

Stock Repurchase Proposal

Valuation analysis of a \$75 million debt-financed share repurchase across bearish, base, and bullish industry scenarios.



Prepared by
Andrew Rodriguez

EXECUTIVE SUMMARY

Authorize the repurchase with a price cap

Approve a \$75 million buyback funded with long-term debt at 5.8%, subject to a \$17.00 pause threshold and quarterly operating checks.

At \$12.51, AG can retire roughly 6.0 million shares below the bearish-case value and keep gross debt near 2.0x estimated EBITDA.

\$12.51

MARKET PRICE
DEC 2011

\$23.61

BASE VALUE
AFTER REPURCHASE

\$20.39

BEARISH FLOOR
AFTER REPURCHASE

+18.6%

EPS LIFT
BY 2015

The category is shrinking, but the stock has fallen faster than the business. A roughly 2% annual category decline and a 6% net-income decline do not explain a 48% drop from the April 2011 high unless AG's cash flows are headed materially below the bearish case. The valuation work in this memo tests that premise.

Under the bearish case, with zero terminal growth and 5% operating margin, AG is worth \$18.96 before the repurchase and \$20.39 after it. The base case rises to \$23.61 after the transaction. Incremental interest is about \$4.4 million a year against trough bearish free cash flow of \$67.1 million.

What this report answers

- Has the market repriced AG below conservative value?
- Does the balance sheet carry the new debt without crowding out investment?
- What facts should stop the board from continuing the program?

Decision rule

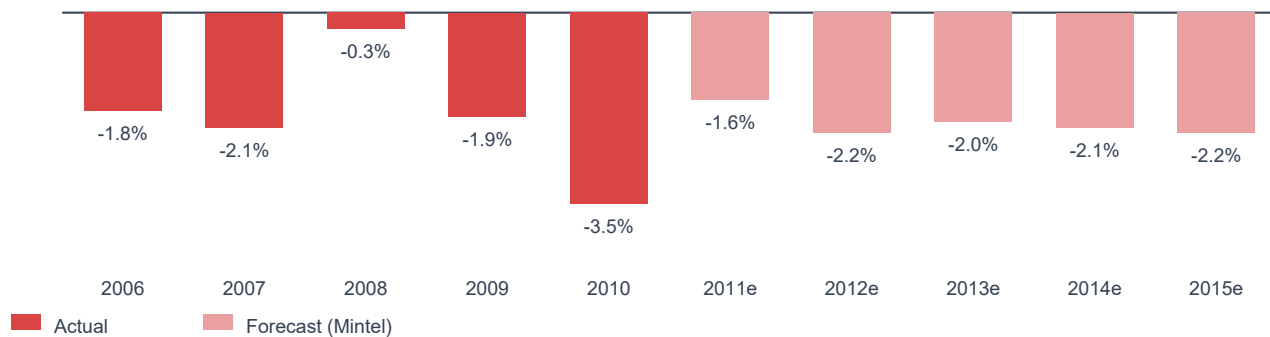
Buy while AG trades well below bearish-case value. Pause if the share price reaches \$17.00, free cash flow misses the bearish path for two quarters, or the BB+ debt assumption breaks.

01 The operating problem

AG is the third-largest player in the U.S. greeting card industry, behind Hallmark and Scholastic. Its brands include Carlton Cards, Gibsons, Recycled Paper Greetings, Papyrus, and DesignWare. The core category has contracted every year since 2005, down 9.2% cumulatively, as consumers shift some occasions to social and digital channels.

The board should focus on the slope of the decline. Mintel forecasts roughly 2% annual category contraction through 2015. The market price implies something harsher: faster cash-flow erosion, weaker margins, or both.

Total U.S. greeting card sales, year-over-year change



Actuals 2006-2010; 2011-2015 are Mintel forecasts. Cumulative decline since 2005: 9.2%.

Operating evidence through 2011

Indicator	Then	Now	Change
Revenue trend, 2006-2010	n/a	n/a	-2.95% / yr
Net income	\$87.0M (2010)	\$81.8M (2011)	-6.0%
Share price	\$24.01 (Apr 2011 high)	\$12.51 (Dec 2011)	-47.9%
Card buyers, trailing 3 months	59%	52%	-7 pts

2011 net income fell 6% despite 7% revenue growth. A \$10 million Q3 marketing spend defended share but compressed margins; the record does not yet show a demand payoff. Christmas-season weakness matters because that period carries disproportionate category weight.

