

AMERICAN GREETINGS CORP

Form 10-Q

July 05, 2007

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q**

(Mark One)

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

For the quarterly period ended May 25, 2007

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

Large accelerated filer Accelerated filer Non-accelerated filer

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 June 29, 2007, the number of shares outstanding of each of the issuer's classes of common stock was:

| | |
|----------------|------------|
| Class A Common | 51,352,831 |
| Class B Common | 4,291,159 |

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AMERICAN GREETINGS CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF INCOME
(Thousands of dollars except share and per share amounts)

| | (Unaudited) | |
|---|---------------------------|---------------------|
| | Three Months Ended | |
| | May 25, | May 26, 2006 |
| | 2007 | 2006 |
| Net sales | \$ 418,013 | \$ 404,170 |
| Costs and expenses: | | |
| Material, labor and other production costs | 161,128 | 175,237 |
| Selling, distribution and marketing | 140,691 | 142,580 |
| Administrative and general | 61,871 | 61,348 |
| Interest expense | 4,757 | 12,464 |
| Other income net | (5,347) | (6,860) |
| | 363,100 | 384,769 |
| Income from continuing operations before income tax expense | 54,913 | 19,401 |
| Income tax expense | 24,291 | 2,851 |
| Income from continuing operations | 30,622 | 16,550 |
| Loss from discontinued operations, net of tax | (572) | (1,158) |
| Net income | \$ 30,050 | \$ 15,392 |
| Earnings per share basic: | | |
| Income from continuing operations | \$ 0.55 | \$ 0.28 |
| Loss from discontinued operations | (0.01) | (0.02) |
| Net income | \$ 0.54 | \$ 0.26 |
| Earnings per share assuming dilution: | | |
| Income from continuing operations | \$ 0.55 | \$ 0.26 |
| Loss from discontinued operations | (0.01) | (0.02) |
| Net income | \$ 0.54 | \$ 0.24 |
| Average number of shares outstanding | 55,262,716 | 58,137,230 |

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| | | |
|--|------------|------------|
| Average number of shares outstanding assuming dilution | 55,650,033 | 71,077,312 |
| Dividends declared per share | \$ 0.10 | \$ 0.08 |

See notes to condensed consolidated financial statements (unaudited).

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

| | (Unaudited) May 25, 2007 | (Note 1) February 28, 2007 | (Unaudited) May 26, 2006 |
|---|--------------------------------|----------------------------------|--------------------------------|
| ASSETS | | | |
| Current assets | | | |
| Cash and cash equivalents | \$ 132,582 | \$ 144,713 | \$ 205,468 |
| Short-term investments | 28,325 | | 83,100 |
| Trade accounts receivable, net | 119,145 | 103,992 | 124,885 |
| Inventories | 192,399 | 182,618 | 233,155 |
| Deferred and refundable income taxes | 76,892 | 135,379 | 163,051 |
| Assets of businesses held for sale | 2,507 | 5,199 | 23,621 |
| Prepaid expenses and other | 215,867 | 227,380 | 211,354 |
| Total current assets | 767,717 | 799,281 | 1,044,634 |
| Goodwill | 225,318 | 224,105 | 206,137 |
| Other assets | 397,567 | 416,887 | 527,630 |
| Deferred and refundable income taxes | 102,060 | 52,869 | |
| Property, plant and equipment at cost | 947,156 | 944,534 | 965,588 |
| Less accumulated depreciation | 666,651 | 659,462 | 661,383 |
| Property, plant and equipment net | 280,505 | 285,072 | 304,205 |
| | \$ 1,773,167 | \$ 1,778,214 | \$ 2,082,606 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | | |
| Current liabilities | | | |
| Debt due within one year | \$ | \$ | \$ 159,122 |
| Accounts payable | 100,914 | 118,204 | 124,789 |
| Accrued liabilities | 77,837 | 80,389 | 72,781 |
| Accrued compensation and benefits | 43,656 | 61,192 | 45,056 |
| Income taxes | 29,878 | 26,385 | 27,036 |
| Liabilities of businesses held for sale | 1,253 | 1,932 | 3,697 |
| Other current liabilities | 84,622 | 84,898 | 94,324 |
| Total current liabilities | 338,160 | 373,000 | 526,805 |
| Long-term debt | 223,800 | 223,915 | 239,838 |
| Other liabilities | 146,384 | 162,410 | 98,729 |
| Deferred income taxes and noncurrent income taxes payable | 27,184 | 6,315 | 25,041 |

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| | | | |
|---|--------------|--------------|--------------|
| Shareholders' equity | | | |
| Common shares - Class A | 51,148 | 50,839 | 53,386 |
| Common shares - Class B | 4,340 | 4,283 | 4,225 |
| Capital in excess of par value | 424,201 | 414,859 | 401,644 |
| Treasury stock | (712,147) | (710,414) | (732,890) |
| Accumulated other comprehensive income (loss) | 6,030 | (1,013) | 23,952 |
| Retained earnings | 1,264,067 | 1,254,020 | 1,441,876 |
| Total shareholders' equity | 1,037,639 | 1,012,574 | 1,192,193 |
| | \$ 1,773,167 | \$ 1,778,214 | \$ 2,082,606 |

See notes to condensed consolidated financial statements (unaudited).

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

| | (Unaudited) | |
|--|--------------------|------------------|
| | Three Months Ended | |
| | May 25, 2007 | May 26, 2006 |
| OPERATING ACTIVITIES: | | |
| Net income | \$ 30,050 | \$ 15,392 |
| Loss from discontinued operations | 572 | 1,158 |
| Income from continuing operations | 30,622 | 16,550 |
| Adjustments to reconcile to net cash provided by operating activities: | | |
| Net gain on disposal of fixed assets | (116) | (79) |
| Loss on extinguishment of debt | | 4,963 |
| Depreciation and amortization | 11,989 | 11,764 |
| Deferred income taxes | 4,466 | (1,934) |
| Other non-cash charges | 1,979 | 3,926 |
| Changes in operating assets and liabilities, net of acquisitions and dispositions: | | |
| (Increase) decrease in trade accounts receivable | (14,750) | 17,424 |
| Increase in inventories | (7,389) | (17,313) |
| Decrease (increase) in other current assets | 646 | (8,708) |
| Decrease in deferred costs net | 11,691 | 12,722 |
| Decrease in accounts payable and other liabilities | (21,753) | (22,438) |
| Other net | 4,236 | 8,923 |
| Cash Provided by Operating Activities | 21,621 | 25,800 |
| INVESTING ACTIVITIES: | | |
| Proceeds from sale of short-term investments | 134,900 | 448,320 |
| Purchases of short-term investments | (163,225) | (322,680) |
| Property, plant & equipment additions | (5,875) | (9,591) |
| Cash payments for business acquisitions | (6,056) | |
| Cash receipts related to discontinued operations | 2,344 | |
| Proceeds from sale of fixed assets | 890 | 182 |
| Cash (Used) Provided by Investing Activities | (37,022) | 116,231 |
| FINANCING ACTIVITIES: | | |
| Increase in long-term debt | | 200,000 |
| Reduction of long-term debt | | (281,363) |
| Sale of stock under benefit plans | 9,358 | 1,052 |
| Purchase of treasury shares | (3,568) | (59,529) |
| Dividends to shareholders | (5,536) | (4,605) |
| Debt issuance costs | | (7,276) |
| Cash Provided (Used) by Financing Activities | 254 | (151,721) |

