

AMERICAN GREETINGS CORP

Form 10-Q

January 05, 2011

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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 November 26, 2010**

**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 incorporation or organization)

(I.R.S. Employer Identification No.)

**One American Road, Cleveland, Ohio**

**44144**

(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

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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 December 31, 2010, the number of shares outstanding of each of the issuer's classes of common stock was:

|                |            |
|----------------|------------|
| Class A Common | 37,237,576 |
| Class B Common | 2,905,076  |

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CONSOLIDATED STATEMENT OF INCOME**

(Thousands of dollars except share and per share amounts)

|  | (Unaudited)             |                         |                         |                         |
|--|-------------------------|-------------------------|-------------------------|-------------------------|
|  | Three Months Ended      |                         | Nine Months Ended       |                         |
|  | November<br>26,<br>2010 | November<br>27,<br>2009 | November<br>26,<br>2010 | November<br>27,<br>2009 |
| Net sales  | \$ 421,990              | \$ 431,512              | \$ 1,147,434            | \$ 1,189,428            |
| Other revenue  | 8,148                   | 8,654                   | 21,831                  | 20,010                  |
| Total revenue  | 430,138                 | 440,166                 | 1,169,265               | 1,209,438               |
| Material, labor and other production costs             | 199,177                 | 204,997                 | 502,903                 | 525,414                 |
| Selling, distribution and marketing expenses           | 117,314                 | 124,167                 | 347,183                 | 373,915                 |
| Administrative and general expenses                    | 58,725                  | 69,233                  | 186,950                 | 180,867                 |
| Other operating (income) expense net                   | (1,048)                 | (575)                   | (2,578)                 | 25,801                  |
| Operating income                                       | 55,970                  | 42,344                  | 134,807                 | 103,441                 |
| Interest expense                                       | 6,221                   | 6,331                   | 19,141                  | 19,989                  |
| Interest income  | (176)                   | (299)                   | (586)                   | (1,564)                 |
| Other non-operating income net                         | (1,618)                 | (1,827)                 | (3,321)                 | (4,160)                 |
| Income before income tax expense                       | 51,543                  | 38,139                  | 119,573                 | 89,176                  |
| Income tax expense                                     | 19,380                  | 8,444                   | 48,039                  | 26,398                  |
| Net income   | \$ 32,163               | \$ 29,695               | \$ 71,534               | \$ 62,778               |
| Earnings per share basic                               | \$ 0.80                 | \$ 0.75                 | \$ 1.79                 | \$ 1.59                 |
| Earnings per share assuming dilution                   | \$ 0.78                 | \$ 0.75                 | \$ 1.75                 | \$ 1.59                 |
| Average number of shares outstanding                   | 40,071,916              | 39,391,399              | 39,912,378              | 39,469,293              |
| Average number of shares outstanding assuming dilution | 40,985,909              | 39,755,233              | 40,911,964              | 39,495,247              |

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|                              |    |      |    |      |    |      |    |      |
|------------------------------|----|------|----|------|----|------|----|------|
| Dividends declared per share | \$ | 0.14 | \$ | 0.12 | \$ | 0.42 | \$ | 0.24 |
|------------------------------|----|------|----|------|----|------|----|------|

See notes to consolidated financial statements (unaudited).

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**AMERICAN GREETINGS CORPORATION**  
**CONSOLIDATED STATEMENT OF FINANCIAL POSITION**  
(Thousands of dollars)

|   | (Unaudited)<br>November<br>26,<br>2010 | (Note 1)<br>February<br>28,<br>2010 | (Unaudited)<br>November<br>27,<br>2009 |
|---|--|-------------------------------------|--|
| <b>ASSETS</b>   |  |                                     |  |
| Current assets  |  |                                     |  |
| Cash and cash equivalents                                 | \$ 93,899                              | \$ 137,949                          | \$ 50,563                              |
| Trade accounts receivable, net                            | 206,286                                | 135,758                             | 208,964                                |
| Inventories   | 181,511                                | 163,956                             | 168,103                                |
| Deferred and refundable income taxes                      | 70,847                                 | 78,433                              | 59,791                                 |
| Assets held for sale                                      | 12,325                                 | 13,280                              | 21,931                                 |
| Prepaid expenses and other                                | 127,598                                | 148,048                             | 151,842                                |
| Total current assets                                      | 692,466                                | 677,424                             | 661,194                                |
| Goodwill  | 31,686                                 | 31,106                              | 38,177                                 |
| Other assets  | 403,815                                | 428,160                             | 349,284                                |
| Deferred and refundable income taxes                      | 146,767                                | 148,210                             | 173,847                                |
| Property, plant and equipment at cost                     | 851,636                                | 840,696                             | 860,670                                |
| Less accumulated depreciation                             | 614,894                                | 595,945                             | 602,863                                |
| Property, plant and equipment net                         | 236,742                                | 244,751                             | 257,807                                |
|   | \$ 1,511,476                           | \$ 1,529,651                        | \$ 1,480,309                           |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>                |  |                                     |  |
| Current liabilities                                       |  |                                     |  |
| Debt due within one year                                  | \$                                     | \$ 1,000                            | \$ 1,000                               |
| Accounts payable  | 97,899                                 | 95,434                              | 86,835                                 |
| Accrued liabilities                                       | 80,744                                 | 79,478                              | 91,469                                 |
| Accrued compensation and benefits                         | 59,128                                 | 85,092                              | 74,770                                 |
| Income taxes payable                                      | 39,593                                 | 13,901                              | 10,479                                 |
| Other current liabilities                                 | 86,419                                 | 97,138                              | 87,221                                 |
| Total current liabilities                                 | 363,783                                | 372,043                             | 351,774                                |
| Long-term debt  | 232,078                                | 328,723                             | 355,974                                |
| Other liabilities   | 173,017                                | 164,642                             | 129,517                                |
| Deferred income taxes and noncurrent income taxes payable | 32,824                                 | 28,179                              | 31,633                                 |

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|                                      |              |              |              |
|--------------------------------------|--------------|--------------|--------------|
| Shareholders' equity                 |              |              |              |
| Common shares - Class A              | 37,199       | 36,257       | 36,111       |
| Common shares - Class B              | 2,905        | 3,223        | 3,232        |
| Capital in excess of par value       | 486,399      | 461,076      | 456,478      |
| Treasury stock                       | (952,183)    | (946,724)    | (946,569)    |
| Accumulated other comprehensive loss | (27,114)     | (29,815)     | (35,824)     |
| Retained earnings                    | 1,162,568    | 1,112,047    | 1,097,983    |
| Total shareholders' equity           | 709,774      | 636,064      | 611,411      |
|                                      | \$ 1,511,476 | \$ 1,529,651 | \$ 1,480,309 |

See notes to consolidated financial statements (unaudited).

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**AMERICAN GREETINGS CORPORATION**  
**CONSOLIDATED STATEMENT OF CASH FLOWS**  
(Thousands of dollars)

|  | (Unaudited)             |                         |
|--|-------------------------|-------------------------|
|  | Nine Months Ended       |                         |
|  | November<br>26,<br>2010 | November<br>27,<br>2009 |
| <b>OPERATING ACTIVITIES:</b>   |                         |                         |
| Net income   | \$ 71,534               | \$ 62,778               |
| Adjustments to reconcile net income to cash flows from operating activities:       |                         |                         |
| Net (gain) loss on dispositions  | (254)                   | 27,671                  |
| Net (gain) loss on disposal of fixed assets  | (1,599)                 | 163                     |
| Depreciation and intangible assets amortization                                    | 30,336                  | 34,121                  |
| Deferred income taxes  | 3,957                   | 20,133                  |
| Other non-cash charges   | 12,351                  | 7,096                   |
| Changes in operating assets and liabilities, net of acquisitions and dispositions: |                         |                         |
| Trade accounts receivable  | (71,336)                | (124,205)               |
| Inventories  | (16,461)                | 16,651                  |
| Other current assets   | (694)                   | 16,927                  |
| Income taxes   | 36,187                  | 17,711                  |
| Deferred costs net   | 19,365                  | 1,904                   |
| Accounts payable and other liabilities   | (31,541)                | (10,636)                |
| Other net  | 5,896                   | 3,886                   |
| <b>Total Cash Flows From Operating Activities</b>                                  | <b>57,741</b>           | <b>74,200</b>           |
| <b>INVESTING ACTIVITIES:</b>   |                         |                         |
| Property, plant and equipment additions  | (19,660)                | (21,368)                |
| Cash payments for business acquisitions, net of cash acquired                      |                         | (19,300)                |
| Proceeds from sale of fixed assets   | 3,835                   | 886                     |
| Proceeds from escrow related to party goods transaction                            | 25,151                  |                         |
| Other net  |                         | 4,713                   |
| <b>Total Cash Flows From Investing Activities</b>                                  | <b>9,326</b>            | <b>(35,069)</b>         |
| <b>FINANCING ACTIVITIES:</b>   |                         |                         |
| Net decrease in long-term debt   | (98,250)                | (34,600)                |
| Net decrease in short-term debt  | (1,000)                 |                         |
| Sale of stock under benefit plans  | 19,831                  | 3,683                   |
| Purchase of treasury shares  | (13,439)                | (11,826)                |
| Dividends to shareholders  | (16,737)                | (14,327)                |
| Debt issuance costs  | (3,178)                 |                         |
| <b>Total Cash Flows From Financing Activities</b>                                  | <b>(112,773)</b>        | <b>(57,070)</b>         |
| <b>EFFECT OF EXCHANGE RATE CHANGES ON CASH</b>                                     | <b>1,656</b>            | <b>8,286</b>            |

|  |           |           |
|--|-----------|-----------|
| DECREASE IN CASH AND CASH EQUIVALENTS          | (44,050)  | (9,653)   |
| Cash and Cash Equivalents at Beginning of Year | 137,949   | 60,216    |
| Cash and Cash Equivalents at End of Period     | \$ 93,899 | \$ 50,563 |

See notes to consolidated financial statements (unaudited).

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**AMERICAN GREETINGS CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**Three and Nine Months Ended November 26, 2010 and November 27, 2009**

**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, 2010 refers to the year ended February 28, 2010.

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 28, 2010, from which the Consolidated Statement of Financial Position at February 28, 2010, presented herein, has been derived. Certain amounts in the prior year financial statements have been reclassified to conform to the 2011 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 operation 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. Investments that do not meet the above criteria are accounted for under the cost method.

The Corporation holds an approximately 15% equity interest in Schurman Fine Papers (Schurman), which is a VIE as defined in Accounting Standards Codification (ASC) topic 810, (ASC 810) Consolidation. Schurman owns and operates approximately 430 specialty card and gift retail stores in the United States and Canada. The stores are primarily located in malls and strip shopping centers. 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, that 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 these activities. As such, Schurman is not consolidated into the Corporation's results. The Corporation's maximum exposure to loss as it relates to Schurman includes:

- § the investment in the equity of Schurman of \$1.9 million;
- § the limited guarantee of Schurman's indebtedness of \$12 million and the limited bridge guarantee of Schurman's indebtedness of \$12 million, see Note 10 for further information;
- § normal course of business trade accounts receivable due from Schurman, the balance of which fluctuates throughout the year due to the seasonal nature of the business;
- § the operating leases currently subleased to Schurman, the aggregate lease payments for the remaining life of which was \$40.3 million and \$50.9 million as of November 26, 2010 and February 28, 2010, respectively.

