

DEPARTMENT 56 INC - 10-K

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Table of Contents

Document (10-K405 10-K405)	1
Base	1
Cover Page	1
Part I	3
Business	3
Employees	7
Properties	7
Legal Proceedings	8
Submission to a Vote	8
Part II	10
Market for Common Equity	10
Financial Stmnts/Suppl Data	10
Changes in Accounting	10
Part III	11
Directors and Executive Officers	11
Executive Compensation	11
Security Ownership	11
Related Transactions	11
Exhibits and Reports	12
List of Exhibits	12
Schedule II	17
Signatures	18
Exhibits	19
Exhibit Index	19
EX-10: Material Contracts (EX-10.3 EXHIBIT 10.3)	22
EX-10: Material Contracts (EX-10.7 EXHIBIT 10.7)	25
EX-10: Material Contracts (EX-10.8 EXHIBIT 10.8)	30
EX-10: Material Contracts (EX-10.9 EXHIBIT 10.9)	35
EX-10: Material Contracts (EX-10.11 EXHIBIT 10.11)	42
EX-10: Material Contracts (EX-10.19 EXHIBIT 10.19)	45
EX-10: Material Contracts (EX-10.25 EXHIBIT 10.25)	54
EX-11: Computation of Earning Per Share (EX-11.1 EXHIBIT 11.1)	65
EX-13: ARS/10-Q/Quarterly Report (EX-13.1 EXHIBIT 13.1)	67
Selected Financial Data	68
Management Discussion	69
Financial Statements	73
Balance Sheet	74
Income Statement	75
Cashflow Statement	76
Shareholders Equity	77
Financial Footnotes	77
Report of Auditors	87
EX-21: Subsidiaries (EX-21.1 EXHIBIT 21.1)	91

EX-23: Consents : Experts/Counsel (EX-23.1 EXHIBIT 23.1)	92
EX-27: Financial Data Schedule (EX-27.1 EXHIBIT 27.1)	93
EX-27: Financial Data Schedule (EX-27.2 EXHIBIT 27.2)	95
EX-27: Financial Data Schedule (EX-27.3 EXHIBIT 27.3)	97

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

FORM 10-K

(MARK ONE)

/X/ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934 (Fee Required) For the fiscal year ended January 3, 1998

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 13-3684956
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification
No.)

ONE VILLAGE PLACE 55344
6436 CITY WEST PARKWAY (Zip Code)
EDEN PRAIRIE, MN
(Address of principal executive
offices)

(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

The aggregate market value of the voting stock held by non-affiliates of the registrant was approximately \$645,113,352 of March 20, 1998 (based on the closing price of consolidated trading in the Common Stock on that date as published in MICROSOFT INVESTOR). 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 20, 1998: 19,149,160

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's Annual Report to Stockholders for the fiscal year ended January 3, 1998 (the "1997 Annual Report") are incorporated by reference in Parts II and IV. Portions of the Company's definitive Proxy Statement for the 1998 Annual Meeting of Stockholders filed with the Securities and Exchange Commission concurrently with this Form 10-K (the "1998 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 incorporated in Delaware in 1992 to hold the equity of a Minnesota corporation formed in 1984 under the name "Department 56, Inc.," which has since changed its name to "D 56, Inc." and has continued as the Company's principal operating subsidiary.

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, figurines and other accessories 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 "Main Street U.S.A." theme. 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.

GENERAL 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. General Giftware products are generally offered as a line of products developed around a central design theme. The Company updates its product offerings twice a year and currently maintains an aggregate of approximately 3,300 stock keeping units, of which approximately 2,800 are General Giftware products.

CUSTOMERS

The Company's principal customers (accounting for approximately 90% of its sales) are approximately 19,000 independent gift retailers across the United States. These retailers include approximately 1,500 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 particular product will be sold exclusively through certain dealers. Approximately 10% of the Company's sales are made to department stores and mail order houses. No single account represented more than 3% of the Company's sales in fiscal 1997. The Company provides volume discounts to its customers with respect to most of its products. The Company has generally had only limited sales outside the United States. International sales were approximately 1% of the Company's sales in fiscal 1997, and the Company does not expect to materially increase international sales in fiscal 1998.

As part of the Company's strategy of selective distribution, only approximately 5,200 retailers receive the Company's Village Series and Snowbabies products. Certain of the Company's lit Village Series products and porcelain Snowbabies figurines have been sold on allocation for each of the last ten years and seven years, respectively. The Company periodically evaluates and adjusts its distribution network, and reviews its dealership policies with a view of optimizing both the Company's distribution strategy and the store-level operations of its independent dealers.

MARKETING AND ADVERTISING

Department 56 sells its products through 10 independently operated wholesale showrooms (including showrooms in New York and Dallas) and four corporate showrooms which cover the major giftware market areas in the United States and Canada. The Company's headquarters in Eden Prairie, Minnesota has a 10,000 square-foot atrium showroom where all of its products, including retired Village Series lighted pieces and Snowbabies figurines, are displayed. The Company also has a corporate showroom of approximately 13,000 square feet at the Atlanta, Georgia gift mart, a corporate showroom of approximately 7,500 square feet at the Chicago, Illinois gift mart, and a corporate showroom of approximately 6,600 square feet at the Los Angeles, California gift mart. In addition, the Company sells through giftware shows throughout the United States. Tests have been conducted of product sales through home television shopping and through corporate gift programs. The Company intends to maintain flexibility in its marketing and distribution strategies in order to take advantage of opportunities that may develop in the future (including the establishment and operation of retail stores so as to build consumer awareness).

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

DESIGN AND PRODUCTION

The Company has an ongoing program of new product development. Each year, the Company introduces new products in its existing product lines and also develops entirely new design concepts. The Company endeavors to develop new products which, although not necessarily similar to the products currently marketed by the Company, fit the Company's quality and pricing criteria and can be distributed through the Company's existing marketing and distribution system.

Department 56 believes that its relationships with its manufacturers, and the quality of their craftsmanship, provide a competitive advantage and are a significant contributor to the Company's success. The

Company imports most of its products from the Pacific Rim, primarily The People's Republic of China, Taiwan (Republic of China) and The Philippines. The Company also imports a small percentage of its products from sources in India, and occasionally from sources in Europe (primarily Italy, England and Poland). In fiscal 1997, the Company imported products from approximately 150 independent manufacturing sources. The Company's single largest manufacturing source represented approximately 10% of the Company's imports in fiscal 1997. The Company's emphasis on high quality craftsmanship at affordable prices limits the sources from which the Company chooses to obtain products. The Company has long-standing relationships with the majority of its manufacturers (several for ten years or more) and often purchases (typically on a year-to-year basis) a manufacturer's entire output for a year. As a result of these relationships, the Company has experienced a low turnover of its manufacturing sources.

The 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 Minneapolis/St. Paul 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 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 generally provide direct linkage with the Company's field salesforce. 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 January 3, 1998, Department 56 had unfilled wholesale orders of approximately \$4.6 million, compared to \$7.2 million at December 28, 1996. All of the backlog is scheduled to be shipped to customers during the current fiscal year. Approximately 6% to 8% of the Company's total annual customer orders have been cancelled in each of the last three years for a number of reasons, 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 66% to 76% of its annual orders for such year. The Company offers extended payment terms to many of its customers for seasonal merchandise. Accordingly, the Company collects a substantial portion of its accounts receivable in the fourth quarter. Due to the seasonal pattern of shipping and accounts receivable collection, the Company generally has had greater working capital needs in its second and third quarters and has experienced greater cash availability in its fourth quarter. The Company typically finances its operations through net cash and marketable securities balances, internally generated cash flow and short-term seasonal borrowings. As a result of the Company's sales pattern, the Company has historically recorded a substantial portion of its revenues in its second and third quarters. The Company expects this seasonal sales pattern to continue for the foreseeable future.

TRADEMARKS AND OTHER PROPRIETARY RIGHTS

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

Department 56 regards its trademarks and other proprietary rights as valuable assets and intends to maintain and renew its trademarks and their registrations and vigorously defend against infringement. The U.S. registrations for the Company's trademarks are currently scheduled to expire or be cancelled at various times between 2002 and 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, televised home shopping networks 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 The People's Republic of China, Taiwan and The Philippines. The Company also imports a small percentage of its products from sources in India, and occasionally from sources in Europe (primarily Italy, England and Poland).

The Company's ability to import products and thereby satisfy customer orders is affected by the availability of, and demand for, quality production capacity abroad. The Company competes with other importers of specialty giftware products for the limited number of foreign manufacturing sources which can produce detailed, high-quality products at affordable prices. The Company is subject to the following risks inherent in foreign manufacturing: fluctuations in currency exchange rates; economic and political instability; cost fluctuations and delays in transportation; restrictive actions by foreign governments; nationalizations; the laws and policies of the U.S. affecting importation of goods (including duties, quotas and taxes); and foreign trade and tax laws. In particular, the Company's costs could be adversely affected if

the currencies of other countries in which the Company sources product appreciate significantly relative to the U.S. dollar.

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

The United States and the countries in which the Company's products are manufactured may, from time to time, impose new quotas, duties, tariffs or other charges or restrictions, or adjust presently prevailing quotas, duty or tariff levels, which could adversely affect the Company's financial condition or results of operations or its ability to continue to import products at current or increased levels. In particular, the Company's costs may be increased, or the mix of countries from which it sources its products may be changed, in the future if countries which are currently accorded "Most Favored Nation" status by the United States cease to have such status or the United States imposes retaliatory duties against imports from such countries. The Company cannot predict what regulatory changes may occur or the type or amount of any financial impact on the Company which such changes may have in the future.

In fiscal 1997, approximately 65% (as compared to approximately 50% in fiscal 1996) 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. The Company expects that the proportion of its products manufactured in The People's Republic of China will increase in the future. Various commercial and legal practices widespread in The People's Republic of China, including the handling of intellectual properties, as well as certain political and military actions taken or suggested by The People's Republic of China in relation to Taiwan and residents of Hong Kong, are under review by the United States government and, accordingly, the duty treatment of goods imported from The People's Republic of China is subject to political uncertainties. To the extent The People's Republic of China may cease to have "Most Favored Nation" status or its exports may be subject to political retaliation, the cost of importing products from such country would increase significantly, and the Company believes that there could be a short-term adverse effect on the Company until alternative manufacturing arrangements were obtained.

EMPLOYEES

As of January 3, 1998, the Company had 205 full-time employees in the United States and 7 full-time employees in Taiwan. All of the Company's 65 U.S.-based warehouse, shipping and receiving personnel employed as of that date are represented by Local Union No. 638 of the Teamsters under a contract that expired on December 31, 1997. The Company is in the process of negotiating a new contract. 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 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 66,400 square feet of the facility and leases the remaining 600 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 and is extendible at the Company's option for an additional five years. 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. Nearby the Bloomington distribution facility is additional bulk storage warehouse space of approximately 52,000 square feet, the Company's lease for which expires on February 28, 1999 and is extendible at the Company's option for an additional three years. The Company believes that its current facilities are adequate to support its needs. However, the Company continuously evaluates its need for additional facilities. The Company also leases a corporate showroom of approximately 13,000 square feet in the Atlanta, Georgia gift mart, a corporate showroom of approximately 7,500 square feet in the Chicago, Illinois gift mart, and a corporate showroom of approximately 6,600 square feet in the Los Angeles, California gift market. These leases expire on December 31, 2006, November 30, 1999, and December 31, 2002, respectively.

ITEM 3. LEGAL PROCEEDINGS

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

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

No matters were submitted to a vote of the Company's security holders during the last quarter of the year ended January 3, 1998.

ADDITIONAL ITEM. EXECUTIVE OFFICERS OF THE REGISTRANT

Set forth below are the executive officers of the Company as of the date hereof. Unless otherwise indicated each executive officer of the Company holds identical positions with D 56, Inc. Officers serve at the discretion of the Board of Directors.

NAME	AGE	POSITION(S) WITH THE COMPANY
Susan E. Engel	51	Chairwoman of the Board and Chief Executive Officer
Mark R. Kennedy	40	Senior Vice President and Chief Financial Officer
David H. Weiser	38	Senior Vice President -- Legal/Human Resources, General Counsel and Secretary
David W. Dewey	40	Executive Vice President -- Overseas Operations
Brett D. Heffes	30	Vice President -- Corporate Development
Robert S. Rose	43	Vice President -- Distribution and Operations
Timothy J. Schugel	39	Vice President -- Finance and Principal Accounting Officer
Joan M. Serena	44	Vice President -- Consumer & Dealer Marketing
Kenneth J. Sobaski	42	Executive Vice President -- Sales and Marketing
Gregory G. Sorensen	35	Vice President -- Management Information Systems

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:

Susan E. Engel has been Chairwoman of the Board of the Company and of D 56, Inc. since September 18, 1997 and Chief Executive Officer of the Company and of D 56, Inc. since November 13, 1996. Ms. Engel was President of the Company and of D 56, Inc. from September 19, 1994 until

September 18, 1997, and Chief Operating Officer of the Company and of D 56, Inc. from September 19, 1994 until November 13, 1996. 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. (a manufacturer of athletic and active sports apparel) from October 1991 to September 1993.

Mark R. Kennedy has been Senior Vice President of the Company and of D 56, Inc. since January 1, 1997 and Chief Financial Officer of the Company and of D 56, Inc. since April 25, 1995. He was Vice President -- Administration of the Company and of D 56, Inc. from April 25, 1995 until January 1, 1997. From January 1995 until April 25, 1995, Mr. Kennedy was a private investor. Mr. Kennedy was Senior Executive Vice President of Shopko Stores, Inc. (a "mass market" department store chain) from June 1993 to January 1995, and its Senior Vice President and Chief Financial Officer from February 1992 to June 1993.

David H. Weiser has been Senior Vice President -- Legal/Human Resources of the Company and of D 56, Inc. since January 1, 1997. He has also been General Counsel of the Company since April 22, 1993, General Counsel of D 56, Inc. since March 15, 1993, and Secretary of the Company and of D 56, Inc. since February 1993. Mr. Weiser was Vice President of the Company from April 22, 1993 until January 1, 1997 and Vice President of D 56, Inc. from March 15, 1993 until January 1, 1997.

David W. Dewey has been Senior Vice President -- Overseas Operations of the Company and of D 56, Inc. since January 1, 1997. He was Vice President -- Overseas Operations of the Company and of D 56, Inc. from April 22, 1993 until January 1, 1997. Mr. Dewey was Vice President of Marketing of D 56, Inc. from March 1990 until April 22, 1993.

Brett D. Heffes has been Vice President -- Corporate Development of the Company and of D 56, Inc. since January 5, 1998. He was associated with Wessels, Arnold & Henderson, a private investment bank, from May 1992 until January 1998, most recently as Principal.

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 Vice President -- Finance of the Company and of D56, Inc. since April 10, 1995, and was Controller of the Company and of D 56, Inc. from April 26, 1993 until April 10, 1995. He was a Senior Manager/Manager with the public accounting firm of Deloitte & Touche LLP from 1986 until April 24, 1993.

Joan M. Serena has been Vice President -- Consumer & Dealer Marketing of the Company and of D 56, Inc. since January 1, 1997. She was Vice President -- Consumer & Retail Marketing of the Company and of D 56, Inc. from October 20, 1995 until January 1, 1997. She was Vice President -- Consumer Services of the Company and of D 56, Inc. from April 22, 1993 until October 20, 1995. Ms. Serena was Vice President, Sales Services of D 56, Inc. from June 1992 until April 22, 1993.

Kenneth J. Sobaski has been Executive Vice President -- Sales and Marketing of the Company and of D 56, Inc. since November 3, 1997. From August 1997 to November 1997, Mr. Sobaski was a private investor. He was Vice President, Sales and Customer Service of The Pillsbury Company (food products) from March 1995 to August 1997, its Vice President, General Manager, Refrigerated Baked Goods from December 1993 to March 1995, and its Vice President, General Manager, Green Giant from October 1992 to December 1993.

Gregory G. Sorensen has been Vice President -- Management Information Systems of the Company and of D 56, Inc. since July 22, 1996. He was Vice President of Information Systems of Tsumura International, Inc. (a distributor of consumer soaps and toiletries) from October 1991 until July 12, 1996, and a consultant to D 56, Inc. from July 12, 1996 until July 22, 1996.

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 25 of the 1997 Annual Report and Note 6 to Five Year Summary on page 7 of the 1997 Annual Report, and such information is incorporated herein by reference.

As of March 20, 1998, the number of holders of record of the Company's Common Stock was 1,031.

ITEM 6. SELECTED FINANCIAL DATA

Information required by this Item is included in Five Year Summary on page 7 of the 1997 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 16 to 23 and 8 to 12 respectively, of the 1997 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 8 to 12 of the 1997 Annual Report, incorporated herein by reference.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not applicable.

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 January 3, 1998, December 28, 1996 and December 30, 1995, the notes to the consolidated financial statements, and the report of independent auditors thereon on pages 13 to 24 of the 1997 Annual Report, and in the Company's unaudited quarterly financial data for the years ended January 3, 1998 and December 28, 1996 on page 10 of the 1997 Annual Report, incorporated herein by reference.

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

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information required by this Item concerning directors of the Company who are nominated by the Company for re-election at the 1998 annual meeting of the Company's stockholders is included in the 1998 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 1998 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.

The principal occupations and positions for the past five years, and in certain cases prior years, of each of the current directors of the Company who are not nominated for re-election at the 1998 annual meeting of stockholders are as follows:

Todd L. Bachman, age 52, has been a director of the Company since October 1992. Mr. Bachman has been Chairman and Chief Executive Officer of Bachman's, Inc. (a floral and nursery wholesaler and retailer), since November 1, 1994. Mr. Bachman was Vice Chairman of the Board and President of the Company and of D 56, Inc. from April 22, 1993 until September 19, 1994. Mr. Bachman was Chief Executive Officer of D 56, Inc. from January 1992 until April 22, 1993.

Sandra J. Horbach, age 37, has been a director of the Company since October 1992. Ms. Horbach has been a General Partner of FLC Partnership, L.P., the General Partner of Forstmann Little & Co. (a private investment firm), since January 1993. She is a director of Gulfstream Aerospace Corp.

ITEM 11. EXECUTIVE COMPENSATION

Information required by this Item is included in the 1998 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 1998 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 1998 Proxy Statement in the section captioned "Certain Related Party Transactions," and such information is incorporated herein by reference. See also, Note 9 to the consolidated financial statements on page 20 of the 1997 Annual Report.

