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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: October 2, 1999

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 incorporation or organization)	(I.R.S. Employer Identification No.)

One Village Place, 6436 City West Parkway, Eden Prairie, MN 55344
(Address of principal executive offices)
(Zip Code)

(612) 944-5600
(Registrant's telephone number, including area code)

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 __

As of October 2, 1999, 16,733,184 shares of the registrant's common stock, par value $.01 per share, were outstanding.

PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

DEPARTMENT 56, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(In thousands)

ASSETS

	OCTOBER 2, 1999	JANUARY 2, 1999
CURRENT ASSETS:		
Cash and cash equivalents	$ 446	$ 2,783
Accounts receivable, net	146,803	26,170
Inventories	26,959	18,287
Other current assets	12,167	10,661
Total current assets	186,375	57,901
PROPERTY AND EQUIPMENT, net	25,017	17,722
GOODWILL, TRADEMARKS AND OTHER, net	155,281	157,531
DEFERRED FINANCING COSTS AND OTHER ASSETS	1,517	129
	$ 368,190	$ 233,283

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES:		
Revolving line of credit	$ 132,500	$ —
Accounts payable	9,241	11,100
Other current liabilities	21,637	17,525
Total current liabilities	163,378	28,625
DEFERRED TAXES	5,923	5,923
LONG-TERM DEBT	20,000	20,000
STOCKHOLDERS' EQUITY	178,889	178,735
	$ 368,190	$ 233,283

See notes to condensed consolidated financial statements.

DEPARTMENT 56, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(In thousands, except per share amounts)

	QUARTER ENDED OCTOBER 2, 1999	QUARTER ENDED OCTOBER 3, 1998
NET SALES	$ 75,093	$ 71,512
COST OF SALES	31,009	29,808
Gross profit	44,084	41,704
OPERATING EXPENSES:		
Selling, general, and administrative	16,494	14,318
Amortization of goodwill, trademarks and other	1,290	1,258
Total operating expenses	17,784	15,576
INCOME FROM OPERATIONS	26,300	26,128
OTHER EXPENSE (INCOME):		

Interest expense	2,224	1,623
Other, net	(54)	(71)
INCOME BEFORE INCOME TAXES	24,130	24,576
PROVISION FOR INCOME TAXES	9,171	9,585
NET INCOME	$ 14,959	$ 14,991
NET INCOME PER COMMON SHARE	$ 0.88	$ 0.82
NET INCOME PER COMMON SHARE ASSUMING DILUTION	$ 0.87	$ 0.81

See notes to condensed consolidated financial statements.

DEPARTMENT 56, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(In thousands, except per share amounts)

	39 WEEKS ENDED OCTOBER 2, 1999	39 WEEKS ENDED OCTOBER 3, 1998
NET SALES	$ 191,462	$ 190,459
COST OF SALES	78,239	79,112
Gross profit	113,223	111,347
OPERATING EXPENSES:		
Selling, general, and administrative	45,446	39,553
Amortization of goodwill, trademarks and other	3,822	3,668
Total operating expenses	49,268	43,221
INCOME FROM OPERATIONS	63,955	68,126
OTHER EXPENSE (INCOME):		
Interest expense	4,136	3,364
Other, net	73	(490)
INCOME BEFORE INCOME TAXES	59,746	65,252
PROVISION FOR INCOME TAXES	22,705	25,651
NET INCOME	$ 37,041	$ 39,601
NET INCOME PER COMMON SHARE	$ 2.11	$ 2.10
NET INCOME PER COMMON SHARE ASSUMING DILUTION	$ 2.08	$ 2.06

See notes to condensed consolidated financial statements.

