

AMERICAN GREETINGS CORP
Form 10-K
May 10, 2006
Table of Contents

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

(Mark One)

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

For the fiscal year ended February 28, 2006

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 No. 1-13859

American Greetings Corporation

(Exact name of registrant as specified in its charter)

Ohio
(State or other jurisdiction)

34-0065325
(I.R.S. Employer Identification No.)

(of incorporation or organization)

One American Road, Cleveland, Ohio
(Address of principal executive offices)

44144
(Zip Code)

Registrant's telephone number, including area code: **(216) 252-7300**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class
Class A Common Shares, Par Value \$1.00

Name of each exchange on which registered
New York Stock Exchange

Edgar Filing: AMERICAN GREETINGS CORP - Form 10-K

Securities registered pursuant to Section 12(g) of the Act:

Class B Common Shares, Par Value \$1.00

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES NO

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 Act) YES NO

State the aggregate market value of the voting stock held by non-affiliates of the registrant as of the last business day of the registrant's most recently completed second fiscal quarter, August 31, 2005 \$1,612,230,683 (affiliates, for this purpose, have been deemed to be directors, executive officers and certain significant shareholders).

Number of shares outstanding as of May 1, 2006:

CLASS A COMMON 53,352,850

CLASS B COMMON 4,217,067

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the American Greetings Corporation Definitive Proxy Statement for the Annual Meeting of Shareholders, to be filed with the Securities and Exchange Commission within 120 days after the close of the registrant's fiscal year (incorporated into Part III). The Report of the Compensation and Management Development Committee on Executive Compensation, the Report of the Audit Committee and the Performance Graph contained in the registrant's Definitive Proxy Statement shall not be deemed incorporated by reference herein.

Table of Contents**AMERICAN GREETINGS CORPORATION****INDEX**

	Page Number
PART I	
Item 1. <u>Business</u>	1
Item 1A. <u>Risk Factors</u>	5
Item 1B. <u>Unresolved Staff Comments</u>	11
Item 2. <u>Properties</u>	11
Item 3. <u>Legal Proceedings</u>	13
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	13
PART II	
Item 5. <u>Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	16
Item 6. <u>Selected Financial Data</u>	18
Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	19
Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risks</u>	36
Item 8. <u>Financial Statements and Supplementary Data</u>	37
Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	73
Item 9A. <u>Controls and Procedures</u>	73
Item 9B. <u>Other Information</u>	73
PART III	
Item 10. <u>Directors and Executive Officers of the Registrant</u>	74
Item 11. <u>Executive Compensation</u>	74
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	74
Item 13. <u>Certain Relationships and Related Transactions</u>	75
Item 14. <u>Principal Accounting Fees and Services</u>	75
PART IV	
Item 15. <u>Exhibits, Financial Statement Schedules</u>	76
SIGNATURES	

Table of Contents

PART I

Unless otherwise indicated or the context otherwise requires, the Corporation, we, our, us and American Greetings are used in this report to refer to the businesses of American Greetings Corporation and its consolidated subsidiaries.

Item 1. Business
OVERVIEW

Founded in 1906, American Greetings operates predominantly in a single industry: the design, manufacture and sale of everyday and seasonal greeting cards and other social expression products. Greeting cards, gift wrap, party goods, candles, balloons, stationery and giftware are manufactured or sold by us in North America, including the United States, Canada and Mexico, and throughout the world, primarily in the United Kingdom, Mexico, Australia, New Zealand and South Africa. In addition, our subsidiary, AG Interactive, Inc., markets e-mail greetings, personalized printable greeting cards and other social expression products through our Web sites www.americangreetings.com, www.bluemountain.com and www.egreetings.com; co-branded Web sites and on-line services. In 2005, AG Interactive launched its AG Mobile unit, which specializes in the distribution of ringtones for cellular telephones, graphics, games, alerts and other social messaging products and applications to mobile devices. Our subsidiary, Learning Horizons, Inc., distributes supplemental educational products. Design licensing and character licensing are done primarily by our subsidiaries, AGC, Inc. and Those Characters From Cleveland, Inc., respectively. The Hatchery, LLC (50% owned by us) also develops and produces original family and children's entertainment for all media. Our A.G. Industries, Inc. subsidiary manufactures custom display fixtures for our products and products of others. As of February 28, 2006, we also owned and operated 503 card and gift shops throughout North America.

Our 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, 2006 refers to the year ended February 28, 2006. Our AG Interactive subsidiary was consolidated on a two-month lag corresponding with its fiscal year-end of December 31. In fiscal 2006, AG Interactive changed its year-end to coincide with our fiscal year-end. As a result, fiscal 2006 includes fourteen months of AG Interactive's operations.