PART IV

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

		FORM 10-K (PAGE)	1997 ANNUAL REPORT (PAGE)
		-----	-----
(a)	1. FINANCIAL STATEMENTS		
	Consolidated Balance Sheets at January 3, 1998 and December 28, 1996		13
	For the years ended January 3, 1998, December 28, 1996 and December 30, 1995:		
	Consolidated Statements of Income		14
	Consolidated Statements of Cash Flows		15
	Consolidated Statements of Stockholders' Equity		16
	Notes to Consolidated Financial Statements		16-23
	Independent Auditors' Report for the years ended January 3, 1998, December 28, 1996 and December 30, 1995		24
	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 January 3, 1998 and December 28, 1996 and the related consolidated statements of income, cash flows and stockholders' equity for the years ended January 3, 1998, December 28, 1996 and December 30, 1995, and have issued our report thereon dated February 12, 1998 (included in the Company's Annual Report to Stockholders for the year ended January 3, 1998 and incorporated herein by reference). 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
Minneapolis, Minnesota
February 12, 1998

DEPARTMENT 56, INC.
(PARENT COMPANY ONLY)
SCHEDULE I -- CONDENSED FINANCIAL INFORMATION
BALANCE SHEETS
(IN THOUSANDS)

	JANUARY 3, 1998	DECEMBER 28, 1996
	-----	-----
ASSETS		
INVESTMENT IN SUBSIDIARIES.....	\$ 184,420	\$ 195,349
RECEIVABLE FROM SUBSIDIARIES.....	2,510	1,543
	-----	-----
	\$ 186,930	\$ 196,982
	-----	-----
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES--		
Accrued expenses.....	\$ 275	\$ 225
STOCKHOLDERS' EQUITY:		
Preferred stock, \$.01 par value; authorized 20,000 shares; no shares issued.....	--	--
Common Stock, \$.01 par value; authorized 100,000 shares; issued 21,765 and 21,584		
shares, respectively.....	218	216
Additional paid-in capital.....	44,645	42,315
Treasury stock, at cost; 2,199 and 0 shares, respectively.....	(55,215)	--
Retained earnings.....	197,007	154,226
	-----	-----
Total stockholders' equity.....	186,655	196,757
	-----	-----
	\$ 186,930	\$ 196,982
	-----	-----

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

See notes to consolidated financial statements included in the
1997 Annual Report, incorporated by reference.

DEPARTMENT 56, INC.
(PARENT COMPANY ONLY)

SCHEDULE I -- CONDENSED FINANCIAL INFORMATION (CONTINUED)
STATEMENTS OF INCOME
(IN THOUSANDS)

	YEAR ENDED JANUARY 3, 1998	YEAR ENDED DECEMBER 28, 1996	YEAR ENDED DECEMBER 30, 1995
Equity in earnings of subsidiaries.....	\$ 43,216	\$ 46,263	\$ 49,435
Interest expense.....	--	--	(955)
General and administrative expenses.....	(435)	(319)	(227)
Net income.....	\$ 42,781	\$ 45,944	\$ 48,253

See notes to consolidated financial statements included in the
1997 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 JANUARY 3, 1998	YEAR ENDED DECEMBER 28, 1996	YEAR ENDED DECEMBER 30, 1995
	-----	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income.....	\$ 42,781	\$ 45,944	\$ 48,253
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Dividends received from subsidiaries.....	55,094	--	109,596
Equity in earnings of subsidiaries.....	(43,216)	(46,263)	(49,435)
Decrease in accrued interest payable.....	--	--	(644)
(Increase) decrease in receivable from subsidiaries.....	(967)	28	(51)
Increase (decrease) in accrued expenses.....	50	(45)	(584)
	-----	-----	-----
Net cash provided by (used in) operating activities.....	53,742	(336)	107,135
	-----	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from the exercise of common stock options.....	1,473	336	865
Principal payments on long-term debt.....	--	--	(108,000)
Purchases of treasury stock.....	(55,215)	--	--
	-----	-----	-----
Net cash provided by (used in) financing activities.....	(53,742)	336	(107,135)
	-----	-----	-----
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
1997 Annual Report, incorporated by reference.

DEPARTMENT 56, INC.
SCHEDULE II -- VALUATION AND QUALIFYING ACCOUNTS
(IN THOUSANDS)

COLUMN A	COLUMN B	COLUMN C	COLUMN D	COLUMN E
DESCRIPTION	BALANCE BEGINNING OF PERIOD	(1) CHARGED TO COSTS AND EXPENSES	DEDUCTIONS	BALANCE END OF PERIOD
Year ended January 3, 1998:				
Allowance for doubtful accounts.....	\$ 5,014	\$ 1,087	\$ 941(a)	\$ 5,160
Allowance for obsolete and overstock inventory.....	2,942	3,447	2,004	4,385
Allowance for sales returns and credits.....	5,249	8,752	6,104	7,897
	\$ 13,205	\$ 13,286	\$ 9,049	\$ 17,442
Year ended December 28, 1996:				
Allowance for doubtful accounts.....	\$ 4,329	\$ 2,014	\$ 1,329(a)	\$ 5,014
Allowance for obsolete and overstock inventory.....	3,604	867	1,529	2,942
Allowance for sales returns and credits.....	2,555	11,585	8,891	5,249
	10,488	\$ 14,466	\$ 11,749	\$ 13,205
Year ended December 30, 1995:				
Allowance for doubtful accounts.....	\$ 3,592	\$ 2,293	\$ 1,556(a)	\$ 4,329
Allowance for obsolete and overstock inventory.....	2,660	1,866	922	3,604
Allowance for sales returns and credits.....	1,641	6,529	5,615	2,555
	\$ 7,893	\$ 10,688	\$ 8,093	\$ 10,488

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

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: /s/ SUSAN E. ENGEL

Susan E. Engel
CHAIRWOMAN OF THE BOARD
AND CHIEF EXECUTIVE OFFICER

Date: April 2, 1998

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

SIGNATURE	CAPACITY IN WHICH SIGNED	DATE
/s/ SUSAN E. ENGEL ----- Susan E. Engel	Chairwoman of the Board, Chief Executive Officer and Director (Principal Executive Officer)	April 2, 1998
/s/ MARK R. KENNEDY ----- Mark R. Kennedy	Chief Financial Officer and Senior Vice President (Principal Financial Officer)	April 2, 1998
/s/ TIMOTHY J. SCHUGEL ----- Timothy J. Schugel	Vice President -- Finance and Principal Accounting Officer (Principal Accounting Officer)	April 2, 1998
/s/ TODD L. BACHMAN ----- Todd L. Bachman	Director	April 2, 1998
/s/ MAXINE CLARK ----- Maxine Clark	Director	April 2, 1998
/s/ SANDRA J. HORBACH ----- Sandra J. Horbach	Director	April 2, 1998
/s/ WM. BRIAN LITTLE ----- Wm. Brian Little	Director	April 2, 1998
/s/ GARY S. MATTHEWS ----- Gary S. Matthews	Director	April 2, 1998
/s/ STEVEN G. ROTHMEIER ----- Steven G. Rothmeier	Director	April 2, 1998
/s/ VIN WEBER ----- Vin Weber	Director	April 2, 1998

DEPARTMENT 56, INC.
INDEX TO EXHIBITS

EXHIBIT	DESCRIPTION
3.1	Restated Certificate of Incorporation of the Company. (Incorporated herein by reference to Exhibit 3.1 of Registrant's Quarterly Report on Form 10-Q for the quarter ended July 3, 1993. SEC File no. 1-11908)
3.2	Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock of the Company. (Incorporated herein by reference to Exhibit 1.1 of Registrant's Amendment No. 1, dated May 12, 1997, to Registration Statement on Form 8-A, dated April 23, 1997. SEC File no. 1-11908)
3.3	Restated By-Laws of the Company. (Incorporated herein by reference to Exhibit 3.2 of Registrant's Registration Statement on Form S-1, No. 33-61514 and to Exhibits 1 and 2 of Registrant's Current Report on Form 8-K dated February 15, 1996. SEC File no. 1-11908)
4.1	Specimen form of Company's Common Stock certificate. (Incorporated herein by reference to Exhibit 4.1 of Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1994. SEC File no. 1-11908)
4.2	Rights Agreement (including Exhibits A, B and C thereto), dated as of April 23, 1997, between the Company and ChaseMellon Shareholder Services, L.L.C., as Rights Agent. (Incorporated herein by reference to Exhibit 1 of Registrant's Registration Statement on Form 8-A, dated April 23, 1997. SEC File no. 1-11908)
4.3	First Amendment, dated as of March 13, 1998, to Rights Agreement between the Company and ChaseMellon Shareholder Services, L.L.C., as Rights Agent. (Incorporated herein by reference to Exhibit 1 to Registrant's Amendment No. 2, dated March 16, 1998, to Registration Statement on Form 8-A, dated April 23, 1997. SEC File no. 1-11908)
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. (Incorporated herein by reference to Exhibit 10.5 of Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1994. SEC File no. 1-11908)
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. SEC File no. 1-11908)
10.7	First Amendment, dated as of November 25, 1996, to Amended and Restated Credit Agreement among D 56, Inc., the Banks parties thereto, and The Chase Manhattan Bank (as successor to Chemical Bank), as agent for the Banks.*
10.8	Second Amendment, dated as of September 30, 1997, to Amended and Restated Credit Agreement among D 56, Inc., the Banks parties thereto, and The Chase Manhattan Bank (as successor to Chemical Bank), as agent for the Banks.*
10.9	Third Amendment, dated as of December 16, 1997, to Amended and Restated Credit Agreement among D 56, Inc., the Banks parties thereto, and The Chase Manhattan Bank (as successor to Chemical Bank), as agent for the Banks.*

EXHIBIT	DESCRIPTION
10.10	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. SEC File no. 1-11908)
10.11	Amendment, dated as of December 30, 1997, to Pledge Agreement by the Company in favor of The Chase Manhattan Bank (as successor to Chemical Bank).*
10.12	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. SEC File no. 1-11908)
10.13	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. SEC File no. 1-11908)
10.14	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. SEC File no. 1-11908)
10.15	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. SEC File no. 1-11908)
10.16	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. SEC File no. 1-11908)
10.17	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. SEC File no. 1-11908)
10.18	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. SEC File no. 1-11908)
10.19	Subsidiaries Guarantee, dated as of December 30, 1997, by Department 56 Retail, Inc. and Department 56 Sales, Inc. in favor of The Chase Manhattan Bank.*
10.20	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.)
10.21	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.)+
10.22	Department 56, Inc. 1995 Stock Incentive Plan. (Incorporated herein by reference to Exhibit 10.18 of Registrant's Annual Report on Form 10-K for the fiscal year ended December 30, 1995. SEC File no. 1-11908)+
10.23	Department 56, Inc. 1997 Stock Incentive Plan. (Incorporated herein by reference to Exhibit 4.4 of Registrant's Registration Statement on Form S-8, No. 333-41639.)+
10.24	Form of Stock Option Agreement in connection with Department 56, Inc. 1993 Stock Incentive Plan, Department 56, Inc. 1995 Stock Incentive Plan, and Department 56, Inc. 1997 Stock Incentive Plan. (Incorporated herein by reference to Exhibit 10.1 of Registrant's Quarterly Report on Form 10-Q for the quarter ended July 3, 1993. SEC File no. 1-11908)+
10.25	Department 56, Inc. Annual Cash Incentive Program +*
11.1	Computation of Earnings Per Share.*
13.1	Excerpts from Annual Report to Stockholders for fiscal year ended January 3, 1998.*

EXHIBIT	DESCRIPTION
21.1	Subsidiaries of the Company.*
23.1	Independent Auditors' Consent*
27.1	Financial Data Schedule (accompanies EDGAR electronic format only)*

+ Management contract or compensatory plan

* Filed herewith

DEPARTMENT 56, INC. STOCK OPTION AGREEMENT (DIRECTOR OPTION)

OPTIONEE: _____ DATE: _____

NUMBER OF SHARES SUBJECT TO THE OPTION: _____ EXERCISE PRICE PER SHARE: \$ _____

1. GENERAL.

1.1 The Company hereby grants to the Optionee, subject to the terms of this Agreement and the Company's 199_ Stock Incentive Plan (the "Plan"), the right and option (the "Option") to purchase, at the Exercise Price, the number of Shares set forth above. The number of Shares and the Exercise Price are subject to adjustment as provided in Section {12} {13} of the Plan, which is made a part hereof as if fully set forth herein. Except as otherwise defined herein, capitalized terms used in this Agreement shall have the same definitions as set forth in the Plan.

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

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

2. EXERCISABILITY OF OPTIONS.

2.1 VESTING. Subject to the provisions of this Agreement and the Plan, the Option shall become exercisable with respect to one-half of the total number of Shares which may be purchased pursuant to the Option on the first business day after each of the first and second annual meetings of stockholders of the Company held after the date of this grant.

2.2 TIMING OF EXERCISE. The Optionee or the guardian, executor, administrator or other legal representative (each a "Legal Representative") of the Optionee (all references herein to "Optionee" being deemed to include the Optionee's Legal Representative, if any, unless the context otherwise requires) may exercise the Option, in whole or in part, at any time or from time to time, but only to the extent the Option has become exercisable pursuant to Section 2.1 or 2.3 at the time of the proposed exercise.

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

3. MANNER OF EXERCISE AND PAYMENT.

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

3.2 The notice of exercise described in Section 3.1 hereof shall be accompanied by the full purchase price for the Shares in respect of which the Option is being exercised, such purchase price to be paid by check and/or the

transfer of Shares to the Company upon such terms and conditions as determined by the Committee. Not less than 10 Shares may be purchased at any one time upon an exercise of the Option, unless the number of Shares so purchased constitutes the total number of Shares then purchasable under the Option.

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

4. CERTAIN RESTRICTIONS.

4.1 NON-TRANSFERABILITY. The Option shall not be transferable by the Optionee otherwise than by will or the laws of descent and distribution, and an Option may be exercised during the lifetime of such Optionee only by the Optionee or his or her Legal Representative. The terms of such Option shall be final, binding and conclusive upon the beneficiaries, executors, administrators, heirs and successors of the Optionee.

4.2 TERMINATION. (a) If the Optionee's service as a Director terminates for any reason other than Cause, the Optionee may for a period of one (1) year after such termination exercise the Option to the extent, and only to the extent, that the Option or portion thereof is vested and exercisable as of the date the Optionee's service as a Director is terminated, after which time the Option shall automatically terminate in full.

(b) If the Optionee's service as a Director terminates for Cause, the Option shall immediately terminate in full and no rights hereunder may be exercised.

(c) If the Optionee dies while a Director or within the one (1) year period after termination of his service as a Director as described in clause (a) of this Section 4.2, the Option may be exercised at any time within twelve (12) months after the Optionee's death by his Legal Representative, after which time the Option shall terminate in full; PROVIDED, HOWEVER, that the Option may be exercised to the extent, and only to the extent, that the Option or portion thereof is exercisable on the date of death or earlier termination of the Optionee's services as a Director.

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

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

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

DEPARTMENT 56, INC.

By:

David H. Weiser
Senior Vice President
Legal and Human Resources

By:

Optionee:

FIRST AMENDMENT

AMENDMENT dated as of November 25, 1996 (this "Amendment") to the Amended and Restated Credit Agreement dated as of February 17, 1995 (as in effect immediately prior to the date hereof, the "Credit Agreement") among D 56, INC., a Minnesota corporation (the "Company"), the several banks and other financial institutions party thereto (the "Banks") and The CHASE MANHATTAN BANK (as successor to Chemical Bank), a New York banking corporation, as agent for the Banks (in such capacity, the "Agent").

W I T N E S S E T H :

WHEREAS, the Company, the Banks, the Co-Agents named therein and the Agent are parties to the Credit Agreement;

WHEREAS, the Company has requested that the Agent and the Banks amend the Credit Agreement in certain respects; and

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

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

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

2. Amendment to Subsection 1.1. The definition of "Excess Cash Flow" set forth in subsection 1.1 is amended by deleting therefrom the following phrase that appears at the end thereof: "subsection 8.11(a), 8.11(c) or 8.11 (d)" and substituting in lieu thereof, the phrase "subsection 8.11(a) or 8.11(c)".

3. Amendment to Subsection 8.8. Subsection 8.8 is amended by deleting said subsection in its entirety and substituting, in lieu thereof, the following new subsection 8.8:

8.8 Consolidated Net Worth. Permit Consolidated Net Worth as at the last day of any fiscal quarter to be less than the sum of (i) \$140,000,000 plus (ii) 50% of Consolidated Net Income for each fiscal quarter (if Consolidated Net Income for such fiscal quarter is positive) ending on or prior to such day, commencing with the fiscal quarter ending April 5, 1997.

4. Amendment to Subsection 8.11. Subsection 8.11 of the Credit Agreement is hereby amended by deleting clause (d) in its entirety and substituting therefor the following new clause (d):

(d) so long as no Default or Event of Default has occurred or would occur after giving effect to such declaration or payment, the Company may, from time to time, pay cash dividends to EBI and Intermediate Co., EBI may declare and pay cash dividends to Intermediate Co. and Intermediate Co. may declare and pay cash dividends to Holding in an aggregate amount not to exceed the sum of (i) \$40,000,000 plus (ii) in any fiscal year ending on or after January 2, 1999, an amount equal to the lesser of (A) 50% (or, from and after the date of payment in full of the Term Loans, 100%) of Excess Cash Flow for the immediately preceding fiscal year and (B) 50% (or, from and after the date of payment in full of the Term Loans, 75%) of Consolidated Net Income for such immediately preceding fiscal year; provided that, in each case, (x) the amount of dividend availability determined for any fiscal year pursuant to clause (ii) above that is not paid as dividends thereunder during such fiscal year may be carried forward and added to such availability in any subsequent fiscal year, (y) no such dividend may be paid if the proceeds thereof are used or are intended to be used to pay principal of Indebtedness of Holding unless at the time of such declaration or payment the aggregate outstanding amount of the Revolving Credit Loans and Acceptance Obligations, other than Revolving Credit Loans used solely to support foreign currency hedges, is zero and (z) the Agent shall have received, with a counterpart for each Bank, a certificate of the chief financial officer of the Company setting forth a calculation of the estimated Consolidated Net Income and Excess Cash Flow for the immediately preceding fiscal year of the Company and, if such dividend is paid in reliance on Consolidated Net Income and Excess Cash Flow periods not covered by audited financial statements of the Company previously delivered to the Banks, stating that such calculation constitutes a good faith reasonable estimate of Consolidated Net Income and Excess Cash Flow for the period not covered by such financial statements based on all facts and circumstances then known.

5. Representations and Warranties. The Company hereby confirms that, after giving effect to the amendments provided for herein, the representations and warranties contained in Section 5 of the Credit Agreement are true and correct in all material respects on and as of the date hereof and no Default or Event of Default has occurred and is continuing.