DEPARTMENT 56, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In thousands)

	39 WEEKS ENDED OCTOBER 2, 1999	39 WEEKS ENDED OCTOBER 3, 1998
CASH FLOWS FROM OPERATING ACTIVITIES—		
Net cash used in operating activities	$ (85,701)	$ (49,363)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(10,111)	(3,248)
Acquisitions	(1,793)	(4,660)
Net cash used in investing activities	(11,904)	(7,908)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from exercise of stock options	1,149	2,648
Net borrowings under revolving credit facility	132,500	75,500
Stock repurchases	(38,381)	(56,074)
Net cash provided by financing activities	95,268	22,074
NET DECREASE IN CASH AND CASH EQUIVALENTS	(2,337)	(35,197)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	2,783	37,361
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 446	$ 2,164
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION—		
Cash paid for:		
Interest	$ 5,373	$ 2,897
Income taxes	$ 21,701	$ 22,498

See notes to condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The accompanying condensed consolidated balance sheet as of January 2, 1999 was derived from the audited consolidated balances as of that date. The remaining accompanying condensed consolidated financial statements are unaudited and, in the opinion of management, include all adjustments necessary for a fair presentation. Such adjustments were of a normal recurring nature.

The results of operations for the quarter ended October 2, 1999 and the 39 weeks ended October 2, 1999 are not necessarily indicative of the results for the full fiscal year.

It is suggested that these financial statements be read in conjunction with the consolidated financial statements and notes thereto included in the 1998 Annual Report to Stockholders and Annual Report on Form 10-K filed by Department 56, Inc. (the "Company") with the Securities and Exchange Commission.

2. 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.

3. Stockholders' Equity

On May 10, 1999, the Board of Directors of the Company authorized a stock repurchase program providing for the repurchase in open market and privately negotiated transactions of up to an additional 3.0 million shares valid through the end of the Company's 2000 fiscal year. During the quarter ended October 2, 1999, the Company repurchased 634,000 shares at a cost of $17.4 million under its existing stock repurchase program. During the 39 weeks ended October 2, 1999, the Company repurchased 1,351,300 shares at a cost of $38.4 million.

Since January 1997, the Company has repurchased a total of 5.2 million shares at an average price of $29 per share. As of October 2, 1999, the Company was authorized to repurchase 2.3 million additional shares under these programs through the end of 2000. The timing and number of shares repurchased under these programs will be determined at the discretion of the Company's management and subject to continued compliance with the Company's credit facilities.

4. Acquisitions

During May 1999, the Company acquired substantially all of the assets of the independent sales representative organization that represented the Company's products in Massachusetts and several other eastern states. During August 1999, the Company acquired substantially all of the assets of the independent sales representative organization that represented the Company's products in Minnesota and several other Midwestern states.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

RESULTS OF OPERATIONS

Comparison of Results of Operations for the Quarter Ended October 2, 1999 to the Quarter Ended October 3, 1998.

	Quarter Ended October 2, 1999		Quarter Ended October 3, 1998	
	(Dollars in millions)			
	Dollars	% of Net Sales	Dollars	% of Net Sales
Net sales	$ 75.1	100%	$ 71.5	100%
Gross profit	44.1	59	41.7	58
Selling, general, and administrative expenses	16.5	22	14.3	20
Amortization of goodwill, trademarks and other	1.3	2	1.3	2
Income from operations	26.3	35	26.1	37
Interest expense	2.2	3	1.6	2
Other expense (income), net	(0.1)	—	(0.1)	—
Income before income taxes	24.1	32	24.6	34
Provision for income taxes	9.2	12	9.6	13
Net income	15.0	20	15.0	21

Net Sales. Net sales increased $3.6 million, or 5%, from $71.5 million in the third quarter of 1998 to $75.1 million in the third quarter of 1999. The increase in sales was principally due to an increase in volume, offset partially by an increase in the amount provided for returned product. Sales of the Company's Village Series products increased $1.5 million, or 3%, while sales of General Giftware products increased $2.1 million, or 8% between the two periods. Village Series and General Giftware products represented 63% and 37%, respectively, of the Company's net sales during the third quarter of 1999.