The Corporation has also made available to Schurman a \$10 million subordinated financing arrangement; however, so long as the Corporation's Bridge Guarantee described in Note 10 exceeds \$10 million, Schurman cannot borrow under this arrangement. If the Bridge Guarantee is less than \$10 million, the availability under the subordinated financing arrangement is limited to the difference between \$10 million and the maximum amount of the Bridge Guarantee. Because the Bridge Guarantee remains at \$12 million, there were no loans outstanding, or available, as of November 26, 2010.



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In addition to the investment in the equity of Schurman, the Corporation holds an investment in a privately held company in the form of common stock warrants. These two investments, totaling approximately \$18.2 million, are accounted for under the cost method. The Corporation is not aware of any events or changes in circumstances that had occurred during the nine months ended November 26, 2010 that the Corporation believes are reasonably likely to have had a significant adverse effect on the carrying amount of these investments.

**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 June 2009, the Financial Accounting Standards Board (the FASB) issued Accounting Standards Update (ASU) No. 2009-17 (ASU 2009-17), (Consolidations Topic 810), Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities. ASU 2009-17 requires an ongoing reassessment of determining whether a variable interest entity gives a company a controlling financial interest in a VIE. It also requires an entity to qualitatively, rather than quantitatively, determine whether a company is the primary beneficiary of a VIE previously required by FASB guidance. Under the new standard, the primary beneficiary of a VIE is a party that has the controlling financial interest in the VIE and has both the power to direct the activities that most significantly impact the VIE's economic success and the obligation to absorb losses or the right to receive benefits that could potentially be significant to the VIE. ASU 2009-17 is effective for interim and annual reporting periods beginning after November 15, 2009. The Corporation adopted ASU 2009-17 as of March 1, 2010. The Corporation's adoption of this standard did not have a material effect on its financial statements. See Note 1 for further information.

In January 2010, the FASB issued ASU No. 2010-06 (ASU 2010-06), Improving Disclosures about Fair Value Measurements. ASU 2010-06 provides amendments to ASC Topic 820, Fair Value Measurements and Disclosures, that require separate disclosure of significant transfers in and out of Level 1 and Level 2 fair value measurements in addition to the presentation of purchases, sales, issuances and settlements for Level 3 fair value measurements. ASU 2010-06 also provides amendments to subtopic 820-10 that clarify existing disclosures about the level of disaggregation, and inputs and valuation techniques. The new disclosure requirements are effective for interim and annual periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements of Level 3 fair value measurements. Those disclosures are effective for interim and annual periods beginning after December 15, 2010. As ASU 2010-06 only requires enhanced disclosures, the Corporation's adoption of this standard did not have a material effect on its financial statements. See Note 12 for further information.

**Note 4 Other Income and Expense**

|  | Three Months Ended      |                      | Nine Months Ended       |                      |
|--|-------------------------|----------------------|-------------------------|----------------------|
|  | November<br>26,<br>2010 | November<br>27, 2009 | November<br>26,<br>2010 | November<br>27, 2009 |
| (In thousands)                                       |                         |                      |                         |                      |
| Loss on disposition of retail stores                 | \$                      | \$                   | \$                      | \$ 28,333            |
| Loss (gain) on disposition of calendar product lines |                         | 90                   |                         | (547)                |
| Gain on disposition of candy product lines           |                         | (115)                |                         | (115)                |
| Miscellaneous  | (1,048)                 | (550)                | (2,578)                 | (1,870)              |
| Other operating (income) expense net                 | \$ (1,048)              | \$ (575)             | \$ (2,578)              | \$ 25,801            |

In April 2009, the Corporation sold the rights, title and interest in certain of the assets of its retail store operations to Schurman, and recognized a loss on disposition of \$28.3 million. In July 2009, the Corporation sold its calendar product lines and recorded a gain of \$0.5 million. In October 2009, the Corporation sold its candy product lines and recorded a gain of \$0.1 million. Proceeds received from the sales of the calendar and candy product lines of \$3.1 million and \$1.6 million, respectively, were included in Other net investing activities on the Consolidated Statement of Cash Flows.



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|                                | Three Months Ended      |                         | Nine Months Ended       |                         |
|--------------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
|                                | November<br>26,<br>2010 | November<br>27,<br>2009 | November<br>26,<br>2010 | November<br>27,<br>2009 |
| <b>(In thousands)</b>          |                         |                         |                         |                         |
| Foreign exchange gain          | \$ (908)                | \$ (1,485)              | \$ (520)                | \$ (2,690)              |
| Rental income                  | (235)                   | (207)                   | (996)                   | (955)                   |
| (Gain) loss on asset disposal  | (331)                   | 154                     | (1,599)                 | 163                     |
| Miscellaneous                  | (144)                   | (289)                   | (206)                   | (678)                   |
| Other non-operating income net | \$ (1,618)              | \$ (1,827)              | \$ (3,321)              | \$ (4,160)              |

In August 2010, the Corporation sold the land and building associated with its Mexican operations that were previously included in Assets of businesses held for sale on the Consolidated Statement of Financial Position and recorded a gain of approximately \$1.0 million. The cash proceeds of \$2.0 million received from the sale of the Mexican assets are included in Proceeds from sale of fixed assets on the Consolidated Statement of Cash Flows.

Miscellaneous includes, among other things, income/loss from equity securities.

**Note 5 Earnings Per Share**

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

|   | Three Months Ended      |                         | Nine Months Ended       |                         |
|---|-------------------------|-------------------------|-------------------------|-------------------------|
|   | November<br>26,<br>2010 | November<br>27,<br>2009 | November<br>26,<br>2010 | November<br>27,<br>2009 |
| <b>Numerator (in thousands):</b>                      |                         |                         |                         |                         |
| Net income  | \$ 32,163               | \$ 29,695               | \$ 71,534               | \$ 62,778               |
| <b>Denominator (in thousands):</b>                    |                         |                         |                         |                         |
| Weighted average shares outstanding                   | 40,072                  | 39,391                  | 39,912                  | 39,469                  |
| Effect of dilutive securities:                        |                         |                         |                         |                         |
| Stock options and other                               | 914                     | 364                     | 1,000                   | 26                      |
| Weighted average shares outstanding assuming dilution | 40,986                  | 39,755                  | 40,912                  | 39,495                  |
| Earnings per share                                    | \$ 0.80                 | \$ 0.75                 | \$ 1.79                 | \$ 1.59                 |
| Earnings per share assuming dilution                  | \$ 0.78                 | \$ 0.75                 | \$ 1.75                 | \$ 1.59                 |

Approximately 4.0 million and 3.2 million stock options outstanding in the three and nine month periods ended November 26, 2010, 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 (4.1 million and 6.1 million stock options outstanding in the three and nine month periods ended November 27, 2009, respectively).

The Corporation issued approximately 0.1 million Class A common shares upon exercise of employee stock options during the three months ended November 26, 2010. The Corporation issued approximately 0.9 million and 0.2 million

Class A and Class B common shares, respectively, upon exercise of employee stock options during the nine months ended November 26, 2010. The Corporation issued approximately 0.2 million Class A common shares upon exercise of employee stock options during the three and nine month periods ended November 27, 2009. There were an insignificant number of Class B common shares issued upon exercise of employee stock options during the prior year three months and nine months ended November 27, 2009.

**Table of Contents****Note 6 Comprehensive Income**

The Corporation's total comprehensive income is as follows:

| (In thousands)  | Three Months Ended      |                         | Nine Months Ended       |                         |
|---|-------------------------|-------------------------|-------------------------|-------------------------|
|   | November<br>26,<br>2010 | November<br>27,<br>2009 | November<br>26,<br>2010 | November<br>27,<br>2009 |
| Net income  | \$ 32,163               | \$ 29,695               | \$ 71,534               | \$ 62,778               |
| Other comprehensive income (loss):                            |                         |                         |                         |                         |
| Foreign currency translation adjustments                      | 4,523                   | 5,279                   | 5,607                   | 33,439                  |
| Pension and postretirement benefit adjustments,<br>net of tax | (823)                   | (541)                   | (2,907)                 | (1,987)                 |
| Unrealized gain on securities, net of tax                     | 1                       |                         | 1                       | 2                       |
| Total comprehensive income                                    | \$ 35,864               | \$ 34,433               | \$ 74,235               | \$ 94,232               |

**Note 7 Trade Allowances and Discounts**

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

| (In thousands)   | November 26,<br>2010 | February 28,<br>2010 | November 27,<br>2009 |
|--|----------------------|----------------------|----------------------|
| Allowance for seasonal sales returns                         | \$ 47,252            | \$ 36,443            | \$ 51,845            |
| Allowance for outdated products                              | 10,349               | 10,438               | 13,969               |
| Allowance for doubtful accounts                              | 4,379                | 2,963                | 3,690                |
| Allowance for cooperative advertising and marketing<br>funds | 26,425               | 24,061               | 26,777               |
| Allowance for rebates  | 26,920               | 29,338               | 33,434               |
|  | \$ 115,325           | \$ 103,243           | \$ 129,715           |

Certain trade allowances and discounts are settled in cash. These accounts, primarily rebates, which are classified as Accrued liabilities on the Consolidated Statement of Financial Position, totaled \$12.8 million, \$15.3 million and \$15.6 million as of November 26, 2010, February 28, 2010 and November 27, 2009, respectively.

**Note 8 Inventories**

| (In thousands)                         | November 26,<br>2010 | February 28,<br>2010 | November 27,<br>2009 |
|--|----------------------|----------------------|----------------------|
| Raw materials                          | \$ 16,885            | \$ 18,609            | \$ 17,181            |
| Work in process                        | 7,842                | 6,622                | 7,403                |
| Finished products                      | 215,361              | 194,283              | 204,422              |
|  | 240,088              | 219,514              | 229,006              |
| Less LIFO reserve                      | 75,818               | 75,491               | 79,506               |
|  | 164,270              | 144,023              | 149,500              |
| Display materials and factory supplies | 17,241               | 19,933               | 18,603               |

\$ 181,511 \$ 163,956 \$ 168,103

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.

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Inventory held on location for retailers with scan-based trading arrangements, which is included in finished products, totaled \$48.7 million, \$37.5 million and \$48.1 million as of November 26, 2010, February 28, 2010 and November 27, 2009, respectively.