6. No Other Amendments. Except as expressly amended hereby, the Credit Agreement shall continue to be, and shall remain, in full force and effect in accordance with its terms.

7. Counterparts. This Amendment may be executed by the parties hereto in any number of separate counterparts and all of such counterparts taken together shall be deemed to constitute one and the same instrument.

8. Conditions to Effectiveness. This Amendment shall become effective as of the date first written above when each of the following conditions to effectiveness shall have been satisfied:

(i) the Agent shall have received counterparts to this Amendment, duly executed by the Company, the Required Banks and the Agent; and

(ii) the Agent shall have received the Acknowledgement and Consent, attached to each counterpart hereof, duly executed by each of the Credit Parties (other than the Company).

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

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

D 56, INC.
By: /s/ TIMOTHY SCHUGEL
Title: Vice President - Finance

THE CHASE MANHATTAN BANK, as Agent
and as a Bank
By: /s/ TIMOTHY STORMS
Title: Credit Executive

BANK OF AMERICA ILLINOIS
By: /s/ MARGARET H. CLAGGETT
Title: Vice President

FIRST BANK NATIONAL ASSOCIATION
By: /s/ DENNIS L. RUGGLES
Title: Vice President

HARRIS TRUST AND SAVINGS BANK
By: /s/ JOHN M. DILLON
Title: Vice President

BANK OF NOVA SCOTIA
By: /s/ F.C.H. ASHBY
Title: Senior Manager Loan Operations

SUMITOMO BANK, LIMITED
By: /s/ BETH C. MCGINNIS
Title: Vice President
By: /s/ MICHAEL J. PHILIPPE
Title: Vice President

DEUTSCHE BANK A.G. CHICAGO AND/OR
CAYMAN ISLAND BRANCHES

By: /s/ HANS RODERICH

Title: Associate

By: /s/ KRYN SZREMSKI

Title: Vice President

NATIONAL BANK OF DETROIT

By: /s/ MARGUERITE MULLINS

Title: Vice President

SOCIETE GENERALE

By: /s/ SUSAN HUMMEL

Title: Assistant Vice President

ABN-AMRO BANK N.V.

By: /s/ CHRISTINE HOLMES

Title: Vice President

By: /s/ THOMAS M. TOERPE

Title: Vice President

THE LONG-TERM CREDIT BANK OF JAPAN,
LIMITED

By: /s/

Title: Deputy General Manager

ACKNOWLEDGEMENT AND CONSENT

Each of the undersigned Credit Parties (as defined in the Amended and Restated Credit Agreement dated as of February 17, 1995; as amended, supplemented and otherwise modified prior to the execution and delivery of the Amendment, the "Credit Agreement") among D 56, INC., a Minnesota corporation (the "Company"), the banks and other financial institutions parties thereto (collectively, the "Banks") and THE CHASE MANHATTAN BANK (as successor to Chemical Bank), a New York banking corporation, as agent for the Banks (in such capacity, the "Agent") hereby acknowledges, and consents to, the execution and delivery of the First Amendment dated as of November 25, 1996 to the Credit Agreement, and agrees to remain bound by each Credit Document to which it is a party.

DEPARTMENT 56, INC.

By: /s/ TIMOTHY J. SCHUGEL

Title: Vice President

FL 56 INTERMEDIATE CORP.

By: /s/ TIMOTHY J. SCHUGEL

Title: Vice President

ed bazinet international, inc.

By: /s/ TIMOTHY J. SCHUGEL

Title: Vice President

DEPARTMENT 56 TRADING CO., LTD.

By: /s/ TIMOTHY J. SCHUGEL

Title: Vice President

SECOND AMENDMENT

SECOND AMENDMENT dated as of September 30, 1997 (this "Amendment") to the Amended and Restated Credit Agreement dated as of February 17, 1995 (as in effect immediately prior to the date hereof, the "Credit Agreement") among D 56, INC., a Minnesota corporation (the "Company"), the several banks and other financial institutions party thereto (the "Banks") and The CHASE MANHATTAN BANK (as successor to Chemical Bank), a New York banking corporation, as agent for the Banks (in such capacity, the "Agent").

W I T N E S S E T H :

WHEREAS, the Company, the Banks, the Co-Agents named therein and the Agent are parties to the Credit Agreement;

WHEREAS, the Company has requested that the Agent and the Banks amend the Credit Agreement in certain respects; and

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

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

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

2. Amendment to Subsection 1.1. (a) Subsection 1.1 of the Credit Agreement is hereby amended by inserting, at the end of clause (a) of the definition of "Net Proceeds", the following new proviso:

"provided, further, that for the purposes of this clause (a), Net Proceeds will include amounts that would otherwise constitute Net Proceeds received as described in clause (ii) of the definition of Aircraft Resale Transaction only to the extent that such amounts are received by the Company or its Subsidiaries on a date that is more than 180 days after the first date on which a payment described in clause (i) of such definition is made;"

(b) Subsection 1.1 of the Credit Agreement is hereby further amended by inserting therein, in appropriate alphabetical order, the following new definition:

"'Aircraft Resale Transaction': the transaction comprising (i) the payment by the Company and/or its Subsidiaries of an aggregate amount not in excess of \$6,000,000 to terminate the lease and receive title in

respect of the Gulfstream GII B S/N 257 and (ii) the subsequent sale of such aircraft by the Company and/or its Subsidiaries for net cash consideration of not less than the amount of the payment referred to above."

3. Amendment to Subsection 8.5. Subsection 8.5 of the Credit Agreement is hereby amended by (i) deleting the word "and" appearing at the end of clause (e) thereof, (ii) replacing the period at the end of clause (f) thereof with the phrase "; and" and (iii) adding at the end of such subsection the following new clause (g):

"(g) the Company and its Subsidiaries may consummate the Aircraft Resale Transaction."

4. Amendment to Subsection 8.6. Subsection 8.6 of the Credit Agreement is hereby amended by (i) deleting the word "and" appearing at the end of clause (h) thereof, (ii) replacing the period at the end of clause (i) thereof with the phrase "; and" and (iii) adding at the end of such subsection the following new clause (j):

"(j) the Company and its Subsidiaries may consummate the Aircraft Resale Transaction."

5. Amendment to Subsection 8.8. Subsection 8.8 of the Credit Agreement is hereby amended by deleting said subsection in its entirety and substituting, in lieu thereof, the following new subsection 8.8:

"8.8 Consolidated Net Worth. Permit Consolidated Net Worth as at the last day of any fiscal quarter ending on or after October 4, 1997 to be less than the sum of (i) \$130,000,000 plus (ii) 50% of Consolidated Net Income for each fiscal quarter (if Consolidated Net Income for such fiscal quarter is positive) that commences after January 3, 1998 and ends on or prior to such last day."

6. Amendment to Subsection 8.11. Subsection 8.11 of the Credit Agreement is hereby amended by deleting clause (d) in its entirety and substituting therefor the following new clause (d):

"(d) so long as no Default or Event of Default has occurred or would occur after giving effect to such declaration or payment, the Company may, from time to time, pay cash dividends to EBI and Intermediate Co., EBI may declare and pay cash dividends to Intermediate Co. and Intermediate Co. may declare and pay cash dividends to Holding in an aggregate amount not to exceed the sum of (i) \$100,000,000 plus (ii) in any fiscal year ending on or after January 2, 1999, an amount equal to the lesser of (A) 50% (or, from and after the date of payment in full of the Term Loans, 100%) of Excess Cash Flow for the immediately preceding fiscal year and (B) 50% (or, from and after the date of payment in full of the Term Loans, 75%) of

Consolidated Net Income for such immediately preceding fiscal year; provided that (x) the amount of dividend availability determined for any fiscal year pursuant to clause (ii) above that is not paid as dividends thereunder during such fiscal year may be carried forward and added to such availability in any subsequent fiscal year, (y) no such dividend may be paid if the proceeds thereof are used or are intended to be used to pay principal of Indebtedness of Holding unless at the time of such declaration or payment the aggregate outstanding amount of the Revolving Credit Loans and Acceptance Obligations, other than Revolving Credit Loans used solely to support foreign currency hedges, is zero and (z) the Agent shall have received, with a counterpart for each Bank, a certificate of the chief financial officer of the Company setting forth a calculation of the estimated Consolidated Net Income and Excess Cash Flow for the immediately preceding fiscal year of the Company and, if such dividend is paid in reliance on Consolidated Net Income and Excess Cash Flow periods not covered by audited financial statements of the Company previously delivered to the Banks, stating that such calculation constitutes a good faith reasonable estimate of Consolidated Net Income and Excess Cash Flow for the period not covered by such financial statements based on all facts and circumstances then known."

7. Representations and Warranties. The Company hereby confirms that, after giving effect to the amendments provided for herein, the representations and warranties contained in Section 5 of the Credit Agreement are true and correct in all material respects on and as of the date hereof and no Default or Event of Default has occurred and is continuing.

8. No Other Amendments. Except as expressly amended hereby, the Credit Agreement shall continue to be, and shall remain, in full force and effect in accordance with its terms.

9. Counterparts. This Amendment may be executed by the parties hereto in any number of separate counterparts and all of such counterparts taken together shall be deemed to constitute one and the same instrument.

10. Conditions to Effectiveness. This Amendment shall become effective as of the date first written above when each of the following conditions to effectiveness shall have been satisfied:

(i) the Agent shall have received counterparts to this Amendment, duly executed by the Company, the Required Banks and the Agent; and

(ii) the Agent shall have received the Acknowledgement and Consent, attached to each counterpart hereof, duly executed by each of the Credit Parties (other than the Company).

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

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

D 56, INC.

By: /s/ TIMOTHY J. SCHUGEL

Title: Vice President

THE CHASE MANHATTAN BANK, as Agent
and as a Bank

By: /s/ JONATHAN TWICHELL

Title: Authorized Signatory

BANK OF AMERICA NT & SA

By: /s/ J. CASEY COSGROVE

Title: Assistant Vice President

FIRST BANK NATIONAL ASSOCIATION

By: /s/ MICHAEL RAYMANN

Title: Vice President

HARRIS TRUST AND SAVINGS BANK

By: /s/ ANDREW T. CLAAR

Title: Authorized Signatory

BANK OF NOVA SCOTIA

By:

Title:

SUMITOMO BANK, LIMITED

By: /s/ JOHN W. HOWARD, JR.

Title: Vice President & Manager

By: /s/ DOUG PUDVAH

Title: Vice President

NBD BANK

By: /s/ MARGUERITE C. GORDY

Title: Vice President

SOCIETE GENERALE

By:

Title:

ABN-AMRO BANK N.V.

By: /s/ JAMES W. PIERPONT

Title: Managing Director and Group

Vice President

By: /s/ JOHN P. RICHARDSON

Title: Assistant Vice President

THE LONG-TERM CREDIT BANK OF JAPAN,
LIMITED

By: /s/ BRADY S. SADEK

Title: Senior Vice President

ACKNOWLEDGEMENT AND CONSENT

Each of the undersigned Credit Parties (as defined in the Amended and Restated Credit Agreement dated as of February 17, 1995; as amended, supplemented and otherwise modified prior to the execution and delivery of the Amendment, the "Credit Agreement") among D 56, INC., a Minnesota corporation (the "Company"), the banks and other financial institutions parties thereto (collectively, the "Banks") and THE CHASE MANHATTAN BANK (as successor to Chemical Bank), a New York banking corporation, as agent for the Banks (in such capacity, the "Agent") hereby acknowledges, and consents to, the execution and delivery of the Second Amendment dated as of September 30, 1997 to the Credit Agreement, and agrees to remain bound by each Credit Document to which it is a party.

DEPARTMENT 56, INC.

By: /s/ TIMOTHY J. SCHUGEL

Title: Vice President

FL 56 INTERMEDIATE CORP.

By: /s/ TIMOTHY J. SCHUGEL

Title: Vice President

ed bazinet international, inc.

By: /s/ TIMOTHY J. SCHUGEL

Title: Vice President

DEPARTMENT 56 TRADING CO., LTD.

By: /s/ TIMOTHY J. SCHUGEL

Title: Vice President

THIRD AMENDMENT

THIRD AMENDMENT dated as of December 16, 1997 (this "Amendment") to the Amended and Restated Credit Agreement dated as of February 17, 1995 (as in effect immediately prior to the date hereof, the "Credit Agreement") among D 56, INC., a Minnesota corporation (the "Company"), the several banks and other financial institutions party thereto (the "Banks") and The CHASE MANHATTAN BANK (as successor to Chemical Bank), a New York banking corporation, as agent for the Banks (in such capacity, the "Agent").

W I T N E S S E T H :

WHEREAS, the Company, the Banks, the Co-Agents named therein and the Agent are parties to the Credit Agreement;

WHEREAS, the Company has requested that the Agent and the Banks amend the Credit Agreement and the Holding Guarantee (as defined in the Credit Agreement) in certain respects in order to permit Holding to create two new Subsidiaries and to permit the Company and its Subsidiaries to enter into certain transactions with such two new Subsidiaries; and

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

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

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

2. Amendments to Subsection 1.1. (a) Subsection 1.1 of the Credit Agreement is hereby amended by inserting the following new definitions:

"Retail Subsidiary": Department 56 Retail, Inc., a Minnesota corporation, or any other direct wholly-owned Subsidiary of Holding created principally to make retail sales of the Company's inventory;

"Sales Subsidiary": Department 56 Sales, Inc., a Minnesota corporation, or any other direct wholly-owned Subsidiary of Holding created principally to employ sales representatives for the Company's inventory.

(b) Subsection 1.1 of the Credit Agreement is hereby further amended by deleting the phrase "its Debt Ratio and its Fixed Charge Coverage Ratio" each time it appears in the definition of "Applicable Level" and substituting therefor each

such time the phrase "the Debt Ratio and the Fixed Charge Coverage Ratio".

(c) Subsection 1.1 of the Credit Agreement is hereby further amended by deleting from the definitions of "Applicable Level", "Capital Expenditures", "Consolidated Current Assets", "Consolidated Current Liabilities", "Consolidated EBITDA", "Consolidated Net Income", "Consolidated Net Worth", "Debt Ratio", "Excess Cash Flow", "Fixed Charge Coverage Ratio", "Indebtedness", "Lease Obligations", "Net Interest Expense", "Net Proceeds" and "Working Capital", the phrase "the Company" each time it appears therein and substituting therefor each such time the phrase "Holding".

(d) Subsection 1.1 of the Credit Agreement is hereby further amended by deleting from the definition of "Fixed Charge Coverage Ratio" the phrase ",plus, for any period, Holding Net Interest Expense".

(e) Subsection 1.1 of the Credit Agreement is hereby further amended by deleting therefrom the definition of "Holding Net Interest Expense".

(f) Subsection 1.1 of the Credit Agreement is hereby amended by deleting from paragraph (b) of the definition of "Net Proceeds" the word "Borrower" and substituting therefor the word "Company".

(g) Subsection 1.1 of the Credit Agreement is hereby further amended by inserting, at the end of the definition of "Subsidiary", the following phrase:

, and Retail Subsidiary and Sales Subsidiary shall be deemed to be Subsidiaries of the Company for purposes of the Credit Documents (except for purposes of computing the Borrowing Base).

3. Amendment to Subsection 7.1. Subsection 7.1 of the Credit Agreement is hereby amended by adding the phrase "each of Holding and its Subsidiaries and" immediately before the phrase "the Company and its Subsidiaries" each time such latter phrase appears.

4. Amendment to Subsection 7.2. Subsection 7.2 of the Credit Agreement is hereby amended by deleting each reference to "the Company" (except for references therein to officers of the Company) and substituting therefor each such time a reference to "Holding".

5. Amendment to Subsection 7.9. Subsection 7.9 of the Credit Agreement is hereby amended by deleting each reference to "the Company" (except for references therein to officers of the Company) and substituting therefor each such time a reference to "Holding".

6. Amendment to Subsection 8.5. Subsection 8.5 of the

Credit Agreement is hereby amended by (i) deleting the word "and" appearing at the end of clause (f) thereof, (ii) replacing the period at the end of clause (g) thereof with the phrase "; and" and (iii) adding at the end of such subsection the following new clause (h):

(h) the Company and its Subsidiaries may transfer assets to Retail Subsidiary and Sales Subsidiary of the type and having values as set forth on Schedule I to the Third Amendment to this Agreement dated as of December 16, 1997.

7. Amendment to Subsection 8.6. Subsection 8.6 of the Credit Agreement is hereby amended by adding at the end of clause (b) the following:

and provided further that the Company and its Subsidiaries may also transfer assets to Retail Subsidiary and Sales Subsidiary in accordance with subsection 8.5(h).

8. Amendment to Subsection 8.11. Subsection 8.11 of the Credit Agreement is hereby amended by (i) deleting the word "and" appearing at the end of clause (c) thereof, (ii) replacing the period at the end of clause (d) thereof with the phrase "; and" and (iii) adding at the end of such subsection the following new clause (e):

(e) the Company may declare and pay dividends to EBI and Intermediate Co., EBI may declare and pay dividends to Intermediate Co. and Intermediate Co. may declare and pay dividends to Holding, in each case consisting of assets which the Company is permitted to transfer to Retail Subsidiary and Sales Subsidiary pursuant to subsection 8.5(h).

9. Amendment to Section 9. Section 9 of the Credit Agreement is hereby amended by adding at the end the proviso clause in clause (j) the following:

and (iii) create and own Retail Subsidiary and Sales Subsidiary as its direct Subsidiaries and permit Retail Subsidiary to engage in the business of retail sales of the inventory of the Company and activities related thereto and the Sales Subsidiary to engage in the business of the employment of sales representatives for the Company's inventory and activities related thereto and make investments in Retail Subsidiary and Sales Subsidiary consisting of (a) assets permitted to be transferred to Retail Subsidiary and Sales Subsidiary pursuant to subsection 8.5(h) and (b) capital contributions of up to \$1,000,000 in the aggregate in Retail Subsidiary and Sales Subsidiary;

10. Amendment to Holding Guarantee. Section 10 of the Holding Guarantee is hereby amended by adding immediately before the phrase "; provided that . . ." the following:

and (iii) create and own Retail Subsidiary and Sales Subsidiary as its direct Subsidiaries and permit Retail Subsidiary to engage in the business of retail sales of the inventory of the Company and activities related thereto and the Sales Subsidiary to engage in the business of the employment of sales representatives for the Company's inventory and activities related thereto and make investments in Retail Subsidiary and Sales Subsidiary consisting of (a) assets permitted to be transferred to Retail Subsidiary and Sales Subsidiary pursuant to subsection 8.5(h) and (b) capital contributions of up to \$1,000,000 in the aggregate in Retail Subsidiary and Sales Subsidiary;

11. Special Provisions Relating to Retail Subsidiary and Sales Subsidiary. Notwithstanding any provisions to the contrary set forth in the Credit Documents (a) Holding and the Company will cause Retail Subsidiary and Sales Subsidiary to be owned as direct wholly-owned Subsidiaries of Holding, and the capital stock of such Subsidiaries shall be free of Liens; (b) Retail Subsidiary and Sales Subsidiary shall not be permitted to make any investment of the type permitted by clauses (h) or (i) of subsection 8.6; (c) for purposes of the Credit Documents, Subsidiaries of the Company shall include Retail Subsidiary and Sales Subsidiary except for purposes of computing the Borrowing Base; and (d) Retail Subsidiary and Sales Subsidiary shall not be permitted to create, incur, assume or suffer to exist any Indebtedness of the type permitted by clause (f) of subsection 8.1, any Liens of the type permitted by clause (h) of subsection 8.2 to secure Indebtedness permitted by clause (f) of subsection 8.1 or any Liens of the type permitted by clause (k) of subsection 8.2.

