AMERICAN GREETINGS CORP
Form 10-Q
July 08, 2005

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**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended May 31, 2005

**OR**

| | |
|---|---|
| o | **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 þ | No o |
| | Yes þ | No o |

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

As of July 5, 2005, the number of shares outstanding of each of the issuer s classes of common stock was:

| | |
|---|---|
| Class A Common | 62,976,982 |
| Class B Common | 4,214,886 |

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## PART I FINANCIAL INFORMATION

### Item 1. Financial Statements

### AMERICAN GREETINGS CORPORATION
### CONDENSED CONSOLIDATED STATEMENT OF INCOME

**(Thousands of dollars except share and per share amounts)**

| | (Unaudited) Three Months Ended May 31, 2005 | (Unaudited) Three Months Ended May 31, 2004 |
|---|---|---|
| Net sales | $ 443,276 | $ 433,541 |
| Costs and expenses: | | |
| Material, labor and other production costs | 180,473 | 181,615 |
| Selling, distribution and marketing | 155,274 | 146,652 |
| Administrative and general | 63,128 | 64,137 |
| Interest expense | 9,682 | 52,694 |
| Other income net | (8,371) | (16,346) |
| Total costs and expenses | 400,186 | 428,752 |
| Income from continuing operations before income tax expense | 43,090 | 4,789 |
| Income tax expense | 16,676 | 1,853 |
| Income from continuing operations | 26,414 | 2,936 |
| Income from discontinued operations, net of tax | | 1,302 |
| Net income | $ 26,414 | $ 4,238 |
| **Earnings per share basic:** | | |
| Income from continuing operations | $ 0.39 | $ 0.04 |
| Income from discontinued operations | | 0.02 |
| Net income | $ 0.39 | $ 0.06 |
| **Earnings per share assuming dilution:** | | |
| Income from continuing operations | $ 0.35 | $ 0.04 |
| Income from discontinued operations | | 0.02 |

| | | |
|---|---|---|
| Net income | $ 0.35 | $ 0.06 |
| Average number of shares outstanding | 68,595,786 | 68,000,691 |
| Average number of shares outstanding assuming dilution | 81,952,895 | 68,846,170 |
| Dividends declared per share | $ 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 31, 2005 | (Note 1) February 28, 2005 | (Unaudited) May 31, 2004 |
|---|---|---|---|
| ASSETS | | | |
| Current assets | | | |
| Cash and cash equivalents | $ 214,273 | $ 250,267 | $ 115,850 |
| Short-term investments | 208,750 | 208,740 | |
| Trade accounts receivable, net | 196,210 | 188,987 | 241,656 |
| Inventories | 233,933 | 222,874 | 254,035 |
| Deferred and refundable income taxes | 165,123 | 193,497 | 154,713 |
| Assets of businesses held for sale | | | 37,905 |
| Prepaid expenses and other | 210,043 | 204,253 | 220,773 |
| Total current assets | 1,228,332 | 1,268,618 | 1,024,932 |
| Goodwill | 263,823 | 270,057 | 220,316 |
| Other assets | 625,847 | 644,140 | 663,449 |
| Property, plant and equipment at cost | 989,983 | 995,281 | 987,875 |
| Less accumulated depreciation | 658,749 | 653,889 | 641,337 |
| Property, plant and equipment net | 331,234 | 341,392 | 346,538 |
| | $ 2,449,236 | $ 2,524,207 | $ 2,255,235 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | | |
| Current liabilities | | | |
| Debt due within one year | $ 10,184 | $ | $ |
| Accounts payable | 117,247 | 143,041 | 112,294 |
| Accrued liabilities | 120,192 | 118,090 | 113,329 |
| Accrued compensation and benefits | 65,514 | 96,789 | 62,921 |
| Income taxes | 31,178 | 38,777 | 15,731 |
| Liabilities of businesses held for sale | | | 4,635 |
| Other current liabilities | 112,575 | 79,549 | 69,862 |
| Total current liabilities | 456,890 | 476,246 | 378,772 |
| Long-term debt | 476,159 | 486,099 | 483,783 |
| Other liabilities | 124,058 | 137,868 | 94,149 |
| Deferred income taxes | 34,612 | 37,214 | 27,300 |

| | | | |
|---|---|---|---|
| Shareholders equity | 1,357,517 | 1,386,780 | 1,271,231 |
| | $ 2,449,236 | $ 2,524,207 | $ 2,255,235 |

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 31, 2005 | 2004 |
|---|---|---|
| OPERATING ACTIVITIES: | | |
| Net income | $ 26,414 | $ 4,238 |
| Income from discontinued operations | | 1,302 |
| Income from continuing operations | 26,414 | 2,936 |
| Adjustments to reconcile to net cash provided by operating activities: | | |
| Gain on sale of investment | | (3,090) |
| Loss (gain) on sale of fixed assets | 944 | (21) |
| Loss on extinguishment of debt | 862 | 39,024 |
| Depreciation and amortization | 14,646 | 14,091 |
| Deferred income taxes | 7,740 | (7,192) |
| Changes in operating assets and liabilities, net of acquisitions: | | |
| Increase in trade accounts receivable | (10,895) | (13,216) |
| Increase in inventories | (13,947) | (17,174) |
| Decrease in other current assets | 14,360 | 7,946 |
| Decrease in deferred costs net | 25,147 | 33,274 |
| Decrease in accounts payable and other liabilities | (48,193) | (28,145) |
| Other net | 654 | (4,882) |
| Cash Provided by Operating Activities | 17,732 | 23,551 |
| INVESTING ACTIVITIES: | | |
| Proceeds from sale of short-term investments | 575,785 | |
| Purchases of short-term investments | (575,795) | |
| Property, plant & equipment additions | (8,607) | (4,403) |
| Proceeds from sale of fixed assets | 36 | 104 |
| Investment in corporate-owned life insurance | 1,614 | 1,098 |
| Other net | (1,205) | 26,879 |
| Cash (Used) Provided by Investing Activities | (8,172) | 23,678 |
| FINANCING ACTIVITIES: | | |
| Reduction of long-term debt | | (216,417) |
| Sale of stock under benefit plans | 8,511 | 12,035 |
| Purchase of treasury shares | (45,533) | (9,299) |
| Dividends to shareholders | (5,500) | |
| Cash Used by Financing Activities | (42,522) | (213,681) |

| | | |
|---|---|---|
| CASH USED BY DISCONTINUED OPERATIONS | | (1,342) |
| EFFECT OF EXCHANGE RATE CHANGES ON CASH | (3,032) | (1,806) |
| DECREASE IN CASH AND CASH EQUIVALENTS | (35,994) | (169,600) |
| Cash and Cash Equivalents at Beginning of Year | 250,267 | 285,450 |
| Cash and Cash Equivalents at End of Period | $ 214,273 | $ 115,850 |

See notes to condensed consolidated financial statements (unaudited).

