equity in losses of minority investment | 3,304 | 427 | - |
| Other, net | (662) | (809) | (153) |
| | ----- | ----- | ----- |
| INCOME BEFORE INCOME TAXES | 27,146 | 33,537 | 68,800 |
| PROVISION FOR INCOME TAXES | 11,184 | 12,744 | 26,144 |
| | ----- | ----- | ----- |

| | | | | | | |
|--|----|--------|----|--------|----|--------|
| NET INCOME | \$ | 15,962 | \$ | 20,793 | \$ | 42,656 |
| ----- | | | | | | |
| NET INCOME PER COMMON SHARE | \$ | 1.24 | \$ | 1.47 | \$ | 2.48 |
| ----- | | | | | | |
| NET INCOME PER COMMON SHARE ASSUMING DILUTION | \$ | 1.24 | \$ | 1.47 | \$ | 2.45 |
| ----- | | | | | | |

See notes to consolidated financial statements.

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DEPARTMENT 56, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

YEARS ENDED DECEMBER 29, 2001, DECEMBER 30, 2000, AND JANUARY 1, 2000

| | 2001 | 2000 | 1999 |
|--|-----------|-----------|-----------|
| ----- | | | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net income | \$ 15,962 | \$ 20,793 | \$ 42,656 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation | 5,873 | 5,168 | 4,189 |
| Gain on sale of assets | (62) | - | - |
| Impairment and equity in losses of minority investment | 3,304 | 427 | - |
| Amortization of goodwill, trademarks and other intangibles | 5,189 | 5,486 | 5,145 |
| Amortization of deferred financing fees | 385 | 382 | 269 |
| Compensation expense - restricted shares | 152 | - | - |
| Deferred taxes | 2,773 | 243 | (1,836) |
| Changes in assets and liabilities: | | | |
| Accounts receivable | 13,488 | 28,586 | (39,410) |
| Inventories | 5,102 | 251 | 2,386 |
| Other assets | (797) | 926 | (2,607) |
| Accounts payable | 2,659 | (1,843) | (1,391) |
| Commissions payable | 287 | (323) | (2,549) |
| Other current liabilities | 2,568 | 1,499 | 990 |
| ----- | | | |
| Net cash provided by operating activities | 56,883 | 61,595 | 7,842 |

CASH FLOWS FROM INVESTING

ACTIVITIES:

| | | | |
|---------------------------------------|----------|----------|----------|
| Purchases of property and equipment | (2,906) | (7,109) | (16,345) |
| Proceeds from sale of assets | 142 | - | - |
| Acquisitions | (9,729) | (4,000) | (3,970) |
| | ----- | ----- | ----- |
| Net cash used in investing activities | (12,493) | (11,109) | (20,315) |

CASH FLOWS FROM FINANCING

ACTIVITIES:

| | | | |
|---|----------|-----------|----------|
| Proceeds from the exercise of common stock options | - | 66 | 1,170 |
| Borrowings on revolving credit agreement | 35,000 | 64,500 | 94,500 |
| Principal payments on revolving credit agreement | (35,000) | (107,000) | (52,000) |
| Purchases of treasury stock | - | (33,316) | (70,018) |
| Proceeds from issuance of long-term debt | - | 90,000 | 40,000 |
| Principal payments on long-term debt | (20,000) | (45,000) | - |
| | ----- | ----- | ----- |
| Net cash (used in) provided by financing activities | (20,000) | (30,750) | 13,652 |

| | | | |
|---|--------|--------|-------|
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 24,390 | 19,736 | 1,179 |
|---|--------|--------|-------|

| | | | |
|--|--------|-------|-------|
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 23,698 | 3,962 | 2,783 |
| | ----- | ----- | ----- |

| | | | |
|--|-----------|-----------|----------|
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | \$ 48,088 | \$ 23,698 | \$ 3,962 |
| | ----- | ----- | ----- |

See notes to consolidated financial statements.

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DEPARTMENT 56, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands)

YEARS ENDED DECEMBER 29, 2001, DECEMBER 30, 2000, AND JANUARY 1, 2000

| Common Stock | | Unearned | | | | Total |
|--------------|------------|--------------|--------|----------|----------|---------------|
| ----- | Additional | Compensation | | Treasury | Retained | Stockholders' |
| Shares | Paid-in | Restricted | Shares | Stock | Earnings | Equity |
| Amount | Capital | | | | | |

| | | | | | | | |
|---------------|---------|--------|-----------|----------|-------------|-----------|------------|
| ----- | | | | | | | |
| BALANCE AS OF | | | | | | | |
| JANUARY 2, | | | | | | | |
| 1999 | 18,023 | \$ 219 | \$ 48,295 | \$ - | \$(113,302) | \$243,523 | \$ 178,735 |
| Net income | | | | | | 42,656 | 42,656 |
| Shares | | | | | | | |
| issued upon | | | | | | | |
| the exercise | | | | | | | |
| of common | | | | | | | |
| stock | | | | | | | |
| options | 60 | 1 | 1,439 | | | | 1,440 |
| Shares | | | | | | | |
| repurchased | (2,925) | | | | (70,018) | | (70,018) |
| Other | 4 | | 111 | | | | 111 |
| | ----- | ----- | ----- | ----- | ----- | ----- | ----- |
| BALANCE AS OF | | | | | | | |
| JANUARY 1, | | | | | | | |
| 2000 | 15,162 | 220 | 49,845 | \$ - | (183,320) | 286,179 | 152,924 |
| Net income | | | | | | 20,793 | 20,793 |
| Shares | | | | | | | |
| issued upon | | | | | | | |
| the exercise | | | | | | | |
| of common | | | | | | | |
| stock | | | | | | | |
| options | 20 | | 81 | | | | 81 |
| Shares | | | | | | | |
| repurchased | (2,364) | | | | (33,316) | | (33,316) |
| Other | 6 | | 93 | | | | 93 |
| | ----- | ----- | ----- | ----- | ----- | ----- | ----- |
| BALANCE AS OF | | | | | | | |
| DECEMBER 30, | | | | | | | |
| 2000 | 12,824 | 220 | 50,019 | \$ - | (216,636) | 306,972 | 140,575 |
| Net income | | | | | | 15,962 | 15,962 |
| Restricted | | | | | | | |
| shares | | | | | | | |
| issued | 67 | 1 | 578 | (579) | | | -- |
| Restricted | | | | | | | |
| shares | | | | | | | |
| vested | | | | 152 | | | 152 |
| Other | 6 | | 58 | | | | 58 |
| | ----- | ----- | ----- | ----- | ----- | ----- | ----- |
| BALANCE AS OF | | | | | | | |
| DECEMBER 29, | | | | | | | |
| 2001 | 12,897 | \$ 221 | \$ 50,655 | \$ (427) | \$(216,636) | \$322,934 | \$ 156,747 |
| | ----- | ----- | ----- | ----- | ----- | ----- | ----- |

See notes to consolidated financial statements.

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DEPARTMENT 56, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except share and per share amounts)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business - Department 56, Inc. and Subsidiaries (the Company) is engaged in the original design and wholesale and retail distribution of specialty giftware products and dolls. The majority of the Company's products are developed and designed by the Company's in-house creative team and are manufactured for the Company by independently owned foreign manufacturers located primarily in the Pacific Rim. The Company's wholesale customer base and accounts receivable are primarily composed of, and are due from, retail stores of various sizes located throughout the United States and Canada. Less than 3% of total revenue is derived from customers outside the United States and less than 1% of all long-lived assets are located outside the United States. No customer represents more than 3% of total revenue in any period presented. Retail revenues represented approximately 10% of total 2001 revenues.

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

Fiscal Year End - The Company's policy is to end its fiscal year on the Saturday closest to December 31. The years ended December 29, 2001, December 30, 2000, and January 1, 2000 include 52 weeks.

Cash Equivalents - All highly liquid debt instruments with original maturities of three months or less are considered to be cash equivalents.

Inventories - Inventories consist of finished goods and are stated at the lower of average cost, which approximates first-in, first-out cost, or market value. The Company records inventory at the date of taking title, which at certain times during the year results in significant in-transit quantities, as inventory is sourced primarily from China, Taiwan, and other Pacific Rim countries. Each period the Company adjusts identified, unsalable and slow-moving inventory to its net realizable value.

Property and Equipment - Property and equipment are stated at cost. Depreciation is computed on a straight-line method over the estimated useful lives of the assets, ranging from 2 to 45 years. Major improvements and replacements of property are capitalized. Maintenance, repairs, and minor improvements are expensed.

Goodwill, Trademarks, and Other Intangible Assets - Goodwill represents the excess of cost over the fair value of acquired net assets of the Company at the acquisition date and is being amortized on a straight-line basis over 20 to 40 years. Trademarks and other intangible assets acquired are being amortized on a straight-line basis over 3 to 40 years. In 2000 and 2001, the Company evaluated the recoverability of goodwill, trademarks and other intangible assets based on an analysis of estimated future undiscounted cash flows and determined that there was no impairment of any of the intangible assets, except for the goodwill associated with the Company's minority investment in 2-Day Designs, Inc. See Note 8.

Revenue Recognition - Revenues are recognized when title passes to the buyer which occurs upon shipment of the product, net of an allowance for returns.

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Advertising Expense - The Company records advertising expense in accordance with Statement of Position No. 93-7. Costs to produce an

advertisement are expensed when the advertisement occurs. Costs to reimburse retailers for cooperative advertising are accrued and expensed when the revenue is recognized. All advertising costs are recorded in selling, general and administrative expense. Advertising expense for 2001, 2000, and 1999 fiscal years was \$1,767, \$1,618, and \$2,960, respectively.

Product Development Expense - The Company's product development costs consist principally of salaries to internal creative talent, royalties paid to outside artists, and costs incurred in developing product samples. The Company expenses as incurred the salaries of creative talent and records it in selling, general and administrative expense. The Company capitalizes into inventory the cost of royalties earned based on the receipt of product and records it in cost of sales as the product is sold. The cost to develop product samples is expensed as incurred and recorded in cost of sales.

Freight Expense - Freight expenses for products shipped to customers (freight-out) are included in cost of products sold, in accordance with Emerging Issues Task Force Issue No. 00-10, Accounting for Shipping and Handling Fees and Costs.

Income Taxes - Deferred income taxes are recognized for the tax consequences in future years of differences between the tax bases of assets and liabilities and their financial reporting amounts at each year-end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income.

Foreign Currency Translation - The Company uses the United States dollar as the functional currency of its foreign operations. Accordingly, translation gains and losses resulting from the remeasurement of foreign operations' financial statements are reflected in the accompanying statements of income.

Foreign Exchange Contracts - The Company imports most of its products and, while the majority of these purchases are denominated in United States dollars, some of the purchases are denominated in foreign currency. In addition, the Company's sales to Canada are denominated in Canadian dollars. The Company, from time to time, will enter into foreign exchange contracts or build foreign currency deposits as a partial hedge against currency fluctuations. The Company did not enter into any foreign exchange contracts nor have any foreign exchange contracts outstanding in fiscal year 2000 and 2001.

Fair Value of Financial Instruments - The carrying amount of cash and cash equivalents, accounts receivable, accounts payable, and commissions payable approximates fair value because of the short-term nature of these instruments. Based on the borrowing rates currently available to the Company for bank loans with similar terms and maturities, the Company also believes the carrying amount of long-term debt approximates fair value. The fair value of the Company's forward currency contracts is determined using the current spot rate. There were no forward currency contracts outstanding at December 29, 2001 and December 30, 2000.

Net Income per Common Share - Net income per common share is calculated by dividing net income by the weighted average number of shares outstanding during the period. Net income per common share assuming dilution reflects per share amounts that would have resulted had the Company's outstanding stock options been converted to common stock. See Note 11.

Management Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and

assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent

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assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications - Certain reclassifications were made to the fiscal 2000 consolidated financial statements in order to conform to the presentation of the fiscal 2001 and 1999 consolidated financial statements. These reclassifications had no impact on consolidated net income or retained earnings as previously reported.

New Accounting Standards - On December 31, 2000 (fiscal year 2001), the Company adopted Statement of Financial Accounting Standard (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended by SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities. SFAS No. 133 establishes accounting and reporting standards for derivative instruments and for hedging activities. It requires that all derivatives, including those embedded in other contracts, be recognized as either assets or liabilities and that those financial instruments be measured at fair value. The accounting for changes in the fair value of derivatives depends on their intended use and designation. Management has reviewed the requirements of SFAS No. 133 and has determined that they have no free-standing or embedded derivatives. All contracts that contain provisions meeting the definition of a derivative also meet the requirements of, and have been designated as, normal purchases or sales. Currently, the Company does not use free-standing derivatives and has not entered into contracts with terms that cannot be designated as normal purchases or sales.

On June 29, 2001, the Financial Accounting Standards Board (FASB) approved for issuance SFAS No. 141, Business Combinations, and SFAS No. 142, Goodwill and Intangible Assets. Major provisions of these statements are as follows: all business combinations initiated after June 30, 2001 must use the purchase method of accounting; the pooling of interest method of accounting is prohibited except for transactions initiated before July 1, 2001; intangible assets acquired in a business combination must be recorded separately from goodwill if they arise from contractual or other legal rights or are separable from the acquired entity and can be sold, transferred, licensed, rented or exchanged, either individually or as part of a related contract, asset or liability; goodwill and intangible assets with indefinite lives are not amortized but are tested for impairment annually, except in certain circumstances, and whenever there is an impairment indicator; all acquired goodwill must be assigned to reporting units for purposes of impairment testing and segment reporting. In general, impairment testing will entail a comparison of the fair value of a reporting unit with its carrying value including goodwill. These statements are effective for fiscal years beginning after December 15, 2001, at which time goodwill will no longer be subject to amortization.

As of December 29, 2001, the Company had net goodwill of approximately \$138.6 million. Goodwill amortization expense recorded during 2001 was \$4.4 million. Based on a preliminary review of the new standard, management believes the Company will record a goodwill impairment charge upon adoption, and that the amount of such charge will likely be significant in relation to the Company's unamortized goodwill balance. However, the Company has not completed its evaluation to determine the exact amount of such charge. Such impairment charge will be recorded as a cumulative effect of a change in accounting principle

and therefore will not affect operating income. Also, the Company believes this charge will not meaningfully affect the financial covenant calculations under the company's credit agreement.

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On August 16, 2001, the FASB issued SFAS No. 143, Accounting for Asset Retirement Obligations. The standard requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred, and a corresponding increase in the carrying value of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. SFAS No. 143 is effective for fiscal years beginning after June 15, 2002. The Company is evaluating the impact of the adoption of this standard and has not yet determined the effect of adoption on its financial position and results of operations.

In October 2001, the FASB issued SFAS No. 144, Accounting for the Impairment of Long-Lived Assets. This statement is effective for fiscal years beginning after December 15, 2001. SFAS No. 144 retains many of the provisions of SFAS No. 121, but addresses certain implementation issues associated with that statement. The Company is currently evaluating the impact of implementing SFAS No. 144.

2. PROPERTY AND EQUIPMENT

Property and equipment at December 29, 2001 and December 30, 2000 is comprised of the following:

| | 2001 | 2000 |
|--------------------------------|-----------|-----------|
| Leasehold improvements | \$ 7,022 | \$ 6,199 |
| Furniture and fixtures | 5,142 | 4,761 |
| Computer hardware and software | 20,320 | 19,205 |
| Other equipment | 7,485 | 6,179 |
| Building | 7,206 | 7,045 |
| Land | 906 | 906 |
| | 48,081 | 44,295 |
| Less accumulated depreciation | 18,332 | 12,499 |
| Property and equipment, net | \$ 29,749 | \$ 31,796 |

3. OTHER CURRENT LIABILITIES

Other current liabilities at December 29, 2001 and December 30, 2000 are comprised of the following:

| | 2001 | 2000 |
|---------------------------|--------|--------|
| Accrued sales tax payable | \$ 787 | \$ 104 |
| Deferred revenue | 504 | 662 |
| Accrued royalty fees | 555 | 1,421 |
| Other | 1,646 | 1,253 |

| | |
|----------|---------|
| ----- | ----- |
| \$ 3,492 | \$3,440 |
| ----- | ----- |

4. CREDIT AGREEMENT

Long-term debt at December 29, 2001 and December 30, 2000 is comprised of the following:

| | 2001 | 2000 |
|---------------------------------------|-----------|------------|
| ----- | ----- | ----- |
| Total debt | \$ 85,000 | \$ 105,000 |
| Less borrowings classified as current | 900 | - |
| | ----- | ----- |
| | \$ 84,100 | \$ 105,000 |
| | ----- | ----- |

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The Company's credit agreement provides for a revolving credit facility and a term loan facility. The Company's term debt of \$85 million requires annual amortization payments of \$0.9 million, \$32.4 million, and \$51.7 due March 2002, 2003, and 2004, respectively. The Company's borrowing capacity under the revolving credit facility as of December 29, 2001 was \$30.0 million and will fluctuate during 2002 based on accounts receivable and inventory levels.

The revolving line of credit provides for borrowings of up to \$100 million, which may be in the form of letters of credit, bankers' acceptances, and revolving credit loans. The letters of credit are issued primarily in connection with inventory purchases. The revolving line of credit includes a clean-down provision whereby the Company's revolving credit loans and bankers' acceptances may not exceed an aggregate of \$30 million during any one 30-consecutive-day period beginning November 1 and ending March 31. Borrowings under the credit agreement are subject to certain borrowing base limitations (as defined). The revolving line of credit provides for commitment fees of 0.25% to 0.50% per annum on the daily average of the unused commitment.

The credit agreement allows the Company to choose between two interest rate options in connection with its term loan and revolving credit loans. The interest rate options are the Alternate Base Rate (as defined) or the LIBOR rate (as defined) plus an applicable margin. The applicable margin ranges from 0.875% to 1.625% for LIBOR rate loans. The credit agreement expires March 19, 2004.

The credit agreement includes restrictions as to, among other things, the amount of additional indebtedness, liens, contingent obligations, investments and dividends. Under the most restrictive of these covenants, approximately \$278,000 of retained earnings were restricted at December 29, 2001. The credit agreement also requires maintenance of minimum levels of interest coverage, net worth and maximum levels of leverage. None of these restrictions are expected to have a material adverse effect on the Company's ability to operate in the future.

The Company has pledged the common stock of its subsidiaries, direct and indirect, as collateral under the credit agreement, and the Company and its subsidiaries, direct and indirect, have guaranteed repayment of amounts borrowed under the credit agreement.

The Company paid interest of \$6,648, \$10,933, and \$8,023 during the years ended December 29, 2001, December 30, 2000, and January 1, 2000, respectively.

5. INCOME TAXES

The provision for income taxes for the years ended December 29, 2001, December 30, 2000, and January 1, 2000 consisted of the following:

| | 2001 | 2000 | 1999 |
|-----------|------------------|------------------|------------------|
| Current: | | | |
| Federal | \$ 7,799 | \$ 11,423 | \$ 25,427 |
| State | 477 | 979 | 2,180 |
| Foreign | 135 | 99 | 373 |
| Deferred: | | | |
| Federal | 2,554 | 224 | (1,691) |
| State | 219 | 19 | (145) |
| | <u>\$ 11,184</u> | <u>\$ 12,744</u> | <u>\$ 26,144</u> |

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The reconciliation between income tax expense based on statutory income tax rates and the provision for income taxes is as follows:

| | 2001 | 2000 | 1999 |
|--|------------------|-----------------|------------------|
| Income taxes at federal statutory rate | \$ 9,501 | \$11,738 | \$ 24,080 |
| State income taxes, net of federal income tax deductions | 332 | 508 | 1,033 |
| Goodwill amortization | 1,448 | 1,448 | 1,448 |
| Deferred tax valuation allowance | 1,520 | - | - |
| Charitable donations of inventory | (681) | (287) | (47) |
| Adjustment of prior year tax accruals | (1,000) | - | - |
| Other | 64 | (663) | (370) |
| Provision for income taxes | <u>\$ 11,184</u> | <u>\$12,744</u> | <u>\$ 26,144</u> |

The components of the net deferred tax asset at December 29, 2001 and December 30, 2000 were as follows:

| | 2001 | 2000 |
|--|----------|----------|
| ----- | | |
| DEFERRED TAX ASSETS: | | |
| Asset valuation reserves | \$ 5,964 | \$ 9,509 |
| Loss on minority investment | 1,520 | - |
| Deferred compensation | 590 | 376 |
| Accrued liabilities | 482 | 414 |
| Charitable contributions | 741 | - |
| Other | 854 | 1,001 |
| Less: Deferred tax valuation allowance | (1,520) | - |
| | ----- | ----- |
| Total deferred tax assets | 8,631 | 11,300 |
| DEFERRED TAX LIABILITIES: | | |
| Trademark amortization | (5,449) | (5,399) |
| Property and equipment depreciation | (3,266) | (3,187) |
| Other | (315) | (340) |
| | ----- | ----- |
| Total deferred tax liabilities | (9,030) | (8,926) |
| | ----- | ----- |
| | \$ (399) | \$ 2,374 |
| | ----- | ----- |

The \$(399) net deferred tax liability at December 29, 2001 is presented as a net deferred current asset of \$7,318 and a net deferred noncurrent liability of \$7,717. The \$2,374 net deferred tax asset at December 30, 2000 is presented as a net deferred current asset of \$10,104 and a net deferred noncurrent liability of \$7,730. The \$1,520 deferred tax asset valuation allowance at December 29, 2001 represents a reserve against the future deductibility of the capital losses the Company recognized from its minority investment in 2-Day Designs. See Note 8. Management believes the probability of deducting the capital losses in the future is remote.

The Company paid income taxes of \$6,739, \$14,101, and \$28,085 during the years ended December 29, 2001, December 30, 2000, and January 1, 2000, respectively.

6. COMMITMENTS AND CONTINGENCIES

Operating Leases - The Company leases warehouse and office space, equipment, and showroom display facilities under renewable operating leases with remaining terms of up to 11 years. In addition

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to the base rent, the Company pays its proportionate share of taxes, special assessments, and operating expenses of the warehouse and showroom display facilities.

The following is a schedule of future annual minimum lease payments for noncancelable operating leases as of December 29, 2001:

| | |
|------|----------|
| 2002 | \$ 3,947 |
|------|----------|

| | |
|------------|-----------|
| 2003 | 3,554 |
| 2004 | 3,528 |
| 2005 | 3,566 |
| 2006 | 3,203 |
| Thereafter | 9,677 |
| | ----- |
| | \$ 27,475 |
| | ----- |

The Company's rental expense was \$7,252, \$3,609, and \$3,326 for the years ended December 29, 2001, December 30, 2000, and January 1, 2000, respectively.

Letters of Credit - The Company had outstanding standby and commercial letters of credit amounting to \$2,864 at December 29, 2001 relating primarily to purchase commitments issued to foreign suppliers and vendors.

Legal Proceedings - On September 14, 2000, Arthur Andersen LLP filed a lawsuit against the Company in The Fourth Judicial District, State of Minnesota alleging breach of contract in connection with computer system implementation work and seeking \$0.6 million plus interest and legal costs. On March 1, 2001, the Company filed suit in The Circuit Court of Baltimore City, State of Maryland against Andersen Worldwide Societe Cooperative and W. Robert Grafton alleging fraud, conspiracy, tortuous conduct and breach of contract in connection with the computer systems implementation work solicited and performed by Arthur Andersen LLP. On July 12, 2001, the Company dismissed all claims brought against W. Robert Grafton. On March 1, 2002, the Company received net proceeds (before taxes) of \$11.0 million in settlement of the litigation.

On March 5 and March 9, 2001 lawsuits seeking unspecified compensatory damages were filed against the Company and its Chairwoman and Chief Executive Officer Susan E. Engel, in the United States District Court for the District of Minnesota purportedly on behalf of the class of persons who purchased Department 56 common stock during the period February 24, 1999 through April 26, 2000. The purported class action lawsuits allege the Company and its Chairwoman violated federal securities laws by making a series of false and misleading statements concerning the Company's financial statements. On August 29, 2001, the Court consolidated all the actions into In Re Department 56, Inc. Securities Litigation. Oral arguments are scheduled to be heard in connection with the Company's Motion to Dismiss on March 22, 2002. The Company has tendered a claim for coverage to the underwriters of its Directors and Officers Liability Insurance, and believes that such insurance will respond to the coverage claim net of a \$250,000 deductible. The Company intends to defend this lawsuit vigorously, but the Company is unable to predict the outcome of these proceedings or to reasonably estimate the impact, if any, that the ultimate resolution of these matters will have on the Company's results of operations, financial position or cash flows.

In addition to the above lawsuits, the Company is involved in various additional legal proceedings, claims, and governmental audits in the ordinary course of its business. The Company believes it has

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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.

7. RETIREMENT PLAN

The Company has a qualified contributory retirement plan (the Plan) under Section 401(k) of the Internal Revenue Code which covers substantially all full-time employees who meet certain eligibility requirements. Voluntary contributions are made by participants, and Company matching contributions are made at the discretion of the Board of Directors, subject to certain limitations. The Plan also allows the Company to make discretionary profit-sharing contributions to the Plan up to the maximum amount deductible for income tax purposes. All company contributions are invested in a series of diversified investment options at the election of the employee. The Company does not make matching or profit sharing contributions in company stock. The Company's total profit-sharing contributions were \$1,857, \$1,517, and \$1,249 for the years ended December 29, 2001, December 30, 2000, and January 1, 2000, respectively.

8. ACQUISITIONS

During 2001, the Company completed its \$9.7 million acquisition of the business of Axis Corporation, a privately held designer, importer, and specialty retailer based in Salt Lake City, Utah. Axis' products, primarily porcelain dolls, doll accessories, and plush items, are marketed under the brand name Geppeddo. (r) The acquired business operates customized kiosks located in approximately 360 major malls and shopping centers throughout the United States and Canada during the peak holiday shopping season. The founders and entire management team of the acquired business are continuing in their positions. Revenue generated by Geppeddo in 2001 was approximately \$12.0 million since the acquisition date.

The asset acquisition is accounted for under the purchase method of accounting and resulted in goodwill of approximately \$7.9 million, and other intangibles including noncompete agreements and trademarks totaling approximately \$0.5 million. The remaining \$1.3 million represents tangible assets purchased, net of liabilities assumed. The results of operations of the acquired business since the acquisition date have been included in the Company's financial statements within the retail operating segment (see Note 9). The selling shareholders of the acquired business have the ability to earn up to an additional \$12.0 million of cash consideration if certain pre-specified financial performance measures are attained as measured annually over a three-year period concluding February 29, 2004. Any additional contingent consideration paid to the sellers will be recorded by the Company as goodwill.

During January 2000, the Company completed a \$4.0 million strategic minority investment in 2-Day Designs, Inc., a manufacturer and marketer of high-quality accent furniture and wooden accessories sold primarily through furniture, home furnishings, and catalog retailers principally in the United States. The transaction was recorded under the equity method of accounting. During 2001, the Company recognized a \$3.0 million impairment of the Company's minority investment in 2-Day Designs, Inc. given continued deterioration in the U.S. home furnishings market. The impairment charge recorded reduced the carrying value of the Company's minority investment to zero. The Company has not guaranteed any debt obligations of 2-Day Designs, Inc.

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During 1999, the Company acquired substantially all of the assets of the independent sales representative organizations that represented

the Company's products in Massachusetts and several other eastern states, Minnesota and several other midwestern states, and Texas and several surrounding southern states. The cost of these acquisitions was \$4.0 million.

9. SEGMENTS OF THE COMPANY AND RELATED INFORMATION

The Company has two reportable segments - wholesale and retail. Although the product produced and sold for each segment is similar, the type of customer for the product and the method used to distribute the product are different. The segmentation of these operations also reflects how the Company's chief executive officer (the "CEO") currently reviews the results of these operations. Income from operations 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 other category. Other components of the statement of operations which are classified below income from operations are also not allocated by segment. In addition, the Company does not account for or report assets, capital expenditures, or depreciation and amortization by segment. All transactions between operating segments have been eliminated and are not included in the table below.

| | Wholesale | Retail | Other | Consolidated |
|---|------------|----------|------------|--------------|
| ----- | | | | |
| Fifty-Two Weeks Ended December 29, 2001: | | | | |
| Net sales | \$ 181,056 | \$19,391 | | \$ 200,447 |
| Income from operations | 81,219 | 1,851 | \$(46,246) | 36,824 |
| Fifty-Two Weeks Ended December 30, 2000: | | | | |
| Net sales | \$ 231,182 | \$ 2,876 | | \$ 234,058 |
| Income (loss) from operations | 95,699 | (324) | \$(50,491) | 44,884 |
| Fifty-Two Weeks Ended January 1, 2000: | | | | |
| Net sales | \$ 253,133 | \$ 2,395 | | \$ 255,528 |
| Income (loss) from operations | 119,708 | (264) | \$(44,078) | 75,366 |

10. STOCKHOLDERS' EQUITY

Stock-Based Compensation Plans - At December 29, 2001, the Company had five stock-based compensation plans allowing the Company to grant options to employees, directors, officers, consultants, and advisors. All employee options granted have an exercise price equal to the market value of the common stock at the date of grant, generally have a term of ten years, and generally are exercisable in equal installments on each of the first, second, and third anniversaries of the date of the grant. At December 29, 2001, 1,240,152 shares were available for granting under the stock option and incentive plans.

A summary of the status of the Company's stock option and incentive plans as of December 29, 2001, December 30, 2000, and January 1, 2000, and changes during the years then ended is presented below:

| | 2001 | | 2000 | | 1999 | |
|--|-------------|--|-----------|--|-----------|--|
| | Shares | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price |
| Outstanding at beginning of year | 2,533,581 | \$22.54 | 2,094,311 | \$26.70 | 1,724,357 | \$26.80 |
| Granted | 286,817 | 8.16 | 693,713 | 12.43 | 458,300 | 25.42 |
| Exercised | - | - | - | - | (56,482) | 20.52 |
| Forfeited | (1,284,671) | 26.32 | (254,443) | 29.81 | (31,864) | 24.77 |
| Outstanding at end of year | 1,535,727 | 16.15 | 2,533,581 | 22.54 | 2,094,311 | 26.70 |
| Options exercisable at end of year | 852,999 | 20.06 | 1,601,921 | 26.22 | 1,446,272 | 27.63 |
| Weighted average fair value of options granted during the year | \$ 4.53 | | \$ 5.83 | | \$ 12.33 | |

The Company applies Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations in accounting for its plans. Accordingly, no compensation cost has been recognized for options granted since the initial public offering. Had compensation cost been determined based on the fair value of the 1999, 2000, and 2001 stock option grants consistent with the method of SFAS No. 123, Accounting for Stock-Based Compensation, the Company's net income and net income per common share assuming dilution would have been reduced to the pro forma amounts indicated below:

| | 2001 | | 2000 | | 1999 | |
|--|------|--------|------|--------|------|--------|
| Net income: | | | | | | |
| As reported | \$ | 15,962 | \$ | 20,793 | \$ | 42,656 |
| Pro forma | | 14,583 | | 19,567 | | 40,647 |
| Net income per common share - basic: | | | | | | |
| As reported | \$ | 1.24 | \$ | 1.47 | \$ | 2.48 |
| Pro forma | | 1.13 | | 1.39 | | 2.36 |
| Net income per common share - | | | | | | |

assuming dilution:

| | | | | | | |
|-------------|----|------|----|------|----|------|
| As reported | \$ | 1.24 | \$ | 1.47 | \$ | 2.45 |
| Pro forma | | 1.13 | | 1.38 | | 2.34 |

In determining the preceding pro forma amounts under SFAS No. 123, the fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in 2001, 2000, and 1999, respectively: risk-free interest rates of 4.9 percent, 6.6 percent, and 5.9 percent; expected volatility of 50 percent, 38 percent, and 38 percent; expected lives of 6 years; and no expected dividends. The effects of applying SFAS No. 123 in this pro forma disclosure are not indicative of future compensation costs. SFAS No. 123 does not apply to awards prior to 1995, and additional awards are anticipated.

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The following table summarizes information about the Company's stock option and incentive plans at December 29, 2001:

| Range of Exercise Prices | Number Outstanding at December 29, 2001 | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | Number Exercisable at December 29, 2001 | Weighted Average Exercise Price |
|--------------------------------|---|---|--|---|--|
| \$ 3.33 | 40,500 | 1.2 years | \$ 3.33 | 40,500 | \$ 3.33 |
| 3.34-17.99 | 953,550 | 8.6 | 10.99 | 299,392 | 11.57 |
| 18.00-21.47 | 263,981 | 5.2 | 20.49 | 251,082 | 20.57 |
| 21.48-37.75 | 277,696 | 5.2 | 31.59 | 262,025 | 31.87 |
| | 1,535,727 | | | 852,999 | |

In addition to stock options granted under the Company's stock option plans, the Company granted options to purchase 30,000 shares of common stock to each of four members of the Company's Board of Directors in December 1992. During February 1993, the Company granted options to purchase 30,000 shares of common stock to one member of the Board of Directors. These options are not subject to a stock option plan. Such options are exercisable, have a term of ten years from the date of grant, and have an exercise price of \$3.33 per share. During 2000 and 1999, members of the Board of Directors exercised 20,000 and 3,000 options, respectively. There were no exercises during 2001. At December 29, 2001, directors' options to purchase 15,000 shares of common stock were exercisable at \$3.33 per share.

Shareholder Rights Plan - In April 1997, the Company adopted a shareholder rights plan. Under the shareholder rights plan, each shareholder received a dividend of one preferred share purchase right for each share held of the Company's common stock. Each right entitles the holder to purchase one one-thousandth of a share of Series A Participating Preferred Stock at an exercise price of \$100, subject to adjustment, or at the discretion of the Board of Directors of the Company, the right to purchase common stock of the Company at a 50% discount. The rights become exercisable only upon the occurrence of certain events involving a buyer acquiring 18.5% or greater beneficial

ownership in the Company's common stock or the announcement of a tender offer or exchange offer which, if consummated, would give the buyer beneficial ownership of an 18.5% or greater position in the Company. Preferred share purchase rights owned by the buyer become null and void following this occurrence. The rights will expire April 2007, and the Company may redeem the rights at any time (prior to the occurrence of a specified event) at a price of one cent per right. If the Company is acquired in a merger or similar transaction after such an occurrence, all rights holders, except the buyer, will have the right to purchase stock in the buyer at a 50% discount.

Performance-Accelerated Vesting Restricted Stock and Performance Shares - During 1999, the Company began to grant performance shares to executive officers on an annual basis. The performance shares granted during 1999 were made for overlapping "initial stub" one-year and two-year cycles, as well as a "full cycle" three-year performance period. During 2000, performance shares were granted for a "full cycle" three-year performance period. Each performance share provides that its holder can receive the market value of up to 1.5 shares of common stock upon the Company's achieving specified diluted earnings per share (EPS) as measured at the end of the particular performance cycle. Upon achievement of the targeted performance, the Company may choose to pay the award in cash, unrestricted common stock, or a combination. During 2000, the Company granted 39,750 performance shares for

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the three-year cycle ending 2002. During 1999, the Company granted 11,500 performance shares for the one-year cycle ended 1999; 23,899 performance shares for the two-year cycle ended 2000; and 35,825 performance shares for the three-year cycle ended 2001. The Company did not achieve the minimum EPS thresholds for both the one-year and two-year cycles ended 1999 and 2000, respectively, and accordingly no pay-outs were made, no compensation expense was recognized, and those performance shares were canceled. The remaining performance shares granted during 1999 and 2000 were canceled and exchanged during 2001 for performance-accelerated vesting restricted shares of common stock (PARS), as described below.

During 2001, the Company began to grant PARS instead of continuing annual grants of performance shares. Generally, each PARS granted on an annual basis vests in equal 20% installments at the end of the calendar year in which the grant is made and the four calendar years thereafter. For all PARS grants, accelerated vesting is possible upon achievement of targeted EPS performance.

During February 2001, 43,225 PARS were issued to executive officers as annual grants for the 2001 fiscal year. In addition, the Company issued to executive officers 1 PARS in exchange for the surrender of every 5 performance shares then outstanding. Pursuant to this exchange, all 64,575 performance shares then outstanding were surrendered and canceled and 12,915 additional PARS were issued. Of the 12,915 PARS issued, 6,265 vest in 50% installments at December 31, 2001, and December 31, 2002; and the remaining 6,650 vest in equal installments at December 31, 2001, 2002, and 2003.

In September 2001, in exchange for certain stock options then held by executive officers, the Company issued PARS at a ratio of 1 PARS for the surrender of an option to purchase 100 shares of common stock. Pursuant to this exchange, outstanding options to purchase 1,035,833 shares of common stock were surrendered and canceled and 10,359 PARS were issued. Each PARS granted in this exchange vests in equal installments at December 31, 2001, 2002, and 2003.

The Company records unearned compensation expense on the grant date based on the publicly quoted fair market value of the Company's common stock, and amortizes the balance over the vesting period. The Company recorded unearned compensation during 2001 of approximately \$0.6 million within stockholders' equity.

11. INCOME PER COMMON SHARE

The following tables reconcile net income per common share and net income per common share assuming dilution:

| | 2001 | 2000 | 1999 |
|---|------------|------------|------------|
| Net income | \$ 15,962 | \$ 20,793 | \$ 42,656 |
| Weighted average number of shares outstanding | 12,878,000 | 14,110,000 | 17,214,000 |
| Net income per common share - basic | \$ 1.24 | \$ 1.47 | \$ 2.48 |
| Net income | \$ 15,962 | \$ 20,793 | \$ 42,656 |
| Weighted average number of shares outstanding | 12,878,000 | 14,110,000 | 17,214,000 |
| Dilutive impact of options outstanding | 30,000 | 54,000 | 174,000 |
| Weighted average number of shares and potential dilutive shares outstanding | 12,908,000 | 14,164,000 | 17,388,000 |
| Net income per common share - assuming dilution | \$ 1.24 | \$ 1.47 | \$ 2.45 |

Options to purchase 1,225,577, 2,297,381, and 914,000 shares of common stock were outstanding at December 29, 2001, December 30, 2000, and January 1, 2000, respectively, but were not included in the computation of net income per common share assuming dilution because the exercise prices were greater than the average market price of the common stock.

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DEPARTMENT 56, INC. AND SUBSIDIARIES

SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS (In thousands)

| Column A | Column B | Column C | Column D | Column E |
|-------------|-----------------------------|-------------------------------|------------|-----------------------|
| Description | Balance Beginning of Period | Charged to Costs and Expenses | Deductions | Balance End of Period |

| | | | | |
|---|-----------|----------|-------------|-----------|
| ----- | | | | |
| Year ended December 29, 2001: | | | | |
| Allowance for doubtful accounts | \$ 10,483 | \$ 545 | \$ 4,566(a) | \$ 6,462 |
| Allowance for sales returns and credits | 9,108 | 4,603 | 8,231 | 5,480 |
| | ----- | ----- | ----- | ----- |
| | \$ 19,591 | \$ 5,148 | \$ 12,797 | \$ 11,942 |
| | ----- | ----- | ----- | ----- |

| | | | | |
|---|-----------|-----------|-------------|-----------|
| Year ended December 30, 2000: | | | | |
| Allowance for doubtful accounts | \$ 7,659 | \$ 8,476 | \$ 5,652(a) | \$ 10,483 |
| Allowance for sales returns and credits | 10,628 | 15,986 | 17,506 | 9,108 |
| | ----- | ----- | ----- | ----- |
| | \$ 18,287 | \$ 24,462 | \$ 23,158 | \$ 19,591 |
| | ----- | ----- | ----- | ----- |

| | | | | |
|---|-----------|-----------|-----------|-----------|
| Year ended January 1, 2000: | | | | |
| Allowance for doubtful accounts | \$ 5,179 | \$ 3,276 | \$ 796(a) | \$ 7,659 |
| Allowance for sales returns and credits | 7,729 | 12,737 | 9,838 | 10,628 |
| | ----- | ----- | ----- | ----- |
| | \$ 12,908 | \$ 16,013 | \$ 10,634 | \$ 18,287 |
| | ----- | ----- | ----- | ----- |

(a) Accounts determined to be uncollectible and charged against allowance account, net of collections on accounts previously charged against allowance account.

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SCHEDULE II

DEPARTMENT 56, INC.
1993 STOCK INCENTIVE PLAN
(AS AMENDED)

1. PURPOSE.

The purpose of this Plan is to strengthen Department 56, Inc., a Delaware corporation (the "Company"), by providing an incentive to its officers, employees, consultants, directors and advisors and thereby encouraging them to devote their abilities and industry to the success of the Company's business enterprise. It is intended that this purpose be achieved by extending to officers, employees, consultants and directors of the Company and its subsidiaries an added long-term incentive for high levels of performance and unusual efforts through the grant of Incentive Stock Options, Nonqualified Stock Options, Stock Appreciation Rights, Restricted Stock, Performance Units and Performance Shares (as each term is hereinafter defined).

2. DEFINITIONS.

For purposes of the Plan:

2.1 "Adjusted Fair Market Value" means, in the event of a Change in Control, the greater of (i) the highest price per Share paid to holders of the Shares in any transaction (or series of transactions) constituting or resulting in a Change in Control or (ii) the highest Fair Market Value of a Share during the ninety (90) day period ending on the date of a Change in Control.

2.2 "Agreement" means the written agreement between the Company and an Optionee or Grantee evidencing the grant of an Option or Award and setting forth the terms and conditions thereof.

2.3 "Award" means a grant of Restricted Stock, a Stock Appreciation Right, a Performance Award or any or all of them.

2.4 "Board" means the Board of Directors of the Company.

2.5 "Cause" means the commission of an act of fraud or intentional misrepresentation or an act of embezzlement, misappropriation or conversion of assets or opportunities of the Company or any Subsidiary.

2.6 "Change in Capitalization" means any increase or reduction in the number of Shares, or any change (including, but not limited to, a change in value) in the Shares or exchange of Shares for a different number or kind of shares or other

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securities of the Company, by reason of a reclassification, recapitalization, merger, consolidation, reorganization, spin-off, split-up, issuance of warrants or rights or debentures, stock dividend, stock split or reverse stock split, cash dividend, property dividend, combination or exchange of shares, repurchase of shares, change in corporate structure or otherwise.

2.7 A "Change in Control" shall mean the occurrence during the term of the Plan of:

(a) An acquisition (other than directly from the Company) of any voting securities of the Company (the "Voting Securities") by any 'Person' (as the term person is used for purposes of Section 13(d) or 14(d) of the Exchange Act), other than

Department 56 Partners, L.P. or Forstmann Little & Co. Subordinated Debt and Equity Management Buyout Partnership IV or any of their affiliates (individually or in the aggregate), immediately after which such Person has 'Beneficial Ownership' (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of fifty-one percent (51%) or more of the combined voting power of the Company's then outstanding Voting Securities; provided, however, in determining whether a Change in Control has occurred, Voting Securities which are acquired in a 'Non-Control Acquisition' (as hereinafter defined) shall not constitute an acquisition which would cause a Change in Control. A 'Non-Control Acquisition' shall mean an acquisition by (i) an employee benefit plan (or a trust forming a part thereof) maintained by (A) the Company or (B) any corporation or other Person of which a majority of its voting power or its voting equity securities or equity interest is owned, directly or indirectly, by the Company (for purposes of this definition, a 'Subsidiary'), (ii) the Company or its Subsidiaries, or (iii) any Person in connection with a 'Non-Control Transaction' (as hereinafter defined);

(b) The individuals who, as of June 1, 1993, are members of the Board (the "Incumbent Board"), cease for any reason to constitute at least two-thirds of the members of the Board; provided, however, that if the election, or nomination for election by the Company's common stockholders, of any new director was approved by a vote of at least two-thirds of the Incumbent Board, such new director shall, for purposes of this Plan, be considered as a member of the Incumbent Board; provided further, however, that no individual shall be considered a member of the Incumbent Board if such individual initially assumed office as a result of either an actual or threatened 'Election Contest' (as described in Rule 14a-11 promulgated under the Exchange Act) or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board (a "Proxy Contest") including by reason of any agreement intended to avoid or settle any Election Contest or Proxy Contest; or

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(c) Approval by stockholders of the Company of:

- (i) A merger, consolidation or reorganization involving the Company, unless (A) the stockholders of the Company, immediately before such merger, consolidation or reorganization, own, directly or indirectly immediately following such merger, consolidation or reorganization, at least sixty percent (60%) of the combined voting power of the outstanding voting securities of the corporation resulting from such merger or consolidation or reorganization (the "Surviving Corporation") in substantially the same proportion as their ownership of the Voting Securities immediately before such merger, consolidation or reorganization, (B) the individuals who were members of the Incumbent Board immediately prior to the execution of the agreement providing for such merger, consolidation or reorganization constitute at least two-thirds of the members of the board of directors of the Surviving Corporation, (C) no Person other than the Company, any Subsidiary, any employee benefit plan (or any trust forming a part thereof) maintained by the Company, the Surviving Corporation, or any Subsidiary, or any Person who, immediately prior to such merger, consolidation or reorganization had

Beneficial Ownership of fifty-one percent (51%) or more of the then outstanding Voting Securities has Beneficial Ownership of fifty-one percent (51%) or more of the combined voting power of the Surviving Corporation's then outstanding voting securities, and (D) a transaction described in clauses (A) through (C) shall herein be referred to as a 'Non-Control Transaction';

- (ii) A complete liquidation or dissolution of the Company; or
- (iii) An agreement for the sale or other disposition of all or substantially all of the assets of the Company to any Person (other than a transfer to a Subsidiary).

Notwithstanding the foregoing, a Change in Control shall not be deemed to occur solely because any Person (the "Subject Person") acquired Beneficial Ownership of more than the permitted amount of the outstanding Voting Securities as a result of the acquisition of Voting Securities by the Company which, by reducing the number of Voting Securities outstanding, increases the proportional number of shares Beneficially Owned by the Subject Persons, provided that if a Change in Control would occur (but for the operation of this sentence) as a result of the acquisition of Voting Securities by the Company, and after such share acquisition by the Company, the Subject Person becomes the Beneficial Owner of any additional Voting Securities which increases the percentage of the then outstanding Voting

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Securities Beneficially Owned by the Subject Person, then a Change in Control shall occur.

2.8 "Code" means the Internal Revenue Code of 1986, as amended.

2.9 "Committee" means a committee consisting of one or more Directors appointed by the Board to administer the Plan and to perform the functions set forth herein.

2.10 "Company" means Department 56, Inc.

2.11 "Director Option" means an Option granted pursuant to Section 6.

2.12 "Disability" means a physical or mental infirmity which impairs the Optionee's ability to perform substantially his or her duties for a period of one hundred eighty (180) consecutive days.

2.13 "Disinterested Director" means a director of the Company who is a "non-employee director" within the meaning of Rule 16b-3 under the Exchange Act.

2.14 "Division" means any of the operating units or divisions of the Company designated as a Division by the Committee.

2.15 "Eligible Individual" means any officer, employee, consultant or advisor of the Company or a Subsidiary designated by the Committee as eligible to receive Options or Awards subject to the conditions set forth herein.

2.16 "Employee Option" means an Option granted pursuant to Section 5.

2.17 "Exchange Act" means the Securities Exchange Act of 1934, as amended.

2.18 "Fair Market Value" on any date means the average of the high and low sales prices of the Shares on such date on the principal national securities exchange on which such Shares are listed or admitted to trading, or if such Shares are not so listed or admitted to trading, the arithmetic mean of the per Share closing bid price and per Share closing asked price on such date as quoted on the National Association of Securities Dealers Automated Quotation System or such other market in which such prices are regularly quoted, or, if there have been no published bid or asked quotations with respect to Shares on such date, the Fair Market Value shall be the value established by the Board in good faith and, in the case of an Incentive Stock Option, in accordance with Section 422 of the Code.

2.19 "Grantee" means a person to whom an Award has been granted under the Plan.

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2.20 "Incentive Stock Option" means an Option satisfying the requirements of Section 422 of the Code and designated by the Committee as an Incentive Stock Option.

2.21 "Nonemployee Director" means a director of the Company who is not an employee of the Company or any Subsidiary.

2.22 "Nonqualified Stock Option" means an Option which is not an Incentive Stock Option.

2.23 "Option" means an Employee Option, a Director Option, or either or both of them.

2.24 "Optionee" means a person to whom an Option has been granted under the Plan.

2.25 "Parent" means any corporation which is a parent corporation (within the meaning of Section 424(e) of the Code) with respect to the Company.

2.26 "Performance Awards" means Performance Units, Performance Shares or either or both of them.

2.27 "Performance Cycle" means the time period specified by the Committee at the time a Performance Award is granted during which the performance of the Company, a Subsidiary or a Division will be measured.

2.28 "Performance Shares" means Shares issued or transferred to an Eligible Individual under Section 10.3.

2.29 "Performance Unit" means Performance Units granted to an Eligible Individual under Section 10.2.

2.30 "Plan" means the Department 56, Inc. 1993 Stock Incentive Plan.

2.31 "Restricted Stock" means Shares issued or transferred to an Eligible Individual pursuant to Section 9.

2.32 "Shares" means the common stock, par value \$.01 per share, of the Company.

2.33 "Stock Appreciation Right" means a right to receive all or some portion of the increase in the value of the Shares as provided in Section 8 hereof.

2.34 "Stockholders Agreement" means a stockholders agreement governing the rights, duties and obligations of present or future employees or

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case may be, of the Company or its Subsidiaries with respect to Shares granted or sold to such persons, or issued pursuant to options or other awards granted to such persons, in such form as is in use by the Company at the time of exercise of an Option or any part thereof or the issuance of Shares pursuant to an Award and which the Company elects to require an Optionee or Grantee to execute in connection with the issuance of Shares.

2.35 "Subsidiary" means any corporation which is a subsidiary corporation (within the meaning of Section 424(f) of the Code) with respect to the Company.

2.36 "Successor Corporation" means a corporation, or a parent or subsidiary thereof within the meaning of Section 424(a) of the Code, which issues or assumes a stock option in a transaction to which Section 424(a) of the Code applies.

2.37 "Ten-Percent Stockholder" means an Eligible Individual, who, at the time an Incentive Stock Option is to be granted to him or her, owns (within the meaning of Section 422(b)(6) of the Code) stock possessing more than ten percent (10%) of the total combined voting power of all classes of stock of the Company, or of a Parent or a Subsidiary.

3. ADMINISTRATION.

3.1 The Plan shall be administered by the Committee which shall hold meetings at such times as may be necessary for the proper administration of the Plan. The Committee shall keep minutes of its meetings. Except as provided in Section 3.4, a quorum shall consist of not less than two members of the Committee and a majority of a quorum may authorize any action. Any decision or determination reduced to writing and signed by a majority of all of the members shall be as fully effective as if made by a majority vote at a meeting duly called and held. Except as provided in Section 3.4, each member of the Committee shall be a Disinterested Director; PROVIDED, HOWEVER, that the Board may, by resolution, authorize a committee consisting of one or more Directors to make grants of Employee Options to Eligible Individuals who are not officers of the Company, subject to such restrictions and limitations as the Board shall set forth in such resolution and as otherwise provided in the Plan. No member of the Committee shall be liable for any action, failure to act, determination or interpretation made in good faith with respect to this Plan or any transaction hereunder, except for liability arising from his or her own willful misfeasance, gross negligence or reckless disregard of his or her duties. The Company hereby agrees to indemnify each member of the Committee for all costs and expenses and, to the extent permitted by applicable law, any liability incurred in connection with defending against, responding to, negotiation for the settlement of or otherwise dealing with any claim, cause of action or dispute of any kind arising in connection with any actions in administering this Plan or in authorizing or denying authorization to any transaction hereunder.

3.2 Subject to the express terms and conditions set forth herein, the Committee

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shall have the power from time to time to:

(a) determine those individuals to whom Options shall be granted under the Plan and the number of Incentive Stock Options and/or Nonqualified Stock Options to be granted to each Eligible Individual or Nonemployee Director and to prescribe the terms and conditions (which need not be

identical) of each Option, including the purchase price per Share subject to each Option, and make any amendment or modification to any Agreement consistent with the terms of the Plan; and

(b) select those Eligible Individuals to whom Awards shall be granted under the Plan and to determine the number of Stock Appreciation Rights, Performance Units, Performance Shares, and/or Shares of Restricted Stock to be granted pursuant to each Award, the terms and conditions of each Award, including the restrictions or Performance Objectives relating to such Units or Shares, the maximum value of each Performance Unit and Performance Share and make any amendment or modification to any Agreement consistent with the terms of the Plan.