12. Representations and Warranties. The Company hereby confirms that, after giving effect to the amendments provided for herein, the representations and warranties contained in Section 5 of the Credit Agreement are true and correct in all material respects on and as of the date hereof and no Default or Event of Default has occurred and is continuing.

13. No Other Amendments. Except as expressly amended hereby, the Credit Documents shall continue to be, and shall remain, in full force and effect in accordance with its terms.

14. Counterparts. This Amendment may be executed by the parties hereto in any number of separate counterparts and all of such counterparts taken together shall be deemed to constitute one and the same instrument.

15. Conditions to Effectiveness. This Amendment shall become effective as of the date first written above when each of the following conditions to effectiveness shall have been satisfied:

(i) the Agent shall have received counterparts to this Amendment, duly executed by the Company, the Required Banks

and the Agent;

(ii) the Agent shall have received the Acknowledgement and Consent, attached to each counterpart hereof, duly executed by each of the Credit Parties (other than the Company);

(iii) the Agent shall have received an amendment to the Holding Pledge Agreement, satisfactory in form and substance to the Agent, which has the effect of pledging the capital stock of each of Retail Subsidiary and Sales Subsidiary to the Agent thereunder, accompanied by the share certificates evidencing such capital stock and duly executed stock powers therefor;

(iv) the Agent shall have received a Subsidiary Guarantee, duly executed by each of Retail Subsidiary and Sales Subsidiary; and

(v) the Agent shall have received an opinion from counsel to the Company with respect to the amendment to the Holding Pledge Agreement delivered pursuant to clause (iii) above and the Subsidiary Guarantee delivered pursuant to clause (iv) above, such opinion to be in form and substance satisfactory to the Agent.

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

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

D 56, INC.

By: /s/ TIMOTHY J. SCHUGEL
Title: Vice President

THE CHASE MANHATTAN BANK, as Agent
and as a Bank

By: /s/ LENARD WEINER
Title: Managing Director

BANK OF AMERICA ILLINOIS

By: /s/ THOMAS SULLIVAN
Title: Vice President

FIRST BANK NATIONAL ASSOCIATION

By: /s/ MICHAEL RAYMANN
Title: Vice President

HARRIS TRUST AND SAVINGS BANK

By: /s/ ANDREW T. CLAAR
Title: Authorized Signatory

THE BANK OF NOVA SCOTIA
By: /s/ F.C.H. ASHBY
Title: Senior Manager Loan Operations

SUMITOMO BANK, LIMITED
By: /s/ DOUG PUDVAH
Title: Vice President
By: /s/ JOHN W. HOWARD, JR.
Title: Vice President & Manager

NBD BANK
By: /s/ MARGUERITE GORDY
Title: Authorized Signatory

SOCIETE GENERALE
By:
Title:

ABN-AMRO BANK N.V.
By: /s/ JAMES PIERPONT
Title: Authorized Signatory

THE LONG-TERM CREDIT BANK OF JAPAN,
LIMITED
By: /s/ ARMUND J. SCHOEN, JR.
Title: Authorized Signatory

ACKNOWLEDGEMENT AND CONSENT

Each of the undersigned Credit Parties (as defined in the Amended and Restated Credit Agreement dated as of February 17, 1995; as amended, supplemented and otherwise modified prior to the execution and delivery of the Amendment, the "Credit Agreement") among D 56, INC., a Minnesota corporation (the "Company"), the banks and other financial institutions parties thereto (collectively, the "Banks") and THE CHASE MANHATTAN BANK (as successor to Chemical Bank), a New York banking corporation, as agent for the Banks (in such capacity, the "Agent") hereby acknowledges, and consents to, the execution and delivery of the Second Amendment dated as of December 16, 1997 to the Credit Agreement, and agrees to remain bound by each Credit Document to which it is a party.

DEPARTMENT 56, INC.
By: /s/ TIMOTHY J. SCHUGEL
Title: Vice President

FL 56 INTERMEDIATE CORP.
By: /s/ TIMOTHY J. SCHUGEL
Title: Vice President

ed bazinet international, inc.
By: /s/ TIMOTHY J. SCHUGEL
Title: Vice President

DEPARTMENT 56 TRADING CO., LTD.

By: /s/ TIMOTHY J. SCHUGEL

Title: Vice President

AMENDMENT TO PLEDGE AGREEMENT

AMENDMENT dated as of December 30, 1997 (this "Amendment") to the Pledge Agreement dated as of February 17, 1995 (as in effect immediately prior to the date hereof, the "Pledge Agreement") among DEPARTMENT 56, INC., a Delaware corporation (the "Pledgor"), in favor of THE CHASE MANHATTAN BANK (as successor to Chemical Bank), a New York banking corporation, as agent for the Banks referred to below (in such capacity, the "Agent").

W I T N E S S E T H :

WHEREAS, D 56, Inc. (the "Company"), certain lenders (the "Banks") and co-agents (the "Co-Agents") and the Agent are parties to the Amended and Restated Credit Agreement dated as of February 17, 1995 (as amended, the "Credit Agreement"); and

WHEREAS, it is a condition precedent to the effectiveness of the Third Amendment dated as of December 17, 1997 that the Pledge Agreement be amended as set forth herein in order to include as Pledged Stock thereunder all of the shares of capital stock of Department 56 Retail, Inc., a Minnesota corporation, and Department 56 Sales, Inc., a Minnesota corporation (collectively, the "New Pledged Subsidiaries"), each of which is a wholly-owned subsidiary of the Pledgor;

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

1. Defined Terms. Unless otherwise defined herein, capitalized terms used herein which are defined in the Credit Agreement or the Pledge Agreement are used herein as so defined.

2. Amendments to Pledge Agreement. (a) All references in the Pledge Agreement to the "Issuer" shall be deemed to be a reference to each of FL 56 Intermediate Corp., a Delaware corporation, and the New Pledged Subsidiaries;

(b) All references in the Pledge Agreement to the "Pledged Stock" shall be deemed to be a reference to all of the capital stock of each of FL 56 Intermediate Corp., a Delaware corporation, and the New Pledged Subsidiaries;

(c) Schedule I to the Pledge Agreement is hereby supplemented by adding thereto the information set forth on Schedule I to this Amendment; and

(d) The address of each Issuer shall be the same address as for the Company under the Credit Agreement.

3. Pledge of Capital Stock of Department 56 Retail,

Inc. and Department 56 Sales, Inc. Upon the effectiveness of this Amendment, the Pledgor will deliver to the Agent, for the ratable benefit of the Banks, all of the Pledgor's right, title and interest in the capital stock of each of Department 56 Retail, Inc. and Department 56 Sales, Inc. and thereby transfer and grant to the Agent, for the ratable benefit of the Banks, a first security interest in all of the Pledgor's right, title and interest in such capital stock, as collateral security for the prompt and complete payment and performance when due (whether at the stated maturity, by acceleration or otherwise) of the Guarantee Obligations. The Pledgor will execute and deliver stock powers to the Agent with respect to such capital stock as required by Section 3 of the Pledge Agreement.

4. No Other Amendments. Except as expressly amended hereby, the Pledge Agreement shall continue to be, and shall remain, in full force and effect in accordance with its terms. Without limitation of the foregoing, the security interest in the Collateral created by the Pledge Agreement prior to the effectiveness of this Amendment shall remain in full force and effect having the same perfected status and priority, and this Amendment shall not affect the perfection or priority of any such security interest.

5. Counterparts. This Amendment may be executed by the parties hereto in any number of separate counterparts and all of such counterparts taken together shall be deemed to constitute one and the same instrument.

6. Conditions to Effectiveness. This Amendment shall become effective as of the date first written above when each of the following conditions to effectiveness shall have been satisfied:

(i) the Agent shall have received counterparts to this Amendment, duly executed by the Pledgor and the Agent; and

(ii) the Agent shall have received the Acknowledgement and Consent, attached to the Pledge Agreement, duly executed by each of the New Pledged Subsidiaries.

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

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

DEPARTMENT 56, INC.
By: /s/ TIMOTHY J. SCHUGEL
Title: Vice President

THE CHASE MANHATTAN BANK, as Agent
By: /s/ JOHATHAN TWITCHELL
Title: Authorized Signatory

Schedule I

INFORMATION ON NEW PLEDGED SUBSIDIARIES TO BE ADDED
TO SCHEDULE I OF THE PLEDGE AGREEMENT

Issuer	Class of Stock	Stock Certificate No.	No. of Shares	Percentage of Issued Shares
Department 56 Retail, Inc.	Common	1	100,000	100%
Department 56 Sales, Inc.	Common	5	100,000	100%

SUBSIDIARIES GUARANTEE

GUARANTEE dated as of December 30, 1997 made by the undersigned parties hereto, (the "Subsidiaries" or the "Guarantors"), in favor of THE CHASE MANHATTAN BANK, as agent (the "Agent") for the lenders (the "Banks") parties to the Amended and Restated Credit Agreement dated as of February 17, 1995 (the "Credit Agreement") among D 56, Inc., a Minnesota corporation (the "Company"), the Agent, the Banks and the co-agents named therein.

W I T N E S S E T H :

WHEREAS, pursuant to the Credit Agreement, the Banks have severally agreed to make loans to, the Issuing Bank has agreed to issue certain letters of credit for the account of, and the Accepting Bank has agreed to create certain acceptances for, the Company upon the terms and subject to the conditions set forth therein; and

WHEREAS, it is a condition precedent to the effectiveness of the Third Amendment dated as of December 16, 1997 (the "Third Amendment") to the Credit Agreement that each Guarantor shall have executed and delivered this Guarantee to the Agent for the ratable benefit of the Banks;

NOW, THEREFORE, in consideration of the premises and to induce the Agent and the Banks to consent to the Third Amendment and to induce the Banks to make their respective loans to, the Issuing Bank to issue certain letters of credit for the account of, and the Accepting Bank to create certain acceptances for, the Company under the Credit Agreement, each Guarantor hereby agrees with the Agent, for the ratable benefit of the Banks, as follows:

1. Defined Terms. Unless otherwise defined herein, terms which are defined in the Credit Agreement and used herein are so used as so defined and as used herein the following terms shall have the following meanings:

"Guarantee": this Guarantee, as amended, supplemented or otherwise modified from time to time.

"Material Adverse Effect": a material adverse effect on the business, financial condition, assets, liabilities, net assets, properties, results of operations, value or prospects of Holding and its Subsidiaries taken as a whole or the Company and its Subsidiaries taken as a whole.

"Obligations": the unpaid principal of and interest on (including, without limitation, interest accruing after the maturity of the Loans, the Acceptances and reimbursement obligations in connection with the Letters of Credit, and interest accruing after the filing of any petition in

bankruptcy, or the commencement of any insolvency, reorganization or like proceeding, relating to the Company, whether or not a claim for post-filing or post-petition interest is allowed in such proceeding) the Notes, all obligations and liabilities of the Company with respect to the Letters of Credit, all Acceptance Obligations and all other obligations and liabilities of the Company to the Agent or the Banks, whether direct or indirect, absolute or contingent, due or to become due, now existing or hereafter incurred, which may arise under, out of, or in connection with, this Agreement, the Notes, the other Credit Documents, any Letter of Credit or L/C Application, any Acceptance, any agreements between the Company and any Bank relating to interest rate, currency or similar swap and hedging arrangements or any other document made, delivered or given in connection therewith, whether on account of principal, interest, reimbursement obligations, fees, indemnities, costs, expenses (including, without limitation, all fees and disbursements of counsel to the Agent or any Bank) or otherwise.

2. Guarantee. Each Guarantor hereby unconditionally and irrevocably guarantees to the Agent, for the ratable benefit of the Banks, the prompt and complete payment and performance by the Company when due (whether at the stated maturity, by acceleration or otherwise) of the Obligations. Such Guarantor further agrees to pay any and all expenses (including, without limitation, all fees and disbursements of counsel) which may be paid or incurred by the Agent and the Banks in enforcing, or obtaining advice of counsel in respect of, any of their rights under this Guarantee. This Guarantee constitutes a guarantee of payment when due and not of collection, and such Guarantor specifically agrees that it shall not be necessary or required that the Agent or any Bank exercise any right, assert any claim or demand or enforce any remedy whatsoever against the Company (or any other Person) before or as a condition to the obligations of such Guarantor hereunder. This Guarantee shall remain in full force and effect until the Obligations are paid in full, no Letters of Credit or Acceptance Obligations are outstanding and the Commitments are terminated, notwithstanding that from time to time prior thereto the Company may be free from any Obligations.

Each Guarantor agrees that whenever, at any time, or from time to time, it shall make any payment to the Agent or any Bank on account of its liability hereunder, it will notify the Agent or such Bank in writing that such payment is made under this Guarantee for such purpose. No payment or payments made by the Company or any other Person or received or collected by the Agent or any Bank from the Company or any other Person by virtue of any action or proceeding or any set-off or appropriation or application, at any time or from time to time, in reduction of or in payment of the Obligations shall be deemed to modify, reduce, release or otherwise affect the liability of such Guarantor hereunder which shall, notwithstanding any such payment or payments, remain liable for the amount of the Obligations until the Obligations are paid in full and the Commitments are

terminated.

Anything herein or in any of the Credit Documents to the contrary notwithstanding, the maximum liability of each Guarantor hereunder and under the other Credit Documents shall in no event exceed the amount which can be guaranteed by such Guarantor under applicable federal and state laws relating to the insolvency of debtors.

3. Right of Setoff. Upon the occurrence and during the continuance of any Event of Default specified in the Credit Agreement, the Agent and each Bank are hereby irrevocably authorized at any time and from time to time without notice to each Guarantor, any such notice being hereby waived by such Guarantor, to set off and appropriate and apply any and all deposits (general or special, time or demand, provisional or final), in any currency, and any other credits, indebtedness or claims, in any currency, in each case whether direct or indirect, absolute or contingent, matured or unmatured, at any time held or owing by the Agent or such Bank to or for the credit or the account of such Guarantor, or any part thereof in such amounts as the Agent or such Bank may elect, on account of the liabilities of such Guarantor hereunder and claims of every nature and description of the Agent or such Bank against such Guarantor, in any currency, whether arising hereunder, under the Credit Agreement, the Notes, any other Credit Document, any Letter of Credit, any Acceptance or otherwise, as the Agent or such Bank may elect, whether or not the Agent or such Bank has made any demand for payment and although such liabilities and claims may be contingent or unmatured. The Agent and each Bank shall notify such Guarantor against which setoff has been made promptly of any such setoff made by it and the application made by it of the proceeds thereof, provided that the failure to give such notice shall not affect the validity of such setoff and application. The rights of the Agent and each Bank under this paragraph are in addition to other rights and remedies (including, without limitation, other rights of setoff) which the Agent and such Bank may have.

4. Subrogation, etc.. Notwithstanding any payment or payments made by the Guarantor hereunder or any set-off or application of funds of the Guarantor by any Bank, the Guarantor shall not exercise any of the rights of the Agent or any Bank which the Guarantor may acquire by way of subrogation, by any payment made hereunder, by reason of such set-off or application of funds or otherwise, against the Company or any collateral security or guarantee or right of offset held by any Bank for the payment of the Obligations, and the Guarantor shall not seek or be entitled to seek any contribution or reimbursement from the Company in respect of payments made by the Guarantor hereunder, until all amounts owing to the Agent and the Banks by the Company on account of the Obligations are paid in full, no Letters of Credit are outstanding and the Commitments are terminated. If any amount shall be paid to the Guarantor on account of such subrogation rights at any time when all of the Obligations shall not have been paid in full, any Letter of Credit shall be

outstanding or the Commitments shall not have been terminated, such amount shall be held by the Guarantor in trust for the Agent and the Banks, segregated from other funds of the Guarantor, and shall, forthwith upon receipt by the Guarantor, be turned over to the Agent in the exact form received by the Guarantor (duly indorsed by the Guarantor to the Agent, if required), to be applied against the Obligations, whether matured or unmatured, in such order as required by the applicable Credit Documents.

5. Amendments, etc. with Respect to the Obligations. Each Guarantor shall remain obligated hereunder notwithstanding that, without any reservation of rights against such Guarantor, and without notice to or further assent by such Guarantor, any demand for payment of any of the Obligations made by the Agent or any Bank may be rescinded by the Agent or such Bank, and any of the Obligations continued, and the Obligations, or the liability of any other Person upon or for any part thereof, or any collateral security or guarantee therefor or right of offset with respect thereto, may, from time to time, in whole or in part, be renewed, extended, amended, modified, accelerated, compromised, waived, surrendered or released by the Agent or any Bank, and the Credit Agreement, any Note, any other Credit Document, any Letter of Credit, any Acceptance and any other documents executed and delivered in connection therewith may be amended, modified, supplemented or terminated, in whole or in part, as the Banks (or the Required Banks, as the case may be) may deem advisable from time to time, and any collateral security, guarantee or right of offset at any time held by the Agent or any Bank for the payment of the Obligations may be sold, exchanged, waived, surrendered or released. Neither the Agent nor any Bank shall have any obligation to protect, secure, perfect or insure any Lien at any time held by it as security for the Obligations or for this Guarantee or any property subject thereto.