**Note 9 Deferred Costs**

Deferred costs and future payment commitments for retail supply agreements are included in the following financial statement captions:

| <b>(In thousands)</b>      | <b>November 26,<br/>2010</b> | <b>February 28,<br/>2010</b> | <b>November 27,<br/>2009</b> |
|----------------------------|------------------------------|------------------------------|------------------------------|
| Prepaid expenses and other | \$ 89,250                    | \$ 82,914                    | \$ 112,154                   |
| Other assets               | 284,908                      | 310,555                      | 245,578                      |
| Deferred cost assets       | 374,158                      | 393,469                      | 357,732                      |
| Other current liabilities  | (54,048)                     | (53,701)                     | (50,252)                     |
| Other liabilities          | (50,900)                     | (51,803)                     | (1,800)                      |
| Deferred cost liabilities  | (104,948)                    | (105,504)                    | (52,052)                     |
| Net deferred costs         | \$ 269,210                   | \$ 287,965                   | \$ 305,680                   |

The Corporation maintains an allowance for deferred costs related to supply agreements of \$11.1 million, \$12.4 million and \$16.3 million at November 26, 2010, February 28, 2010 and November 27, 2009, respectively. This allowance is included in Other assets in the Consolidated Statement of Financial Position.

**Note 10 Debt**

The Corporation was party to an amended and restated \$450 million secured credit agreement (the Original Credit Agreement). The Original Credit Agreement included a \$350 million revolving credit facility and a \$100 million delay draw term loan, which the Corporation drew down in 2009 to provide it with greater financial flexibility and to enhance liquidity for the long-term.

On June 11, 2010, the Corporation further amended and restated its Original Credit Agreement by entering into an Amended and Restated Credit Agreement (the Amended and Restated Credit Agreement) among various lending institutions. Pursuant to the terms of the Amended and Restated Credit Agreement, the Corporation may continue to borrow, repay and re-borrow up to \$350 million under the revolving credit facility, with the ability to increase the size of the facility to up to \$400 million, subject to customary conditions. The Amended and Restated Credit Agreement also continues to provide for a \$25 million sub-limit for the issuance of swing line loans and a \$100 million sub-limit for the issuance of letters of credit.

The obligations under the Amended and Restated Credit Agreement continue to be guaranteed by the Corporation's material domestic subsidiaries and continue to be secured by substantially all of the personal property of the Corporation and each of its material domestic subsidiaries, including a pledge of all of the capital stock in substantially all of the Corporation's domestic subsidiaries and 65% of the capital stock of the Corporation's first tier international subsidiaries. The revolving loans under the Original Credit Agreement were scheduled to mature on April 4, 2011 and the term loan was scheduled to mature on April 4, 2013. The Amended and Restated Credit Agreement, including revolving loans thereunder, will mature on June 11, 2015. In connection with the Amended and Restated Credit Agreement, the term loan was terminated and the Corporation repaid the full \$99 million outstanding under the term loan using cash on hand. The proceeds of the borrowings under the Amended and Restated Credit Agreement may be used to provide working capital and for other general corporate purposes.

Revolving loans that are denominated in U.S. dollars will bear interest at either the U.S. base rate or the London Inter-Bank Offer Rate (LIBOR), at the Corporation's election, plus a margin determined according to the Corporation's leverage ratio. Swing line loans will bear interest at a quoted rate agreed upon by the Corporation and the swing line

lender. In addition to interest, the Corporation is required to pay commitment fees on the unused portion of the revolving credit facility. The commitment fee rate is initially 0.50% per annum and is subject to adjustment thereafter based on the Corporation's leverage ratio.

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The Amended and Restated Credit Agreement contains certain restrictive covenants that are customary for similar credit arrangements, including covenants relating to limitations on liens, dispositions, issuance of debt, investments, payment of dividends, repurchases of capital stock, acquisitions and transactions with affiliates. There are also financial performance covenants that require the Corporation to maintain a maximum leverage ratio and a minimum interest coverage ratio. The Amended and Restated Credit Agreement also requires the Corporation to make certain mandatory prepayments of outstanding indebtedness using the net cash proceeds received from certain dispositions, events of loss and additional indebtedness that the Corporation incurs.

The Corporation is also party to an amended and restated receivables purchase agreement that has available financing of up to \$80 million. The amended and restated receivables purchase agreement has a maturity date of September 21, 2012, however, the agreement will terminate upon termination of the liquidity commitments obtained by the purchaser groups from third party liquidity providers. Such commitments may be made available to the purchaser groups for 364-day periods only (initial 364-day period began on September 23, 2009), and there can be no assurances that the third party liquidity providers will renew or extend their commitments under the receivables purchase agreement. If that is the case, the receivables purchase agreement will terminate and the Corporation will not receive the benefit of the entire three-year term of the agreement. On September 22, 2010, the liquidity commitments were renewed for an additional 364-day period.

There was no debt due within one year as of November 26, 2010. Debt due within one year as of February 28, 2010 and November 27, 2009 was \$1.0 million.

Long-term debt and their related calendar year due dates, net of unamortized discounts which totaled \$22.8 million and \$24.9 million as of November 26, 2010 and November 27, 2009, respectively, were as follows:

| <b>(In thousands)</b>               | <b>November 26,<br/>2010</b> | <b>February 28,<br/>2010</b> | <b>November 27,<br/>2009</b> |
|-------------------------------------|------------------------------|------------------------------|------------------------------|
| 7.375% senior notes, due 2016       | \$ 212,832                   | \$ 212,184                   | \$ 211,982                   |
| 7.375% notes, due 2016              | 19,065                       | 18,103                       | 17,802                       |
| Term loan facility                  |                              | 98,250                       | 98,500                       |
| Revolving credit facility, due 2015 |                              |                              | 27,500                       |
| 6.10% senior notes, due 2028        | 181                          | 181                          | 181                          |
| Other                               |                              | 5                            | 9                            |
|                                     | <b>\$ 232,078</b>            | <b>\$ 328,723</b>            | <b>\$ 355,974</b>            |

The total fair value of the Corporation's publicly traded debt, which includes the 7.375% senior notes, 7.375% notes and 6.10% senior notes, based on quoted market prices, was \$237.4 million (at a carrying value of \$232.1 million), \$224.7 million (at a carrying value of \$230.5 million) and \$220.8 million (at a carrying value of \$230.0 million) at November 26, 2010, February 28, 2010 and November 27, 2009, respectively.

As of November 26, 2010, there were no balances outstanding under the Corporation's revolving credit facility or receivables purchase agreement, neither of which is publicly traded debt. The total fair value of the Corporation's non-publicly traded debt, based on comparable privately traded debt prices, was \$99.3 million (at a carrying value of \$99.3 million) at February 28, 2010.

In addition, the Corporation had, in the aggregate, \$45.9 million outstanding under letters of credit, which reduces the total credit availability for the Corporation.

At November 26, 2010, the Corporation was in compliance with the financial covenants under its borrowing agreements.

**Guarantees**

In April 2009, the Corporation sold certain of the assets of its Retail Operations segment to Schurman and purchased from Schurman its Papyrus trademark and its Papyrus wholesale business division. As part of the transaction, the Corporation agreed to provide Schurman limited credit support through the provision of a limited guarantee ( Liquidity Guarantee ) and a limited bridge guarantee ( Bridge Guarantee ) in favor of the lenders under Schurman's senior

revolving credit facility (the Senior Credit Facility ).

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Pursuant to the terms of the Liquidity Guarantee, the Corporation has guaranteed the repayment of up to \$12 million of Schurman's borrowings under the Senior Credit Facility to help ensure that Schurman has sufficient borrowing availability under this facility. The Liquidity Guarantee is required to be backed by a letter of credit for the term of the Liquidity Guarantee, which is currently anticipated to end in January 2014. Pursuant to the terms of the Bridge Guarantee, the Corporation has guaranteed the repayment of up to \$12 million of Schurman's borrowings under the Senior Credit Facility until Schurman is able to include the inventory and other assets of the acquired retail stores in its borrowing base. The Bridge Guarantee is required to be backed by a letter of credit. The letters of credit required to back both guarantees are included within the \$45.9 million outstanding letters of credit mentioned above. The Bridge Guarantee is scheduled to expire in January 2014; however, upon the Corporation's request, the Bridge Guarantee may be reduced as Schurman is able to include such inventory and other assets in its borrowing base. The Corporation does not currently anticipate requesting such reduction. The Corporation's obligations under the Liquidity Guarantee and the Bridge Guarantee 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 November 26, 2010 requiring the use of the guarantees.

**Note 11 Retirement Benefits**

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

|                                    | <b>Defined Benefit Pension</b> |                 |                          |                 |
|------------------------------------|--------------------------------|-----------------|--------------------------|-----------------|
|                                    | <b>Three Months Ended</b>      |                 | <b>Nine Months Ended</b> |                 |
|                                    | <b>November</b>                | <b>November</b> | <b>November</b>          | <b>November</b> |
|                                    | <b>26,</b>                     | <b>27,</b>      | <b>26,</b>               | <b>27,</b>      |
| <b>(In thousands)</b>              | <b>2010</b>                    | <b>2009</b>     | <b>2010</b>              | <b>2009</b>     |
| Service cost                       | \$ 214                         | \$ 193          | \$ 715                   | \$ 576          |
| Interest cost                      | 2,216                          | 2,304           | 6,634                    | 6,872           |
| Expected return on plan assets     | (1,660)                        | (1,416)         | (4,973)                  | (4,216)         |
| Amortization of prior service cost | 50                             | 67              | 138                      | 200             |
| Amortization of actuarial loss     | 529                            | 487             | 1,579                    | 1,454           |
|                                    | \$ 1,349                       | \$ 1,635        | \$ 4,093                 | \$ 4,886        |

|                                      | <b>Postretirement Benefit</b> |                 |                          |                 |
|--------------------------------------|-------------------------------|-----------------|--------------------------|-----------------|
|                                      | <b>Three Months Ended</b>     |                 | <b>Nine Months Ended</b> |                 |
|                                      | <b>November</b>               | <b>November</b> | <b>November</b>          | <b>November</b> |
|                                      | <b>26,</b>                    | <b>27,</b>      | <b>26,</b>               | <b>27,</b>      |
| <b>(In thousands)</b>                | <b>2010</b>                   | <b>2009</b>     | <b>2010</b>              | <b>2009</b>     |
| Service cost                         | \$ 575                        | \$ 593          | \$ 1,725                 | \$ 1,778        |
| Interest cost                        | 1,550                         | 1,840           | 4,650                    | 5,520           |
| Expected return on plan assets       | (1,125)                       | (1,028)         | (3,375)                  | (3,083)         |
| Amortization of prior service credit | (1,850)                       | (1,855)         | (5,550)                  | (5,565)         |
| Amortization of actuarial loss       | 250                           | 598             | 750                      | 1,793           |
|                                      | \$ (600)                      | \$ 148          | \$ (1,800)               | \$ 443          |

The Corporation has a discretionary profit-sharing plan with a 401(k) provision covering most of its United States employees. The profit-sharing plan expense for the nine months ended November 26, 2010 was \$7.4 million,

compared to \$6.9 million in the prior year period. The Corporation also matches a portion of 401(k) employee contributions. The expenses recognized for the three and nine month periods ended November 26, 2010 were \$1.0 million and \$3.1 million (\$1.2 million and \$3.3 million for the three and nine month periods ended November 27, 2009), respectively. The profit-sharing plan and 401(k) matching expenses for the nine month periods are estimates as actual contributions are determined after fiscal year-end.

