Fairness Opinion of American Greetings Buyout Offer

by Philip Scuderi

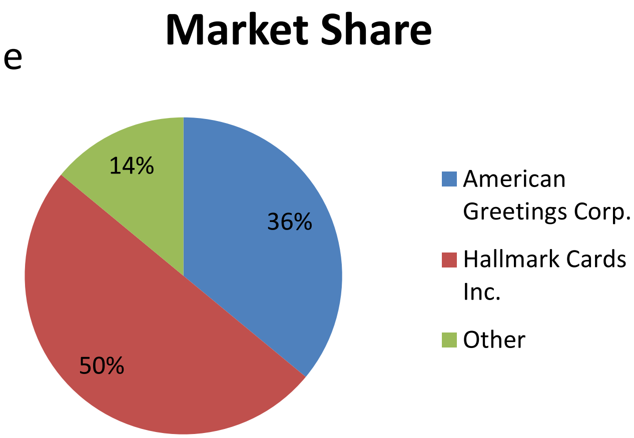
Deal Summary

- Participants
  - Buyers: Members of the Weiss family and related parties lead by Zev Weiss, CEO and Jeffrey Weiss, President and COO
  - Target: American Greetings Corp.

- Deal Terms
  - Weiss family are descendants of the founder
  - Weiss family controls 50% of the voting shares, and are highly represented in management and on the Board
  - 100% acquisition @ $17.18 per share in cash
  - 20% premium to closing price day before the deal announcement
  - Proposed price is merely 2.57x EBITDA
  - 1 lawsuit already filed against the Board for breach of fiduciary duty to shareholders

Greeting Card Industry Overview

- Key industry drivers
  - Household spending and personal disposable income
  - Women purchase 80% of all greeting cards



- Major Players
  - Hallmark (50% market share)
  - American Greetings (36% market share)

- Current Trends
  - Competition from digital alternatives (e.g., e-cards) is escalating
  - Industry in decline b/c Internet communication, scanning technology, and digital photography enable more personalized messages

- Industry Outlook
  - Revenue projected to decline at 4% annualized rate for next 5 years

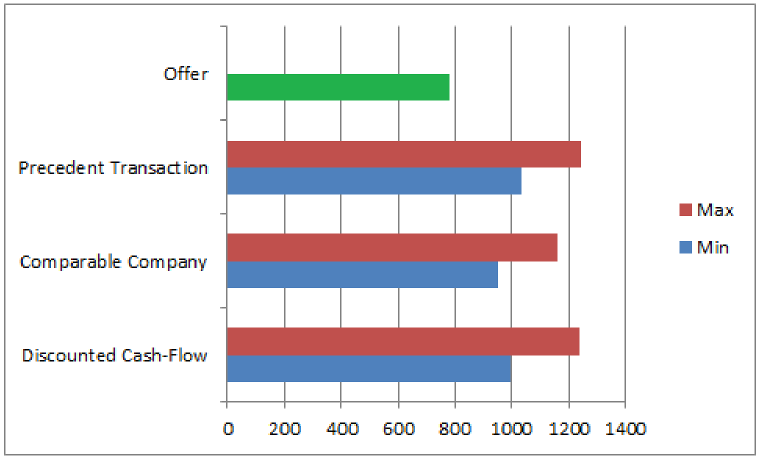
American Greetings Background

- Company history
  - Founded in 1906 by Jacob Sapirstein selling greeting cards from a horse-drawn cart
  - Family-run since inception
- Operations
  - Based in Brooklyn, Ohio
  - 17,900 full-time equivalent employees
- Products
  - Primary product is greeting cards
  - Also sell gift packaging, party goods, giftware, stationery, and custom display fixtures
  - Licensing Strawberry Shortcake & Care Bears copyrights
- 1 of only 2 major players, both having significant economies of scale
- Underperformed S&P 500 by 5.5% annually for last 5 years
- EBITDA up 4.35% annually for last 4 years despite revenue decrease of 1.2% annually over same time frame

Key Financial Statistics	
EBITDA	211.4m
Operating Income	172.2m
Net Income	57.2m
Gross Margin	56.3%
EBITDA Margin	12.5%