PRODUCTS

American Greetings creates, manufactures and distributes social expression products including greeting cards, gift wrap, party goods, calendars, candles and stationery as well as educational products and custom display fixtures. Our major domestic greeting card brands are American Greetings, Carlton Cards, and Gibson, and other domestic products include DesignWare party goods, Guildhouse candles, Plus Mark gift wrap and boxed cards, DateWorks calendars, Learning Horizons educational products and AGI Schutz display fixtures. On-line greeting card offerings and other digital content are available through our subsidiary, AG Interactive, Inc. We also create and license our intellectual properties, such as the Care Bear and Strawberry Shortcake characters. Information concerning sales by major product classifications is included in Part II, Item 7.

BUSINESS SEGMENTS

At February 28, 2006, we operated in five business segments: North American Social Expression Products, International Social Expression Products, Retail Operations, AG Interactive and non-reportable operating segments. For information regarding the various business segments comprising our business, see the discussion included in Part II, Item 7 and in Note 16 to the Consolidated Financial Statements included in Part II, Item 8.

CONCENTRATION OF CREDIT RISKS

Net sales to our five largest customers, which include mass merchandisers and national drug store and supermarket chains, accounted for approximately 35% of net sales in fiscal year 2006 and approximately 32% of

Table of Contents

net sales in fiscal years 2005 and 2004. Net sales to Wal-Mart Stores, Inc. and its subsidiaries accounted for approximately 16%, 15% and 13% of net sales in 2006, 2005 and 2004, respectively. No other customer accounted for 10% or more of our net sales.

CONSUMERS

We believe that women purchase more than 80% of all greeting cards sold and that the median age of our consumers is approximately 54. We also believe that the average American household purchases about 17 greeting cards per year, the average number of greeting cards purchased per transaction is approximately two, and consumers make approximately seven card purchasing trips per year.

COMPETITION

The greeting card and gift wrap industries are intensely competitive. Competitive factors include quality, design, customer service and terms, which may include payments and other concessions to retail customers under long-term agreements. These agreements are discussed in greater detail below. There are an estimated 3,000 greeting card publishers in the United States, ranging from small family-run organizations to major corporations. In general, however, the greeting card business is extremely concentrated. We believe that we are one of only two main suppliers offering a full line of social expression products that, together, are estimated to encompass approximately 85% of the overall market. Our principal competitor is Hallmark Cards, Inc. Based upon our general familiarity with the greeting card and gift wrap industry and limited information as to our competitors, we believe that we are the second-largest company in the industry and the largest publicly owned greeting card company.

PRODUCTION AND DISTRIBUTION

In 2006, our three distinct channels of distribution continued to be primarily through mass retail, which is comprised of mass merchandisers, chain drug stores and supermarkets. Other major channels of distribution included card and gift shops, department stores, military post exchanges, variety stores and combo stores (stores combining food, general merchandise and drug items). We also sell our products through our card and gift retail stores. As of February 28, 2006, we owned and operated 503 card and gift retail stores in the United States and Canada through our Retail Operations segment, which are primarily located in malls and strip shopping centers. From time to time, we also sell our products to independent, third-party distributors. Our distribution centers are located near our manufacturing facilities. Our automated distribution system enables us to replenish retailers' shelves promptly following the initiation of a re-order.

Many of our products are manufactured at common production facilities and marketed by a common sales force. Our manufacturing operations involve complex processes including printing, die cutting, hot stamping and embossing. We employ modern printing techniques which allow us to perform short runs and multi-color printing, have a quick changeover and utilize direct-to-plate technology, which minimizes time to market. Our products are manufactured globally, primarily at facilities located in North America, the United Kingdom and Australia. We also source products from domestic and foreign third party suppliers. Additionally, information by geographic area is included in Note 16 to the Consolidated Financial Statements included in Part II, Item 8.

Production of our products is generally on a level basis throughout the year. Everyday inventories (such as birthday and anniversary related products) remain relatively constant throughout the year, while seasonal inventories peak in advance of each major holiday season, including Christmas, Valentine's Day, Easter, Mother's Day, Father's Day and Graduation. Payments for seasonal shipments are generally received during the month in which the major holiday occurs, or shortly thereafter. Extended payment terms may also be offered in response to competitive situations with individual customers. Payments for both everyday and seasonal sales from customers that have been converted to a scan-based trading model are received generally within 10 to 15

Table of Contents

days of the product being sold by those customers at their retail locations. As of February 28, 2006, three of our five largest customers in 2006 conduct business with us under a scan-based trading model. The core of this business model rests with American Greetings providing product to the customer on a consignment basis with American Greetings recording sales at the time a product is electronically scanned through the retailer's cash register. American Greetings and many of its competitors sell seasonal greeting cards with the right of return. Sales of non-seasonal products are generally sold without the right of return. Sales credits for non-seasonal product are issued at our sole discretion for damaged, obsolete and outdated products. Information regarding the return of product is included in Note 1 to the Consolidated Financial Statements included in Part II, Item 8.

During the year, we experienced no material difficulties in obtaining raw materials from our suppliers.

