

MICHAELS STORES INC
Form 10-K
March 24, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 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 January 29, 2011

or

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

For the transition period from to

Commission file number 001-09338

MICHAELS STORES, INC.

Edgar Filing: MICHAELS STORES INC - Form 10-K

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

75-1943604
(I.R.S. employer
identification number)

8000 Bent Branch Drive

Irving, Texas 75063

(Address of principal executive offices, including zip code)

(972) 409-1300

(Registrant's telephone number, including area code)

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT: **None**

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT: **None**

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 Exchange 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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark 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 the 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.

Edgar Filing: MICHAELS STORES INC - Form 10-K

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The aggregate market value of the registrant's voting and non-voting common equity held by non-affiliates of the registrant is zero. The registrant's common equity is not publicly traded.

As of March 21, 2011, 118,967,418 shares of the Registrant's Common Stock were outstanding.

*The Registrant has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934, but is not required to file such reports under such sections.

DOCUMENTS INCORPORATED BY REFERENCE

None.

PART I

ITEM 1. Business.

The following discussion, as well as other portions of this Annual Report on Form 10-K, contains forward-looking statements that reflect our plans, estimates, and beliefs. Any statements contained herein (including, but not limited to, statements to the effect that Michaels or its management anticipates, plans, estimates, expects, believes, and other similar expressions) that are not statements of historical fact should be considered forward-looking statements. Our actual results could materially differ from those discussed in these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed below and elsewhere in this Annual Report on Form 10-K, and particularly in Item 1A. Risk Factors and Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. Unless the context otherwise indicates, references in this Annual Report on Form 10-K to we, our, us, the Company and Michaels means Michaels Stores, Inc., together with its subsidiaries.

General

With over \$4.0 billion in sales in fiscal 2010, Michaels Stores, Inc., together with its subsidiaries, is the largest arts and crafts specialty retailer in North America providing materials, project ideas and education for creative activities. Our mission is to be a world class performer that inspires and enables consumers to experience creativity and to lead industry growth and innovation, while creating a fun and rewarding place to work that fosters meaningful connections with our communities. Through our broad product assortments, educational in-store events, project sheets and displays, and on-line information, we offer a shopping experience that inspires creativity in the areas of arts, crafts, floral displays, framing, home accents, and kid's hobbies and activities.

Michaels Stores, Inc. was incorporated in Delaware in 1983, and as of March 21, 2011, we operate 1,047 Michaels retail stores in 49 states, as well as in Canada, averaging 18,300 square feet of selling space per store. Our stores offer arts and crafts supplies and products for the crafter and do-it-yourself home decorator. We also operate 137 Aaron Brothers stores as of March 21, 2011, in nine states, averaging 5,600 square feet of selling space per store, offering photo frames, a full line of ready-made frames, custom framing services, and a wide selection of art supplies.

On October 31, 2006, substantially all of the Common Stock of Michaels Stores, Inc. was acquired through a merger transaction (the Merger) by affiliates of two investment firms, Bain Capital Partners, LLC and The Blackstone Group (collectively, together with their applicable affiliates, the Sponsors), with certain shares retained by affiliates of Highfields Capital Partners (a then-existing shareholder of Michaels Stores, Inc.). As a result of the Merger, Michaels Holdings LLC, an entity controlled by the Sponsors, owns approximately 93% of our outstanding Common Stock, which is no longer publicly traded.

On October 16, 2007, we announced plans to align resources around our core retail chains, Michaels and Aaron Brothers stores. As a result, we discontinued our concept businesses, Recollections and Star Decorators Wholesale (Star). As of the end of fiscal 2007, we had closed all 11 Recollections and three of the four Star locations. The Star Decorators Wholesale Los Angeles store, the sole remaining Star location, is now being operated as a Michaels store. The operations of Recollections and Star have been reflected as discontinued operations.

Edgar Filing: MICHAELS STORES INC - Form 10-K

We provide links to our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports, filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, on our Internet website at www.michaels.com under the heading Investor Relations. These links are automatically updated, so the filings are available immediately after they are made publicly available by the Securities and Exchange Commission (SEC). These filings are also available through the SEC s EDGAR system at www.sec.gov.

Industry Overview

We are the largest specialty retailer in North America providing materials, project ideas, and education for creative activities in arts and crafts, home, and scrapbooking. We believe we are well positioned to benefit from favorable demographics, particularly a more affluent baby boomer population, and an increasing focus on savings and home-based, family activities. According to industry consumer participation surveys conducted in 2010, approximately 56% of U.S. households participate in an arts and crafts category and our typical customer is:

- Female 77% are women.
- Young 67% of crafters are under 55, with 42% of them between the ages of 35 and 54.

Edgar Filing: MICHAELS STORES INC - Form 10-K

- **Middle class** 72% of our crafters have household incomes greater than \$50,000, with a median income of about \$75,000.
- **Loyal** Most crafters shop for craft supplies about three times a month, with approximately 40% of their visits to Michaels.

We compete across many segments of the industry, including adult and kid's crafts, scrapbooking and paper crafting, jewelry making, art supplies, home, floral, celebrations, and ready-made and custom framing. Industry association reports estimate that the addressable market size associated with the core arts and crafts market is about \$29 billion, and we estimate another \$3 billion is associated with the framing market for a total market size of \$32 billion annually.

The market we compete in is highly fragmented, including stores across the nation operated primarily by small, independent retailers along with a few regional and national chains. We believe customers choose where to shop based upon store location, breadth of selection, price, quality of merchandise, availability of product, and customer service. We compete with many different types of retailers and classify our competition within the following categories:

- **Mass merchandisers.** This category includes companies such as Wal-Mart Stores, Inc., Target Corporation, and other mass merchandisers. These retailers typically dedicate only a small portion of their selling space to a limited selection of home accents, arts and crafts supplies, and seasonal merchandise, but they do seek to capitalize on the latest trends by stocking products that are complimentary to those trends and their current merchandise offerings. These mass merchandisers generally have limited customer service staffs with varying amounts of experience in crafting projects.
- **Multi-store chains.** This category includes several multi-store chains, each operating more than 30 stores, and comprises: Hobby Lobby, which operates approximately 470 stores in 39 states, primarily in the Midwestern and Southern United States; Jo-Ann Stores, Inc., which operates approximately 235 large-format stores across the country; A.C. Moore Arts & Crafts, Inc., which operates approximately 135 stores primarily in the mid-Atlantic and Northeast regions; and Garden Ridge Corporation, which operates approximately 45 stores in 18 states, primarily in the Midwestern and Southern United States. We believe all of these chains are significantly smaller than Michaels with respect to total net sales.
- **Small, local specialty retailers.** This category includes local independent arts and crafts retailers and custom framing shops. Typically, these are single store operations managed by the owner. These stores generally have limited resources for advertising, purchasing, and distribution. Many of these stores have established a loyal customer base within a given community and compete based on relationships and customer service.

Business Strategy

We continue to strive to increase sales and productivity by strengthening our position as a world class performer through the following strategies:

Edgar Filing: MICHAELS STORES INC - Form 10-K

- **Merchandise.** Our goal is to drive sales by inspiring our customers with a broad assortment of products at competitive prices and by creating an excellent in-store experience. We expect to continue to expand the custom framing business with exciting new offerings.

- **Improving our merchandise assortment.** We are focused on introducing more new products in our categories to inspire the creativity of our customers. We accomplish this through frequent merchandise resets to provide more new products, inspiration, and excitement to our customers. We continue to test new merchandise assortments in selected markets before implementing regional or national rollouts. Our assortments include highly differentiated and exclusive product lines, which we believe help us further maximize our opportunities within arts and crafts trends.

- **Ideas and inspiration.** We believe our customer experience can be a key advantage that differentiates us from our competitors and is a critical component of our merchandising strategy. Many of the craft supplies sold in our Michaels stores can be assembled into unique end products with an appropriate amount of guidance and direction. Accordingly, we offer a variety of classes, demonstrations, and family focused make-it and take-it events to inspire our customers with product ideas and information. In addition, we have in-store displays to stimulate new project ideas and we supply free project sheets with detailed instructions on how to assemble the finished product. We also offer project sheets and webisodes demonstrating techniques to make crafts, gifts, and more at www.michaels.com. Through our Internet site and social media outlets, we are encouraging co-creation between our associates and customers by providing forums for two-way dialogue and a place to share ideas. We believe this strategy enhances our customers' relationship with Michaels, drives incremental sales, and is core to our brand positioning.