6. Guarantee Absolute and Unconditional. Each Guarantor waives any and all notice of the creation, renewal, extension or accrual of any of the Obligations and notice of or proof of reliance by the Agent or any Bank upon this Guarantee or acceptance of this Guarantee; the Obligations, and any of them, shall conclusively be deemed to have been created, contracted or incurred in reliance upon this Guarantee; and all dealings between the Company or any Guarantor, on the one hand, and the Agent or the Banks, on the other, shall likewise be conclusively presumed to have been had or consummated in reliance upon this Guarantee. Such Guarantor waives diligence, presentment, protest, demand for payment and notice of default or nonpayment to or upon the Company or such Guarantor with respect to the Obligations. This Guarantee shall be construed as a continuing, absolute and unconditional guarantee of payment without regard to (a) the validity or enforceability of the Credit Agreement, any Note, any other Credit Document, any Letter of Credit, any Acceptance, any of the Obligations or any collateral security therefor or guarantee or right of offset with respect thereto at any time or from time to time held by the Agent or any Bank, (b) any defense, setoff or counterclaim (other than a defense of payment or performance) which may at any time be available to or

be asserted by the Company against the Agent or any Bank, or (c) any other circumstance whatsoever (with or without notice to or knowledge of the Company or such Guarantor) which constitutes, or might be construed to constitute, an equitable or legal discharge of the Company for the Obligations, or of such Guarantor under this Guarantee, in bankruptcy or in any other instance. When the Agent is pursuing its rights and remedies hereunder against such Guarantor, the Agent or any Bank may, but shall be under no obligation to, pursue such rights and remedies as it may have against the Company or any other Person or against any collateral security or guarantee for the Obligations or any right of offset with respect thereto, and any failure by the Agent or any Bank, or any release of the Company or any such other Person or of any such collateral security, guarantee or right of offset, shall not relieve any such Guarantor of any liability hereunder, and shall not impair or affect the rights and remedies, whether express, implied or available as a matter of law, of the Agent and the Banks against such Guarantor.

7. Reinstatement. This Guarantee shall continue to be effective, or be reinstated, as the case may be, if at any time payment, or any part thereof, of any of the Obligations is rescinded or must otherwise be restored or returned by the Agent or any Bank, upon the insolvency, bankruptcy, dissolution, liquidation or reorganization of the Company or any Guarantor or upon or as a result of the appointment of a receiver, intervenor or conservator of, or trustee or similar officer for, the Company or any Guarantor or any substantial part of its property, or otherwise, all as though such payments had not been made.

8. Payments. Each Guarantor hereby agrees that the Obligations will be paid to the Agent without setoff or counterclaim in U.S. Dollars and immediately available funds at the office of the Agent located at 270 Park Avenue, New York, New York 10017.

9. Representations and Warranties. Each Guarantor hereby represents and warrants that:

(a) it is a corporation duly organized, validly existing and in good standing under the laws of the State of Minnesota and has the corporate power and authority and the legal right to own and operate its property, to lease the property it operates and to conduct the business in which it is currently engaged, except to the extent that the failure to possess such corporate power and authority and such legal right would not, in the aggregate, have a Material Adverse Effect;

(b) it has the corporate power and authority and the legal right to execute and deliver, and to perform its obligations under, this Guarantee and has taken all necessary corporate action to authorize its execution, delivery and performance of this Guarantee;

(c) this Guarantee constitutes a legal, valid and

binding obligation of such Guarantor enforceable in accordance with its terms, except as enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium or similar laws affecting the enforcement of creditors' rights generally and by general principles of equity (regardless of whether enforcement is sought in a proceeding in equity or at law);

(d) the execution, delivery and performance of this Guarantee will not violate any provision of any Requirement of Law or Contractual Obligation of such Guarantor and will not result in or require the creation or imposition of any Lien on any of the properties or revenues of such Guarantor pursuant to any Requirement of Law or Contractual Obligation of such Guarantor;

(e) no consent or authorization of, filing with, or other act by or in respect of, any arbitrator or Governmental Authority and no consent of any other Person (including, without limitation, any stockholder or creditor of such Guarantor) is required in connection with the execution, delivery, performance, validity or enforceability of this Guarantee;

(f) no litigation, investigation or proceeding of or before any arbitrator or Governmental Authority is pending or, to the knowledge of such Guarantor, threatened by or against such Guarantor or against any of its properties or revenues (i) with respect to this Guarantee or (ii) which would have a Material Adverse Effect;

(g) it has good record and marketable title in fee simple to or valid leasehold interests in all its material real property, and good title to all its other material property, and none of such property is subject to any Lien of any nature whatsoever; and

(h) it has filed or caused to be filed or has timely requested an extension to file or has received an approved extension to file all tax returns required to be filed by it, and has paid all taxes due on said returns or extension requests or on any assessments made against it (other than those being contested in good faith by appropriate proceedings for which reserves in conformity with GAAP have been provided on its books), except any such filings or taxes, fees or other charges, the making or payment of which, or the failure to make or pay, would not have a Material Adverse Affect.

Each Guarantor agrees that the foregoing representations and warranties shall be deemed to have been made by it on each Borrowing Date by the Company under the Credit Agreement on and as of such Borrowing Date as though made hereunder on and as of such Borrowing Date.

10. Severability. Any provision of this Guarantee

which is prohibited or unenforceable in any jurisdiction shall, as to such jurisdiction, be ineffective to the extent of such prohibition or unenforceability without invalidating the remaining provisions hereof, and any such prohibition or unenforceability in any jurisdiction shall not invalidate or render unenforceable such provision in any other jurisdiction.

11. Paragraph Headings. The paragraph headings used in this Guarantee are for convenience of reference only and are not to affect the construction hereof or be taken into consideration in the interpretation hereof.

12. No Waiver; Cumulative Remedies. Neither the Agent nor any Bank shall by any act (except by a written instrument pursuant to paragraph 13 hereof), delay, indulgence, omission or otherwise be deemed to have waived any right or remedy hereunder or to have acquiesced in any Default or Event of Default or in any breach of any of the covenants, terms, or conditions hereof. No failure to exercise, nor any delay in exercising, on the part of the Agent or any Bank, any right, power or privilege hereunder shall operate as a waiver thereof. No single or partial exercise of any right, power or privilege hereunder shall preclude any other or further exercise thereof or the exercise of any other right, power or privilege. A waiver by the Agent or any Bank or any right or remedy hereunder on any one occasion shall not be construed as a bar to any right or remedy which the Agent or such Bank would otherwise have on any future occasion. The rights and remedies herein provided are cumulative, may be exercised singly or concurrently and are not exclusive of any rights or remedies provided by law.

13. Waivers and Amendments; Successors and Assigns; Governing Law. None of the terms or provisions of this Guarantee may be waived, amended, supplemented or otherwise modified except by a written instrument executed by each Guarantor and the Agent, provided that any provision of this Guarantee may be waived by the Agent in a letter or agreement executed by the Agent or by telex or facsimile transmission from the Agent. This Guarantee shall be binding upon the successors and assigns of the such Guarantor and shall inure to the benefit of the Agent and the Bank and their successors and assigns. THIS GUARANTEE SHALL BE GOVERNED BY, AND CONSTRUED AND INTERPRETED IN ACCORDANCE WITH, THE LAWS OF THE STATE OF NEW YORK.

14. Notices. All notices, requests and demands to or upon any Guarantor or the Agent or any Bank to be effective shall be in writing or by telecopy or telex and, unless otherwise expressly provided herein, shall be deemed to have been duly given or made when delivered by hand, or, in the case of mail, three Business Days after deposit in the postal system, first class postage prepaid, or, in the case of telecopy notice, when sent, confirmation of receipt received, or, in the case of telex or facsimile notices, when sent, answerback received, addressed, in the case of the Agent or any Bank, at the address provided for such party in subsection 11.2 of the Credit Agreement or, in the case of such Guarantor, at the addresses provided on the

signature page hereto, as the case may be.

15. Authority of Agent. Each Guarantor acknowledges that the rights and responsibilities of the Agent under this Guarantee with respect to any action taken by the Agent or the exercise or non-exercise by the Agent of any option, right, request, judgment or other right or remedy provided for herein or resulting or arising out of this Guarantee shall, as between the Agent or the Banks, be governed by the Credit Agreement and by such other agreements with respect thereto as may exist from time to time among them, but, as between the Agent and such Guarantor, the Agent shall be conclusively presumed to be acting as agent for the Banks with full and valid authority so to act or refrain from acting, and such Guarantor shall not be under any obligation, or entitlement, to make any inquiry respecting such authority.

16. Integration; Acknowledgements. Each Guarantor hereby confirms its agreement with subsections 11.9 and 11.12 of the Credit Agreement.

17. SUBMISSION TO JURISDICTION; WAIVERS. (a) EACH GUARANTOR HEREBY IRREVOCABLY AND UNCONDITIONALLY:

(i) SUBMITS FOR ITSELF AND ITS PROPERTY IN ANY LEGAL ACTION OR PROCEEDING RELATING TO THIS GUARANTEE AND EACH OTHER CREDIT DOCUMENT TO WHICH IT IS A PARTY OR, OR FOR RECOGNITION AND ENFORCEMENT OF ANY JUDGMENT IN RESPECT THEREOF, TO THE NON-EXCLUSIVE GENERAL JURISDICTION OF THE COURTS OF THE STATE OF NEW YORK, THE COURTS OF THE UNITED STATES OF AMERICA FOR THE SOUTHERN DISTRICT OF NEW YORK, AND APPELLATE COURTS FROM ANY THEREOF;

(ii) CONSENTS THAT ANY SUCH ACTION OR PROCEEDING MAY BE BROUGHT IN SUCH COURTS, AND WAIVES ANY OBJECTION THAT IT MAY NOW OR HEREAFTER HAVE TO THE VENUE OF ANY SUCH ACTION OR PROCEEDING IN ANY SUCH COURT OR THAT SUCH ACTION OR PROCEEDING WAS BROUGHT IN AN INCONVENIENT COURT AND AGREES NOT TO PLEAD OR CLAIM THE SAME;

(iii) AGREES THAT SERVICE OR PROCESS IN ANY SUCH ACTION OR PROCEEDING MAY BE AFFECTED BY MAILING A COPY THEREOF BY REGISTERED OR CERTIFIED MAIL (OR ANY SUBSTANTIALLY SIMILAR FORM OF MAIL), POSTAGE PREPAID, TO SUCH GUARANTOR AT ITS ADDRESS SET FORTH UNDER ITS SIGNATURE BELOW OR AT SUCH OTHER ADDRESS OF WHICH THE AGENT SHALL HAVE BEEN NOTIFIED PURSUANT TO PARAGRAPH 14; AND

(iv) AGREES THAT NOTHING HEREIN SHALL AFFECT THE RIGHT TO EFFECT SERVICE OF PROCESS IN ANY OTHER MANNER PERMITTED BY LAW OR SHALL LIMIT THE RIGHT TO SUE IN ANY OTHER JURISDICTION.

(b) EACH OF THE AGENT, EACH BANK AND EACH GUARANTOR UNCONDITIONALLY WAIVES TRIAL BY JURY IN ANY LEGAL ACTION OR

PROCEEDING REFERRED TO IN PARAGRAPH (a) ABOVE.

IN WITNESS WHEREOF, the undersigned has caused this
Guarantee to be duly executed and delivered as of the date first
above written.

DEPARTMENT 56 RETAIL, INC.
By: /s/ TIMOTHY J. SCHUGEL
Title: Vice President

Address:
1 Village Place
6436 City West Parkway
Eden Prairie, Minnesota 55344
Attention: Chief Financial Officer

DEPARTMENT 56 SALES, INC.
By: /s/ TIMOTHY J. SCHUGEL
Title: Vice President

Address:
1 Village Place
6436 City West Parkway
Eden Prairie, Minnesota 55344
Attention: Chief Financial Officer

DEPARTMENT 56, INC.
ANNUAL CASH INCENTIVE PROGRAM

1. PURPOSE

The purpose of the Annual Cash Incentive Program is to enhance Department 56, Inc.'s ability to attract, motivate, reward and retain employees, to strengthen their commitment to the success of the Company and to align their interests with those of the Company's stockholders by providing additional compensation to designated employees of the Company based on the achievement of performance objectives. To this end, the Annual Cash Incentive Program provides a means of annually rewarding participants largely based on the performance of the Company and, to a much lesser degree, based on exceptional instances of personal performance.

2. DEFINITIONS

(a) "Award" shall mean the cash incentive award earned by a Participant under the Program for any Performance Period.

(b) "Base Salary" shall mean the Participant's annual base salary rate, based on the Company's latest Form CTN in effect for the Participant during the Performance Period to which such Form CTN relates. Annual base salary rate (1) does not include (i) Awards under the Program, (ii) profit sharing, 401(k) "match", or other long-term incentive awards, (iii) imputed or actual income from stock option exercises or such programs as life insurance or (iv) nonrecurring earnings such as moving expenses, and (2) is based on salary rate before reductions for such items as contributions under Section 401(k) of the Internal Revenue Code of 1986, as amended, and Company-sponsored deferred compensation arrangements.

(c) "Board" shall mean the Board of Directors of the Company.

(d) "Business Program", for any Performance Period, shall mean the Company's final financial plan for such Performance Period, submitted to and approved by the Board before the earlier of (1) the ninety-first day of such Performance Period or (2) the end of the first quarter of such Performance Period.

(e) "Change of Control" shall mean the occurrence during the term of the Program of:

(i) An acquisition (other than directly from the Company) of any voting securities of the Company (the "Voting Securities") by any 'Person' (as the term person is used for purposes of Section 13(d) or 14(d) of the Exchange Act), immediately after which such Person has 'Beneficial Ownership' (within the meaning of Rule 13d-3 promulgated

under the Exchange Act) of fifty-one percent (51%) or more of the combined voting power of the Company's then outstanding Voting Securities; provided, however, in determining whether a Change of Control has occurred, Voting Securities which are acquired in a 'Non-Control Acquisition' (as hereinafter defined) shall not constitute an acquisition which would cause a Change of Control. A 'Non-Control Acquisition' shall mean an acquisition by (i) an employee benefit plan (or a trust forming a part thereof) maintained by (A) the Company or (B) any corporation or other Person of which a majority of its voting power or its voting equity securities or equity interest is owned, directly or indirectly, by the Company (for purposes of this definition, a 'Subsidiary'), (ii) the Company or its Subsidiaries, or (iii) any Person in connection with a 'Non-Control Transaction' (as hereinafter defined);

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

(iii) Approval by stockholders of the Company of:

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

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

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

PAGE 2 OF 11

the Voting Securities of the Surviving Corporation,

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

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

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

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

(f) "Company" shall mean Department 56, Inc., its successors and assigns.

(g) "Compensation Committee" shall mean the Compensation Committee of the Board.

(h) "Consolidated EBIT", for any fiscal year or Performance Period, shall mean the Consolidated Net Income ((i) including earnings and losses from discontinued operations, except to the extent that any such losses represent reserves for losses attributable to the planned disposition of material assets, (ii) excluding extraordinary gains or losses, and gains and losses arising from the sale of material assets, and (iii) including other non-recurring gains or losses) of the Company and its Subsidiaries for such fiscal year or Performance Period, PLUS to the extent reflected as a charge in the statement of Consolidated Net Income for such fiscal year or Performance Period, the sum of (a) net interest expense, amortization of debt discount and debt issuance costs (including the write-off of such costs in connection with prepayments of debt) and commissions,

PAGE 3 OF 11

discounts and other fees and charges associated with letters of credit, (b) taxes measured by income accrued as an expense during such fiscal year or Performance Period, and (c) non-cash compensation expense resulting from the accounting treatment applied, in accordance with GAAP, to management's equity interest.

(i) "Consolidated Net Income": for any period, the net income or net loss of the Company and its Subsidiaries for such period determined in accordance with GAAP on a consolidated basis.

(j) "Current Year EBIT Target", for any Performance Period, shall mean the Consolidated EBIT goal for such Performance Period, (i) as reflected as EBIT (or Income From Operations in lieu thereof) in the Business Program or (ii) if such Performance Period is not a fiscal year, as established by the Compensation Committee.

(k) "Current Year Financial Target Earned", for any Performance Period, shall mean the percentage based on the achievement of Current Year EBIT Target.

(l) "Disability" shall mean permanent disability, as provided in the Company's long-term disability plan.

(m) "Effective Date" shall mean the date that the Program is adopted by the Board.

(n) "Employee" shall mean any person (including an officer) employed by the Company or any of its Subsidiaries on a full-time basis except for any (i) commissioned sales representative, (ii) non-exempt employee or seasonal or temporary worker, (iii) employee represented in his or her employment relationship by a collective bargaining unit or other labor union, guild or association, (iv) employee principally in a non-managerial position in any operation of the Company or any Subsidiary located outside the United States of America, or (v) employee of a Subsidiary (other than D56, Inc.) which the Compensation Committee or the Management HR Committee, as the case may be, designates in such committee's discretion as being ineligible to participate in the Program.

(o) "Exchange Act" shall mean the Securities Exchange Act of 1934, as amended.

(p) "GAAP" shall mean generally accepted accounting principles in the United States of America in effect from time to time.

(q) "Key Employee" shall mean any Employee so designated by the Management HR Committee.

(r) "Management HR Committee" shall mean a committee composed of four Company officers, being the Chief Executive Officer and the Company's senior human resources officer (both of whom shall be standing members of the Management HR

Committee), and, on an annual rotating basis, two officers (Vice President level or higher) of the Company selected by the standing members of the Management HR Committee.

(s) "Participant", for any Performance Period, shall mean an Employee who is eligible to participate in the Program for such Performance Period as provided in Section 3 of the Program.

(t) "Performance Period" shall mean the fiscal year of the Company or any other period designated by the Compensation Committee with respect to which an Award is earned.

(u) "Program" shall mean this Department 56, Inc. Annual Cash Incentive Program, as from time to time amended and in effect.

(v) "Retirement" shall mean retirement at or after age 65 or early retirement with the prior written approval of the Company.

(w) "Subsidiary" shall mean a corporation as defined in Section 424(f) of the Internal Revenue Code of 1986, as amended, with the Company being treated as the employer corporation for purposes of this definition.

(x) "Target Award Percentage" for any Participant with respect to any Performance Period, shall mean the percentage of the Participant's Base Salary that the Participant would earn as an Award for that Performance Period if each of the Current Year Financial Target Earned and Trend Financial Target Earned for that Performance Period is 100%, and shall be as set forth on a schedule adopted by the Compensation Committee with respect to officers who are Participants and as set forth on a schedule adopted by the Management HR Committee with respect to all other Participants, based on the Participant's responsibility level or the position or positions held during the Performance Period; PROVIDED, HOWEVER, that if any Participant held more than one position during the Performance Period, then the Compensation Committee or Management HR Committee, as applicable, may designate different Target Award Percentages with respect to each position and the Award will be pro-rated to reflect the number of days during which such Participant had each Target Award Percentage.