3.3 Subject to the express terms and conditions set forth herein, the Committee shall have the power from time to time:

(a) to construe and interpret the Plan and the Options and Awards granted hereunder and to establish, amend and revoke rules and regulations for the administration of the Plan, including, but not limited to, correcting any defect or supplying any omission, or reconciling any inconsistency in the Plan or in any Agreement, in the manner and to the extent it shall deem necessary or advisable so that the Plan complies with applicable law including Rule 16b-3 under the Exchange Act and the Code to the extent applicable, and otherwise to make the Plan fully effective. All decisions and determinations by the Committee in the exercise of this power shall be final, binding and conclusive upon the Company, its Subsidiaries, the Optionees and Grantees and all other persons having any interest therein;

(b) to determine the duration and purposes for leaves of absence which may be granted to an Optionee or Grantee on an individual basis without constituting a termination of employment or service for purposes of the Plan;

(c) to exercise its discretion with respect to the powers and rights granted to it as set forth in the Plan; and

(d) generally, to exercise such powers and to perform such acts as are deemed necessary or advisable to promote the best interests of the Company with respect to the Plan.

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3.4 BOARD RESERVATION AND DELEGATION.

(a) The Board may, in its discretion, reserve to itself or delegate to another committee of the Board any or all of the authority and responsibility of the Committee with respect to Options and Awards granted hereunder to Eligible Individuals who are not subject to Section 16 of the Exchange Act or Section 162(m) of the Code at the time any such delegated authority or responsibility is exercised. Such other committee may consist of one or more directors who may, but need not be, officers or employees of the Company or of any of its Subsidiaries. To the extent that the Board has reserved to itself or delegated the authority and responsibility of the Committee to such other committee, all references to the Committee in the Plan shall be to the Board or to such other committee.

(b) The Board may, by resolution, authorize a committee (the "Director Option Grant Committee") consisting of one or more directors of the Company to make grants of Director Options which are intended to satisfy the conditions for exemption from Section 16b of the Exchange Act pursuant to Rule 16b-3(d)(3). The authority of the Director Option Grant Committee shall be subject to such restrictions and limitations

as the Board shall set forth in such resolution and as otherwise provided in the Plan. References to the term Committee in Section 6 shall be deemed to include the Director Option Grant Committee wherever it is used insofar as it relates to the Committee's authority and responsibility to make grants and establish the terms of Director Options but only to the extent the Director Option Grant Committee is acting within the scope of its authority as established by the Board.

4. STOCK SUBJECT TO THE PLAN.

4.1 The maximum number of Shares that may be made the subject of Options and Awards granted under the Plan is 775,000; PROVIDED, HOWEVER, that, in the aggregate, not more than one-third of the number of allotted shares may be made the subject of Restricted Stock Awards under the Plan. Upon a Change in Capitalization the maximum number of Shares shall be adjusted in number and kind pursuant to Section 12. The Company shall reserve for the purposes of the Plan, out of its authorized but unissued Shares or out of Shares held in the Company's treasury, or partly out of each, such number of Shares as shall be determined by the Board.

4.2 Upon the granting of an Option or an Award, the number of Shares available under Section 4.1 for the granting of further Options and Awards shall be reduced as follows:

(a) In connection with the granting of an Option or an Award (other than the granting of a Performance Unit denominated in dollars), the number of Shares shall be reduced by the number of Shares in respect of which the Option or Award is granted or denominated.

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(b) In connection with the granting of a Performance Unit denominated in dollars, the number of Shares shall be reduced by an amount equal to the quotient of (i) the dollar amount in which the Performance Unit is denominated, divided by (ii) the Fair Market Value of a Share on the date the Performance Unit is granted.

4.3 Whenever any outstanding Option or Award or portion thereof expires, is cancelled or is otherwise terminated for any reason without having been exercised or payment having been made in respect of the entire Option or Award, the Shares allocable to the expired, cancelled or otherwise terminated portion of the Option or Award may again be the subject of Options or Awards granted hereunder.

4.4 Notwithstanding anything contained in this Section 4, the number of Shares available for Options and Awards at any time under the Plan shall be reduced to such lesser amount as may be required pursuant to the methods of calculation necessary so that the exemptions provided pursuant to Rule 16b-3 under the Exchange Act will continue to be available for transactions involving all current and future Options and Awards. In addition, during the period that any Options and Awards remain outstanding under the Plan, the Committee may make good faith adjustments with respect to the number of Shares attributable to such Options and Awards for purposes of calculating the maximum number of Shares available for the granting of future Options and Awards under the Plan, provided that following such adjustments the exemptions provided pursuant to Rule 16b-3 under the Exchange Act will continue to be available for transactions involving all current and future Options and Awards.

5. OPTION GRANTS FOR ELIGIBLE INDIVIDUALS.

5.1 AUTHORITY OF COMMITTEE. Subject to the provisions of the Plan and to Section 4.1 above, the Committee shall have full and final authority

to select those Eligible Individuals who will receive Options (each, an "Employee Option"), the terms and conditions of which shall be set forth in an Agreement; PROVIDED, HOWEVER, that no person shall receive any Incentive Stock Options unless he or she is an employee of the Company, a Parent or a Subsidiary at the time the Incentive Stock Option is granted.

5.2 PURCHASE PRICE. The purchase price or the manner in which the purchase price is to be determined for Shares under each Employee Option shall be determined by the Committee and set forth in the Agreement; PROVIDED, HOWEVER, that the purchase price per Share under each Employee Option shall not be less than 100% of the Fair Market Value of a Share on the date the Employee Option is granted (110% in the case of an Incentive Stock Option granted to a Ten-Percent Stockholder).

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5.3 MAXIMUM DURATION. Employee Options granted hereunder shall be for such term as the Committee shall determine, provided that an Incentive Stock Option shall not be exercisable after the expiration of ten (10) years from the date it is granted (five (5) years in the case of an Incentive Stock Option granted to a Ten-Percent Stockholder) and a Nonqualified Stock Option shall not be exercisable after the expiration of ten (10) years from the date it is granted. The Committee may, subsequent to the granting of any Employee Option, extend the term thereof but in no event shall the term as so extended exceed the maximum term provided for in the preceding sentence.

5.4 VESTING. Subject to Section 7.4 hereof, each Employee Option shall become exercisable in such installments (which need not be equal) and at such times as may be designated by the Committee and set forth in the Agreement. To the extent not exercised, installments shall accumulate and be exercisable, in whole or in part, at any time after becoming exercisable, but not later than the date the Employee Option expires. The Committee may accelerate the exercisability of any Option or portion thereof at any time.

5.5 MODIFICATION OR SUBSTITUTION. The Committee may, in its discretion, modify outstanding Employee Options or accept the surrender of outstanding Employee Options (to the extent not exercised) and grant new Employee Options in substitution for them; PROVIDED, HOWEVER, that, no modification or substitution may reduce or have the effect of reducing the per share purchase price of any outstanding Employee Option. Notwithstanding the foregoing, no modification of an Employee Option shall adversely alter or impair any rights or obligations under the Employee Option without the Optionee's consent.

6. NONEMPLOYEE DIRECTOR PROVISIONS.

6.1 OPTION GRANTS FOR NONEMPLOYEE DIRECTORS. Subject to the provisions of the Plan and to Section 4.1, the Committee may grant Director Options to any Nonemployee Director on such terms and conditions, including option price, exercisability and duration, as the Committee in its discretion shall determine. The Committee shall determine the number of Shares subject to each Director Option.

6.2 ELECTION TO RECEIVE SHARES IN LIEU OF DIRECTORS' FEES.

(a) ELECTION. Each Nonemployee Director may elect, on a form provided for such purpose by the Committee, to have all or any part (but only in 25% increments) of his or her Directors' Fees converted into, and transferred to him or her, in the form of Shares (an "Election"). For purposes of this Section 6.2, "Directors' Fees" means all cash annual retainer and meeting fees payable by the Company to an Nonemployee

Director with respect to services rendered by such Nonemployee Director.

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(b) TIME OF ELECTION; EFFECTIVE DATE OF ELECTION. An Nonemployee Director may make an Election at any time during any particular year during his or her directorship. An Election made on or prior to June 10 shall be effective with respect to Directors' Fees payable on or after July 1 of such year. An Election made on or prior to December 10 shall be effective with respect to Directors' Fees payable on or after January 1 of the following year.

(c) SHARES RECEIVED IN LIEU OF FEES. On each date following the effective date of an Election on which Directors' Fees would otherwise be paid (a "Director Payment Date"), the Directors' Fees that an Nonemployee Director would have received but for his or her Election shall be converted into the right to receive a number of Shares with a Fair Market Value (determined as of the Director Payment Date) equal to 110% of such Directors' Fees. Shares shall be issued by the Company to an Nonemployee Director who has made an Election as promptly as practicable following each Director Payment Date.

(d) ELECTION EFFECTIVE UNTIL REVOKED. An Nonemployee Director's Election shall remain effective until revoked. An Nonemployee Director may revoke his or her Election (a "Revocation") on a form provided for such purpose by the Committee at any time during any particular year during his or her directorship. A Revocation made on or prior to June 10 shall be effective with respect to Directors' Fees payable on or after July 1 of such year. A Revocation made on or prior to December 10 shall be effective with respect to Directors' Fees payable on or after January 1 of the following year.

6.3 LIMITATIONS ON AMENDMENT; MODIFICATION. The provisions in this Section 6 shall not be amended more than once every six months, other than to comport with changes in the Code or the rules and regulations thereunder. No modification of a Director Option shall adversely alter or impair any rights or obligations under such Director Option without the Optionee's consent nor shall any modification reduce or have the effect of reducing the per share purchase price of any outstanding Director Option.

7. TERMS AND CONDITIONS APPLICABLE TO ALL OPTIONS.

7.1 NON-TRANSFERABILITY. No Option granted hereunder shall be transferable by the Optionee to whom granted otherwise than by will or the laws of descent and distribution, and an Option may be exercised during the lifetime of such Optionee only by the Optionee or his or her guardian or legal representative. The terms of such Option shall be final, binding and conclusive upon the beneficiaries, executors, administrators, heirs and successors of the Optionee.

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7.2 METHOD OF EXERCISE. The exercise of an Option shall be made only by a written notice delivered in person or by mail to the Secretary of the Company at the Company's principal executive office, specifying the number of Shares to be purchased and accompanied by payment therefor and otherwise in accordance with the Agreement pursuant to which the Option was granted and, if the Committee then requires, a fully executed Stockholders Agreement. The purchase price for any Shares purchased pursuant to the exercise of an Option shall be paid in full upon such exercise by any one or a combination of the following: (i) cash or (ii) transferring Shares to the Company upon such terms and

conditions as determined by the Committee. Notwithstanding the foregoing, the Committee shall have discretion to determine at the time of grant of each Employee Option or at any later date (up to and including the date of exercise) the form of payment acceptable in respect of the exercise of such Employee Option and Options may be exercised pursuant to such cashless exercise procedures which are, from time to time, deemed acceptable by the Committee. The written notice pursuant to this Section 7.2 may also provide instructions from the Optionee to the Company that upon receipt of the purchase price in cash from the Optionee's broker or dealer, designated as such on the written notice, in payment for any Shares purchased pursuant to the exercise of an Option, the Company shall issue such Shares directly to the designated broker or dealer. Any Shares transferred to the Company as payment of the purchase price under an Option shall be valued at their Fair Market Value on the day preceding the date of exercise of such Option. If requested by the Committee, the Optionee shall deliver the Agreement evidencing the Option to the Secretary of the Company who shall endorse thereon a notation of such exercise and return such Agreement to the Optionee. No fractional Shares (or cash in lieu thereof) shall be issued upon exercise of an Option and the number of Shares that may be purchased upon exercise shall be rounded to the nearest number of whole Shares.

7.3 RIGHTS OF OPTIONEES. No Optionee shall be deemed for any purpose to be the owner of any Shares subject to any Option unless and until (i) the Option shall have been exercised pursuant to the terms thereof, (ii) the Company shall have issued and delivered the Shares to the Optionee and (iii) the Optionee's name shall have been entered as a stockholder of record on the books of the Company. Thereupon, the Optionee shall have full voting, dividend and other ownership rights with respect to such Shares.

7.4 EFFECT OF CHANGE IN CONTROL. Notwithstanding anything contained in the Plan or an Agreement to the contrary, in the event of a Change in Control, all Options outstanding on the date of such Change in Control shall become immediately and fully exercisable. In addition, to the extent set forth in an Agreement evidencing the grant of an Option, an Optionee will be permitted to surrender for cancellation within sixty (60) days after such Change in Control, any Option or portion of an Option to the extent not yet exercised and the Optionee will be entitled to receive a cash payment in an amount equal to the excess, if any, of (x) (A) in the case of a

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Nonqualified Stock Option, the greater of (1) the Fair Market Value, on the date preceding the date of surrender, of the Shares subject to the Option or portion thereof surrendered or (2) the Adjusted Fair Market Value of the Shares subject to the Option or portion thereof surrendered or (B) in the case of an Incentive Stock Option, the Fair Market Value, on the date preceding the date of surrender, of the Shares subject to the Option or portion thereof surrendered, over (y) the aggregate purchase price for such Shares under the Option or portion thereof surrendered; PROVIDED, HOWEVER, that in the case of an Option granted within six (6) months prior to the Change in Control to any Optionee who may be subject to liability under Section 16(b) of the Exchange Act, such Optionee shall be entitled to surrender for cancellation his or her Option during the sixty (60) day period commencing upon the expiration of six (6) months from the date of grant of any such Option.

8. STOCK APPRECIATION RIGHTS. The Committee may, in its discretion, either alone or in connection with the grant of an Employee Option, grant Stock Appreciation Rights in accordance with the Plan and the terms and conditions of which shall be set forth in an Agreement. If granted in connection with an Employee Option, a Stock Appreciation Right shall cover the same Shares covered by the Employee Option (or such lesser number of Shares as the Committee may determine) and

shall, except as provided in this Section 8, be subject to the same terms and conditions as the related Employee Option.

8.1 TIME OF GRANT. A Stock Appreciation Right may be granted (i) at any time if unrelated to an Option, or (ii) if related to an Employee Option, either at the time of grant, or at any time thereafter during the term of the Option.

8.2 STOCK APPRECIATION RIGHT RELATED TO AN EMPLOYEE OPTION.

(a) EXERCISE. Subject to Section 8.6, a Stock Appreciation Right granted in connection with an Employee Option shall be exercisable at such time or times and only to the extent that the related Employee Option is exercisable, and will not be transferable except to the extent the related Employee Option is transferable. A Stock Appreciation Right granted in connection with an Incentive Stock Option shall be exercisable only if the Fair Market Value of a Share on the date of exercise exceeds the purchase price specified in the related Incentive Stock Option Agreement.

(b) AMOUNT PAYABLE. Upon the exercise of a Stock Appreciation Right related to an Employee Option, the Grantee shall be entitled to receive an amount determined by multiplying (A) the excess of the Fair Market Value of a Share on the date preceding the date of exercise of such Stock Appreciation Right over the per Share purchase price under the related Employee Option, by (B) the number of Shares as to which such Stock Appreciation Right is being exercised. Notwithstanding the foregoing, the Committee may limit in any manner the amount payable with respect to any Stock Appreciation Right by including such a limit in the Agreement

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evidencing the Stock Appreciation Right at the time it is granted.

(c) TREATMENT OF RELATED OPTIONS AND STOCK APPRECIATION RIGHTS UPON EXERCISE. Upon the exercise of a Stock Appreciation Right granted in connection with an Employee Option, the Employee Option shall be cancelled to the extent of the number of Shares as to which the Stock Appreciation Right is exercised, and upon the exercise of an Employee Option granted in connection with a Stock Appreciation Right or the surrender of such Employee Option pursuant to Section 7.4, the Stock Appreciation Right shall be cancelled to the extent of the number of Shares as to which the Employee Option is exercised or surrendered.

8.3 STOCK APPRECIATION RIGHT UNRELATED TO AN OPTION. The Committee may grant to Eligible Individuals Stock Appreciation Rights unrelated to Options. Stock Appreciation Rights unrelated to Options shall contain such terms and conditions as to exercisability (subject to Section 8.6), vesting and duration as the Committee shall determine, but in no event shall they have a term of greater than ten (10) years. Upon exercise of a Stock Appreciation Right unrelated to an Option, the Grantee shall be entitled to receive an amount determined by multiplying (A) the excess of the Fair Market Value of a Share on the date preceding the date of exercise of such Stock Appreciation Right over the Fair Market Value of a Share on the date the Stock Appreciation Right was granted, by (B) the number of Shares as to which the Stock Appreciation Right is being exercised. Notwithstanding the foregoing, the Committee may limit in any manner the amount payable with respect to any Stock Appreciation Right by including such a limit in the Agreement evidencing the Stock Appreciation Right at the time it is granted.

8.4 METHOD OF EXERCISE. Stock Appreciation Rights shall be exercised by a Grantee only by a written notice delivered in person or by mail to the Secretary of the Company at the Company's principal executive office, specifying the number of Shares with respect to which the Stock Appreciation Right is being exercised. If requested by the Committee, the Grantee shall deliver the Agreement evidencing the Stock Appreciation Right being exercised and the Agreement evidencing any related Employee Option to the Secretary of the Company who shall endorse thereon a notation of such exercise and return such Agreement to the Grantee.

8.5 FORM OF PAYMENT. Payment of the amount determined under Sections 8.2(b) or 8.3 may be made in the discretion of the Committee, solely in whole Shares in a number determined at their Fair Market Value on the date preceding the date of exercise of the Stock Appreciation Right, or solely in cash, or in a combination of cash and Shares. If the Committee decides to make full payment in Shares and the amount payable results in a fractional Share, payment for the fractional Share will be made in cash. Notwithstanding the foregoing, no payment in the form of cash may be made upon the exercise of a Stock Appreciation Right pursuant to Sections 8.2(b) or 8.3 to a Grantee who is an officer of the Company or a Subsidiary

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who is subject to liability under Section 16(b) of the Exchange Act, unless the exercise of such Stock Appreciation Right is made either (i) during the period beginning on the third business day and ending on the twelfth business day following the date of release for publication of the Company's quarterly or annual statements of earnings or (ii) pursuant to an irrevocable election to receive cash made at least six months prior to the exercise of such Stock Appreciation Right.

8.6 RESTRICTIONS. No Stock Appreciation Right may be exercised before the date six (6) months after the date it is granted.

8.7 MODIFICATION OR SUBSTITUTION. Subject to the terms of the Plan, the Committee may modify outstanding Awards of Stock Appreciation Rights or accept the surrender of outstanding Awards of Stock Appreciation Rights (to the extent not exercised) and grant new Awards in substitution for them. Notwithstanding the foregoing, no modification of an Award shall adversely alter or impair any rights or obligations under the Agreement without the Grantee's consent.

8.8 EFFECT OF CHANGE IN CONTROL. In the event of a Change in Control, subject to Section 8.6, all Stock Appreciation Rights shall become immediately and fully exercisable. Notwithstanding Sections 8.3 and 8.5, to the extent set forth in an Agreement evidencing the grant of a Stock Appreciation Right unrelated to an Option, upon the exercise of such a Stock Appreciation Right or any portion thereof during the sixty (60) day period following a Change in Control, the amount payable shall be in cash and shall be an amount equal to the excess, if any, of (A) the greater of (x) the Fair Market Value, on the date preceding the date of exercise, of the Shares subject to Stock Appreciation Right or portion thereof exercised and (y) the Adjusted Fair Market Value, on the date preceding the date of exercise, of the Shares over (B) the aggregate Fair Market Value, on the date the Stock Appreciation Right was granted, of the Shares subject to the Stock Appreciation Right or portion thereof exercised; PROVIDED, HOWEVER, that in the case of a Stock Appreciation Right granted within six (6) months prior to the Change in Control to any Grantee who may be subject to liability under Section 16(b) of the Exchange Act, such Grantee shall be entitled to exercise his Stock Appreciation Right during the sixty (60) day period commencing upon the expiration of six (6) months from the date of grant of any such Stock Appreciation Right.

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9. RESTRICTED STOCK.

9.1 GRANT. The Committee may grant to Eligible Individuals Awards of Restricted Stock, and may issue Shares of Restricted Stock in payment in respect of vested Performance Units (as hereinafter provided in Section 10.2), which shall be evidenced by an Agreement between the Company and the Grantee. Each Agreement shall contain such restrictions, terms and conditions as the Committee may, in its discretion, determine and (without limiting the generality of the foregoing) such Agreements may require that an appropriate legend be placed on Share certificates. Awards of Restricted Stock shall be subject to the terms and provisions set forth below in this Section 9.

9.2 RIGHTS OF GRANTEE. Shares of Restricted Stock granted pursuant to an Award hereunder shall be issued in the name of the Grantee as soon as reasonably practicable after the Award is granted provided that the Grantee has executed an Agreement evidencing the Award, the appropriate blank stock powers and, in the discretion of the Committee, an escrow agreement and any other documents which the Committee may require as a condition to the issuance of such Shares. If a Grantee shall fail to execute the Agreement evidencing a Restricted Stock Award, the appropriate blank stock powers and, in the discretion of the Committee, an escrow agreement and any other documents which the Committee may require within the time period prescribed by the Committee at the time the Award is granted, the Award shall be null and void. At the discretion of the Committee, Shares issued in connection with a Restricted Stock Award shall be deposited together with the stock powers with an escrow agent (which may be the Company) designated by the Committee. Unless the Committee determines otherwise and as set forth in the Agreement, upon delivery of the Shares to the escrow agent, the Grantee shall have all of the rights of a stockholder with respect to such Shares, including the right to vote the Shares and to receive all dividends or other distributions paid or made with respect to the Shares.

9.3 NON-TRANSFERABILITY. Until any restrictions upon the Shares of Restricted Stock awarded to a Grantee shall have lapsed in the manner set forth in Section 9.4, such Shares shall not be sold, transferred or otherwise disposed of and shall not be pledged or otherwise hypothecated, nor shall they be delivered to the Grantee.

9.4 LAPSE OF RESTRICTIONS.

(a) GENERALLY. Restrictions upon Shares of Restricted Stock awarded hereunder shall lapse at such time or times and on such terms and conditions as the Committee may determine, which restrictions shall be set forth in the Agreement evidencing the Award.

(b) EFFECT OF CHANGE IN CONTROL. The Committee shall determine at the

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time of the grant of an Award of Restricted Stock the extent to which, if any, the restrictions upon Shares of Restricted Stock shall lapse upon a Change in Control. The Agreement evidencing the Award shall set forth such provisions.

9.5 MODIFICATION OR SUBSTITUTION. Subject to the terms of the Plan, the Committee may modify outstanding Awards of Restricted Stock or accept the surrender of outstanding Shares of Restricted Stock (to the extent the restrictions on such Shares have not yet lapsed) and grant new Awards in substitution for them. Notwithstanding the foregoing, no modification of an Award shall adversely alter or impair any rights or obligations under the Agreement without the Grantee's consent.

9.6 TREATMENT OF DIVIDENDS. At the time the Award of Shares of Restricted Stock is granted, the Committee may, in its discretion, determine that the payment to the Grantee of dividends, or a specified portion thereof, declared or paid on such Shares by the Company shall be (i) deferred until the lapsing of the restrictions imposed upon such Shares and (ii) held by the Company for the account of the Grantee until such time. In the event that dividends are to be deferred, the Committee shall determine whether such dividends are to be reinvested in Shares (which shall be held as additional Shares of Restricted Stock) or held in cash. If deferred dividends are to be held in cash, there may be credited at the end of each year (or portion thereof) interest on the amount of the account at the beginning of the year at a rate per annum as the Committee, in its discretion, may determine. Payment of deferred dividends in respect of Shares of Restricted Stock (whether held in cash or as additional Shares of Restricted Stock), together with interest accrued thereon, if any, shall be made upon the lapsing of restrictions imposed on the Shares in respect of which the deferred dividends were paid, and any dividends deferred (together with any interest accrued thereon) in respect of any Shares of Restricted Stock shall be forfeited upon the forfeiture of such Shares.

9.7 DELIVERY OF SHARES. Upon the lapse of the restrictions on Shares of Restricted Stock, the Committee shall cause a stock certificate to be delivered to the Grantee with respect to such Shares, free of all restrictions hereunder.

10. PERFORMANCE AWARDS.

10.1 PERFORMANCE OBJECTIVES. Performance objectives for Performance Awards may be expressed in terms of (i) earnings per Share, (ii) pre-tax profits, (iii) net earnings, (iv) return on equity or assets, (v) revenues or (vi) any combination of the foregoing. Performance objectives may be in respect of the performance of the Company and its Subsidiaries (which may be on a consolidated basis), a Subsidiary or a Division. Performance objectives may be absolute or relative and may be expressed in terms of a progression within a specified range. Prior to the end of a Performance Cycle, the

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Committee, in its discretion, may adjust the performance objectives to reflect a Change in Capitalization, a change in the tax rate or book tax rate of the Company or any Subsidiary, or any other event which may materially affect the performance of the Company, a Subsidiary or a Division, including, but not limited to, market conditions or a significant acquisition or disposition of assets or other property by the Company, a Subsidiary or a Division.

10.2 PERFORMANCE UNITS. The Committee, in its discretion, may grant Awards of Performance Units to Eligible Individuals, the terms and conditions of which shall be set forth in an Agreement between the Company and the Grantee. Performance Units may be denominated in Shares or a specified dollar amount and, contingent upon the attainment of specified performance objectives within the Performance Cycle, represent the right to receive payment as provided in Section 10.2(b) of (i) in the case of Share-denominated Performance Units, the Fair Market Value of a Share on the date the Performance Unit was granted, the date the Performance Unit became vested or any other date specified by the Committee, (ii) in the case of dollar-denominated Performance Units, the specified dollar amount or (iii) a percentage (which may be more than 100%) of the amount described in clause (i) or (ii) depending on the level of performance objective attainment; PROVIDED, HOWEVER, that the Committee may at the time a Performance Unit is granted, specify a maximum amount payable in respect of a vested Performance

Unit. Each Agreement shall specify the number of the Performance Units to which it relates, the performance objectives which must be satisfied in order for the Performance Units to vest and the Performance Cycle within which such performance objectives must be satisfied.

(a) VESTING AND FORFEITURE. A Grantee shall become vested with respect to the Performance Units to the extent that the Performance Objectives set forth in the Agreement are satisfied for the Performance Cycle.

(b) PAYMENT OF AWARDS. Payment to Grantees in respect of vested Performance Units shall be made within sixty (60) days after the last day of the Performance Cycle to which such Award relates unless the Agreement evidencing the Award provides for the deferral of payment, in which event the terms and conditions of the deferral shall be set forth in the Agreement. Subject to Section 10.4, such payments may be made entirely in Shares valued at their Fair Market Value as of the last day of the applicable Performance Cycle or such other date specified by the Committee, entirely in cash, or in such combination of Shares and cash as the Committee in its discretion, shall determine at any time prior to such payment; PROVIDED, HOWEVER, that if the Committee in its discretion determines to make such payment entirely or partially in Shares of Restricted Stock, the Committee must determine the extent to which such payment will be in Shares of Restricted Stock and the terms of such Restricted Stock at the time the Award is granted.

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10.3 PERFORMANCE SHARES. The Committee, in its discretion, may grant Awards of Performance Shares to Eligible Individuals, the terms and conditions of which shall be set forth in an Agreement between the Company and the Grantee. Each Agreement may require that an appropriate legend be placed on Share certificates. Awards of Performance Shares shall be subject to the following terms and provisions:

(a) RIGHTS OF GRANTEE. The Committee shall provide at the time an Award of Performance Shares is made, the time or times at which the actual Shares represented by such Award shall be issued in the name of the Grantee; PROVIDED, HOWEVER, that no Performance Shares shall be issued until the Grantee has executed an Agreement evidencing the Award, the appropriate blank stock powers and, in the discretion of the Committee, an escrow agreement and any other documents which the Committee may require as a condition to the issuance of such Performance Shares. If a Grantee shall fail to execute the Agreement evidencing an Award of Performance Shares, the appropriate blank stock powers and, in the discretion of the Committee, an escrow agreement and any other documents which the Committee may require within the time period prescribed by the Committee at the time the Award is granted, the Award shall be null and void. At the discretion of the Committee, Shares issued in connection with an Award of Performance Shares shall be deposited together with the stock powers with an escrow agent (which may be the Company) designated by the Committee. Except as restricted by the terms of the Agreement, upon delivery of the Shares to the escrow agent, the Grantee shall have, in the discretion of the Committee, all of the rights of a stockholder with respect to such Shares, including the right to vote the Shares and to receive all dividends or other distributions paid or made with respect to the Shares.

(b) NON-TRANSFERABILITY. Until any restrictions upon the Performance Shares awarded to a Grantee shall have lapsed in the manner set forth in Sections 10.3(c) or 10.4, such

Performance Shares shall not be sold, transferred or otherwise disposed of and shall not be pledged or otherwise hypothecated, nor shall they be delivered to the Grantee. The Committee may also impose such other restrictions and conditions on the Performance Shares, if any, as it deems appropriate.

(c) LAPSE OF RESTRICTIONS. Subject to Section 10.4, restrictions upon Performance Shares awarded hereunder shall lapse and such Performance Shares shall become vested at such time or times and on such terms, conditions and satisfaction of Performance Objectives as the Committee may, in its discretion, determine at the time an Award is granted.

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(d) TREATMENT OF DIVIDENDS. At the time the Award of Performance Shares is granted, the Committee may, in its discretion, determine that the payment to the Grantee of dividends, or a specified portion thereof, declared or paid on actual Shares represented by such Award which have been issued by the Company to the Grantee shall be (i) deferred until the lapsing of the restrictions imposed upon such Performance Shares and (ii) held by the Company for the account of the Grantee until such time. In the event that dividends are to be deferred, the Committee shall determine whether such dividends are to be reinvested in shares of Stock (which shall be held as additional Performance Shares) or held in cash. If deferred dividends are to be held in cash, there may be credited at the end of each year (or portion thereof) interest on the amount of the account at the beginning of the year at a rate per annum as the Committee, in its discretion, may determine. Payment of deferred dividends in respect of Performance Shares (whether held in cash or in additional Performance Shares), together with interest accrued thereon, if any, shall be made upon the lapsing of restrictions imposed on the Performance Shares in respect of which the deferred dividends were paid, and any dividends deferred (together with any interest accrued thereon) in respect of any Performance Shares shall be forfeited upon the forfeiture of such Performance Shares.

(e) DELIVERY OF SHARES. Upon the lapse of the restrictions on Performance Shares awarded hereunder, the Committee shall cause a stock certificate to be delivered to the Grantee with respect to such Shares, free of all restrictions hereunder.

10.4 EFFECT OF CHANGE IN CONTROL. In the event of a Change in Control:

(a) With respect to the Performance Units, the Grantee shall (i) become vested in a percentage of Performance Units as determined by the Committee at the time of the Award of such Performance Units and as set forth in the Agreement and (ii) be entitled to receive in respect of all Performance Units which become vested as a result of a Change in Control, a cash payment within ten (10) days after such Change in Control in an amount as determined by the Committee at the time of the Award of such Performance Unit and as set forth in the Agreement.

(b) With respect to the Performance Shares, restrictions shall lapse immediately on all or a portion of the Performance Shares as determined by the Committee at the time of the Award of such Performance Shares and as set forth in the Agreement.

(c) The Agreements evidencing Performance Shares and Performance Units shall provide for the treatment of such Awards (or portions thereof) which do not become vested as the

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result of a Change in Control, including,

but not limited to, provisions for the adjustment of applicable performance objectives.

10.5 NON-TRANSFERABILITY.. No Performance Awards shall be transferable by the Grantee otherwise than by will or the laws of descent and distribution.

10.6 MODIFICATION OR SUBSTITUTION. Subject to the terms of the Plan, the Committee may modify outstanding Performance Awards or accept the surrender of outstanding Performance Awards and grant new Performance Awards in substitution for them. Notwithstanding the foregoing, no modification of a Performance Award shall adversely alter or impair any rights or obligations under the Agreement without the Grantee's consent.

11. EFFECT OF A TERMINATION OF EMPLOYMENT.

The Agreement evidencing the grant of each Employee Option and each Award shall set forth the terms and conditions applicable to such Employee Option or Award upon a termination of the employment or other change in the status of the employment of the Optionee or Grantee by the Company, a Subsidiary or a Division (including a termination or change by reason of the sale of a Subsidiary or a Division), as the Committee may, in its discretion, determine at the time the Option or Award is granted or thereafter.

12. ADJUSTMENT UPON CHANGES IN CAPITALIZATION.

(a) In the event of a Change in Capitalization, the Committee shall conclusively determine the appropriate adjustments, if any, to the (i) maximum number and class of Shares or other stock or securities with respect to which Options or Awards may be granted under the Plan, and (ii) the number and class of Shares or other stock or securities which are subject to outstanding Options or Awards granted under the Plan, and the purchase price therefor, if applicable.

(b) Any such adjustment in the Shares or other stock or securities subject to outstanding Incentive Stock Options (including any adjustments in the purchase price) shall be made in such manner as not to constitute a modification as defined by Section 424(h)(3) of the Code and only to the extent otherwise permitted by Sections 422 and 424 of the Code.

(c) If, by reason of a Change in Capitalization, a Grantee of an Award shall be entitled to, or an Optionee shall be entitled to exercise an Option with respect to, new, additional or different shares of stock or securities, such new additional or different shares shall thereupon be subject to all of the conditions, restrictions and performance criteria which were applicable to the Shares subject to the Award or Option, as the case may be, prior to such Change in Capitalization.

13. EFFECT OF CERTAIN TRANSACTIONS. Subject to Sections 7.4, 8.8, 9.4(b) and 10.4 or as

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otherwise provided in an Agreement, in the event of (i) the liquidation or dissolution of the Company or (ii) a merger or consolidation of the Company (a "Transaction"), the Plan and the Options and Awards issued hereunder shall continue in effect in accordance with their respective terms and each Optionee and Grantee shall be entitled to receive in respect of each Share subject to any outstanding Options or Awards, as the case may be, upon exercise of any Option or payment or transfer in respect of any Award, the same number and kind of stock, securities, cash, property, or other consideration that each holder of a Share was entitled to receive in the Transaction in respect of a Share.

14. TERMINATION AND AMENDMENT OF THE PLAN.

The Plan shall terminate on the day preceding the tenth anniversary of the date of its adoption by the Board and no Option or Award may be granted thereafter. The Board may sooner terminate the Plan and the Board may at any time and from time to time amend, modify or suspend the Plan; PROVIDED, HOWEVER, that:

(a) No such amendment, modification, suspension or termination shall impair or adversely alter any Options or Awards theretofore granted under the Plan, except with the consent of the Optionee or Grantee, nor shall any amendment, modification, suspension or termination deprive any Optionee or Grantee of any Shares which he or she may have acquired through or as a result of the Plan; and

(b) To the extent necessary under Section 16(b) of the Exchange Act and the rules and regulations promulgated thereunder or other applicable law, no amendment shall be effective unless approved by the stockholders of the Company in accordance with applicable law and regulations.

15. NON-EXCLUSIVITY OF THE PLAN.

The adoption of the Plan by the Board shall not be construed as amending, modifying or rescinding any previously approved incentive arrangement or as creating any limitations on the power of the Board to adopt such other incentive arrangements as it may deem desirable, including, without limitation, the granting of stock options otherwise than under the Plan, and such arrangements may be either applicable generally or only in specific cases.

16. LIMITATION OF LIABILITY.

As illustrative of the limitations of liability of the Company, but not intended to be exhaustive thereof, nothing in the Plan shall be construed to:

(i) give any person any right to be granted an Option or Award other than at the sole discretion of the Committee;

(ii) give any person any rights whatsoever with respect to Shares except as

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specifically provided in the Plan;

(iii) limit in any way the right of the Company to terminate the employment of any person at any time; or

(iv) be evidence of any agreement or understanding, expressed or implied, that the Company will employ any person at any particular rate of compensation or for any particular period of time.

17. REGULATIONS AND OTHER APPROVALS; GOVERNING LAW.

17.1 Except as to matters of federal law, this Plan and the rights of all persons claiming hereunder shall be construed and determined in accordance with the laws of the State of Delaware without giving effect to conflicts of law principles.

17.2 The obligation of the Company to sell or deliver Shares with respect to Options and Awards granted under the Plan shall be subject to all applicable laws, rules and regulations, including all applicable federal and state securities laws, and the obtaining of all such approvals by governmental agencies as may be deemed necessary or appropriate by the Committee.

17.3 The Plan is intended to comply with Rule 16b-3 promulgated under

the Exchange Act and the Committee shall interpret and administer the provisions of the Plan or any Agreement in a manner consistent therewith. Any provisions inconsistent with such Rule shall be inoperative and shall not affect the validity of the Plan.

17.4 The Board may make such changes as may be necessary or appropriate to comply with the rules and regulations of any government authority, or to obtain for Eligible Individuals granted Incentive Stock Options the tax benefits under the applicable provisions of the Code and regulations promulgated thereunder.

17.5 (a) Each Option and Award is subject to the requirement that, if at any time the Committee determines, in its discretion, that the listing, registration or qualification of Shares issuable pursuant to the Plan is required by any securities exchange or under any state or federal law, or the consent or approval of any governmental regulatory body is necessary or desirable as a condition of, or in connection with, the grant of an Option or Award or the issuance of Shares, no Options or Awards shall be granted or payment made or Shares issued, in whole or in part, unless listing, registration, qualification, consent or approval has been effected or obtained free of any conditions as acceptable to the Committee.

(b) Notwithstanding anything to the contrary contained in the Plan or any Agreement, as a prerequisite to the granting, vesting, payment, settlement or

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lapsing of restrictions with respect to an Option or Award, the Committee may require the Optionee or Grantee, as the case may be, to execute and deliver a Stockholders Agreement in a form acceptable to the Committee.

17.6 Notwithstanding anything contained in the Plan or any Agreement to the contrary, in the event that the disposition of Shares acquired pursuant to the Plan is not covered by a then current registration statement under the Securities Act of 1933, as amended, and is not otherwise exempt from such registration, such Shares shall be restricted against transfer to the extent required by the Securities Act of 1933, as amended, and Rule 144 or other regulations thereunder. The Committee may require any individual receiving Shares pursuant to an Option or Award granted under the Plan, as a condition precedent to receipt of such Shares, to represent and warrant to the Company in writing that the Shares acquired by such individual are acquired without a view to any distribution thereof and will not be sold or transferred other than pursuant to an effective registration thereof under said Act or pursuant to an exemption applicable under the Securities Act of 1933, as amended, or the rules and regulations promulgated thereunder. The certificates evidencing any of such Shares shall be appropriately amended to reflect their status as restricted securities as aforesaid.

18. MISCELLANEOUS.

18.1 MULTIPLE AGREEMENTS. The terms of each Option or Award may differ from other Options or Awards granted under the Plan at the same time, or at some other time. The Committee may also grant more than one Option or Award to a given Eligible Individual during the term of the Plan, either in addition to, or in substitution for, one or more Options or Awards previously granted to that Eligible Individual.

18.2 WITHHOLDING OF TAXES. (a) The Company shall have the right to deduct from any distribution of cash to any Optionee or Grantee, an amount equal to the federal, state and local income taxes and other amounts as may be required by law to be withheld (the "Withholding

Taxes") with respect to any Option or Award. If an Optionee or Grantee is to experience a taxable event in connection with the receipt of Shares pursuant to an Option exercise or payment or vesting of an Award (a "Taxable Event"), the Optionee or Grantee shall pay the Withholding Taxes to the Company prior to the issuance, or release from escrow, of such Shares. In satisfaction of the obligation to pay Withholding Taxes to the Company, the Optionee or Grantee may make a written election (the "Tax Election"), which may be accepted or rejected in the discretion of the Committee, to have withheld a portion of the Shares then issuable to him or her having an aggregate Fair Market Value, on the date preceding the date of such issuance, equal to the Withholding Taxes, provided that in respect of an Optionee or Grantee who may be subject to liability under Section 16(b) of the Exchange Act either: (i) in the case of a Taxable Event involving an Option or an Award (A) the Tax Election is made at least six (6) months prior to the date of the Taxable Event and (B) the Tax Election is irrevocable

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with respect to all Taxable Events of a similar nature occurring prior to the expiration of six (6) months following a revocation of the Tax Election; or (ii) in the case of the exercise of an Option (A) the Optionee makes the Tax Election at least six (6) months after the date the Option was granted, (B) the Option is exercised during the ten (10) day period beginning on the third business day and ending on the twelfth business day following the release for publication of the Company's quarterly or annual statement of sales and earnings (a "Window Period") and (C) the Tax Election is made during the Window Period in which the related Option is exercised or prior to such Window Period and subsequent to the immediately preceding Window Period; or (iii) in the case of a Taxable Event relating to the payment of an Award (A) the Grantee makes the Tax Election at least six (6) months after the date the Award was granted and (B) the Tax Election is made (x) in the case of a Taxable Event occurring within a Window Period, during the Window Period in which the Taxable Event occurs, or (y) in the case of a Taxable Event not occurring within a window period, during the Window Period immediately preceding the Taxable Event relating to the Award. Notwithstanding the foregoing, the Committee may, by the adoption of rules or otherwise, (i) modify the provisions of this Section 18.2 or impose such other restrictions or limitations on Tax Elections as may be necessary to ensure that the Tax Elections will be exempt transactions under Section 16(b) of the Exchange Act, and (ii) permit Tax Elections to be made at such other times and subject to such other conditions as the Committee determines will constitute exempt transactions under Section 16(b) of the Exchange Act.

(b) If an Optionee makes a disposition, within the meaning of Section 424(c) of the Code and regulations promulgated thereunder, of any Share or Shares issued to such Optionee pursuant to the exercise of an Incentive Stock Option within the two-year period commencing on the day after the date of the grant or within the one-year period commencing on the day after the date of transfer of such Share or Shares to the Optionee pursuant to such exercise, the Optionee shall, within ten (10) days of such disposition, notify the Company thereof, by delivery of written notice to the Company at its principal executive office.

(c) The Committee shall have the authority, at the time of grant of an Option or Award under the Plan or at any time thereafter, to award tax bonuses to designated Optionees or Grantees, to be paid upon their exercise of Employee Options or payment in respect of Awards granted hereunder. The amount of any such payments shall be determined by the Committee. The Committee shall have full authority in its absolute discretion to determine the amount of any such tax bonus and the terms and conditions affecting the vesting and payment thereof.

19. EFFECTIVE DATE. The effective date of the Plan shall be as determined by the Board, subject only to the approval by the affirmative vote of the holders of a

majority of the securities of the Company present, or represented, and entitled to vote at a meeting of stockholders duly held in accordance with the applicable laws of the State of Delaware within twelve (12) months of the adoption of the Plan by the Board.

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DEPARTMENT 56, INC.
1995 STOCK INCENTIVE PLAN
(AS AMENDED)

1. PURPOSE.

The purpose of this Plan is to strengthen Department 56, Inc., a Delaware corporation (the "Company"), by providing an incentive to its officers, employees, consultants, directors and advisors and thereby encouraging them to devote their abilities and industry to the success of the Company's business enterprise. It is intended that this purpose be achieved by extending to officers, employees, consultants and directors of the Company and its subsidiaries an added long-term incentive for high levels of performance and unusual efforts through the grant of Incentive Stock Options, Nonqualified Stock Options, Stock Appreciation Rights, Restricted Stock, Performance Units, Performance Shares and Dividend Equivalent Rights (as each term is hereinafter defined).

2. DEFINITIONS.

For purposes of the Plan:

2.1 "Adjusted Fair Market Value" means, in the event of a Change in Control, the greater of (i) the highest price per Share paid to holders of the Shares in any transaction (or series of transactions) constituting or resulting in a Change in Control or (ii) the highest Fair Market Value of a Share during the ninety (90) day period ending on the date of a Change in Control.

2.2 "Agreement" means the written agreement between the Company and an Optionee or Grantee evidencing the grant of an Option or Award and setting forth the terms and conditions thereof.

2.3 "Award" means a grant of Restricted Stock, a Stock Appreciation Right, a Performance Award, a Dividend Equivalent Right or any or all of them.

2.4 "Board" means the Board of Directors of the Company.

2.5 "Cause" means the commission of an act of fraud or intentional misrepresentation or an act of embezzlement, misappropriation or conversion of assets or opportunities of the Company or any Subsidiary.

2.6 "Change in Capitalization" means any increase or reduction in the number of Shares, or any change (including, but not limited to, a change in value) in the

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Shares or exchange of Shares for a different number or kind of shares or other securities of the Company, by reason of a reclassification, recapitalization, merger, consolidation, reorganization, spin-off, split-up, issuance of warrants or rights or debentures, stock dividend, stock split or reverse stock split, cash dividend, property dividend, combination or exchange of shares, repurchase of shares, change in corporate structure or otherwise.

2.7 A "Change in Control" shall mean the occurrence during the term of the Plan of:

(a) An acquisition (other than directly from the Company) of any voting securities of the Company (the "Voting Securities")

by any 'Person' (as the term person is used for purposes of Section 13(d) or 14(d) of the Exchange Act), other than Department 56 Partners, L.P. or Forstmann Little & Co. Subordinated Debt and Equity Management Buyout Partnership IV or any of their affiliates (individually or in the aggregate), immediately after which such Person has 'Beneficial Ownership' (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of fifty-one percent (51%) or more of the combined voting power of the Company's then outstanding Voting Securities; provided, however, in determining whether a Change in Control has occurred, Voting Securities which are acquired in a 'Non-Control Acquisition' (as hereinafter defined) shall not constitute an acquisition which would cause a Change in Control. A 'Non-Control Acquisition' shall mean an acquisition by (i) an employee benefit plan (or a trust forming a part thereof) maintained by (A) the Company or (B) any corporation or other Person of which a majority of its voting power or its voting equity securities or equity interest is owned, directly or indirectly, by the Company (for purposes of this definition, a 'Subsidiary'), (ii) the Company or its Subsidiaries, or (iii) any Person in connection with a 'Non-Control Transaction' (as hereinafter defined);

(b) The individuals who, as of June 1, 1993, are members of the Board (the "Incumbent Board"), cease for any reason to constitute at least two-thirds of the members of the Board; provided, however, that if the election, or nomination for election by the Company's common stockholders, of any new director was approved by a vote of at least two-thirds of the Incumbent Board, such new director shall, for purposes of this Plan, be considered as a member of the Incumbent Board; provided further, however, that no individual shall be considered a member of the Incumbent Board if such individual initially assumed office as a result of either an actual or threatened 'Election Contest' (as described in Rule 14a-11 promulgated under the Exchange Act) or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board (a "Proxy Contest") including by reason of any agreement intended to avoid or settle

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any Election Contest or Proxy Contest; or

(c) Approval by stockholders of the Company of:

- (i) A merger, consolidation or reorganization involving the Company, unless (A) the stockholders of the Company, immediately before such merger, consolidation or reorganization, own, directly or indirectly immediately following such merger, consolidation or reorganization, at least sixty percent (60%) of the combined voting power of the outstanding voting securities of the corporation resulting from such merger or consolidation or reorganization (the "Surviving Corporation") in substantially the same proportion as their ownership of the Voting Securities immediately before such merger, consolidation or reorganization, (B) the individuals who were members of the Incumbent Board immediately prior to the execution of the agreement providing for such merger, consolidation or reorganization

constitute at least two-thirds of the members of the board of directors of the Surviving Corporation, or a corporation beneficially owing a majority of the Voting Securities of the Surviving Corporation, (C) no Person other than the Company, any Subsidiary, any employee benefit plan (or any trust forming a part thereof) maintained by the Company, the Surviving Corporation, or any Subsidiary, or any Person who, immediately prior to such merger, consolidation or reorganization had Beneficial Ownership of fifty-one percent (51%) or more of the then outstanding Voting Securities owns, directly or indirectly fifty-one percent (51%) or more of the combined voting power of the Surviving Corporation's then outstanding voting securities, and (D) a transaction described in clauses (A) through (C) shall herein be referred to as a 'Non-Control Transaction';

- (ii) A complete liquidation or dissolution of the Company; or
- (iii) An agreement for the sale or other disposition of all or substantially all of the assets of the Company to any Person (other than a transfer to a Subsidiary).

Notwithstanding the foregoing, a Change in Control shall not be deemed to occur solely because any Person (the "Subject Person") acquired Beneficial Ownership of more than the permitted amount of the outstanding Voting Securities as a result of the acquisition of Voting Securities by the Company which, by reducing the number of Voting Securities outstanding, increases the proportional number of shares Beneficially Owned by the Subject Persons, provided that if a Change in Control would occur (but for the

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operation of this sentence) as a result of the acquisition of Voting Securities by the Company, and after such share acquisition by the Company, the Subject Person becomes the Beneficial Owner of any additional Voting Securities which increases the percentage of the then outstanding Voting Securities Beneficially Owned by the Subject Person, then a Change in Control shall occur.

2.8 "Code" means the Internal Revenue Code of 1986, as amended.

2.9 "Committee" means a committee consisting of one or more Directors appointed by the Board to administer the Plan and to perform the functions set forth herein.

2.10 "Company" means Department 56, Inc.

2.11 "Director Option" means an Option granted pursuant to Section 6.

2.12 "Disability" means a physical or mental infirmity which impairs the Optionee's ability to perform substantially his or her duties for a period of one hundred eighty (180) consecutive days.

2.13 "Disinterested Director" means a director of the Company who is a "non-employee director" within the meaning of Rule 16b-3 under the

Exchange Act.

2.14 "Dividend Equivalent Right" means a right to receive all or some portion of the cash dividends that are or would be payable with respect to Shares.

2.15 "Division" means any of the operating units or divisions of the Company designated as a Division by the Committee.

2.16 "Eligible Individual" means any officer, employee, consultant or advisor of the Company or a Subsidiary designated by the Committee as eligible to receive Options or Awards subject to the conditions set forth herein.

2.17 "Employee Option" means an Option granted pursuant to Section 5.

2.18 "Exchange Act" means the Securities Exchange Act of 1934, as amended.

2.19 "Fair Market Value" on any date means the average of the high and low sales prices of the Shares on such date on the principal national securities exchange on which such Shares are listed or admitted to trading, or if such Shares are not so listed or admitted to trading, the arithmetic mean of the per Share closing bid price and per Share closing asked price on such date as quoted on the National Association of Securities Dealers Automated Quotation System or such other

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market in which such prices are regularly quoted, or, if there have been no published bid or asked quotations with respect to Shares on such date, the Fair Market Value shall be the value established by the Board in good faith and, in the case of an Incentive Stock Option, in accordance with Section 422 of the Code.

2.20 "Grantee" means a person to whom an Award has been granted under the Plan.

2.21 "Incentive Stock Option" means an Option satisfying the requirements of Section 422 of the Code and designated by the Committee as an Incentive Stock Option.

2.22 "Nonemployee Director" means a director of the Company who is not an employee of the Company or any Subsidiary.

2.23 "Nonqualified Stock Option" means an Option which is not an Incentive Stock Option.

2.24 "Option" means an Employee Option, a Director Option, or either or both of them.

2.25 "Optionee" means a person to whom an Option has been granted under the Plan.

2.26 "Outside Director" means a director of the Company who is an "outside director" within the meaning of Section 162(m) of the Code and the regulations promulgated thereunder.

2.27 "Parent" means any corporation which is a parent corporation (within the meaning of Section 424(e) of the Code) with respect to the Company.

2.28 "Performance Awards" means Performance Units, Performance Shares or either or both of them.

2.29 "Performance Cycle" means the time period specified by the

Committee at the time a Performance Award is granted during which the performance of the Company, a Subsidiary or a Division will be measured.

2.30 "Performance Objectives" has the meaning set forth in Section 10.1.

2.31 "Performance Shares" means Shares issued or transferred to an Eligible Individual under Section 10.3.

2.32 "Performance Unit" means Performance Units granted to an Eligible

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Individual under Section 10.2.

2.33 "Plan" means the Department 56, Inc. 1995 Stock Incentive Plan.

2.34 "Pooling Transaction" means an acquisition of or by the Company in a transaction which is intended to be treated as a "pooling of interests" under generally accepted accounting principles.

2.35 "Restricted Stock" means Shares issued or transferred to an Eligible Individual pursuant to Section 9.

2.36 "Shares" means the common stock, par value \$.01 per share, of the Company.

2.37 "Stock Appreciation Right" means a right to receive all or some portion of the increase in the value of the Shares as provided in Section 8 hereof.

2.38 "Stockholders Agreement" means a stockholders agreement governing the rights, duties and obligations of present or future employees or directors, as the case may be, of the Company or its Subsidiaries with respect to Shares granted or sold to such persons, or issued pursuant to options or other awards granted to such persons, in such form as is in use by the Company at the time of exercise of an Option or any part thereof or the issuance of Shares pursuant to an Award and which the Company elects to require an Optionee or Grantee to execute in connection with the issuance of Shares.

