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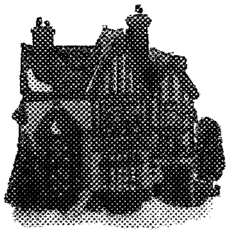
DEPARTMENT 56, INC.

1995 Annual Report



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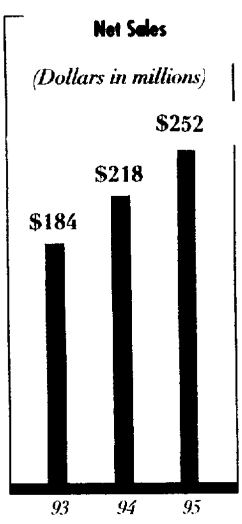
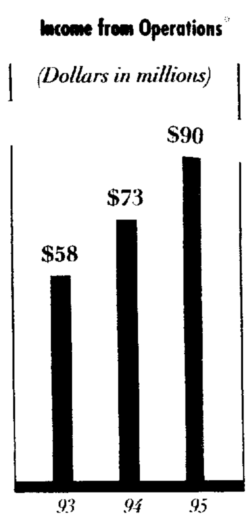
Building on Tradition

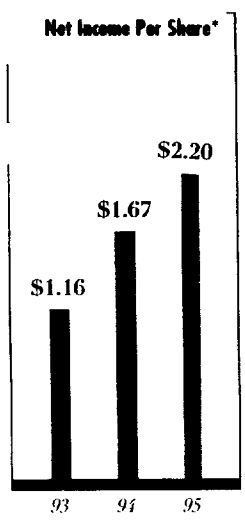
Department 56, Inc., is a leading designer and marketer of lighted ceramic and porcelain houses and accessories, and an extensive array of holiday and decorative products for the home. We partner with manufacturers to cost-effectively produce fine-quality, handcrafted products, which are sold through more than 19,000 leading gift, home accessory, specialty and department store retailers across the United States. Founded in 1976, Department 56 is headquartered in Eden Prairie, Minnesota, and employs over 200 people worldwide.

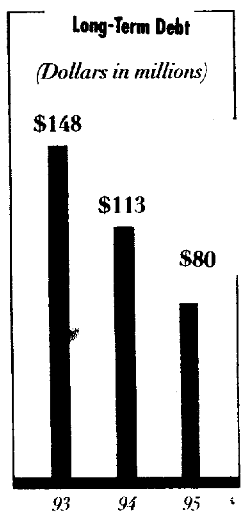
Financial Highlights

(Dollars in thousands, except per share amounts)	*1995*	*1994*	*1993*
Net Sales	$252,047	$217,865	$184,359
Income From Operations*	89,573	72,977	57,783
Net Income*	47,856	36,099	24,997
Net Income Per Share*	2.20	1.67	1.16
Working Capital	$ 36,015	$ 13,362	$ 26,392
Total Assets	259,085	239,680	234,893
Long-Term Debt	80,000	113,000	148,000
Stockholders' Equity	150,286	100,305	61,731





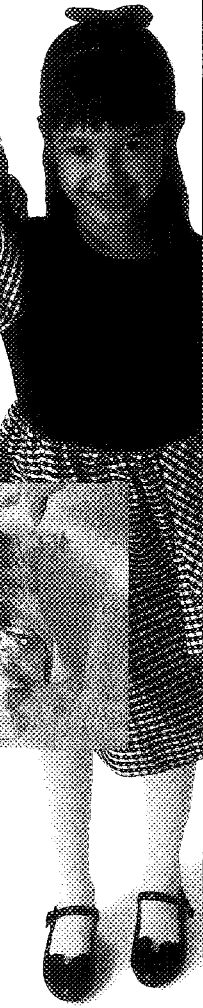




* *1995 income from operations excludes recovery of import duties, and 1995 net income and net income per share also exclude the extraordinary charge due to debt refinancing.*

Product Overview

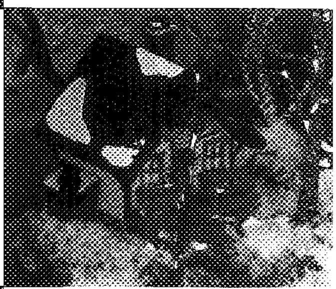
Department 56 currently offers more than 2,000 products of which more than 25% are new in 1996. Our annual product introductions and retirements create continuity and vitality among our core product lines, including lighted Village houses and accessories, Snowbabies and Snowbunnies.



Villages

1995 SALES: $175.1 MILLION DEALERS: 5,400

Snow Village



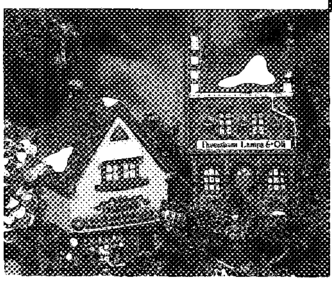
Snow Village

Introduced	1976
Total Lighted Pieces	190
Current Lighted Pieces	39
Retired Lighted Pieces	151

Village Accessories

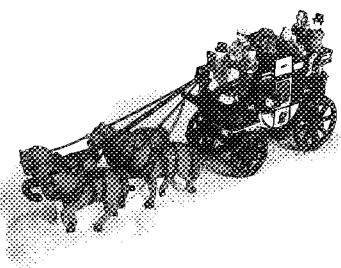
Current Pieces	268
Retired Pieces	149

Heritage Village



HERITAGE VILLAGE COLLECTION

Introduced	1984
Total Lighted Pieces	215
Current Lighted Pieces	100
Retired Lighted Pieces	115

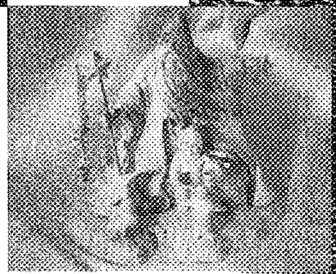


- The Dickens' Village Series
- The New England Village Series
- The Alpine Village Series
- The Little Town of Bethlehem Series
- The Christmas in the City Series
- The North Pole Series
- Disney Parks Village Series

Giftware

1995 SALES: $76.9 MILLION DEALERS: 19,400

Collectible Figurines



Snowbabies.

Introduced	1986
Total Bisque Pieces	91
Current Bisque Pieces	50
Retired Bisque Pieces	41

Snowbunnies.