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DISCONTINUED OPERATIONS:

| | | |
|--|------------|------------|
| Cash used by operating activities from discontinued operations | (542) | (2,540) |
| Cash provided by investing activities from discontinued operations | | 1,644 |
| Cash Used by Discontinued Operations | (542) | (896) |
| EFFECT OF EXCHANGE RATE CHANGES ON CASH | 3,558 | 2,441 |
| DECREASE IN CASH AND CASH EQUIVALENTS | (12,131) | (8,145) |
| Cash and Cash Equivalents at Beginning of Year | 144,713 | 213,613 |
| Cash and Cash Equivalents at End of Period | \$ 132,582 | \$ 205,468 |

See notes to condensed consolidated financial statements (unaudited).

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AMERICAN GREETINGS CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Three Months Ended May 25, 2007 and May 26, 2006

Note 1 Basis of Presentation

The accompanying unaudited condensed 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, 2007 refers to the year ended February 28, 2007.

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, 2007, from which the Condensed Consolidated Statement of Financial Position at February 28, 2007, presented herein, has been derived. Certain amounts in the prior year financial statements have been reclassified to reflect certain business units as discontinued operations and adjusted to reflect the Corporation's adoption of Staff Accounting Bulletin No. 108 (SAB 108). Beginning retained earnings in 2007 was adjusted \$5.2 million (\$3.3 million after-tax) to record the correction of the overstatement of the allowance for rebates (correspondingly, an understatement of net income of prior periods) pursuant to the special transition provision detailed in SAB 108.

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 2006, the Financial Accounting Standards Board (the FASB) ratified Emerging Issues Task Force Issue No. 06-3 (EITF 06-3), How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation). The scope of EITF 06-3 includes any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer. This issue provides that a company may adopt a policy of presenting taxes either gross within revenue or net. If taxes subject to this issue are significant, a company is required to disclose its accounting policy for presenting taxes and the amount of such taxes that are recognized on a gross basis. EITF 06-3 is effective for the first interim or annual reporting period beginning after December 15, 2006. The adoption of EITF 06-3 during the first quarter of fiscal 2008 had no material impact on the consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes and Interpretation of FASB Statement No. 109. FIN 48 clarifies the accounting for uncertain tax positions recognized in a company's financial statements in accordance with Statement of Financial Accounting Standards (SFAS) No. 109,

Accounting for Income Taxes, including what criteria must be met prior to recognition of the financial statement benefit of a position taken or expected to be taken in a tax return. FIN 48 requires a company to include additional qualitative and quantitative disclosures within its financial statements. The disclosures include potential tax benefits from positions taken for tax return purposes that have not been recognized for financial reporting purposes and a tabular presentation of significant changes during each period. The disclosures also include a discussion of the nature of uncertainties, factors that could cause a change and an estimated range of reasonably possible changes in tax uncertainties. FIN 48 requires a company to recognize a financial statement benefit for a position taken for tax return purposes when it is more likely than not that the position will be sustained. The cumulative effect of adopting FIN 48 is recorded as an adjustment to the opening balance of retained earnings in the period of adoption. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Corporation adopted FIN 48 on March 1, 2007. See Note 12.

Table of Contents**Note 4 Other Income Net**

| (In thousands) | Three Months Ended | |
|-----------------------|---------------------------|---------------------|
| | May 25, 2007 | May 26, 2006 |
| Royalty revenue | \$ (1,952) | \$ (1,441) |
| Foreign exchange gain | (1,120) | (1,427) |
| Interest income | (1,492) | (2,830) |
| Other | (783) | (1,162) |
| | \$ (5,347) | \$ (6,860) |

Other includes, among other things, gains and losses on asset disposals and rental income.

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 | |
|---|---------------------------|---------------------|
| | May 25, 2007 | May 26, 2006 |
| Numerator (in thousands): | | |
| Income from continuing operations | \$ 30,622 | \$ 16,550 |
| Add-back interest on convertible subordinated notes, net of tax | | 1,874 |
| Income from continuing operations assuming dilution | \$ 30,622 | \$ 18,424 |
| Denominator (in thousands): | | |
| Weighted average shares outstanding | 55,263 | 58,137 |
| Effect of dilutive securities: | | |
| Convertible debt | | 12,576 |
| Stock options and other | 387 | 364 |
| Weighted average shares outstanding assuming dilution | 55,650 | 71,077 |
| Income from continuing operations per share | \$ 0.55 | \$ 0.28 |
| Income from continuing operations per share assuming dilution | \$ 0.55 | \$ 0.26 |

Approximately 2.8 million and 4.7 million stock options outstanding in the three month periods ended May 25, 2007 and May 26, 2006, 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. The convertible debt was retired during the second quarter of 2007.

Note 6 Comprehensive Income

The Corporation's total comprehensive income is as follows:

Three Months Ended

| (In thousands) | May 25, 2007 | May 26, 2006 |
|---|-----------------------------|---------------------|
| Net income | \$ 30,050 | \$ 15,392 |
| Other comprehensive income: | | |
| Foreign currency translation adjustment and other | 7,043 | 14,057 |
| Unrealized gain on securities | | 72 |
| Total comprehensive income | \$ 37,093 | \$ 29,521 |

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

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

| (In thousands) | May 25, 2007 | February 28, 2007 | May 26, 2006 |
|---|-------------------------|------------------------------|-------------------------|
| Allowance for seasonal sales returns | \$ 73,909 | \$ 62,567 | \$ 82,917 |
| Allowance for doubtful accounts | 5,009 | 6,350 | 8,875 |
| Allowance for cooperative advertising and marketing funds | 27,142 | 24,048 | 24,379 |
| Allowance for rebates | 47,965 | 40,053 | 57,205 |
| | \$ 154,025 | \$ 133,018 | \$ 173,376 |

Note 8 Inventories

| (In thousands) | May 25, 2007 | February 28, 2007 | May 26, 2006 |
|--|-------------------------|------------------------------|-------------------------|
| Raw materials | \$ 19,568 | \$ 17,590 | \$ 24,175 |
| Work in process | 14,957 | 11,315 | 18,898 |
| Finished products | 209,688 | 207,676 | 244,315 |
| | 244,213 | 236,581 | 287,388 |
| Less LIFO reserve | 80,567 | 79,145 | 79,802 |
| | 163,646 | 157,436 | 207,586 |
| Display materials and factory supplies | 28,753 | 25,182 | 25,569 |
| | \$ 192,399 | \$ 182,618 | \$ 233,155 |

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.