- *Pricing and promotional strategy.* We continue to develop an integrated pricing and promotion strategy based on customer behavior, while improving our long-term organizational capabilities, processes, and tools. Our promotional activity is item and/or price based, with promotions spanning across categories and regions. We believe we can improve margins through enhancements to our merchandise planning and merchandising systems by applying more sophisticated pricing models which are customized at the store level. We further believe that we will be able to increase our core market as we more precisely identify the promotional items that drive customer traffic.
- *Custom Framing.* We are executing on strategies, and evaluating new opportunities, to drive the custom frame business. We have a heightened focus on ensuring that we have well trained custom framing sales associates to provide our customers with new products and service offerings. In addition, we plan to upgrade the capabilities of our manufacturing subsidiary that provides framing merchandise to our stores.
- *Custom Personalization.* We are expanding our merchandise assortment to include custom personalization offerings. During fiscal 2010, we completed the acquisition of an online digital scrapbooking and photo-booking business that will allow customers to work online to create digital scrapbooks which can be printed at home or professionally bound into a book.
- *Direct Imports and Private Brands.*
- *Global sourcing.* We believe that importing product directly from the manufacturer presents a significant long-term opportunity to enhance our margin, improve our product quality, and mitigate external cost pressures. We will continue to expand our relationships internationally, both through agents and directly with manufacturers, and will collaboratively plan to bring a compelling assortment to market. We also intend to improve our import process by reducing the lead time it takes to receive goods. In fiscal 2010, as a percent of total receipts, we sourced approximately 23% of our merchandise through direct relationships with international manufacturers or through agents, compared to 17% in fiscal 2009. We anticipate that we will continue to significantly expand our direct import business. In order to mitigate the risk of the rising cost of goods from China, we are actively exploring sourcing opportunities outside of China. We will also continue to identify and leverage key strategic domestic vendors who will work with us to bring fresh ideas, quality products and exceptional value to our customers.
- *Private Brand Development.* Currently, we sell numerous products under a portfolio of private brands that have been designed and developed based on consumer insights. We believe that by focusing on a select number of strong, private brands, we will help drive differentiation, improve our image, and provide the framework for Michaels to more effectively market our globally sourced products. In fiscal 2010, our private label brands represented approximately 36% of total sales. We plan to increase the number of private label products we offer through proactive, fact-based, integrated product development. We expect to improve brand acceptance, awareness, and loyalty through internal and external marketing efforts. We believe our efforts will strengthen our value proposition in the marketplace, differentiate Michaels from its competitors, enhance customer loyalty, and increase market share by supporting Michaels' position in selection, newness, and value. We also plan to leverage social networking for consumer research on product development and brand building to enhance our private brand growth.
- *Store Experience.*

The in-store experience. We want our stores to be the destination for Where Creativity Happens® by providing not just the products for which our customer is looking, but also ideas and inspiration that allow for an entertaining and enjoyable shopping experience. Our internet based customer relationship management platform has provided us timely, actionable feedback on our customers' in-store experience and has shown continued improvement in our stores' overall service levels. In support of our ongoing commitment to improve the in-store experience and

Edgar Filing: MICHAELS STORES INC - Form 10-K

provide customers with world class service, we will be evaluating and refining the responsibilities of our associates to increase our associate engagement with the customer. We believe these modifications will drive sales by building a stronger one-on-one relationship with our customer and delivering a higher level of service.

- **Marketing.**

- *Improving marketing execution.* We are committed to deepening our relationship with our customers. We utilize a diversified marketing mix including print, direct mail, email, in-store promotional activities, social media, and online advertising. We continue to explore ways to optimize our print advertising distribution while evaluating the efficiencies and effectiveness of alternative, more direct channels for customer connection. We are enhancing our digital marketing approach by creating an online experience that will engage our customers in a more social manner while providing a forum to interact with like-minded crafters. We are also examining ways to develop multi-channel marketing plans for key merchandise categories by establishing a targeted marketing approach based on customer-specific behavior, including testing of a loyalty program. These approaches will be specifically directed towards those customer segments that represent the greatest sales opportunities.

- **Store Growth.**

- *New store openings.* We believe the combined United States and Canadian markets can support a total of 1,400 to 1,600 Michaels stores. We continue to make refinements to our store prototype model to maximize the return on our new store investments. Successes in our prototype models are being incorporated into merchandise resets across the chain. We will continue to evaluate and expand our urban and small market formats to further penetrate new and existing markets. In recent years, we have opened a greater number of stores in locations where we paid to build the stores to our specifications. We expect this trend to continue in fiscal 2011. During fiscal 2011, we anticipate opening 35 to 40 new Michaels stores including 10 to 15 relocations, funded primarily through cash provided by operating activities.

- **Cash Flow and Expense Management.**

- *Inventory optimization.* We are working to develop processes and systems to improve our inventory turnover. We plan to upgrade our replenishment and allocation systems as well as add a demand forecasting system, which we believe will improve the efficiency of our inventory by providing more accurate forecasts to our suppliers and highlighting unproductive inventory. In addition, we are benchmarking our supply chain with world class companies to identify opportunities to optimize investment in inventory, improve inventory turnover and drive sales through improved in-stocks. We believe additional tools and training for our stores will allow us to reduce shrink. We will also continue collaborating with our vendors on packaging standards to further reduce product damages.

- **Engaged Associates.**

- *Workforce.* Our associates are essential to ensuring the success of our strategic initiatives. We continue to identify opportunities to invest in and enrich our associates with improved training, development and support. We plan to drive performance of our associates in a sales-focused environment with clear accountability and rewards. Our goal is to create a culture that enhances the experiences of our associates, our customers and the communities we serve.

Merchandising

Edgar Filing: MICHAELS STORES INC - Form 10-K

Our Michaels store merchandising strategy is to provide a broad assortment of products at competitive prices and to inspire our consumer through new products, finished projects, project sheets, and special events. Each Michaels store offers approximately 39,000 basic SKUs in a number of product categories. The following table shows a breakdown of sales for Michaels stores by department as a percentage of total sales:

	Fiscal Year		
	2010	2009	2008
General and children's crafts	46%	44%	42%
Home and seasonal	20	21	23
Scrapbooking	16	18	17
Framing	18	17	18
	100%	100%	100%

We continue to search for ways to leverage our position as a market leader by establishing strategic partnerships and exclusive product relationships that will provide our customers with exciting merchandise. During fiscal 2010, we were the exclusive provider of the Duff bakeware collection from Chef Duff Goldman. In addition, we also launched our Paula Deen® line and Build-A-Bear Craftshop as well as the Peanuts and Dr. Seuss holiday offerings. We plan to continue to form partnerships and exclusive product associations in the future.

We routinely identify merchandise that requires some price reduction to accelerate sales of the product. The need for this reduction is generally attributable to clearance of seasonal merchandise or product that is being displaced from its assigned location in the store to make room for new merchandise. Additional SKUs that are candidates for repricing are identified using our perpetual inventory data. In each case, the appropriate repricing is determined at our corporate office. Price changes are transmitted electronically to the store and instructions are provided to our stores regarding product placement, signage, and display to ensure the product is effectively cleared.

Our Aaron Brothers stores offer on average approximately 7,300 SKUs, including photo frames, a full line of ready-made frames, art prints, framed art, art supplies and custom framing services. The merchandising strategy for our Aaron Brothers stores is to provide a unique, upscale framing assortment in an appealing environment with attentive customer service.

Seasonality

Our business is highly seasonal, with higher sales in the third and fourth fiscal quarters. Our fourth quarter, which includes the Christmas selling season, has on average accounted for approximately 35% of our net sales and approximately 50% of our operating income.

Purchasing and Inventory Management

We purchase merchandise from approximately 700 vendors. We believe our buying power and ability to make centralized purchases enables us to acquire products on favorable terms. Central merchandising management teams negotiate with vendors in an attempt to obtain the lowest net merchandise costs and improve product mix and inventory levels. In fiscal 2010, one vendor supplied approximately 10% of our purchases, with no other vendor accounting for more than 3% of total purchases.

In addition to purchasing from outside vendors, our Michaels and Aaron Brothers stores purchase custom frames, framing supplies, mats, and art prints from our framing operation, Artistree, which consists of a manufacturing facility and four regional processing centers to support our retail stores.

Substantially all of the products sold in Michaels stores are manufactured in Asia, Canada, Mexico, and the United States. Goods manufactured in Asia generally require long lead times and are ordered four to six months in advance of delivery. Those products are either imported directly by us or acquired from distributors based in the United States, and their purchase prices are denominated in United States dollars.