Introduced	1994
Total Pieces	27
Current Pieces	27
Retired Pieces	0

Christmas Trim

Current Major Lines

- Angelica
- Mercury Glass
- Noel
- Sugar & Spice

Everyday

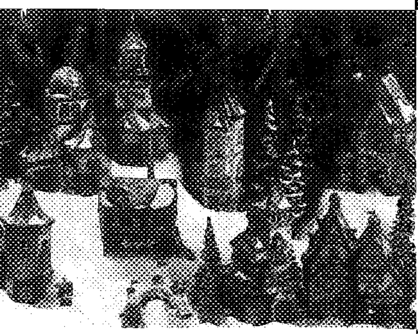
Current Major Lines

- Coffee Break
- Rooster
- Silver Collection

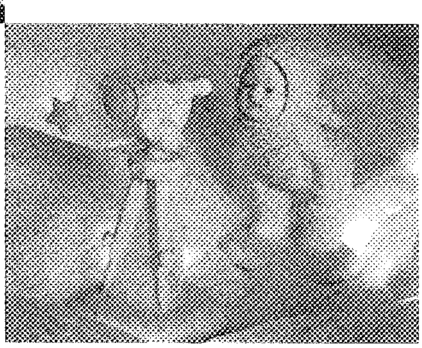
To our Shareholders

The Department 56 tradition of growth, innovation, and quality continued to build in fiscal 1995. *We are proud of the role we play in helping families create their own traditions and decorate their homes for the holidays.*

Exceptional Financial Performance



Department 56 earnings for the fiscal year ended December 31, 1995, increased 32 percent to $47.9 million, or $2.20 per share, compared with fiscal 1994 earnings of $36.1 million, or $1.67 per share, before an extraordinary charge of $1.3 million in the first quarter of 1995 and excluding the effect of a $2.9 million net import duty refund. Net sales rose 16 percent, totaling $252 million versus $218 million in the prior year. Our collectible Village Products accounted for 69 percent of total sales. General giftware, which includes Snowbabies, other collectible products, holiday trim lines and home decorative accessories, accounted for the remaining 31 percent of sales.

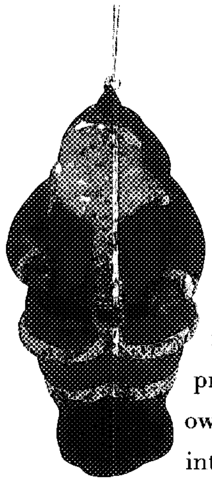


As baby boomers continue to focus on family and home, their interests — along with a passion for nostalgia and tradition — are poised to sustain a growing collectibles market.

Several factors contributed to a higher earnings rate this year. Gross margins significantly improved due to the favorable effects of the GATT agreement and continued benefits from manufacturing efficiencies. In addition, we further leveraged our amortization of goodwill and obtained interest expense savings by applying our strong cash flow to pay down debt.

Building Homes for the Holidays

Department 56 has been building holiday traditions with families for nearly 20 years, whether it be through ornaments on the tree, collectibles throughout the house, or lighted villages carefully created from our extensive assortment of houses and accessories. In the pages that follow, we discuss three overlapping segments of consumers decorators, gift-givers and collectors who enjoy our products in many ways. Decorators find the villages appealing for the warmth that just a few pieces can add to their homes during the holiday season. Consumers give and receive village



Our original designs and worldwide sourcing capabilities have helped establish Department 56 as a market leader in holiday trim lines.

pieces year-round as gifts for any occasion, thus introducing family and friends to the joy of creating their own holiday traditions. Collectors become involved in the detail and nostalgia of displaying their villages which can range from a few in number to hundreds of pieces.

Our unique product designs and sourcing capabilities, coupled with our dedicated dealer network, give Department 56 important competitive advantages. First, our ability to design proprietary product lines puts us in a select class of companies that create value through their own creative energies. As a result, we are able to constantly revitalize our offerings through new introductions and retirements. Second, the continuity and breadth of our product lines have contributed to making them part of consumers' traditions. Third, relationships we have developed with suppliers enable us to source increasingly intricate, yet affordable, pieces. Fourth, our strategy of limited distribution encourages our retail partners to devote attention to displaying our products and serving consumers to a degree unequaled in the industry.

Continuing the Traditions

We have built one of the premier consumer products companies in America, yet a large, untapped market still exists for our products. Only a small percentage of American households or collectors own lighted villages like those produced by Department 56. We will continue to expand our marketing initiatives to reach new consumers.

In the fall of 1995, we undertook our most comprehensive and successful marketing program ever, appropriately called "Homes for the Holidays." The objectives of the program included providing current consumers with a means to help others start their own traditions and enticing new collectors to start a tradition for themselves. Our "Start A Tradition Set," a ready-to-display ensemble of houses, accessories and trees was overwhelmingly received in the marketplace.

Our Homes for the Holidays campaign was energized by the involvement of World and Olympic Figure Skating Champion and long-time collector Dorothy Hamill, as well as our efforts to support all 142 Ronald McDonald Houses in North America. Together with our participating dealers, we contributed almost $500,000, including the decoration of each Ronald McDonald House with our North Pole Series.

Building the Tradition in 1996

To further strengthen the integrity of our collectible products, early in 1996 we re-evaluated our distribution network. We also initiated a program to help dealers better balance store-level inventories after several years of substantial growth. Even though these actions may have a financial impact in 1996, we believe strongly that both are in the best long-term interest of our retailers, consumers and shareholders and will further strengthen our franchise and position us for continued long-term growth.

We wish to thank our dealers, suppliers, employees and you, our shareholders, for your continued interest and support.

Sincerely,

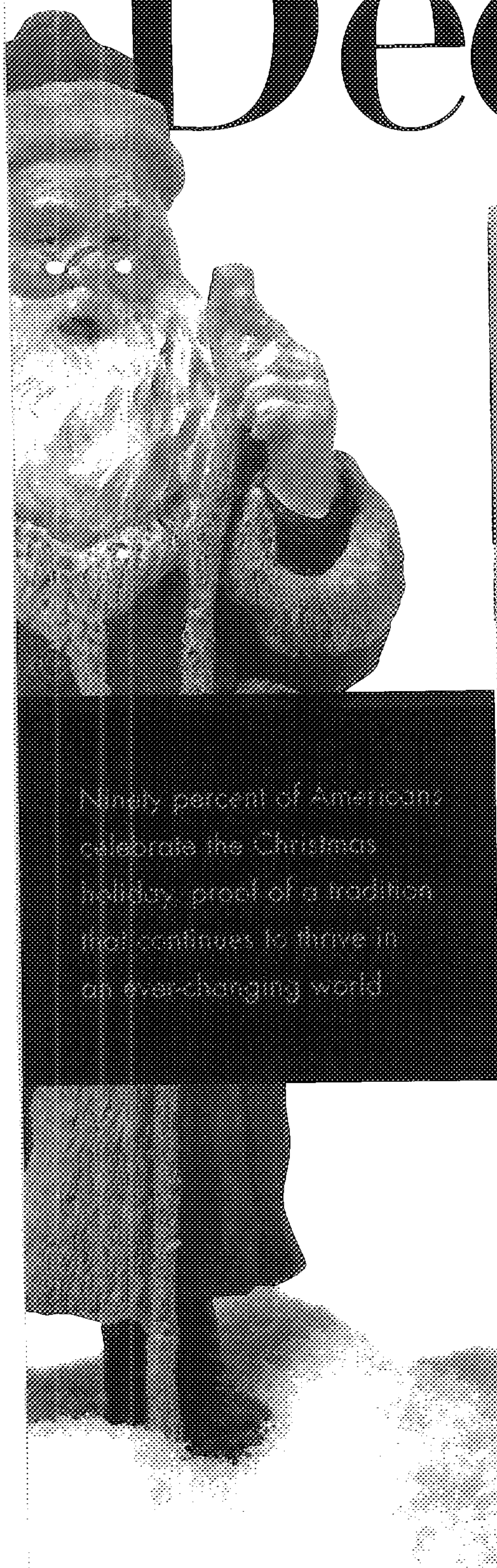
Edward R. Bazinet

Edward R. Bazinet
Chairman and Chief Executive Officer

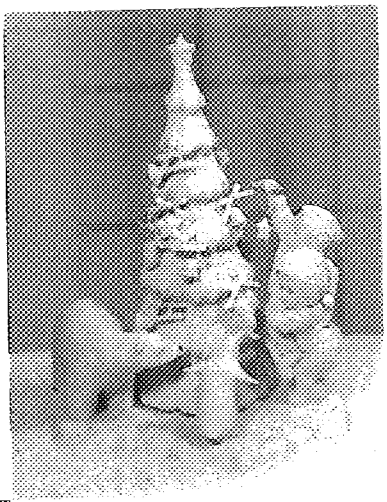
Susan E. Engel

Susan E. Engel
President and Chief Operating Officer

Decorating



Ninety percent of Americans celebrate the Christmas holiday, proof of a tradition that continues to thrive in an ever-changing world.