(y) "Trend EBIT Performance", for any fiscal year Performance Period, shall mean the three-year rolling average annual change in Consolidated EBIT. Trend EBIT Performance shall be calculated as a fraction (and expressed as a percentage), the numerator of which is the sum of Trend EBIT Snapshot for such fiscal year and Trend EBIT Snapshot for each of the two immediately preceding fiscal years, and the denominator of which is three; PROVIDED, HOWEVER, that Trend EBIT Performance for the 1997 fiscal year Performance Period shall equal Trend EBIT Snapshot solely for the Company's 1997 fiscal year; and FURTHER PROVIDED, that Trend EBIT Performance for the 1998 fiscal year

Performance Period shall equal a fraction (expressed as a percentage), the numerator of which is the sum of Trend EBIT Snapshot for each of the Company's 1997 and 1998 fiscal years, and the denominator of which is two.

(z) "Trend EBIT Snapshot", for any Company fiscal year shall mean the percentage change in Consolidated EBIT for such fiscal year in relation to Consolidated EBIT for the immediately preceding fiscal year; PROVIDED, HOWEVER, that Trend EBIT Snapshot for the 1997 fiscal year shall be deemed to equal zero for purposes of calculating Trend EBIT Performance for the 1997, 1998 and 1999 fiscal year Performance Periods and for all other purposes under the Program.

(aa) "Trend Financial Target Earned", for any fiscal year Performance Period, shall mean the percentage based on the achievement of Trend EBIT Target.

(bb) "Trend EBIT Target", for any fiscal year Performance Period, shall mean the Trend EBIT Performance goal for such year as established by the Compensation Committee.

3. ELIGIBILITY

Participation in the Program for a Performance Period shall be limited to those Employees who are eligible to participate as provided in this Section 3. To be eligible to participate in the Program in any Performance Period, an Employee shall have had a least three months active tenure during such Performance Period and be actively employed by the Company on the Award payment date. The Compensation Committee or Management HR Committee may approve, in accordance with Sections 7 and 8 of this Program, exceptions for special circumstances.

Employees shall participate in only one annual cash or sales incentive program for any specific period in time. For example, an individual may not participate in both the Program and the Company's sales commission or sales incentive program at the same time. An individual may participate in two programs sequentially during any Performance Period because of promotion or reassignment, provided that participation in each such program is pro-rated based on the number of days he or she participated in each program.

If an Employee becomes a Participant during a Performance Period, such Participant's Award will be pro-rated based on the number of days that he or she is a Participant.

4. ADMINISTRATION

The administration of the Program shall be consistent with the purpose and the terms of the Program. The Program shall be administered by the Compensation Committee with respect to officers and by the Management HR Committee with respect to all other Participants. Each member of the Compensation Committee shall be an "outside director" within the meaning of Treasury Regulations under Section 162(m) of

the Internal Revenue Code of 1986, as amended. The Compensation Committee and the Management HR Committee, as the case may be, shall have full authority to establish the rules and regulations relating to the Program, to interpret the Program and those rules and regulations, to decide the facts in any case arising under the Program, to reduce or eliminate any Participant's Award that would otherwise be payable pursuant to the terms of the Program in the event the Participant has demonstrated job performance below Company expectations or otherwise in such committee's discretion, and to make all other determinations and to take all other actions necessary or appropriate for the proper administration of the Program, including the delegation of such authority or power, where appropriate; PROVIDED, HOWEVER, that only the Compensation Committee shall have authority to amend or terminate the Program. In addition, the Management HR Committee shall have, with respect to non-officer Employees, full authority to select such Participants in the Program and to determine each such Participant's Target Award Percentage. Moreover, with respect to Participants who are not officers or Key Employees, the Management HR Committee shall have full authority to grant Awards in such amounts as it may determine in any event that (i) no Awards to such Participants would otherwise be payable pursuant to Section 5 of this Program or (ii) Awards to such Participants of lesser amounts would otherwise be payable pursuant to Section 5 of this Program. The Compensation Committee's and the Management HR Committee's administration of the Program, including all such rules and regulations, interpretations, selections, determinations, approvals, decisions, delegations, amendments, terminations and other actions, shall be final and binding on the Company, the Subsidiaries, their respective stockholders and all employees of the Company and the Subsidiaries, including the Participants and their respective beneficiaries. No member of the Compensation Committee or the Management HR Committee shall be liable for any action, failure to act, determination or interpretation made in good faith with respect to the Program or any transaction hereunder, except for liability arising from his or her own willful misfeasance, gross negligence or reckless disregard of his or her duties. The Company hereby agrees to indemnify each member of the Compensation Committee and each member of the Management HR Committee for all costs and expenses and, to the extent permitted by applicable law, any liability incurred in connection with defending against, responding to, negotiating for the settlement of or otherwise dealing with any claim, cause of action or dispute of any kind arising in connection with any actions in administering the Program or in authorizing or denying authorization to any transaction hereunder.

5. DETERMINATION OF DEFINED AWARDS

Prior to, or as soon as practicable following, the commencement of each Performance Period, the Management HR Committee with respect to all non-officer Participants shall then determine each such Participant's Target Award Percentage.

PAGE 7 OF 11

The Company shall notify each Participant of his or her Target Award Percentage for the Performance Period. In addition to, and without limiting the generality of the foregoing, the Company's officers shall also participate in the Program for every Performance Period in accordance with Section 3 hereof, and the Target Award Percentage of each officer shall be as determined by the Compensation Committee.

Generally, a Participant earns an Award for a Performance Period based on (i) the Company's achievement of the Current Year EBIT Target and the Trend EBIT Target, and (ii) as further described in Section 6 below, his or her achievement of extraordinary personal quality performance. The portion of Awards based on "COMPONENT A" set forth below will only be earned if the Company achieves 90% or higher of the Current Year EBIT Target for such Performance Period. The portion of Awards based on "COMPONENT B" set forth below will only be earned if the Company achieves one-half or more of the Trend EBIT Target.

Awards shall be earned by Participants in accordance with the following formula:

"COMPONENT A"

Target Award Percentage	x	Base Salary	x	Current Year Financial Target Earned
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PLUS

"COMPONENT B"

Target Award Percentage	x	Base Salary	x	Trend Financial Target Earned
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6. DETERMINATION OF DISCRETIONARY AWARDS

There shall be a pool (not exceeding one hundred thousand dollars) created each fiscal year Performance Period from which Awards may be granted to any Participant solely in respect of such Participant's personal job performance and without regard to the determination of defined Awards or achievement of financial targets contemplated by Section 5 above; PROVIDED, HOWEVER, that no such pool shall be created for a Performance Period unless the Business Program for such Performance Period assumes and reflects the expense effect of full utilization of the pool.

The Compensation Committee (with respect to any Participant) and the

Management HR Committee (with respect to any non-officer Participant) shall each have the authority to grant and pay Awards from any pool described in the preceding paragraph at such times and in such amounts as such committee, in its sole discretion, shall determine. Notwithstanding the proviso contained in the preceding paragraph, there shall be no obligation of either the Compensation Committee or the Management HR Committee to grant any Awards (or to continue or repeat the granting of any Awards) to any Participant or Participants pursuant to this Section 6.

Discretionary bonus pool amounts not utilized in a Performance Period shall not be carried over or accumulated with any discretionary bonus pool amounts permitted in any subsequent Performance Periods.

7. CHANGES TO TARGET AWARD PERCENTAGES

The Compensation Committee, with respect to officers who are Participants, and the Management HR Committee, with respect to all other Participants, may at any time prior to the final determination of Awards change the Target Award Percentage of any Participant or assign a different Target Award Percentage to a Participant to reflect any change in the Participant's responsibility level or position during the course of the Performance Period.

The Compensation Committee, with respect to officers who are Participants, and the Management HR Committee, with respect to all other Participants, may at any time prior to the final determination of Awards change the Current Year EBIT Target to reflect extraordinary events, accounting changes or a corporate transaction, such as a merger, consolidation, separation, reorganization or partial or complete liquidation.

8. PAYMENT OF DEFINED AWARDS

As soon as practicable after the close of a Performance Period (but not before the Audit Committee of the Board has approved the corresponding audited financial statements if such Performance Period is a fiscal year), the Management HR Committee shall confirm the calculation of each Participant's Award pursuant to Section 5. Subject to the provisions of Section 9 of the Program, each Award to the extent earned pursuant to Section 5 shall be paid in a single lump sum cash payment, as soon as practicable after the close of the Performance Period, but no later than 120 days after the close of the Performance Period.

If a Change of Control occurs, the Company shall, within 60 days thereafter, pay to each Participant in the Program immediately prior to the Change of Control (regardless of whether the Participant remains employed after the Change of Control) an Award under Section 5 which is calculated assuming that Current Year EBIT Target and Trend EBIT Target for such Performance Period are fully (100%) achieved, and such Award shall be

prorated to the date of the Change of Control based on the number of days that have elapsed during the Performance Period through the date of the Change of Control.

9. LIMITATIONS ON RIGHTS TO PAYMENT OF AWARDS

No Participant shall have any right to receive payment of an Award under Section 5 or Section 6 of the Program for a Performance Period unless the Participant remains in the employ of the Company through the December 31 of the fiscal year for such Performance Period, except as provided in the last paragraph of Section 8 of the Program. However, if the Participant has active service with the Company or the Subsidiary for at least three months during any Performance Period, but, prior to payment of the Award for such Performance Period, a Participant's employment with the Company terminates due to the Participant's death, Disability or Retirement, the Participant (or, in the event of the Participant's death, the Participant's estate, beneficiary or beneficiaries as determined under Section 10 of the Program) shall remain eligible to receive any earned Award, which in the case of any Award under Section 5 shall be prorated to a portion based on the number of days that the Participant was actively employed by the Company or a Subsidiary and performed services for it during such Performance Period.

10. DESIGNATION OF BENEFICIARY

A Participant may designate a beneficiary or beneficiaries who, in the event of the Participant's death prior to full payment of any Award hereunder, shall receive payment of any Award due under the Program. The Participant may, at any time, change or revoke his or her express written designation. A beneficiary designation, or revocation of a prior beneficiary designation, will be effective only if it is made in writing on a form provided by the Company, signed by the Participant and received by the Secretary of the Company. If the Participant does not designate a beneficiary or the beneficiary dies prior to receiving any payment of an Awards, Awards payable under the Program shall be paid to the Participant's estate.

11. AMENDMENTS

The Compensation Committee may at any time amend (in whole or in part) this Program. No such amendment which adversely affects any Participant's rights to or interest in an Award earned prior to the date of the amendment shall be effective unless the Participant shall have agreed thereto.

12. TERMINATION

PAGE 10 OF 11

The Compensation Committee may terminate this Program (in whole or in part) at any time. In the case of such termination of the Program, the following provisions of this Section 12 shall apply notwithstanding any other provisions of the Program to the contrary:

(i) The Compensation Committee shall promulgate administrative rules applicable to Program termination, pursuant to which each affected Participant shall receive, with respect to each Performance Period which has commenced on or prior to the effective date of the Program termination (the "Termination Date") and for which the Award under Section 5 has not yet been paid, the amount equal to the amount his or her Award under Section 5 would have been had the Program not been terminated (prorated for the Performance Period in which the Termination Date occurred), subject to reduction in the discretion of the Compensation Committee.

(ii) Each Award payable under this Section 12 shall be paid as soon as practicable, but in no event later than 120 days after the end of the fiscal year in which the Termination Date occurs.

13. MISCELLANEOUS PROVISIONS

(a) This Program is not a contract between the Company or any Subsidiary and the Employees or the Participants. Neither the establishment of this Program, nor any action taken hereunder, shall be construed as giving any Employee or any Participant any right to be retained in the employ of the Company or any Subsidiary. The Company is under no obligation to continue the Program.

(b) A Participant's right and interest under the Program may not be assigned or transferred, except as provided in Section 10 of the Program, and any attempted assignment or transfer shall be null and void and shall extinguish, in the Company's sole discretion, the Company's obligation under the Program to pay Awards with respect to the Participant.

(c) The Program shall be unfunded. The Company shall not be required to establish any special or separate fund, or to make any other segregation of assets, to assure payment of Awards.

(d) The Company shall have the right to deduct from Awards paid any interest thereon, any taxes or other amounts required by law to be withheld.

(e) Nothing contained in the Program shall limit or affect in any manner or degree the normal and usual powers of management, exercised by the officers and the Board or committees thereof, to change the duties or the character of employment of any employee of the Company or any Subsidiary or to remove the individual from the employment of the Company or any Subsidiary at any time, all of which rights and powers are expressly reserved.

Exhibit 11.1

DEPARTMENT 56, INC.
 COMPUTATION OF NET INCOME AND INCOME BEFORE EXTRAORDINARY ITEM
 PER SHARE
 (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	Year Ended January 3, 1998 ----	Year Ended December 28, 1996 ----	Year Ended December 30, 1995 ----
BASIC:			
Income Before Extraordinary Item	\$42,781 -----	\$45,944 -----	\$49,565 -----
Net Income	\$42,781 -----	\$45,944 -----	\$48,253 -----
Weighted average number of common shares outstanding	20,744	21,560	21,519
Income Before Extraordinary Item per Common Share	\$ 2.06 -----	\$ 2.13 -----	\$ 2.30 -----
Net Income per Common Share	\$ 2.06 -----	\$ 2.13 -----	\$ 2.24 -----
ASSUMING DILUTION:			
Income Before Extraordinary Item	\$42,781 -----	\$45,944 -----	\$49,565 -----
Net Income	\$42,781 -----	\$45,944 -----	\$48,253 -----
Weighted average number of common shares outstanding	20,744	21,560	21,519
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	152 -----	199 -----	228 -----
Weighted average number of common and common equivalent shares	20,896 -----	21,759 -----	21,747 -----
Income Before Extraordinary Item per Common Share Assuming Dilution	\$ 2.05	\$ 2.11	\$ 2.28

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-----	-----	-----
-----	-----	-----
Net Income per Common Share Assuming Dilution	\$ 2.05	\$ 2.11
\$ 2.22	-----	-----
-----	-----	-----
-----	-----	-----

FIVE-YEAR SUMMARY

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	YEAR ENDED JAN. 3, 1998(1)	YEAR ENDED DEC. 28, 1996(1)	YEAR ENDED DEC. 30, 1995(1)	YEAR ENDED DEC. 31, 1994(1)	YEAR ENDED JAN. 1, 1994(1)
STATEMENTS OF INCOME					
Net sales	\$219,496	\$228,775	\$252,047	\$217,865	\$184,359
Cost of sales	94,040	95,190	110,008	98,480	87,331
Gross profit	125,456	133,585	142,039	119,385	97,028
Operating expenses:					
Selling, general and administrative	50,142	48,306	47,889	41,831	34,670
Amortization of goodwill and trademarks	4,577	4,577	4,577	4,577	4,575
Recovery of import duties(2)	(370)	(453)	(2,872)	--	--
Total operating expenses	54,349	52,430	49,594	46,408	39,245
Income from operations	71,107	81,155	92,445	72,977	57,783
Other expense (income):					
Interest expense	4,362	6,063	9,582	12,629	16,143
Gain on sale of aircraft(3)	(2,882)	--	--	--	--
Other, net	(1,086)	(648)	(439)	(837)	(1,030)
Income before income taxes and extraordinary item	70,713	75,740	83,302	61,185	42,670
Provision for income taxes	27,932	29,796	33,737	25,086	17,673
Income before extraordinary item	42,781	45,944	49,565	36,099	24,997
Extraordinary charge due to refinancing of debt(4)	--	--	1,312	--	--
Net income	\$ 42,781	\$ 45,944	\$ 48,253	\$ 36,099	\$ 24,997
Income before extraordinary item per common share assuming dilution(5)	\$ 2.05	\$ 2.11	\$ 2.28	\$ 1.67	\$ 1.16
Net income per common share assuming dilution(5)	\$ 2.05	\$ 2.11	\$ 2.22	\$ 1.67	\$ 1.16
	JAN. 3, 1998	DEC. 28, 1996	DEC. 30, 1995	DEC. 31, 1994	JAN. 1, 1994
BALANCE SHEET DATA					
Working capital	\$ 40,857	\$ 67,997	\$ 36,015	\$ 13,362	\$ 26,392
Total assets	259,695	285,733	259,085	239,680	234,893
Long-term debt, including current maturities	40,000	60,000	80,000	113,000	148,000
Total stockholders' equity(6)	186,655	196,757	150,286	100,305	61,731

(1) THE YEARS ENDED JANUARY 1, 1994, DECEMBER 31, 1994, DECEMBER 30, 1995 AND DECEMBER 28, 1996 WERE 52-WEEK PERIODS AND THE YEAR ENDED JANUARY 3, 1998 WAS A 53-WEEK PERIOD.

(2) SEE NOTE 8 TO THE CONSOLIDATED FINANCIAL STATEMENTS.

(3) SEE NOTE 6 TO THE CONSOLIDATED FINANCIAL STATEMENTS.

(4) SEE NOTE 4 TO THE CONSOLIDATED FINANCIAL STATEMENTS.

(5) SEE NOTE 11 TO THE CONSOLIDATED FINANCIAL STATEMENTS.

(6) 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 COMPANY'S PRINCIPAL OPERATING SUBSIDIARY) 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.

MANAGEMENT'S
DISCUSSION AND ANALYSIS

RESULTS OF OPERATIONS

COMPARISON OF RESULTS OF OPERATIONS 1997 TO 1996

NET SALES Net sales decreased \$9.3 million, or 4%, from \$228.8 million in 1996 to \$219.5 million in 1997. This decrease was due principally to a decrease in volume. Sales of Village Series products decreased 9% from 1996 to 1997, while General Giftware product sales increased 7% during the same period. Village Series products continued to account for the most significant portion of the Company's sales, 64% in 1997 versus 67% in 1996.

GROSS PROFIT Gross Profit decreased \$8.1 million, or 6%, between 1996 and 1997. Gross profit as a percentage of sales decreased from 58.4% in 1996 to 57.2% in 1997, principally due to a change in the mix of product shipped during 1997 as compared to 1996.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES Selling, general and administrative expenses increased \$1.8 million, or 4%, between 1996 and 1997 principally due to a 20% increase in marketing expense and a 6% increase in administrative expense, offset by a 7% decrease in commission expense. Selling, general and administrative expenses as a percentage of sales increased from approximately 21% in 1996 to approximately 23% in 1997.

RECOVERY OF IMPORT DUTIES, NET The Company received net refunds of \$.4 million and \$.5 million in custom duties and related interest during 1997 and 1996, respectively. The duties pertained principally to certain merchandise imported into the United States from 1989 to 1994.

