

AMERICAN GREETINGS CORP

Form 10-Q

July 09, 2008

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended May 30, 2008

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-13859

**AMERICAN GREETINGS CORPORATION**

(Exact name of registrant as specified in its charter)

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**Ohio**  
(State or other jurisdiction of  
incorporation or organization)

**34-0065325**  
(I.R.S. Employer  
Identification No.)

**One American Road, Cleveland, Ohio**  
(Address of principal executive offices)

**44144**  
(Zip Code)

**(216) 252-7300**  
(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  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of July 7, 2008, the number of shares outstanding of each of the issuer's classes of common stock was:

|                |            |
|----------------|------------|
| Class A Common | 45,346,060 |
| Class B Common | 3,493,732  |

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**Table of Contents****PART I - FINANCIAL INFORMATION****Item 1. Financial Statements****AMERICAN GREETINGS CORPORATION****CONSOLIDATED STATEMENT OF INCOME****(Thousands of dollars except share and per share amounts)**

|  | <b>(Unaudited)</b>        |                     |
|--|---------------------------|---------------------|
|  | <b>Three Months Ended</b> |                     |
|  | <b>May 30, 2008</b>       | <b>May 25, 2007</b> |
| Net sales  | \$ 425,463                | \$ 418,016          |
| Other revenue  | 2,837                     | 1,951               |
| <b>Total revenue</b>   | <b>428,300</b>            | <b>419,967</b>      |
| Material, labor and other production costs                         | 193,342                   | 161,128             |
| Selling, distribution and marketing expenses                       | 150,875                   | 140,694             |
| Administrative and general expenses                                | 62,561                    | 62,235              |
| Other operating income net   | (727)                     | (360)               |
| <b>Operating income</b>  | <b>22,249</b>             | <b>56,270</b>       |
| Interest expense   | 4,905                     | 4,757               |
| Interest income  | (990)                     | (1,499)             |
| Other non-operating income net                                     | (901)                     | (1,543)             |
| <b>Income from continuing operations before income tax expense</b> | <b>19,235</b>             | <b>54,555</b>       |
| Income tax expense   | 5,902                     | 24,292              |
| <b>Income from continuing operations</b>                           | <b>13,333</b>             | <b>30,263</b>       |
| Loss from discontinued operations, net of tax                      |                           | (213)               |
| <b>Net income</b>  | <b>\$ 13,333</b>          | <b>\$ 30,050</b>    |
| <b>Earnings per share basic:</b>                                   |                           |                     |
| Income from continuing operations                                  | \$ 0.27                   | \$ 0.54             |
| Loss from discontinued operations                                  |                           |                     |
| <b>Net income</b>  | <b>\$ 0.27</b>            | <b>\$ 0.54</b>      |
| <b>Earnings per share assuming dilution:</b>                       |                           |                     |
| Income from continuing operations                                  | \$ 0.27                   | \$ 0.54             |
| Loss from discontinued operations                                  |                           |                     |
| <b>Net income</b>  | <b>\$ 0.27</b>            | <b>\$ 0.54</b>      |

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|  |            |            |
|--|------------|------------|
| Average number of shares outstanding                   | 48,800,941 | 55,262,716 |
| Average number of shares outstanding assuming dilution | 48,833,108 | 55,650,033 |
| Dividends declared per share                           | \$ 0.12    | \$ 0.10    |

See notes to consolidated financial statements (unaudited).

**Table of Contents****AMERICAN GREETINGS CORPORATION****CONSOLIDATED STATEMENT OF FINANCIAL POSITION**

(Thousands of dollars)

|   | (Unaudited)<br>May 30, 2008 | (Note 1)<br>February 29, 2008 | (Unaudited)<br>May 25, 2007 |
|---|-----------------------------|-------------------------------|-----------------------------|
| <b>ASSETS</b>   |                             |                               |                             |
| Current assets  |                             |                               |                             |
| Cash and cash equivalents                                 | \$ 108,192                  | \$ 123,500                    | \$ 132,582                  |
| Short-term investments                                    |                             |                               | 28,325                      |
| Trade accounts receivable, net                            | 59,897                      | 61,902                        | 119,147                     |
| Inventories   | 212,032                     | 216,671                       | 192,399                     |
| Deferred and refundable income taxes                      | 67,604                      | 72,280                        | 76,892                      |
| Prepaid expenses and other                                | 186,977                     | 195,017                       | 215,983                     |
| <b>Total current assets</b>                               | <b>634,702</b>              | <b>669,370</b>                | <b>765,328</b>              |
| Goodwill  | 300,323                     | 285,072                       | 225,318                     |
| Other assets  | 405,116                     | 420,219                       | 399,880                     |
| Deferred and refundable income taxes                      | 133,118                     | 133,762                       | 102,060                     |
| Property, plant and equipment at cost                     | 983,988                     | 974,073                       | 947,268                     |
| Less accumulated depreciation                             | 685,336                     | 678,068                       | 666,687                     |
| <b>Property, plant and equipment net</b>                  | <b>298,652</b>              | <b>296,005</b>                | <b>280,581</b>              |
|   | <b>\$ 1,771,911</b>         | <b>\$ 1,804,428</b>           | <b>\$ 1,773,167</b>         |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>                |                             |                               |                             |
| Current liabilities                                       |                             |                               |                             |
| Debt due within one year                                  | \$ 70,835                   | \$ 42,790                     | \$                          |
| Accounts payable  | 110,394                     | 123,713                       | 100,955                     |
| Accrued liabilities                                       | 73,281                      | 79,345                        | 77,837                      |
| Accrued compensation and benefits                         | 39,582                      | 68,669                        | 43,656                      |
| Income taxes payable                                      | 23,348                      | 29,037                        | 29,878                      |
| Other current liabilities                                 | 117,160                     | 108,867                       | 84,621                      |
| <b>Total current liabilities</b>                          | <b>434,600</b>              | <b>452,421</b>                | <b>336,947</b>              |
| Long-term debt  | 200,541                     | 200,518                       | 223,800                     |
| Other liabilities   | 157,610                     | 181,720                       | 147,597                     |
| Deferred income taxes and noncurrent income taxes payable | 26,986                      | 26,358                        | 27,184                      |
| Shareholders equity                                       |                             |                               |                             |
| Common shares Class A                                     | 45,345                      | 45,324                        | 51,148                      |
| Common shares Class B                                     | 3,495                       | 3,434                         | 4,340                       |
| Capital in excess of par value                            | 446,075                     | 445,696                       | 424,201                     |
| Treasury stock  | (871,379)                   | (872,949)                     | (712,147)                   |
| Accumulated other comprehensive income                    | 20,746                      | 21,244                        | 6,030                       |
| Retained earnings   | 1,307,892                   | 1,300,662                     | 1,264,067                   |
| <b>Total shareholders equity</b>                          | <b>952,174</b>              | <b>943,411</b>                | <b>1,037,639</b>            |

|              |              |              |
|--------------|--------------|--------------|
| \$ 1,771,911 | \$ 1,804,428 | \$ 1,773,167 |
|--------------|--------------|--------------|

See notes to consolidated financial statements (unaudited).

