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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
January 1, 2000

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)

(612) 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 \$207,950,546 as of March 21, 2000 (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 21, 2000: 14,636,577

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's definitive Proxy Statement for the 2000 Annual Meeting of Stockholders filed with the Securities and Exchange Commission concurrently with this Form 10-K (the "2000 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, importer and distributor of fine quality collectibles and other giftware products sold through gift, home accessory and specialty retailers. The Company is best known for its Village Series of collectible, handcrafted, lit 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 and home decorative accessories, including its Snowbabies TM collectible porcelain and pewter handpainted 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 complementary businesses that reinforce synergies, allow it to supplement its internal product development and accelerate its penetration into new markets and new channels. In this connection, in the first quarter of fiscal year 2000 the Company completed a \$4 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. The Company's focused, multi-faceted strategy is intended to position Department 56 as the premier giftware and collectibles company for the future.

Products

Village Series Products. Department 56 is best known for its Village Series, several series of collectible, handcrafted, lit ceramic and porcelain houses, buildings and related accessories that depict nostalgic scenes. The Company introduces new lit 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.

Village Accessories. Department 56 also produces a range of accessories

for its villages, 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 to refresh their collections by changing their displays and by creating personalized settings. Many of the accessories can be used interchangeably between the various villages, although certain accessories are designed uniquely for specific villages.

General Giftware. The Company offers a wide range of other decorative giftware and home accessory items, including the Company's Snowbabies and Snowbunnies (r) collectible figurines, Candle Crown™ candle extinguishers, Christmas, Easter, and non-seasonal decorative items, tableware, decorative tins, acrylics, "teddy bears" and other "plush" items, and gift bags. Department 56 develops these decorative giftware and home accessories both to satisfy specific consumer demand

and to introduce new product concepts that may develop into important product lines for the Company in the future. Snowbabies figurines, originally introduced in 1987 as part of the Company's general Christmas collection, rapidly became a popular product line and subsequently have achieved their own collectible status. Candle Crown candle extinguishers, introduced in January 2000, provide a new product category to the North American gift and collectible marketplace, and are composed of collections and coordinating accessories which enable continuity purchases. General Giftware products are generally offered as a line of products developed around a central design theme. The Company updates its product offerings twice a year and currently maintains an aggregate of approximately 3,700 stock keeping units, of which approximately 3,100 are General Giftware products.

Customers

The Company's principal customers (accounting for approximately 92% of its sales) are approximately 17,500 independent gift retailers across the United States. These retailers include approximately 1,800 independently owned Gold Key and Showcase Dealers, who receive special recognition and qualify for improved sales terms, and who must satisfy 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 1999. 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 were less than 3% of the Company's sales in fiscal 1999.

As part of the Company's strategy of selective distribution, only approximately 5,900 retailers receive the Company's Village Series and/or Snowbabies products. Certain of the Company's lit Village Series products and porcelain Snowbabies figurines have been sold on allocation for each of the last eleven years and eight years, respectively. The Company periodically evaluates and adjusts its distribution network, and reviews its dealership policies with a view of optimizing both the Company's distribution strategy and the store-level operations of its independent dealers.

Marketing and Advertising

Department 56 sells its products through 8 corporate showrooms and 2 independently operated wholesale showrooms which cover the major giftware market areas in the United States and Canada. The Company's headquarters in Eden Prairie, Minnesota has a 10,000 square-foot atrium showroom where all of its products, including retired Village Series lighted pieces and

Snowbabies figurines, are displayed. The Company is also embarking on business to business extranet/e-commerce initiatives in order to develop greater operational efficiencies and merchandising effectiveness for the Company and its retailers in the future. In addition, the Company sells through giftware trade shows throughout the United States. In 1999, the Company opened a retail store in the Mall of America outside Minneapolis which has helped to increase the visibility of the brand and cultivated consumer awareness. The creation of an additional 1 or 2 corporately owned stores during 2000 is currently under consideration. Tests have been conducted of product sales through home television shopping, direct mail, Internet-based retailers and corporate gift programs. The Company intends to maintain flexibility in its marketing and distribution strategies in order to take advantage of opportunities that may develop in the future.

The Company advertises its products to retailers principally through trade journals, giftware trade shows and brochures, and provides merchandising and product information to its collectible product dealers through a periodical newsletter. It advertises to consumers through brochures, point of sale information and seasonal advertisements in magazines and newspapers, and booth presence at major collectibles expos. The Company has also expanded its consumer advertising through use of cooperative advertising with its Gold Key Dealers using various media formats. In addition, the Company publishes and sells Fifty-SixTM, a quarterly consumer-oriented magazine which contains product-related articles and description of its product lines, and maintains an interactive consumer information center on an Internet web site. Department 56 maintains a toll-free telephone line for collector 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.

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 and pricing criteria and can be distributed through the Company's existing marketing and distribution system.

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 sources in India, and occasionally from sources in Europe (primarily Italy, England, Poland and Czechoslovakia). In fiscal 1999, the Company imported products from approximately 150 independent manufacturing sources, some of which are represented by independent trading companies. The Company's single largest manufacturing source represented approximately 10% of the Company's imports in fiscal 1999. 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 ten years or more) and often purchases (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 final conception of the design idea to market introduction typically takes approximately 12 months, although the Company has initiated processes intended to reduce this time substantially.

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, ceramic and resin.

Distribution and Systems

The products sold by the Company in the United States are generally shipped by ocean freight from abroad and then by rail to the Company's two warehouse and distribution centers, each located within

10 miles of the other in the southwest quadrant of the Minneapolis/St. Paul metropolitan area. In April 2000, the Company plans to consolidate its distribution operations from the existing two distribution centers and a storage facility into a new distribution center. Shipments from the Company to its customers are handled by United Parcel Service or commercial trucking lines.

The Company utilizes Year 2000 compliant computer systems to maintain order processing from the time a product enters the Company's system through shipping and ultimate payment collection from its 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.

Backlog and Seasonality

The Company receives products, pays its suppliers and ships products throughout the year, although the majority of shipments historically 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 merchandise until mid-December each year. Accordingly, the Company's backlog typically is lowest at the beginning of January. As of January 1, 2000, Department 56 had unfilled wholesale orders of approximately \$5.4 million, compared to \$4.0 million at January 2, 1999. All of the backlog is scheduled to be shipped to customers during the current fiscal year. Approximately 7% to 8% of the Company's total annual customer orders have been cancelled in each of the last three years for a number of reasons, primarily including inventory shortages and customer credit considerations.

Department 56 experiences a significant seasonal pattern in its working capital requirements and operating results. During the first quarter of each of the last three years, the Company received approximately 65% of its annual orders for such year. The Company offers extended payment terms to many of its customers for seasonal merchandise. Accordingly, the Company collects a substantial portion of its accounts receivable in the fourth quarter. 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 quarter. 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 revenues in its second and third quarters.

Trademarks and other Proprietary Rights

The Company owns twenty-six U.S. trademark registrations and has pending U.S. trademark applications with respect to certain of its logos and

brandnames. 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 2009, but can be maintained and renewed provided that the marks are still in use for the goods and services covered by such registrations.

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, 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. These elements, as well as presence in large, category-leading retail chains, also apply in the home decor marketplace. 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 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 Italy, England, 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. The Company is subject to the following risks inherent in foreign manufacturing: fluctuations in currency exchange rates; economic and political instability; cost fluctuations and delays in transportation; restrictive actions by foreign governments; nationalizations; the laws and policies of the U.S. affecting importation of goods (including duties, quotas and taxes); and foreign trade and tax laws. In particular, 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.

Substantially all of 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 the ordinary course of its business, from time to time, the Company is 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.

The United States and the countries in which the Company's products are manufactured may, from time to time, impose new quotas, duties, tariffs or other charges or restrictions, or adjust presently prevailing quotas, duty or tariff levels, which could adversely affect the Company's financial condition or results of operations or its ability to continue to import products at current or increased levels. In particular, the Company's costs may be increased, or the mix of countries from which it sources its

products may be changed, in the future if countries which are currently accorded "Most Favored Nation" status by the United States cease to have such status or the United States imposes retaliatory duties against imports from such countries. The Company cannot predict what regulatory changes may occur or the type or amount of any financial impact on the Company which such changes may have in the future.

In fiscal 1999, approximately 76% (as compared to approximately 71% in fiscal 1998) of the Company's imports were manufactured in The People's Republic of China, which is accorded "Most Favored Nation" status on a currently temporary basis and generally is not subject to U.S. retaliatory duties. Various commercial and legal practices widespread in The People's Republic of China, including the handling of intellectual properties, as well as certain political and military actions taken or suggested by The People's Republic of China in relation to Taiwan, are under review by the United States government and, accordingly, the duty treatment of goods imported from The People's Republic of China is subject to political uncertainties. To the extent The People's Republic of China may cease to have "Most Favored Nation" status or its exports may be subject to political retaliation, the cost of importing products from such country would increase significantly, and the Company believes that there could be a short-term adverse effect on the Company until alternative manufacturing arrangements were obtained.

Employees

As of January 1, 2000, the Company had 315 full-time employees in the United States, 8 in Canada and 1 in Taiwan. Of the total workforce, approximately 90 are engaged in wholesale sales representation throughout North America and 12 are associated with the Company's corporate-owned retail properties. The Company's 77 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, 2001. 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 which the Company cannot now predict.

Item 2. PROPERTIES

The Company owns or leases buildings that contain approximately 777,000 square feet of floor space. The Company's primary corporate showroom, executive offices and creative center are located in Eden Prairie,

Minnesota. The Company entered into a lease agreement in April 1999 for a new warehouse and distribution facility in Rogers, Minnesota. The office building in Eden Prairie, Minnesota is owned by the Company and the remainder of the Company's facilities are leased. The following table identifies each of the facilities utilized by the Company's operations.

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
Warehouse and Distribution Facility	Eden Prairie, MN	3-31-2001	150,000
Warehouse and Distribution Facility	Bloomington, MN	2-28-2002	159,000
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
Retail store	Bloomington, MN	4-30-2009	10,200
Showroom	Minnetonka, MN	10-31-2007	5,144
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

Item 3. LEGAL PROCEEDINGS

The Company is involved in various legal proceedings, claims and governmental audits in the ordinary course of its business. In the opinion of the Company's management, the ultimate disposition of these proceedings, claims and audits will not have a material adverse effect on the financial position or results of operations 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 January 1, 2000.

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 1999		
First quarter	37.88	29.44
Second quarter	33.31	24.50
Third quarter	29.00	23.63
Fourth quarter	24.81	18.31
Fiscal 1998		
First quarter	39.00	26.63
Second quarter	39.31	32.19
Third quarter	36.75	26.25
Fourth quarter	37.63	22.94

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 21, 2000, the number of holders of record of the Company's Common Stock was 880.

Item 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data for the years ended January 1, 2000, January 2, 1999, January 3, 1998, December 28, 1996, and December 30, 1995 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.

	January 1, 20001	January 2, 19991	January 3, 19981	December 28, 19961	December 30, 19951
	-----	-----	-----	-----	-----
(In thousands, except per share amounts)					
STATEMENTS OF INCOME					
Net sales	\$245,856	\$243,365	\$219,496	\$ 228,775	\$ 252,047
Cost of sales	103,803	100,782	94,040	95,190	110,008
	-----	-----	-----	-----	-----
Gross profit	142,053	142,583	125,456	133,585	142,039
Operating expenses:					
Selling, general and administrative ²	61,542	56,648	49,772	47,853	45,017
Amortization of goodwill, trademarks and other intangibles	5,145	4,926	4,577	4,577	4,577
	-----	-----	-----	-----	-----
Total operating expenses	66,687	61,574	54,349	52,430	49,594
	-----	-----	-----	-----	-----
Income from operations	75,366	81,009	71,107	81,155	92,445
Other expense (income):					
Interest expense	6,719	4,817	4,362	6,063	9,582
Gain on sale of aircraft ³	--	--	(2,882)	--	--

Other, net	(153)	(397)	(1,086)	(648)	(439)
Income before income taxes and extraordinary item	68,800	76,589	70,713	75,740	83,302
Provision for income taxes	26,144	30,073	27,932	29,796	33,737
Income before extraordinary item	42,656	46,516	42,781	45,944	49,565
Extraordinary charge due to refinancing of debt ⁴	--	--	--	--	1,312
Net income	\$ 42,656	\$ 46,516	\$ 42,781	\$ 45,944	\$ 48,253
Income before extraordinary item per common share assuming dilution	\$ 2.45	\$ 2.45	\$ 2.05	\$ 2.11	\$ 2.28
Net income per common share assuming dilution	\$ 2.45	\$ 2.45	\$ 2.05	\$ 2.11	\$ 2.22
BALANCE SHEET DATA					
Working capital	\$ 32,289	\$ 29,276	\$ 40,857	\$ 67,997	\$ 36,015
Total assets	287,108	233,283	259,695	285,733	259,085
Total debt	102,500	20,000	40,000	60,000	80,000
Total stockholders' equity ⁵	152,924	178,735	186,655	196,757	150,286

- 1 The years ended December 30, 1995, December 28, 1996, January 2, 1999 and January 1, 2000 were 52-week periods, and the year ended January 3, 1998, was a 53-week period.
- 2 Selling, general and administrative expenses for the year ended December 30, 1995 included \$2,872 of net customs duties refunds and related interest. The refunds pertained principally to certain merchandise imported into the United States from 1989 to 1994.
- 3 See Note 6 to the Consolidated Financial Statements.
- 4 During February 1995, the Company entered into a credit agreement and recorded an extraordinary charge of \$1,312, net of income taxes, to write-off deferred financing costs.
- 5 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.

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

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.

1999

1998

1997

(In millions, except per share amounts)

	Dollars	Percent of Net Sales	Dollars	Percent of Net Sales	Dollars	Percent of Net Sales
Net sales	\$ 245.9	100%	\$ 243.4	100%	\$ 219.5	100%
Gross profit	142.1	58	142.6	59	125.5	57
Selling, general and administrative expenses	61.5	25	56.6	23	49.8	23
Amortization of goodwill, trademarks and other intangibles	5.2	2	4.9	2	4.6	2
Income from operations	75.4	31	81.0	33	71.1	32
Interest expense	6.7	3	4.8	2	4.4	2
Gain on sale of aircraft	--	--	--	--	(2.9)	(1)
Other, net	(.2)	--	(.4)	--	(1.1)	(1)
Income before income taxes	68.8	28	76.6	31	70.7	32
Provision for income taxes	26.1	11	30.1	12	27.9	13
Net income	42.7	17	46.5	19	42.8	19
Net income per common share assuming dilution	2.45		2.45		2.05	
Operating cash flow ¹	84.9		88.7		81.7	

- 1 Operating cash flow represents earnings before interest, income taxes, depreciation and amortization. Operating cash flow is used by management and certain investors as an indicator of a company's historical ability to service debt. However, operating cash flow is not intended to represent cash flow from operations for the period, nor has it been presented as an alternative to either (i) operating income (as determined by GAAP) as an indicator of operating performance or (ii) cash flow from operating, investing and financing activities (as determined by GAAP). Operating cash flow is, therefore, susceptible to varying calculations and, as presented, may not be comparable to other similarly titled measures of other companies.

COMPARISON OF RESULTS OF OPERATIONS 1999 TO 1998

Net Sales--Net sales increased \$2.5 million, or 1%, from \$243.4 million in 1998 to \$245.9 million in 1999. The increase in sales was principally due to an increase in sales volume, offset partially by an increase in the amount provided for returned product. Sales of Village Series products increased 5% from 1998 to 1999, while General Giftware product sales decreased 6% during the same period. Village Series products continued to account for the most significant portion of the Company's sales, 67% in 1999 versus 65% in 1998.

Gross Profit--Gross Profit decreased \$.5 million, or less than 1%, between 1998 and 1999. Gross profit as a percentage of sales decreased from 58.6% in 1998 to 57.8% in 1999, principally due to an increase in the amount provided for returned product.

Selling, General and Administrative Expenses--Selling, general and administrative expenses increased \$4.9 million, or 9%, between 1998 and

1999. The increase is principally due to a 31% increase in distribution expenses, a 12% increase in marketing expenses and a 2% increase in administrative expenses. The increase in distribution expense was principally due to a \$.9 million charge related to the Company's consolidation of its two current distribution centers and a storage facility into one new distribution center in 2000, and a 63% increase in temporary labor due to the shipping difficulties

experienced as a result of the implementation of the Company's new integrated computer system. The increase in administrative expenses is principally due to an increase in bad debt expense, the write-off of failed acquisition costs, an increase in showroom expense as a result of the Company's acquisition of showrooms during 1999 and 1998, an increase in depreciation expense associated with the implementation of the integrated computer system, and expenses associated with the operation of the Company's first retail store. These increases were principally offset by a decrease in commission expense due to the acquisition of showrooms, a decrease in bonus expense and a decrease in other administrative expenses. Selling, general and administrative expenses as a percentage of sales was 23% and 25% during 1998 and 1999, respectively.

Income from Operations--Income from operations decreased \$5.6 million, or 7%, from 1998 to 1999 due to the factors described above. Operating margins decreased from 33% of net sales in 1998 to 31% of net sales in 1999.

Interest Expense--Interest expense increased \$1.9 million, or 40%, between 1998 and 1999 principally due to increased borrowings under the revolving credit agreement. Additional borrowings were required as a result of slower cash collections which were impacted by the timing and manner in which invoices, shipping documents and statements were mailed to customers as a result of the implementation of the new integrated computer system. Additional borrowings were also required due to increased capital expenditures.

Provision for Income Taxes--The effective income tax rate was 39.3% and 38.0% during 1998 and 1999, respectively.

COMPARISON OF RESULTS OF OPERATIONS 1998 TO 1997

Net Sales--Net sales increased \$23.9 million, or 11%, from \$219.5 million in 1997 to \$243.4 million in 1998. This increase was due principally to an increase in volume. Sales of Village Series products increased 13% from 1997 to 1998, while General Giftware product sales increased 7% during the same period. Village Series products continued to account for the most significant portion of the Company's sales, 65% in 1998 versus 64% in 1997.

Gross Profit--Gross Profit increased \$17.1 million, or 14%, between 1997 and 1998. Gross profit as a percentage of sales increased from 57.2% in 1997 to 58.6% in 1998, principally due to a change in the mix of product shipped during 1998 as compared to 1997 and the benefit derived from selling directly to the Canadian market.

Selling, General and Administrative Expenses--Selling, general and administrative expenses increased \$6.9 million, or 14%, between 1997 and 1998 principally due to a 45% increase in marketing expenses, a 19% increase in distribution expenses, and a 6% increase in administrative expense. Selling, general and administrative expenses as a percentage of sales was 23% in both 1997 and 1998.

Income from Operations--Income from operations increased \$9.9 million, or 14%, from 1997 to 1998 due to the factors described above. Operating margins increased from 32% of net sales in 1997 to 33% of net sales in 1998.

Interest Expense--Interest expense increased \$.5 million, or 10%, between 1997 and 1998 principally due to increased borrowings under the revolving credit agreement, offset by a decrease in interest

expense from the repayment of \$20 million of debt in December 1997. Borrowings under the revolving credit agreement increased as a result of the timing of stock repurchases and the increase in capital expenditures and acquisitions.

Provision for Income Taxes--The effective income tax rate was 39.5% and 39.3% during 1997 and 1998, respectively.

SEASONALITY

Historically, principally due to the timing of wholesale trade shows early in the calendar year and the limited supply of the Company's products, the Company has received the majority of its total annual customer orders during the first quarter of each year. The Company entered 65% of its total annual customer orders for both 1999 and 1998, during the first quarter of each of those years. Cancellations of total annual customer orders were approximately 8% and 7% in 1999 and 1998, respectively.

The Company shipped and recorded as net sales (net of returns, allowances and cash discounts), approximately 87% and 91% of its annual customer orders in 1999 and 1998, 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 was \$5.4 million and \$4.0 million at January 1, 2000 and January 2, 1999, respectively.

The Company receives products, pays its suppliers and ships products throughout the year, although historically the majority of 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 sales during the second and third quarters of each year. The Company expects this seasonal pattern to continue for the foreseeable future. The Company can experience fluctuations in quarterly sales growth and related net income compared with the prior year due to the timing of receipt of product from suppliers and subsequent shipment of product from the Company to customers, as well as the timing of orders placed by customers. The Company is not managed to maximize quarter-to-quarter results, but rather to achieve broader, long-term annual growth consistent with the Company's business strategy.