Our automated replenishment system uses perpetual inventory records to analyze individual store/SKU on-hand quantities, as well as other pertinent information such as sales forecasts, seasonal selling patterns, promotional events, and vendor lead times, to generate recommended merchandise reorder information. These recommended orders are reviewed daily and purchase orders are delivered electronically to our vendors and our distribution centers. In addition to improving our store in-stock position, these systems enable us to better forecast merchandise ordering quantities for our vendors and give us the ability to identify, order, and replenish the stores' merchandise using less store associate labor. These systems also allow us to react more quickly to selling trends and allow our store associates to devote more time to customer service, thereby improving inventory productivity and sales opportunities. As mentioned above, we are developing processes and systems to improve our inventory turnover. We plan to upgrade our replenishment and allocation systems as well as add a demand forecasting system.

Artistree

We currently operate a vertically integrated framing operation that leverages Artistree, our wholly-owned manufacturing subsidiary, across our Michaels and Aaron Brothers store networks. Artistree supplies high quality custom and specialty framing merchandise, including art prints and precut mats.

Our moulding manufacturing plant, located in Kernersville, North Carolina, converts lumber into finished frame moulding that is supplied to our regional processing centers for custom framing orders for our stores. We manufacture approximately 16% of the moulding we process, import another 47% from quality manufacturers in Indonesia, Malaysia, China, and Italy, and purchase the balance from distributors. We directly source metal moulding for processing in our regional centers. The custom framing orders are processed (frames cut and joined, along with cutting mats and foamboard backing) and shipped to our stores where the custom frame order is completed for customer pick-up.

During fiscal 2010, we operated four regional processing centers in City of Industry, California; Coppell, Texas; Kernersville, North Carolina; and Mississauga, Ontario. Our art prints and pre-cut mats, along with our custom frame supplies, are packaged and

Edgar Filing: MICHAELS STORES INC - Form 10-K

distributed out of our Coppell regional processing center. Combined, these facilities occupy approximately 538,000 square feet and, in fiscal 2010, processed nearly 28 million linear feet of frame moulding and over 6 million individually custom cut mats for our Michaels and Aaron Brothers stores.

We believe Artistree provides a competitive advantage to our Michaels and Aaron Brothers stores. Based on the benefits we have received from this vertically integrated solution, we continue to evaluate opportunities to further leverage our strong framing operations.

Distribution

We currently operate a distribution network for supplying our stores with merchandise. Approximately 85% of Michaels stores merchandise receipts are shipped through the distribution network with the remainder shipped directly from vendors. Approximately 56% of Aaron Brothers stores merchandise is shipped through the distribution network with the remainder shipped directly from vendors. Our seven distribution centers are located in California, Florida, Illinois, Pennsylvania, Texas, and Washington. In addition, we utilize one third-party warehouse to store and supply our seasonal merchandise in preparation for the holiday season.

Michaels stores generally receive deliveries from the distribution centers weekly through a transportation network using a dedicated fleet of trucks and contract carriers. Aaron Brothers stores generally receive merchandise on a biweekly basis from a dedicated 174,000 square foot distribution center located in the Los Angeles, California area.

Store Expansion and Relocation

The following table shows our total store growth for the last five years:

	Fiscal Year (1)				
	2010	2009	2008	2007	2006
Michaels stores:					
Retail stores open at beginning of year	1,023	1,009	963	921	886
Retail stores opened during the year	23	18	51	45	43
Retail stores opened (relocations) during the year	10	5	11	11	7
Retail stores closed during the year	(1)	(4)	(5)	(3)	(8)
Retail stores closed (relocations) during the year	(10)	(5)	(11)	(11)	(7)
Retail stores open at end of year	1,045	1,023	1,009	963	921
Aaron Brothers stores:					
Retail stores open at beginning of year	152	161	166	166	166
Retail stores opened during the year				2	1
Retail stores opened (relocations) during the year			1		
Retail stores closed during the year	(15)	(9)	(5)	(2)	(1)
Retail stores closed (relocations) during the year			(1)		
Retail stores open at end of year	137	152	161	166	166
Total store count at end of year	1,182	1,175	1,170	1,129	1,087

(1) In fiscal year 2006, the Star Decorators Wholesale Los Angeles store is retroactively presented as a Michaels store.

We plan to open approximately 35 to 40 Michaels stores in fiscal 2011. Included in these openings are relocations of 10 to 15 Michaels stores. We continue to pursue a store relocation program to improve the quality and performance of our store base.

We have developed a standardized procedure that allows for the efficient opening of new stores and their integration into our information and distribution systems. We develop the floor plan and merchandise layout and organize the advertising and promotions in connection with the opening of each new store. In addition, we maintain qualified store opening teams to provide new store personnel with in-store training.

Costs for opening stores at particular locations depend upon the type of building, the general cost levels in the area, store size, operating format, and the time of the year the store is opened. In fiscal 2010, the average net cost of opening a new Michaels store included approximately \$0.8 million of leasehold improvements, furniture, fixtures and equipment, and pre-opening costs, and an

estimated initial inventory investment, net of accounts payable, of approximately \$0.4 million.

During fiscal 2011, we anticipate closing up to five Michaels stores and 5 to 10 Aaron Brothers stores. Many of our store closings are stores that have reached the end of their lease term.

Foreign Sales

All of our current international business is in Canada, which accounted for approximately 9% of total sales in fiscal 2010, and approximately 8% in each of fiscal 2009 and fiscal 2008. During the last three years, less than 6% of our assets have been located outside of the United States. See Note 12 to the Consolidated Financial Statements for net sales and assets by country.

Trademarks and Service Marks

We own or have rights to trademarks, service marks or trade names that we use in connection with the operation of our business, including Aaron Brothers, Aaron Brothers Art & Framing, Artistree, Michaels, Michaels the Arts and Crafts Store, Recollections, Timeframe, Creativity Happens, and the stylized Michaels logo. We are registering or have registered our primary private brands including Artist's Loft, ArtMinds, Celebrate It, Creatology, Craft Smart, Recollections, Loops & Threads, Studio Décor, Bead Landing and Ashland, and various sub-brands associated with these primary marks.

Employees

As of March 21, 2011, we employed approximately 40,500 associates, approximately 29,600 of whom were employed on a part-time basis. The number of part-time associates substantially increases during the Christmas selling season. Of our full-time associates, approximately 2,300 are engaged in various executive, operating, training, distribution, and administrative functions in our corporate and division offices and distribution centers, and the remainder are engaged in store operations. None of our associates are subject to a collective bargaining agreement.

ITEM 1A. Risk Factors.

Our financial performance is subject to various risks and uncertainties. The risks described below are those which we believe are the material risks we face. Any of the risk factors described below could significantly and adversely affect our business, prospects, sales, revenues, gross profit, cash flows, financial condition, and results of operations.

We Face Risks Related to the Effect of Economic Uncertainty

If recovery from the economic downturn continues to be slow or prolonged, our results of operations, cash flows and financial condition could be adversely impacted. Our stores offer arts and crafts supplies and products for the crafter, and custom framing for the do-it-yourself home decorator, which some customers may perceive as discretionary. Pressure on discretionary income brought on by the recent economic downturn and slow recovery, including housing market declines, rising energy prices and a weak labor market, may cause consumers to reduce the amount they spend on discretionary items. The downturn in the economy may continue to adversely affect consumer confidence and retail spending, decreasing demand for our merchandise. Current economic conditions also make it difficult for us to accurately forecast future demand trends, which could cause us to purchase excess inventories, resulting in increases in our inventory carrying cost, or insufficient inventories, resulting in our inability to satisfy our customer demand and potentially lose market share. In addition, as discussed under *Liquidity and Capital Resources*, we believe that our current liquidity resources are adequate for the foreseeable future. Although we do not anticipate needing additional sources of capital in the near term, any disruption in the capital markets could make it difficult for us to raise additional capital when needed, or to eventually refinance our existing indebtedness on acceptable terms or at all. Similarly, if our suppliers face challenges in obtaining credit when needed or otherwise face difficult business conditions, they may become unable to offer us the merchandise we use in our business thereby causing reductions in our revenues, or they may demand more favorable payment terms, all of which could adversely affect our results of operations, cash flows and financial condition.