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**AMERICAN GREETINGS CORPORATION**  
**CONSOLIDATED STATEMENT OF CASH FLOWS**

(Thousands of dollars)

|  | (Unaudited)        |              |
|--|--------------------|--------------|
|  | Three Months Ended |              |
|  | May 30, 2008       | May 25, 2007 |
| <b>OPERATING ACTIVITIES:</b>   |                    |              |
| Net income   | \$ 13,333          | \$ 30,050    |
| Loss from discontinued operations  |                    | 213          |
| Income from continuing operations  | 13,333             | 30,263       |
| Adjustments to reconcile to net cash (used) provided by operating activities:      |                    |              |
| Net loss (gain) on disposal of fixed assets  | 168                | (116)        |
| Depreciation and amortization  | 12,785             | 11,995       |
| Deferred income taxes  | 5,459              | 4,466        |
| Other non-cash charges   | 1,718              | 1,979        |
| Changes in operating assets and liabilities, net of acquisitions and dispositions: |                    |              |
| Decrease (increase) in trade accounts receivable                                   | 5,310              | (14,745)     |
| Decrease (increase) in inventories   | 6,463              | (7,389)      |
| Decrease in other current assets   | 2,001              | 646          |
| Decrease in deferred costs net   | 1,253              | 11,691       |
| Decrease in accounts payable and other liabilities                                 | (57,606)           | (21,759)     |
| Other net  | (2,771)            | 4,107        |
| Cash (Used) Provided by Operating Activities                                       | (11,887)           | 21,138       |
| <b>INVESTING ACTIVITIES:</b>   |                    |              |
| Proceeds from sale of short-term investments                                       |                    | 134,900      |
| Purchases of short-term investments  |                    | (163,225)    |
| Property, plant and equipment additions  | (10,088)           | (5,875)      |
| Cash payments for business acquisitions, net of cash acquired                      | (15,625)           | (6,056)      |
| Cash receipts related to discontinued operations                                   |                    | 2,344        |
| Proceeds from sale of fixed assets   | 265                | 890          |
| Cash Used by Investing Activities  | (25,448)           | (37,022)     |
| <b>FINANCING ACTIVITIES:</b>   |                    |              |
| Net increase in short-term debt  | 28,045             |              |
| Sale of stock under benefit plans  | 363                | 9,358        |
| Purchase of treasury shares  | (38)               | (3,568)      |
| Dividends to shareholders  | (5,852)            | (5,536)      |
| Cash Provided by Financing Activities  | 22,518             | 254          |
| <b>DISCONTINUED OPERATIONS:</b>  |                    |              |
| Cash used by operating activities from discontinued operations                     |                    | (59)         |
| Cash Used by Discontinued Operations   |                    | (59)         |
| EFFECT OF EXCHANGE RATE CHANGES ON CASH  | (491)              | 3,558        |
| DECREASE IN CASH AND CASH EQUIVALENTS  | (15,308)           | (12,131)     |



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|  |            |            |
|--|------------|------------|
| Cash and Cash Equivalents at Beginning of Year | 123,500    | 144,713    |
| Cash and Cash Equivalents at End of Period     | \$ 108,192 | \$ 132,582 |

See notes to consolidated financial statements (unaudited).

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**AMERICAN GREETINGS CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**Three Months Ended May 30, 2008 and May 25, 2007**

**Note 1 Basis of Presentation**

The accompanying unaudited consolidated financial statements of American Greetings Corporation and its subsidiaries (the Corporation) have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary to fairly present financial position, results of operations and cash flows for the periods have been included.

The Corporation's fiscal year ends on February 28 or 29. References to a particular year refer to the fiscal year ending in February of that year. For example, 2008 refers to the year ended February 29, 2008.

These interim financial statements should be read in conjunction with the Corporation's financial statements and notes thereto included in its Annual Report on Form 10-K for the year ended February 29, 2008, from which the Consolidated Statement of Financial Position at February 29, 2008, presented herein, has been derived. During the fourth quarter of 2008, it was determined that the Corporation's entertainment development and production joint venture no longer met all of the criteria necessary to be classified as held for sale in accordance with Statement of Financial Accounting Standards (SFAS) No. 144 (SFAS 144), Accounting for the Impairment or Disposal of Long-Lived Assets. As a result, this business unit has been reclassified into continuing operations for all periods presented. In addition, certain other amounts in the prior year financial statements have also been reclassified to conform to the 2009 presentation. These reclassifications had no material impact on earnings or cash flows.

**Note 2 Seasonal Nature of Business**

A significant portion of the Corporation's business is seasonal in nature. Therefore, the results of operations for interim periods are not necessarily indicative of the results for the fiscal year taken as a whole.

**Note 3 Recent Accounting Pronouncements**

In September 2006, the Financial Accounting Standards Board (the FASB) issued SFAS No. 157 (SFAS 157), Fair Value Measurements, which provides a definition of fair value, establishes a framework for measuring fair value and requires expanded disclosures about fair value measurements. In November 2007, the FASB deferred the effective date of SFAS 157 for non-financial assets and liabilities until fiscal years and interim periods beginning after November 15, 2008. SFAS 157 is still effective for the Corporation in fiscal 2009 for financial assets and liabilities. The provisions of SFAS 157 will be applied prospectively. The Corporation adopted SFAS 157 for financial assets and liabilities on March 1, 2008. See Note 12.

In February 2007, the FASB issued SFAS No. 159 (SFAS 159), The Fair Value Option for Financial Assets and Financial Liabilities. SFAS 159 allows companies to choose to measure financial instruments and certain other financial assets and financial liabilities at fair value. SFAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Corporation adopted SFAS 159 on March 1, 2008 and elected not to measure any additional financial instruments or other items at fair value.

**Table of Contents****Note 4 Other Income and Expense**

| (In thousands)                 | Three Months Ended |              |
|--------------------------------|--------------------|--------------|
|                                | May 30, 2008       | May 25, 2007 |
| Other operating income net     | \$ (727)           | \$ (360)     |
| Foreign exchange gain          | \$ (537)           | \$ (1,120)   |
| Rental income                  | (537)              | (397)        |
| Miscellaneous                  | 173                | (26)         |
| Other non-operating income net | \$ (901)           | \$ (1,543)   |

Miscellaneous includes, among other things, gains and losses on asset disposals.

**Note 5 Earnings Per Share**

The following table sets forth the computation of earnings per share and earnings per share - assuming dilution:

| Numerator (in thousands):                                     | Three Months Ended |              |
|---|--------------------|--------------|
|   | May 30, 2008       | May 25, 2007 |
| Income from continuing operations                             | \$ 13,333          | \$ 30,263    |
| <b>Denominator (in thousands):</b>                            |                    |              |
| Weighted average shares outstanding                           | 48,801             | 55,263       |
| Effect of dilutive securities:                                |                    |              |
| Stock options and other                                       | 32                 | 387          |
| Weighted average shares outstanding assuming dilution         | 48,833             | 55,650       |
| Income from continuing operations per share                   | \$ 0.27            | \$ 0.54      |
| Income from continuing operations per share assuming dilution | \$ 0.27            | \$ 0.54      |

Approximately 5.6 million and 2.8 million stock options outstanding in the three month periods ended May 30, 2008 and May 25, 2007, respectively, were excluded from the computation of earnings per share assuming dilution because the options exercise prices were greater than the average market price of the common shares during the respective periods.