2.39 "Subsidiary" means any corporation which is a subsidiary corporation (within the meaning of Section 424(f) of the Code) with respect to the Company.

2.40 "Successor Corporation" means a corporation, or a parent or subsidiary thereof within the meaning of Section 424(a) of the Code, which issues or assumes a stock option in a transaction to which Section 424(a) of the Code applies.

2.41 "Ten-Percent Stockholder" means an Eligible Individual, who, at the time an Incentive Stock Option is to be granted to him or her, owns (within the meaning of Section 422(b)(6) of the Code) stock possessing more than ten percent (10%) of the total combined voting power of all classes of stock of the Company, or of a Parent or a Subsidiary.

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3. ADMINISTRATION.

3.1 The Plan shall be administered by the Committee which shall hold meetings at such times as may be necessary for the proper administration of the Plan. The Committee shall keep minutes of its meetings. Except as provided in Section 3.4, a quorum shall consist of not less than two members of the Committee and a majority of a quorum

may authorize any action. Any decision or determination reduced to writing and signed by a majority of all of the members shall be as fully effective as if made by a majority vote at a meeting duly called and held. Except as provided in Section 3.4, the Committee shall consist of at least two (2) Directors and may consist of the entire Board; PROVIDED, HOWEVER, that (A) except as provided in clause (B) below, (i) if the Committee consists of less than the entire Board, each member shall be a Nonemployee Director and (ii) to the extent necessary for any Option or Award intended to qualify as performance-based compensation under Section 162(m) of the Code to so qualify, each member of the Committee, whether or not it consists of the entire Board, shall be an Outside Director and (B) the Board may, by resolution, authorize a committee consisting of one or more Directors to make grants of Employee Options to Eligible Individuals who are not officers of the Company, subject to such restrictions and limitations as the Board shall set forth in such resolution and as otherwise provided in the Plan. No member of the Committee shall be liable for any action, failure to act, determination or interpretation made in good faith with respect to this Plan or any transaction hereunder, except for liability arising from his or her own willful misfeasance, gross negligence or reckless disregard of his or her duties. The Company hereby agrees to indemnify each member of the Committee for all costs and expenses and, to the extent permitted by applicable law, any liability incurred in connection with defending against, responding to, negotiation for the settlement of or otherwise dealing with any claim, cause of action or dispute of any kind arising in connection with any actions in administering this Plan or in authorizing or denying authorization to any transaction hereunder.

3.2 Subject to the express terms and conditions set forth herein, the Committee shall have the power from time to time to:

(a) determine those individuals to whom Options shall be granted under the Plan and the number of Incentive Stock Options and/or Nonqualified Stock Options to be granted to each Eligible Individual or Nonemployee Director and to prescribe the terms and conditions (which need not be identical) of each Option, including the purchase price per Share subject to each Option, and make any amendment or modification to any Agreement consistent with the terms of the Plan; and

(b) select those Eligible Individuals to whom Awards shall be granted under the Plan and to determine the number of Stock Appreciation Rights,

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Performance Units, Performance Shares, and/or Shares of Restricted Stock to be granted pursuant to each Award, the terms and conditions of each Award, including the restrictions or Performance Objectives relating to such Units or Shares, the maximum value of each Performance Unit and Performance Share and make any amendment or modification to any Agreement consistent with the terms of the Plan.

3.3 Subject to the express terms and conditions set forth herein, the Committee shall have the power from time to time:

(a) to construe and interpret the Plan and the Options and Awards granted hereunder and to establish, amend and revoke rules and regulations for the administration of the Plan, including, but not limited to, correcting any defect or supplying any omission, or reconciling any inconsistency in the Plan or in any Agreement, in the manner and to the extent it shall deem necessary or advisable so that the Plan complies

with applicable law including Rule 16b-3 under the Exchange Act and the Code to the extent applicable, and otherwise to make the Plan fully effective. All decisions and determinations by the Committee in the exercise of this power shall be final, binding and conclusive upon the Company, its Subsidiaries, the Optionees and Grantees and all other persons having any interest therein;

(b) to determine the duration and purposes for leaves of absence which may be granted to an Optionee or Grantee on an individual basis without constituting a termination of employment or service for purposes of the Plan;

(c) to exercise its discretion with respect to the powers and rights granted to it as set forth in the Plan; and

(d) generally, to exercise such powers and to perform such acts as are deemed necessary or advisable to promote the best interests of the Company with respect to the Plan.

3.4 BOARD RESERVATION AND DELEGATION.

(a) The Board may, in its discretion, reserve to itself or delegate to another committee of the Board any or all of the authority and responsibility of the Committee with respect to Options and Awards granted hereunder to Eligible Individuals who are not subject to Section 16 of the Exchange Act or Section 162(m) of the Code at the time any such delegated authority or responsibility is exercised. Such other committee may consist of one or more directors who may, but need not be, officers or employees of the Company or of any of its Subsidiaries. To the extent that the Board has reserved to itself or delegated the authority and

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responsibility of the Committee to such other committee, all references to the Committee in the Plan shall be to the Board or to such other committee.

(b) The Board may, by resolution, authorize a committee (the "Director Option Grant Committee") consisting of one or more directors of the Company to make grants of Director Options which are intended to satisfy the conditions for exemption from Section 16b of the Exchange Act pursuant to Rule 16b-3(d)(3). The authority of the Director Option Grant Committee shall be subject to such restrictions and limitations as the Board shall set forth in such resolution and as otherwise provided in the Plan. References to the term Committee in Section 6 shall be deemed to include the Director Option Grant Committee wherever it is used insofar as it relates to the Committee's authority and responsibility to make grants and establish the terms of Director Options but only to the extent the Director Option Grant Committee is acting within the scope of its authority as established by the Board.

4. STOCK SUBJECT TO THE PLAN.

4.1 The maximum number of Shares that may be made the subject of Options and Awards granted under the Plan is 600,000; PROVIDED, HOWEVER, that, in the aggregate, not more than one-third of the number of allotted shares may be made the subject of Restricted Stock Awards under the Plan and, PROVIDED, FURTHER, HOWEVER, that the maximum number of Shares that any Eligible Individual may receive during the term of the Plan in respect of Options and Awards may not exceed 400,000 Shares and the maximum dollar amount that any Eligible Individual may receive during the term of the Plan in respect of Performance Units denominated in dollars may not exceed \$5,000,000. Upon a Change in Capitalization the maximum number of Shares shall be adjusted in number and kind

pursuant to Section 13. The Company shall reserve for the purposes of the Plan, out of its authorized but unissued Shares or out of Shares held in the Company's treasury, or partly out of each, such number of Shares as shall be determined by the Board.

4.2 Upon the granting of an Option or an Award, the number of Shares available under Section 4.1 for the granting of further Options and Awards shall be reduced as follows:

(a) In connection with the granting of an Option or an Award (other than the granting of a Performance Unit denominated in dollars), the number of Shares shall be reduced by the number of Shares in respect of which the Option or Award is granted or denominated.

(b) In connection with the granting of a Performance Unit denominated in dollars, the number of Shares shall be reduced by an amount equal to the quotient of (i) the dollar amount in which the Performance Unit is denominated, divided by (ii) the Fair Market Value of a Share on the date the

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Performance Unit is granted.

4.3 Whenever any outstanding Option or Award or portion thereof expires, is cancelled or is otherwise terminated for any reason without having been exercised or payment having been made in respect of the entire Option or Award, the Shares allocable to the expired, cancelled or otherwise terminated portion of the Option or Award may again be the subject of Options or Awards granted hereunder.

4.4 Notwithstanding anything contained in this Section 4, the number of Shares available for Options and Awards at any time under the Plan shall be reduced to such lesser amount as may be required pursuant to the methods of calculation necessary so that the exemptions provided pursuant to Rule 16b-3 under the Exchange Act will continue to be available for transactions involving all current and future Options and Awards. In addition, during the period that any Options and Awards remain outstanding under the Plan, the Committee may make good faith adjustments with respect to the number of Shares attributable to such Options and Awards for purposes of calculating the maximum number of Shares available for the granting of future Options and Awards under the Plan, provided that following such adjustments the exemptions provided pursuant to Rule 16b-3 under the Exchange Act will continue to be available for transactions involving all current and future Options and Awards.

5. OPTION GRANTS FOR ELIGIBLE INDIVIDUALS.

5.1 AUTHORITY OF COMMITTEE. Subject to the provisions of the Plan and to Section 4.1 above, the Committee shall have full and final authority to select those Eligible Individuals who will receive Options (each, an "Employee Option"), the terms and conditions of which shall be set forth in an Agreement; PROVIDED, HOWEVER, that no person shall receive any Incentive Stock Options unless he or she is an employee of the Company, a Parent or a Subsidiary at the time the Incentive Stock Option is granted.

5.2 PURCHASE PRICE. The purchase price or the manner in which the purchase price is to be determined for Shares under each Employee Option shall be determined by the Committee and set forth in the Agreement; PROVIDED, HOWEVER, that the purchase price per Share under each Employee Option shall not be less than 100% of the Fair Market Value of a Share on the date the Employee Option is granted (110% in the case of an Incentive Stock Option granted to a Ten-Percent

Stockholder).

5.3 MAXIMUM DURATION. Employee Options granted hereunder shall be for such term as the Committee shall determine, provided that an Incentive Stock Option shall not be exercisable after the expiration of ten (10) years from the date it is granted (five (5) years in the case of an Incentive Stock Option granted to a Ten-

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Percent Stockholder) and a Nonqualified Stock Option shall not be exercisable after the expiration of ten (10) years from the date it is granted. The Committee may, subsequent to the granting of any Employee Option, extend the term thereof but in no event shall the term as so extended exceed the maximum term provided for in the preceding sentence.

5.4 VESTING. Subject to Section 7.4 hereof, each Employee Option shall become exercisable in such installments (which need not be equal) and at such times as may be designated by the Committee and set forth in the Agreement. To the extent not exercised, installments shall accumulate and be exercisable, in whole or in part, at any time after becoming exercisable, but not later than the date the Employee Option expires. The Committee may accelerate the exercisability of any Option or portion thereof at any time.

5.5 MODIFICATION OR SUBSTITUTION. The Committee may, in its discretion, modify outstanding Employee Options or accept the surrender of outstanding Employee Options (to the extent not exercised) and grant new Employee Options in substitution for them; PROVIDED, HOWEVER, that, no modification or substitution may reduce or have the effect of reducing the per share purchase price of any outstanding Employee Option. Notwithstanding the foregoing, no modification of an Employee Option shall adversely alter or impair any rights or obligations under the Employee Option without the Optionee's consent.

6. NONEMPLOYEE DIRECTOR PROVISIONS.

6.1 OPTION GRANTS FOR NONEMPLOYEE DIRECTORS. Subject to the provisions of the Plan and to Section 4.1, the Committee may grant Director Options to any Nonemployee Director on such terms and conditions, including option price, exercisability and duration, as the Committee in its discretion shall determine. The Committee shall determine the number of Shares subject to each Director Option.

6.2 ELECTION TO RECEIVE SHARES IN LIEU OF DIRECTORS' FEES.

(a) ELECTION. Each Nonemployee Director may elect, on a form provided for such purpose by the Committee, to have all or any part (but only in 25% increments) of his or her Directors' Fees converted into, and transferred to him or her, in the form of Shares (an "Election"). For purposes of this Section 6.2, "Directors' Fees" means all cash annual retainer and meeting fees payable by the Company to an Nonemployee Director with respect to services rendered by such Nonemployee Director.

(b) TIME OF ELECTION; EFFECTIVE DATE OF ELECTION. An Nonemployee Director may make an Election at any time during any particular year during his or her directorship. An Election made on or prior

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to June 10 shall be effective with respect to Directors' Fees

payable on or after July 1 of such year. An Election made on or prior to December 10 shall be effective with respect to Directors' Fees payable on or after January 1 of the following year.

(c) SHARES RECEIVED IN LIEU OF FEES. On each date following the effective date of an Election on which Directors' Fees would otherwise be paid (a "Director Payment Date"), the Directors' Fees that an Nonemployee Director would have received but for his or her Election shall be converted into the right to receive a number of Shares with a Fair Market Value (determined as of the Director Payment Date) equal to 110% of such Directors' Fees. Shares shall be issued by the Company to an Nonemployee Director who has made an Election as promptly as practicable following each Director Payment Date.

(d) ELECTION EFFECTIVE UNTIL REVOKED. An Nonemployee Director's Election shall remain effective until revoked. An Nonemployee Director may revoke his or her Election (a "Revocation") on a form provided for such purpose by the Committee at any time during any particular year during his or her directorship. A Revocation made on or prior to June 10 shall be effective with respect to Directors' Fees payable on or after July 1 of such year. A Revocation made on or prior to December 10 shall be effective with respect to Directors' Fees payable on or after January 1 of the following year.

6.3 LIMITATIONS ON AMENDMENT; MODIFICATION. The provisions in this Section 6 shall not be amended more than once every six months, other than to comport with changes in the Code or the rules and regulations thereunder. No modification of a Director Option shall adversely alter or impair any rights or obligations under such Director Option without the Optionee's consent nor shall any modification reduce or have the effect of reducing the per share purchase price of any outstanding Director Option.

7. TERMS AND CONDITIONS APPLICABLE TO ALL OPTIONS.

7.1 NON-TRANSFERABILITY. No Option granted hereunder shall be transferable by the Optionee to whom granted otherwise than by will or the laws of descent and distribution, and an Option may be exercised during the lifetime of such Optionee only by the Optionee or his or her guardian or legal representative. The terms of such Option shall be final, binding and conclusive upon the beneficiaries, executors, administrators, heirs and successors of the Optionee.

7.2 METHOD OF EXERCISE. The exercise of an Option shall be made only by a written notice delivered in person or by mail to the Secretary of the Company at the

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Company's principal executive office, specifying the number of Shares to be purchased and accompanied by payment therefor and otherwise in accordance with the Agreement pursuant to which the Option was granted and, if the Committee then requires, a fully executed Stockholders Agreement. The purchase price for any Shares purchased pursuant to the exercise of an Option shall be paid in full upon such exercise by any one or a combination of the following: (i) cash or (ii) transferring Shares to the Company upon such terms and conditions as determined by the Committee. Notwithstanding the foregoing, the Committee shall have discretion to determine at the time of grant of each Employee Option or at any later date (up to and including the date of exercise) the form of payment acceptable in respect of the exercise of such Employee Option and Options may be exercised pursuant to such cashless exercise procedures which are, from time to time, deemed acceptable by the

Committee. The written notice pursuant to this Section 7.2 may also provide instructions from the Optionee to the Company that upon receipt of the purchase price in cash from the Optionee's broker or dealer, designated as such on the written notice, in payment for any Shares purchased pursuant to the exercise of an Option, the Company shall issue such Shares directly to the designated broker or dealer. Any Shares transferred to the Company as payment of the purchase price under an Option shall be valued at their Fair Market Value on the day preceding the date of exercise of such Option. If requested by the Committee, the Optionee shall deliver the Agreement evidencing the Option to the Secretary of the Company who shall endorse thereon a notation of such exercise and return such Agreement to the Optionee. No fractional Shares (or cash in lieu thereof) shall be issued upon exercise of an Option and the number of Shares that may be purchased upon exercise shall be rounded to the nearest number of whole Shares.

7.3 RIGHTS OF OPTIONEES. No Optionee shall be deemed for any purpose to be the owner of any Shares subject to any Option unless and until (i) the Option shall have been exercised pursuant to the terms thereof, (ii) the Company shall have issued and delivered the Shares to the Optionee and (iii) the Optionee's name shall have been entered as a stockholder of record on the books of the Company. Thereupon, the Optionee shall have full voting, dividend and other ownership rights with respect to such Shares.

7.4 EFFECT OF CHANGE IN CONTROL. In the event of a Change in Control, all Options outstanding on the date of such Change in Control shall become immediately and fully exercisable. In addition, to the extent set forth in an Agreement evidencing the grant of an Option, an Optionee will be permitted to surrender for cancellation within sixty (60) days after such Change in Control, any Option or portion of an Option to the extent not yet exercised and the Optionee will be entitled to receive a cash payment in an amount equal to the excess, if any, of (x) (A) in the case of a Nonqualified Stock Option, the greater of (1) the Fair Market Value, on the date preceding the date of surrender, of the Shares subject to the Option or portion

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thereof surrendered or (2) the Adjusted Fair Market Value of the Shares subject to the Option or portion thereof surrendered or (B) in the case of an Incentive Stock Option, the Fair Market Value, on the date preceding the date of surrender, of the Shares subject to the Option or portion thereof surrendered, over (y) the aggregate purchase price for such Shares under the Option or portion thereof surrendered; PROVIDED, HOWEVER, that in the case of an Option granted within six (6) months prior to the Change in Control to any Optionee who may be subject to liability under Section 16(b) of the Exchange Act, such Optionee shall be entitled to surrender for cancellation his or her Option during the sixty (60) day period commencing upon the expiration of six (6) months from the date of grant of any such Option. In the event an Optionee's employment with the Company is terminated by the Company within two years following a Change in Control each Employee Option held by the Optionee that was exercisable as of the date of termination of the Optionee's employment shall remain exercisable for a period ending not before the earlier of the first anniversary of the termination of the Optionee's employment or the expiration of the ordinary term of the Option.

8. STOCK APPRECIATION RIGHTS. The Committee may, in its discretion, either alone or in connection with the grant of an Employee Option, grant Stock Appreciation Rights in accordance with the Plan and the terms and conditions of which shall be set forth in an Agreement. If granted in connection with an Employee Option, a Stock Appreciation Right shall cover the same Shares covered by the Employee Option (or such lesser number of Shares as the Committee may determine) and

shall, except as provided in this Section 8, be subject to the same terms and conditions as the related Employee Option.

8.1 TIME OF GRANT. A Stock Appreciation Right may be granted (i) at any time if unrelated to an Option, or (ii) if related to an Employee Option, either at the time of grant, or at any time thereafter during the term of the Option.

8.2 STOCK APPRECIATION RIGHT RELATED TO AN EMPLOYEE OPTION.

(a) EXERCISE. Subject to Section 8.6, a Stock Appreciation Right granted in connection with an Employee Option shall be exercisable at such time or times and only to the extent that the related Employee Option is exercisable, and will not be transferable except to the extent the related Employee Option is transferable. A Stock Appreciation Right granted in connection with an Incentive Stock Option shall be exercisable only if the Fair Market Value of a Share on the date of exercise exceeds the purchase price specified in the related Incentive Stock Option Agreement.

(b) AMOUNT PAYABLE. Upon the exercise of a Stock Appreciation Right related to an Employee Option, the Grantee shall be entitled to receive an amount determined by multiplying (A) the excess of the Fair Market Value of a Share on the date preceding the date of exercise of such Stock

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Appreciation Right over the per Share purchase price under the related Employee Option, by (B) the number of Shares as to which such Stock Appreciation Right is being exercised. Notwithstanding the foregoing, the Committee may limit in any manner the amount payable with respect to any Stock Appreciation Right by including such a limit in the Agreement evidencing the Stock Appreciation Right at the time it is granted.

(c) TREATMENT OF RELATED OPTIONS AND STOCK APPRECIATION RIGHTS UPON EXERCISE. Upon the exercise of a Stock Appreciation Right granted in connection with an Employee Option, the Employee Option shall be cancelled to the extent of the number of Shares as to which the Stock Appreciation Right is exercised, and upon the exercise of an Employee Option granted in connection with a Stock Appreciation Right or the surrender of such Employee Option pursuant to Section 7.4, the Stock Appreciation Right shall be cancelled to the extent of the number of Shares as to which the Employee Option is exercised or surrendered.

8.3 STOCK APPRECIATION RIGHT UNRELATED TO AN OPTION. The Committee may grant to Eligible Individuals Stock Appreciation Rights unrelated to Options. Stock Appreciation Rights unrelated to Options shall contain such terms and conditions as to exercisability (subject to Section 8.6), vesting and duration as the Committee shall determine, but in no event shall they have a term of greater than ten (10) years. Upon exercise of a Stock Appreciation Right unrelated to an Option, the Grantee shall be entitled to receive an amount determined by multiplying (A) the excess of the Fair Market Value of a Share on the date preceding the date of exercise of such Stock Appreciation Right over the Fair Market Value of a Share on the date the Stock Appreciation Right was granted, by (B) the number of Shares as to which the Stock Appreciation Right is being exercised. Notwithstanding the foregoing, the Committee may limit in any manner the amount payable with respect to any Stock Appreciation Right by including such a limit

in the Agreement evidencing the Stock Appreciation Right at the time it is granted.

8.4 METHOD OF EXERCISE. Stock Appreciation Rights shall be exercised by a Grantee only by a written notice delivered in person or by mail to the Secretary of the Company at the Company's principal executive office, specifying the number of Shares with respect to which the Stock Appreciation Right is being exercised. If requested by the Committee, the Grantee shall deliver the Agreement evidencing the Stock Appreciation Right being exercised and the Agreement evidencing any related Employee Option to the Secretary of the Company who shall endorse thereon a notation of such exercise and return such Agreement to the Grantee.

8.5 FORM OF PAYMENT. Payment of the amount determined under Sections 8.2(b) or 8.3 may be made in the discretion of the Committee, solely in whole Shares in a number determined at their Fair Market Value on the date preceding the date of

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exercise of the Stock Appreciation Right, or solely in cash, or in a combination of cash and Shares. If the Committee decides to make full payment in Shares and the amount payable results in a fractional Share, payment for the fractional Share will be made in cash. Notwithstanding the foregoing, no payment in the form of cash may be made upon the exercise of a Stock Appreciation Right pursuant to Sections 8.2(b) or 8.3 to a Grantee who is an officer of the Company or a Subsidiary who is subject to liability under Section 16(b) of the Exchange Act, unless the exercise of such Stock Appreciation Right is made either (i) during the period beginning on the third business day and ending on the twelfth business day following the date of release for publication of the Company's quarterly or annual statements of earnings or (ii) pursuant to an irrevocable election to receive cash made at least six months prior to the exercise of such Stock Appreciation Right.

8.6 RESTRICTIONS. No Stock Appreciation Right may be exercised before the date six (6) months after the date it is granted.

8.7 MODIFICATION OR SUBSTITUTION. Subject to the terms of the Plan, the Committee may modify outstanding Awards of Stock Appreciation Rights or accept the surrender of outstanding Awards of Stock Appreciation Rights (to the extent not exercised) and grant new Awards in substitution for them. Notwithstanding the foregoing, no modification of an Award shall adversely alter or impair any rights or obligations under the Agreement without the Grantee's consent.

8.8 EFFECT OF CHANGE IN CONTROL. In the event of a Change in Control, subject to Section 8.6, all Stock Appreciation Rights shall become immediately and fully exercisable. Notwithstanding Sections 8.3 and 8.5, to the extent set forth in an Agreement evidencing the grant of a Stock Appreciation Right unrelated to an Option, upon the exercise of such a Stock Appreciation Right or any portion thereof during the sixty (60) day period following a Change in Control, the amount payable shall be in cash and shall be an amount equal to the excess, if any, of (A) the greater of (x) the Fair Market Value, on the date preceding the date of exercise, of the Shares subject to Stock Appreciation Right or portion thereof exercised and (y) the Adjusted Fair Market Value, on the date preceding the date of exercise, of the Shares over (B) the aggregate Fair Market Value, on the date the Stock Appreciation Right was granted, of the Shares subject to the Stock Appreciation Right or portion thereof exercised; PROVIDED, HOWEVER, that in the case of a Stock Appreciation Right granted within six (6) months prior to the Change in Control to any Grantee who may be subject to liability under Section 16(b) of the Exchange Act, such Grantee shall be entitled to

exercise his Stock Appreciation Right during the sixty (60) day period commencing upon the expiration of six (6) months from the date of grant of any such Stock Appreciation Right.

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9. RESTRICTED STOCK.

9.1 GRANT. The Committee may grant to Eligible Individuals Awards of Restricted Stock, and may issue Shares of Restricted Stock in payment in respect of vested Performance Units (as hereinafter provided in Section 10.2), which shall be evidenced by an Agreement between the Company and the Grantee. Each Agreement shall contain such restrictions, terms and conditions as the Committee may, in its discretion, determine and (without limiting the generality of the foregoing) such Agreements may require that an appropriate legend be placed on Share certificates. Awards of Restricted Stock shall be subject to the terms and provisions set forth below in this Section 9.

9.2 RIGHTS OF GRANTEE. Shares of Restricted Stock granted pursuant to an Award hereunder shall be issued in the name of the Grantee as soon as reasonably practicable after the Award is granted provided that the Grantee has executed an Agreement evidencing the Award, the appropriate blank stock powers and, in the discretion of the Committee, an escrow agreement and any other documents which the Committee may require as a condition to the issuance of such Shares. If a Grantee shall fail to execute the Agreement evidencing a Restricted Stock Award, the appropriate blank stock powers and, in the discretion of the Committee, an escrow agreement and any other documents which the Committee may require within the time period prescribed by the Committee at the time the Award is granted, the Award shall be null and void. At the discretion of the Committee, Shares issued in connection with a Restricted Stock Award shall be deposited together with the stock powers with an escrow agent (which may be the Company) designated by the Committee. Unless the Committee determines otherwise and as set forth in the Agreement, upon delivery of the Shares to the escrow agent, the Grantee shall have all of the rights of a stockholder with respect to such Shares, including the right to vote the Shares and to receive all dividends or other distributions paid or made with respect to the Shares.

9.3 NON-TRANSFERABILITY. Until any restrictions upon the Shares of Restricted Stock awarded to a Grantee shall have lapsed in the manner set forth in Section 9.4, such Shares shall not be sold, transferred or otherwise disposed of and shall not be pledged or otherwise hypothecated, nor shall they be delivered to the Grantee.

9.4 LAPSE OF RESTRICTIONS.

(a) GENERALLY. Restrictions upon Shares of Restricted Stock awarded hereunder shall lapse at such time or times and on such terms and conditions as the Committee may determine, which restrictions shall be set forth in the Agreement evidencing the Award.

(b) EFFECT OF CHANGE IN CONTROL. The Committee shall determine at the

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time of the grant of an Award of Restricted Stock the extent to which, if any, the restrictions upon Shares of Restricted Stock shall lapse upon a Change in Control. The Agreement evidencing the Award shall set forth such provisions.

9.5 MODIFICATION OR SUBSTITUTION. Subject to the terms of the Plan, the

Committee may modify outstanding Awards of Restricted Stock or accept the surrender of outstanding Shares of Restricted Stock (to the extent the restrictions on such Shares have not yet lapsed) and grant new Awards in substitution for them. Notwithstanding the foregoing, no modification of an Award shall adversely alter or impair any rights or obligations under the Agreement without the Grantee's consent.

9.6 TREATMENT OF DIVIDENDS. At the time the Award of Shares of Restricted Stock is granted, the Committee may, in its discretion, determine that the payment to the Grantee of dividends, or a specified portion thereof, declared or paid on such Shares by the Company shall be (i) deferred until the lapsing of the restrictions imposed upon such Shares and (ii) held by the Company for the account of the Grantee until such time. In the event that dividends are to be deferred, the Committee shall determine whether such dividends are to be reinvested in Shares (which shall be held as additional Shares of Restricted Stock) or held in cash. If deferred dividends are to be held in cash, there may be credited at the end of each year (or portion thereof) interest on the amount of the account at the beginning of the year at a rate per annum as the Committee, in its discretion, may determine. Payment of deferred dividends in respect of Shares of Restricted Stock (whether held in cash or as additional Shares of Restricted Stock), together with interest accrued thereon, if any, shall be made upon the lapsing of restrictions imposed on the Shares in respect of which the deferred dividends were paid, and any dividends deferred (together with any interest accrued thereon) in respect of any Shares of Restricted Stock shall be forfeited upon the forfeiture of such Shares.

9.7 DELIVERY OF SHARES. Upon the lapse of the restrictions on Shares of Restricted Stock, the Committee shall cause a stock certificate to be delivered to the Grantee with respect to such Shares, free of all restrictions hereunder.

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10. PERFORMANCE AWARDS.

10.1 (a) PERFORMANCE OBJECTIVES. Performance Objectives for Performance Awards may be expressed in terms of (i) earnings per Share, (ii) pre-tax profits, (iii) net earnings, (iv) return on equity or assets, (v) revenues or (vi) any combination of the foregoing. Performance Objectives may be in respect of the performance of the Company and its Subsidiaries (which may be on a consolidated basis), a Subsidiary or a Division. Performance Objectives may be absolute or relative and may be expressed in terms of a progression within a specified range. The Performance Objectives with respect to a Performance Cycle shall be established in writing by the Committee by the earlier of (i) the date on which a quarter of the Performance Cycle has elapsed or (ii) the date which is 90 days after the commencement of the Performance Cycle.

(b) DETERMINATION OF PERFORMANCE. Prior to the vesting, payment, settlement or lapsing of any restrictions with respect to any Performance Award made to a Grantee who is subject to Section 162(m) of the Code, the Committee shall certify in writing that the applicable Performance Objectives have been satisfied; PROVIDED, HOWEVER, that satisfaction of any applicable Performance Objectives shall be made without regard to any change in accounting standards that may be required after the Performance Objectives are established.

10.2 PERFORMANCE UNITS. The Committee, in its discretion, may grant Awards of Performance Units to Eligible Individuals, the terms and conditions of which shall be set forth in an Agreement between the Company and the Grantee. Performance Units may be denominated in Shares

or a specified dollar amount and, contingent upon the attainment of specified Performance Objectives within the Performance Cycle, represent the right to receive payment as provided in Section 10.2(b) of (i) in the case of Share-denominated Performance Units, the Fair Market Value of a Share on the date the Performance Unit was granted, the date the Performance Unit became vested or any other date specified by the Committee, (ii) in the case of dollar-denominated Performance Units, the specified dollar amount or (iii) a percentage (which may be more than 100%) of the amount described in clause (i) or (ii) depending on the level of Performance Objective attainment; PROVIDED, HOWEVER, that the Committee may at the time a Performance Unit is granted, specify a maximum amount payable in respect of a vested Performance Unit. Each Agreement shall specify the number of the Performance Units to which it relates, the Performance Objectives which must be satisfied in order for the Performance Units to vest and the Performance Cycle within which such Performance Objectives must be satisfied.

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(a) VESTING AND FORFEITURE. Subject to Section 10.1(b) and 10.4, a Grantee shall become vested with respect to the Performance Units to the extent that the Performance Objectives set forth in the Agreement are satisfied for the Performance Cycle.

(b) PAYMENT OF AWARDS. Payment to Grantees in respect of vested Performance Units shall be made within sixty (60) days after the last day of the Performance Cycle to which such Award relates unless the Agreement evidencing the Award provides for the deferral of payment, in which event the terms and conditions of the deferral shall be set forth in the Agreement. Subject to Section 10.4, such payments may be made entirely in Shares valued at their Fair Market Value as of the last day of the applicable Performance Cycle or such other date specified by the Committee, entirely in cash, or in such combination of Shares and cash as the Committee in its discretion, shall determine at any time prior to such payment; PROVIDED, HOWEVER, that if the Committee in its discretion determines to make such payment entirely or partially in Shares of Restricted Stock, the Committee must determine the extent to which such payment will be in Shares of Restricted Stock and the terms of such Restricted Stock at the time the Award is granted.

10.3 PERFORMANCE SHARES. The Committee, in its discretion, may grant Awards of Performance Shares to Eligible Individuals, the terms and conditions of which shall be set forth in an Agreement between the Company and the Grantee. Each Agreement may require that an appropriate legend be placed on Share certificates. Awards of Performance Shares shall be subject to the following terms and provisions:

(a) RIGHTS OF GRANTEE. The Committee shall provide at the time an Award of Performance Shares is made, the time or times at which the actual Shares represented by such Award shall be issued in the name of the Grantee; PROVIDED, HOWEVER, that no Performance Shares shall be issued until the Grantee has executed an Agreement evidencing the Award, the appropriate blank stock powers and, in the discretion of the Committee, an escrow agreement and any other documents which the Committee may require as a condition to the issuance of such Performance Shares. If a Grantee shall fail to execute the Agreement evidencing an Award of Performance Shares, the appropriate blank stock powers and, in the discretion of the Committee, an escrow agreement and any other documents which the Committee may require within the time period prescribed by the Committee at the time the Award is granted, the Award shall be null and

void. At the discretion of the Committee, Shares issued in connection with an Award of Performance Shares shall be deposited together with the stock powers with an escrow

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agent (which may be the Company) designated by the Committee. Except as restricted by the terms of the Agreement, upon delivery of the Shares to the escrow agent, the Grantee shall have, in the discretion of the Committee, all of the rights of a stockholder with respect to such Shares, including the right to vote the Shares and to receive all dividends or other distributions paid or made with respect to the Shares.

(b) NON-TRANSFERABILITY. Until any restrictions upon the Performance Shares awarded to a Grantee shall have lapsed in the manner set forth in Sections 10.3(c) or 10.4, such Performance Shares shall not be sold, transferred or otherwise disposed of and shall not be pledged or otherwise hypothecated, nor shall they be delivered to the Grantee. The Committee may also impose such other restrictions and conditions on the Performance Shares, if any, as it deems appropriate.

(c) LAPSE OF RESTRICTIONS. Subject to Sections 10.1(b) or 10.4, restrictions upon Performance Shares awarded hereunder shall lapse and such Performance Shares shall become vested at such time or times and on such terms, conditions and satisfaction of Performance Objectives as the Committee may, in its discretion, determine at the time an Award is granted.

(d) TREATMENT OF DIVIDENDS. At the time the Award of Performance Shares is granted, the Committee may, in its discretion, determine that the payment to the Grantee of dividends, or a specified portion thereof, declared or paid on actual Shares represented by such Award which have been issued by the Company to the Grantee shall be (i) deferred until the lapsing of the restrictions imposed upon such Performance Shares and (ii) held by the Company for the account of the Grantee until such time. In the event that dividends are to be deferred, the Committee shall determine whether such dividends are to be reinvested in shares of Stock (which shall be held as additional Performance Shares) or held in cash. If deferred dividends are to be held in cash, there may be credited at the end of each year (or portion thereof) interest on the amount of the account at the beginning of the year at a rate per annum as the Committee, in its discretion, may determine. Payment of deferred dividends in respect of Performance Shares (whether held in cash or in additional Performance Shares), together with interest accrued thereon, if any, shall be made upon the lapsing of restrictions imposed on the Performance Shares in respect of which the deferred dividends were paid, and any dividends deferred (together with any interest accrued thereon) in respect of any Performance Shares shall be forfeited upon the forfeiture of such Performance Shares.

(e) DELIVERY OF SHARES. Upon the lapse of the restrictions on Performance Shares awarded hereunder, the Committee shall cause a stock certificate to

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be delivered to the Grantee with respect to such Shares, free of all restrictions hereunder.

10.4 EFFECT OF CHANGE IN CONTROL. In the event of a Change in Control:

(a) With respect to the Performance Units, the Grantee shall (i) become vested in a percentage of Performance Units as determined by the Committee at the time of the Award of such Performance Units and as set forth in the Agreement and (ii) be entitled to receive in respect of all Performance Units which become vested as a result of a Change in Control, a cash payment within ten (10) days after such Change in Control in an amount as determined by the Committee at the time of the Award of such Performance Unit and as set forth in the Agreement.

(b) With respect to the Performance Shares, restrictions shall lapse immediately on all or a portion of the Performance Shares as determined by the Committee at the time of the Award of such Performance Shares and as set forth in the Agreement.

(c) The Agreements evidencing Performance Shares and Performance Units shall provide for the treatment of such Awards (or portions thereof) which do not become vested as the result of a Change in Control, including, but not limited to, provisions for the adjustment of applicable Performance Objectives.

10.5 MODIFICATION OR SUBSTITUTION. Subject to the terms of the Plan, the Committee may modify outstanding Performance Awards or accept the surrender of outstanding Performance Awards and grant new Performance Awards in substitution for them. Notwithstanding the foregoing, no modification of a Performance Award shall adversely alter or impair any rights or obligations under the Agreement without the Grantee's consent.

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11. DIVIDEND EQUIVALENT RIGHTS.

Dividend Equivalent Rights may be granted to Eligible Individuals and Nonemployee Directors in tandem with of another Award or as a separate Award. The terms and conditions applicable to each Dividend Equivalent Right shall be specified in the Agreement under which the Dividend Equivalent Right is granted. Amounts payable in respect of Dividend Equivalent Rights may be payable currently or deferred until the lapsing of restrictions on such Dividend Equivalent Rights or until the vesting, exercise, payment, settlement or other lapse of restrictions on the Award to which the Dividend Equivalent Rights relate. In the event that the amount payable in respect of Dividend Equivalent Rights are to be deferred, the Committee shall determine whether such amounts are to be held in cash or reinvested in Shares or deemed (notionally) to be reinvested in Shares. If amounts payable in respect of Dividend Equivalent Rights are to be held in cash, there may be credited at the end of each year (or portion thereof) interest on the amount of the account at the beginning of the year at a rate per annum as the Committee, in its discretion, may determine. Dividend Equivalent Rights may be settled in cash or Shares or a combination thereof, in a single installment or multiple installments.

12. EFFECT OF A TERMINATION OF EMPLOYMENT.

The Agreement evidencing the grant of each Option and each Award shall set forth the terms and conditions applicable to such Option or Award upon a termination of the employment or service (or other change in the status) of the Optionee or Grantee by the Company, a Subsidiary or a Division (including a termination or change by reason of the sale of a Subsidiary or a Division), as the Committee may, in its discretion, determine at the time the Option or Award is granted or thereafter.

13. ADJUSTMENT UPON CHANGES IN CAPITALIZATION.

(a) In the event of a Change in Capitalization, the Committee shall conclusively determine the appropriate adjustments, if any, to the (i) maximum number and class of Shares or other stock or securities with respect to which Options or Awards may be granted under the Plan, (ii) the number and class of Shares or other stock or securities which are subject to outstanding Options or Awards granted under the Plan, and the purchase price therefor, if applicable and (iii) the Performance Objectives relating to outstanding Awards.

(b) Any such adjustment in the Shares or other stock or securities subject to outstanding Incentive Stock Options (including any adjustments in the purchase price) shall be made in such manner as not to constitute a modification as defined by Section 424(h)(3) of the Code and only to the extent otherwise permitted by Sections 422 and 424 of the Code.

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(c) If, by reason of a Change in Capitalization, a Grantee of an Award shall be entitled to, or an Optionee shall be entitled to exercise an Option with respect to, new, additional or different shares of stock or securities, such new additional or different shares shall thereupon be subject to all of the conditions, restrictions and performance criteria which were applicable to the Shares subject to the Award or Option, as the case may be, prior to such Change in Capitalization.

14. EFFECT OF CERTAIN TRANSACTIONS. Subject to Sections 7.4, 8.8, 9.4(b) and 10.4 or as otherwise provided in an Agreement, in the event of (i) the liquidation or dissolution of the Company or (ii) a merger or consolidation of the Company (a "Transaction"), the Plan and the Options and Awards issued hereunder shall continue in effect in accordance with their respective terms and each Optionee and Grantee shall be entitled to receive in respect of each Share subject to any outstanding Options or Awards, as the case may be, upon exercise of any Option or payment or transfer in respect of any Award, the same number and kind of stock, securities, cash, property, or other consideration that each holder of a Share was entitled to receive in the Transaction in respect of a Share.

15. INTERPRETATION.

(a) The Plan is intended to comply with Rule 16b-3 promulgated under the Exchange Act and the Committee shall interpret and administer the provisions of the Plan or any Agreement in a manner consistent therewith. Any provisions inconsistent with such Rule shall be inoperative and shall not affect the validity of the Plan.

(b) Unless otherwise expressly stated in the relevant Agreement, each Option, Stock Appreciation Right and Performance Award granted under the Plan is intended to be performance-based compensation within the meaning of Section 162(m)(4)(C) of the Code. The Committee shall not be entitled to exercise any discretion otherwise authorized hereunder with respect to such Options or Awards if the ability to exercise such discretion or the exercise of such discretion itself would cause the compensation attributable to such Options or Awards to fail to qualify as performance-based compensation.

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16. POOLING TRANSACTIONS.

Notwithstanding anything contained in the Plan or any Agreement to the contrary, in the event of a Change in Control which also constitutes a Pooling Transaction, the Committee may take such actions which are specifically recommended by an independent accounting firm retained by the Company to the

extent reasonably necessary in order to assure that the Pooling Transaction will qualify as such, including but not limited to (i) deferring the vesting, exercise, payment, settlement or lapsing of restrictions with respect to any Option or Award, (ii) providing that the payment or settlement in respect of any Option or Award be made in the form of cash, Shares or securities of a successor or acquiror of the Company, or a combination of the foregoing and (iii) providing for the extension of the term of any Option or Award to the extent necessary to accommodate the foregoing, but not beyond the maximum term permitted for any Option or Award.

17. TERMINATION AND AMENDMENT OF THE PLAN.

The Plan shall terminate on the day preceding the tenth anniversary of the date of its adoption by the Board and no Option or Award may be granted thereafter. The Board may sooner terminate the Plan and the Board may at any time and from time to time amend, modify or suspend the Plan; PROVIDED, HOWEVER, that:

(a) No such amendment, modification, suspension or termination shall impair or adversely alter any Options or Awards theretofore granted under the Plan, except with the consent of the Optionee or Grantee, nor shall any amendment, modification, suspension or termination deprive any Optionee or Grantee of any Shares which he or she may have acquired through or as a result of the Plan; and

(b) To the extent necessary under Section 16(b) of the Exchange Act and the rules and regulations promulgated thereunder or other applicable law, no amendment shall be effective unless approved by the stockholders of the Company in accordance with applicable law and regulations.

18. NON-EXCLUSIVITY OF THE PLAN.

The adoption of the Plan by the Board shall not be construed as amending, modifying or rescinding any previously approved incentive arrangement or as creating any limitations on the power of the Board to adopt such other incentive arrangements as it may deem desirable, including, without limitation, the granting of stock options otherwise than under the Plan, and such arrangements may be either applicable generally or only in specific cases.

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19. LIMITATION OF LIABILITY.

As illustrative of the limitations of liability of the Company, but not intended to be exhaustive thereof, nothing in the Plan shall be construed to:

(i) give any person any right to be granted an Option or Award other than at the sole discretion of the Committee;

(ii) give any person any rights whatsoever with respect to Shares except as specifically provided in the Plan;

(iii) limit in any way the right of the Company to terminate the employment of any person at any time; or

(iv) be evidence of any agreement or understanding, expressed or implied, that the Company will employ any person at any particular rate of compensation or for any particular period of time.

20. REGULATIONS AND OTHER APPROVALS; GOVERNING LAW.

20.1 Except as to matters of federal law, this Plan and the rights of all persons claiming hereunder shall be construed and determined in accordance with the laws of the State of Delaware without giving effect to conflicts of law principles.

20.2 The obligation of the Company to sell or deliver Shares with respect to Options and Awards granted under the Plan shall be subject to all applicable laws, rules and regulations, including all applicable federal and state securities laws, and the obtaining of all such approvals by governmental agencies as may be deemed necessary or appropriate by the Committee.

20.3 The Board may make such changes as may be necessary or appropriate to comply with the rules and regulations of any government authority, or to obtain for Eligible Individuals granted Incentive Stock Options the tax benefits under the applicable provisions of the Code and regulations promulgated thereunder.

20.4 (a) Each Option and Award is subject to the requirement that, if at any time the Committee determines, in its discretion, that the listing, registration or qualification of Shares issuable pursuant to the Plan is required by any securities exchange or under any state or federal law, or the consent or approval of any governmental regulatory body is necessary or desirable as a condition of, or in connection with, the grant of an Option or Award or the issuance of Shares, no Options or Awards shall be granted or payment made or Shares issued, in whole or in part, unless listing, registration, qualification,

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consent or approval has been effected or obtained free of any conditions as acceptable to the Committee.

(b) Notwithstanding anything to the contrary contained in the Plan or any Agreement, as a prerequisite to the granting, vesting, payment, settlement or lapsing of restrictions with respect to an Option or Award, the Committee may require the Optionee or Grantee, as the case may be, to execute and deliver a Stockholders Agreement in a form acceptable to the Committee.

20.5 Notwithstanding anything contained in the Plan or any Agreement to the contrary, in the event that the disposition of Shares acquired pursuant to the Plan is not covered by a then current registration statement under the Securities Act of 1933, as amended, and is not otherwise exempt from such registration, such Shares shall be restricted against transfer to the extent required by the Securities Act of 1933, as amended, and Rule 144 or other regulations thereunder. The Committee may require any individual receiving Shares pursuant to an Option or Award granted under the Plan, as a condition precedent to receipt of such Shares, to represent and warrant to the Company in writing that the Shares acquired by such individual are acquired without a view to any distribution thereof and will not be sold or transferred other than pursuant to an effective registration thereof under said Act or pursuant to an exemption applicable under the Securities Act of 1933, as amended, or the rules and regulations promulgated thereunder. The certificates evidencing any of such Shares shall be appropriately amended to reflect their status as restricted securities as aforesaid.

21. MISCELLANEOUS.

21.1 MULTIPLE AGREEMENTS. The terms of each Option or Award may differ from other Options or Awards granted under the Plan at the same time, or at some other time. The Committee may also grant more than one Option or Award to a given Eligible Individual during the term of the Plan, either in addition to, or in substitution for, one or more Options or Awards previously granted to that Eligible Individual.

21.2 WITHHOLDING OF TAXES. (a) The Company shall have the right to

deduct from any distribution of cash to any Optionee or Grantee, an amount equal to the federal, state and local income taxes and other amounts as may be required by law to be withheld (the "Withholding Taxes") with respect to any Option or Award. If an Optionee or Grantee is to experience a taxable event in connection with the receipt of Shares pursuant to an Option exercise or payment or vesting of an Award (a "Taxable Event"), the Optionee or Grantee shall pay the Withholding Taxes to the Company prior to the issuance, or release from escrow, of such Shares. In satisfaction of the obligation to pay Withholding Taxes to the Company, the Optionee or Grantee may make a written election (the "Tax Election"), which may be accepted or rejected in the discretion of the Committee, to have withheld a

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portion of the Shares then issuable to him or her having an aggregate Fair Market Value, on the date preceding the date of such issuance, equal to the Withholding Taxes, provided that in respect of an Optionee or Grantee who may be subject to liability under Section 16(b) of the Exchange Act either: (i) in the case of a Taxable Event involving an Option or an Award (A) the Tax Election is made at least six (6) months prior to the date of the Taxable Event and (B) the Tax Election is irrevocable with respect to all Taxable Events of a similar nature occurring prior to the expiration of six (6) months following a revocation of the Tax Election; or (ii) in the case of the exercise of an Option (A) the Optionee makes the Tax Election at least six (6) months after the date the Option was granted, (B) the Option is exercised during the ten (10) day period beginning on the third business day and ending on the twelfth business day following the release for publication of the Company's quarterly or annual statement of sales and earnings (a "Window Period") and (C) the Tax Election is made during the Window Period in which the related Option is exercised or prior to such Window Period and subsequent to the immediately preceding Window Period; or (iii) in the case of a Taxable Event relating to the payment of an Award (A) the Grantee makes the Tax Election at least six (6) months after the date the Award was granted and (B) the Tax Election is made (x) in the case of a Taxable Event occurring within a Window Period, during the Window Period in which the Taxable Event occurs, or (y) in the case of a Taxable Event not occurring within a window period, during the Window Period immediately preceding the Taxable Event relating to the Award. Notwithstanding the foregoing, the Committee may, by the adoption of rules or otherwise, (i) modify the provisions of this Section 21.2 or impose such other restrictions or limitations on Tax Elections as may be necessary to ensure that the Tax Elections will be exempt transactions under Section 16(b) of the Exchange Act, and (ii) permit Tax Elections to be made at such other times and subject to such other conditions as the Committee determines will constitute exempt transactions under Section 16(b) of the Exchange Act.

(b) If an Optionee makes a disposition, within the meaning of Section 424(c) of the Code and regulations promulgated thereunder, of any Share or Shares issued to such Optionee pursuant to the exercise of an Incentive Stock Option within the two-year period commencing on the day after the date of the grant or within the one-year period commencing on the day after the date of transfer of such Share or Shares to the Optionee pursuant to such exercise, the Optionee shall, within ten (10) days of such disposition, notify the Company thereof, by delivery of written notice to the Company at its principal executive office.

(c) The Committee shall have the authority, at the time of grant of an Option or Award under the Plan or at any time thereafter, to award tax bonuses to designated Optionees or Grantees, to be paid upon their exercise of Employee Options or payment in respect of Awards granted hereunder. The amount of any such payments shall be determined by the

Committee. The Committee shall have full

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authority in its absolute discretion to determine the amount of any such tax bonus and the terms and conditions affecting the vesting and payment thereof.

22. EFFECTIVE DATE. The effective date of the Plan shall be as determined by the Board, subject only to the approval by the affirmative vote of the holders of a majority of the securities of the Company present, or represented, and entitled to vote at a meeting of stockholders duly held in accordance with the applicable laws of the State of Delaware within twelve (12) months of the adoption of the Plan by the Board.

DEPARTMENT 56, INC.
1997 STOCK INCENTIVE PLAN
(as amended)

1. PURPOSE.

The purpose of this Plan is to strengthen Department 56, Inc., a Delaware corporation (the "Company"), by providing an incentive to its officers, employees, consultants, directors and advisors and thereby encouraging them to devote their abilities and industry to the success of the Company's business enterprise. It is intended that this purpose be achieved by extending to officers, employees, consultants and directors of the Company and its Subsidiaries an added long-term incentive for high levels of performance and unusual efforts through the grant of Incentive Stock Options, Nonqualified Stock Options, Stock Appreciation Rights, Restricted Stock, Performance Units, Performance Shares and Dividend Equivalent Rights (as each term is hereinafter defined).

2. DEFINITIONS.

For purposes of the Plan:

2.1 "Adjusted Fair Market Value" means, in the event of a Change in Control, the greater of (i) the highest price per Share paid to holders of the Shares in any transaction (or series of transactions) constituting or resulting in a Change in Control or (ii) the highest Fair Market Value of a Share during the ninety (90) day period ending on the date of a Change in Control.

2.2 "Agreement" means the written agreement between the Company and an Optionee or Grantee evidencing the grant of an Option or Award and setting forth the terms and conditions thereof.

2.3 "Award" means a grant of Restricted Stock, a Stock Appreciation Right, a Performance Award, a Dividend Equivalent Right or any or all of them.

2.4 "Board" means the Board of Directors of the Company.

2.5 "Cause" means the commission of an act of fraud or intentional misrepresentation or an act of embezzlement, misappropriation or conversion of assets or opportunities of the Company or any Subsidiary.

2.6 "Change in Capitalization" means any increase or reduction in the number of Shares, or any change (including, but not limited to, a change in value) in the Shares or exchange of Shares for a different number or kind of shares or other securities of the Company or another corporation, by reason of a reclassification, recapitalization, merger, consolidation, reorganization, spin-off, split-up, issuance of warrants or rights or debentures, stock dividend, stock split or reverse stock split, cash dividend, property dividend, combination or exchange of shares, repurchase of shares, change in corporate structure or otherwise.