INTELLECTUAL PROPERTY RIGHTS

We have a number of trademarks, service marks, trade secrets, copyrights, inventions and other intellectual property, which are used in connection with our products and services. Our designs, artwork, musical compositions, photographs and editorial verse are protected by copyright. In addition, we seek to register our trademarks in the United States and elsewhere. From time to time, we seek protection of our inventions by filing patent applications for which patents may be granted. We also obtain license agreements for the use of intellectual property owned or controlled by others. Although the licensing of intellectual property produces additional revenue, we do not believe that our operations are dependent upon any individual invention, trademark, service mark, copyright or other intellectual property license. Collectively, our intellectual property is an important asset to us. As a result, we follow an aggressive policy of protecting our rights in our intellectual property and intellectual property licenses.

EMPLOYEES

At February 28, 2006, we employed approximately 9,700 full-time employees and approximately 19,800 part-time employees which, when jointly considered, equate to approximately 19,200 full-time equivalent employees. Approximately 2,700 of our hourly plant employees are unionized and covered by collective bargaining agreements. The following table sets forth by location the unions representing our domestic employees, together with the expiration date of the applicable governing collective bargaining agreement.

Union	Location	Contract Expiration Date
International Brotherhood of Teamsters	Bardstown, Kentucky; Kalamazoo, Michigan; Cleveland, Ohio	March 20, 2011 April 30, 2010 March 31, 2010
UNITE-HERE Union	Greeneville, Tennessee (Plus Mark)	October 19, 2008
Firemen and Oilers Conference of the Service Employees International Union	Berea, Kentucky	August 31, 2006

Other locations with unions are the United Kingdom, Mexico, Australia, New Zealand and South Africa. We believe that labor relations at each location where we operate have generally been satisfactory.

SUPPLY AGREEMENTS

In the normal course of business, we enter into agreements with certain customers for the supply of greeting cards and related products. We view the use of such agreements as advantageous in developing and maintaining business with our retail customers. Under these agreements, the customer typically receives from American Greetings a combination of cash payments, credits, discounts, allowances and other incentive considerations to be earned by the customer as product is purchased from us over the effective time period of the agreement to

Table of Contents

meet a minimum purchase volume commitment. The agreements are negotiated individually to meet competitive situations and, therefore, while some aspects of the agreements may be similar, important contractual terms vary. The agreements may or may not specify American Greetings as the sole supplier of social expression products to the customer. In the event an agreement is not completed, we have a claim for unearned advances under the agreement.

Although risk is inherent in the granting of advances, we subject such customers to our normal credit review. We maintain a general reserve for deferred costs based on estimates developed by using standard quantitative measures incorporating historical write-offs. In instances where we are aware of a particular customer's inability to meet its performance obligation, we record a specific reserve to reduce the deferred cost asset to our estimate of its value based upon expected performance. These agreements are accounted for as deferred costs. Losses attributed to these specific events have historically not been material. The balances and movement of the valuation reserve accounts are disclosed on Schedule II of this Annual Report on Form 10-K. See Note 10 to the Consolidated Financial Statements in Part II, Item 8, and the discussion under the "Deferred Costs" heading in the "Critical Accounting Policies" section of Item 7 for further information and discussion of deferred costs.

ENVIRONMENTAL REGULATIONS

Our business is subject to numerous foreign and domestic environmental laws and regulations maintained to protect the environment. These environmental laws and regulations apply to chemical usage, air emissions, wastewater and storm water discharges, and other releases into the environment as well as the generation, handling, storage, transportation, treatment and disposal of waste materials, including hazardous waste. Although we believe that we are in substantial compliance with all applicable laws and regulations, because legal requirements frequently change and are subject to interpretation, these laws and regulations may give rise to claims, uncertainties or possible loss contingencies for future environmental remediation liabilities and costs. We have implemented various programs designed to protect the environment and comply with applicable environmental laws and regulations. The costs associated with these compliance and remediation efforts have not and are not expected to have a material adverse effect on our financial condition, cash flows, or operating results. In addition, the impact of increasingly stringent environmental laws and regulations, the discovery of unknown conditions, and third party claims for damages to the environment, real property, or persons could also result in additional liabilities and costs in the future.

AVAILABLE INFORMATION

We make available, free of charge, on or through the Investors section of our www.corporate.americangreetings.com Web site, our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and, if applicable, amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission ("SEC"). Copies of our filings with the SEC also can be obtained at the SEC's Internet site, www.sec.gov.

Our Corporate Governance Guidelines, Code of Business Conduct and Ethics, and the charters of the Board's Audit Committee, Compensation and Management Development Committee, and Nominating and Governance Committee are available on or through the Investors section of our www.corporate.americangreetings.com Web site, and will be made available in print upon request by any shareholder to the Secretary of American Greetings.

Table of Contents

Item 1A. Risk Factors

You should carefully consider each of the risks and uncertainties we describe below and all other information in this report. The risks and uncertainties we describe below are not the only ones we face. Additional risks and uncertainties of which we are currently unaware or that we currently believe to be immaterial may also adversely affect our business.

The growth of our greeting card business is critical to future profitability and cash flow.