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

**Three Months Ended May 31, 2005 and 2004**

**Note 1 Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements 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 period have been included.

These interim financial statements should be read in conjunction with the financial statements and notes thereto included in the Annual Report on Form 10-K for the year ended February 28, 2005 of American Greetings Corporation (the Corporation ), from which the Condensed Consolidated Statement of Financial Position at February 28, 2005, presented herein, has been derived. Certain amounts in the prior year financial statements have been reclassified to conform to the 2006 presentation.

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, 2005 refers to the year ended February 28, 2005. For 2005, the Corporation s subsidiary, AG Interactive, was consolidated on a two-month lag corresponding with its fiscal year-end of December 31. For 2006, AG Interactive has changed its year-end to coincide with the Corporation s fiscal year-end. As a result, the fiscal quarter ended May 31, 2005 includes five months of AG Interactive s operations. The additional two months of activity generated revenues of approximately $11 million, but had no impact on segment earnings.

**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 November 2004, the Financial Accounting Standards Board (the FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 151 ( SFAS 151 ), Inventory Costs an amendment of ARB No. 43, Chapter 4. SFAS 151 seeks to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage) in the determination of inventory carrying costs. The statement requires such costs to be treated as a current period expense. SFAS

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151 also establishes the concept of normal capacity and requires the allocation of fixed production overhead to inventory based on the normal capacity of the production facilities. Any unallocated overhead would be treated as a current period expense in the period incurred. This statement is effective for fiscal years beginning after July 15, 2005. The Corporation does not believe that the adoption of SFAS 151 will have a significant impact on the Corporation s consolidated financial statements.

In December 2004, the FASB issued SFAS No. 123 (revised 2004) ( SFAS 123(R) ), Share-Based Payment. SFAS 123(R) requires that compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. SFAS 123(R) eliminates the alternative to use the intrinsic value method of accounting in accordance with Accounting Principles Board ( APB ) Opinion No. 25, Accounting for Stock Issued to Employees. The Corporation is in the process of evaluating the impact that the adoption of this statement will have on the consolidated financial statements. It is, however, expected to reduce consolidated net income. This statement is effective for the first interim or annual period beginning after June 15, 2005. In April 2005, the Securities and Exchange Commission amended the compliance date of SFAS 123(R) through an amendment of Regulation S-X. The new effective date for the Corporation is March 1, 2006. Refer to Note 12 for the Corporation s current accounting for stock-based compensation.

**Note 4 Other Income Net**

| | Three Months Ended May 31, | |
|---|---|---|
| **(In thousands)** | **2005** | **2004** |
| Royalty revenue | $ (5,679) | $ (10,483) |
| Foreign exchange loss (gain) | 1,239 | (305) |
| Interest income | (2,640) | (706) |
| Gain on sale of investment | | (3,090) |
| Other | (1,291) | (1,762) |
| | $ (8,371) | $ (16,346) |

Other includes, among other things, gains and losses on asset disposals and rental income. Proceeds of $19.1 million received from the sale of an investment in the prior year are included in Other net investing activities in the Condensed Consolidated Statement of Cash Flows for the period.

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**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 31, | |
|---|---|---|
| | **2005** | **2004** |
| **Numerator (in thousands):** | | |
| Income from continuing operations | $ 26,414 | $ 2,936 |
| Add-back interest on convertible subordinated notes, net of tax | 1,875 | |
| Income from continuing operations assuming dilution | $ 28,289 | $ 2,936 |
| **Denominator (in thousands):** | | |
| Weighted average shares outstanding | 68,596 | 68,001 |
| Effect of dilutive securities: | | |
| Stock options | 756 | 845 |
| Deferred shares | 10 | |
| Convertible debt | 12,591 | |
| Weighted average shares outstanding assuming dilution | 81,953 | 68,846 |
| Income from continuing operations per share | $ 0.39 | $ 0.04 |
| Income from continuing operations per share assuming dilution | $ 0.35 | $ 0.04 |

Approximately 2.7 million and 4.0 million stock options outstanding in the three month periods ended May 31, 2005 and 2004, respectively, were excluded because the effect would have been antidilutive. In addition, the effect of the convertible subordinated notes has been excluded for the three months ended May 31, 2004, because the effect would have been antidilutive. See Note 10 for further discussion.

**Note 6 Comprehensive Income (Loss)**

The Corporation s total comprehensive income (loss) is as follows:

| | Three Months Ended May 31, | |
|---|---|---|
| **(In thousands)** | **2005** | **2004** |
| Net income | $ 26,414 | $ 4,238 |
| Other comprehensive income (loss): | | |
| Foreign currency translation adjustments | (14,144) | (7,047) |
| Unrealized loss on securities | (1) | |

| | | | | |
|---|---|---|---|---|
| Total comprehensive income (loss) | $ | 12,269 | $ | (2,809) |

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**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 31, 2005 | February 28, 2005 | May 31, 2004 |
|---|---|---|---|
| Allowance for seasonal sales returns | $ 85,425 | $ 94,672 | $ 86,773 |
| Allowance for doubtful accounts | 17,040 | 16,684 | 20,250 |
| Allowance for cooperative advertising | 19,145 | 23,571 | 20,914 |
| Allowance for rebates | 59,308 | 48,240 | 38,726 |
| | $ 180,918 | $ 183,167 | $ 166,663 |