**Note 6 Comprehensive Income**

The Corporation's total comprehensive income is as follows:

| (In thousands) | Three Months Ended |              |
|----------------|--------------------|--------------|
|                | May 30, 2008       | May 25, 2007 |
| Net income     | \$ 13,333          | \$ 30,050    |

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Other comprehensive (loss) income:

|   |                  |                  |
|---|------------------|------------------|
| Foreign currency translation adjustment and other | (273)            | 7,043            |
| Pension and other postretirement benefit plans    | (225)            |                  |
| <b>Total comprehensive income</b>                 | <b>\$ 12,835</b> | <b>\$ 37,093</b> |

**Table of Contents****Note 7 Trade Accounts Receivable, Net**

Trade accounts receivable are reported net of certain allowances and discounts. The most significant of these are as follows:

| <b>(In thousands)</b>                                     | <b>May 30, 2008</b> | <b>February 29, 2008</b> | <b>May 25, 2007</b> |
|---|---------------------|--------------------------|---------------------|
| Allowance for seasonal sales returns                      | \$ 59,451           | \$ 59,626                | \$ 67,039           |
| Allowance for outdated products                           | 23,199              | 21,435                   | 26,769              |
| Allowance for doubtful accounts                           | 4,111               | 3,778                    | 5,009               |
| Allowance for cooperative advertising and marketing funds | 35,247              | 33,662                   | 30,528              |
| Allowance for rebates                                     | 57,900              | 41,435                   | 47,965              |
|   | \$ 179,908          | \$ 159,936               | \$ 177,310          |

**Note 8 Inventories**

| <b>(In thousands)</b>                  | <b>May 30, 2008</b> | <b>February 29, 2008</b> | <b>May 25, 2007</b> |
|--|---------------------|--------------------------|---------------------|
| Raw materials                          | \$ 20,437           | \$ 17,701                | \$ 19,568           |
| Work in process                        | 12,414              | 10,516                   | 14,957              |
| Finished products                      | 234,910             | 244,379                  | 209,688             |
|  | 267,761             | 272,596                  | 244,213             |
| Less LIFO reserve                      | 83,194              | 82,085                   | 80,567              |
|  | 184,567             | 190,511                  | 163,646             |
| Display materials and factory supplies | 27,465              | 26,160                   | 28,753              |
|  | \$ 212,032          | \$ 216,671               | \$ 192,399          |

The valuation of inventory under the Last-In, First-Out (LIFO) method is made at the end of each fiscal year based on inventory levels and costs at that time. Accordingly, interim LIFO calculations, by necessity, are based on estimates of expected fiscal year-end inventory levels and costs and are subject to final fiscal year-end LIFO inventory calculations.

Inventory held on location for retailers with scan-based trading arrangements totaled approximately \$37 million, \$32 million and \$32 million as of May 30, 2008, February 29, 2008 and May 25, 2007, respectively.

**Note 9 Deferred Costs**

Deferred costs and future payment commitments are included in the following financial statement captions:

| <b>(In thousands)</b>      | <b>May 30, 2008</b> | <b>February 29, 2008</b> | <b>May 25, 2007</b> |
|----------------------------|---------------------|--------------------------|---------------------|
| Prepaid expenses and other | \$ 110,633          | \$ 119,069               | \$ 119,741          |
| Other assets               | 326,777             | 338,003                  | 337,358             |
| Deferred cost assets       | 437,410             | 457,072                  | 457,099             |
| Other current liabilities  | (71,348)            | (68,457)                 | (47,609)            |
| Other liabilities          | (29,182)            | (50,491)                 | (30,681)            |
| Deferred cost liabilities  | (100,530)           | (118,948)                | (78,290)            |

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|                    |            |            |            |
|--------------------|------------|------------|------------|
| Net deferred costs | \$ 336,880 | \$ 338,124 | \$ 378,809 |
|--------------------|------------|------------|------------|

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The Corporation is party to an amended and restated \$450 million secured credit agreement and to an amended and restated receivables purchase agreement that had available financing of up to \$150 million. The credit agreement includes a \$350 million revolving credit facility and a \$100 million delay draw term loan. The agreements were each amended on March 28, 2008. The amendment to the credit agreement extends the period during which the Corporation may borrow on the term loan until April 3, 2009 and changes the start of the amortization period from April 4, 2008 until April 3, 2009. The amendment to the accounts receivable facility decreases the amount of available financing from \$150 million to \$90 million.

Debt due within one year is as follows:

| (In thousands)                              | May 30, 2008 | February 29, 2008 |
|---|--------------|-------------------|
| Revolving credit facility                   | \$ 35,000    | \$ 20,100         |
| Accounts receivable securitization facility | 13,145       |                   |
| 6.10% senior notes, due 2028                | 22,690       | 22,690            |
|   | \$ 70,835    | \$ 42,790         |

There was no debt due within one year as of May 25, 2007.

At May 30, 2008, the balances outstanding on the revolving credit facility and accounts receivable securitization facility bear interest at a rate of approximately 3.2% and 3.4%, respectively. In addition to the balances outstanding under the aforementioned agreements, the Corporation has, in the aggregate, \$25.7 million outstanding under letters of credit, which reduces the total credit availability thereunder. The balance of the 6.10% senior notes was reclassified to current during the second quarter of 2008 as these notes may be put back to the Corporation on August 1, 2008, at the option of the holders, at 100% of the principal amount provided the holders exercise this option between July 1, 2008 and August 1, 2008.

Long-term debt and their related calendar year due dates are as follows:

| (In thousands)                | May 30, 2008 | February 29, 2008 | May 25, 2007 |
|-------------------------------|--------------|-------------------|--------------|
| 7.375% senior notes, due 2016 | \$ 200,000   | \$ 200,000        | \$ 200,000   |
| 6.10% senior notes, due 2028  |              |                   | 22,690       |
| Other (due 2010)              | 541          | 518               | 1,110        |
|                               | \$ 200,541   | \$ 200,518        | \$ 223,800   |

At May 30, 2008, the Corporation was in compliance with the financial covenants under its borrowing agreements.

**Note 11 Retirement Benefits**

The components of periodic benefit cost for the Corporation's defined benefit pension and postretirement benefit plans are as follows:

| (In thousands)                 | Defined Benefit Pension<br>Three Months Ended |              | Postretirement Benefit<br>Three Months Ended |              |
|--------------------------------|---|--------------|--|--------------|
|                                | May 30, 2008                                  | May 25, 2007 | May 30, 2008                                 | May 25, 2007 |
| Service cost                   | \$ 241  | \$ 244       | \$ 950                                       | \$ 1,050     |
| Interest cost                  | 2,304   | 2,265        | 2,200  | 2,150        |
| Expected return on plan assets | (2,043)                                       | (2,154)      | (1,250)                                      | (1,250)      |

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|   |        |        |          |          |
|---|--------|--------|----------|----------|
| Amortization of prior service cost (credit) | 77     | 64     | (1,850)  | (1,850)  |
| Amortization of actuarial loss              | 320    | 410    | 1,075    | 1,650    |
|   | \$ 899 | \$ 829 | \$ 1,125 | \$ 1,750 |

The Corporation has a non-contributory profit-sharing plan with a contributory 401(k) provision covering most of its United States employees. The profit-sharing plan expense for the three months ended May 30, 2008 was \$1.1 million, compared to \$3.1 million in the prior year period. The profit-sharing plan expense for the three month



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periods are estimates as actual contributions to the profit-sharing plan are made after fiscal year-end. The Corporation also matches a portion of 401(k) employee contributions. The expense recognized for the 401(k) match for the three months ended May 30, 2008 and May 25, 2007 was \$1.8 million and \$1.2 million, respectively.