Our Reliance on Foreign Suppliers Increases Our Risk of Obtaining Adequate, Timely, and Cost-Effective Product Supplies

We rely to a significant extent on foreign manufacturers of various products that we sell, particularly manufacturers located in the People's Republic of China. In addition, many of our domestic suppliers purchase a portion of their products from foreign sources. This reliance increases the risk that we will not have adequate and timely supplies of various products due to local political, economic, social, or environmental conditions (including acts of terrorism, the outbreak of war, or the occurrence of natural disaster), transportation delays (including dock strikes and other work stoppages), restrictive actions by foreign governments, or changes in United States laws and regulations affecting imports or domestic distribution. Reliance on foreign manufacturers also increases our

exposure to fluctuations in exchange rates and trade infringement claims and reduces our ability to return product for various reasons.

Additionally, the cost of labor and wage taxes have increased in China, which means we are at risk of higher costs associated with goods manufactured in China. Significant increases in wages or wage taxes paid by contract facilities may increase the cost of goods manufactured in China, which could have a material adverse effect on our profit margins and profitability.

All of our products manufactured overseas and imported into the United States are subject to duties collected by the United States Customs Service. We may be subjected to additional duties, significant monetary penalties, the seizure and forfeiture of the products we are attempting to import, or the loss of import privileges if we or our suppliers are found to be in violation of U.S. laws and regulations applicable to the importation of our products.

Significant Increases in Inflation or Commodity Prices such as Petroleum, Natural Gas, Electricity, Steel and Paper May Adversely Affect Our Costs, Including Cost of Merchandise

Any future increases in commodity prices or inflation may adversely affect our costs, including cost of merchandise and distribution costs. Furthermore, the transportation industry may experience a shortage or reduction of capacity, which could be exacerbated by higher fuel prices. Our results of operations may be adversely affected if we are unable to secure, or are able to secure only at significantly higher costs, adequate transportation resources to fulfill our receipt of goods or delivery schedules to the stores, particularly as we receive and deliver our fall and Christmas seasonal merchandise.

We Face Risks Related to Our Substantial Indebtedness

Our substantial leverage could adversely affect our ability to raise additional capital to fund our operations, limit our ability to react to changes in the economy or our industry, expose us to interest rate risk associated with our variable rate debt and prevent us from meeting our obligations under our notes and credit facilities. Our high degree of leverage could have important consequences to us, including:

- making it more difficult for us to make payments on our debt;
- increasing our vulnerability to general economic and industry conditions;
- requiring a substantial portion of cash flow from operations to be dedicated to the payment of principal and interest on our debt, thereby reducing our ability to use our cash flow to fund our operations, capital expenditures, and future business opportunities;

Edgar Filing: MICHAELS STORES INC - Form 10-K

- exposing us to the risk of increased interest rates as certain of our borrowings under our senior secured credit facilities are at variable rates;
- restricting us from making strategic acquisitions or causing us to make non-strategic divestitures;
- limiting our ability to obtain additional financing for working capital, capital expenditures, product development, debt service requirements, acquisitions, and general corporate or other purposes; and
- limiting our ability to adjust to changing market conditions and placing us at a competitive disadvantage compared to our competitors who may be less highly leveraged.

We and our subsidiaries may be able to incur substantial additional indebtedness in the future, subject to the restrictions contained in our senior secured credit facilities and the indentures governing our notes. In addition, our senior secured credit facilities and indentures governing our notes do not restrict our owners from creating new holding companies that may be able to incur indebtedness without regard to the restrictions set forth in our credit facilities and indentures. If new indebtedness is added to our current debt levels, the related risks that we now face could intensify.

Our Debt Agreements Contain Restrictions That Limit Our Flexibility in Operating Our Business

Our senior secured credit facilities and the indentures governing our notes contain various covenants that limit our ability to engage in specified types of transactions. These covenants limit our ability and the ability of our restricted subsidiaries to, among other things:

- incur additional debt;

- pay dividends or distributions on our capital stock or repurchase our capital stock;

- issue stock of subsidiaries;

- make certain investments;

- create liens on our assets to secure debt;

- enter into transactions with affiliates;

- merge or consolidate with another company; and

- sell or otherwise transfer assets.

In addition, under our senior secured term loan facility, we are required to maintain specified financial ratios upon the occurrence of certain events and under our senior secured asset-based revolving credit facility, we are required to meet an availability condition described below. Our ability to meet those tests can be affected by events beyond our control, and we cannot assure that we will meet them. A breach of any of these covenants could result in a default under our senior secured credit facilities. Upon the occurrence of an event of default under our senior secured credit facilities, the lenders could elect to declare all amounts outstanding under our senior secured credit facilities to be immediately due and payable and terminate all commitments to extend further credit. If we were unable to repay those amounts, the lenders under our senior secured credit facilities could proceed against the collateral granted to them to secure that indebtedness. We have pledged a significant portion of our assets as collateral under our senior secured credit facilities. If the lenders under our senior secured credit facilities accelerate the repayment of borrowings, we cannot assure that we will have sufficient assets to repay our senior secured credit facilities, as well as our unsecured indebtedness, including the Notes.

Our senior secured asset-based revolving credit facility permits us to borrow up to \$900 million; however, our ability to borrow thereunder is limited by a borrowing base, which at any time will equal the sum of 90% of eligible credit card receivables and debit card receivables plus between 85% and 87.5% of the appraised net orderly liquidation value of eligible inventory and of eligible letters of credit plus a percentage of eligible in-transit inventory to be agreed upon, less certain reserves, and the sum of an additional 5% of the appraised net orderly liquidation value of eligible inventory and of eligible letters of credit plus an additional 5% of eligible credit card receivables and debit card receivables under a "last out" tranche. We must not permit excess availability at any time to be less than the greater of (a) \$75 million and (b) 10% of the lesser of (1) the then borrowing base under the senior secured asset-based revolving credit facility or (2) a revolving credit ceiling of \$900 million (as reduced or increased in accordance with the terms of the senior secured asset-based revolving credit facility, the "Revolving Credit Ceiling"). In addition, (a) for the period of thirty consecutive days preceding our termination of the tranche A commitments of the Non-Extending Lenders and (b) on a projected pro forma basis, giving effect to such termination of commitments, for the six-month period following such termination of commitments, we must not permit excess availability at any time to be less than \$125 million. Excess availability under the senior secured asset-based revolving credit facility means the lesser of (a) the Revolving Credit Ceiling minus the outstanding credit extensions and (b) the then borrowing base minus the outstanding credit extensions.

Our Growth Depends on Our Ability to Open New Stores and Increase Comparable Store Sales

One of our key business strategies is to expand our base of retail stores. If we are unable to continue this strategy, our ability to increase our sales, profitability, and cash flow could be impaired. To the extent we are unable to open new stores as we anticipate, our sales growth would come only from increases in comparable store sales. Growth in profitability in that case would depend significantly on our ability to reduce our costs as a percentage of our sales. We may be unable to continue our store growth strategy if we cannot identify suitable sites for additional stores, negotiate acceptable leases, access sufficient capital to support store growth, or hire and train a sufficient number of qualified associates.

Our Success Will Depend on How Well We Manage Our Business

Even if we are able to substantially continue our strategy of expanding our store base, or additionally, to expand our business through acquisitions or vertical integration opportunities, we may experience problems, which may adversely impact profitability or cash flow. For example:

- the costs of opening and operating new stores may offset the increased sales generated by the additional stores;
- the closure of unsuccessful stores may result in the retention of liability for expensive leases;
- a significant portion of our management's time and energy may be consumed with issues unrelated to advancing our core business strategy;
- the implementation of future operational efficiency initiatives, which may include the consolidation of certain operations and/or the possible co-sourcing of additional selected functions, may not produce the desired reduction in costs and may result in disruptions arising from such actions;
- we may be unable to hire, train, and retain qualified employees, including management and senior executives, and significant turnover could be disruptive to our core business strategy and operations;
- failure to maintain stable relations with our labor force;
- our suppliers may be unable to meet the increased demand of additional stores in a timely manner; and
- we may be unable to expand our existing distribution centers or use third-party distribution centers on a cost-effective basis to provide merchandise for sale by our new stores.

Changes in Customer Demands Could Materially Adversely Affect Our Sales, Results of Operations, and Cash Flow

Edgar Filing: MICHAELS STORES INC - Form 10-K

Our success depends on our ability to anticipate and respond in a timely manner to changing customer demands and preferences for products and supplies used in creative activities. If we misjudge the market, we may significantly overstock unpopular products and be forced to take significant inventory markdowns, which would have a negative impact on our operating results and cash flow. Also, shortages of key items could have a material adverse impact on our operating results. In addition, adverse weather conditions, economic instability, and consumer confidence volatility could have a material adverse impact on our sales and operating results.