At November 26, 2010, February 28, 2010 and November 27, 2009, the liability for postretirement benefits other than pensions was \$51.3 million, \$44.0 million and \$62.4 million, respectively, and is included in Other liabilities on the Consolidated Statement of Financial Position. At November 26, 2010, February 28, 2010 and November 27,

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2009, the long-term liability for pension benefits was \$59.3 million, \$58.6 million and \$53.5 million, respectively, and is included in Other liabilities on the Consolidated Statement of Financial Position.

**Note 12 Fair Value Measurements**

The following table presents information about those assets and liabilities measured at fair value as of the measurement date, November 26, 2010, and the basis for that measurement, by level within the fair value hierarchy:

|   | <b>Balance<br/>as<br/>of<br/>November<br/>26, 2010</b> | <b>Quoted<br/>prices in<br/>active<br/>markets<br/>for<br/>identical<br/>assets and<br/>liabilities<br/>(Level 1)</b> | <b>Quoted<br/>prices in<br/>active<br/>markets<br/>for<br/>similar<br/>assets and<br/>liabilities<br/>(Level 2)</b> | <b>Significant<br/>unobservable<br/>inputs<br/>(Level 3)</b> |
|---|--|---|---|--|
| Assets measured on a recurring basis:       |  |   |   |  |
| Active employees' medical plan trust assets | \$ 4,261   | \$ 4,261  | \$  | \$   |
| Deferred compensation plan assets (1)       | 6,382  | 6,382   |   |  |
| Total                                       | \$ 10,643  | \$ 10,643   | \$  | \$   |
| Assets measured on a non-recurring basis:   |  |   |   |  |
| Assets held for sale                        | \$ 5,557   | \$  | \$ 5,557  | \$   |
| Total                                       | \$ 5,557   | \$  | \$ 5,557  | \$   |

(1) There is an offsetting liability for the obligation to its employees on the Corporation's books.

The fair value of the investments in the active employees' medical plan trust was considered a Level 1 valuation as it is based on the quoted market value per share of each individual security investment in an active market.

The deferred compensation plan is comprised of mutual fund assets and the Corporation's common shares. The fair value of the mutual fund assets was considered a Level 1 valuation as it is based on each fund's quoted market value per share in an active market. The fair value of the Corporation's common shares was considered a Level 1 valuation as it is based on the quoted market value per share of the Class A common shares in an active market. Although the Corporation is under no obligation to fund employees' non-qualified accounts, the fair value of the related non-qualified deferred compensation liability is based on the fair value of the mutual fund assets and the Corporation's common shares.

The Corporation has assets held for sale, certain of which are measured at fair value on a non-recurring basis and are subject to fair value adjustments only in certain circumstances. Land and buildings related to the Corporation's DesignWare party goods product lines was classified as held for sale during the fourth quarter of 2010. In accordance with ASC Topic 360, Property, Plant and Equipment, assets held for sale shall be measured at the lower of its carrying amount or fair value less cost to sell. The fair value of these assets held for sale was considered a Level 2 valuation as it was based on observable selling prices for similar assets that were sold within the past eighteen months.

**Note 13 Income Taxes**

The Corporation's provision for income taxes in interim periods is computed by applying its estimated annual effective tax rate against income before income tax expense for the period. In addition, non-recurring or discrete items are recorded during the period in which they occur. The magnitude of the impact that discrete items have on the

Corporation's quarterly effective tax rate is dependent on the level of income in the period. The effective tax rate was 37.6% and 40.2% for the three and nine months ended November 26, 2010, respectively, and 22.1% and 29.6% for the three and nine months ended November 27, 2009, respectively. The higher than statutory rate for the nine months ended November 26, 2010 is due primarily to the impact of unfavorable settlements of audits in foreign

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jurisdictions, the release of insurance reserves that generated taxable income and the recognition of the deferred tax effects of the reduced deductibility of the postretirement prescription drug coverage due to the recently enacted U.S. Patient Protection and Affordable Care Act.

At November 26, 2010, the Corporation had unrecognized tax benefits of \$44.6 million that, if recognized, would have a favorable effect on the Corporation's income tax expense of \$34.1 million. During the third quarter of 2011, the Corporation's unrecognized tax benefits decreased approximately \$2.5 million due primarily to cash payments for the settlement of foreign audits. It is reasonably possible that the Corporation's unrecognized tax benefits could decrease by approximately \$9.6 million during the next twelve months due to anticipated settlements and resulting cash payments related to open years after 1999, which are currently under examination.

The Corporation recognizes interest and penalties accrued on unrecognized tax benefits and refundable income taxes as a component of income tax expense. As of November 26, 2010, the Corporation recognized net expense of \$0.6 million for interest and penalties on unrecognized tax benefits and refundable income taxes. As of November 26, 2010, the total amount of gross accrued interest and penalties related to unrecognized tax benefits less refundable income taxes, was a net payable of \$0.2 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 international tax jurisdictions, including Canada, the United Kingdom, Australia, France, Italy, Mexico and New Zealand for tax years 2005 to the present.

**Note 14 Business Segment Information**

|   | Three Months Ended      |                         | Nine Months Ended       |                         |
|---|-------------------------|-------------------------|-------------------------|-------------------------|
|   | November<br>26,<br>2010 | November<br>27,<br>2009 | November<br>26,<br>2010 | November<br>27,<br>2009 |
| <b>(In thousands)</b>                     |                         |                         |                         |                         |
| <b>Total Revenue:</b>                     |                         |                         |                         |                         |
| North American Social Expression Products | \$ 312,773              | \$ 329,869              | \$ 865,664              | \$ 920,568              |
| Intersegment items                        |                         |                         |                         | (5,104)                 |
| Exchange rate adjustment                  | 4,748                   | 2,761                   | 12,324                  | 5,174                   |
| Net                                       | 317,521                 | 332,630                 | 877,988                 | 920,638                 |
| International Social Expression Products  | 77,601                  | 73,972                  | 190,364                 | 184,613                 |
| Exchange rate adjustment                  | 2,502                   | 2,736                   | 2,048                   | 1,597                   |
| Net                                       | 80,103                  | 76,708                  | 192,412                 | 186,210                 |
| Retail Operations                         |                         |                         |                         | 11,727                  |
| Exchange rate adjustment                  |                         |                         |                         | 112                     |
| Net                                       |                         |                         |                         | 11,839                  |
| AG Interactive                            | 19,234                  | 19,393                  | 56,160                  | 56,743                  |
| Exchange rate adjustment                  | (1)                     | 84                      | (206)                   | 76                      |
| Net                                       | 19,233                  | 19,477                  | 55,954                  | 56,819                  |
| Non-reportable segments                   | 13,281                  | 11,185                  | 42,911                  | 33,546                  |
| Unallocated                               |                         | 166                     |                         | 386                     |

\$ 430,138      \$ 440,166      \$ 1,169,265      \$ 1,209,438

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|   | <b>Three Months Ended</b>        |                                  | <b>Nine Months Ended</b>         |                                  |
|---|----------------------------------|----------------------------------|----------------------------------|----------------------------------|
|   | <b>November<br/>26,<br/>2010</b> | <b>November<br/>27,<br/>2009</b> | <b>November<br/>26,<br/>2010</b> | <b>November<br/>27,<br/>2009</b> |
| <b>(In thousands)</b>                     |                                  |                                  |                                  |                                  |
| <b>Segment Earnings (Loss):</b>           |                                  |                                  |                                  |                                  |
| North American Social Expression Products | \$ 54,277                        | \$ 46,675                        | \$ 155,997                       | \$ 167,441                       |
| Intersegment items                        |                                  |                                  |                                  | (3,511)                          |
| Exchange rate adjustment                  | 2,218                            | 1,246                            | 5,661                            | 2,318                            |
| Net                                       | 56,495                           | 47,921                           | 161,658                          | 166,248                          |
| International Social Expression Products  | 10,001                           | 9,404                            | 14,196                           | 12,227                           |
| Exchange rate adjustment                  | (19)                             | 154                              | (55)                             | (15)                             |
| Net                                       | 9,982                            | 9,558                            | 14,141                           | 12,212                           |
| Retail Operations                         |                                  |                                  |                                  | (34,830)                         |
| Exchange rate adjustment                  |                                  |                                  |                                  | (285)                            |
| Net                                       |                                  |                                  |                                  | (35,115)                         |
| AG Interactive                            | 5,134                            | 1,510                            | 10,553                           | 5,209                            |
| Exchange rate adjustment                  | 1                                | 61                               | (160)                            | 7                                |
| Net                                       | 5,135                            | 1,571                            | 10,393                           | 5,216                            |
| Non-reportable segments                   | 1,438                            | 1,634                            | 6,907                            | 1,872                            |
| Unallocated                               | (21,761)                         | (22,507)                         | (73,924)                         | (61,550)                         |
| Exchange rate adjustment                  | 254                              | (38)                             | 398                              | 293                              |
| Net                                       | (21,507)                         | (22,545)                         | (73,526)                         | (61,257)                         |
|   | \$ 51,543                        | \$ 38,139                        | \$ 119,573                       | \$ 89,176                        |

**Termination Benefits**

Termination benefits are primarily considered part of an ongoing benefit arrangement, accounted for in accordance with ASC Topic 712, Compensation - Nonretirement Postemployment Benefits, and are recorded when payment of the benefits is probable and can be reasonably estimated.

During the nine months ended November 26, 2010, the Corporation recorded severance expense of approximately \$3 million. Approximately \$2 million of the expense is included in the North American Social Expression Products segment and the remaining \$1 million is included in the AG Interactive segment.

The balance of the severance accrual was \$6.2 million, \$14.0 million and \$10.5 million at November 26, 2010, February 28, 2010 and November 27, 2009, 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 \$31.4 million, \$40.2 million and \$33.9 million at November 26, 2010, February 28, 2010 and November 27, 2009, respectively. The amounts relate primarily to subscription revenue in the Corporation's AG Interactive segment and the licensing activities included in non-reportable segments.

**Note 15 Subsequent Event**

On December 2, 2010, the Corporation received a cash distribution of approximately \$7 million related to its investment in the warrants of AAH Holdings Corporation.

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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 used in this Report to refer to the businesses of American Greetings Corporation and its consolidated subsidiaries.

**Overview**

For the third quarter ended November 26, 2010, total revenue decreased approximately \$10 million, or 2%, compared to the prior year period. Approximately 85% of the revenue decline was driven by lower sales of party goods, which, as expected, was the result of the party goods transaction completed in the prior year fourth quarter. The remaining 15% of the revenue decline was primarily the net impact of lower sales from gift packaging and other non-card products in the North American Social Expression Products segment, substantially offset by increased sales in the International Social Expression Products segment and higher sales in the fixtures business. The revenue improvement in our International Social Expression Products segment was primarily the result of higher sales of holiday boxed cards and products we distribute on behalf of third parties. Revenues in our AG Interactive segment and licensing business were virtually flat compared to the prior year quarter.

