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American Greetings

This year American Greetings is demonstrating to naysayers that the greeting card space is not dead. The company has accelerated top-line [growth] through a combination of organic growth and acquisitions, and year-to-date revenues are trending well ahead of our forecast. However, the growth has come at a cost that is also far greater than we had anticipated…In Q3 marketing, spending increased by a surprising $10 million…The company also accelerated investment spending in the digital space to support the growth of recently launched cardstore.com. In addition, [American Greetings] has incurred…incremental expenses this year to roll out new doors in the dollar-store channel.

—Jeff Stein
Managing Director, Northcoast Research

It was New Year's Day 2012, and the weather was unseasonably warm in Cleveland, Ohio, headquarters for American Greetings Corporation (AG). But while temperatures were up, the same could not be said of AG's share price, which had been cut in half over the previous several months to a year-end closing price of $12.51 (**Exhibit 1**).

At times of low equity valuation, AG management historically had turned to share buybacks. With current valuation levels, management was considering going into the market with a $75 million repurchase program. The repurchase was to be funded from AG's operating profit and cash reserves. The decision hinged on how the future of the enterprise was expected to play out. If the share price reasonably reflected bleak prospects for AG, management should preserve cash for future needs. If, on the other hand, AG stock was simply temporarily out of favor, the buyback plan presented a prudent defensive strategy.

American Greetings

With $1.7 billion in revenue, AG was the second-largest greeting card publisher in the United States. To meet the changing times, AG sold greeting cards as both paper products through traditional retail channels and electronic products through a number of company websites. In addition to gift cards, AG marketed gift wrap, candles, party goods, candles, and other giftware. To strengthen its business, the company owned and maintained the following major brands: American Greetings, Carlton Cards, Gibson, Recycled Paper Greetings, Papyrus, and DesignWare. AG owned the rights to a variety of popular characters, including Strawberry Shortcake, the Care Bears, Holly Hobbie, the Get Along Gang, and the Nickelodeon characters. The company was able to generate additional revenue by licensing the rights to these characters. Overall,

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management positioned AG as a leader in social expression products that assisted "consumers in enhancing their relationships to create happiness, laughter, and love."[1]

The company had a long affiliation with the founding Sapirstein family. Shortly after immigrating to the United States in 1905, Jacob Sapirstein, a Polish entrepreneur, launched a business distributing German manufactured postcards in Cleveland with the help of his young family. Eventually the business leadership was passed on to Jacob's oldest son, Irving Stone, then to Irving's son-in-law, Morry Weiss. In 2003, Morry's sons, Zev and Jeffrey Weiss, were appointed as CEO and president, respectively. Morry Weiss continued to serve as chairman.

Despite the strong family affiliation, AG was widely held in the public equity markets, with more than 11,000 shareholders, including large positions by such institutional investors as the British investment fund MAM Investments (10.6% of AG shares) and U.S. funds Dimensional Fund Advisors (10.5%), BlackRock (7.9%), and LSV Asset Management (6.7%). Dividend payments to investors had been on an upward trend in recent years, rising from 12 cents per share in 2004 to 56 cents in 2010.

Exhibits 2 and **3** provide AG's detailed financial statements. Since AG's fiscal year ended in February, the figures for 2011, for example, included results through February 2012, so remained estimates for the remaining two months.

Greeting Cards

Two players, Hallmark and AG, dominated the U.S. greetings card industry. Hallmark, privately held by the Hall family, was the larger of the two, with total worldwide revenue at $4 billion. From its headquarters in Kansas City, Missouri, Hallmark had aggressively expanded its business internationally with operations in more than 100 countries. Hallmark maintained licensing agreements with independent Hallmark Gold Crown retail stores that marketed Hallmark products and owned ancillary businesses such as Crayola (the crayon maker) and the Hallmark Channel cable network. Other card companies, such as Avanti Press, Blyth, CSS Industries, and Deluxe had found successful niches in the $6 billion U.S. greeting card market.

Mintel, the industry analyst firm, maintained that the overall greeting card market had contracted by 9% since 2005 and that the contraction would continue (**Exhibit 4**). Mintel's best-case scenario called for a 4% market decline over the next four years; its worst-case called for a 16% decline. The market contraction was thought to be driven by the substitution for greeting cards of other forms of social expression products, due to the ease of such alternative forms as smart phones, electronic social networking, and digital imaging, the last of which affected the traditional Christmas card market in particular. The rapid expansion of social media networks such as Facebook provided even stronger challenges to electronic cards. An industry survey found that the social media substitution was particularly acute in a younger demographic (**Exhibit 5**). Analysts expected the trend to continue as the ease of digital communication substituted for traditional forms of social expression.