One of our key business strategies is to gain profitable market share by spending at least \$100 million to revamp our greeting card business over the next several years, with the majority of the expense occurring during fiscal 2007 in our core greeting card business. We expect approximately one-third of this amount to be related to converting additional customers to the scan-based trading business model, with the remainder associated with creative initiatives, process changes, and a reduction of certain retailers' inventory in order to flow future new product changes more quickly. These expenditures will impact net sales, earnings and cash flows over future periods. The actual amount and timing of the expenditures will depend on the success of the strategy and the schedules of our retail partners. Moreover, our long-term success will depend in part on how well we implement our strategy to revamp the greeting card business and we cannot assure you that this strategy will either increase our revenue or profitability. Even if we are able to implement, to a significant degree, this strategy, we may experience systemic, cultural and operational challenges that may prevent any significant increase in profitability or that may otherwise negatively influence our cash flow. In addition, even if our strategy is successful, our profitability may be adversely affected if consumer demand for lower priced, value cards continues to expand, thereby eroding our average selling prices. Our strategy may also have flaws and may not be successful. For example, we may not be able to anticipate or respond in a timely manner to changing customer demands and preferences for greeting cards. If we misjudge the market, we may significantly overstock unpopular products and be forced to grant significant credits or accept significant returns, which would have a negative impact on our results of operations and cash flow. Conversely, shortages of key items could have a materially adverse impact on our results of operations and financial condition.

We rely on a few mass-market retail customers for a significant portion of our sales.

A few of our customers are material to our business and operations. Net sales to our five largest customers, which include mass merchandisers and national drug store and supermarket chains, accounted for approximately 35% of net sales in fiscal year 2006 and approximately 32% of net sales for fiscal years 2005 and 2004. Net Sales to Wal-Mart Stores, Inc. and its subsidiaries accounted for approximately 16%, 15% and 13% of net sales in fiscal years 2006, 2005 and 2004, respectively. No other customer accounted for 10% or more of our net sales. There can be no assurance that our large customers will continue to purchase our products in the same quantities that they have in the past. The loss of sales to one of our large customers could materially and adversely affect our business, results of operations and financial condition.

We operate in extremely competitive markets, and our business, results of operations and financial condition will suffer if we are unable to compete effectively.

We operate in highly competitive industries. There are an estimated 3,000 greeting card publishers in the United States ranging from small family-run organizations to major corporations. In general, however, the greeting card business is extremely concentrated. We believe that we are one of only two main suppliers offering a full line of social expression products that, together, are estimated to encompass approximately 85% of the overall market. Our main competitor, Hallmark Cards, Inc., may have substantially greater financial, technical or marketing resources, a greater customer base, stronger name recognition and a lower cost of funds than we do. That competitor may also have longstanding relationships with certain large customers to which it may offer products that we do not provide, putting us at a competitive disadvantage. As a result, this competitor or others may be able to:

adapt to changes in customer requirements more quickly;

Table of Contents

take advantage of acquisitions and other opportunities more readily;

devote greater resources to the marketing and sale of its products; and

adopt more aggressive pricing policies.

There can be no assurance that we will be able to continue to compete successfully in this market or against such competition. If we are unable to introduce new and innovative products that are attractive to our customers and ultimate consumers, or if we are unable to allocate sufficient resources to effectively market and advertise our products to achieve widespread market acceptance, we may not be able to compete effectively, and our results of operations and financial condition could be adversely affected.

Our business, results of operations and financial condition may be adversely affected by retail consolidations.

With the growing trend toward retail trade consolidation, we are increasingly dependent upon a reduced number of key retailers whose bargaining strength is growing. We may be negatively affected by changes in the policies of our retail trade customers, such as inventory de-stocking, limitations on access to shelf space, scan-based trading and other conditions. Increased consolidations in the retail industry could result in other changes that could damage our business, such as a loss of customers. In addition, as the bargaining strength of our retail customers grows, we may be required to grant greater credits, discounts, allowances and other incentive considerations to these customers. We may not be able to recover the costs of these incentives if the customer does not purchase a sufficient amount of products during the term of its agreement with us, which could materially and adversely affect our business, results of operations and financial condition.

Our business, results of operations and financial condition may be adversely affected by volatility in the demand for our products.

Our success depends on the sustained demand for our products. Many factors affect the level of consumer spending on our products, including, among other things, general business conditions, interest rates, the availability of consumer credit, taxation, the effects of war, terrorism or threats of war or terrorism, fuel prices and consumer confidence in future economic conditions. Our business, and that of most of our customers, may experience periodic downturns in direct relation to downturns in the general economy. A general slowdown in the economies in which we sell our products, or even an uncertain economic outlook, could adversely affect consumer spending on discretionary items, such as our products, and, in turn, could adversely affect our sales, results of operations and financial condition.

Rapidly changing trends in the children's entertainment market could adversely affect our business.