Operating income increased approximately \$14 million, compared to the prior year. The prior year quarter included a charge of approximately \$6 million associated with the shutdown of our distribution facility in Mexico and approximately \$12 million of incremental variable compensation expense related to the then anticipated achievement at above target levels under our Key Management Annual Incentive Plan and our performance share award program. Compared to prior year, the current year included the unfavorable impact of lower revenues and higher product content costs, partially offset by lower field sales and distribution costs associated with the integration of our acquisitions of Recycled Paper Greetings (RPG) and the Papyrus trademark and wholesale division of Schurman Fine Papers (Schurman), and lower shipment volume.

Over the past several years, many consumers have been gradually shifting to value shopping resulting in a shift to a higher mix of value line cards, which lowers the average selling price of our greeting cards. We have experienced this lower average selling price trend within both the mass merchandiser and dollar store channels of distribution. We believe that this trend to a higher mix of value line cards will accelerate due to certain changes to agreements with existing retail customers in the value channel that are occurring during our fourth quarter. While we anticipate these changes will cause continued downward pressure on average selling price, we also believe that they will result in expanded distribution, card unit growth and incremental revenue gains during the coming years. We expect to incur some incremental costs associated with this expanded distribution, including upfront costs (a portion of which will be incurred in the fourth quarter) prior to any incremental revenue generated. Such costs will include, but are not limited to, fixture costs, field sales expenses and retailer allowances, as well as costs associated with implementing a new scan-based trading arrangement in one of these retailers. In total, we estimate that the foregoing factors may impact operating income during our fourth quarter ending February 28, 2011 by approximately \$7 million to \$11 million.

**Table of Contents****Results of Operations*****Three months ended November 26, 2010 and November 27, 2009***

Net income was \$32.2 million, or \$0.78 per share, in the third quarter compared to net income of \$29.7 million, or \$0.75 per share, in the prior year third quarter (all per-share amounts assume dilution).

Our results for the three months ended November 26, 2010 and November 27, 2009 are summarized below:

| <b>(Dollars in thousands)</b>                | <b>2010</b>      | <b>%<br/>Total<br/>Revenue</b> | <b>2009</b>      | <b>%<br/>Total<br/>Revenue</b> |
|--|------------------|--------------------------------|------------------|--------------------------------|
| Net sales                                    | \$ 421,990       | 98.1%                          | \$ 431,512       | 98.0%                          |
| Other revenue                                | 8,148            | 1.9%                           | 8,654            | 2.0%                           |
| <b>Total revenue</b>                         | <b>430,138</b>   | <b>100.0%</b>                  | <b>440,166</b>   | <b>100.0%</b>                  |
| Material, labor and other production costs   | 199,177          | 46.3%                          | 204,997          | 46.6%                          |
| Selling, distribution and marketing expenses | 117,314          | 27.3%                          | 124,167          | 28.2%                          |
| Administrative and general expenses          | 58,725           | 13.6%                          | 69,233           | 15.7%                          |
| Other operating income net                   | (1,048)          | (0.2%)                         | (575)            | (0.1%)                         |
| <b>Operating income</b>                      | <b>55,970</b>    | <b>13.0%</b>                   | <b>42,344</b>    | <b>9.6%</b>                    |
| Interest expense                             | 6,221            | 1.4%                           | 6,331            | 1.4%                           |
| Interest income                              | (176)            | (0.0%)                         | (299)            | (0.1%)                         |
| Other non-operating income net               | (1,618)          | (0.4%)                         | (1,827)          | (0.4%)                         |
| <b>Income before income tax expense</b>      | <b>51,543</b>    | <b>12.0%</b>                   | <b>38,139</b>    | <b>8.7%</b>                    |
| Income tax expense                           | 19,380           | 4.5%                           | 8,444            | 1.9%                           |
| <b>Net income</b>                            | <b>\$ 32,163</b> | <b>7.5%</b>                    | <b>\$ 29,695</b> | <b>6.8%</b>                    |

For the three months ended November 26, 2010, consolidated net sales were \$422.0 million, down from \$431.5 million in the prior year third quarter. This 2.2%, or approximately \$10 million, decrease was primarily the result of lower sales in our North American Social Expression Products segment of approximately \$17 million. This decrease was partially offset by increases in our International Social Expression Products segment of approximately \$4 million and in our fixtures business, included in non-reportable segments, of approximately \$2 million.

The decline in net sales of approximately \$17 million in our North American Social Expression Products segment is attributable to lower sales of party goods of approximately \$9 million due to the transaction completed in the prior year fourth quarter in which we sold certain assets, equipment and processes of the DesignWare party goods product lines, and decreased sales of gift packaging and other non-card products of approximately \$10 million. Partially offsetting these decreases was an improvement in seasonal card net sales of approximately \$2 million.

During the three months ended November 26, 2010, sales in our International Social Expression Products segment increased approximately \$4 million. This improvement was primarily driven by an increase in boxed cards associated with our Christmas program and sales of products we distribute on behalf of third parties.

Other revenue, primarily royalty revenue from our Strawberry Shortcake and Care Bears properties, decreased \$0.6 million from \$8.7 million during the three months ended November 27, 2009 to \$8.1 million for the three months ended November 26, 2010.



**Table of Contents****Wholesale Unit and Pricing Analysis for Greeting Cards**

Unit and pricing comparatives (on a sales less returns basis) for the three months ended November 26, 2010 and November 27, 2009 are summarized below:

|                                  | <b>Increase (Decrease) From the Prior Year</b> |             |                       |             |                             |             |
|----------------------------------|--|-------------|-----------------------|-------------|-----------------------------|-------------|
|                                  | <b>Everyday Cards</b>                          |             | <b>Seasonal Cards</b> |             | <b>Total Greeting Cards</b> |             |
|                                  | <b>2010</b>                                    | <b>2009</b> | <b>2010</b>           | <b>2009</b> | <b>2010</b>                 | <b>2009</b> |
| Unit volume                      | 0.4%   | 5.6%        | (5.2%)                | (5.0%)      | (1.0%)                      | 2.8%        |
| Selling prices                   | (0.6%)   | (0.9%)      | 6.8%                  | 1.8%        | 1.2%                        | (0.2%)      |
| Overall increase /<br>(decrease) | (0.2%)   | 4.6%        | 1.2%                  | (3.3%)      | 0.2%                        | 2.6%        |

During the third quarter, combined everyday and seasonal greeting card sales less returns improved 0.2% compared to the prior year quarter, including a 1.2% increase in selling prices which more than offset a 1.0% decline in unit volume. The overall increase was driven by our North American Social Expression Products segment, where improvements in seasonal card sales less returns more than offset decreases of everyday card sales less returns.

Everyday card sales less returns for the three months ended November 26, 2010 were down 0.2% compared to the prior year quarter, with increases in unit volume of 0.4% partially offsetting decreases in selling prices of 0.6%. The decrease in selling prices is primarily the result of the continued shift towards our value line cards, a trend that is likely to continue.

Seasonal card sales less returns improved 1.2% during the third quarter including 6.8% selling price improvement partially offset by a 5.2% decline in unit volume. The decrease in unit volume during the current year quarter was primarily driven by our Fall and Christmas programs.

**Expense Overview**

Material, labor and other production costs ( MLOPC ) for the three months ended November 26, 2010 were \$199.2 million, approximately \$6 million less than the prior year three months. As a percentage of total revenue, these costs were 46.3% in the current period compared to 46.6% for the three months ended November 27, 2009.

Approximately \$6 million of the decrease was attributable to cost savings as a result of the wind down of our Mexican operations during the third quarter of the prior year. Favorable volume variances, primarily driven by the party goods transaction in the prior year fourth quarter, were offset by increased product content costs.

Selling, distribution and marketing ( SDM ) expenses for the three months ended November 26, 2010 were \$117.3 million, decreasing approximately \$7 million from \$124.2 million during the prior year three months.

Approximately \$2 million of the decrease was attributable to the elimination of costs as a result of the wind down of our Mexican operations during the third quarter of the prior year. Supply chain costs decreased approximately \$5 million due to Papyrus Recycled Greetings ( PRG ) integration savings and a reduction in units shipped, specifically field sales and service operations, and distribution costs.

Administrative and general expenses were \$58.7 million for the three months ended November 26, 2010, compared to \$69.2 million for the prior year three months. The decrease of approximately \$11 million is primarily the result of reduced variable compensation expense, including bonus and profit-sharing expense of approximately \$10 million.

The prior year included additional variable compensation expense as it was probable, based on the operating results as of November 27, 2009, that we were going to exceed previously established compensation targets. This situation did not occur in the current year three months.

The effective tax rate was 37.6% and 22.1% for the three months ended November 26, 2010 and November 27, 2009, respectively. The lower than statutory effective tax rate in the prior year third quarter was primarily a result of favorable impacts of the wind down of our Mexican operations and settlements with taxing authorities in foreign jurisdictions.

**Table of Contents****Results of Operations*****Nine months ended November 26, 2010 and November 27, 2009***

Net income was \$71.5 million, or \$1.75 per share, in the nine months ended November 26, 2010 compared to net income of \$62.8 million, or \$1.59 per share, in the prior year nine months.

Our results for the nine months ended November 26, 2010 and November 27, 2009 are summarized below:

| <b>(Dollars in thousands)</b>                | <b>2010</b>      | <b>%<br/>Total<br/>Revenue</b> | <b>2009</b>      | <b>%<br/>Total<br/>Revenue</b> |
|--|------------------|--------------------------------|------------------|--------------------------------|
| Net sales                                    | \$ 1,147,434     | 98.1%                          | \$ 1,189,428     | 98.3%                          |
| Other revenue                                | 21,831           | 1.9%                           | 20,010           | 1.7%                           |
| <b>Total revenue</b>                         | <b>1,169,265</b> | <b>100.0%</b>                  | <b>1,209,438</b> | <b>100.0%</b>                  |
| Material, labor and other production costs   | 502,903          | 43.0%                          | 525,414          | 43.4%                          |
| Selling, distribution and marketing expenses | 347,183          | 29.7%                          | 373,915          | 30.9%                          |
| Administrative and general expenses          | 186,950          | 16.0%                          | 180,867          | 15.0%                          |
| Other operating (income) expense net         | (2,578)          | (0.2)%                         | 25,801           | 2.1%                           |
| <b>Operating income</b>                      | <b>134,807</b>   | <b>11.5%</b>                   | <b>103,441</b>   | <b>8.6%</b>                    |
| Interest expense                             | 19,141           | 1.6%                           | 19,989           | 1.6%                           |
| Interest income                              | (586)            | 0.0%                           | (1,564)          | (0.1)%                         |
| Other non-operating income net               | (3,321)          | (0.3)%                         | (4,160)          | (0.3)%                         |
| <b>Income before income tax expense</b>      | <b>119,573</b>   | <b>10.2%</b>                   | <b>89,176</b>    | <b>7.4%</b>                    |
| Income tax expense                           | 48,039           | 4.1%                           | 26,398           | 2.2%                           |
| <b>Net income</b>                            | <b>\$ 71,534</b> | <b>6.1%</b>                    | <b>\$ 62,778</b> | <b>5.2%</b>                    |

For the nine months ended November 26, 2010, consolidated net sales were \$1.15 billion, down from \$1.19 billion in the prior year nine months. This 3.5%, or approximately \$42 million, decline was primarily the result of decreased net sales in our North American Social Expression Products segment and our Retail Operations segment of approximately \$50 million and \$12 million, respectively. These decreases were partially offset by higher net sales in our fixtures business and in our International Social Expression Products segment of approximately \$7 million and \$6 million, respectively. Foreign currency translation also favorably impacted net sales by approximately \$7 million.