The stock reset before the model case broke



From April to December 2011, AG lost about 48% of market value. That move is too large to attribute to

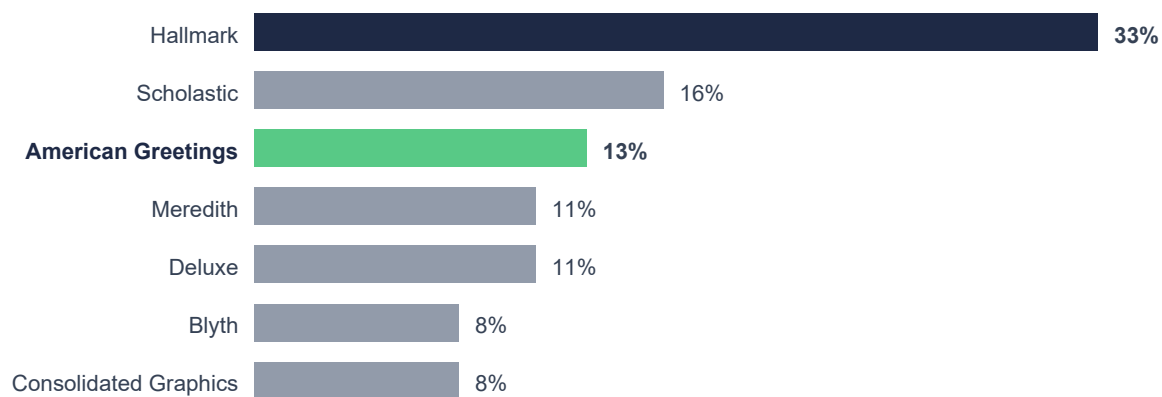
Interpretation

The price chart is not proof that AG is cheap. It is the setup for the valuation test. If the bearish case still clears the market price, the repurchase has a margin of safety. If it does not, the board should keep the cash.

02 Market position

AG's position is imperfect but useful for a buyback test. The company holds roughly 13% market share, third behind Hallmark (33%) and Scholastic (16%). Its ownership base is concentrated: MAM Investments, Dimensional Fund Advisors, BlackRock, and LSV Asset Management together hold more than one third of the shares.

Industry market share



Strategic initiatives do not justify hoarding cash

- Digital cards and online platforms defend existing occasions; the record does not show they can absorb \$75 million at high returns.
- In-store customization protects store traffic but does not reverse category decline on its own.
- Dollar-store distribution broadens reach in value channels.
- Care Bears and Strawberry Shortcake create cash flows outside physical card volume.

The multiple already discounts a steeper decline

Valuation multiple (2011)	AG	Reading
Price / Earnings	6.0x	Bottom of comparable group
Enterprise Value / EBITDA	3.5x	Bottom of comparable group
Market / Book	0.75x	Priced below net asset value

03 Valuation framework

The model uses three cases because the board's real risk is cash-flow decay. The bearish case is deliberately hard on the company: 5% operating margin and no terminal growth. The base case splits the range. The bullish case gives credit for digital and licensing offsets.

Scenario	Operating margin	Terminal growth	Represents
Bearish	5%	0.0%	Accelerated decline; margin compression
Base	7%	1.5%	Average of bull and bear assumptions
Bullish	9%	3.0%	Digital initiatives offset category decline

Key assumptions

Input	Value	Basis
Risk-free rate	2.8%	Long-term Treasury yield
Market risk premium	5.5%	Standard equity premium
Beta	1.63	Company-specific
Cost of equity (CAPM)	11.8%	$2.8\% + 1.63 \times 5.5\%$
Cost of debt	5.8%	BB+ rating, highest in the industry
Fixed asset turnover	1.95	Historical average
Working capital turnover	6.0 to 7.5	Improving 0.5 / yr, 2012-2015

Cost of capital

Using 2011 balance sheet weights (\$235 million of long-term debt against \$752 million of shareholders' equity), AG's weighted average cost of capital is 9.80%. After the repurchase, WACC falls to 9.63% because lower-cost debt replaces equity bought at a depressed price.