Gross Profit. Gross profit increased $2.4 million, or 6%, between the third quarter of 1998 and the third quarter of 1999. The increase in gross profit was principally due to the increase in sales volume. Gross profit as a percentage of net sales increased from 58% in the third quarter of 1998 to approximately 59% in the third quarter of 1999, principally due to a change in the mix of product shipped, offset partially by an increase in the amount provided for returned product.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased $2.2 million, or 15%, between the third quarter of 1998 and the third quarter of 1999. The increase is principally due to the one time write-off of certain acquisition related investigatory costs. Additional factors include expenses associated with operation of the Company's first retail store, an increase in depreciation expense associated with the Company's implementation of its new integrated computer system, an increase in marketing expense, an increase in distribution expense, offset partially by a decrease in commission expense. Selling, general and administrative expenses as a percentage of sales was 22% and 20% in the third quarter of 1999 and 1998, respectively.

Income from Operations. Income from operations increased $0.2 million, or 1%, between the third quarter of 1998 and the third quarter of 1999 due to the factors described above. Income from operations was 35% and 37% of net sales in the third quarter of 1999 and 1998, respectively.

Interest Expense. Interest expense increased $0.6 million, or 37%, between the third quarter of 1998 and the third quarter of 1999 principally due to increased borrowings under the revolving line of credit in 1999. Additional borrowings were required as a result of lower cash collections which were impacted by the timing and manner in which invoices and statements were mailed to customers as a result of the implementation of the new integrated computer system.

Provision for Income Taxes. The effective tax rate was 39% during the third quarter of 1998 and 38% during the third quarter of 1999.

RESULTS OF OPERATIONS

Comparison of Results of Operations for the 39 weeks ended October 2, 1999 to the 39 weeks ended October 3, 1998.

	39 Weeks Ended October 2, 1999		39 Weeks Ended October 3, 1998	
	(Dollars in millions)			
	Dollars	% of Net Sales	Dollars	% of Net Sales
Net sales	$ 191.5	100%	$ 190.5	100%
Gross profit	113.2	59	111.3	58
Selling, general, and administrative expenses	45.5	24	39.6	21
Amortization of goodwill, trademarks and other	3.8	2	3.7	2
Income from operations	64.0	33	68.1	36
Interest expense	4.1	2	3.4	2
Other expense (income), net	0.1	—	(0.5)	—
Income before income taxes	59.7	31	65.3	34
Provision for income taxes	22.7	12	25.7	13
Net income	37.0	19	39.6	21

Net Sales. Net sales increased $1.0 million, or 1%, from $190.5 million in 1998 to $191.5 million in 1999. The increase in sales was principally due to an increase in sales volume, offset partially by an increase in the amount provided for returned product. Sales of the Company's Village Series products increased $3.4 million, or 3%, while sales of General Giftware products decreased $2.4 million, or 4% between the two periods. Village Series and General Giftware products represented 67% and 33%, respectively, of the Company's net sales in 1999.

Gross Profit. Gross profit increased $1.9 million, or 2%, between 1998 and 1999. Gross profit as a percentage of net sales increased from 58% in 1998 to approximately 59% in 1999, principally due to a change in the mix of product shipped, offset partially by an increase in the amount provided for returned product.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased $5.9 million, or 15%, between 1998 and 1999. The increase is principally due to the one time write-off of certain acquisition related investigatory costs. Additional factors include an increase in showroom expenses as a result of the Company's acquisition of showrooms during 1998 and 1999, expenses associated with operation of the Company's first retail store, an increase in depreciation expense associated with the Company's implementation of its new integrated computer system, an increase in marketing expense, an increase in distribution expense, offset partially by a decrease in commission expense. Selling, general and administrative expenses as a percentage of sales increased from approximately 21% in 1998 to 24% in 1999.

Income from Operations. Income from operations decreased $4.2 million, or 6%, between 1998 and 1999 due to the factors described above. Income from operations was 36% and 33% of net sales in 1998 and 1999, respectively.