**Note 8 Inventories**

| (In thousands) | May 31, 2005 | February 28, 2005 | May 31, 2004 |
|---|---|---|---|
| Raw materials | $ 27,316 | $ 23,241 | $ 35,377 |
| Work in process | 24,139 | 19,719 | 25,165 |
| Finished products | 234,655 | 228,088 | 234,344 |
| | 286,110 | 271,048 | 294,886 |
| Less LIFO reserve | 76,673 | 75,890 | 71,440 |
| | 209,437 | 195,158 | 223,446 |
| Display materials and factory supplies | 24,496 | 27,716 | 30,589 |
| Inventories | $ 233,933 | $ 222,874 | $ 254,035 |

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**

In the normal course of its business, the Corporation enters into agreements with certain customers for the supply of greeting cards and related products. Under these agreements, the customer typically receives from the Corporation a combination of cash payments, credits, discounts, allowances and other incentive considerations to be earned by the customer as product is purchased from the Corporation over the effective time period of the agreement to meet a minimum purchase volume commitment. In the event a contract is not completed, the Corporation has a claim for unearned advances under the agreement. The Corporation periodically reviews the progress toward the commitment and adjusts the estimated amortization period accordingly to match the costs with the revenue associated with the agreement. The agreements may or may not specify the Corporation as the sole supplier of social expression products to the customer.

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The Corporation classifies the total contractual amount of the incentive consideration committed to the customer but not yet earned as a deferred cost asset at the inception of an agreement, or any future amendments. Deferred costs estimated to be earned by the customer and charged to operations during the next twelve months are classified as Prepaid expenses and other in the Condensed Consolidated Statement of Financial Position, and the remaining amounts to be charged beyond the next twelve months are classified as Other assets.

A portion of the total consideration may be payable by the Corporation at the time the agreement is consummated. All future payment commitments are classified as liabilities at inception until paid. The payments that are expected to be made in the next twelve months are classified as Other current liabilities in the Condensed Consolidated Statement of Financial Position, and the remaining payment commitments beyond the next twelve months are classified as Other liabilities. The Corporation believes that it maintains adequate reserves for deferred costs related to supply agreements and does not expect that the non-completion of any particular contract would result in a material loss.

As of May 31, 2005, February 28, 2005 and May 31, 2004, deferred costs and future payment commitments are included in the following financial statement captions:

| **(In thousands)** | **May 31, 2005** | **February 28, 2005** | **May 31, 2004** |
|---|---|---|---|
| Prepaid expenses and other | $ 158,055 | $ 156,665 | $ 173,710 |
| Other assets | 567,175 | 582,401 | 605,755 |
| Deferred cost assets | 725,230 | 739,066 | 779,465 |
| Other current liabilities | (92,568) | (65,944) | (54,809) |
| Other liabilities | (81,921) | (95,452) | (68,154) |
| Deferred cost liabilities | (174,489) | (161,396) | (122,963) |
| Net deferred costs | $ 550,741 | $ 577,670 | $ 656,502 |

**Note 10 Debt**

On May 11, 2004, the Corporation amended and restated its senior secured credit facility. This facility was originally entered into on August 9, 2001, as a $350 million facility and was amended on July 22, 2002, to a $320 million facility. The amended and restated senior secured credit facility consists of a $200 million revolving facility maturing on May 10, 2008. There were no outstanding balances under this facility at May 31, 2005, February 28, 2005 or May 31, 2004.

The amended and restated credit facility is secured by the domestic assets of the Corporation and a 65% interest in the common stock of its foreign subsidiaries. The Corporation pays an annual commitment fee of 25 basis points on the undrawn portion of the facility. The facility contains various restrictive covenants. Some of these restrictions require that the Corporation meet specified periodic financial ratios, minimum net worth, maximum leverage, and interest coverage. The credit facility places certain restrictions on the Corporation s ability to incur additional indebtedness, to engage in acquisitions of other businesses, to repurchase its own capital stock and to pay shareholder dividends. These covenants are less restrictive than the covenants previously in place.

In April 2005, the Corporation amended its amended and restated senior secured credit facility dated May 11, 2004. The amendment, among other things, increases the maximum amount of dividends that the Corporation may pay to its shareholders, increases the maximum amount of its own capital stock that it may repurchase and extends the period during which the Corporation may repurchase its 11.75% senior subordinated notes due July 15, 2008.

The Corporation is also party to a three-year accounts receivable securitization financing agreement that provides for up to $200 million of financing and is secured by certain trade accounts receivable. Under the terms of the agreement, the Corporation transfers receivables to a wholly-owned consolidated subsidiary that in turn utilizes the receivables to secure borrowings through a credit facility with a financial institution. On August 2, 2004, the agreement was amended to extend the maturity date to August 1, 2007. The related interest rate is commercial paper-based. The Corporation pays an annual commitment fee of 25 basis points on the undrawn portion of the accounts receivable facility. There were no outstanding balances under this agreement at May 31, 2005, February 28, 2005 or May 31, 2004.

During the three months ended May 31, 2004, the Corporation commenced a cash tender offer for all of its outstanding 11.75% senior subordinated notes due July 15, 2008. As a result of this tender offer, a total of $186.2 million of these senior subordinated notes were repurchased and the Corporation recorded a charge of $39.0 million, included in Interest expense on the Condensed Consolidated Statement of Income, for the payment of the premium and other fees associated with the notes repurchased as well as for the write-off of related deferred financing costs. At May 31, 2005, approximately $10 million of these notes remained outstanding. As part of this transaction, substantially all restrictive covenants were eliminated from the remaining outstanding notes.

During the three months ended May 31, 2005, the Corporation issued formal notification that the remaining 11.75% senior subordinated notes will be called on July 15, 2005. As a result, the balance of the outstanding notes was reclassified to short-term on the Condensed Consolidated Statement of Financial Position and a charge of $0.9 million, included in Interest expense on the Condensed Consolidated Statement of Income, was recorded during the three months ended May 31, 2005, for the premium associated with the notes as well as for the write-off of related deferred financing costs.

At May 31, 2005, the Corporation was in compliance with its financial covenants.