At May 30, 2008, February 29, 2008 and May 25, 2007, the liability for postretirement benefits other than pensions was \$64.9 million, \$63.0 million and \$68.5 million, respectively, and is included in Other liabilities on the Consolidated Statement of Financial Position.

**Note 12 Fair Value Measurements**

SFAS 157 outlines a valuation framework, which requires use of the market approach, income approach and/or cost approach when measuring fair value and creates a fair value hierarchy in order to increase the consistency and comparability of fair value measurements and the related disclosures. SFAS 157 also expands disclosure requirements to include the methods and assumptions used to measure fair value.

The hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The classification of fair value measurements within the hierarchy is based upon the lowest level of input that is significant to the measurement. The three levels are defined as follows:

Level 1 Valuation is based upon quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 Valuation is based upon quoted prices for similar assets and liabilities in active markets, or other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 Valuation is based upon unobservable inputs that are significant to the fair value measurement.

As of May 30, 2008, the Corporation had \$6.3 million of mutual fund assets held in a rabbi trust and \$6.3 million of a non-qualified deferred compensation plan liability. The fair value of the mutual fund assets was based on each fund's quoted market value per share in an active market and was considered a Level 1 valuation. Although the Corporation is under no obligation to fund employees' nonqualified accounts, the fair value of the related non-qualified deferred compensation liability is based on the fair value of the mutual fund assets. The fair value measurement of the deferred compensation liability was also considered a Level 1 valuation because the liability was measured by quoted prices in an active market.

**Note 13 Income Taxes**

Effective March 1, 2007, the Corporation adopted FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109, including the provisions of FASB Staff Position No. FIN-48-1, Definition of Settlement in FASB Interpretation No. 48. In connection with the adoption of FIN 48, the Corporation recorded a decrease to retained earnings of \$14.0 million to recognize an increase in its liability (or decrease to its refundable) for unrecognized tax benefits, interest and penalties under the recognition and measurement criteria of FIN 48.

Included in the balance of unrecognized tax benefits at February 29, 2008, was \$21.0 million in unrecognized tax benefits, the recognition of which would have a favorable effect on the effective tax rate. It is reasonably possible that the Corporation's unrecognized tax positions as of February 29, 2008 could decrease approximately \$2 million during 2009 due to anticipated settlements and resulting cash payments related to open years after 1999, which are currently under examination. As of February 29, 2008, the total amount of gross accrued interest and penalties included in the Consolidated Statement of Financial Position was \$6.5 million.

The Corporation is subject to examination by the U.S. Internal Revenue Service and various U.S. state and local jurisdictions for tax years 1996 to the present. The Corporation is also subject to tax examination in various foreign tax jurisdictions, including Canada, the United Kingdom, Australia, France, Italy, Mexico and New Zealand for tax years 2003 to the present.

There were no significant changes to any of these amounts during the first quarter of 2009.

**Table of Contents****Note 14 Business Segment Information**

| (In thousands)                            | Total Revenue<br>Three Months Ended |              | Segment Earnings (Loss)<br>Three Months Ended |              |
|---|-------------------------------------|--------------|---|--------------|
|   | May 30, 2008                        | May 25, 2007 | May 30, 2008                                  | May 25, 2007 |
| North American Social Expression Products | \$ 302,418                          | \$ 299,944   | \$ 53,695                                     | \$ 88,862    |
| Intersegment items                        | (14,644)                            | (8,503)      | (11,243)                                      | (6,522)      |
| Exchange rate adjustment                  | 513                                 | (2,509)      | 59  | (1,650)      |
| Net                                       | 288,287                             | 288,932      | 42,511  | 80,690       |
| International Social Expression Products  | 69,873                              | 64,417       | 2,862   | 176          |
| Exchange rate adjustment                  | 1,087                               | (668)        | (57)  | 11           |
| Net                                       | 70,960                              | 63,749       | 2,805   | 187          |
| Retail Operations                         | 41,493                              | 40,539       | (3,407)                                       | (2,769)      |
| Exchange rate adjustment                  | 490                                 | (1,611)      | (6)   | (12)         |
| Net                                       | 41,983                              | 38,928       | (3,413)                                       | (2,781)      |
| AG Interactive                            | 20,527                              | 19,899       | (1,096)                                       | 3,279        |
| Exchange rate adjustment                  | 34                                  | (3)          | 35  | 8            |
| Net                                       | 20,561                              | 19,896       | (1,061)                                       | 3,287        |
| Non-reportable segments                   | 6,509                               | 8,385        | (1,966)                                       | 563          |
| Unallocated                               |                                     | 77           | (19,633)                                      | (27,352)     |
| Exchange rate adjustment                  |                                     |              | (8)   | (39)         |
| Net                                       |                                     | 77           | (19,641)                                      | (27,391)     |
| Consolidated total                        | \$ 428,300                          | \$ 419,967   | \$ 19,235                                     | \$ 54,555    |

**Termination Benefits**

Termination benefits are primarily considered part of an ongoing benefit arrangement, accounted for in accordance with SFAS No. 112,

Employers Accounting for Postemployment Benefits, and are recorded when payment of the benefits is probable and can be reasonably estimated.

The balance of the severance accrual was \$7.0 million, \$9.6 million and \$6.8 million at May 30, 2008, February 29, 2008 and May 25, 2007, respectively, and is included in Accrued liabilities on the Consolidated Statement of Financial Position.

**Deferred Revenue**

Deferred revenue, included in Other current liabilities on the Consolidated Statement of Financial Position, totaled \$37.8 million, \$37.9 million and \$34.9 million at May 30, 2008, February 29, 2008 and May 25, 2007, respectively. The amounts relate primarily to the Corporation's AG Interactive segment and the licensing business included in non-reportable segments.

**Table of Contents**Acquisitions

In March 2008, the Corporation acquired a card publisher and franchised distributor of greeting cards in the United Kingdom ( U.K. ), for approximately \$16 million. Cash paid, net of cash acquired was \$15.6 million and is reflected in investing activities in the Consolidated Statement of Cash Flows. Although the allocation of the purchase price has not yet been finalized, goodwill of approximately \$12 million has been recorded as of May 30, 2008. The purchase agreement provides for a contingent payment of up to 2 million U.K. Pounds Sterling to be paid based on the company's operating results over a three-year period from the date of acquisition. The financial results of this acquisition are included in the Corporation's consolidated results from the date of acquisition. Pro forma results of operations have not been presented because the effect of this acquisition was not deemed material.

