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

FORM 10-K

(Mark One)

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (Fee Required) For the fiscal year ended December 31, 1994

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 $464,082,018 as of March 22, 1995 (based on the closing price of consolidated trading in the Common Stock on that date as published in *The Wall Street Journal*). 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 22, 1995: 21,497,387.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's Annual Report to Stockholders for the fiscal year ended December 31, 1994 (the "1994 Annual Report") are incorporated by reference in Parts II and IV. Portions of the Company's definitive Proxy Statement for the 1995 Annual Meeting of Stockholders filed with the Securities and Exchange Commission concurrently with this Form 10-K (the "1995 Proxy Statement") are incorporated by reference in Part III.

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 Collection and The Heritage Village Collection as well as its extensive line of holiday and home decorative accessories, including its Snowbabies collectible porcelain and pewter handpainted figurines.

The Company was organized in 1992 by affiliates of Forstmann Little & Co. ("Forstmann Little") for the purpose of acquiring (the "Acquisition") Department 56, Inc., a privately-held Minnesota corporation (the "Predecessor Company"). The Acquisition was consummated in October 1992 for an aggregate purchase price of approximately $250 million (including the payment of expenses), plus the payment of approximately $28 million of nonrecurring charges and approximately $6 million of long-term indebtedness. The Acquisition was funded by the issuance of Common Stock for $57.6 million (before the accrual of $2.2 million for stock offering expenses) to affiliates of Forstmann Little (the "Forstmann Little Partnerships"), the issuance of Common Stock for approximately $13.4 million (which consideration was primarily in the form of securities of the two stockholders of the Predecessor Company) to certain members of the senior management of the Company and the issuance of subordinated debentures of the Company for $213 million to one of the Forstmann Little Partnerships. Subsequent to the Acquisition, the senior management of the Predecessor Company has continued as the senior management of the Company and the Predecessor Company, which changed its name to "D 56, Inc.," has continued as the Company's principal operating subsidiary.

On June 17, 1993, the Forstmann Little Partnerships and certain members of senior management and other employees of the Company sold 5,290,000 shares of Common Stock in an initial public offering (the "Initial Public Offering") at a price of $18.00 per share. On May 5, 1994, the Forstmann Little Partnerships and certain members of senior management and other employees of the Company sold 5,750,000 shares of Common Stock in a public offering at a price of $27.375 per share. As of March 22, 1995, the Forstmann Little Partnerships owned approximately 35% of the outstanding shares of Common Stock.

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 winter scenes. The Company introduces new lit pieces, limited edition pieces, street lamps, figurines and other accessory groups each year to complement 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 and manufacturing considerations.

The Company's Village Series products are comprised of two broad collections: The Original Snow Village Collection and The Heritage Village Collection. The Original Snow Village Collection, introduced in 1976, consists of lit ceramic houses and accessories designed around a single village theme. The Original Snow Village Collection is the largest collection, based on number of pieces, in the Company's Village Series. The Heritage Village Collection, introduced in 1984 and expanded since that time, consists of lit porcelain houses and accessories designed around several different village themes. By using porcelain for The Heritage Village Collection products, the Company has been able to achieve a higher level of detail, in a smaller scale product, than would have been possible by using ceramic.

Village Accessories. Department 56 also produces a range of accessories for its villages, including figurines, vehicles, musical tapes, 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.

Other Giftware. The Company offers a wide range of other decorative giftware and home accessory items, including the Company's Snowbabies and Snowbunnies figurines, Christmas and Easter decorative items, tableware, decorative tins, acrylics 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. Other 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 2,200 stock keeping units, of which approximately 1,900 are Other Giftware products.

Customers

The Company's principal customers (accounting for approximately 89% of its sales) are approximately 19,000 independent gift retailers across the United States. These retailers include approximately 1,100 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. Occasionally, a piece will be sold exclusively through certain dealers in the first year that it is introduced. Approximately 11% of the Company's sales are made to department stores and mail order houses. No single account represented more than 2% of the Company's sales in fiscal 1994. The Company provides volume discounts to its customers with respect to most of its products. The Company has generally used its available production capacity to satisfy demand in the United States market and, accordingly, has had only limited sales outside the United States. International sales were approximately 1% of the Company's sales in fiscal 1994, and the Company does not expect to materially increase international sales in fiscal 1995.

As part of the Company's strategy of managed growth, only approximately 6,000 retailers receive the Company's Village Series and Snowbabies products. There is currently a waiting list of more than 3,000 additional retailers who are interested in carrying the Company's Village Series and Snowbabies collectible products. Due to strong demand, the Company's lit Village Series products and porcelain Snowbabies figurines have been sold on allocation for each of the last seven years and four years, respectively. In addition, the Company may also sell particular pieces or limited editions on an allocation basis, which may involve setting restrictions on how many pieces may be purchased by a particular customer.

Marketing and Advertising

Department 56 sells its products through 13 independently operated wholesale showrooms (including showrooms in New York, Dallas and Los Angeles) and three corporate showrooms which cover the major giftware market areas in the United States. 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 also has a corporate showroom of approximately 10,200 square feet at the Atlanta, Georgia gift mart and a corporate showroom of approximately 7,500 square feet at the Chicago, Illinois gift mart. In addition, the Company sells through giftware shows throughout the United States. 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 shows and brochures. It advertises to consumers through brochures, point of sale information and seasonal advertisements in magazines and newspapers. In 1994, the Company 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 a quarterly newsletter, which contains product-related articles and description of its product lines, to subscriber groups and others. Department 56 maintains a toll-free telephone line for collector questions and participates in collector conventions.

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 product 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 Taiwan (Republic of China), The People's Republic of China and The Philippines. The Company also imports a small percentage of its products from sources in Europe, primarily Italy, England and Germany. In fiscal 1994, the Company imported products from approximately 140 independent manufacturing sources. The Company's single largest manufacturing source represented approximately 9% of the Company's imports in fiscal 1994. The Company's emphasis on high quality craftsmanship at affordable prices limits the sources from which the Company chooses to obtain products and, accordingly, results in controlled growth of its product lines. The Company has long-standing relationships with the majority of its manufacturers (several for ten years or more) and often contracts (typically on a year-to-year basis) for 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 Company's wholly owned indirect subsidiary, Department 56 Trading Co., Ltd., the principal operations of which are based in Taiwan, sources many of the Company's products in the Pacific Rim, monitors and coordinates production and assists in the export of the Company's products to the United States. The Company believes that this overseas subsidiary provides the Company with greater product and quality control, at a lower cost, than would be available from a third party trading company. The Company also purchases products, to a limited extent, from selected independent trading companies operating in particular geographic regions.

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 18 months. 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 porcelain.

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 automated warehouse and distribution centers, each located within 10 miles of the other in the southwest quadrant of the Minnesota Twin Cities metropolitan area. The Bloomington facility is dedicated to the warehousing and distribution of Village Series lit pieces, while the Eden Prairie facility handles all other products. Shipments from the Company to its customers are handled by United Parcel Service or commercial trucking lines.

The Company utilizes computer systems and internally developed software to maintain efficient 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, uniform computer and communication software systems allow on-line information access between the Company's headquarters and its showrooms, and those systems are being expanded to provide direct linkage with the Company's field salespersons. The Company believes its complex yet efficient software for the processing and shipment of orders from its central warehouse allows it to better serve its retail customer base.

Backlog and Seasonality

The Company receives products, pays its suppliers and ships products throughout the year, although the majority of shipments occur 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 December 31, 1994, Department 56 had unfilled wholesale orders of approximately $8.4 million, compared to $5.3 million at January 1, 1994. All of the backlog is scheduled to be shipped to customers during the current fiscal year. Approximately 5% of the Company's total annual customer orders have been cancelled in each of the last three years for a number of reasons, including customer credit considerations, inventory shortages or customer cancellation requests.

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 orders ranging from approximately 76% to 80% 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 typically records a substantial portion of its revenues in its second and third quarters. The Company expects this seasonal pattern to continue for the foreseeable future.

Trademarks and other Proprietary Rights

The Company owns seven Federal trademark registrations and has pending Federal trademark applications in the United States Patent and Trademark Office 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 Federal registrations for the Company's trademarks are currently scheduled to expire or be cancelled at various times between 1997 and 2008, 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 and mail order houses or through direct response marketing. The Company believes that the principal elements of competition in the specialty giftware industry are product design and quality, product and brand-name loyalty, product display and price. The Company believes that its competitive position is enhanced by a variety of factors, including the innovativeness, quality and enduring themes of the Company's products, its reputation among retailers and consumers, its in-house design expertise, its sourcing and marketing capabilities and the pricing of its products. Some of the Company's competitors, however, are part of large, diversified companies having 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 Taiwan, The People's Republic of China and The Philippines. The Company also imports a small percentage of its products from sources in Europe, primarily Italy, England and Germany.

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. In addition, the Company's import operations may be adversely affected by political instability resulting in the disruption of trade from exporting countries, regulatory changes, increases in transportation costs or delays, any significant fluctuation in the value of the United States dollar against foreign currencies and restrictions on the transfer of funds.

Substantially all of the Company's products are subject to Customs Service 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 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. In fiscal 1994, approximately 29% of the Company's imports were manufactured in The People's Republic of China, which is currently accorded "Most Favored Nation" status 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, are under review by the United States government and, accordingly, the duty treatment of goods imported from China is subject to political uncertainties. 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.

Employees

As of December 31, 1994, the Company had 193 full-time employees in the United States and 11 full-time employees in Taiwan. Substantially all of the Company's 70 U.S.-based warehouse, shipping and receiving employees are represented by Local Union No. 638 of the Teamsters under a contract that expires on December 31, 1997. 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 a 67,000 square-foot office facility in Eden Prairie, Minnesota, which includes 57,000 square feet of office space. Its executive offices, creative center and primary corporate showroom are located in this facility, which is known as "One Village Place." The Company currently occupies approximately 56,000 square feet of the facility and leases the remaining 11,000 square feet to others.

The Company leases a warehouse and distribution facility in Eden Prairie of approximately 150,000 square feet. The current lease for this facility expires on March 31, 2001. The Company also leases a warehouse and distribution facility in Bloomington, Minnesota of approximately 159,000 square feet, the lease for which expires on February 28, 1999 and is extendible at the Company's option for an additional three years. Approximately 23,000 square feet of the Bloomington facility are sublet by the Company to an unaffilated third party until February 28, 1996. The Company believes that its current facilities are adequate to support its needs and presently anticipated growth. However, the Company continuously evaluates its need for additional facilities. The Company also leases a corporate showroom of approximately 10,200 square feet in the Atlanta, Georgia gift mart and a corporate showroom of approximately 7,500 square feet in the Chicago, Illinois gift mart. These leases expire on December 31, 1998 and November 30, 1999, respectively.

Item 3. LEGAL PROCEEDINGS

The Company is involved in various legal proceedings and governmental audits in the ordinary course of its business. In the opinion of the Company's management, the ultimate disposition of these proceedings 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 December 31, 1994.

Additional Item. EXECUTIVE OFFICERS OF THE REGISTRANT

Set forth below are the executive officers of the Company as of the date hereof. In connection with the Initial Public Offering, each person then an executive officer of D 56, Inc. was appointed on April 22, 1993 to serve as an executive officer of the Company. Unless otherwise indicated each executive officer of D 56, Inc. holds identical positions with the Company as he or she does with D 56, Inc. Officers serve at the discretion of the Board of Directors.

Name	Age	Position(s) with the Company
Edward R. Bazinet	51	Chairman of the Board and Chief Executive Officer
Susan E. Engel	48	President and Chief Operating Officer
David H. Weiser	35	Vice President, General Counsel and Secretary
David W. Dewey	37	Vice President — Overseas Operations
William E. Kirchner	47	Vice President — Product Development and Advertising
Sing F. Lo	50	Vice President — Management Information Systems
Robert S. Rose	40	Vice President — Distribution and Operations
Timothy J. Schugel	36	Controller and Principal Accounting Officer
Joan M. Serena	41	Vice President — Consumer Services

The principal occupations and positions for the past five years, and in certain cases prior years, of each of the executive officers of the Company are as follows:

Edward R. Bazinet has been Chairman of the Board and Chief Executive Officer of the Company and of D 56, Inc. since April 22, 1993. Mr. Bazinet was the founder of D 56, Inc. and was President of D 56, Inc. from 1984 until April 22, 1993.

Susan E. Engel has been President and Chief Operating Officer of the Company and of D 56, Inc. since September 19, 1994. Ms. Engel was a consultant to retail and consumer goods companies from September 1993 until September 1994, and Chief Executive Officer and President of Champion Products, Inc. from October 1991 to September 1993. Prior to October 1991, Ms. Engel served 14 years at Booz-Allen and Hamilton, the management consulting firm, most recently as Partner-in-Charge of the U.S. Eastern region retailing practice.

David H. Weiser has been Vice President and General Counsel of the Company since April 22, 1993 and Secretary of the Company and of D 56, Inc. since February 1993. Mr. Weiser has been Vice President and General Counsel of D 56, Inc. since March 15, 1993. He was an associate in the law firm of Fried, Frank, Harris, Shriver & Jacobson from 1986 until March 15, 1993.

David W. Dewey has been Vice President — Overseas Operations of the Company and of D 56, Inc. since April 22, 1993. Mr. Dewey was Vice President of Marketing of D 56, Inc. from March 1990 until April 22, 1993. He was Director of Far East Operations for D 56, Inc. from December 1987 until March 1990.

William E. Kirchner has been Vice President — Product Development and Advertising of the Company and of D 56, Inc. since April 22, 1993. Mr. Kirchner was Director of Advertising and New Product Development of D 56, Inc. from May 1984 until April 22, 1993.

Sing F. Lo has been Vice President — Management Information Systems of the Company and of D 56, Inc. since June 6, 1994. Mr. Lo was Director — Management Information Systems of D 56, Inc. from September 1989 until June 6, 1994.

Robert S. Rose has been Vice President — Distribution and Operations of the Company and of D 56, Inc. since April 22, 1993. Mr. Rose was Vice President of Operations of D 56, Inc. from September 1988 until April 22, 1993.

Timothy J. Schugel has been Controller of the Company and of D 56, Inc. since April 26, 1993. He was a Senior Manager/Manager with the public accounting firm of Deloitte & Touche from 1986 until April 24, 1993.

Joan M. Serena has been Vice President — Consumer Services of the Company and of D 56, Inc. since April 22, 1993. Ms. Serena was Vice President, Sales Services of D 56, Inc. from June 1992 until April 22, 1993. Ms. Serena was Divisional Product Merchandising Manager of the Home Furnishing Division of Associated Merchandising Corporation from August 1988 through May 1992.

PART II

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

Information required by this Item is included in Corporate and Stockholder Information on page 38 of the 1994 Annual Report and Note 5 to Five Year Summary on page 19 of the 1994 Annual Report, and such information is incorporated herein by reference.

As of March 22, 1995, the number of holders of record of the Company's Common Stock was 731.

Item 6. SELECTED FINANCIAL DATA

Information required by this Item is included in Five Year Summary on page 19 of the 1994 Annual Report, and such information is incorporated herein by reference. See also the notes to the consolidated financial statements and Management's Discussion and Analysis on pages 30 to 36 and 20 to 24, respectively, of the 1994 Annual Report, and such information is incorporated herein by reference.

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

Information required by this Item is included in Management's Discussion and Analysis on pages 20 to 24 of the 1994 Annual Report, incorporated herein by reference.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Information required by this Item is included in the consolidated financial statements of the Company for the years ended December 31, 1994 and January 1, 1994 and for the period from October 4, 1992 to January 2, 1993, the consolidated financial statements of the Predecessor Company for the period from December 29, 1991 to October 3, 1992, the notes to the consolidated financial statements, and the report of independent auditors thereon on pages 26 to 37 of the 1994 Annual Report, and in the Company's unaudited quarterly financial data for the years ended January 1, 1994 and December 31, 1994 on page 22 of the 1994 Annual Report, incorporated herein by reference.

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

None in 1994.

PART III

Item 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information required by this Item concerning directors of the Company is included in the 1995 Proxy Statement in the section captioned "Item 1 — Election of Directors," and such information is incorporated herein by reference. Information required by this Item concerning the executive officers of the Company is included in Part I, pages 7 and 8 of this Annual Report on Form 10-K as permitted by General Instruction G(3) to Form 10-K. Information required by this Item concerning compliance with Section 16(a) of the Securities Exchange Act of 1934 is included in the 1995 Proxy Statement in the last paragraph of the section captioned "Security Ownership of Certain Beneficial Owners and Management," and such information is incorporated herein by reference. Theodore J. Forstmann and Nicholas C. Forstmann, both of whom are directors of the Company, are brothers.

Item 11. EXECUTIVE COMPENSATION

Information required by this Item is included in the 1995 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 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 1995 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

Information required by this Item is included in the 1995 Proxy Statement in the section captioned "Certain Related Party Transactions," and such information is incorporated herein by reference. See also, Note 11 to the consolidated financial statements on page 35 of the 1994 Annual Report.

PART IV

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

			Form 10-K (Page)	1994 Annual Report (Page)
(a)	1.	*Financial Statements*		
		Consolidated Balance Sheets at December 31, 1994 and January 1, 1994		26
		For the years ended December 31, 1994 and January 1, 1994 ("Company"), the period from October 4, 1992 to January 2, 1993 ("Company"), and the period from December 29, 1991 to October 3, 1992 ("Predecessor Company"):		
		Consolidated Statements of Operations		27
		Consolidated Statements of Cash Flows		28
		Consolidated Statements of Stockholders' Equity		29
		Notes to Consolidated Financial Statements		30-36
		Independent Auditors' Report for the years ended December 31, 1994 and January 1, 1994 ("Company"), the period from October 4, 1992 to January 2, 1993 ("Company") and the period from December 29, 1991 to October 3, 1992 ("Predecessor Company")		37
	2.	*Financial Statement Schedules*		
		Independent Auditors' Report	12	
		I. Condensed financial information	13-15	
		II. Valuation and qualifying accounts	16	

All other schedules have been omitted because they are not applicable, not required or the information required is included in the consolidated financial statements or notes thereto.

3. *Exhibits*

The exhibits are listed in the accompanying Index to Exhibits on pages 19 and 20.

(b) Reports on Form 8-K

None.

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 December 31, 1994 and January 1, 1994 and the related consolidated statements of operations, cash flows and stockholders' equity for the years ended December 31, 1994 and January 1, 1994 and the period from October 4, 1992 to January 2, 1993, and have issued our report thereon dated February 17, 1995 (included in the Company's Annual Report to Stockholders for the year ended December 31, 1994). We have also audited the consolidated statements of operations, cash flows and stockholders' equity of D 56, Inc. (the "Predecessor Company") for the period from December 29, 1991 to October 3, 1992 and have issued our report thereon dated February 17, 1995. Our audits also included the financial statement schedules for the aforementioned periods listed in Item 14 of Form 10-K. These financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statement schedules based on our audits. In our opinion, such financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

Deloitte + Touche LLP

Deloitte & Touche LLP
Minneapolis, Minnesota
February 17, 1995

DEPARTMENT 56, INC.
(Parent company only)

SCHEDULE I — CONDENSED FINANCIAL INFORMATION
BALANCE SHEETS
(In thousands)

	December 31, 1994	January 1, 1994
ASSETS		
INVESTMENT IN SUBSIDIARY	$208,461	$213,069
RECEIVABLE FROM SUBSIDIARY	1,342	—
	$209,803	$213,069
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current portion of long-term debt	$ 20,000	$ —
Accrued stock issuance costs	854	1,606
Accrued interest payable	644	870
Payable to subsidiary	—	862
	21,498	3,338
LONG-TERM DEBT, NET OF CURRENT PORTION	88,000	148,000
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 21,475 and 21,343 shares, respectively	215	213
Additional paid-in capital	40,244	38,269
Unearned compensation on common stock options	(183)	(681)
Retained earnings	60,029	23,930
Total stockholders' equity	100,305	61,731
	$209,803	$213,069

Note: Investment in subsidiary is accounted for under the equity method of accounting.

See notes to consolidated financial statements included in the 1994 Annual Report, incorporated by reference.

DEPARTMENT 56, INC.
(Parent company only)

SCHEDULE I — CONDENSED FINANCIAL INFORMATION (Continued)
STATEMENTS OF OPERATIONS
(In thousands)

	Year Ended December 31, 1994	Year Ended January 1, 1994	October 4, 1992 Through January 2, 1993
Equity in earnings of subsidiary	$46,740	$39,959	$ 920
Interest expense	(10,376)	(14,930)	(3,154)
General and administrative expenses	(265)	(32)	—
Income (loss) before income taxes	36,099	24,997	(2,234)
Benefit for income taxes	—	—	1,167
Net income (loss)	$36,099	$24,997	$(1,067)

See notes to consolidated financial statements included in the 1994 Annual Report, incorporated by reference.