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2.7 A "Change in Control" shall mean the occurrence during the term of the Plan of:

(a) An acquisition (other than directly from the Company) of any voting securities of the Company (the "Voting Securities") by any 'Person' (as the term person is used for purposes of Section 13(d) or 14(d) of the Exchange Act), immediately after which such Person has 'Beneficial Ownership' (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of fifty-one percent (51%) or more of the combined voting power of the Company's then outstanding Voting Securities; provided, however, in determining whether a Change in Control has occurred, Voting Securities which are acquired in a 'Non-Control Acquisition' (as hereinafter defined) shall not constitute an acquisition which would cause a Change in

Control. A 'Non-Control Acquisition' shall mean an acquisition by (i) an employee benefit plan (or a trust forming a part thereof) maintained by (A) the Company or (B) any corporation or other Person of which a majority of its voting power or its voting equity securities or equity interest is owned, directly or indirectly, by the Company (for purposes of this definition, a 'Subsidiary'), (ii) the Company or its Subsidiaries, or (iii) any Person in connection with a 'Non-Control Transaction' (as hereinafter defined);

(b) The individuals who, as of May 16, 1997, are members of the Board (the "Incumbent Board"), cease for any reason to constitute at least two-thirds of the members of the Board; provided, however, that if the election, or nomination for election by the Company's common stockholders, of any new director was approved by a vote of at least two-thirds of the Incumbent Board, such new director shall, for purposes of this Plan, be considered as a member of the Incumbent Board; provided further, however, that no individual shall be considered a member of the Incumbent Board if such individual initially assumed office as a result of either an actual or threatened 'Election Contest' (as described in Rule 14a-11 promulgated under the Exchange Act) or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board (a "Proxy Contest") including by reason of any agreement intended to avoid or settle any Election Contest or Proxy Contest; or

(c) The consummation of:

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(i) A merger, consolidation or reorganization with or into the Company or in which securities of the Company are issued, unless such merger, consolidation or reorganization is a "Non-Control Transaction." A "Non-Control Transaction" is a merger, consolidation or reorganization with or into the Company or in which securities of the Company are issued where

(A) the stockholders of the Company, immediately before such merger, consolidation or reorganization, own, directly or indirectly immediately following such merger, consolidation or reorganization, at least sixty percent (60%) of the combined voting power of the outstanding voting securities of the corporation resulting from such merger or consolidation or reorganization (the "Surviving Corporation") in substantially the same proportion as their ownership of the Voting Securities immediately before such merger, consolidation or reorganization,

(B) the individuals who were members of the Incumbent Board immediately prior to the execution of the agreement providing for such merger, consolidation or reorganization constitute at least two-thirds of the members of the board of directors of the Surviving Corporation, or a corporation beneficially owning a majority of the Voting Securities of the Surviving Corporation,

(C) no Person other than (1) the Company, (2) any Subsidiary, (3) any employee benefit plan (or any trust forming a part thereof) maintained immediately prior to such merger, consolidation or reorganization by the Company or any Subsidiary, or any (4) Person who, immediately prior to such merger, consolidation or reorganization had Beneficial Ownership of fifty-one percent (51%) or more of the then outstanding Voting Securities owns, directly or indirectly fifty-one percent (51%) or more of the

combined voting power of the Surviving Corporation's then outstanding voting securities;

(ii) A complete liquidation or dissolution of the Company; or

(iii) The sale or other disposition of all or substantially all of the assets of the Company to any Person (other than a transfer to a Subsidiary).

Notwithstanding the foregoing, a Change in Control shall not be deemed to occur solely because any Person (the "Subject Person") acquired Beneficial Ownership of

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more than the permitted amount of the outstanding Voting Securities as a result of the acquisition of Voting Securities by the Company which, by reducing the number of Voting Securities outstanding, increases the proportional number of shares Beneficially Owned by the Subject Persons, provided that if a Change in Control would occur (but for the operation of this sentence) as a result of the acquisition of Voting Securities by the Company, and after such share acquisition by the Company, the Subject Person becomes the Beneficial Owner of any additional Voting Securities which increases the percentage of the then outstanding Voting Securities Beneficially Owned by the Subject Person, then a Change in Control shall occur.

2.8 "Code" means the Internal Revenue Code of 1986, as amended.

2.9 "Committee" means a committee, as described in Section 3.1, appointed by the Board from time to time to administer the Plan and to perform the functions set forth herein.

2.10 "Company" means Department 56, Inc.

2.11 "Director" means a director of the Company.

2.11 "Director Option" means an Option granted pursuant to Section 6.

2.12 "Disability" means a physical or mental infirmity which impairs the Optionee's ability to perform substantially his or her duties for a period of one hundred eighty (180) consecutive days.

2.14 "Dividend Equivalent Right" means a right to receive all or some portion of the cash dividends that are or would be payable with respect to Shares.

2.15 "Division" means any of the operating units or divisions of the Company designated as a Division by the Committee.

2.16 "Eligible Director" means a Director who is not an employee of the Company or any Subsidiary.

2.17 "Eligible Individual" means any Director (other than an Eligible Director), officer or employee of the Company or a Subsidiary, or any consultant or advisor who is receiving cash compensation from the Company or a Subsidiary designated by the Committee as eligible to receive Options or Awards subject to the conditions set forth herein.

2.18 "Employee Option" means an Option granted pursuant to Section 5.

2.19 "Exchange Act" means the Securities Exchange Act of 1934, as amended.

2.20 "Fair Market Value" on any date means the average of the high and low sales prices of the Shares on such date on the principal national securities exchange on which such Shares are listed or admitted to trading, or if such Shares are not

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so listed or admitted to trading, the average of the per Share closing bid price and per Share closing asked price on such date as quoted on the National Association of Securities Dealers Automated Quotation System or such other market in which such prices are regularly quoted, or, if there have been no published bid or asked quotations with respect to Shares on such date, the Fair

Market Value shall be the value established by the Board in good faith and, in the case of an Incentive Stock Option, in accordance with Section 422 of the Code.

2.21 "Grantee" means a person to whom an Award has been granted under the Plan.

2.22 "Incentive Stock Option" means an Option satisfying the requirements of Section 422 of the Code and designated by the Committee as an Incentive Stock Option.

2.23 "Nonemployee Director" means a Director who is a "nonemployee director" within the meaning of Rule 16b-3 promulgated under the Exchange Act.

2.24 "Nonqualified Stock Option" means an Option which is not an Incentive Stock Option.

2.25 "Option" means a Nonqualified Stock Option, an Incentive Stock Option, Director Option, or any or all of them.

2.26 "Optionee" means a person to whom an Option has been granted under the Plan.

2.27 "Outside Director" means a director of the Company who is an "outside director" within the meaning of Section 162(m) of the Code and the regulations promulgated thereunder.

2.28 "Parent" means any corporation which is a parent corporation (within the meaning of Section 424(e) of the Code) with respect to the Company.

2.29 "Performance Awards" means Performance Units, Performance Shares or either or both of them.

2.30 "Performance Cycle" means the time period specified by the Committee at the time a Performance Award is granted during which the performance of the Company, a Subsidiary or a Division will be measured.

2.31 "Performance Objectives" has the meaning set forth in Section 10.1.

2.32 "Performance Shares" means Shares issued or transferred to an Eligible Individual under Section 10.3.

2.33 "Performance Units" means Performance Units granted to an Eligible Individual under Section 10.2.

2.34 "Plan" means the Department 56, Inc. 1997 Stock Incentive Plan, as amended from time to time.

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2.35 "Pooling Transaction" means an acquisition of or by the Company in a transaction which is intended to be treated as a "pooling of interests" under generally accepted accounting principles.

2.36 "Restricted Stock" means Shares issued or transferred to an Eligible Individual pursuant to Section 9.

2.37 "Shares" means the common stock, par value \$.01 per share, of the Company.

2.38 "Stock Appreciation Right" means a right to receive all or some portion of the increase in the value of the Shares as provided in Section 8 hereof.

2.39 "Stockholders Agreement" means a stockholders agreement governing the rights, duties and obligations of present or future employees or directors, as the case may be, of the Company or its Subsidiaries with respect to Shares granted or sold to such persons, or issued pursuant to options or other awards granted to such persons, in such form as is in use by the Company at the time of exercise of an Option or any part thereof or the issuance of Shares pursuant to an Award and which the Company elects to require an Optionee or Grantee to execute in connection with the issuance of Shares.

2.40 "Subsidiary" means any corporation which is a subsidiary corporation (within the meaning of Section 424(f) of the Code) with respect to the Company.

2.41 "Successor Corporation" means a corporation, or a parent or subsidiary thereof within the meaning of Section 424(a) of the Code, which issues or assumes a stock option in a transaction to which Section 424(a) of the Code applies.

2.42 "Ten-Percent Stockholder" means an Eligible Individual, who, at the time an Incentive Stock Option is to be granted to him

or her, owns (within the meaning of Section 422(b)(6) of the Code) stock possessing more than ten percent (10%) of the total combined voting power of all classes of stock of the Company, or of a Parent or a Subsidiary.

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3. ADMINISTRATION.

3.1 The Plan shall be administered by the Committee which shall hold meetings at such times as may be necessary for the proper administration of the Plan. The Committee shall keep minutes of its meetings. Except as provided in Section 3.3, a quorum shall consist of not less than two members of the Committee and a majority of a quorum may authorize any action. Any decision or determination reduced to writing and signed by a majority of all of the members of the Committee shall be as fully effective as if made by a majority vote at a meeting duly called and held. Except as provided in Section 3.3, the Committee shall consist of at least two (2) Directors and may consist of the entire Board; PROVIDED, HOWEVER, that (A) except as provided in clause (B) below, (i) if the Committee consists of less than the entire Board, each member shall be a Nonemployee Director and (ii) to the extent necessary for any Option or Award intended to qualify as performance-based compensation under Section 162(m) of the Code to so qualify, each member of the Committee, whether or not it consists of the entire Board, shall be an Outside Director and (B) the Board may, by resolution, authorize a committee consisting of one or more Directors to make grants of Employee Options to Eligible Individuals who are not officers of the Company, subject to such restrictions and limitations as the Board shall set forth in such resolution and as otherwise provided in the Plan. No member of the Committee shall be liable for any action, failure to act, determination or interpretation made in good faith with respect to this Plan or any transaction hereunder, except for liability arising from his or her own willful misfeasance, gross negligence or reckless disregard of his or her duties. The Company hereby agrees to indemnify each member of the Committee for all costs and expenses and, to the extent permitted by applicable law, any liability incurred in connection with defending against, responding to, negotiating for the settlement of or otherwise dealing with any claim, cause of action or dispute of any kind arising in connection with any actions in administering this Plan or in authorizing or denying authorization to any transaction hereunder.

3.2 Subject to the express terms and conditions set forth herein, the Committee shall have the power from time to time to:

(a) determine those Eligible Individuals to whom Employee Options shall be granted under the Plan and the number of such Employee Options to be granted and to prescribe the terms and conditions (which need not be identical) of each such Employee Option, including the purchase price per Share subject to each Employee Option, and make any amendment or modification to any Option Agreement consistent with the terms of the Plan;

(b) select those Eligible Individuals to whom Awards shall be granted under the Plan and to determine the number of Stock Appreciation Rights, Performance Units, Performance Shares, Shares of

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Restricted Stock and/or Dividend Equivalent Rights to be granted pursuant to each Award, the terms and conditions of each Award, including the restrictions or Performance Objectives relating to such Units or Shares, the maximum value of each Performance Unit and Performance Share and make any amendment or modification to any Agreement consistent with the terms of the Plan;

(c) to construe and interpret the Plan and the Options and Awards granted hereunder and to establish, amend and revoke rules and regulations for the administration of the Plan, including, but not limited to, correcting any defect or

supplying any omission, or reconciling any inconsistency in the Plan or in any Agreement, in the manner and to the extent it shall deem necessary or advisable so that the Plan complies with applicable law including Rule 16b-3 under the Exchange Act and the Code to the extent applicable, and otherwise to make the Plan fully effective. All decisions and determinations by the Committee in the exercise of this power shall be final, binding and conclusive upon the Company, its Subsidiaries, the Optionees and Grantees and all other persons having any interest therein;

(d) to determine the duration and purposes for leaves of absence which may be granted to an Optionee or Grantee on an individual basis without constituting a termination of employment or service for purposes of the Plan;

(e) to exercise its discretion with respect to the powers and rights granted to it as set forth in the Plan; and

(f) generally, to exercise such powers and to perform such acts as are deemed necessary or advisable to promote the best interests of the Company with respect to the Plan.

3.3

BOARD RESERVATION AND DELEGATION.

(a) The Board may, in its discretion, reserve to itself or delegate to another committee of the Board any or all of the authority and responsibility of the Committee with respect to Options and Awards granted hereunder to Eligible Individuals who are not subject to Section 16 of the Exchange Act or Section 162(m) of the Code at the time any such delegated authority or responsibility is exercised. Such other committee may consist of one or more directors who may, but need not be, officers or employees of the Company or any of its Subsidiaries. To the extent that the Board has reserved to itself or delegated the authority and responsibility of the Committee to such other committee, all references to the Committee in the Plan shall be to the Board or to such other committee.

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(b) The Board may, by resolution, authorize a committee (the "Director Option Grant Committee") consisting of one or more directors of the Company to make grants of Director Options which are intended to satisfy the conditions for exemption from Section 16b of the Exchange Act pursuant to Rule 16b-3(d)(3). The authority of the Director Option Grant Committee shall be subject to such restrictions and limitations as the Board shall set forth in such resolution and as otherwise provided in the Plan. References to the term Committee in Section 6 shall be deemed to include the Director Option Grant Committee wherever it is used insofar as it relates to the Committee's authority and responsibility to make grants and establish the terms of Director Options but only to the extent the Director Option Grant Committee is acting within the scope of its authority as established by the Board.

4. STOCK SUBJECT TO THE PLAN; GRANT LIMITATIONS.

4.1

The maximum number of Shares that may be made the subject of Options and Awards granted under the Plan is 1,500,000. The maximum number of Shares that any Eligible Individual may receive during the term of the Plan in respect of Options and Awards may not exceed 500,000 Shares. The maximum dollar amount of cash or the fair market value of Shares that any Eligible Individual may receive during the term of the Plan in respect of Performance Units denominated in dollars may not exceed \$5,000,000. Upon a Change in Capitalization the maximum number of Shares referred to in the first two sentences of this Section 4.1 shall be adjusted in number and kind pursuant to Section 13. The Company shall reserve for the purposes of the Plan, out of its authorized but unissued Shares or out of

Shares held in the Company's treasury, or partly out of each, such number of Shares as shall be determined by the Board.

4.2 Upon the granting of an Option or an Award, the number of Shares available under Section 4.1 for the granting of further Options and Awards shall be reduced as follows:

(a) In connection with the granting of an Option or an Award (other than the granting of a Performance Unit denominated in dollars), the number of Shares shall be reduced by the number of Shares in respect of which the Option or Award is granted or denominated.

(b) In connection with the granting of a Performance Unit denominated in dollars, the number of Shares shall be reduced by an amount equal to the quotient of (i) the dollar amount in which the Performance Unit is denominated, divided by (ii) the Fair Market Value of a Share on the date the Performance Unit is granted.

4.3 Whenever any outstanding Option or Award or portion thereof expires, is cancelled or is otherwise terminated for any reason without having

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been exercised or payment having been made in respect of the entire Option or Award, the Shares allocable to the expired, cancelled or otherwise terminated portion of the Option or Award may again be the subject of Options or Awards granted hereunder.

5. OPTION GRANTS FOR ELIGIBLE INDIVIDUALS.

5.1 AUTHORITY OF COMMITTEE. Subject to the provisions of the Plan and to Section 4.1 above, the Committee shall have full and final authority to select those Eligible Individuals who will receive Employee Options and the terms and conditions of the grant to such Eligible Individuals shall be set forth in an Agreement; provided, however, that no person shall receive any Incentive Stock Options unless he or she is an employee of the Company, a Parent or a Subsidiary at the time the Incentive Stock Option is granted.

5.2 PURCHASE PRICE. The purchase price or the manner in which the purchase price is to be determined for Shares under each Employee Option shall be determined by the Committee and set forth in the Agreement; provided, however, that the purchase price per Share under each Employee Incentive Stock Option shall not be less than 100% of the Fair Market Value of a Share on the date the Option is granted (110% in the case of an Incentive Stock Option granted to a Ten-Percent Stockholder).

5.3 MAXIMUM DURATION. Employee Options granted hereunder shall be for such term as the Committee shall determine, provided that no Option shall be exercisable after the expiration of ten (10) years from the date it is granted (five (5) years in the case of an Incentive Stock Option granted to a Ten-Percent Stockholder). The Committee may, subsequent to the granting of any Employee Option, extend the term thereof but in no event shall the term as so extended exceed the maximum term provided for in the preceding sentence.

5.4 VESTING. Subject to Section 7.4 hereof, each Employee Option shall become exercisable in such installments (which need not be equal) and at such times as may be designated by the Committee and set forth in the Agreement. To the extent not exercised, installments shall accumulate and be exercisable, in whole or in part, at any time after becoming exercisable, but not later than the date the Employee Option expires. The Committee may accelerate the exercisability of any Employee Option or portion thereof at any time.

5.5 MODIFICATION OR SUBSTITUTION. The Committee may, in its discretion, modify outstanding Employee Options or accept the surrender of outstanding Employee Options (to the extent not exercised) and grant new Employee Options in substitution for them. Notwithstanding the foregoing, no modification of an Employee Option shall adversely alter or impair any rights or obligations under the Employee Option without the Optionee's consent.

6. ELIGIBLE DIRECTOR PROVISIONS.

6.1 OPTION GRANTS FOR ELIGIBLE DIRECTORS. Subject to the provisions

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of the Plan and to Section 4.1, the Committee may grant Director Options to any Eligible Director on such terms and conditions, including option price, exercisability and duration, as the Committee in its discretion shall determine. The Committee shall determine the number of Shares subject to each Director Option.

6.2 ELECTION TO RECEIVE SHARES IN LIEU OF DIRECTORS' FEES.

(a) ELECTION. Each Eligible Director may elect, on a form provided for such purpose by the Committee, to have all or any part (but only in 25% increments) of his or her Directors' Fees converted into, and transferred to him or her, in the form of Shares (an "Election"). For purposes of this Section 6.2, "Directors' Fees" means all cash annual retainer and meeting fees payable by the Company to an Eligible Director with respect to services rendered by such Eligible Director.

(b) TIME OF ELECTION; EFFECTIVE DATE OF ELECTION. An Eligible Director may make an Election at any time during any particular year during his or her directorship. An Election made on or prior to June 10 shall be effective with respect to Directors' Fees payable on or after July 1 of such year. An Election made on or prior to December 10 shall be effective with respect to Directors' Fees payable on or after January 1 of the following year.

(c) SHARES RECEIVED IN LIEU OF FEES. On each date following the effective date of an Election on which Directors' Fees would otherwise be paid (a "Director Payment Date"), the Directors' Fees that an Eligible Director would have received but for his or her Election shall be converted into the right to receive a number of Shares with a Fair Market Value (determined as of the Director Payment Date) equal to 110% of such Directors' Fees. Shares shall be issued by the Company to an Eligible Director who has made an Election as promptly as practicable following each Director Payment Date.

(d) ELECTION EFFECTIVE UNTIL REVOKED. An Eligible Director's Election shall remain effective until revoked. An Eligible Director may revoke his or her Election (a "Revocation") on a form provided for such purpose by the Committee at any time during any particular year during his or her directorship. A Revocation made on or prior to June 10 shall be effective with respect to Directors' Fees payable on or after July 1 of such year. A Revocation made on or prior to December 10 shall be effective with respect to Directors' Fees payable on or after January 1 of the following year.

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6.3 LIMITATIONS ON AMENDMENT; MODIFICATION.

The provisions in this Section 6 shall not be amended more than once every six months, other than to comport with changes in the Code or the rules and regulations thereunder. No modification of a Director Option shall adversely alter or impair any rights or obligations under such Director Option without the Optionee's consent nor shall any modification reduce or have the effect of reducing the per Share purchase price of any outstanding Director Option.

7. TERMS AND CONDITIONS APPLICABLE TO ALL OPTIONS.

7.1 NON-TRANSFERABILITY. No Option granted hereunder shall be transferable by the Optionee to whom granted except by will or the laws of descent and distribution, and an Option may be exercised during the lifetime of such Optionee only by the Optionee or his or her guardian or legal representative. The terms of such Option shall be final, binding and conclusive upon the beneficiaries, executors, administrators, heirs and successors of the

Optionee.

7.2 METHOD OF EXERCISE. The exercise of an Option shall be made only by a written notice delivered in person or by mail to the Secretary of the Company at the Company's principal executive office, specifying the number of Shares to be purchased and accompanied by payment therefor and otherwise in accordance with the Agreement pursuant to which the Option was granted and, unless the Committee determines otherwise, a fully executed Stockholders Agreement. The purchase price for any Shares purchased pursuant to the exercise of an Option shall be paid in either of the following forms (or any combination thereof): (i) cash or (ii) the transfer of Shares to the Company upon such terms and conditions as determined by the Committee. Notwithstanding the foregoing, (i) the Committee shall have discretion to determine at the time of grant of each Employee Option or at any later date (up to and including the date of exercise) the form of payment acceptable in respect of the exercise of such Employee Option and (ii) Options may be exercised pursuant to such cashless exercise procedures which are, from time to time, deemed acceptable by the Committee. The written notice pursuant to this Section 7.2 may also provide instructions from the Optionee to the Company that upon receipt of the purchase price in cash from the Optionee's broker or dealer, designated as such on the written notice, in payment for any Shares purchased pursuant to the exercise of an Option, the Company shall issue such Shares directly to the designated broker or dealer. Any Shares transferred to the Company as payment of the purchase price under an Option shall be valued at their Fair Market Value on the day preceding the date of exercise of such Option. If requested by the Committee, the Optionee shall deliver the Agreement evidencing the Option to the Secretary of the Company who shall endorse thereon a notation of such exercise and return such Agreement to the Optionee. No fractional Shares (or cash in lieu thereof) shall be issued upon exercise of an Option and the number of Shares that may be purchased upon

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exercise shall be rounded to the nearest number of whole Shares.

7.3 RIGHTS OF OPTIONEES. No Optionee shall be deemed for any purpose to be the owner of any Shares subject to any Option unless and until (i) the Option shall have been exercised pursuant to the terms thereof, (ii) the Company shall have issued and delivered the Shares to the Optionee and (iii) the Optionee's name shall have been entered as a stockholder of record on the books of the Company. Thereupon, the Optionee shall have full voting, dividend and other ownership rights with respect to such Shares, subject to such terms and conditions as may be set forth in the applicable Agreement.

7.4 EFFECT OF CHANGE IN CONTROL. In the event of a Change in Control, all Options outstanding on the date of such Change in Control shall become immediately and fully exercisable. In addition, to the extent set forth in an Agreement evidencing the grant of an Option, an Optionee will be permitted to surrender to the Company for cancellation within sixty (60) days after such Change in Control, any Option or portion of an Option to the extent not yet exercised and the Optionee will be entitled to receive a cash payment in an amount equal to the excess, if any, of (x) (A) in the case of a Nonqualified Stock Option, the greater of (1) the Fair Market Value, on the date preceding the date of surrender, of the Shares subject to the Option or portion thereof surrendered or (2) the Adjusted Fair Market Value of the Shares subject to the Option or portion thereof surrendered or (B) in the case of an Incentive Stock Option, the Fair Market Value, on the date preceding the date of surrender, of the Shares subject to the Option or portion thereof surrendered, over (y) the aggregate purchase price for such Shares under the Option or portion thereof surrendered. In the event an Optionee's employment with, or service as a Director of, the Company is terminated by the Company within two years following a Change in Control each Option held by the Optionee that was exercisable as of the date of termination of the Optionee's employment or service shall remain exercisable for a period ending not before the earlier of (A) the first anniversary of the termination of the Optionee's employment or service or (B) the expiration of the stated term of the Option.

8. STOCK APPRECIATION RIGHTS. The Committee may, in its discretion, either alone or in connection with the grant of an Employee Option,

grant Stock Appreciation Rights in accordance with the Plan, the terms and conditions of which shall be set forth in an Agreement. If granted in connection with an Employee Option, a Stock Appreciation Right shall cover the same Shares covered by the Employee Option (or such lesser number of Shares as the Committee may determine) and shall, except as provided in this Section 8, be subject to the same terms and conditions as the related Employee Option.

8.1 TIME OF GRANT. A Stock Appreciation Right may be granted (i) at any time if unrelated to an Option, or (ii) if related to an Employee Option, either at

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the time of grant, or at any time thereafter during the term of the Option.

8.2 STOCK APPRECIATION RIGHT RELATED TO AN EMPLOYEE OPTION.

(a) EXERCISE. A Stock Appreciation Right granted in connection with an Employee Option shall be exercisable at such time or times and only to the extent that the related Employee Option is exercisable, and will not be transferable except to the extent the related Employee Option is transferable. A Stock Appreciation Right granted in connection with an Incentive Stock Option shall be exercisable only if the Fair Market Value of a Share on the date of exercise exceeds the purchase price specified in the related Incentive Stock Option Agreement.

(b) AMOUNT PAYABLE. Upon the exercise of a Stock Appreciation Right related to an Employee Option, the Grantee shall be entitled to receive an amount determined by multiplying (A) the excess of the Fair Market Value of a Share on the date preceding the date of exercise of such Stock Appreciation Right over the per Share purchase price under the related Employee Option, by (B) the number of Shares as to which such Stock Appreciation Right is being exercised. Notwithstanding the foregoing, the Committee may limit in any manner the amount payable with respect to any Stock Appreciation Right by including such a limit in the Agreement evidencing the Stock Appreciation Right at the time it is granted.

(c) TREATMENT OF RELATED OPTIONS AND STOCK APPRECIATION RIGHTS UPON EXERCISE. Upon the exercise of a Stock Appreciation Right granted in connection with an Employee Option, the Employee Option shall be cancelled to the extent of the number of Shares as to which the Stock Appreciation Right is exercised, and upon the exercise of an Employee Option granted in connection with a Stock Appreciation Right or the surrender of such Employee Option pursuant to Section 7.4, the Stock Appreciation Right shall be cancelled to the extent of the number of Shares as to which the Employee Option is exercised or surrendered.

8.3 STOCK APPRECIATION RIGHT UNRELATED TO AN OPTION. The Committee may grant to Eligible Individuals Stock Appreciation Rights unrelated to Options. Stock Appreciation Rights unrelated to Options shall contain such terms and conditions as to exercisability (subject to Section 8.7), vesting and duration as the Committee shall determine, but in no event shall they have a term of greater than ten (10) years. Upon exercise of a Stock Appreciation Right unrelated to an Option, the Grantee shall be entitled to receive an amount determined by multiplying (A) the excess of the Fair Market Value of a Share on the date preceding the date of exercise of such Stock Appreciation Right over the Fair Market Value of a Share on the date the Stock Appreciation Right was granted, by (B) the number of Shares as to which the Stock Appreciation Right is being exercised. Notwithstanding the foregoing, the Committee may limit in any manner the amount payable with respect to any Stock Appreciation Right by including such a limit in the Agreement evidencing the Stock Appreciation Right at

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the time it is granted.

8.4 METHOD OF EXERCISE. Stock Appreciation Rights shall be exercised by a Grantee only by a written notice delivered in person or by mail to the Secretary of the Company at the Company's principal executive

office, specifying the number of Shares with respect to which the Stock Appreciation Right is being exercised. If requested by the Committee, the Grantee shall deliver the Agreement evidencing the Stock Appreciation Right being exercised and the Agreement evidencing any related Employee Option to the Secretary of the Company who shall endorse thereon a notation of such exercise and return such Agreement to the Grantee.

8.5 FORM OF PAYMENT. Payment of the amount determined under Sections 8.2(b) or 8.3 may be made in the discretion of the Committee, solely in whole Shares in a number determined at their Fair Market Value on the date preceding the date of exercise of the Stock Appreciation Right, or solely in cash, or in a combination of cash and Shares. If the Committee decides to make full payment in Shares and the amount payable results in a fractional Share, payment for the fractional Share will be made in cash.

8.6 MODIFICATION OR SUBSTITUTION. Subject to the terms of the Plan, the Committee may modify outstanding Awards of Stock Appreciation Rights or accept the surrender of outstanding Awards of Stock Appreciation Rights (to the extent not exercised) and grant new Awards in substitution for them. Notwithstanding the foregoing, no modification of an Award shall adversely alter or impair any rights or obligations under the Agreement without the Grantee's consent.

8.7 EFFECT OF CHANGE IN CONTROL. In the event of a Change in Control, all Stock Appreciation Rights shall become immediately and fully exercisable. Notwithstanding Sections 8.3 and 8.5, to the extent set forth in an Agreement evidencing the grant of a Stock Appreciation Right unrelated to an Option, upon the exercise of such a Stock Appreciation Right or any portion thereof during the sixty (60) day period following a Change in Control, the amount payable shall be in cash and shall be an amount equal to the excess, if any, of (A) the greater of (x) the Fair Market Value, on the date preceding the date of exercise, of the Shares subject to Stock Appreciation Right or portion thereof exercised and (y) the Adjusted Fair Market Value, on the date preceding the date of exercise, of the Shares over (B) the aggregate Fair Market Value, on the date the Stock Appreciation Right was granted, of the Shares subject to the Stock Appreciation Right or portion thereof exercised. In the event an Optionee's employment with the Company is terminated by the Company within two years following a Change in Control each Option held by the Optionee that was exercisable as of the date of termination of the Optionee's employment or service shall remain exercisable for a period ending not before the earlier of (A) the first anniversary of the termination of the Optionee's employment or service or (B) the expiration of the stated term of the Option.

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9. RESTRICTED STOCK.

9.1 GRANT. The Committee may grant to Eligible Individuals Awards of Restricted Stock, and may issue Shares of Restricted Stock in payment in respect of vested Performance Units (as hereinafter provided in Section 10.2), which shall be evidenced by an Agreement between the Company and the Grantee. Each Agreement shall contain such restrictions, terms and conditions as the Committee may, in its discretion, determine and (without limiting the generality of the foregoing) such Agreements may require that an appropriate legend be placed on Share certificates. Awards of Restricted Stock shall be subject to the terms and provisions set forth below in this Section 9.

9.2 RIGHTS OF GRANTEE. Shares of Restricted Stock granted pursuant to an Award hereunder shall be issued in the name of the Grantee as soon as reasonably practicable after the Award is granted provided that the Grantee has executed an Agreement evidencing the Award, the appropriate blank stock powers and, in the discretion of the Committee, an escrow agreement and any other documents which the Committee may require as a condition to the issuance of such Shares. If a Grantee shall fail to execute the Agreement evidencing a Restricted Stock Award, the appropriate blank stock powers and, in the discretion of the Committee, an escrow agreement and any other documents which the Committee may require within the time period prescribed by the Committee at the time the Award is granted, the Award shall be null and void. At the discretion of the Committee, Shares issued in connection with a Restricted Stock Award shall be deposited together with the stock powers with an escrow agent (which may be the Company) designated by the Committee. Unless the

Committee determines otherwise and as set forth in the Agreement, upon delivery of the Shares to the escrow agent, the Grantee shall have all of the rights of a stockholder with respect to such Shares, including the right to vote the Shares and to receive all dividends or other distributions paid or made with respect to the Shares.

9.3 NON-TRANSFERABILITY. Until the restrictions upon the Shares of Restricted Stock awarded to a Grantee shall have lapsed in the manner set forth in Section 9.4, such Shares shall not be sold, transferred or otherwise disposed of and shall not be pledged or otherwise hypothecated, nor shall they be delivered to the Grantee.

9.4 LAPSE OF RESTRICTIONS.
(a) GENERALLY. Restrictions upon Shares of Restricted Stock awarded hereunder shall lapse at such time or times and on such terms and conditions as the Committee may determine, which restrictions shall be set forth in the Agreement evidencing the Award.

(b) EFFECT OF CHANGE IN CONTROL. The Committee shall determine at the time of the grant of an Award of Restricted Stock the extent to which, if any, the restrictions upon Shares of Restricted Stock shall lapse upon a Change in

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Control. The Agreement evidencing the Award shall set forth such provisions.

9.5 MODIFICATION OR SUBSTITUTION. Subject to the terms of the Plan, the Committee may modify outstanding Awards of Restricted Stock or accept the surrender of outstanding Shares of Restricted Stock (to the extent the restrictions on such Shares have not yet lapsed) and grant new Awards in substitution for them. Notwithstanding the foregoing, no modification of an Award shall adversely alter or impair any rights or obligations under the Agreement without the Grantee's consent.

9.6 TREATMENT OF DIVIDENDS. At the time an Award of Shares of Restricted Stock is granted, the Committee may, in its discretion, determine that the payment to the Grantee of dividends, or a specified portion thereof, declared or paid on such Shares by the Company shall be (i) deferred until the lapsing of the restrictions imposed upon such Shares and (ii) held by the Company for the account of the Grantee until such time. In the event that dividends are to be deferred, the Committee shall determine whether such dividends are to be reinvested in Shares (which shall be held as additional Shares of Restricted Stock) or held in cash. If deferred dividends are to be held in cash, there may be credited at the end of each year (or portion thereof) interest on the amount of the account at the beginning of the year at a rate per annum as the Committee, in its discretion, may determine. Payment of deferred dividends in respect of Shares of Restricted Stock (whether held in cash or as additional Shares of Restricted Stock), together with interest accrued thereon, if any, shall be made upon the lapsing of restrictions imposed on the Shares in respect of which the deferred dividends were paid, and any dividends deferred (together with any interest accrued thereon) in respect of any Shares of Restricted Stock shall be forfeited upon the forfeiture of such Shares.

9.7 DELIVERY OF SHARES. Upon the lapse of the restrictions on Shares of Restricted Stock, the Committee shall cause a stock certificate to be delivered to the Grantee with respect to such Shares, free of all restrictions hereunder.

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10. PERFORMANCE AWARDS.

10.1 (a) PERFORMANCE OBJECTIVES. Performance Objectives for Performance Awards may be expressed in terms of (i) earnings per Share, (ii) pre-tax profits, (iii) operating income, (iv) EBIT, (v) EBITDA, (vi) net earnings, (vii) return on equity or assets, (viii) revenues or (ix) any combination of the foregoing. Performance Objectives may be in respect of the performance of the Company and its Subsidiaries (which may be on a consolidated basis), a Subsidiary or a Division. Performance Objectives may be absolute or relative and may be expressed in terms of a progression within a specified

range. The Performance Objectives with respect to a Performance Cycle shall be established in writing by the Committee by the earlier of (i) the date on which a quarter of the Performance Cycle has elapsed or (ii) the date which is 90 days after the commencement of the Performance Cycle, and in any event while the performance relating to the Performance Objectives remain substantially uncertain. At the time of the granting of a Performance Award and to the extent permitted under Section 162(m) of the Code and the regulations thereunder, the Committee may provide for the manner in which the Performance Objectives will be measured to reflect the impact of specified corporate transactions, extraordinary events, accounting changes and other similar events.

(b) DETERMINATION OF PERFORMANCE. Prior to the vesting, payment, settlement or lapsing of any restrictions with respect to any Performance Award made to a Grantee who is subject to Section 162(m) of the Code, the Committee shall certify in writing that the applicable Performance Objectives have been satisfied.

10.2 PERFORMANCE UNITS. The Committee, in its discretion, may grant Awards of Performance Units to Eligible Individuals, the terms and conditions of which shall be set forth in an Agreement between the Company and the Grantee. Performance Units may be denominated in Shares or a specified dollar amount and, contingent upon the attainment of specified Performance Objectives within the Performance Cycle, represent the right to receive payment as provided in Section 10.2(b) of (i) in the case of Share-denominated Performance Units, the Fair Market Value of a Share on the date the Performance Unit was granted, the date the Performance Unit became vested or any other date specified by the Committee, (ii) in the case of dollar-denominated Performance Units, the specified dollar amount or (iii) a percentage (which may be more than 100%) of the amount described in clause (i) or (ii) depending on the level of Performance Objective attainment; PROVIDED, HOWEVER, that the Committee may at the time a Performance Unit is granted, specify a maximum amount payable in respect of a vested Performance Unit. Each Agreement shall specify the number of the Performance Units to which it relates, the Performance Objectives which must be satisfied in order for the Performance Units to vest and the Performance Cycle within which such Performance Objectives must be satisfied.

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(a) VESTING AND FORFEITURE. Subject to Section 10.1(b) and 10.4, a Grantee shall become vested with respect to the Performance Units to the extent that the Performance Objectives set forth in the Agreement are satisfied for the Performance Cycle.

(b) PAYMENT OF AWARDS. Payment to Grantees in respect of vested Performance Units shall be made within sixty (60) days after the last day of the Performance Cycle to which such Award relates unless the Agreement evidencing the Award provides for the deferral of payment, in which event the terms and conditions of the deferral shall be set forth in the Agreement. Subject to Section 10.4, such payments may be made entirely in Shares valued at their Fair Market Value as of the day preceding the date of payment or such other date specified by the Committee, entirely in cash, or in such combination of Shares and cash as the Committee in its discretion, shall determine at any time prior to such payment; PROVIDED, HOWEVER, that if the Committee in its discretion determines to make such payment entirely or partially in Shares of Restricted Stock, the Committee must determine the extent to which such payment will be in Shares of Restricted Stock and the terms of such Restricted Stock at the time the Award is granted.

10.3 PERFORMANCE SHARES. The Committee, in its discretion, may grant Awards of Performance Shares to Eligible Individuals, the terms and conditions of which shall be set forth in an Agreement between the Company and the Grantee. Each Agreement may require that an appropriate legend be placed on Share certificates. Awards of Performance Shares shall be subject to the following terms and provisions:

(a) RIGHTS OF GRANTEE. The Committee shall provide at the time an Award of Performance Shares is made, the time or times at which the actual Shares represented by such Award shall be issued in the name of the Grantee; PROVIDED, HOWEVER, that no Performance Shares shall be issued until the Grantee has executed an Agreement evidencing the Award, the appropriate blank stock powers and, in the discretion of the Committee, an escrow agreement and

any other documents which the Committee may require as a condition to the issuance of such Performance Shares. If a Grantee shall fail to execute the Agreement evidencing an Award of Performance Shares, the appropriate blank stock powers and, in the discretion of the Committee, an escrow agreement and any other documents which the Committee may require within the time period prescribed by the Committee at the time the Award is granted, the Award shall be null and void. At the discretion of the Committee, Shares issued in connection with an Award of Performance Shares shall be deposited together with the stock powers with an escrow agent (which may be the Company) designated by the Committee. Except as restricted by the terms of the Agreement, upon delivery of the Shares to the escrow agent, the Grantee shall have, in the discretion of the Committee, all of the rights of a stockholder with respect to such Shares, including the right to vote the Shares and to receive all dividends or other distributions paid or made with respect to the Shares.

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(b) NON-TRANSFERABILITY. Until any restrictions upon the Performance Shares awarded to a Grantee shall have lapsed in the manner set forth in Sections 10.3(c) or 10.4, such Performance Shares shall not be sold, transferred or otherwise disposed of and shall not be pledged or otherwise hypothecated, nor shall they be delivered to the Grantee. The Committee may also impose such other restrictions and conditions on the Performance Shares, if any, as it deems appropriate.

(c) LAPSE OF RESTRICTIONS. Subject to Sections 10.1(b) or 10.4, restrictions upon Performance Shares awarded hereunder shall lapse and such Performance Shares shall become vested at such time or times and on such terms, conditions and satisfaction of Performance Objectives as the Committee may, in its discretion, determine at the time an Award is granted.

(d) TREATMENT OF DIVIDENDS. At the time the Award of Performance Shares is granted, the Committee may, in its discretion, determine that the payment to the Grantee of dividends, or a specified portion thereof, declared or paid on actual Shares represented by such Award which have been issued by the Company to the Grantee shall be (i) deferred until the lapsing of the restrictions imposed upon such Performance Shares and (ii) held by the Company for the account of the Grantee until such time. In the event that dividends are to be deferred, the Committee shall determine whether such dividends are to be reinvested in shares of Stock (which shall be held as additional Performance Shares) or held in cash. If deferred dividends are to be held in cash, there may be credited at the end of each year (or portion thereof) interest on the amount of the account at the beginning of the year at a rate per annum as the Committee, in its discretion, may determine. Payment of deferred dividends in respect of Performance Shares (whether held in cash or in additional Performance Shares), together with interest accrued thereon, if any, shall be made upon the lapsing of restrictions imposed on the Performance Shares in respect of which the deferred dividends were paid, and any dividends deferred (together with any interest accrued thereon) in respect of any Performance Shares shall be forfeited upon the forfeiture of such Performance Shares.

(e) DELIVERY OF SHARES. Upon the lapse of the restrictions on Performance Shares awarded hereunder, the Committee shall cause a stock certificate to be delivered to the Grantee with respect to such Shares, free of all restrictions hereunder.

10.4 EFFECT OF CHANGE IN CONTROL. In the event of a Change in Control:

(a) With respect to Performance Units, the Grantee shall (i) become vested in a percentage of Performance Units as determined by the Committee at the time of the Award of such Performance Units and as set forth in the Agreement and (ii) be entitled to receive in respect of all Performance Units which become vested as a result of a Change in Control, a cash payment within ten (10) days after such Change in

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Control in an amount as determined by the Committee at the time of the Award of such Performance Unit and as set forth in the Agreement.

(b) With respect to Performance Shares, restrictions shall lapse immediately on all or a portion of the Performance Shares as determined by the Committee at the time of the Award of such Performance Shares and as set forth in the Agreement.

(c) The Agreements evidencing Performance Shares and Performance Units shall provide for the treatment of such Awards (or portions thereof) which do not become vested as the result of a Change in Control, including, but not limited to, provisions for the adjustment of applicable Performance Objectives.

10.5 MODIFICATION OR SUBSTITUTION. Subject to the terms of the Plan, the Committee may modify outstanding Performance Awards or accept the surrender of outstanding Performance Awards and grant new Performance Awards in substitution for them. Notwithstanding the foregoing, no modification of a Performance Award shall adversely alter or impair any rights or obligations under the Agreement without the Grantee's consent.

11. DIVIDEND EQUIVALENT RIGHTS.

Dividend Equivalent Rights may be granted to Eligible Individuals and Eligible Directors in tandem with an Option or Award or as a separate Award. The terms and conditions applicable to each Dividend Equivalent Right shall be specified in the Agreement under which the Dividend Equivalent Right is granted. Amounts payable in respect of Dividend Equivalent Rights may be payable currently or deferred until the lapsing of restrictions on such Dividend Equivalent Rights or until the vesting, exercise, payment, settlement or other lapse of restrictions on the Option or Award to which the Dividend Equivalent Rights relate. In the event that the amount payable in respect of Dividend Equivalent Rights are to be deferred, the Committee shall determine whether such amounts are to be held in cash or reinvested in Shares or deemed (notionally) to be reinvested in Shares. If amounts payable in respect of Dividend Equivalent Rights are to be held in cash, there may be credited at the end of each year (or portion thereof) interest on the amount of the account at the beginning of the year at a rate per annum as the Committee, in its discretion, may determine. Dividend Equivalent Rights may be settled in cash or Shares or a combination thereof, in a single installment or multiple installments.

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12. EFFECT OF A TERMINATION OF EMPLOYMENT.

The Agreement evidencing the grant of each Option and each Award shall set forth the terms and conditions applicable to such Option or Award upon a termination of the employment or service (or other change in the status) of the Optionee or Grantee by the Company, a Subsidiary or a Division (including a termination or change by reason of the sale of a Subsidiary or a Division), which, except for Director Options, shall be as the Committee may, in its discretion, determine at the time the Option or Award is granted or thereafter.

13. ADJUSTMENT UPON CHANGES IN CAPITALIZATION.

(a) In the event of a Change in Capitalization, the Committee shall conclusively determine the appropriate adjustments, if any, to (i) the maximum number and class of Shares or other stock or securities with respect to which Options or Awards may be granted under the Plan, (ii) the maximum number and class of Shares or other stock or securities with respect to which Options or Awards may be granted to any Eligible Individual during the term of the Plan, (iii) the number and class of Shares or other stock or securities which are subject to outstanding Options or Awards granted under the Plan and the purchase price therefor, if applicable, and (iv) the number and class of Shares or other securities in respect of which Director Options are to be granted under Section 6.

(b) Any such adjustment in the Shares or other stock or securities subject to outstanding Incentive Stock Options (including any adjustments in the purchase price) shall be made in such manner as not to constitute a modification as defined by Section 424(h)(3) of the Code and only to the extent otherwise permitted by Sections 422 and 424 of the Code.

(c) If, by reason of a Change in Capitalization, a Grantee of an Award shall be entitled to, or an Optionee shall be entitled to exercise an Option with respect to, new, additional or different shares of stock or securities, such new additional or different shares shall thereupon be subject

to all of the conditions, restrictions and performance criteria which were applicable to the Shares subject to the Award or Option, as the case may be, prior to such Change in Capitalization.

14. EFFECT OF CERTAIN TRANSACTIONS. Subject to Sections 7.4, 8.7, 9.4(b) and 10.4 or as otherwise provided in an Agreement, in the event of (i) the liquidation or dissolution of the Company or (ii) a merger or consolidation of the Company (a "Transaction"), the Plan and the Options and Awards issued hereunder shall continue in effect in accordance with their respective terms, except that following a Transaction each Optionee and Grantee shall be entitled to receive in respect of each Share subject to any outstanding Options or Awards, as the case may be, upon exercise of any Option or payment or transfer in respect of any Award, the same number and kind of stock, securities, cash, property, or other consideration that each holder of a Share was entitled

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to receive in the Transaction in respect of a Share; PROVIDED, HOWEVER, that such stock, securities, cash, property, or other consideration shall remain subject to all of the conditions, restrictions and performance criteria which were applicable to the Options and Awards prior to such Transaction.

15. INTERPRETATION.

(a) The Plan is intended to comply with Rule 16b-3 promulgated under the Exchange Act and the Committee shall interpret and administer the provisions of the Plan or any Agreement in a manner consistent therewith. Any provisions inconsistent with such Rule shall be inoperative and shall not affect the validity of the Plan.

(b) Unless otherwise expressly stated in the relevant Agreement, each Option, Stock Appreciation Right and Performance Award granted under the Plan is intended to be performance-based compensation within the meaning of Section 162(m)(4)(C) of the Code. The Committee shall not be entitled to exercise any discretion otherwise authorized hereunder with respect to such Options or Awards if the ability to exercise such discretion or the exercise of such discretion itself would cause the compensation attributable to such Options or Awards to fail to qualify as performance-based compensation.

16. POOLING TRANSACTIONS.

Notwithstanding anything contained in the Plan or any Agreement to the contrary, in the event of a Change in Control which is intended to constitute a Pooling Transaction, the Committee shall take such actions, if any, as are specifically recommended by an independent accounting firm retained by the Company to the extent reasonably necessary in order to assure that the Pooling Transaction will qualify as such, including but not limited to (i) deferring the vesting, exercise, payment, settlement or lapsing of restrictions with respect to any Option or Award, (ii) providing that the payment or settlement in respect of any Option or Award be made in the form of cash, Shares or securities of a successor or acquirer of the Company, or a combination of the foregoing and (iii) providing for the extension of the term of any Option or Award to the extent necessary to accommodate the foregoing, but not beyond the maximum term permitted for any Option or Award.

17. TERMINATION AND AMENDMENT OF THE PLAN.

The Plan shall terminate on the day preceding the tenth anniversary of the date of its adoption by the Board and no Option or Award may be granted thereafter. The Board may sooner terminate the Plan and the Board may at any time and from time to time amend, modify or suspend the Plan; provided, however, that:

(a) no such amendment, modification, suspension or termination shall impair or adversely alter any Options or Awards theretofore granted under the Plan, except with the consent of the Optionee or Grantee, nor

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shall any amendment, modification, suspension or termination deprive any Optionee or Grantee of any Shares which he or she may have acquired through or as a result of the Plan; and

(b) to the extent necessary under applicable law, no amendment shall be effective unless approved by the stockholders of the Company

in accordance with applicable law.

18. NON-EXCLUSIVITY OF THE PLAN.

The adoption of the Plan by the Board shall not be construed as amending, modifying or rescinding any previously approved incentive arrangement or as creating any limitations on the power of the Board to adopt such other incentive arrangements as it may deem desirable, including, without limitation, the granting of stock options otherwise than under the Plan, and such arrangements may be either applicable generally or only in specific cases.

19. LIMITATION OF LIABILITY.

As illustrative of the limitations of liability of the Company, but not intended to be exhaustive thereof, nothing in the Plan shall be construed to:

- (i) give any person any right to be granted an Option or Award other than at the sole discretion of the Committee;
- (ii) give any person any rights whatsoever with respect to Shares except as specifically provided in the Plan;
- (iii) limit in any way the right of the Company to terminate the employment of any person at any time; or
- (iv) be evidence of any agreement or understanding, expressed or implied, that the Company will employ any person at any particular rate of compensation or for any particular period of time.

20. REGULATIONS AND OTHER APPROVALS; GOVERNING LAW.

20.1 Except as to matters of federal law, this Plan and the rights of all persons claiming hereunder shall be construed and determined in accordance with the laws of the State of Delaware without giving effect to conflicts of law principles.

20.2 The obligation of the Company to sell or deliver Shares with respect to Options and Awards granted under the Plan shall be subject to all applicable laws, rules and regulations, including all applicable federal and state securities laws, and the obtaining of all such approvals by governmental agencies as may be deemed necessary or appropriate by the Committee.

20.3 The Board may make such changes as may be necessary or appropriate to comply with the rules and regulations of any government authority, or to obtain for Eligible Individuals granted Incentive Stock Options the tax benefits under the applicable provisions of the Code and regulations promulgated thereunder.

20.4 (a) Each Option and Award is subject to the requirement that, if at any time the Committee determines, in its discretion, that the listing, registration

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or qualification of Shares issuable pursuant to the Plan is required by any securities exchange or under any state or federal law, or the consent or approval of any governmental regulatory body is necessary or desirable as a condition of, or in connection with, the grant of an Option or Award or the issuance of Shares, no Options or Awards shall be granted or payment made or Shares issued, in whole or in part, unless listing, registration, qualification, consent or approval has been effected or obtained free of any conditions as acceptable to the Committee.

(b) Notwithstanding anything to the contrary contained in the Plan or any Agreement, as a prerequisite to the granting, vesting, payment, settlement or lapsing of restrictions with respect to an Option or Award, the Committee may require the Optionee or Grantee, as the case may be, to execute and deliver a Stockholders Agreement in a form acceptable to the Committee.

20.5 Notwithstanding anything contained in the Plan or any Agreement to the contrary, in the event that the disposition of Shares acquired pursuant to the Plan is not covered by a then current registration statement under the Securities Act of 1933, as amended (the "Securities Act"), and is not otherwise exempt from such registration, such Shares shall be restricted against transfer to the extent required by the Securities Act and Rule 144 or other regulations thereunder. The Committee may require any individual receiving Shares pursuant to an Option or Award granted under the Plan, as a condition

precedent to receipt of such Shares, to represent and warrant to the Company in writing that the Shares acquired by such individual are acquired without a view to any distribution thereof and will not be sold or transferred other than pursuant to an effective registration thereof under said Act or pursuant to an exemption applicable under the Securities Act or the rules and regulations promulgated thereunder. The certificates evidencing any of such Shares shall be appropriately amended to reflect their status as restricted securities as aforesaid.

21. MISCELLANEOUS.

21.1 MULTIPLE AGREEMENTS. The terms of each Option or Award may differ from other Options or Awards granted under the Plan at the same time, or at some other time. The Committee may also grant more than one Option or Award to a given Eligible Individual during the term of the Plan, either in addition to, or in substitution for, one or more Options or Awards previously granted to that Eligible Individual.

21.2 WITHHOLDING OF TAXES.

(a) At such times as an Optionee or Grantee recognizes taxable income in connection with the receipt of Shares or cash hereunder (a "Taxable Event"), the Optionee or Grantee shall pay to the Company an amount equal to the federal, state and local income taxes and other amounts as may be required by law to be withheld by the Company in connection with the Taxable Event (the "Withholding

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Taxes") prior to the issuance, or release from escrow, of such Shares or the payment of such cash. The Company shall have the right to deduct from any payment of cash to an Optionee or Grantee an amount equal to the Withholding Taxes in satisfaction of the obligation to pay Withholding Taxes. In satisfaction of the obligation to pay Withholding Taxes to the Company, the Optionee or Grantee may make a written election (the "Tax Election"), which may be accepted or rejected in the discretion of the Committee, to have withheld a portion of the Shares then issuable to him or her having an aggregate Fair Market Value equal to the Withholding Taxes; PROVIDED, HOWEVER, that the Committee, by resolution, may provide that all Tax Elections related to Options granted prior to the revocation of such resolution (by all or only specified Optionees as set forth in such resolution) will be deemed to have been approved without any subsequent action by the Committee.

(b) If an Optionee makes a disposition, within the meaning of Section 424(c) of the Code and regulations promulgated thereunder, of any Share or Shares issued to such Optionee pursuant to the exercise of an Incentive Stock Option within the two-year period commencing on the day after the date of the grant or within the one-year period commencing on the day after the date of transfer of such Share or Shares to the Optionee pursuant to such exercise, the Optionee shall, within ten (10) days of such disposition, notify the Company thereof, by delivery of written notice to the Company at its principal executive office.

(c) The Committee shall have the authority, at the time of grant of an Option or Award under the Plan or at any time thereafter, to award tax bonuses to designated Optionees or Grantees, to be paid upon their exercise of Employee Options or payment in respect of Awards granted hereunder. The amount of any such payments shall be determined by the Committee. The Committee shall have full authority in its absolute discretion to determine the amount of any such tax bonus and the terms and conditions affecting the vesting and payment thereof.

22. EFFECTIVE DATE. The effective date of the Plan shall be as determined by the Board, subject only to the approval by the affirmative vote of the holders of a majority of the securities of the Company present, or represented, and entitled to vote at a meeting of stockholders duly held in accordance with the applicable laws of the State of Delaware within twelve (12) months of the adoption of the Plan by the Board.