During the first quarter of 2009, a preliminary valuation of the intangible assets of PhotoWorks, Inc., which was acquired in the second half of 2008, was completed. Although the allocation of the purchase price has not yet been finalized, the value of the intangible assets acquired was reduced approximately \$4 million with a corresponding increase in goodwill recorded as a result of the preliminary valuation.

**Note 15 Discontinued Operations**

Discontinued operations include Learning Horizons, the Corporation's educational products business. This subsidiary meets the definition of a component of an entity and has been accounted for as a discontinued operation under SFAS 144. Accordingly, the Corporation's consolidated financial statements and related notes have been presented to reflect Learning Horizons as a discontinued operation for all periods presented. Learning Horizons was previously included within the Corporation's non-reportable segments.

In February 2007, the Corporation entered into an agreement to sell Learning Horizons. The sale reflects the Corporation's strategy to focus its resources on business units closely related to its core social expression business. The sale closed in March 2007 and the Corporation received cash proceeds of \$2.3 million, which is included in Cash receipts related to discontinued operations in the Consolidated Statement of Cash Flows.

The following summarizes the results of discontinued operations:

| <b>(In thousands)</b>                         | <b>Three Months Ended<br/>May 25, 2007</b> |       |
|---|--|-------|
| Total revenue                                 | \$   | 299   |
| Pre-tax loss from operations                  | \$   | (47)  |
| Gain on sale                                  |  | 195   |
|   |  | 148   |
| Income tax expense                            |  | 361   |
| Loss from discontinued operations, net of tax | \$   | (213) |

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

This Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with our unaudited consolidated financial statements. This discussion and analysis, and other statements made in this Report, contain forward-looking statements, see Factors That May Affect Future Results at the end of this discussion and analysis for a description of the uncertainties, risks and assumptions associated with these statements. Unless otherwise indicated or the context otherwise requires, the Corporation, we, our, us and American Greetings are used in this Report to refer to the businesses of American Greetings Corporation and its consolidated subsidiaries.

#### **Overview**

During the first quarter, we continued to transition fresh new products to retail, which continues to drive sales growth in the card business. The level of activity, including production, distribution and merchandising, needed to drive these sales provided increased costs that put downward pressure on earnings. The growth in the value card line continued in the quarter, driving down the average selling price of both everyday and seasonal cards, while overall card unit sales increased compared to the prior year period. The content costs of cards also continued to increase with growth in the sale of technology cards and changes in product design that add creative embellishments to the card line.

We experienced higher consolidated total revenues and lower earnings during the first quarter of 2009, compared to the prior year quarter. The higher revenues were primarily the result of favorable foreign currency translation. Revenue improvement in the International Social Expression Products segment, primarily in the United Kingdom ( U.K. ), was substantially offset by decreased revenue in the North American Social Expression Products segment. In the card businesses, growth in card unit sales was partially offset by lower average selling prices caused by a higher mix of value line cards.

Our lower earnings were driven by several factors within our North American Social Expression Products segment, which experienced increased costs in the current quarter compared to the prior year period. These items include the rollout of the new single priced card line in Canada, increases in product content costs and increased supply chain, scrap and distribution costs.

As noted in our fiscal year 2008 Annual Report on Form 10-K, the recent parity of the currency exchange rate between the U.S. dollar and the Canadian dollar have created some challenges in the marketplace. To address these challenges, we have created a new Canadian line of products resulting in a temporary reduction in revenues and a temporary increase in costs to create, manufacture and distribute the new product. These impacts continued during the first quarter and reduced pre-tax earnings by approximately \$10 million. We anticipate that the rollout of the new Canadian line will be completed during the second quarter of 2009.

As also noted in the prior year, we have experienced increases in card product costs associated with more technology cards (paper cards that include light and/or sound) and other creative content costs. These costs continue to be higher compared to the prior year first quarter, particularly in seasonal cards, as we add technology and other creative embellishments that increase consumers' perceived value of the card product.

Increases in card shipments outpaced increases of card net sales, particularly seasonal cards, driving up supply chain, scrap and distribution costs during the first quarter compared to the prior year period. In total, these costs along with the increased card product content costs impacted pre-tax earnings by approximately \$24 million compared to the prior year period.

The AG Interactive segment also contributed to the decrease in first quarter earnings, primarily related to the two acquisitions in the online photo sharing space that we made during the second half of last year. We are still developing these product lines, which historically are seasonally stronger during the second half of the year. Our overall photo strategy is designed to bring together the strength of both operations, and then leverage the user across all of our existing websites.

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In March 2008, we acquired a card publisher and franchised distributor of greeting cards in the U.K. This acquisition provides us with additional distribution in an increasingly fragmented U.K. market and we anticipate leveraging supply chain synergies as we integrate this new business.

**Results of Operations***Three months ended May 30, 2008 and May 25, 2007*

Net income was \$13.3 million, or \$0.27 per share, in the first quarter compared to \$30.1 million, or \$0.54 per share, in the prior year first quarter (all per-share amounts assume dilution).

Our results for the three months ended May 30, 2008 and May 25, 2007 are summarized below:

| <b>(Dollars in thousands)</b>                                      | <b>2008</b>      | <b>% Total Revenue</b> | <b>2007</b>      | <b>% Total Revenue</b> |
|--|------------------|------------------------|------------------|------------------------|
| Net sales  | \$ 425,463       | 99.3%                  | \$ 418,016       | 99.5%                  |
| Other revenue  | 2,837            | 0.7%                   | 1,951            | 0.5%                   |
| <b>Total revenue</b>   | <b>428,300</b>   | <b>100.0%</b>          | <b>419,967</b>   | <b>100.0%</b>          |
| Material, labor and other production costs                         | 193,342          | 45.1%                  | 161,128          | 38.4%                  |
| Selling, distribution and marketing expenses                       | 150,875          | 35.2%                  | 140,694          | 33.5%                  |
| Administrative and general expenses                                | 62,561           | 14.6%                  | 62,235           | 14.8%                  |
| Other operating income net   | (727)            | (0.1)%                 | (360)            | (0.1)%                 |
| <b>Operating income</b>  | <b>22,249</b>    | <b>5.2%</b>            | <b>56,270</b>    | <b>13.4%</b>           |
| Interest expense   | 4,905            | 1.1%                   | 4,757            | 1.1%                   |
| Interest income  | (990)            | (0.2)%                 | (1,499)          | (0.3)%                 |
| Other non-operating income net                                     | (901)            | (0.2)%                 | (1,543)          | (0.4)%                 |
| <b>Income from continuing operations before income tax expense</b> | <b>19,235</b>    | <b>4.5%</b>            | <b>54,555</b>    | <b>13.0%</b>           |
| Income tax expense   | 5,902            | 1.4%                   | 24,292           | 5.8%                   |
| <b>Income from continuing operations</b>                           | <b>13,333</b>    | <b>3.1%</b>            | <b>30,263</b>    | <b>7.2%</b>            |
| Loss from discontinued operations, net of tax                      |                  | (0.0)%                 | (213)            | (0.0)%                 |
| <b>Net income</b>  | <b>\$ 13,333</b> | <b>3.1%</b>            | <b>\$ 30,050</b> | <b>7.2%</b>            |

For the three months ended May 30, 2008, consolidated net sales were \$425.5 million, up from \$418.0 million in the prior year first quarter. This 1.8%, or \$7.4 million, increase was primarily the result of higher net sales in our International Social Expression Products segment of approximately \$5 million and a favorable foreign currency translation impact of approximately \$7 million. These increases were partially offset by lower net sales in our North American Social Expression Products segment of approximately \$4 million.