The industry had responded to the substantive technological shift with important market innovations. Both Hallmark and AG had created an extensive collection of electronic cards that made it easy for customers to send cards electronically. Card manufacturers maintained websites that allowed consumers to purchase paper greeting cards on the Internet via computer or smart phone and have the physical cards delivered directly to the recipient. Kiosks had been placed in retail stores that allowed customers to create

[1] Company website.

custom cards. Distribution had expanded to build a substantive presence in the expanding dollar-store retail channel, where greeting cards were reported to be a top-selling item.

Despite the trends, large numbers of people continued to buy greeting cards. In a recent survey, 52% of U.S. respondents had purchased a greeting card in the past three months. This figure was down from 59% who had responded affirmatively in 2006.[2]

Valuation

With an end-of-year close of $12.51 per share, AG's PE ratio was at 6 times, its enterprise value to EBITDA ratio at 3.5 times, and its market-to-book ratio was below 1. All these valuation ratios were at the bottom of AG's group of comparable companies. **Exhibit 6** contains financial details and business descriptions for the AG-comparable group. AG's management believed its valuation suggested an opportunity, but low levels also demonstrated substantial concern by the capital market regarding the prospects of the company. For example, equity analysts at Standard and Poor's maintained a hold recommendation on the stock, claiming the following:

> We see [AG's 2012] sales increasing 2.5% to $1.73 billion…We see demand benefitting from increased promotional spending in a more stable economic environment as the company pursues growth within the discount distribution channel…acquisitions…[and] international sales...We expect margins to narrow…reflecting a shift in customer mix toward the discount channel, increasing marketing costs to spur demand, distribution expansion costs, and expenses related to plans to move AG's headquarters building. While we believe channel migration will result in a permanent negative margin shift, we do not believe transition costs related to expanded distribution efforts will be a factor in the long term.[3]

Orly Seidman, a Value Line analyst, held a more optimistic view, expecting steady margins and steady long-term growth:

> The company has been improving the product pipeline. Management should continue to follow consumer and societal trends to better brand its offerings. It has shifted its focus from its core segment to pursue noncard merchandise. Product innovation, stronger retail partnerships, and sell-diversified portfolio ought to drive customer interest in its goods. Technological enhancements will likely remain key to its long-term approach. Over the past few quarters, [AG] rolled out several complementary interactive products (i.e., mobile apps) and should continue to bolster its digital position.[4]

It was clear that there was substantial disagreement regarding the future growth trajectory and operating margins for the company. Over the past several years, revenue growth had been near to below zero. In 2011, however, revenue growth was anticipated to be more than 7% (**Exhibit 7**). Similarly, operating margins, which had been abnormally low two to five years previously, had improved to 9% recently. The marginal tax rate for AG income was 39%.

[2] Greeting Cards and E-Cards—U.S.: February 2011, Mintel report, February 2011.
[3] American Greetings Corp., Standard & Poor's stock report, December 27, 2011.
[4] Orly Seidman, *American Greetings*, Value Line investment survey, November 11, 2011.