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At May 31, 2005, February 28, 2005 and May 31, 2004, long-term debt and their related calendar year due dates were as follows:

| (In thousands) | May 31, 2005 | February 28, 2005 | May 31, 2004 |
|---|---|---|---|
| 6.10% Senior Notes, due 2028 | $ 298,603 | $ 298,503 | $ 298,215 |
| 11.75% Senior Subordinated Notes, due 2008 | 10,184 | 10,016 | 9,978 |
| 7.00% Convertible Subordinated Notes, due 2006 | 175,000 | 175,000 | 175,000 |
| Other (due 2007-2011) | 2,556 | 2,580 | 590 |
| | 486,343 | 486,099 | 483,783 |
| Less: Current maturities of long-term debt | 10,184 | | |
| | $ 476,159 | $ 486,099 | $ 483,783 |

The 7.00% convertible subordinated notes are convertible at the option of the holders into shares of the Corporation s class A common shares at any time before the close of business on July 15, 2006, at a conversion rate of 71.9466 common shares per $1 thousand principal amount of notes.

**Note 11 Retirement Benefits**

The components of periodic benefit cost for the Corporation s defined benefit pension and postretirement benefit plans for the quarter ended May 31, are as follows:

| | Defined Benefit Pension | | Postretirement Benefit | |
|---|---|---|---|---|
| (In thousands) | 2005 | 2004 | 2005 | 2004 |
| Service cost | $ 128 | $ 112 | $ 711 | $ 628 |
| Interest cost | 1,811 | 1,841 | 1,872 | 2,221 |
| Expected return on plan assets | (1,721) | (1,415) | (1,201) | (1,336) |
| Amortization of prior service cost | 23 | | (1,849) | (1,559) |
| Amortization of actuarial loss | 358 | | 1,771 | 1,546 |
| | $ 599 | $ 538 | $ 1,304 | $ 1,500 |

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act ) was signed into law. The Act provides plan sponsors a federal subsidy for certain qualifying prescription drug benefits covered under the sponsor s postretirement health care plans. FASB Staff Position No. FAS 106-2, Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003, ( FSP 106-2 ) was issued on May 19, 2004. FSP 106-2 provides guidance on accounting for the effects of the new Medicare prescription drug legislation by employers whose prescription drug benefits are actuarially equivalent to the drug benefit under Medicare Part D. FSP 106-2 also contains basic guidance on related income tax accounting and complex rules for transition that permit various alternative prospective and retroactive transition approaches. The Corporation adopted the provisions of FSP 106-2 effective September 1, 2004. The effect of the adoption of FSP

106-2 was a reduction of the net periodic postretirement benefit cost for the three months ended May 31, 2005 of approximately $0.2 million.

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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 31, 2005 was $3.2 million, compared to $2.5 million in the prior year period. 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 expenses recognized for the three month periods ended May 31, 2005 and 2004 were $0.7 million and $1.2 million, respectively.

**Note 12 Stock-Based Compensation**

The Corporation follows APB Opinion No. 25 and related Interpretations in accounting for its stock options granted to employees and directors. Because the exercise price of the Corporation s stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized. The Corporation has adopted the disclosure-only provisions of SFAS No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure. Refer to Note 3 for information regarding recent changes to the accounting guidance for stock-based compensation.

The following illustrates the pro forma effect on net income and earnings per share if the Corporation had applied the fair value recognition provisions of SFAS 123:

| | Three Months Ended May 31, | |
|---|---|---|
| **(In thousands, except per share amounts)** | **2005** | **2004** |
| Net income as reported | $ 26,414 | $ 4,238 |
| Deduct: Stock-based compensation expense determined under fair value based method, net of tax | 1,029 | 1,330 |
| Pro forma net income | $ 25,385 | $ 2,908 |
| Earnings per share: | | |
| As reported | $ 0.39 | $ 0.06 |
| Pro forma | 0.37 | 0.04 |
| Earnings per share assuming dilution: | | |
| As reported | $ 0.35 | $ 0.06 |
| Pro forma | 0.33 | 0.04 |

During the three months ended May 31, 2004, shares held in trust related to a deferred compensation plan were withdrawn from the trust. This transaction had no impact on the Corporation s results of operations during the quarter ended May 31, 2004.

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## Note 13    Business Segment Information

The Social Expression Products segment primarily designs, manufactures and sells greeting cards and other related products through various channels of distribution, with mass retailers as the primary channel, and is managed by geographic location.

At May 31, 2005, the Corporation owned and operated 534 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 Social Expression Products segment and products purchased from other vendors.

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

Non-reportable operating segments primarily include 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.

Centrally-incurred and managed costs are not allocated back to the operating segments. The unallocated items include interest expense on centrally-incurred debt and domestic profit-sharing 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.

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Operating Segment Information

| | Net Sales Three Months Ended May 31, | | Segment Earnings (Loss) Three Months Ended May 31, | |
|---|---|---|---|---|
| **(In thousands)** | **2005** | **2004** | **2005** | **2004** |
| Social Expression Products | $ 372,068 | $ 381,549 | $ 84,965 | $ 94,962 |
| Intersegment items | (11,675) | (14,824) | (8,534) | (10,936) |
| Exchange rate adjustment | 4,562 | 390 | 752 | 157 |
| Net | 364,955 | 367,115 | 77,183 | 84,183 |
| Retail Operations | 42,860 | 51,323 | (6,238) | (4,144) |
| Exchange rate adjustment | 1,382 | 216 | (42) | 15 |
| Net | 44,242 | 51,539 | (6,280) | (4,129) |
| AG Interactive | 28,047 | 9,445 | 330 | 363 |
| Exchange rate adjustment | 214 | | (95) | |
| Net | 28,261 | 9,445 | 235 | 363 |
| Non-reportable segments | 4,770 | 5,391 | 474 | (6,906) |
| Unallocated items net | 1,048 | 51 | (28,620) | (68,714) |
| Exchange rate adjustment | | | 98 | (8) |
| Net | 1,048 | 51 | (28,522) | (68,722) |
| Consolidated Total | $ 443,276 | $ 433,541 | $ 43,090 | $ 4,789 |

Other

During 2005, the Corporation recorded a severance accrual of $18.3 million related to an overhead reduction program that eliminated approximately 300 associates and the Franklin, Tennessee plant closure. Substantially all of the associates receiving payments separated from the Corporation on or prior to February 28, 2005. Approximately 70% of the severance will be paid prior to February 28, 2006, with the remaining payments extending through 2008. The remaining balance of the severance accrual was $11.1 million at May 31, 2005.