DEPARTMENT 56, INC.
(Parent company only)
SCHEDULE I — CONDENSED FINANCIAL INFORMATION (Continued)
STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended December 31, 1994	Year Ended January 1, 1994	October 4, 1992 Through January 2, 1993
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss)	$ 36,099	$ 24,997	$(1,067)
Adjustment to reconcile net income (loss) to net cash provided by operating activities:			
Dividends received from subsidiaries	51,455	82,194	—
Equity in earnings of subsidiaries	(46,740)	(39,959)	(920)
Increase (decrease) in accrued interest payable	(226)	(2,284)	3,154
Increase in payable to subsidiaries	(862)	862	—
Decrease (increase) in receivable from subsidiaries	(15)	1,167	(1,167)
Payment of stock issuance costs	(752)	(2,094)	—
Net cash provided by operating activities	38,959	64,883	—
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from the exercise of stock options	1,041	117	—
Principal payments on long-term debt	(40,000)	(65,000)	—
Net cash used in financing activities	(38,959)	(64,883)	—
NET CHANGE IN CASH AND CASH EQUIVALENTS	—	—	—
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	—	—	—
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ —	$ —	$ —

See notes to consolidated financial statements included in the 1994 Annual Report, incorporated by reference.

DEPARTMENT 56, INC.

SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS
(In thousands)

Column A	Column B	Column C — Additions		Column D	Column E
Description	Balance at Beginning of Period	(1)Charged to Costs and Expenses	(2)Charged to Other Accounts	Deductions	Balance at End of Period
COMPANY					
Year ended December 31, 1994:					
Allowance for doubtful accounts receivable	$3,314	$1,107	—	$ 829(a)	$3,592
Allowance for obsolete and overstock inventory	2,413	539	—	292	2,660
Allowance for sales returns and credits	1,470	4,593	—	4,422	1,641
	$7,197	$6,239	—	$5,543	$7,893
Year ended January 1, 1994:					
Allowance for doubtful accounts receivable	$2,433	$1,922	—	$1,041(a)	$3,314
Allowance for obsolete and overstock inventory	1,575	1,680	—	842	2,413
Allowance for sales returns and credits	921	3,142	$307(c)	2,900	1,470
	$4,929	$6,744	$307	$4,783	$7,197
Period from October 4, 1992 to January 2, 1993:					
Allowance for doubtful accounts receivable	$2,120	$ 455	—	$ 142(a)	$2,433
Allowance for obsolete and overstock inventory	1,468	107	—	—	1,575
Allowance for sales returns and credits	1,045	—	—	124(b)	921
	$4,633	$ 562	—	$ 266	$4,929
PREDECESSOR COMPANY					
Period from December 29, 1991 to October 3, 1992:					
Allowance for doubtful accounts receivable	$1,487	$1,479	—	$ 846(a)	$2,120
Allowance for obsolete and overstock inventory	850	618	—	—	1,468
Allowance for sales returns and credits	240	805	—	—	1,045
	$2,577	$2,902	—	$ 846	$4,633

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

(b) Adjustment in reserve due to decrease in level of accounts receivable during the fourth quarter which is the result of sales seasonality.

(c) Adjustment in reserve for the estimated amount of resaleable inventory to be returned in the future.

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.

By: Edward R Bazinet
Edward R. Bazinet
Chairman of the Board
and Chief Executive Officer

Date: March 31, 1995

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
Edward R. Bazinet Edward R. Bazinet	Chairman of the Board, Chief Executive Officer and Director (Principal Executive Officer)	March 31, 1995
Timothy J. Schugel	Controller and Principal Accounting Officer (Acting Principal Financial Officer)	March 31, 1995
Todd L. Bachman	Director	March 31, 1995
Nicholas C. Forstmann	Director	March 31, 1995
Theodore J. Forstmann	Director	March 31, 1995
Stephen Fraidin	Director	March 31, 1995

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Nicholas C. Forstmann	Director	March 31, 1995
Theodore J. Forstmann	Director	March 31, 1995
Stephen Fraidin	Director	March 31, 1995

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Nicholas C. Forstmann	Director	March 31, 1995
Theodore J. Forstmann	Director	March 31, 1995
Stephen Fraidin	Director	March 31, 1995

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By: ______________________
Edward R. Bazinet
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Date: March 31, 1995

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Nicholas C. Forstmann	Director	March 31, 1995
Theodore J. Forstmann	Director	March 31, 1995
Stephen Fraidin	Director	March 31, 1995

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Signature	Capacity in which signed	Date
Richard S. Friedland	Director	March 31, 1995
Sandra J. Horbach	Director	March 31, 1995
Wm. Brian Little	Director	March 31, 1995
Steven G. Rothmeier	Director	March 31, 1995
Arthur T. Shorin	Director	March 31, 1995
Vin Weber	Director	March 31, 1995

Signature	Capacity in which signed	Date
Richard S. Friedland	Director	March 31, 1995
Sandra J. Hurbach	Director	March 31, 1995
Wm. Brian Little	Director	March 31, 1995
Steven G. Rothmeier	Director	March 31, 1995
Arthur T. Shorin	Director	March 31, 1995
Vin Weber	Director	March 31, 1995

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Signature	Capacity in which signed	Date
Richard S. Friedland	Director	March 31, 1995
Sandra J. Horbach	Director	March 31, 1995
Wm. Brian Little	Director	March 31, 1995
Steven G. Rothmeier	Director	March 31, 1995
Arthur T. Shorin	Director	March 31, 1995
Vin Weber	Director	March 31, 1995

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Signature	Capacity in which signed	Date
Richard S. Friedland	Director	March 31, 1995
Sandra J. Horbach	Director	March 31, 1995
Wm. Brian Little	Director	March 31, 1995
Steven G. Rothmeier	Director	March 31, 1995
Arthur T. Shorin	Director	March 31, 1995
Vin Weber	Director	March 31, 1995

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Signature	Capacity in which signed	Date
Richard S. Friedland	Director	March 31, 1995
Sandra J. Horbach	Director	March 31, 1995
Wm. Brian Little	Director	March 31, 1995
Steven G. Rothmeier	Director	March 31, 1995
Arthur T. Shorin	Director	March 31, 1995
Vin Weber	Director	March 31, 1995

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Signature	Capacity in which signed	Date
Richard S. Friedland	Director	March 31, 1995
Sandra J. Horbach	Director	March 31, 1995
Wm. Brian Little	Director	March 31, 1995
Steven G. Rothmeier	Director	March 31, 1995
Arthur T. Shorin	Director	March 31, 1995
Vin Weber	Director	March 31, 1995

DEPARTMENT 56, INC.
INDEX TO EXHIBITS

Exhibit	Description	Page
2.1	Agreement of Purchase and Sale, dated as of October 6, 1992, by and among the Company, Bachman's Holdings, Inc., ed bazinet international, inc., Edward R. Bazinet and certain other individuals (the Company agrees to furnish to the Commission, upon request, on a supplemental basis, a copy of any omitted exhibit). (Incorporated herein by reference to Exhibit 2.1 of Registrant's Registration Statement on Form S-1, No. 33-61514.)	—
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.)	—
3.2	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.)	—
4.1	Specimen form of Company's Common Stock certificate.	—
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.†	—
10.4	Lease, dated April 1, 1989, as amended, between Hoyt Properties, Inc. and the Company for the Eden Prairie warehouse. (Incorporated herein by reference to Exhibit 10.7 of Registrant's Registration Statement on Form S-1, No. 33-61514.)	—
10.5	Lease, dated December 8, 1993 as amended August 25, 1994, between Grantor Retained Income Trust of Robert L. Johnson and the Company for the Bloomington warehouse.*	31
10.6	Amended and Restated Credit Agreement, dated as of February 17, 1995, among D 56, Inc., the Banks parties thereto, and Chemical Bank as agent, issuing bank and accepting bank. (Incorporated herein by reference to Exhibit 10.1 of Registrant's Current Report on Form 8-K dated February 17, 1995.)	—
10.7	Pledge Agreement, dated as of February 17, 1995, by the Company in favor of Chemical Bank. (Incorporated herein by reference to Exhibit 10.2 of Registrant's Current Report on Form 8-K dated February 17, 1995.)	—
10.8	Guarantee, dated as of February 17, 1995, by the Company in favor of Chemical Bank. (Incorporated herein by reference to Exhibit 10.3 of Registrant's Current Report on Form 8-K dated February 17, 1995.)	—
10.9	Pledge Agreement, dated as of February 17, 1995, by D 56, Inc. in favor of Chemical Bank. (Incorporated herein by reference to Exhibit 10.8 of Registrant's Current Report on Form 8-K dated February 17, 1995.)	—
10.10	Pledge Agreement, dated as of February 17, 1995, by FL 56 Intermediate Corp. in favor of Chemical Bank. (Incorporated herein by reference to Exhibit 10.4 of Registrant's Current Report on Form 8-K dated February 17, 1995.)	—
10.11	Guarantee, dated as of February 17, 1995, by FL 56 Intermediate Corp. in favor of Chemical Bank. (Incorporated herein by reference to Exhibit 10.5 of Registrant's Current Report on Form 8-K dated February 17, 1995.)	—
10.12	Pledge Agreement, dated as of February 17, 1995, by ed bazinet international, inc. in favor of Chemical Bank. (Incorporated herein by reference to Exhibit 10.6 of Registrant's Current Report on Form 8-K dated February 17, 1995.)	—
10.13	Guarantee, dated as of February 17, 1995, by ed bazinet international, inc. in favor of Chemical Bank. (Incorporated herein by reference to Exhibit 10.7 of Registrant's Current Report on Form 8-K dated February 17, 1995.)	—

Exhibit	Description
10.14	Guarantee, dated as of February 17, 1995, by Department 56 Trading Co., Ltd. in favor of Chemical Bank. (Incorporated herein by reference to Exhibit 10.9 of Registrant's Current Report on Form 8-K dated February 17, 1995.)
10.15	Registration Rights Agreement between the Company, Department 56 Partners, L.P. and Forstmann Little & Co. Subordinated Debt and Equity Management Buyout Partnership-IV. (Incorporated herein by reference to Exhibit 10.23 of Registrant's Registration Statement on Form S-1, No. 33-61514.)
10.16	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.)
10.17	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.)†
10.18	Form of Stock Option Agreement in connection with Department 56, Inc. 1993 Stock Incentive Plan. (Incorporated herein by reference to Exhibit 10.1 of Registrant's Quarterly Report on Form 10-Q for the quarter ended July 3, 1993.)†
10.19	Aircraft Lease, dated as of April 15, 1994, between Fleet Credit Corporation, as Lessor, and D 56, Inc., as Lessee. (Incorporated herein by reference to Exhibit 10.27 of Registrant's Registration Statement on Form S-1, No. 33-77278.)
10.20	Aircraft Management Agreement, dated February 10, 1994, between Department 56 Trading Co., Ltd. (subsequently assigned to D 56, Inc.) and Lear Siegler Management Corp. (Incorporated herein by reference to Exhibit 10.25 of Registrant's Annual Report on Form 10-K for the fiscal year ended January 1, 1994.)
10.21	Time Sharing Agreement, dated February 10, 1994, between Department 56 Trading Co., Ltd. (subsequently assigned to D 56, Inc.) and Edward R. Bazinet. (Incorporated herein by reference to Exhibit 10.26 of Registrant's Annual Report on Form 10-K for the fiscal year ended January 1, 1994.)
11.1	Computation of Earnings Per Share.*
13.1	Annual Report to Stockholders for fiscal year ended December 31, 1994. (The 1994 Annual Report, except for those portions thereof which are expressly incorporated by reference in this Annual Report on Form 10-K, is being furnished for the Information of the Commission and is not to be deemed "filed" as part of the Form 10-K.)*
21.1	Subsidiaries of the Company.*

† Management contract or compensatory plan

* Filed herewith

EXHIBIT 10.5

LEASE AGREEMENT

BETWEEN

GRANTOR RETAINED INCOME TRUST OF ROBERT L. JOHNSON
LANDLORD

AND

D 56, INC.
TENANT

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TABLE OF CONTENTS

LEASE BRIEF

_X_ New Lease __ Amendment __ Lease Renewal __ Option __Other
__ Sublease __ Assignment

LOCATION (city, state)
10801 Hampshire Avenue South
Bloomington, MN 55438

PROPERTY TYPE:
_X_ Office
_X_ Warehouse
__ Other ____________

NAME OF LESSEE (ALSO DBA, AFFILIATE OF, ETC.)

_X_ Lessee
__ Sublessee
__ Assignee

D 56, Inc.

SPACE

Square Feet of Premises _80,800_
Total Square Feet of Building _159,200_
Percentage of Operating Costs _50.75%_

RENTAL

YEAR	RENT/YEAR	$/S.F./YEAR
1994-98	$209,272.00	$2.59

DEPOSIT $ 0.00

TERM

COMMENCES _February 1st_
_5_ Years _0_ Months

TERMINATES _February 28th_
Lease Year _1994_ to _1999_

Early Cancellation Provision __ Yes _X_ No
Effective Date ________

Lessor's Option __ Lessee's Option __
Notification Date ________

RENEWAL OPTION

OPTION #	LENGTH	RENT	NOTICE DATE	ASSIGNABLE?
1	3 years	$2.95	180 days	__ Yes __ No

SPACE OPTION

TYPE	SUITE #	SQ. FT.	NOTICE DATE	RENT
RFR	all adjacent space		10 days notice	match 3rd party

ASSIGNABLE? __ Yes __ No

SUBJECT TO SPACE OPTION

Is space subject to other tenants space option? __ Yes _X_ No
If yes, describe who's option, amount of space, effective and date:

ASSIGNMENT OR SUBLEASE INFORMATION

CAN LESSEE

Sublet	Assign	
__	__	Yes
__	__	No
__	_X_	Yes, with Lessor's Approval

Does Lessor have option to terminate lease if assignment or sublease is proposed?
__ Yes _X_ No

Does assignment release Lessee of liability? __ Yes _X_ No
Does right exist for further assignment? __ Yes _X_ No
sublet? __ Yes _X_ No

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LEASE

THIS LEASE made this 8th day of December , 19 93 , between Grantor Retained Income Trust of Robert L. Johnson, with its principal place of business at 701 Decatur Avenue North, Suite 107, Minneapolis, Minnesota 55427 (hereinafter referred to as "Landlord") and D 56, Inc., with its principal place of business at 6436 City West Parkway, Eden Prairie, Minnesota 55344 (hereinafter referred to as "Tenant").

W I T N E S S E T H :

ARTICLE I.
DEFINITIONS

The following words shall be defined as follows:

Building - structure containing 159,200 square feet of gross leasable space commonly known as Hampshire Distribution Center and located upon the Real Property.

Common Area - the entire area designated from time to time by Landlord for common use or benefit of the occupants of the Building, including, but not by way of limitation, any and all portions of the Building not available for lease to tenants; the Real Property; the roof; the structure, the exterior walls; the floors; the heating, ventilating and air conditioning; parking lots; landscaped and vacant areas; passages for trucks and automobiles; areaways; roads; walks; curbs; corridors; and facilities such as washrooms, drinking fountains, toilets, stairs, ramps, elevators and escalators, if any.

Premises - a portion of the Building containing 2,400 square feet of mezzanine office space and 78,400 square feet of warehouse space which is outlined in red on the plot plan attached hereto as Exhibit "A" and made a part hereof.

Operating Costs - shall consist of all costs and expenses of operating and maintaining the Building and the Common Area and such additional facilities in subsequent years as may be determined by the Landlord to be necessary to the Building, which costs and expenses shall be determined in accordance with generally accepted accounting principles, which shall be

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consistently applied (with accruals appropriate to Landlord's business (but not including any reserves); and shall include without limitation all ordinary, necessary and reasonable costs and expenses (but not costs which are separately billed to and paid by tenants) of every kind and nature which Landlord shall pay or become obligated to pay (excluding principal and interest payments to the holder of any mortgage on the Building, or rent to the Landlord under any ground lease) because of or in connection with the ownership and operating of the Building and the Common Area, such as the following:

(a) Wages, salaries and related expenses of all on-site employees engaged in the operation, maintenance and security of the Building.

(b) All supplies and materials used in the operation and maintenance of the Building.

(c) Management fees to third parties, maintenance and service agreements for the Building and the equipment therein, including without limitation, window cleaning, elevator maintenance, mechanical maintenance, trash removal and janitorial services.

(d) Accounting costs, including the costs of audits by certified public accountants.

(e) Cost of all insurance customarily carried including, but not limited to fire, casualty, liability and rental abatement for rent loss insurance applicable to the Building and Landlord's personal property used in connection with the Building.

(f) Cost of all repairs, replacements and general maintenance, (excluding repairs and general maintenance by proceeds of insurance or by Tenant and other third parties, and leasehold improvements and alterations attributable to tenants of the Building other than Tenant).

(g) All charges for sewer and water at the Building.

(h) All real estate taxes and installments of special assessments, excluding penalties but including interest thereon, service payments in lieu of taxes, excises, levies, fees or charges, general and special, ordinary and extraordinary, unforeseen as well as foreseen of any kind which are assessed, levied, charged, confirmed, or imposed by any public authority upon the Building and the Real Property, its operations or the rent provided for in this Lease. It is agreed that Tenant will be responsible for ad valorem taxes on its personal property and on the value of leasehold improvements to the extent that same exceeds standard building allowances, but shall not be responsible for Landlord's franchise, corporate, personal property, capital levy, capital stock, excess profits, transfer, revenue, estate, inheritance, gift, succession, gross receipts, State or Federal Income Tax.

(i) Amortization over the useful life of capital improvements made to the Building subsequent to the commencement date of the Lease which will improve the operating efficiency of the Premises, and which cost will not exceed the amount of the expense of such capital improvement.

Notwithstanding anything in this Lease to the contrary, Operating Costs shall not include:

1. leasing commissions, advertising expenses;
2. the cost of restoration of Building following a fire, casualty or condemnation;
3. captial improvements (except reasonable roof replacement and as provided in (i) above), any one capital improvement in excess of $250,000.00 unless previously consented to in writing by Tenant, and captial improvements the construction or installation of which would significantly invade the Premises or impair Tenant's use of the Premises;
4. cost of utilities furnished directly to tenants';
5. any expense for which Landlord is compensated by insurance;
6. legal fees in connection with leasing or enforcement of leases (except this lease);
7. depreciation;
8. financing costs;
9. costs of removing Hazardous Materials, except costs brought about by Tenant; and
10. costs of complying with any statute, rule, regulation, order or assessment of any governmental authority in effect as of the Commencement Date.

Real Property - land legally described on Exhibit "B" attached hereto and made a part hereof.

Tenant's Proportionate Share - shall be a fraction the numerator of which shall be the area of the Premises (which the parties agree is 80,800 square feet as of the date hereof for all purposes of this Lease) and the denominator of which shall be the area of the Building (which the parties agree is 159,200 square feet as of the date hereof for all purposes under this Lease). In no instance shall Tenant's Proportionate Share be misconstrued to apply to a tract of the Real Property on which the Building is not situated.

ARTICLE II.
PREMISES

The Landlord, in consideration of the rent herein agreed to be paid by the Tenant and the other conditions, agreements and stipulations by the Tenant herein expressed and agreed to be kept and performed by the Tenant, does hereby demise and lease unto the Tenant the Premises.

Psh [handwritten initials]

ARTICLE III.
TERM

The term of this Lease shall commence on the First day of February, 1994 (the "Commencement Date") and shall terminate on the Last day of February, 1999. Notwithstanding the foregoing, (i) but subject to Article XIV, in the event any damage to the Premises or delay in occupancy is caused by fire, acts of God, acts of war, or any other calamity, for which the Landlord is not responsible or any other event not under the control of the Landlord, the term of this Lease as stated above shall be extended for a period equal to the amount of time lost by reason of any such cause, but in any event not beyond the last day of June, 1999 and (ii) Landlord shall deliver vacant possession of the Premises to Tenant on January 1, 1994 in order for Tenant to there begin the improvements referred to in Clause I of the Addendum hereto and Tenant shall be responsbile for Tenant's Proportionate Share of Operating Costs for the month of January, 1994.

ARTICLE IV.
RENT

A. Commencing on the Commencement Date, Tenant shall pay to Landlord without demand at 701 Decatur Avenue North, Suite 107, Minneapolis, Minnesota 55427 or at such other place as Landlord may from time to time designate in writing, an annual base rental of $209,272.00, payable in advance in successive equal monthly installments of $17,439.33 each on the first day of each month during the entire term hereof and any extensions or renewals thereof.

B. The Tenant shall also pay, as additional rent, such other sums of money as shall become due and payable by Tenant to Landlord under this Lease, including without limitation, Tenant's Proportionate Share of Operating Costs.

C. If the term of this Lease as heretofore established, commences on other than the first day of a month or terminates on other than the last day of a month, then the all rent provided for in this Article for such month or months shall be appropriately prorated.