Net sales in our North American Social Expression Products segment decreased approximately \$50 million. This decrease is attributable to lower sales of party goods of approximately \$26 million, gift packaging and other non-card products of approximately \$20 million, and everyday cards of approximately \$5 million. Net sales of party goods decreased due to the transaction completed in the prior year fourth quarter.

Net sales in our Retail Operations segment decreased approximately \$12 million due to the sale of our retail store assets in April 2009. There were no net sales in our Retail Operation segment during the nine months ended November 26, 2010.

The increase in our International Social Expression Products segment's net sales of approximately \$6 million was driven by our United Kingdom ( U.K. ) operations where boxed cards associated with our Christmas program and sales of products we distribute on behalf of third parties, have been favorable.

Other revenue, primarily royalty revenue from our Strawberry Shortcake and Care Bears properties, increased \$1.8 million from \$20.0 million during the nine months ended November 27, 2009 to \$21.8 million for the nine months ended November 26, 2010.

**Table of Contents****Wholesale Unit and Pricing Analysis for Greeting Cards**

Unit and pricing comparatives (on a sales less returns basis) for the nine months ended November 26, 2010 and November 27, 2009 are summarized below:

|                               | Increase (Decrease) From the Prior Year |      |                |      |                      |      |
|-------------------------------|---|------|----------------|------|----------------------|------|
|                               | Everyday Cards                          |      | Seasonal Cards |      | Total Greeting Cards |      |
|                               | 2010                                    | 2009 | 2010           | 2009 | 2010                 | 2009 |
| Unit volume                   | (0.8%)                                  | 5.2% | (1.2%)         | 1.1% | (0.9%)               | 4.1% |
| Selling prices                | (0.6%)                                  | 1.1% | 1.6%           | 2.2% | 0.0%                 | 1.4% |
| Overall increase / (decrease) | (1.4%)                                  | 6.4% | 0.3%           | 3.3% | (0.9%)               | 5.5% |

During the nine months ended November 26, 2010, combined everyday and seasonal greeting card sales less returns declined 0.9%, compared to the prior year nine months, driven by a decrease in everyday card sales less returns of 1.4%. The overall decrease was driven by our North American Social Expression Products segment, where decreases of everyday card sales less returns continues to more than offset improvements in seasonal card sales less returns. Everyday card sales less returns were down 1.4%, compared to the prior year nine months, including decreases in both unit volume and selling prices of 0.8% and 0.6%, respectively. A decline in selling prices across our two Social Expression Products segments was driven by the continued shift to a higher mix of value line cards, which more than offset the pricing and mix benefits related to the prior year acquisitions. In addition, both of our Social Expression Products segments contributed to the decreased unit volume during the current year quarter.

Seasonal card sales less returns increased 0.3%, with improved selling prices of 1.6% offsetting a decline in unit volume of 1.2% compared to the prior year nine months. The selling price improvement was driven primarily by our prior year acquisitions.

**Expense Overview**

MLOPC for the nine months ended November 26, 2010 were \$502.9 million, a decrease of approximately \$23 million from \$525.4 million for the comparable period in the prior year. As a percentage of total revenue, these costs were 43.0% in the current period compared to 43.4% for the nine months ended November 27, 2009. Approximately \$5 million and \$8 million of the decrease was due to the elimination of operating costs as a result of the divestiture of the retail store operations and the wind down of our Mexican operations in the prior year, respectively. The remaining approximately \$10 million decrease was due to favorable volume variances as a result of a combination of the party goods transaction in the prior year fourth quarter and lower net sales of our gift packaging products. In addition, lower inventory scrap expense in the quarter was offset by higher product content costs.

SDM expenses for the nine months ended November 26, 2010 were \$347.2 million, decreasing from \$373.9 million for the comparable period in the prior year. The decrease of almost \$27 million is due to lower spending of approximately \$29 million and unfavorable foreign currency translation of approximately \$2 million. The elimination of operating costs due to the disposition of our retail stores and the wind down of our Mexican operations, which both occurred in the prior year, accounted for approximately \$12 million and \$4 million, respectively, of the decrease in the current year nine months. Lower supply chain costs, specifically field sales and service operations costs of approximately \$13 million, and freight and distribution costs of approximately \$4 million were the result of PRG integration savings and a reduction in units shipped during the current year nine months. These reductions were partially offset by higher marketing and product management costs of approximately \$4 million.

Administrative and general expenses were \$187.0 million for the nine months ended November 26, 2010, an increase from \$180.9 million for the nine months ended November 27, 2009. The increase of approximately \$6 million is primarily related to continued PRG integration costs of approximately \$8 million, and increased stock

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compensation expense of approximately \$6 million. In addition, the prior year included a benefit of approximately \$8 million related to corporate owned life insurance, which did not recur in the current year nine months. These increases were partially offset by reduced variable compensation expenses of approximately \$10 million, the elimination of costs associated with our retail store operations of approximately \$2 million, and lower expenses related to our post retirement benefit plan of approximately \$3 million.

Other operating (income) expense net was income of \$2.6 million for the nine months ended November 26, 2010 compared to expense of \$25.8 million in the prior period. The prior year nine months included a loss of \$28.3 million on the sale of our retail stores to Schurman and a gain of \$0.5 million on the sale of our calendar product lines.

Interest expense for the nine months ended November 26, 2010 was \$19.1 million, down from \$20.0 million in the prior year period. The decrease of \$0.9 million is primarily attributable to interest savings resulting from the \$99.3 million repayment of our term loan, previously outstanding under our senior secured credit facility.

The effective tax rate was 40.2% and 29.6% for the nine months ended November 26, 2010 and November 27, 2009, respectively. The higher than statutory rate in the current nine months is due primarily to the impact of unfavorable settlements of audits in a foreign jurisdiction, the release of insurance reserves that generated taxable income as well as the recognition of the deferred tax effects of the reduced deductibility of postretirement prescription drug coverage due to the recently enacted U.S. Patient Protection and Affordable Care Act. The lower than statutory rate in the prior year nine months is primarily a result of favorable impacts of the wind down of our Mexican operations and settlements with taxing authorities in foreign jurisdictions.

**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 Accounting Standards Codification Topic 280, Segment Reporting, 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. The AG Interactive segment 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. The AG Interactive segment also offers online photo sharing 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, including the evaluation of management performance, using consistent exchange rates between years to eliminate the impact of foreign currency fluctuations from operating performance. The 2011 segment results below are presented using our planned foreign exchange rates, which were set at the beginning of the year. For a consistent presentation, 2010 segment results have been recast to reflect the 2011 foreign exchange rates. Refer to Note 14, Business Segment Information, to the Consolidated Financial Statements for further information and a reconciliation of total segment revenue to consolidated Total revenue and total segment earnings (loss) to consolidated Income before income tax expense.

*North American Social Expression Products Segment*

| (Dollars in thousands) | Three Months Ended |           |        | Nine Months Ended |           |        |
|------------------------|--------------------|-----------|--------|-------------------|-----------|--------|
|                        | November           |           | %      | November          |           | %      |
|                        | 26, 2010           | 27, 2009  | Change | 26, 2010          | 27, 2009  | Change |
| Total revenue          | \$312,773          | \$329,869 | (5.2%) | \$865,664         | \$915,464 | (5.4%) |
| Segment earnings       | 54,277             | 46,675    | 16.3%  | 155,997           | 163,930   | (4.8%) |

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Total revenue of our North American Social Expression Products segment, excluding the impact of foreign exchange and intersegment items, decreased \$17.1 million and \$49.8 million for the three and nine months ended November 26, 2010, respectively, compared to the prior year periods. The main driver of this decline in both periods was the lower sales of party goods, which decreased approximately \$9 million and \$26 million for the current year three and nine months, respectively, primarily due to the transaction completed in the prior year fourth quarter. Also contributing to the decline was a decrease in gift packaging and other non-card products during the three and nine month periods of approximately \$10 million and \$20 million, respectively. Our seasonal card sales improved by over \$2 million during the current year three months while everyday card sales declined almost \$5 million during the nine months ended November 26, 2010.

Segment earnings, excluding the impact of foreign exchange and intersegment items, increased \$7.6 million in the current year three months compared to the prior year period. The increase is primarily driven by the elimination of operating costs due to the wind down of our Mexican operations during the prior year third quarter. The remaining increase in earnings was a result of a combination of lower variable compensation costs, and reduced supply chain costs driven by both PRG integration savings and a reduction in units shipped, specifically field sales and service operations, and distribution costs, partially offset by the gross margin impact of lower sales due to the party goods transaction in the prior year fourth quarter. During the nine months ended November 26, 2010, segment earnings, excluding the impact of foreign exchange and intersegment items, decreased \$7.9 million. This decrease was primarily driven by the gross margin impact of lower sales volume due to the party goods transaction in the prior year fourth quarter and lower sales of gift packaging and other non-card products compared to the prior year nine months. In addition, continued integration costs associated with our recent acquisitions of RPG and the Papyrus trademark and wholesale division of Schurman had an unfavorable impact on earnings. Partially offsetting these unfavorable items were reduced supply chain costs, specifically field sales and service operations as a result of savings achieved through PRG integration efforts and a reduction in units shipped, reduced variable compensation costs and the elimination of operating costs due to the wind down of our Mexican operations during the prior year third quarter.

*International Social Expression Products Segment*

| (Dollars in thousands) | Three Months Ended |           |        | Nine Months Ended |            |        |
|------------------------|--------------------|-----------|--------|-------------------|------------|--------|
|                        | November           |           | %      | November          |            | %      |
|                        | 26, 2010           | 27, 2009  | Change | 26, 2010          | 27, 2009   | Change |
| Total revenue          | \$ 77,601          | \$ 73,972 | 4.9%   | \$ 190,364        | \$ 184,613 | 3.1%   |
| Segment earnings       | 10,001             | 9,404     | 6.3%   | 14,196            | 12,227     | 16.1%  |

Total revenue of our International Social Expression Products segment, excluding the impact of foreign exchange, increased \$3.6 million and \$5.8 million for the three and nine months ended November 26, 2010, respectively, compared to the prior year periods. The increase in both periods was primarily driven by an increase in boxed cards associated with our Christmas program and sales of products we distribute on behalf of third parties.