In connection with the plant closing, the Social Expression Products segment recorded an additional charge of $3.2 million during the three months ended May 31, 2005 for the remaining shutdown and relocation costs incurred during the period.

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**Note 14 Discontinued Operations**

On July 30, 2004, the Corporation announced it had signed a letter of agreement to sell its Magnivision nonprescription reading glasses business to AAiFosterGrant, a unit of sunglasses maker Foster Grant. 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 the third quarter of fiscal 2005 although an additional amount may be recorded during the next six months based on closing balance sheet adjustments. This adjustment is not expected to exceed ten percent of the cash proceeds. During the third quarter of fiscal 2005, the Corporation received cash proceeds of $77.0 million and recorded a gain of $35.5 million for the sale of Magnivision.

Magnivision meets the definition of a component of an entity and has been accounted for as a discontinued operation under SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. Accordingly, the Corporation s condensed consolidated financial statements and related notes have been presented to reflect Magnivision as a discontinued operation for all periods presented. Magnivision was previously included within the Corporation s non-reportable segments.

The following summarizes the results of discontinued operations for the three months ended May 31, 2004:

| **(In thousands)** | |
|---|---|
| Net sales | $ 12,634 |
| Pretax income from operations | 2,124 |
| Income tax expense | 822 |
| Income from discontinued operations | $ 1,302 |

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 31, 2004** |
|---|---|
| Assets of businesses held for sale: | |
| Current assets | $ 19,786 |
| Other assets | 6,911 |
| Fixed assets | 11,208 |
| | $ 37,905 |
| Liabilities of businesses held for sale: | |
| Current liabilities | $ 3,019 |
| Noncurrent liabilities | 1,616 |
| | $ 4,635 |

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## Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

### Overview

During the first quarter of 2006, the Corporation believes that its North American operations began to realize the benefit of the initiatives focused on achieving a better understanding of consumer needs and improving the shopping experience. New products are driving increased sales and earnings in North America from everyday cards due to both an improved product mix and higher sell-through at retail. However, consolidated sales of everyday cards remained flat compared to the prior year as a soft international market, particularly in the U.K., offset the successes in the North American market. Consolidated sales of seasonal cards were down compared to the prior year, however a substantial portion of the decrease is based on timing and is not expected to impact full year comparative results.

As expected, the Retail segment contributed lower sales and earnings as it continued its turnaround plan by closing low performing stores. However, improvements in the quality and mix of the product offering and lower promotional activity contributed to a significantly higher gross margin percentage than in the prior year quarter.

Continued cost savings initiatives and operational improvements contributed to significant improvements in the display fixtures business, which generated unfavorable production variances and inventory rationalization costs in the prior year.

During the three months ended May 31, 2005, the Corporation recognized net income of $26.4 million compared to $4.2 million in the prior year quarter.

For 2006, AG Interactive changed its year-end to coincide with the Corporation s fiscal year end. As a result, the quarter ended May 31, 2005 includes five months of AG Interactive s operations.

The current year quarter included $3.2 million for shutdown and relocation costs incurred during the period in connection with the closure of the Corporation s Franklin, Tennessee manufacturing facility. The Corporation also recorded a charge of $0.9 million for the costs associated with the commitment to repurchase the Corporation s remaining outstanding 11.75% senior subordinated notes. The Corporation issued formal notification during the quarter that the remaining 11.75% senior subordinated notes will be called on July 15, 2005.

The prior year quarter included a charge of $39.0 million for costs associated with the repurchase of $186.2 million of the Corporation s 11.75% senior subordinated notes and a gain of $3.1 million on the sale on an investment.

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**Results of Operations**

*Three months ended May 31, 2005 and 2004*

Net income was $26.4 million, or $0.35 per share, in the quarter compared to $4.2 million, or $0.06 per share, in the prior year first quarter (all per-share amounts assume dilution).

The Corporation s results for the three months ended May 31, 2005 and 2004 are summarized below:

| (Dollars in thousands) | 2005 | % Net Sales | 2004 | % Net Sales | Fav (Unfav) |
|---|---|---|---|---|---|
| Net sales | $ 443,276 | 100.0% | $ 433,541 | 100.0% | 2.2% |
| Material, labor and other production costs | 180,473 | 40.7% | 181,615 | 41.9% | 0.6% |
| Selling, distribution and marketing | 155,274 | 35.0% | 146,652 | 33.8% | (5.9)% |
| Administrative and general | 63,128 | 14.3% | 64,137 | 14.8% | 1.6% |
| Interest expense | 9,682 | 2.2% | 52,694 | 12.2% | 81.6% |
| Other income net | (8,371) | (1.9)% | (16,346) | (3.8)% | (48.8)% |
| Total costs and expenses | 400,186 | 90.3% | 428,752 | 98.9% | 6.7% |
| Income from continuing operations before income tax expense | 43,090 | 9.7% | 4,789 | 1.1% | 799.8% |
| Income tax expense | 16,676 | 3.7% | 1,853 | 0.4% | (800.0)% |
| Income from continuing operations | 26,414 | 6.0% | 2,936 | 0.7% | 799.7% |
| Income from discontinued operations, net of tax | | 0.0% | 1,302 | 0.3% | (100.0)% |
| Net income | $ 26,414 | 6.0% | $ 4,238 | 1.0% | 523.3% |

For the three months ended May 31, 2005, consolidated net sales were $443.3 million, up from $433.5 million in the prior year first quarter. This 2.2% increase was primarily the result of increased sales of approximately $7 million due to the two AG Interactive acquisitions in the prior year second quarter as well as approximately $11 million from the additional two months of activity from the AG Interactive business due to the change in its fiscal year-end. A strong performance in the North American everyday card business, aided by improved product sell through, was offset by a soft international market. Foreign exchange accounted for approximately $6 million or 1.3% of the 2.2% increase. Partially offsetting these increases were lower sales in the Corporation s retail and U.K. businesses. The retail business was down approximately $5 million due to fewer stores and same-store sales decreased approximately $3 million or 7.1% from the prior year period. The U.K. business was down approximately $7 million compared to the prior year due to lower seasonal card sales related to the timing of spring holidays and lower everyday product sales related to unfavorable results at several large retailers.