Note 9 Deferred Costs

As of May 25, 2007, February 28, 2007 and May 26, 2006, deferred costs and future payment commitments are included in the following financial statement captions:

| (In thousands) | May 25, 2007 | February 28, 2007 | May 26, 2006 |
|----------------------------|-------------------------|------------------------------|-------------------------|
| Prepaid expenses and other | \$ 119,741 | \$ 131,972 | \$ 149,812 |
| Other assets | 337,358 | 355,115 | 466,926 |
| Deferred cost assets | 457,099 | 487,087 | 616,738 |
| Other current liabilities | (47,609) | (47,692) | (63,555) |
| Other liabilities | (30,681) | (49,648) | (48,771) |
| Deferred cost liabilities | (78,290) | (97,340) | (112,326) |

| | | | |
|--------------------|------------|------------|------------|
| Net deferred costs | \$ 378,809 | \$ 389,747 | \$ 504,412 |
|--------------------|------------|------------|------------|

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At May 25, 2007, February 28, 2007 and May 26, 2006, long-term debt and their related calendar year due dates were as follows:

| (In thousands) | May 25, 2007 | February 28, 2007 | May 26, 2006 |
|--|-------------------------|------------------------------|-------------------------|
| 6.10% Senior Notes, due 2028 | \$ 22,690 | \$ 22,690 | \$ 22,615 |
| 7.375% Senior Notes, due 2016 | 200,000 | 200,000 | 200,000 |
| 7.00% Convertible Subordinated Notes, due 2006 | | | 15,662 |
| Other | 1,110 | 1,225 | 1,561 |
| | \$ 223,800 | \$ 223,915 | \$ 239,838 |

There was no debt due within one year at May 25, 2007 or February 28, 2007. As of May 26, 2006, debt due within one year was \$159.1 million.

The Corporation's convertible subordinated notes were retired during the second quarter of 2007.

There were no balances outstanding under the \$600 million secured credit agreement or the amended and restated receivables purchase agreement as of May 25, 2007. While there were no balances outstanding under either facility, the Corporation does have, in the aggregate, \$27.9 million outstanding under letters of credit, which reduces the total credit availability thereunder.

At May 25, 2007, the Corporation was in compliance with the financial covenants under its borrowing agreements.

Note 11 Retirement Benefits

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

| (In thousands) | Defined Benefit Pension Three Months Ended | | Postretirement Benefit Three Months Ended | |
|---|---|-------------------------|--|-------------------------|
| | May 25, 2007 | May 26, 2006 | May 25, 2007 | May 26, 2006 |
| Service cost | \$ 244 | \$ 212 | \$ 1,050 | \$ 999 |
| Interest cost | 2,265 | 2,104 | 2,150 | 1,925 |
| Expected return on plan assets | (2,154) | (2,108) | (1,250) | (1,275) |
| Amortization of prior service cost (credit) | 64 | 67 | (1,850) | (1,849) |
| Amortization of actuarial loss | 410 | 761 | 1,650 | 1,700 |
| | \$ 829 | \$ 1,036 | \$ 1,750 | \$ 1,500 |

The Corporation has a non-contributory profit-sharing plan with a contributory 401(k) provision covering most of its United States employees. The profit-sharing plan expense for the three months ended May 25, 2007 and May 26, 2006 was \$3.1 million and \$0.9 million, respectively. The profit-sharing plan expense for the three month periods are estimates as actual contributions to the profit-sharing plan are made after fiscal year-end and are contingent upon final year-end results. The Corporation matches a portion of 401(k) employee contributions contingent upon meeting specified annual operating results goals. The expense recognized for the 401(k) match for the three months ended May 25, 2007 and May 26, 2006 was \$1.2 million and \$1.1 million, respectively.

At May 25, 2007, February 28, 2007 and May 26, 2006, the liability for postretirement benefits other than pensions was \$68.5 million, \$66.7 million and \$12.4 million, respectively, and is included in Other liabilities on the Condensed Consolidated Statement of Financial Position. The change since May 26, 2006 is due to the adoption of SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB

Statements No. 87, 88, 106, and 132(R), effective February 28, 2007.

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Note 12 Income Taxes

Effective March 1, 2007, the Corporation adopted FIN 48, including the provisions of FASB Staff Position No. FIN-48-1, Definition of Settlement in FASB Interpretation No. 48. In connection with the adoption of FIN 48, the Corporation recorded a decrease to retained earnings of \$14.0 million to recognize an increase in its liability (or decrease to its refundable) for unrecognized tax benefits, interest and penalties under the recognition and measurement criteria of FIN 48. As of March 1, 2007, the Corporation had \$33.5 million of total gross unrecognized tax benefits, the recognition of which would have a favorable effect of \$29.3 million on the effective tax rate. It is reasonably possible that the Corporation's unrecognized tax positions as of March 1, 2007 could decrease approximately \$2 million during 2008. The anticipated decrease is primarily due to settlements and resulting cash payments related to open years after 1999, which are currently under examination by the U.S. Internal Revenue Service (IRS) and the states of Florida, New York and Indiana.

The Corporation recognizes interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of March 1, 2007, the Corporation had \$8.8 million of gross accrued interest and penalties related to uncertain tax positions. As of May 25, 2007, the Corporation is subject to examination by the IRS and various U.S. state and local jurisdictions for tax years 1999 to the present. The Corporation is also subject to tax examination in various foreign tax jurisdictions, including Canada, the United Kingdom, Australia, France, Italy, Mexico and New Zealand for tax years 2003 to the present.

During the first quarter of 2008, the Corporation's net unrecognized tax benefits decreased \$1.1 million as the Corporation reached an agreement with the IRS on a significant tax issue that was not anticipated at the beginning of the year. As of May 25, 2007, the Corporation had \$33.6 million of total gross unrecognized tax benefits, the recognition of which would have a favorable effect of \$28.2 million on the effective tax rate. It is reasonably possible that the Corporation's unrecognized tax positions as of May 25, 2007 could decrease approximately \$2 million during the next twelve months. The anticipated decrease is primarily due to settlements and resulting cash payments related to open years after 1999, which are currently under examination by the IRS and the states of Florida, New York and Indiana.

As of May 25, 2007, the Corporation had \$10.6 million of gross accrued interest and penalties related to uncertain tax positions.

Note 13 Business Segment Information

The Corporation is organized and managed according to a number of factors, including product categories, geographic locations and channels of distribution.