Interest Expense. Interest expense increased $0.8 million, or 23%, between 1998 and 1999 principally due to increased borrowings under the revolving line of credit in 1999. Additional borrowings were required as a result of lower cash collections which were impacted by the timing and manner in which invoices and statements were mailed to customers as a result of the implementation of the new integrated computer system.

Provision for Income Taxes. The effective tax rate was 39.3% during the 39 weeks ended October 3, 1998 and 38% during the 39 weeks ended October 2, 1999.

LIQUIDITY AND CAPITAL RESOURCES

In March 1999, the Company entered into a new credit agreement providing a $100 million revolving credit facility and a $150 million revolver/term loan. The $150 million revolver/term loan converts to a four-year term loan after one year. The revolver/term loan will have annual amortization payments of 15%, 20%, 25% and 40% of the amount outstanding at conversion in March 2001, 2002, 2003, and 2004, respectively.

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

The revolving credit facility provides for borrowings of up to $100 million including letters of credit. The letters of credit are issued primarily in connection with inventory purchases. The credit agreement contains financial and operating covenants, including restrictions on incurring indebtedness and liens, selling property and paying dividends. In addition, the Company is required to satisfy consolidated net worth, interest coverage ratio and leverage ratio tests, in each case at the end of each fiscal quarter.

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

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

Accounts receivable increased from $114.4 million at October 3, 1998 to $146.8 million at October 2, 1999. The increase in accounts receivable was principally due to lower cash collections which were impacted by the timing and manner in which invoices and statements were mailed to customers as a result of the implementation of the new integrated computer system.

In April 1999, the Company executed a lease for a new distribution center in Minnesota. In 2000, the Company plans to consolidate its three current distribution centers into the new distribution center. The lease provides for a 10-year term, with options to renew the lease, as well as to expand and/or acquire the facility, and requires minimum future annual rentals that approximate the combined annual rentals of the three existing distribution centers.

On May 10, 1999, the Board of Directors of the Company authorized a stock repurchase program providing for the repurchase in open market and privately negotiated transactions of up to an additional 3.0 million shares valid through the end of the Company's 2000 fiscal year. During the quarter ended October 2, 1999, the Company repurchased 634,000 shares at a cost of $17.4 million under its existing stock repurchase program. During the 39 weeks ended October 2, 1999, the Company repurchased 1,351,300 shares at a cost of $38.4 million. Since January 1997, the Company has repurchased a total of 5.2 million shares at an average price of $29 per share. As of October 2, 1999, the Company was authorized to repurchase 2.3 million additional shares under these programs through the end of 2000. The timing and number of shares repurchased under these programs will be determined at the discretion of the Company's management and subject to continued compliance with the Company's credit facilities.

YEAR 2000

On January 3, 1999, the Company substantially implemented a new integrated computer system, which replaced its primary operating and financial computing systems. The vendor of the core software program for the new integrated system has indicated that this system will substantially address Year 2000 requirements, and the Company does not anticipate that it will experience any material disruption to its transaction processing operations or financial or accounting functions solely as a result of the failure of any of its systems to be Year 2000 compliant. The Company is continuing to monitor and evaluate its new and existing systems so that, in the event substantial non-compliance with Year 2000 needs is detected, the remainder of 1999 can be utilized to achieve necessary functionality.

Total expenditures (aside of internal labor costs) for implementation of the new system is expected to be approximately $10.1 million. Approximately $7.4 million of the systems expenditures have been incurred as of October 2, 1999. Hardware, software and certain project costs were capitalized and will be amortized over their useful lives. All other costs were expensed as incurred.