Unexpected or Unfavorable Consumer Responses to Our Promotional or Merchandising Programs Could Materially Adversely Affect Our Sales, Results of Operations, Cash Flow and Financial Condition

Brand recognition, quality, and price have a significant influence on consumers' choices among competing products and brands. Advertising, promotion, merchandising, and the cadence of new product introductions also have a significant impact on consumers' buying decisions. If we misjudge consumer responses to our existing or future promotional activities, this could have a material adverse impact on our sales, results of operations, cash flow and financial condition.

We believe improvements in our merchandise offering help drive sales at our stores. We could be materially adversely affected by poor operational execution of changes to our merchandise offering or by unexpected consumer responses to changes in our merchandise offering.

Changes in Newspaper Subscription Rates May Result in Reduced Exposure to Our Circular Advertisements

The majority of our promotional activities utilize circular advertisements in local newspapers. A continued decline in consumer subscriptions of these newspapers could reduce the frequency with which consumers receive our circular advertisements, thereby negatively affecting sales, results of operations, and cash flow.

Improvements to Our Supply Chain May Not Be Fully Successful

An important part of our efforts to achieve efficiencies, cost reductions, and sales and cash flow growth is the identification and implementation of improvements to our supply chain, including merchandise ordering, transportation, and receipt processing. During fiscal 2011, we plan to continue to implement enhancements to our distribution systems and processes, which are designed to improve efficiency through the supply chain and at our stores. Significant changes to our supply chain could have a material adverse impact on our results of operations.

Our Suppliers May Fail Us

Many of our suppliers are small firms that produce a limited number of items. Given their limited resources, these firms are susceptible to cash flow issues, access to capital, production difficulties, quality control issues, and problems in delivering agreed-upon quantities on schedule. We may not be able, if necessary, to return products to these suppliers and obtain refunds of our purchase price or obtain reimbursement or indemnification from them if their products prove defective. In addition, these suppliers may be unable to withstand a downturn in economic conditions. Significant failures on the part of our key suppliers could have a material adverse effect on our results of operations.

In addition, many of these suppliers require extensive advance notice of our requirements in order to supply products in the quantities we desire. This long lead time requires us to place orders far in advance of the time when certain products will be offered for sale, exposing us to risk of shifts in demand.

Risks Associated with the Vendors from Whom Our Products Are Sourced Could Materially Adversely Affect Our Revenue and Gross Profit

The products we sell are sourced from a wide variety of domestic and international vendors. Global sourcing has become an increasingly important part of our business, as we have undertaken efforts to increase the amount of product we source directly from overseas manufacturers. Our ability to find qualified vendors who meet our standards and supply products in a timely and efficient manner is a significant challenge, especially with respect to goods sourced from outside the U.S. Any issues related to the transition from domestic to international vendors could adversely affect our revenue and gross profit.

Product Recalls and/or Product Liability, as well as Changes in Product Safety and Other Consumer Protection Laws, May Adversely Impact Our Operations, Merchandise Offerings, Reputation, Results of Operations, Cash Flow and Financial Condition

We are subject to regulations by a variety of federal, state and international regulatory authorities, including the Consumer Product Safety Commission. In fiscal 2010, we purchased merchandise from approximately 700 vendors. Since a majority of our merchandise is manufactured in foreign countries, one or more of our vendors might not adhere to product safety requirements or our quality control standards, and we might not identify the deficiency before merchandise ships to our stores. Any issues of product safety, including but not limited to those manufactured in foreign countries, could cause us to recall some of those products. If our vendors fail to manufacture or import merchandise that adheres to our quality control standards, our reputation and brands could be damaged, potentially leading to increases in customer litigation against us. Furthermore, to the extent we are unable to replace any recalled products, we may have to reduce our merchandise offerings, resulting in a decrease in sales, especially if a recall occurs near or during a seasonal period. If our vendors are unable or unwilling to recall products failing to meet our quality standards, we may be required to recall those products at a substantial cost to us. Moreover, changes in product safety or

Edgar Filing: MICHAELS STORES INC - Form 10-K

other consumer protection laws could lead to increased costs to us for certain merchandise, or additional labor costs associated with readying merchandise for sale. Long lead times on merchandise ordering cycles increase the difficulty for us to plan and prepare for potential changes to applicable laws. The Consumer Product Safety Improvement Act of 2008 imposes significant requirements on manufacturing, importing, testing and labeling requirements for our products. In the event that we are unable to timely comply with regulatory changes, significant fines or penalties could result, and could adversely affect our reputation, results of operations, cash flow and financial condition.

We Have Co-sourced Certain of Our Information Technology, Accounts Payable, Payroll, Accounting, and Human Resources Functions and May Co-source Other Administrative Functions, Which Makes Us More Dependent Upon Third Parties

We place significant reliance on a third party provider for the co-sourcing of certain of our information technology (IT), accounts payable, payroll, accounting, and human resources functions. This co-sourcing initiative is a component of our ongoing strategy to increase efficiencies, increase our IT capabilities, monitor our costs and seek additional cost savings. These functions are generally performed in an offshore location, with Michaels oversight. As a result, we are relying on third parties to ensure that certain functional needs are sufficiently met. This reliance subjects us to risks arising from the loss of control over these processes, changes in pricing that may affect our operating results, and potentially, termination of provision of these services by our supplier. If our service providers fail to perform, we may have difficulty arranging for an alternate supplier or rebuilding our own internal resources, and we could incur

significant costs, all of which may have a significant adverse effect on our business. We may co-source other administrative functions in the future, which would further increase our reliance on third parties. Further, the use of offshore service providers may expose us to risks related to local political, economic, social or environmental conditions (including acts of terrorism, the outbreak of war, or the occurrence of natural disaster), restrictive actions by foreign governments or changes in United States laws and regulations.

Our Information Systems May Prove Inadequate

We depend on our management information systems for many aspects of our business, including our perpetual inventory, automated replenishment, and weighted average cost stock ledger systems which are necessary to properly forecast, manage, and analyze our inventory. We will be materially adversely affected if our operational or management information systems are disrupted or we are unable to improve, upgrade, maintain, and expand our systems.

Failure to Adequately Maintain Security and Prevent Unauthorized Access to Electronic and Other Confidential Information Could Materially Adversely Affect Our Financial Condition and Operating Results

We have become increasingly centralized and dependent upon automated information technology processes. In addition, a portion of our business operations is conducted over the Internet, increasing the risk of viruses that could cause system failures and disruptions of operations. Any failure to maintain the security of our customers' confidential information, or data belonging to ourselves or our suppliers, could put us at a competitive disadvantage, result in deterioration in our customers' confidence in us, and subject us to potential litigation, liability, fines and penalties, resulting in a possible material adverse impact on our financial condition and results of operations. Even though we are compliant with the requirements of the payment card industry, we may not be able to maintain such compliance, and even with continued compliance, unauthorized access of our electronic and other confidential information may occur.

Changes in Regulations or Enforcement May Adversely Impact Our Business

We are subject to federal, state, provincial and local regulations with respect to our operations in the U.S. and Canada. There are a number of legislative and regulatory initiatives, which the enactment or enforcement of, could adversely impact our business. Those initiatives include wage or workforce issues, collective bargaining matters, environmental regulation, price and promotion regulation, trade regulations and others. In addition, we expect that the Patient Protection and Affordable Care Act, which was signed into law on March 23, 2010, will increase our annual associate health care costs, with the most significant increases coming in 2014. Proposed changes in tax regulations may also change our effective tax rate as our business is subject to a combination of applicable tax rates in the various countries, states and other jurisdictions in which we operate.

A Weak Fourth Quarter Would Materially Adversely Affect Our Result of Operations

Our business is highly seasonal. Our inventories and short-term borrowings may grow in the second and third fiscal quarters as we prepare for our peak selling season in the third and fourth fiscal quarters. Our most important quarter in terms of sales, profitability, and cash flow historically has been the fourth fiscal quarter. If for any reason our fourth fiscal quarter results were substantially below expectations, our operating results for the full year would be materially adversely affected, and we could have substantial excess inventory, especially in seasonal

merchandise, that is difficult to liquidate.