{Date}

{Name of Officer}

{Address}

Dear _____:

In recognition of your contributions to Department 56, Inc. ("DFS" or the "Company") and the Company's desire to assure your continued services in your current position in the event of a pending or actual Change in Control (as defined) of DFS, the Company's Board of Directors is pleased to offer you the Change of Control protection outlined in this letter agreement ("Agreement").

1. Term Of Agreement. The Term of this Agreement shall commence on the date of this letter (the "Effective Date") and end on the third anniversary of such date (the "Original Term"). The Original Term shall be automatically renewed for successive one-year terms (the "Renewal Terms") unless at least 180 days prior to the expiration of the Original Term or any Renewal Term, either of us notifies the other in writing that you or we are electing to terminate this Agreement at the end of the then current Term. "Term" shall mean the Original Term and all Renewal Terms. If a Change in Control occurs during the Term, the Term shall not expire earlier than two years from the date of the Change in Control.

2. Entitlement to Severance Benefits.

(a) Cash Severance Benefit. In the event your employment terminates (a "Termination") (1) for any reason whatsoever (other than due to death, disability, retirement, or an involuntary termination for Cause) within one year following an Unapproved Change in Control or (2) without Cause or for Good Reason (other than due to death, disability or retirement), in either case within two years following an Approved Change in Control, you shall be entitled to receive the sum of the following, payable in a cash lump sum no later than 15 days after the Termination date: (i) Base Salary through the Termination date; (ii) an amount equal to 200% of the sum of (x) your Base Salary; plus (y) the highest annual cash bonus earned by you during the most recent 3 years, and (iii) pro rata annual incentive award at target for the year in which the Termination occurs.

(b) Other Severance Benefits. In addition to the benefits provided in Section 2(a), you shall also be entitled to the following: (i) elimination of all restrictions on any restricted or deferred stock awards outstanding on the Termination date; (ii) immediate vesting of all outstanding stock options and the right to exercise such stock options for 24 months (or the remainder of the exercise period, if less); (iii) immediate vesting of all restricted or deferred stock awards and non-qualified retirement benefits; (iv) continued participation in all DFS welfare benefit plans at the same benefit level at which you were participating on the Termination date for a period of 24 months unless and until the date or dates you receive substantially equivalent coverage from a subsequent employer.

(c) Section 280(G) Gross-Up Protection. In the event you become entitled to payments, all or a portion of which become subject to tax imposed under Section 4999 of the Internal Revenue Code of 1986, as amended (the "Code") (or any other similar tax, but not income tax of any nature) ("Excise Tax"), DFS shall pay you an additional amount ("Gross-Up Payment") such that the amount retained by you after reduction for any Excise Tax (including penalties or interest thereon) equals the amount to be paid to you by DFS hereunder prior to the imposition of such Excise Tax ("Total Payments"),

provided that in the event the amount to be retained after imposition of the Excise tax is equal to or exceeds 80% of the Total Payments, no such Gross-Up payment shall be made to you by DFS. The amount of the Gross-Up Payment shall be calculated by DFS' independent auditors. In the event that such Gross-Up Payment is finally determined to be less than the amount of any Excise Tax, DFS shall pay an additional amount to you in respect of such deficiency (including any interest and penalties). In the event that such Gross-Up Payment is finally determined to exceed the amount of any Excise Tax, you must promptly repay the entire amount of such excess Gross-Up Payment to DFS.

(d) No Mitigation; No Offset. In the event of any Termination, you shall be under no obligation to seek other employment; and no amounts due to you under this Agreement shall be subject to offset due to any remuneration attributable to subsequent employment that you may obtain.

(e) Exclusivity of Severance Payments; Release. Except as provided in this Section 2, upon any Termination of your employment during the Term, you shall not be entitled to any severance payments or severance benefits from DFS or any payments by DFS on account of any claim by you of wrongful termination, including claims under any federal, state or local human and civil rights or labor laws. Termination payments and benefits made to you are conditioned upon your execution of a release agreement, in a form reasonably satisfactory to DFS, releasing any and all claims arising out of your employment (other than enforcement of this Agreement), any rights under DFS's incentive compensation and employee benefit plans, and any claim for any non-employment related tort for personal injury.

3. Definitions. For purposes of this Agreement, the following terms shall have the meanings ascribed to them.

(a) An "Approved Change in Control" is any Change in Control that is approved by the DFS Board of Directors in force immediately prior to the Change in Control.

(b) "Base Salary" means the annualized rate of pay in effect on the Termination date, provided that if a reduction in Base Salary is the basis for a Termination for Good Reason, then "Base Salary" shall mean the rate of pay in effect immediately prior to such reduction.

(c) "Cause" shall exist if: (i) you are convicted of, or plead nolo contendere to, any felony which materially and adversely impacts DFS' financial condition or reputation, (ii) you engage in conduct that constitutes willful gross neglect or willful gross misconduct in carrying out your duties which materially and adversely impacts DFS' financial condition or reputation, or (iii) you violate Section 4 of this Agreement.

(d) A "Change in Control" shall be deemed to occur upon any of the following: (i) acquisition by any one "person" (as such term is defined in 3(a)(9) of the Securities and Exchange Act of 1934, as amended, and used in 13(d) and 14(d) thereof, including "group" as defined in 13(d) thereof) of 20% or more of DFS' voting shares, (ii) directors elected to the Board over any 24 month period not nominated by the DFS Nominating Committee represent 30% or more of the total number of directors constituting the Board at the beginning of the period (for these purposes, a director "not nominated by the DFS Nominating Committee" shall include, without limitation, any individual(s) whose nomination results from an actual or threatened proxy contest or whose initial assumption of office as a director occurs as a result of an actual or threatened proxy contest or other

actual or threatened solicitation or execution of proxies or consents by or on behalf of any "person(s)" other than the Company or the Board); (iii) any merger, consolidation or other corporate combination upon the completion of which DFS shares do not represent more than 50% of the combined voting power of the resulting entity; and (iv) upon the sale of all or substantially all of the consolidated assets of DFS, other than a distribution to shareholders.

(e) "Confidential Information" shall mean all information concerning the business of DFS relating to any of their products, product development, trade secrets, customers, suppliers, finances, and business plans and strategies. Excluded from the definition of "Confidential Information" is information (i) that is or becomes part of the public domain, other than through your breach of this Agreement, or (ii) regarding DFS' business or industry properly acquired by you in the course of your career as an employee in DFS' industry and independent of your

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employment by DFS. For this purpose, information known or available generally within the trade or industry of DFS shall be deemed to be known or available to the public.

(f) "Good Reason" shall mean your termination of your employment based upon one or more of the following events (except as a result of a prior termination): (i) any material change in your position or responsibilities or assignment of duties materially inconsistent with your status prior to the Change of Control; (ii) any decrease in your Base Salary, target annual incentive or long term incentive award opportunity, or equity grants; (iii) any breach of the terms of this Agreement by DFS after receipt of written notice from you and a reasonable opportunity to cure such breach; (iv) DFS fails to obtain any successor entity's assumption of its obligations to you hereunder; or (v) upon relocation of you to a location more than 50 miles from our current headquarters.

(g) An "Unapproved Change in Control" is any Change in Control that is not approved by the DFS Board of Directors in force immediately prior to the Change in Control.

4. Non-Disclosure; Non-Solicitation; Non-Disparagement.

(a) During the Term and thereafter, you shall not, without DFS' prior written consent disclose to anyone (except in good faith in the ordinary course of business) or make use of any Confidential Information except in the performance of your duties hereunder or when required to do so by law. In the event that you are so ordered, you shall give prompt written notice to DFS sufficient to allow DFS the opportunity to object to or otherwise resist such order.

(b) During the Term and for a period of 24 months thereafter, you shall not, without DFS' prior written consent, solicit for employment, whether directly or indirectly, any person who at the time is employed by DFS or any affiliate.

(c) You agree that, during the Term and thereafter (including following any Termination for any reason) you will not make statements or representations, or otherwise communicate, directly or indirectly, in writing, orally, or otherwise, or take any action which may, directly or indirectly, disparage or be damaging to DFS or its respective officers, directors, employees, advisors, businesses or reputations. Notwithstanding the foregoing, nothing in this Agreement shall preclude you from making truthful statements or disclosures that

are required by applicable law, regulation or legal process.

5. Resolution of Disputes. Any controversy or claim arising out of or relating to this Agreement or any breach or asserted breach hereof shall be resolved by binding arbitration, to be held at an office closest to DFS' principal offices in accordance with the rules and procedures of the American Arbitration Association. Judgment upon the award rendered by the arbitrator(s) may be entered in any court of competent jurisdiction. Pending the resolution of any arbitration or court proceeding, DFS shall continue payment of all amounts and benefits due you hereunder. All reasonable costs and expenses of any arbitration or court proceeding (including fees and disbursements of counsel) shall be promptly paid on your behalf by DFS; provided, however, that no such expense reimbursement shall be made if and to the extent the arbitrator(s) determine(s) that any of your litigation assertions or defenses were in bad faith or frivolous.

6. Effect of Agreement on Other Benefits. Except as specifically provided in this Agreement, the existence of this Agreement shall not be interpreted to prohibit or restrict your participation in any other employee benefit or other plans or programs in which you currently participate.

7. Not an Employment Agreement. This Agreement is not a contract of employment between you and DFS. DFS may terminate you at any time, subject to the terms of any employment agreement between you and DFS that may then be in effect.

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8. Assignability; Binding Nature. This Agreement shall be binding upon and inure to the benefit of the parties and their respective successors, heirs (as applies to you) and permitted assigns. DFS agrees that in the event of a sale or transfer of assets, it shall take whatever action it legally can to cause such assignee or transferee to expressly assume DFS's liabilities, obligations and duties hereunder.

9. Governing Law/Jurisdiction. This Agreement shall be governed by and construed and interpreted in accordance with the laws of Minnesota without reference to principles of conflict of laws.

Please acknowledge your acceptance of the terms of this Agreement by executing below and returning a copy to DFS.

DEPARTMENT 56, INC.

By: _____

Name:

Title:

Accepted:

{Name}

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{Date}

{Name of Officer}

{Address}

Dear _____:

In recognition of your contributions to Department 56, Inc. ("DFS" or the "Company") and the Company's desire to assure your continued services in your current position in the event of a pending or actual Change in Control (as defined) of DFS, the Company's Board of Directors is pleased to offer you the Change of Control protection outlined in this letter agreement ("Agreement").

1. Term Of Agreement. The Term of this Agreement shall commence on the date of this letter (the "Effective Date") and end on the third anniversary of such date (the "Original Term"). The Original Term shall be automatically renewed for successive one-year terms (the "Renewal Terms") unless at least 180 days prior to the expiration of the Original Term or any Renewal Term, either of us notifies the other in writing that you or we are electing to terminate this Agreement at the end of the then current Term. "Term" shall mean the Original Term and all Renewal Terms. If a Change in Control occurs during the Term, the Term shall not expire earlier than two years from the date of the Change in Control.

2. Entitlement to Severance Benefits.

(a) Cash Severance Benefit. In the event your employment terminates (a "Termination") (1) for any reason whatsoever (other than due to death, disability, retirement, or an involuntary termination for Cause) within one year following an Unapproved Change in Control or (2) without Cause or for Good Reason (other than due to death, disability or retirement), in either case within two years following an Approved Change in Control, you shall be entitled to receive the sum of the following, payable in a cash lump sum no later than 15 days after the Termination date: (i) Base Salary through the Termination date; (ii) an amount equal to 150% of the sum of (x) your Base Salary; plus (y) the highest annual cash bonus earned by you during the most recent 3 years, and (iii) pro rata annual incentive award at target for the year in which the Termination occurs.

(b) Other Severance Benefits. In addition to the benefits provided in Section 2(a), you shall also be entitled to the following: (i) elimination of all restrictions on any restricted or deferred stock awards outstanding on the Termination date; (ii) immediate vesting of all outstanding stock options and the right to exercise such stock options for 24 months (or the remainder of the exercise period, if less); (iii) immediate vesting of all restricted or deferred stock awards and non-qualified retirement benefits; (iv) continued participation in all DFS welfare benefit plans at the same benefit level at which you were participating on the Termination date for a period of 24 months unless and until the date or dates you receive substantially equivalent coverage from a subsequent employer.

(c) Section 280(G) Gross-Up Protection. In the event you become entitled to payments, all or a portion of which become subject to tax imposed under Section 4999 of the Internal Revenue Code of 1986, as amended (the "Code") (or any other similar tax, but not income tax of any nature) ("Excise Tax"), DFS shall pay you an additional amount ("Gross-Up Payment") such that the amount retained by you after reduction for any Excise Tax (including penalties or interest thereon) equals the amount to be paid to you by DFS hereunder prior to the imposition of such Excise Tax ("Total Payments"), provided that in the event the amount to be retained after imposition

of the Excise tax is equal to or exceeds 80% of the Total Payments, no such Gross-Up payment shall be made to you by DFS. The amount of the Gross-Up Payment shall be calculated by DFS' independent auditors. In the event that such Gross-Up Payment is finally determined to be less than the amount of any Excise Tax, DFS shall pay an additional amount to you in respect of such deficiency (including any interest and penalties). In the event that such Gross-Up Payment is finally determined to exceed the amount of any Excise Tax, you must promptly repay the entire amount of such excess Gross-Up Payment to DFS.

(d) No Mitigation; No Offset. In the event of any Termination, you shall be under no obligation to seek other employment; and no amounts due to you under this Agreement shall be subject to offset due to any remuneration attributable to subsequent employment that you may obtain.

(e) Exclusivity of Severance Payments; Release. Except as provided in this Section 2, upon any Termination of your employment during the Term, you shall not be entitled to any severance payments or severance benefits from DFS or any payments by DFS on account of any claim by you of wrongful termination, including claims under any federal, state or local human and civil rights or labor laws. Termination payments and benefits made to you are conditioned upon your execution of a release agreement, in a form reasonably satisfactory to DFS, releasing any and all claims arising out of your employment (other than enforcement of this Agreement), any rights under DFS's incentive compensation and employee benefit plans, and any claim for any non-employment related tort for personal injury.

3. Definitions. For purposes of this Agreement, the following terms shall have the meanings ascribed to them.

(a) An "Approved Change in Control" is any Change in Control that is approved by the DFS Board of Directors in force immediately prior to the Change in Control.

(b) "Base Salary" means the annualized rate of pay in effect on the Termination date, provided that if a reduction in Base Salary is the basis for a Termination for Good Reason, then "Base Salary" shall mean the rate of pay in effect immediately prior to such reduction.

(c) "Cause" shall exist if: (i) you are convicted of, or plead nolo contendere to, any felony which materially and adversely impacts DFS' financial condition or reputation, (ii) you engage in conduct that constitutes willful gross neglect or willful gross misconduct in carrying out your duties which materially and adversely impacts DFS' financial condition or reputation, or (iii) you violate Section 4 of this Agreement.

(d) A "Change in Control" shall be deemed to occur upon any of the following: (i) acquisition by any one "person" (as such term is defined in 3(a)(9) of the Securities and Exchange Act of 1934, as amended, and used in 13(d) and 14(d) thereof, including "group" as defined in 13(d) thereof) of 20% or more of DFS' voting shares, (ii) directors elected to the Board over any 24 month period not nominated by the DFS Nominating Committee represent 30% or more of the total number of directors constituting the Board at the beginning of the period (for these purposes, a director "not nominated by the DFS Nominating Committee" shall include, without limitation, any individual(s) whose nomination results from an actual or threatened proxy contest or whose initial assumption of office as a director occurs as a result of an actual or threatened proxy contest or other actual or threatened solicitation or execution of proxies or consents

by or on behalf of any "person(s)" other than the Company or the Board); (iii) any merger, consolidation or other corporate combination upon the completion of which DFS shares do not represent more than 50% of the combined voting power of the resulting entity; and (iv) upon the sale of all or substantially all of the consolidated assets of DFS, other than a distribution to shareholders.

(e) "Confidential Information" shall mean all information concerning the business of DFS relating to any of their products, product development, trade secrets, customers, suppliers, finances, and business plans and strategies. Excluded from the definition of "Confidential Information" is information (i) that is or becomes part of the public domain, other than through your breach of this Agreement, or (ii) regarding DFS' business or industry properly acquired by you in the course of your career as an employee in DFS' industry and independent of your

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employment by DFS. For this purpose, information known or available generally within the trade or industry of DFS shall be deemed to be known or available to the public.

(f) "Good Reason" shall mean your termination of your employment based upon one or more of the following events (except as a result of a prior termination): (i) any material change in your position or responsibilities or assignment of duties materially inconsistent with your status prior to the Change of Control; (ii) any decrease in your Base Salary or target annual incentive; (iii) any breach of the terms of this Agreement by DFS after receipt of written notice from you and a reasonable opportunity to cure such breach; (iv) DFS fails to obtain any successor entity's assumption of its obligations to you hereunder; or (v) upon relocation of you to a location more than 50 miles from our current headquarters.

(g) An "Unapproved Change in Control" is any Change in Control that is not approved by the DFS Board of Directors in force immediately prior to the Change in Control.

4. Non-Disclosure; Non-Solicitation; Non-Disparagement.

(a) During the Term and thereafter, you shall not, without DFS' prior written consent disclose to anyone (except in good faith in the ordinary course of business) or make use of any Confidential Information except in the performance of your duties hereunder or when required to do so by law. In the event that you are so ordered, you shall give prompt written notice to DFS sufficient to allow DFS the opportunity to object to or otherwise resist such order.

(b) During the Term and for a period of 24 months thereafter, you shall not, without DFS' prior written consent, solicit for employment, whether directly or indirectly, any person who at the time is employed by DFS or any affiliate.

(c) You agree that, during the Term and thereafter (including following any Termination for any reason) you will not make statements or representations, or otherwise communicate, directly or indirectly, in writing, orally, or otherwise, or take any action which may, directly or indirectly, disparage or be damaging to DFS or its respective officers, directors, employees, advisors, businesses or reputations. Notwithstanding the foregoing, nothing in this Agreement shall preclude you from making truthful statements or disclosures that are required by applicable law, regulation or legal process.

5. Resolution of Disputes. Any controversy or claim arising out of or relating to this Agreement or any breach or asserted breach hereof shall be resolved by binding arbitration, to be held at an office closest to DFS' principal offices in accordance with the rules and procedures of the American Arbitration Association. Judgment upon the award rendered by the arbitrator(s) may be entered in any court of competent jurisdiction. Pending the resolution of any arbitration or court proceeding, DFS shall continue payment of all amounts and benefits due you hereunder. All reasonable costs and expenses of any arbitration or court proceeding (including fees and disbursements of counsel) shall be promptly paid on your behalf by DFS; provided, however, that no such expense reimbursement shall be made if and to the extent the arbitrator(s) determine(s) that any of your litigation assertions or defenses were in bad faith or frivolous.

6. Effect of Agreement on Other Benefits. Except as specifically provided in this Agreement, the existence of this Agreement shall not be interpreted to prohibit or restrict your participation in any other employee benefit or other plans or programs in which you currently participate.

7. Not an Employment Agreement. This Agreement is not a contract of employment between you and DFS. DFS may terminate you at any time, subject to the terms of any employment agreement between you and DFS that may then be in effect.

8. Assignability; Binding Nature. This Agreement shall be binding upon and inure to the benefit of the parties and their respective successors, heirs (as applies to you) and permitted assigns. DFS

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agrees that in the event of a sale or transfer of assets, it shall take whatever action it legally can to cause such assignee or transferee to expressly assume DFS's liabilities, obligations and duties hereunder.

9. Governing Law/Jurisdiction. This Agreement shall be governed by and construed and interpreted in accordance with the laws of Minnesota without reference to principles of conflict of laws.

Please acknowledge your acceptance of the terms of this Agreement by executing below and returning a copy to DFS.

DEPARTMENT 56, INC.

By: _____

Name:

Title:

Accepted:

{Name}

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{Department 56, Inc. Letterhead}

{Date}

Dear Ms. Engel:

In recognition of your contributions to Department 56, Inc. ("DFS" or the "Company") and the Company's desire to assure your continued services in your current position in the event of a pending or actual Change in Control (as defined) of DFS, the Company's Board of Directors is pleased to offer you the Change of Control protection outlined in this letter agreement ("Agreement").

1. Term Of Agreement. The Term of this Agreement shall commence on the date of this letter (the "Effective Date") and end on the third anniversary of such date (the "Original Term"). The Original Term shall be automatically renewed for successive one-year terms (the "Renewal Terms") unless at least 180 days prior to the expiration of the Original Term or any Renewal Term, either of us notifies the other in writing that you or we are electing to terminate this Agreement at the end of the then current Term. "Term" shall mean the Original Term and all Renewal Terms. If a Change in Control occurs during the Term, the Term shall not expire earlier than two years from the date of the Change in Control.

2. Entitlement to Severance Benefits.

(a) Cash Severance Benefit. In the event your employment terminates (a "Termination") or for any reason whatsoever (other than due to death, disability, retirement, or an involuntary termination for Cause) within one year following a Change in Control, you shall be entitled to receive the sum of the following, payable in a cash lump sum no later than 15 days after the Termination date: (i) Base Salary through the Termination date; (ii) an amount equal to 299% of the sum of (x) your Base Salary; plus (y) the maximum annual cash bonus for which you are eligible in the year of the Change in Control, and (iii) pro rata annual incentive award at target for the year in which the Termination occurs.

(b) Other Severance Benefits. In addition to the benefits provided in Section 2(a), you shall also be entitled to the following: (i) elimination of all restrictions on any restricted or deferred stock awards outstanding on the Termination date; (ii) immediate vesting of all outstanding stock options and the right to exercise such stock options for 36 months (or the remainder of the exercise period, if less); (iii) immediate vesting of all restricted or deferred stock awards and non-qualified retirement benefits; (iv) continued participation in all DFS welfare benefit plans at the same benefit level at which you were participating on the Termination date for a period of 36 months unless or until the date or dates you receive substantially equivalent coverage from a subsequent employer; and (v) reimbursement of all expenses relating to your relocation to New York City, including without limitation, an amount equal to the difference, if any, of (1) the tax basis of your primary residence located in the Minneapolis-St. Paul metropolitan area minus (2) the net proceeds you receive relating to the sale of such primary residence.

(c) Section 280(G) Gross-Up Protection. In the event you become entitled to payments which become subject to tax imposed under Section 4999 of the Internal Revenue Code of 1986, as amended (the "Code") (or any other similar tax, but not income tax of any nature) ("Excise Tax"), DFS shall pay you an additional amount ("Gross-Up Payment") such that the amount retained by you after reduction for any Excise Tax (including penalties or interest thereon) equals the amount to be paid to you hereunder prior to the imposition of such Excise Tax. The amount of the Gross-Up Payment shall be calculated by DFS' independent auditors. In the event that such

Gross-Up Payment is ultimately determined to be less than the amount of any Excise Tax, DFS shall pay an additional amount to you in respect of such deficiency (including any interest and penalties). In the event that such Gross-Up Payment is ultimately determined to exceed the amount of any Excise Tax, you must promptly repay the entire amount of such excess Gross-Up Payment to DFS.

(d) No Mitigation; No Offset. In the event of any Termination, you shall be under no obligation to seek other employment; and no amounts due to you under this Agreement shall be

subject to offset due to any remuneration attributable to subsequent employment that you may obtain.

(e) Exclusivity of Severance Payments; Release. Except as provided in this Section 2, upon any Termination of your employment during the Term, you shall not be entitled to any severance payments or severance benefits from DFS or any payments by DFS on account of any claim by you of wrongful termination, including claims under any federal, state or local human and civil rights or labor laws. Termination payments and benefits made to you are conditioned upon your execution of a release agreement, in a form reasonably satisfactory to DFS, releasing any and all claims arising out of your employment (other than enforcement of this Agreement), any rights under DFS's incentive compensation and employee benefit plans, and any claim for any non-employment related tort for personal injury.

3. Definitions. For purposes of this Agreement, the following terms shall have the meanings ascribed to them.

(a) "Base Salary" means the annualized rate of pay in effect on the Termination date, provided that if a reduction in Base Salary is the basis for a Termination for Good Reason, then "Base Salary" shall mean the rate of pay in effect immediately prior to such reduction.

(b) "Cause" shall exist if: (i) you are convicted of, or plead nolo contendere to, any felony which materially and adversely impacts DFS' financial condition or reputation, (ii) you engage in conduct that constitutes willful gross neglect or willful gross misconduct in carrying out your duties which materially and adversely impacts DFS' financial condition or reputation, or (iii) you violate Section 4 of this Agreement.

(c) A "Change in Control" shall be deemed to occur upon any of the following: (i) acquisition by any one "person" (as such term is defined in 3(a)(9) of the Securities and Exchange Act of 1934, as amended, and used in 13(d) and 14(d) thereof, including "group" as defined in 13(d) thereof) of 20% or more of DFS' voting shares; (ii) directors elected to the Board over any 24 month period not nominated by the DFS Nominating Committee represent 30% or more of the total number of directors constituting the Board at the beginning of the period (for these purposes, a director "not nominated by the DFS Nominating Committee" shall include, without limitation, any individual(s) whose nomination results from an actual or threatened proxy contest or whose initial assumption of office as a director occurs as a result of an actual or threatened proxy contest or other actual or threatened solicitation or execution of proxies or consents by or on behalf of any "person(s)" other than the Company or the Board); (iii) any merger, consolidation or other corporate combination upon the completion of which DFS shares do not represent more than 50% of the combined voting power of the resulting entity; and (iv) upon the sale of all or substantially all of the consolidated assets of DFS, other than a distribution to shareholders.

(d) "Confidential Information" shall mean all information concerning the business of DFS relating to any of their products, product development, trade secrets, customers, suppliers, finances, and business plans and strategies. Excluded from the definition of "Confidential Information" is information (i) that is or becomes part of the public domain, other than through your breach of this Agreement, or (ii) regarding DFS' business or industry properly acquired by you in the course of your career as an employee in DFS' industry and independent of your employment by DFS. For this purpose, information known or available generally within the trade or industry of DFS shall be deemed to be known or available to the public.

4. Non-Disclosure; Non-Solicitation; Non-Disparagement.

(a) During the Term and thereafter, you shall not, without DFS' prior written consent disclose to anyone (except in good faith in the ordinary course of business) or make use of any

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Confidential Information except in the performance of your duties hereunder or when required to do so by law. In the event that you are so ordered, you shall give prompt written notice to DFS sufficient to allow DFS the opportunity to object to or otherwise resist such order.

(b) During the Term and for a period of 24 months thereafter, you shall not, without DFS' prior written consent, solicit for employment, whether directly or indirectly, any person who at the time is employed by DFS or any affiliate.

(c) You agree that, during the Term and thereafter (including following any Termination for any reason) you will not make statements or representations, or otherwise communicate, directly or indirectly, in writing, orally, or otherwise, or take any action which may, directly or indirectly, disparage or be damaging to DFS or its respective officers, directors, employees, advisors, businesses or reputations. Notwithstanding the foregoing, nothing in this Agreement shall preclude you from making truthful statements or disclosures that are required by applicable law, regulation or legal process.

5. Resolution of Disputes. Any controversy or claim arising out of or relating to this Agreement or any breach or asserted breach hereof shall be resolved by binding arbitration, to be held at an office closest to DFS' principal offices in accordance with the rules and procedures of the American Arbitration Association. Judgment upon the award rendered by the arbitrator(s) may be entered in any court of competent jurisdiction. Pending the resolution of any arbitration or court proceeding, DFS shall continue payment of all amounts and benefits due you hereunder. All reasonable costs and expenses of any arbitration or court proceeding (including fees and disbursements of counsel) shall be promptly paid on your behalf by DFS; provided, however, that no such expense reimbursement shall be made if and to the extent the arbitrator(s) determine(s) that any of your litigation assertions or defenses were in bad faith or frivolous.

6. Effect of Agreement on Other Benefits. Except as specifically provided in this Agreement, the existence of this Agreement shall not be interpreted to prohibit or restrict your participation in any other employee benefit or other plans or programs in which you currently participate.

7. Not an Employment Agreement. This Agreement is not a contract of employment between you and DFS. DFS may terminate you at any

time, subject to the terms of any employment agreement between you and DFS that may then be in effect.

8. Assignability; Binding Nature. This Agreement shall be binding upon and inure to the benefit of the parties and their respective successors, heirs (as applies to you) and permitted assigns. DFS agrees that in the event of a sale or transfer of assets, it shall take whatever action it legally can to cause such assignee or transferee to expressly assume DFS's liabilities, obligations and duties hereunder.

9. Governing Law/Jurisdiction. This Agreement shall be governed by and construed and interpreted in accordance with the laws of Minnesota without reference to principles of conflict of laws.

Please acknowledge your acceptance of the terms of this Agreement by executing below and returning a copy to DFS.

DEPARTMENT 56, INC.

By: _____

Name:

Title:

Accepted:

Susan E. Engel

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THIS AGREEMENT, made as of the day
of (the "Grant Date"), between Department 56, Inc.,
a Delaware corporation (the "Corporation"), and (the
"Grantee").

such Lapse Date; provided, however, that the Transfer Restrictions with respect to one hundred percent (100%) of the shares of Restricted Stock shall lapse on the date of the Grantee's termination of employment with the Corporation as a result of the Grantee's retirement (which may be without Committee approval at or after age 65 or with Committee approval if before age 65 ("Qualifying Retirement")), death or Disability (also, a "Lapse Date"). Notwithstanding anything in the vesting acceleration provisions contained in the proviso of the preceding sentence to the contrary, in no event shall the Grantee (as a result of the operation of such vesting acceleration provisions) be vested or otherwise entitled to more than one hundred percent (100%) of the shares of Restricted Stock granted pursuant to section 1.1 above.

3.2 Notwithstanding anything in this Agreement to the contrary, upon the termination of the Grantee's employment with the Corporation for any reason other than as a result of the Grantee's Qualifying Retirement, death or Disability, all shares of Restricted Stock in respect of which the Transfer Restrictions have not previously lapsed in accordance with Section 3.1 hereof shall be forfeited and automatically transferred to and reacquired by the Corporation at no cost to the Corporation, and neither the Grantee nor any heirs, executors, administrators or successors of such Grantee shall thereafter have any right or interest in such shares of Restricted Stock.

3.3 In the event the Grantee takes a leave of absence from the Corporation which exceeds six (6) consecutive months in duration, whether such leave of absence is paid or unpaid, the shares of Restricted Stock shall be treated as if the Grantee had terminated his or her employment other than by reason of his or her Qualifying Retirement, death or Disability, as of the first day of the leave of absence; provided, however, that the Committee (x) shall treat an absence by reason of Disability and (y) may, in its sole discretion, may treat an approved leave of absence, in either case, of more than six (6) consecutive months as not constituting a termination of employment with respect to all or a portion of the shares of Restricted Stock issued hereunder in which case the leave of absence will be treated in the manner set forth in the following sentence. In the event of an approved leave of absence for a period consisting of six (6) consecutive months or less, the period of such leave of absence shall not be taken into account in determining if the Grantee was employed by the Corporation on any Lapse Date.

4. Escrow and Delivery of Shares.

4.1 Certificates representing the shares of Restricted Stock shall be issued and held by the Corporation (or its stock transfer agent) in escrow (together with any stock transfer powers which the Corporation may request of Grantee) and shall remain in the custody of the Corporation (or its stock transfer agent) until (i) their delivery to the Grantee or his/her estate as set forth in Section 4.2 hereof, or (ii) their forfeiture and transfer to the Corporation as set forth in Section 3.2 hereof.

4.2 (a) Subject to paragraph (b) of this Section 4.2, certificates representing those shares of Restricted Stock in respect of which the Transfer Restrictions have lapsed pursuant to Section 3.1 hereof shall be delivered to the Grantee as soon as practicable following the Lapse Date, subject to the application of Section 8 below.

(b) Certificates representing those shares of Restricted Stock in respect of which the Transfer Restrictions have lapsed

pursuant to Section 3.1(b) upon the Grantee's death shall be delivered to the executors or administrators of the Grantee's estate as soon as practicable following the Lapse Date and the Corporation's receipt of notification of the Grantee's death, accompanied by an official death certificate, subject to the application of Section 8 below.

(c) The Grantee, or the executors or administrators of the Grantee's estate, as the case may be, may receive, hold, sell or otherwise dispose of those shares of Restricted Stock delivered to him or her pursuant to paragraphs (a) or (b) of this Section 4.2 free and clear of the Transfer Restrictions, but subject to compliance with all federal and state securities laws.

4.3 (a) Each stock certificate shall bear a legend in substantially the following form:

This certificate and the shares of stock represented hereby are subject to the terms and conditions applicable to Restricted Stock contained in the 1993, 1995 and/or 1997 Stock Incentive Plans (as applicable) (the "Plans") and a Restricted Stock Agreement (the "Agreement") between the registered owner of the shares represented hereby. Release from such terms and conditions shall be made only in accordance with the provisions of the Plan(s) and the Agreement, copies of which are on file in the office of the Secretary of the Corporation.

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(b) As soon as practicable following a Lapse Date, the Corporation shall issue a new certificate for shares of the Restricted Stock which have become non-forfeitable in relation to such Lapse Date, which new certificate shall not bear the legend set forth in paragraph (a) of this Section 4.3 and shall be delivered in accordance with Section 4.2 hereof.

5. Dividends.

All dividends declared and paid by the Corporation on shares of Restricted Stock shall be deferred until the lapsing of the Transfer Restrictions pursuant to Section 3.1. The deferred dividends shall be held by the Corporation for the account of the Grantee until the Lapse Date, at which time the dividends, with no interest thereon, shall be paid to the Grantee or her/his estate, as the case may be. Upon the forfeiture of the shares of Restricted Stock pursuant to Section 3.2, any deferred dividends shall also be forfeited.

6. No Right to Continued Employment.

Nothing in this Agreement or the Plans shall be interpreted or construed to confer upon the Grantee any right with respect to continuance of employment by the Corporation, nor shall this Agreement or the Plans interfere in any way with the right of the Corporation to terminate the Grantee's employment at any time.

7. Adjustments Upon Change in Capitalization.

If, by reason of a Change in Capitalization, the Grantee shall be entitled to new, additional or different shares of stock or securities of the Corporation or any successor corporation or entity or other property, such new, additional or different shares or other property shall thereupon be subject to all of the conditions and restrictions which were applicable to the shares of Restricted Stock immediately prior to such Change in Capitalization.

8. Withholding of Taxes and Tax Election.

In satisfaction of the obligation to pay Withholding Taxes to the Corporation upon the lapse of Transfer Restrictions on any shares of Restricted Stock, the Grantee hereby makes her/his irrevocable written election, the acceptance of which by the Committee being hereby acknowledged, to have withheld a portion of the shares of Restricted Stock then deliverable to the Grantee having an aggregate Fair Market Value, on the Lapse Date, equal to the Withholding Taxes. For these purposes, Withholding Taxes shall be calculated as thirty-five percent (35%) of the aggregate Fair Market Value of the shares of Restricted Stock becoming non-forfeitable by Grantee on the applicable Lapse Date.

9. Modification of Agreement.

Except as set forth in the Plans and herein, this Agreement may be modified, amended, suspended or terminated, and any terms or conditions may be waived, but only by a written instrument executed by the parties hereto.

10. Non-Compete and Non-Disclosure.

(a) By acceptance of the Restricted Stock, the Grantee acknowledges that if the Grantee were, without the prior written consent of the Corporation, to use or disclose the Corporation's trade secrets or confidential information or threaten to do so, the Corporation would be entitled to injunctive and other appropriate relief to prevent the Grantee from doing so. The Grantee acknowledges that the harm caused to the Corporation by the breach or anticipated breach of this Section 10 is by its nature irreparable because, among other things, it is not readily susceptible of proof as to the monetary harm that would ensue. The Grantee consents that any interim or final equitable relief entered by a court of competent jurisdiction shall, at the request of the Corporation, be entered on consent and enforced by any court having jurisdiction over the Grantee, without prejudice to any rights either party may have to appeal from the proceedings which resulted in any grant of such relief.

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(b) The provisions of this Section 10 are not in lieu of but are in addition to the continuing obligation of the Grantee (which Grantee hereby acknowledges) not to use or disclose the Corporation's trade secrets and confidential information known to the Grantee until any particular trade secret or confidential information become generally known (through no fault of the Grantee), whereupon the restriction on use and disclosure shall cease as to that item. Information regarding products in development, in test marketing or being marketed or promoted in a discrete geographic region, which information the Corporation is considering for broader use, shall not be deemed generally known until such broader use is actually commercially implemented. As used in this Section 10, "generally known" means known throughout the domestic U.S. industry.

(c) If any of the provisions contained in this Section 10 shall for any reason, whether by application of existing law or law which may develop after the Grantee's acceptance of the Shares, be determined by a court of competent jurisdiction to be overly broad as to scope of activity, duration, or territory, the Grantee agrees to join the Corporation in requesting such court to construe such provision by limiting or reducing it so as to be enforceable to the extent compatible with then applicable law.

(d) In the event the Grantee violates any provision of this

Section 10, in addition to other remedies available to the Corporation provided herein, and in addition to any other damages that may be recoverable by the Corporation, the Corporation shall be entitled to damages equal to the Fair Market Value of any shares of Restricted Stock with respect to which the Transfer Restrictions lapsed by reason of, or within one (1) year prior to, the Grantee's Termination of Employment (such Fair Market Value to be determined as of the date or dates of lapse of the Transfer Restrictions).

11. Severability.

Should any provision of this Agreement be held by a court of competent jurisdiction to be unenforceable or invalid for any reason, the remaining provisions of this Agreement shall not be affected by such holding and shall continue in full force and effect in accordance with their terms.

12. Governing Law.

The validity, interpretation, construction and performance of this Agreement shall be governed by the laws of the State of Delaware without giving effect to the conflicts of laws principles thereof.

13. Successors in Interest.

This Agreement shall inure to the benefit of and be binding upon any successor to the Corporation. This Agreement shall inure to the benefit of the Grantee's heirs, executors, administrators and successors. All obligations imposed upon the Grantee and all rights granted to the Corporation under this Agreement shall be binding upon the Grantee's heirs, executors, administrators and successors.

DEPARTMENT 56, INC.

By:

Name: David H. Weiser
Title: Senior Vice President
Legal and Human Resources

GRANTEE:

DEPARTMENT 56, INC.

2001 NON-OFFICER STOCK OPTION PLAN

1. Purpose.

The purpose of this Plan is to strengthen Department 56, Inc., a Delaware corporation (the "Company"), by providing an incentive to its non-officer employees, consultants and advisors and thereby encouraging them to devote their abilities and industry to the success of the Company's business enterprise. It is intended that this purpose be achieved by extending to non-officer employees, consultants and advisors of the Company and its Subsidiaries an added long-term incentive for high levels of performance and unusual efforts through the grant of Nonqualified Stock Options (as hereinafter defined).

2. Definitions.

For purposes of the Plan:

2.1 "Adjusted Fair Market Value" means, in the event of a Change in Control, the greater of (i) the highest price per Share paid to holders of the Shares in any transaction (or series of transactions) constituting or resulting in a Change in Control or (ii) the highest Fair Market Value of a Share during the ninety (90) day period ending on the date of a Change in Control.

2.2 "Agreement" means the written agreement between the Company and an Optionee evidencing the grant of an Option and setting forth the terms and conditions thereof.

2.3 {Intentionally omitted.}

2.4 "Board" means the Board of Directors of the Company.

2.5 {Intentionally omitted.}

2.6 "Change in Capitalization" means any increase or reduction in the number of Shares, or any change (including, but not limited to, a change in value) in the Shares or exchange of Shares for a different number or kind of shares or other securities of the Company or another corporation, by reason of a reclassification, recapitalization, merger, consolidation, reorganization, spin-off, split-up, issuance of warrants or rights or debentures, stock dividend, stock split or reverse stock split, cash dividend, property dividend, combination or exchange of shares, repurchase of shares, change in corporate structure or otherwise.

2.7 A "Change in Control" shall mean the occurrence during the term of the Plan of:

(a) An acquisition (other than directly from the Company) of any voting securities of the Company (the "Voting Securities") by any 'Person' (as the term person is used for purposes of Section 13(d) or 14(d) of the Exchange Act), immediately after which such Person has 'Beneficial Ownership' (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of fifty-one percent (51%) or more of the combined voting power of the Company's then outstanding Voting Securities; provided, however, in determining whether a Change in Control has occurred, Voting Securities which are acquired in a 'Non-Control

Acquisition' (as hereinafter defined) shall not constitute an acquisition which would cause a Change in Control. A 'Non-Control Acquisition' shall mean an acquisition by (i) an employee benefit plan (or a trust forming a part thereof) maintained by (A) the Company or (B) any corporation or other Person of which a majority of its voting power or its voting equity securities or equity interest is owned, directly or indirectly, by the Company (for purposes of this definition, a 'Subsidiary'), (ii) the Company or its Subsidiaries, or (iii) any Person in connection with a 'Non-Control Transaction' (as hereinafter defined);

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(b) The individuals who, as of January 1, 2001, are members of the Board (the "Incumbent Board"), cease for any reason to constitute at least two-thirds of the members of the Board; provided, however, that if the election, or nomination for election by the Company's common stockholders, of any new director was approved by a vote of at least two-thirds of the Incumbent Board, such new director shall, for purposes of this Plan, be considered as a member of the Incumbent Board; provided further, however, that no individual shall be considered a member of the Incumbent Board if such individual initially assumed office as a result of either an actual or threatened 'Election Contest' (as described in Rule 14a-11 promulgated under the Exchange Act) or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board (a "Proxy Contest") including by reason of any agreement intended to avoid or settle any Election Contest or Proxy Contest; or

(c) The consummation of:

(i) A merger, consolidation or reorganization with or into the Company or in which securities of the Company are issued, unless such merger, consolidation or reorganization is a "Non-Control Transaction." A "Non-Control Transaction" is a merger, consolidation or reorganization with or into the Company or in which securities of the Company are issued where

(A) the stockholders of the Company, immediately before such merger, consolidation or reorganization, own, directly or indirectly immediately following such merger, consolidation or reorganization, at least sixty percent (60%) of the combined voting power of the outstanding voting securities of the corporation resulting from such merger or consolidation or reorganization (the "Surviving Corporation") in substantially the same proportion as their ownership of the Voting Securities immediately before such merger, consolidation or reorganization,

(B) the individuals who were members of the Incumbent Board immediately prior to the execution of the agreement providing for such merger, consolidation or reorganization constitute at least two-thirds of the members of the board of directors of the Surviving Corporation, or a corporation beneficially owning a majority of the Voting Securities of the Surviving Corporation,

(C) no Person other than (1) the Company, (2) any Subsidiary, (3) any employee benefit plan (or

any trust forming a part thereof) maintained immediately prior to such merger, consolidation or reorganization by the Company or any Subsidiary, or any (4) Person who, immediately prior to such merger, consolidation or reorganization had Beneficial Ownership of fifty-one percent (51%) or more of the then outstanding Voting Securities owns, directly or indirectly fifty-one percent (51%) or more of the combined voting power of the Surviving Corporation's then outstanding voting securities;

(ii) A complete liquidation or dissolution of the Company; or

(iii) The sale or other disposition of all or substantially all of the assets of the Company to any Person (other than a transfer to a Subsidiary).

Notwithstanding the foregoing, a Change in Control shall not be deemed to occur solely because any Person (the "Subject Person") acquired Beneficial Ownership of more than the permitted amount of the outstanding Voting Securities as a result of the acquisition of Voting Securities by the Company which, by reducing the number of Voting Securities outstanding, increases the proportional number of shares Beneficially Owned by the Subject Persons, provided that if a Change in Control would occur (but for the operation of this sentence) as a result of the

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acquisition of Voting Securities by the Company, and after such share acquisition by the Company, the Subject Person becomes the Beneficial Owner of any additional Voting Securities which increases the percentage of the then outstanding Voting Securities Beneficially Owned by the Subject Person, then a Change in Control shall occur.

2.8 "Code" means the Internal Revenue Code of 1986, as amended.

2.9 "Committee" means a committee of the Company's Chief Executive Officer and the Company's Chief Human Resources Officer, as described in Section 3.1, who may act jointly as a committee or independently from time to time to administer the Plan and to perform the functions set forth herein.

2.10 "Company" means Department 56, Inc.

2.11 "Director" means a director of the Company.

2.11 {Intentionally omitted.}

2.12 {Intentionally omitted.}

2.14 {Intentionally omitted.}

2.15 "Division" means any of the operating units or divisions of the Company designated as a Division by the Committee.

2.16 {Intentionally omitted.}

2.17 "Eligible Individual" means any non-officer employee of the Company or a Subsidiary, or any consultant or advisor who is receiving cash compensation from the Company or a Subsidiary designated by the Committee as eligible to receive Options subject to

the conditions set forth herein.

2.18 "Employee Option" means an Option granted pursuant to Section 5.

2.19 "Exchange Act" means the Securities Exchange Act of 1934, as amended.

2.20 "Fair Market Value" on any date means the average of the high and low sales prices of the Shares on such date on the principal national securities exchange on which such Shares are listed or admitted to trading, or if such Shares are not so listed or admitted to trading, the average of the per Share closing bid price and per Share closing asked price on such date as quoted on the National Association of Securities Dealers Automated Quotation System or such other market in which such prices are regularly quoted, or, if there have been no published bid or asked quotations with respect to Shares on such date, the Fair Market Value shall be the value established by the Committee in good faith.

2.21 {Intentionally omitted.}

2.22 {Intentionally omitted.}

2.23 {Intentionally omitted.}

2.24 "Nonqualified Stock Option" means an Option which does not satisfy the requirements of Section 422 of the Code and is not designated by the Committee as an Incentive Stock Option.

2.25 "Option" means a Nonqualified Stock Option.

2.26 "Optionee" means a person to whom an Option has been granted under the Plan.

2.27 {Intentionally omitted.}

2.28 {Intentionally omitted.}

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2.29 {Intentionally omitted.}

2.30 {Intentionally omitted.}

2.31 {Intentionally omitted.}

2.32 {Intentionally omitted.}

2.33 {Intentionally omitted.}

2.34 "Plan" means the Department 56, Inc. 2001 Non-Officer Stock Option Plan, as amended from time to time.

2.35 "Pooling Transaction" means an acquisition of or by the Company in a transaction which is intended to be treated as a "pooling of interests" under generally accepted accounting principles.

2.36 {Intentionally omitted.}

2.37 "Shares" means the common stock, par value \$.01 per share, of the Company.

2.38 {Intentionally omitted.}

2.39 {Intentionally omitted.}

2.40 "Subsidiary" means any corporation which is a subsidiary corporation (within the meaning of Section 424(f) of the Code) with respect to the Company.

2.41 "Successor Corporation" means a corporation, or a parent or subsidiary thereof within the meaning of Section 424(a) of the Code, which issues or assumes a stock option in a transaction to which Section 424(a) of the Code applies.

2.42 {Intentionally omitted.}

3. Administration.

3.1 The Plan shall be administered by the Committee which shall hold meetings and take such actions at such times as may be necessary for the proper administration of the Plan. No member of the Committee shall be liable for any action, failure to act, determination or interpretation made in good faith with respect to this Plan or any transaction hereunder, except for liability arising from his or her own willful misfeasance, gross negligence or reckless disregard of his or her duties. The Company hereby agrees to indemnify each member of the Committee for all costs and expenses and, to the extent permitted by applicable law, any liability incurred in connection with defending against, responding to, negotiating for the settlement of or otherwise dealing with any claim, cause of action or dispute of any kind arising in connection with any actions in administering this Plan or in authorizing or denying authorization to any transaction hereunder.

3.2 Subject to the express terms and conditions set forth herein, the Committee shall have the power from time to time to:

(a) determine those Eligible Individuals to whom Employee Options shall be granted under the Plan and the number of such Employee Options to be granted and to prescribe the terms and conditions (which need not be identical) of each such Employee Option, including the purchase price per Share subject to each Employee Option, and make any amendment or modification to any Option Agreement consistent with the terms of the Plan;

(b) to construe and interpret the Plan and the Options and Awards granted hereunder and to establish, amend and revoke rules and regulations for the administration of the Plan, including, but not limited to, correcting any defect or supplying any omission, or reconciling

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any inconsistency in the Plan or in any Agreement, in the manner and to the extent it shall deem necessary or advisable so that the Plan complies with applicable law including Rule 16b-3 under the Exchange Act and the Code to the extent applicable, and otherwise to make the Plan fully effective. All decisions and determinations by the Committee in the exercise of this power shall be final, binding and conclusive upon the Company, its Subsidiaries, the Optionees and all other persons having any interest therein;

(c) to determine the duration and purposes for leaves of absence which may be granted to an Optionee on an individual basis without constituting a termination of employment or service

for purposes of the Plan;

(d) to exercise its discretion with respect to the powers and rights granted to it as set forth in the Plan; and

(e) generally, to exercise such powers and to perform such acts as are deemed necessary or advisable to promote the best interests of the Company with respect to the Plan.

4. Stock Subject to the Plan; Grant Limitations.

4.1 The maximum number of Shares that may be made the subject of Options granted under the Plan is 225,000. The maximum number of Shares that any Eligible Individual may receive during the term of the Plan in respect of Options may not exceed 175,000 Shares. Upon a Change in Capitalization the maximum number of Shares referred to in the first two sentences of this Section 4.1 shall be adjusted in number and kind pursuant to Section 13. The Company shall reserve for the purposes of the Plan, out of its authorized but unissued Shares or out of Shares held in the Company's treasury, or partly out of each, such number of Shares as shall be determined by the Board.

4.2 Upon the granting of an Option, the number of Shares available under Section 4.1 for the granting of further Options shall be reduced by the number of Shares in respect of which the Option or Award is granted or denominated.

4.3 Whenever any outstanding Option or Award or portion thereof expires, is cancelled or is otherwise terminated for any reason without having been exercised or payment having been made in respect of the entire Option or Award, the Shares allocable to the expired, cancelled or otherwise terminated portion of the Option or Award may again be the subject of Options or Awards granted hereunder.

5. Option Grants for Eligible Individuals.

5.1 Authority of Committee. Subject to the provisions of the Plan and to Section 4.1 above, the Committee shall have full and final authority to select those Eligible Individuals who will receive Employee Options and the terms and conditions of the grant to such Eligible Individuals shall be set forth in an Agreement.

5.2 Purchase Price. The purchase price or the manner in which the purchase price is to be determined for Shares under each Employee Option shall be determined by the Committee and set forth in the Agreement.

5.3 Maximum Duration. Employee Options granted hereunder shall be for such term as the Committee shall determine, provided that no Option shall be exercisable after the expiration of ten (10) years from the date it is granted. The Committee may, subsequent to the granting of any Employee Option, extend the term thereof but in no event shall the term as so extended exceed the maximum term provided for in the preceding sentence.

5.4 Vesting. Subject to Section 7.4 hereof, each Employee Option shall become exercisable in such installments (which need not be equal) and at such times as may be designated by the Committee and set forth in the Agreement. To the extent not exercised, installments shall

accumulate and be exercisable, in whole or in part, at any time after

becoming exercisable, but not later than the date the Employee Option expires. The Committee may accelerate the exercisability of any Employee Option or portion thereof at any time.

5.5 Modification or Substitution. The Committee may, in its discretion, modify outstanding Employee Options or accept the surrender of outstanding Employee Options (to the extent not exercised) and grant new Employee Options in substitution for them. Notwithstanding the foregoing, no modification of an Employee Option shall adversely alter or impair any rights or obligations under the Employee Option without the Optionee's consent.

6. {Intentionally omitted.}

7. Terms and Conditions Applicable to All Options.

7.1 Non-transferability. No Option granted hereunder shall be transferable by the Optionee to whom granted except by will or the laws of descent and distribution, and an Option may be exercised during the lifetime of such Optionee only by the Optionee or his or her guardian or legal representative. The terms of such Option shall be final, binding and conclusive upon the beneficiaries, executors, administrators, heirs and successors of the Optionee.