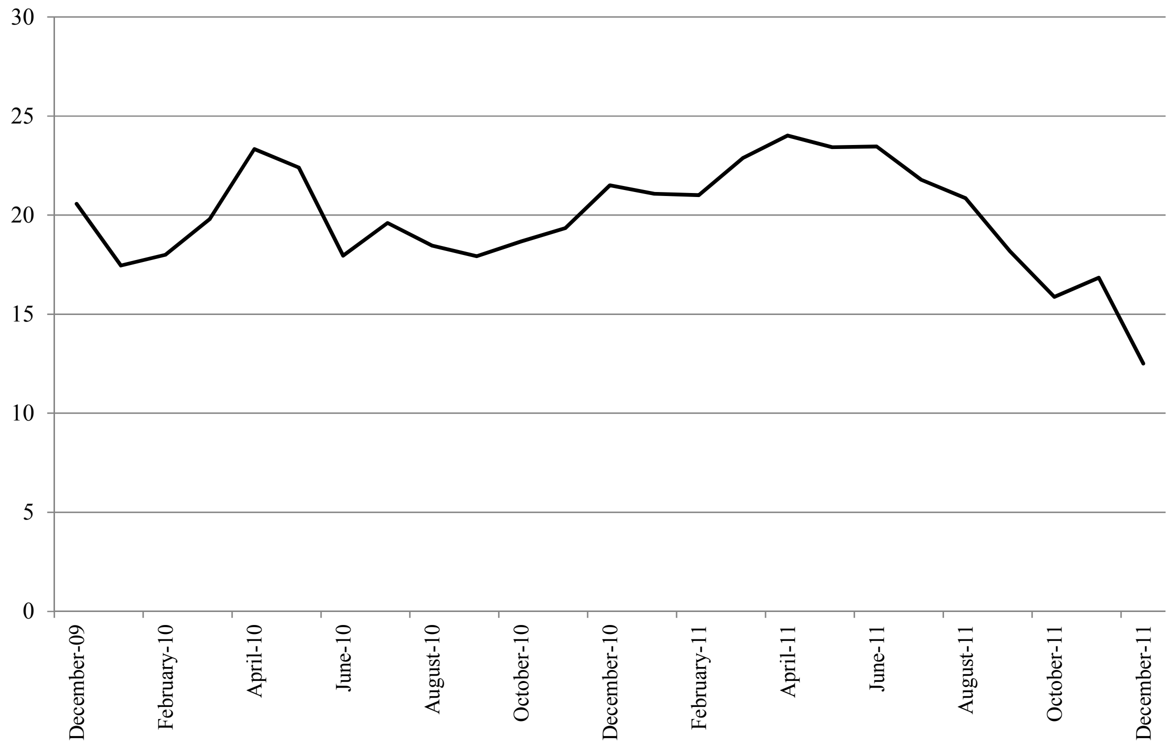
A bullish view held that AG would be able to maintain operating margins at 9% and achieve long-term ongoing revenue growth of 3%. A bearish view held that AG's prospective revenue growth would be near zero into the future and that margins would continue to erode to a long-term rate of 5%. The expectation was that recent investments and ongoing electronic product substitution would generate some future working capital efficiency for AG, but there was little evidence that fixed asset turnover would improve. **Exhibit 8** details the specific assumptions for the two scenarios.

Management understood that returns and growth were challenging to achieve in early 2012. Yields on U.S. Treasury bills and bonds were at historic lows of 0.1% and 2.8%, respectively (**Exhibit 9**). In such an environment, investors would richly reward returns of even small magnitudes.

Exhibit 1

American Greetings

American Greetings Share Price
(monthly close)



Data source: Yahoo! Finance.

Exhibit 2

American Greetings

American Greetings Income Statement, December 2011[1]
(in millions of dollars)

	2008 (Feb 2009)	2009 (Feb 2010)	2010 (Feb 2011)	2011E (Feb 2012)
Total American Greetings Figures				
Total Revenue	1,691	1,636	1,593	1,677
Material, Labor, and Other Pruduction Costs	810	713	682	743
Selling, Distribution, and Marketing Expenses	619	508	478	526
Administrative and General Expenses	226	276	261	258
Goodwill and Other Intangible Asset Impairment	290	0	0	0
Other Operating Expenses	1	0	3	(6)
Operating Income	(253)	139	175	157
Net Interest and Other Nonoperating Expenses	22	18	19	28
Income Before Income Tax Expense	(275)	121	156	129
Income Tax Expense	(47)	39	69	47
Net Income	(228)	82	87	82
Earnings Per Share (Basic)	(4.89)	2.07	2.18	2.22
Dividends per Share	0.60	0.36	0.56	0.60
By Business Unit				
Operating Segment Net Sales				
North American Social Expression Products	1,095	1,235	1,191	1,215
International Social Expression Products	271	254	262	344
Retail Operations	179	12		
AG Interactive	83	80	78	68
Operating Segment Earnings				
North American Social Expression Products	70	236	218	148
International Social Expression Products	(78)	17	20	20
Retail Operations	(19)	(35)		
AG Interactive	(162)	11	14	14
Total Revenue by Product Category				
Everyday Greeting Cards	704	764	753	823
Seasonal Greeting Cards	357	369	377	408
Gift Packaging	240	221	223	239
Other Revenue	44	38	32	32
All Other Products	345	244	207	176

Data sources: Company accounts; management and case writer estimates.

[1] Fiscal year ends February of subsequent year.

Exhibit 3

American Greetings

American Greetings Balance Sheet[1]
(in millions of dollars)

	2009 (Feb 2010)	2010 (Feb 2011)	2011E (Feb 2012)
Cash and Cash Equivalents	138	216	172
Trade Accounts Receivable	136	120	130
Inventories	164	180	190
Prepaid Expenses	148	128	131
Other Current Assets	94	72	54
Total Current Assets	679	716	677
Net Property, Plant, and Equipment and Other Assets	850	832	859
Total Assets	1,529	1,547	1,536
Debt Due within One Year	1	0	0
Accounts Payable	95	87	87
Other Current Liabilities	272	245	255
Current Liabilities	369	332	343
Long-Term Debt	329	233	235
Other Liabilities	196	219	206
Shareholders' Equity	636	763	752
Total Liabilities and Shareholders' Equity	1,529	1,547	1,536

Data sources: Company accounts; management and case writer estimates.