The North American Social Expression Products and 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.

At May 25, 2007, the Corporation owned and operated 432 card and gift retail stores in the United States and Canada through its Retail Operations segment. The stores are primarily located in malls and strip shopping centers. The stores sell products purchased from the North American Social Expression Products segment as well as products purchased from other vendors.

AG Interactive is an electronic provider of social expression content through the Internet and wireless platforms.

The Corporation's non-reportable operating segments primarily include licensing activities and the design, manufacture and sale of display fixtures.

Segment results are internally reported and evaluated at consistent exchange rates between years to eliminate the impact of foreign currency fluctuations. An exchange rate adjustment is included in the reconciliation of the segment results to the consolidated results; this adjustment represents the impact on the segment results of the difference between the exchange rates used for segment reporting and evaluation and the actual exchange rates for the periods presented.

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Centrally incurred and managed costs are not allocated back to the operating segments. The unallocated items include interest expense on centrally-incurred debt, domestic profit-sharing expense and stock-based compensation expense. In addition, the costs associated with corporate operations including the senior management, corporate finance, legal and human resource functions, among other costs, are included in the unallocated items.

Operating Segment Information

| (In thousands) | Net Sales | | Segment Earnings (Loss) | |
|---|---------------------------|-------------------------|--------------------------------|-------------------------|
| | Three Months Ended | | Three Months Ended | |
| | May 25, 2007 | May 26, 2006 | May 25, 2007 | May 26, 2006 |
| North American Social Expression Products | \$ 297,066 | \$ 292,950 | \$ 86,940 | \$ 68,161 |
| Intersegment items | (8,167) | (17,548) | (6,255) | (12,910) |
| Exchange rate adjustment | 5 | (63) | 5 | (33) |
| Net | 288,904 | 275,339 | 80,690 | 55,218 |
| International Social Expression Products | 59,145 | 63,865 | 40 | 497 |
| Exchange rate adjustment | 4,057 | (2,251) | 147 | 46 |
| Net | 63,202 | 61,614 | 187 | 543 |
| Retail Operations | 38,924 | 43,501 | (2,781) | (7,301) |
| Exchange rate adjustment | 4 | (62) | | 2 |
| Net | 38,928 | 43,439 | (2,781) | (7,299) |
| AG Interactive | 19,894 | 19,960 | 3,296 | 2,041 |
| Exchange rate adjustment | 3 | 5 | (9) | (1) |
| Net | 19,897 | 19,965 | 3,287 | 2,040 |
| Non-reportable segments | 7,082 | 3,813 | 927 | (2,095) |
| Unallocated | | | (27,393) | (28,906) |
| Exchange rate adjustment | | | (4) | (100) |
| Net | | | (27,397) | (29,006) |
| Consolidated total | \$ 418,013 | \$ 404,170 | \$ 54,913 | \$ 19,401 |

Termination Benefits and Plant Closings

Termination benefits are primarily considered part of an ongoing benefit arrangement, accounted for in accordance with SFAS No. 112, Employers Accounting for Postemployment Benefits, and are recorded when payment of the benefits is probable and can be reasonably estimated.

The balance of the severance accrual was \$6.8 million, \$8.4 million and \$6.7 million at May 25, 2007, February 28, 2007 and May 26, 2006, respectively.

Deferred Revenue

Deferred revenue, included in Other current liabilities on the Condensed Consolidated Statement of Financial Position, totaled \$34.9 million, \$35.5 million and \$29.6 million at May 25, 2007, February 28, 2007 and May 26,

2006, respectively. The amounts relate primarily to the Corporation's AG Interactive segment and the licensing activities included in non-reportable segments.

Table of Contents**Note 14 Discontinued Operations**

Discontinued operations include the Corporation's educational products business, its entertainment development and production joint venture and its South African business unit. Learning Horizons, the Hatchery and the South African business units each meet the definition of a component of an entity and have been accounted for as discontinued operations under SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. Accordingly, the Corporation's consolidated financial statements and related notes have been presented to reflect all three as discontinued operations for all periods presented. Learning Horizons and the Hatchery were previously included within the Corporation's non-reportable segments and the South African business unit was included within the former Social Expression Products segment.

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

Also, in February 2007, the Corporation committed to a plan to exit its investment in the Hatchery, which seeks growth from opportunities that are inconsistent with the Corporation's objectives and that would require significant capital commitments. The Corporation is taking this action as it has decided to focus its efforts on opportunities in children's animation.

In February 2006, the Corporation committed to a plan to sell its South African business unit as it had been determined that the business unit was no longer a strategic fit for the Corporation. The sale closed in the second quarter of 2007.

The following summarizes the results of discontinued operations:

| (In thousands) | Three Months Ended | |
|---|---------------------------|---------------------|
| | May 25, 2007 | May 26, 2006 |
| Net sales | \$ 302 | \$ 6,168 |
| Pre-tax loss from operations | \$ (405) | \$ (1,155) |
| Gain on sale | 195 | |
| | (210) | (1,155) |
| Income tax expense | 362 | 3 |
| Loss from discontinued operations, net of tax | \$ (572) | \$ (1,158) |

Assets of businesses held for sale and Liabilities of businesses held for sale in the Condensed Consolidated Statement of Financial Position include the following:

| (In thousands) | May 25, 2007 | February 28, 2007 | May 26, 2006 |
|-------------------------------------|---------------------|--------------------------|---------------------|
| Assets of businesses held for sale: | | | |
| Current assets | \$ 118 | \$ 2,933 | \$ 19,844 |
| Other assets | 2,313 | 2,185 | 3,559 |
| Fixed assets | 76 | 81 | 218 |
| | \$ 2,507 | \$ 5,199 | \$ 23,621 |

Liabilities of businesses held for sale:

| | | | | | | |
|------------------------|----|-------|----|-------|----|-------|
| Current liabilities | \$ | 41 | \$ | 610 | \$ | 3,594 |
| Noncurrent liabilities | | 1,212 | | 1,322 | | 103 |
| | \$ | 1,253 | \$ | 1,932 | \$ | 3,697 |

Table of Contents**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

We experienced higher consolidated net sales and earnings during the first quarter of 2008, compared to the prior year quarter, primarily driven by our North American Social Expression Products segment where we spent significantly less on the implementation of our strategy to invest in our core greeting card business (investment in cards strategy) and scan-based trading (SBT) implementations. For fiscal 2008, we expect these expenditures to total approximately \$35 million, compared to actual expenditures of approximately \$66 million in fiscal 2007.