7.2 Method of Exercise. The exercise of an Option shall be made only by a written notice delivered in person or by mail to the Secretary of the Company at the Company's principal executive office, specifying the number of Shares to be purchased and accompanied by payment therefor and otherwise in accordance with the Agreement pursuant to which the Option was granted. The purchase price for any Shares purchased pursuant to the exercise of an Option shall be paid in either of the following forms (or any combination thereof): (i) cash or (ii) the transfer of Shares to the Company upon such terms and conditions as determined by the Committee. Notwithstanding the foregoing, (i) the Committee shall have discretion to determine at the time of grant of each Employee Option or at any later date (up to and including the date of exercise) the form of payment acceptable in respect of the exercise of such Employee Option and (ii) Options may be exercised pursuant to such cashless exercise procedures which are, from time to time, deemed acceptable by the Committee. The written notice pursuant to this Section 7.2 may also provide instructions from the Optionee to the Company that upon receipt of the purchase price in cash from the Optionee's broker or dealer, designated as such on the written notice, in payment for any Shares purchased pursuant to the exercise of an Option, the Company shall issue such Shares directly to the designated broker or dealer. Any Shares transferred to the Company as payment of the purchase price under an Option shall be valued at their Fair Market Value on the day preceding the date of exercise of such Option. If requested by the Committee, the Optionee shall deliver the Agreement evidencing the Option to the Secretary of the Company who shall endorse thereon a notation of such exercise and return such Agreement to the Optionee. No fractional Shares (or cash in lieu thereof) shall be issued upon exercise of an Option and the number of Shares that may be purchased upon exercise shall be rounded to the nearest number of whole Shares.

7.3 Rights of Optionees. No Optionee shall be deemed for any purpose to be the owner of any Shares subject to any Option unless and until (i) the Option shall have been exercised pursuant to the terms thereof, (ii) the Company shall have issued and delivered the Shares to the Optionee and (iii) the Optionee's name shall have been entered as a stockholder of record on the books of the Company. Thereupon, the Optionee shall have full voting, dividend and other ownership rights with respect to such Shares, subject to such terms and conditions as may be set forth in the applicable Agreement.

7.4 Effect of Change in Control. In the event of a Change in Control, all Options outstanding on the date of such Change in Control shall become immediately and fully exercisable. In addition, to the extent set forth in an Agreement evidencing the grant of an Option, an Optionee will be

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permitted to surrender to the Company for cancellation within sixty (60) days after such Change in Control, any Option or portion of an Option to the extent not yet exercised and the Optionee will be entitled to receive a cash payment in an amount equal to the excess, if any, of (x) the greater of (1) the Fair Market Value, on the date preceding the date of surrender, of the Shares subject to the Option or portion thereof surrendered or (2) the Adjusted Fair Market Value of the Shares subject to the Option or portion thereof surrendered, over (y) the aggregate purchase price for such Shares under the Option or portion thereof surrendered. In the event an Optionee's employment with, or service as a consultant or advisor of, the Company is terminated by the Company within two years following a Change in Control each Option held by the Optionee that was exercisable as of the date of termination of the Optionee's employment or service shall remain exercisable for a period ending not before the earlier of (A) the first anniversary of the termination of the Optionee's employment or service or (B) the expiration of the stated term of the Option.

8. {Intentionally omitted.}
9. {Intentionally omitted.}
10. {Intentionally omitted.}
11. {Intentionally omitted.}
12. Effect of a Termination of Employment.

The Agreement evidencing the grant of each Option shall set forth the terms and conditions applicable to such Option upon a termination of the employment or service (or other change in the status) of the Optionee by the Company, a Subsidiary or a Division (including a termination or change by reason of the sale of a Subsidiary or a Division), which shall be as the Committee may, in its discretion, determine at the time the Option is granted or thereafter.

13. Adjustment Upon Changes in Capitalization.

(a) In the event of a Change in Capitalization, the Committee shall conclusively determine the appropriate adjustments, if any, to (i) the maximum number and class of Shares or other stock or securities with respect to which Options may be granted under the Plan, (ii) the maximum number and class of Shares or other stock or securities with respect to which Options may be granted to any Eligible Individual during the term of the Plan, and (iii) the number and class of Shares or other stock or securities which are subject to outstanding Options granted under the Plan and the purchase price therefor, if applicable.

(b) {Intentionally omitted.}

(c) If, by reason of a Change in Capitalization, an Optionee shall be entitled to exercise an Option with respect to, new, additional or different shares of stock or securities, such new additional or different shares shall thereupon be subject to all of

the conditions, restrictions and performance criteria which were applicable to the Shares subject to the Option prior to such Change in Capitalization.

14. Effect of Certain Transactions.

Subject to Section 7.4, or as otherwise provided in an Agreement, in the event of (i) the liquidation or dissolution of the Company or (ii) a merger or consolidation of the Company (a "Transaction"), the Plan and the Options issued hereunder shall continue in effect in accordance with their respective terms, except that following a Transaction each Optionee shall be entitled to receive in respect of each Share subject to any outstanding Options upon exercise of any Option, the same number and kind of stock, securities, cash, property, or other consideration that each holder of a Share was entitled to receive in the Transaction in respect of a Share; provided, however, that such stock, securities, cash, property, or other consideration shall remain subject to all of the conditions, restrictions and performance criteria which were applicable to the Options prior to such Transaction.

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15. Interpretation.

(a) The Plan is intended to comply with Rule 16b-3 promulgated under the Exchange Act and the Committee shall interpret and administer the provisions of the Plan or any Agreement in a manner consistent therewith. Any provisions inconsistent with such Rule shall be inoperative and shall not affect the validity of the Plan.

(b) Unless otherwise expressly stated in the relevant Agreement, each Option granted under the Plan is intended to be performance-based compensation within the meaning of Section 162(m)(4)(C) of the Code. The Committee shall not be entitled to exercise any discretion otherwise authorized hereunder with respect to such Options if the ability to exercise such discretion or the exercise of such discretion itself would cause the compensation attributable to such Options to fail to qualify as performance-based compensation.

16. Pooling Transactions.

Notwithstanding anything contained in the Plan or any Agreement to the contrary, in the event of a Change in Control which is intended to constitute a Pooling Transaction, the Committee shall take such actions, if any, as are specifically recommended by an independent accounting firm retained by the Company to the extent reasonably necessary in order to assure that the Pooling Transaction will qualify as such, including but not limited to (i) deferring the vesting, exercise, payment, settlement or lapsing of restrictions with respect to any Option, (ii) providing that the payment or settlement in respect of any Option be made in the form of cash, Shares or securities of a successor or acquirer of the Company, or a combination of the foregoing and (iii) providing for the extension of the term of any Option to the extent necessary to accommodate the foregoing, but not beyond the maximum term permitted for any Option.

17. Termination and Amendment of the Plan.

The Plan shall terminate on the day preceding the tenth anniversary of the date of its adoption by the Board and no Option may be granted thereafter. The Board may sooner terminate the Plan and the Board may at any time and from time to time amend, modify or suspend the Plan; provided, however, that:

(a) no such amendment, modification, suspension or termination shall impair or adversely alter any Options theretofore granted under the Plan, except with the consent of the Optionee, nor shall any amendment, modification, suspension or termination deprive any Optionee of any Shares which he or she may have acquired through or as a result of the Plan; and

(b) to the extent necessary under applicable law, no amendment shall be effective unless approved by the stockholders of the Company in accordance with applicable law.

18. Non-Exclusivity of the Plan.

The adoption of the Plan by the Board shall not be construed as amending, modifying or rescinding any previously approved incentive arrangement or as creating any limitations on the power of the Board to adopt such other incentive arrangements as it may deem desirable, including, without limitation, the granting of stock options otherwise than under the Plan, and such arrangements may be either applicable generally or only in specific cases.

19. Limitation of Liability.

As illustrative of the limitations of liability of the Company, but not intended to be exhaustive thereof, nothing in the Plan shall be construed to:

(i) give any person any right to be granted an Option other than at the sole discretion of the Committee;

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(ii) give any person any rights whatsoever with respect to Shares except as specifically provided in the Plan;

(iii) limit in any way the right of the Company to terminate the employment of any person at any time; or

(iv) be evidence of any agreement or understanding, expressed or implied, that the Company will employ any person at any particular rate of compensation or for any particular period of time.

20. Regulations and Other Approvals; Governing Law.

20.1 Except as to matters of federal law, this Plan and the rights of all persons claiming hereunder shall be construed and determined in accordance with the laws of the State of Delaware without giving effect to conflicts of law principles.

20.2 The obligation of the Company to sell or deliver Shares with respect to Options granted under the Plan shall be subject to all applicable laws, rules and regulations, including all applicable federal and state securities laws, and the obtaining of all such approvals by governmental agencies as may be deemed necessary or appropriate by the Committee.

20.3 The Board may make such changes as may be necessary or appropriate to comply with the rules and regulations of any government authority.

20.4 Each Option is subject to the requirement that, if at any time the Committee determines, in its discretion, that the listing, registration or qualification of Shares issuable pursuant to

the Plan is required by any securities exchange or under any state or federal law, or the consent or approval of any governmental regulatory body is necessary or desirable as a condition of, or in connection with, the grant of an Option or the issuance of Shares, no Options shall be granted or payment made or Shares issued, in whole or in part, unless listing, registration, qualification, consent or approval has been effected or obtained free of any conditions as acceptable to the Committee.

20.5 Notwithstanding anything contained in the Plan or any Agreement to the contrary, in the event that the disposition of Shares acquired pursuant to the Plan is not covered by a then current registration statement under the Securities Act of 1933, as amended (the "Securities Act"), and is not otherwise exempt from such registration, such Shares shall be restricted against transfer to the extent required by the Securities Act and Rule 144 or other regulations thereunder. The Committee may require any individual receiving Shares pursuant to an Option granted under the Plan, as a condition precedent to receipt of such Shares, to represent and warrant to the Company in writing that the Shares acquired by such individual are acquired without a view to any distribution thereof and will not be sold or transferred other than pursuant to an effective registration thereof under said Act or pursuant to an exemption applicable under the Securities Act or the rules and regulations promulgated thereunder. The certificates evidencing any of such Shares shall be appropriately amended to reflect their status as restricted securities as aforesaid.

21. Miscellaneous.

21.1 Multiple Agreements. The terms of each Option may differ from other Options granted under the Plan at the same time, or at some other time. The Committee may also grant more than one Option to a given Eligible Individual during the term of the Plan, either in addition to, or in substitution for, one or more Options previously granted to that Eligible Individual.

21.2 Withholding of Taxes. At such times as an Optionee recognizes taxable income in connection with the receipt of Shares or cash hereunder (a "Taxable Event"), the Optionee shall pay to the Company an amount equal to the federal, state and local income taxes and other amounts as may be required by law to be withheld by the Company in connection with the Taxable Event (the "Withholding Taxes") prior to the issuance, or release from escrow, of such Shares or the payment of such cash. The Company shall have the right to deduct from any payment of cash to an Optionee an amount equal to the Withholding Taxes in satisfaction of the obligation to pay Withholding Taxes.

QuickLinks

DEPARTMENT 56, INC. 2001 NON-OFFICER STOCK OPTION PLAN

DEPARTMENT 56, INC.
ANNUAL CASH INCENTIVE PROGRAM

1. PURPOSE

The purpose of the Annual Cash Incentive Program is to enhance Department 56, Inc.'s ability to attract, motivate, reward and retain employees, to strengthen their commitment to the success of the Company and to align their interests with those of the Company's stockholders by providing additional compensation to designated employees of the Company based on the achievement of performance objectives. To this end, the Annual Cash Incentive Program provides a means of annually rewarding participants largely based on the performance of the Company and, to a much lesser degree, based on exceptional instances of personal performance.

2. DEFINITIONS

(a) "Award" shall mean the cash incentive award earned by a Participant under the Program for any Performance Period.

(b) "Base Salary" shall mean the Participant's annual base salary, based on the Company's latest payroll action/salary adjustment form in effect for the Participant during the Performance Period to which such form relates. Annual base salary (1) does not include (i) Awards under the Program, (ii) profit sharing, 401(k) "match", or other long-term incentive awards, (iii) imputed or actual income from stock option exercises or such programs as life insurance or (iv) nonrecurring earnings such as moving expenses, and (2) is based on salary earnings before reductions for such items as contributions under Section 401(k) of the Internal Revenue Code of 1986, as amended, and Company-sponsored deferred compensation arrangements.

(c) "Board" shall mean the Board of Directors of the Company.

(d) "Business Program", for any Performance Period, shall mean the Company's final financial plan for such Performance Period, submitted to and approved by the Board before the earlier of (1) the ninety-first day of such Performance Period or (2) the end of the first quarter of such Performance Period.

(e) "Change of Control" shall mean the occurrence during the term of the Program of:

(i) An acquisition (other than directly from the Company) of any voting securities of the Company (the "Voting Securities") by any 'Person' (as the term person is used for purposes of Section 13(d) or 14(d) of the Exchange Act), immediately after which such Person has 'Beneficial Ownership' (within the meaning of Rule 13d-3 promulgated

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under the Exchange Act) of fifty-one percent (51%) or more of the combined voting power of the Company's then outstanding Voting Securities; provided, however, in determining whether a Change of Control has occurred, Voting Securities which are acquired in a 'Non-Control Acquisition' (as hereinafter defined) shall not constitute an acquisition which would cause a Change of Control. A 'Non-Control Acquisition' shall mean an acquisition by (i) an employee benefit plan (or a trust forming a part thereof) maintained by (A) the Company or (B) any corporation or other Person of which a majority of its voting power or its voting equity securities or equity interest is owned, directly or indirectly, by the Company (for purposes of this definition, a 'Subsidiary'), (ii) the Company or its Subsidiaries, or (iii) any Person in connection with a

'Non-Control Transaction' (as hereinafter defined);

(ii) The individuals who, as of May 16, 1997, are members of the Board (the "Incumbent Board"), cease for any reason to constitute at least two-thirds of the members of the Board; provided, however, that if the election, or nomination for election by the Company's common stockholders, of any new director was approved by a vote of at least two-thirds of the Incumbent Board, such new director shall, for purposes of this Program, be considered as a member of the Incumbent Board; provided further, however, that no individual shall be considered a member of the Incumbent Board if such individual initially assumed office as a result of either an actual or threatened 'Election Contest' (as described in Rule 14a-11 promulgated under the Exchange Act) or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board (a "Proxy Contest") including by reason of any agreement intended to avoid or settle any Election Contest or Proxy Contest; or

(iii) Approval by stockholders of the Company of:

(1) A merger, consolidation or reorganization with or into the Company or in which securities of the Company are issued, unless such merger, consolidation or reorganization is a "Non-Control Transaction." A "Non-Control Transaction" is a merger, consolidation or reorganization with or into the Company or in which securities of the Company are issued where

(A) the stockholders of the Company, immediately before such merger, consolidation or reorganization, own, directly or indirectly immediately following such merger, consolidation or reorganization, at least sixty percent (60%) of the combined voting power of the outstanding voting securities of the corporation resulting from such merger or consolidation or reorganization (the "Surviving Corporation") in substantially the same proportion as their ownership of the Voting Securities immediately before such merger, consolidation or reorganization,

(B) the individuals who were members of the Incumbent Board immediately prior to the execution of the agreement providing for such merger, consolidation or reorganization constitute at least two-thirds of the members of the board of directors of the Surviving Corporation, or a corporation beneficially owning a majority of the
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Voting Securities of the Surviving Corporation,

(C) no Person other than (1) the Company, (2) any Subsidiary, (3) any employee benefit plan (or any trust forming a part thereof) maintained immediately prior to such merger, consolidation or reorganization by the Company or any Subsidiary, or (4) any Person who, immediately prior to such merger, consolidation or reorganization had Beneficial Ownership of fifty-one percent (51%) or more of the then outstanding Voting Securities owns, directly or indirectly fifty-one percent (51%) or more of the combined voting power of the Surviving Corporation's then outstanding voting securities;

(2) A complete liquidation or dissolution of the Company; or

(3) The sale or other disposition of all or substantially all of the assets of the Company to any Person (other than a transfer to a Subsidiary).

Notwithstanding the foregoing, a Change of Control shall not be deemed to occur solely because any Person (the "Subject Person") acquired Beneficial Ownership of more than the permitted amount of the outstanding Voting Securities as a result of the acquisition of Voting Securities by the Company which, by reducing the number of Voting Securities outstanding, increases the proportional number of shares Beneficially Owned by the Subject Persons,

provided that if a Change of Control would occur (but for the operation of this sentence) as a result of the acquisition of Voting Securities by the Company, and after such share acquisition by the Company, the Subject Person becomes the Beneficial Owner of any additional Voting Securities which increases the percentage of the then outstanding Voting Securities Beneficially Owned by the Subject Person, then a Change of Control shall occur.

(f) "Company" shall mean Department 56, Inc., its successors and assigns.

(g) "Company Operating Income": for any period, the net income from operations of (1) the Company and its Subsidiaries on a consolidated basis determined in accordance with GAAP, or (2) any portion (or combination of portions) of the Company's business as calculated in a manner consistent with the Company's internal reporting for such period, in either case as determined by the Management HR Committee in its discretion.

(h) "Compensation Committee" shall mean the Compensation Committee of the Board.

(i) "Current Year EPS", for any period, shall mean the fully diluted earnings per share goal for the Company and its Subsidiaries for such period determined in accordance with GAAP on a consolidated basis.
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(j) "Current Year EPS Target", for any Performance Period, shall mean the Current Year EPS goal for the Company and its Subsidiaries (with such adjustments as the Compensation Committee may in its discretion authorize for any one or more officer Participants) (i) as reflected as EPS in the Business Program or (ii) if such Performance Period is not a fiscal year, as established by the Compensation Committee.

(k) "Current Year Operating Income Target", for any Performance Period, shall mean the Company Operating Income goal for such Performance Period as established by the Management HR Committee.

(l) "Current Year Financial Target Earned", for any Performance Period, shall mean (1) with respect to any non-officer Participant, the bonus payout percentage based on the achievement of Current Year Operating Income Target (and based on the achievement of Current Year EPS Target for any non-officer participant designated by the Management HR Committee) as determined by the Management HR Committee (or the Board in lieu thereof), and (2) with respect to any officer Participant, the bonus payout percentage based on the achievement of Current Year EPS Target as determined by the Compensation Committee (or the Board in lieu thereof).

(m) "Disability" shall mean permanent disability, as provided in the Company's long-term disability plan.

(n) "Effective Date" shall mean the date that the Program is adopted by the Board.

(o) "Employee" shall mean any person (including an officer) employed by the Company or any of its Subsidiaries on a full-time basis except for any (i) commissioned sales representative, (ii) non-exempt employee or seasonal or temporary worker, (iii) employee represented in his or her employment relationship by a collective bargaining unit or other labor union, guild or association, (iv) employee of the Company's retail operations who does not office in its Minneapolis-St. Paul metropolitan area headquarters office building or (v) employee principally in a non-managerial position in any operation of the Company or any Subsidiary located outside the United States of America.

(p) "Exchange Act" shall mean the Securities Exchange Act of 1934, as amended.

(q) "GAAP" shall mean generally accepted accounting principles in the United States of America in effect from time to time.

(r) "Key Employee" shall mean any Employee so designated by the Management HR Committee.

(s) "Management HR Committee" shall mean a committee composed of the
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Company's Chief Executive Officer and the Company's senior human resources officer.

(t) "Participant", for any Performance Period, shall mean an Employee who is eligible to participate in the Program for such Performance Period as provided in Section 3 of the Program.

(u) "Performance Period" shall mean the fiscal year of the Company or any other period designated by the Compensation Committee with respect to which an Award is earned.

(v) "Program" shall mean this Department 56, Inc. Annual Cash Incentive Program, as from time to time amended and in effect.

(w) "Retirement" shall mean retirement at or after age 65 or early retirement with the prior written approval of the Company.

(x) "Subsidiary" shall mean a corporation as defined in Section 424(f) of the Internal Revenue Code of 1986, as amended, with the Company being treated as the employer corporation for purposes of this definition.

(y) "Target Award Percentage" for any Participant with respect to any Performance Period, shall mean the percentage of the Participant's Base Salary that the Participant would earn as an Award for that Performance Period if each of the Current Year Financial Target Earned for that Performance Period is 100%, and shall be as set forth on a schedule adopted by the Compensation Committee with respect to officers who are Participants and as set forth on a schedule adopted by the Management HR Committee with respect to all other Participants, based on the Participant's responsibility level or the position or positions held during the Performance Period; PROVIDED, HOWEVER, that if any Participant held more than one position during the Performance Period, then the Compensation Committee or Management HR Committee, as applicable, may designate different Target Award Percentages with respect to each position and the Award will be pro-rated to reflect the number of days during which such Participant had each Target Award Percentage.

3. ELIGIBILITY

Participation in the Program for a Performance Period shall be limited to those Employees who are eligible to participate as provided in this Section 3. To be eligible to participate in the Program in any Performance Period, an Employee shall have had a least three months active tenure during such Performance Period and be actively employed by the Company on the Award payment date. The Compensation Committee or Management HR Committee may approve, in accordance with Sections 7 and 8 of this Program, exceptions for special circumstances.
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Employees shall participate in only one annual cash or sales incentive program for any specific period in time. For example, an individual may not participate in both the Program and the Company's sales commission or sales incentive program at the same time. An individual may participate in two programs sequentially during any Performance Period because of promotion or reassignment, provided that participation in each such program is pro-rated based on the number of days he or she participated in each program.

If an Employee becomes a Participant during a Performance Period, such Participant's Award will be pro-rated based on the number of days that he or she is a Participant.

4. ADMINISTRATION

The administration of the Program shall be consistent with the purpose and the terms of the Program. The Program shall be administered by the Compensation Committee with respect to officers and by the Management HR Committee with respect to all other Participants. Each member of the Compensation Committee shall be an "outside director" within the meaning of Treasury Regulations proposed under Section 162(m) of the Internal Revenue Code of 1986, as amended. The Compensation Committee and the Management HR Committee, as the case may be, shall have full authority to establish the rules and regulations relating to the Program, to interpret the Program and those rules and regulations, to decide the facts in any case arising under the Program, to reduce or eliminate any Participant's Award that would otherwise be payable pursuant to the terms of the Program in the event the Participant has demonstrated job performance below Company expectations or otherwise in such committee's discretion, and to make all other determinations and to take all other actions necessary or appropriate for the proper administration of the Program, including the delegation of such authority or power, where appropriate; PROVIDED, HOWEVER, that only the Compensation Committee shall have authority to amend or terminate the Program. In addition, the Management HR Committee shall have, with respect to non-officer Employees, full authority to select such Participants in the Program and to determine each such Participant's Target Award Percentage. Moreover, with respect to Participants who are not officers or Key Employees, the Management HR Committee shall have full authority to grant Awards in such amounts as it may determine in any event that (i) no Awards to such Participants would otherwise be payable pursuant to Section 5 of this Program or (ii) Awards to such Participants of lesser amounts would otherwise be payable pursuant to Section 5 of this Program. The Compensation Committee's and the Management HR Committee's administration of the Program, including all such rules and regulations, interpretations, selections, determinations, approvals, decisions, delegations, amendments, terminations and other actions, shall be final and binding on the Company, the Subsidiaries, their respective stockholders and all employees of the Company and the Subsidiaries, including the Participants and their respective beneficiaries. No member of the Compensation Committee or the Management HR Committee shall be liable for any action, failure to act,

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determination or interpretation made in good faith with respect to the Program or any transaction hereunder, except for liability arising from his or her own willful misfeasance, gross negligence or reckless disregard of his or her duties. The Company hereby agrees to indemnify each member of the Compensation Committee and each member of the Management HR Committee for all costs and expenses and, to the extent permitted by applicable law, any liability incurred in connection with defending against, responding to, negotiating for the settlement of or otherwise dealing with any claim, cause of action or dispute of any kind arising in connection with any actions in administering the Program or in authorizing or denying authorization to any transaction hereunder.

5. DETERMINATION OF DEFINED AWARDS

Prior to, or as soon as practicable following, the commencement of each Performance Period, the Management HR Committee with respect to all non-officer Participants shall then determine each such Participant's Target Award Percentage. The Company shall then prepare schedules, which will be treated as part of the Program for that Performance Period, setting forth (x) the Participants during that Performance Period, (y) each Participant's Target Award Percentage for that Performance Period and (z) the Current Year EPS Target and the Current Year Operating Income Target for that Performance Period. The Company shall notify each Participant of his or her Target Award Percentage and the Current Year EPS Target and the Current Year Operating Income Target for the

Performance Period, as applicable. In addition to, and without limiting the generality of the foregoing, the Company's officers shall also participate in the Program for every Performance Period in accordance with Section 3 hereof, and the Target Award Percentage of each officer shall be as set forth on a schedule adopted by the Compensation Committee.

Generally, a Participant earns an Award for a Performance Period based on (i) the Company's achievement of the Current Year EPS Target and/or the Current Year Operating Income Target applicable to such Participant (the "Applicable Measure") , and (ii) as further described in Section 6 below, his or her achievement of extraordinary personal quality performance. Awards pursuant to this Section 5 will only be earned if achievement of the Applicable Measure is 90% or higher for such Performance Period.

Awards shall be earned by Participants in accordance with the following formula:

| | | | | |
|------------|---|--------|---|-----------|
| Target | | | | Current |
| Award | | Base | | Year |
| Percentage | x | Salary | x | Financial |
| <Page> | | | | Target |
| | | | | Earned |

6. DETERMINATION OF DISCRETIONARY AWARDS

There shall be a pool (generally not exceeding one hundred thousand dollars) created each fiscal year Performance Period from which Awards may be granted to any Participant solely in respect of such Participant's personal job performance and without regard to the determination of defined Awards or achievement of financial targets contemplated by Section 5 above; PROVIDED, HOWEVER, that no such pool shall be created for a Performance Period unless the Business Program for such Performance Period assumes and reflects the expense effect of full utilization of the pool.

The Compensation Committee (with respect to any Participant) and the Management HR Committee (with respect to any non-officer Participant) shall each have the authority to grant and pay Awards from any pool described in the preceding paragraph at such times and in such amounts as such committee, in its sole discretion, shall determine. Notwithstanding the proviso contained in the preceding paragraph, there shall be no obligation of either the Compensation Committee or the Management HR Committee to grant any Awards (or to continue or repeat the granting of any Awards) to any Participant or Participants pursuant to this Section 6.

Discretionary bonus pool amounts not utilized in a Performance Period shall not be carried over or accumulated with any discretionary bonus pool amounts permitted in any subsequent Performance Periods.

7. CHANGES TO TARGET AWARD PERCENTAGES

The Compensation Committee, with respect to officers who are Participants, and the Management HR Committee, with respect to all other Participants, may at any time prior to the final determination of Awards change the Target Award Percentage of any Participant or assign a different Target Award Percentage to a Participant to reflect any change in the Participant's responsibility level or position during the course of the Performance Period.

The Compensation Committee, with respect to officers who are Participants, and the Management HR Committee, with respect to all other Participants, may at any time prior to the final determination of Awards change the Current Year EPS Target and/or the Current Year Operating Income Target (as the case may be) to reflect extraordinary events, accounting changes or a corporate transaction, such as a merger, consolidation, separation, reorganization or partial or complete liquidation.

8. PAYMENT OF DEFINED AWARDS

As soon as practicable after the close of a Performance Period (but not before the Audit Committee of the Board has approved the corresponding audited financial statements if such Performance Period is a fiscal year), the Compensation Committee, with respect to officers who are Participants, and the Management HR Committee, with respect

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to all other Participants, shall confirm the calculation of each Participant's Award pursuant to Section 5. Subject to the provisions of Section 9 of the Program, each Award to the extent earned pursuant to Section 5 shall be paid in a single lump sum cash payment, as soon as practicable after the close of the Performance Period, but no later than 120 days after the close of the Performance Period.

If a Change of Control occurs, the Company shall, within 60 days thereafter, pay to each Participant in the Program immediately prior to the Change of Control (regardless of whether the Participant remains employed after the Change of Control) an Award under Section 5 which is calculated assuming that Current Year EPS Target and Current Year Operating Income Target for such Performance Period are fully (100%) achieved, and such Award shall be prorated to the date of the Change of Control based on the number of days that have elapsed during the Performance Period through the date of the Change of Control.

9. LIMITATIONS ON RIGHTS TO PAYMENT OF AWARDS

No Participant shall have any right to receive payment of an Award under Section 5 or Section 6 of the Program for a Performance Period unless the Participant remains in the employ of the Company through the payment date of the Award for such Performance Period, except as provided in the last paragraph of Section 8 of the Program. However, if the Participant has active service with the Company or the Subsidiary for at least three months during any Performance Period, but, prior to payment of the Award for such Performance Period, a Participant's employment with the Company terminates due to the Participant's death, Disability or Retirement, the Participant (or, in the event of the Participant's death, the Participant's estate, beneficiary or beneficiaries as determined under Section 10 of the Program) shall remain eligible to receive any earned Award, which in the case of any Award under Section 5 shall be prorated to a portion based on the number of days that the Participant was actively employed by the Company or a Subsidiary and performed services for it during such Performance Period.

10. DESIGNATION OF BENEFICIARY

A Participant may designate a beneficiary or beneficiaries who, in the event of the Participant's death prior to full payment of any Award hereunder, shall receive payment of any Award due under the Program. Such designation shall be made by the Participant on a form prescribed by the Management HR Committee. The Participant may, at any time, change or revoke such designation. A beneficiary designation, or revocation of a prior beneficiary designation, will be effective only if it is made in writing on a form provided by the Company, signed by the Participant and received by the Secretary of the Company. If the Participant does not designate a beneficiary or the beneficiary dies prior to receiving any payment of an Awards, Awards payable under the Program shall be paid to the Participant's estate.

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11. AMENDMENTS

The Compensation Committee may at any time amend (in whole or in part) this Program. No such amendment which adversely affects any Participant's rights to or interest in an Award earned prior to the date of the amendment shall be effective unless the Participant shall have agreed thereto.

12. TERMINATION

The Compensation Committee may terminate this Program (in whole or in part) at any time. In the case of such termination of the Program, the following provisions of this Section 12 shall apply notwithstanding any other provisions of the Program to the contrary:

(i) The Compensation Committee shall promulgate administrative rules applicable to Program termination, pursuant to which each affected Participant shall receive, with respect to each Performance Period which has commenced on or prior to the effective date of the Program termination (the "Termination Date") and for which the Award under Section 5 has not yet been paid, the amount equal to the amount his or her Award under Section 5 would have been had the Program not been terminated (prorated for the Performance Period in which the Termination Date occurred), subject to reduction in the discretion of the Compensation Committee.

(ii) Each Award payable under this Section 12 shall be paid as soon as practicable, but in no event later than 120 days after the end of the fiscal year in which the Termination Date occurs.

13. MISCELLANEOUS PROVISIONS

(a) This Program is not a contract between the Company and the Employees or the Participants. Neither the establishment of this Program, nor any action taken hereunder, shall be construed as giving any Employee or any Participant any right to be retained in the employ of the Company. The Company is under no obligation to continue the Program.

(b) A Participant's right and interest under the Program may not be assigned or transferred, except as provided in Section 10 of the Program, and any attempted assignment or transfer shall be null and void and shall extinguish, in the Company's sole discretion, the Company's obligation under the Program to pay Awards with respect to the Participant.

(c) The Program shall be unfunded. The Company shall not be required to establish any special or separate fund, or to make any other segregation of assets, to
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assure payment of Awards.

(d) The Company shall have the right to deduct from Awards paid any interest thereon, any taxes or other amounts required by law to be withheld.

(e) Nothing contained in the Program shall limit or affect in any manner or degree the normal and usual powers of management, exercised by the officers and the Board or committees thereof, to change the duties or the character of employment of any employee of the Company or to remove the individual from the employment of the Company at any time, all of which rights and powers are expressly reserved.

ASSET PURCHASE AGREEMENT

BY
AND
AMONG

DEPARTMENT 56, INC.,

AXIS HOLDINGS CORPORATION,

AXIS CORPORATION,

ALL THE SHAREHOLDERS OF AXIS CORPORATION

AND

KIRK WILLEY IN THE CAPACITY OF SHAREHOLDERS' REPRESENTATIVE

DATED AS OF

AUGUST 14, 2001

ASSET PURCHASE AGREEMENT

THIS ASSET PURCHASE AGREEMENT, dated as of August 14, 2001, is by and among Department 56, Inc., a Delaware corporation ("Parent"), Axis Holdings Corporation, a Delaware corporation and wholly-owned subsidiary of Parent (the "Purchaser"), Axis Corporation, a Utah corporation (the "Seller"), all of the shareholders of Seller (the "Shareholders") and Kirk Willey in the capacity of Shareholders' Representative (as defined below).

A. The parties hereto wish to provide for the terms and conditions upon which the Purchaser will purchase all of the assets of Seller's business (the "Business").

B. The parties hereto wish to make certain representations, warranties, covenants and agreements in connection with the purchase of the assets and the Business.

Accordingly, and in consideration of the representations, warranties, covenants and agreements herein contained, the parties hereto agree as follows:

1. PURCHASE OF ASSETS.

1.1. Assets to be Purchased.

(a) Upon the terms and subject to the conditions of this Agreement, Seller will sell, transfer, convey, assign and deliver to the Purchaser, and the Purchaser will purchase, from Seller, at the Closing, all of Seller's right, title and interest in and to the businesses, assets, properties, goodwill and rights of Seller used in or arising out of the operation of the Business, of every nature, kind and description, tangible and intangible, real, personal or mixed, wheresoever located and whether or not carried or reflected on the books and records of Seller (collectively, the "Assets"). The Assets include, but are not limited to, all of Seller's right, title and interest in and to the following:

(i) personal property that is now owned or leased by Seller

and used in the Business;

(ii) franchises relating to the Business;

(iii) Seller's corporate or entity names used in the Business and all derivatives or combinations thereof, including, without limitation, the "Geppeddo" trade name;

(iv) logos, trademarks, trademark registrations and trademark applications or registrations thereof used in or relating to the Business, including the goodwill associated therewith, and the goodwill of the Business;

(v) copyrights, copyright applications and copyright registrations, patents and patent applications used in or relating to the Business;

(vi) rights under or pursuant to licenses by or to Seller used in or relating to the Business;

(vii) development and prototype hardware, software, processes, formula, trade secrets, inventories and royalties, including all rights to sue for past infringements used in or relating to the Business;

(viii) inventory (raw materials, work in process, finished goods, accumulated costs of jobs and supplies) used in the Business;

(ix) equipment, machinery, furniture, fixtures, motor vehicles and supplies used in or relating to the Business;

(x) prepaid expenses relating to the Business;

(xi) contracts and purchase orders relating to the Business;

(xii) lists of customers of the Business, including those customers identified on Exhibit 1.1(a)(xii) attached hereto;

(xiii) lists of suppliers and all favorable business relationships, causes of action, judgments, claims and demands of whatever nature relating to the Business;

(xiv) telephone, telefax and telex numbers and all listings in all telephone books and directories relating to the Business;

(xv) all credit balances of or insuring to Seller under any state unemployment compensation plan or fund related to employees of the Business;

(xvi) employment contracts, including all confidentiality, assignment of invention and non-competition agreements relating to the employees and consultants of the Business, except for those employment contracts specifically excluded herein;

(xvii) obligations of the present and former officers and employees of the Business and of individuals and corporations of the Business;

(xviii) rights under joint venture agreements or arrangements relating to the Business;

(xix) files, papers and records relating to the Business and assets used in the Business;

(xx) all web sites, URLs and domain names of Seller used in and relating to the Business, including without limitation the web sites listed in Disclosure Schedule 2.12;

(xxi) the assets as reflected on the balance sheet of Seller dated as of June 30, 2001, attached hereto as Exhibit 1.1(a)(xxi) (the "Latest Balance Sheet"), with only such dispositions of such assets reflected on the Latest Balance Sheet as will have occurred in the ordinary course of business between the date thereof and the Closing and which are permitted by the terms hereof;

(xxii) cash, money and deposits with financial institutions and others, certificates of deposit, commercial paper, notes, evidences of indebtedness, stocks, bonds and other investments of the Business;

(xxiii) accounts receivables of the Business; and

(xxiv) all of Seller's rights under that certain letter dated July 11, 2001 from Harvey C. Gordon (General Counsel, Ashton-Drake Galleries) to Michael E. Mangelson (it agreed and understood that neither Parent nor Purchaser assumes any Liability arising out of Ashton-Drake's underlying infringement and other claims against the Seller or any of its customers arising out of the same).

(b) Notwithstanding the foregoing, Seller will not sell, transfer, convey, assign or deliver to the Purchaser, and the Purchaser will not purchase from Seller, the following assets:

(i) the consideration delivered to Seller pursuant to this Agreement for the Assets;

(ii) the minute books (and any documents related to Seller's organization, corporate affairs or foreign qualification contained in such minute books), corporate seal and stock records of Seller;

(iii) shares of the capital stock of Seller, including shares held by Seller as treasury shares;

(iv) all documentation pertaining to any liability of Seller not assumed by the Purchaser;

(v) all employment or severance agreements of management not hired by Parent or Purchaser; and

(vi) the assets specifically described on Exhibit 1.1(b) hereto.

1.2. Liabilities Assumed.

At the Closing, the Purchaser will assume the liabilities of the Business (the "Assumed Liabilities") set forth on Exhibit 1.2 (the "Liabilities Undertaking"). Each of Seller and the Shareholders expressly understands and agrees that, except for the Assumed Liabilities, the Purchaser and Parent have not

agreed to pay, will not be required to assume and will have no liability or obligation, direct or indirect, absolute or contingent, for, the liabilities of the Business, Seller, the Shareholders or any of their respective affiliates or associates or any other person, which liabilities will, as between Seller and Shareholders, on the one hand, and the Purchaser and Parent, on the other hand, remain the sole responsibility of, and will be satisfied by, Seller or the Shareholders, as applicable,

pursuant to the terms of this Agreement (the "Retained Liabilities"). The Retained Liabilities include, but are not limited to, the following:

(a) any debt, liability or obligation of the Business or Seller, or any of their respective affiliates or associates, direct or indirect, known or unknown, fixed, contingent or otherwise, that (i) is unrelated to the Assets or the Business; or (ii) relates to the Assets or the Business and is based upon or arises from any act, omission, transaction, circumstance, sale of goods or services, state of facts or other condition occurring or existing on or before the Closing Date, whether or not then known, due or payable, except to the extent that the same constitutes an Assumed Liability;

(b) any obligation for Taxes related to any of the Assets for any Tax period or portion thereof ending on or before the Closing Date (including any tax liability relating to or arising from the transfer of Assets) and any obligation for other Taxes of Seller;

(c) any debt, liability or obligation, direct or indirect, known or unknown, fixed, contingent or otherwise, based upon or arising from any act, omission, transaction, circumstance, state of facts or other condition occurring or existing on or before the Closing Date and relating to any collective bargaining agreement or any employee benefit plan, policy, practice or agreement to which Seller is a party or under which any of Seller's employees or former employees, or their spouses, dependents, family members, domestic partners or beneficiaries is covered, including without limitation any obligation to contribute to, or any obligation or liability for any withdrawal liability arising in connection with, any "multiemployer plan" within the meaning of Section 4001(a)(3) of the Employment Retirement Income Security Act of 1974, as amended ("ERISA"), attributable to participation therein by current or former employees of Seller as a result of this Agreement and the transactions contemplated hereby or otherwise;

(d) (i) any liability arising out of or related to the events, circumstances or conditions described in Section 2.21 of the Disclosure Schedule; (ii) any liability arising out of or related to the management of wastes, byproducts or spent materials generated by the Seller or any of its subsidiaries, former subsidiaries or affiliates; or any liability arising out of or related to any pollution or threat to human health or the environment or violation of any Environmental and Occupational Safety and Health Law that is related in any way to any of Seller's management, use, control, ownership or operation of the Assets, any property or the business of Seller, any of its subsidiaries, former subsidiaries or affiliates, including without limitation any on-site or off-site activities involving Environmentally Regulated Materials, and that occurred, existed, arises out of conditions or circumstances that occurred or existed, or was caused, in whole or in part, on or before the Closing Date, whether or not the pollution or threat to human health or the environment or violation of any Environmental and Occupational Safety and Health Law is described in the Disclosure Schedule; and (iii) any Environmental Claim against any person or entity whose liability for such Environmental Claim of the Seller has or may have assumed or retained either contractually or by operation of law;

(e) any debt, liability or obligation, direct or indirect, known or unknown, fixed, contingent or otherwise owing by Seller to any of its affiliates, officers, directors or stockholders;

(f) any debt, liability or obligation, direct or indirect, known or unknown, fixed, contingent or otherwise owing by Seller or any Shareholder to any attorney, accountant, investment banker or other Person, to the extent relating to or incurred in connection with this Agreement or the transactions contemplated hereby;

(g) any debt, liability or obligation, direct or indirect, known or unknown, fixed, contingent or otherwise, relating to the claims or matters described in Disclosure Schedules 2.13, 2.18, Item 1 of 2.26, or 2.27.

At the Closing, Seller will convey, transfer, assign and delegate, and the Purchaser will accept and assume, those contracts, agreements and commitments listed on Exhibit A to the Liabilities Undertaking (the "Assumed Contracts").

1.3. Purchase Price.

(a) The total consideration to be paid by the Purchaser to Seller for the Assets (the "Purchase Price") will be an amount equal to:

(i) seven million nine hundred thirty-eight thousand five hundred twenty-one dollars (\$7,938,521), plus or minus the aggregate amount of any Initial Purchase Price Adjustment as defined below in Section 1.3(a)(iv) (such amount, after giving effect to any Initial Purchase Price Adjustment, the "Initial Cash Consideration"); plus

(ii) a contingent right to receive up to an additional twelve million dollars (\$12,000,000) (the "Contingent Consideration"), as determined under and more fully described below in this Section 1.3(a)(ii);

(1) Definitions. Capitalized terms used but not defined in this section 1.3(a)(ii) have the meanings given elsewhere in this Agreement, and for the purposes of this section 1.3(a)(ii) the following additional terms have the respective meanings indicated.

(A) "Fiscal 2000" means the twelve month period ending February 28, 2001; "Fiscal 2001" means the twelve month period ending February 28, 2002; "Fiscal 2002" means the twelve month period ending February 28, 2003; and "Fiscal 2003" means the twelve month period ending February 29, 2004.

(B) "Operating Income" means income of the Purchaser from continuing operations in the referenced period in the ordinary course of business per audited financial statements prepared in accordance with generally accepted accounting principles consistently applied ("GAAP") (it being understood that income from continuing operations is exclusive of interest income, rental income, gains on fixed asset sales and similar non-operating income, interest expense and provisions for federal, state and local income taxes).

(C) "Operating Income Margin" means Operating Income in a given fiscal year divided by Revenue in the same fiscal year.

(D) "Period" means the three year period from and including Fiscal 2001 through and including Fiscal 2003.

(E) "Revenue" means net sales in the referenced period in the ordinary course of business per audited financial statements prepared in accordance with GAAP, adjusted for bad debt expense per audited financial statements prepared in accordance with GAAP (it being understood that net sales is net of returns, allowances and discounts and exclusive of sales taxes, interest income,

rental income, gains on fixed asset sales and similar non-operating income) and "Revenue in Fiscal 2000" means \$14,532,097.

(F) "Revenue Base", for purposes of subsection (4) below, has the meaning determined in accordance with subsections (3)(A)(ii), (3)(B)(ii), (3)(C)(ii) or 3(D)(ii), as the case may be, and for purposes of subsection (5) below, has the meaning determined in accordance with subsections (4)(A)(ii), (4)(B)(ii), (4)(C)(ii) or (4)(D)(ii), as the case may be.

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(2) Procedures for Determining Contingent Consideration.

(A) Delivery of Contingent Consideration Statement by Purchaser. Within seventy (70) days after the close of each fiscal year during the Period, Purchaser will deliver to the Shareholders' Representative a statement setting forth in reasonable detail Purchaser's calculation of the Contingent Consideration due for such fiscal year (each such statement, a "Contingent Consideration Statement"). The Contingent Consideration Statements for Fiscal 2001, Fiscal 2002 and Fiscal 2003 shall be prepared in accordance with subsections 3, 4 and 5 below, respectively, and each Contingent Consideration Statement shall be prepared in accordance with subsections 6 and 7 below.

(B) Review of Contingent Consideration Statement by Shareholders' Representative. Within sixty (60) days after the receipt by the Shareholders' Representative of a Contingent Consideration Statement, the Shareholders' Representative will notify Purchaser in writing of any disagreement with respect to the calculation of the Contingent Consideration due. If such notice of disagreement is not received by Purchaser within sixty (60) days after the receipt by the Shareholders' Representative of a Contingent Consideration Statement (or if the Shareholders' Representative sooner provides written notice to Purchaser that the Shareholders' Representative has no objection to such calculations), then the Contingent Consideration Statement sent by Purchaser will be final and conclusive for all purposes.

(C) Disputes Regarding Contingent Consideration Statements.

(i) If the Shareholders' Representative timely delivers a notice of disagreement (the "Disagreement Notice") to the Purchaser as described in the preceding paragraph (B), then

(A) within ten (10) days after the receipt by Purchaser of the Disagreement Notice, the Purchaser shall wire (pursuant to wire instructions of the Shareholders' Representative provided at least three (3) days in advance), readily available funds equal to the amount of the Contingent Consideration reflected on the Contingent Consideration Statement (the "Undisputed Contingent Consideration"); and

(B) beginning on the date of the receipt

by the Purchaser of the Disagreement Notice, the Shareholders' Representative and Purchaser shall commence a 30-day period of good faith negotiations to resolve their disagreement as to the amount of Contingent Consideration that the Shareholders' Representative claims is due in excess of the Undisputed Contingent Consideration (such excess, the "Disputed Contingent Consideration").

(ii) If the Shareholders' Representative and Purchaser are not able to resolve their differences regarding the Disputed Contingent Consideration within the 30-day period described in the preceding paragraph (i), then the Purchaser and the Shareholders' Representative shall immediately submit the dispute for mediation as contemplated by Section 9.8 and shall proceed in good faith to resolve, within 90 days of Purchaser's receipt of the Disagreement Notice, their disagreement as to the amount of the Disputed Contingent Consideration.

(iii) If the Shareholders' Representative and Purchaser are not able to resolve their differences regarding the Disputed Contingent Consideration within the 90-day period described in the preceding paragraph (ii), then the Purchaser, within ten (10) days after Purchaser's receipt of a further written notice from the Shareholders' Representative, shall deposit the full amount of the Disputed Contingent

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Consideration with an escrow agent on escrow terms reasonably and mutually agreeable to the Shareholders' Representative and Purchaser, and such dispute shall be resolved as promptly as reasonably possible in accordance with the dispute resolutions set forth in section 9.8 of this Agreement.

(iv) If the Purchaser fails to (A) timely wire the Undisputed Contingent Consideration, (B) timely deposit the Disputed Contingent Consideration with an escrow agent if the dispute is submitted to arbitration as described in the preceding paragraph (iii), or (C) pay the Disputed Contingent Consideration within ten (10) days after receipt of a further written demand from the Shareholders' Representative following the final decision of arbitrators in favor of the Shareholders' Representative, then the covenants of the Seller and the Shareholders set forth in Section 4.12 of this Agreement shall immediately terminate and be of no further force or effect. If Purchaser Indemnified Parties are entitled to indemnification pursuant to Article 8 and elect, to the extent permitted by Section 8.6 of this Agreement, to offset the amount due pursuant to such claim against Contingent Consideration otherwise payable, then such offset, and consequent non-payment of Contingent Consideration, shall not trigger the termination provisions of this paragraph.

(D) Payment of Contingent Consideration by Purchaser. Within ten (10) days after the earliest of:

(i) the receipt by Purchaser of written notice from the Shareholders' Representative that the Shareholders' Representative has no objection to the calculations, as set forth in a Contingent Consideration Statement; (ii) the expiration of the sixty-day period for giving notice of disagreement with such calculation, if no such notice is timely received by Purchaser; or (iii) the resolution of any dispute pursuant to Section 1.3(a)(ii)(2)(C) above (including Purchaser's receipt of a further written demand by the Shareholders' Representative), Purchaser shall wire (pursuant to wire instructions of the Shareholders' Representative provided at least three (3) days in advance), readily available funds equal to the Contingent Consideration due, if any, for the applicable fiscal year (the tenth day after the earliest of (i), (ii) or (iii) is referred to as the "Payment Date"). If the Payment Date, or any other date on which any payment is due by any party under this Agreement, is not a business day, then the Contingent Consideration due will be due without interest on the first business day following the Payment Date.

(E) Reasonable Audit Rights of Shareholders' Representative. Purchaser shall keep and maintain records of the information directly related to the Contingent Consideration (the "Contingent Consideration Documentation"). The Contingent Consideration Documentation shall be open to inspection at reasonable times (but no more than twice in any fiscal year during the Period) by the Shareholders' Representative and a certified public accountant chosen by the Shareholders' Representative and acceptable to Purchaser, which approval Purchaser will not unreasonably withhold. Such inspection shall be made at the Shareholders' Representative's expense (but may be charged back to the Shareholders pursuant to any agreement between the Shareholders' Representative and the Shareholders). The Shareholders' Representative agrees to hold the Contingent Consideration Documentation confidential; provided, however, that the Shareholders' Representative may permit the Shareholders, the Seller and their respective counsel, accountants and other advisors to review, use and copy the Contingent Consideration Documentation, subject to the foregoing confidentiality obligation. The Contingent Consideration Documentation shall be maintained by the Purchaser and available for inspection in accordance with this Agreement for a period of one (1) year following the end of the Period.

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(3) Fiscal 2001. In preparing the Contingent Consideration Statement with respect to Fiscal 2001 pursuant to the procedures set forth in subsection 2 above, the following shall apply.

(A) Revenue Growth and OIM Surplus. If (X) Revenue in Fiscal 2001 exceeds Revenue in Fiscal 2000 and (Y) Operating Income Margin in Fiscal 2001 exceeds 12.5%, then

(i) A dollar amount shall be arrived at pursuant to the following steps. STEP 1: divide (X) the difference between Revenue in Fiscal 2001 minus Revenue in Fiscal 2000 by (Y) Revenue in Fiscal 2000. STEP 2: multiply the result from Step 1 by 100. STEP 3:

Multiply the result from Step 2 by \$67,000. STEP 4: divide (X) Operating Income in Fiscal 2001 by (Y) Revenue in Fiscal 2001. STEP 5A: multiply the result from Step 4 by 100. STEP 5B: subtract 12.5 from the result from Step 5A. STEP 6: multiply the result from Step 5 by \$200,000. STEP 7: combine the result from Step 3 and the result from Step 6. The result of STEP 7 shall be the Contingent Consideration due with respect to Fiscal 2001.

(ii) The term "Revenue Base" in subsection (4) below shall mean the Revenue in Fiscal 2001.

(B) Revenue Growth and OIM Shortfall. If (X) Revenue in Fiscal 2001 exceeds Revenue in Fiscal 2000 and (Y) Operating Income Margin in Fiscal 2001 is less than 12.5%, then

(i) A dollar amount shall be arrived at pursuant to the following steps. STEP 1: divide (X) the difference between Revenue in Fiscal 2001 minus Revenue in Fiscal 2000 by (Y) Revenue in Fiscal 2000. STEP 2: multiply the result from Step 1 by 100. STEP 3: Multiply the result from Step 2 by \$67,000. STEP 4: divide (X) Operating Income in Fiscal 2001 by (Y) Revenue in Fiscal 2001. STEP 5A: multiply the result from Step 4 by 100. STEP 5B: subtract 12.5 from the result from Step 5A. STEP 6: multiply the result from Step 5 by \$200,000. STEP 7: combine the result from Step 3 and the result from Step 6. If the result of Step 7 is greater than zero (\$0), then such amount shall be the Contingent Consideration due with respect to Fiscal 2001; if the result of Step 7 is less than zero (\$0), then no Contingent Consideration shall be due for Fiscal 2001.

(ii) The term "Revenue Base" in subsection (4) below shall mean the Revenue in Fiscal 2001.

(C) Revenue Shortfall and OIM Surplus. If (X) Revenue in Fiscal 2001 is less than Revenue in Fiscal 2000 and (Y) Operating Income Margin in Fiscal 2001 exceeds 12.5%, then

(i) A dollar amount shall be arrived at pursuant to the following steps. STEP 1: divide (X) the difference between Revenue in Fiscal 2001 minus Revenue in Fiscal 2000 by (Y) Revenue in Fiscal 2001. STEP 2: multiply the result from Step 1 by 100. STEP 3: Multiply the result from Step 2 by \$67,000. STEP 4: divide (X) Operating Income in Fiscal 2001 by (Y) Revenue in Fiscal 2001. STEP 5A: multiply the result from Step 4 by 100. STEP 5B: subtract 12.5 from the result from Step 5A. STEP 6: multiply the result from Step 5 by \$200,000. STEP 7: combine the result from Step 3 and the result from Step 6. If the result of Step 7 is greater than zero (\$0), then such amount shall be the Contingent Consideration due with respect to Fiscal 2001; if the result of Step 7 is less than zero (\$0), then no Contingent Consideration shall be due for Fiscal 2001.