A broad segment of buyers purchase our Villages, Christmas trim lines and other collectibles *based on their appeal as expressions of the holiday season.*

Villages offer an endless number of decorating ideas for any area of a home.

Whether displaying a few lighted houses on the mantle, adding to a Santa collection or creating a winter Snowbabies scene, more and more families are celebrating with traditions from Department 56.

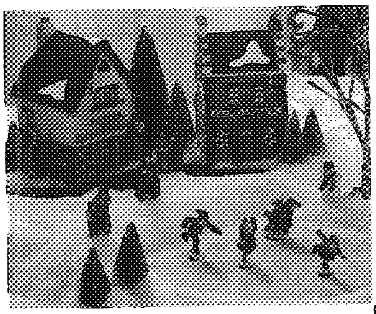
Each year, millions of consumers renew the tradition of decorating their homes for the holidays. This seasonal celebration represents a substantial growth opportunity for Department 56.

Department 56 offers more than 2,000 uniquely styled products designed to appeal to a wide range of consumers.

Our core product strengths are key to building sales among established, as well as potential new, consumers. Many holiday decorators already have come to value the trademark styles and intricate detail unique to Department 56 products, and this high regard for our products translates into repeat purchases.

A comprehensive marketing effort to attract new consumers positions Department 56 as the holiday decorating expert, and demonstrates the many ways our products contribute to lasting holiday traditions. Through brochures, videos and other marketing programs, we provide over 19,000 authorized dealers and their consumers with attractive and affordable ideas for using Department 56 products throughout the house.

Gift Giving



Our 1995 "Start A Tradition Set" featured two lighted houses and all the trimmings to create a holiday scene.

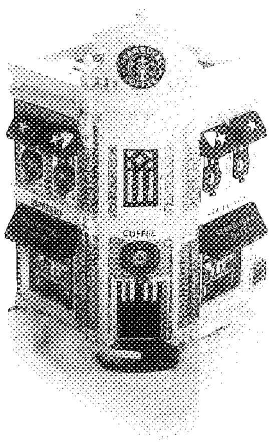
Our ability to market Department 56 products as gifts is a powerful tool in expanding our consumer base. *Our goal in this multi-billion dollar segment is to create year-round Department 56 gift-giving traditions.*

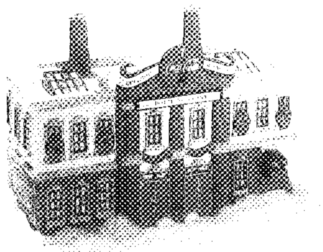
"Snowbunnies" have met with overwhelming demand since the line's 1994 introduction and have become an important category and popular springtime gift.

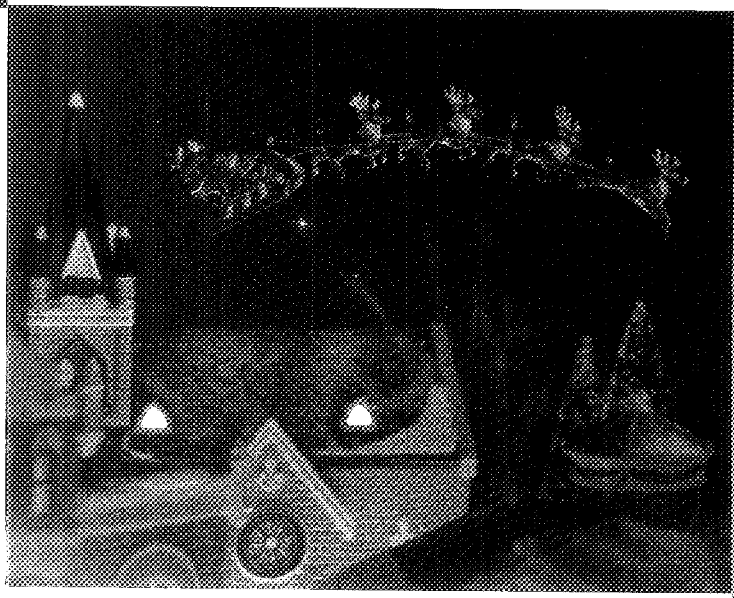
Nearly two-thirds of our collectors say they received their first Village piece as a gift.

The Original Snow Village contains all the nostalgia and variety of a vibrant "Main Street USA." Products in this line make ideal gifts for memorabilia collectors.

Animated products like "Up, Up & Away" bring Village scenes to life. These products are the [illegible] any of our themed Villages and are often given as gifts.







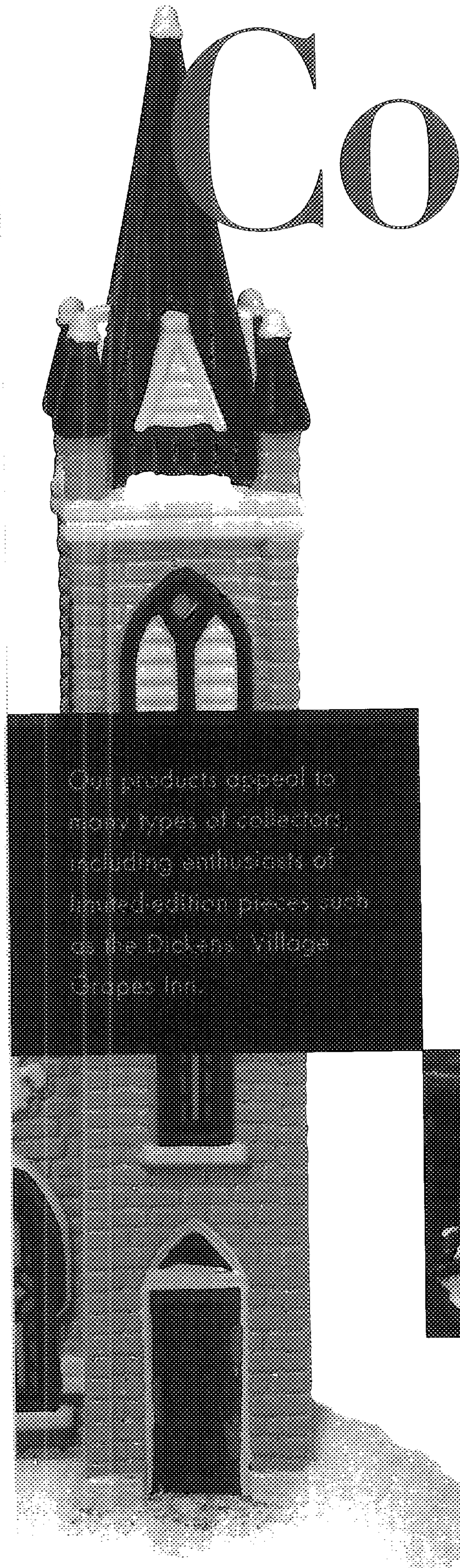
We offer a variety of gift opportunities for consumers, with a broad range of distinctive products and price points.