The strategy to invest in our core greeting card business is focused on improving the design, production, display and promotion of our cards. We are dedicated to creating relevant and on-trend products, brought to market quickly and merchandised in a manner that enhances the shopping experience. The most significant costs associated with this strategy are for new fixtures and removal of product that is replaced with fresh designs. Due to the nature of these costs, generally sales incentives and credits for removed product, they are reported as reductions to net sales. In addition, there are costs to implement the strategy, such as merchandiser, systems, point of purchase materials and order filling costs, which are reported within the expense lines of the Condensed Consolidated Statement of Income. During the first quarter, actions related to the investment in cards strategy decreased net sales by approximately \$1 million and SBT implementations reduced net sales by approximately \$1 million, compared to approximately \$6 million and \$7 million, respectively, in the prior year quarter. In total, actions related to the investment in cards strategy and SBT implementations reduced consolidated pre-tax income by approximately \$3 million, compared with approximately \$16 million in the prior year period.

Also contributing to the increased earnings in the North American Social Expression Products segment was an improvement in the net sales of everyday greetings cards, a change in the mix of products sold to a richer mix (as defined by higher gross margins) of card versus non-card products and the impact of continued cost savings programs, particularly in the areas of manufacturing and supply chain.

The AG Interactive and Retail Operations segments also experienced growth in earnings. AG Interactive, with stable net sales over the periods, experienced a favorable shift in the mix of sales, with continued growth in its core online subscription and advertising revenue streams. The Retail Operations segment improved earnings over the prior year period with stores open one year or more showing quarter over quarter net sales growth for the third consecutive quarter. This progress is also the result of the closure of approximately 60 underperforming stores during the prior year fourth quarter.

The effective tax rate for the first quarter of 2008 was 44.2% compared to 14.7% in the first quarter of 2007 due to unfavorable discrete events that increased income tax expense in the current period and favorable discrete events that reduced income tax expense in the prior period. The effective tax rates were also significantly impacted by the level of pre-tax earnings in the respective periods.

During the prior year first quarter, we completed the exchange offering for our convertible notes, repurchased substantially all of our \$300 million 6.10% senior notes, replaced our credit facility with a new \$650 million credit facility and issued \$200 million of 7.375% senior unsecured notes. As a result, the prior year first quarter results included approximately \$6 million for the consent payment, transaction costs and the write-off of deferred financing costs associated with the extinguished debt instruments. These costs were partially offset by a net gain of \$2.4 million associated with an interest rate derivative designed to offset the initial interest rate risk related to the issuance of our \$200 million 7.375% senior unsecured notes during the period.

Table of Contents**Results of Operations*****Three months ended May 25, 2007 and May 26, 2006***

Net income was \$30.1 million, or \$0.54 per share, in the quarter compared to \$15.4 million, or \$0.24 per share, in the prior year first quarter (all per-share amounts assume dilution).

Our results for the three months ended May 25, 2007 and May 26, 2006 are summarized below:

| (Dollars in thousands) | 2007 | % Net Sales | 2006 | % Net Sales |
|---|-------------|------------------------|-------------|------------------------|
| Net sales | \$ 418,013 | 100.0% | \$ 404,170 | 100.0% |
| Material, labor and other production costs | 161,128 | 38.6% | 175,237 | 43.4% |
| Selling, distribution and marketing | 140,691 | 33.7% | 142,580 | 35.3% |
| Administrative and general | 61,871 | 14.8% | 61,348 | 15.2% |
| Interest expense | 4,757 | 1.1% | 12,464 | 3.0% |
| Other income net | (5,347) | (1.3%) | (6,860) | (1.7%) |
| | 363,100 | 86.9% | 384,769 | 95.2% |
| Income from continuing operations before income tax expense | 54,913 | 13.1% | 19,401 | 4.8% |
| Income tax expense | 24,291 | 5.8% | 2,851 | 0.7% |
| Income from continuing operations | 30,622 | 7.3% | 16,550 | 4.1% |
| Loss from discontinued operations, net of tax | (572) | (0.1%) | (1,158) | (0.3%) |
| Net income | \$ 30,050 | 7.2% | \$ 15,392 | 3.8% |

For the three months ended May 25, 2007, consolidated net sales were \$418.0 million, up from \$404.2 million in the prior year first quarter. This 3.4% or approximately \$14 million increase was primarily the result of higher net sales in our North American Social Expression Products segment of approximately \$14 million and our fixtures business of approximately \$3 million combined with a favorable foreign exchange impact of approximately \$6 million partially offset by lower net sales in our International Social Expression Products and Retail Operations segments, each approximately \$5 million.

Net sales of our North American Social Expression Products segment increased approximately \$14 million. Our candle product lines, which were sold in January 2007, contributed approximately \$7 million to net sales in the prior year quarter. As a result, sales of products other than candles increased approximately \$21 million. Approximately \$5 million of the increase was due to lower spending on our investment in cards strategy and approximately \$6 million resulted from fewer SBT implementations. The majority of the remaining increase was due to improvements in everyday card sales. Favorable timing of seasonal shipments, primarily Easter and summer seasonal programs, was substantially offset by our Mother's Day performance compared to the prior year quarter.

The reduction in our International Social Expression Products segment's net sales was due primarily to the challenging retail environment in the United Kingdom (U.K.) which continues to demand reduced inventory levels for most of our product lines. Our Retail Operations segment was down approximately \$5 million, or 10.5%, as favorable same-store sales of 2.4% were more than offset by the decrease in store doors of approximately 13%.

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 May 25, 2007 and May 26, 2006 are summarized below:

| | Increase (Decrease) From the Prior Year | | | | | |
|----------------------------------|---|---------|----------------|--------|----------------------|--------|
| | Everyday Cards | | Seasonal Cards | | Total Greeting Cards | |
| | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 |
| Unit volume | 8.0% | (13.2%) | (1.5%) | 4.6% | 4.3% | (7.2%) |
| Selling prices | (4.7%) | 7.0% | 1.5% | (1.5%) | (2.5%) | 4.3% |
| Overall increase / (decrease) | 2.9% | (7.1%) | 0.0% | 3.0% | 1.7% | (3.2%) |

During the first quarter, combined everyday and seasonal greeting card sales less returns improved 1.7% compared to the prior year quarter, with the increase coming from everyday cards. This increase was due to SBT implementations that reduced unit volume in the prior year.

Everyday card unit volume, up 8.0%, and selling prices, down 4.7%, were significantly impacted by the SBT implementations during the prior year first quarter. As reported in the prior year first quarter Form 10-Q, there was a significant amount of SBT implementations during the quarter that decreased unit volume and increased selling prices. Net of the impact from the prior year SBT implementations, everyday unit volume and selling prices were essentially flat in the current year first quarter compared to the prior year period. Within the North American Social Expression Products segment, everyday unit volume improved, but was substantially offset by lower performance from our International Social Expression Products segment.