The increase in our International Social Expression Products segment's net sales was driven by our U.K. operations where approximately half of the increase was due to the acquisition completed in the current quarter. The remaining increase was primarily the result of a comparison to a soft prior period and additional distribution in the current year at existing customers in the U.K. The prior period was unfavorably impacted by costs associated with incentive allowances for removal of product at retail, as credits issued to customers exceeded new product shipments.

Net sales of our North American Social Expression Products segment decreased approximately \$4 million. The majority of the decrease is attributable to the new Canadian line of single-priced cards. The effect of implementing the new product line was a reduction of approximately \$5 million in net sales. Lower sales of our gift packaging products and party goods also contributed to the decrease. These decreases were

partially offset by higher sales of both everyday and seasonal cards.

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Other revenue, primarily royalty revenue, increased \$0.8 million from \$2.0 million during the three months ended May 25, 2007 to \$2.8 million for the three months ended May 30, 2008.

**Wholesale Unit and Pricing Analysis for Greeting Cards**

Unit and pricing comparatives (on a sales less returns basis) for the three months ended May 30, 2008 and May 25, 2007 are summarized below:

|                               | Increase (Decrease) From the Prior Year |        |                |        |                      |        |
|-------------------------------|---|--------|----------------|--------|----------------------|--------|
|                               | Everyday Cards                          |        | Seasonal Cards |        | Total Greeting Cards |        |
|                               | 2008                                    | 2007   | 2008           | 2007   | 2008                 | 2007   |
| Unit volume                   | 11.2%                                   | 8.0%   | 7.1%           | (1.5)% | 9.7%                 | 4.3%   |
| Selling prices                | (4.6)%                                  | (4.7)% | (5.8)%         | 1.5%   | (5.2)%               | (2.5)% |
| Overall increase / (decrease) | 6.0%                                    | 2.9%   | 0.9%           | 0.0%   | 4.0%                 | 1.7%   |

During the first quarter, combined everyday and seasonal greeting card sales less returns improved 4.0%, compared to the prior year quarter, with most of the increase coming from everyday cards.

Everyday card sales less returns for the first quarter were up 6.0%, compared to the prior year quarter with improvement in both the North American Social Expression Products segment and International Social Expression Products segment. Overall, unit volume was up 11.2% and selling prices were down 4.6%. The lower selling prices were the result of a higher mix of value line cards compared to the prior year.

Seasonal card unit volume increased 7.1%, driven primarily by the Mother's Day program. Lower selling prices of 5.8% related to a higher mix of value priced cards across most programs in the North American Social Expression Products segment compared to the prior year period.

**Expense Overview**

During the current quarter, we experienced increased costs. These higher costs were due to the rollout of the new single priced card line in Canada, added content to our cards, including music and lights, and increased shipments outpacing increased net sales. These activities were undertaken to drive profitable sales growth.

Material, labor and other production costs for the three months ended May 30, 2008 were \$193.3 million, an increase from \$161.1 million for the comparable period in the prior year. As a percentage of total revenue, these costs were 45.1% in the current period compared to 38.4% for the three months ended May 25, 2007. The increase of \$32.2 million is due to unfavorable spending and product mix of approximately \$20 million and \$10 million, respectively, and foreign currency translation impacts of approximately \$2 million. The increased spending is primarily attributable to higher scrap and creative content costs as well as costs associated with the conversion to our new Canadian line of cards. The unfavorable product mix is attributable to a shift toward cards with more content, including music, lights and other embellishments.

Selling, distribution and marketing expenses for the three months ended May 30, 2008 were \$150.9 million, increasing from \$140.7 million for the comparable period in the prior year. The increase of \$10.2 million is due to unfavorable foreign currency translation of approximately \$3 million and higher spending of approximately \$7 million. The additional spending is attributable to increases in supply chain costs, specifically freight and distribution costs, due to an increase in products shipped. Merchandiser expense and freight and distribution costs each increased approximately \$4 million.

Administrative and general expenses were \$62.6 million for the three months ended May 30, 2008, an increase from \$62.2 million for the three months ended May 25, 2007. The increase of \$0.4 million is primarily related to unfavorable foreign currency translation.

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Interest expense for the three months ended May 30, 2008 was \$4.9 million, up from \$4.8 million for the prior year quarter. The increase of \$0.1 million is attributable to increased short-term borrowings on the revolving credit facility and the accounts receivable securitization facility in the current period.

Other non-operating income net was \$0.9 million in the current year first quarter compared to \$1.5 million for the three months ended May 25, 2007. The \$0.6 million reduction in income is due primarily to decreased foreign exchange gains in the current period.

The effective tax rate on income from continuing operations was 30.7% and 44.5% for the three months ended May 30, 2008 and May 25, 2007, respectively. The higher effective tax rate in the prior quarter related to several discrete events during that period, primarily agreements reached with the Internal Revenue Service as it closed its audit cycle.

**Segment Information**

Our operations are organized and managed according to a number of factors, including product categories, geographic locations and channels of distribution. Our North American Social Expression Products and our International Social Expression Products segments primarily design, manufacture and sell greeting cards and other related products through various channels of distribution, with mass retailers as the primary channel. As permitted under Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information, certain operating divisions have been aggregated into both the North American Social Expression Products and International Social Expression Products segments. The aggregated operating divisions have similar economic characteristics, products, production processes, types of customers and distribution methods. At May 30, 2008, we owned and operated 417 card and gift retail stores in the United States and Canada through our Retail Operations segment. The stores are primarily located in malls and strip shopping centers. The stores sell products purchased from the North American Social Expression Products segment as well as products purchased from other vendors. AG Interactive distributes social expression products, including electronic greetings, personalized printable greeting cards and a broad range of graphics and digital services and products, through a variety of electronic channels, including Web sites, Internet portals, instant messaging services and electronic mobile devices. AG Interactive also offers online photo sharing space and a platform to provide consumers the ability to use their own photos to create unique, high quality physical products, including greeting cards, calendars, photo albums and photo books.

We review segment results using consistent exchange rates between periods to eliminate the impact of foreign currency fluctuations.

*North American Social Expression Products Segment*

| <b>(Dollars in thousands)</b> | <b>Three Months Ended</b> |                     | <b>% Change</b> |
|-------------------------------|---------------------------|---------------------|-----------------|
|                               | <b>May 30, 2008</b>       | <b>May 25, 2007</b> |                 |
| Total revenue                 | \$ 287,774                | \$ 291,441          | (1.3)%          |
| Segment earnings              | 42,452                    | 82,340              | (48.4)%         |

Total revenue of our North American Social Expression Products segment for the quarter ended May 30, 2008, excluding the impact of foreign exchange and intersegment items, decreased \$3.7 million, or 1.3%, from the prior year period. The majority of the decrease was driven by the rollout of the new Canadian card line. The effect of implementing the new product line was a reduction of approximately \$5 million in revenue. Lower sales of our gift packaging products and party goods also contributed to the decrease. These decreases were partially offset by higher sales of both everyday and seasonal cards.