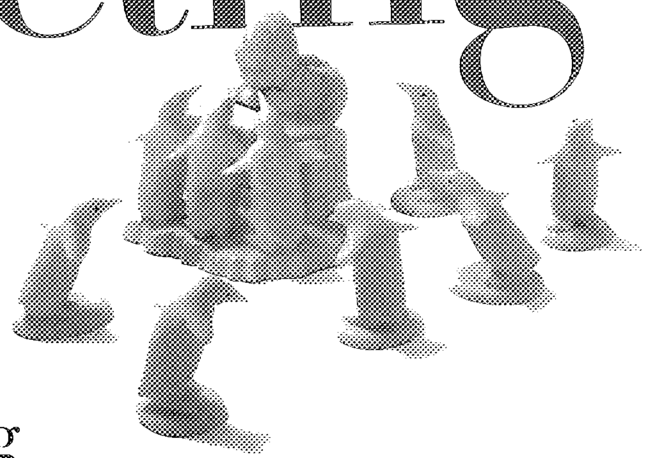
Over the years, Department 56 products have become desirable gifts for many consumers. Our unique product makes gift giving easy and satisfying, supporting a marketing strategy to introduce new families to the Department 56 tradition.

We do this by designing product lines that appeal to a wide range of ages, occupations, interests and hobbies. We also create specially packaged product sets. As part of our "Homes for the Holidays" promotion, we introduced a 13-piece "Start A Tradition Set," complete with two new houses for the Dickens' Village, porcelain accessories, road, trees and snow. The set was overwhelmingly successful among first-time buyers, holiday decorators and avid Village collectors, with approximately 20 percent purchasing two or more sets.

Our authorized dealers nationwide are receiving new marketing tools to help introduce their customers, including current collectors and holiday decorators, to the endless number of gifts available from Department 56. It's our experience that, once introduced, consumers come to appreciate the unique design and fine quality of our product lines, which leads to repeat gift purchases.

Collecting





Almost 20 years after introducing the first lighted houses, *our Villages continue to offer endless potential for unique, new products.*

Our products appeal to many types of collectors, including enthusiasts of limited-edition pieces such as the Dickens' Village Grapes Inn.

Our brands are highly regarded throughout the industry, and our authorized dealers represent many of the country's finest retailers. With these resources and an outstanding product we are well positioned to increase our share of the collectibles market, furthering our prospects for long-term growth.

Among all the people who collect, many begin as holiday decorators, or they may give or receive our products as gifts. Over time, some of these consumers move from casual buyers to brand enthusiasts.

Consumers who actively identify themselves as collectors are one of the most important constituencies in our

$7.2 billion industry. Collectors appreciate the enduring design, handcrafted detail and affordable prices they find in Department 56 products. Continuing improvements in our manufacturing process are allowing for even greater design complexity.

Product design and distinctiveness are essential to meet the needs of avid collectors. Our annual product introductions and retirements are much anticipated events in the collecting community. In addition, we periodically offer limited-edition pieces, as well as event pieces for key dealers.

We also publish the *Quarterly*, a top quality magazine, that informs our consumers of new product introductions, as well as, the history, tradition and decorative uses of our products. It is distributed to more than 140,000 dealers and collectors. This publication reinforces our relationships with our valued consumers.

We are confident that Department 56 products have achieved only a fraction of their market potential. With significant untapped opportunities, our emphasis on product innovation, strong marketing strategies and sound financial management will allow us to continue building our tradition of growth.

The appeal of nostalgia and tradition is woven throughout the Department 56 product line and will be a cornerstone to its continued growth.

Five Year Summary

In thousands, except per share amounts	Company					Predecessor Company	
	Year ended Dec. 30, 1995 [1]	*Year ended Dec. 31, 1994* [1]	*Year ended Jan. 1, 1994* [1]	*Year ended Jan. 2, 1993* [1,2]	*Oct. 4, 1992 – Jan. 2, 1993*	*Dec. 29, 1991 – Oct. 3, 1992*	*Year ended Dec. 28, 1991* [1]
STATEMENTS OF OPERATIONS				*pro forma for the Acquisition*			
Net sales	$252.047	$217.865	$184.359	$150.754	$ 24.600	$125.713	$121.712
Cost of sales	110.008	98.480	87.331	74.958	12.967	62.485	60.848
Gross profit	142.039	119.385	97.028	75.796	11.633	63.228	60.864
Operating expenses:							
Selling, general and administrative	47.889	41.831	34.670	29.151	7.537	20.678	23.187
Performance bonuses[3]	—	—	—	450		6.658	5.654
Amortization of goodwill and trademarks	4.577	4.577	4.575	4.568	1.150		
Nonrecurring charges[4]	—	—	—			28.350	
Recovery of import duties[5]	(2.872)	—	—	—			
Total operating expenses	49.594	46.408	39.245	34.169	8.687	55.686	28.841
Income from operations	92.445	72.977	57.783	41.627	2.946	7.542	32.023
Other expense (income):							
Interest expense	9.582	12.629	16.143	16.339	4.341	790	1.134
Other, net	(439)	(837)	(1.030)	(1.044)	(304)	(503)	(777)
Income (loss) before income taxes and extraordinary item	83.302	61.185	42.670	26.332	1.091	7.255	31.666
Provision (benefit) for income taxes	33.737	25.086	17.673	11.168	24	6.887	11.552
Income (loss) before extraordinary item	49.565	36.099	24.997	15.164	1.067	368	20.114
Extraordinary charge due to refinancing of debt[6]	1.312						
Net income (loss)	$ 48.253	$ 36.099	$ 24.997	$ 15.164	$ 1.067	$ 368	$ 20.114
Income (loss) before extraordinary item per share	$ 2.28	$ 1.67	$ 1.16	$ .70	$ .05		
Net income (loss) per share	$ 2.22	$ 1.67	$ 1.16	$ .70	$ .05		

	Dec. 30, 1995	*Dec. 31, 1994*	*Jan. 1, 1994*		*Jan. 2, 1993*		*Dec. 28, 1991*
BALANCE SHEET DATA							
Working capital	$ 36.015	$ 13.362	$ 26.392		$ 61.697		$34.138
Total assets	259.085	239.680	234.893		275.370		61.751
Long-term debt, including current maturities	80.000	113.000	148.000		213.000		5.051
Total stockholders' equity[7]	150.286	100.305	61.731		37.158		41.382

[1] *The years ended December 28, 1991, January 1, 1994, December 31, 1994 and December 30, 1995 were 52-week periods and the year ended January 2, 1993 was a 53-week period.*