	1999					1998				
	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	Total	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	Total
Customer orders entered	\$182.3	\$47.7	\$39.9	\$11.4	\$281.3	\$173.7	\$50.0	\$37.1	\$ 7.7	\$268.5
Net sales	33.7	82.7	75.1	54.4	245.9	49.0	69.9	71.5	52.9	243.4
Gross profit	19.9	49.2	44.1	28.8	142.1	28.4	41.2	41.7	31.2	142.6
Selling, general and administrative expenses	12.5	16.5	16.5	16.1	61.5	11.6	13.6	14.3	17.1	56.6
Amortization of goodwill, trademarks and other										

intangibles	1.3	1.3	1.3	1.3	5.2	1.2	1.3	1.3	1.3	4.9
Income from operations	6.2	31.5	26.3	11.4	75.4	15.7	26.3	26.1	12.9	81.0
Net income	3.3	18.7	15.0	5.6	42.7	9.2	15.4	15.0	6.9	46.5
Net income per common share assuming dilution ²	0.18	1.04	0.87	0.35	2.45	0.47	0.80	0.81	0.38	2.45

- 1 Customer orders entered are orders received and approved by the Company, subject to 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

In March 1999, the Company entered into a new credit agreement providing a \$100 million revolving credit facility and a \$150 million revolver/term loan. The \$150 million revolver/term loan converts to a four-year term loan after one year.

The Company used the proceeds of the revolver/term loan to refinance the remaining \$20 million term loan under its former credit agreement. In connection therewith, the Company recorded \$1.7 million in deferred financing fees, which are being amortized over the life of the credit agreement.

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 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 current credit facility. As of March 17, 2000, the total term debt outstanding is \$150 million. All term debt is four-year term debt which requires annual amortization payments of 15%, 20%, 25%, and 40% due March 2001, 2002, 2003, and 2004, respectively. The proceeds will be used primarily to fund the Company's share repurchase program, other strategic initiatives, and general corporate purposes.

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.

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

Accounts receivable increased from \$26.2 million at January 2, 1999 to \$65.6 million at January 1, 2000. The increase in accounts receivable was principally due to lower cash collections which were impacted by the timing

and manner in which invoices, shipping documents and statements were mailed to customers as a result of the implementation of the Company's integrated computer system. As of March 18, 2000, the Company's accounts receivable were \$69.1 million, as compared to a comparable historical balance of less than \$40 million. Management believes there is adequate provision for any doubtful accounts receivable and sales returns that may arise.

Capital expenditures were \$16.4 million, \$6.8 million, and \$7.8 million for 1999, 1998 and 1997, respectively. Included in 1999 and 1998 capital expenditures is \$7.7 million and \$4.1 million, respectively, incurred in connection with the Company's implementation of its integrated computer system. The new integrated system significantly updates the Company's predecessor information system capabilities and eliminated the Year 2000 issues for the Company's primary business systems. During 1999, capital expenditures related to the Company's new distribution facility and the

Company's first retail store totaled \$5.7 million and \$2.0 million, respectively. Included in 1997 capital expenditures is \$4.9 million in connection with the Company's exercise of a purchase option under its aircraft lease agreement. See Note 6 to the Consolidated Financial Statements.

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.

During 1998, the Company acquired substantially all of the assets of the independent sales representative organizations that represented the Company's products in California and several surrounding western states and New York and several surrounding eastern states. Also during 1998, the Company acquired the inventory and certain other assets of its Canadian distributor. The cost of these acquisitions was \$4.7 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 will consolidate its two current distribution centers and storage facility into the new distribution center. Estimated costs of \$.9 million (pre-tax) were recorded in 1999 related to noncancelable lease contracts associated with the existing rented facilities.

Operating cash flow, defined as earnings before interest, income tax, depreciation, and amortization expenses, decreased \$3.8 million, or 4%, from \$88.7 million in 1998 to \$84.9 million in 1999. The decrease was principally due to the decrease in net income.

The Company has a stock repurchase program. On May 10, 1999, the Board of Directors of the Company authorized the repurchase in open market and privately negotiated transactions of up to an additional 3.0 million shares valid through the end of the Company's 2000 fiscal year. On December 15, 1999, the Board of Directors approved an additional \$75 million authorization valid through the end of the Company's 2000 fiscal year. The timing, prices and amounts of shares repurchased will be determined at the discretion of the Company's management and subject to continued compliance with the Company's credit facilities. Under the program, the Company repurchased in the open market 2.9 million shares during 1999 at a weighted average price of \$24 per share. The Company is authorized to repurchase an additional 0.7 million shares, in addition to the \$75 million authorization, through the end of 2000.

YEAR 2000

On January 3, 1999, the Company substantially implemented a new integrated computer system, which replaced its primary operating and financial computing systems and allowed the Company to substantially address Year 2000 requirements. While the implementation did negatively impact the Company in fiscal 1999 and is expected to present increased expense in fiscal 2000, as of March 21, 2000, the Company has not experienced and does not anticipate any adverse effects on the Company's systems and operations as a result solely of Year 2000 compliance issues. Further, as of March 21, 2000, the Company has not experienced any operating problems or product failures as a result of Year 2000 compliance issues with its vendors, service providers, or customers.

Total expenditures for implementation of the integrated computer system were approximately \$12 million, of which, approximately \$8 million and \$4 million were incurred during 1999 and 1998, respectively. Hardware, software, internal labor costs, and certain project costs were capitalized and will be amortized over their useful lives. All other costs were expensed as incurred.

FOREIGN EXCHANGE

The dollar value of the Company's assets abroad is not significant. Substantially all of the Company's sales are denominated in U.S. dollars and, as a result, are not subject to changes in exchange rates.

The Company imports its product from manufacturers located in the Pacific Rim, primarily China, Taiwan (Republic of China), and The Philippines. These transactions are principally denominated in U.S. dollars, except for imports from Taiwan which are principally denominated in New Taiwan 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 intends to manage foreign exchange risks to the extent possible and take appropriate action where warranted. The Company's costs could be adversely affected if the currencies of the Countries in which the manufacturers operate appreciate significantly relative to the U.S. dollar.

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.

RECENT DEVELOPMENTS

On February 23, 2000, the Company issued a press release stating in relevant part: "We continue to see this year as a rebuilding year with our dealers... Dealer orders through February 19 were down approximately 8% against the comparable period in the prior year. Year-to-date Village orders were approximately 10% behind the comparable period in the prior year, while General Giftware orders were down approximately 3%. The Company stated that excluding the impact of the special one-time Customer Appreciation Discount that it has offered on early orders for most product categories, as announced in December 1999, dealer orders would be down only approximately 4%." The press release also noted, "While we are disappointed with the pace of our current orders, many of our customers have expressed confidence that we will be able to ship in a more timely fashion, enabling them to reorder more frequently. Our own successful initiative to, for the first time, have actual samples for all of our Village lines at the early gift shows, coupled with earlier product availability, may support or reinforce this belief of our dealers. This potential change in our historical order pattern, combined with other analyses, suggests that the

gap in our order trends may close as we progress through the year. It is important to keep in mind that, as history has shown, where we are in terms of orders at this point in the year is not necessarily indicative of where we will end up at the end of the first quarter or even the year."

The press release further stated: "The Company expects certain costs that impacted its 1999 results to continue in fiscal 2000, primarily related to the ongoing information systems implementation and distribution facility consolidation costs. In addition, continued strategic investments in the Company's infrastructure, including business-to-business e-commerce initiatives, are expected to result in higher costs in fiscal 2000 in order to position greater operational efficiencies and

merchandising effectiveness for the Company and its dealers in the future. As a result, the Company believes that fiscal 2000 earnings per share will be below that of fiscal 1999 results, excluding the impact of its stock repurchase initiatives..."

"I am pleased to report that our systems have performed well during the gift shows and that our shipping and invoicing operations are back to normal. Feedback from our dealers suggests that they view our current product offering as one of the strongest ever," Ms. Engel continued. "We continue to be excited about the quality and breadth of our product development capabilities."

"We maintain our belief that investment in our infrastructure is necessary to sustain our industry leadership, maximize long-term growth and create value for our shareholders. Therefore, we remain committed to investing in programs that insure the success of our current dealer base. At the same time, we will continue to look toward other avenues that will allow us to leverage our current skills and achieve our growth objectives."

Additionally, the Company announced it completed a \$4 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. "We are excited about the opportunity that we have to partner with an organization that possesses a creative skill set much like ours. The management of 2-Day has proven success in marketing differentiated products, and we are excited about the access to new channels that this investment creates," said Ms. Engel. The terms of the transaction were not disclosed.

On Form 8-K dated February 25, 2000, the Company stated: "In addition to the statements contained in the press release, the Company expects that its fiscal 2000 Gross Margin Rate (i.e., the amount that Gross Profit represents as a percentage of Net Sales) will approximate or slightly exceed its fiscal 1999 Gross Margin Rate. The Company expects that its fiscal 2000 Selling, General & Administrative expenses (SG&A) will reflect approximately \$7 million in infrastructure and strategic initiative expenses in addition to the Company's usual and customary SG&A expenses. The expected incremental infrastructure and strategic initiative expenses are attributable primarily to costs associated with the Company's ongoing information systems implementation, distribution facility consolidation and direct retail initiatives, as well as a new business-to-business e-commerce initiative. The Company also notes that a reduced base of Net Sales for fiscal 2000 would imply a current year deleveraging of its total SG&A expenses."

The federal securities laws provide "safe harbor" status to certain statements that go beyond historical information and which may provide an indication of future results. Any conclusions or expectations expressed in, or drawn from, the statements in the press release or the Form 8-K 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 expectations regarding 2000 earnings per share are based on the Company's 2000 expectations for sales and operating margin. The Company's sales expectations for 2000 are based on the Company's current forecast of dealer orders and planned sales through its retail arm, and is further dependent on the timing and extent of promotional and marketing efforts undertaken by the Company as well as the timing and extent of product receipts and shipments, the efficiency of information systems developed to collect, compile and execute customer orders, and retailer and consumer demand. Dealer orders have principally been dependent on the amount, quality and market acceptance of the new product introductions and retailer demand, but order patterns have

historically varied in number, mix and timing, and there can be no assurance that the year-to-date order levels or trends will not deteriorate, or that they will exhibit levels or trends supportive of a shift toward greater orders later in the year. Moreover, the Company's order forecasting model is dependent on assumptions concerning retail inventory levels, consumer demand, and dealer expectations. The Company's operating margin may be impacted by, amongst other factors, shifts in product mix and/or gross margin, exchange rate fluctuations with countries the Company imports from, changes in freight rates and changes in the Company's historical selling, general and administrative expense rate, including bad debts.

If not otherwise mentioned, other factors, including consumer acceptance of new products; product development efforts; identification and retention of sculpting and other talent; completion of third party product manufacturing; dealer reorders and order cancellations; control of operating expenses; 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; and industry, general economic, regulatory, transportation, and international trade and monetary conditions, can significantly impact the Company's sales, earnings and earnings per share. 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.

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Information required by this Item is included in Management's Discussion and Analysis on page 10, and Note 1 to the Consolidated Financial Statements.

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 2000 Proxy Statement in the sections captioned "Item 1 -- Election of Directors -- Nominees for Terms Ending at the 2001 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 2000 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 2000 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

See Note 9 to the Consolidated Financial Statements on page F-13.

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.	
Management's Responsibility for Financial Reporting	F-1
Independent Auditors' Report	F-2
Consolidated Balance Sheets as of January 1, 2000 and January 2, 1999	F-3
For the years ended January 1, 2000, January 2, 1999 and January 3, 1998:	
Consolidated Statements of Income	F-4
Consolidated Statements of Cash Flows	F-5
Consolidated Statements of Stockholders' Equity	F-6
Notes to Consolidated Financial Statements	F-7

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)
- 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.*
- 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.*
- 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.*
- 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. (Incorporated herein by reference to Exhibit 10.25 of Registrant's Registration Statement on Form S-1, No. 33-61514.)
- 10.11 Department 56, Inc. 1995 Stock Incentive Plan. (Incorporated herein by reference to Exhibit 10.18 of Registrant's Annual Report on Form 10-K for the fiscal year ended December 30, 1995. SEC File no. 1-11908)
- 10.12 Department 56, Inc. 1997 Stock Incentive Plan. (Incorporated herein by reference to Exhibit 4.4 of Registrant's Registration Statement on Form S-8, No. 333-41639.)
- 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.*
- 10.14 Form of Executive Performance Share Agreement in connection with Department 56, Inc. 1993, 1995 and 1997 Stock Incentive Plans.*
- 10.15 Department 56, Inc. Annual Cash Incentive Program. (Incorporated herein by reference to Exhibit 10.25 of Registrant's Annual Report on Form 10-K for the year ended January 3, 1998. SEC File no. 1-11908)
- 21.1 Subsidiaries of the Company.*
- 23.1 Independent Auditors' Consent.*

27.1 Financial Data Schedule. (accompanies EDGAR electronic format only)*

Management contract or compensatory plan

* Filed herewith

(b) Reports on Form 8-K

No reports on Form 8-K were filed during the fourth quarter of the year ended January 1, 2000.

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 29, 2000

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 ----- Susan E. Engel	Chairwoman of the Board, Chief Executive Officer and Director (Principal Executive Officer)	March 29, 2000
/s/ PERCY C. TOMLINSON, JR. ----- Percy C. Tomlinson, Jr.	Chief Financial Officer and Executive Vice President (Principal Financial Officer)	March 29, 2000
/s/ GREGG A. PETERS ----- Gregg A. Peters	Director -- Finance and Principal Accounting Officer (Principal Accounting Officer)	March 29, 2000
/s/ PETER K. BARKER ----- Peter K. Barker	Director	March 29, 2000
/s/ JAY CHIAT ----- Jay Chiat	Director	March 29, 2000

/s/ MAXINE CLARK		

Maxine Clark	Director	March 29, 2000
/s/ WM. BRIAN LITTLE		

Wm. Brian Little	Director	March 29, 2000
/s/ GARY S. MATTHEWS		

Gary S. Matthews	Director	March 29, 2000
/s/ STEVEN G. ROTHMEIER		

Steven G. Rothmeier	Director	March 29, 2000
/s/ VIN WEBER		

Vin Weber	Director	March 29, 2000

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

Management is responsible for the preparation and accuracy of the consolidated financial statements and other information included in this report. The consolidated financial statements have been prepared in conformity with generally accepted accounting principles using, where appropriate, management's best estimates and judgements.

The Company maintains a system of internal control that is adequate to provide reasonable assurance that the assets are safeguarded from loss or unauthorized use. This system produces records adequate for preparation of financial information. We believe the Company's internal control system is effective, and the cost of the internal control system does not exceed the benefits obtained.

The Board of Directors reviews the financial statements and reporting practices of the Company through its Audit Committee, which is composed entirely of directors who are not officers or employees of the Company. The Audit Committee meets with the independent auditors and management to discuss audit scope and results and to consider internal control and financial reporting matters. The independent auditors have direct unrestricted access to the Audit Committee. The entire Board of Directors reviews the Company's financial performance and financial plan.

Susan E. Engel
Chairwoman and Chief Executive Officer
Department 56, Inc.

INDEPENDENT AUDITORS' REPORT

To the 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 January 1, 2000, and January 2, 1999 and the related consolidated statements of income, cash flows, and

stockholders' equity for the years ended January 1, 2000, January 2, 1999, and January 3, 1998. 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 generally accepted auditing standards. 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 as of January 1, 2000 and January 2, 1999 and the results of its operations and its cash flows for the years ended January 1, 2000, January 2, 1999, and January 3, 1998 in conformity with generally accepted accounting principles. 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
March 17, 2000

DEPARTMENT 56, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except per share amounts)
AS OF JANUARY 1, 2000 AND JANUARY 2, 1999

	1999	1998
	-----	-----
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 3,962	\$ 2,783
Accounts receivable, net of allowances of \$18,287 and \$12,908, respectively	65,580	26,170
Inventories	15,901	18,287
Deferred taxes	9,448	6,704
Other current assets	4,751	3,957
	-----	-----
Total current assets	99,642	57,901
PROPERTY AND EQUIPMENT, net	29,857	17,722
GOODWILL, net of accumulated amortization of \$30,096 and \$25,862, respectively	139,340	141,528
TRADEMARKS AND OTHER INTANGIBLES, net of accumulated amortization of \$4,009 and \$3,097, respectively	16,596	16,003

OTHER ASSETS	1,673	129
	-----	-----
	\$ 287,108	\$ 233,283
	-----	-----
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Borrowings on revolving credit agreement	\$ 42,500	
Accounts payable	9,709	\$ 11,100
Commissions payable	513	3,062
Other current liabilities	14,631	14,463
	-----	-----
Total current liabilities	67,353	28,625
DEFERRED TAXES	6,831	5,923
LONG-TERM DEBT	60,000	20,000
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 and outstanding 21,964 and 21,900 shares, respectively	220	219
Additional paid-in capital	49,845	48,295
Treasury stock, at cost; 6,802 and 3,876 shares, respectively	(183,320)	(113,302)
Retained earnings	286,179	243,523
	-----	-----
Total stockholders' equity	152,924	178,735
	-----	-----
	\$ 287,108	\$ 233,283
	-----	-----

See notes to consolidated financial statements.

DEPARTMENT 56, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share amounts)
YEARS ENDED JANUARY 1, 2000, JANUARY 2, 1999, AND JANUARY 3, 1998

	1999	1998	1997
	-----	-----	-----
NET SALES	\$245,856	\$243,365	\$219,496
COST OF SALES	103,803	100,782	94,040
	-----	-----	-----
Gross profit	142,053	142,583	125,456
OPERATING EXPENSES:			
Selling, general and administrative	61,542	56,648	49,772
Amortization of goodwill, trademarks and other intangibles	5,145	4,926	4,577
	-----	-----	-----
Total operating expenses	66,687	61,574	54,349

INCOME FROM OPERATIONS	75,366	81,009	71,107
OTHER EXPENSE (INCOME):			
Interest expense	6,719	4,817	4,362
Gain on sale of aircraft	--	--	(2,882)
Other, net	(153)	(397)	(1,086)
INCOME BEFORE INCOME TAXES	68,800	76,589	70,713
PROVISION FOR INCOME TAXES	26,144	30,073	27,932
NET INCOME	\$ 42,656	\$ 46,516	\$ 42,781
NET INCOME PER COMMON SHARE	\$ 2.48	\$ 2.49	\$ 2.06
NET INCOME PER COMMON SHARE ASSUMING DILUTION	\$ 2.45	\$ 2.45	\$ 2.05

See notes to consolidated financial statements.

DEPARTMENT 56, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
YEARS ENDED JANUARY 1, 2000, JANUARY 2, 1999, AND JANUARY 3, 1998

	1999	1998	1997
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 42,656	\$ 46,516	\$ 42,781
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	4,189	2,385	2,031
Amortization of goodwill, trademarks and other intangibles	5,145	4,926	4,577
Amortization of deferred financing fees	269	--	--
Provision for uncollectible accounts receivable	3,276	888	1,087
Gain on sale of aircraft	--	--	(2,882)
Deferred taxes	(1,836)	(629)	(2,774)
Changes in assets and liabilities:			
Accounts receivable	(42,686)	(4,054)	11,512
Inventories	2,386	186	2,456
Other assets	(2,607)	(961)	(1,337)
Accounts payable	(1,391)	1,127	2,355
Commissions payable	(2,549)	(893)	(728)
Other current liabilities	990	2,582	4,882
Net cash provided by operating activities	7,842	52,073	63,960
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of property and equipment	(16,345)	(6,750)	(7,829)
Proceeds from sale of aircraft	--	--	8,567

Acquisitions	(3,970)	(4,660)	--
Net cash (used in) provided by investing activities	(20,315)	(11,410)	738
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from the exercise of common stock options	1,170	2,846	1,473
Borrowings on revolving credit agreement	94,500	75,500	17,985
Principal payments on revolving credit agreement	(52,000)	(75,500)	(17,985)
Purchases of treasury stock	(70,018)	(58,087)	(55,215)
Proceeds from issuance of long-term debt	40,000	--	--
Principal payments on long-term debt	--	(20,000)	(20,000)
Net cash provided by (used in) financing activities	13,652	(75,241)	(73,742)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,179	(34,578)	(9,044)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	2,783	37,361	46,405
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 3,962	\$ 2,783	\$ 37,361

See notes to consolidated financial statements.

DEPARTMENT 56, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands)
YEARS ENDED JANUARY 1, 2000, JANUARY 2, 1999, AND JANUARY 3, 1998

	Common Stock		Additional Paid-in Capital	Treasury Stock	Retained Earnings	Total Stockholders' Equity
	Shares	Amount				
BALANCE AS OF DECEMBER 28, 1996	21,584	\$ 216	\$ 42,315		\$ 154,226	\$ 196,757
Net income					42,781	42,781
Shares issued upon the exercise of common stock options	181	2	2,330			2,332
Shares repurchased	(2,199)			\$ (55,215)		(55,215)

BALANCE AS OF JANUARY 3, 1998	19,566	218	44,645	(55,215)	197,007	186,655
Net income					46,516	46,516
Shares issued upon the exercise of common stock options	131	1	3,541			3,542
Shares repurchased	(1,677)			(58,087)		(58,087)
Other	3		109			109
	-----	-----	-----	-----	-----	-----
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
	-----	-----	-----	-----	-----	-----

See notes to consolidated financial statements.