Segment earnings, excluding the impact of foreign exchange and intersegment items, decreased \$39.9 million in the current period compared to the three months ended May 25, 2007. The conversion to the new Canadian card line reduced earnings by approximately \$10 million in the current three months. Also contributing to the decrease are lower margins and increased supply chain costs. The lower margins are a result of a shift in product mix toward cards with more content, including music, lights and other embellishments. The additional supply chain spending,



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specifically freight and distribution costs, is due to an increase in products shipped. In total, these costs along with the increased card product content costs impacted segment earnings by approximately \$24 million compared to the prior year period.

*International Social Expression Products Segment*

| (Dollars in thousands) | Three Months Ended |              | % Change |
|------------------------|--------------------|--------------|----------|
|                        | May 30, 2008       | May 25, 2007 |          |
| Total revenue          | \$ 69,873          | \$ 64,417    | 8.5%     |
| Segment earnings       | 2,862              | 176          | 1,526.1% |

Total revenue of our International Social Expression Products segment, excluding the impact of foreign exchange, increased \$5.5 million, or 8.5%, compared to the prior year quarter. Approximately half of the revenue improvement in the three-month period is attributable to the acquisition completed in the current period. The remaining increase was primarily the result of a comparison to a soft prior period and additional distribution in the current year at existing customers in the U.K. The prior period was unfavorably impacted by costs associated with incentive allowances for removal of product at retail, as credits issued to customers exceeded new product shipments.

Segment earnings, excluding the impact of foreign exchange, increased \$2.7 million compared to the prior year three months. The increase is attributable to the higher sales volume in the current period and lower distribution and marketing expenses. The distribution and marketing expenses were higher in the prior year quarter due to the activities related to the removal of product at retail during that period.

*Retail Operations Segment*

| (Dollars in thousands) | Three Months Ended |              | % Change |
|------------------------|--------------------|--------------|----------|
|                        | May 30, 2008       | May 25, 2007 |          |
| Total revenue          | \$ 41,493          | \$ 40,539    | 2.4%     |
| Segment loss           | (3,407)            | (2,769)      | (23.0)%  |

Total revenue, excluding the impact of foreign exchange, in our Retail Operations segment increased \$1.0 million, or 2.4%, for the three months ended May 30, 2008, compared to the prior year period due to favorable same-store sales. The current year period benefited from the performance of children's gifting products, which was the driver of the same-store sales increase.

Segment earnings, excluding the impact of foreign exchange, was a loss of \$3.4 million in the three months ended May 30, 2008, compared to a loss of \$2.8 million during the three months ended May 25, 2007. Segment earnings were unfavorably impacted by a weakening of gross margins as a result of more promotional pricing. Gross margins decreased by approximately 1.9 percentage points.

*AG Interactive Segment*

| (Dollars in thousands)  | Three Months Ended |              | % Change |
|-------------------------|--------------------|--------------|----------|
|                         | May 30, 2008       | May 25, 2007 |          |
| Total revenue           | \$ 20,527          | \$ 19,899    | 3.2%     |
| Segment (loss) earnings | (1,096)            | 3,279        | (133.4)% |

Total revenue of AG Interactive for the three months ended May 30, 2008, excluding the impact of foreign exchange, was \$20.5 million compared to \$19.9 million in the prior year first quarter. The current year period includes approximately \$3 million of revenue from the digital photography acquisitions completed during the second half of 2008. These revenues were partially offset by lower advertising revenues in our online product group. At the end of the first quarter of 2009, AG Interactive had approximately 3.9 million online paid subscriptions versus 3.6 million at the prior year quarter end.



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Segment earnings, excluding the impact of foreign exchange, was a loss of \$1.1 million for the quarter ended May 30, 2008, compared to earnings of \$3.3 million in the prior year period. The decrease is primarily attributable to expenses incurred in the current period associated with the digital photo product line, including marketing and technology costs. Included in these expenses is approximately \$1 million of amortization expense of intangible assets.

## **Liquidity and Capital Resources**

The seasonal nature of our business precludes a useful comparison of the current period and the fiscal year-end financial statements; therefore, a Consolidated Statement of Financial Position as of May 25, 2007, has been included.

### **Operating Activities**

Operating activities used \$11.9 million of cash during the three months ended May 30, 2008, compared to providing \$21.1 million of cash in the prior year period.

Accounts receivable was a source of cash of \$5.3 million during the three months ended May 30, 2008, compared to a use of cash of \$14.7 million in the prior year first quarter. The change is attributable to an increase in allowances and discounts as well as increased collections in the U.K.

Deferred costs - net generally represents payments under agreements with retailers net of the related amortization of those payments. During the three months ended May 30, 2008, amortization exceeded payments by \$1.3 million; in the three months ended May 25, 2007, amortization exceeded payments by \$11.7 million. See Note 9 to the consolidated financial statements for further detail of deferred costs related to customer agreements.

Accounts payable and other liabilities used \$57.6 million of cash during the three months ended May 30, 2008, compared to \$21.8 million in the prior year period. The change from the prior year is due primarily to income taxes as well as the change in accrued compensation and benefits. The change in income taxes is primarily the result of the lower income level in the current year three months compared to the prior year three months.

### **Investing Activities**

Investing activities used \$25.4 million of cash during the three months ended May 30, 2008, compared to \$37.0 million in the prior year period. The use of cash in the current quarter is related to cash payments for business acquisitions as well as capital expenditures of \$10.1 million. During the first quarter of fiscal 2009, we purchased a card publisher and franchised distributor of greeting cards in the U.K. for \$15.6 million. The use of cash in the prior quarter is related to purchases exceeding sales of short-term investments as well as cash payments for business acquisitions. The final payment of \$6.1 million for the online greeting card business purchased in the second quarter of fiscal 2007 was made during the first quarter of fiscal 2008.

### **Financing Activities**

Financing activities provided \$22.5 million of cash during the three months ended May 30, 2008, compared to \$0.3 million during the three months ended May 25, 2007. The current year source of cash relates primarily to short-term debt borrowings of \$28.0 million and our receipt of the exercise price on stock options, which provided \$0.4 million in the current period. Our receipt of the exercise price on stock options provided \$9.4 million in the prior year quarter, but was almost completely offset by dividend payments and share repurchases. Our Class A common share repurchase programs were made through 10b5-1 programs. During the three months ended May 25, 2007, \$3.4 million was paid to repurchase approximately 0.1 million shares under the repurchase program.

During the three months ended May 30, 2008 and May 25, 2007, we paid quarterly dividends of \$0.12 and \$0.10 per common share, respectively, which totaled \$5.9 million and \$5.5 million, respectively.

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### **Credit Sources**

Substantial credit sources are available to us. In total, we had available sources of approximately \$540 million at May 30, 2008. This included our \$450 million senior secured credit facility and our \$90 million accounts receivable securitization facility. Borrowings under the accounts receivable securitization facility are limited based on our eligible receivables outstanding. We had \$35.0 million outstanding under the revolving credit facility and \$13.1 million outstanding under the accounts receivable securitization agreement at May 30, 2008. In addition to these borrowings, we have, in the aggregate, \$25.7 million outstanding under letters of credit, which reduces the total credit availability thereunder.