Competition Could Negatively Impact Our Business

The retail arts and crafts industry is competitive, which could result in the reduction of our prices and our loss of market share. We must remain competitive in the areas of quality, price, breadth of selection, customer service, and convenience. We compete with mass merchants (*e.g.*, Wal-Mart Stores, Inc. and Target Corporation), who dedicate a portion of their selling space to a limited selection of craft supplies and seasonal and holiday merchandise, along with national and regional chains and local merchants. We also compete with specialty arts and crafts retailers, which include Hobby Lobby, A.C. Moore Arts & Crafts, Inc., Jo-Ann Stores, Inc., and Garden Ridge Corporation. Some of our competitors, particularly the mass merchants, are larger and have greater financial resources than we do. In addition, alternative methods of selling crafts, such as over the Internet, could result in additional competitors in the future and increased price competition since our customers could more readily comparison shop. Furthermore, we ultimately compete with alternative sources of entertainment and leisure for our customers.

The Interests of Our Controlling Stockholders May Conflict with the Interests of Our Creditors

The Sponsors indirectly own approximately 93% of the Company's Common Stock. The interests of these funds as equity holders may conflict with those of our creditors. The controlling stockholders may have an incentive to increase the value of their investment

or cause us to distribute funds at the expense of our financial condition, which could affect our ability to make payments on the outstanding notes. In addition, these funds have the power to elect a majority of our board of directors and appoint new officers and management and, therefore, effectively control many other major decisions regarding our operations. In addition, our Sponsors have in the past and may continue to purchase our debt which could adversely affect the liquidity of the remaining debt of any series.

ITEM 1B. Unresolved Staff Comments.

None.

ITEM 2. Properties.

We lease substantially all of the sites for our Michaels and Aaron Brothers stores, with the majority of our stores having initial lease terms of approximately 10 years. The leases are generally renewable, with increases in lease rental rates. Lessors have made leasehold improvements to prepare our stores for opening under a majority of our existing leases. As of January 29, 2011, in connection with stores that we plan to open or relocate in future fiscal years, we had signed 24 leases for Michaels stores.

As of March 21, 2011, we lease and occupy the following non-store facilities:

	Square Footage
Distribution centers:	
Centralia, Washington	718,000
City of Commerce, California (Aaron Brothers)	174,000
Hazleton, Pennsylvania	1,005,000
Jacksonville, Florida	776,000
Lancaster, California	763,000
New Lenox, Illinois	693,000
Tarrant County, Texas	433,000
	4,562,000
Artistree:	
City of Industry, California (regional processing center)	90,000
Coppell, Texas (regional processing and fulfillment operations center)	230,000
Kernersville, North Carolina (manufacturing plant and regional processing center)	156,000
Mississauga, Ontario (regional processing center)	62,000
	538,000
Office space:	
Coppell, Texas (corporate satellite office)	67,000
Grand Prairie, Texas (corporate processing center)	35,000
Irving, Texas (corporate headquarters)	217,000
Mississauga, Ontario (Canadian regional office)	3,000
	322,000

Edgar Filing: MICHAELS STORES INC - Form 10-K

Coppell, Texas (new store staging warehouse)	29,000
Dallas, Texas (warehouse)	70,000
	5,521,000

Edgar Filing: MICHAELS STORES INC - Form 10-K

The following table indicates the number of our retail stores located in each state or province as of March 21, 2011:

State/Province	Number of Stores		Total
	Michaels	Aaron Brothers	
Alabama	10		10
Alaska	3		3
Alberta	15		15
Arizona	28	6	34
Arkansas	4		4
British Columbia	15		15
California	130	86	216
Colorado	21	6	27
Connecticut	13		13
Delaware	4		4
Florida	74		74
Georgia	30	2	32
Idaho	6	1	7
Illinois	41		41
Indiana	16		16
Iowa	7		7
Kansas	8		8
Kentucky	7		7
Louisiana	12		12
Maine	2		2
Manitoba	3		3
Maryland	22		22
Massachusetts	24		24
Michigan	35		35
Minnesota	22		22
Mississippi	5		5
Missouri	19		19
Montana	4		4
Nebraska	4		4
Nevada	10	5	15
New Brunswick	3		3
Newfoundland and Labrador	1		1
New Hampshire	7		7
New Jersey	27		27
New Mexico	3		3
New York	52		52
North Carolina	31		31
North Dakota	2		2
Nova Scotia	4		4
Ohio	30		30
Oklahoma	8		8
Ontario	35		35
Oregon	15	2	17
Pennsylvania	43		43
Prince Edward Island	1		1
Rhode Island	3		3
Saskatchewan	2		2
South Carolina	10		10
South Dakota	2		2
Tennessee	13		13

Edgar Filing: MICHAELS STORES INC - Form 10-K

Texas	69	20	89
Utah	12		12
Vermont	2		2
Virginia	32		32
Washington	22	9	31
West Virginia	5		5
Wisconsin	18		18
Wyoming	1		1
Total	1,047	137	1,184

ITEM 3. Legal Proceedings.

Employee Claims

Adams Claim

On April 22, 2009, 129 individuals commenced an action against the Company styled Adams, et. al. v. Michaels Stores, Inc. in the United States District Court for the Central District of California. The Adams suit alleges that Michaels failed to pay overtime wages, provide meal and rest periods (or compensation in lieu thereof), accurately record hours worked and provide itemized employee wage statements. The Adams suit additionally alleges that the foregoing conduct was in breach of California's unfair competition law. Similar claims were subsequently filed by an additional eight individuals. The plaintiffs seek injunctive relief, damages for unpaid wages, penalties, restitution, interest, and attorneys' fees and costs. A number of the individual plaintiff claims have been settled for immaterial amounts. A bench trial on one of the plaintiff's case occurred in December 2010, and no decision has been rendered. We believe we have meritorious defenses and intend to defend the remaining individual claims vigorously. We do not believe the resolution of these cases will have a material effect on our business.

Tijero and Godfrey Consolidated Claim

On February 12, 2010, the Company was served with a lawsuit filed on May 7, 2009 by Jose Tijero, a former assistant manager for Aaron Brothers as a purported class action proceeding on behalf of himself and all current and former hourly retail employees employed by Aaron Brothers in California. On July 12, 2010, the Company was served with a lawsuit filed on July 9, 2010 by Amanda Godfrey, a former Aaron Brothers hourly employee alleging similar allegations as in the Tijero suit. On October 15, 2010, the cases were consolidated and refiled in the United States District Court-Northern District of California. These suits allege that Aaron Brothers failed to pay all wages and overtime, failed to provide its hourly employees with adequate meal and rest breaks (or compensation in lieu thereof), failed to timely pay final wages, unlawfully withheld wages and failed to provide accurate wage statements and further alleges that the foregoing conduct was in breach of various laws, including California's unfair competition law. The plaintiff seeks injunctive relief, compensatory damages, meal and rest break penalties, waiting time penalties, interest, and attorneys' fees and costs. The Company filed a Motion to Dismiss various claims and a hearing is set for March 29, 2011. We believe we have meritorious defenses and intend to defend the lawsuit vigorously. We are unable to estimate a range of loss, if any, in this case.

Consumer Class Action Claims

Carson Claim

On August 15, 2008, Linda Carson, a consumer, filed a purported class action proceeding against Michaels Stores, Inc. in the Superior Court of California, County of San Diego (San Diego Superior Court), on behalf of herself and all similarly-situated California consumers. The Carson suit alleges that Michaels unlawfully requested and recorded personally identifiable information (i.e., her zip code) as part of a credit card transaction. The plaintiff sought statutory penalties, costs, interest, and attorneys' fees. We contested certification of this claim as a class action and filed a motion to dismiss the claim. On March 9, 2009, the Court dismissed the case with prejudice. The plaintiff appealed this decision to the California Court of Appeal for the Fourth District, San Diego. On July 22, 2010, the Court of Appeal upheld the dismissal of the case. The

Edgar Filing: MICHAELS STORES INC - Form 10-K

plaintiff appealed this decision to the Supreme Court of California (California Supreme Court). On September 29, 2010, the California Supreme Court granted the plaintiff s petition for review; however, it stayed any further proceedings in the case until another similar zip code case pending before the court, Pineda v. Williams-Sonoma, was decided. On February 10, 2011, the California Supreme Court ruled, in the Williams-Sonoma case, that zip codes are personally identifiable information and therefore the Song-Beverly Credit Card Act of 1971, as amended (Song Act) prohibits businesses from requesting or requiring zip codes in connection with a credit card transaction. We anticipate that the Carson case will be remanded to the San Diego Superior Court for further proceedings consistent with the California Supreme Court decision. We are reviewing the matter in light of this recent decision and, at this time, we are unable to estimate a range of loss, if any, in this

Edgar Filing: MICHAELS STORES INC - Form 10-K

case. Additionally, since the California Supreme Court decision on February 10, 2011, three additional purported class action lawsuits alleging violations of the Song Act have been filed against the Company: Carolyn Austin v. Michaels Stores, Inc. and Tiffany Heon v. Michaels Stores, Inc., both in the San Diego Superior Court and Sandra A. Rubinstein v. Michaels Stores, Inc. in the Superior Court of California, County of Los Angeles, Central Division. We intend to vigorously defend each of these cases and we are unable, at this time, to estimate a range of loss, if any.

