AMERICAN GREETINGS CORP
Form 10-Q
October 07, 2016
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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 August 26, 2016

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)

Ohio	**34-0065325**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
One American Boulevard, Cleveland, Ohio	**44145**
(Address of principal executive offices)	**(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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

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

All of the outstanding capital stock of the registrant is held by Century Intermediate Holding Company. As of October 7, 2016, 100 shares of the registrant s common stock, par value $0.01 per share, were outstanding.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

AMERICAN GREETINGS CORPORATION

CONSOLIDATED STATEMENT OF INCOME

(Thousands of dollars)

	(Unaudited)			
	Three Months Ended		Six Months Ended	
	August 26, 2016	August 28, 2015	August 26, 2016	August 28, 2015
Net sales	$ 374,748	$ 418,611	$ 811,935	$ 890,503
Other revenue	2,265	2,417	4,386	3,968
Total revenue	377,013	421,028	816,321	894,471
Material, labor and other production costs	159,214	177,985	338,114	373,459
Selling, distribution and marketing expenses	142,061	153,641	295,589	317,400
Administrative and general expenses	55,797	59,365	119,815	117,586
Other operating income net	(1,741)	(7,309)	(3,631)	(69,729)
Operating income	21,682	37,346	66,434	155,755
Interest expense	5,940	6,486	11,537	14,599
Interest income	(230)	(84)	(335)	(183)
Other non-operating expense (income) net	698	(54)	710	(992)
Income before income tax expense	15,274	30,998	54,522	142,331
Income tax expense	4,970	6,518	17,748	45,087
Net income	$ 10,304	$ 24,480	$ 36,774	$ 97,244

See notes to consolidated financial statements (unaudited).

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AMERICAN GREETINGS CORPORATION

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(Thousands of dollars)

	(Unaudited)			
	Three Months Ended		Six Months Ended	
	August 26, 2016	August 28, 2015	August 26, 2016	August 28, 2015
Net income	$ 10,304	$ 24,480	$ 36,774	$ 97,244
Other comprehensive (loss) income, net of tax:				
Foreign currency translation adjustments	(12,152)	(2,351)	(5,342)	(4,379)
Pension and postretirement benefit adjustments	227	505	230	721
Unrealized gain (loss) on equity securities	8,252	(10,133)	16,110	34,477
Other comprehensive (loss) income, net of tax	(3,673)	(11,979)	10,998	30,819
Comprehensive income	$ 6,631	$ 12,501	$ 47,772	$ 128,063

See notes to consolidated financial statements (unaudited).

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AMERICAN GREETINGS CORPORATION

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

(Thousands of dollars except share and per share amounts)

	(Unaudited) August 26, 2016	(Note 1) February 29, 2016	(Unaudited) August 28, 2015
ASSETS			
Current assets			
Cash and cash equivalents	$ 25,236	$ 100,893	$ 33,501
Trade accounts receivable, net	77,875	94,392	104,690
Inventories	288,644	227,456	297,338
Deferred and refundable income taxes	4,782	8,056	45,082
Prepaid expenses and other	132,907	129,071	131,635
Total current assets	529,444	559,868	612,246
Other assets	509,564	473,100	535,436
Deferred and refundable income taxes	90,268	99,512	60,897
Property, plant and equipment at cost	999,723	945,059	878,035
Less accumulated depreciation	489,355	477,349	467,304
Property, plant and equipment net	510,368	467,710	410,731
	$ 1,639,644	$ 1,600,190	$ 1,619,310
LIABILITIES AND SHAREHOLDER S EQUITY			
Current liabilities			
Accounts payable	$ 115,262	$ 109,014	$ 116,450
Accrued liabilities	51,675	79,873	69,196
Accrued compensation and benefits	40,024	101,014	63,301
Income taxes payable	28,684	11,151	14,398
Deferred revenue	22,235	26,271	23,044
Other current liabilities	77,908	50,617	67,850
Total current liabilities	335,788	377,940	354,239
Long-term debt	418,962	403,058	458,155
Other liabilities	411,093	379,769	359,427
Deferred income taxes and noncurrent income taxes payable	10,628	10,129	10,824
Shareholder s equity			
Common shares par value $.01 per share: 100 shares issued and outstanding			
Capital in excess of par value	240,000	240,000	240,000
Accumulated other comprehensive (loss) income	(8,660)	(19,658)	6,416
Retained earnings	231,833	208,952	190,249

Total shareholder s equity		463,173		429,294		436,665
	$	1,639,644	$	1,600,190	$	1,619,310

See notes to consolidated financial statements (unaudited).