Please refer to the discussion of our borrowing arrangements as disclosed in the Credit Sources section of our Annual Report on Form 10-K for the year ended February 29, 2008 for further information.

Our future operating cash flow and borrowing availability under our credit agreement and our accounts receivable securitization facility are expected to meet currently anticipated funding requirements. The seasonal nature of the business results in peak working capital requirements that may be financed through short-term borrowings.

### **Critical Accounting Policies**

Please refer to the discussion of our Critical Accounting Policies as disclosed in our Annual Report on Form 10-K for the year ended February 29, 2008.

### **Factors That May Affect Future Results**

Certain statements in this report may constitute forward-looking statements within the meaning of the Federal securities laws. These statements can be identified by the fact that they do not relate strictly to historic or current facts. They use such words as anticipate, estimate, expect, project, intend, plan, believe, and other words and terms of similar meaning in connection with any discussion of future operating or financial performance. These forward-looking statements are based on currently available information, but are subject to a variety of uncertainties, unknown risks and other factors concerning our operations and business environment, which are difficult to predict and may be beyond our control. Important factors that could cause actual results to differ materially from those suggested by these forward-looking statements, and that could adversely affect our future financial performance, include, but are not limited to, the following:

- a weak retail environment;
- retail consolidations, acquisitions and bankruptcies, including the possibility of resulting adverse changes to retail contract terms;
- competitive terms of sale offered to customers;
- the timing and impact of investments in new retail or product strategies as well as new product introductions and achieving the desired benefits from those investments;
- consumer acceptance of products as priced and marketed;
- the impact of technology on core product sales;
- the timing and impact of converting customers to a scan-based trading model;
- the escalation in the cost of providing employee health care;
- the ability to successfully integrate acquisitions;
- our ability to successfully implement, or achieve the desired benefits associated with, any information systems refresh that we may implement;
- the ability to execute share repurchase programs or the ability to achieve the desired accretive effect from such repurchases;
- the ability to comply with our debt covenants;
- our ability to successfully complete, or achieve the desired benefits associated with, dispositions;
- fluctuations in the value of currencies in major areas where we operate, including the U.S. Dollar, Euro, U.K. Pound Sterling and Canadian Dollar; and
- the outcome of any legal claims known or unknown.

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Risks pertaining specifically to AG Interactive include the viability of online advertising, subscriptions as revenue generators and the public's acceptance of online greetings and other social expression products, and the ability to gain a leadership position in the digital photo sharing space.

The risks and uncertainties identified above are not the only risks we face. Additional risks and uncertainties not presently known to us or that we believe to be immaterial also may adversely affect us. Should any known or unknown risks or uncertainties develop into actual events, or underlying assumptions prove inaccurate, these developments could have material adverse effects on our business, financial condition and results of operations. For further information concerning the risks we face and issues that could materially affect our financial performance related to forward-looking statements, refer to our periodic filings with the Securities and Exchange Commission, including the Risk Factors section of our Annual Report on Form 10-K for the fiscal year ended February 29, 2008.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

For further information, refer to our Annual Report on Form 10-K for the year ended February 29, 2008. There were no material changes in market risk, specifically interest rate and foreign currency exposure, for us from February 29, 2008, the end of our preceding fiscal year, to May 30, 2008, the end of our most recent fiscal quarter.

### **Item 4. Controls and Procedures**

American Greetings maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in its reports under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms and that such information is accumulated and communicated to the Corporation's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

American Greetings carries out a variety of on-going procedures, under the supervision and with the participation of the Corporation's management, including its Chief Executive Officer and Chief Financial Officer, to evaluate the effectiveness of the design and operation of the Corporation's disclosure controls and procedures. Based on the foregoing, the Chief Executive Officer and Chief Financial Officer of American Greetings concluded that the Corporation's disclosure controls and procedures were effective as of the end of the period covered by this report.

There has been no change in the Corporation's internal control over financial reporting during the Corporation's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting.

**Table of Contents****PART II OTHER INFORMATION****Item 1. Legal Proceedings**

We are involved in certain legal proceedings arising in the ordinary course of business. We, however, do not believe that any of the litigation in which we are currently engaged, either individually or in the aggregate, will have a material adverse effect on our business, consolidated financial position or results of operations.

**Item 1A. Risk Factors**

There have been no material changes in the risk factors that were discussed in our Annual Report on Form 10-K for the year ended February 29, 2008.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

(a) Not applicable.

(b) Not applicable.

(c) The following table provides information with respect to our purchases of our common shares during the three months ended May 30, 2008.

| <b>Period</b> | <b>Total Number of Shares Repurchased</b> | <b>Average Price Paid per Share</b> | <b>Total Number of Shares Purchased as Part of Publicly Announced Plans</b> | <b>Maximum Number of Shares (or Approximate Dollar Value) that May Yet Be Purchased Under the Plans</b> |
|---------------|---|-------------------------------------|---|---|
| March 2008    | Class A                                   |                                     | (2)   | \$ 50,935,815   |
|               | Class B                                   | 890 (1)                             | \$ 18.65  |   |
| April 2008    | Class A                                   |                                     | (2)   | \$ 50,935,815   |
|               | Class B                                   | 500 (1)                             | \$ 17.75  |   |
| May 2008      | Class A                                   |                                     | (2)   | \$ 50,935,815   |
|               | Class B                                   | 670 (1)                             | \$ 18.31  |   |
| Total         | Class A                                   |                                     | (2)   |   |
|               | Class B                                   | 2,060 (1)                           |   |   |

- (1) There is no public market for the Class B common shares of the Corporation. Pursuant to our Articles of Incorporation, a holder of Class B common shares may not transfer such Class B common shares (except to permitted transferees, a group that generally includes members of the holder's extended family, family trusts and charities) unless such holder first offers such shares to the Corporation for purchase at the most recent closing price for the Corporation's Class A common shares. If the Corporation does not purchase such Class B common shares, the holder must convert such shares, on a share for share basis, into Class A common shares prior to any transfer. All of the shares were repurchased by American Greetings for cash pursuant to this right of first refusal.
- (2) On January 8, 2008, American Greetings announced that its Board of Directors authorized a program to repurchase up to \$100 million of its Class A common shares. There is no set expiration date for this repurchase program. No shares were repurchased under this program during the first quarter of fiscal 2009.

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**Item 6. Exhibits**

Exhibits required by Item 601 of Regulation S-K

**Exhibit**

| <b>Number</b> | <b>Description</b>   |
|---------------|--|
| 10.1          | Key Management Annual Incentive Plan (fiscal year 2009 Description)  |
| 10.2          | Employment Agreement, dated as of June 12, 2008, between John W. Beeder and the Corporation                                    |
| (31) a        | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                             |
| (31) b        | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                             |
| (32)          | Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

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.

AMERICAN GREETINGS CORPORATION

By: /s/ Joseph B. Cipollone  
Joseph B. Cipollone  
Vice President, Corporate Controller, and Chief  
Accounting Officer \*

July 9, 2008

\* (Signing on behalf of Registrant as a duly authorized officer of the Registrant and signing as the chief accounting officer of the Registrant.)