Cost of capital benchmark



Forecast free cash flows

Scenario	2012	2013	2014	2015
Bullish	\$136.2M	\$99.2M	\$92.6M	\$87.1M
Base	\$136.3M	\$96.1M	\$86.0M	\$76.6M
Bearish	\$136.5M	\$93.1M	\$79.8M	\$67.1M

Even the bearish path generates \$67.1 million of free cash flow in its weakest year. That figure matters because the proposed debt adds about \$4.4 million of annual pre-tax interest. The financing burden is visible, but it is not close to the cash-flow floor in the model.

What the valuation has to prove

The board does not need a growth story to approve the buyback. It needs evidence that conservative cash flows support a value above \$12.51 and that the balance sheet remains usable if the bearish case arrives.

04 Valuation results

Before the repurchase, the bearish case still clears the market price

Scenario	Enterprise value	Equity value	Implied price	Upside
Bearish	\$789M	\$726M	\$18.96	+52%
Base	\$889M	\$826M	\$21.57	+72%
Bullish	\$1,035M	\$972M	\$25.38	+103%

Equity value = enterprise value - \$235M total debt + \$172M cash; per-share values on 38.32M shares.

Repurchase mechanics

Capital structure item	Before	After	Change
Long-term debt	\$235M	\$310M	+\$75M at 5.8%
Shares outstanding	38.32M	32.32M	6.0M at \$12.51
Cost of equity	11.8%	12.4%	Higher beta from new debt
WACC	9.80%	9.63%	Cheaper debt replaces equity

Per-share value rises in every case



Scenario	No repurchase	With repurchase	Value added
Bearish	\$18.96	\$20.39	+\$1.43
Base	\$21.57	\$23.61	+\$2.04
Bullish	\$25.38	\$28.31	+\$2.93

Post-repurchase equity values (\$659M / \$763M / \$915M) reflect \$310M debt, \$172M cash, and 32.32M shares.

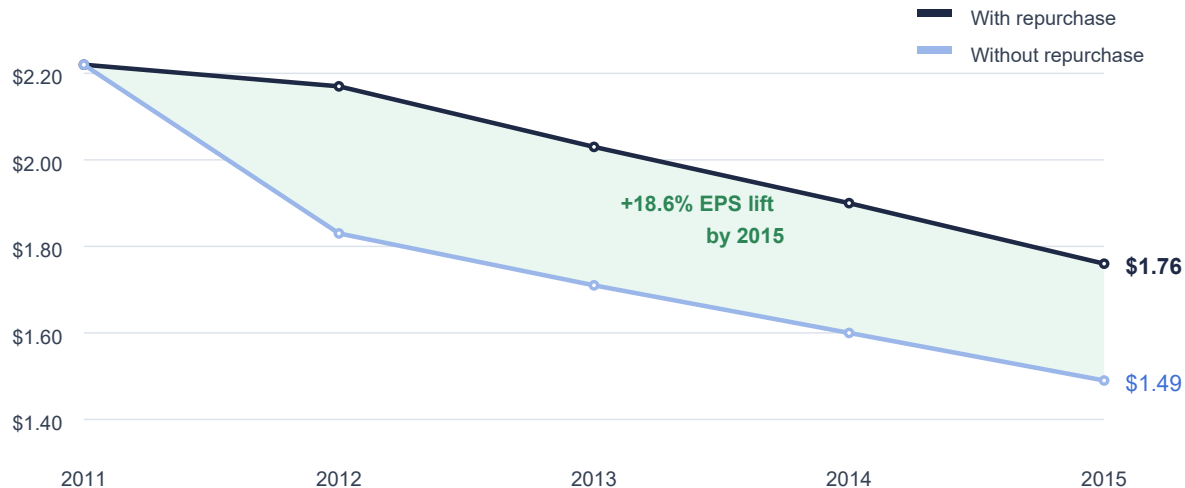
Why per-share value rises

The transaction works because each dollar retires stock worth \$18.96 to \$25.38 for \$12.51. The WACC improvement helps, but the main driver is simpler: fewer shares own the same operating cash flows.