[1] Fiscal year ends February of subsequent year.

Exhibit 4

American Greetings

Total U.S. Greeting Cards Sales (Actual and Forecast)

	Sales at current prices in millions of dollars	% annual change
2005	6,537	
2006	6,420	-1.8
2007	6,285	-2.1
2008	6,266	-0.3
2009	6,149	-1.9
2010	5,935	-3.5
2011 (est.)	5,838	-1.6
2012 (est.)	5,711	-2.2
2013 (est.)	5,596	-2.0
2014 (est.)	5,478	-2.1
2015 (est.)	5,359	-2.2

Data source: Mintel, based on U.S. Census Bureau, Economic Census.

Exhibit 5

American Greetings

Feelings about e-Cards: Usage Change among 2,000 Respondents, October 2010

		By Age Category					
	All	18-24	25-34	35-44	45-54	55-64	65+
In the last year, I have sent more e-cards than I used to.	22%	17%	26%	20%	22%	21%	24%
In the last year, I have sent fewer e-cards than I used to because I send greetings over social networking sites such as Facebook.	20%	26%	27%	21%	19%	15%	13%

Data source: Mintel.

Exhibit 6

American Greetings

Comparable Firms, End of 2011
(in millions of dollars except share price)

	Share Price	Shares Outstanding	Total Cash	Total Debt	Enterprise Value	Revenue	EBITDA	EBITDA Multiple*
American Greetings	12.51	38.3	86	235	714	1,660	204	3.5
Blyth	56.80	8.2	182	101	568	984	48	11.7
Consolidated Graphics	48.28	10.2	7	197	692	1,050	122	5.6
CSS Industries	19.92	9.7	10	0	194	453	30	6.5
Deluxe	22.76	50.9	31	742	1,901	1,420	359	5.3
Hallmark	NA	NA	NA	NA	NA	4,100	NA	NA
Lancaster Colony	69.34	27.3	162	0	1,890	1,090	156	12.2
Meredith	32.65	44.8	26	250	1,712	1,350	240	7.1
Scholastic	29.97	31.1	114	215	1,145	1,950	189	6.0

	ROA	ROE	Beta	Bond Rating**
American Greetings	7%	11%	1.63	BB+
Blyth	4%	9%	1.60	B
Consolidated Graphics	5%	10%	1.45	BB
CSS Industries	4%	2%	1.36	
Deluxe	13%	55%	1.85	B
Hallmark	NA	NA	NA	
Lancaster Colony	14%	19%	0.42	
Meredith	7%	15%	1.75	BB
Scholastic	6%	8%	1.04	BB-

* EBITDA miltiple is defined as Enterprise Value divided by EBITDA

** The ratings for Cons. Graphics and Meredith are estimated by case writer.

Data sources: Yahoo! Finance, Standard & Poor's, Mergent.

Exhibit 6 (continued)

Comparable Firms

Blyth	Global marketer of candles, gourmet foods, weight management products, holiday cards, photo albums, and houseware products
Consolidated Graphics	Provides commercial printing services in North America, including brochures, shareholder communications, trading cards, calendars, catalogs, and greeting cards
CSS Industries	Designs, produces, and sells social expression products in North America, including greeting cards, gift wrapping, Valentine cards, Halloween costumes, and stationery
Deluxe	Provides printed products to financial institutions and small businesses worldwide, including forms, checks, envelopes, and greeting cards
Lancaster Colony	Manufactures and markets specialty foods, glassware, and candles in the United States
Meredith	Licenses brands and publishes magazines (e.g., *Better Homes and Gardens*, *Ladies' Home Journal*, *FamilyFun*) in the United States
Scholastic	Publishes and distributes children's books and other media in the United States