Overall, seasonal card performance was flat compared to the prior year period, with a slight decrease in unit volume offset by a small increase in selling prices. However, there were some favorable timing of sales, without which, seasonal sales would have been lower than in the prior period. The lower unit volume was related to Mother's Day performance and timing differences related to Father's Day, partially offset by timing differences in Easter and summer seasonal programs. These timing differences are related to the quarter that seasonal shipments occur compared to the prior year period and the impact of SBT implementations. The implementation of SBT impacts the timing of sales with these customers compared to the prior year because, under SBT arrangements, American Greetings owns the product delivered to the retail customer until the product is sold by the retailer to the ultimate consumer, at which time we record the sale. From a timing perspective, the differences related to Father's Day and summer seasonal programs are expected to unfavorably impact the current year second quarter results. The increase in selling prices was related to the timing differences noted above and are the result of the change in mix of various seasonal programs sold in the current year period compared to the prior period.

Expense Overview

Material, labor and other production costs (MLOPC) for the three months ended May 25, 2007 were \$161.1 million, a decrease from \$175.2 million for the comparable period in the prior year. As a percentage of net sales, these costs were 38.6% in the current period compared to 43.4% for the three months ended May 26, 2006. The decrease of \$14.1 million is due to favorable spending and mix of approximately \$19 million partially offset by unfavorable volume variances of approximately \$1 million due to the increased sales in the current period and foreign exchange impacts of approximately \$4 million. The \$19 million decrease from the prior year is due to favorable product mix (primarily attributable to the sale of our candle product lines in January 2007) and plant efficiencies, which in the aggregate accounted for approximately \$20 million of the increase. Also contributing to the increase was scrap and inventory adjustments of approximately \$2 million. These increases were partially offset by higher creative content costs of approximately \$3 million.

Selling, distribution and marketing costs for the three months ended May 25, 2007 were \$140.7 million, decreasing from \$142.6 million for the comparable period in the prior year. The decrease of \$1.9 million is due to favorable spending variances of approximately \$4 million partially offset by unfavorable foreign exchange impacts of approximately \$2 million. The favorable spending is due to decreases in retail store expenses of approximately \$3 million, savings from supply chain cost reduction programs of approximately \$3

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million and expenses related to AG Interactive's mobile product group of approximately \$1 million partially offset by higher advertising expenses of approximately \$3 million primarily attributable to our focus on our core greeting card business.

Administrative and general expenses were \$61.9 million for the three months ended May 25, 2007, an increase from \$61.4 million for the three months ended May 26, 2006. The dollar increase of \$0.5 million is primarily related to unfavorable foreign exchange impacts of \$0.7 million partially offset by favorable spending of \$0.2 million. The favorable spending is attributable to lower bad debt expense and stock-based compensation expense partially offset by higher profit-sharing and 401(k) matching contribution expenses. The increased profit-sharing expense is directly related to the increased pre-tax earnings in the current year period.

Interest expense for the three months ended May 25, 2007 was \$4.8 million, a decrease from \$12.5 million for the prior year quarter. The decrease of \$7.7 million is attributable to the financing activities from the prior year quarter. Expenses of \$5.0 million were incurred related to the early retirement of substantially all of our 6.10% senior notes including the consent payment, fees paid and the write-off of deferred financing costs. Deferred financing costs of \$1.0 million associated with the credit facility that was terminated in April 2006 were written off in the prior quarter. Savings of \$7.0 million were realized in the current period due to the reduced debt balances for the 6.10% senior notes and the 7.00% convertible notes as a result of the prior period financing activities. Partially offsetting these amounts are \$3.7 million for interest expense on the new 7.375% notes issued in May 2006 and \$2.4 million for the net gain recognized on the interest rate derivative entered into and settled during the three months ended May 26, 2006.

Other income net was \$5.4 million for the three months ended May 25, 2007, a decrease from \$6.9 million for the comparable period in the prior year. The decrease of \$1.5 million is principally related to lower interest income of \$1.3 million due to the reduced cash and short-term investment balances in the current period and a decrease in foreign exchange gains of \$0.3 million compared to the prior period.

The effective tax rate on income from continuing operations was 44.2% and 14.7% for the three months ended May 25, 2007 and May 26, 2006, respectively. The increase in the effective tax rate relates to several discrete events during the current year period, primarily agreements reached with the Internal Revenue Service as it closed its audit cycle. The low effective tax rate for the three months ended May 26, 2006 was primarily attributable to additional tax benefits related to the extraterritorial income (ETI) exclusion. The effective tax rates in both periods were also impacted by the level of pre-tax earnings in the respective periods.

Segment Information

Our operations are organized and managed according to a number of factors, including product categories, geographic locations and channels of distribution. Our North American Social Expression Products and our International Social Expression Products segments primarily design, manufacture and sell greeting cards and other related products through various channels of distribution, with mass retailers as the primary channel. As permitted under Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information, certain operating divisions have been aggregated into both the North American Social Expression Products and International Social Expression Products segments. The aggregated operating divisions have similar economic characteristics, products, production processes, types of customers and distribution methods. At May 25, 2007, we owned and operated 432 card and gift retail stores in the United States and Canada through our Retail Operations segment. The stores are primarily located in malls and strip shopping centers. The stores sell products purchased from the North American Social Expression Products segment as well as products purchased from other vendors. AG Interactive is an electronic provider of social expression content through the Internet and wireless platforms. We review segment results using consistent exchange rates between periods to eliminate the impact of foreign currency fluctuations.

Table of Contents*North American Social Expression Products Segment*

| (Dollars in thousands) | Three Months Ended | | % |
|-------------------------------|---------------------------|---------------------|---------------|
| | May 25, 2007 | May 26, 2006 | Change |
| Net sales | \$288,899 | \$275,402 | 4.9% |
| Segment earnings | 80,685 | 55,251 | 46.0% |

Net sales of our North American Social Expression Products segment for the three months ended May 25, 2007, excluding the impact of foreign exchange and intersegment items, increased \$13.5 million, or 4.9%, from the prior year period. Lower spending on our investment in cards strategy and SBT conversions in the current quarter compared to the prior year quarter accounted for approximately \$5 million and \$6 million, respectively, of the net sales increase. Also contributing to the increase was sales of everyday cards. These increases were partially offset by the sale of our candle product lines in January 2007, which contributed approximately \$7 million to net sales in the prior year quarter.

Segment earnings, excluding the impact of foreign exchange and intersegment items, increased \$25.4 million, or 46.0%, compared to the prior year period. The lower spending on our investment in cards strategy and SBT implementations accounted for approximately \$13 million of the increase. The remaining increase is attributable to higher everyday card sales as well as lower costs. The lower costs are due to product mix, including the favorable impact from the sale of our lower margin candle product lines in January 2007, plant efficiencies and supply chain cost reduction programs.