(ii) (X) If the result of Step 7 is greater than zero (\$0), then the term "Revenue Base" in subsection (4) below shall mean Revenue in Fiscal 2001; and (Y) if the result of Step 7 is less than zero (\$0), then the term "Revenue Base" in subsection (4) below shall mean the result arrived at pursuant to the following additional steps. STEP Q: divide the result from Step 6 by \$67,000. STEP R: divide the result from Step Q by 100. STEP S: add 1.00 to the result from Step R. STEP T: divide Revenue in Fiscal 2000 by the result from Step S.

(D) Revenue Shortfall and OIM Shortfall. If (X) Revenue in Fiscal 2001 is less than Revenue in Fiscal 2000 and (Y) Operating Income Margin in Fiscal 2001 is less than 12.5%, then

(i) No Contingent Consideration shall be due for Fiscal 2001.

(ii) The term "Revenue Base" in subsection (4) below shall mean Revenue in Fiscal 2000.

(4) Fiscal 2002. In preparing the Contingent Consideration Statement with respect to Fiscal 2002 pursuant to the procedures set forth in subsection 2 above, the following shall apply.

(A) Revenue Growth and OIM Surplus. If (X) Revenue in Fiscal 2002 exceeds Revenue Base and (Y) Operating Income Margin in Fiscal 2002 exceeds 15.0%, then

(i) A dollar amount shall be arrived at pursuant to the following steps. STEP 1: divide (X) the difference between Revenue in Fiscal 2002 minus Revenue Base by (Y) Revenue Base. STEP 2: multiply the result from Step 1 by 100. STEP 3: Multiply the result from Step 2 by \$67,000. STEP 4: divide (X) Operating Income in Fiscal 2002 by (Y) Revenue in Fiscal 2002. STEP 5A: multiply the result from Step 4 by 100. STEP 5B: subtract 15.0 from the result from Step 5A. STEP 6: multiply the result from Step 5 by \$200,000. STEP 7: combine the result from Step 3 and the result from Step 6. The result of STEP 7 shall be the Contingent Consideration due with respect to Fiscal 2002.

(ii) The term "Revenue Base" in subsection (5) below shall mean the Revenue in Fiscal 2002.

(B) Revenue Growth and OIM Shortfall. If (X) Revenue in Fiscal 2002 exceeds Revenue Base and (Y) Operating Income Margin in Fiscal 2002 is less than 15.0%, then

(i) A dollar amount shall be arrived at pursuant to the following steps. STEP 1: divide (X) the difference between Revenue in Fiscal 2002 minus Revenue Base by (Y) Revenue Base. STEP 2: multiply the result from Step 1 by 100. STEP 3: Multiply the result from Step 2 by \$67,000. STEP 4: divide (X) Operating Income in Fiscal 2002 by (Y) Revenue in Fiscal 2002. STEP 5A: multiply the result from Step 4 by 100. STEP 5B: subtract 15.0 from the result from Step 5A. STEP 6: multiply the result from Step 5 by \$200,000. STEP 7: combine the result from Step 3 and the result from Step 6. If the result of Step 7 is greater than zero (\$0),

then such amount shall be the Contingent Consideration due with respect to Fiscal 2002; if the result of Step 7 is less than zero (\$0), then no Contingent Consideration shall be due for Fiscal 2002.

(ii) The term "Revenue Base" in subsection (5) below shall mean the Revenue in Fiscal 2002.

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(C) Revenue Shortfall and OIM Surplus. If
(X) Revenue in Fiscal 2002 is less than Revenue Base and
(Y) Operating Income Margin in Fiscal 2002 exceeds 15.0%,
then

(i) A dollar amount shall be arrived at pursuant to the following steps. STEP 1: divide (X) the difference between Revenue in Fiscal 2002 minus Revenue Base by (Y) Revenue in Fiscal 2002. STEP 2: multiply the result from Step 1 by 100. STEP 3: Multiply the result from Step 2 by \$67,000. STEP 4: divide (X) Operating Income in Fiscal 2002 by (Y) Revenue in Fiscal 2002. STEP 5A: multiply the result from Step 4 by 100. STEP 5B: subtract 15.0 from the result from Step 5A. STEP 6: multiply the result from Step 5 by \$200,000. STEP 7: combine the result from Step 3 and the result from Step 6. If the result of Step 7 is greater than zero (\$0), then such amount shall be the Contingent Consideration due with respect to Fiscal 2002; if the result of Step 7 is less than zero (\$0), then no Contingent Consideration shall be due for Fiscal 2002.

(ii) (X) If the result of Step 7 is greater than zero (\$0), then the term "Revenue Base" in subsection (5) below shall mean Revenue in Fiscal 2002; and (Y) if the result of Step 7 is less than zero (\$0), then the term "Revenue Base" in subsection (5) below shall mean the result arrived at pursuant to the following additional steps. STEP Q: divide the result from Step 6 by \$67,000. STEP R: divide the result from Step Q by 100. STEP S: add 1.00 to the result from Step R. STEP T: divide Revenue Base by the result from Step S.

(D) Revenue Shortfall and OIM Shortfall. If
(X) Revenue in Fiscal 2002 is less than Revenue Base and
(Y) Operating Income Margin in Fiscal 2002 is less than 15.0%, then

(i) No Contingent Consideration shall be due for Fiscal 2002.

(ii) The term "Revenue Base" in subsection (5) below shall not change and shall have the same meaning as in this subsection (4).

(5) Fiscal 2003. In preparing the Contingent Consideration Statement with respect to Fiscal 2003 pursuant to the procedures set forth in subsection 2 above, the following shall apply.

(A) Revenue Growth and OIM Surplus. If (i) Revenue in Fiscal 2003 exceeds Revenue Base and (ii) Operating

Income Margin in Fiscal 2003 exceeds 17.5%, then a dollar amount shall be arrived at pursuant to the following steps. STEP 1: divide (X) the difference between Revenue in Fiscal 2003 minus Revenue Base by (Y) Revenue Base. STEP 2: multiply the result from Step 1 by 100. STEP 3: Multiply the result from Step 2 by \$67,000. STEP 4: divide (X) Operating Income in Fiscal 2003 by (Y) Revenue in Fiscal 2003. STEP 5A: multiply the result from Step 4 by 100. STEP 5B: subtract 17.5 from the result from Step 5A. STEP 6: multiply the result from Step 5 by \$200,000. STEP 7: combine the result from Step 3 and the result from Step 6. The result of STEP 7 shall be the Contingent Consideration due with respect to Fiscal 2003.

(B) Revenue Growth and OIM Shortfall. If
(i) Revenue in Fiscal 2003 exceeds Revenue Base and
(ii) Operating Income Margin in Fiscal 2003 is less than 17.5%, then a dollar amount shall be arrived at pursuant to the following steps. STEP 1: divide (X) the difference between Revenue in Fiscal 2003 minus Revenue Base by (Y) Revenue Base. STEP 2: multiply the result from Step 1 by 100. STEP 3: Multiply the result from Step 2 by \$67,000. STEP 4: divide (X) Operating Income in Fiscal 2003 by (Y) Revenue in Fiscal 2003. STEP 5A: multiply the result from Step 4 by 100. STEP 5B: subtract 17.5 from the result from Step 5A. STEP 6: multiply the result from Step 5 by \$200,000. STEP 7: combine the result from Step 3 and the result from Step 6. If the result of Step 7 is

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greater than zero (\$0), then such amount shall be the Contingent Consideration due with respect to Fiscal 2003; if the result of Step 7 is less than zero (\$0), then no Contingent Consideration shall be due for Fiscal 2003.

(C) Revenue Shortfall and OIM Surplus. If
(i) Revenue in Fiscal 2003 is less than Revenue Base and
(ii) Operating Income Margin in Fiscal 2003 exceeds 17.5%, then a dollar amount shall be arrived at pursuant to the following steps. STEP 1: divide (X) the difference between Revenue in Fiscal 2003 minus Revenue Base by (Y) Revenue in Fiscal 2003. STEP 2: multiply the result from Step 1 by 100. STEP 3: Multiply the result from Step 2 by \$67,000. STEP 4: divide (X) Operating Income in Fiscal 2003 by (Y) Revenue in Fiscal 2003. STEP 5A: multiply the result from Step 4 by 100. STEP 5B: subtract 17.5 from the result from Step 5A. STEP 6: multiply the result from Step 5 by \$200,000. STEP 7: combine the result from Step 3 and the result from Step 6. If the result of Step 7 is greater than zero (\$0), then such amount shall be the Contingent Consideration due with respect to Fiscal 2003; if the result of Step 7 is less than zero (\$0), then no Contingent Consideration shall be due for Fiscal 2003.

(D) Revenue Shortfall and OIM Shortfall. If
(i) Revenue in Fiscal 2003 is less than Revenue Base and
(ii) Operating Income Margin in Fiscal 2003 is less than 17.5%, then no Contingent Consideration shall be due for Fiscal 2003.

(6) Fiscal and Period Ceilings. In preparing the Contingent Consideration Statements pursuant to the procedures set forth in subsection 2 above, and notwithstanding any

provision of this Agreement, the parties acknowledge and agree as follows.

(A) In no case shall the Purchaser be required to pay Contingent Consideration of more than six million dollars (\$6,000,000) with respect to any one fiscal year during the Period.

(B) The total Contingent Consideration payable pursuant to this Agreement shall not exceed twelve million dollars (\$12,000,000).

(7) Certain Capital Expenditures and Other Matters. The parties further acknowledge and agree as follows.

(A) Certain post-Closing capital expenditures of the Purchaser, including capital expenditures and other operating costs, may be advantageous to development of the Business subsequent to the Closing Date. Accordingly, upon the mutual written agreement of the Shareholders' Representative and the Parent, certain post-Closing expenditures shall be excluded from the relevant calculations in preparing the Contingent Consideration Statements. However, absent fraud, Parent's refusal to agree to such exclusions shall be unfettered and not subject to challenge pursuant to the dispute resolution provisions of this Agreement or otherwise.

(B) Notwithstanding Section 7(A), the parties agree that interest charged on advances or other indebtedness owed by Purchaser to Parent, whether pursuant to the Management Agreement or otherwise, shall be excluded entirely from the relevant calculations in preparing the Contingent Consideration Statements.

(C) Notwithstanding Section 1.3(a)(ii)(B) above, the parties agree that, for purposes of determining the amount of Contingent Consideration payable to the Seller, the amount of any rental income received by or for the benefit of the Purchaser during the Period shall be credited against, and shall reduce the amount of, lease expense attributed to the Purchaser (it being the intention of the parties that the receipt by or for the benefit of Purchaser of any rental income shall have the effect of increasing the amount of

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Operating Income for the fiscal year in which the rental income is received, insofar as such rental income is not already reflected in the Operating Income as reflected in the audited financial statements for such fiscal year.)

(iii) the assumption by the Purchaser of the Assumed Liabilities as of the Closing Date pursuant to the Liabilities Undertaking referred to in Section 1.2 hereof;

(iv) minus the amount, if any, by which the difference between (A) total assets (as determined in accordance with GAAP) of the Business as of the Closing Date minus (B) total liabilities (as determined in accordance with GAAP) of the Business as of the Closing Date is less than two hundred forty-two thousand dollars (\$242,000) (the "Net Assets Adjustment"). In addition, up to \$100,000 of reasonable business expenses incurred by the Seller in the ordinary

course after June 30, 2001 shall be excluded from the total liabilities component of the preceding calculation in this paragraph (iv).

For the purposes of determining the amount of the Purchase Price to be paid at the Closing, the amount of the Net Assets Adjustment (the "Purchase Price Adjustment") will be based on the amounts shown on the Latest Balance Sheet, unless a more recent balance sheet is available, in which case the more recent balance sheet will be used to determine such amounts. The Purchase Price Adjustment so determined will be referred to herein as the "Initial Purchase Price Adjustment." After the Closing, final Purchase Price Adjustment will be determined in accordance with Section 1.3(c) below.

(b) At the Closing, the Purchaser will:

(i) pay Seller, by wire transfer, immediately available funds equal to 95% of the Initial Cash Consideration to a bank account of Seller pursuant to written instructions of Seller given to the Purchaser at least 48 hours prior to the Closing; provided, however, that the parties acknowledge Purchaser's tender to Seller, prior to or concurrent with the execution of this Agreement, of an aggregate of \$25,000 at the signing of the letter of intent relating to this Agreement (the "Earnest Deposit"), and such Earnest Deposit will be applied toward the amount due at Closing under this paragraph;

(ii) Deposit, on behalf of Seller, an amount equal to 5% of the Initial Cash Consideration (the "Escrow Deposit") with U.S. Bank, N.A. or another escrow agent mutually acceptable to Seller and the Purchaser (the "Escrow Agent") under the escrow agreement (the "Escrow Agreement"), a copy of which is attached as Exhibit 1.3(b)(ii) hereto, which Escrow Deposit will be retained and disbursed by the Escrow Agent under the terms of the Escrow Agreement; and

(iii) execute and deliver to Seller, the Liabilities Undertaking.

(c) After the Closing Date, the Purchase Price Adjustment will be determined as follows:

(i) Seller will prepare and deliver to the Purchaser within 30 days following the Closing Date (or as soon thereafter as practicable) a balance sheet for the Business as of the opening of business on the Closing Date (the "Closing Balance Sheet"). The Closing Balance Sheet will be used to determine the Purchase Price Adjustment for purposes of determining the Purchase Price for the Assets (the "Final Basic Purchase Price").

(ii) The Closing Balance Sheet will be prepared in accordance with GAAP, applied consistently with the principles, practices and procedures used in the preparation of the Latest Balance Sheet. Seller and the Purchaser will provide each other with full cooperation in connection with the preparation of the Closing Balance Sheet, and each will have the right to review the supporting work papers in connection with the preparation of the Closing Balance Sheet.

(iii) Within 30 days after the parties' receipt of the Closing Balance Sheet, the Purchaser will notify Seller as to whether it disagrees with any of the amounts included in the Closing Balance

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Sheet. If such notice is not given, the Closing Balance Sheet will be final and conclusive for all purposes. If the parties are unable to

resolve their differences within 60 days of their receipt of the Closing Balance Sheet, the Purchaser and Seller agree to retain the accounting firm of PricewaterhouseCoopers to arbitrate the dispute and render a decision within 30 days of such retention, which decision will be final and binding for all purposes. Any award pursuant to this Section 1.3(c)(iii) may be entered in and enforced by any court having jurisdiction over the matter, as described in Section 9.8(a). The Purchaser, on the one hand, and Seller, on the other hand, will each pay one-half of the actual and reasonable costs of services rendered by said accounting firm.

(iv) Within five days after the expiration of the 30-day period for giving notice of disagreement with the accountants' finding, if no such notice is given, or within five days after the resolution of disputes, if any, pursuant to Section 1.3(c)(iii) above, the Purchase Price Adjustment will be determined using the Closing Balance Sheet and the formulas set forth in Section 1.3(a)(iv)--(vi) (the "Final Purchase Price Adjustment") and the Purchase Price will be determined using the Final Purchase Price Adjustment. The Purchaser or Seller, as appropriate, will by wire transfer in immediately available funds make payment to the other of any appropriate amounts, such that after such payments, and taking into account amounts previously received by Seller pursuant to Section 1.3(b) hereof, the Purchaser will have paid Seller the Purchase Price (other than the Contingent Consideration, if any is earned).

1.4. Allocation of Purchase Price.

The Purchase Price will be allocated among the Assets in the manner required by Section 1060 of the Internal Revenue Code of 1986, as amended (the "Code"). The parties recognize that due to the potential adjustment to the Purchase Price referenced in Section 1.3(c) of this Agreement, the allocations set forth in Exhibit 1.4 hereto are an estimate. Accordingly, in making the final, actual allocation, the estimated allocations set forth in Exhibit 1.4 attached hereto will be binding and apply; provided, however, that during the 90-day period following Closing, and in connection with finalization of the Purchase Price pursuant to Section 1.3(c) of this Agreement, the Purchaser and Seller will negotiate in good faith to refine Exhibit 1.4 to reflect the actual values of the Assets and the resulting modified and final allocation of the Purchase Price among the various Assets. Such final determination (or the estimate in Exhibit 1.4 if the parties cannot in good faith agree to any modification) will be binding on the Purchaser only for the purposes of U.S. federal, state and local taxation. The Purchaser and Seller will file all Tax Returns and tax reports (including IRS Form 8594) in accordance with and based upon such final allocation (or the estimate in Exhibit 1.4 if the parties cannot in good faith agree to any modification) and will take no position in any Tax Return, tax proceeding or tax audit which is inconsistent with such allocation.

1.5. Closing.

Concurrently with execution of this Agreement, a closing (the "Closing") will be held at such time and place as the parties may agree upon (the "Closing Date"). At the Closing, the documents and instruments necessary or appropriate to effect the transactions contemplated herein will be exchanged by the parties.

1.6. Instruments of Transfer to Purchaser.

(a) At the Closing, Seller will deliver to the Purchaser such bills of sale, endorsements, assignments, deeds and other good and sufficient instruments of conveyance and transfer, in form and substance reasonably satisfactory to the Purchaser and its counsel, as will be required to vest in the Purchaser title to the Assets, including without

limitation:

(i) bills of sale executed by Seller vesting in the Purchaser good and marketable title to all of the personal property of Seller included in the Assets, substantially in the form attached as Exhibit 1.6(a)(i) hereof;

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(ii) appropriate endorsements and assignments of the contracts, licenses, agreements, permits, plans, commitments and other binding arrangements included in the Assets;

(iii) all written and electronic data relating to the Assets, property and goodwill included in the Business; and

(iv) to the extent owned or used by Seller all copies of the source code and object code and all documentation relating thereto for all computer software programs included in the Assets.

(b) Seller will take all other actions necessary to put the Purchaser in actual possession and operating control of the Assets.

(c) At the Closing, Purchaser and Parent will deliver to Seller such assumption agreements and similar documents, in form and substance reasonably satisfactory to Seller, as will be required to effect Purchaser's assumption of all of the Assumed Contracts and other Assumed Liabilities on and as of the Closing Date and to fulfill the other obligations of Purchaser and Parent contemplated by this Agreement, including, but not limited to:

(i) the Liabilities Undertaking; and

(ii) a Security Agreement, substantially in the form of Exhibit 1.6(c)(ii).

2. REPRESENTATIONS AND WARRANTIES OF THE SELLER AND THE SHAREHOLDERS Seller and the Shareholders, jointly and severally, hereby represent and warrant to the Purchaser and Parent as of the date hereof as follows (provided, however, that the representations and warranties made by and with respect to any individual Shareholder in Sections 2.3, 2.4, 2.5, 2.8, 2.13, 2.24 or 2.26 are made solely by such Shareholder):

2.1. Disclosure Schedule.

The disclosure schedule attached as Exhibit 2 hereto (the "Disclosure Schedule") is divided into sections which correspond to the sections of this Article 2. The Disclosure Schedule is accurate and complete. Nothing in the Disclosure Schedule will be deemed adequate to disclose an exception to a representation or warranty made herein, unless the Disclosure Schedule identifies the exception with reasonable particularity and describes the relevant facts in reasonable detail. Without limiting the generality of the foregoing, the mere listing (or inclusion of a copy) of a document or other item will not be deemed adequate to disclose an exception to a representation or warranty made herein (unless the representation or warranty has to do with the existence of the document or other item itself).

2.2. Corporate Organization.

Seller is a corporation duly organized, validly existing and in good standing under the laws of the State of Utah with requisite corporate power and corporate authority to carry on the Business as it is now being conducted by Seller and to own, operate and lease its properties and assets

used in the conduct of the Business. Seller is duly qualified or licensed to do business as a foreign corporation in good standing in every other jurisdiction in which the character or location of the properties and assets owned, leased or operated by it in the conduct of the Business or the conduct of the Business, itself, requires such qualification or licensing, except those jurisdictions in which the failure to be qualified or licensed would not have a Material Adverse Effect on the Business. The Disclosure Schedule contains a list of all jurisdictions in which Seller is qualified or licensed to do business as a result of the Business.

2.3. Authorization.

Seller has full corporate power and corporate authority to enter into this Agreement and to carry out the transactions contemplated herein. The execution and delivery of this Agreement and the consummation of the transactions contemplated herein have been duly and validly authorized by the board of directors of Seller and the Shareholders, and no other corporate proceedings on the part of Seller are necessary therefor. Seller has taken all action required by law, its articles of incorporation and its bylaws, and otherwise to authorize the execution, delivery and performance of this Agreement

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and the consummation of the transactions contemplated herein. This Agreement has been duly and validly executed and delivered by Seller and the Shareholders and is the valid and binding legal obligation of Seller and the Shareholders, enforceable against them in accordance with its terms, subject to bankruptcy, insolvency, reorganization, moratorium and other similar laws of applicability relating to or affecting creditors' rights and general principles of equity. The Shareholders, and each of them, have the legal capacity to enter into this Agreement and to carry out the transactions contemplated by this Agreement, including without limitation the legal capacity to execute, deliver and perform the agreements or contracts, if any, required to be executed and delivered by any of them in connection with the Closing.

2.4. Non-Contravention.

Except as set forth in the Disclosure Schedule, neither the execution, delivery and performance of this Agreement nor the consummation of the transactions contemplated herein will: (i) violate or be in conflict with any provision of the articles of incorporation or bylaws of Seller; (ii) be in conflict with, or constitute a default, however defined (or an event which, with the giving of due notice or lapse of time, or both, would constitute such a default), under, or cause or permit the acceleration of the maturity of, or give rise to any right of termination, cancellation, imposition of material fees or penalties under any of the following if (A) listed or required to be listed in the Disclosure Schedule or (B) otherwise material to the Business: any debt, note, bond, lease, mortgage, indenture, license, obligation, contract, commitment, franchise, permit, instrument or other agreement or obligation to which Seller or the Shareholders is a party or by which Seller or the Shareholders, or any of their properties or assets is or may be bound; (iii) result in the creation or imposition of any mortgage, pledge, lien, security interest, conditional or installment sales agreement, encumbrance, claim, easement, right of way, tenancy, covenant, encroachment, restriction or charge of any kind of nature (whether or not of record) (a "Lien"), other than (A) mechanics', carriers', workers' or other like liens arising in the ordinary course of business; (B) minor imperfections of title which do not individually or in the aggregate, impair the continued use and operation of the real property assets and fixtures to which they relate in the operation of the Business as currently conducted; and (C) liens for current taxes not yet due and payable ("Permitted Liens"), upon the Assets, under any Assumed Contract or

any debt, obligation, contract, agreement or commitment to which Seller is a party or by which Seller or any of the Assets is or may be bound; or (iv) violate any statute, treaty, law, judgment, writ, injunction, decision, decree, order, regulation, ordinance or other similar authoritative matters (referred to herein individually as a "Law" and collectively as "Laws") of any foreign, federal, state or local governmental or quasi- governmental, administrative, regulatory or judicial court, department, commission, agency, board, bureau, instrumentality or other authority (referred to herein individually as an "Authority" and collectively as "Authorities").

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2.5. Consents and Approvals.

Except as set forth in the Disclosure Schedule, with respect to Seller and the Shareholders, no consent, approval, order or authorization of or from, or registration, notification, declaration or filing (referred to herein individually as a "Consent" and collectively as "Consents") with any individual or entity, including without limitation any Authority, is required in connection with the execution, delivery or performance of this Agreement by Seller or the Shareholders, or the consummation by Seller or the Shareholders of the transactions contemplated herein.

2.6. Financial Statements.

The Disclosure Schedule contains true and complete copies of an audited balance sheet of the Business as of February 28, 2001 and the related statements of earnings, changes in stockholders' equity, and cash flows, for the fiscal year then ended, and the unaudited balance sheet of the Business as of June 30, 2001, and its related statements of operations (or income or loss) for the Business for the fiscal year to date period and month then ended. Except as disclosed therein, the foregoing financial statements (i) are in accordance with the books and records of Seller; and (ii) fairly present, in all material respects, the financial position of the Business as of the respective dates thereof, and its results of operations (or income or loss) for the periods then ended.

2.7. Absence of Undisclosed Liabilities.

Except as and to the extent (i) reflected on or reserved for in the Latest Balance Sheet, (ii) set forth on the Disclosure Schedule or (iii) incurred in the ordinary course of business after the date of the Latest Balance Sheet and not material in amount (none of which results from, arises out of, relates to, is in the nature of, or was caused by any breach of contract, breach of warranty, tort, infringement or violation of Law), either individually or in the aggregate, neither Seller nor any Shareholder has any debt, liability or obligation of any kind whatsoever relating to the Business, whether known or unknown, secured or unsecured, accrued or unaccrued, fixed or contingent, matured or unmatured, direct or indirect, absolute, contingent, unasserted or otherwise, and whether due or to become due (referred to herein as a "Liability" and collectively as "Liabilities").

2.8. Absence of Certain Changes.

Except as set forth in the Disclosure Schedule, since the date of the Latest Balance Sheet, Seller has owned or operated the Assets in the ordinary course of business and consistent with past practice. Without limiting the generality of the foregoing, subject to the foregoing exceptions neither Seller nor any Shareholder has, since the date of the Latest Balance Sheet:

- (a) experienced any change which has had a Material Adverse Effect

on the Business or experienced any event or failed to take any action which reasonably could be expected to result in a Material Adverse Effect on the Business;

(b) suffered, in connection with or related to the Business, any material loss, damage, destruction of property used in the conduct of the Business or other casualty to property used in the conduct of the Business (whether or not covered by insurance);

(c) suffered any loss of officers, directors, partners, employees, dealers, distributors, independent contractors, customers or suppliers which had or may reasonably be expected to result in a Material Adverse Effect on the Business;

(d) (i) increased in any manner the compensation of any of the officers, employees, consultants and others who provide services to the Business; (ii) paid or agreed to pay any pension, retirement allowance or other employee benefit not required or permitted by any existing plan, agreement or arrangement to any such officer, employee, consultant or other person, whether past or present of the Business; (iii) except in connection with any written arrangement approved by the Purchaser, committed the Business to any additional pension, profit-sharing, bonus, incentive, deferred

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compensation, group insurance, severance pay, retirement or other employee benefit plan, agreement or arrangement, or to any employment agreement or consulting agreement (arising out of prior employment) with or for the benefit of any person providing services to the Business; (iv) terminated, entered into, adopted, instituted or otherwise become subject to or amend any collective bargaining agreement; or (v) amended any of such plans or any of such agreements in existence on the date of this Agreement;

(e) incurred, assumed, suffered or become subject to, whether directly or by way of guarantee or otherwise, any Liabilities which, individually or in the aggregate, have or would have a Material Adverse Effect on the financial conditions of the Business or the condition of the Assets;

(f) paid, discharged or satisfied any Liabilities of the Business other than the payment, discharge or satisfaction in the ordinary course of the Business and consistent with past practice;

(g) sold, transferred, or otherwise disposed of any material Assets, other than inventory in the ordinary course of the Business and consistent with past practice;

(h) permitted or allowed any of the Assets to be subjected to any Lien, except for Permitted Liens;

(i) written down the value of any Inventory (including write-downs by reason of shrinkage or mark-down), except for immaterial write-downs in the ordinary course of the Business and consistent with past practice;

(j) canceled or amended any debts, waived any claims or rights or sold, transferred or disposed of any of the Assets, other than Inventory in the ordinary course of the Business;

(k) licensed, sold, transferred, pledged, modified, disclosed, disposed of or permitted to lapse any rights to the use of any of the Intellectual Property Rights (except as necessary in the conduct of the Business);

(l) made or entered into any commitment for capital expenditures for additions to property, plant, equipment or intangible capital assets of the Business in excess of \$25,000;

(m) paid, lent or advanced any amount to, or sold, transferred, disposed of or leased any of the properties or assets (real, personal or mixed, tangible or intangible) used in connection with the Business to, or entered into any agreement or arrangement with, any officer, director, employee or any other person providing services to the Business;

(n) terminated, entered into or amended in any material respect any contract, agreement, lease, license or commitment identified in the Disclosure Schedule, or taken any action or omitted to take any action which will cause a breach, violation or default (however defined) under any such items, except in the ordinary course of the Business and consistent with past practice;

(o) acquired for the Business any material business or assets of any other person or entity;

(p) permitted any of current insurance (or reinsurance) policies relating to the Business to be canceled or terminated or any of the coverage thereunder to lapse, unless simultaneously with such termination, cancellation or lapse, replacement policies providing coverage equal to or greater than coverage remaining under those canceled, terminated or lapsed are in full force and effect;

(q) suffered any adverse change in the Business' relationship with any customer, including the loss of any such customer;

(r) entered into other agreements, commitments or contracts not in the ordinary course of the Business or in excess of current requirements;

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(s) modified, amended or terminated any Assumed Contract, or waived, released relinquished or assigned any Assumed Contract or other right or claim;

(t) settled or compromised any material suit, claim or dispute or threatened material suit, claim or dispute;

(u) made any change in the accounting methods, principles or practices used in connection with the Business except as required or permitted by GAAP, including revenue recognition methodologies; or

(v) agreed in writing or otherwise to take any of the foregoing actions or any action which would make any representation or warranty in this Agreement untrue or incorrect in any material respect.

2.9. Assets.

(a) Except as set forth in the Disclosure Schedule, Seller has good and marketable title to all of the Assets owned by Seller and a valid leasehold interest in all of the Assets leased by Seller, in each case free and clear of any Lien, other than Permitted Liens.

(b) Seller has full right and power to, and at the Closing will, convey to the Purchaser good title to (or the valid right to use) all of the Assets, free and clear of any Lien, other than Permitted Liens.

(c) The machinery, equipment, vehicles and other personal property used by Seller in the Business are in good operating condition and repair,

normal wear and tear excepted, and fit for the intended purposes thereof. Such machinery, vehicles and other personal property has been maintained in accordance with Seller's standard maintenance procedures and no material maintenance, replacement or repair has been deferred or neglected.

(d) Except as set forth in the Disclosure Schedule, all real properties included in the Latest Balance Sheet or acquired after the date thereof by Seller, and all real properties leased by Seller (collectively, the "Real Property"), are free from any structural defects, in good operating condition and repair, with no material maintenance, repair or replacement having been deferred or neglected, suitable for the intended use, and free from other material defects, normal wear and tear accepted. Except as set forth on the Disclosure Schedule, each such Real Property and its present use conform in all respects to all occupational, safety or health, zoning, planning, subdivision, platting and similar Laws. Except as set forth on the Disclosure Schedule, all public utilities necessary for the use and operation of any facilities on the Real Property are available for use or access at such Real Property and there is no legal or physical impairment to free ingress or egress from any of such facilities or Real Property. With respect to the leased Real Property, the Disclosure Schedule includes termination/renewal provisions of such leasehold interest, and the amount of rent and/or royalty to be paid under the terms of such leases. All such leasehold interests are valid and in full force and effect and enforceable in accordance with their terms, subject to the effect of applicable bankruptcy, reorganization, insolvency, moratorium, fraudulent conveyance, and other laws affecting the rights of creditors generally or the availability of specific performance, injunctive relief and other equitable remedies. There does not exist any violation, breach or default, of or under such leasehold interest. Except as set forth in the Disclosure Schedule, no such leasehold interest contains any provision that would be triggered or cause a breach or a right to terminate such leasehold interests upon a change in control (or change in ownership) of the lessee. Except as set forth in the Disclosure Schedule, the lease by and between the Seller and 613S, LLC for the real property located at 643 South 400 West, Salt Lake City, Utah is freely assignable by the Seller to the Purchaser without the consent of the landlord or any other person. Upon such assignment to, and assumption by, the Purchaser, the Purchaser will be entitled to all of the benefits of such lease and the terms of such lease will be binding upon the landlord.

(e) The Assets constitute all of the material property and assets, real, personal and mixed, tangible and intangible, presently used to carry on the Business of Seller, and the Assets are adequate to carry on the Business of Seller as presently conducted.

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(f) Neither Seller nor any Shareholder is a foreign person or is controlled by a foreign person, as the term foreign person is defined in Section 1445(f)(3) of the Code.

2.10. Inventories.

Except as set forth in the Disclosure Schedule, all inventory used in the Business (the "Inventory") are of a quality and quantity usable in the ordinary course of the Business, and the present quantities of Inventory used in the Business are reasonable.

2.11. Receivables and Payables

(a) The Disclosure Schedule contains a listing of all of the receivables, if any, of Seller relating to the Business as of July 31, 2001. Except as set forth on the Disclosure Schedule, (i) Seller has good right, title and interest in and to all of its trade accounts receivable

and notes receivable relating to the Business; (ii) none of such trade accounts receivable and notes receivable is subject to any Lien, other than Permitted Liens; (iii) all of the trade accounts receivable and notes receivable owing to Seller constitute valid and enforceable claims arising from bona fide transactions in the ordinary course of business, and there are no known claims, refusals to pay or other rights of set-off against any thereof; (iv) no account or note debtor is delinquent in payment by more than 30 days; (v) the aging schedule of the trade accounts receivable and notes receivable accounts of Seller attached to the Disclosure Schedule is complete and accurate; and (vi) the reserve established by Seller on the Latest Balance Sheet is adequate to cover any doubtful accounts.

(b) The Disclosure Schedule contains a listing of all trade accounts payable and notes payable of Seller relating to the Business as of the date first set forth above in this Agreement. All such trade accounts payable and notes payable arose from bona fide transactions in the ordinary course of the Business and, except as set forth on the Disclosure Schedule, no such account payable or note payable is delinquent by more than 30 days in its payment.

2.12. Intellectual Property Rights.

(a) The Disclosure Schedule contains a listing of all (i) patents, patent applications (collectively the "Patents"), (ii) copyrights, copyright applications (the "Copyrights"), (iii) tradenames, registered and common law trademarks, trademark applications (the "Trademarks"), (iv) service marks, service mark applications (the "Service Marks"), and (v) computer programs and other computer software, trade secrets, plans and specifications, inventions, know-how, technology, proprietary processes and formulae (the "Trade Secrets") necessary or used in connection with the Assets and for the conduct of the Business (the Patents, Copyrights, Trademarks, Service Marks and Trade Secrets are collectively referred to as "Intellectual Property Rights"). All issued Patents and registered Copyrights, Trademarks and Service Marks are collectively referred to as the "Registered Intellectual Property Rights." The Intellectual Property Rights are sufficient to conduct the Business as presently conducted and as proposed to be conducted.

(b) Except as set forth in the Disclosure Schedule, Seller owns, has the unrestricted right to use and has sole and exclusive possession of and has good and valid title to, or sufficient license or other rights to, all of the Intellectual Property Rights, free and clear of all Liens.

(c) All Registered Intellectual Property Rights owned by Seller are in compliance with formal legal requirements (including the payment of filing, examination and maintenance fees and proofs of working or use), are valid and enforceable and, except as set forth on the Disclosure Schedule, are not subject to any maintenance fees or taxes or actions falling due within 90 days after the Closing Date. All Patents issued to Seller are valid and enforceable and no Patents have been or are now involved in any interference, reissue, reexamination, opposition, declaratory judgment or other invalidating proceeding, nor, to the Knowledge of Seller is any such action threatened with respect to any of the Patents. To the Knowledge of Seller, no application for a potentially infringing patent has been filed and no potentially infringing patent has been issued. To the Knowledge of Seller, no Trademarks have

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been or are involved in any opposition, invalidation or cancellation proceeding and, there is no basis for the commencement of any such proceeding. The Trademarks owned by Seller are valid and enforceable and no person holds any infringing or potentially infringing trademark and, to the Knowledge of Seller, no application for any infringing or potentially

infringing trademark has been made.

(d) Copies of all material documentation relating to the Trade Secrets have been furnished to the Purchaser. Such documentation is current, accurate, complete in all material respects. To the Knowledge of Seller, no Trade Secrets owned by Seller are part of the public domain or literature or have been used, divulged or appropriated for the benefit of any person or entity other than Seller or to the detriment of Seller. Seller has taken reasonable measures and precautions to protect the secrecy, confidentiality and value of the Trade Secrets owned by Seller.

(e) Except as set forth on Section 2.12(C) of the Disclosure Schedule, the use of all Intellectual Property Rights necessary or required for the conduct of the Business as presently conducted and as proposed to be conducted does not and will not infringe or violate any trade secrets, plans and specifications, patents, copyrights, tradenames, registered and common law trademarks, trademark applications, service marks, service mark applications, computer programs and other computer software, inventions, know-how, technology, proprietary processes and formulae or other intellectual property rights of any other person or entity (the "Third Party Intellectual Property Rights"). Neither Seller nor any Shareholder nor any of their respective employees, contractors, consultants or agents is using any confidential information or trade secrets of others in the conduct of the Business.

(f) All agreements relating to licenses of Intellectual Property Rights granted by or to Seller or any of their respective subsidiaries, officers, directors and stockholders and relating to the Business are set forth on the Disclosure Schedule. Except as set forth on the Disclosure Schedule, all such licenses set forth on the Disclosure Schedule are in good standing, valid and effective in accordance with their respective terms and there is not, under any of such licenses, any existing default or event of default (or event which with notice or lapse of time, or both, would constitute a default, or would constitute a basis for a claim of force majeure or other claim of excusable delay or non-performance), in each case by Seller or by any other party thereto. There are no outstanding and, to the Knowledge of Seller, no threatened disputes or disagreements with respect to any such agreement.

(g) Except as set forth on the Disclosure Schedule, neither Seller nor any Shareholder is obligated or under any Liability whatsoever to make any payments by way of royalties, fees or otherwise to any owner of, licensor of, or other claimant to, any Intellectual Property Rights or Third Party Intellectual Property Rights.

(h) Except as set forth on the Disclosure Schedule, all employees, contractors and consultants of Seller involved in the technical or scientific aspects of the Business have executed written agreements with Seller which assign to Seller, as the case may be, all rights to any inventions, improvements, discoveries or information which relate to the Business. No employee, contractor or consultant of Seller has entered into any agreement which restricts or limits in any way the scope or type of work in which such employee, contractor or consultant may be engaged or requires such employee, contractor or consultant to transfer, assign or disclose information concerning such employee's, contractor's or consultant's work to anyone other than Seller.

(i) Except as set forth in the Disclosure Schedule, the software, hardware, and firmware used by Seller in the Business are Year 2000 Compliant and are sufficient for operation of the Business. The term "Year 2000 Compliant" as used in the preceding sentence, means that no operational, financial, data transmission, communication or process has been or will be materially affected or materially

interrupted by dates prior to, during or after the Year 2000, and in particular, without prejudice to the generality of the foregoing that:

(i) no value for current date has caused or will cause any interruption in operation;

(ii) all manipulation of time related data has been produced and will continue to produce the required results for all valid date values prior to, during and after the Year 2000;

(iii) if the date elements in interfaces and data storage specify the century, they have permitted and will continue to permit specifying the correct century either explicitly or by unambiguous algorithms or inferencing rules; and where any date element is represented without a century, the correct century has been unambiguous and will continue to be unambiguous for all manipulations involving that element; and

(iv) Year 2000 has been and will continue to be recognized as a leap year.

2.13. Litigation.

Except as set forth in the Disclosure Schedule, there is no legal, administrative, arbitration, or other proceeding, suit, claim or action of any nature or investigation, review or audit of any kind (including without limitation a proceeding, suit, claim or action, or an investigation, review or audit, involving any environmental Law or matter), judgment, decree, decision, injunction, writ or order pending, or, to the Knowledge of Seller, noticed, scheduled, threatened or contemplated (a) by or against or involving Seller, any Shareholder, the Assets or Seller's officers, directors, agents or employees (but only in their capacity as such), whether at law or in equity, before or by any person or entity or Authority relating to the Business, or (b) which questions or challenges the validity of this Agreement or any action taken or to be taken by the parties hereto pursuant to this Agreement or in connection with the transactions contemplated herein.

2.14. Tax Matters.

(a) Seller has properly completed and duly filed on a timely basis (or a valid extension has been obtained and the extension period has not expired) and in form and substance that is, in all material respects, correct, all Tax Returns required to be filed on or prior to the date hereof with respect to Taxes of Seller (or relating to the Business). As of the time of filing, the foregoing Tax Returns correctly reflected, in all material respects, the facts regarding the income, business, assets, operations, activities, status or other matters of Seller or any other information required to be shown thereon. There is no material omission, deficiency, error, misstatement or misrepresentation, whether innocent, intentional or fraudulent, in any Tax Return filed by Seller for any period. Any Tax Returns filed by or on behalf of Seller or any Shareholder after the date hereof, but including periods through the Closing Date, will conform with the provisions of this Section 2.14.

(b) With respect to all amounts of Taxes imposed upon Seller, or for which Seller is or could be liable, whether to taxing Authorities (as, for example, under Law) or to other persons or entities (as, for example, under tax allocation agreements), with respect to all taxable periods or portions of periods ending on or before or including the Closing Date, all applicable Tax Laws and agreements have been or will be complied with, and all such amounts of Taxes required to be paid by Seller to taxing Authorities or others on or before the date hereof have been duly paid or will be paid on or before the Closing Date. There are no Liens affecting

any of the Assets arising out of, connected with, or related to Taxes other than Liens arising under Law for Taxes not yet due and payable. Seller has withheld and remitted all amounts required to be withheld and remitted by them in respect of Taxes.

(c) Except as set forth in the Disclosure Schedule, neither the federal Tax Returns of the Seller nor any state, local or foreign Tax Return of Seller has been examined by the Internal Revenue Service or any similar state, local or foreign Authority, and, except to the extent shown therein, all deficiencies asserted as a result of such examinations have been paid or finally settled and no issue has been raised

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by the Internal Revenue Service or any similar state, local or foreign Authority in any such examination which, by application of similar principles, reasonably could be expected to result in a proposed deficiency for any other period not so examined. Except as set forth in the Disclosure Schedule, all deficiencies and assessments of Taxes of Seller resulting from an examination of any Tax Returns by any Authority have been paid and there are no pending examinations currently being made by any Authority nor has there been any written or oral notification to Seller of any intention to make an examination of any Taxes by any Authority. Except as set forth in the Disclosure Schedule, there are no outstanding agreements or waivers extending the statutory period of limitations applicable to any Tax Return for any period.

(d) For purposes of computing Taxes and the filing of Tax Returns, neither Seller nor any Shareholder has failed to treat as "employees" any individual providing services to the Business who would be classified as an "employee" under the applicable rules or regulations of any Authority with respect to such classification.

2.15. Benefit Plans.

(a) Section 2.15 of the Disclosure Schedule lists each pension, welfare, incentive, deferred compensation, equity-based compensation, perquisite, paid time off, severance or other benefit plan, policy or practice covering current or former employees of the Business or their spouses, dependents, family members, domestic partners or beneficiaries (a "Benefit Plan"). With respect to each Benefit Plan, Seller has made available to Purchaser the current Plan document or a complete and accurate description of the Plan.

(b) Seller does not and could not have any liability arising directly or indirectly under Section 412 of the Internal Revenue Code of 1986, as amended (the "Code") or Section 302 or Title IV of ERISA.

(c) Seller does not and could not have any liability arising directly or indirectly to or with respect to any "multiemployer plan" within the meaning of Section 4001(a)(3) of ERISA.

(d) Seller does not and could not have any liability arising directly or indirectly in connection with any failure of Seller or any affiliate of Seller to comply with Section 4980B of the Code or Part 6 of Subtitle B of Title I of ERISA.

(e) Nothing has occurred or failed to occur with respect to any Benefit Plan which could result in any liability to Purchaser or any affiliate of Purchaser other than a liability expressly assumed pursuant to this Agreement.

(f) Except as set forth in Section 2.15(f) of the Disclosure Schedule, there are no facts or circumstances which could, directly or

indirectly, subject Parent, the Purchaser or any of their respective affiliates to any liability of any nature with respect to any pension, welfare, incentive, deferred compensation, perquisite, paid time off, severance or other benefit plan, policy, practice or agreement sponsored, maintained or contributed to by the Seller or any affiliate, to which the Seller or any affiliate is a party or with respect to which the Seller or any affiliate could have any liability (a "Seller Plan").

2.16. Powers of Attorney.

There are no persons or entities holding general or special powers of attorney from Seller relating to the Business.

2.17. Contracts and Commitments; No Default.

(a) The Disclosure Schedule contains an accurate and complete list of:

(i) All real property in which Seller has a leasehold or other interest and which is included in the Assets or which is used by Seller in connection with the operation of the Business, together with a list identifying each lease, sublease, license, or any other instrument under which Seller

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claims or holds such leasehold or other interest or right to the use thereof or pursuant to which Seller has assigned, sublet or granted any rights therein, identifying the parties thereto, the rental or other payment terms, expiration date and cancellation and renewal terms thereof, has been delivered to the Purchaser.

(ii) All machinery, tools, equipment, motor vehicles and other tangible personal property (other than inventory and supplies), owned, leased or used by Seller in the conduct of the Business and included in the Assets, except for items having a cost of less than \$5,000. Seller has provided the Purchaser with either a copy of or a summary description of all leases and Liens relating thereto, identifying the parties thereto, the rental or other payment terms, expiration date and cancellation and renewal terms thereof.

(iii) All contracts, agreements and commitments not fully performed, in respect of the issuance, sale or transfer of capital stock, bonds, or other securities of Seller or pursuant to which Seller has acquired any Asset material to the Business, regardless of cost.

(iv) All contracts, agreements, commitments or understandings that restrict Seller from carrying on the Business or any part thereof anywhere in the world or from competing in any line of business with any person or entity.

(v) All purchase or sale contracts or agreements that call for aggregate purchases or sales in excess over the course of such contract or agreement of \$25,000 or which continues for a period of more than 12 months (including without limitation periods covered by any option to renew or extend by either party) which is not terminable on 60 days' or less notice without cost or other Liability at or any time after the Closing.

(vi) Any contract, commitment, agreement or arrangement with any "disqualified individual" (as defined in Section 280G(c) of the Code) which contains any severance or termination pay liabilities which would result in a disallowance of the deduction for any "excess

parachute payment" (as defined in Section 280G(b)(1) of the Code) under Section 280G of the Code.

(vii) All Assumed Contracts.

(viii) The names and current annual salary rates of all employees of and consultants to the Business, showing separately for each such person the amounts paid or payable as salary, bonus payments and any indirect compensation for the fiscal year ended February 28, 2001, as well as the vacation time, holiday time and sick pay due each such employee and consultant as of the date of this Agreement.

(ix) All collective bargaining agreements, employment and consulting agreements, executive compensation plans, bonus plans, deferred compensation agreements, employee option or purchase plans, other employee arrangements or commitments, whether or not legally binding, including without limitation, holiday, vacation, paid time-off, Christmas and other bonus practices, to which Seller is a party or is bound and which relates to employees or consultants of the Business or the operation of the Business.

(x) All imaging, scanning, coding, pricing agreements, schedules and other contracts or agreements with customers for services provided in the Business.

(b) The Assumed Contracts and all other contracts, agreements, leases, licenses and commitments required to be listed on the Disclosure Schedule (other than those which have been fully performed), are valid and binding, enforceable in accordance with their respective terms in all material respects, except as enforcement might be limited by bankruptcy and other laws related to creditors' rights and principles of equity, and are in full force and effect. Except as otherwise specified in the Disclosure Schedule, the Assumed Contracts are validly assignable to the Purchaser without the consent of any other party so that, after the assignment thereof to the Purchaser pursuant hereto, the Purchaser will

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be entitled to the full benefits thereof (subject to the performance thereof by Purchaser). Except as disclosed in the Disclosure Schedule, none of the payments required to be made under any Assumed Contract has been prepaid more than 30 days prior to the due date of such payment thereunder. Except as set forth in the Disclosure Schedule, neither Seller nor any Shareholder is in material breach, violation or default, however defined, in the performance of any of their obligations under any Assumed Contract or any other contract, agreement, lease, license or commitment required to be listed on the Disclosure Schedule, and no facts and circumstances exist which, whether with the giving of due notice, lapse of time, or both, would constitute such a material breach, violation or default thereunder or thereof. None of the Assumed Contracts is, either when considered singly or in the aggregate with others, materially adverse, unduly burdensome, or onerous to the Business or likely, either before or after the Closing, to result in any material loss or liability to the Business. Except as set forth in the Disclosure Schedule, none of the Assumed Contracts is subject to renegotiation with any government body. True and complete copies of all of the Assumed Contracts (together with any and all amendments thereto) have been delivered to the Purchaser.

2.18. Orders, Commitments and Returns.

Except as set forth in the Disclosure Schedule, all accepted and unfulfilled orders for the sale of products and the performance of services entered into by Seller relating to the Business and all outstanding material contracts or material commitments for the purchase of supplies,

materials and services were made in bona fide transactions in the ordinary course of the Business. Except as set forth in the Disclosure Schedule, Seller has not received any claims against Seller to return products of the Business by reason of alleged over-shipments, defective products or otherwise, or of products in the hands of customers, retailers or distributors under an understanding that such products would be returnable. To the Knowledge of Seller, neither Seller nor any Shareholder is subject to any outstanding sales or purchase contracts, commitments or proposals relating to the Business which is anticipated to result in a loss upon completion or performance thereof.

2.19. Labor Matters.

Except as set forth in the Disclosure Schedule, in connection with the Business:

(a) Seller is and has been in compliance in all material respects with all applicable Laws respecting employment and employment practices, terms and conditions of employment and wages and hours, including without limitation any such Laws respecting employment discrimination and occupational safety and health requirements, and has not and is not engaged in any unfair labor practice;

(b) there is no unfair labor practice complaint against Seller pending or to the Knowledge of Seller, threatened before the National Labor Relations Board or any other comparable Authority;

(c) there is no labor strike, dispute, slowdown or stoppage actually pending or to the Knowledge of Seller, threatened against or directly affecting Seller and the Business;

(d) no labor representation question exists respecting the employees of the Business and there is not pending or to the Knowledge of Seller, threatened any activity intended or likely to result in a labor representation vote respecting the employees of the Business;

(e) to the Knowledge of Seller during the last 12 months, there has been no attempt by either employees of the Business, any labor organization, or others to organize the employees of the Business into a labor union or to provide for other labor representation;

(f) no grievance or any arbitration proceeding arising out of or under collective bargaining agreements is pending and no claims therefor exist or, to the Knowledge of Seller, have been threatened;

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(g) no collective bargaining agreement is binding and in force against Seller or currently being negotiated by Seller relating to the Business;

(h) Seller has not experienced any significant work stoppage or other significant labor difficulty relating to the Business;

(i) Seller is not delinquent in payments to any persons performing services for the Business for any wages, salaries, commissions, bonuses or other direct or indirect compensation for any services performed by them or amounts required to be reimbursed to such persons, including without limitation any amounts due under any Seller Plan, including any Benefit Plan;

(j) upon termination of the employment of any person, neither Seller, any Shareholder the Purchaser, nor any affiliate of the Purchaser will, by reason of anything done at or prior to or as of the Closing Date,

be liable to any of such persons for so-called "severance pay" or any other payments; and

(k) within the twelve-month period prior to the date of the Agreement, there has not been any expression of intention to Seller by any officer or key employee (including but not limited to area and district managers) of the Business to terminate such employment.

2.20. Compliance with Law; Permits and Other Operating Rights.

Except as set forth in the Disclosure Schedule, and without limiting the scope of any other representations or warranties contained in this Agreement, but without intending to duplicate the scope of such other representations and warranties, the assets, properties, business and operations of the Business, are and have been in compliance with all Laws applicable to the assets, properties, business and operations of the Business. Except as set forth in the Disclosure Schedule, neither Seller nor any Shareholder requires the Consent of any Authority to permit the Business to operate in the manner in which it is presently being operated. Seller possesses all material permits, licenses and other authorizations from all Authorities necessary to permit Seller to operate the Business in the manner in which Seller presently conducts it, and the consummation of the transactions contemplated by this Agreement will not prevent the Purchaser from being able to continue to use such permits and operating rights.

2.21. Environmental and Safety Matters.

Except as set forth on the Disclosure Schedule:

(a) Neither Seller, any Shareholder any subsidiary or former subsidiary of Seller, nor, to the Knowledge of Seller, any previous owner, tenant, occupant or user of any property owned or leased by or to Seller and used in connection with the Business, or by or to any subsidiary or former subsidiary (the "Properties") engaged in or permitted, direct or indirect operations or activities upon, or any use or occupancy of the Properties, or any portion thereof, for the purpose of or in any way involving the handling, manufacture, treatment, storage, use, generation, emission, release, discharge, refining, dumping or disposal of any Environmentally Regulated Materials (whether legal or illegal, accidental or intentional, direct or indirect) on, under, in or about the Properties, or transported any Environmentally Regulated Materials to, from or across the Properties, nor are any Environmentally Regulated Materials presently constructed, deposited, stored, placed or otherwise located on, under, in or about the Properties. The Properties do not contain any: (i) underground or aboveground storage tanks; (ii) asbestos; (iii) equipment using PCBs; (iv) underground injection wells; or (v) septic tanks in which process waste water or any Environmentally Regulated Materials have been disposed.