ARTICLE V.
COMMON AREA

A. Subject to such reasonable and non-discriminatory rules and regulations that may be created by Landlord from time to time, the Common Area is hereby made available to Tenant and its employees, agents, customers and invitees for their reasonable, nonexclusive use in common with other Tenants, their employees, agents, customers, invitees and Landlord. Landlord shall have the right to enter into, modify and terminate easements and other agreements pertaining to the use and maintenance of the Common Area; to close all or any portion of the Common Area to such extent as, in the opinion of Landlord's counsel, may be necessary to prevent a dedication thereof or the accrual of any rights to any person or to the public therein; to close temporarily any or all portions of the Common Area; and to do and perform such other acts in and to said areas and improvements as in the exercise of good business judgement, as Landlord shall determine to be reasonable or necessary with a view to the improvement of the convenience and use thereof by Tenants, their officers, agents, employees and customers; provided, however, that Landlord shall not do or perform any acts which would adversely affect Tenant's use of the Premises for office and warehouse use.

B. Landlord shall operate and maintain the Common Area or shall cause the same to be operated and maintained in manner deemed by Landlord reasonable, appropriate and for the best interests of the occupants of the Building.

ARTICLE VI.
OPERATING COSTS

A. Landlord has prepared an estimate of the Operating Costs for the calendar year of the operation of the Building, (hereinafter referred to as "Estimated Costs"), all of which shall be initially paid by Landlord.

B. Tenant's Proportionate Share of the Estimated Costs for each calendar year shall be paid in monthly installments on the first day of each calendar month, in advance, in an amount reasonably estimated by Landlord from time to time. Within ninety (90) days after the end of each calendar year, Landlord shall furnish Tenant with a statement of the actual amount of Tenant's Proportionate Share of the Operating Costs for such period. Tenant's CPA shall thereon have the right, upon at least five (5) business days notice, to inspect the Landlord's books, records and documents and material in the possession or under the control of Landlord with respect to the subject matter of this Lease at the place or places where such records are normally retained by Landlord. Tenant's CPA shall have free and full access thereto for such purposes and shall be permitted to make copies thereof and extracts therefrom. In the event that Tenant shall have delivered to Landlord a written statement objecting to Landlord's statement of the actual amount of Tenant's Proportionate Share of Operating Costs within 25 days of Tenant's receipt thereof, the parties shall promptly meet and in good faith attempt to resolve such objections. Tenant and Tenant's CPA shall be required to enter into a confidentiality agreement reasonably acceptable to Landlord's and Tenant's respective counsels prior to such inspection. In the event the total of Tenant's monthly installments paid for any calendar year does not equal Tenant's Proportionate Share as is agreed upon, then upon receipt of such annual statement, Tenant shall promptly pay Landlord any deficiency or Landlord shall issue to Tenant a credit invoice for such excess, as the case may be. The estimated Operating Costs for the year the Lease is executed is $1.43 per square foot.

C. Notwithstanding any other provision herein to the contrary, it is agreed that in the event the Building is not fully occupied during any partial or full calendar year, an adjustment shall be made in computing the Operating Costs for such year so that the Operating Costs shall be computed for such year as though the Building has been fully occupied during such year. Landlord shall bear Operating Costs relating to non-occupied but rentable space.

ARTICLE VII.
USE

The Premises shall be used only as an office/warehouse facility and Tenant shall not suffer, use or permit the use of the Premises or any portion thereof for any other purpose not incidental thereto unless the prior written consent of the Landlord is first obtained; or use or permit the use of the Premises or any portion thereof in violation of any law, ordinance or regulation applicable thereto.

D. Tenant, at its sole cost and expense, shall have the right to protest the taxes and/or special assessments on the Real Property provided: (i) Landlord has not already done so for any given tax or assessment period; and (ii) Tenant consults with Landlord prior to and during such protest.

ARTICLE VIII.
UTILITIES

Commencing on January 1, 1994, Tenant shall pay, as and when due, all charges for electricity, gas, telephone, trash removal, and all other services or utilities including any extraordinary amount of sewer and water which are used, rendered or supplied to or upon the Premises throughout the term of this Lease, including but not limited to all such costs or charges incurred to provide heat, ventilation and air conditioning to the Premises; and Tenant shall indemnify Landlord and save it harmless of and from any cost, liability, charge or expense with respect thereto. Tenant. at its sole cost and expense, shall use its best efforts to separately meter the gas and electrical services for the Building on or before June 1, 1994. Tenant shall have the right to arrange to obtain gas and/or electric energy directly from the public utility company furnishing gas and/or electric energy to the Building. Such gas and/or electric energy may be furnished to Tenant by means of the then existing building system feeders, risers and wiring to the extent that the same are available, suitable and safe for such purpose. All meters and additional panel boards, feeders, risers, wiring and other conductors and equipment whatsoever which may be required to obtain gas and/or electric energy directly from such public utility company whether currently available for Tenant's use or requiring Tenant's installation shall be furnished and installed by Tenant at Tenant's sole expense and shall be left intact upon Tenants vacancy of the Building.

ARTICLE IX.
SIGNS

Tenant shall not place or cause to be placed or maintained on any exterior door, wall or window of the Premises or the Building any advertising matter or other thing of any kind and shall not place or maintain any decoration, lettering or advertising matter on the glass of any window or door of the Premises or any hanging sign within five (5) feet of any such window or door without Landlord's reasonable prior written consent. Tenant further agrees to maintain any such sign, awning, canopy, decoration, lettering, advertising matter or other thing, as may be approved, in good condition and repair at all times.

ARTICLE X.
ACCEPTANCE OF PREMISES, REPAIR AND MAINTENANCE

Tenant acknowledges that it has caused the Premises to be inspected in order to ascertain the quality and the condition thereof, and that no representations, either expressed or implied, have been made regarding the quality or condition thereof. Tenant does hereby accept the demise of the Premises in "as is" condition, and relies solely on its inspection of the Premises with respect thereto.

Tenant, at its sole cost and expense, shall keep and maintain the non-structural portions of the Premises and all equipment and improvements thereon, and every part thereof specifically including, but not limited to, the interior walls and floors in good repair and in a clean, safe and tenantable condition and in conformity with the regulations of any governmental authority and in conformity with the standards established, from time to time, by the National Fire Protection Association. Tenant shall comply with all health and police and fire and other regulations, in all respects and at all times. Tenant shall not allow refuse, garbage or debris to accumulate or be stored outside of or adjacent to the Premises except in dumpsters, other trash containers or in or adjacent to the site of trash compactor which Tenant may install on the Real Property in accordance with applicable governmental rules and regulations.

Tenant shall keep Landlord harmless and indemnified at all times against any loss, damage, penalties, costs and expenses (including reasonable attorney's fees), judgements and decrees by reason of a failure so to do in any respect, or by reason of any violation by Tenant, its invitees or agents of any of the laws or ordinances or regulations above referred to, or by reason of any accident, loss, wrong, injury or damage to person, life or property in or about said Premises resulting from any act or omission of Tenant, its invitees or agents, or the streets, sidewalks and alleys adjoining the same, or by reason of any use which may be made of the Premises by Tenant, its invitees or agents or improvements thereon or by reason of any act or thing done or omitted to be done by Tenant, its invitees or agents or by reason of anything happening in damage to person, life or property in or about said Premises resulting from any act or omission of Tenant, its invitees or agents, or the streets, sidewalks and alleys adjoining the same, or by reason of any use which may be made of the Premises or improvements thereon or by reason of any act or thing done or omitted to be done by Tenant, its invitees or agents or by reason of anything happening in connection with or upon said Premises, or by reason of the failure of Tenant in any respect fully to carry out and perform any of its covenants, agreements, provisions or undertakings in the Lease contained. If the repairs required to be made by Tenant pursuant to the terms hereof are not promptly made after notice is given to Tenant by Landlord, Landlord may cause such repairs to be made without any responsibility to Tenant for any loss or damage that may be sustained to Tenant's stock or merchandise, furniture, fixtures or business by reason thereof other than by Landlord's willful misconduct in which event Tenant shall promptly pay Landlord as additional rent hereunder the cost of such repair plus 10% for overhead and supervision.

Landlord shall make all necessary repairs and maintenance to the foundation and the structure of the Building unless such repairs and maintenance are required by reason of the intentional negligent acts or omissions of Tenant, its agents or employees in which latter event such repairs or maintenance shall be promptly performed by Tenant.

ARTICLE XI
ALTERATIONS AND ADDITIONS

Tenant shall not make any alterations, additions, repairs or improvements to the Premises in excess of $10,000.00 without, in each such instance, first obtaining Landlord's written consent, (which consent shall not be unreasonably withheld, or delayed), except for (x) a merchandise and inventory receiving, palletizing, stacking, shipping and conveyor system substantially in the design of Exhibit E attached hereto and (y) the installation upon Real Property adjacent to the Premises of a trash compactor consistent in size and operation with those customarily used by warehousing operations similar in volume to Tenant's in accordance with applicable governmental authorities.. Any such alteration, addition, repair or improvement by Tenant consented to by Landlord shall be performed by Tenant in a good workmanlike manner, at Tenant's sole cost and expense, and in accordance with all laws and regulations of applicable governing bodies. Any such alterations, additions, repairs and improvements including fixtures which are permanently affixed to the Building shall become the property of Landlord upon expiration of the term of this Lease.

Tenant shall indemnify and save Landlord harmless from and against any lien or claim of lien attached to or upon the Premises or any part thereof by reason of any act or omission on the part of Tenant.

Landlord or Landlord's agents shall at all reasonable times have the right to enter upon the Premises for the purpose of inspecting the same, and for the purpose of posting or keeping posted notices of non-responsibility or any or all forms of notice reasonably necessary or proper to protect Landlord or the Premises against mechanics or materialmen's liens, or charges, or other liens or charges which might or could arise out of the use of the Premises by Tenant, or the construction of the improvements or the making of alterations or repairs to the Premises.

ARTICLE XII.
ASSIGNMENT AND SUBLETTING

Except in the case of merger, consolidation or combination, Tenant shall not (i) sell, assign, mortgage, pledge, hypothecate or in any manner transfer this Lease or any estate or interest thereunder; or (ii) sublet the Premises or any part or parts thereof; without prior written consent of the Landlord in each instance, which consent shall not be unreasonably withheld or delayed. Such assignment or sublet does not release Tenant from any of its obligations and/or liabilities under this Lease.

Landlord's right to assign this Lease or sell or convey the Premises are and shall remain unqualified. Upon any said assignment, sale or conveyance, Landlord shall thereupon be entirely freed of all obligations of the Landlord hereunder and shall not be subject to any liability resulting from any act or omission or event occurring after said assignment, sale or conveyance.

ARTICLE XIII.
INSURANCE

Tenant, at its sole expense, shall provide and keep in full force and effect during the full term hereof for the benefit of Landlord and Landlord's mortgagee, if any, as their interest may appear (the Landlord and Landlord's mortgagee to be named as additional insureds thereon) the following insurance coverages:

(a) Property Insurance for fire, extended coverage, vandalism and sprinkler leakage to Tenant's leasehold improvements, merchandise inventory, trade fixtures, furnishings, operating equipment, wall coverings, carpeting, drapes and other Personal Property ("Tenant's Contents") and all other leasehold improvements to the Premises with a minimum liability of $100,000.00.

(b) Comprehensive General Liability insurance with a minimum limit of liability of $1,000,000.00 combined single limit.

(c) Worker's Compensation insurance affording statutory coverage and containing statutory limits of liability as may be required by Minnesota's Workers Compensation or other similar statutes.

All insurance policies required hereunder shall (i) be in form and content satisfactory to Landlord, (ii) be placed with companies qualified to do business in the State of Minnesota, (iii) provide for at least thirty (30) days prior written notice to Landlord before cancellation, modification or amendment and (iv) provide that the proceeds thereof and Landlord's interest therein shall not be affected or subject to cancellation by reason of any act or omission of Tenant. Two copies of all policies of insurance shall be delivered to Landlord.

Landlord shall maintain in effect insurance covering the Building against loss or damage by fire and such other casualties as are included in a broad form of extended coverage, in an amount not less than one hundred percent (100%) of the full replacement value of the Building.

ARTICLE XIV.
DAMAGE OR DESTRUCTION

A. In the event the Premises or the Building are damaged or destroyed by fire, or other casualty (hereinafter referred to as the "Damage"), Landlord, subject to being able to obtain all necessary permits and approvals therefor within one hundred eighty (180) days of the Damage, and provided Landlord has not terminated this Lease pursuant to paragraph C hereof, shall commence to repair, reconstruct and restore the Damage to substantially the condition in which it was immediately prior to the happening thereof and prosecute the same diligently to completion. If the Premises are rendered partially or totally untenantable as a result of such casualty, then to the extent the Premises are rendered untenantable, the rent shall be proportionately abated and Tenant's Proportionate Share shall be correspondingly reduced until Landlord has completed such repair, reconstruction or restoration.

B. In the event Landlord is required or elects to repair, reconstruct or restore the Damage, Tenant agrees to repair or replace any damage to Tenant's Contents (other than merchandise, inventory, books and records), as soon as possible after the completion of Landlord's restoration to at least a condition equal to that prior to its damage or destruction. In no event shall Landlord be liable for interruption to the business of Tenant or for damage to or repair, reconstruction or restoration of any items belonging to Tenant or within the Premises.

C. Landlord shall have the option to terminate this Lease upon giving written notice to Tenant of the exercise thereof within sixty (60) days after the occurrence of the Damage, if:

(i) The damage occurs within the last year of the term hereof (unless Tenant shall have exercised its right to extend the Lease); or

(ii) Fifty percent (50%) or more of the area of the Building designated by Landlord for occupancy by its Tenants immediately prior to the Damage is rendered untenantable thereby; or

(iii) If Landlord cannot, using its best efforts, obtain all necessary permits and approvals for the repair, reconstruction and restoration of the Damage within the period permitted under Paragraph A hereof.

Landlord shall, within ninety (90) days after any loss, damage or destruction to the Premises, deliver to Tenant an estimate setting forth the reasonable time required to repair such casualty. If such estimated repair time period exceeds one hundred eighty (180) days, Tenant may elect to terminate this Lease by notice to Landlord not later than thirty (30) days following delivery of such estimate. If Tenant makes such election, the term of this Lease shall expire sixty (60) days after notice of such election is given by Tenant and Tenant shall vacate the Premises and surrender the same to Landlord. In any case where the estimate does not give rise to Tenant's termination right as aforesaid (as well as any case where Tenant does not elect to exercise its termination right as aforesaid), Tenant may elect to terminate this Lease if by reason of Landlord's negligence, Landlord fails to repair the Premises by the estimated completion date, in either case by delivering notice to Landlord. If Tenant makes such election, the term of this Lease shall expire sixty (60) days after notice of such election is given by Tenant and Tenant shall vacate the Premises and surrender the same to Landlord.

If more than twenty percent (20%) of the area of the Building designated by Landlord for occupancy by Tenant shall be damaged during the final twelve (12) full calendar months of the term, either Landlord or Tenant may elect to terminate this Lease upon thirty (30) days notice to the other (and rent shall be abated as of the date of such damage) unless Tenant shall exercise its option to extend the term hereof pursuant to the Addendum, in which case Landlord shall, at its sole cost and expense, proceed forthwith to rebuild or repair such damage.

D. Upon any termination of this Lease under the provisions of this Article, the rent imposed under this Lease shall be adjusted as of the date of such termination and the parties shall be released thereby without further obligation to the other party except for items which have been theretofore accrued and are then unpaid, and except for obligations which are designated as surviving such termination, if any.

ARTICLE XV.
WAIVER OF SUBROGATION

Landlord and Tenant agree that in the event the Premises, the Building, the Real Property, the fixtures or personal property contained thereon are damaged or destroyed by fire or other casualty, included under so-called "extended coverage", the rights, if any, of each party against the other with respect to such damage or destruction whether caused by negligent act or omission, or otherwise, to the extent that such damage or destruction is recovered from the insurer of policies of insurance, are waived.

ARTICLE XVI.
CONDEMNATION

In the event of a condemnation (which shall in this Article whenever appearing be defined to include a taking for public or quasi-public use or a voluntary deed executed by the Landlord in lieu thereof) of all or a substantial part of the Real Property, the Building, or the Premises, this Lease and Tenant's rights to possession of the Premises shall terminate as of, and rent shall be paid to, the date title is vested in the condemnor. In the event of condemnation of less than all or a substantial part of the Real Property or the Building, this Lease shall continue as to the part not so taken and the annual rent to Landlord by Tenant shall be reduced by prorata for the area of the Premises so taken and Tenant's Proportionate Share shall be correspondingly reduced;

provided, however, that if the condemnation applies to more than twenty percent (20%) of the the Premises, or if the condemnation substantially impairs Tenant's access to the Premises, then Tenant may terminate this Lease on the date of such taking upon giving fifteen (15) days notice to Landlord. Subject to the provision contained in the preceding sentence, if the condemnation does not include a portion of the Premises, the annual rent to be paid to Landlord by Tenant shall not be reduced.

Any and all awards or voluntary compensation paid in lieu thereof shall be the sole property of Landlord, whether resulting from the diminution of the value of the leasehold estate or otherwise, and Tenant shall have no right to or interest in any portion thereof, unless a specific award is made to Tenant for any of Tenant's Contents, relocation costs or moving expenses.

ARTICLE XVII.
COMPLIANCE WITH LAW

Tenant shall not use or occupy the Premises or permit the use of occupancy of the Premises nor do or permit anything to be done in or upon the Premises in any manner which will in any way violate any certificate of occupancy affecting Premises or make void, voidable or make more expensive any insurance then in force with respect thereto or which will make it impossible to obtain fire or other insurance or which will cause or be likely to cause structural damage to the Building or any part thereof situate upon the Premises nor which will constitute a public or private nuisance and shall not use or occupy the Premises or permit the use or occupancy of the Premises in any manner which will violate any present or future law, ordinance, statute or regulation of any governmental authority.

ARTICLE XVIII.
QUIET ENJOYMENT

Tenant, upon payment of the rent herein reserved and upon performance of all of the terms, covenants and conditions of this Lease by it to be kept and performed, shall at all times during the term hereof or during any extension or renewal hereof, peaceably and quietly enjoy the Premises without any disturbance from Landlord or from any other person claiming through

Landlord.

ARTICLE XIX.
SURRENDER OF THE PREMISES

Upon expiration or sooner termination of the term hereof, Tenant shall surrender the Premises to Landlord, in good condition and repair, reasonable wear and tear, condemnation and casualty excepted.

ARTICLE XX.
DEFAULT

The occurrence of any of the following shall constitute an event of default:

(a) If Tenant should either fail to make due and punctual payment of rent or any other sum due Landlord under this Lease;

(b) If Tenant shall fail in the punctual performance of or compliance with any of the obligations, covenants, conditions or agreements contained in this Lease by Tenant to be kept or performed other than those referred to in paragraph (a) above, which default continues for a period of twenty (20) days after written notice thereof; provided, however, if any such default is not susceptible of being cured within said twenty (20) day period, the time permitted to Tenant to cure such default shall be extended for so long as shall be reasonably necessary to cure the same so long as Tenant commences promptly and proceeds diligently to cure the default and provided, further, that such period of time shall not be so extended if such extension, in Landlord's sole judgement, shall jeopardize the interest of Landlord pursuant to a mortgage, now or hereafter encumbering the Premises or so as to subject Landlord or Tenant to any civil or criminal liabilities.

(c) If, at any time during the term hereof, proceedings in bankruptcy shall be instituted by Tenant by the filing of a voluntary petition in bankruptcy or if Tenant shall take any benefit under the Bankruptcy Act or any other insolvency of debtor release statute, either state or federal, or if Tenant shall make a general assignment for the benefit of creditors or if a receiver shall be appointed for the property of Tenant, and provided Tenant within sixty (60) days thereafter shall have failed to cause such receivership to be vacated, or if an involuntary petition under any provision or section of the Bankruptcy Act is filed against Tenant and provided Tenant within sixty (60) days thereafter shall have failed to cause said involuntary petition to be dismissed and set aside.

Upon the occurrence of an event of default, Landlord, at any time thereafter and without limiting Landlord in the exercise of any other right or remedy it may have on account of such default and without any further notice of demand, may:

(i) declare this Lease at an end, re-enter the Premises with process of law, eject all parties in possession thereof and repossess the Premises together with all additions, alterations and improvements thereto;

or

(ii) re-enter the Premises with process of law, eject all parties in possession thereof and, without terminating this Lease, at any time and from time to time, relet the Premises or any part or parts thereof for the account of Tenant or otherwise, receive and collect the rents therefor, applying the same first to the payment of such expense as Landlord may have paid, assumed or incurred in recovering the possession of the Premises including reasonable costs, expenses and attorneys' fees and for placing the same in good order and condition or preparing or altering the same for reletting, and all other reasonable expenses, commissions and charges paid, assumed or incurred by Landlord in or about the letting of the Premises. Any such reletting as provided for herein may be for the remainder of the term of this Lease as originally granted or for a longer or shorter period. Landlord may execute any lease made pursuant to the terms hereof in its own name and any tenant therein shall be under no obligation whatsoever for the application by Landlord of any rent collected by Landlord from such subtenant to any and all sums due and owing or which may become due and owing under the provisions of this Lease, nor shall Tenant have any rights or authority whatever to collect any rent whatever from such tenant. In any case and whether or not the Premises or any part hereof be relet, Tenant shall pay to Landlord all sums required to be paid by Tenant up to the time of re-entry by Landlord, and thereafter, Tenant shall pay the Landlord the equivalent of the amount of all rent and other charges required to be paid by Tenant under the terms hereof less any rent collected by Landlord from such reletting, if any, after payment of the expense of Landlord as aforesaid, and the same shall be due and payable on the several rent days herein specified. Landlord, at its sole option, may apply the sums deposited by Tenant to the obligations of Tenant as in this subparagraph set forth which are due from time to time, or may retain said sums until the conclusion of the full term hereof and the full performance hereof by or on behalf of Tenant in which latter event they shall thereafter be returned to Tenant.