International Social Expression Products Segment

| (Dollars in thousands) | Three Months Ended | | % Change |
|-------------------------------|---------------------------|---------------------|-----------------|
| | May 25, 2007 | May 26, 2006 | |
| Net sales | \$59,145 | \$63,865 | (7.4%) |
| Segment earnings | 40 | 497 | (92.0%) |

Net sales of our International Social Expression Products segment, excluding the impact of foreign exchange, decreased \$4.7 million, or 7.4%, compared to the prior year quarter. This decrease was attributable primarily to lower sales in the U.K., which continues to experience a challenging retail environment including reductions of inventory at retail.

Segment earnings for the three months ended May 25, 2007, excluding the impact of foreign exchange, decreased \$0.5 million compared to the prior year three months and is attributable to the reduced sales volume.

Retail Operations Segment

| (Dollars in thousands) | Three Months Ended | | % Change |
|-------------------------------|---------------------------|---------------------|-----------------|
| | May 25, 2007 | May 26, 2006 | |
| Net sales | \$38,924 | \$43,501 | (10.5%) |
| Segment loss | (2,781) | (7,301) | 61.9% |

Net sales, excluding the impact of foreign exchange, in our Retail Operations segment decreased \$4.6 million, or 10.5%, for the three months ended May 25, 2007, compared to the prior year period as favorable same-store sales of approximately \$1 million, or 2.4%, were more than offset by the reduction in store doors. Net sales for the quarter decreased approximately \$6 million due to fewer stores. The average number of stores was approximately 13% less than in the prior year quarter.

Segment earnings, excluding the impact of foreign exchange, was a loss of \$2.8 million in the three months ended May 25, 2007, compared to a loss of \$7.3 million in the three months ended May 26, 2006. Earnings were favorably impacted by improved gross margins as a result of less promotional pricing. Gross margins increased by

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approximately 6.9 percentage points. Segment earnings benefited from lower store rent, operating expenses and associate costs of approximately \$3 million due to fewer stores as we closed approximately 60 underperforming stores in the fourth quarter of 2007.

AG Interactive Segment

| (Dollars in thousands) | Three Months Ended | | % Change |
|------------------------|--------------------|-----------------|-------------|
| | May 25, 2007 | May 26, 2006 | |
| Net sales | \$19,894 | \$19,960 | (0.3%) |
| Segment earnings | 3,296 | 2,041 | 61.4% |

Net sales of AG Interactive for the three months ended May 25, 2007, excluding the impact of foreign exchange, were essentially flat compared to the prior year quarter. Growth in advertising and subscription revenue in our online product group, due to both ongoing operations and the second quarter 2007 acquisition of an online greeting card business, was offset by reduced offerings in our mobile product group. At the end of the first quarter of 2008, AG Interactive had approximately 3.6 million online paid subscribers versus 2.7 million at the prior year quarter end. Approximately 0.6 million of the subscriber increase was due to the second quarter 2007 acquisition.

Segment earnings, excluding the impact of foreign exchange, increased \$1.3 million for the quarter ended May 25, 2007, compared to the prior year period. Segment earnings benefited from the growth in advertising and subscription revenue as well as lower expenses in the mobile product group due to the reduced offerings in that group.

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 Condensed Consolidated Statement of Financial Position as of May 26, 2006, has been included.

Operating Activities

Operating activities provided \$21.6 million of cash during the three months ended May 25, 2007, compared to \$25.8 million of cash in the prior year quarter.

Other non-cash charges were \$2.0 million for the three months ended May 25, 2007, compared to \$3.9 million in the prior year period. This decrease is primarily related to the prior period write-off of deferred financing fees associated with our old credit facility and lower amortization of debt financing fees in the current quarter.

Accounts receivable used \$14.8 million of cash from February 28, 2007, compared to providing cash of \$17.4 million during the three months ended May 26, 2006. The change is due to the timing of collections, primarily due to significantly more collections in the fourth quarter of 2007 compared to the fourth quarter of 2006.

Inventory was a use of \$7.4 million from February 28, 2007, compared to a use of \$17.3 million in the prior year period. As a percentage of the prior twelve months MLOPC, inventories were 23.7% at May 25, 2007, compared to 27.6% at May 26, 2006. The higher usage in the prior quarter was related to inventory build to support our investment in cards strategy.

Other current assets provided \$0.6 million of cash from February 28, 2007, compared to using \$8.7 million in the prior year quarter. The difference is due to refundable tax amounts in the prior year.

Deferred costs net represents payments under agreements with retailers net of the related amortization of those payments. During the three months ended May 25, 2007, amortization exceeded payments by \$11.7 million; in the three months ended May 26, 2006, amortization exceeded payments by \$12.7 million. See Note 9 to the condensed consolidated financial statements for further detail of deferred costs related to customer agreements.

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Investing Activities

Investing activities used \$37.0 million of cash during the three months ended May 25, 2007, compared to providing \$116.2 million in the prior year period. The use of cash in the current quarter is related to purchases exceeding sales of short-term investments as well as cash payments for business acquisitions. The final payment of \$6.1 million for the online greeting card business purchased in the prior year's second quarter was made during the current year. The source of cash in the prior year is primarily related to sales of short-term investments exceeding purchases. Short-term investments decreased from \$208.7 million at February 28, 2006 to \$83.1 million at May 26, 2006.

Financing Activities

Financing activities provided \$0.3 million of cash during the three months ended May 25, 2007, compared to using \$151.7 million during the three months ended May 26, 2006. Our receipt of the exercise price on stock options provided \$9.4 million in the current quarter, but was almost completely offset by dividend payments and share repurchases as discussed below. The prior year amount relates primarily to our refinancing activities during the period. We issued \$200.0 million of 7.375% senior unsecured notes and retired \$277.3 million of our 6.10% senior notes, approximately 92% of the total outstanding. We paid \$7.3 million of debt issuance costs during the prior period for our new credit facility, the 7.375% senior unsecured notes and the exchange offer on our 7.00% convertible subordinated notes. These amounts were deferred and are being amortized over the respective periods of the instruments. Our Class A common share repurchase programs also contributed to the cash used for financing activities in both periods. These repurchases were made through 10b5-1 programs. During the three months ended May 25, 2007, \$3.4 million was paid to repurchase approximately 0.1 million shares under the repurchase program, compared to \$59.4 million used in the prior year quarter to repurchase approximately 2.8 million shares.

During the three months ended May 25, 2007 and May 26, 2006, we paid quarterly dividends of \$0.10 and \$0.08 per common share, respectively, which totaled \$5.5 million and \$4.6 million, respectively.

Credit Sources

Substantial credit sources are available to us. In total, we had available sources of approximately \$600 million at May 25, 2007. This included our \$450 million senior secured credit facility and our \$150 million accounts receivable securitization facility. There were no balances outstanding under either of these arrangements at May 25, 2007. While there were no balances outstanding under either facility, we do have, in the aggregate, \$27.9 million outstanding under letters of credit, which reduces the total credit availability thereunder.