(IN MILLIONS, EXCEPT PER SHARE AMOUNTS)	1997		1996		1995	
	DOLLARS	PERCENT OF NET SALES	DOLLARS	PERCENT OF NET SALES	DOLLARS	PERCENT OF NET SALES
Net sales	\$219.5	100%	\$228.8	100%	\$252.0	100%
Gross profit	125.5	57	133.6	58	142.0	56
Selling, general and administrative expenses	50.1	23	48.3	21	47.9	19
Amortization of goodwill and trademarks	4.6	2	4.6	2	4.6	2
Recovery of import duties	(.4)	--	(.5)	--	(2.9)	(1)
Income from operations	71.1	32	81.2	35	92.4	37
Interest expense	4.4	2	6.1	3	9.6	4
Gain on sale of aircraft	(2.9)	(1)	--	--	--	--
Other, net	(1.1)	(1)	(.6)	--	(.4)	--
Income before income taxes and extraordinary item	70.7	32	75.7	33	83.3	33
Provision for income taxes	27.9	13	29.8	13	33.7	13
Income before extraordinary item	42.8	19	45.9	20	49.6	20
Extraordinary charge due to refinancing of debt	--	--	--	--	1.3	1
Net income	42.8	19	45.9	20	48.3	19
Income before extraordinary item per common share assuming dilution	2.05		2.11		2.28	
Net income per common share assuming dilution	2.05		2.11		2.22	
Operating cash flow(1)	81.7		88.1		99.1	

(1) EARNINGS BEFORE INTEREST, INCOME TAX, DEPRECIATION AND AMORTIZATION EXPENSES

MANAGEMENT'S
DISCUSSION AND ANALYSIS

INCOME FROM OPERATIONS Income from operations decreased \$10.0 million, or 12%, from 1996 to 1997 due to the factors described above. Operating margins decreased from 35% of net sales in 1996 to 32% of net sales in 1997.

INTEREST EXPENSE Interest expense decreased \$1.7 million, or 28%, between 1996 and 1997 principally due to the repayment of \$20 million of debt in December 1996.

GAIN ON SALE OF AIRCRAFT During December 1997, the Company exercised its purchase option under an aircraft lease agreement and subsequently sold the aircraft to a former officer of the Company for \$8.6 million, its appraised value, recognizing a gain of \$2.9 million.

PROVISION FOR INCOME TAXES The effective income tax rate was 39.3% and 39.5% during 1996 and 1997, respectively.

COMPARISON OF RESULTS OF OPERATIONS 1996 TO 1995

NET SALES Net sales decreased \$23.3 million, or 9%, from \$252.0 million in 1995 to \$228.8 million in 1996. This decrease was due principally to a decrease in volume. Sales of Village Series products decreased 12% from 1995 to 1996, while General Giftware product sales decreased 3% during the same period. Village Series products continued to account for the most significant portion of the Company's sales, 67% in 1996 versus 69% in 1995.

GROSS PROFIT Gross Profit decreased \$8.5 million, or 6%, between 1995 and 1996. Gross profit as a percentage of sales increased from approximately 56.4% in 1995 to approximately 58.4% in 1996, principally due to increased manufacturing efficiencies and lower volume discounts as a percent of sales.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES Selling, general and administrative expenses increased \$.4 million, or 1%, between 1995 and 1996 principally due to an 18% increase in marketing expense and inflationary increases in administrative expenses, offset by a 7% decrease in commission expense. Selling, general and administrative expenses as a percentage of sales increased from approximately 19% in 1995 to approximately 21% in 1996.

RECOVERY OF IMPORT DUTIES, NET The Company received net refunds of \$.5 million and \$2.9 million in custom duties and related interest during 1996 and 1995, respectively. The duties pertained to certain merchandise imported into the United States from 1989 to 1994.

INCOME FROM OPERATIONS Income from operations decreased \$11.3 million, or 12%, from 1995 to 1996 due to the factors described above. Operating margins decreased from 37% of net sales in 1995 to 35% of net sales in 1996.

INTEREST EXPENSE Interest expense decreased \$3.5 million, or 37%, between 1995 and 1996 principally due to the prepayment of \$33 million of debt during 1995, decreased interest rates in 1996 and reduced borrowings under the revolving line of credit in 1996.

PROVISION FOR INCOME TAXES The effective income tax rate was 40.5% and 39.3% during 1995 and 1996, 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

MANAGEMENT'S
DISCUSSION AND ANALYSIS

each year. The Company entered 66% and 71% of its total annual customer orders for 1997 and 1996, respectively, during the first quarter of each of those years. Cancellations of total annual customer orders were approximately 8% and 6% in 1997 and 1996, respectively. The Company's backlog was \$4.6 million and \$7.2 million at January 3, 1998 and December 28, 1996, respectively.

The Company shipped and recorded as net sales approximately 90% and 92% of its annual customer orders in 1997 and 1996, 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 orders for Spring and Easter products.

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

(IN MILLIONS, EXCEPT PER SHARE AMOUNTS)	1997					1996				
	1ST QTR.	2ND QTR.	3RD QTR.	4TH QTR.	TOTAL	1ST QTR.	2ND QTR.	3RD QTR.	4TH QTR.	TOTAL
Customer orders entered(1)	\$160.6	\$43.8	\$34.3	\$6.2	\$244.9	\$177.5	\$35.3	\$28.3	\$7.7	\$248.8
Net sales	45.7	58.6	61.6	53.6	219.5	59.0	75.3	60.2	34.3	228.8
Gross profit	26.6	33.9	35.8	29.2	125.5	33.8	44.3	34.8	20.7	133.6
Selling, general and administrative expenses	11.1	11.4	12.1	15.5	50.1	11.5	13.0	11.7	12.1	48.3
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, net	(.4)	--	--	--	(.4)	(.2)	--	(.3)	--	(.5)
Income from operations	14.7	21.3	22.5	12.6	71.1	21.4	30.2	22.2	7.4	81.2
Net income	8.7	12.4	13.1	8.6	42.8	12.2	17.3	12.3	4.1	45.9
Net income per common share assuming dilution(2)	0.40	0.59	0.63	0.42	2.05	0.56	0.79	0.57	0.19	2.11

(1) CUSTOMER ORDERS ENTERED ARE ORDERS RECEIVED AND APPROVED BY THE COMPANY, SUBJECT TO CANCELLATION FOR VARIOUS REASONS INCLUDING CREDIT CONSIDERATIONS, INVENTORY SHORTAGES, AND CUSTOMER REQUESTS.

(2) SEE FOOTNOTE 11 TO THE CONSOLIDATED FINANCIAL STATEMENTS.

MANAGEMENT'S
DISCUSSION AND ANALYSIS

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 installments of \$20 million, payable in December of each year. At January 3, 1998, the term loan outstanding was \$40 million.

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 twelve 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, the Company and its principal operating subsidiary, D 56, Inc., are 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 \$85 million at January 3, 1998.

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 cash and cash equivalents balances peak in December, following the collection in November and December of accounts receivable with extended payment terms. Cash and cash equivalents balances decreased from \$46.4 million at December 28, 1996 to \$37.4 million at January 3, 1998 principally due to the repurchase of \$55.2 million of stock and the repayment of \$20.0 million of debt during 1997, offset by the increase in net cash provided by operating activities.

Accounts receivable decreased from \$35.6 million at December 28, 1996 to \$23.0 million at January 3, 1998, principally due to six days of additional cash collections in 1997 resulting from the timing of the Company's fiscal year end.

Capital expenditures were \$7.8 million, \$1.5 million and \$1.6 million for 1997, 1996 and 1995, respectively. Included in 1997 capital expenditures is \$4.9 million in connection with the Company's exercise of a purchase option under its aircraft lease agreement. See Note 6 to the consolidated financial statements. In addition, the Company is currently in the process of implementing a new information system. The new information system will significantly update the Company's current information system capabilities and is expected to eliminate the year 2000 issues for the Company's primary information systems. The Company plans to have the new information system substantially implemented by the first quarter of 1999. The new information system is expected to cost approximately \$4 million.

Operating cash flow, defined as earnings before interest, income tax, depreciation and amortization expenses, decreased \$6.4 million, or 7%, from \$88.1 million in 1996 to \$81.7 million in 1997. The decrease was principally due to the decrease in income from operations.

MANAGEMENT'S
DISCUSSION AND ANALYSIS

The Company has a stock repurchase program. Under this program, the Company repurchased in the open market 2.2 million shares during 1997 at a weighted average price of \$25 per share. The Company is authorized to repurchase an additional 0.8 million shares through the end of 1999. The timing, prices and amounts of shares repurchased will be determined at the discretion of the Company's management based on its view of prevailing economic and market conditions.

FOREIGN EXCHANGE

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

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

EFFECT OF INFLATION

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

RECENT DEVELOPMENTS

On February 23, 1998, the Company issued a press release stating in relevant part: "Dealer orders through February 14 {1998} were 8% higher than the comparable period in the prior year. Year-to-date Village orders were 8% higher than the comparable period in the prior year, while year-to-date orders for General Giftware were tracking 5% ahead." The press release also stated: "'We are pleased with {1997's revenue and earnings} given the need at the beginning of the year to further address retail inventories,' said Susan Engel, Chairwoman and CEO of Department 56. 'Data collected from a broad spectrum of dealers indicated a reduction in average retail inventory level in 1997, which was both significant and more substantial than in 1996.'"

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

Dealer orders are principally dependent on the amount, quality and market acceptance of the new product introductions and retailer demand. Dealer order patterns have historically varied in number, mix and timing, and there can be no assurance that the order trend experienced from January 4, 1998 through February 14, 1998 will continue. Moreover, the statements in the press release or throughout this annual report concerning retail inventory levels, consumer demand, and dealer expectations are based on statistical research conducted by or for the Company, and assume that such findings are correct and representative of market conditions as a whole.

Other factors, including product development efforts, completion of third party product manufacturing, dealer reorders and order cancellations, control of operating expenses, corporate cash flow application, and industry, general economic, regulatory and international trade conditions, can significantly impact the Company's sales and earnings. Actual results may vary materially from forward-looking statements and the assumptions on which they are based. The Company undertakes no obligation to update or publish in the future any forward-looking statements.

CONSOLIDATED
BALANCE SHEETS

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	JANUARY 3, 1998	DECEMBER 28, 1996
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$37,361	\$46,405
Accounts receivable, net of allowances of \$13,057 and \$10,264, respectively	23,004	35,603
Inventories	18,070	20,526
Deferred taxes	6,303	5,048
Other current assets	3,008	1,721
Total current assets	87,746	109,303
Property and equipment, net	12,753	12,318
Goodwill, net of accumulated amortization of \$21,683 and \$17,554, respectively	143,491	147,620
Trademarks, net of accumulated amortization of \$2,349 and \$1,902, respectively	15,551	15,998
Other assets	154	494
	\$259,695	\$285,733
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current portion of long-term debt	\$20,000	\$ 20,000
Accounts payable	9,973	7,618
Commissions payable	3,955	4,683
Other current liabilities	12,961	9,005
Total current liabilities	46,889	41,306
Deferred taxes	6,151	7,670
Long-term debt	20,000	40,000
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 21,765 and 21,584 shares, respectively	218	216
Additional paid-in capital	44,645	42,315
Treasury stock, at cost; 2,199 and 0 shares, respectively	(55,215)	--
Retained earnings	197,007	154,226
Total stockholders' equity	186,655	196,757
	\$259,695	\$285,733

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

Department 56, Inc. 13 1997 Annual Report

CONSOLIDATED
STATEMENTS OF INCOME

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	YEAR ENDED JANUARY 3, 1998	YEAR ENDED DECEMBER 28, 1996	YEAR ENDED DECEMBER 30, 1995
Net sales	\$219,496	\$228,775	\$252,047
Cost of sales	94,040	95,190	110,008
Gross profit	125,456	133,585	142,039
Operating expenses:			
Selling, general and administrative	50,142	48,306	47,889
Amortization of goodwill and trademarks	4,577	4,577	4,577
Recovery of import duties	(370)	(453)	(2,872)
Total operating expenses	54,349	52,430	49,594
Income from operations	71,107	81,155	92,445
Other expense (income):			
Interest expense	4,362	6,063	9,582
Gain on sale of aircraft	(2,882)	--	--
Other, net	(1,086)	(648)	(439)
Income before income taxes and extraordinary item	70,713	75,740	83,302
Provision for income taxes	27,932	29,796	33,737
Income before extraordinary item	42,781	45,944	49,565
Extraordinary charge due to refinancing of debt	--	--	1,312
Net income	\$ 42,781	\$ 45,944	\$ 48,253
Income before extraordinary item per common share	\$ 2.06	\$ 2.13	\$ 2.30
Income before extraordinary item per common share assuming dilution	\$ 2.05	\$ 2.11	\$ 2.28
Net income per common share	\$ 2.06	\$ 2.13	\$ 2.24
Net income per common share assuming dilution	\$ 2.05	\$ 2.11	\$ 2.22

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

CONSOLIDATED
STATEMENTS OF CASH FLOWS

(IN THOUSANDS)	YEAR ENDED JANUARY 3, 1998	YEAR ENDED DECEMBER 28, 1996	YEAR ENDED DECEMBER 30, 1995
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 42,781	\$ 45,944	\$ 48,253
Adjustments to reconcile net income to net cash provided by operating activities:			
Extraordinary charge	--	--	1,312
Depreciation	2,031	1,721	1,609
Amortization of goodwill and trademarks	4,577	4,577	4,577
Provision for uncollectible accounts receivable	1,087	2,014	2,293
Gain on sale of aircraft	(2,882)	--	--
Compensation expense - common stock options	--	14	169
Deferred taxes	(2,774)	(37)	(1,528)
Changes in assets and liabilities:			
Accounts receivable	11,512	(3,349)	(12,605)
Inventories	2,456	8,533	(8,693)
Other assets	(1,337)	502	520
Accounts payable	2,355	1,019	1,442
Commissions payable	(728)	212	262
Other current liabilities	4,882	(1,379)	1,766
Net cash provided by operating activities	63,960	59,771	39,377
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of property and equipment	(7,829)	(1,507)	(1,617)
Proceeds from sale of aircraft	8,567	--	--
Net cash provided by (used in) investing activities	738	(1,507)	(1,617)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from the exercise of common stock options	1,473	336	865
Borrowings on revolving credit agreement	17,985	34,338	36,500
Principal payments on revolving credit agreement	(17,985)	(34,338)	(41,500)
Purchases of treasury stock	(55,215)	--	--
Proceeds from issuance of long-term debt	--	--	100,000
Principal payments on long-term debt	(20,000)	(20,000)	(128,000)
Net cash used in financing activities	(73,742)	(19,664)	(32,135)
Net increase (decrease) in cash and cash equivalents	(9,044)	38,600	5,625
Cash and cash equivalents at beginning of period	46,405	7,805	2,180
Cash and cash equivalents at end of period	\$ 37,361	\$ 46,405	\$ 7,805

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

Department 56, Inc. 15 1997 Annual Report

CONSOLIDATED
STATEMENTS OF STOCKHOLDERS' EQUITY

(IN THOUSANDS)	COMMON STOCK SHARES	COMMON STOCK AMOUNT	ADDITIONAL PAID-IN CAPITAL	UNEARNED COMPENSATION ON COMMON STOCK OPTIONS	TREASURY STOCK	RETAINED EARNINGS	TOTAL STOCKHOLDERS' EQUITY
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
Net income	--	--	--	--	--	45,944	45,944
Shares issued upon the exercise Of common stock options	38	1	512	--	--	--	513
Common stock options vested	--	--	--	14	--	--	14
Balance as of December 28, 1996	21,584	216	42,315	--	--	154,226	196,757
Net income	--	--	--	--	--	42,781	42,781
Shares issued upon the exercise Of common stock options	181	2	2,330	--	--	--	2,332
Shares repurchased	(2,199)	--	--	--	(55,215)	--	(55,215)
Balance as of January 3, 1998	19,566	\$218	\$44,645	\$ --	\$(55,215)	\$197,007	\$186,655

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

NOTES TO
CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BUSINESS The Company is engaged in the original design, importation, and wholesale distribution of specialty giftware products. The majority of the Company's products are developed and designed by the Company's in-house creative team and are manufactured for the Company by independently owned foreign manufacturers located primarily in the Pacific Rim. The Company's customer base and accounts receivable are primarily 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. All significant intercompany accounts and transactions have been eliminated in consolidation.

FISCAL YEAR END The Company's policy is to end its fiscal year on the Saturday closest to December 31. The years ended December 30, 1995 and December 28, 1996 include 52 weeks and the year ended January 3, 1998 includes 53 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 sheets.

NOTES TO
CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)

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. Gains or losses on these contracts will be recognized and included in cost of sales at the time the related inventory is sold. The Company is exposed to credit risk to the extent of nonperformance by a counterparty to the foreign currency contracts. However, the Company believes it uses a strong financial counterparty in these transactions and that the resulting credit risk under these hedging strategies is not significant.

FAIR VALUE OF FINANCIAL INSTRUMENTS The carrying amount of cash and cash equivalents, accounts receivable, accounts payable, and commissions payable approximates fair value because of the short-term nature of these instruments. Based on the borrowing rates currently available to the Company for bank loans with similar terms and maturities, the Company also believes the carrying amount of long-term debt approximates fair value. The fair value of the Company's forward currency contracts is determined using the current spot rate. There were no forward currency contracts outstanding at December 28, 1996 and January 3, 1998.

NOTES TO
CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)

NET INCOME PER COMMON SHARE Net income per common share is calculated by dividing net income by the weighted average number of shares outstanding during the period. Net income per common share assuming dilution reflects per share amounts that would have resulted had the Company's outstanding stock options been converted to common stock. See note 11.

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

2 **PROPERTY AND EQUIPMENT**

PROPERTY AND EQUIPMENT IS COMPRISED OF THE FOLLOWING:

	JAN. 3, 1998	DEC. 28, 1996
Leasehold Improvements	\$ 1,253	\$ 2,156
Furniture and Fixtures	1,758	1,485
Computer Equipment	4,646	2,540
Other Equipment	4,804	4,756
Building	6,288	5,882
Land	906	906
	19,655	17,725
Less accumulated depreciation	6,902	5,407
Property and Equipment, Net	\$12,753	\$12,318
	-----	-----

3 **OTHER CURRENT LIABILITIES**

OTHER CURRENT LIABILITIES ARE COMPRISED OF THE FOLLOWING:

	JAN. 3, 1998	DEC. 28, 1996

Accrued compensation and benefits	\$ 3,377	\$ 1,281
Income taxes payable	7,644	5,893
Deferred revenue	679	517
Accrued royalty fees	570	593

Other	691	721
	\$ 12,961	\$ 9,005
	-----	-----

4 CREDIT AGREEMENT
LONG-TERM DEBT IS COMPRISED OF THE FOLLOWING:

	JAN. 3, 1998	DEC. 28, 1996
-----	-----	-----
TERM LOAN	\$40,000	\$60,000
Less current portion	20,000	20,000
	\$20,000	\$40,000
	-----	-----

The Company's credit agreement consists of a term loan and a revolving line of credit. The term loan is due and payable in annual installments of \$20,000, payable in December of each year.