The foregoing rights of Landlord shall be cumulative to all other rights and remedies now or hereafter provided by law or by the terms of this Lease. In addition, the maintenance of any action or proceeding to recover the possession or repossession of the Premises or any installment or installments of rent or any other obligation which may be due or become due from Tenant to Landlord shall not preclude Landlord from thereafter instituting and maintaining subsequent acts or proceedings whether the recovery of possession or repossession of the Premises or of any subsequent installment of rent or of any other obligations which may be due or become due from Tenant to Landlord under any of the provisions hereof. Suit or suits for the recovery of such deficiency or damage may be brought by Landlord from time to time at the election of Landlord and nothing herein shall be deemed to require Landlord to await the date whereon this Lease or the demised term would have expired by limitation had there been no such default by Tenant.

The subsequent acceptance by Landlord of rent or other sums required hereunder shall not be deemed a waiver of any preceding breach of any obligation hereunder by Tenant other than the failure to pay the particular rental or other sum so accepted and the waiver of any breach of any covenant or condition by Landlord herein shall not constitute a waiver of any other breach regardless of knowledge thereof. The exercise of any right, option or privilege hereunder by Landlord shall not exclude Landlord from exercising any and all other rights, privileges and options hereunder, and Landlord's failure to exercise any right, option or privilege hereunder shall not be deemed a waiver of such right, option or privilege, nor shall it relieve Tenant of Tenant's obligations to perform each and every covenant and condition on Tenant's part to be performed hereunder, nor from damages or other remedy for failure to perform or meet the obligations of this Lease.

ARTICLE XXI.
LATE PAYMENT PENALTY

If any payments by Tenant due hereunder are not made within five (5) days of the due date thereof, then Tenant shall pay, as additional rent, an amount equal to interest on such delinquent payment from the due date hereof at the annual percentage rate of the lesser of 18% or highest rate permitted by law.

ARTICLE XXII.
NOTICES

Any notice or demand to be given to or served upon either Landlord or Tenant in connection with this Lease, shall be deemed to have been sufficiently given or served for all purpose, on the date of delivery, if it is personally served or, on the third business day after mailing, if it is sent certified mail, return receipt requested, postage prepaid, to the Landlord as follows:

Grantor Retained Income Trust of Robert L. Johnson
c/o R. L. Johnson Company
701 Decatur Avenue North #107
Minneapolis, MN 55427

With copy to:

and to Tenant:

Bob Rose
Vice President of Distribution and Operations
D 56, Inc.
6436 City West Parkway
Eden Prairie, MN 55334

With copy to:

General Counsel
D56, Inc.
6436 City West Parkway
Eden Prairie, MN 55344

Either party may change the place to which notice is to be sent by sending a written notice thereof to the other in the same manner hereinabove provided.

ARTICLE XXIII. SUBORDINATION AND ESTOPPEL CERTIFICATE

Tenant agrees that this Lease shall be subordinate to any mortgage that may now or hereafter be placed upon the Demised Premises and to any and all advances to be made thereunder and to the interests thereon, and all renewals, replacements and extensions thereof, provided that the mortgagee named in said mortgages shall agree to recognize the lease of Tenant and agree that Tenant's possession of the Premises will not be disturbed in the event of foreclosure if Tenant is not in default hereunder beyond the expiration of any applicable notice and/or cure periods. In the event any mortgagee elects to have this Lease prior to the lien of its mortgage, then, and in such event, upon such mortgagee notifying Tenant to that effect, this Lease shall be deemed prior in lien to said mortgage whether this Lease is dated prior to or subsequent to the date of said mortgage. Within ten (10) days after the request therefor by Landlord, Tenant agrees hereby to deliver a certificate to any proposed mortgagee or to a purchaser of the Building certifying (if such be the case) that this Lease is in full force and effect and that, to Tenant's knowledge, there are no defenses or offsets thereto, or stating those claimed by Tenant, if any; all to be in such form and content reasonably satisfactory to said mortgagee or purchaser. In the event Tenant fails to deliver said statement within said ten (10) days after request, Tenant hereby appoints irrevocably Landlord as the attorney-in-fact of Tenant to execute and deliver said statement.

ARTICLE XXIV.
HAZARDOUS MATERIAL

Tenant shall not use, or permit the use of the Premises, Building or Real Property for the storage or disposal of any Hazardous Material (other than in accordance with all applicable governmental law and regulations) as hereinafter defined.

Hazardous Material as used in this Lease means any hazardous or toxic substance, material, waste or similar term which is regulated by local authorities, the State of Minnesota or the federal government, including, but not limited to, any material, substance, waste or similar term which is:

(a) defined as a Hazardous Material under the laws of the State of Minnesota, as amended from time to time;

(b) defined as a hazardous substance under Section 311 of the Federal Water Pollution Control Act (33 U.S.C. 1317) as amended from time to time;

(c) defined as a hazardous waste under Section 1004 of the Federal Resource Conservation and Recovery Act (42 U.S.C. 6901 et. seq.) as amended from time to time;

(d) defined as a hazardous waste substance under Section 101 of the Comprehensive Environmental Response, Compensation and Liability Act, (42 U.S.C. 9601 et. seq.) as amended from time to time;

(e) defined as a hazardous waste or toxic substance, waste, material or similar term in any rules and regulations, as amended from time to time, which are adopted by any administrative agency including, but not limited to the Environmental

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Protection Agency, the Occupational Safety and Health Administration, and any such similar state or local agency having jurisdiction over the Premises whether or not such rules and regulations have the force of law; or

(f) defined as a hazardous or toxic waste, substance, material or similar term in any statute, regulation, rule or law enacted or adopted at any time after the date of this Lease by local authorities, the State of Minnesota, or the federal government.

Tenant shall indemnify and defend Landlord and hold it harmless of, from and against any loss, damage or cost or expense, including reasonable attorney's fees, which may result from any breach or claimed breach of the foregoing.

To the best of Landlord's knowledge, Landlord represents to Tenant as follows: (i) there are no Hazardous Materials in the Premises, and Landlord has not used and shall not use any material which is a Hazardous Material in the construction of the Building, except in accordance with applicable governmental laws and regulations; (ii) neither the Premises nor Landlord is in violation of any federal, state of local statute, law, rule or regulation relating to or governing the use, storage, disposal, handling, generation, manufacturing, production, processing and treatment of Hazardous Materials (collectively, "Environmental Laws") or is the subject of any existing, pending or threatened investigation by any governmental authority with respect to a violation of any Environmental Laws.

In the event of a breach of its representations herein, Landlord shall be solely responsible, at its sole cost and expense, for the removal of all Hazardous Material from the Premises. At Tenant's request, Landlord shall furnish Tenant evidence of removal including copies of the inspection report together with a compliance certificate or other documents, if any, of release or approval from any applicable governmental authority.

Landlord shall be solely responsible for and shall comply with all Environmental Laws relating to the Premises including, without limitation, the removal, encapsulation or other remedial measures required by applicable Environmental Laws with respect to any Hazardous Materials provided that the same was not installed by or stored, kept or brought on the Premises by Tenant, its invitees or agents or its contractors on or after the Commencement Date, in which case Tenant shall be solely responsible for such compliance.

ARTICLE XXV.
MISCELLANEOUS

A. The article headings herein are inserted only for convenience and reference and shall in no way define, limit or describe the scope or intent of any provisions of this Lease. As used herein and where necessary, the singular imports the plural and vice versa, and masculine, feminine and neuter pronouns and expressions are interchangeable.

B. The covenants and agreements herein contained shall bind and shall inure to the benefit of the Landlord and Tenant, their respective heirs, administrators, legal representatives, successors and assigns.

C. This Lease shall be governed by, construed and enforced in accordance with the laws of the State of Minnesota.

D. If Tenant shall hold over the Premises or any part thereof after the expiration of the term hereof such holding over shall be construed only to be a tenancy from month to month subject to all of the covenants, conditions and obligations hereof, except that the rent shall be twice the amount set forth in paragraph IV.A hereof. Nothing herein shall be construed to give Tenant any rights to hold over and to continue in possession of the Premises after the expiration of the term hereof.

E. The relationship of the parties hereto is that of Landlord and Tenant and it is expressly understood and agreed that Landlord is not in any way or for any purpose a partner of Tenant or a joint venturer with Tenant in the conduct of Tenant's business or otherwise.

F. This Lease and any exhibits or schedules related thereto is the entire agreement between the parties and may not be changed verbally but only by an agreement in writing and signed by the party against whom enforcement of any waiver, change, modification or discharge is sought.

G. Time is of the essence of this Lease and of each and every of the provisions herein contained.

H. Landlord, at all reasonable times upon reasonable notice, shall have the right to inspect the Premises.

I. One or more waivers of any covenant, term or condition of this Lease by one party shall not be construed by the other party as a waiver of subsequent breach of same covenant, term of condition. The failure or delay on the part of the other party to enforce or exercise at any time any of the provisions, rights or remedies of this Lease shall in no way be construed to be a waiver thereof nor in any way effect the validity of this Lease or any part thereof or the right of the party to thereafter enforce each and every such provision, right or remedy.

J. The invalidity or unenforceability of any provision hereof shall not affect or impair the validity of any other provision.

K. No payment by Tenant or receipt by Landlord of a lessor amount than the base rent or additional rent due shall be deemed to be other than on account of the earliest installment thereof then due nor shall any endorsement or statement on any check or any letter accompanying any check or payment be deemed an accord and satisfaction. Landlord may accept such check or payment without prejudice to Landlord's right to any additional amount due hereunder or pursuant to any other remedy in this Lease provided.

L. Save for its negligence, recklessness or intentional acts Landlord shall not be responsible or liable to Tenant for any loss or damage that may be occasioned by or through the acts or omissions of persons occupying adjoining premises or any part of the premises adjacent to or connected with the Premises or any part of the Building or any persons transacting any business in the Building or present in the Building for any other purpose or 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.

M. Landlord represents and warrants to Tenant as follows:

a. Landlord has full right and lawful authority to lease the Premises to Tenant; and

b. This Lease has been duly authorized by all necessary action on the part of Landlord to be done and the person executing this Lease on behalf of Landlord has full power and authority to do so.

N. Tenant represents and warrants to Landlord as follows:

a. Tenant has full right and lawful authority to lease the Premises from Landlord; and

b. This Lease has been duly authorized by all necessary action on the part of

Tenant to be done and the person executing this Lease on behalf of Tenant has full power and authority to do so.

O. The parties agree that all disputes or controversies arising out of this Lease that cannot be resolved between the parties may, with consent of other party, be resolved by arbitration. Either party may demand such arbitration only within nine (9) months after the controversy arises by sending a notice of demand to arbitrate to the American Arbitration Association (the "Association"), at 514 Nicollet Mall, Suite 600, Minneapolis, Minnesota 55402, with a copy to the other party. The dispute shall then be arbitrated by a three arbitrator panel in keeping with the Commercial Rules of the Association at the Association office in Minneapolis, Minnesota. In the disposition of the dispute, the arbitrators shall be governed by the express terms of this Lease and by the laws of the State of Minnesota. The decision of the arbitrators shall be final and shall be a bar to any suit, action or proceeding in any court or before any administrative tribunal. Judgement on any award by the arbitrators may be entered in any appropriate court. This arbitration provision shall continue in effect even after the termination of this Lease.

IN WITNESS WHEREOF, the parties hereto have caused this instrument to be duly executed as of the day and year first above written.

GRANTOR RETAINED INCOME TRUST OF
ROBERT L. JOHNSON

by: R. L. Johnson Company
its: Managing Agent

by: ______________________

its: President

D 56, INC.

by: Robert Shore

its: Vice President Operations/Distribution

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ADDENDUM
to
LEASE AGREEMENT BETWEEN
GRANTOR RETAINED INCOME TRUST OF ROBERT L. JOHNSON, Landlord
and
D 56, INC.,Tenant
Dated December 8, 1993

PREAMBLE

This addendum is an integral part of this Lease between the parties. In the event of a conflict between the terms and conditions of this addendum and the Lease and exhibits, the provisions of this addendum shall control. Capitalized words or defined terms contained in this addendum shall have the same meaning as in the Lease unless the context requires otherwise.

I. TENANT IMPROVEMENTS

At it's sole cost and expense, Tenant shall construct the tenant improvements as outlined on the attached workletter (Exhibit C) and floor plan (Exhibit D).

II. RIGHT OF FIRST REFUSAL

Tenant shall have the right of first refusal to lease any space adjacent to the Premises provided the following conditions are met:

A. Tenant is not in default (beyond the expiration of any applicable notice and/or cure periods) of any of the terms, covenants and conditions of the Lease; and

B. Landlord shall give Tenant written notice that it has received a bona fide offer from an unaffiliated third party to lease said adjacent space. Landlord's notice shall include the principle business terms and conditions upon which the third party is offering to lease the space, its contemplated configuration and usage, as well as the net effective base rent derived according to the following formula:

Third Party's Proposed Base Rent Per Square Foot
- Amortized Tenant Improvements Per Square Foot
- Amortized Landlord's Improvements Per Square Foot
- Amortized Commissions Per Square Foot
= Net Effective Rent Per Square Foot

Tenant shall then have ten (10) days from the date of receiving Landlord's notice in which to exercise its Right of First Refusal; and

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RRH

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C. If Tenant desires to lease said space, it agrees to do so upon the same principle business terms and conditions; but in any event, the net effective rent per square foot shall be no less than than the proposed third party's Net Effective Rent Per Square Foot as specified in Landlord's notice. If Tenant does not notify Landlord within the stated time period, Tenant's Right of First Refusal shall be deemed to be null and void.

D. If Landlord shall not enter into a lease with such third party within one-hundred eighty (180) days after delivering notice of such offer to Tenant, Landlord shall comply with the terms of this provision II for each succeeding bona fide offer.

III . OPTION TO EXTEND THE TERM

Tenant has the option to extend the term of the lease for three (3) years provided the following conditions are met:

A. Tenant is not in default (beyond the expiration of any applicable notice and/or cure periods) of any of the terms, covenants and conditions of the Lease; and

B. Tenant shall exercise its Option to Extend the Term by notifying Landlord in writing no later than one-hundred eighty (180) days prior to the termination date of the initial lease term as defined herein; and

C. The base lease rate for the extended term shall be $2.95 per square foot.

IV. LEASING OF OTHER SPACE ON THE REAL PROPERTY

Tenant may consider expanding its warehouse needs after the commencement date of this Lease. Accordingly, Landlord agrees that it will offer for lease to third parties vacant space on the Real Property in accordance with the following priority: first, Landlord will offer vacant space in the other warehouse located on the Real Property; second, Landlord will offer vacant space in the Building up to 48,000square feet beginning from Line "A" as shown on the floor plan of Exhibit D; and last, Landlord will offer vacant space in the Building touching upon demising wall provided for in the Exhibit C workletter.

EXHIBIT A

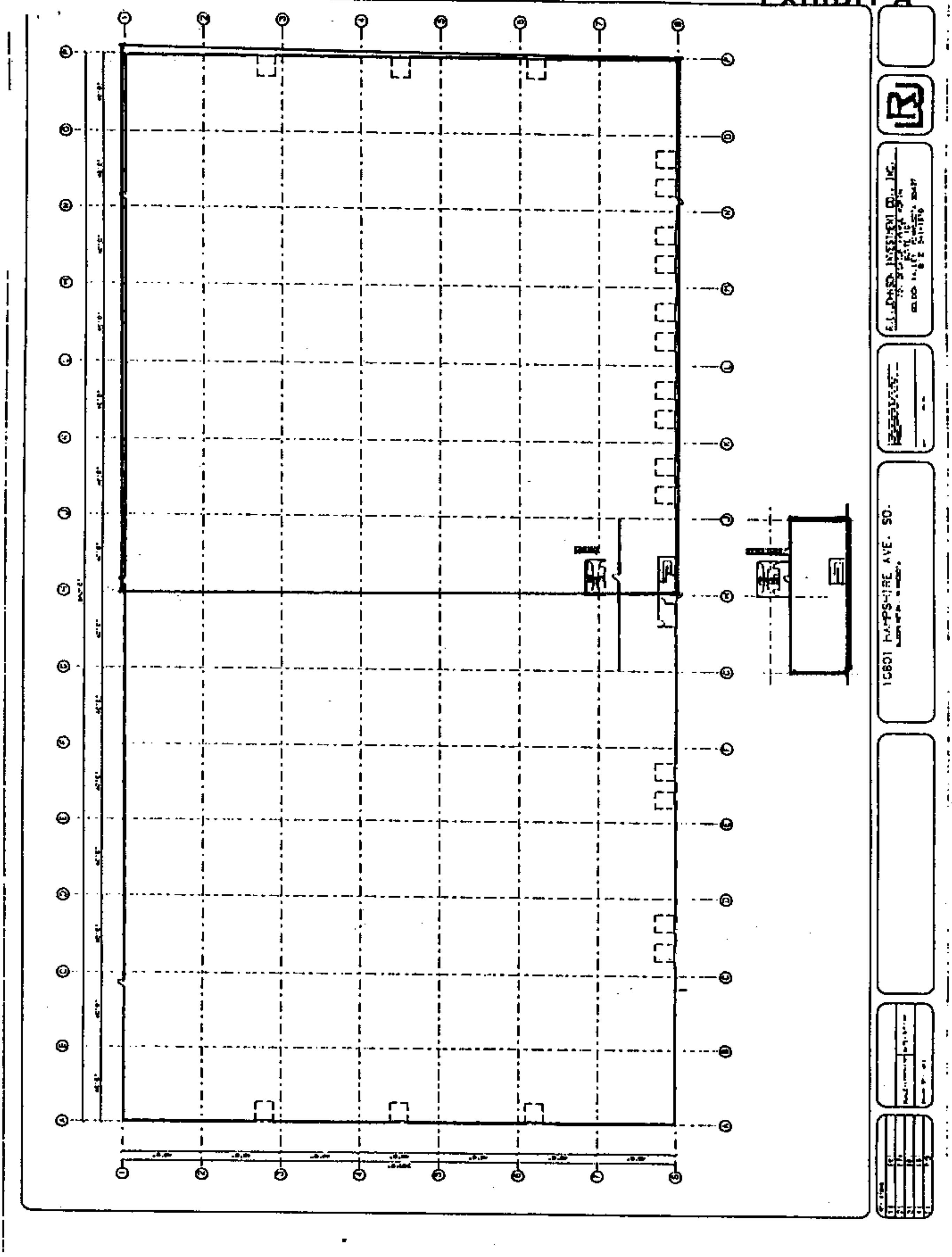

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EXHIBIT B

LEGAL DESCRIPTION

TRACT I:

Lot 1, Block 4, L.M.J. 2nd Addition, except that part embraced within that part of the West 225 feet of the South 1/2 of the Southeast 1/4 of Section 32, Township 116, Range 21, lying North of the South 831.15 feet of said Southeast 1/4.

TRACT II:

That part of Lot 1, Block 4, embraced within that part of the West 225 feet of the Southeast 1/4 of Section 32, Township 116, Range 21, lying North of the South 831.15 feet thereof, L.M.J. 2nd Addition.

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EXHIBIT C

D 56, INC.
10801 Hampshire Avenue South
Bloomington, Minnesota

WORKLETTER
November 23, 1993

CONCRETE & MASONRY
Saw cut and pour back plumbing trenches.

ROOF CURBS & JACKS
Mop in (2) jacks per mechanicals.

HOLLOW METAL FRAMES & HARDWARE
Furnish and install (2) 3' X 7' knockdown metal frames and solid core oak doors with push pull hardware, and (1) 60 min. hollow metal frame and door assemblie with closure and lever lock set. Furnish and install toilet accessories.

ALUMINUM FRAMES, GLASS & MIRRORS
Remove existing aluminum frame and glass entry. Furnish and install new aluminum frame and glass entry to consist of (2) 3' X 6'-8" dark bronze aluminum frame doors with 1" dark bronze insulated glass. Furnish and install (2) 24" X 36" mirrors in restrooms.

ACOUSTICAL CEILING
Replace damaged standard 2' X 4' ceiling tile in office area..

GYPSUM BOARD SYSTEM
Provide labor and material for drywall construction of a demising wall: 6" 20 GA steel studs with 5/8" each side fire taped. Metal stud and gypsum walls for bathroom walls; gypsum board ceilings in baths. Includes misc. demolition.