[2] *In October 1992, D 56, Inc., the principal operating subsidiary of the Company (the "Predecessor Company"), was acquired by corporations formed by affiliates of Forstmann Little & Co. (the "Acquisition"). 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.*

[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.*

[4] *Nonrecurring charges include payments to terminate employment contracts, special bonuses and costs incurred by the Predecessor Company in connection with the Acquisition.*

[5] *Reflects a refund of custom duties and interest that the Company received related to certain merchandise imported into the United States from 1989 to 1994. (See Note 8 to the Consolidated Financial Statements).*

[6] *Reflects an extraordinary charge the Company incurred in connection with its refinancing of debt. (See Note 4 to the Consolidated Financial Statements).*

[7] *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. 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.*

Results of Operations

Comparison of Results of Operations
1995 to 1994

Net Sales Net sales increased $34.2 million, or 16%, from $217.9 million in 1994 to $252.0 million in 1995. This increase was due principally to an increase in volume. Sales of Village Series products increased 17% from 1994 to 1995, while General Giftware product sales increased 12% during the same period. Village Series products continued to account for the most significant portion of the Company's sales, 69% in both 1995 and 1994.

The increase in the sales volume of Village Series products during 1995 resulted from continued strong customer demand which was supported by the introduction of new lighted pieces. As a result, the Company continued its policy of allocating the amount of Village Series products customers were allowed to purchase in both 1994 and 1995, 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.

In General Giftware products, sales increased at a lower rate than the Company's overall sales due principally to a reduction in the growth rate of the Company's Christmas Trim products. The Company 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 $22.7 million, or 19%, between 1994 and 1995. Gross profit as a percentage of sales increased from approximately 55% in 1994 to approximately 56% in 1995, principally as a result of reduced import duties resulting from the United States' implementation of GATT, effective January 1, 1995, and certain manufacturing efficiencies.

Selling, General and Administrative Expenses Selling, general and administrative expenses increased $6.1 million, or 14%, between 1994 and 1995, 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 typically vary in proportion to the Company's sales.

	1995		1994		1993	
In millions, except per share amounts	*Dollars*	*Percent of Net Sales*	*Dollars*	*Percent of Net Sales*	*Dollars*	*Percent of Net Sales*
Net sales	$252.0	100%	$217.9	100%	$184.4	100%
Gross profit	142.0	56	119.4	55	97.0	53
Selling, general and administrative expenses	47.9	19	41.8	19	34.7	19
Amortization of goodwill and trademarks	4.6	2	4.6	2	4.6	2
Recovery of import duties	2.9	1				
Income from operations	92.4	37	73.0	33	57.8	31
Interest expense	9.6	4	12.6	6	16.1	9
Other, net	.4	—	.8		1.0	1
Income before income taxes and extraordinary item	83.3	33	61.2	28	42.7	23
Provision for income taxes	33.7	13	25.1	12	17.7	10
Income before extraordinary item	49.6	20	36.1	17	25.0	14
Extraordinary charge due to refinancing of debt	1.3	1				
Net income	48.3	19	36.1	17	25.0	14
Income before extraordinary item per share	2.28		1.67		1.16	
Net income per share	2.22		1.67		1.16	
Operating cash flow[1]	99.1		79.7		64.4	

[1] *Earnings before interest, income tax, depreciation and amortization expenses.*

Management's Discussion and Analysis

Recovery of Import Duties The Company received a net refund of $2.9 million in custom duties and related interest during 1995. The duties pertained to certain merchandise imported into the United States from 1989 to 1994.

Income from Operations Income from operations increased $19.5 million, or 27%, from 1994 to 1995 due to the factors described above. Operating margins increased from 33% of net sales in 1994 to 37% of net sales in 1995.

Interest Expense Interest expense decreased $3.0 million, or 24%, between 1994 and 1995 due to the prepayment of $40 million of long-term debt on December 31, 1994.

Provision for Income Taxes The effective income tax rate was 41.0% and 40.5% during 1994 and 1995, respectively.

Extraordinary Charge due to Refinancing of Debt The Company refinanced its long-term debt in February 1995. In connection therewith, the Company recorded an extraordinary charge of $1.3 million, net of a tax benefit of $0.9 million, or $0.06 per share.

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 General 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. 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.

In General Giftware products, sales increased at a lower rate than the Company's overall sales. The Company 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 long-term debt on December 31, 1993.

Provision for Income Taxes The effective income tax rate was 41.4% and 41.0% during 1993 and 1994, respectively.

Seasonality

Historically, principally due to the timing of wholesale trade shows early in the calendar year and the limited supply of the Company's products, the Company has received the majority of its total annual customer orders during the first quarter of each year. The Company entered 76% of its total annual customer orders for 1995 and 1994, during the first quarter of each of those years. Cancellations of total annual customer orders were approximately 7% and 5% in 1995 and 1994, respectively. The Company's backlog was $11.0 million and $8.4 million at December 30, 1995 and December 31, 1994, respectively.

The Company shipped and recorded as net sales approximately 91% and 92% of its annual customer orders in 1995 and 1994, 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, the Company generally records its highest sales during the second and third quarters of each year and expects this 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. See "Recent Developments."

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 recorded 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 in

	1995					1994				
In millions, except per share amounts	*1st Qtr.*	*2nd Qtr.*	*3rd Qtr.*	*4th Qtr.*	*Total*	*1st Qtr.*	*2nd Qtr.*	*3rd Qtr.*	*4th Qtr.*	*Total*
Customer orders entered[1]	$209.9	$30.0	$27.3	$8.6	$275.8	$181.0	$27.0	$20.2	$ 8.9	$237.1
Net sales	53.0	74.8	77.0	47.2	252.0	45.5	64.4	66.4	41.6	217.9
Gross profit	29.7	42.4	43.6	26.3	142.0	24.6	35.4	36.4	23.0	119.4
Selling, general and administrative expenses	10.0	12.2	11.8	13.9	47.9	8.8	10.8	10.5	11.7	41.8
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
Recovery of import duties			2.8	.1	2.9					
Income from operations	18.5	29.1	33.4	11.4	92.4	14.7	23.5	24.7	10.1	73.0
Income before extraordinary item	9.9	15.9	18.2	5.6	49.6	7.1	12.0	12.8	4.2	36.1
Net income	8.6	15.9	18.2	5.6	48.3	7.1	12.0	12.8	4.2	36.1
Income before extraordinary item per share	0.46	0.73	0.84	0.25	2.28	0.33	0.56	0.59	0.19	1.67
Net income per share	0.40	0.73	0.84	0.25	2.22	0.33	0.56	0.59	0.19	1.67

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

December of each year, commencing in 1995. The Company believes that its internally generated cash flow and seasonal borrowings under the revolving line of credit will be 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., the Company's principal operating subsidiary, is required to satisfy consolidated net worth, interest coverage ratio and current ratio tests, in each case at the end of each fiscal quarter. The available borrowings under the revolving line of credit were $84,960,000 at December 30, 1995.

Consistent with customary practice in the giftware industry, the Company offers extended accounts receivable terms to many of its customers. This practice has typically created significant working capital requirements in the second and third quarters which the Company has generally financed with available cash, internally generated cash flow and seasonal borrowings. The Company's bad debt experience relating to these accounts receivable has not been material.