Segment earnings, excluding the impact of foreign exchange, increased \$0.6 million, or 6.3%, from the prior year quarter to \$10.0 million in the current quarter. The increase in the current year three months was driven by a combination of higher sales and lower inventory scrap expense partially offset by higher product costs. Segment earnings, excluding the impact of foreign exchange, increased \$2.0 million in the nine months ended November 26, 2010 compared to the prior year nine months. This increase was attributable to higher sales, reduced inventory scrap expense, and savings realized as a result of prior year cost reduction initiatives, partially offset by higher product costs.

*Retail Operations Segment*

| (Dollars in thousands) | Three Months Ended |          |        | Nine Months Ended |           |        |
|------------------------|--------------------|----------|--------|-------------------|-----------|--------|
|                        | November           |          | %      | November          |           | %      |
|                        | 26, 2010           | 27, 2009 | Change | 26, 2010          | 27, 2009  | Change |
| Total revenue          | \$                 | \$       |        | \$                | \$ 11,727 | (100%) |

|              |    |          |      |
|--------------|----|----------|------|
| Segment loss | 22 | (34,830) | 100% |
|--------------|----|----------|------|

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In April 2009, we sold our retail store assets to Schurman. As a result, there was no activity in the Retail Operations segment during the nine months ended November 26, 2010. The prior year results included the loss on disposition of the segment of approximately \$28 million.

*AG Interactive Segment*

| (Dollars in thousands) | Three Months Ended |           |        | Nine Months Ended |           |        |
|------------------------|--------------------|-----------|--------|-------------------|-----------|--------|
|                        | November           |           | %      | November          |           | %      |
|                        | 26, 2010           | 27, 2009  | Change | 26, 2010          | 27, 2009  | Change |
| Total revenue          | \$ 19,234          | \$ 19,393 | (0.8%) | \$ 56,160         | \$ 56,743 | (1.0%) |
| Segment earnings       | 5,134              | 1,510     | 240.0% | 10,553            | 5,209     | 102.6% |

Total revenue of our AG Interactive segment for the three months ended November 26, 2010, excluding the impact of foreign exchange, was \$19.2 million compared to \$19.4 million in the prior year third quarter. Total revenue of our AG Interactive segment for the nine months ended November 26, 2010, excluding the impact of foreign exchange, was \$56.2 million compared to \$56.7 million in the prior year nine months. While revenues were relatively flat in both periods, there has been a shift in the mix of revenue sources. During the three months ended November 26, 2010, decreased subscription revenue in our online product group and search revenue was offset by higher revenue from new product introductions. For the nine months ended November 26, 2010, we experienced lower subscription revenue in our online product group and e-commerce revenue in our digital photography product group compared to prior year periods, which were substantially offset by higher revenue from advertising and new product introductions. At the end of the third quarter of 2011, AG Interactive had approximately 3.8 million online paid subscriptions versus 3.9 million at the prior year third quarter end.

Segment earnings, excluding the impact of foreign exchange, increased \$3.6 million during the quarter ended November 26, 2010 compared to the prior year quarter. Segment earnings, excluding the impact of foreign exchange, increased \$5.3 million in the nine months ended November 26, 2010. The increase in both the three and nine month periods ended November 26, 2010 compared to the prior year periods was driven by the continued decrease in overhead expenses and technology costs. In addition, marketing expenses were down in the current year quarter compared to the prior year quarter.

**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 November 27, 2009, has been included.

**Operating Activities**

Operating activities provided \$57.7 million of cash during the nine months ended November 26, 2010, compared to \$74.2 million in the prior year period.

Accounts receivable used \$71.3 million of cash during the nine months ended November 26, 2010, compared to \$124.2 million of cash during the prior year period. The improvement in cash flow in the current year was the result of a higher accounts receivable balance at February 28, 2010 as compared to February 28, 2009. As disclosed with our results for the year ended February 28, 2010, the increased balance was partially due to higher sales in the fourth quarter and the timing of collections from certain customers compared to the prior year. These amounts were collected during the nine months ended November 26, 2010, bringing the accounts receivable balance back to a level more consistent with prior periods, thus resulting in less cash usage for the period.

Inventory used \$16.5 million of cash from February 28, 2010, compared to providing \$16.7 million in the prior year nine months. Historically, the first nine months of our fiscal year is a period of inventory build, and thus a use of cash, in preparation for the winter seasonal holidays. Continued efforts to improve inventory planning and management have resulted in less cash usage during the nine months ended November 26, 2010 than in our

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historically typical nine-month period. The prior year nine months period was an anomaly to historical trends, with inventory providing a source of cash. During the prior year, everyday inventory declined substantially through improved inventory planning and management efforts as well as the continued decline in demand of the seasonal gift packaging product line.

Other current assets used \$0.7 million of cash during the nine months ended November 26, 2010, compared to providing \$16.9 million in the prior year nine months. The prior year cash generation is attributable to the use of trust assets to fund active medical claim expenses.

Deferred costs net generally represents payments under agreements with retailers net of the related amortization of those payments. During the nine months ended November 26, 2010, amortization exceeded payments by \$19.4 million; in the nine months ended November 27, 2009, amortization exceeded payments by \$1.9 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 \$31.5 million of cash during the nine months ended November 26, 2010, compared to \$10.6 million in the prior year period. The change was attributable primarily to the difference in variable compensation payments in the nine months ended November 26, 2010 compared to the nine months ended November 27, 2009. The current year nine months includes the payment of variable compensation from the year ended February 28, 2010 where we exceeded our established compensation targets, thus a large use of cash in the current year period. In the prior year, the nine months included minimal cash payments related to the year ended February 28, 2009, as compensation targets were not met.

**Investing Activities**

Investing activities provided \$9.3 million of cash during the nine months ended November 26, 2010, compared to using \$35.1 million in the prior year period. The source of cash in the current nine months was primarily related to \$25.2 million received for the sale of certain assets, equipment and processes of the DesignWare party goods product lines in conjunction with the transaction completed in the prior year fourth quarter. This cash was held in escrow at February 28, 2010. In addition, we received approximately \$2 million related to the sale of the land and buildings associated with the closure of our Mexico facility during the current period. Partially offsetting these sources of cash in the current period were cash payments for capital expenditures of \$19.7 million.

The use of cash in the prior period is related to cash payments for business acquisitions as well as capital expenditures of \$21.4 million. During fiscal 2010, we acquired the Papyrus brand and its related wholesale business division from Schurman. At the same time, we sold the assets of our Retail Operations segment to Schurman and acquired an equity interest in Schurman. Cash paid, net of cash acquired, was \$14.0 million. Also, in fiscal 2010, we paid \$5.3 million of acquisition costs related to RPG, which we acquired in the fourth quarter of 2009. Partially offsetting these uses of cash were proceeds of \$4.7 million from the sale of our calendar and candy product lines.

**Financing Activities**

Financing activities used \$112.8 million of cash during the current year nine months, compared to \$57.1 million during the prior year. The current year use of cash relates primarily to the repayment of the term loan in the amount of \$99.3 million as well as share repurchases and dividend payments. During the nine months ended November 26, 2010, we paid \$13.4 million to repurchase approximately 0.5 million Class B common shares in accordance with our Amended and Restated Articles of Incorporation and we paid cash dividends of \$16.7 million. Partially offsetting these uses of cash was our receipt of the exercise price on stock options, which provided \$19.8 million of cash during the current year nine months.

The prior year use of cash relates primarily to net repayments of long-term debt borrowings of \$34.6 million as well as share repurchases and dividend payments. During the nine months ended November 27, 2009, \$5.8 million was paid to repurchase approximately 1.5 million Class A common shares under our repurchase program. In addition to

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the repurchases under the Class A common share repurchase program, \$6.0 million was paid to repurchase approximately 0.3 million Class B common shares in accordance with our Amended and Restated Articles of Incorporation. We paid \$14.3 million for dividends, which were declared in February 2009, June 2009 and September 2009.

**Credit Sources**

Substantial credit sources are available to us. In total, we had available sources of approximately \$430 million at November 26, 2010. This included our \$350 million senior secured credit facility and our \$80 million accounts receivable securitization facility. Borrowings under the accounts receivable securitization facility are limited based on our eligible receivables outstanding. At November 26, 2010, we had no borrowings outstanding under the accounts receivable securitization facility or the revolving credit facility. At November 26, 2010, we had, in the aggregate, \$45.9 million outstanding under letters of credit, which reduces the total credit availability under these facilities. 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 28, 2010 for further information.

On June 11, 2010, we amended and restated our senior secured credit facility by entering into an Amended and Restated Credit Agreement (the Amended and Restated Credit Agreement ) among various lending institutions. Pursuant to the terms of the Amended and Restated Credit Agreement, we may continue to borrow, repay and re-borrow up to \$350 million under the revolving credit facility, with the ability to increase the size of the facility to up to \$400 million, subject to customary conditions. The Amended and Restated Credit Agreement also continues to provide for a \$25 million sub-limit for the issuance of swing line loans and a \$100 million sub-limit for the issuance of letters of credit.

The obligations under the Amended and Restated Credit Agreement continue to be guaranteed by our material domestic subsidiaries and continue to be secured by substantially all of our personal property and our material domestic subsidiaries, including a pledge of all of the capital stock in substantially all of our domestic subsidiaries and 65% of the capital stock of our first tier international subsidiaries. The Amended and Restated Credit Agreement, including revolving loans thereunder, will mature on June 11, 2015. In connection with the Amended and Restated Credit Agreement, the term loan under the original credit facility was terminated and we repaid the full \$99 million outstanding under the term loan using cash on hand. The proceeds of the borrowings under the Amended and Restated Credit Agreement may be used to provide working capital and for other general corporate purposes.

Revolving loans that are denominated in U.S. dollars will bear interest at either the U.S. base rate or the London Inter-Bank Offer Rate, at our election, plus a margin determined according to our leverage ratio. Swing line loans will bear interest at a quoted rate agreed upon by us and the swing line lender. In addition to interest, we are required to pay commitment fees on the unused portion of the revolving credit facility. The commitment fee rate is initially 0.50% per annum and is subject to adjustment thereafter based on our leverage ratio.

The Amended and Restated Credit Agreement contains certain restrictive covenants that are customary for similar credit arrangements, including covenants relating to limitations on liens, dispositions, issuance of debt, investments, payment of dividends, repurchases of capital stock, acquisitions and transactions with affiliates. There are also financial performance covenants that require us to maintain a maximum leverage ratio and a minimum interest coverage ratio. The Amended and Restated Credit Agreement also requires us to make certain mandatory prepayments of outstanding indebtedness using the net cash proceeds received from certain dispositions, events of loss and additional indebtedness that we incur.

We are also party to an amended and restated receivables purchase agreement. The agreement has available financing of up to \$80 million. The maturity date of the agreement is September 21, 2012, however, the agreement will terminate upon termination of the liquidity commitments obtained by the purchaser groups from third party liquidity providers. Such commitments may be made available to the purchaser groups for 364-day periods only (initial 364-day period began on September 23, 2009), and there can be no assurances that the third party liquidity

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providers will renew or extend their commitments under the receivables purchase agreement. If that is the case, the receivables purchase agreement will terminate and we will not receive the benefit of the entire three-year term of the agreement. On September 22, 2010, the liquidity commitments were renewed for an additional 364-day period. At November 26, 2010, we were in compliance with our financial covenants under the borrowing agreements described above.