CERAMIC TILE
Furnish and install 1" X 1" ceramic floor tile; 4' high wainscot of 4 1/4" X 4 1/4" wall tile at wet wall and sanitary base throughout in (2) new restrooms.

PAINTING & WALLCOVERING
Paint and patch gypsum surfaces in office area as needed. Paint (3) hollow metal frames (2) coats of enamel. Paint gypsum surfaces in restrooms. Seal and varnish (2) 3' X 7' wood doors.

FIRE PROTECTION
Drop sprinkler heads to 8' ceiling in restrooms per code. Relocate heads as necessary along demising wall. Upgrade the existing system design to a density of .232 gpm over 2000 sq. ft. This revised density meets with NFPA 23 1C for storage to 18' high class 1 commodity (non encapsulated). Re-supply the remaining system not in the lease area. Three (3) hose stations each with 100' of hose and (1) 1/2" valve are provided. All new pipe to be black standard or lightweight with black screwed or mechanical fittings. Upgrade of the system at the roof line only.

EXHIBIT C

PLUMBING

Complete rough-in of waste, vent, hot and cold water piping for the following fixtures: (3) tank type, 18" high water closets, (1) urinal, (2) wall hung lavs with lever handle faucets, (1) handicapped electric water cooler, (1) 18" floor mount laundry tray, (1) 6 gallon electric water heater, and (2) 2" floor drains. Includes necessary demolition.

H.V.A.C.

Furnish and install PRV exhaust fan for toilet group.

ELECTRICAL

A complete electrical installation to include the following

3	- single pole switches
	- wire drinking fountain and water heater
2	- exit lights
2	- bath fans
4	- bath lights
2	- GFI in bath

All work to be performed by skilled tradesmen in accordance with current industry standards. D 56, Inc. to secure all necessary permits per all applicable codes and ordinances.

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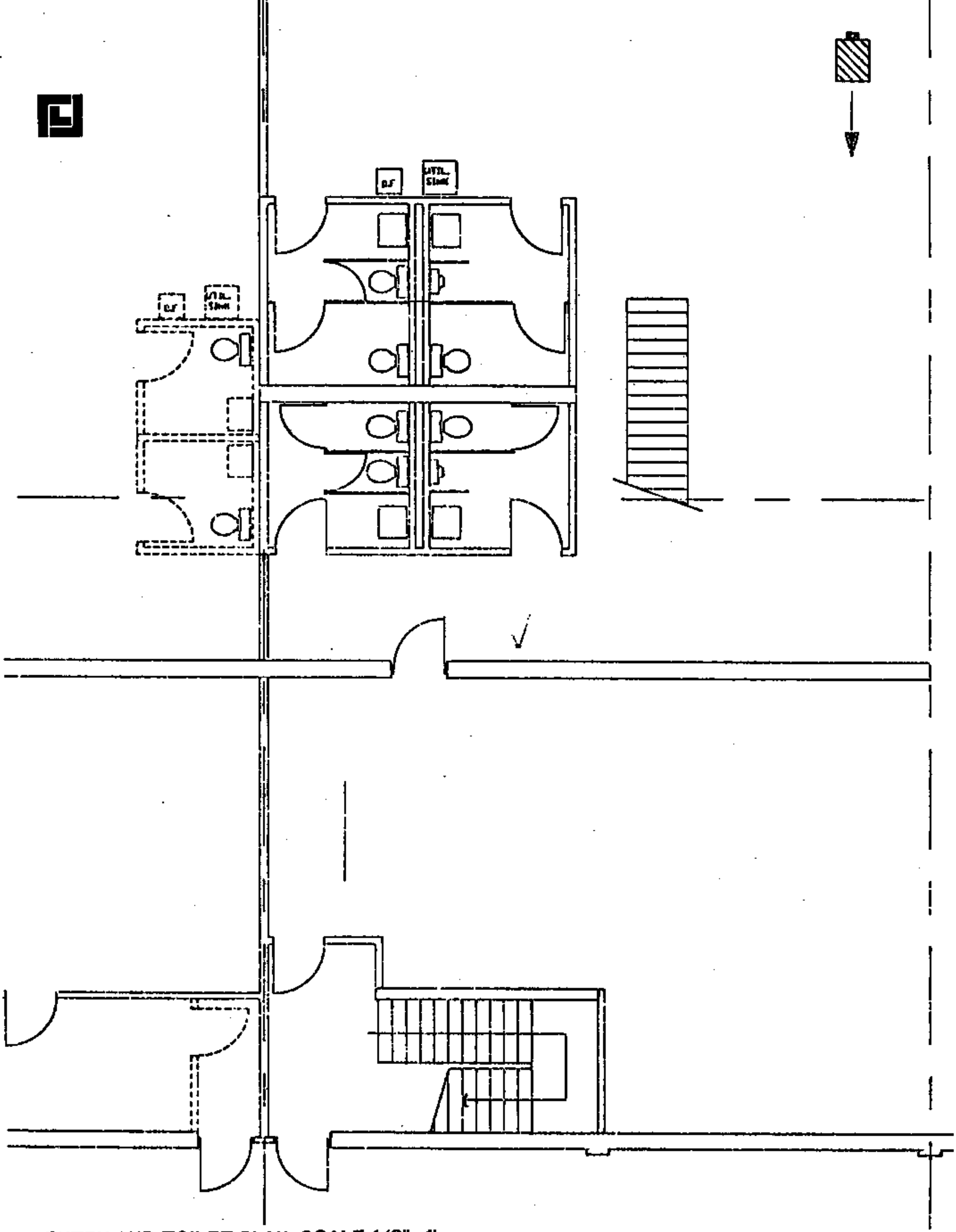
EXHIBIT D

U.H.



ENTRY AND TOILET PLAN SCALE 1/8"=1'

10801 HAMPSHIRE

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SAF

FIRST AMENDMENT TO LEASE AGREEMENT

This First Amendment to Lease Agreement is made as of the 25th day of August, 1994, by and between Grantor Retained Income Trust of Robert L. Johnson ("Landlord") and D 56, Inc. ("Tenant").

WHEREAS, Landlord and Tenant are parties to that certain Lease Agreement, dated as of December 8, 1993 (the "Lease Agreement"), pertaining to Hampshire Distribution Center, 10801 Hampshire Avenue South, Bloomington, Minnesota; and

WHEREAS, Landlord and Tenant desire to increase, effective October 1, 1994, the amount of space leased to Tenant and the amount of rent paid to Landlord under the Lease Agreement, and therefore are willing to enter into this First Amendment to the Lease Agreement on the terms and conditions hereof.

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

1. Defined Terms.

   Unless otherwise defined herein, capitalized terms used herein which are defined in the Lease Agreement are used herein as so defined.

2. Amendments to Lease Agreement.

   2.1 The definition of "Common Area" set forth in Article I of the Lease Agreement is hereby amended to delete the following:

   > "the entire area designated from time to time by Landlord for common use or benefit of the occupants of the Building, including, but not by way of limitation, any and all portions of the Building not available for lease to tenants;".

   2.2 The definition of "Premises" set forth in Article I of the Lease Agreement is hereby amended in its entirety to read as follows:

   > "Premises - all of the leaseable space within the Building (for illustrative purposes, being 2,400 square feet of mezzanine office space and 156,800

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square feet of warehouse space delineated from Line A, 1-8 to Line P, 1-8 set forth on the floor plan attached hereto as Exhibit "A" and made a part hereof).".

2.3 The first parenthetical of the definition of "Tenant's Proportionate Share" set forth in Article I of the Lease Agreement is hereby amended in its entirety to read as follows:

"(which the parties agree from all purposes of the Lease is 80,800 square feet for the period from January 1, 1994 through September 30, 1994 and 159,200 square feet from October 1, 1994 through the last day of February, 1999)".

2.4 The last sentence of Article III of the Lease Agreement is hereby amended to add the following Clause (iii) immediately after Clause (ii) thereof:

"and (iii) for all purposes of the Lease, October 1, 1994 shall be the Commencement Date with respect to 78,400 square feet of warehouse space running continuously from Line A, 1-8 to Line H, 1-8 set forth on the Exhibit A floor plan attached hereto (it being understood and agreed that, notwithstanding anything in this Lease to the contrary, Tenant shall not be liable to or indemnify Landlord for any cost, liability, loss, penalty, damage, decree, judgment, claim, charge or expense to the extent attributable or ratable to any portion of the Premises delineated from Line A, 1-8 to Line H, 1-8 set forth on the Exhibit A floor plan and which was incurred or accrued or arises from conditions therein existing prior to October 1, 1994)".

2.5 Article IV, Paragraph A of the Lease Agreement is hereby amended to add the following immediately after the end thereof:

"; provided, however, that from and after October 1, 1994 the annualized base rental shall equal $444,472.00, payable in advance in successive equal monthly installments of $37,039.33 each on the first day of each month during the remaining term hereof ~~and any extensions or renewals thereof~~ (it being understood and agreed that Tenant shall not be liable to Landlord for, and Landlord shall not be entitled to claim or re-coup, such higher rental for the period from February 1, 1994 through September 30, 1994)".

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2.6 The first sentence of Article XI of the Lease Agreement is hereby amended to delete the figure "$10,000.00" between the words "of" and "without" and to insert in its place the figure "$50,000.00"; and to add the following Clause (z) immediately after Clause (y) thereof:

"and (z) the installation in the portion of the Premises delineated by Line A, 1-8 through Line H, 1-8 on the Exhibit A floor plan of sheetrock demising walls, separate electric metering, exterior doorways, handicapped-accessible toilet/washrooms and office/lunchroom spaces so as to subdivide such portion of the Premises into separate secure spaces as needed in order for Tenant to achieve maximum utilization/subtenant occupancy".

2.7 The first sentence of Article XII of the Lease Agreement is hereby amended to add the following immediately after the end thereof:

"; <u>provided, however</u>, that Landlord hereby consents to a sublease to Tsumura International, Inc. or any of its corporate affiliates of any or all of the Premises delineated by Line A, 1-8 through Line H, 1-8 on the Exhibit A floor plan and waives any claim for a broker's or finder's fee in respect of such sublease".

2.8 Article XVIII of the Lease Agreement is hereby amended to add the following immediately after the first sentence thereof:

"If Landlord fails or refuses to timely perform any of its obligations under this Lease, Tenant may (after 5 business days' prior notice to Landlord, or without notice in the event of any emergency) perform such obligations for Landlord and bill Landlord for all costs of such performance and failure to perform plus 10% for overhead and supervision.".

3. <u>Amendment to Lease Agreement Addendum</u>.

Clause C, Section III of the Addendum to the Lease Agreement is hereby amended to delete the figure "$2.95" between the words "be" and "per" and to insert in its place the figure "$3.15".

4. <u>No Other Amendments</u>.

Except as expressly amended hereby, the Lease Agreement shall continue to be, and shall remain, in full force and effect in accordance with its terms, and shall inure to the benefit of and shall be binding upon the parties hereto and their successors and permitted assigns.

5. <u>Governing Law</u>.

This Agreement shall be governed and construed in accordance with the laws of the State of Minnesota.

6. <u>Counterparts</u>.

This First Amendment to Lease Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which shall constitute one and the same instrument.

IN WITNESS WHEREOF, the parties hereto, intending to be legally bound, have caused this First Amendment to Lease Agreement to be executed as of the day and year first above written.

GRANTOR RETAINED INCOME TRUST
OF ROBERT L. JOHNSON

By: R.L. Johnson Company
Its: Managing Agent

By: ____________________
Robb Johnson
President

D 56, INC.

By: ____________________
Robert S. Rose
Vice President

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EXHIBIT 11.1

Exhibit 11.1

DEPARTMENT 56, INC.
COMPUTATION OF NET INCOME PER SHARE
(In thousands, except per share amounts)

	Company (a)			
	Year Ended December 31, 1994	Year Ended January 1, 1994	Year ended January 2, 1993 Pro forma for the acquisition	October 4, 1992 through January 2, 1993
Primary Net Income (Loss) Per Share:				
Net Income (Loss)	$36,099	$24,997	$15,164	($1,067)
Weighted average number of common shares outstanding	21,419	21,327	21,308	21,308
The number of shares resulting from the assumed exercise of stock options reduced by the number of shares which could have been purchased with the proceeds from such exercise, using the average market price during the period	230	217	240	240
Weighted average number of common and common equivalent shares	21,649	21,544	21,548	21,548
Net Income (Loss) per Common and Common Equivalent Share	$1.67	$1.16	$0.70	($0.05)
Fully Diluted Net Income (Loss) Per Share:				
Net Income (Loss)	$36,099	$24,997	$15,164	($1,067)
Weighted average number of common shares outstanding	21,419	21,327	21,308	21,308
The number of shares resulting from the assumed exercise of stock options reduced by the number of shares which could have been purchased with the proceeds from such exercise, using the greater of average market price during the period or period-end market price	245	242	240	240
Weighted average number of common and common equivalent shares	21,664	21,569	21,548	21,548
Fully Diluted Net Income (Loss) per Common and Common Equivalent Share	$1.67	$1.16	$0.70	($0.05)

(a) Adjusted to give effect to the exchange of each share of Series A and Series B common stock for 300 shares of common stock during June 1993.

(b) Stock options granted by the Company prior to the initial public offering have been presented as outstanding for all periods.

EXHIBIT 13.1

Yesterday's memories. Tomorrow's traditions

1 9 9 4 ANNUAL REPORT









Department 56 INC.

Department 56, Inc. 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 collectible, handcrafted, lighted ceramic and porcelain houses, and related accessories in The Original Snow Village® and The Heritage Village Collection,® as well as for its extensive line of holiday and home decorative accessories, including its Snowbabies© collectible porcelain and pewter hand painted figurines.

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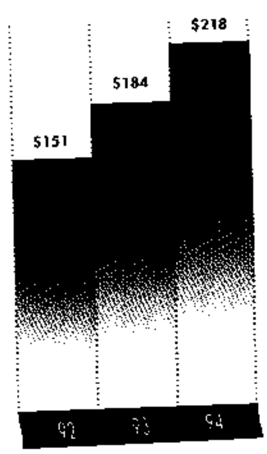
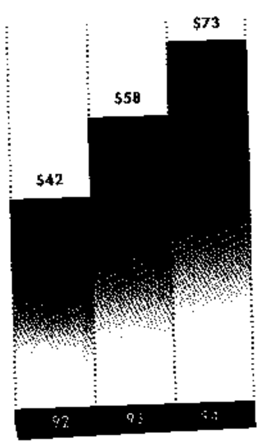
Financial Highlights

(Dollars in thousands, except per share amounts)	1994	1993	% Change
Net Sales	$217,865	$ 184,359	18%
Income From Operations	72,977	57,783	26%
Net Income	36,099	24,997	44%
Net Income Per Share	1.67	1.16	44%
Working Capital	$ 13,362	$ 26,392	
Total Assets	239,680	234,893	
Long-Term Debt	113,000	148,000	
Stockholders' Equity	100,305	61,731	

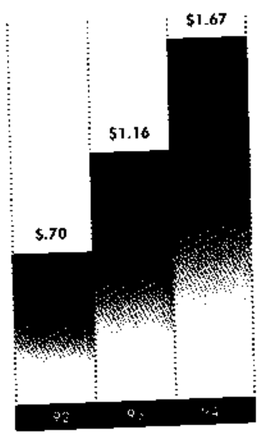
NET SALES
(Dollars in millions)



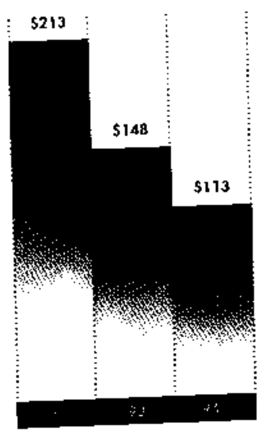
INCOME FROM OPERATIONS
(Dollars in millions)



NET INCOME PER SHARE



LONG TERM DEBT
(Dollars in millions)



Letter from the Chairman

The Department 56 tradition of growth, innovation, and quality continued in fiscal 1994. Both areas of our business—Village Products and Other Giftware—grew substantially. As a result, we're pleased to report that the Company achieved another year of record sales and earnings.

FINANCIAL HIGHLIGHTS Department 56 earnings for the fiscal year ending December 31, 1994 increased 44 percent to $36.1 million or $1.67 per share, compared with $25.0 million or $1.16 per share, for fiscal 1993. Net sales rose 18 percent, reaching $217.9 million versus $184.4 million the prior year. Our collectible Village Products, including ceramic and porcelain lighted houses and accessories, accounted for 69 percent of total sales. Other Giftware, which includes the popular Snowbabies line, accounted for the remaining 31 percent of sales.

Our strong growth in operating profitability is primarily the result of an improved gross margin, reflecting increased efficiencies at our production facilities, favorable foreign currency exchange rates, and effective management of our overhead and fixed costs. Consistent with 1993, we prepaid an additional $40 million in subordinated debt at 1994 year-end from our strong cash flow.

NEW PRODUCTS Among our accomplishments in 1994, we introduced three outstanding new product lines: The Disney Parks Village Series; The Upstairs, Downstairs Bears;™ and Snowbunnies.™

The porcelain Disney Parks Village Series recreates the unique images of Disney theme parks. This is the seventh product line in The Heritage Village Collection. It also is our first new lighted Village series to be introduced since the North Pole® in 1991. The Disney Parks Village Series was introduced to consumers in September and is now available at select Department 56 dealers and Disney theme park stores.

Our second new line—The Upstairs, Downstairs Bears—features hand-painted resin bears attired in charming Edwardian costume, each on a mahogany base inlaid with a porcelain medallion identifying the name and title of the piece. Like other Department 56 products, The Upstairs, Downstairs Bears reflect a complete attention to detail not often found in reasonably priced giftware items—from the design and handcrafted intricacies, to the product's packaging.

As an extension of our popular Snowbabies series, we introduced 10 Snowbunnies pieces during July in our Spring product line. In its first year on the market, demand was so strong that our entire production sold out in just five months. The Snowbunnies introduction serves as a prime example of what Department 56 does well—developing new market niches.

GROWTH STRATEGIES We believe that we have just begun to penetrate the market for our products. We intend to continue our proven growth strategy and build on the untapped market for our products by: strengthening Department 56 brand awareness and consumer loyalty; carefully developing the growth of our collectible product lines; continually producing new, innovative designs; sourcing high-quality products at affordable prices; and reaching consumers through our extensive distribution network of more than 19,000 quality giftware retailers.

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The majority of collectors buy two to three new Village pieces each year, providing an important consumer base from which to grow. In addition, our marketing efforts are focused on reaching first-time buyers who may become collectors. We expect to experience future growth through new collectors, introductions in existing Village series, and the creation of new Village Product lines. Among buyers of Village Products, the Department 56 brand name is six times more popular than our nearest competitor. We seek to build on that consumer loyalty.

The category of Other Giftware products will also play a key role in our future growth. Other Giftware creates opportunities to leverage our strengths in design and production. We often introduce new concepts in the Other Giftware category, like Snowbabies, that later develop into collectible product lines.

We continued to expand our worldwide production capabilities during fiscal 1994, using skilled artisans who meet our product standards. In particular, the expansion of our production in mainland China was a significant accomplishment that provides a strong competitive advantage. We have developed dependable, low-cost production sources there with proven abilities to produce extremely intricate pieces for Department 56. The volume of Department 56 products sourced from mainland China grew from 16 percent in 1993 to 29 percent in 1994. We anticipate that this trend will continue in fiscal 1995.

OUTLOOK Going forward, the contributions of the Company's management and employees are important to our future success. In 1994, we welcomed Susan Engel as our new president and chief operating officer. Susan brings 20 years of marketing and management experience to this position and we're delighted to have her as part of our team. She succeeds Todd Bachman, who left to become more active in the management of his family's business, but still remains on the Department 56 Board of Directors. We appreciate the many significant contributions Todd made at Department 56, and wish him well in his new endeavors.

We are pleased with our accomplishments to date, and we see many opportunities for future growth. Our guiding philosophy is the same today as it was in 1976, when we first introduced The Original Snow Village collection of lighted houses: to provide attractive, innovative products at affordable prices. And now, as a public company, our goal is also to create long-term value for our shareholders. We will continue to do both by offering consumers and collectors alike the handcrafted, quality giftware for which Department 56 is known.

Edward R. Bazinet

Edward R. Bazinet

Chairman and Chief Executive Officer

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Review of Operations

Department 56's growth is due in large part to our ability to produce high quality, handcrafted giftware at affordable prices. Our success in this area has enabled us to create pieces cost-effectively and with superb detail, giving Department 56 a significant competitive advantage over other giftware companies.

At Department 56 we strive to set new standards in every aspect of our design and production, continually seeking ways to combine materials and to add intricate finishing touches. Each piece—from The Original Snow Village to The Heritage Village Collection, to Snowbabies or one of our many Other Giftware lines—goes through a complex process on its way to becoming a finely handcrafted product.