Summary of Valuation Analysis

- Deal Offer
  - 17.18/share implies an Enterprise Value of 783.5m
- Valuation range
  - Discounted Cash-Flow Method: 996m to 1,237m
  - Comparable Company Method: 951m to 1,163m
  - Precedent Transaction Method: 1,032m to 1,243m



- Conclusion
  - **The deal is not fair from a financial perspective**
  - **At 17.18/share (EV of 783.5m), the company is undervalued by at least 17.6%**

Summary of DCF Assumptions

- Key Assumptions
  - Beta: 0.9 (assumed historical beta), Equity Premium: 6% (~historical mean), Risk-Free Rate: 1.70% (10-year treasury)
  - Margins, Working Capital, CapEx, and Depreciation held constant as a percent of revenue
  - Growth: used IBISWorld industry projections for the next 5 years
- Terminal Value calculated using Exit Multiple Method
  - Used Exit Multiple because it is unclear whether the company will be a going concern in the distant future due of threats from digital alternatives
  - Exit Multiple range of 4.5x to 5.5x because of multiples from comparable company CSS Industries (4.65x) and recent acquisition of MedWestvaco's Consumer and Office Products business (5.38x)
- WACC assumption between 6.0% and 9.0%
  - WACC estimate using CAPM was 5.88% and cannot go much lower b/c interest rates are near zero
  - A beta of 1.5 and risk free rate of 3.70% would drive WACC to our high-end of 9.0%
- **Enterprise Value Range: 996m to 1,237m**
- Implied Perpetuity Growth Rate Range: -5.66% to -1.01% (indicative of an industry in decline)

Enterprise Value Sensitivity to WACC and EV/EBITDA Exit Multiple

		EV/EBITDA Exit Multiple										
		2.00x	2.50x	3.00x	3.50x	4.00x	4.50x	5.00x	5.50x	6.00x	6.50x	7.00x
WACC	5.0%	759	834	908	982	1,056	1,130	1,204	1,278	1,352	1,427	1,501
	6.0%	738	809	881	952	1,023	1,094	1,165	1,237	1,308	1,379	1,450
	7.0%	718	786	855	923	992	1,060	1,128	1,197	1,265	1,334	1,402
	8.0%	699	764	830	896	962	1,027	1,093	1,159	1,225	1,290	1,356
	9.0%	680	743	807	870	933	996	1,059	1,123	1,186	1,249	1,312
	10.0%	662	723	784	845	906	966	1,027	1,088	1,149	1,210	1,270
	11.0%	645	704	762	821	879	938	996	1,055	1,114	1,172	1,231
	12.0%	629	686	742	798	854	911	967	1,023	1,080	1,136	1,192

Summary of Comparable Company Analysis

- American Greetings is the only major player in Greeting Cards that is public
- Guideline Companies
  - CSS Industries: much smaller but primary source of revenue from very similar products including greeting cards, gift packaging, party goods, giftware, and stationary
  - ACCO Brands: extremely similar in size and financial measures such as EBITDA and listed alongside American Greetings in many industry reports; focuses on office products (binders, etc.) that are somewhat different and less susceptible to threats from digital alternatives

American Greetings (NYSE: AM) Comparable Company Analysis											
Company	Equity Value (m)	Enterprise Value (m)	Sales (m)	EBITDA (m)	EBIT (m)	Net Income (m)	P/E	EV/Sales	EV/EBITDA	EV/EBIT	EV/Net Income
CSS Industries	194.26	184.43	385	39.66	31.78	15.67	12.01	0.48	4.65	5.80	11.77
ACCO Brands	800.83	1,890	1,318	203.2	162.1	56.7	4.09	1.43	9.30	11.66	33.33

- Analysis and Results
  - CSS Industries is a better comparable because its product mix is so similar and it is also similarly subject to the risk of consumers moving to digital alternatives
  - Somewhat higher multiples are appropriate for American Greetings because it has size and economy of scale advantages over CSS Industries
  - 4.5x to 5.5x EV/EBITDA is an appropriate range (near to a bit higher than CSS Industries) and use of EBITDA is appropriate because the industry is not capital intensive
  - **Enterprise Value Range: 951m to 1,163m**