(b)

(i) No violation or noncompliance with Environmental and Occupational Safety and Health Laws has occurred with respect to the Properties or operations conducted thereon during the period in which Seller operated such Properties and conducted such operations; Seller has

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obtained all permits, licenses and authorizations required by, and Seller, the Seller and the Properties are in compliance with, all Environmental and Occupational Safety and Health Laws including, without limitation, all applicable restrictions, conditions,

standards, limitations, prohibitions, requirements, obligations, schedules and timetables contained in the Environmental and Occupational Safety and Health Laws or contained in any regulation, code, plan, order, decree, judgment, injunction, notice or demand letter issued, entered, promulgated or approved thereunder;

(ii) no enforcement, investigation, cleanup, removal, remediation or response or other governmental or regulatory actions have been, or could have been at any time in the past, asserted or threatened (A) with respect to operations conducted by Seller on the Properties or, (B) against Seller or any of its subsidiaries or former subsidiaries with respect to or in any way regarding the Properties pursuant to any Environmental and Occupational Safety and Health Laws; and

(iii) no claims or settlements relating to or arising out of Environmental and Occupational Safety and Health Laws or Environmentally Regulated Materials, have been made or, to the Knowledge of Seller, been threatened by any third party, including any Authority, nor, to the Knowledge of Seller, does there exist any basis for any such claim (any such enforcement, investigation, cleanup, removal, remediation or response, other governmental or regulatory action, claim or settlement is herein referred to as an "Environmental Claim") against Seller, the Seller or any of their respective subsidiaries or former subsidiaries with respect to the Properties or operations conducted thereon, or with respect to the Properties or the operations thereon.

(c) With regard to Seller, there are no past or present events, conditions, circumstances, activities, practices, incidents, actions or plans which may interfere with or prevent compliance or continued compliance with Environmental and Occupational Health and Safety Laws, as in effect on the Closing Date.

2.22. Insurance.

The Disclosure Schedule contains a listing of all policies of fire and other casualty, general liability, theft, life, workers' compensation, health, directors and officers, business interruption and other forms of insurance owned or held by Seller and relating to the Business, identifying the insurer, the policy number, the risk insured against, the term of the coverage, the limits of coverage, the deductible amount (if any), the premium rate, the date through which coverage will continue by virtue of premiums already paid and, in the case of any "claims made" coverage, the same information as to predecessor policies for the previous five years. All present policies are in full force and effect and all premiums with respect thereto have been paid. Seller has not been denied any form of insurance and no policy of insurance has been revoked or rescinded during the past five years, except as described on the Disclosure Schedule.

2.23. Brokers.

Except as set forth in Schedule 2.23 of the Disclosure Schedule, neither Seller, the Shareholders nor any of Seller's or any Shareholder's directors, officers, shareholders, agents or employees has employed any broker, finder, or financial advisor or incurred any liability for any brokerage fee or commission, finder's fee or financial advisory fee, in connection with the transactions contemplated hereby, nor is there any basis for any such fee or commission to be claimed by any person or entity.

2.24. Absence of Certain Business Practices.

Neither Seller, any Shareholder nor any director, officer, partner, employee or agent of Seller, nor any other person acting on their behalf, has, directly or indirectly, within the past five years given or agreed to give any gift or similar benefit to any customer, supplier, governmental

employee or other person who is or may be in a position to help or hinder Seller (or assist Seller in connection with any

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actual or proposed transaction) which: (i) might subject Seller, any Shareholder the Purchaser, Parent or the Purchaser's or Parent's affiliates to any damage or penalty in any civil, criminal or governmental litigation proceeding; (ii) if not given in the past, might have had a Material Adverse Effect on the Business; or (iii) if not continued in the future, might materially adversely affect the Business or which might subject Seller, any Shareholder the Purchaser, Parent or the Purchaser's or Parent's affiliates to suit or penalty in any private or governmental litigation or proceeding.

2.25. Business Generally.

Except as set forth in the Disclosure Schedule, there has been no event, transaction or information which has come to the attention of Seller which would, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect on the Business. Without limiting the generality of the foregoing, except as set forth in the Disclosure Schedule, there has not been in the 12-month period prior to the date hereof any change in the business relationship of Seller with any customer, dealer or supplier to the Business which may reasonably be expected to have a Material Adverse Effect on the Business.

2.26. Transactions with Certain Persons.

Except as set forth in the Disclosure Schedule, during the past three years, neither Seller nor any Shareholder has, directly or indirectly, purchased, leased or otherwise acquired any property or obtained any services from, or sold, leased or otherwise disposed of any property or furnished any services to in connection with the Business, or otherwise dealt with, in the ordinary course of the Business or otherwise in connection with the Business, any affiliate or associate of Seller or any member, shareholder, or partner of any affiliate or associate of Seller (except with respect to compensation in the ordinary course of the Business for services rendered as a director, officer, employee or consultant of Seller). Neither Seller nor any Shareholder owes any amount to, or has any agreement or contract with or commitment to, any of its partners, directors, officers, employees or consultants or any affiliate or associate thereof (other than compensation for current services not yet due and payable and reimbursement of expenses arising in the ordinary course of business), and none of such persons owes any amount to Seller.

2.27. Customers.

Except as set forth on the Disclosure Schedule, there has not been in the 12-month period prior to the date hereof, any dispute with any customer of the Business, or any set of circumstances, either of which is reasonably anticipated to have a Material Adverse Effect on the relationship between Seller and any customer or which may reasonably be expected to have a Material Adverse Effect on the Business. Except as set forth on the Disclosure Schedule, neither Seller nor any Shareholder is aware of any circumstances that could materially and adversely affect the ability of any customer of the Business to continue doing business with Seller in the manner in which such business has been conducted in the past or commence doing business with the Purchaser or Parent.

3. REPRESENTATIONS AND WARRANTIES OF PURCHASER AND PARENT.

The Purchaser and the Parent, jointly and severally, represent and warrant to Seller as of the date hereof as follows:

3.1. Corporate Organization.

Each of the Parent and the Purchaser is a corporation duly organized, validly existing and in good standing under the laws of the State of Delaware.

3.2. Authorization.

Each of the Purchaser and the Parent has all the requisite corporate power and authority to enter into this Agreement and to carry out the transactions contemplated herein. Each of the boards of

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directors of the Purchaser and the Parent has taken all action required by law, its articles of incorporation and bylaws or otherwise to authorize the execution, delivery and performance of this Agreement and the consummation of the transactions contemplated herein and no action of the stockholders of the Purchaser or the Parent is required. This Agreement is a valid and binding legal obligation of the Purchaser and the Parent enforceable against each of them in accordance with its terms subject to bankruptcy, insolvency, reorganization, moratorium and other similar laws of applicability relating to or affecting creditors' rights and general principals of equity.

3.3. Consents and Approvals.

No Consent is required by any person or entity, including without limitation any Authority, in connection with the execution, delivery and performance by the Purchaser and the Parent of this Agreement, or the consummation of the transactions contemplated herein, other than any Consent which, if not made or obtained, will not, individually or in the aggregate, have a Material Adverse Effect on the business of the Purchaser or the Parent.

3.4. Brokers.

Except for its agreement with U.S. Bancorp Piper Jaffray, neither the Purchaser, the Parent nor any of their officers, directors or employees have employed any broker, finder, or financial advisor or incurred any liability for any brokerage fee or commission, finder's fee or financial advisory fee, in connection with the transactions contemplated hereby, nor is there any basis known to the Purchaser or the Parent for any such fee or commission to be claimed by any person or entity.

3.5. Litigation.

Except as disclosed to Seller in writing prior to the execution of this Agreement, there is no legal, administrative arbitration or other proceeding, suit, claim or action of any nature or investigation, review or audit of any kind, judgment, decree, decision, injunction, writ or order pending or, to the knowledge of Purchaser threatened or contemplated by or against or involving Purchaser, Parent or their respective officers, directors, agents or employees (but only in their capacity as such) whether at law or in equity, before or by any person, entity or Authority, which (a) questions or challenges the validity of this Agreement or any action taken or to be taken by the parties hereto pursuant to this Agreement or in connection with the transactions contemplated herein or (b) is material to the business and operations of Parent and all its affiliates (including Purchaser) taken as a whole.

3.6. Securities Filings.

The Parent has filed all reports, registration statements, forms and other documents that it is required to file with the United States Securities and Exchange Commission or any exchange on which it is traded or reporting service through which any of its securities are quoted, including without limitation all filings required by the Securities Act of 1933, as amended, and any rules promulgated thereunder (the "Parent SEC Filings"). At the time filed, none of the Parent SEC Filings included any untrue statement of material fact or omitted a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading.

4. COVENANTS OF THE PARTIES.

4.1. {Intentionally Omitted}

4.2. {Intentionally Omitted}

4.3. {Intentionally Omitted}

4.4. Confidentiality.

Each of the parties hereto agrees that it will not use, or permit the use of, any of the information relating to any other party hereto furnished to it in connection with the transactions contemplated herein ("Information") in a manner or for a purpose detrimental to such other party or otherwise than

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in connection with the transaction, and that they will not disclose, divulge, provide or make accessible (collectively, "Disclose"), or permit the Disclosure of, any of the Information to any person or entity, other than their respective directors, officers, governors, managers, employees, investment advisors, accountants, counsel and other authorized representatives and agents, except as may be required by judicial or administrative process or, in the opinion of such party's counsel, by other requirements of Law; provided, however, that prior to any Disclosure of any Information permitted hereunder, the disclosing party will first obtain the recipients' undertaking to comply with the provisions of this subsection with respect to such information. The term "Information" as used herein will not include any information relating to a party which the recipient of such information can show: (i) to have been in its possession prior to its receipt from another party hereto; (ii) to be now or to later become generally available to the public through no fault of the recipient; (iii) to have been available to the public at the time of its receipt by the recipient; (iv) to have been received separately by the recipient in an unrestricted manner from a person entitled to disclose such information; or (v) to have been developed independently by the recipient without regard to any information received in connection with this transaction. Each party hereto also agrees to promptly return to the party from whom it originally received such information all original and duplicate copies of materials in any media containing Information should the transactions contemplated herein not occur. A party hereto will be deemed to have satisfied its obligations to hold the Information confidential if it exercises the same care as it takes with respect to its own similar information.

4.5. Filings; Consents; Removal of Objections.

Subject to the terms and conditions herein provided, the parties hereto will use their respective good faith best efforts to take or cause to be taken all actions and do or cause to be done all things necessary, proper or advisable under applicable Laws to consummate and make effective, as soon as reasonably practicable, the transactions contemplated hereby, including without limitation obtaining all Consents of any person or

entity, whether private or governmental, required in connection with the consummation of the transactions contemplated herein. In furtherance, and not in limitation of the foregoing, it is the intent of the parties to consummate the transactions contemplated herein at the earliest practicable time, and they respectively agree to exert their respective good faith best efforts to that end, including without limitation: (i) the removal or satisfaction, if possible, of any objections to the validity or legality of the transactions contemplated herein; and (ii) the satisfaction of the conditions to consummation of the transactions contemplated hereby.

4.6. Further Assurances; Cooperation; Notification; Management Agreement.

(a) Each party hereto will, at and after Closing, execute and deliver such instruments and take such other actions as the other party or parties, as the case may be, may reasonably require in order to carry out the intent of this Agreement. Without limiting the generality of the foregoing, at any time after the Closing, at the reasonable request of the Purchaser and without further consideration, Seller and the Shareholders will execute and deliver such instruments of sale, transfer, conveyance, assignment and confirmation and take such action as the Purchaser may reasonably deem necessary or desirable in order to more effectively consummate the transactions contemplated hereby and to vest in the Purchaser good and marketable title to, all of the Assets (to the extent contemplated by this Agreement), to put the Purchaser in actual possession and operating control thereof and to assist the Purchaser in exercising all rights with respect thereto, without unreasonable cost or expense to Seller or the Shareholders.

(b) Seller and the Shareholders will cooperate with the Purchaser to promptly develop plans for the management of the Business after the Closing, including without limitation plans relating to productivity, marketing, operations and improvements, and Seller and the Shareholders will further cooperate with the Purchaser to provide for the implementation of such plans as soon as practicable after the Closing. Subject to applicable Law, Seller and the Shareholders will confer on a regular and

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reasonable basis with one or more representatives of the Purchaser to report on material operational matters and the general status of ongoing operations.

(c) At all times from the date hereof until the Closing, each party will promptly notify the other in writing of the occurrence of any event which it reasonably believes will or may result in a failure by such party to satisfy the conditions specified in Article 5 and Article 6 hereof.

(d) Each party hereto will, at and after the Closing, comply with the terms and provisions of the management agreement for the operation of the Business and Assets during Fiscal 2001, Fiscal 2002 and Fiscal 2003 attached hereto as Exhibit 4.6(d) (the "Management Agreement").

4.7. {Intentionally Omitted}

4.8. Public Announcements.

None of the parties hereto will make any public announcement with respect to the transactions contemplated herein without the prior written consent of the other party, which consent will not be unreasonably withheld or delayed; provided, however, that any of the parties hereto may at any time make any announcements which are required by applicable Law so long as the party so required to make an announcement promptly upon learning of

such requirement notifies the other party of such requirement and discusses with the other party in good faith the exact proposed wording of any such announcement.

4.9. Tax Matters.

(a) No new elections with respect to Taxes, or any changes in current elections with respect to Taxes, affecting the Assets will be made after the date of this Agreement without the prior written consent of the Parent or the Purchaser.

(b) As a condition precedent to the consummation of the transactions contemplated by this Agreement, Seller and the Shareholders will provide the Purchaser with any clearance certificate or similar document(s) which may be required by any state taxing authority in order to relieve the Purchaser of any obligation to withhold any portion of the Purchase Price.

(c) In addition to and without limiting those representations and warranties set forth in Section 2.14 of this Agreement, in the event that any sales or use Tax, or any Tax in the nature of a sales or use tax, or any transactional Tax is payable or assessed relative to the transactions contemplated herein, Seller and the Shareholders will pay all such Taxes and will not collect any part thereof from the Purchaser or the Parent. The parties hereto will cooperate to make any necessary filings with state and local or foreign taxing Authorities and to furnish any required supplemental information with respect to any state and local or foreign Tax liabilities resulting from the consummation of the transactions contemplated herein.

(d) In addition to and without limiting those representations and warranties set forth in Section 2.14 of this Agreement, Seller and the Shareholders will pay all Taxes arising from or relating to the transactions contemplated by this Agreement, including without limitation Tax on any income or gains arising from the sale of the Assets; but excluding any Taxes attributed to the income of Parent or Purchaser. Seller and the Shareholders will cause to be prepared and filed all federal, foreign and state income Tax Returns for the Business reflecting all activities of the Business through and including the Closing Date.

(e) Seller and the Shareholders, on the one hand, and the Purchaser, on the other hand, will:

(i) each provide the other with such assistance as may reasonably be requested by any of them in connection with the preparation of any Tax Return, audit or other examination by any taxing Authority or judicial or administrative proceedings relating to liability for Taxes,

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(ii) each retain and provide the other with any records or other information which may be relevant to such Tax Return, audit or examination, proceeding or determination, and

(iii) each provide the other with any final determination of such audit or examination, proceeding or determination that affects any amount required to be shown on any Tax Return of the other for any period.

Without limiting the generality of the foregoing, Seller, the Shareholders and the Purchaser will retain, until the applicable statutes of limitations (including all extensions) have expired, copies of all Tax Returns, supporting work schedules and other records

or information which may be relevant to such Tax Returns for all Tax periods or portions thereof ending on or before the Closing Date and will not destroy or otherwise dispose of any such records without first providing the other party with a reasonable opportunity to review and copy the same.

4.10. Bulk Transfers.

Seller and the Shareholders have requested and the Purchaser has, subject to its indemnification rights, agreed to waive the requirements of the Uniform Commercial Code concerning bulk transfers, as in effect in the various states in which Seller and the Shareholders have assets used in the Business, including without limitation the requirement of notice to creditors.

4.11. Employee Benefits.

(a) On or as soon as administratively practicable after the Closing Date, the Purchaser will extend offers of immediate employment to employees of the Business listed on Exhibit 4.11 hereto (the "Selected Employees"). Except as otherwise expressly provided in this Agreement, the terms and conditions of each such offer and of any continuing employment will be determined by the Purchaser in its sole discretion and any resulting employment relationship will be at will; provided, however, that Purchaser shall, to the fullest extent permitted under applicable laws, recognize accrued vacation and other employment benefits of the Selected Employees that are based upon periods of service with Seller and that constitute Assumed Liabilities. Any employee of the Business who accepts such an employment offer and reports for work on the date directed by the Purchaser will be sometimes hereinafter referred to as a "Transferred Employee." Seller and the Shareholders hereby authorize the Purchaser to enter into discussions with any of the Selected Employees concerning the future employment of such individual by the Purchaser; provided, however, that (i) such discussions will not be commenced prior to the giving of notice by Seller or the Shareholders to the employees of the Business of the transactions contemplated by this Agreement; and (ii) all such discussions will be conducted in such a manner as not to interfere unreasonably with the operations of the Business.

(b) {Reserved}

(c) {Reserved}

(d) The Purchaser will not be obligated under, and hereby specifically disclaims any assumption or liability with respect to, any collective bargaining agreement to which Seller is a party or under which Seller's or any Shareholder's employees or former employees are covered or any Seller Plan, including any Benefit Plan. Without limiting the generality of the foregoing, (i) the Purchaser is not assuming any obligation to contribute to, or any obligation or liability for any withdrawal liability arising in connection with, any "multiemployer plan" within the meaning of Section 4001(a)(3) of ERISA, attributable to participation therein by current or former employees of Seller as a result of this Agreement or the transactions contemplated hereby, and (ii) with respect to each current or former employee of Seller, the Seller or any affiliate and each other individual who is a "qualified beneficiary" with respect to such current or former employee in connection with a "group health plan" maintained by Seller, the Seller or any affiliate (as such terms are defined in Section 4980B of the Code), as between the Purchaser, on the one hand, and Seller, on the other hand, Seller are responsible for providing group health plan continuation coverage in accordance with Section 4980B of the Code and

Part 6 of Subtitle B of Title I of ERISA (without regard to whether the Purchaser is ultimately determined to be responsible to provide such coverage to any such current or former employee) and will indemnify, defend and hold harmless the Purchaser and its affiliates from and against any liability, expense, cost, tax or obligation of any nature with respect to such current or former employee or other individual arising in connection with group health plan coverage required under Section 4980B of the Code or Part 6 of Subtitle B of Title I of ERISA.

4.12. Covenant Not to Compete; Non-Solicitation.

(a) In order that the Purchaser and the Parent may have and enjoy the benefit of the transactions contemplated in this Agreement, each of Seller and the Shareholders covenants and agrees that, for a period expiring on the earlier to occur of (i) four (4) years from the Closing Date or (ii) one (1) year after the entire Contingent Consideration has been earned (as determined pursuant to Section 1.3(a)(ii)(2) and, if necessary, Section 9.8 (such that, for instance, if the Shareholders' Representative claims that the Contingent Consideration is fully earned on February 28, 2003, the Parent contests such claim in an arbitration resolved favorably to the Shareholders on May 1, 2003, then the Restricted Period will expire February 28, 2004 rather than May 1, 2004)) (the "Restricted Period"), neither they nor any of their affiliates will, directly or indirectly, within any geographical area or territory in the United States, own, manage, operate or control, or participate in the ownership, management, operation or control of, or have any interest in, as a stockholder, member, director, governor, manager, officer, employee, agent, consultant or partner, any business of the type engaged in or contemplated by the Business; provided, however, that nothing contained herein will prohibit them from owning less than 4% of any class of securities listed on a national securities exchange or traded publicly in the over-the-counter market.

(b) During the Restricted Period, neither Seller, any Shareholder nor any of their respective affiliates will call upon, solicit, contact or serve: (i) any of the clients, customers, vendors or suppliers of the Business existing as such on or before the last date of the Restricted Period; (ii) any clients, customers, vendors or suppliers that have had a relationship with Seller or any Shareholder relating to the Business during the twelve (12) months preceding expiration of the Restricted Period; or (iii) any potential clients, customers, vendors or suppliers that were solicited by Seller or any Shareholder in connection with the Business during the twelve (12) months preceding expiration of the Restricted Period.

(c) During the Restricted Period, neither Seller, any Shareholder nor any of their respective affiliates will employ or attempt to employ (by soliciting or assisting anyone else in the solicitation of) any of the Selected Employees or the Purchaser's or the Parent's then employees on behalf of any other entity, whether or not such entity competes with Seller, any Shareholder the Purchaser or the Parent.

(d) The invalidity or unenforceability of any provision of this Section 4.12, in whole or by virtue of the following sentence in part, will not affect the validity or enforceability of any other provision of this Section 4.12 or of any other provision of this Agreement, all of which will to the full extent consistent with applicable law continue in full force and effect. In addition, if any provision of Section 4.12(a) are adjudged to be excessively broad as to duration, geographical scope, activity or subject, the parties intend that such provision will be deemed modified to the minimum degree necessary to make such provision valid and enforceable under applicable law and that such modified provision will thereafter be enforced to the fullest extent possible. Each of Seller and the Shareholder acknowledges that any violation of any of the provisions of Section 4.12(a) is likely to cause irreparable damage to the Purchaser and the Parent and

it is agreed that the Purchaser and the Parent will be entitled to equitable relief, including injunction and specific performance, in the event of any violation of such provision.

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(e) Notwithstanding the foregoing provisions of this Section 4.12, if the Purchaser fails to (A) timely wire the Contingent Consideration as contemplated by Section 1.3(ii)(2)(D)(i) or (ii) above, (B) timely wire the Undisputed Contingent Consideration, (C) timely deposit the Disputed Contingent Consideration with an escrow agent as described in Section 1.3(a)(ii)(2)(C)(iii), or (D) pay the Disputed Contingent Consideration within ten (10) days after receipt of a further written demand from the Shareholders' Representative following the final decision of arbitrators in favor of the Shareholders' Representative, then (i) the covenants of the Seller and the Shareholders set forth in this Section 4.12 shall immediately terminate and be of no further force or effect, and (ii) with respect to Purchaser and the Parent, Seller and each of the Shareholders shall have no further obligation, covenant, restriction or limitation as to (A) their ownership, management, operation or control of any business, enterprise or other operation, or (B) any solicitation, contact, service, or other communication with any client, customer, vender, supplier or other party having any contact or relationship with the Business. If Purchaser Indemnified Parties are entitled to indemnification pursuant to Article 8 and elect, to the extent permitted by Section 8.6 of this Agreement, to offset the amount due pursuant to such claim against Contingent Consideration otherwise payable, then such offset, and consequent non-payment of Contingent Consideration, shall not trigger the termination provisions of this paragraph.

4.13. {Intentionally Omitted}

5. {INTENTIONALLY OMITTED}

6. {INTENTIONALLY OMITTED}

7. {INTENTIONALLY OMITTED}

8. SURVIVAL AND INDEMNIFICATION.

8.1. Survival of Representations, Warranties and Covenants; Investigation.

All representations and warranties of the parties contained in this Agreement will survive the Closing Date for a period expiring on March 1, 2004 (other than the representations and warranties set forth in Section 2.9(a), 2.12(b), which survive for a period of five (5) years after the date of this Agreement and the representations and warranties set forth in Sections 2.14, 2.15 and 2.20 which survive until the expiration of the applicable statute of limitations plus three months). The covenants, agreements and obligations contained herein and in the exhibits hereto will survive the Closing without limitation as to time unless the covenant or agreement specifies the term, in which case such covenant or agreement will survive until the expiration of such specified term and will thereupon expire. The right to indemnification or any other remedy based on representations, warranties, covenants and obligations in this Agreement will not be affected by any investigation conducted with respect to, or any knowledge acquired (or capable of being acquired) at any time, whether before or after the execution and delivery of this Agreement or the Closing Date, with respect to the accuracy or inaccuracy of or compliance with, any such representation, warranty, covenant or obligation.

8.2. Indemnification by the Purchaser and Parent.

Subject to the provisions of Section 8.5, the Purchaser and Parent agree, jointly and severally, to indemnify, defend and hold Seller and the Shareholders harmless from and against any and all losses, liabilities, obligations, demands, judgments, settlements, damages (but excluding consequential damages, lost profits or punitive damages suffered directly by the Seller or Shareholders as opposed to consequential damages, lost profits or punitive damages paid by the Seller or any Shareholder to a third party) or expense (including but not limited to interest, penalties, fees and reasonable professional fees and expenses) and against all claims in respect thereof (including, without limitation, amounts paid in settlement and costs of investigation) or diminution in value, whether or not involving a third-party claim (collectively as "Seller's Loss" or "Seller's Losses") to which Seller or the Shareholders may suffer or incur, directly or indirectly, as a result from or in connection with:

(a) any untrue representation of, or breach of warranty by, the Purchaser or Parent in any part of this Agreement;

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(b) the breach of or nonfulfillment of any covenant, agreement or undertaking of the Purchaser or Parent in this Agreement;

(c) the operation of the Assets or the Business after the Closing Date (including, without limitation, any obligation for Taxes associated with the Business or the Assets for any period (or portion thereof) subsequent to the Closing Date and any obligation of Parent or Purchaser for Taxes, regardless of the period to which they are attributable; and

(d) any failure of Purchaser or Parent to pay or perform Assumed Liabilities or to pay any portion of the Purchase Price, including, but not limited to, the Contingent Consideration, if and to the extent earned and payable.

8.3. Indemnification by Seller and the Shareholders.

Subject to the provisions of Section 8.5, Seller and the Shareholders agree, jointly and severally (provided that the following indemnity shall be several with respect to any Purchaser's Loss relating to a breach of a representation or warranty relating exclusively to a Shareholder under Sections 2.3, 2.4, 2.5, 2.8, 2.13, 2.24 or 2.26), to indemnify the Purchaser and Parent, their respective subsidiaries and affiliates and each of their respective shareholders, officers, directors and employees (the "Purchaser Indemnified Parties") against all losses, liabilities, obligations, demands, judgments, settlements, damages (but excluding any claims for consequential damages, lost profits or punitive damages suffered directly by the Purchaser or Parent as opposed to consequential damages, lost profits or punitive damages paid by the Purchaser to a third party), Taxes, or expenses (including, but not limited to, interest, penalties, fees, and reasonable professional fees and expenses) and against all claims in respect thereof (including, without limitation, amounts paid in settlement and costs of investigation) or diminution in value, whether or not involving a third-party claim (herein referred to collectively as "Purchaser's Losses" or individually as a "Purchaser's Loss") to which the Purchaser or Parent may become subject to or which it may suffer or incur, directly or indirectly, as a result from or in connection with:

(a) any untrue representation of or breach of warranty, by Seller or the Shareholders in any part of this Agreement;

(b) the breach of or nonfulfillment of any covenant, agreement or undertaking of Seller or the Shareholders in this Agreement;

(c) any debt, liability or obligation, direct or indirect, fixed, contingent or otherwise not included in the Assumed Liabilities, that relates to Seller or the Shareholders and is based upon or arises from any act or omission, transaction, circumstance, state of facts or other condition occurring or existing on or before the Closing Date, wither or not then known, due or payable;

(d) any obligation for Taxes of Seller or the Shareholders for any period (or portion thereof) prior to the Closing Date;

(e) any Retained Liabilities;

(f) the failure of Seller or the Shareholders to comply with the requirements of the Uniform Commercial Code concerning bulk transfers, as in effect in the various states in which Seller or any Shareholder has assets, including, without limitation, the requirement of notice to creditors;

(g) the failure of Seller or the Shareholders to obtain any clearance certificate or similar document required by any taxing Authority in order to relieve the Purchaser or the Parent of any obligation to withhold any portion of the Purchase Price or in order to avoid any successor liability for Taxes;

(h) any liability, expense, cost, tax or obligation of any nature with respect to such current or former employee of the Business or other individual arising in connection with group health plan coverage required under Section 4980B of the Code or Part 6 of Subtitle B of Title I of ERISA; and

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(i) the failure of Seller or the Shareholders to disclose to the Purchaser or Parent a complete and accurate list of any and all severance compensation required to be paid in connection with the transactions contemplated by this Agreement to any employee of Seller who is not a Transferred Employee.

Seller and the Shareholders acknowledge that if a representation or warranty that is qualified by materiality (including a Material Adverse Effect) is breached after giving effect to such materiality qualification then the Purchaser Losses resulting from such breach will include all Purchaser Losses resulting from a breach of such representation or warranty and not solely the portion of such Purchaser Losses in excess of such materiality qualifier.

8.4. Claims for Indemnification; Shareholders' Representatives and Power of Attorney.

(a) General. The parties intend that all indemnification claims be made as promptly as practicable by the party seeking indemnification (the "Indemnified Party"). Whenever any claim will arise for indemnification hereunder the Indemnified Party will promptly notify the party from whom indemnification is sought (the "Indemnifying Party") of the claim and, when known, the facts constituting the basis for such claim. The failure so to notify the Indemnifying Party will not relieve the Indemnifying Party of any liability that it may have to the Indemnified Party except to the extent the Indemnifying Party demonstrates that the defense of such action is materially prejudiced thereby.

(b) Claims by Third Parties. With respect to claims made by third parties, the Indemnifying Party will be entitled to assume control of the defense of such action or claim with counsel reasonably satisfactory to the Indemnified Party; provided, however, that:

(i) the Indemnified Party will be entitled to participate in the defense of such claim and to employ counsel at its own expense to assist in the handling of such claim;

(ii) no Indemnifying Party will consent to (A) the entry of any judgment or enter into any settlement that does not include as an unconditional term thereof the giving by each claimant or plaintiff to each Indemnified Party of a release from all liability in respect of such claim or (B) if, pursuant to or as a result of such consent or settlement, injunctive or other equitable relief would be imposed against the Indemnified Party or such judgment or settlement could materially interfere with the business, operations or assets of the Indemnified Party; and,

(iii) if the Indemnifying Party does not assume control of the defense of such claim in accordance with the foregoing provisions within ten (10) business days after receipt of notice of the claim, the Indemnified Party will have the right to defend such claim in such manner as it may deem appropriate at the cost and expense of the Indemnifying Party, and the Indemnifying Party will promptly reimburse the Indemnified Party therefore in accordance with this Article 8; provided that the Indemnified Party will not be entitled to consent to the entry of any judgment or enter into any settlement of such claim that does not include as an unconditional term thereof the giving by each claimant or plaintiff to each Indemnifying Party of a release from all liability in respect of such claim without the prior written consent of the Indemnifying Party if, pursuant to or as a result of such consent or settlement, injunctive or other equitable relief would be imposed against the Indemnifying Party or such judgment or settlement could materially interfere with the business, operations or assets of the Indemnifying Party.

(c) Remedies Exclusive. The remedies provided in this Section 8 shall be the exclusive remedy of any party hereto for any breaches of representations, warranties, agreements or covenants in Section 2 or Section 3 of this Agreement, except to the extent any such breaches relate to (i) fraud or (ii) bad faith action, with respect to which the remedies provided herein will be cumulative and will not preclude assertion by any party of any rights or the seeking of any other remedies against any other party.

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(d) Shareholders' Representative; Power of Attorney.

(i) Upon execution of this Agreement by the Shareholders, and without further act of any Shareholder, Kirk Willey ("Willey") shall be appointed as agent and attorney-in-fact (the "Shareholders' Representative") for each Shareholder, for and on behalf of the Shareholders, to give and receive notices and communications, to authorize delivery to the Purchaser Indemnified Parties of funds from the Escrow Deposit or other sources in satisfaction of claims by such Purchaser Indemnified Parties, to object to such deliveries, to agree to, negotiate, enter into settlements and compromises of, and demand arbitration and comply with orders of courts and awards of arbitrators with respect to such claims, and to take all actions necessary or appropriate in the judgment of the Shareholders' Representative for the accomplishment of the foregoing. Such agency may be changed by the Shareholders from time to time upon not less than thirty (30) days prior written notice to Parent; provided that the Shareholders' Representative may not be changed unless holders of a two-thirds interest of the Escrow Deposit agree to such change and to the identity of the substituted agent. If Willey is unable or unwilling to

serve as Shareholders' Representative, Jeff Price shall be automatically appointed as the Shareholders' Representative to replace Willey. Except as provided in the preceding sentence, any vacancy in the position of a Shareholders' Representative may be filled by the holders of a majority in interest of the Escrow Deposit. No bond shall be required of the Shareholders' Representative, and the Shareholders' Representative shall not receive compensation for his services. Notices or communications to or from the Shareholders' Representative shall constitute notice to or from each of the Shareholders.

(ii) The Shareholders' Representative shall not be liable for any act done or omitted hereunder as Shareholders' Representative, except for gross negligence or willful misconduct. The Shareholders on whose behalf the Escrow Deposit was contributed to the Escrow Deposit shall severally, in proportion to their ownership amounts as set forth in Exhibit 8.5(c), indemnify the Shareholders' Representative and hold the Shareholders' Representative harmless against any loss, liability or expense (except for any loss, liability or expense arising out of the gross negligence or willful misconduct of the Shareholders' Representative) incurred on the part of the Shareholders' Representative and arising out of or in connection with the acceptance or administration of the Shareholders' Representative's duties hereunder, including the reasonable fees and expenses of any legal counsel retained by the Shareholders' Representative.

(iii) Each decision, act, consent or instruction of the Shareholders' Representative, including but not limited to an amendment, extension or waiver of this Agreement, shall constitute a decision of all the Shareholders and shall be final, binding and conclusive upon each such Shareholder, and the Escrow Agent and other parties to this Agreement may rely upon any such decision, act, consent or instruction of the Shareholders' Representative as being the decision, act, consent or instruction of each and every such Shareholder. The Escrow Agent and other parties to this Agreement are hereby relieved from any liability to any person for any acts done by them in accordance with such decision, act, consent or instruction of the Shareholders' Representative.

8.5. Basket and Cap Limitations on Claims for Indemnification.

(a) In the event of any claim for indemnity under Section 8.3, the Indemnified Party under such representation and warranty claim shall not be entitled to indemnification therefor unless such Indemnified Party has sustained Losses in excess of One Hundred Thousand and no/100 Dollars (\$100,000.00) in the aggregate (the "Exception Amount"), in which event the Indemnified Party shall be entitled to indemnification for the full amount of all Losses suffered or incurred in excess of Seventy-Five Thousand and no/100 Dollars (\$75,000.00) of Losses; provided, however, that such Exception Amount limitation shall not apply to (i) any claim by the Purchaser Indemnified Parties with respect to an intentional breach of or intentional nonfulfillment of any covenant, agreement or undertaking of Seller or the Shareholders contemplated in Section 8.3(b); (ii) any claim based on any breach of the representations and warranties contained in subsections 2.3 (authorization), or 2.23

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(brokers) hereof; or (iii) any claim based on any breach of the representations and warranties contained in Section 2.14 (tax matters), but only to the extent such breach relates to payment or non-payment of federal, state or local income taxes by Seller or the Shareholders, and accordingly, the Indemnified Party shall be entitled to indemnification for the full amount of all such Losses, even if they do not exceed the

Exception Amount (the "Rep Basket"). Notwithstanding anything herein to the contrary, the Exception Amount and Rep Basket shall not apply with respect to (A) any fraudulent breach of any representation or warranty or any claim with respect to fraudulent inducement to enter into this Agreement or (B) any bad faith action. The parties do not intend that the Exception Amount be deemed to be a definition of what is "material" for any purpose in this Agreement.

(b) The Indemnifying Party shall not indemnify the Indemnified Parties to the extent Losses exceed, in the aggregate, the Purchase Price (the "Limitation Amount"); provided, however, that (a) such limitation shall not apply to any claim based on, any breach of the representations and warranties contained in subsections 2.3 (authorization); or 2.23 (brokers) hereof; or (ii) subsection 2.14 (tax matters), to the extent such breach relates to payment or non-payment of federal, state or local taxes by Seller or the Shareholders, for which the Purchaser Indemnified Parties may recover to the full extent of their Losses, subject only to the Rep Basket, if applicable; and (b) notwithstanding anything herein to the contrary, the Limitation Amount shall not apply with respect to (A) any fraudulent breach of any representation or warranty or any claim with respect to fraudulent inducement to enter into this Agreement or (B) any bad faith action. The parties do not intend that the Limitation Amount be deemed to be a definition of what is "material" for any purpose in this Agreement.

(c) The percentage of each total Purchaser's Loss that the Purchaser Indemnified Parties may recover from any particular Shareholder shall equal such Shareholder's percentage interest in the Seller immediately prior to the Closing, as indicated on Exhibit 8.5(c); provided, however, that (i) the maximum amount that the Purchaser Indemnified Parties may recover from any particular Shareholder shall not exceed the product of such Shareholder's percentage interest indicated on Exhibit 8.5(c) multiplied by the aggregate amount of the Purchase Price actually received (regardless of when received) by Seller, and (ii) notwithstanding anything herein to the contrary, the limitation described in this Section 8.5(c) shall not apply with respect to (A) any fraudulent breach of any representation or warranty or any claim with respect to fraudulent inducement to enter into this Agreement or (B) bad faith. Accordingly, and without limiting the foregoing, if a Shareholder owned 10% of the outstanding capital stock of the Seller immediately prior to Closing, the Purchaser's Loss for which the Purchaser Indemnified Parties are entitled to indemnification is one million dollars, and the Seller had actually received, or thereafter receives, aggregate Purchase Price payment of at least one million dollars, then the maximum amount the Purchaser Indemnified Parties may recover from such Shareholder would be one hundred thousand dollars (\$100,000), which is 10% of the total Loss (absent fraud or bad faith, as described in the preceding sentence) and is not in excess of 10% of the aggregate amount of Purchase Price received, then or later, by Seller.

8.6. Set-Off Right.

(a) Upon not less than thirty (30) days' notice to the Shareholders' Representative, specifying in reasonable detail the basis therefor, the Purchaser or Parent may set off any amount to which they may be entitled under this Article 8 against amounts otherwise payable as Contingent Consideration. If the Shareholders' Representative disputes the amount set off by Parent or Purchaser, neither Purchaser nor Parent may exercise such set-off rights until such dispute is finally resolved pursuant to Section 9.8 of this Agreement.

(b) The exercise of such right of set-off by the Purchaser or Parent will not constitute a breach of this Agreement or any other agreement or instrument contemplated by this Agreement. Neither the exercise of, nor the failure to exercise, such right of set-off will constitute an election of remedies nor limit the Purchaser or Parent in any manner in the enforcement of any other remedies that may be available to

8.7. Effect of Purchaser's Actual Knowledge.

If (a) there exists Purchaser's Actual Knowledge of a breach of any representation or warranty contained in Section 2 of this Agreement, (b) the effect of such breach constitutes a Material Adverse Effect with respect to the Seller or the Business, and (c) Purchaser elected to consummate the Closing notwithstanding such breach, then Purchaser shall be deemed to have waived any claim against the Seller and Shareholders pursuant to Section 8 of this Agreement to the extent of Purchaser's Actual Knowledge with respect to such breach. For purposes of this Section, "Purchaser's Actual Knowledge" means the actual knowledge of Susan Engel, David Weiser, Lisa Riedesel, Tom Tomlinson and Tony Ishaug acquired after April 16, 2001. Without limiting the preceding sentence, Purchaser's Actual Knowledge (i) shall not include any knowledge of any other individuals employed by (whether or not supervised directly or indirectly by Susan Engel, David Weiser, Lisa Riedesel, Tom Tomlinson and Tony Ishaug) or acting as an agent or representative of Purchaser and (ii) shall not be construed under any circumstance to mean that Susan Engel, David Weiser, Lisa Riedesel, Tom Tomlinson or Tony Ishaug has conducted any independent investigation to determine if there is any breach of the Shareholders' representations and warranties. In addition, the Seller and Shareholders acknowledge that notwithstanding any provision in this Agreement to the contrary, in the event there is any dispute as to whether there exists Purchaser's Actual Knowledge, then the burden of proof shall be on the Seller and Shareholders to establish Purchaser's Actual Knowledge. It is further acknowledged and agreed that if there exists Purchaser's Actual Knowledge of a breach of any representation or warranty contained in Section 2 of this Agreement and the effect of such breach does not constitute a Material Adverse Effect with respect to the Seller or the Business, then such breach shall be treated as a breach of this Agreement and the waiver described above in this Section shall not apply.

9. MISCELLANEOUS PROVISIONS.

9.1. Expenses.

Parent and the Purchaser, on the one hand, and Seller and the Shareholders, on the other hand, will each bear their own costs and expenses relating to the transactions contemplated hereby, including without limitation, fees and expenses of legal counsel, accountants, investment bankers, brokers or finders, printers, copiers, consultants or other representatives for the services used, hired or connected with the transactions contemplated hereby.

9.2. Amendment and Modification.

This Agreement may not be amended or modified by the parties hereto except by means of a writing duly executed by each of the parties hereto.

9.3. Waiver of Compliance; Consents.

Any failure of a party to comply with any obligation, covenant, agreement or condition herein may be expressly waived in writing by the party entitled hereby to such compliance, but such waiver or failure to insist upon strict compliance with such obligation, covenant, agreement or condition will not operate as a waiver of, or estoppel with respect to, any subsequent or other failure. No single or partial exercise of a right or remedy will preclude any other or further exercise thereof or of any other right or remedy hereunder. Whenever this Agreement requires or permits the consent by or on behalf of a party, such consent will be given in writing

in the same manner as for waivers of compliance.

9.4. No Third Party Beneficiaries.

Nothing in this Agreement will entitle any person or entity (other than a party hereto and his, her or its respective successors and assigns permitted hereby) to any claim, cause of action, remedy or right of any kind.

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9.5. Notices.

All notices, requests, demands and other communications required or permitted hereunder will be made in writing and will be deemed to have been duly given and effective: (i) on the date of delivery, if delivered personally; (ii) on the earlier of the fifth (5th) day after mailing or the date of the return receipt acknowledgment, if mailed, postage prepaid, by certified or registered mail, return receipt requested; or (iii) on the date of transmission, if sent by facsimile, telecopy, telegraph, telex or other similar telegraphic communications equipment and receipt thereof is confirmed telephonically:

If to
Seller:

To: Axis Corporation
370 East Harmon Avenue--Suite C-311
Las Vegas, NV 89109
Attn.: Kirk Willey
Fax: (801) 366-5025

With
copies
to:

Stoel Rives LLP
201 South Main Street, Suite 1100
Salt Lake City, UT 84111
Attn: Brian G. Lloyd
Fax: (801) 578-6999

or to such other person or address as Seller will furnish to the other parties hereto in writing in accordance with this subsection.

If to the Purchaser or the Parent:

To: Department 56, Inc.
One Village Place
6436 City West Parkway
Eden Prairie, MN 55344
Attn.: Percy C. Tomlinson
Fax: (952) 943-4500

With a copy
to:

To: Mark J. Sexton

or to such other person or address as Parent or the Purchaser will furnish to the other parties hereto in writing in accordance with this subsection.

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9.6. Assignment.

This Agreement and all of the provisions hereof will be binding upon and inure to the benefit of the parties hereto and their respective successors and permitted assigns, but neither this Agreement nor any of the rights, interests or obligations hereunder will be assigned (whether voluntarily, involuntarily, by operation of law or otherwise) by any of the parties hereto without the prior written consent of the other parties, provided, however, that the Purchaser may assign its rights (but not its obligations) under this Agreement, in whole or in any part, and from time to time, to a wholly owned, direct or indirect, subsidiary of Parent.

9.7. Governing Law.

This Agreement and the legal relations among the parties hereto will be governed by and construed in accordance with the internal substantive laws of the State of Delaware (without regard to the laws of conflict that might otherwise apply) as to all matters, including without limitation matters of validity, construction, effect, performance and remedies.

9.8. Arbitration.

(a) The parties agree that any dispute arising out of or relating to this Agreement or the formation, breach, termination or validity thereof, except for injunctive relief contemplated by Section 9.12 (a "Dispute") will be resolved as follows. If the Dispute cannot be settled through direct discussions, the parties will first try to settle the Dispute in an amicable manner by mediation under the Commercial Mediation Rules of the American Arbitration Association, before resorting to arbitration. Any Dispute that has not been resolved within 60 days of the initiation of the mediation procedure (the "Mediation Deadline") will be settled by binding arbitration in Minneapolis, Minnesota by a panel of three (3) arbitrators, selected in accordance with subsection (b) below, in accordance with the Commercial Arbitration Rules of the American Arbitration Association (the "American Arbitration Rules"). The arbitrators in any such arbitration will have the discretion to order a pre-hearing exchange of information by the parties, including, without limitation, production of requested documents, exchange of summaries of testimony and proposed witnesses, and examination by deposition of parties. The arbitrators are not empowered to award damages in excess of compensatory damages, as limited by this Agreement, and each party hereby irrevocably waives any damages in excess of compensatory damages. Judgment upon any arbitration award may be entered in any court having jurisdiction thereof and the parties consent to the jurisdiction of the courts of the State of Minnesota and the federal district court for the State of Minnesota for this purpose. The parties agree that service of process and of any notices required in connection with any arbitration hereunder or any related court proceedings may be given in the manner provided for the giving of notices under this Agreement as set forth in Section 9.5.

(b) Within twenty (20) days of the Mediation Deadline, the

Purchaser will nominate one arbitrator and the Seller and the Shareholders, together, will nominate one arbitrator. Within thirty (30) days of the nomination and appointment of the two arbitrators, the two arbitrators will select a third arbitrator, and if they fail to do so, a neutral arbitrator will be chosen in accordance with the American Arbitration Rules.

9.9. Counterparts.

This Agreement may be executed simultaneously in one or more counterparts, each of which will be deemed an original, but all of which together will constitute one and the same instrument.

9.10. Headings.

The table of contents and the headings of the sections and subsections of this Agreement are inserted for convenience only and will not constitute a part hereof.

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9.11. Entire Agreement.

This Agreement, the Disclosure Schedule and the exhibits and other writings referred to in this Agreement or in the Disclosure Schedule or any such exhibit or other writing are part of this Agreement, together they embody the entire agreement and understanding of the parties hereto in respect of the transactions contemplated by this Agreement and together they are referred to as this "Agreement" or the "Agreement". There are no restrictions, promises, warranties, agreements, covenants or undertakings, other than those expressly set forth or referred to in this Agreement. This Agreement supersedes all prior agreements and understandings between the parties with respect to the transaction or transactions contemplated by this Agreement, including, but not limited to, the letter of intent dated April 16, 2001. Any provision of this Agreement that becomes invalid or unenforceable under applicable Law will be stricken to the extent necessary and the remainder of such provisions and the remainder of this Agreement will continue in full force and effect.

9.12. Injunctive Relief.

It is expressly agreed among the parties hereto that monetary damages would be inadequate to compensate a party hereto for any breach by any other party of its agreements and covenants in Sections 4.4 and 4.12 of this Agreement. Accordingly, the parties agree and acknowledge that any such violation or threatened violation will cause irreparable injury to the other and that, in addition to any other remedies which may be available, such party will be entitled to injunctive relief against the threatened breach of Sections 4.4 and 4.12 of this Agreement hereof or the continuation of any such breach without the necessity of proving actual damages and may seek to specifically enforce the terms thereof.

9.13. Certain Definitions.

For purposes of this Agreement, the terms:

(a) "Environmental and Occupational Safety and Health Law" means any common law or duty, case law or other Law, that (i) regulates, creates standards for or imposes liability or standards of conduct concerning any element, compound, pollutant, contaminant, or toxic or hazardous substance, material or waste, or any mixture thereof, or relates in any way to emissions or releases into the environment or ambient environmental conditions, or conduct affecting such matters, or (ii) is designed to provide safe and healthful working conditions or reduce occupational safety and health hazards. Such laws will include, but not be limited to, the

National Environmental Policy Act, 42 U.S.C. 4321 et seq., the Comprehensive Environmental Response, Compensation, and Liability Act, 42 U.S.C. 9601 et seq., the Resource Conservation and Recovery Act, 42 U.S.C. 6901 et seq., the Federal Water Pollution Control Act, 33 U.S.C. 1251 et seq., the Federal Clean Air Act, 42 U.S.C. 7401 et seq., the Toxic Substances Control Act, 15 U.S.C. 2601 et seq., the Emergency Planning and Community Right to Know Act, 42 U.S.C. 11011, the Hazard Communication Act, 29 U.S.C. 651 et seq., the Occupational Safety and Health Act, 29 U.S.C. 651 et seq., the Federal Insecticide, Fungicide and Rodenticide Act, 7 U.S.C. 136, and any case law interpretations, amendments or restatements thereof, or similar enactments thereto, as is now or at any time hereafter may be in effect, as well as their international, state and local counterparts.

(b) "Environmentally Regulated Materials" means any element, compound, pollutant, contaminant, substance, material or waste, or any mixture thereof, designated, listed, referenced, regulated or identified pursuant to any Environmental and Occupational Safety and Health Law.

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(c) "Material Adverse Effect" means an individual or cumulative material adverse change in or material adverse effect on the business, customers, customer relations, operations, properties, working capital condition (financial or otherwise), assets, properties or liabilities of the Business, taken as a whole, or the Purchaser, Parent and their subsidiaries, as the case may be, or would prevent Seller, on the one hand, or Parent and the Purchaser, on the other hand, from consummating the transactions contemplated hereby.

(d) "Knowledge of Seller" and other terms of similar import means (i) the actual knowledge or awareness of Seller or any Shareholder, and (ii) the knowledge or awareness after due inquiry which a prudent business person in the position of any Shareholder would have obtained in the conduct of such business person's business.

(e) "Taxes" means all federal, state, local, foreign and other net income, gross income, gross receipts, sales, use, ad valorem, transfer, franchise, profits, license, lease, service, service use, withholding, payroll, employment, excise, severance, stamp, occupation, premium, real or personal property, windfall profits, customs, duties or other taxes, fees, assessments, charges or levies of any kind whatever, together with any interest and any penalties, additions to tax or additional amounts with respect thereto, and the term "Tax" means any one of the foregoing Taxes.

(f) "Tax Returns" means all returns, declarations, reports, statements and other documents required to be filed with any Authority in respect of Taxes, and the term "Tax Return" means any one of the foregoing Tax Returns.

{Remainder of page intentionally left blank}

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IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed as of the day and year first above written.

DEPARTMENT 56, INC.

AXIS CORPORATION

By: _____
Percy C. Tomlinson
Its: Executive Vice President &
Chief Financial Officer

AXIS HOLDINGS CORPORATION

By: _____
Percy C. Tomlinson
Its: Vice President

By: _____

Its: _____

SHAREHOLDERS' REPRESENTATIVE

Kirk Willey

SHAREHOLDERS

Kirk Willey

Matt Musgrave

Jeff Price

Jeremy Willey

Lee Willey

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LIST OF EXHIBITS

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|---|---------------------|
| List of Customers of the Business | Exhibit 1.1(a)(xii) |
| Latest Balance Sheet | Exhibit 1.1(a)(xxi) |
| Excluded Assets | Exhibit 1.1(b) |
| Form of Liabilities Undertaking | Exhibit 1.2 |
| Form of Escrow Agreement | Exhibit 1.3(b)(ii) |
| Allocation of Purchase Price Among the Assets | Exhibit 1.4 |
| Form of Bill of Sale | Exhibit 1.6(a)(i) |
| Form of Security Agreement | Exhibit 1.6(c)(ii) |
| Disclosure Schedule | Exhibit 2 |

| | |
|--|----------------|
| Management Agreement | Exhibit 4.6(d) |
| Employees to be Hired | Exhibit 4.11 |
| Ownership of Seller Immediately Prior to Closing | Exhibit 8.5(c) |

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SUBSIDIARIES OF THE COMPANY

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Name of Subsidiary

Jurisdiction

Department 56 Retail, Inc.

Minnesota

Department 56 Sales, Inc.

Minnesota

D 56, Inc.

Minnesota

CAN 56, Inc.

Minnesota

Axis Holdings Corporation

Delaware

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EXHIBIT 23.1

INDEPENDENT AUDITORS' CONSENT

We consent to the incorporation by reference in Registration Statement No. 33-95704, No. 33-79960, and No. 333-41639 of Department 56, Inc. and subsidiaries on Form S-8 of our report dated February 22, 2002 (March 1, 2002 as to the first paragraph of Legal Proceedings of Note 6) appearing in this Annual Report on Form 10-K of Department 56, Inc. and subsidiaries for the year ended December 29, 2001.

Deloitte & Touche LLP
Minneapolis, Minnesota
March 28, 2002