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--The Company is engaged in the original design, importation, and wholesale distribution of specialty giftware products. 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 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. During 1999, the Company opened its first retail store located in Bloomington, Minnesota. Retail revenues represented less than 1% of total 1999 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 January 1, 2000 and January 2, 1999 include 52 weeks, and the year ended January 3, 1998 includes 53 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.

Long-Lived Assets--The Company's policy is to review long-lived assets for impairment when events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If impairment indicators are present and the estimated future undiscounted cash flows are less than the carrying value of the assets and any related goodwill, the carrying value is reduced to the estimated fair value as measured by the discounted cash flows.

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. Upon retirement or other disposition of property, applicable cost and accumulated depreciation are removed from the accounts. Any gains or losses are included in earnings.

Goodwill--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. The Company periodically evaluates the recoverability of goodwill based on an analysis of estimated future undiscounted cash flows.

Trademarks and Other Intangible Assets--Trademarks and other intangible assets acquired are being amortized on a straight-line basis over 3 to 40 years. The Company periodically evaluates the recoverability of trademarks based on an analysis of estimated future undiscounted cash flows.

Revenue Recognition--Revenues are recognized when products are shipped, net of an allowance for returns.

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 U.S. dollars, some of the purchases are denominated in foreign currency. In addition, the Company's sales to Canada are denominated in Canadian dollars. To hedge its foreign exchange exposure, the Company may enter into foreign exchange contracts. The foreign exchange contracts reduce the Company's overall exposure to exchange rate movements, since the gains and losses on these contracts offset gains and losses on the transactions being hedged. Gains or losses on these contracts will be recognized and included in cost of sales at the time the related inventory is sold. The Company is exposed to credit risk to the extent of nonperformance by a counterparty to the foreign currency contracts. However, the Company believes it uses a strong financial counterparty in these transactions and that the resulting credit risk under these hedging strategies is not significant.

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 January 1, 2000 and January 2, 1999.

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 generally accepted accounting principles requires management to make estimates and assumptions that

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

Reclassifications--Certain reclassifications were made to the fiscal 1997 consolidated financial statements in order to conform to the presentation of the fiscal 1999 and 1998 consolidated financial statements. These reclassifications had no impact on consolidated net income or retained earnings as previously reported.

New Accounting Standards--During 1999, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 137, Accounting for Derivative Instruments and Hedging Activities--Deferral of the Effective Date of SFAS No. 133. This Statement delays the effective date of SFAS 133 to fiscal periods beginning after June 15, 2000. SFAS 133, Accounting for Derivative Instruments and Hedging Activities, was issued by the FASB during 1998. SFAS 133 establishes accounting and reporting standards for derivative instruments and hedging activities. The Company is currently evaluating the impact, if any, of this statement.

2. PROPERTY AND EQUIPMENT

Property and equipment at January 1, 2000 and January 2, 1999 is comprised of the following:

	1999	1998
	-----	-----
Leasehold improvements	\$ 6,519	\$ 3,026
Furniture and fixtures	4,239	2,585
Computer equipment	15,560	8,495
Other equipment	8,735	5,175
Building	6,896	6,764
Land	906	906
	-----	-----
	42,855	26,951
Less accumulated depreciation	12,998	9,229
	-----	-----
Property and equipment, net	\$ 29,857	\$ 17,722
	-----	-----

3. OTHER CURRENT LIABILITIES

Other current liabilities at January 1, 2000 and January 2, 1999 are comprised of the following:

	1999	1998
	-----	-----
Accrued compensation and benefits	\$ 3,581	\$ 4,698
Income taxes payable	8,411	7,768
Deferred revenue	694	754
Accrued royalty fees	818	578
Other	1,127	665
	-----	-----
	\$ 14,631	\$ 14,463
	-----	-----

4. CREDIT AGREEMENT

Long-term debt at January 1, 2000 and January 2, 1999 is comprised of the following:

	1999	1998
	-----	-----
Total debt	\$ 102,500	\$ 20,000
Less borrowings classified as current	42,500	--
	-----	-----
	\$ 60,000	\$ 20,000
	-----	-----

In March 1999, the Company entered into a new credit agreement providing a \$100 million revolving credit facility and a \$150 million revolver/term loan. The \$150 million revolver/term loan converts to a four-year term loan after one year. The revolver/term loan will have

annual amortization payments of 15%, 20%, 25%, and 40% of the amount outstanding at conversion in March 2001, 2002, 2003, and 2004, respectively. See Note 12.

The Company used the proceeds of the revolver/term loan to refinance the remaining \$20 million term loan under its former credit agreement. As of January 2, 1999, the \$20 million term loan is classified as non-current to reflect the refinancing. In connection therewith, the Company recorded \$1.7 million in deferred financing fees which are being amortized over the life of the credit agreement.

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 sum of the Company's revolving credit loans and bankers' acceptances may not exceed an aggregate of \$30 million during any one 30-consecutive-day period each calendar year. 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. The credit agreement also requires maintenance of minimum levels of interest coverage, net worth and maximum levels of leverage.

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 \$8,023, \$4,859, and \$4,400 during the years ended January 1, 2000, January 2, 1999, and January 3, 1998, respectively.

5. INCOME TAXES

The provision for income taxes at January 1, 2000, January 2, 1999, and January 3, 1998 consisted of the following:

	1999	1998	1997
	-----	-----	-----
Current:			
Federal	\$25,427	\$28,188	\$28,225
State	2,180	2,416	2,419
Foreign	373	98	62
Deferred	(1,836)	(629)	(2,774)
	-----	-----	-----
	\$26,144	\$30,073	\$27,932
	-----	-----	-----

At January 1, 2000, January 2, 1999, and January 3, 1998, the reconciliation between income tax expense based on statutory income tax rates and the provision for income taxes per the consolidated statements of income is as follows:

	1999	1998	1997
	-----	-----	-----
Income taxes at federal statutory rate	\$24,080	\$26,806	\$24,750
State income taxes, net of federal income tax	1,033	1,915	1,768
Amortization of goodwill	1,448	1,448	1,448
Other	(417)	(96)	(34)
	-----	-----	-----
Provision for income taxes	\$26,144	\$30,073	\$27,932
	-----	-----	-----

The components of the net deferred tax asset at January 1, 2000 and January 2, 1999 were as follows:

	1999	1998
	-----	-----
DEFERRED TAX ASSETS:		
Asset valuation allowances	\$ 8,416	\$ 6,431
Compensation expense -- common stock options	286	121
Accrued liabilities	730	400
Other	564	172
	-----	-----
Total deferred tax assets	9,996	7,124
DEFERRED TAX LIABILITIES:		
Trademarks	(5,569)	(5,739)
Property and equipment	(1,667)	(379)
Other	(143)	(225)
	-----	-----
Total deferred tax liabilities	(7,379)	(6,343)
	-----	-----
	\$ 2,617	\$ 781
	-----	-----

The \$2,617 net deferred tax asset at January 1, 2000 is presented as a net deferred current asset of \$9,448 and a net deferred noncurrent liability of \$6,831. The \$781 net deferred tax asset at January 2, 1999 is presented as a net deferred current asset of \$6,704 and a net deferred noncurrent liability of \$5,923.

The Company paid income taxes of \$28,085, \$29,829, and \$28,134 during the years ended January 1, 2000, January 2, 1999, and January 3, 1998, 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 ten years. In addition to the base rent, the Company pays its proportionate share of taxes and 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 January 1, 2000:

2000	\$ 3,453
2001	2,996
2002	3,040
2003	2,839
2004	2,850
Thereafter	9,849

	\$25,027

The Company's rental expense was \$3,326, \$2,533, and \$2,934 for the years ended January 1, 2000, January 2, 1999, and January 3, 1998, respectively.

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 will consolidate its two current distribution centers and storage facility into the new distribution center. Estimated costs of \$931 (pre-tax) were recorded in 1999 related to noncancelable lease contracts associated with the existing rented facilities.

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.

Letters of Credit--The Company had outstanding standby and commercial letters of credit amounting to \$1,701 at January 1, 2000 relating primarily to purchase commitments issued to foreign suppliers and vendors.

Legal Proceedings--The Company is involved in various legal proceedings, claims and governmental audits in the ordinary course of its business. In the opinion of the Company's management, the ultimate disposition of these proceedings, claims and audits will not have a material adverse effect on the financial position or results of operations 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. The Company's total profit-sharing contributions were \$1,249, \$1,025, and \$1,136 for the years ended January 1, 2000, January 2, 1999, and

January 3, 1998, respectively.

8. ACQUISITIONS

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.

During 1998, the Company acquired substantially all of the assets of the independent sales representative organizations that represented the Company's products in California and several surrounding western states and New York and several surrounding eastern states. Also during 1998, the Company acquired the inventory and certain other assets of its Canadian distributor. The cost of these acquisitions was \$4.7 million.

9. RELATED-PARTY TRANSACTIONS

In the ordinary course of business, the Company sells product to a floral and nursery wholesaler and retailer, of which a former director of the Company is an officer, director and stockholder. The Company had sales to this floral and nursery business during the years ended January 1, 2000, January 2, 1999, and January 3, 1998 of \$1,097, \$1,448, and \$1,323, respectively.

During the year ended January 3, 1998, the Company paid \$1,343 for aircraft management, transportation and other expenses to an affiliate of a former director of the Company.

During 1997, the Company was reimbursed \$467 by a former director and officer of the corporation for use of the Company's aircraft.

On November 10, 1997, the Company purchased 250,000 shares of its common stock from a former director and officer of the Company at a price per share equal to the closing price in consolidated trading on that day.

10. STOCKHOLDERS' EQUITY

Stock-Based Compensation Plans--At January 1, 2000, the Company had four stock-based compensation plans. Under the 1992, 1993, 1995, and 1997 stock option and incentive plans, the Company may grant options to its directors, officers, employees, consultants and advisors of the Company for up to 292,500, 1,000,000, 600,000 and 1,500,000 shares of common stock, respectively. All employee options granted after the initial public offering have an exercise price equal to the market value of the common stock at the date of grant, generally have a term of 10 years, and generally are exercisable in equal installments on each of the first, second and third anniversaries of the date of the grant. At January 1, 2000, the shares available for granting under the 1992, 1993, 1995, and 1997 stock option and incentive plans were 7,333, 79,532, 19,548, and 586,392 shares, respectively.

A summary of the status of the Company's four stock option and incentive plans as of January 1, 2000, January 2, 1999, and January 3, 1998, and changes during the years ended on those dates is presented below:

	1999		1998		1997	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	1,724,357	\$ 26.80	1,983,578	\$ 26.25	1,291,908	\$ 27.51
Granted	458,300	25.42	97,000	31.87	806,000	23.07
Exercised	(56,482)	20.52	(129,625)	21.90	(85,415)	13.53
Forfeited	(31,864)	24.77	(226,596)	26.94	(28,915)	31.93
Outstanding at end of year	2,094,311	26.70	1,724,357	26.80	1,983,578	26.25
Options exercisable at end of year	1,446,272	27.63	1,085,026	28.95	798,258	30.43
Weighted average fair value of options granted during the year	\$ 12.33		\$ 14.89		\$ 10.96	

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 1997, 1998, and 1999 stock option grants consistent with the method of SFAS 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:

	1999	1998	1997
Net Income:			
As reported	\$42,656	\$46,516	\$ 42,781
Pro forma	40,647	44,223	40,245
Net Income per Common Share Assuming Dilution:			
As reported	\$ 2.45	\$ 2.45	\$ 2.05
Pro forma	2.34	2.33	1.93

In determining the preceding pro forma amounts under SFAS 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 1999, 1998, and 1997, respectively: risk-free interest rates of 5.9 percent, 5.2 percent, and 6.2 percent, expected volatility of 38 percent, expected lives of

6 years and no expected dividends. The effects of applying SFAS 123 in this pro forma disclosure are not indicative of future compensation costs. SFAS 123 does not apply to awards prior to 1995, and additional awards are anticipated.

The following table summarizes information about the Company's stock option and incentive plans at January 1, 2000:

Range of Exercise Prices	Number Outstanding at January 1, 2000	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable at January 1, 2000	Weighted Average Exercise Price
\$ 3.33	40,500	2.1 years	\$ 3.33	40,500	\$ 3.33
18.00-21.47	983,117	7.3	20.75	662,249	20.84
21.48-37.75	1,070,694	6.8	33.04	743,523	34.99
	2,094,311			1,446,272	

In addition to stock options granted under the Company's stock option and incentive 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 1999, 1998 and 1997, members of the Board of Directors exercised 3,000, 2,000, and 95,000 options, respectively. At January 1, 2000, directors' options to purchase 35,000 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 Shares--During 1999, the Company began to grant performance shares to executive officers. The performance share grants were made for overlapping "initial stub" one-year and two-year cycles, as well as a "full cycle" three-year performance period. Each performance

share represents one notional common stock equivalent and 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 1999, the Company granted: 11,500 performance shares for the one-year cycle ended 1999; 23,899 performance shares granted and

outstanding for the two-year cycle ending 2000; and 35,825 performance shares granted and outstanding for the three-year cycle ending 2001. The Company did not achieve the minimum EPS threshold for the one-year cycle (ended 1999) performance shares, and accordingly no pay-outs were made and those performance shares were cancelled.

11. INCOME PER COMMON SHARE

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

	1999	1998	1997
Net income	\$ 42,656	\$ 46,516	\$ 42,781
Weighted average number of shares outstanding	17,214,000	18,676,000	20,744,000
Net income per common share	\$ 2.48	\$ 2.49	\$ 2.06
Net income	\$ 42,656	\$ 46,516	\$ 42,781
Weighted average number of shares outstanding	17,214,000	18,676,000	20,744,000
Dilutive impact of options outstanding	174,000	284,000	152,000
Weighted average number of shares and potential dilutive shares outstanding	17,388,000	18,960,000	20,896,000
Net income per common share assuming dilution	\$ 2.45	\$ 2.45	\$ 2.05

Options to purchase 914,000 shares of common stock at exercise prices between \$27 and \$38 per share were outstanding at January 1, 2000 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.

12. SUBSEQUENT EVENTS

On January 20, 2000, the Company completed a \$4 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 will be accounted for under the equity method of accounting.

During the first quarter of 2000, the Company borrowed an additional \$90 million of term debt under its current facility. As of March 17, 2000, the total term debt outstanding is \$150 million. All term debt is four-year term debt which requires annual amortization payments of

15%, 20%, 25% and 40% due March 2001, 2002, 2003, and 2004, respectively.

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 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
	<u>\$ 12,908</u>	<u>\$ 16,013</u>	<u>\$ 10,634</u>	<u>\$ 18,287</u>
Year ended January 2, 1999:				
Allowance for doubtful accounts	\$ 5,160	\$ 888	\$ 869(a)	\$ 5,179
Allowance for sales returns and credits	7,897	8,657	8,825	7,729
	<u>\$ 13,057</u>	<u>\$ 9,545</u>	<u>\$ 9,694</u>	<u>\$ 12,908</u>
Year ended January 3, 1998:				
Allowance for doubtful accounts	\$ 5,014	\$ 1,087	\$ 941(a)	\$ 5,160
Allowance for sales returns and credits	5,249	8,752	6,104	7,897
	<u>\$ 10,263</u>	<u>\$ 9,839</u>	<u>\$ 7,045</u>	<u>\$ 13,057</u>

(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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MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING
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LEASE AGREEMENT

This LEASE AGREEMENT, made as of this 14th day of April, 1999, between Ryan Companies US, Inc., a Minnesota corporation ("Landlord"), and D56, Inc., a Minnesota corporation ("Tenant");

WITNESSETH, THAT

1.1 PREMISES: Landlord, subject to the terms and conditions hereof, hereby leases to Tenant, its successors and assigns, certain premises ("Premises") consisting of the building to be built at Wilfred Lane North and Commerce Boulevard, Rogers, Minnesota ("Building"), the land underlying and contiguous thereto together with any appurtenant easements and all improvements thereon. The legal description of the land is attached hereto as Exhibit A. A schematic depiction of the Project is attached hereto as Exhibit B. The Premises are subject to certain easements, restrictions, reservations and encumbrances as set forth on Exhibit A (the "PERMITTED EXCEPTIONS").

Landlord represents that it is the fee simple owner of the Premises subject only to the Permitted Exceptions, and that it will not subject the Premises to new or additional Permitted Exceptions without the written consent of Tenant.

1.2 OPTION TO EXPAND INTO ADDITIONAL SPACE: Tenant may from time to time elect to expand the Building (such expansion referred to as the "Expansion Space"). Tenant's election shall be exercised by written notice to Landlord specifying the approximate size, location and general design requirements of the proposed expansion, delivered no less than one (1) year prior to the date on which Tenant desires to occupy the Expansion Space (the "Election Notice"). The area designated Expansion on Exhibit B depicts the maximum anticipated expansion of the Building.

(a) Within thirty (30) days of receipt of the Election Notice, Landlord and Tenant will meet two (2) times to discuss and attempt to agree upon schematic plans and specifications for the Expansion Space (the "SCHEMATICS"). Following the written approval of the Schematics by Landlord and Tenant, Landlord will proceed with the preparation of the "EXPANSION SPACE OUTLINE PLANS AND SPECIFICATIONS" which will be developed from the Schematics. The Expansion Space Outline Plans and Specifications will be submitted to Tenant for its approval within thirty (30) days of said approval of the Schematics and will contain similar detail as are contained in the Outline Plans and Specifications attached hereto as Exhibit D.

Within twenty (20) days following receipt of the Expansion Space Outline Plans and Specifications, Tenant will either approve the same or request such changes as it deems appropriate, which changes will then be incorporated into the Expansion Space Outline Plans and Specifications by Landlord. Landlord and Tenant will use reasonable efforts to agree upon the Expansion Space Outline Plans and Specifications within sixty (60) days of their approval of the Schematics. During the development of the Expansion Space Outline Plans and Specifications, Landlord will make application for all required governmental approvals for the Expansion Space, (the "EXPANSION SPACE PERMITS") and will diligently pursue the issuance of the Expansion Space Permits. Landlord shall prepare the Schematics, the Expansion Space Outline Plans and Specifications and the

Expansion Space Final Plans and Specifications (as defined below) at Landlord's initial cost, but to be included in the Expansion Space Total Project Cost.

(b) Upon the approval of the Expansion Space Outline Plans and Specifications, Landlord will inform Tenant of the proposed increase in Base Rent attributable to the Expansion Space (the "EXPANSION SPACE BASE Rent") and the Landlord's "EXPANSION SPACE TOTAL PROJECT COST", which shall include all costs in the categories identified on Exhibit "C", but not including any land costs. To determine the Expansion Space Total Project Cost, Landlord or Landlord's designated general contractor shall solicit bids from no less than two (2) financially responsible subcontractors in each of the major subcontract categories, including, by way of example, earthwork concrete, steel, steel erection, roofing, mechanical and electrical. The Expansion Space Base Rent, beginning on the date of Substantial Completion of the Expansion Space and continuing for five (5) years thereafter, shall be equal to the Expansion Space Total Project Cost, (minus any savings) plus an amount equal to six percent (6%) of the "EXPANSION SPACE ACTUAL CONSTRUCTION COSTS" which shall be calculated in the same manner as Actual Construction Costs are calculated pursuant to Exhibit C but only with respect to the Expansion Space, and which shall be reduced by the amount of any savings, multiplied by a commercially reasonable mortgage constant plus fifty (50) basis points. For purposes of the Expansion Space, the term "Substantial Completion" will have the same meaning as set forth in Exhibit C. Landlord and Tenant shall cooperatively make a reasonable effort to secure commercially reasonable financing containing terms no less favorable to Landlord as borrower than (i) a twenty (20) year amortization schedule, (ii) an eighty percent (80%) loan to value ratio and (iii) a mortgage constant no greater than eleven and one-half percent (11.5%). Tenant shall not be obligated for the payment of Expansion Space Base Rent, or other charges with respect to the Expansion Space until the Expansion Space has been Substantially Completed. At the same time Landlord informs Tenant of the Expansion Space Base Rent and the Expansion Space Total Project Cost, Landlord shall also advise Tenant whether, in Landlord's reasonable judgment, the Expansion Space can be Substantially Completed on or before the date which is five (5) full calendar years prior to the expiration of the Term, as it may have been previously extended and, if not, Landlord will advise Tenant when the Landlord estimates that the Expansion Space will be Substantially Completed.