The Company believes that the implementation of the new integrated computer system will allow it to be substantially Year 2000 compliant. There can be no assurance, however, that the systems of third parties on which the Company relies will be Year 2000 compliant in a timely manner. Given the Year 2000 certification of the Company's main operating system, the Company's approach to addressing any noncompliance that may arise in that system is to analyze and rectify, through programming on an as detected, as needed basis. Additional alternatives available in a non-compliance contingency include the use of electronic spreadsheets, resetting system dates and manual workarounds. An interruption of the Company's ability to conduct its business due to a Year 2000 problem with a third party could have a material adverse effect on the Company. The Company's product vendor and customer bases are fragmented, and generally are not dependent on computer control or systematization of their business operations. Management, therefore, believes that the greatest risks presented by potential Year 2000 failures of third parties are those which would affect the general economy or certain industries, such as may occur if there were insufficient electric power or other utilities needed for the Company's operations or manufacture of its products or insufficient reliable means of transporting the Company's products. While such failures could affect important operations of the Company, either directly or indirectly, in a significant manner, the Company cannot at present estimate either the likelihood or the potential cost of such failures. The statements concerning future matters are "forward-looking statements" and actual results may vary.

FOREIGN EXCHANGE

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

The Company imports most of its products 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 not had a material impact on the Company's results of operations.

SEASONALITY AND CUSTOMER ORDERS

The Company generally records its highest level of sales during the second and third quarters as retailers stock merchandise in anticipation of the holiday season. The Company can also experience fluctuations in quarterly sales and related net income compared with the prior year due to timing of receipt of product from suppliers and subsequent shipment of product from the Company to customers.

Customer Orders Entered (1)
(In millions)

	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total
1997	$ 161	$ 44	$ 34	$ 6	$ 245
1998	174	50	37	8	269
1999	182(2)	48	40	—	—

(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) Customer orders entered for the first quarter of 1999 have been adjusted from previously reported first quarter 1999 customer orders entered, consistent with the Company's press release dated June 9, 1999.

Historically, principally due to the timing of trade shows early in the calendar year and the limited supply of the Company's products, the Company has received the majority of its orders in the first quarter of each year. The Company entered 65% and 66% of its total annual customer orders during the first quarter of both 1998 and 1997, respectively. Cancellations were approximately 7% and 8% of total annual orders in 1998 and 1997, respectively.

The Company shipped and recorded as net sales approximately 91% and 90% of its annual customer orders in 1998 and 1997, respectively. Orders not shipped in a particular period, net of cancellations, returns, allowances and cash discounts, are carried into backlog. The backlog was $64.3 million as of October 2, 1999, as compared to $61.2 million as of October 3, 1998.

Through the third quarter of 1999, customer orders entered increased 3% as compared to the same period for 1998. Customer orders entered for Village Series products have increased 6% through the third quarter of 1999 while customer orders entered for General Giftware products have decreased 1%.

Certain General Giftware products have lower gross profit rates than the Company's average gross profit rate. In addition, from time to time, the Company liquidates product at lower than average gross profit rates. As a result, gross profit may vary depending on the mix of product shipped.

Item 6. Exhibits and Reports on Form 8-K.

(a) The following documents are filed as exhibits to this Report.

11.1 Computation of net income per share.

27.1 Financial data schedule (EDGAR filing only).

99.1 Company press release, dated October 26, 1999.

(b) Reports on Form 8-K.

None.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	DEPARTMENT 56, INC.
Date: November 2, 1999	/s/ SUSAN E. ENGEL
	Susan E. Engel *Chairwoman, Chief Executive Officer and Director*
Date: November 2, 1999	/s/ PERCY C. TOMLINSON, JR.
	Percy C. Tomlinson, Jr. *Executive Vice President and Chief Financial Officer*
Date: November 2, 1999	/s/ GREGG A. PETERS
	Gregg A. Peters *Director of Finance and Principal Accounting Officer*

EXHIBIT INDEX

Exhibit Number	Exhibit Name	Page Number
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QuickLinks

PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
RESULTS OF OPERATIONS
RESULTS OF OPERATIONS
LIQUIDITY AND CAPITAL RESOURCES
YEAR 2000
FOREIGN EXCHANGE

EFFECT OF INFLATION
SEASONALITY AND CUSTOMER ORDERS
Item 6. Exhibits and Reports on Form 8-K.

SIGNATURES

EXHIBIT INDEX