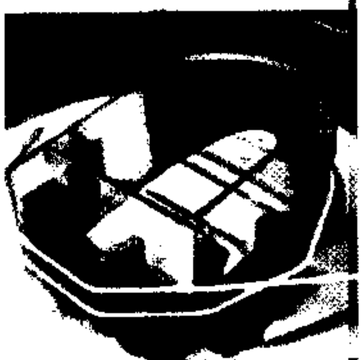
First, every Department 56 product begins as an idea. It then goes through numerous stages of production on its way to the retailer's shelves. And although each stage is important to the creation of our product, it is the combination of all our processes—design, sculpting, hand painting, detailing, and packaging—that distinguishes Department 56's products from all others.

DESIGN We encourage our designers to challenge us with fresh product ideas; they often propose details that require new manufacturing techniques. For this reason, Department 56 has developed many industry "firsts," such as the "Village Animated Skating Pond" which was introduced in 1994. Skaters glide freely over a "frozen pond" without any visible connection to the motor in the base.

Our designers combine their own imagination with careful research of historic buildings and costumes to create the feeling of a particular

DESIGN Production of every new Village building begins with the creation of scaled drawings. The roof, each side, and all exterior details are drawn in exact proportion to show the piece's architectural features.

SCULPTING A prototype model is sculpted from clay, capturing each individual detail of a building or an accessory. The model must be 15% larger than the desired product size to offset shrinkage during kiln firing.



MOLDS The clay models are used to create a "mothermold" from which production molds are cast. Because the detail of a mold erodes after 30 to 40 castings, hundreds of production molds are required for a single design.

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The Original Snow Village

I get such pleasure from my Original Snow Village. It reminds me of the small town I grew up in and just looking at my collection brings back so many fond memories. It takes me back to those magical white Christmases I loved as a child. What a long time ago that was! — ***Omaha***

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CASTING Liquid clay or "slip" is poured into production molds to form the pieces. The liquid clay remains in each mold for varying lengths of time depending on the size of the piece.

CASTING The excess liquid is poured out and the pieces continue to form as the mold draws moisture from the remaining clay. Once the pieces are set, the molds are opened and the pieces are carefully removed.

CUTTING WINDOWS After being removed from the mold, and before the clay hardens, window and door openings are hand cut on each of the houses. Every opening requires four to six separate hand cuts.

Village, down to the buckle on a shoe for an accessory piece or the type of shingles on a roof in the Dickens' Village. Department 56's master architects then produce scaled "blueprint" drawings of each design. On Village buildings, for example, all exterior details, such as windows, doors, porches, dormers, chimneys, and brick, must be drawn in precise proportion.

Full-size three-dimensional paper prototypes are then constructed from these "blueprint" drawings, which are used as detailed guides by experienced sculptors, who translate them into clay models.

SCULPTING, MOLDING, AND CASTING The intricately sculpted clay models become the pattern from which the production molds are made. The sculpting and modeling process is therefore critical to bringing out the warmth and character of a Department 56 house or Village accessory design. It is at this stage the true details take shape. The depth and type of cut a sculptor makes on a roof's shingle or to an elf's facial features defines whether or not the final piece appears flat or comes alive. The production mold, in which the final piece is cast, is only as good as this clay model and is the key to manufacturing consistent product.

Department 56 sculptors are proficient at understanding the unique properties of clay. Clay is a difficult material to work with as it shrinks at various stages during the production process. Our sculptors must anticipate the 15 percent shrinkage during firing when sculpting the detail of any piece, such as the roundness in a face or the bricks of a building. For a lighted piece, the sculptors build a house wall by wall. They know how to contour each wall to compensate for the shrinkage during firing so that the detail remains in proportion and the building will be square. The sculptor's judgment and skill is applied

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Dickens' Village™

Our whole family enjoys our Dickens' Village. My husband and I have been collecting for only three years, but we already have a beautiful display. It's become our annual Christmas tradition for our two young children to help us arrange it. They are as enchanted by it as we are. Each Christmas Eve, our family and friends gather around the tree and admire our glowing village from long ago — ***Seattle***

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ATTACHMENTS Attachments, such as Snowbabies wings, a church steeple, or a horse's legs, which have been separately cast, are now individually joined to the main body of the piece with liquid clay.

FIRING Pieces are stacked and loaded into large kilns that fire up to 450 pieces at one time, transforming clay into ceramic or porcelain. The firing process lasts approximately 15 hours at temperatures up to 1800° F.

HAND PAINTING Every Department 56 piece is a handcrafted original. Our talented artists undergo extensive training that enables them to produce fine, hand-painted products.

to the various attachments that extend beyond the main body of the piece — to the chimney, porch, or dormers on a Village house.

The intricate sculpting process may take several weeks to complete. Once a piece is sculpted, a distinguishing stamp is added to the bottom of the piece, listing the title, year of original design, the appropriate series logo, and the Department 56 copyright symbol.

Using the original clay model, a series of production molds are then made from which final pieces are cast. After casting, pieces are removed from their molds and separately molded attachments are carefully "glued" into place with liquid clay. Also at this stage, windows and doors are skillfully hand cut. One individual design may have as many as 50 window openings, each requiring up to six separate hand cuts, totaling more than 300 cuts per piece. Casting marks and rough edges are brushed out and smoothed with liquid clay. Following inspection, pieces are fired at temperatures up to 1800° F, transforming the clay into rock-hard ceramic or porcelain.

HAND PAINTING AND DETAILING Nowhere is the quality and style of Department 56 products more evident than in our hand painting and detailing. Hand painting, like sculpting, is critical to the appeal of each piece and brings to life a product's design. Every piece is individually hand-painted, requiring great patience and skill. Trained artisans expertly paint facial details, shutters around windows, or a welcome mat at the door. The painters work in teams. One team may work with the thinnest of brushes to shape the expressions on a caroler's face with each team member responsible for adding a different color or feature, while still another team adds snow to the roofs and doorways.

Special detailing techniques add touches that collectors expect from Department 56. The Dickens' Village accessory "Holiday Coach," for

Snowbabies

For Christmas last year my daughter gave me one of your Snowbabies, "Jack Frost…A Touch of Winter's Magic." I was hooked! And now I have several pieces in my collection. What I really like most about the Snowbabies is not only the beautiful quality, but your attention to detail. Each design is like a small story, complete with a title…you have captured my imagination. — ***Boston***

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HAND PAINTING Hand painting is one of the most labor intensive stages of production. A variety of brush types are used to achieve the proper detail, facial features, and expressions.

DETAILING The addition of details such as sisal trees on a snowman, a touch of roping, reins, flags, or decals are the finishing touches that distinguish our product in the marketplace.

PACKAGING Department 56 products come in uniquely distinctive packages, preserving them for generations. Storybook boxing, illustrated sleeves, and individually molded storage cartons demonstrate our attention to detail.

example, has 19 separate attachments. Using a variety of materials, this horse-drawn carriage must be finished in multiple stages. The passengers and driver alone comprise eight separate porcelain pieces that are individually attached. Intricate crests are hand-applied to the doors of this coach, which rides on a separate metal undercarriage and wheels. Silver reins that drive four chestnut horses add to this piece's appeal.

The final touches on Snowbabies are what make them so unique. The porcelain bisque crystals are created by forcing pieces of clay through fine mesh screens, then sifting to achieve the proper uniform size. The figure is finally painted with liquid clay and showered with the porcelain bisque crystals. Other detailing touches may include a fishing pole, baton, or tiny porcelain stars tied with satin ribbons. Whatever the item, our attention to detail consistently differentiates Department 56 products in the marketplace.

PACKAGING Over the years, we have developed distinctive packaging that complements the handcrafted value of our products.

In our packaging, like our manufacturing, no detail is overlooked. Each Village piece is packed in its own custom-fit storage carton with an illustrated sleeve. This allows our collectibles to be preserved for generations to come. For Snowbabies and Snowbunnies, we've developed special storybook boxes which tell the tales of these charming collectibles. Our creative packaging and hang tags are used throughout our Christmas and Other Giftware lines and serve to further complement each piece's unique design.

Each year, new collectors discover what existing collectors already know—that Department 56 products are timeless pieces crafted with extraordinary skill and care. We take great pride in creating "Yesterday's Memories, Tomorrow's Traditions."

Tea Party

I collect Dickens' Village and The North Pole and have always loved your quality and designs. I was shopping recently and came across a beautiful display of tins and ceramics called "Tea Party" only to discover it was made by Department 56. I was delighted and purchased several pieces. I had no idea you made so many different kinds of products. I know to keep an eye out for these now. —***Atlanta***

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Product Overview

The Department 56 name has become highly regarded among consumers and retailers, since the Company was founded in 1976. Each year, Department 56 introduces new hand-crafted pieces. In 1994, the Company offered more than 2,000 different products, of which 600 were new. These products were sold through more than 19,000 retailers nationwide. We maintain an overall constant number of products—such as our collectible lighted Village pieces, accessories, and Snowbabies—by retiring selected pieces on an annual basis. For a glimpse of the wide variety of Department 56 offerings, turn to the following pages.

THE ORIGINAL SNOW VILLAGE

The Original Snow Village recreates the warm, nostalgic images of a snow-covered "Main Street U.S.A." cheerfully lighted and decorated for the holidays. This became the first series of lighted Villages to be produced by Department 56.

- Year Introduced: 1976
- Total Lighted Pieces: 178
- Retired Pieces: 143
- Current Pieces: 35

DICKENS' VILLAGE SERIES

Charles Dickens' classic tale, *A Christmas Carol*, captured the spirit of Christmas in Victorian England. The Department 56 Dickens' Village Series recreates this bygone era with an assortment of period shops and accessories, including characters from Dickens' stories.

- Year Introduced: 1984
- Total Lighted Pieces: 78
- Retired Pieces: 51
- Current Pieces: 27

NEW ENGLAND VILLAGE SERIES

The New England Village Series depicts winter scenes in an early American era of covered bridges, log cabins, and horse-drawn sleighs. This collection reminds one of the song verse, "Dashing through the snow, in a one-horse open sleigh..."

- Year Introduced: 1986
- Total Lighted Pieces: 37
- Retired Pieces: 25
- Current Pieces: 12

ALPINE VILLAGE SERIES

The Alpine Village Series recreates the old-world charm of hamlets in the Austrian and Swiss Alps. Buildings such as a farmhouse, grist mill, and church with a clock tower lend a quaint air to this mountain Village.

- Year Introduced: 1986
- Total Lighted Pieces: 14
- Retired Pieces: 3
- Current Pieces: 11

CHRISTMAS IN THE CITY SERIES

Bustling crowds and cheerfully lighted shops create a joyous mood for the Christmas in the City Series. Activities abound as throngs of people mingle, buying gifts, lighting the Town Tree, attending the theater, and worshipping at the cathedral.

- Year Introduced: 1987
- Total Lighted Pieces: 31
- Retired Pieces: 18
- Current Pieces: 13

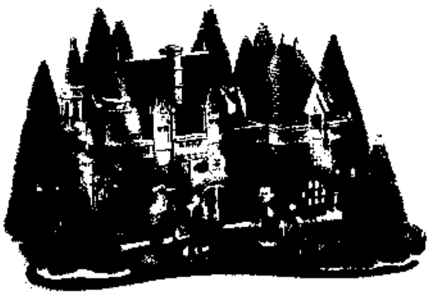
NORTH POLE SERIES

The North Pole Series was inspired by the enduring legend of Santa Claus. At the North Pole, Santa and his elves busily work and sing, preparing all sorts of toys for children everywhere.

- Year Introduced: 1990
- Total Lighted Pieces: 18
- Retired Pieces: 1
- Current Pieces: 17

DISNEY PARKS VILLAGE SERIES

Disney Parks Village Series pieces produced under authority of Walt Disney Co. Inc.



The wonderful world of Disney is interpreted with the new Disney Parks Village Series. These porcelain houses are the first recreations of existing Disney theme park buildings in Anaheim and Orlando. The collection includes Mickey's Christmas Shop, two antique shops, a fire station, and a Mickey and Minnie Mouse accessory, among others.

- Year Introduced: 1994
- Total Lighted Pieces: 5
- Retired Pieces: 0
- Current Pieces: 5

ALL AROUND THE PARK

In this 18-piece Village animated accessory set, figures take a mid-winter stroll on a cobblestone path surrounded by trees. The set can be incorporated into The Original Snow Village or any of the Heritage Village Series.

- **Year Introduced: 1995**

SNOWBABIES

Snowbabies have captivated the hearts of collectors everywhere. These bisque figurines convey an aura of innocence frozen forever in a moment of time. Snowbabies pieces also are available as ornaments, picture frames, music boxes, waterglobes, and in miniature pewter groupings.

- Year Introduced: 1986
- Total Bisque Figures: 80
- Retired Pieces: 35
- Current Pieces: 45

MERRY MAKERS

The collectible Merry Makers are a jovial group of porcelain monks, available as stand-alone figures, ornaments, and waterglobes. Each year, the Merry Makers collection depicts new "merry making" themes.

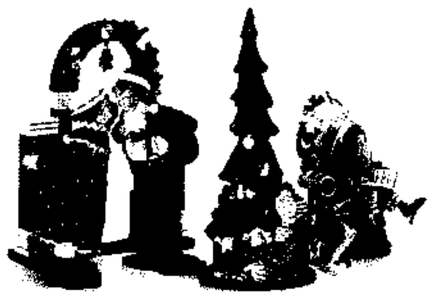
- **Year Introduced: 1991**
- **Total Pieces: 53**
- **Retired Pieces: 0**
- **Current Pieces: 53**

WINTER SILHOUETTE

The pristine white of new fallen snow is captured in each classically designed Winter Silhouette piece. These collectible, winter-white porcelain scenes reflect the serene beauty of the season.

- Year Introduced: 1987
- Total Pieces: 57
- Retired Pieces: 11
- Current Pieces: 46

...ALL THROUGH THE HOUSE



The Department 56 collection...All Through The House interprets the spirit of the classical Clement C. Moore poem, *A Visit From St. Nicholas.* Facades of houses—detailed inside and out—and homey scenes, depicting the preparation for the holiday, bring this story of the night before Christmas to life.

- Year Introduced: 1991
- Total Pieces: 44
- Retired Pieces: 0
- Current Pieces: 44

MERCURY GLASS

Our Mercury Glass collection is reminiscent of old, vintage European ornaments. Department 56 has developed a unique line of oversize Christmas decorations which come in traditional and contemporary styles—from bright, solid-colored globes and finials, to tree ornaments featuring, for example, a Santa Claus, a teddy bear, an ice cream cone, a candy cane, and a buffalo nickel.

- Year Introduced: 1988
- Total Pieces: 238 of which 44 are dimensional

JINGLE

The Jingle line demonstrates Department 56's ability to coordinate a single graphic theme across a wide variety of giftware items. Jingle products depict a glitzy red, gold, and black musical motif on a variety of hanging ornaments, accessories, and tabletop—including glasses, tins, trays, and wreaths.

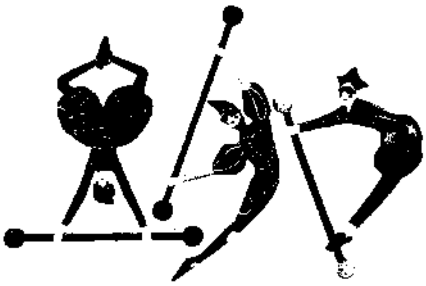
- Year Introduced: 1995

FATHER FROST

The Father Frost trim line features papier-mache figures and ornaments that capture the nostalgic image of old European designs.

- Year Introduced: 1993
- Total Pieces: 26

CIRQUE DU SOLEIL *Licensed by Determined Productions, Inc.*



Translating the bold, sophisticated style of the Cirque Du Soleil, Department 56 created a brilliantly colored trim line of ornaments and tins. Uniquely non-traditional, our Cirque Du Soleil line captures the dramatic flair of this famous acrobatic troupe.

- Year Introduced: 1995

TEA PARTY

The Tea Party line brings a fresh, new look to afternoon tea. The striking polka-dot motif appears on oversize teapots, cups, saucers, plates, and tins.

- Year Introduced: 1995

SILVER COLLECTION

The Silver collection by Department 56 represents the Company's ability to offer the market a combination of design, style, and value. These non-seasonal home accessories include items such as candle holders, vases, trays, and wire baskets.

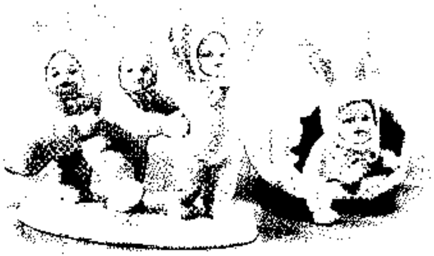
- Year Introduced: 1995

UPSTAIRS, DOWNSTAIRS BEARS

The hand painted, cold cast resin Upstairs, Downstairs Bears feature a family, their friends, and household staff attired in traditional Edwardian costume, with mahogany bases. They are adapted from the original designs by Carol Lawson, a well-known English illustrator and author.

- Year Introduced: 1994
- Total Pieces: 25

SNOWBUNNIES



The Snowbunnies collection is an extension of our collectible Snowbabies series. The playful and heartwarming Snowbunnies add a new dimension to Department 56's spring product line.

- Year Introduced: 1994
- Total Pieces: 10

- The Original Snow Village
- Dickens' Village
- New England Village
- Alpine Village
- Christmas In The City
- North Pole
- Disney Parks Village
- All Around The Park
- Snowbabies
- Merry Makers
- Winter Silhouette
- ...All Through The House
- Mercury Glass
- Jingle
- Father Frost
- Cirque Du Soleil
- Tea Party
- Silver Collection
- Upstairs, Downstairs Bears
- Snowbunnies

Financial Review

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Five Year Summary

(In thousands, except per share amounts)	Company				Predecessor Company		
	Year Ended Dec. 31, 1994[1]	Year Ended Jan. 1, 1994[1]	Year Ended Jan. 2, 1993[1,2] (Pro forma for the Acquisition)	Oct. 4, 1992 – Jan. 2, 1993	Dec. 29, 1991 – Oct. 3, 1992	Year Ended Dec. 28, 1991[1]	47 Wks. Ended Dec. 29, 1990[1]
STATEMENTS OF OPERATIONS							
Net sales	$217,865	$184,359	$150,754	$ 24,600	$125,713	$121,712	$92,441
Cost of sales	98,480	87,331	74,958	12,967	62,485	60,848	49,061
Gross profit	119,385	97,028	75,796	11,633	63,228	60,864	43,380
Operating expenses:							
Selling, general and administrative	41,831	34,670	29,151	7,537	20,678	23,187	16,001
Performance bonuses[3]	–	–	450	–	6,658	5,654	3,935
Amortization of goodwill and trademarks	4,577	4,575	4,568	1,150	–	–	–
Nonrecurring charges[4]	–	–	–	–	28,350	–	–
Total operating expenses	46,408	39,245	34,169	8,687	55,686	28,841	19,936
Income from operations	72,977	57,783	41,627	2,946	7,542	32,023	23,444
Other expense (income):							
Interest expense	12,629	16,143	16,339	4,341	790	1,134	1,123
Other, net	(837)	(1,030)	(1,044)	(304)	(503)	(777)	(487)
Income (loss) before income taxes	61,185	42,670	26,332	(1,091)	7,255	31,666	22,808
Provision (benefit) for income taxes	25,086	17,673	11,168	(24)	6,887	11,552	7,998
Net income (loss)	$ 36,099	$ 24,997	$ 15,164	$ (1,067)	$ 368	$ 20,114	$14,810
Net income (loss) per share	$ 1.67	$ 1.16	$ 0.70	$ (0.05)			

	Dec. 31, 1994	Jan. 1, 1994		Jan. 2, 1993		Dec. 28, 1991	Dec. 29, 1990
BALANCE SHEET DATA							
Cash and cash equivalents	$ 2,180	$ 7,366		$ 38,355		$ 13,072	$ 8,535
Marketable securities	–	-		9,870		5,881	4,625
Working capital	13,362	26,392		61,697		34,138	28,246
Total assets	239,680	234,893		275,370		61,751	48,833
Long-term debt, including current maturities	113,000	148,000		213,000		5,051	5,670
Total stockholders' equity[5]	100,305	61,731		37,158		41,382	31,849

1 The years ended December 28, 1991, January 1, 1994 and December 31, 1994 were 52-week periods and the year ended January 2, 1993 was a 53-week period. In 1990, the Predecessor Company changed its fiscal year end for financial reporting purposes from the Saturday closest to January 31 to the Saturday closest to December 31. Therefore, the period ended December 29, 1990 includes only 47 weeks.

2 The pro forma statement of operations for the year ended January 2, 1993 is based on the assumption that the Acquisition had occurred on December 29, 1991. The pro forma data includes the effects of adjustments to historical asset values as required by the purchase accounting method, adjustments to interest expense to reflect financing costs of the Acquisition, amortization of intangibles related to the Acquisition, adjustments to eliminate performance bonus payments related to Predecessor Company employment contracts that were terminated in connection with the Acquisition, adjustments for nonrecurring costs incurred by the Predecessor Company and the related income tax effect of the preceding items (see Note 1 to the Consolidated Financial Statements).