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Unit and Pricing Analysis

Unit and pricing comparatives for the three months ended May 31, 2005 and 2004 are summarized below:

| | Increase (Decrease) From the Prior Year | | | | | |
|---|---|---|---|---|---|---|
| | **Everyday Cards** | | **Seasonal Cards** | | **Total Greeting Cards** | |
| | **2005** | **2004** | **2005** | **2004** | **2005** | **2004** |
| Unit volume | (0.3)% | 0.5% | (12.6)% | 1.2% | (4.9)% | 0.7% |
| Selling prices | 1.1% | (1.9)% | 4.3% | 0.4% | 1.8% | (1.0)% |
| Overall Increase / (Decrease) | 0.8% | (1.4)% | (8.9)% | 1.6% | (3.1)% | (0.3)% |

Seasonal card unit volume decreased 12.6% in the current year quarter. Approximately half of this decrease is due to the new merchandising strategy for seasonal space management announced in the second half of the prior year. In the prior year, these programs were sold on an outright basis while in the current year they are sold with full return privileges. As such, the current year includes an accrual for the estimated returns recorded at the time the sales are recognized. The remaining decrease is due primarily to lower unit sales of Mother s Day, Father s Day and Graduation cards. Approximately 3 percentage points of the lower unit sales are expected to be recovered during the second quarter, as this decrease relates to timing differences on sales of Father s Day and Graduation cards with customers that implemented scan-based trading subsequent to the prior year first quarter. The 4.3% increase in selling prices of seasonal cards is primarily due to product mix of Mother s Day cards, with a lower volume of value priced cards than in the prior year.

Sales of everyday card units decreased 0.3% compared to the prior year as a 4.7% improvement in North American unit sales, due to product mix enhancements, was more than offset by soft international everyday card unit sales, particularly in the U.K. The 1.1% increase in selling prices of everyday cards was driven by the international business units as the mix of cards sold shifted to higher priced units.

Expense Overview

Material, labor and other production costs for the three months ended May 31, 2005 were $180.5 million, a decrease from $181.6 million for the same period in the prior year. As a percentage of net sales, these costs were 40.7% in the current period compared to 41.9% for the three months ended May 31, 2004. The $1.1 million decrease from the prior year is due to a decrease in costs of approximately $12 million, primarily related to lower sales and lower markdown costs in our retail business and lower sales and production improvements in our fixtures business. Also, the fixtures business recorded inventory adjustments in the prior year first quarter. These decreases were partially offset by approximately $11 million due to shutdown and relocation costs for the plant closure, foreign exchange rate impacts and the AG Interactive prior year acquisitions and additional two months of activity.

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Selling, distribution and marketing costs for the three months ended May 31, 2005 were $155.3 million, increasing from the $146.7 million for the same period in the prior year. As a percentage of net sales, these costs increased from 33.8% for the three months ended May 31, 2004 to 35.0% for the three months ended May 31, 2005. Of the $8.6 million increase, approximately $10 million was attributable to the two months of additional activity related to the change in fiscal year-end for AG Interactive as well as the expenses incurred by the AG Interactive acquisitions. Foreign exchange accounted for approximately $2 million of the increase. These increases were partially offset by approximately $3 million due to reduced costs in the retail segment stores arising from fewer stores.

Administrative and general expenses were $63.1 million for the three months ended May 31, 2005, a decrease from $64.1 million for the same period in the prior year. The $1.0 million decrease is due to lower consulting fees and bad debt expense offset by increased costs from the AG Interactive acquisitions.

Interest expense decreased by $43.0 million to $9.7 million for the three months ended May 31, 2005 from $52.7 million for the same period in the prior year. This decrease is due to the repurchase of $186.2 million of the Corporation s 11.75% senior subordinated notes during the quarter ended May 31, 2004. Interest expense in the three months ended May 31, 2005 was $4.5 million lower than the prior period due to savings related to the repurchase. Interest expense in the quarter ended May 31, 2004 included $39.0 million for the premium payment, fees and the write-off of deferred financing costs associated with the repurchase.

Other income net decreased to $8.4 million for the three months ended May 31, 2005, from $16.3 million in the same period in the prior year. The $7.9 million decrease is due to $4.8 million less royalty revenue and $1.5 million more foreign exchange losses offset by a $1.9 million increase in interest income. The prior year three months also included a $3.1 million gain on sale of investment.

The effective tax rate was 38.7% for both the three months ended May 31, 2005 and 2004. During the first quarter of fiscal 2006, the Corporation established additional tax reserves to cover anticipated examination adjustments. In addition, the Corporation adjusted its valuation allowances against deferred tax assets due to improved earnings at certain foreign locations. These adjustments essentially offset.

**Segment Information**

The Corporation is organized and managed according to a number of factors, including product categories, geographic locations and channels of distribution. The Social Expression Products segment primarily designs, manufactures and sells greeting cards and other related products through various channels of distribution with mass retailers as the primary channel and is managed by geographic location. 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 the Social Expression Products segment. These operating divisions have similar economic characteristics, products, production processes, types of customers and distribution methods. The Corporation owns and operates 534 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.

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The stores sell products purchased from the Social Expression Products segment and products purchased from other vendors. AG Interactive is an electronic provider of social expression content through the Internet and wireless platforms.

The Corporation reviews segment results using consistent exchange rates between periods to eliminate the impact of foreign currency fluctuations.

*Social Expression Products Segment*

| | Three Months Ended May 31, | | |
|---|---|---|---|
| **(Dollars in thousands)** | **2005** | **2004** | **% Change** |
| Net sales | $ 360,393 | $ 366,725 | (1.7)% |
| Segment earnings | 76,431 | 84,026 | (9.0)% |

Net sales of the Social Expression Products segment excluding the impact of foreign exchange and intersegment items, for the three months ended May 31, 2005, decreased $6.3 million or 1.7% from the same period in the prior year due primarily to decreases in our U.K. business. In North America, improved product mix and better sell-through of everyday cards was offset by lower sales of seasonal cards, primarily due to the revised strategy for seasonal space management and lower sales of both Father s Day and Graduation cards in the quarter.