The Company's net cash balances peak in December, following the collection in November and December of accounts receivable with extended payment terms. At December 30, 1995, cash and cash equivalents balances were $7.8 million as compared to $2.2 million at December 31, 1994.

Accounts receivable increased from $24.0 million at December 31, 1994 to $34.3 million at December 30, 1995 principally as a result of increased volume, a larger amount of receivables qualifying for December dating terms, and a small change in payment patterns.

During 1995, the Company increased its production capacity, resulting in higher inventory levels than experienced in 1994. The Company believes that, even with this increase, its overall inventory turnover rate is higher than or equal to that of other large U.S. giftware companies, and that higher inventory levels can enable the Company to better serve its customers. Inventories increased from $20.4 million at December 31, 1994 to $29.1 million at December 30, 1995.

Capital expenditures were $1.6 million, $2.6 million and $1.3 million for 1995, 1994 and 1993, respectively.

Operating cash flow, defined as earnings before interest, income tax, depreciation and amortization expenses, increased $19.4 million, or 24%, from $79.7 million in 1994 to $99.1 million in 1995. The increase was principally due to the increase in income before income taxes.

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 $27.375 per share and received net cash proceeds from the offering of approximately $150.3 million.

On May 15, 1995 and on May 23, 1995, the Forstmann Little Partnerships and a member of senior management completed a public offering of 5.75 million shares of the Company's common stock at a price of $37.625 and received net cash proceeds from the offering of approximately $207.7 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 30, 1995, the Company had $35.0 million of foreign exchange contracts outstanding to hedge 1996 Taiwan dollar denominated inventory purchases. These contracts mature from January 1996 through November 1996 at a rate of approximately 27.00 NTS/US$.

Effect of Inflation

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

Recent Developments

On February 12, 1996, the Company issued a press release stating, in relevant part: "Department 56 also announced the implementation of several steps to further strengthen the quality of its distribution, protect its premium brand equity and reinforce its long-term market prospects. The Company implemented an inventory management initiative to help dealers better balance store-level inventories after several years of high growth, and to assist the Company in fine-tuning its collectible products allocation policy, helping dealers carry appropriate inventory levels. In addition, the Company has terminated approximately 50 accounts, including one of its largest department store customers, that in 1995 violated the Company's collectible merchandising guidelines.

These actions, which facilitated a rebalancing of dealer inventory levels, are expected to have a negative effect on first-quarter 1996 orders, which are projected to be approximately 10% lower than during the same period in 1995. Even so, full year earnings for 1996 are expected to equal or exceed 1995 earnings. Actual results may vary from these forecasts."

The Private Securities Litigation Reform Act of 1995 (the "Act") provides "safe harbor" status to certain statements that go beyond historical information and which may provide an indication of future results. The press release further stated: "The statements in this press release relating to matters that are not historical facts are forward-looking statements that involve risks and uncertainties.

Among others, the forecast set forth in this press release regarding first quarter 1996 orders is based on the following assumptions:

- The order trend experience on orders received from existing and new customers from the beginning of 1996 to date will continue with respect to accounts of similar type through the end of the first quarter of 1996
- The number, mix and timing of customers ordering during the first quarter of 1996 will be similar to that experienced during the first quarter 1995
- General and giftware-industry economic conditions will remain stable

Among others, the forecast set forth in this press release regarding 1996 earnings is based on the following assumptions:

- The 1996 first quarter order forecast set forth in the press release will be realized
- Annual sales will be more favorable than the actual first quarter order rate would historically suggest
- Customer orders for 1996 mid-year product introductions and response to 1996 marketing programs will be at least at historical levels
- Reorder and order cancellation rates will be at least as favorable as historical levels
- There will be a slight increase in gross and net margin rate
- Selling, general and administrative expense rate (relative to net sales) will be consistent overall with 1995 levels other than for the effect of an anticipated increase in marketing expense
- The application of corporate cash flow will benefit earnings
- The regulatory and trade environment will remain stable

Actual results may vary materially from these forecasts and the assumptions on which they are based. The forward-looking statements in this press release speak as of this date only, and the Company undertakes no obligation to update such forward-looking statements or publish any forward-looking statements in the future."

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 Audit Committee meets with the independent auditors and management to discuss audit scope and results and to consider internal control and financial reporting matters. The independent auditors have direct unrestricted access to the Audit Committee. The entire Board of Directors reviews the Company's financial performance and financial plan.

Edward R. Bazinet
Chief Executive Officer

Susan E. Engel
Chief Operating Officer

Consolidated Balance Sheets

(In thousands, except per share amounts)	December 30, 1995	December 31, 1994
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 7,805	$ 2,180
Accounts receivable, net of allowances of $6,884 and $5,232, respectively	34,271	23,959
Inventories	29,059	20,366
Deferred taxes	4,476	3,161
Other current assets	2,068	2,723
Total current assets	77,679	52,389
Property and equipment, net	12,445	12,330
Goodwill, net of accumulated amortization of $13,425 and $9,295, respectively	151,749	155,878
Trademarks, net of accumulated amortization of $1,454 and $1,007, respectively	16,446	16,893
Other assets	766	2,190
	$259,085	$239,680
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Current portion of long-term debt	$ 20,000	$ 20,000
Accounts payable	6,599	5,157
Commissions payable	4,471	4,209
Accrued interest	151	646
Other current liabilities	10,443	9,015
Total current liabilities	41,664	39,027
Deferred taxes	7,135	7,348
Long-term debt	60,000	93,000
Commitments and contingencies (note 6)		
Stockholders' Equity:		
Preferred stock, $.01 par value; authorized 20,000 shares; no shares issued	—	—
Common stock, $.01 par value; authorized 100,000 shares; issued and outstanding 21,546 and 21,475 shares, respectively	215	215
Additional paid-in capital	41,803	40,244
Unearned compensation on common stock options	(14)	(183)
Retained earnings	108,282	60,029
Total stockholders' equity	150,286	100,305
	$259,085	$239,680

See notes to consolidated financial statements.

Consolidated Statements of Income

(In thousands, except per share amounts)	Year ended December 30, 1995	Year ended December 31, 1994	Year ended January 1, 1994
Net sales	$252,047	$217,865	$184,359
Cost of sales	110,008	98,480	87,331
Gross profit	142,039	119,385	97,028
Operating expenses:			
Selling, general and administrative	47,889	41,831	34,670
Amortization of goodwill and trademarks	4,577	4,577	4,575
Recovery of import duties	(2,872)	—	—
Total operating expenses	49,594	46,408	39,245
Income from operations	92,445	72,977	57,783
Other expense (income):			
Interest expense	9,582	12,629	16,143
Other, net	(439)	(837)	(1,030)
Income before income taxes and extraordinary item	83,302	61,185	42,670
Provision for income taxes	33,737	25,086	17,673
Income before extraordinary item	49,565	36,099	24,997
Extraordinary charge due to refinancing of debt	1,312	—	—
Net income	$ 48,253	$ 36,099	$ 24,997
Income before extraordinary item per share	$ 2.28	$ 1.67	$ 1.16
Net income per share	$ 2.22	$ 1.67	$ 1.16
Weighted average common and common equivalent shares outstanding	21,747	21,649	21,544