3 Reflects performance bonuses that the Predecessor Company paid in connection with employment agreements it had with certain officers, which agreements were terminated in connection with the Acquisition (see Note 7 to the Consolidated Financial Statements).

4 Nonrecurring charges include payments to terminate employment contracts, special bonuses and costs incurred by the Predecessor Company in connection with the Acquisition (see Note 10 to the Consolidated Financial Statements).

5 Since the Acquisition, 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. The revolving credit agreement of D 56, Inc. (the principal operating subsidiary of the Company) permits it to declare and pay cash dividends (subject to certain limitations) to the Company which may then be declared and paid to holders of Common Stock.

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Management's Discussion and Analysis

RESULTS OF OPERATIONS

The Company was organized in 1992 by affiliates of Forstmann Little & Co. (the "Forstmann Little Partnerships") for the purpose of acquiring D 56, Inc. (the "Predecessor Company"), referred to herein as the "Acquisition" (See Note 1 to the Consolidated Financial Statements). The Company operates primarily in the collectible area of the giftware industry.

For purposes of discussion set forth below, the results of operations for 1992 are shown pro forma for the Acquisition and based on the assumption that the Acquisition had occurred on December 29, 1991. The pro forma results of operations for 1992 reflect the effects of adjustments to historical asset values as required by the purchase accounting method, adjustments to interest expense to reflect the financing costs of the Acquisition, amortization of intangible assets related to the Acquisition, adjustments to eliminate performance bonus payments related to the Predecessor Company's employment contracts that were terminated in conjunction with the Acquisition, adjustments for nonrecurring costs incurred by the Predecessor Company and the related income tax effects of the preceding items.

COMPARISON OF RESULTS OF OPERATIONS

1994 TO 1993

Net Sales. Net sales increased $33.5 million, or 18%, from $184.4 million in 1993 to $217.9 million in 1994. This increase was due principally to an increase in volume. Sales of Village Series products increased 22% from 1993 to 1994, while Other Giftware product sales increased 11% during the same period. Village Series products continued to account for the most significant portion of the Company's sales, 69% in 1994 versus 67% in 1993.

The increase in the sales volume of Village Series products during 1994 resulted from continued strong customer demand which was supported by the introduction of new lighted pieces. Demand for the Village Series products continued to exceed supply in 1994. As a result, the Company continued its policy of allocating the amount of Village Series products customers were allowed to purchase in both 1993 and 1994, as well as limiting the number of new accounts that carry Village Series products. This allocation policy, begun in 1989, has enabled the Company to control growth and enhance the collectibility of its Village Series products.

	1994		1993		1992 (Pro Forma for the Acquisition)	
(In millions, except per share amounts)	Dollars	Percent of Net Sales	Dollars	Percent of Net Sales	Dollars	Percent of Net Sales
Net sales	$217.9	100%	$184.4	100%	$150.8	100%
Gross profit	119.4	55	97.0	53	75.8	50
Selling, general and administrative expenses	41.8	19	34.7	19	29.6	20
Amortization of goodwill and trademarks	4.6	2	4.6	2	4.6	3
Income from operations	73.0	33	57.8	31	41.6	28
Interest expense	12.6	6	16.1	9	16.3	11
Other, net	(.8)	-	(1.0)	(1)	(1.0)	(1)
Income before income taxes	61.2	28	42.7	23	26.3	17
Provision for income taxes	25.1	12	17.7	10	11.1	7
Net income	36.1	17	25.0	14	15.2	10
Net income per share	1.67		1.16		0.70	

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In Other Giftware products, sales increased at a lower rate than the Company's overall sales. The Company has continued its policy, begun in 1992, of allocating the supply of its Snowbabies products to customers and limiting the number of new accounts that carry Snowbabies products.

Gross Profit. Gross profit increased $22.4 million, or 23%, between 1993 and 1994. Gross profit as a percentage of sales increased from approximately 53% in 1993 to approximately 55% in 1994, principally as a result of decreased product costs due to lower cost, high quality production capacity added during 1994, as well as favorable foreign currency exchange rates and $30 million of non-deliverable New Taiwan dollar contracts.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased $7.2 million, or 21%, between 1993 and 1994, and remained relatively constant at 19% of sales in both periods. The increase in expenses was primarily due to higher sales and marketing expenses, including commissions, on the Company's higher sales volume. These expenses generally vary in proportion to the Company's sales.

Income from Operations. Income from operations increased $15.2 million, or 26%, from 1993 to 1994 due to the factors described above. Operating margins increased from 31% of net sales in 1993 to 33% of net sales in 1994.

Interest Expense. Interest expense decreased $3.5 million, or 22%, between 1993 and 1994 due to the prepayment of $65 million of subordinated debentures on December 31, 1993.

Provision for Income Taxes. The effective income tax rate remained relatively constant at 41% during both 1993 and 1994.

COMPARISON OF RESULTS OF OPERATIONS
1993 TO PRO FORMA 1992

Net Sales. Net sales increased $33.6 million, or 22%, from $150.8 million in 1992 to $184.4 million in 1993. This increase was due principally to higher sales volume in all major product categories. Sales of Village Series products increased 16% from 1992 to 1993, while Other Giftware products sales increased 32% during the same period. While Village Series products continued to account for the most significant portion of net sales, Village Series decreased from 70% of net sales in 1992 to 67% of net sales in 1993. The proportion of net sales derived from Village Series products decreased in 1993 due to the continued rapid sales growth of the Company's Other Giftware products. Demand for Village Series continued to exceed supply in 1993. As a result, the Company continued its policy of allocating the amount of Village Series products customers were allowed to purchase in both 1993 and 1992, as well as limiting the number of new accounts that carry Village Series products. Allocation of the Village Series, begun in 1989, has enabled the Company to control growth and enhance the collectibility of its Village Series products.

The sales volume increase in the Village Series products in 1993 resulted from continued strong customer demand which was supported by the introduction of new lighted pieces.

In Other Giftware products, sales of the Company's General Christmas product lines during 1993 increased at a greater rate than the Company's overall sales. In addition, sales of the Snowbabies product line continued to expand at a higher rate than the Company's overall sales. Demand for Snowbabies products continued to exceed supply in 1993 and the Company continued its policy, begun in 1992, of allocating supply to customers and limiting the number of new accounts that carry Snowbabies products.

Gross Profit. Gross profit increased $21.2 million, or 28%, between 1992 and 1993. Gross profit as a percentage of net sales increased from approximately 50% in 1992 to approximately 53% in 1993, principally as a result of decreased inventory costs due to the relative decline in the New Taiwan dollar, and also due to lower cost, high quality production capacity that was added in 1993.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased $5.1 million, or 17%, between 1992 and 1993, and declined slightly from 20% of net sales in 1992 to 19% in 1993. The increase in expenses was primarily due to higher sales and marketing expenses, including commissions, on the Company's higher sales volume. These expenses generally vary in proportion to the Company's sales.

Income from Operations. Income from operations increased $16.2 million, or 39%, from 1992 to 1993 due to the factors described above. Operating margins increased from 28% of net sales in 1992 to 31% of net sales in 1993.

Interest Expense. Interest expense remained relatively constant, decreasing $0.2 million, or 1%, between 1992 to 1993.

Provision for Income Taxes. The effective income tax rate decreased from 42% in 1992 to 41% in 1993. The effect of the 1 percentage point increase in the Federal income tax rate in 1993 was more than offset by the effect of the decrease of the nondeductible goodwill amortization expense as a percentage of income before income taxes.

SEASONALITY

(In millions, except per share amounts)	1994					1993				
	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total
Customer orders entered[1]	$181.0	$27.0	$20.2	$8.9	$237.1	$157.5	$21.8	$13.2	$5.2	$197.7
Net sales	45.5	64.4	66.4	41.6	217.9	39.2	55.4	57.0	32.8	184.4
Gross profit	24.6	35.4	36.4	23.0	119.4	20.0	28.9	30.4	17.7	97.0
Selling, general and administrative expenses	8.8	10.8	10.5	11.7	41.8	7.5	9.4	9.0	8.8	34.7
Amortization of goodwill and trademarks	1.1	1.1	1.2	1.2	4.6	1.1	1.1	1.2	1.2	4.6
Income from operations	14.7	23.5	24.7	10.1	73.0	11.4	18.4	20.2	7.8	57.8
Net income	7.1	12.0	12.8	4.2	36.1	4.6	8.8	9.3	2.3	25.0
Net income per share	0.33	0.56	0.59	0.19	1.67	0.21	0.41	0.43	0.11	1.16

[1] Customer orders entered are domestic orders received and approved by the Company, subject to cancellation for various reasons including credit considerations, inventory shortages, and customer requests.

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 76% and 80% of its total annual customer orders for 1994 and 1993, respectively, during the first quarter of each of those years. Cancellations were approximately 5% of total annual customer orders in each of 1994 and 1993. The Company's backlog was $8.4 million and $5.3 million at December 31, 1994 and January 1, 1994, respectively.

The Company shipped and recorded as net sales approximately 92% and 93% of its annual customer orders in 1994 and 1993, respectively. Orders not shipped in a particular year, net of cancellations, returns, allowances and cash discounts, are carried into backlog for the following year and have historically been Easter orders.

The Company receives products, pays its suppliers and ships products throughout the year, although 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 objectives which are consistent with the Company's business strategy.

LIQUIDITY AND CAPITAL RESOURCES

In February 1995, the Company entered into a new credit agreement providing a $100 million term loan and a revolving line of credit. In connection therewith, the Company will record an extraordinary charge of $1,312,000, net of tax, to write off deferred financing costs during the first quarter of 1995. The Company used the proceeds of the term loan combined with $8 million of the revolving line of credit to refinance its subordinated debt. The term loan is due and payable in five consecutive installments of $20 million, payable on December 31 of each year, commencing December 31, 1995. The Company believes that its internally generated cash flow and seasonal borrowings under the revolving line of credit will be more than adequate to fund operations, capital expenditures, and required principal payments on its term loan for the next 12 months.

The revolving line of credit provides for borrowings of up to $90 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, entering into any transaction to acquire or merge with any entity or making certain other fundamental changes, selling property, incurring capital expenditures and paying dividends. In addition, D 56, Inc. is required to satisfy consolidated net worth, interest coverage ratio and current ratio tests, in each case at the end of each fiscal quarter.

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 and marketable securities balances, internally generated cash flow and seasonal borrowings. The Company's bad debt experience relating to these accounts receivable has not been material.

The Company's net cash and marketable securities balances peak in December, following the collection in November and December of accounts receivable with extended payment terms. On December 30, 1994 and December 31, 1993, the Company prepaid subordinated debentures with an aggregate principal amount of $40 million and $65 million, respectively. At December 31, 1994, cash and cash equivalents balances were $2.2 million as compared to $7.4 million at January 1, 1994.

Accounts receivable increased from $13.6 million at January 1, 1994 to $24.0 million at December 31, 1994 principally as a result of increased volume, later shipments in 1994 than 1993, a larger amount of receivables qualifying for December dating terms and slightly slower payment patterns in 1994 versus 1993.

Capital expenditures were $2.6 million, $1.3 million and $1.0 million for 1994, 1993 and 1992, respectively.

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On June 17, 1993, the Forstmann Little Partnerships and certain members of senior management and other employees of the Company completed an initial public offering of 5.29 million shares of common stock at a price of $18.00 per share and received net cash proceeds from the offering of approximately $88.7 million. On May 5, 1994, the Forstmann Little Partnerships and certain members of senior management and other employees of the Company completed a public offering of 5.75 million shares of common stock at a price of $27⅜ per share and received net cash proceeds from the offering of approximately $150.3 million.

FOREIGN EXCHANGE

The dollar value of the Company's assets abroad is not significant. 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 Taiwan (Republic of China), China and The Philippines. The Company's costs could be adversely affected on a short-term basis if the New Taiwan dollar (or the currencies of other countries in which the Company conducts business) appreciates significantly relative to the U.S. dollar. 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.

At December 31, 1994, the Company had $32.5 million of foreign exchange contracts outstanding to hedge 1995 Taiwan dollar denominated inventory purchases. These contracts mature from January 1995 through December 1995 at a rate of 27.00 NT$/US$.

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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 an internal control structure that is adequate to provide reasonable assurance that the assets are safeguarded from loss or unauthorized use. This structure produces records adequate for preparation of financial information. We believe the Company's internal control structure is effective, and the cost of the internal control structure 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 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.

Edward R. Bazinet

Edward R. Bazinet
Chief Executive Officer

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Consolidated Balance Sheets

(In thousands, except per share amounts)	Company December 31, 1994	Company January 1, 1994
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 2,180	$ 7,366
Accounts receivable, net of allowances of $5,232 and $4,784, respectively	23,959	13,555
Inventories	20,366	17,395
Deferred taxes	3,161	2,986
Other current assets	2,723	3,282
Total current assets	52,389	44,584
Property and equipment, net	12,330	10,908
Goodwill, net of accumulated amortization of $9,295 and $5,166, respectively	155,878	160,007
Trademarks, net of accumulated amortization of $1,007 and $559, respectively	16,893	17,341
Other assets	2,190	2,053
	$239,680	$234,893
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Current portion of long-term debt	$ 20,000	$ –
Accounts payable	5,157	5,146
Commissions payable	4,209	3,619
Accrued interest	646	870
Other current liabilities	9,015	8,557
Total current liabilities	39,027	18,192
Deferred taxes	7,348	6,970
Long-term debt	93,000	148,000
Commitments (note 8)		
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 21,475 and 21,343 shares, respectively	215	213
Additional paid-in capital	40,244	38,269
Unearned compensation on common stock options	(183)	(681)
Retained earnings	60,029	23,930
Total stockholders' equity	100,305	61,731
	$239,680	$234,893

See notes to consolidated financial statements.

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Consolidated Statements of Operations

(In thousands, except per share amounts)	Company: Year ended December 31, 1994	Company: Year ended January 1, 1994	Company: October 4, 1992 through January 2, 1993	Predecessor Company: December 29, 1991 through October 3, 1992
Net sales	$217,865	$184,359	$24,600	$125,713
Cost of sales	98,480	87,331	12,967	62,485
Gross profit	119,385	97,028	11,633	63,228
Operating expenses:				
Selling, general and administrative	41,831	34,670	7,537	20,678
Performance bonuses	–	–	–	6,658
Amortization of goodwill and trademarks	4,577	4,575	1,150	–
Nonrecurring charges	–	–	–	28,350
Total operating expenses	46,408	39,245	8,687	55,686
Income from operations	72,977	57,783	2,946	7,542
Other expense (income):				
Interest expense	12,629	16,143	4,341	790
Other, net	(837)	(1,030)	(304)	(503)
Income (loss) before income taxes	61,185	42,670	(1,091)	7,255
Provision (benefit) for income taxes	25,086	17,673	(24)	6,887
Net income (loss)	$ 36,099	$ 24,997	$ (1,067)	$ 368
Net income (loss) per share	$ 1.67	$ 1.16	$ (0.05)	
Weighted average common and common equivalent shares outstanding	21,649	21,544	21,548	

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

(In thousands)	Company: Year ended December 31, 1994	Company: Year ended January 1, 1994	Company: October 4, 1992 through January 2, 1993	Predecessor Company: December 29, 1991 through October 3, 1992
Cash Flows from Operating Activities:				
Net income (loss)	$ 36,099	$ 24,997	$ (1,067)	$ 368
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:				
Depreciation	1,296	1,037	280	801
Amortization of goodwill, trademarks and other intangible assets	5,254	5,243	1,266	–
Provision for uncollectible accounts receivable	1,107	1,922	455	1,528
Compensation expense—common stock options	498	829	–	–
Imputed interest	–	–	727	–
Deferred taxes	203	(682)	(462)	(1,111)
Nonrecurring charges	–	–	–	28,350
Changes in assets and liabilities:				
Accounts receivable	(11,511)	(3,590)	55,949	(53,985)
Prepayment to Fifty-Six Trading Co., Ltd. for inventory	–	–	–	(5,826)
Inventories	(2,971)	(719)	(4,924)	3,216
Other assets	(361)	(2,299)	170	(535)
Accounts payable	11	(1,331)	2,766	3,033
Commissions payable	590	1,369	(3,037)	3,189
Accrued interest	(224)	(2,284)	3,117	21
Other current liabilities	1,403	698	(33,293)	(4,574)
Net cash provided by (used in) operating activities	31,394	25,190	21,947	(25,525)
Cash Flows from Investing Activities:				
Acquisition, net of cash acquired	–	–	(233,460)	–
Sales of marketable securities	–	9,870	–	15,464
Purchases of marketable securities	–	–	(9,409)	(10,044)
Proceeds from the disposal of property and equipment	–	–	–	445
Purchases of property and equipment	(2,621)	(1,296)	(158)	(866)
Net cash provided by (used in) investing activities	(2,621)	8,574	(243,027)	4,999
Cash Flows from Financing Activities:				
Proceeds from the exercise of common stock options	1,041	247	–	–
Borrowings on revolving credit agreement	97,577	–	–	21,500
Principal payments on revolving credit agreement	(92,577)	–	(18,583)	(3,000)
Principal payments on long-term debt	(40,000)	(65,000)	(6,007)	(980)
Proceeds from the issuance of subordinated debentures	–	–	213,000	–
Proceeds from the issuance of common stock	–	–	71,025	–
Dividends paid	–	–	–	(244)
Net cash provided by (used in) financing activities	(33,959)	(64,753)	259,435	17,276
Net increase (decrease) in cash and cash equivalents	(5,186)	(30,989)	38,355	(3,250)
Cash and cash equivalents at beginning of period	7,366	38,355	–	13,072
Cash and cash equivalents at end of period	$ 2,180	$ 7,366	$ 38,355	$ 9,822

See notes to consolidated financial statements.

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Consolidated Statements of Stockholders' Equity

(In thousands)	Common Stock Shares	Common Stock Amount	Retained Earnings	Total Stockholders' Equity
PREDECESSOR COMPANY				
Balance as of December 28, 1991	500	$250	$41,132	$41,382
Dividends	–	–	(162)	(162)
Net income	–	–	368	368
Balance as of October 3, 1992	500	$250	$41,338	$41,588

(In thousands)	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Unearned Compensation on Common Stock Options	Retained Earnings (Deficit)	Total Stockholders' Equity
COMPANY						
Initial capitalization as of October 4, 1992	21,308	$213	$ 68,612	$ –	$ –	$ 68,825
Reduction for predecessor cost carryover basis	–	–	(30,600)	–	–	(30,600)
Net loss	–	–	–	–	(1,067)	(1,067)
Balance as of January 2, 1993	21,308	213	38,012	–	(1,067)	37,158
Net income	–	–	–	–	24,997	24,997
Shares issued upon the exercise of common stock options	35	–	247	–	–	247
Common stock options granted	–	–	1,510	(1,510)	–	–
Common stock options vested	–	–	–	829	–	829
Accrued stock issuance costs	–	–	(1,500)	–	–	(1,500)
Balance as of January 1, 1994	21,343	213	38,269	(681)	23,930	61,731
Net income	–	–	–	–	36,099	36,099
Shares issued upon the exercise of common stock options	132	2	1,975	–	–	1,977
Common stock options vested	–	–	–	498	–	498
Balance as of December 31, 1994	21,475	$215	$ 40,244	$ (183)	$60,029	$100,305

See notes to consolidated financial statements.

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Notes to Consolidated Financial Statements

(In thousands, except share and per share amounts)

1. ACQUISITION

In October 1992, Department 56, Inc. (the "Company"), through its wholly owned subsidiary, FL 56 Intermediate Corp. ("Intermediate"), corporations formed by affiliates of Forstmann Little & Co. ("FL & Co."), entered into a purchase agreement to acquire all of the outstanding common stock of Bachman's Holdings, Inc. ("BHI") and ed bazinet international, inc., the sole stockholders of D 56, Inc., and the assets, subject to certain liabilities, of Fifty-Six Trading Co., Ltd. (referred to herein as the Acquisition) for an aggregate purchase price of $250,263, including $7,097 of acquisition costs. The purchase price, and the payment of nonrecurring charges (see Note 10) and certain assumed debt obligations were funded by the issuance of $71,025 of common stock, before the accrual of $2,200 for stock offering expenses, and $213,000 of subordinated debentures. The Acquisition was consummated on October 15, 1992, and BHI was subsequently dissolved and its assets were transferred to Intermediate. The Acquisition was recorded as of October 4, 1992 and, consequently, the statement of operations for the period from October 4, 1992 to January 2, 1993 includes a $727 charge for imputed interest on the purchase price from that date to October 15, 1992. D 56, Inc. is referred to as the Predecessor Company on or prior to the date of the Acquisition.