A portion of our business and results of operations depends upon the appeal of our licensed character properties, which are used to create various toy and entertainment items for children. Consumer preferences, particularly among children, are continuously changing. The children's entertainment industry experiences significant, sudden and often unpredictable shifts in demand caused by changes in the preferences of children to more on trend entertainment properties. In recent years, there have been trends towards shorter life cycles for individual youth entertainment products. Our ability to maintain our current market share and increase our market share in the future depends on our ability to satisfy consumer preferences by enhancing existing entertainment properties and developing new entertainment properties. If we are not able to successfully meet these challenges in a timely and cost-effective manner, demand for our collection of entertainment properties could decrease and our business, results of operations and financial condition may be materially and adversely affected.

Our results of operations fluctuate on a seasonal basis.

The social expression industry is a seasonal business, with sales generally being higher in the second half of our fiscal year due to the concentration of major holidays during that period. Consequently, our overall results of

Table of Contents

operations in the future may fluctuate substantially based on seasonal demand for our products. Such variations in demand could have a material adverse effect on the timing of cash flow and therefore our ability to meet our obligations with respect to our debt and other financial commitments. Seasonal fluctuations also affect our inventory levels, since we usually order and manufacture merchandise in advance of peak selling periods and sometimes before new trends are confirmed by customer orders or consumer purchases. We must carry significant amounts of inventory, especially before the holiday season selling period. If we are not successful in selling the inventory during the holiday period, we may have to sell the inventory at significantly reduced prices, or we may not be able to sell the inventory at all.

We depend on mall traffic and the availability of suitable lease space.

Many of our retail stores are located in shopping malls. Sales at these stores are derived, in part, from the high volume of traffic attributable to mall anchor tenants (generally large department stores) and other area attractions, as well as from the continued appeal of malls as shopping destinations. Sales volume related to mall traffic may be adversely affected by economic downturns in a particular area, competition from non-mall retailers or from other malls where we do not have stores, or from the closing of anchor department stores. In addition, a decline in the popularity of a particular mall, or a decline in the appeal of mall shopping generally among our target consumers, would adversely affect our business. Our ability to grow our Retail Operations is dependent on our ability to open new stores in desirable locations with capital investment and lease costs that allow us to earn a reasonable return. We cannot be sure as to when or whether such desirable locations will become available at reasonable costs. In addition, to the extent that shopping mall owners are not satisfied with the sales volume of our current retail stores, we may lose existing store locations.

We rely on foreign sources of production and face a variety of risks associated with doing business in foreign markets.

We rely to a significant extent on foreign manufacturers for various products we distribute to customers. In addition, many of our domestic suppliers purchase a portion of their products from foreign sources. We generally do not have long-term merchandise supply contracts and some of our imports are subject to existing or potential duties, tariffs or quotas. In addition, a portion of our current operations are conducted and located abroad. The success of our sales to, and operations in, foreign markets depends on numerous factors, many of which are beyond our control, including economic conditions in the foreign countries in which we sell our products. We also face a variety of other risks generally associated with doing business in foreign markets and importing merchandise from abroad, such as:

political instability and civil unrest;

imposition of new legislation and Customs regulations relating to imports that may limit the quantity and/or increase the costs of goods which may be imported into the United States from countries in a particular region;

currency and foreign exchange risks; and

potential delays or disruptions in transportation.

Also, new regulatory initiatives may be implemented that have an impact on the trading status of certain countries and may include antidumping duties or other trade sanctions, which could increase the cost of products purchased from suppliers in such countries.

Additionally, as a large, multinational corporation, we are subject to a host of governmental regulations throughout the world, including antitrust and tax requirements, anti-boycott regulations, import/export/customs regulations and other international trade regulations, the USA Patriot Act and the Foreign Corrupt Practices Act. Failure to comply with any such legal requirements could subject us to criminal or monetary liabilities and other sanctions, which could harm our business, results of operations and financial condition.

Table of Contents

Our inability to protect our intellectual property rights could reduce the value of our products and brand.

Our trademarks, trade secrets, copyrights, patents and all of our other intellectual property rights are important assets. We rely on copyright and trademark laws in the United States and other jurisdictions and on confidentiality agreements with some employees and others to protect our proprietary rights. If any of these rights were infringed or invalidated, our business could be materially and adversely affected. In addition, our activities could infringe upon the proprietary rights of others, who could assert infringement claims against us. We could face costly litigation if we are forced to defend these claims. If we are unsuccessful in doing so, our business, results of operations and financial condition may be materially and adversely affected.

We seek to register our trademarks in the United States and elsewhere. These registrations could be challenged by others or invalidated through administrative process or litigation. In addition, our confidentiality agreements with some employees or others may not provide adequate protection in the event of unauthorized use or disclosure of our proprietary information, or if our proprietary information otherwise becomes known, or is independently developed by competitors.

We may not realize the full benefit of the material we license from third parties if the licensed material has less market appeal than expected or if sales revenues from the licensed products is not sufficient to earn out the minimum guaranteed royalties.