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

(In thousands)	Year ended December 30, 1995	Year ended December 31, 1994	Year ended January 1, 1994
Cash Flows from Operating Activities:			
Net income	$ 48,253	S 36,099	$ 24,997
Adjustments to reconcile net income to net cash provided by operating activities:			
Extraordinary charge	1,312	—	—
Depreciation	1,609	1,296	1,037
Amortization of goodwill, trademarks and other intangible assets	4,577	5,254	5,243
Provision for uncollectible accounts receivable	2,293	1,107	1,922
Compensation expense—common stock options	169	498	829
Deferred taxes	(1,528)	203	(682)
Changes in assets and liabilities:			
Accounts receivable	(12,605)	(11,511)	(3,590)
Inventories	(8,693)	(2,971)	(719)
Other assets	520	(361)	(2,299)
Accounts payable	1,442	11	(1,331)
Commissions payable	262	590	1,369
Accrued interest	(495)	(224)	(2,284)
Other current liabilities	2,261	1,403	698
Net cash provided by operating activities	39,377	31,394	25,190
Cash Flows from Investing Activities:			
Sales of marketable securities	—	—	9,870
Purchases of property and equipment	(1,617)	(2,621)	(1,296)
Net cash provided by (used in) investing activities	(1,617)	(2,621)	8,574
Cash Flows from Financing Activities:			
Proceeds from the exercise of common stock options	865	1,041	247
Borrowings on revolving credit agreement	36,500	97,577	—
Principal payments on revolving credit agreement	(41,500)	(92,577)	—
Proceeds from issuance of long-term debt	100,000	—	—
Principal payments on long-term debt	(128,000)	(40,000)	(65,000)
Net cash used in financing activities	(32,135)	(33,959)	(64,753)
Net increase (decrease) in cash and cash equivalents	5,625	(5,186)	(30,989)
Cash and cash equivalents at beginning of period	2,180	7,366	38,355
Cash and cash equivalents at end of period	$ 7,805	$ 2,180	S 7,366

See notes to consolidated financial statements.

Consolidated Statements of Stockholders' Equity

(In thousands)	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Unearned Compensation on Common Stock Options	Retained Earnings (Deficit)	Total Stockholders' Equity
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
Net income	–	–	–	–	48,253	48,253
Shares issued upon the exercise of common stock options	71	–	1,559	–	–	1,559
Common stock options vested	–	–	–	169	–	169
Balance as of December 30, 1995	21,546	$215	$41,803	$ (14)	$108,282	$150,286

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

(In thousands, except share and per share amounts)

Summary of Significant Accounting Policies

Business The Company is engaged in the original design, importation, and wholesale distribution of specialty giftware products. The majority of the Company's products are developed by the Company's in-house creative team and are manufactured for the Company by independently-owned foreign manufacturers located primarily in the Pacific Rim. The Company's customer base and accounts receivable are primarily 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., Browndale Tanley Limited and Department 56 Trading Co., Ltd., all of which are wholly owned. All significant intercompany accounts and transactions have been eliminated in consolidation.

Fiscal Year End The Company's policy is to end its fiscal year on the Saturday closest to December 31. The years ended January 1, 1994, December 31, 1994, and December 30, 1995 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 China, 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 cost over the fair value of acquired net assets of the Company at the acquisition date and is being amortized on a straight-line basis over 40 years. The Company periodically evaluates the recoverability of goodwill based on an analysis of estimated future undiscounted cash flows.

Trademarks Trademarks acquired 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.

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

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

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

Foreign Exchange Contracts The Company imports certain product from Taiwan. To hedge its foreign exchange exposure, the Company may enter into foreign exchange contracts. The foreign exchange contracts reduce the Company's overall exposure to exchange rate movements, since the gains and losses on these contracts offset gains and losses on the transaction being hedged. At December 30, 1995, the Company had nondeliverable Taiwan currency forward contracts with a notional amount of $35,000 which mature from January 1996 to November 1996. At December 30, 1995, the Company had deferred losses of $77 in connection with these contracts. These losses will be recognized and included in cost of sales at the time the related inventory is sold. The Company is exposed to credit risk to the extent of nonperformance by a counterparty to the foreign currency contracts. However, the Company believes it uses a strong financial counterparty in these transactions and that the resulting credit risk under these hedging strategies is not significant.

Fair Value of Financial Instruments The carrying amount of cash and cash equivalents, accounts receivable, accounts payable, and commissions payable approximates fair value because of the short-term nature of these instruments. Based on the borrowing rates currently available to the Company for bank loans with similar terms and maturities, the Company also believes the carrying amount of long term debt approximates fair value. The fair value of the Company's forward currency contracts is determined using the current spot rate. The fair value and carrying amount of such contracts were $(77) and $0 at December 30, 1995 and $433 and $192 at December 31, 1994, respectively.

Net Income per Share Net income 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.

Management Estimates The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

New Accounting Standards In March 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of." This Statement requires that assets to be held and used be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss should be recognized when the estimated future cash flows from the asset are less than the carrying value of the asset. Assets to be disposed of should be reported at the lower of their carrying amount or fair value less cost to sell. This Statement is effective for financial statements for fiscal years beginning after December 15, 1995, and adoption by the Company in 1996 is not expected to have a material impact on results of operations or financial position.

In October 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (SFAS 123), "Accounting for Stock-Based Compensation." The Company has elected to continue following the guidance of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," for measurement and recognition of stock-based transactions with employees. The Company will adopt the disclosure provisions of SFAS 123 in 1996.

Notes to Consolidated Financial Statements

(In thousands, except share and per share amounts)

Property and Equipment

Property and equipment is comprised of the following:

	Dec. 30, 1995	Dec. 31, 1994
Leasehold improvements	$ 2,020	$ 1,172
Furniture and fixtures	2,983	2,588
Equipment	4,518	4,207
Building	5,882	5,876
Land	906	906
	16,309	14,749
Less accumulated depreciation	(3,864)	(2,419)
Property and equipment, net	$12,445	$12,330

Other Current Liabilities

Other current liabilities are comprised of the following:

	Dec. 30, 1995	Dec. 31, 1994
Accrued compensation and benefits	$ 1,370	$1,161
Income taxes payable	6,917	5,143
Accrued stock issuance costs	271	853
Accrued royalty fees	1,245	1,348
Other	640	510
	$10,443	$9,015

The Company accrued 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.

Credit Agreement

Long-term debt is comprised of the following:

	Dec. 30, 1995	Dec. 31, 1994
Revolving line of credit	$ –	$ 13,000
Term loan	80,000	100,000
	80,000	113,000
Less current portion	20,000	20,000
	$60,000	$ 93,000

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 to refinance the Company's previous long-term debt. In connection therewith, the Company recorded an extraordinary charge of $1,312, net of tax, to write off deferred financing costs during the first quarter of 1995. The term loan is due and payable in five consecutive annual installments of $20,000, payable in December of each year commencing in 1995.

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 available borrowings under the revolving line of credit were $84,960 at December 30, 1995.

(In thousands, except share and per share amounts)

The credit agreement allows the Company to choose between two interest rate options in connection with its term loan and revolving credit loans. The interest rate options are the Alternate Base Rate (as defined) or the Eurodollar Rate (as defined) plus an applicable margin. 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 $10,086, $12,182 and $17,595 during the years ended December 30, 1995, December 31, 1994 and January 1, 1994, respectively.