Segment earnings excluding the impact of foreign exchange and intersegment items for the three months ended May 31, 2005, decreased $7.6 million compared to the prior year period. These results include approximately $3 million of shutdown and relocation costs associated with the plant closure and the impact of the lower sales in the U.K. business.

*Retail Operations Segment*

| | Three Months Ended May 31, | | |
|---|---|---|---|
| **(Dollars in thousands)** | **2005** | **2004** | **% Change** |
| Net sales | $ 42,860 | $ 51,323 | (16.5)% |
| Segment loss | (6,238) | (4,144) | (50.5)% |

Net sales excluding the impact of foreign exchange in the Retail Operations segment decreased $8.5 million or 16.5% as same-store sales decreased approximately $3 million or 7.1% for the three months ended May 31, 2005 compared to the same period in the prior year. The average number of stores was approximately 9.8% less than in the prior year quarter, which accounted for approximately $5 million of the decrease in net sales.

Segment earnings excluding the impact of foreign exchange was a loss of $6.2 million in the three months ended May 31, 2005, compared to a loss of $4.1 million in the three months ended May 31, 2004. Earnings were unfavorably impacted by certain noncapitalizable implementation costs associated with a systems infrastructure upgrade in the stores. The impact of lower sales on earnings was softened due to a lower level of promotional activity and improved product mix that improved the gross margins by approximately 4.3 percentage points. Segment earnings benefited from lower store rent and associate costs due to fewer stores.

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*AG Interactive Segment*

| | Three Months Ended May 31, | | |
|---|---|---|---|
| **(Dollars in thousands)** | **2005** | **2004** | **% Change** |
| Net sales | $ 28,047 | $ 9,445 | 197.0% |
| Segment earnings | 330 | 363 | (9.1)% |

For 2006, AG Interactive changed its year-end to coincide with the Corporation s fiscal year end. As a result, the quarter ended May 31, 2005 includes five months of AG Interactive s operations.

Net sales excluding the impact of foreign exchange of AG Interactive increased $18.6 million for the quarter ended May 31, 2005, compared to the same period in the prior year. The additional two months of activity accounted for approximately $11 million of the increase while the prior year acquisitions within the AG Mobile wireless division contributed $7 million to the net sales increase. Net sales for the core online greeting card business improved by approximately $1 million compared to the prior year period.

Segment earnings decreased less than $0.1 million for the quarter ended May 31, 2005, compared to the prior year period as the impact of sales increases were offset by acquisition costs, higher technology costs and the cost of new business initiatives. Segment earnings for the core online greeting card business improved by approximately $1 million, more than offset by the cost of new business initiatives in the acquired businesses.

## Liquidity and Capital Resources

The seasonal nature of the Corporation s business precludes a useful comparison of the current period and the fiscal year-end financial statements; therefore, a Condensed Consolidated Statement of Financial Position for May 31, 2004 has been included.

### Operating Activities

Operating activities provided $17.7 million in cash during the three months ended May 31, 2005, compared to providing $23.6 million of cash in the same period in the prior year.

Accounts receivable used $10.9 million of cash from February 28, 2005, compared to a use of $13.2 million in the same period in the prior year. As a percentage of the prior twelve months net sales, net accounts receivable were 10.3% at May 31, 2005, compared to 12.9% at May 31, 2004.

Inventory was a use of $13.9 million from February 28, 2005, compared to a use of $17.2 million in the same period in the prior year. As a percentage of the prior twelve months material, labor and other production costs, inventories were 25.9% at May 31, 2005, compared to 27.7% at May 31, 2004.

Other current assets were a source of $14.4 million in cash from February 28, 2005, compared to a source of $7.9 million in the same period in the prior year. The difference relates to the current year tax refund of payments partially offset by payments for insurance premiums.

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Deferred costs net represents payments under agreements with retailers net of the related amortization of those payments. During the three months ended May 31, 2005, amortization exceeded payments by $25.1 million; in the three months ended May 31, 2004, amortization exceeded payments by $33.3 million. Payments for new or amended contracts are flat compared to the prior year while the related amortization has decreased by $9.4 million compared to the prior year three months. See Note 9 to the condensed consolidated financial statements for further discussion of deferred costs related to customer agreements.

Accounts payable and other liabilities were a use of $48.2 million during the three months ended May 31, 2005, compared to a use of $28.1 million in the prior year period. The increase from the prior year is due to higher bonuses and profit sharing payments as well as payments related to the headcount reduction and plant closure and tax payments.

Investing Activities

Investing activities used $8.2 million in cash during the three months ended May 31, 2005, compared to providing $23.7 million in the same period in the prior year. The decrease of $31.9 million is primarily due to increased capital expenditures in the three months ended May 31, 2005 and the proceeds received from the sale of the marketable security investment of $19.1 million during the three months ended May 31, 2004.

Financing Activities

Financing activities used $42.5 million of cash during the three months ended May 31, 2005, compared to $213.7 million in the same period in the prior year. The current year amount relates primarily to the Corporation s program to repurchase up to $200 million of its Class A common shares announced on April 5, 2005. During the three months ended May 31, 2005, $45.5 million was paid to repurchase approximately 1.9 million shares under the repurchase program. The prior year amount relates primarily to the repurchase of the Corporation s 11.75% senior subordinated notes.

Stock activity provided and used a significant amount of cash during both the current and prior year three months. The receipt by the Corporation of the exercise price on stock options provided $8.5 million and $12.0 million during the three months ended May 31, 2005 and 2004, respectively. During the three months ended May 31, 2005, $45.5 million was paid to repurchase approximately 1.9 million Class A common shares under the Corporation s $200 million repurchase program. In addition, in accordance with its articles of incorporation, the Corporation repurchased Class B common shares at a cost of approximately $9.3 million into its Treasury in the prior year quarter.

During the quarter ended May 31, 2005, the Corporation paid a quarterly dividend of $0.08 per common share, which totaled $5.5 million.

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Credit Sources

Substantial credit sources are available to the Corporation. In total, the Corporation had available sources of approximately $400 million at May 31, 2005. This includes the Corporation s $200 million senior secured revolving credit facility and its $200 million accounts receivable securitization financing. There were no outstanding balances under either of these arrangements at May 31, 2005.