(c) If Tenant is dissatisfied with the Expansion Space Total Project Costs and/or the Expansion Space Base Rent, it may retract its Election Notice.

(d) If Tenant elects to proceed to have Landlord construct the Expansion Space, as specified above, then Landlord and Tenant shall enter into an amendment to this Lease (the "EXPANSION AMENDMENT") in form and content reasonably acceptable to Landlord and Tenant, which will be prepared by Landlord and which will provide as follows:

(i) a summary of the Expansion Space Base Rent; and

(ii) if, pursuant to the Landlord's completion estimate, as specified in Section 1.2(b) above, the Expansion Space cannot be Substantially Completed on or before a date which is five (5) full calendar years prior to the expiration of the Term, as it may have been previously extended, an extension of the then current Term so that the Term shall expire on the last day of the

month which is five (5) years from the date of Substantial Completion of the Expansion Space (the "EXPANSION EXTENSION").

The Expansion Extension shall be in lieu of any portion of the Term which would have existed upon the date of Substantial Completion of the Expansion Space; provided, however, the exercise of the Expansion Extension shall not eliminate any unexercised Extended Terms. The extension of the Term or any Extended Term due to an Expansion Extension will not adjust the rent schedule for any space not subject to the Expansion Extension then being exercised, and the Base Rent for any such space will adjust at the same time it would have absent such expansion (as though options to extend had been exercised). In the event that there would not be at least two (2) three (3) year Extended Terms remaining following the Expansion Extension, the Expansion Amendment shall also include the addition of a sufficient number of Extended Terms to provide for at least two (2) three (3) year Extended Terms following the Expansion Extension.

(e) Upon the execution by Landlord and Tenant of the Expansion Amendment, Landlord shall immediately commence the preparation of the "EXPANSION SPACE FINAL PLANS AND SPECIFICATIONS" to be consistent with the approved Expansion Space Outline Plans and Specifications, to satisfy any physical requirements of the site. Landlord shall submit the Expansion Space Final Plans and Specifications to Tenant for review and approval. Landlord shall construct the Expansion Space in a good and workmanlike manner, consistently with the best practices of the industry in accordance with the Expansion Space Final Plans and Specifications and Landlord agrees to complete the construction thereof in accordance with all applicable legal requirements.

(f) Upon execution of the Expansion Amendment and approval of the Expansion Space Final Plans and Specifications, Landlord shall, subject to Excused Delay, (as such term is defined in Section 3.7 of Exhibit C attached hereto) diligently proceed with the construction of the Expansion Space and complete the same and deliver possession thereof to Tenant within a reasonable time thereafter. Landlord will give Tenant written notice of any such Excused Delay specifying the nature and the period of such Excused Delay within fifteen (15) days after the occurrence thereof. The time of completion of said construction shall be extended for the additional time caused by such Excused Delay.

(g) During the period of construction of the Expansion Space, Tenant or its designated agent or agents shall have the right of inspection and Landlord shall cooperate with Tenant or its designated agent or agents with respect to any such inspection and facilitate the same as long as such inspection does not interfere with the work of Landlord in completing the Expansion Space.

(h) At least five (5) days prior to Substantial Completion of the Expansion Space, Landlord and Tenant will agree upon a list of all Punchlist Items (as such term is defined in Section 3.9 of Exhibit C attached hereto) not completed in accordance with the Expansion Space Final Plans and Specifications, and Landlord shall forthwith complete said Punchlist Items. The acceptance of possession of the Expansion Space by Tenant shall be deemed conclusively to establish that the Expansion Space has been Substantially Completed, subject to any Punchlist Items; provided, however, that Tenant may supplement the Punchlist Items by identifying Punchlist Items which Tenant establishes were deficiencies in the Expansion Space as of the date of Substantial Completion, so long as such supplemental Punchlist Items are identified for Landlord within one hundred twenty (120) days following Substantial Completion.

(i) Landlord guarantees the Expansion Space and such other items as are covered by the Expansion Space Final Plans and Specifications against defective workmanship and/or defective materials for a period of two (2) years from the date of Substantial Completion of the Expansion Space. Landlord does further agree, at its sole cost and expense to repair or replace any defective item occasioned by defective workmanship and/or defective materials during said two (2) year period.

From and after the expiration of the two (2) year guaranty of Landlord against defective workmanship and materials, Landlord agrees to cooperate with Tenant in the enforcement by Tenant, at Tenant's sole cost and expense, of any excess warranties or guaranties of workmanship or materials given by subcontractors or materialmen that guarantee or warrant against defective workmanship or materials for a period of time in excess of the two (2) year period described above and to cooperate with Tenant in the enforcement by Tenant, at Tenant's sole cost and expense, of any service contracts that provide service, repair or maintenance to any of the Expansion Space for a period of time in excess of such two (2) year period. Upon expiration of the two (2) year guaranty of Landlord, Landlord will assign to Tenant any then unexpired warranties which Landlord received from any subcontractors performing work with respect to the Expansion Space.

(j) Notwithstanding the foregoing, in the event the sum of the mortgage constant plus fifty (50) basis points is greater than twelve percent (12%), and Landlord does not elect, at its option, to offer Tenant an Expansion Space Base Rent constant no greater than twelve percent (12%), then Tenant shall have the option to purchase the Premises. If Tenant exercises such option to purchase the Premises, Landlord shall sell the Premises to Tenant and Tenant shall purchase the Premises from Landlord pursuant to the terms and conditions contained in Section 1.3 hereof except that the closing date shall be postponed pending the determination of Fair Market Value to the extent necessary, and except that the purchase price shall be the greater of (i) the sum of (a) the Total Project Cost plus (b) the Expansion Space Total Project Cost for any previous expansions plus (c) the sum of \$150,000.00 or (ii) the Fair Market Value of the Premises as of the date of Tenant's exercise of this option reduced by the sum of (a) the Rent Credit Amount (as defined in Section 13.3 of this Lease) not yet realized by Tenant in the form of a cash payment or as an offset against Base Rent or Additional Rent plus (b) the amount of any accrued Offsets (as defined in Section 3.2 herein, other than those included in (a) above). Tenant's option to purchase under the terms of this Section 1.2(j) shall expire ninety (90) days following written notice from Landlord as to the Expansion Space Base Rent and the Expansion Space Total Project Cost.

The "Fair Market Value" is defined as the cash price which would be obtained for the Premises, subject to this Lease, in an arm's length transaction between a willing buyer and a willing seller under no compulsion to do so. If the parties have not agreed in writing upon the Fair Market Value within thirty (30) days of Tenant's exercise of its option to purchase, (the "APPRAISAL PERIOD"), Fair Market Value shall be determined by the appraisal process described below.

Within fifteen (15) days after the expiration of the Appraisal Period, the parties shall either (1) jointly appoint an appraiser for this purpose or (2) failing this joint action, separately designate a disinterested appraiser. No person shall be appointed or designated an appraiser unless he or she has at least five (5) years experience in appraising major commercial property in the Minneapolis - St. Paul Metropolitan area and is a member of a recognized society of real estate

appraisers. If, within thirty (30) days after their appointment, the two appraisers reach agreement on the Fair Market Value, that value shall be binding and conclusive upon the parties. If the two appraisers thus appointed cannot reach agreement on the question presented within thirty (30) days after their appointment, then the appraisers thus appointed shall, within fifteen (15) days thereafter appoint a third disinterested appraiser having like qualifications. Within ten (10) days after the appointment of the third appraiser, the two appraisers appointed by the parties shall each submit to the third appraiser and to the parties their independent appraisal of the Fair Market Value of the Premises for the purchase in question. Within thirty (30) days after receipt of the two independent appraisals, the third appraiser shall select one of the two appraisals submitted by the two appraisers appointed by the parties as the appraisal closest to the Fair Market Value of the Premises. The appraisal of the Fair Market Value so selected by the third appraiser shall be binding and conclusive upon the parties. Each party shall pay the fees and expenses of the appraiser appointed by it and shall share equally the fees and expenses of the third appraiser. If the two appraisers appointed by the parties cannot agree on the appointment of the third appraiser within the fifteen (15) day period referenced above, they or either of them shall give notice of such failure to agree to the parties and if the parties fail to agree upon the selection of such third appraiser within ten (10) days after the appraisers appointed by the parties give such notice, then either of the parties, upon notice to the other party may request such appointment by the American Arbitration Association, or on its failure, refusal or inability to act, may apply for such appointment to the presiding judge of the District Court of Hennepin County, Minnesota.

Notwithstanding anything contained herein to the contrary, in the event Tenant is dissatisfied with the determined Fair Market Value, Tenant shall have the right, upon written notice to Landlord, to rescind its notice of its option to purchase the Premises which notice must be given, if at all, within thirty (30) days of the date Tenant is notified in writing of the Fair Market Value. In the event Tenant elects to rescind its notice, Tenant shall promptly reimburse Landlord for the fees and expenses incurred by Landlord for Landlord's appraiser and Landlord's share of the third appraiser.

1.3 INITIAL OPTION TO PURCHASE: Tenant shall have the further option to purchase the Premises (i) on the date of Substantial Completion (the "FIRST OPTION") and (ii) on the last day of the twenty fourth (24th) full month of the Initial Term (the "SECOND OPTION") (the "Purchase Date"), provided that as of the Purchase Date no event of default shall have occurred and be continuing beyond any applicable notice and cure period provided for under Section 17 herein. Tenant shall exercise its option to purchase by giving written notice thereof to Landlord not later than forty five (45) days prior to the Purchase Date, time being of the essence. If Tenant exercises the First Option, the price to be paid by Tenant shall be the "Final Total Project Cost" as defined in Exhibit "C", reduced by the sum of (a) the Rent Credit Amount (as defined in Section 13.3 of this Lease) not yet realized by Tenant in the form of a cash payment or as an offset against Base Rent or Additional Rent, plus (b) the amount of any accrued Offsets (other than those included in (a) above). If Tenant exercises the Second Option, the price to be paid by Tenant shall be the Final Total Project Cost plus \$300,000.00, reduced by the sum of (a) the Available Gross Rent Credit (as defined in Section 13.1) of this Lease not yet realized by Tenant in the form of a cash payment or as an offset against Base Rent or Additional Rent, plus (b) the amount of any accrued Offsets (other than those included in (a) above). On the Purchase Date, Tenant shall pay the applicable purchase price to Landlord and Landlord shall execute and deliver to Tenant a Limited Warranty Deed, with State Deed Tax paid thereon, conveying fee title to the Premises to Tenant, it being understood that

the title to the Premises will be free and clear of any Mortgage and shall be subject only to the following encumbrances:

- (i) the Permitted Exceptions;
- (ii) any encumbrances resulting from Tenant's failure to keep or perform its obligations under this Lease;
- (iii) any encumbrances created by Tenant or anyone claiming under Tenant;
- (iv) any encumbrances or takings resulting from a proceeding in eminent domain or threat thereof;
- (v) any non-monetary encumbrances consented to in writing by Tenant; and
- (vi) unpaid taxes and special assessments which are the obligation of Tenant to pay pursuant to this Lease.

Within ten (10) days after Tenant exercises its option to purchase, Landlord shall furnish to Tenant a commitment for an ALTA Owner's Title Insurance Policy covering title to the Premises, with extended coverage in the amount of the purchase price, reasonably acceptable to Tenant, showing title to the Premises in Landlord and subject only to the exceptions described above. Landlord shall simultaneously furnish an as-built survey of the Premises and Landlord shall pay all costs of the preparation and issuance of such survey and commitment and any policy issued in connection therewith. Tenant shall be allowed twenty (20) days after receipt thereof for examination of title and notifying Landlord in writing of any objections thereto. If any objection to title is not made and Landlord notified as herein provided, such objection shall be deemed waived. If objections to title are made and Landlord is notified thereof as herein provided, Landlord shall have until the Purchase Date to cure such objections and Landlord shall use its best efforts to cure any such objections. If such objections are not cured prior to the Purchase Date, Tenant may at its option (i) elect not to purchase the Premises, in which event this Lease shall remain in full force and effect, or (ii) close the purchase in the same manner as if there had been no title objections, in which event the purchase shall be closed on the Purchase Date and Landlord shall convey title to the Premises subject to the matters as to which objections were made but Tenant shall not be deemed to have waived any rights to damages hereunder, or (iii) attempt to cause such encumbrances to be removed. However, if Tenant elects alternative (iii) above, closing shall be postponed until the encumbrances in question are removed and, if Tenant is unable within a further period of sixty (60) days to cause such encumbrances to be removed, Tenant may then elect either alternative (i) or (ii) above. No such postponement shall alter the purchase price. All costs and expenses incurred by Tenant in causing or attempting to cause such encumbrances to be removed, including reasonable attorneys' fees, shall be payable by Landlord. Objections which can be remedied by the payment of money shall be paid from Landlord's proceeds at the closing. In the event Landlord defaults in its obligations hereunder, Tenant shall have the right to seek specific performance.

If, subsequent to the exercise of Tenant's election to purchase, but prior to the closing of the subject purchase, any proceedings in condemnation or eminent domain are commenced, Tenant may elect to rescind its purchase election by giving written notice to Landlord of such intent within thirty (30) days following the commencement of such proceedings.

At closing, Landlord shall deliver to Tenant the following:

- (a) Originals or copies of all governmental permits obtained in connection with the construction of Landlord's Work;
- (b) A certificate executed by Landlord that the Landlord's Work has been constructed to date in substantial compliance with the applicable Final Plans and Specifications as amended by agreement by the parties;
- (c) A limited warranty bill of sale and assignment of all personal property owned by Landlord which is located on the Premises at the time of closing; and
- (d) Such additional documents or instruments in form reasonably acceptable to Tenant which are necessary to convey to Tenant all of Landlord's right, title and interest in and to the Premises and any personal property located thereon or appurtenant thereto.

The Purchase Price shall not be reduced by reason of damages or destruction by fire or other causes. Landlord shall, however, deliver to Tenant at closing, all of Landlord's right, title and interest in any property insurance proceeds arising out of such damage or destruction to the Premises.

1.4 RIGHT OF FIRST OFFER: If during the term hereof, Landlord elects to offer the Premises for sale, it shall notify Tenant thereof. Tenant shall have seven (7) business days thereafter in which to notify Landlord of its interest to purchase the Premises, time being of the essence. If Tenant so notifies Landlord of its interest to purchase the Premises, then the purchase price shall be determined in accordance with the appraisal process described in Section 1.2 hereof.

Landlord shall, within fifteen (15) days of the date Landlord is notified in writing of the Fair Market Value, notify Tenant in writing of the price for which it is willing to sell the Premises (the "OFFER PRICE"). Tenant shall have thirty (30) days thereafter in which to notify Landlord of its agreement to purchase the Premises for the Offer Price, time being of the essence. If Tenant so notifies Landlord of its agreement to purchase the Premises, then Landlord shall sell the Premises to Tenant and Tenant shall purchase the Premises from Landlord pursuant to the terms and conditions contained in Section 1.3 hereof, except that (a) the purchase price shall be the Offer Price reduced by the sum of (i) the Rent Credit Amount (as defined in Section 13.3 of this Lease) not yet realized by Tenant in the form of a cash payment or as an offset against Base Rent or Additional Rent, plus (ii) the amount of any accrued offsets (other than those included in (i) above, and (b) the Purchase Date shall be the date which is ninety (90) days subsequent to the date of Tenant's notice to Landlord (or, if such date is not a Business Day, the next Business Day thereafter). The Premises shall be conveyed to Tenant pursuant to this Section 1.4 free from any mortgage and free from all

title matters other than Permitted Exceptions. If Tenant does not so notify Landlord of its agreement to purchase the Premises for the Offer Price within such thirty (30) day period, then Landlord may at any time within one (1) year after the date of Tenant's notice to Landlord agree to sell the Premises to a third party (and thereafter close such sale), subject to this Lease, for a sale price which is not less than one hundred percent (100%) of the Offer Price. In the event of such a sale of the Premises to a third party, all of the Tenant's right to purchase the Premises under this Section 1.4 shall terminate and Tenant shall have no further purchase rights under this Section 1.4. If Landlord does not sell the Premises to a third party for one hundred percent (100%) of the Offer Price within such twelve (12) month period, Tenant's First Offer Rights, as herein set forth, will be reinstated.

Notwithstanding the provisions of this Section, in the event that Landlord offers to sell the Premises or any part thereof to a Permitted Affiliate (as defined herein), then such offer to sell shall not be subject to Tenant's right of first offer as set forth in this Section. Any transfer of title to the Premises or any part thereof pursuant to the foregoing provisions of this Section shall not cause Tenant's right of first offer under this Section to terminate, and the right of first offer set forth in this Section shall remain in full force and effect with respect to the Premises following any such transfer. As used above, the term "PERMITTED AFFILIATE" means (i) any entity controlling, controlled by or under common control with Landlord; (ii) any (a) officer or director of or (b) member, partner, shareholder or other equity holder, in either such event with an entity interest of ten percent (10%) or more in any of the foregoing entities or (iii) any combination of (i) and (ii).

1.5 OPTION TO TERMINATE PRIOR TO EXPANSION: Provided that the Building has not been expanded by a total amount exceeding 50,000 square feet, pursuant to Section 1.2, Tenant shall have the option to terminate this Lease effective as of either the last day of the seventy fifth (75th) full calendar month of the Term or the last day of the ninety ninth (99th) full calendar month of the Term, at Tenant's option. Tenant shall exercise its option by giving written notice thereof to Landlord not later than ten calendar months prior to the elected termination date. No later than five (5) calendar months prior to the elected termination date, Tenant shall pay to Landlord a sum equal to (i) nine (9) months Base Rent if the elected termination date is the last day of the seventy fifth (75th) full calendar month of the Term or (ii) seven (7) months Base Rent if the elected termination date is the last day of the ninety ninth (99th) full calendar month of the Term. Time is of the essence. If Tenant fails to timely exercise its right hereunder, or fails to deliver in a timely manner the sum due, Tenant's notice shall have no force or effect.

1.6 OPTION TO TERMINATE FOLLOWING EXPANSION:

A. In the event the Building is expanded by a total amount exceeding 50,000 square feet pursuant to Section 1.2, and Substantial Completion of such expansion(s) occurs between the last day of the fifteenth (15th) full calendar month of the Term and the last day of twenty seventh (27th) full calendar month of the Term, Tenant shall have the option to terminate this Lease as of the last day of the eighty seventh (87th) full calendar month of the Term. Tenant shall exercise its option by giving written notice thereof to Landlord not later than ten (10) full calendar months prior to the elected termination date. No later than five (5) full calendar months prior to the elected termination date, Tenant shall pay to Landlord a sum equal to nine (9) months Base Rent.

B. In the event the Building is expanded by a total amount exceeding 50,000 square feet pursuant to Section 1.2, and Substantial Completion of such expansion(s) occurs between the

last day of the thirty ninth (39th) full calendar month of the Term and the last day of fifty first (51st) full calendar month of the Term, Tenant shall have the option to terminate this Lease as of the last day of the one hundred eleventh (111th) full calendar month of the Term. Tenant shall exercise its option by giving written notice thereof to Landlord not later than ten (10) full calendar months prior to the elected termination date. No later than five (5) full calendar months prior to the elected termination date, Tenant shall pay to Landlord a sum equal to seven (7) months Base Rent.

Simultaneously with Tenant's written notice to Landlord of any termination right under Section 1.5 or Section 1.6, Tenant shall submit a Lease termination agreement (the "TERMINATION AGREEMENT") which shall memorialize the fact that the Lease shall be terminated from and after the effective date of termination selected by Tenant, and that neither Landlord or Tenant shall have any further obligations under the Lease except for any that accrue prior to such effective termination date, and containing any further provisions reasonably requested by Landlord or Tenant. Landlord shall promptly execute the Termination Agreement and return the same to Tenant. Tenant shall have no obligation to pay any termination "fee" referenced herein until Tenant has received the executed Termination Agreement.

If Tenant fails to timely exercise its right hereunder, or fails to deliver in a timely manner the sum due, Tenant's notice shall have no force or effect.

2.1 TERM: The initial term of this Lease (the "INITIAL TERM") shall commence on the date of "Substantial Completion" (as defined in Section 3.8 of Exhibit C) of the Landlord's Work (including, for this purpose, the Fire Protection associated with coverage in and under the Mezzanines, the mechanical ventilation related to the Mezzanines and the electrical lighting systems and any basic electrical requirements (convenience power) in and under the Mezzanine) (collectively, the "MEZZANINE MECHANICALS"), and shall end on the last day of the one hundred twenty third (123rd) full calendar month after the date of Substantial Completion. The date of Substantial Completion of the Landlord's Work and the Mezzanine Mechanicals is sometimes referred to as the Commencement Date. The Commencement Date may not occur prior to November 1, 1999.