An important part of our business involves obtaining licenses to produce products based on various popular brands, character properties, design and other licensed material owned by third parties. Such license agreements usually require that we pay an advance and/or provide a minimum royalty guarantee that may be substantial, and in some cases may be greater than what we will be able to recoup in profits from actual sales, which could result in write-offs of such amounts that would adversely affect our results of operations. In addition, we may acquire or renew licenses requiring minimum guarantee payments that may result in us paying higher effective royalties, if the overall benefit of obtaining the license outweighs the risk of potentially losing, not renewing or otherwise not obtaining a valuable license. When obtaining a license, we realize there is no guarantee that a particular licensed property will make a successful greeting card or other product in the eye of the ultimate consumer. Furthermore, there can be no assurance that a successful licensed property will continue to be successful or maintain a high level of sales in the future. In the event that we are not able to acquire or maintain advantageous licenses, our business, results of operations and financial condition may be materially and adversely affected.

We cannot assure you that we will have adequate liquidity to fund our ongoing cash needs.

One of our key business strategies is to gain profitable market share by spending at least \$100 million to revamp our greeting card business over the next several years, primarily in our core greeting card business, with the majority of the expense occurring during fiscal year 2007. The actual amount and timing of the expenditures will depend on the success of the strategy and the schedules of our retail partners. In addition, we may have additional funding needs during or after that period that are not currently known. There can be no assurance that additional financing will be available to us or, if available, that it can be obtained on terms acceptable to management or within limitations that are contained in our current or future financing arrangements. Failure to obtain any necessary additional financing could result in the delay or abandonment of some or all of our plans, negatively impact our ability to make capital expenditures and result in our failure to meet our obligations.

The terms of our indebtedness may restrict our ability to pursue our growth strategy.

The terms of our credit agreement impose restrictions on our ability to, among other things, borrow and make investments, acquire other businesses, and make capital expenditures and distributions on our capital stock. In addition, our credit agreement requires us to satisfy specified financial covenants. Our ability to comply with these provisions depends, in part, on factors over which we may not have control. These restrictions could adversely affect our ability to pursue our growth strategy. If we were to breach any of our financial covenants or fail to make scheduled payments, our creditors could declare all amounts owed to them to be immediately due and payable. We may not have available funds sufficient to repay the amounts declared due and payable, and

Table of Contents

may have to sell our assets to repay those amounts. Our credit agreement is secured by substantially all of our domestic assets, including the stock of certain of our subsidiaries. If we cannot repay all amounts that we have borrowed under our credit agreement, our lenders could proceed against our assets.

Bankruptcy of key customers could give rise to an inability to pay us and increase our exposure to losses from bad debts.

Many of our largest customers are mass-market retailers. The mass-market retail channel in the U.S. has experienced significant shifts in market share among competitors in recent years, causing large retailers to experience liquidity problems and file for bankruptcy protection. There is a risk that these key customers will not pay us, or that payment may be delayed because of bankruptcy or other factors beyond our control, which could increase our exposure to losses from bad debts. Additionally, our business, results of operations and financial condition could be materially and adversely affected if these mass-market retailers were to cease doing business as a result of bankruptcy, or significantly reduce the number of stores they operate.

Difficulties in integrating potential acquisitions could adversely affect our business.

We regularly evaluate potential acquisition opportunities to support and strengthen our business. We cannot be sure that we will be able to locate suitable acquisition candidates, acquire candidates on acceptable terms or integrate acquired businesses successfully. Future acquisitions may require us to incur additional debt and contingent liabilities, which may materially and adversely affect our business, results of operations and financial condition. Furthermore, the process of integrating acquired businesses effectively involves the following risks:

unexpected difficulty in assimilating operations and products;

diverting management's attention from other business concerns;

entering into markets in which we have limited or no direct experience; and

losing key employees of an acquired business.

Increases in raw material and energy costs may materially raise our cost of goods sold and materially impact our profitability.

Paper is a significant expense in the production of our greeting cards. Significant increases in paper prices, which have been volatile in past years, or increased costs of other raw materials or energy may result in declining margins and operating results if market conditions prevent us from passing these increased costs on to our customers through timely price increases on our greeting cards and other social expression products.

The loss of key members of our senior management and creative teams could adversely affect our business.

Our success and continued growth depend largely on the efforts and abilities of our current senior management team as well as upon a number of key members of our creative staff, who have been instrumental in our success thus far, and upon our ability to attract and retain other highly capable and creative individuals. The loss of some of our senior executives or key members of our creative staff, or an inability to attract or retain other key individuals, could materially and adversely affect us. We seek to compensate our key executives, as well as other employees, through competitive salaries, stock ownership, bonus plans, or other incentives, but we can make no assurance that these programs will enable us to retain key employees or hire new employees.

If we fail to extend or renegotiate our primary collective bargaining contracts with our labor unions as they expire from time to time, or if our unionized employees were to engage in a strike, or other work stoppage, our business and results of operations could be materially adversely affected.

We are party to collective bargaining contracts with our labor unions, which represent a significant number of our employees. In particular, approximately 2,700 of our employees are unionized and are covered by collective bargaining agreements. Although we believe our relations with our employees are satisfactory, no

Table of Contents

assurance can be given that we will be able to successfully extend or renegotiate our collective bargaining agreements as they expire from time to time. If we fail to extend or renegotiate our collective bargaining agreements, if disputes with our unions arise, or if our unionized workers engage in a strike or other work related stoppage, we could incur higher ongoing labor costs or experience a significant disruption of operations, which could have a material adverse effect on our business.