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AMERICAN GREETINGS CORPORATION

CONSOLIDATED STATEMENT OF CASH FLOWS

(Thousands of dollars)

	(Unaudited) Six Months Ended	
	August 26, 2016	**August 28, 2015**
OPERATING ACTIVITIES:		
Net income	$ 36,774	$ 97,244
Adjustments to reconcile net income to cash flows from operating activities:		
Gain on sale of Strawberry Shortcake		(61,625)
Net loss on disposal of fixed assets	28	66
Depreciation and intangible assets amortization	25,305	28,114
Provision for doubtful accounts	231	367
Deferred income taxes	4,469	8,076
Other non-cash charges	2,057	3,614
Changes in operating assets and liabilities, net of acquisitions and dispositions:		
Trade accounts receivable	17,918	(3,431)
Inventories	(65,528)	(49,866)
Other current assets	(3,416)	(7,193)
Net payable/receivable with related parties	(754)	(1,698)
Income taxes	15,625	(7,554)
Deferred costs net	17,470	19,377
Accounts payable and other liabilities	(83,462)	(91,698)
Other net	1,277	680
Total Cash Flows From Operating Activities	(32,006)	(65,527)
INVESTING ACTIVITIES:		
Property, plant and equipment additions	(46,005)	(31,735)
Proceeds from sale of fixed assets	813	55
Cash paid for acquired character property rights		(2,800)
Adjustment to proceeds from sale of AGI In-Store		(3,200)
Proceeds from sale of Strawberry Shortcake		105,000
Proceeds from surrender of corporate-owned life insurance policies		24,068
Total Cash Flows From Investing Activities	(45,192)	91,388
FINANCING ACTIVITIES:		
Proceeds from revolving line of credit	73,275	191,200
Repayments on revolving line of credit	(58,275)	(139,500)
Dividends to shareholder	(13,894)	(20,724)
Repayments on term loan		(65,000)
Total Cash Flows From Financing Activities	1,106	(34,024)

EFFECT OF EXCHANGE RATE CHANGES ON CASH	435	(1,663)
DECREASE IN CASH AND CASH EQUIVALENTS	(75,657)	(9,826)
Cash and Cash Equivalents at Beginning of Year	100,893	43,327
Cash and Cash Equivalents at End of Period	$ 25,236	$ 33,501

See notes to consolidated financial statements (unaudited).

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AMERICAN GREETINGS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Three and Six Months Ended August 26, 2016 and August 28, 2015

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, 2016 refers to the year ended February 29, 2016. The Corporation s subsidiary, AG Retail Cards Limited is consolidated on a one-month lag corresponding with its fiscal year-end of January 28 for 2017.

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, 2016, from which the Consolidated Statement of Financial Position at February 29, 2016, presented herein, has been derived. Certain amounts in the prior year financial statements have been reclassified to conform to the 2017 presentation. These reclassifications had no material impact on financial position, earnings or cash flows.

The Corporation s investments in less than majority-owned companies in which it has the ability to exercise significant influence over the operating and financial policies are accounted for using the equity method except when they qualify as variable interest entities (VIE) and the Corporation is the primary beneficiary, in which case, the investments are consolidated in accordance with Accounting Standards Codification (ASC) Topic 810 (ASC 810), Consolidation.

The Corporation provides limited credit support to Schurman Fine Papers (Schurman) which is a VIE as defined in ASC 810. Schurman owns and operates specialty card and gift retail stores in the United States and Canada. The stores are primarily located in malls and strip shopping centers. This limited credit support is provided through the provision of a liquidity guaranty (Liquidity Guaranty) in favor of the lenders under Schurman s senior revolving credit facility (the Senior Credit Facility). Pursuant to the terms of the Liquidity Guaranty, the Corporation has guaranteed the repayment of up to $10.0 million of Schurman s borrowings under the Senior Credit Facility to help ensure that Schurman has sufficient borrowing availability under this facility. The Liquidity Guaranty is required to be backed by a letter of credit for the term of the Liquidity Guaranty, which expires in January 2019. The Corporation s obligations under the Liquidity Guaranty generally may not be triggered unless Schurman s lenders under its Senior Credit Facility have substantially completed the liquidation of the collateral under Schurman s Senior Credit Facility, or 91 days after the liquidation is started, whichever is earlier, and will be limited to the deficiency, if any, between the amount owed and the amount collected in connection with the liquidation. There was no triggering event or liquidation of collateral as of August 26, 2016 requiring the use of the Liquidity Guaranty.

During the current period, the Corporation assessed the variable interests in Schurman and determined that a third party holder of variable interests has the controlling financial interest in the VIE and thus, the third party, not the

Corporation, is the primary beneficiary. In completing this assessment, the Corporation identified the activities that it considers most significant to the future economic success of the VIE and determined that it does not have the power to direct those activities. As such, Schurman is not consolidated in the Corporation s results.