2.2. OPTION TO EXTEND: Tenant shall have the option to extend the Term of this Lease with respect to the entire Premises for five (5) additional terms of three (3) years each, (collectively, the "Extended Terms", and individually, an "Extended Term"). Each Extended Term shall be upon the same terms as provided in this Lease for the Term, except for the Base Rent which shall be as set forth in Exhibit C for each Extended Term. Tenant shall exercise its option by giving written notice of such exercise to Landlord, not less than nine (9) months prior to the end of the Term, or the then current Extended Term, as the case may be. Should Tenant fail to exercise any option to extend the term of this Lease within the time provided in this Section, all of Tenant's rights to further extend the term hereof shall expire.

3.1 MONTHLY BASE RENT: Tenant agrees to pay to Landlord during the Term a monthly Base Rent ("Base Rent") as specified on Exhibit C hereto payable on the first day of each month in advance, without deduction or setoff of any kind, except as specifically authorized herein, to Landlord and delivered to Landlord's managing agent, Ryan Properties, Inc., 700 International Centre, 900 Second Avenue South, Minneapolis, Minnesota 55402, or at such other place as may from time to time be designated by Landlord. Notwithstanding the foregoing, Tenant shall not be

liable to Landlord for the payment of any Base Rent, Additional Rent or other sums due hereunder until the Landlord's Work and the Mezzanine Mechanicals are Substantially Complete.

3.2 OFFSETS: Notwithstanding anything herein to the contrary, Tenant may offset the following sums against Tenant's obligation to pay Base Rent (but not Additional Rent):

- (i) If Tenant demands a "Rent Credit Amount" (as defined in Section 13.3 hereof), said Rent Credit Amount may be offset against Base Rent payable commencing on the Commencement Date;
- (ii) If Tenant exercises its right of self help under Section 7 of this Lease, any amount spent by Tenant pursuant to that Section 7 may be offset against Base Rent payable commencing on the Commencement Date; and
- (iii) Any Landlord Payments not received by Tenant as required by Section 4.2 hereof may be offset against Base Rent payable commencing on the Commencement Date.

4.1. USE: Tenant may use the Premises for any lawful business use.

4.2 LANDLORD PAYMENTS: Subject to the conditions that:

- (i) Within sixty (60) days after the initial occupancy of the Building by Tenant, there are (and will be for the succeeding 12 month period) at least sixty (60) full time employees employed at the Premises, and Tenant furnishes Landlord with reasonably satisfactory evidence thereof; and
- (ii) Within twelve (12) months after the commencement of the Initial Term hereof, Tenant has created (and will maintain for a period of at least 12 months) at least two (2) new permanent full-time employment positions in the State of Minnesota (as opposed to transfers of positions already existing in the State) in addition to those existing on the date hereof, at a wage at least equal to \$9.00 per hour, and Tenant furnishes Landlord with reasonably satisfactory evidence thereof; and
- (iii) Tenant is not in default hereunder,

then Landlord shall pay the following amounts (the "Landlord Payments") to Tenant at the following times:

- (a) At such time as the conditions contained in (i) and (ii) hereof have been satisfied, an amount equal to the then present value (determined using a discount rate of 10.07% per annum) of the following stream of payments:

AMOUNT -----	DATE -----
\$32,225	August 1, 2001
\$32,225	February 1, 2002
\$32,225	August 1, 2002

\$32,225	February 1, 2003
\$32,225	August 1, 2003
\$32,225	February 1, 2004
\$32,225	August 1, 2004
\$32,225	February 1, 2005
\$32,225	August 1, 2005
\$32,225	February 1, 2006

- (b)(i) At such time as Tenant no longer has the right to terminate this Lease as of the last day of the 75th calendar month, pursuant to either Section 1.5 or Section 1.6 hereof, an amount equal to the then present value (determined using a discount rate of 10.07% per annum) of the following stream of payments:

AMOUNT	DATE
-----	----
\$32,225	August 1, 2006
\$32,225	February 1, 2007

- (b)(ii) At such time as Tenant no longer has the right to terminate this Lease as of the last day of the 87th calendar month, pursuant to either Section 1.5 or Section 1.6 hereof, an amount equal to the then present value (determined using a discount rate of 10.07% per annum) of the following stream of payments:

\$32,225	August 1, 2007
\$32,225	February 1, 2008

- (b)(iii) At such time as Tenant no longer has the right to terminate this Lease as of the last day of the 99th calendar month, pursuant to either Section 1.5 or Section 1.6 hereof, an amount equal to the then present value (determined using a discount rate of 10.07% per annum) of the following stream of payments:

\$32,225	August 1, 2008
\$32,225	February 1, 2009

- (b)(iv) At such time as Tenant no longer has the right to terminate this Lease as of the last day of the 111th calendar month, pursuant to either Section 1.5 or Section 1.6 hereof, an amount equal to the then present value (determined using a discount rate of 10.07% per annum) of the following stream of payments:

\$32,225
\$32,225

August 1, 2009
February 1, 2010

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- (c) If Tenant exercises an option to terminate this Lease pursuant to Section 1.5 or Section 1.6 hereof, then at the expiration of the term, the total of the payments set forth in (b) above for the dates prior to the expiration date, plus interest thereon at the rate of 10.07% per annum.
- (d) At such time as Tenant purchases the Premises from Landlord pursuant to Section 1.3 or Section 1.4 hereof, an amount equal to the then present value (determined using a discount rate of 10.07% per annum) of any payments not yet due, but to be made pursuant to (a) and (b) hereof.

5. OPERATING COSTS: Tenant shall, for the entire Term, pay to Landlord as an item of additional rent, without any setoff or deduction therefrom, except as expressly provided in this Lease, all costs ("Operating Costs") which Landlord may incur in maintaining and operating the Premises during each calendar year of the Term. "OPERATING COSTS" are defined to include all reasonable expenses and costs (but not specific costs which are separately billed to and paid by Tenant) which the Landlord shall pay or become obligated to pay because of or in connection with the operation and maintenance of the Premises, including but not limited to all real estate taxes and annual installments of special assessments due and payable in such calendar year with respect to the Premises; costs of any contest of such taxes, including reasonable attorney's fees; management fees, insurance premiums, utility costs, security costs, costs of wages, maintenance costs (relating to the Premises including sidewalks, landscaping and parking or service areas, common areas, service contracts, equipment and supplies) which for federal tax purposes may be expensed rather than capitalized, all in accordance with Generally Accepted Accounting Principles ("GAAP"), consistently applied but exclusive of legal fees, leasing commissions, depreciation, costs of leasehold improvements and all costs of a capital nature except as provided in the next sentence and payments of principal and interest on any mortgages, deeds of trusts, or other security devices covering the Premises. Operating Costs shall also include the yearly amortization of capital costs (amortized over the useful life of the improvement as reasonably determined by Landlord in accordance with GAAP) incurred by the Landlord for improvements to the Premises required to comply with any change (after the Commencement Date) in the laws, rules or regulations of any governmental authority having jurisdiction, or, for purposes of reducing Operating Costs, which costs shall be amortized over the useful life of such improvements as reasonably estimated by the Landlord in accordance with GAAP, but in no event shall the annual amortization be in excess of the savings.

Notwithstanding anything contained in this Lease to the contrary, the following shall apply with respect to real estate taxes and assessments:

A. Provided Tenant pays when due the taxes and assessments specified above, Landlord agrees that it shall pay all taxes and installments of special assessments on or prior to the date the same are due to the taxing authority and shall provide Tenant with evidence of payment thereof upon request of Tenant. Tenant shall have no obligation to pay or reimburse Landlord for any penalties imposed for the late payment of any real estate tax or assessment, provided Tenant pays the same to Landlord when due under the terms hereof. Upon any request by Landlord for payment of any taxes or installments of assessments, Landlord shall provide Tenant with a copy of the then current real estate tax bill for the Premises.

B. Landlord shall, at its sole cost and expense (and without reimbursement as an Operating Cost), pay as and when due all special improvement or betterment assessments which were pending in existence or levied or which were due and payable on or prior to the Commencement Date, and for any assessments for on or off-site improvements which arise, in whole or in part, due to the development of the Premises. Notwithstanding the foregoing, Tenant shall be responsible to pay to Landlord, as part of Operating Costs, installments of assessments due solely to the paving, with curb and gutter, of Wilfred Lane North and the installation of sanitary sewers, water lines and storm sewers therein from the center of extended Commerce Boulevard to the north line of the Premises. The extension of Commerce Boulevard shall be the sole responsibility of Landlord, and the cost thereof shall neither be assessed to the Premises nor included in the Actual Construction Costs.

C. Whether or not Landlord shall take the benefit of the provisions of any statute or ordinance permitting any assessment for public betterments or improvements to be paid over a period of time, Landlord shall, nevertheless, be deemed to have taken such benefits so that the term "taxes and assessments" shall include only the current annual installment of any such assessments.

D. Tenant shall have the right, at its own cost and expense and in its own name or in the name of Landlord, to seek to have reviewed, reduced, equalized, or abated any taxes or assessments payable by Tenant hereunder. Landlord shall join with Tenant and execute any and all documents, applications, petitions, instruments, or complaints necessary for any such protest, contest, review or other proceedings, desired or conducted by Tenant. During the period of any such proceedings, Tenant shall continue to pay such taxes and assessments or shall provide to Landlord such security as Landlord deems reasonably necessary to insure that such payment will be made all to the end that the interest of Landlord in the Premises shall in no way be injured or diminished by any such proceedings.

The following shall be excluded from Operating Costs:

- A. Landlord's costs and obligations under Sections 7.A and 7.D;
- B. Costs directly or indirectly resulting from or relating to (including repairs, restoration, security measures, emergency or temporary services, inspection and, during the period of such repair or restoration, any increase in operating expenses resulting from) fire, windstorm or other casualty or damage or destruction from any other cause, whether or not insured or insurable;
- C. Costs of correcting defects in, or inadequacy of, the design or construction of the Building or the materials used in the construction of the Building or in the Building equipment or appurtenances thereto, except that, for the purposes of this paragraph, conditions resulting from ordinary wear and tear and use shall not be deemed defects;
- D. Financing and refinancing costs, interest or debt or amortization payments on any mortgage or mortgages and rental under any ground or underlying leases or lease, together with all costs incidental thereto;

- E. Costs of Landlord's general corporate overhead and general administrative expenses (including costs and expenses paid to third parties to collect rents, prepare tax returns and accounting reports and obtain financing);
- F. Costs resulting from the negligence or misconduct of Landlord or its employees, agents or contractors;
- G. Travel, entertainment and related expenses incurred by Landlord or its personnel.
- H. Special assessments levied or pending as of the date of this Lease except for those specifically permitted as Operating Costs as set forth above;
- I. Reserves for anticipated future expenses;
- J. Any management and/or administrative fee which, in the aggregate (regardless of how characterized) exceeds 15% of Operating Costs, exclusive of insurance costs and real estate taxes and assessments.

As soon as reasonably practicable prior to the Commencement Date and the commencement of each calendar year during the Term, Landlord shall, with input and direction from Tenant, determine an estimate of, and budget for, Operating Costs for the ensuing calendar year. All levels of service, operation and maintenance, to the extent controllable, shall be determined from time to time by Tenant in its reasonable discretion, but at all times consistent with similar Premises in the Minneapolis/St. Paul metropolitan area. The budget, as initially established for any year, shall be adjusted to reflect Tenant's determinations as to such levels. No expenditure in excess of any line item in the budget (or which will, with reasonably anticipated expenses, cause such excess) shall be made without Tenant's consent and an adjustment to the budget, except in case of emergency where Landlord may take reasonable necessary action without such prior authorization. Tenant shall pay, as additional rent hereunder together with each installment of Base Rent, one-twelfth (1/12th) of estimated Operating Costs less real estate taxes and installments of special assessments. Real estate taxes and installments of special assessments shall be due on or before the later of (a) twenty (20) days after receipt of Landlord's invoice or (b) twenty (20) days prior to the last date such taxes and installments of special assessments are due without penalty. As soon as reasonably practicable after the end of each calendar year during the Term (but in no event more than ninety (90) days thereafter), Landlord shall furnish to Tenant a statement of the actual Operating Costs for the previous calendar year, and within twenty (20) days thereafter Tenant shall pay to Landlord, or Landlord shall credit to the next rent payments due Landlord from Tenant, as the case may be, any difference between the actual Operating Costs and the estimated Operating Costs paid by Tenant. Operating Costs for the years in which this Lease commences and terminates shall be prorated by multiplying the actual Operating Costs by a fraction the numerator of which is the number of days of that year of the Term and the denominator of which is 365.

For a period of one (1) year following Tenant's receipt of Landlord's statement of actual Operating Costs (provided that if Tenant commences an audit, as specified below, within such one (1) year period, such period shall be extended by the amount of time reasonably necessary for Tenant to complete such audit), Landlord shall keep available for Tenant's inspection and/or audit complete books and records relating to Operating Costs. During this period Tenant may

copy, inspect and/or audit Landlord's Operating Costs books and records upon reasonable notice to Landlord. The audit must be performed during regular business hours in the offices where Landlord maintains its accounting records. An assignee may have the right to audit as provided herein, however, such right shall only apply to the assignee's term pursuant to the Lease. In the event a discrepancy of five percent (5%) or more is found in favor of Tenant, Landlord shall pay the cost of such audit. If the audit discloses an overcharge by Landlord, Landlord shall reimburse Tenant for such overcharge within twenty (20) days, unless Landlord reasonably and in good faith disputes the result of the audit.}

6. ADDITIONAL TAXES: Tenant shall pay as additional rent to Landlord, together with each installment of Base Rent, the amount of any gross receipts tax, sales tax or similar tax (but excluding therefrom any income, estate, inheritance, corporate or franchise tax), payable by Landlord.

7. OBLIGATIONS OF LANDLORD: Landlord agrees that Tenant shall quietly enjoy the Premises in accord with the provisions hereof, subject only to Section 17. Landlord shall:

- A. Keep the structure of the Building, and all structural components thereof, including without limitation, footings, foundations, columns, exterior walls, interior weight bearing walls, floor and ceiling slabs, and roof (and all elements of the roof, whether structural or non-structural), in good condition and repair, ordinary wear and tear excepted, and make all necessary or appropriate replacements thereto, all at Landlord's sole cost and without inclusion in Operating Costs; and
- B. Keep all Building systems, including HVAC, life safety, fire suppression sprinkler systems and utility lines and conduits in good condition and repair, ordinary wear and tear excepted, and make all necessary or appropriate replacements thereto. The cost thereof shall be deemed an Operating Cost.
- C. Provide mains and conduits to supply water, gas, electricity and sanitary sewer service to the Premises; and
- D. Consistent with the budget approved by Tenant, operate, maintain and manage the Premises, including grounds and parking areas in a manner reasonably satisfactory to Tenant. All such maintenance which is provided by Landlord shall be provided as reasonably necessary for the comfortable use and occupancy of the Premises, upon the condition that the Landlord shall not be liable for damages for failure to do so due to causes beyond its reasonable control; and
- E. Maintain in full force and effect during the term hereof, a policy of all-risk insurance, including Difference in Conditions, insuring the improvements for their full replacement value.

It is understood that Landlord does not warrant that any of the services and utilities referred to above will be free from interruption from causes beyond the reasonable control of Landlord. Such interruption of service or utilities shall never be deemed an eviction or disturbance of Tenant's use and possession of the Premises or any part thereof or render Landlord liable to Tenant for damages by abatement of rent or otherwise or relieve Tenant from performance of Tenant's obligations under this Lease, provided Landlord uses all reasonable efforts to restore such services and utilities as soon as possible.

Tenant may, at its option, upon no less than ninety days written notice to Landlord, elect to perform obligations of Landlord contained in Section 7B, 7C, 7D and 7E. Upon such election, Tenant shall provide Landlord with verification of its performance in a form reasonably satisfactory to Landlord.

In the event Landlord shall be in default of any of the terms and conditions of this Lease then, after Tenant has sent a written notice to Landlord of such default and Landlord and the holder of any mortgage against the Premises (but only if Tenant has been previously notified of the existence of such mortgage) has failed to cure such default within thirty (30) days after Landlord's receipt of such written notice, Tenant shall have the right to cure such default; provided, however, that if the failure set forth in Tenant's written notice is such that it requires more than thirty (30) days to correct, Tenant shall not be entitled to exercise the foregoing self-help right if Landlord (i) promptly and diligently commences curing the failure within thirty (30) days after the written notice is received by Landlord and (ii) diligently prosecutes to cure to completion such default. Notwithstanding the foregoing sentence, emergency repairs which are Landlord's responsibility pursuant to a specific provision of this Lease and which shall be necessary to prevent imminent injury or damage to persons or Tenant's property may be made by Tenant after Tenant has notified Landlord of the need for such emergency repair, if such notice is reasonably practical under the circumstances, in Tenant's reasonable opinion, and Landlord has failed to commence such repair within such period of time as is reasonable under the circumstances. If notice is not reasonably practical under the circumstances, Tenant may make such repairs without notice. Notwithstanding the foregoing provisions, despite such notices and the expiration of such cure periods, except as expressly provided in this Lease, no rent or other payments due from Tenant hereunder may be offset by Tenant, and Tenant shall have no right to perform any obligation of Landlord. In the event Tenant has exercised a self-help right pursuant to the foregoing provisions of this Section 7, Landlord shall reimburse Tenant for its reasonable out-of-pocket expenditures within thirty (30) days of presentation of invoice in detail reasonably satisfactory to Landlord together with interest from the date that is twenty (20) days following presentation of invoice until the date such charges have been paid at an annual equal to the rate specified in Section 22 herein.

8. COVENANTS OF TENANT: Tenant agrees that it shall:

- A. Give Landlord access to the Premises at all reasonable times, without charge or diminution of rent or interference with Tenant's business, to enable Landlord to examine the same and to make such repairs as Landlord may deem advisable, and during the nine (9) months prior to the expiration of the Term, to exhibit the Premises to prospective tenants and to place upon the Project or Premises any usual or ordinary "For Lease" signs.

- B. Upon the termination of this Lease in any manner whatsoever, remove Tenant's personal property and such of its equipment and trade fixtures as it desires and those of any other person claiming under Tenant, and quit and deliver up the Premises to Landlord peaceably and quietly in as good order and condition as the same are now in or hereafter may be put in by Landlord or Tenant, reasonable use and wear thereof and repairs which are Landlord's obligation and damage by fire or other casualty excepted. Goods and effects not removed by Tenant at the termination of this Lease, however terminated, shall be considered abandoned and Landlord may dispose of the same as it deems expedient. Tenant shall not be required to repair damage to the Premises caused by removal of such items provided that it uses reasonable means to remove the same.
- C. Except as permitted herein, not assign this Lease or sublet all or any part of the Premises voluntarily, involuntarily or by operation of law, without first obtaining Landlord's written consent thereto. Landlord shall, within ten (10) days of its receipt of Tenant's request, approve or reject the assignment or sublease and, if rejected, Landlord shall specify its reason(s) for withholding approval. Landlord's failure to respond within ten (10) days shall be deemed approval. Landlord's consent will not be withheld provided that (i) the proposed use of the assignee or sublessee is not inconsistent with the use specified in Section 4.1 herein; (ii) such assignee (but not any sublessee) shall assume in writing the performance of the covenants and obligations of Tenant hereunder which arise after the effective date of the assignment; and (iii) a fully executed copy of any such assignment or sublease shall be delivered to Landlord within ten (10) days after the execution thereof, but the making of such assignment or sublease shall not be deemed to release Tenant from the payment and performance of any of its obligations under this Lease.

Notwithstanding anything in this Lease to the contrary, Tenant may, without consent of Landlord, at any time assign or otherwise transfer this Lease or any portion thereof to any parent, subsidiary or affiliate corporation or entity; or any corporation resulting from the consolidation or merger of Tenant into or with any other entity, or to any person, firm, entity or corporation acquiring a majority of Tenant's issued and outstanding capital stock or a substantial part of Tenant's physical assets, or at any time form a privately-held corporation or subsequently make a public offering of its stock. As used herein, the expression "affiliate corporation or entity" means a person or business entity, corporation or otherwise, that directly or indirectly through one or more intermediaries, controls or is controlled by, or is under common control with Tenant. The word "control" means the right and power, direct or indirect, to direct or cause the direction of the management and policies of an ownership or voting securities, by contract or otherwise. Further, notwithstanding anything in this Lease to the contrary, the following shall not be deemed an assignment or violation of

this Lease or give rise to any right of Landlord to terminate this Lease: (a) any public offering of stock of Tenant or Tenant's parent company, if any; or (b) the conversion of Tenant or Tenant's parent company, if any, from a publicly held corporation to a privately held corporation. In addition, any change in ownership of stock of Tenant shall not be considered an assignment of this Lease.