On May 11, 2004, the Corporation amended and restated its senior secured revolving credit facility. This facility was originally entered into on August 9, 2001, as a $350 million facility and was amended on July 22, 2002, to a $320 million facility. The amended and restated senior secured revolving credit facility consists of a $200 million revolving facility maturing on May 10, 2008. The amended facility is secured by the domestic assets of the Corporation and a 65% interest in the common stock of its foreign subsidiaries. The Corporation pays an annual commitment fee of 25 basis points on the undrawn portion of the facility. The facility contains various restrictive covenants. Some of these restrictions require that the Corporation meet specified periodic financial ratios, minimum net worth, maximum leverage, and interest coverage. The credit facility places certain restrictions on the Corporation s ability to incur additional indebtedness, to engage in acquisitions of other businesses, to repurchase its own capital stock and to pay shareholder dividends. These covenants are less restrictive than the covenants previously in place.

The accounts receivable securitization financing agreement was amended on August 2, 2004, to extend the maturity date to August 1, 2007. The Corporation pays an annual commitment fee of 25 basis points on the undrawn portion of the accounts receivable facility.

During the three months ended May 31, 2004, the Corporation commenced a cash tender offer for all of its outstanding 11.75% senior subordinated notes due July 15, 2008. As a result of this tender offer, a total of $186.2 million of these senior subordinated notes were repurchased and the Corporation recorded a charge of $39.0 million for the payment of the premium and other fees associated with the notes repurchased as well as for the write-off of related deferred financing costs. At May 31, 2005, approximately $10 million of these notes remained outstanding. As part of this transaction, substantially all restrictive covenants were eliminated from the remaining outstanding notes.

During the quarter ended May 31, 2005, the Corporation issued formal notification that the remaining 11.75% senior subordinated notes will be called on July 15, 2005.

There were no material changes in the financial condition, liquidity or capital resources of the Corporation from February 28, 2005, the end of its preceding fiscal year, to May 31, 2005, the end of its latest fiscal quarter and the date of the most recent balance sheet included in this report, nor from May 31, 2004, the end of the corresponding fiscal quarter last year, to May 31, 2005, except for the changes discussed above and aside from normal seasonal fluctuations. The Corporation s future operating cash flow and borrowing availability under existing credit facilities and its accounts receivable securitization financing program are expected to meet currently anticipated funding requirements.

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## Critical Accounting Policies

Please refer to the discussion of the Corporation s Critical Accounting Policies as disclosed in the Corporation s Annual Report on Form 10-K for the year ended February 28, 2005.

## Prospective Information

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 ter 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 the Corporation s operations and business environment, which are difficult to predict and may be beyond the control of the Corporation. Important factors that could cause actual results to differ materially from those suggested by these forward-looking statements, and that could adversely affect the Corporation s future financial performance, include, but are not limited to, the following: retail bankruptcies and consolidations; successful integration of acquisitions; successful transition of management; 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; successfully implementing supply chain improvements and achieving projected cost savings from those improvements; the Corporation s ability to generate revenues from licensing activities and maximize the value of its intellectual property; the Corporation s ability to comply with its debt covenants; fluctuations in the value of currencies in major areas where the Corporation operates, including the U.S. Dollar, Euro, U.K. Pound Sterling, and Canadian Dollar; escalation in the cost of providing employee health care; and the outcome of any legal claims known or unknown. Risks pertaining specifically to AG Interactive include the viability of online advertising and subscriptions as revenue generators, the public s acceptance of online greetings and other social expression products, and the ability of the mobile division to compete effectively in the wireless content aggregation market.

The risks and uncertainties identified above are not the only risks the Corporation faces. Additional risks and uncertainties not presently known to the Corporation or that it believes to be immaterial also may adversely affect the Corporation. 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 the Corporation s business, financial condition and results of operations.

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

For further information, refer to the Corporation s annual report on Form 10-K for the year ended February 28, 2005. There were no material changes in market risk, specifically interest rate and foreign currency exposure, for the Corporation from February 28, 2005, the end of its preceding fiscal year, to May 31, 2005, the end of its most recent fiscal quarter.

## Item 4. Controls and Procedures

The Corporation maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Corporation s 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 Principal 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.

The Corporation carries out a variety of on-going procedures, under the supervision and with the participation of the Corporation s management, including the Corporation s Chief Executive Officer and principal financial officer, to evaluate the effectiveness of the design and operation of the Corporation s disclosure controls and procedures. Based on the foregoing, the Corporation s Chief Executive Officer and principal financial officer 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.

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## PART II OTHER INFORMATION

### Item 1. Legal Proceedings

The Corporation is involved in certain legal actions and claims arising in the ordinary course of business. The Corporation does not believe that any of the litigation in which it is currently engaged, either individually or in the aggregate, will have a material adverse effect on its consolidated financial condition 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 purchases of common shares of the Corporation made during the three months ended May 31, 2005, by American Greetings Corporation.

| Period | Total Number of Shares Repurchased | Average Price Paid per Share (1) | 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 |
|---|---|---|---|---|
| March 2005 | | | | |
| April 2005 | Class A - 940,000 | $ 23.44 | 940,000(2) | $ 177,966,561 |
| May 2005 | Class A - 965,000 | $ 24.29 | 965,000(2) | $ 154,524,482 |
| Total | Class A - 1,905,000 | $ 23.87 | 1,905,000(2) | |

(1) Excludes commissions paid, if any, related to the share repurchase transactions.

(2) On April 5, 2005, American Greetings announced that its Board of Directors authorized a program to repurchase up to $200 million of its Class A Common Shares over a 12-month period, which will expire in April 2006. These repurchases will be made through a 10b5-1 program in open market or privately negotiated transactions in compliance with the SEC s Rule 10b-18, subject to market conditions, applicable legal requirements and other factors.

**Item 3. Defaults Upon Senior Securities**

Not applicable

**Item 4. Submission of Matters to a Vote of Security Holders**

Not applicable

**Item 5. Other Information**

Not applicable

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## Item 6. Exhibits

Exhibits required by Item 601 of Regulation S-K

(31) a Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

(31) b Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

(32) Certification of Chief Executive Officer and Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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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
Corporate Controller
Chief Accounting Officer

July 8, 2005

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

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