Various environmental regulations and risks applicable to a manufacturer and/or distributor of consumer products may require us to take actions, which will adversely affect our results of operations.

Our business is subject to numerous federal, state, provincial, local and foreign laws and regulations, including regulations with respect to chemical usage, air emissions, wastewater and storm water discharges and the generation, handling, storage, transportation, treatment and disposal of waste materials, including hazardous materials. Although we believe that we are in substantial compliance with all applicable laws and regulations, because legal requirements frequently change and are subject to interpretation, we are unable to predict the ultimate cost of compliance with these requirements, which may be significant, or the effect on our operations. We cannot be certain that existing laws or regulations, as currently interpreted or reinterpreted in the future, or future laws or regulations, will not have a material and adverse effect on our business, results of operations and financial condition.

We may be subject to product liability claims and our products could be subject to involuntary recalls and other actions.

We are subject to regulations by the Consumer Product Safety Commission and other regulatory agencies. Concerns about product safety may lead to a recall of selected products. We have experienced, and in the future may experience, defects or errors in products after their production and sale to customers. Such defects or errors could result in the rejection of our products by consumers, damage to our reputation, lost sales, diverted development resources and increased customer service and support costs, any of which could harm our business. Individuals could sustain injuries from our products, and we may be subject to claims or lawsuits resulting from such injuries. There is a risk that these claims or liabilities may exceed, or fall outside the scope of, our insurance coverage. Additionally, we may be unable to obtain adequate liability insurance in the future. Recalls, post-manufacture repairs of our products, absence or cost of insurance, and administrative costs associated with recalls could harm our reputation, increase costs or reduce sales.

Acts of nature could result in an increase in the cost of raw materials; other catastrophic events, including earthquakes, could interrupt critical functions and otherwise adversely affect our business and results of operation.

Acts of nature could result in an increase in the cost of raw materials or a shortage of raw materials, which could influence the costs of goods supplied to us. Additionally, we have significant operations, including our largest manufacturing facility, near a major earthquake fault line in Arkansas. A catastrophic event, such as an earthquake, fire, tornado, or other natural or man made disaster, could disrupt our operations and impair production or distribution of our products, damage inventory, interrupt critical functions or otherwise affect our business negatively, harming our results of operations.

Members of the Weiss family and related entities own a substantial portion of our common shares, whose interests may differ from those of other shareholders.

Our authorized capital stock consists of Class A common shares and Class B common shares. The economic rights of each class of common shares are identical, but the voting rights differ. Class A common shares are entitled to one vote per share, and Class B common shares are entitled to ten votes per share. There is no public trading market for the Class B common shares, which are held by members of the extended family of American Greetings founder, officers and directors of American Greetings and their extended family members, family trusts, institutional investors and certain other persons. As of March 31, 2006, Morry Weiss, the Chairman of the

Table of Contents

Board of Directors, Zev Weiss, the Chief Executive Officer, Jeffrey Weiss, the President and Chief Operating Officer, and Erwin Weiss, the Senior Vice President, Specialty Business, together with other members of the Weiss family and certain trusts and foundations established by the Weiss family beneficially owned approximately 73% in the aggregate of our outstanding Class B common shares, which, together with Class A common shares beneficially owned by them, represents approximately 35% of the voting power of our outstanding capital stock. Accordingly, these members of the Weiss family, together with the trusts and foundations established by them, would be able to significantly influence the outcome of shareholder votes, including votes concerning the election of directors, the adoption or amendment of provisions in our Articles of Incorporation or Code of Regulations, and the approval of mergers and other significant corporate transactions, and their interests may not be aligned with your interests. The existence of these levels of ownership concentrated in a few persons makes it less likely that any other shareholder will be able to affect our management or strategic direction. These factors may also have the effect of delaying or preventing a change in our management or voting control or its acquisition by a third party.

Our charter documents and Ohio law may inhibit a takeover and limit our growth opportunities, which could adversely affect the market price of our common shares.

Certain provisions of Ohio law and our Articles of Incorporation could have the effect of making it more difficult or discouraging for a third party to acquire or attempt to acquire control of American Greetings. Our Articles of Incorporation provide for the Board of Directors to be divided into three classes of directors serving staggered three-year terms. Such classification of the Board of Directors expands the time required to change the composition of a majority of directors and may tend to discourage a proxy contest or other takeover bid for the Corporation. In addition, the Articles of Incorporation provide for Class B common shares, which have ten votes per share.

As an Ohio corporation, we are subject to the provisions of Section 1701.831 of the Ohio Revised Code, known as the Ohio Control Share Acquisition Statute. The Ohio Control Share Acquisition Statute provides that notice and information filings, and special shareholder meeting and voting procedures, must occur prior to any person's acquisition of an issuer's shares that would entitle the acquirer to exercise or direct the voting power of the issuer in the election of directors within specified ranges of share ownership. The Ohio Control Share Acquisition Statute does not apply to a corporation if its articles of incorporation or code of regulations so provide. We have not opted out of the application of the Ohio Control Share Acquisition Statute.