EPS impact

Retiring 15.7% of the float lifts EPS by roughly 18.6% in every forecast year through share count alone. In the 2012 base case, $\$1.83 \times 38.32 / 32.32 = \2.17 . EPS still declines over the period because the business declines; the buyback changes each share's claim on the remaining cash flow.

Forecast EPS, base case



EPS is evidence, not the thesis

EPS accretion is mechanical. It does not prove operating improvement. The board should rely on intrinsic value, cash-flow coverage, and stop conditions; the EPS lift is a secondary benefit.

05 Risks and debt capacity

Debt-funded buybacks in declining businesses can turn a slow problem into a fast one. This proposal works only because the new debt is small relative to cash flow and because the board can stop buying before the math turns.

Debt capacity after the repurchase

Debt metric	Value	Context
Gross debt	\$310M	\$235M existing + \$75M new
Net debt, less \$172M cash	\$138M	Under 1.0x estimated EBITDA
Gross debt / EBITDA	~2.0x	EBITDA estimated from 3.5x EV/EBITDA
Incremental interest	\$4.4M / yr	\$75M x 5.8%
Total interest	~\$18M / yr	vs. \$67.1M bearish trough-year FCF

EBITDA is estimated from AG's 2011 enterprise value of roughly \$542 million at market prices and its 3.5x EV/EBITDA multiple. In the bearish trough year, free cash flow covers total interest about 3.7 times before touching the \$172 million cash balance.

Best alternative use of \$75 million

The \$75 million competes with digital investment, acquisitions, and a special dividend. On current facts, the buyback ranks first. Digital work is already funded from operating cash flow and has not shown a return profile that demands another \$75 million. Acquisitions in a shrinking category add category risk. A dividend returns cash at face value; the buyback buys a dollar of bearish-case value for about 66 cents.

What breaks the recommendation

- Demand falls through the bearish floor. Mintel's worst case is a 16% market decline through 2015, roughly four times the base forecast.
- Operating margin falls below 5%. The bearish case already assumes two points of margin loss.
- Debt costs move above the 5.8% assumption or the BB+ rating comes under pressure.
- The share-price discount closes before execution, reducing the value captured by each repurchased share.

Monitoring triggers

Trigger	Action	Rationale
Share price above \$17.00	Pause purchases	Margin of safety largely gone
Two quarters below bearish FCF path	Suspend and reassess	Floor case failing in practice
Negative rating watch or downgrade	Halt debt-funded buying	Financing assumption invalidated
Trailing 12-mo revenue decline above 4%	Board review	Approaching Mintel worst-case path

On the \$17.00 threshold

The threshold is a policy line, not a valuation claim. It is set at roughly 90% of the pre-repurchase bearish value of \$18.96. The board may choose a different line, but it should set one before the first share is bought.

06

Recommendation and implementation

Authorize the \$75 million share repurchase, financed with long-term debt at 5.8%, and bind the program to the stop conditions in Section 05. The case rests on buying AG below conservative value while cash generation still covers the added debt cost.

Implementation plan

- Financing: issue \$75 million of long-term debt at 5.8%, consistent with the existing BB+ rating.
- Execution: stage purchases under a pre-set price grid, buying more aggressively at lower prices and pausing at \$17.00.
- Communication: frame the program as disciplined capital allocation, not a claim that the category will recover.
- Governance: report quarterly against the Section 05 triggers; any trigger suspends purchases pending board review.

AG has executed buybacks at higher prices

Period	Shares purchased	Avg. price paid	Dollar value
December 2007	1,863,900	\$22.75	\$42.4M
January 2008	1,494,672	\$19.00	\$28.4M
February 2008	1,300,000	\$20.40	\$26.5M
Total since 2007	4,658,572	\$20.90	\$97.3M

The company has already deployed \$97.3 million buying its own shares at a weighted average of \$20.90. Today's proposal uses the same operating muscle at a 40% lower price, with a valuation case and stop discipline that were not present in the prior program.

Board action

Approve the program, set the \$17.00 pause threshold, and require quarterly reporting against free cash flow, revenue decline, and credit-rating triggers. If the price rises or results fall below the bearish case, stop buying. Until then, the board is being offered a cash-generating business at a discount to its own conservative value.