- D. Tenant may, at its sole expense, erect exterior signage and a decorative Building facade not in excess of that permitted by applicable code and regulation for the Premises.
- E. Not do any act which may make void or voidable any insurance on the Premises, or which may render an increased or extra premium payable for any insurance deemed necessary or advisable by Landlord, provided, however, that upon notice from Landlord, Tenant may elect to pay such additional cost.
- F. Tenant shall not make structural changes or alterations to the Premises without the prior written approval of Landlord, which approval shall not be unreasonably withheld or delayed. Landlord agrees to cooperate with Tenant in obtaining licenses and permits to make such alterations from the applicable governmental authorities.

Tenant may, at its own cost and expense, without the prior approval of Landlord make non-structural changes to the Premises, including but not limited to, mechanical system, electrical system, HVAC, installation of fixtures and equipment, painting, papering or changing floor coverings in and to the interior of the Premises, provided that the structural integrity of the Building shall not be adversely affected or diminished.

All fixtures, equipment and property of any nature which may be installed or placed in or upon the Premises by Tenant shall remain the property of Tenant. Landlord waives any right or lien it may have in said fixtures, equipment and property. Tenant may assign, lien, encumber, mortgage or create a security interest in or upon its equipment, fixtures or other property in the Premises without the consent of Landlord. Upon the request of Tenant, Landlord agrees to provide Tenant, within ten (10) days of each such request, a written waiver in form reasonably satisfactory to Landlord and Tenant evidencing Landlord's waiver of any rights it has or may have in Tenant's fixtures, equipment and other property.

All alterations, additions or improvements (including carpeting or other floor covering which has been glued or otherwise affixed to the floor) which may be made by either of the parties hereto upon the Premises, shall be the property of Landlord, and shall remain upon and be surrendered with the Premises, as a part thereof, at the termination of this Lease. Notwithstanding the foregoing, office furniture, trade fixtures and

equipment (even if bolted or fastened to the Building for stabilization purposes) shall be the property of Tenant and may be removed by Tenant and the termination of this Lease.

- G. Except for the initial construction which is the obligation of Landlord under Exhibits "C" and "D", and except for any other work performed by Landlord on the Premises including, without limitation, any expansion of the Building, keep the Premises free from any mechanics', materialmen's, contractors' or other liens arising from, or any claims for damages growing out of, any work performed, materials furnished or obligations incurred by or on behalf of Tenant.

Tenant shall have the right to contest any such lien, in which event such lien shall not be considered a default under this Lease until the existence of the lien has been finally adjudicated and all appeal periods have expired. Tenant shall indemnify and hold harmless Landlord from and against any such lien, or claim or action thereon, reimburse Landlord promptly upon demand therefor by Landlord for costs of suit and reasonable attorneys' fees incurred by Landlord in connection with any such lien, claim or action, and, upon written request of Landlord if Landlord reasonably deems itself insecure with the prospect for payment by Tenant, provide Landlord with a bond, letter of credit, cash deposit or other reasonable security in an amount necessary to obtain a release of the Premises from such lien if the lien claimant ultimately prevails.

- H. Tenant shall, at its own expense, comply with the requirements, as to Tenant's particular use, of insurance underwriters and insurance rating bureaus and governmental authorities having jurisdiction.
- I. Maintain in full force and effect during the term hereof, a policy of public liability insurance under which Landlord is named as additional insured. The minimum limits of liability of such insurance shall be \$5,000,000.00 combined single limit as to bodily injury and property damage. Tenant agrees to deliver a certificate of insurance evidencing such coverage to Landlord. Such policy shall contain a provision requiring thirty (30) days written notice to Landlord before cancellation of the policy can be effected.

9. AMERICANS WITH DISABILITIES ACT: The parties agree that the liabilities and obligations of Landlord and Tenant under that certain federal statute commonly known as the Americans With Disabilities Act as well as the regulations and accessibility guidelines promulgated thereunder as each of the foregoing is supplemented or amended from time to time (collectively, the "ADA") shall be apportioned as follows:

- A. If the Premises as initially constructed as Landlord's responsibility does not conform to the requirements of the ADA in effect at the time of Substantial Completion thereof, then in any such case such nonconformity shall be promptly made to comply by Landlord at its sole expense.

- B. From and after the Commencement Date of the Lease, Tenant covenants and agrees to conduct its operations within the Premises in compliance with the ADA.

10. INTENTIONALLY OMITTED.

11. CASUALTY LOSS: If the Building is damaged in part or whole from any cause and the Building can be substantially repaired and restored within the Repair Period (as defined below) from the date of the damage using standard working methods and procedures, Landlord shall at its expense promptly and diligently repair and restore the Building, including all leasehold improvements, to substantially the same condition as existed before the damage. This repair and restoration shall be made promptly and diligently, subject only to delays by causes beyond Landlord's reasonable control. As soon as reasonably possible and in any event within thirty (30) days after the damage, Landlord shall notify Tenant in writing of the number of days reasonably estimated by Landlord to complete repairs from the date of the damage. As used herein, the "REPAIR PERIOD" means a period of three hundred and sixty-five (365) days.

If the Building cannot be repaired and restored within the Repair Period, then either party may, within ten (10) days after the date Tenant receives Landlord's notice of the estimated repair completion period as provided above, cancel the Lease by giving notice to the other party. If Landlord does not commence repairs within 30 days after the damage or continue to prosecute such repair continuously with reasonable diligence, or if the Building is not repaired and restored within the Repair Period, then Tenant may cancel the Lease at any time thereafter and prior to completion of the repair. Tenant shall not be able to cancel this Lease if its willful misconduct caused the damage unless Landlord is not promptly and diligently repairing and restoring the Premises.

The Base Rent and Additional Rent shall abate to the extent fair and equitable and the abatement shall include any period that Tenant is unable to occupy or use the Building, or its occupancy or use is materially adversely affected by reason of any casualty or cause. The abatement shall consider the nature and extent of interference to Tenant's ability to conduct business in the Premises and the need for access and essential services. The abatement shall continue from the date the damage occurred to the date Landlord completes the repairs and restoration, or until Tenant again uses the Premises or the part rendered unusable, whichever is first.

Notwithstanding anything else in Section 11, Landlord is not obligated to repair or restore damage to Tenant's trade fixtures, furniture, equipment, or other personal property.

If the Lease is in the last twenty four (24) months of its Term when "material" damage to the Building occurs, either party may elect to terminate this Lease provided that Landlord's election to terminate shall be vitiated if Tenant gives notice within ten (10) days after receipt of notice of such cancellation from Landlord of its election to extend the Term of the Lease for the next available Extended Term, if any. Material is defined as costing more than 25% of the replacement cost of the Building. To cancel, Landlord must give notice to Tenant within ten (10) days after the Landlord knows of the damage and Tenant must give notice within ten (10) days of receipt of notice from Landlord as to whether or not the damage is material, which notice Landlord shall give to Tenant within thirty (30) days after the damage. The notice must specify the cancellation date, which shall be at least thirty (30) but not more than sixty (60) days after the date notice is given.

12. CONDEMNATION: If the entire Premises is taken by eminent domain or transferred under threat of such taking, this Lease shall automatically terminate as of the date of taking. If a portion of the Premises, or portion of the Building, or good and sufficient access thereto or a material portion of the parking, is taken by eminent domain and it is unfeasible, in Tenant's reasonable judgment, for Tenant to continue to operate its business in the portion of the Premises remaining, Tenant shall have the right to terminate this Lease as of the date of taking by giving written notice thereof to Landlord within ninety (90) days after the date of taking. If a material portion of the Building is taken by eminent domain (i.e. more than twenty-five percent (25%)), Landlord shall have the right to terminate this Lease as of the date of taking by giving written notice thereof to Tenant within ninety (90) days after the date of taking. If neither Landlord nor Tenant elects to terminate this Lease, Landlord shall, at its expense, restore the Premises, including any improvements or other changes made therein by Tenant, to as near the condition which existed immediately prior to the date of taking as reasonably possible, and to the extent that the Premises or the Building, including the access thereto or the use thereof by Tenant is adversely affected, the rent shall equitably abate. All damages awarded for a taking under the power of eminent domain shall belong to and be the exclusive property of Landlord, whether such damages be awarded as compensation for diminution in value of the leasehold estate hereby created or to the fee of the Premises; provided, however, that Landlord shall not be entitled to any separate award made to Tenant for the value and cost of its personal property and fixtures or for relocation benefits.

13.1 DELAY IN COMPLETION: If "Phase I" (as defined on Exhibit "C") of the Landlord's Work is not "Substantially Complete" (as defined on Exhibit "C") by August 23, 1999, the Landlord will be in default hereunder (a "PHASE I COMPLETION DEFAULT").

If "Phase II" (as defined on Exhibit C) of the Landlord's Work is not Substantially Complete by October 15, 1999, the Landlord will be in default hereunder (a "PHASE II COMPLETION DEFAULT").

If the entirety of the Landlord's Work (including the Mezzanine Mechanicals) is not Substantially Complete by March 1, 2000, the Landlord will be in default hereunder (a "SUBSTANTIAL COMPLETION DEFAULT").

If Phase I of the Landlord's Work is Substantially Complete by July 5, 1999 and if Phase II of the Landlord's Work is Substantially Complete by August 1, 1999 and if the entirety of the Landlord's Work (including the Mezzanine Mechanicals) is Substantially Complete by December 1, 1999, then Landlord will have earned a "SUCCESS FEE" in the amount of \$100,000.00 which will be included in the calculation of Final Project Cost as set forth in Section 2.1 of Exhibit C to this Lease.

All dates in this Section 13.1 will be adjusted one (1) day for each day of "Excused Delay" (as set forth on Exhibit "C").

13.2 REMEDY FOR DELAYED COMPLETION. In the event of a Phase I Completion Default, Tenant may terminate this Lease by giving notice of such termination to Landlord at any time following August 23, 1999 and prior to 5:00 p.m. on August 30, 1999. In the event of a Phase II Completion Default, Tenant may terminate this Lease by giving notice of such termination to Landlord at any time following October 15, 1999 and prior to 5:00 p.m. on October 22, 1999. In

the event of a Substantial Completion Default, Tenant may terminate this Lease by giving notice of such termination to Landlord at any time following March 1, 2000 and prior to 5:00 p.m. on March 8, 2000. In the event that Tenant gives any such termination notice, this Lease shall, upon receipt of that notice, be deemed terminated and of no further force and effect and neither party shall, following such termination, have further liability to the other by reason hereof or by reason of that certain Interim Agreement between the parties dated January 28, 1999, as amended other than as set forth in the immediately following sentence. Within five (5) days of Tenant's notice to terminate this Lease, Landlord will pay Tenant \$400,000.00 (the "TERMINATION PAYMENT") to assist Tenant in paying the cost of removing Tenant's fixtures and equipment from the Premises and other costs associated with the failure to complete Landlord's Work. The parties agree that the actual damages which will be incurred by Tenant on account of a Phase I Completion Default, a Phase II Completion Default or a Substantial Completion Default will be significant and very difficult to calculate and have, therefor, agreed upon the Termination Payment as a liquidated sum to compensate Tenant for such damage. Such termination, if exercised by Tenant, and the Landlord's payment of the Termination Fee shall be Tenant's sole remedy for Landlord's failure to Substantially Complete the Landlord's Work (or any Phase thereof) as herein required.

If Phase I of the Landlord's Work is not Substantially Complete by July 5, 1999, or if Phase II of the Landlord's Work is not Substantially Complete by August 1, 1999 or if the entirety of the Landlord's Work (including the Mezzanine Mechanicals) is not been Substantially Complete by December 1, 1999, and provided that Tenant has not terminated this Lease as herein provided, Tenant may exercise the remedy provided for in Section 13.3 hereof. If Tenant does exercise the remedy provided for in Section 13.3, such exercise shall be Tenant's sole remedy for Landlord's failure to Substantially Complete the Landlord's Work, or any Phase thereof, as herein required.

13.3 SATISFACTION GUARANTY: Landlord has delivered a "SATISFACTION GUARANTY" to Tenant in the amount of Three Hundred Thousand and 00/100 (\$300,000.00) Dollars. In the event Phase I is not Substantially Complete by July 5, 1999, or Phase II is not Substantially Complete by August 1, 1999 or Landlord's Work is not Substantially Complete by December 1, 1999, the amount of the Satisfaction Guaranty will be deemed to be \$400,000.00. Landlord and Tenant agree that Tenant may make demand for payment under the Satisfaction Guaranty if, for any reason, Tenant is dissatisfied with Landlord's performance hereunder (including, without limitation, the circumstances addressed in the immediately preceding paragraph). If Tenant makes such demand for payment, the amount demanded by Tenant (the "RENT CREDIT AMOUNT") will be treated in the manner set forth in Section 2.5 of Exhibit C to this Lease. If Tenant is dissatisfied with Landlord's performance hereunder, the parties acknowledge Tenant's damages on account of that dissatisfaction will be difficult to measure. If, under those circumstances, the Tenant makes a demand for a Rent Credit Amount, the parties agree that the Rent Credit Amount demanded by Tenant (up to the maximum amount of \$300,000.00) will be deemed a reasonable liquidated sum intended to compensate Tenant for such damages.

All dates in this Section 13.3 will be adjusted one (1) day for each day of Excused Delay (as set forth in Exhibit C).

14. LIABILITY AND INDEMNITY: Save for its negligence and willful acts and that of its agents, Landlord shall not be responsible or liable to Tenant for any loss or damage (i) that may be occasioned by or through the acts or omissions of persons occupying any part of the Building or

any persons transacting any business in or about the Building or persons present in or about the Building for any other purpose or (ii) for any loss or damage resulting to Tenant or its property from burst, stopping or leaking water, sewer, sprinkler or steam pipes or plumbing fixtures or from any failure of or defect in any electric line, circuit or facility. Subject to Section 15, Tenant shall defend, indemnify and save Landlord harmless from and against all liabilities, damages, claims, costs, charges, judgments and expenses, including, but not limited to, reasonable attorneys' fees, which may be imposed upon or incurred or paid by or asserted against Landlord, the Premises or any interest therein or in the Building by reason of or in connection with any negligent or tortious act on the part of Tenant or any of its agents, contractors, servants, employees, licensees or invitees, any accident, injury, death or damage to any person or property occurring in the Premises or any part thereof, or any default of Tenant of its obligations under this Lease provided, however, that nothing contained in this paragraph shall be deemed to require Tenant to indemnify Landlord with respect to any negligence or tortious act or omission committed by Landlord or its agents or any other tenant, occupant, licensee or invitee, or to any extent prohibited by law.

Subject to Section 15, Landlord shall defend, indemnify and save Tenant harmless from and against all liabilities, damages, claims, costs, charges, judgments and expenses, including, but not limited to, reasonable attorneys' fees, which may be imposed upon or incurred or paid by or asserted against Tenant, the Premises or any interest therein or in the Building by reason of or in connection with any negligent or tortious act on the part of Landlord or any of its agents, contractors, servants, employees, licensees or invitees, any accident, injury, death or damage to any person or property occurring in the Premises or any part thereof, or any default by Landlord of its obligations under this Lease, provided, however, that nothing contained in this paragraph shall be deemed to require Landlord to indemnify Tenant with respect to any negligence or tortious act or omission committed by Tenant or its agents or any other tenant, occupant, licensee or invitee, or to any extent prohibited by law.

15. MUTUAL RELEASE/WAIVER OF SUBROGATION: Each of Landlord and Tenant hereby releases the other from any and all liability or responsibility to the other or anyone claiming through or under them by way of subrogation or otherwise for any loss or damage to property caused by any of the all risk casualties insurable under an all risk property insurance policy, even if such casualty shall have been caused by the fault or negligence of the other party, or anyone for whom such party may be responsible.

16.1 HAZARDOUS SUBSTANCES: Tenant shall at all times and in all respects comply with all federal, state and local laws, ordinances and regulations ("HAZARDOUS MATERIALS LAWS") relating to the industrial hygiene, environmental protection or the use, analysis, generation, manufacture, storage, presence, disposal or transportation of any oil, petroleum products, flammable explosives, asbestos, urea formaldehyde, polychlorinated biphenyls, radioactive materials or waste, or other hazardous toxic, contaminated or polluting materials, substances or wastes, including without limitation any "hazardous substances", "hazardous wastes", "hazardous materials" or "toxic substances" under any such laws, ordinances or regulations (collectively, "HAZARDOUS MATERIALS").

Tenant shall at its own expense procure, maintain in effect and comply with all conditions of any and all permits, licenses and other governmental and regulatory approvals required for Tenant's use of the Premises, including without limitation, discharge of (appropriately treated)

materials or waste into or through any sanitary sewer system serving the Premises. Tenant shall in all respects, handle, treat, deal with and manage any and all Hazardous Materials in, on, under or about the Premises in complete conformity with all applicable Hazardous Materials Laws and prudent industry practices regarding the management of such Hazardous Materials. Tenant may utilize such Hazardous Materials as are used by Tenant in the ordinary course of its business so long as Tenant complies with the requirement hereof. Upon written notice from Landlord requesting the identity of such substances or materials, Tenant will provide Landlord with a list of same. If any lender or governmental agency shall ever require testing to ascertain whether or not there has been any release of Hazardous Materials, then the reasonable costs thereof shall be reimbursed by Tenant to Landlord upon demand as additional charges if such requirement applies to the Premises and if the results of such testing confirm that Hazardous Materials are present on the Premises in violation of the provisions hereof and that Tenant has caused such release of Hazardous Materials at the Premises. In addition, Tenant shall certify on a reasonable basis from time to time at Landlord's request concerning Tenant's best knowledge and belief, without the necessity of inquiry, regarding the presence of Hazardous Materials brought by Tenant on to the Premises. Tenant shall indemnify Landlord in the manner elsewhere provided in this Lease from any violation by Tenant.

16.2 To Landlord's knowledge as of the date hereof and as of the Commencement Date, Landlord is not aware of any Hazardous Materials which exist or are located on or in the Premises. Further, Landlord represents to Tenant that: (i) to the best of its knowledge, Landlord has not caused the generation, storage or release of Hazardous Materials upon the Premises; (ii) any Hazardous Materials located on the Premises during construction of the Improvements will, by the Commencement Date, be removed therefrom in compliance with Hazardous Materials Laws; and (iii) the Improvements will contain no asbestos or asbestos-containing materials. Landlord will indemnify Tenant from any violation by Landlord of its obligations under this Section 16.2.

17. DEFAULT: Tenant hereby agrees that in case Tenant shall default in making its payments hereunder or any of them or in performing any of the other agreements, terms and conditions of this Lease and such default continues for five days after written notice thereof as to the payment of Base Rent or Additional Rent (a "Monetary Default") or thirty (30) days (or such longer period as Tenant, acting diligently, may reasonably require) after written notice thereof as to all other defaults, then, in any such event, Landlord, in addition to all other rights and remedies available to Landlord by law or by other provisions hereof, may after five days written notice, with due process, re-enter immediately into the Premises and remove all persons and property therefrom, and, at Landlord's option, annul and cancel this Lease as to all future rights of Tenant and Tenant hereby expressly waives the service of any notice in writing of intention to re-enter as aforesaid (other than the notices specified above). Tenant further agrees that in case of any such termination Tenant will indemnify the Landlord against all loss of rents and other actual pecuniary loss which Landlord incurs by reason of such termination, including, but not being limited to, reasonable costs of restoring and repairing the Premises as required by this Lease, costs of renting the Premises to another tenant, loss or diminution of rents and other damage which Landlord may incur by reason of such termination, and all reasonable attorney's fees and expenses incurred in enforcing any of the terms of the Lease. Neither acceptance of rent by Landlord, with or without knowledge of breach, nor failure of Landlord to take action on account of any breach hereof or to enforce its rights hereunder shall be deemed a waiver of any breach, and absent written notice or consent, said breach shall be a continuing one.

18. NOTICES: All bills, statements, notices or communications which Landlord may desire or be required to give to Tenant shall be deemed sufficiently given or rendered if in writing and sent by registered or certified mail, or sent by a nationally recognized overnight courier service addressed to Tenant at One Village Place, 6436 City West Parkway, Eden Prairie, Minnesota 55344, or, as to Monetary Default, by facsimile, with a copy to Jack A. Rosberg, Esq., Parsinen, Kaplan, Levy, Rosberg & Gotlieb, P.A., Suite 1100, 100 South Fifth Street, Minneapolis, Minnesota 55402. The giving of such notice or communication shall be deemed to be the third (3rd) day following the time when the same is deposited in the mail or the day following deposit with such overnight courier as herein provided or, as to notice by facsimile, upon receipt. Any notice by Tenant to Landlord must be served by registered or certified mail, or sent by a nationally recognized overnight courier service addressed to Landlord at the address where the last previous rental hereunder was payable, or in case of subsequent change upon notice given, to the latest address furnished, and the giving of such notice shall be deemed to occur in the same manner as notices from Landlord to Tenant as specified above. Either Landlord or Tenant may, upon ten (10) days prior written notice to the other as herein provided, change its address for notices under this Lease.