The Corporation s maximum exposure to loss as it relates to Schurman as of August 26, 2016 includes:

Liquidity Guaranty of Schurman s indebtedness of $10.0 million;

normal course of business trade and other receivables due from Schurman of $31.3 million, the balance of which fluctuates throughout the year due to the seasonal nature of the business; and

the retail store operating leases currently subleased to Schurman, the aggregate lease payments for the remaining life of which was $1.8 million as of August 26, 2016.

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 August 2016, the Financial Accounting Standards Board (the FASB) issued Accounting Standards Update (ASU) No. 2016-15, Statement of Cash Flows (Topic 230): Clarification of Certain Cash Receipts and Cash Payments. The objective of ASU 2016-15 is to eliminate the diversity in practice related to the classification of certain cash receipts and payments in the statement of cash flows, by adding or clarifying guidance on eight specific cash flow issues. For public business entities, ASU 2016-15 is effective for annual and interim reporting periods beginning after December 15, 2017, with early adoption permitted. The amendments in this update should be applied retrospectively to all periods presented, unless deemed impracticable, in which case, prospective application is permitted. The Corporation is currently evaluating the new guidance and has not determined the impact this standards update may have on its consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. ASU 2016-13 introduces a new forward-looking approach, based on expected losses, to estimate credit losses on certain types of financial instruments, including trade receivables. The estimate of expected credit losses will require entities to incorporate considerations of historical information, current information and reasonable and supportable forecasts. This ASU also expands the disclosure requirements to enable users of financial statements to understand the entity s assumptions, models and methods for estimating expected credit losses. For public business entities, ASU 2016-13 is effective for annual and interim reporting periods beginning after December 15, 2019, and the guidance is to be applied using the modified-retrospective approach. Earlier adoption is permitted for annual and interim reporting periods beginning after December 15, 2018. The Corporation is currently evaluating the new guidance and has not determined the impact this standards update may have on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). ASU 2016-02 will require lessees to recognize a right-of-use asset and a lease liability. The right-of-use asset and lease liability will be initially measured at the present value of the lease payments in the statement of financial position. Lessor accounting under the new guidance is largely unchanged. For public business entities, ASU 2016-02 is effective for interim and annual reporting periods beginning after December 15, 2018, with early adoption permitted. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified-retrospective approach, which includes a number of optional practical expedients. The Corporation is currently evaluating the new guidance and has not determined the impact this standards update may have on its consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01 addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments. In particular, this ASU requires equity investments (except those accounted for under the equity method or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. ASU 2016-01 is effective for interim and annual periods beginning after December 15, 2017. The Corporation is currently evaluating the new guidance and has not determined the impact this standards update may have on its consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, Disclosure of Uncertainties About an Entity s Ability to Continue as a Going Concern. ASU 2014-15 requires management to perform interim and annual assessments of an entity s ability to continue as a going concern within one year of the date the financial statements are issued and provides guidance on determining when and how to disclose going concern uncertainties in the financial statements. Certain disclosures will be required if conditions give rise to substantial doubt about an entity s ability to continue as a going concern. ASU 2014-15 applies to all entities and is effective for annual and interim reporting periods ending after December 15, 2016, with early adoption permitted. The Corporation does not expect that the adoption of this standards update will impact its consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers. Subsequent accounting standards updates have been issued which amend and/or clarify the application of ASU 2014-09. The objective of ASU 2014-09, and its related amendments and clarifications, is to establish a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and will supersede most of the existing revenue recognition guidance, including industry-specific guidance. The core principle of the new guidance is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. More detailed disclosures will also be required to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. For public business entities, the new revenue recognition guidance will be effective for annual and interim reporting periods beginning after December 15, 2017. Earlier adoption is permitted for annual and interim reporting periods beginning after December 15, 2016. The new guidance permits the use of either a retrospective or modified-retrospective transition method. The Corporation is currently evaluating the new guidance and has not determined the impact it may have on its consolidated financial statements, nor the preferred method of adoption.

Note 4 Acquisitions and Dispositions

Sale of Strawberry Shortcake

As reported in its Annual Report on Form 10-K for the year ended February 29, 2016, in March 2015, the Corporation completed the sale of its Strawberry Shortcake property and related intangible assets and licensing agreements (Strawberry Shortcake) and received cash proceeds of $105.0 million, which are reflected in Proceeds from sale of Strawberry Shortcake within Investing Activities on the Consolidated Statement of Cash Flows for the six months ended August 28, 2015. The Corporation also recognized a n