Summary of Precedent Transaction Analysis

- Unable to find any relatively recent acquisitions of public greeting card companies
- Only 1 Precedent Transaction with Financial Data Available
  - Acquisition of MeadWestvaco's (NYSE: MWV) Consumer and Office Products (C&OP) business by ACCO Brands (NYSE: ABD)
  - C&OP business sells stationary, calendars, personal organizers, and other business/office products primarily through retail distribution
  - C&OP business similar to American Greetings in EBITDA, Net Income, capital intensity

American Greetings (NYSE: AM)
Precedent Transaction Analysis

Date	Target	Acquiror	EV/Sales	EV/EBITDA	EV/EBIT	EV/Net Income
11-Nov-2011	MeadWestvaco Corporation's (NYSE: MWV) Consumer and Office Products business	ACCO Brands Corporation (NYSE: ACCO)	1.10	5.38	6.45	13.72

- Results
  - EV/EBITDA most appropriate: substantially accounting and tax policy agnostic, and industry is not capital intensive
  - EV/EBITDA in precedent transaction of 5.38, assumed a range of ±0.5: 4.88 to 5.88
  - **Enterprise Value Range: 1,032m to 1,243m**

APPENDIX: Discounted Cash Flow Calculations

American Greetings (NYSE: AM)
Discounted Cash Flow Analysis

	Historical Period					Projection Period				
Period Ending	**29-Feb-2008**	**28-Feb-2009**	**28-Feb-2010**	**28-Feb-2011**	**29-Feb-2012**	**28-Feb-2013**	**28-Feb-2014**	**28-Feb-2015**	**29-Feb-2016**	**28-Feb-2017**
Net sales	1,730.8	1,646.4	1,603.3	1,565.5	1,663.3	1,660.0	1,628.4	1,589.3	1,511.5	1,435.9
Other Revenue	45.7	44.3	37.6	32.4	31.9	31.8	31.2	30.4	29.0	27.5
Total Revenue	**1,776.5**	**1,690.7**	**1,640.9**	**1,597.9**	**1,695.1**	**1,691.8**	**1,659.6**	**1,619.8**	**1,540.4**	**1,463.4**
Revenue Growth		**-4.8%**	**-3.0%**	**-2.6%**	**6.1%**	**-0.2%**	**-1.9%**	**-2.4%**	**-4.9%**	**-5.0%**
Cost Of Goods Sold	780.8	810.0	692.7	682.4	741.6	740.2	726.1	708.7	673.9	640.2
Gross Profit	**995.7**	**880.8**	**948.2**	**915.5**	**953.5**	**951.6**	**933.5**	**911.1**	**866.5**	**823.1**
Gross Margin	**56.05%**	**52.09%**	**57.79%**	**57.30%**	**56.25%**	**56.25%**	**56.25%**	**56.25%**	**56.25%**	**56.25%**
SG&A	818.2	795.2	718.0	693.0	745.3	743.8	729.7	712.2	677.3	643.4
Other Operating Expense/(Income)	(1.3)	(1.4)	(2.6)	(3.0)	(3.2)	(3.2)	(3.1)	(3.1)	(2.9)	(2.8)
EBITDA	**178.8**	**87.0**	**232.8**	**225.5**	**211.4**	**211.0**	**207.0**	**202.0**	**192.1**	**182.5**
EBITDA Margin	**10.1%**	**5.1%**	**14.2%**	**14.1%**	**12.5%**	**12.5%**	**12.5%**	**12.5%**	**12.5%**	**12.5%**
Depreciation and Amortization	48.5	50.0	45.2	41.0	39.2	39.1	38.4	37.5	35.6	33.9
EBIT	**130.2**	**37.0**	**187.6**	**184.5**	**172.2**	**171.8**	**168.6**	**164.5**	**156.5**	**148.6**
EBIT Margin	**7.3%**	**2.2%**	**11.4%**	**11.5%**	**10.2%**	**10.2%**	**10.2%**	**10.2%**	**10.2%**	**10.2%**
Taxes	40.6	(47.2)	39.4	69.0	40.6	40.5	39.8	38.8	36.9	35.1
EBIAT	**89.6**	**84.2**	**148.2**	**115.5**	**131.6**	**131.3**	**128.8**	**125.7**	**119.6**	**113.6**
Plus: Depreciation and Amortization	48.5	50.0	45.2	41.0	39.2	39.1	38.4	37.5	35.6	33.9
Less: Capital Expenditures	56.6	55.7	26.6	36.3	70.9	70.8	69.4	67.7	64.4	61.2
Less: Increase in Net Working Capital		(9.1)	97.6	58.7	(48.3)	(0.7)	(6.4)	(7.9)	(15.7)	(15.3)
Unlevered Free Cash Flow		**87.6**	**69.1**	**61.6**	**148.2**	**100.4**	**104.2**	**103.3**	**106.5**	**101.5**
WACC	5.88%									
Discount Period						0.3	1.3	2.3	3.3	4.3
Discount Factor						0.99	0.93	0.88	0.83	0.78
Present Value of Free Cash Flow						**98.9**	**96.9**	**90.8**	**88.4**	**79.6**