The credit agreement includes a \$350 million revolving credit facility and a \$100 million delay draw term loan. The obligations under the credit agreement are guaranteed by our material domestic subsidiaries and are secured by substantially all of the personal property of American Greetings Corporation and each of 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 foreign subsidiaries. The revolving credit facility will mature on April 4, 2011, and any outstanding term loans will mature on April 4, 2013. Each term loan will amortize in equal quarterly installments equal to 0.25% of the amount of such term loan, beginning on April 4, 2008, with the balance payable on April 4, 2013.

Revolving loans denominated in U.S. dollars under the credit agreement will bear interest at a rate per annum based on the then applicable London Inter-Bank Offer Rate (LIBOR) or the alternate base rate (ABR), as defined in the credit agreement, in each case, plus margins adjusted according to our leverage ratio. Term loans will bear interest at a rate per annum based on either LIBOR plus 150 basis points or based on the ABR, as defined in the credit agreement, plus 25 basis points. We pay an annual commitment fee of 75 basis points on the undrawn portion of the term loan.

The commitment fee on the revolving facility fluctuates based on our leverage ratio.

The 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

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performance covenants that require us to maintain a maximum leverage ratio and a minimum interest coverage ratio. The 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 may incur from time to time.

We are also party to an amended and restated receivables purchase agreement with available financing of up to \$150 million. The agreement expires on October 23, 2009. Under the amended and restated receivables purchase agreement, American Greetings and certain of its subsidiaries sell accounts receivable to AGC Funding Corporation (AGC Funding), a wholly-owned, consolidated subsidiary of American Greetings, which in turn sells undivided interests in eligible accounts receivable to third party financial institutions as part of a process that provides funding similar to a revolving credit facility. Funding under the facility may be used for working capital, general corporate purposes and the issuance of letters of credit.

The interest rate under the accounts receivable securitization facility is based on (i) commercial paper interest rates, (ii) LIBOR rates plus an applicable margin or (iii) a rate that is the higher of the prime rate as announced by the applicable purchaser financial institution or the federal funds rate plus 0.50%. AGC Funding pays an annual commitment fee of 28 basis points on the unfunded portion of the accounts receivable securitization facility, together with customary administrative fees on outstanding letters of credit that have been issued and on outstanding amounts funded under the facility.

The amended and restated receivables purchase agreement contains representations, warranties, covenants and indemnities customary for facilities of this type, including the obligation of American Greetings to maintain the same consolidated leverage ratio as it is required to maintain under its secured credit facility.

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

In a continued effort to return value to our shareholders, we announced on April 17, 2007, an additional program to repurchase up to \$100 million of our Class A common shares. These repurchases will be made through a 10b5-1 program in open market or privately negotiated transactions which are intended to be in compliance with the Securities and Exchange Commission's Rule 10b-18, subject to market conditions, applicable legal requirements and other factors. There is no set expiration date for this program.

Critical Accounting Policies

Please refer to the discussion of our Critical Accounting Policies as disclosed in our Annual Report on Form 10-K for the year ended February 28, 2007.

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 with similar meaning in connection with any discussion of future operating or financial performance. These forward-looking statements are based on currently available information, but are subject to a variety of uncertainties, unknown risks and other factors concerning our operations and business environment, which are difficult to predict and may be beyond our control. Important factors that could cause actual results to differ materially from those suggested by these forward-looking statements, and that could adversely affect our future financial performance, include, but are not limited to, the following:

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

- our ability to successfully implement our strategy to invest in our core greeting card business;

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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;

the ability to execute share repurchase programs or the ability to achieve the desired accretive effect from such repurchases;

our ability to successfully complete, or achieve the desired benefits associated with, dispositions;

a weak retail environment;

consumer acceptance of products as priced and marketed;

the impact of technology on core product sales;

competitive terms of sale offered to customers;

successful implementation of supply chain improvements and achievement of projected cost savings from those improvements;

increases in the cost of material, energy, freight and other production costs;

our 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;

escalation in the cost of providing employee health care;

successful integration of acquisitions; 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 public's acceptance of online greetings and other social expression products.

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, 2007.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

For further information, refer to our Annual Report on Form 10-K for the year ended February 28, 2007. There were no material changes in market risk, specifically interest rate and foreign currency exposure, for us from February 28, 2007, the end of our preceding fiscal year, to May 25, 2007, the end of our most recent fiscal quarter.

Item 4. Controls and Procedures

American Greetings maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in its reports under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms and that such information is accumulated and communicated to the Corporation's management, including its Chief Executive Officer

and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

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

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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**

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

Item 1A. Risk Factors

There have been no material changes in the risk factors that were discussed in our Annual Report on Form 10-K for the year ended February 28, 2007.

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

(a) Not applicable.

(b) Not applicable.

(c) The following table provides information with respect to our purchases of our common shares during the three months ended May 25, 2007.

| Period | Total Number of Shares | | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans | Maximum Number of Shares (or Approximate Dollar Value) that May Yet Be Purchased Under the Plans |
|------------|------------------------|----------|------------------------------|--|--|
| | Repurchased | | | | |
| March 2007 | Class A | | | | |
| | Class B | 2,756(1) | \$22.87 | | |
| April 2007 | Class A | 35,000 | \$25.45(2) | 35,000(3) | \$99,109,342 |
| | Class B | 2,381(1) | \$25.20 | | |
| May 2007 | Class A | 100,000 | \$25.51(2) | 100,000(3) | \$96,558,472 |
| | Class B | | | | |
| Total | Class A | 135,000 | | 135,000(3) | |
| | Class B | 5,137(1) | | | |

(1) There is no public market for our Class B common shares. Pursuant to our Amended Articles of Incorporation, all of the Class B common shares were

repurchased by American Greetings for cash pursuant to its right of first refusal.

- (2) Excludes commissions paid, if any, related to the share repurchase transactions.
- (3) On April 17, 2007, American Greetings announced that its Board of Directors authorized a new program to repurchase up to \$100 million of its Class A common shares. There is no set expiration date for this repurchase program and these repurchases are made through a 10b5-1 program in open market or privately negotiated transactions which are intended to be in compliance with the SEC's Rule 10b-18, subject to market conditions, applicable legal requirements and other factors.

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Item 6. Exhibits

Exhibits required by Item 601 of Regulation S-K

| Exhibit Number | Description |
|---------------------------|--|
| 10.1 | Form of Employee Stock Option Agreement under the American Greetings Corporation 2007 Omnibus Incentive Compensation Plan |
| (31) a | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| (31) b | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| (32) | Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AMERICAN GREETINGS CORPORATION

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

July 5, 2007

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