19. HOLDING OVER: Should Tenant continue to occupy the Premises after expiration or termination for any reason of the Term or any renewal or renewals thereof such tenancy shall be from month to month and in no event from year to year or for any longer term, and shall be on all the terms and conditions hereof applicable to a month to month tenancy except that Base Rent shall equal one hundred percent (100%) if in the Initial Term (and one hundred twenty-five percent (125%) if in an Extended Term) of the Base Rent payable at the time of such expiration or termination. In addition, Tenant shall continue to pay Operating Costs. Nothing in this Section 19, however, shall prevent Landlord from removing Tenant forthwith and seeking all remedies available to Landlord in law or equity.

20. SUBORDINATION: Subject to the non-disturbance provided for below, the rights of Tenant shall be and are subject and subordinate at all times to the lien of any first mortgage now or hereafter in force against the Premises, and Tenant shall, within twenty days (20) after request, execute such further instruments subordinating this Lease to the lien of any such mortgage as shall be requested by Landlord, which shall include agreement by Tenant to attorn to the holder of such mortgage, covenant of nondisturbance of Tenant's occupancy by such holder in the event that such holder, its successors or assigns, succeeds to the interest of Landlord and such holder consent to the application of insurance proceeds to restoration of casualty loss damage, subject to such reasonable conditions as such holder may impose. All such instruments shall be in form and substance satisfactory to Landlord and Tenant, both acting reasonably.

21. ESTOPPEL CERTIFICATE: Tenant and Landlord shall each at any time and from time to time, upon not less than ten (10) days prior written notice from the other, execute, acknowledge and deliver to the other and any other parties designated by the other, a statement in writing certifying (a) that this Lease is in full force and effect and is unmodified (or, if modified, stating the nature of such modification), (b) the date to which the rental and other charges payable hereunder have been paid in advance, if any, and (c) that there are, to such party's actual knowledge, no uncured defaults on the part of the other hereunder (or specifying such defaults if any are claimed).

Any such statement may be furnished to and relied upon by any prospective purchaser or encumbrancer, assignee or sublessee of all or any portion of the Project.

22. SERVICE CHARGE: Tenant agrees to pay interest at the per annum rate equal to two percent (2%) plus the prime rate announced as such from time to time in the Wall Street Journal under the section "Money Rates" of any payment of monthly Base Rent or additional charge payable by Tenant hereunder which is not paid within five (5) days from the date due.

23. BINDING EFFECT: The word "Tenant", wherever used in this Lease, shall be construed to mean tenants in all cases where there is more than one tenant, and the necessary grammatical changes required to make the provisions hereof apply to corporations, partnerships or individuals, men or women, shall in all cases be assumed as though in each case fully expressed. Each provision hereof shall extend to and shall, as the case may require, bind and inure to the benefit of Landlord and Tenant and their respective heirs, legal representatives, successors and assigns.

24. TRANSFER OF LANDLORD'S INTEREST: In the event of any transfer or transfers of Landlord's interest in the Premises, other than a transfer for security purposes only, the transferor shall be automatically relieved of any and all obligations and liabilities on the part of Landlord accruing from and after the date of such transfer, provided that the transferee assumes this Lease and agrees to pay and perform the obligations of Landlord which accrue thereafter; provided, however, that Landlord may not transfer its interest in the Premises prior to the Commencement Date hereof and further provided, that following such transfer Landlord will not be relieved of any obligation it has to Tenant by reason of any events occurring prior to the date of such transfer.

25. LIMITATION OF LIABILITY: In the event that Landlord is ever adjudged by any court to be liable to Tenant in damages, Tenant specifically agrees to look solely to Landlord for the recovery of any judgment from Landlord, it being agreed that if Landlord is a partnership, its partners whether general or limited, or if Landlord is a corporation, its directors, officers, or shareholders, shall never be personally liable for any judgment. The provision contained in the foregoing sentence is not intended to, and shall not, limit any right that Tenant might otherwise have to obtain injunctive relief against Landlord or Landlord's successor in interest, or to maintain any other action not involving the personal liability of Landlord (or if Landlord is a partnership, its partners whether general or limited, or if Landlord is a corporation, requiring its directors, officers or shareholders to respond in monetary damages from assets other than Landlord's in the Building) or to maintain any suit or action in connection with enforcement or collection of amounts which may become owing or payable under or on account of insurance maintained by Landlord.

26. ADDITIONAL RENT AMOUNTS: Any amounts in addition to Base Rent payable to Landlord by Tenant hereunder, including without limitation amounts payable pursuant to Sections 5, 14, 16.1 and EXHIBIT C, and hereof ("Additional Rent") shall be an obligation of Tenant hereunder and all such Additional Rent shall be due and payable on the date expressly set forth herein or, if no date has been specified, within twenty (20) days after receipt of written demand thereof, accompanied by reasonable substantiation in case of amounts which are not fixed under this Lease.

27. INCORPORATION OF EXHIBITS: The following exhibits to this Lease are hereby incorporated by reference for all purposes as fully set forth at length herein:

Exhibit A-1	Legal Description and Permitted Exceptions
Exhibit B	Site Plan
Exhibit C	Additional Terms and Conditions
Exhibit D	Outline Plans and Specifications
Exhibit E	Construction Schedule
Exhibit F	Phase I Completion
Exhibit G	Project Cost Estimate
Exhibit H	Memorandum of Lease Agreement

28. BROKERS: Landlord acknowledges and agrees that it is obligated to pay a brokerage fee of \$440,000.00 to Mark Sims and United Properties, payable one-half upon Lease execution, one-fourth upon occupancy, and one-fourth upon the earlier of (1) the release of Tenant from its obligations for its existing facilities in Bloomington and Eden Prairie or (ii) December 31, 2000.

Except as specifically provided for in this Section 28, Landlord and Tenant each represent and warrant to the other that no brokerage fee, commission or finders fee of any kind is due any party by reason of this transaction.

29. GENERAL: The submission of this Lease for examination does not constitute the reservation of or an option for the Premises, and this Lease becomes effective only upon execution and delivery hereof by Landlord and Tenant. This Lease does not create the relationship of principal and agent or of partnership, joint venture or any association between Landlord and Tenant, the sole relationship between Landlord and Tenant being that of lessor and lessee. No waiver of any default of Tenant hereunder shall be implied from any omission by Landlord to take any action on account of such default if such default persists or is repeated, and no express waiver shall affect any default other than the default specified in the express waiver and that only for the time and to the extent therein stated. The topical headings of the several paragraphs and clauses are for convenience only and do not define, limit or construe the contents of such paragraphs or clauses. All preliminary negotiations are merged into and incorporated in this Lease. This Lease can only be modified or amended by an agreement in writing signed by the parties hereto, their successors or assigns. All provisions hereof shall be binding upon the heirs, successors and assigns of each party hereto.

Tenant may exercise and continue to exercise all of its rights under this Lease upon the occurrence and during the continuance of any default under this Lease up to the point of termination of this Lease.

Time is of the essence under this Lease.

30. SEVERABILITY: The invalidity of any provision, clause or phrase herein contained shall not serve to render the balance of this Lease ineffective or void and the same shall be construed as if such had not been herein set forth.

31. LEASE ASSUMPTION: INTENTIONALLY DELETED

32. AUTHORITY:

- A. Landlord represents and warrants to Tenant that:
- (i) Landlord has good title to the Premises free and clear of any encumbrances that materially affects Tenant's rights or obligations under this Lease.
 - (ii) Landlord has full power, right and authority to execute and perform this Lease and all corporate action necessary so to do has been duly taken.
 - (iii) Provided Tenant is not in default hereunder, Tenant shall and may peaceably and quietly occupy the Premises during the Term of this Lease and any renewal or extension thereof.
- B. Tenant represents and warrants to Landlord that:
- (i) Tenant has full power, right and authority to execute and perform this Lease and all corporate action necessary so to do has been duly taken.

33. ANTENNA INSTALLATION: Subject to the provisions of this Section 33, Landlord grants Tenant the right to install, operate and maintain, at Tenant's expense and risk, and without rent or other charge therefor, a lawfully permitted antenna, satellite dish and associated equipment (the "Antenna Equipment") at a location on the Building to be determined by Tenant and reasonably acceptable to Landlord (the "Antenna Premises"):

- a) Tenant shall submit to Landlord for its approval, plans and specifications for the proposed Antenna Equipment installation, such approval not to be unreasonably withheld, conditioned or delayed;
- b) Tenant shall make all required conduit or cable connections between Tenant's equipment in the Premises and the Antenna Equipment, subject to approval of such connections by Landlord, which approval shall not be unreasonably withheld, conditioned, or delayed;
- c) Tenant shall obtain necessary municipal, state and federal permits and authorizations required to install, maintain and operate the Antenna Equipment and pay any charges levied by government agencies which are the sole result of Tenant having the Antenna Equipment. Landlord agrees to fully cooperate with Tenant in obtaining all such permits and authorizations, at no cost or expense to Landlord;
- d) Tenant agrees to maintain the Antenna Equipment and Antenna Premises in a good state of repair and to save Landlord harmless from any claims, liability or expenses resulting from the erection, maintenance, existence or removal of the Antenna Equipment, provided that such loss, costs or damages are not due, in whole or in part, to the negligence or willful misconduct of Landlord, its agents, employees or contractors;
- e) At the conclusion of the Term, Tenant shall remove the Antenna Equipment and surrender and restore the Antenna Premises to Landlord in substantially as good condition as when entered, except for loss or damages resulting from casualty,

condemnation, act of God or ordinary wear and tear.

34. MEMORANDUM OF LEASE: If requested by either party. Landlord and Tenant shall enter into and record a Memorandum of Lease Agreement, in the form of Exhibit H.

IN WITNESS WHEREOF, the respective parties hereto have caused this Lease to be executed the day and year first above written.

LANDLORD:

RYAN COMPANIES US, INC.

BY: /s/ Timothy McShane

Its: Vice President

TENANT:

D56, INC.

BY: /s/ Robert Rose

Its: Vice President

Exhibit 10.5

GUARANTY OF LEASE

WHEREAS, Ryan Companies US, Inc., a Minnesota corporation, as Landlord, has entered into a certain Lease Agreement dated April 14, 1999, between Landlord and D56, Inc., a Minnesota corporation, as Tenant (herein referred to as the "Lease").

WHEREAS, the undersigned ("Guarantor") is the parent company of the Tenant.

NOW, THEREFORE, for value received, the undersigned hereby absolutely and unconditionally guarantees to said Landlord, its successors and assigns, the due and prompt performance and observance of all of the obligations of said Lease to be met by Tenant, including but not limited to the payment of rent and other payments to be made under the Lease. The undersigned agrees that no act or thing, except for payment in full or written release of this Guaranty by Landlord, which but for this provision might or could in law or equity act as a release of the liability of the undersigned hereunder, shall in any way affect or impair the absolute and unconditional obligation of the undersigned. This Guaranty shall be a continuing, absolute and unconditional Guaranty and shall be in full force and effect for the term of the Lease or until this Guaranty has been released in writing by Landlord, whichever occurs first. This Guaranty is a guaranty of payment (and not of collection), and of performance. The liability of Guarantor is co-extensive with that of Tenant and also joint and several with that of Tenant, and this Guaranty shall be enforceable against Guarantor without the necessity of any suit or proceeding on Landlord's part of any kind or nature whatsoever against Tenant. This Guaranty shall inure to the benefit of the successors and assigns of said Landlord, including any subsequent holder of the Landlord's interest in the Lease.

The undersigned expressly agrees that the liability and obligations under this Guaranty shall not in any way be affected by the institution by or against the Tenant of any bankruptcy, reorganization, arrangement, insolvency or liquidation proceedings, or any other similar proceedings for relief under any bankruptcy law or similar law for relief of debtors and that upon the institution of any of the above actions, at Landlord's sole discretion and without any notice thereof or demand therefor, Guarantor shall pay all rent and other payments to be made under the Lease and perform and observe all covenants under the Lease.

The undersigned hereby further agrees that notwithstanding any assignment of the Lease or sublettings, the undersigned shall remain liable as a guarantor of the Lease, irrespective of whether or not the Tenant has been released from liability; and the Guarantor agrees to execute a reaffirmation of this Guarantee upon the request of Landlord in connection with any such assignment or subletting. Landlord shall deliver to Guarantor a copy of any and all notices of default required pursuant to the terms and conditions of the Lease to be given by Landlord to Tenant (and simultaneously with any such notice to Tenant), by certified mail, return receipt requested as follows (or to such other address as Guarantor may designate from time to time by written notice to Landlord):

Department 56, Inc.
One Village Place
6436 City West Parkway
Eden Prairie, MN 55344

Landlord agrees to accept the cure by Guarantor of any such default by Tenant so long as such cure is completed during the same cure period, if any, accorded Tenant under the Lease.

This Guaranty is executed under and intended to be constructed by the laws of the State of Minnesota.

IN WITNESS WHEREOF, the undersigned has caused this Guaranty to be executed as of this 14 day of April, 1999.

DEPARTMENT 56, INC., a Delaware corporation

BY /s/ Robert Rose

Its Vice President

STATE OF MINNESOTA)
) SS.
COUNTY OF HENNEPIN)

The foregoing instrument was acknowledged before me this 14 day of April, 1999, by Robert Rose, the Vice President of Department 56, Inc., a Delaware corporation, on behalf of the corporation.

/s/ Stephen M. Hickok

Notary Public

EXECUTION COPY

FIRST AMENDMENT

FIRST AMENDMENT dated as of January 27, 2000 (this "AMENDMENT") to the Credit Agreement dated as of March 19, 1999 (the "CREDIT AGREEMENT") among DEPARTMENT 56, INC., a Delaware corporation (the "BORROWER"), the several banks and other financial institutions party thereto (the "LENDERS") and THE CHASE MANHATTAN BANK, a New York banking corporation, as administrative agent for the Lenders (in such capacity, the "ADMINISTRATIVE AGENT").

W I T N E S S E T H :

WHEREAS, the Borrower, the Lenders and the Administrative Agent are parties to the Credit Agreement;

WHEREAS, the Borrower has requested that the Administrative Agent and the Lenders amend the Credit Agreement in certain respects; and

WHEREAS, the Administrative Agent and the Lenders are willing to enter into this Amendment on the terms and conditions hereof;

NOW, THEREFORE, in consideration of the premises and the mutual covenants herein contained, the parties hereto agree as follows:

1. DEFINED TERMS. Unless otherwise defined herein, capitalized terms used herein which are defined in the Credit Agreement are used herein as so defined.

1. AMENDMENT TO SECTION 1.1. Subsection 1.1 of the Credit Agreement is hereby amended by inserting therein, in appropriate alphabetical order, the following new definitions:

"`FIRST AMENDMENT': the First Amendment dated as of January 27, 2000, to this Agreement.

`FIRST AMENDMENT EFFECTIVE DATE': the date on which the First Amendment shall become effective."

1. AMENDMENT TO SECTION 7.1(c). Section 7.1(c) of the Credit Agreement is hereby amended by deleting such Section 7.1(c) in its entirety and inserting the following in lieu thereof:

"(c) CONSOLIDATED NET WORTH. Permit Consolidated Net Worth at the last day of any fiscal quarter to be less than the greater of (i) \$65,000,000 or (ii) \$142,988,000 MINUS, (A) for any fiscal quarter ending after the First Amendment Effective Date (and, for purposes of calculating pro forma compliance pursuant to Section 7.6(b), the applicable fiscal quarter ending prior to the First Amendment Effective Date) and on or prior to December 30, 2000, the amount expended by the Borrower to repurchase its Capital Stock pursuant to Section 7.6(b) (after giving effect to this clause (ii)(A)) during the period from the First Amendment Effective Date to the last day of such fiscal quarter and (B) for any fiscal quarter ending thereafter, the amount expended by the Borrower to repurchase its Capital Stock pursuant to Section 7.6(b) (after giving effect to clause (ii)(A)) during the period from the First Amendment Effective Date to December 30, 2000."

1. REPRESENTATIONS AND WARRANTIES. The Borrower hereby confirms that, after giving effect to the amendments provided for herein, the representations and warranties contained in Section 4 of the Credit Agreement are true and correct in all material respects on and as of the date hereof and no Default or Event of Default has occurred and is continuing.

1. NO OTHER AMENDMENTS. Except as expressly amended hereby, the Credit Agreement shall continue to be, and shall remain, in full force and effect in accordance with its terms.

1. COUNTERPARTS. This Amendment may be executed by the parties hereto in any number of separate counterparts and all of such counterparts taken together shall be deemed to constitute one and the same instrument. Delivery of an executed counterpart of a signature page to this Amendment by telecopier shall be effective as delivery of a manually executed counterpart of this Amendment.

1. CONDITIONS TO EFFECTIVENESS. This Amendment shall become effective upon the receipt by the Administrative Agent of (i) this Amendment, executed and delivered by a duly authorized officer of each of the Borrower and the Required Lenders and (ii) all fees required to be paid by the Borrower pursuant to Section 9 of this Amendment.

1. GOVERNING LAW. THIS AMENDMENT SHALL BE GOVERNED BY, AND SHALL BE CONSTRUED AND INTERPRETED IN ACCORDANCE WITH, THE LAWS OF THE STATE OF NEW YORK.

1. AMENDMENT FEE. The Borrower shall pay an amendment fee to each of the Lenders entering into this Amendment prior to January 27, 2000 of .075% of each such Lender's Commitment, payable on the First Amendment Effective Date.

IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be duly executed and delivered by their proper and duly authorized officers as of the date set forth above.

DEPARTMENT 56, INC.

By: /s/ Percy C. Tomlinson

Title: Executive Vice President and
Chief Financial Officer

THE CHASE MANHATTAN BANK, as Administrative Agent and as a Lender

By: /s/ Jonathan L. Twichell

Title: Vice President

ABN AMRO BANK N.V., as Co-Documentation Agent and as a Lender

By: /s/ John E. Robertson

Title: Vice President

By: /s/ Peter J. Hallan

Title: Assistant Vice President

BANK ONE, NA (Main Office Chicago),
as Co-Documentation Agent and as a Lender

By: /s/ Lisa Whatley

Title: Vice President

U.S. BANK NATIONAL ASSOCIATION, as Managing Agent and as a Lender

By: /s/ Michael J. Reymann

Title: Vice President

COMERICA BANK

By: /s/ Timothy O'Rourke

Title: Vice President

FIRSTAR BANK MILWAUKEE, N.A.

By: /s/ Jason R. Hickey

Title: Assistant Vice President

HARRIS TRUST AND SAVINGS BANK

By: /s/ Andrew K. Peterson

Title: Managing Director

M&I MARSHALL & ILSLEY BANK

By: /s/ John W. Howard

Title: Vice President

THE FIFTH THIRD BANK

By: /s/ Kevin J. Walter

Title: Corporate Banking Officer

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WELLS FARGO BANK, NATIONAL ASSOCIATION

By: /s/ Molly S. Van Metre

Title: Vice President and Senior Banker

MICHIGAN NATIONAL BANK

By: /s/ Draga B. Palincas

Title: Vice President

WACHOVIA BANK

By: /s/ Walter R. Gillikin

Title: Senior Vice President

BANK HAPOALIM B.M.

By:
Title:

By: /s/ Conrad Wagner

Title: First Vice President

DEPARTMENT 56, INC. STOCK OPTION AGREEMENT
FOR OPTIONS UNDER THE 199{7} STOCK INCENTIVE PLAN

Optionee: _____ Date: _____
Number of Shares subject to the Option: _____ Exercise Price per Share: _____

1. GENERAL.

1.1 The Company hereby grants to the Optionee, subject to the terms of this Agreement and the Company's 199{7} Stock Incentive Plan (the "Plan"), the right and option (the "Option") to purchase, at the Exercise Price, the number of Shares set forth above. The number of Shares and the Exercise Price are subject to adjustment as provided in Section {13} of the Plan, which is made a part hereof as if fully set forth herein. Except as otherwise defined herein, capitalized terms used in this Agreement shall have the same definitions as set forth in the Plan. For purposes of this Agreement, (a) the term "person" shall mean an individual, a corporation, a partnership, an association, a trust, a sole proprietorship, a limited liability company, or any other entity or organization, including a government or governmental agency, instrumentality, authority, commission or court, (b) the term "Affiliate" of the Company shall mean any person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the Company and (b) the term "control" shall mean the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of any person, whether through the ownership of equity interests, by contract or otherwise.