Assumptions	
Risk-free rate (10-Year U.S. Treasury)	1.70%
Beta (Yahoo! Finance)	0.90
Tax Rate	40.00%
Enterprise Value	757.47
Market risk premium	6.00%
Market value of equity	539.02
Market value of publicly traded debt	247.1
Non-publicly traded debt (level 2 valuation)	55.0
Weighted cost of debt (Rd)	6.17%

Weighted Average Cost of Capital Calculation	
After-tax cost of debt	3.70%
Total debt value	302.1
Cost of equity (Re)	7.10%
Total equity value	539.02
WACC	**5.88%**

Enterprise Value - Exit Multiple Method	
Cumulative Present Value of FCF	454.6
Terminal Year EBITDA (2017E)	182.5
Exit Multiple	5.00x
Terminal Value	**912.52**
Discout Factor	0.78
Present Value of Terminal Value	**715.4**
% of Enterprise Value	61.1%
Enterprise Value	**1,170.0**

Implied Equity Value and Share Price	
Enterprise Value	1,170.0
Less: Total Debt	302.1
Plus: Cash & Equivalents	61.7
Implied	**929.6**
Shares Outstanding	31,614,646
Implied Share Price	**29.40**

Implied Perpetuity Growth Rate	
Terminal Year Free Cash Flow (2017E)	101.5
WACC	5.88%
Terminal Value (2017E)	912.52
Implied Perpetuity Growth Rate	**-4.72%**

Appendix: Comparison Company and Precedent Transaction Method Supporting Documentation

The following financial disclosure of MeadWestvaco's Consumer and Office Products business was taken from a 2012-03-20 SEC filing by Monaco Spinco Inc., which further discloses the transaction used an Enterprise Value of $860m.

(In millions)	Years ended December 31		
	2011	2010	2009
Statement of Operations Data:			
Net sales	$ 743.8	$748.1	$ 748.4
Cost of good sold	489.0	493.3	499.1
Gross profit	254.8	254.8	249.3
Gross Profit Margin	*34.3%*	*34.1%*	*33.3%*
Advertising, selling, general and administrative expenses (1)	137.4	143.2	132.4
Amortization of intangibles	12.6	14.1	14.2
Restructuring charges	0.4	1.2	5.3
Operating income	104.4	96.3	97.4
Operating Income Margin	*14.0%*	*12.9%*	*13.0%*
Income from continuing operations	62.7	55.2	55.0
Cash flow provided by (used in):			
Operating activities	$ 78.4	$ 84.5	$ 102.6
Investing activities	(42.0)	(13.1)	(13.4)
Financing activities	(116.9)	(56.3)	(106.3)
Balance Sheet Data (at period end):			
Cash and cash equivalents	$ 16.8	$ 22.6	$ 2.2
Working capital—continuing operations	221.1	221.0	187.8
Property, plant and equipment, net	88.7	95.8	96.2
Total assets	730.4	875.0	869.7
External long-term debt	—	0.1	1.0
Total equity	524.6	607.9	615.5
Other Data:			
Capital expenditures	$ 15.0	$ 13.0	$ 4.5
Depreciation expense (2)	14.0	15.3	15.3
Stock-based compensation expense	2.2	2.1	2.0

	2011	2012	2013	2014	2015	2016
			(In millions)			
Sales	$780	$814	$847	$885	$928	$955
EBITDA*	160	165	170	178	189	194
Capital Expenditures	17	17	15	14	14	14

Full financials for ACCO Brands (NYSE: ACCO) and CSS Industries (NYSE: CSS) were not included because they are freely available online given that these are public companies.