The Acquisition has been reflected in the accompanying consolidated financial statements using the purchase method of accounting. Accordingly, the assets acquired and the liabilities assumed in connection with the Acquisition have been recorded at their fair values. The fair values of assets and liabilities were based on independent appraisals and estimates by management. The allocation of the purchase price was as follows:

Current assets	$101,845
Property and equipment	10,862
Intangibles and other assets	216,262
Liabilities assumed	(78,706)
	$250,263

In connection with the Acquisition, the Company has recorded a reduction for predecessor cost carryover basis. The adjustment reduced the predecessor stockholders' investments in the Company to the original cost of the predecessor stockholders' investments in the Predecessor Company plus their proportionate shares of net earnings and distributions.

The following unaudited pro forma results of operations are based on the assumption the Acquisition had occurred on December 29, 1991 and that the purchase price would have been the same. The pro forma results reflect the effects of adjustments to historical asset values as required by the purchase accounting method, adjustments to interest expense to reflect the financing costs of the Acquisition, amortization of intangible assets related to the Acquisition, adjustments to eliminate performance bonus payments related to the Predecessor Company's employment contracts that were terminated in conjunction with the Acquisition, adjustments for nonrecurring costs incurred by the Predecessor Company and the related income tax effects of the preceding items.

Year ended	Jan. 2, 1993
Net sales	$150,754
Net income	$ 15,164
Net income per common share	$ 0.70

The pro forma results have been prepared for comparative purposes only and do not purport to represent what the results would have been if the Acquisition had actually occurred on December 29, 1991 or to project the future results.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business — The Company is engaged in the original design, importation, and wholesale distribution of specialty giftware products. The Company's customer base and accounts receivable are primarily comprised of, and are due from, retail stores of various sizes located throughout the United States.

Principles of Consolidation — The accompanying consolidated financial statements of the Company include the accounts of the Company and its subsidiaries, FL 56 Intermediate Corp., ed bazinet international, inc., D 56, Inc.,

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Notes to Consolidated Financial Statements

(In thousands, except share and per share amounts)

Browndale Tanley Limited and Department 56 Trading Co., Ltd., all of which are wholly owned. The accompanying consolidated financial statements of the Predecessor Company include the accounts of the Predecessor Company and its wholly owned subsidiary, Browndale Tanley Limited. 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 period ended January 2, 1993 includes 13 weeks, the period ended October 3, 1992 includes 40 weeks and the years ended January 1, 1994 and December 31, 1994 include 52 weeks.

Cash and Cash Equivalents — All highly liquid debt instruments with original maturities of three months or less are considered to be cash equivalents and are reported as cash and cash equivalents on the consolidated balance sheet.

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 Taiwan and other Pacific Rim countries. Each period the Company provides for identified, unsalable and slow-moving inventory.

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 two 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 the Acquisition cost over the fair value of the identifiable net assets of the Company at the Acquisition date and is being amortized on a straight-line basis over 40 years. The Company periodically evaluates the recoverability of goodwill based on an analysis of estimated future undiscounted cash flows.

Trademarks — Trademarks acquired in connection with the Acquisition are being amortized on a straight-line basis over 40 years. The Company periodically evaluates the recoverability of trademarks based on an analysis of estimated future undiscounted cash flows.

Deferred Financing Costs — Deferred financing costs are being amortized over the term of the related debt agreements.

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

Income Taxes — The Predecessor Company filed a consolidated federal tax return with BHI and, as agreed, the consolidated provision for income taxes was allocated between the Predecessor Company and BHI based on their pro rata share of consolidated income before income taxes, which approximates the provision for income taxes as determined on a separate company basis. 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 U.S. 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 operations.

Foreign Exchange Contracts — The Company imports certain product from Taiwan. To hedge its foreign exchange exposure, the Company may enter into foreign exchange contracts. At December 31, 1994, the Company had non-deliverable Taiwan currency forward contracts aggregating $32,500 which mature from January 1995 to December 1995. At December 31, 1994, the Company had deferred gains of $241 in connection with these contracts. These gains will be recognized and included in cost of sales at the time the related inventory is sold.

Notes to Consolidated Financial Statements

(In thousands, except share and per share amounts)

Fair Value of Financial Instruments — The carrying amount of cash and cash equivalents approximates fair value because of the short-term nature of these instruments. The Company believes that it was not practicable to estimate the fair value of the subordinated debentures at January 1, 1994 because of 1) the fact that they were issued in connection with the issuance of the original equity of the Company at the date of acquisition as an investment unit, 2) the related-party nature of the securities, 3) the lack of comparable securities, and 4) the lack of a credit rating of the Company by an established rating agency. In February 1995, the Company refinanced its subordinated debentures. Although the fair value of the subordinated debentures could have been impacted by their related party nature, based on the refinancing, the Company believes the fair value of the subordinated debentures approximated their carrying value as of December 31, 1994. The fair value of the Company's forward currency contracts is determined using the current spot rate. The fair value and carrying amount of such contracts were $433 and $192 at December 31, 1994 and $268 and $0 at January 1, 1994, respectively.

Net Income (Loss) Per Share — Net income (loss) per share is based on the weighted average number of common and common equivalent shares outstanding during the period. Common equivalent shares consist of the Company's common stock issuable upon exercise of common stock options, determined using the treasury stock method. All common stock options granted by the Company prior to the Company's initial public offering (June 17, 1993) have been included in the calculation of common and common equivalent shares outstanding as if they were outstanding for all periods presented.

3. PROPERTY AND EQUIPMENT

Property and equipment is comprised of the following:

	Dec. 31, 1994	Jan. 1, 1994
Leasehold improvements	$ 1,172	$ 688
Furniture and fixtures	2,588	2,050
Equipment	4,207	2,638
Building	5,876	5,861
Land	906	906
	14,749	12,143
Less accumulated depreciation	(2,419)	(1,235)
Property and equipment, net	$12,330	$10,908

4. OTHER CURRENT LIABILITIES

Other current liabilities are comprised of the following:

	Dec. 31, 1994	Jan. 1, 1994
Accrued compensation and benefits	$1,161	$1,059
Income taxes payable	5,143	4,875
Accrued stock issuance costs	853	1,605
Other	1,858	1,018
	$9,015	$8,557

The Company accrued $2,200 of liabilities for future stock issuance costs in connection with its initial capitalization. During 1993, the Company revised its estimate of future stock issuance costs in connection with its initial capitalization and, as a result, recorded an additional $1,500 for future stock issuance costs.

5. CREDIT AGREEMENT

Long-term debt is comprised of the following:

	Dec. 31, 1994	Jan. 1, 1994
Revolving line of credit	$ 13,000	$ –
Term loan	100,000	–
Subordinated debentures	–	148,000
	113,000	148,000
Less current portion	20,000	–
	$ 93,000	$148,000

During February 1995, the principal operating subsidiary of the Company, D 56, Inc., entered into a credit agreement providing a $100,000 term loan and a revolving line of credit. In connection therewith, the Company will record an extraordinary charge of $1,312, net of tax, to write off deferred financing costs during the first quarter of 1995. The proceeds of the term loan, combined with $8,000 from the revolving line of credit was used to refinance $108,000 of subordinated debentures. The subordinated debentures outstanding as of December 31, 1994 have been reclassified to reflect the refinancing. The term loan is due and payable in five consecutive annual installments of $20,000, payable on December 31 of each year commencing December 31, 1995.

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Notes to Consolidated Financial Statements

(In thousands, except share and per share amounts)

The revolving line of credit provides for borrowings of up to $90,000, 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 $20,000 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 ¼% to ⅜% 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 Eurodollar Rate (as defined) plus an applicable margin or the Alternate Base Rate (as defined). The applicable margin ranges from ½% to 1¼% for Eurodollar loans. The credit agreement expires December 31, 1999.

The credit agreement includes restrictions as to, among other things, the amount of additional indebtedness, liens, contingent obligations, investments, capital expenditures and dividends. The credit agreement also requires maintenance of minimum levels of interest coverage, net worth and liquidity. None of these restrictions are expected to have a material adverse effect on the Company's ability to operate in the future. The Company has pledged the common stock of its subsidiaries, direct and indirect, as collateral under the credit agreement and the Company and its subsidiaries, direct and indirect, have guaranteed repayment of amounts borrowed under the credit agreement.

The Company paid interest of $12,182, $17,595 and $497 during the years ended December 31, 1994 and January 1, 1994 and the period from October 4, 1992 to January 2, 1993, respectively. The Predecessor Company paid $769 during the period from December 29, 1991 to October 3, 1992. The weighted average interest rate on outstanding short-term borrowings at December 31, 1994 was 8.5%.

In connection with the Acquisition, the Company issued $213,000 of 7% subordinated debentures to MBO-IV, which is an affiliate of FL & Co., and such subordinated debentures were then immediately distributed to the limited partners of such limited partnership, none of which are affiliates of the Company or of FL & Co. The Company prepaid $40,000 and $65,000 of the subordinated debentures on December 30, 1994 and December 31, 1993, respectively.

6. INCOME TAXES

The provision (benefit) for income taxes consisted of the following:

	Company			Predecessor Company
	Year Ended Dec. 31, 1994	Year Ended Jan. 1, 1994	Oct. 4, 1992 through Jan. 2, 1993	Dec. 29, 1991 through Oct. 3, 1992
Current:				
Federal	$22,339	$16,680	$ 403	$ 7,303
State	2,298	1,333	35	695
Foreign	246	342	–	–
Deferred	203	(682)	(462)	(1,111)
	$25,086	$17,673	$ (24)	$ 6,887

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Notes to Consolidated Financial Statements

(In thousands, except share and per share amounts)

	Company			Predecessor Company
	Year Ended Dec. 31, 1994	Year Ended Jan. 1, 1994	Oct. 4, 1992 through Jan. 2, 1993	Dec. 29, 1991 through Oct. 3, 1992
Income taxes (benefit) at federal statutory rate (35% in 1994 and 1993 and 34% in prior periods)	$21,414	$14,935	$(371)	$2,467
State income taxes net of federal income tax	1,929	1,300	(33)	218
Amortization of goodwill and other intangibles	1,448	1,440	358	–
Adjustment to deferred tax assets and liabilities for the change in the federal tax rate	–	111	–	–
Costs incurred by Predecessor Company in connection with the sale of D 56, Inc. for which no income tax benefit was recorded	–	–	–	4,139
Other	295	(113)	22	63
Provision (benefit) for income taxes	$25,086	$17,673	$ (24)	$6,887

The components of the net deferred tax liability were as follows:

	Dec. 31, 1994	Jan. 1, 1994
Deferred tax assets:		
Accounts receivable valuation allowances	$ 1,988	$ 1,817
Inventory valuation allowances	822	774
Compensation expense—common stock options	345	269
Accrued liabilities	115	197
Other	49	33
Total deferred tax assets	3,319	3,090
Deferred tax liabilities:		
Trademarks	(6,419)	(6,589)
Property and equipment	(929)	(381)
Other	(158)	(104)
Total deferred tax liabilities	(7,506)	(7,074)
	$(4,187)	$(3,984)

The $4,187 net deferred tax liability at December 31, 1994 is presented as a net deferred current asset of $3,161 and a deferred noncurrent liability of $7,348. The $3,984 net deferred tax liability at January 1, 1994 is presented as a net deferred current asset of $2,986 and a deferred noncurrent liability of $6,970.

The Company paid income taxes of $23,677, $15,228 and $384 during the years ended December 31, 1994 and January 1, 1994 and the period from October 3, 1992 to January 2, 1993, respectively. The Predecessor Company paid income taxes of $10,640 during the period from December 29, 1991 to October 3, 1992.

7. PERFORMANCE BONUSES

The Predecessor Company had employment agreements with certain of its officers. Compensation under these agreements included aggregate performance bonuses equal to 15% of pretax income (as defined). These agreements were terminated in connection with the Acquisition.

8. COMMITMENTS

Operating Leases — The Company leases an aircraft, warehouse and office space, equipment, and showroom display facilities under operating leases ranging from three to 12 years in duration. 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.

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Notes to Consolidated Financial Statements

(In thousands, except share and per share amounts)

The following is a schedule of future annual minimum lease payments for noncancelable operating leases as of December 31, 1994:

1995	$ 2,592
1996	2,529
1997	2,315
1998	2,334
1999	2,055
Thereafter	2,382
	$14,207

The Company's rental expense was $2,359, $1,534 and $292 for the years ended December 31, 1994 and January 1, 1994 and the period from October 4, 1992 to January 2, 1993, respectively. The Predecessor Company's rental expense was $845 for the period from December 29, 1991 to October 3, 1992.

Letters of Credit — The Company had outstanding standby and commercial letters of credit amounting to $9,038 at December 31, 1994 relating to purchase commitments issued to foreign suppliers and vendors and to certain banks.

9. RETIREMENT PLAN

The Company has a profit sharing plan covering substantially all employees. Contributions to this plan are at the discretion of the Board of Directors, subject to certain limitations. The Company's total profit sharing contributions were $819, $783 and $195 for the years ended December 31, 1994 and January 1, 1994 and the period from October 4, 1992 to January 2, 1993, respectively. The Predecessor Company's contribution for the period from December 29, 1991 to October 3, 1992 was $446.

10. NONRECURRING CHARGES

The Predecessor Company incurred certain one-time costs in connection with the sale of D 56, Inc. to the Company. These costs are comprised of payments to terminate employment contracts and special bonuses of $25,000 and costs incurred by the Predecessor Company in connection with the sale of D 56, Inc. of $3,350.

11. RELATED-PARTY TRANSACTIONS

In the ordinary course of business, the Company sells product to a floral and nursery wholesaler and retailer, of which a director of the Company is an officer, director and stockholder. The Company had sales to this floral and nursery business during the years ended December 31, 1994 and January 1, 1994 and the period from October 4, 1992 to January 2, 1993 of $1,494, $1,458 and $468, respectively. The Predecessor Company had sales to this floral and nursery business of $1,041 during the period from December 29, 1991 to October 3, 1992.

During the years ended December 31, 1994 and January 1, 1994, the Company paid FL & Co. and its affiliates $1,549 and $252, respectively, for aircraft management, transportation and other expenses.

In February 1994, the Company entered into an agreement with an affiliate of FL & Co. to purchase a corporate aircraft for $6,650. The Company assigned the purchase agreement to an unaffiliated third party and entered into an operating lease of the aircraft from such third party following the assignment.

The Predecessor Company purchased imported merchandise from Fifty-Six Trading Co., Ltd., a Taiwan-based trading company, in the amount of $31,813 during the period from December 29, 1991 to October 3, 1992. Two officers and stockholders of the Company were the principal stockholders of Fifty-Six Trading Co., Ltd. As of the date of the Acquisition, the Company purchased the assets, subject to certain liabilities, of Fifty-Six Trading Co., Ltd. (See Note 1).

12. STOCKHOLDERS' EQUITY

Public Offerings — On June 17, 1993, FL & Co. and certain members of senior management and other employees of the Company sold in an initial public offering (the "June Offering") 5,290,000 shares of the Company's common stock, par value $.01 per share (the "Common Stock"), at an initial public offering price of $18.00 per share.

On May 5, 1994, FL & Co. and certain members of senior management and other employees completed a public offering of 5,750,000 shares of the Company's common stock at a price of $27.375 per share.

Notes to Consolidated Financial Statements

(In thousands, except share and per share amounts)

Stock Options — In October 1992, the Company adopted a stock option plan ("1992 Stock Option Plan") which provides for granting stock options to directors, officers, and key employees. A total of 292,500 shares of Common Stock are reserved for issuance under the stock option plan. In October 1992 and February 1993, pursuant to this plan, options to purchase 22,500 and 225,000 shares, respectively, were granted. The options have a term of 10 years, are exercisable in equal installments on each of the first, second, and third anniversaries of the date of the grant, and have an exercise price of $3.33 per share.

Under the 1992 Stock Option Plan, options to purchase 81,501 and 35,144 shares of Common Stock were exercised during the years ended December 31, 1994 and January 1, 1994, respectively. At December 31, 1994, options to purchase 10,855 shares of Common Stock were exercisable at $3.33 per share.

In December 1992, the Company granted options to purchase 30,000 shares of Common Stock to each of four members of the Company's Board of Directors. 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 in equal installments on each of the first, second, and third anniversaries of the date of the grant, have a term of 10 years, and have an exercise price of $3.33 per share. Directors' options to purchase 10,000 shares were exercised during the year ended December 31, 1994. At December 31, 1994, directors' options to purchase 80,000 shares of Common Stock were exercisable at $3.33 per share.

In April 1993, the Company adopted a stock incentive plan ("1993 Stock Option Plan") which provides for granting stock options, stock appreciation rights and various other awards to officers, employees, consultants and advisors to the Company. A total of 1,000,000 shares of Common Stock are reserved for issuance under this plan.

Options granted under this plan have an exercise price equal to the market value at the date of grant ($18.00 to $37.75), have a term of 10 years and are exercisable in equal installments on each of the first, second and third anniversaries of the date of grant. Information regarding the 1993 Stock Option Plan is as follows:

Year ended	Dec. 31, 1994	Jan. 1, 1994
Outstanding at beginning of year	192,200	–
Granted	424,700	198,900
Exercised	(40,900)	–
Cancelled	(4,100)	(6,700)
Outstanding at end of year	571,900	192,200
Exercisable at end of year	22,100	–

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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 December 31, 1994 and January 1, 1994 and the related consolidated statements of operations, cash flows and stockholders' equity for the years ended December 31, 1994 and January 1, 1994 and the period from October 4, 1992 to January 2, 1993. We have also audited the consolidated statements of operations, cash flows and stockholders' equity of D 56, Inc. (the "Predecessor Company") for the period from December 29, 1991 to October 3, 1992. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 1994 and January 1, 1994 and the results of its operations and its cash flows for the years ended December 31, 1994 and January 1, 1994 and the period from October 4, 1992 to January 2, 1993 and the Predecessor Company's results of operations and cash flows for the period from December 29, 1991 to October 3, 1992 in conformity with generally accepted accounting principles.

Deloitte & Touche LLP

Deloitte & Touche LLP
Minneapolis, Minnesota
February 17, 1995

Corporate and Stockholder Information

BOARD OF DIRECTORS

Edward R. Bazinet [1]
Chairman of the Board and
Chief Executive Officer,
Department 56, Inc.

Todd L. Bachman
Chairman and Chief
Executive Officer,
Bachman's, Inc.

Nicholas C. Forstmann [1,3]
General Partner,
Forstmann Little & Co.

Theodore J. Forstmann
General Partner,
Forstmann Little & Co.

Stephen Fraidin
Partner,
Fried, Frank, Harris,
Shriver & Jacobson

Richard S. Friedland [2]
President and Chief
Operating Officer,
General Instrument Corporation

Sandra J. Horbach [1]
General Partner,
Forstmann Little & Co.

Wm. Brian Little [1]
Private Investor

Steven G. Rothmeier [2]
Chairman of the Board
and Chief Executive Officer,
Great Northern Capital

Arthur T. Shorin [2,3]
Chairman of the Board
and Chief Executive Officer,
The Topps Co. Inc.

Vin Weber [3]
Vice Chairman,
Empower America

[1] Member of Executive Committee
[2] Member of Audit Committee
[3] Member of Compensation Committee

OFFICERS

Edward R. Bazinet
Chief Executive Officer

Susan E. Engel
President and Chief Operating Officer

David H. Weiser
Vice President, General Counsel
and Secretary

David W. Dewey
Vice President–Overseas Operations

William E. Kirchner
Vice President–Product Development
and Advertising

Sing F. Lo
Vice President–Management
Information Systems

Robert S. Rose
Vice President–Distribution and
Operations

Timothy J. Schugel
Controller and Principal
Accounting Officer

Joan M. Serena
Vice President–Consumer Services

STOCKHOLDER INFORMATION

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

Transfer Agent
Chemical Bank
450 West 33rd Street
New York, NY 10001

Attorneys
Fried, Frank, Harris, Shriver &
Jacobson

Independent Accountants
Deloitte & Touche LLP

Stock Listing
New York Stock Exchange Symbol
"DFS"

Annual Meeting
10:00 a.m.
May 18, 1995
Chemical Bank
270 Park Avenue
New York, NY

Department 56, Inc. Market Price (Per Share)

1994	High	Low
First Quarter	$35	$26
Second Quarter	$33⅞	$26¾
Third Quarter	$39	$31½
Fourth Quarter	$40	$34
1993		
Second Quarter	$24	$18⅝
Third Quarter	$27	$21⅞
Fourth Quarter	$29⅞	$24⅛

Copies of Department 56's annual report to the Securities and Exchange Commission on Form 10-K may be obtained without charge by contacting Investor Relations, Department 56, Inc., (612) 944-5600.

As of February 21, 1995, there were 723 record holders of the Company's common stock.

Department 56, Inc. and its subsidiaries employ more than 200 persons worldwide.

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Department 56 INC

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

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EXHIBIT 21.1

Exhibit 21.1

SUBSIDIARIES OF THE COMPANY

Name of Subsidiary	Jurisdiction of Organizaton
FL56 Intermediate Corp.	Delaware
ed bazinet international, inc.	Minnesota
D 56, Inc.	Minnesota
Department 56 Trading Co., Ltd.	Delaware
Browndale Tanley Limited	Hong Kong