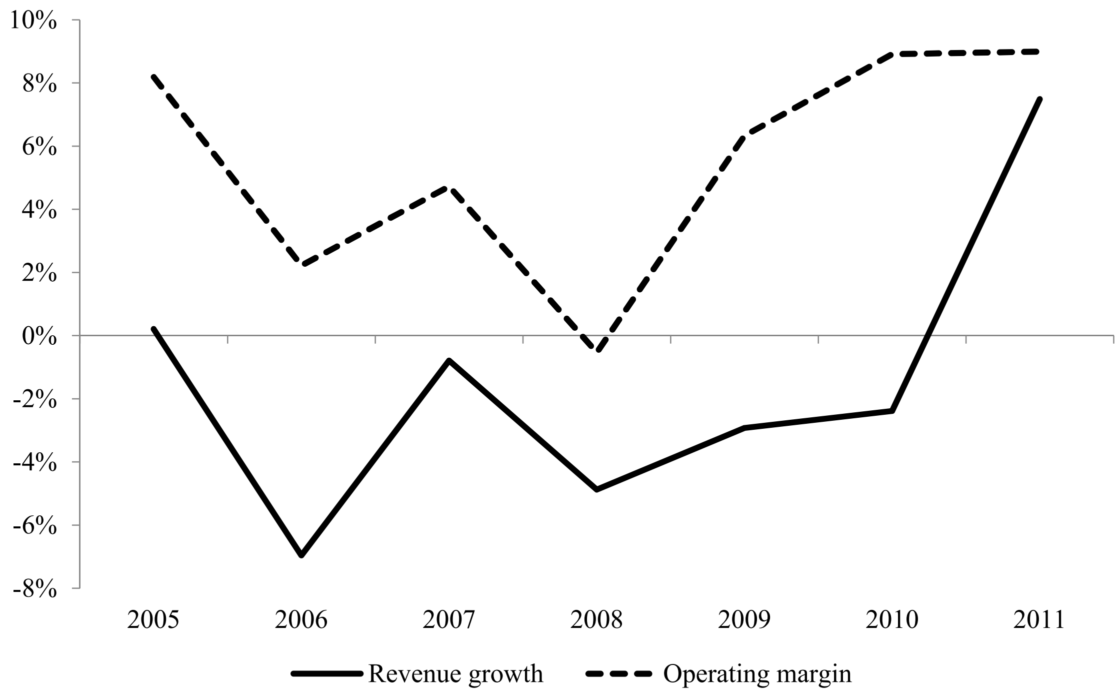
Data source: Case writer descriptions.

Exhibit 7

American Greetings

American Greetings Operating Performance

	2005	2006	2007	2008	2009	2010	2011
Revenue Growth	0%	-7%	-1%	-5%	-3%	-2%	7%
Operating Margin	8%	2%	5%	-1%	6%	9%	9%



Note: Fiscal year ends February of subsequent year.

Data source: Company financial statements.

Exhibit 8

American Greetings

Financial Forecast Assumptions

	Actual	*********** Forecast ***********			
	2011	**2012**	**2013**	**2014**	**2015**
Bullish Scenario					
Revenue Growth	5.3%	1.0%	1.5%	2.0%	2.5%
Operating Margin	9.4%	9.0%	9.0%	9.0%	9.0%
Net Working Capital Turnover	5.02	6.00	6.50	7.00	7.50
Fixed Asset Turnover	1.95	1.95	1.95	1.95	1.95
Bearish Scenario					
Revenue Growth	5.3%	0.0%	0.0%	0.0%	0.0%
Operating Margin	9.4%	8.0%	7.0%	6.0%	5.0%
Net Working Capital Turnover	5.02	6.00	6.50	7.00	7.50
Fixed Asset Turnover	1.95	1.95	1.95	1.95	1.95

Note: The ratios are defined in the following manner: Revenue Growth is the annual percentage change in total revenue, Operating Margin is operating income divided by total revenue, Net Working Capital Turnover is total revenue divided by net working capital where net working capital is current assets less current liabilities, Fixed Asset Turnover is total revenue divided by net PP&E and other assets.

Data source: Case writer estimates.

Exhibit 9

American Greetings

Capital Market Data

	Yield
30-Day Treasury Bill	0.1%
10-Year Treasury Bond	2.8%
10-Year Corporate Bonds of Industrial Companies	
AAA	2.8%
AA	2.9%
A+	3.2%
A	3.3%
A-	3.5%
BBB+	3.8%
BBB	4.1%
BBB-	4.6%
BB+	5.8%
BB	6.5%
BB-	6.5%
B+	6.8%
B	8.4%
B-	9.0%
Historical Market Risk Premium	
Equity Market Index Less Government Debt	5.5%

	5-Year Forecast
U.S. Real GDP Annual Growth Rate	3.3%
U.S. GDP Annual Deflator Rate	1.8%
Consumer Price Index Annual Rate	2.2%

Data sources: Bloomberg, Value Line Investment Survey, and case writer estimates.