We are also subject to Chapter 1704 of the Ohio Revised Code, known as the Merger Moratorium Statute. If a person becomes the beneficial owner of 10% or more of an issuer's shares without the prior approval of its board of directors, the Merger Moratorium Statute prohibits a merger, consolidation, combination or majority share acquisition between us and such shareholder or an affiliate of such shareholder for a period of three years from the date on which the shareholder first became a beneficial owner of 10% or more of the issuer's shares. The prohibition imposed by Chapter 1704 continues indefinitely after the initial three-year period unless the transaction is approved by the holders of at least two-thirds of the voting power of the issuer or satisfies statutory conditions relating to the fairness of the consideration to be received by the shareholders. The Merger Moratorium Statute does not apply to a corporation if its articles of incorporation or code of regulations so provide. We have not opted out of the application of the Merger Moratorium Statute.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

As of February 28, 2006, we own or lease approximately 11 million square feet of plant, warehouse and office space, of which approximately 300,000 square feet are leased. We believe our manufacturing and distribution facilities are well maintained and are suitable and adequate, and have sufficient productive capacity to meet our current needs.

Table of Contents

The following table summarizes our principal plants and materially important physical properties. Under the revolving credit facility that was terminated and replaced on April 4, 2006, all of our domestic real property secured indebtedness outstanding from time to time thereunder and under our 6.10% notes due August 1, 2028. On April 4, 2006, we entered into a new credit agreement under which we are not required to pledge our real property to secure indebtedness thereunder. As a result, as of the date of this report, our domestic real property no longer secures indebtedness under either our revolving credit facility or our 6.10% notes.

* Indicates calendar year

Location	Approximate Square Feet Occupied		Expiration	Principal Activity
	Owned	Leased	Date of	
Cleveland	1,700,000			World Headquarters:
Ohio				General offices of North American Greeting Card Division; Plus Mark, Inc.; Carlton Cards Retail, Inc.; Learning Horizons, Inc.; AG Interactive, Inc.; and AGC, Inc.; creation and design of greeting cards, gift wrap, party goods, candles, stationery and giftware; marketing of electronic greetings
Bardstown,	413,500			Cutting, folding, finishing and packaging of greeting cards
Kentucky				
Berea,	552,000			Production and distribution of candles
Kentucky				
Danville,	1,374,000			Distribution of everyday products including greeting cards
Kentucky				
Lafayette,	194,000			Manufacture of envelopes for greeting cards, cutting, folding, finishing and packaging of cellos and stationery cards
Tennessee				
Burgaw,		59,000	2006	Manufacture of plastic molded party ware
North Carolina				
Osceola,	2,552,000			Cutting, folding, finishing and packaging of greeting cards and warehousing; distribution of seasonal products
Arkansas				
Philadelphia,		98,000	2007	Hand finishing of greeting cards
Mississippi				
Ripley,	165,000			Greeting card printing (lithography)
Tennessee				
Kalamazoo,	602,500			Manufacture and distribution of party goods
Michigan				

Edgar Filing: AMERICAN GREETINGS CORP - Form 10-K

Forest City,	498,000			Manufacture of display fixtures and other custom display fixtures by A.G. Industries, Inc.
North Carolina				
(Two Locations)				
Greeneville,	1,410,000			Printing and packaging of seasonal greeting cards and wrapping items and order filling and shipping for Plus Mark, Inc.
Tennessee				
(Two Locations)				
Toronto,	87,000	2008		General office of Carlton Cards Limited (Canada)
Ontario				
Canada				

Table of Contents

Location	Approximate Square Feet Occupied		Expiration		Principal Activity
	Owned	Leased	Date of		
Clayton, Australia	208,000				General offices of John Sands companies and manufacture of greeting cards and related products
Dewsbury, England (Two Locations)	394,000				General offices of Carlton Cards Limited (U.K.) and manufacture of greeting cards and related products
Croydon, Hull, Leicester and Oxford, England (Three Locations)	116,500	31,000	2007/2014		Manufacture and distribution of greeting cards and related products
Stafford Park, England (Two Locations)	219,000	29,000	2010		General offices and warehouse for Gibson Hanson Graphics Ltd.
Mexico City, Mexico	89,000				General offices of Carlton Mexico, S.A. de C.V. and distribution of greeting cards and related products

Item 3. 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 4. Submission of Matters to Vote of Security Holders

None

Executive Officers of the Registrant

The following table sets forth our executive officers, their ages as of April 30, 2006, and their positions and offices:

Name	Age	Current Position and Office
Morry Weiss	65	Chairman
Zev Weiss	39	Chief Executive Officer
Jeffrey Weiss	42	President and Chief Operating Officer
John S. N. Charlton	60	Senior Vice President, International
Michael L. Goulder	46	Senior Vice President, Executive Supply Chain Officer