Income Taxes

The provision for income taxes, excluding the $893 tax benefit from the extraordinary charge due to the refinancing of debt, consisted of the following:

	Year Ended Dec. 30, 1995	Year Ended Dec. 31, 1994	Year Ended Jan. 1, 1994
Current:			
Federal	$30,560	$22,339	$16,680
State	2,619	2,298	1,333
Foreign	272	246	342
Deferred	286	203	(682)
	$33,737	$25,086	$17,673
Income taxes at federal statutory rate	$29,156	$21,414	$14,935
State income taxes, net of federal income tax benefit	2,566	1,929	1,300
Amortization of goodwill and other intangibles	1,448	1,448	1,440
Adjustment to deferred tax assets and liabilities for the change in the federal tax rate	–	–	111
Other	567	295	(113)
Provision for income taxes	$33,737	$25,086	$17,673

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

	Dec. 30, 1995	Dec. 31, 1994
Deferred tax assets:		
Accounts receivable valuation allowances	$2,704	$ 1,988
Inventory valuation allowances	1,369	822
Compensation expense—common stock options	366	345
Accrued liabilities	620	115
Other	310	49
Total deferred tax assets	5,369	3,319
Deferred tax liabilities:		
Trademarks	(6,249)	(6,419)
Property and equipment	(1,626)	(929)
Other	(153)	(158)
Total deferred tax liabilities	(8,028)	(7,506)
	$(2,659)	$(4,187)

(In thousands, except share and per share amounts)

The $2,659 net deferred tax liability at December 30, 1995 is presented as a net deferred current asset of $4,476 and a net deferred noncurrent liability of $7,135. 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 Company paid income taxes of $31,855, $23,677 and $15,228 during the years ended December 30, 1995, December 31, 1994 and January 1, 1994, respectively.

Commitments and Contingencies

Operating Leases The Company leases an aircraft, warehouse and office space, equipment, and showroom display facilities under renewable 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.

The following is a schedule of future annual minimum lease payments for noncancelable operating leases as of December 30, 1995:

1996	$ 2,629
1997	2,357
1998	2,370
1999	1,996
2000	1,764
Thereafter	2,272
	$13,388

The Company's rental expense was $2,875, $2,359 and $1,534 for the years ended December 30, 1995, December 31, 1994 and January 1, 1994, respectively.

Letters of Credit The Company had outstanding standby and commercial letters of credit amounting to $5,040 at December 30, 1995 relating primarily to purchase commitments issued to foreign suppliers and vendors.

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

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 $975, $819 and $783 for the years ended December 30, 1995, December 31, 1994 and January 1, 1994, respectively.

Recovery of Import Duties

The Company received a net refund of $2,872 in custom duties and related interest during the year ended December 30, 1995. The duties refund pertained to certain merchandise imported into the United States from 1989 to 1994.

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 30, 1995, December 31, 1994 and January 1, 1994 of $1,893, $1,494 and $1,458, respectively.

During the years ended December 30, 1995, December 31, 1994 and January 1, 1994, the Company paid Forstmann Little & Co. ("FL & Co."), a shareholder, and its affiliates $2,537, $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.

(In thousands, except share and per share amounts)

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 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 Common Stock at a price of $27.375 per share.

On May 15, 1995 and on May 23, 1995, FL & Co. and a member of senior management completed a public offering of 5,750,000 shares of Common Stock at a price of $37.625 per share.

Stock Options In 1992, 1993 and 1995, the Company adopted plans which provide for granting stock options to directors, officers, employees, consultants, and advisors to the Company. The options generally have a term of 10 years, and generally are exercisable in equal installments on each of the first, second and third anniversaries of the date of the grant. All employee options granted after the initial public offering have an exercise price equal to the market value of the stock at the date of grant. Information regarding the option plans is as follows:

	Number of shares		
	1995	1994	1993
Outstanding at beginning of year	702,755	404,556	22,500
Granted	448,660	424,700	423,900
Exercised	(70,742)	(122,401)	(35,144)
Cancelled	(7,900)	(4,100)	(6,700)
Outstanding at end of year	1,072,773	702,755	404,556
Exercisable at end of year	224,271	32,955	1,951

Options were granted at $34.63, $36.31 and $40.875 per share in 1995, $34.625 and $37.75 per share in 1994, and $3.33 and $18.00 per share in 1993. Options were exercised at $3.33 and $18.00 in 1995, $3.33 and $18.00 in 1994, and $3.33 in 1993. At December 30, 1995, options for 591,440 shares remained available for issuance under the plans.

In addition to stock options granted under the Company's stock option plans, the Company granted options to purchase 30,000 shares of Common Stock to each of four members of the Company's Board of Directors in December 1992. During February 1993, the Company granted options to purchase 30,000 shares of Common Stock to one member of the Board of Directors. These options are not subject to a stock option plan. Such options 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 30, 1995, directors' options to purchase 130,000 shares of Common Stock were exercisable at $3.33 per share.

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 30, 1995 and December 31, 1994 and the related consolidated statements of income, cash flows and stockholders' equity for the years ended December 30, 1995, December 31, 1994 and January 1, 1994. 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 30, 1995 and December 31, 1994 and the results of its operations and its cash flows for the years ended December 30, 1995, December 31, 1994 and January 1, 1994 in conformity with generally accepted accounting principles.

Deloitte & Touche LLP

Minneapolis, Minnesota

February 14, 1996

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 [2]
Chairman of the Board and Chief Executive Officer
Bachman's, Inc.

Susan E. Engel
President and Chief Operating Officer
Department 56, 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]
Chairman of the Board and Chief Executive Officer
General Instrument Corporation

Sandra J. Horbach [1,3]
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 [3]
Chairman of the Board and Chief Executive Officer
The Topps Co., Inc.

Vin Weber
Partner
Clark & Weinstock, Inc.

[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

Mark R. Kennedy
Chief Financial Officer and Vice President—Administration

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

Bruce A. Maurer
Vice President—Sales

Robert S. Rose
Vice President—Distribution and Operations

Timothy J. Schugel
Vice President—Finance

Joan M. Serena
Vice President—Consumer and Retail Marketing

Stockholder Information

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

Transfer Agent
Chemical Mellon
Shareholder Services
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
2:00 p.m.
May 16, 1996
Chemical Bank
270 Park Avenue
New York, NY

Department 56, Inc. Market Price *(Per Share)*

1995	*High*	*Low*
First Quarter	\$ 40⅝	\$ 33¾
Second Quarter	\$ 42	\$ 35⅝
Third Quarter	\$ 47¼	\$ 37⅝
Fourth Quarter	\$ 48	\$ 32⅝

1994	*High*	*Low*
First Quarter	\$ 35	\$ 26
Second Quarter	\$ 33⅞	\$ 26¾
Third Quarter	\$ 39	\$ 31½
Fourth Quarter	\$ 40	\$ 34

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 20, 1996, there were 825 record holders of the Company's common stock.

DESIGN: LITTLE & COMPANY

B5343

Department 56 INC.

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Eden Prairie, MN 55344, USA