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 1/4% to 3/8% per annum on the daily average of the unused commitment. The available borrowings under the revolving line of credit were \$85,341 at January 3, 1998.

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

NOTES TO
CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)

Rate (as defined) plus an applicable margin. The applicable margin ranges from 1/2% to 1 1/4% 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 \$4,400, \$6,129 and \$10,086 during the years ended January 3, 1998, December 28, 1996 and December 30, 1995, respectively.

During February 1995, the Company entered into its existing credit agreement and recorded an extraordinary charge of \$1,312, net of income taxes, to write off deferred financing costs.

5 INCOME TAXES

THE PROVISION FOR INCOME TAXES, EXCLUDING THE \$893 TAX BENEFIT FROM THE EXTRAORDINARY CHARGE DUE TO THE REFINANCING OF DEBT IN 1995, CONSISTED OF THE FOLLOWING:

	YEAR ENDED JAN. 3, 1998	YEAR ENDED DEC. 28, 1996	YEAR ENDED DEC. 30, 1995
CURRENT:			
Federal	\$28,225	\$27,376	\$30,560
State	2,419	2,347	2,619
Foreign	62	110	272
Deferred	(2,774)	(37)	286
	\$27,932	\$29,796	\$33,737
	-----	-----	-----

THE RECONCILIATION BETWEEN INCOME TAX EXPENSE BASED ON STATUTORY INCOME TAX RATES AND THE PROVISION FOR INCOME TAXES PER THE CONSOLIDATED STATEMENTS OF INCOME IS AS FOLLOWS:

	YEAR ENDED JAN. 3, 1998	YEAR ENDED DEC. 28, 1996	YEAR ENDED DEC. 30, 1995
Income taxes at federal			

statutory rate	\$24,750	\$26,509
\$29,156		
State income taxes, net of federal income tax	1,768	1,893
2,566		
Amortization of goodwill	1,448	1,448
1,448		
Other	(34)	(54)
567		
Provision for income taxes	\$27,932	\$29,796
\$33,737		
---	-----	

THE COMPONENTS OF THE NET DEFERRED TAX ASSET (LIABILITY) WERE AS FOLLOWS:

	JAN. 3, 1998	DEC. 28, 1996
Deferred tax assets:		
Accounts Receivable		
Valuation allowances	\$4,660	\$3,516
Inventory valuation allowances	1,469	1,118
Compensation expense -		
Common stock options	141	331
Accrued liabilities	264	354
Other	220	263
Total Deferred tax assets	6,754	5,582
Deferred tax liabilities:		
Trademarks	(5,909)	(6,079)
Property and equipment	(440)	(1,986)
Other	(253)	(139)
Total deferred tax liabilities	(6,602)	(8,204)
	\$152	\$(2,622)

The \$152 net deferred tax asset at January 3, 1998 is presented as a net deferred current asset of \$6,303 and a net deferred noncurrent liability of \$6,151. The \$2,622 net deferred tax liability at December 28, 1996 is presented as a net deferred current asset of \$5,048 and a net deferred noncurrent liability of \$7,670.

The company paid income taxes of \$28,134, \$28,943 and \$31,855 during the years ended January 3, 1998, December 28, 1996 and December 30, 1995, respectively.

Department 56, Inc. 19 1997 Annual Report

NOTES TO
CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)

6 COMMITMENTS AND CONTINGENCIES

OPERATING LEASES The Company leases warehouse and office space, equipment, and showroom display facilities under renewable operating leases ranging from three to twelve 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 JANUARY 3, 1998:

1998	\$1,863
1999	1,325
2000	1,075
2001	518
2002	536
Thereafter	1,704
	\$7,021

The Company's rental expense was \$2,934, \$3,238 and \$2,875 for the years ended January 3, 1998, December 28, 1996 and December 30, 1995, respectively.

During December 1997, the company exercised its purchase option under an aircraft lease agreement and subsequently sold the aircraft at its appraised value to a former officer of the Company for \$8,567, recognizing a gain of \$2,882.

LETTERS OF CREDIT The Company had outstanding standby and commercial letters of credit amounting to \$4,659 at January 3, 1998 relating primarily to purchase commitments issued to foreign suppliers and vendors.

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

7 RETIREMENT PLAN

The Company has a 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 \$1,136, \$750 and \$975 for the years ended January 3, 1998, December 28, 1996 and December 30, 1995, respectively.

8 RECOVERY OF IMPORT DUTIES

During the years ended January 3, 1998, December 28, 1996 and December 30, 1995 the Company received net refunds in custom duties and related interest of \$370, \$453, and \$2,872 respectively. The refunds pertained principally to certain merchandise imported into the United States from 1989 to 1994.

9 RELATED-PARTY TRANSACTIONS

In the ordinary course of business, the Company sells product to a floral and nursery wholesaler and retailer, of which a director of the Company is an officer, director and stockholder. The Company had sales to this floral and nursery business during the years ended January 3, 1998, December 28, 1996 and December 30, 1995 of \$1,323, \$1,305 and \$1,893, respectively.

During the years ended January 3, 1998, December 28, 1996 and December 30, 1995, the Company paid \$1,343, \$2,116 and \$2,537 respectively, for aircraft management, transportation and other expenses to an affiliate of a director of the Company.

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

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

NOTES TO
CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)

10 STOCKHOLDERS' EQUITY

STOCK-BASED COMPENSATION PLANS At January 3, 1998, the Company had four stock-based compensation plans. Under the 1992, 1993, 1995 and 1997 stock option plans, the Company may grant options to its directors, officers, employees, consultants and advisors of the Company for up to 292,500, 1,000,000, 600,000 and 1,500,000 shares of common stock, respectively. All employee options granted after the initial public offering have an exercise price equal to the market value of the common stock at the date of grant, generally have a term of 10 years, and generally are exercisable in equal installments on each of the first, second and third anniversaries of the date of the grant.

A summary of the status of the Company's four stock option plans as of January 3, 1998, December 28, 1996 and December 30, 1995, and changes during the years ended on those dates is presented below:

STOCK OPTIONS	1997		1996		1995	
	SHARES	WEIGHTED-AVERAGE EXERCISE PRICE	SHARES	WEIGHTED-AVERAGE EXERCISE PRICE	SHARES	WEIGHTED-AVERAGE EXERCISE PRICE
Outstanding at beginning of year	1,291,908	\$27.51	1,072,773	\$31.73	702,755	\$26.32
Granted	806,000	23.07	433,350	20.48	448,660	37.13
Exercised	(85,415)	13.53	(33,500)	9.36	(70,742)	12.23
Forfeited	(28,915)	31.93	(180,715)	39.09	(7,900)	31.26
Outstanding at end of year	1,983,578	26.25	1,291,908	27.51	1,072,773	31.73
Options exercisable at end of year	798,258	30.43	536,583	28.09	224,271	26.57
Weighted average fair value of options granted during the year	\$10.96		\$10.75		\$16.07	

The Company applies Accounting Principle's Board Opinion No. 25 "Accounting for Stock Issued to Employees" and related interpretations in accounting for its plans. Accordingly, no compensation cost has been recognized for options granted since the initial public offering. Had compensation cost been determined based on the fair value of the 1995, 1996 and 1997 stock option grants consistent with the method of Statement of Financial Accounting Standards No. 123 "Accounting for Stock-Based Compensation" (SFAS 123), the Company's income before extraordinary item, net income, income before extraordinary item per common share assuming dilution and net income per share common share assuming dilution would have been reduced to the pro forma amounts indicated to the right:

	1997	1996	1995
INCOME BEFORE EXTRAORDINARY ITEM			
As reported	\$42,781	\$45,944	\$49,565
Pro forma	\$40,245	\$43,410	\$48,885
NET INCOME			
As reported	\$42,781	\$45,944	\$48,253
Pro forma	\$40,245	\$43,410	\$47,573
INCOME BEFORE EXTRAORDINARY ITEM PER COMMON SHARE ASSUMING DILUTION			
As reported	\$2.05	\$2.11	\$2.28
Pro forma	\$1.93	\$2.00	\$2.25
NET INCOME PER COMMON SHARE ASSUMING DILUTION			
As reported	\$2.05	\$2.11	\$2.22
Pro forma	\$1.93	\$2.00	\$2.19

NOTES TO
CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)

In determining the preceding pro forma amounts under SFAS 123, the fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in 1997, 1996 and 1995, respectively: expected volatility of 38, 46 and 32 percent, risk-free interest rates of 6.2 percent, 5.8 percent and 6.0 percent, expected lives of 6 years and no expected dividends. The effects of applying SFAS 123 in this pro forma disclosure are not indicative of future compensation costs. SFAS 123 does not apply to awards prior to 1995, and additional awards are anticipated.

The following table summarizes information about the Company's stock option plans at January 3, 1998:

RANGE OF EXERCISE PRICES	NUMBER OUTSTANDING AT JAN. 3, 1998	WEIGHTED-AVERAGE REMAINING CONTRACTUAL LIFE	WEIGHTED-AVERAGE EXERCISE PRICE	NUMBER EXERCISABLE AT JAN. 3, 1998	WEIGHTED-AVERAGE EXERCISE PRICE
\$3.33	52,013	4.1 years	\$3.33	52,013	\$3.33
18.00-21.47	1,052,971	8.8	20.87	171,009	19.73
21.48-37.75	878,594	7.8	34.04	575,236	36.06
	1,983,578			798,258	

In addition to stock options granted under the Company's stock option plans, the Company granted options to purchase 30,000 shares of Common Stock to each of four members of the Company's Board of Directors in December 1992. During February 1993, the Company granted options to purchase 30,000 shares of Common Stock to one member of the Board of Directors. These options are not subject to a stock option plan. Such options are exercisable, have a term of ten years from the date of grant, and have an exercise price of \$3.33 per share. During 1997, members of the Board of Directors exercised 95,000 options. At January 3, 1998, directors options to purchase 40,000 shares of Common Stock were exercisable at \$3.33 per share.

SHAREHOLDER RIGHTS PLAN In April 1997, the Company adopted a shareholder rights plan. Under the shareholder rights plan, each shareholder received a dividend of one preferred share purchase right for each share held of the Company's common stock. Each right entitles the holder to purchase one one-thousandth of a share of Series A Participating Preferred Stock at an exercise price of \$100, subject to adjustment, or at the discretion of the Board of Directors of the Company, the right to purchase common stock of the Company at a 50% discount. The rights become exercisable only upon the occurrence of certain events involving a buyer acquiring 18 1/2% or greater beneficial ownership in the Company's common stock or the announcement of a tender offer or exchange offer which, if consummated, would give the buyer beneficial ownership of an 18 1/2% or greater position in the Company. Preferred share purchase rights owned by the buyer become null and void following this occurrence. The rights will expire April 2007, and the Company may redeem the rights at any time (prior to the occurrence of a specified event) at a price of one cent per right, except in certain circumstance where there is a change in the majority of the Board of Directors. If the Company is acquired in a merger or similar transaction after such an occurrence, all rights holders, except the buyer, will have the right to purchase stock in the buyer at a 50% discount.

NOTES TO
CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)

11 INCOME PER COMMON SHARE

Effective December 15, 1997, the Company adopted Statement of Financial Accounting Standards No. 128, "Earnings per Share" (SFAS No. 128). Income per common share amounts presented for 1996 and 1995 have been restated for the adoption of SFAS No. 128. The following tables reconcile income before extraordinary item per common share and income before extraordinary item per common share assuming dilution:

	1997	1996	1995
Income before extraordinary item	\$ 42,781	\$ 45,944	\$ 49,565
Weighted average number of shares outstanding	20,744,000	21,560,000	21,519,000
Income before extraordinary item per common share	\$ 2.06	\$ 2.13	\$ 2.30
	1997	1996	1995
Income before extraordinary item	\$ 42,781	\$ 45,944	\$ 49,565
Weighted average number of shares outstanding	20,744,000	21,560,000	21,519,000
Dilutive impact of options outstanding	152,000	199,000	228,000
Weighted average number of shares and potential dilutive shares outstanding	20,896,000	21,759,000	21,747,000
Income before extraordinary item per common share assuming dilution	\$ 2.05	\$ 2.11	\$ 2.28

Options to purchase 879,000 shares of common stock at exercise prices between \$27 and \$38 per share were outstanding at January 3, 1998 but were not included in the computation of income before extraordinary item per common share assuming dilution because the option exercise prices were greater than the average market price of the common stock.

INDEPENDENT AUDITORS' REPORT

TO THE BOARD OF DIRECTORS AND STOCKHOLDERS OF DEPARTMENT 56, INC.:

We have audited the consolidated balance sheets of Department 56, Inc. and subsidiaries (the "Company") as of January 3, 1998 and December 28, 1996 and the related consolidated statements of income, cash flows and stockholders' equity for the years ended January 3, 1998, December 28, 1996 and December 30, 1995. 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 January 3, 1998 and December 28, 1996 and the results of its operations and its cash flows for the years ended January 3, 1998, December 28, 1996 and December 30, 1995 in conformity with generally accepted accounting principles.

/s/ Deloitte & Touche LLP

Minneapolis, Minnesota
February 12, 1998

Department 56, Inc. 24 1997 Annual Report

CORPORATE AND STOCKHOLDER INFORMATION

BOARD OF DIRECTORS

SUSAN E. ENGEL (1)
CHAIRWOMAN AND CHIEF EXECUTIVE OFFICER
Department 56, Inc.

TODD L. BACHMAN (2)
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
Bachman's Inc.

MAXINE CLARK
FOUNDER AND CHIEF EXECUTIVE OFFICER
Build-A-Bear Workshop

SANDRA J. HORBACH (1), (3)
GENERAL PARTNER
Forstmann Little & Co.

WM. BRIAN LITTLE (1), (3), (5)
PRIVATE INVESTOR

GARY S. MATTHEWS
PRESIDENT AND CHIEF EXECUTIVE OFFICER
Guinness Import Company

STEVEN G. ROTHMEIER (2), (3), (4)
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
Great Northern Capital

VIN WEBER (3), (4), (5)
PARTNER
Clark & Weinstock Inc.

- (1) MEMBER OF EXECUTIVE COMMITTEE
- (2) MEMBER OF AUDIT COMMITTEE
- (3) MEMBER OF COMPENSATION COMMITTEE
- (4) MEMBER OF STOCK INCENTIVE COMMITTEE
- (5) MEMBER OF NOMINATING COMMITTEE

OFFICERS

SUSAN E. ENGEL
CHAIRWOMAN AND CHIEF EXECUTIVE OFFICER

DAVID W. DEWEY
EXECUTIVE VICE PRESIDENT - OVERSEAS OPERATIONS

BRETT D. HEFFES
VICE PRESIDENT - CORPORATE DEVELOPMENT

MARK R. KENNEDY
SENIOR VICE PRESIDENT AND CHIEF FINANCIAL OFFICER

YEH-HUANG LIN
VICE PRESIDENT - D 56 TRADING

ROBERT S. ROSE
VICE PRESIDENT - DISTRIBUTION AND OPERATIONS

TIMOTHY J. SCHUGEL
VICE PRESIDENT - FINANCE

JOAN M. SERENA
VICE PRESIDENT - CONSUMER AND DEALER MARKETING

KENNETH J. SOBASKI
EXECUTIVE VICE PRESIDENT - SALES AND MARKETING

GREGORY G. SORENSEN
VICE PRESIDENT - MANAGEMENT INFORMATION SYSTEMS

DAVID H. WEISER
SENIOR VICE PRESIDENT - LEGAL/HUMAN RESOURCES AND SECRETARY

BRUCE R. WOLLAK
VICE PRESIDENT - D 56 SALES

STOCKHOLDER INFORMATION

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

TRANSFER AGENT
Chase Mellon
Shareholder Services
450 West 33rd Street
New York, NY 10001

INDEPENDENT AUDITORS
Deloitte & Touche LLP

STOCK LISTING
New York Stock Exchange Symbol "DFS"

ANNUAL MEETING
1:00 p.m.
May 14, 1998
Marriott Southwest Hotel
5801 Opus Parkway
Minnetonka, MN

Department 56, Inc. Market Price (PER SHARE)

1997	High	Low
.....		
First Quarter	\$24 3/4	\$16 7/8
.....		
Second Quarter	\$23	\$17 1/4
.....		
Third Quarter	\$29 13/16	\$21
.....		
Fourth Quarter	\$31 3/4	\$27 7/16

1996	High	Low
First Quarter	\$41 7/8	\$20
Second Quarter	\$26 1/8	\$20
Third Quarter	\$25 3/8	\$19 1/2
Fourth Quarter	\$25 3/4	\$21 3/8

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 19, 1998, there were 1,049 record holders of the Company's common stock.

"HARLEY-DAVIDSON" TRADEMARK OF H-D MICHIGAN, INC.

"MCDONALD'S" AND RESTAURANT DESIGN TRADEMARKS OF MCDONALD'S CORPORATION.

"HERSHEY" TRADEMARK OF HERSHEY FOODS CORPORATION.

CONSUMER INFORMATION

The dealer nearest you can be identified by calling our consumer information line at 1-800-LIT-TOWN (1-800-548-8696) or by accessing our Web site at www.D56.com. Our Web site also includes other consumer information.

SUBSIDIARIES OF THE COMPANY

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

INDEPENDENT AUDITORS' CONSENT

We consent to the incorporation by reference in Registration Statement No. 33-95704, No. 33-79960, and No. 333-41639 of Department 56, Inc. and subsidiaries on Form S-8 of our reports dated February 12, 1998, appearing in and incorporated by reference in this Annual Report on Form 10-K of Department 56, Inc. and subsidiaries for the year ended January 3, 1998.

Deloitte & Touche LLP

Minneapolis, Minnesota
March 30, 1998

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		46,405	2,810
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		35,603	107,161
		0	0
		20,526	25,363
		109,303	142,507
		12,318	12,119
		0	0
		285,733	321,105
		41,306	73,799
		40,000	60,000
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		0	0
		216	216
		0	0
		285,733	321,105
		228,775	134,273
		228,775	134,273
		95,190	56,151
		95,190	56,151
		52,430	26,559
		0	0
		6,063	2,846
		75,740	49,049
		29,796	19,620
		45,944	29,429
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		0	0
		45,944	29,429

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69,660			
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37,630			
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3,240			
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56,524			
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22,327			
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34,197			
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0			
<NET-INCOME>	8,723		21,122
34,197			

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1.62		