1.2 This Option is not intended to qualify as an Incentive Stock Option within the meaning of Section 422 of the Code.

1.3 The Option shall be exercisable to the extent and in the manner provided herein for a period of 10 years from the date hereof (the "Exercise Term"); PROVIDED, HOWEVER, that the Option may be earlier terminated as provided in Section 4 or 5 hereof.

2. EXERCISABILITY OF OPTIONS.

2.1 VESTING. Subject to the provisions of this Agreement and the Plan, the Option shall become exercisable cumulatively with respect to one-third of the total number of Shares which may be purchased pursuant to the Option on each of the first, second and third anniversary hereof.

2.2 TIMING OF EXERCISE. The Optionee or the guardian, executor, administrator or other legal representative (each a "Legal Representative") of the Optionee (all references herein to "Optionee" being deemed to include the Optionee's Legal Representative, if any, unless the context otherwise requires) may exercise the Option, in whole or in part, at any time or from time to time, but only to the extent the Option is exercisable at such time.

2.3 EFFECT OF CHANGE IN CONTROL. Notwithstanding anything contained in this Agreement to the contrary, in the event of a Change in Control, the Option shall become immediately and fully exercisable.

3. MANNER OF EXERCISE AND PAYMENT.

3.1 Subject to the terms and conditions of this Agreement and the Plan, the Option may be exercised by delivery of written notice, in person or by mail, to the Secretary of the Company, at the Company's principal executive office (or such other address as the Company may from time to time notify the Optionee in writing). Such notice shall state that the Optionee is electing to exercise the Option and the number of Shares in respect of which the Option is being exercised and shall be signed by the Optionee or, where applicable, by his Legal Representative. The Company may require proof satisfactory to it as to the right of the Legal Representative to exercise the Option.

3.2 The notice of exercise described in Section 3.1 hereof shall be accompanied by the full purchase price for the Shares in respect of which the Option is being exercised, such purchase price to be paid by check. Not less than 100 Shares may be purchased at any one time upon an exercise of the Option, unless the number of Shares so purchased constitutes the total number of Shares then purchasable under the Option.

3.3 The Optionee shall not be deemed to be the holder of, or to have any of the rights of a holder with respect to, any Shares subject to the Option until the conditions in Section 7.3 of the Plan have been satisfied.

4. CERTAIN RESTRICTIONS.

4.1 NON-TRANSFERABILITY. The Option shall not be transferable by the Optionee 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 Legal Representative. The terms of such Option shall be final, binding and conclusive upon the beneficiaries, executors, administrators, heirs and successors of the Optionee.

4.2 EMPLOYMENT TERMINATION. (a) Except as may be agreed between the Committee and the Optionee, if the Optionee shall no longer be employed by the Company or any of its Subsidiaries, or, if the Option was granted by reason of the Optionee serving as a director of the Company or any of its Subsidiaries, the Optionee shall cease to serve as a director of the Company or any of its Subsidiaries, for any reason whatsoever ("Terminated" or a "Termination"), irrespective of whether the Optionee receives, in connection with the Termination, any severance or other payment from the Company or any of its Subsidiaries under any employment agreement or otherwise, the Option, to the extent it is not exercisable pursuant to Section 2.1 or 2.3 hereof at the date of such Termination, shall terminate and shall be of no further force and effect from and after the date of such Termination (the "Termination Date").

(b) If any portion of the Option is exercisable pursuant to Section 2.1 or 2.3 hereof on the Termination Date, the Terminated Optionee may exercise the Option, to the extent the Option was exercisable on the Termination Date, at any time on or before the earliest of --

(i) three (3) months after the Optionee's Termination if he or she is terminated for Cause ("Cause" shall exist if: (x) the Optionee is convicted of, or pleads NOLO CONTENDERE to, any felony which has materially and adversely impacted the Company's financial condition or reputation, or (ii) the Optionee has engaged in conduct that constitutes willful gross neglect or willful gross misconduct in carrying out his or her duties which has materially and adversely impacted the Company's financial condition or reputation);

(ii) forty-eight (48) months after the Optionee's date of death;

(iii) twelve (12) months after the Optionee's Termination before his or her attainment of age sixty (60) if his or her service is Terminated for any reason other than death or Cause; or

(iv) the last day of the Exercise Term -

PROVIDED, HOWEVER, that if the Optionee dies within the period following Termination during which the Option is exercisable as set forth above and has not fully exercised the Option prior to death, then the Legal Representative may exercise the Option, to the extent the Option was exercisable on the Termination Date, at any time within forty-eight (48) months after the Legal Representative is appointed (but in no event after the expiration of the Exercise Term).

5. PROHIBITION AGAINST CERTAIN ACTIVITIES.

5.1 OPTIONEE'S FOREBEARANCE. The Optionee understands that the Company is granting to the Optionee an option to purchase Shares hereunder to reward the Optionee for the Optionee's future efforts and loyalty to the Company and its Affiliates by giving the Optionee the opportunity to participate in the potential future appreciation of the Company. Accordingly, the Optionee agrees that (a) he will not at any time during his employment with the Company or any Affiliate thereof, or after any Termination, directly or indirectly disclose or furnish to any other person or use for his own or any other person's account any confidential or proprietary knowledge or any other information which is not a matter of public knowledge obtained during the course of his employment with, or other performance of services for, the Company or any Affiliate thereof or any predecessor of any of the foregoing, no matter from where or in what manner the Optionee may have acquired such knowledge or information, and he shall retain all such knowledge and information in trust for the benefit of the Company, its Affiliates and the successors and assigns of any of them, (b) if he is Terminated, he will not for three years following the Termination directly or indirectly solicit for employment, including without limitation recommending to

any subsequent employer the solicitation for employment of, any person who at the time of the solicitation is employed by the Company or any Affiliate thereof (a "Dept. 56 Employee") (it being understood that, if the Optionee becomes affiliated with another person (the "Successor") and the Successor solicits for employment a Dept. 56 Employee, it shall not constitute a solicitation hereunder if the Optionee does not solicit, recommend to the Successor, or otherwise bring to the attention of the Successor, the Dept. 56 Employee), and (c) he will not at any time during his employment or after any Termination publish any statement or make any statement (under circumstances reasonably likely to become public or that he might reasonably expect to become public) critical of the Company or any Affiliate thereof, or in any way adversely affecting or otherwise maligning the business or reputation of the Company or any of its Affiliates or any of their respective officers, directors or employees (any activity described in clause (a), (b) or (c) of this sentence being herein referred to as a "Prohibited Activity"). In addition, accordingly, the Optionee agrees that he will not at any time during his employment with the Company or any Affiliate thereof or the one year thereafter (including any period following Termination during or in respect of which he is receiving any severance payment) engage in any Competitive Activity (as hereinafter defined) anywhere in the world (including, without limitation, anywhere in the United States of America, the United Kingdom, Hong Kong, The Peoples' Republic of China or the Republic of China (Taiwan)).

The term "Competitive Activity" shall mean engaging in any of the following activities: (i) directly or indirectly through one or more intermediaries (X) controlling any Competitor (as hereinafter defined) or (Y) owning any equity or debt interests in any Competitor (other than equity or debt interests which are publicly traded and do not exceed 2% of the particular class of interests outstanding), (ii) directly or indirectly soliciting, diverting, taking away, appropriating or otherwise interfering with any of the employees, customers or suppliers of the Company or any Affiliate thereof, or (iii) employment by (including serving as an officer or director of), or providing consulting or other services to, any Competitor. The term "Competitor" means any person that competes either directly or indirectly with any of the businesses conducted or products developed (including, without limitation, miniature ceramic or porcelain buildings and figurines) by the Company or any of its Affiliates at any time or from time to time during the period

of the Optionee's employment with the Company or any of its Affiliates.

5.2 RIGHT TO TERMINATE OPTION. The Optionee understands that the Company is granting to the Optionee an option to purchase Shares hereunder to reward the Optionee for the Optionee's future efforts and loyalty to the Company and its affiliates by giving the Optionee the opportunity to participate in the potential future appreciation of the Company. Accordingly, if the Optionee (a) engages in any Prohibited Activity, (b) engages in any Competitive Activity, or (c) is convicted of a crime against the Company or any affiliate, then, in addition to any other rights and remedies available to the Company, the Company shall be entitled, at its option, to terminate the Option, which shall then be of no further force and effect.

6. SPECIFIC PERFORMANCE. The parties hereto acknowledge that there will be no adequate remedy at law for a violation of any of the provisions of this Agreement and that, in addition to any other remedies which may be available, all of the provisions of this Agreement shall be specifically enforceable in accordance with their respective terms.

7. WITHHOLDING. Prior to the issuance of any Shares to the Optionee hereunder, the Optionee shall remit to the Company the full amount of any applicable Withholding Taxes. The Company shall have the right to deduct from any distribution of cash to the Optionee any amount necessary in satisfaction of any applicable Withholding Taxes.

8. ENTIRE AGREEMENT. This Agreement and the Plan constitute the entire agreement, and supersede all prior agreements and understandings, oral and written, between the parties hereto with respect to the subject matter hereof.

9. ACKNOWLEDGMENT. The Optionee hereby acknowledges prior receipt of a copy of the Plan and agrees to be bound by all the terms and provisions thereof as the same may be amended from time to time. The Optionee hereby acknowledges that he has reviewed the Plan and this Agreement and understands his rights and obligations thereunder and hereunder. The Optionee also acknowledges that he has been provided with such information concerning the Company, the Plan and this Agreement as he and his advisors have requested.

DEPARTMENT 56, INC.

By: _____

Optionee:

AGREEMENT FOR SHARE-DENOMINATED PERFORMANCE UNITS
UNDER THE DEPARTMENT 56, INC. 199{7} STOCK INCENTIVE PLAN

Grantee: _____
Number of PSPs Granted: _____

Performance Cycle: _____
Target EPS at Performance Cycle End: \$ _____

Minimum Number of PSPs that may be earned:	0% of number set forth above as granted
Threshold Number of PSPs that may be earned:	25% of number set forth above as granted
Target Number of PSPs that may be earned:	100% of number set forth above as granted
Maximum Number of PSPs that may be earned:	150% of number set forth above as granted

1. GENERAL. Pursuant to Section 10.2 of the Company's 199{7} Stock Incentive Plan (the "Plan") and subject to the terms of this Agreement and the Plan, the Company hereby grants to the Grantee the number of Share-denominated Performance Units ("PSPs") set forth above as granted (the "Grant"). The number of PSPs granted and which may be ultimately vested and earned is subject to adjustment for recapitalizations and other events as provided in Section {13} of the Plan. Except as otherwise defined herein, capitalized terms used in this Agreement shall have the same definitions as set forth in the Plan. For purposes of this Agreement, (a) the term "person" shall mean an individual, a corporation, a partnership, an association, a trust, a sole proprietorship, a limited liability company, or any other entity or organization, including a government or governmental agency, instrumentality, authority, commission or court, (b) the term "Affiliate" of the Company shall mean any person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the Company and (b) the term "control" shall mean the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of any person, whether through the ownership of equity interests, by contract or otherwise.

2. VESTING AND DISTRIBUTION OF PSPS.

2.1 VESTING AND EARNING. Subject to the provisions of this Agreement, the Plan and the specifications for the Grant adopted by the Committee (e.g., vesting percentage formula, and threshold, target and maximum number of PSPs that may be earned by the Grantee under this Grant), as of the last day of the Performance Cycle shown above (the "Performance Cycle"), the Grantee may earn and become vested in a specific percentage of the PSPs covered by the Grant depending upon the extent to which Target EPS at Performance Cycle End (the "Target EPS") as shown above is met as of such date. The determination as to what extent such performance objective is met shall be made with reference to the Company's diluted earnings per Common Share reported in its audited financial statements for the last year of the Performance Cycle. (By way of illustration: if the reported amount of diluted earnings per Common Share for the last fiscal year of the Performance Cycle equals 100% of the Target EPS, then 100% of the number of PSPs set forth above as granted shall be earned and fully vested in the Grantee).

2.2 DISTRIBUTION OF VESTED AND EARNED GRANT. Distribution of the Grantee's vested and earned PSPs as determined in Section 2.1 hereof shall be made as soon as practicable following the determination of earning and vesting made in accordance with Section 2.1 hereof. Distribution shall be made in the form of Common Shares, cash or a combination of Common Shares, as determined in the sole discretion of the Committee.

2.3 VALUATION OF VESTED AND EARNED GRANT. . For purposes hereof, to the extent it is paid in cash, the "value" of a vested Grant is equal to the same extent in the total number of PSPs earned and vested,

multiplied by the average fair market value of a Common Share. The "average fair market value" shall be determined by totalling the fair market value of a Common Share on each of the last 20 business days including and immediately preceding the last day of the Performance Cycle, and dividing such total by the number 20, with the resulting figure being the average fair market value. The "fair market value" of the Common Share, as such term is used herein, is the highest closing price of a Common Share on the New York Stock Exchange (or other established stock exchange, where applicable) on the applicable date(s) or, if no sale of a Common Share has occurred on such exchange on an applicable date, on the next preceding date on which there was such a sale. In the event the Common Shares are not listed on the New York Stock Exchange (or any other established stock exchange) as of an applicable date for valuation, the "fair market value" is the mean between the "bid" and "asked" prices quoted by a recognized market maker in the Common Shares on such date. For purposes hereof, to the extent it is paid in Common Shares, the "value" of a vested Grant is equal to the same extent in the total number of PSPs earned and vested.

- 2.4 WAIVER OF REQUIREMENTS. Notwithstanding any provisions hereof or of the Plan to the contrary, the requirements for vesting and distribution of PSPs may be waived, in whole or part, if it is determined unanimously by the Committee and by two-thirds vote of the members of the Board that waiver of such requirements and distribution of PSPs, and the resulting additional compensation to the Grantee, would be in the best interest of the Company.

2.5 EFFECT OF CHANGE IN CONTROL. Notwithstanding anything contained in this Agreement to the contrary and unless otherwise provided in the Plan or another agreement between the Company and the Grantee, in the event of a Change in Control all PSPs shall vest and be distributed to the Grantee distributed on the following bases and subject to the following conditions:

(i) If a Change in Control occurs prior to the last day of the Performance Cycle, the Grantee shall become vested in a number of PSPs hereunder determined as follows:

A. First, the Company shall be deemed to have achieved the greater of (x) the Target EPS and (y) if the Change in Control occurs after the first quarter of the Performance Cycle, the diluted earnings per Common Share most recently projected by the Company prior to the Change in Control for the last year of the Performance Cycle (or, if no such projection exists, such projection for the next preceding year for which such a projection exists, but in the event no such earlier projection exists, the diluted earnings per Common Share at Performance Cycle End projected by assuming achievement for the remainder of the Performance Cycle of a compound annual growth rate in diluted earnings per Common Share equal to the rate by which diluted earnings per Common Share for the fiscal year ended immediately preceding the date of the Change of Control varied from the prior fiscal year), in each case adjusted to exclude (1) all legal, accounting, investment banking and other costs and expenses incurred or projected by the Company in connection with, or in opposition to, the events resulting in the Change in Control and (2) the projected effect of the Change in Control upon such measurements.

B. Next, the result obtained in Clause (A) of this Paragraph (i) is multiplied by a fraction, the numerator of which is the number of months of the Grantee's continuous employment within the Performance Cycle prior to the Change in Control and the denominator of which is the number of months within the entire Performance Cycle.

(ii) Distribution of the Grantee's vested PSPs as determined in Paragraph (i) hereof shall be made as soon as practicable after the first occurrence of a Change in Control. Such distribution shall be in Common Stock, cash or a mix in the manner provided by Section 2.2 hereof and shall be valued as provided in Section 2.3 hereof. Upon the making of any such distribution, this Grant and the underlying PSPs shall be deemed canceled and of no further force and effect.

3. CERTAIN RESTRICTIONS.

3.1 NON-TRANSFERABILITY. This Grant and the underlying PSPs shall not be transferable by the Grantee otherwise than by will or the laws of descent and distribution, or to his or her guardian, executor, administrator or other legal representative (each a "Legal Representative") (all references herein to "Grantee" being deemed to include the Grantee's Legal Representative, if any, unless the context otherwise requires). The terms of such Grant shall be final, binding and conclusive upon the beneficiaries, executors, administrators, heirs and successors of the Grantee. The Grantee may designate in writing on forms prescribed by and filed with the Company a beneficiary or beneficiaries to receive any benefits payable after his or her death, and may at any time amend or revoke such designation. If no beneficiary designation is in effect at the time of the Grantee's death, payments under this Agreement, if any, shall be

made to his or her Legal Representative.

3.2 EMPLOYMENT TERMINATION. Except as may be agreed between the Committee and the Grantee or otherwise provided in the Plan or another agreement between the Company and the Grantee, if the Grantee shall no longer be employed by the Company or any of its Subsidiaries for any reason whatsoever prior to the end of the Performance Cycle ("Terminated" or a "Termination"), the Grantee shall forfeit any right or entitlement to or in the Grant and the underlying PSPs; PROVIDED, HOWEVER, that if the Termination occurs six (6) months or more after the date this Grant was made but prior to the last day of the Performance Cycle due to the occurrence of the Grantee's death, approved retirement, other approved separation from employment, or disability, the Grantee may become vested in a number of PSPs hereunder, the number being determined as follows: A. First, the number of PSPs which would have vested in the Grantee as of the last day of the Performance Cycle had the Grantee remained employed throughout such Performance Cycle shall be calculated upon completion of the Performance Cycle in accordance with Section 2.1 hereof. B. Next, the result obtained in Clause (A) of this Section 3.2 shall be multiplied by a fraction, the numerator of which is the number of months of such Grantee's continuous employment within the Performance Cycle prior to Termination, and the denominator of which is the number of months within the entire Performance Cycle.

3.3 SHAREHOLDER RIGHTS. The Grantee shall not be deemed to be the holder of, or to have any of the rights of a holder with respect to, any Common Shares which may be paid upon any vesting of the Grant until such Common Shares are actually paid to him or her. The designation and crediting of PSPs to the Grantee before any are earned and paid in Common Shares is solely for the Company's accounting purposes.

4. SPECIFIC PERFORMANCE. The parties hereto acknowledge that there will be no adequate remedy at law for a violation of any of the provisions of this Agreement and that, in addition to any other remedies which may be available, all of the provisions of this Agreement shall be specifically enforceable in accordance with their respective terms.

5. WITHHOLDING. Prior to the issuance of any Common Shares to the Grantee hereunder, the Grantee shall remit to the Company the full amount of any applicable Withholding Taxes. The Company shall have the right to deduct from any distribution of cash to the Grantee any amount necessary in satisfaction of any applicable Withholding Taxes. The Committee may permit a Grantee to elect to satisfy Withholding Taxes relating to the earning and vesting of PSPs by having the Company withhold a sufficient number of Common Shares otherwise payable in respect of the earned and vested PSPs. Any Common Shares so withheld by the Company shall be valued at their per share "fair market value," which shall mean for the purposes of this Section the closing composite transactions listing on the date the Withholding Tax is determined (or such other meaning as the Committee may hereafter adopt).

6. ACKNOWLEDGMENT. The Grantee hereby acknowledges prior receipt of a copy of the Plan and agrees to be bound by all the terms and provisions thereof as the same may be amended from time to time. The Grantee hereby acknowledges that he has reviewed the Plan and this Agreement and understands his rights and obligations thereunder and hereunder. The Grantee also acknowledges that he has been provided with such information concerning the Company, the Plan and this Agreement as he and his advisors have requested.

DEPARTMENT 56, INC.

By: _____

Grantee:

Exhibit 21.1

SUBSIDIARIES OF THE COMPANY

Name of Subsidiary -----	Jurisdiction -----
Department 56 Retail, Inc.	Minnesota
Department 56 Sales, Inc.	Minnesota
D 56, Inc.	Minnesota
CAN 56, Inc.	Minnesota

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 March 17, 2000, appearing in this Annual Report on Form 10-K of Department 56, Inc. and subsidiaries for the year ended January 1, 2000.

Deloitte & Touche LLP

Minneapolis, Minnesota
March 31, 2000

<ARTICLE> 5

<LEGEND>

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE CONSOLIDATED BALANCE SHEETS OF DEPARTMENT 56, INC. & SUBSIDIARIES (THE COMPANY) AS OF 1/1/00, & 1/2/99 & THE RELATED CONSOLIDATED STATEMENTS OF INCOME, CASH FLOWS, & STOCKHOLDERS' EQUITY FOR THE YEARS ENDED 1/1/00, 1/2/99, & 1/3/98, & IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

</LEGEND>

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