Throughout fiscal 2011, we will continue to consider all options for capital deployment including growth options, capital expenditures, the opportunity to repurchase our own shares, reducing debt or, as appropriate, preserving cash. Consistent with this ongoing objective, as announced in January 2009, our Board of Directors has authorized the repurchase of up to \$75 million of Class A common shares (\$46.6 million remaining at November 26, 2010), that may be made through open market purchases or privately negotiated transactions as market conditions warrant, at prices we deem appropriate, and subject to applicable legal requirements and other factors. There is no set expiration date for this program. We also may, from time to time, seek to retire or purchase our outstanding debt through cash purchases and/or exchanges, in open market purchases, privately negotiated transactions or otherwise, including strategically repurchasing our 7.375% senior unsecured notes due in 2016. Such repurchases or exchanges, if any, will depend on prevailing market conditions, our liquidity requirements, contractual restrictions and other factors. The amounts involved may be material.

Over the next five to seven years we expect to allocate resources, including capital, to refresh our information technology systems by modernizing our systems, redesigning and deploying new processes, and evolving new organization structures all intended to drive efficiencies within the business and add new capabilities. Because we are in the early stages of this project, currently we cannot reasonably estimate amounts that we will spend on this project, but amounts could be material in a given fiscal year and over the life of the project. In addition, as described in Notes 1 and 10 to the Consolidated Financial Statements included in Part I of this report, in connection with our sale of certain of the assets of our Retail Operations segment to Schurman, we remain subject to a number of Schurman's retail store leases on a contingent basis through our subleases, and have provided Schurman credit support, including \$24 million of guarantees of amounts that may from time to time be owed by Schurman to the lenders under its senior revolving credit facility. As a result, we may decide to provide Schurman with additional financial support, either through credit arrangements, operational support or otherwise. The form and amount of any such support are not presently determinable, however, such amounts could be material.

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 our business results in peak working capital requirements that may be financed through short-term borrowings when cash on hand is insufficient.

**Critical Accounting Policies**

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods presented. 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 28, 2010.

**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

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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 and general economic conditions;

competitive terms of sale offered to customers;

our successful transition of the Retail Operations segment to its buyer, Schurman, and Schurman's ability to successfully operate its retail operations and satisfy its obligations to us;

retail consolidations, acquisitions and bankruptcies, including the possibility of resulting adverse changes to retail contract terms;

the ability to achieve the desired benefits associated with our cost reduction efforts;

the timing and impact of converting customers to a scan-based trading model;

our ability to successfully integrate both Recycled Paper Greetings and Papyrus;

the ability to achieve both the desired benefits from the party goods transaction as well as ensuring a seamless transition for affected retail customers and consumers;

our ability to successfully implement, or achieve the desired benefits associated with, any information systems refresh we may implement;

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;

escalation in the cost of providing employee health care;

the ability to achieve the desired accretive effect from any share repurchase programs;

the ability to comply with our debt covenants;

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.

Risks pertaining specifically to AG Interactive include the viability of online advertising, subscriptions as revenue generators, and the ability to adapt to rapidly changing social media and 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 28, 2010.

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

For further information, refer to our Annual Report on Form 10-K for the fiscal year ended February 28, 2010. There were no material changes in market risk, specifically interest rate and foreign currency exposure, for us from February 28, 2010, the end of our preceding fiscal year, to November 26, 2010, the end of our most recent fiscal quarter.

**Table of Contents****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.

**PART II OTHER INFORMATION****Item 1. Legal Proceedings**

**Electrical Workers Pension Fund, Local 103, I.B.E.W. Litigation.** As previously disclosed, on March 20, 2009, a shareholder derivative complaint was filed in the Court of Common Pleas of Cuyahoga County, Ohio, by the Electrical Workers Pension Fund, Local 103, I.B.E.W., against certain of our current and former officers and directors (the Individual Defendants) and names American Greetings Corporation as a nominal defendant. The suit alleges that the Individual Defendants breached their fiduciary duties to American Greetings Corporation by, among other things, backdating stock options granted to our officers and directors, accepting backdated options and causing American Greetings Corporation to file false and misleading financial statements. The suit seeks an unspecified amount of damages from the Individual Defendants and modifications to our corporate governance policies. On April 16, 2009, the Individual Defendants removed the matter to the United States District Court for the Northern District of Ohio, Eastern Division. On February 17, 2010, the case was remanded to state court. The defendants then moved to transfer the matter to the commercial docket, but their motion and subsequent appeal were denied. On April 2, 2010, the defendants filed a writ of mandamus to the Supreme Court of Ohio, seeking to have the matter heard by the commercial docket. On December 1, 2010, the Supreme Court of Ohio denied the writ, thereby requiring the case to be heard by the non-commercial, civil court in the Cuyahoga County Court of Common Pleas. Management continues to believe the allegations made in the complaint are without merit and continues to vigorously defend this action. We currently do not believe that the impact of this lawsuit, if any, will have a material adverse effect on our financial position, liquidity or results of operations. We currently believe that any liability will be covered by insurance coverage available with financially viable insurance companies, subject to self-insurance retentions and customary exclusions, conditions, coverage gaps, and policy limits, as well as insurer solvency.

**Cookie Jar/MoonScoop Litigation.** As previously disclosed, on May 6, 2009, American Greetings Corporation and its subsidiary, Those Characters From Cleveland, Inc. (TCFC), filed an action in the Cuyahoga County (Ohio) Court of Common Pleas against Cookie Jar Entertainment Inc. (Cookie Jar) and its affiliates, Cookie Jar Entertainment (USA) Inc. (formerly known as DIC Entertainment Corporation) (DIC), and Cookie Jar Entertainment Holdings (USA) Inc. (formerly known as DIC Entertainment Holdings, Inc.) relating to the July 20, 2008 Binding Letter Agreement between American Greetings Corporation and Cookie Jar (the Cookie Jar Agreement) for the sale of the Strawberry Shortcake and Care Bears properties (the Properties). On May 7, 2009, Cookie Jar removed the case to the United States District Court for the Northern District of Ohio. Simultaneously, Cookie Jar filed an action against American Greetings Corporation, TCFC, Mike Young Productions, LLC (Mike Young Productions) and MoonScoop SAS (MoonScoop) in the Supreme Court of the



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State of New York, County of New York. Mike Young Productions and MoonScoop were named as defendants in the action in connection with the binding term sheet between American Greetings Corporation and MoonScoop dated March 24, 2009 (the MoonScoop Binding Agreement ), providing for the sale to MoonScoop of the Properties. On May 7, 2010, the legal proceedings involving American Greetings Corporation, TCFC, Cookie Jar and DIC were settled. As part of the settlement, on May 7, 2010, the Cookie Jar Agreement was amended to, among other things, terminate American Greetings Corporation's obligation to sell to Cookie Jar, and Cookie Jar's obligation to purchase, the Properties. As part of the settlement, Cookie Jar Entertainment (USA) Inc. will continue to represent the Strawberry Shortcake property on behalf of American Greetings Corporation, and will become an international agent for the Care Bears property. On May 19, 2010, the Northern District of Ohio court granted the parties' joint motion to dismiss all claims and counterclaims without prejudice.

On August 11, 2009, MoonScoop filed an action against American Greetings Corporation and TCFC in the United States District Court for the Northern District of Ohio, alleging breach of contract and promissory estoppel relating to the MoonScoop Binding Agreement. On MoonScoop's request, the court agreed to consolidate this lawsuit with the first Ohio lawsuit (described above) for all pretrial purposes. The parties filed motions for summary judgment on various claims. On April 27, 2010, the court granted American Greetings Corporation's motion for summary judgment on MoonScoop's breach of contract and promissory estoppel claims, dismissing these claims with prejudice. On the same day, the court also ruled that American Greetings Corporation must indemnify MoonScoop against Cookie Jar's claims in this lawsuit. On May 21, 2010, MoonScoop appealed the court's summary judgment ruling. On June 4, 2010, American Greetings Corporation and TCFC appealed the court's ruling that it must indemnify MoonScoop against the cross claims asserted against it. We believe that the allegations in the lawsuit against American Greetings Corporation and TCFC are without merit and intend to continue to defend the actions vigorously. We currently do not believe that the impact of the lawsuit against American Greetings Corporation and TCFC, if any, will have a material adverse effect on our financial position, liquidity or results of operations.

In addition to the foregoing, we are involved in certain legal proceedings arising in the ordinary course of business. We, however, do not believe that any of the other 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 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 November 26, 2010.

| Period         | Total Number of<br>Shares<br>Repurchased | Average<br>Price Paid<br>per Share | Total Number<br>of<br>Shares<br>Purchased as<br>Part of Publicly<br>Announced<br>Plans | Maximum Number<br>of<br>Shares (or<br>Approximate Dollar<br>Value) that May Yet<br>Be<br>Purchased Under the<br>Plans |
|----------------|--|------------------------------------|--|---|
|                |  |                                    |  |   |
| September 2010 | Class A (1)                              |                                    |  | \$ 46,578,874   |
|                | Class B 18,437 (2)                       | \$20.66                            |  |   |

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|               |         |            |         |               |
|---------------|---------|------------|---------|---------------|
| October 2010  | Class A | (1)        |         | \$ 46,578,874 |
|               | Class B | (2)        |         |               |
| November 2010 | Class A | (1)        |         | \$ 46,578,874 |
|               | Class B | 324 (2)    | \$19.09 |               |
| Total         | Class A | (1)        |         |               |
|               | Class B | 18,761 (2) |         |               |
|               |         |            | 29      |               |

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- (1) On January 13, 2009, American Greetings announced that its Board of Directors authorized a program to repurchase up to \$75 million of its Class A common shares. There is no set expiration date for this repurchase program. No repurchases were made in the current quarter under this program.
- (2) 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. It is the Corporation's general policy to repurchase Class B common shares, in accordance with the terms set forth in our Amended and Restated Articles of Incorporation, whenever they are offered by a holder, unless such repurchase is not otherwise permitted under agreements to which the Corporation is a party. All of the shares were repurchased by American Greetings for cash pursuant to this right of first refusal.

**Item 6. Exhibits**

Exhibits required by Item 601 of Regulation S-K

| <b>Exhibit<br/>Number</b> | <b>Description</b>   |
|---------------------------|--|
| (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   |
| 101                       | Financial statements from the quarterly report on Form 10-Q of American Greetings Corporation for the quarter ended November 26, 2010, filed on January 5, 2011, formatted in (Extensible Business Reporting Language) XBRL: (i) the Consolidated Statement of Income, (ii) the Consolidated Statement of Financial Position, (iii) the Consolidated Statement of Cash Flows and (iv) the Notes to the Consolidated Financial Statements tagged as blocks of text. |

In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section, and shall not be part of any registration statement or other document filed under the Securities Act of 1933 or the Securities Exchange Act of 1934, as amended, except as shall be expressly set forth by specific reference in such filing.

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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 and Chief Accounting  
Officer \*

January 5, 2011

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