Ratray Claim

On April 9, 2010, Ross Ratray, a consumer, filed a purported class action proceeding against Michaels Stores, Inc. in the San Diego Superior Court, on behalf of himself and all similarly-situated California consumers. The Ratray suit alleges causes of action for unlawful and unfair business practices and false advertising under the California Business and Professions Code, and a violation of the Consumer Legal Remedies Act, for misrepresentation that Michaels gift cards are not redeemable for cash and for failure to disclose that the plaintiff could redeem the unused cash balance on a gift card when the value fell below \$10.00. On March 15, 2011, the matter was mediated and a tentative settlement agreement was reached with the plaintiff for an immaterial amount, which is subject to Court approval.

Governmental Inquiries and Related Matters

Non-U.S. Trust Inquiry

In early 2005, the District Attorney's office of the County of New York and the SEC opened inquiries concerning non-U.S. trusts that directly or indirectly held shares of Michaels common stock and common stock options. A federal grand jury requested information with respect to the same facts. We are cooperating in these inquiries and have provided information in response to the requests.

Certain of these trusts and corporate subsidiaries of the trusts acquired securities of Michaels in transactions directly or indirectly with Charles J. Wyly, Jr. and Sam Wyly, who were, respectively, Chairman and Vice Chairman of the Board of Directors prior to the consummation of the Merger, or with other Wyly family members. In addition, subsidiaries of certain of these trusts acquired securities directly from us in private placement transactions in 1996 and 1997 and upon the exercise of stock options transferred, directly or indirectly, to the trusts or their subsidiaries by Charles Wyly, Sam Wyly, or other Wyly family members.

We understand that Charles Wyly and Sam Wyly and/or certain of their family members are beneficiaries of irrevocable non-U.S. trusts. The 1996 and 1997 private placement sales by us of Michaels securities to subsidiaries of certain of these trusts were disclosed by us in filings with the SEC. The transfer by Charles Wyly and/or Sam Wyly (or by other Wyly family members or family-related entities) of Michaels securities to certain of these trusts and subsidiaries was also disclosed in filings with the SEC by us and/or by Charles Wyly and Sam Wyly. Based on information provided to us, our SEC filings prior to 2005 did not report securities owned by the non-U.S. trusts or their corporate subsidiaries as beneficially owned by Charles Wyly and Sam Wyly.

Charles Wyly and Sam Wyly filed an amended Schedule 13D with the SEC on April 8, 2005, stating that they may be deemed the beneficial owners of Michaels securities held directly or indirectly by the non-U.S. trusts. In our 2005 and 2006 proxy statements, we included the securities held in the non-U.S. trusts or their separate subsidiaries, as reported by the Wyllys, in the beneficial ownership table of our principal stockholders and management, with appropriate footnotes.

On July 29, 2010, the SEC filed a civil enforcement action in federal district court for the Southern District of New York against Charles Wyly, Sam Wyly and others alleging, among other things, violations of various federal securities laws, including those governing ownership reporting and trading of securities, in connection with the non-U.S. trusts and their subsidiaries. Additional information may be obtained at the SEC's website. Charles Wyly, Sam Wyly and their attorney Michael French, a former director of the Company, have requested indemnification from the Company for certain legal costs with respect to these matters. The Company is currently assessing the Wyllys' claim and French's claim.

Pricing and Promotions Inquiry

On or about February 11, 2011, the Company received a notice of investigation and a subpoena from the New York State Attorney General requiring the production of certain documents relating to the frequency of the Company's pricing promotions and advertisements. At this time, we are unable to determine the scope of the investigation, the relief which may be sought in any such proceeding or whether such proceeding could have a material adverse effect on our business.

General

We are a defendant from time to time in lawsuits incidental to our business. Based on currently available information, we believe that resolution of all known contingencies is uncertain. There can be no assurance that future costs of such litigation would not be material to our financial position, results of operations, or cash flows.

PART II

ITEM 4. (Removed and Reserved)

ITEM 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Market Information

Our Common Stock is privately held and there is no established public trading market for our stock.

Holder

As of March 21, 2011, there were 40 holders of record of our Common Stock.

Dividends

The Company has not declared or paid any cash dividends on its Common Stock in fiscal 2010 and fiscal 2009. The Company does not anticipate paying any cash dividends in the near future.

ITEM 6. Selected Financial Data.

The following financial information for the five most recent fiscal years has been derived from our consolidated financial statements. This information should be read in conjunction with the consolidated financial statements and related notes thereto included elsewhere herein. The selected financial data for fiscal year 2006 reflects adjustments to reclassify the operations of Star and Recollections as discontinued operations.

	2010 (1)	2009	Fiscal Year 2008		2007	2006 (2)
	(In millions, except per share and store count data)					
Results of Operations Data:						
Net sales	\$ 4,031	\$ 3,888	\$ 3,817	\$ 3,862	\$ 3,843	
Operating income	488	397	304	354	208	
Income (loss) before discontinued operations	98	107	(5)	(22)	44	
Discontinued operations loss, net of income tax				(10)	(3)	
Net income (loss)	98	107	(5)	(32)	41	
Dividends per common share (3)						0.12
Balance Sheet Data:						
Cash and equivalents	\$ 319	\$ 217	\$ 33	\$ 29	\$ 30	
Merchandise inventories	826	873	900	845	840	
Total current assets	1,275	1,207	1,049	980	1,000	
Total assets	1,770	1,710	1,625	1,614	1,693	
Total current liabilities	687	717	681	679	742	
Long-term debt	3,667	3,684	3,756	3,741	3,729	
Total liabilities	4,434	4,481	4,512	4,506	4,568	
Stockholders' deficit	(2,664)	(2,771)	(2,887)	(2,892)	(2,875)	
Other Financial Data:						
Cash flow from operating activities	\$ 438	\$ 405	\$ 59	\$ 268	\$ 157	
Cash flow from investing activities	(83)	(43)	(85)	(100)	(143)	
Cash flow from financing activities	(253)	(178)	30	(169)	(436)	
Other Operating Data:						
Average net sales per selling square foot (4) (5)	\$ 208	\$ 205	\$ 206	\$ 217	\$ 224	
Comparable store sales increase (decrease) (6)	2.5%	0.2%	(4.6)%	(0.7)%	0.2%	
Total selling square footage	20	20	19	19	18	
Stores Open at End of Year:						
Michaels (5)	1,045	1,023	1,009	963	921	
Aaron Brothers	137	152	161	166	166	
Total stores open at end of year	1,182	1,175	1,170	1,129	1,087	

(1) Fiscal 2010 net income includes a \$53 million loss related to the early extinguishment of our 2014 Notes.

(2) Fiscal 2006 operational data, excluding comparable store sales, includes the 53rd week, which had net sales of approximately \$56 million.

Edgar Filing: MICHAELS STORES INC - Form 10-K

(3) The per share amounts in the table were retroactively adjusted to reflect the 2.9333-for-one Common Stock split effected in the form of stock dividends to stockholders of record as of the close of business on January 26, 2007.

(4) The calculation of average net sales per selling square foot includes only Michaels stores open longer than 36 months, and excludes Aaron Brothers stores.

(5) For fiscal year 2006, the Star Decorators Wholesale Los Angeles store has been retroactively presented as a Michaels store.

(6) Comparable store sales increase (decrease) represents the increase (decrease) in net sales for stores open the same number of months in the indicated and comparable period of the previous year, including stores that were relocated or expanded during

either period. A store is deemed to become comparable in its 14th month of operation in order to eliminate grand opening sales distortions. A store temporarily closed more than 2 weeks due to a catastrophic event is not considered comparable during the month it closed. If a store is closed longer than 2 weeks but less than 2 months, it becomes comparable in the month in which it reopens, subject to a mid-month convention. A store closed longer than 2 months becomes comparable in its 14th month of operation after its reopening. These percentages for fiscal year 2006 have been adjusted to exclude Star and Recollections.

ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion should be read in conjunction with our consolidated financial statements and the related notes included elsewhere in this Annual Report on Form 10-K. The following discussion, as well as other portions of this Annual Report on Form 10-K, contains forward-looking statements that reflect our plans, estimates, and beliefs. Any statements contained herein (including, but not limited to, statements to the effect that Michaels or its management anticipates, plans, estimates, expects, believes, intends, and other similar expressions) that are not statements of historical fact should be considered forward-looking statements and should be read in conjunction with our consolidated financial statements and related notes contained elsewhere in this report. Specific examples of forward-looking statements include, but are not limited to, statements regarding our forecasts of financial performance, capital expenditures, working capital requirements, and forecasts of effective tax rate. Our actual results could materially differ from those discussed in these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed below and elsewhere in this Annual Report on Form 10-K, and particularly in Item 1A. Risk Factors.

We report on the basis of a 52 or 53-week fiscal year, which ends on the Saturday closest to January 31. References to fiscal year mean the year in which that fiscal year began. Fiscal 2010 ended on January 29, 2011, fiscal 2009 ended on January 30, 2010, and fiscal 2008 ended on January 31, 2009. Each of these three fiscal years contained 52 weeks.

Executive Overview

We are the largest arts and crafts specialty retailer in North America, with fiscal 2010 sales of over \$4.0 billion. Our primary business is the operation of 1,047 Michaels stores across the United States and Canada. We also operate 137 Aaron Brothers stores, a custom frame, framing, and art supply chain (all store counts are as of March 21, 2011). Through our broad product assortments, educational in-store events, project sheets and displays, and on-line information, we offer a shopping experience that inspires creativity in the areas of arts, crafts, floral displays, framing, home accents, and kids hobbies and activities.

Highlights for fiscal 2010 include the following:

- We surpassed the \$4 billion sales mark for the first time in Company history with \$4.031 billion in sales, a 3.7% improvement over last year, driven by a 2.5% increase in comparable store sales as well as the opening of 23 new stores. Our new store growth included three urban market format stores as well as our first small market format store. In addition, we completed 10 store relocations during the year.
- Our private brand merchandise represented 36% of total sales.

Edgar Filing: MICHAELS STORES INC - Form 10-K

- Direct import penetration, as a percent of total receipts, increased to 23% compared to 17% in fiscal 2009.
- Gross margin improved by 110 basis points to 38.8% for fiscal 2010.
- We reported record operating income of \$488 million, an increase of 22.9% from prior year.
- Adjusted EBITDA improved by 14.3%, from \$544 million in fiscal 2009 to \$622 million fiscal 2010. Net cash provided by operating activities increased \$33 million, or 8.1%, and net income decreased by \$9 million to \$98 million.
- During the third quarter of fiscal 2010, we refinanced our \$750 million 10% Senior Notes maturing in 2014 with \$800 million 7¾% Senior Notes maturing in 2018.
- We reduced our senior secured term loan facility by \$228 million.
- Our average inventory per store decreased by 6.8% compared to fiscal 2009.

- On September 15, 2010, we acquired certain assets of ScrapHD, LLC, a digital scrapbooking and photo-booking business that, once re-launched in early fiscal 2011, will allow customers to work online to create digital scrapbooks which can be printed at home or professionally bound into a book.
- We launched new strategic merchandising alliances and exclusive product partnerships, such as the exclusive Duff bakeware collection of Chef Duff Goldman.

In fiscal 2011, we will continue to focus on strategic initiatives such as:

- enhancing the in-store experience,
- introducing new products through frequent merchandise resets,
- diversifying marketing programs,
- continued growth of global sourcing and private brand penetration,
- store expansion and portfolio optimization, and
- inventory optimization.

Critical Accounting Policies and Estimates

We have prepared our financial statements in conformity with U.S. generally accepted accounting principles, and these financial statements necessarily include some amounts that are based on our informed judgments and estimates. Our senior management has discussed the development and selection of these critical accounting estimates, and the disclosure in this section of this report regarding them, with the Audit Committee of our Board of Directors. Our significant accounting policies are discussed in Note 1 of Notes to Consolidated Financial Statements. Our critical accounting policies represent those policies that are subject to judgments and uncertainties. As discussed below, our financial position and results of operations may be materially different when reported under different conditions or when using different assumptions in the application of these policies. In the event estimates or assumptions prove to be different from actual amounts, adjustments are made in subsequent periods to reflect more current information. Our critical accounting policies include:

Merchandise Inventories Merchandise inventories are valued at the lower of cost or market, with cost determined using a weighted average method. Cost is calculated based upon the price paid for an item at the time it is received by us, and also includes the cost of warehousing, handling, purchasing, and importing the inventory, as well as inbound and outbound transportation, partially offset by vendor allowances. This net inventory cost is recognized through Cost of sales when the inventory is sold. It is impractical for us to assign specific allocated overhead costs and vendor allowances to individual units of inventory. As such, to match net inventory costs against the related revenues, we estimate the net inventory costs to be deferred and recognized each period as the inventory is sold.

Vendor allowances, which primarily represent volume rebates and cooperative advertising funds, are recorded as a reduction of the cost of the merchandise inventories and a subsequent reduction in Cost of sales when the inventory is sold. We generally earn vendor allowances as a percentage of certain merchandise purchases with no minimum purchase requirements. Typically, our vendor allowance programs extend for a period of 12 months. We recognized vendor allowances of \$112 million, or 2.8% of net sales, in fiscal 2010, \$133 million, or 3.4% of net sales, in fiscal 2009, and \$149 million, or 3.9% of net sales, in fiscal 2008. During the three fiscal years ended January 29, 2011, the number of vendors from which vendor allowances were received ranged from approximately 670 to 770. As a result of our increased direct import penetration, vendor allowances, as a percentage of sales, have been declining and we expect this trend to continue in future years.

We utilize perpetual inventory records to value inventory in our stores. Physical inventory counts are performed in a significant number of stores during each fiscal quarter by a third party inventory counting service. Substantially all stores open longer than one year are subject to at least one count each fiscal year. We adjust our perpetual records based on the results of the physical counts. We maintain a provision for estimated shrinkage based on the actual historical results of our physical inventories. We compare our estimates to the actual results of the physical inventory counts as they are taken and adjust the shrink estimates accordingly. A 10% change in our estimated shrinkage would have affected net income by \$1 million for fiscal 2010. We also evaluate our merchandise to ensure that the expected net realizable value of the merchandise held at the end of a fiscal period exceeds cost. In the event that the expected net realizable value is less than cost, we reduce the value of that inventory accordingly. A 10% change in our inventory valuation reserve would have affected net income by \$1 million for fiscal 2010.

Goodwill We review goodwill for impairment each year in the fourth quarter, or more frequently if certain events occur or circumstances change. The impairment review is performed by comparing each reporting unit's carrying value to its estimated fair value, determined through estimated discounted future cash flows and market-based methodologies. If the carrying value exceeds the estimated fair value, we determine the fair value of all assets and liabilities of the reporting unit, including the implied fair value of goodwill. If the carrying value of goodwill exceeds the implied fair value, we recognize an impairment charge equal to the difference.

Factors used in the valuation of goodwill include, but are not limited to, management's plans for future operations, recent operating results and discounted projected future cash flows. Material assumptions used in our impairment analysis include the weighted average cost of capital (WACC) percentage, terminal growth rate and forecasted long-term sales growth. During fiscal 2010, fiscal 2009, and fiscal 2008, there was no impairment charge taken on our goodwill. A 1% change in the WACC rate represents an approximate \$540 million change to the enterprise fair value of the Michaels reporting unit. A 1% change in the terminal growth rate and long-term sales growth rate represents an approximate combined \$420 million change to the enterprise fair value. Neither assumption change would have resulted in an impairment of goodwill.

Impairment of Long-Lived Assets We evaluate long-lived assets, other than goodwill and assets with indefinite lives, for indicators of impairment whenever events or changes in circumstances indicate their carrying amounts may not be recoverable. Additionally, for store assets, we evaluate the performance of individual stores for indicators of impairment and underperforming stores are selected for further evaluation of the recoverability of the carrying amounts. The evaluation of long-lived assets is performed at the lowest level of identifiable cash flows, which is at the individual store level.

Our evaluation requires consideration of a number of factors including changes in consumer demographics and uncertain future events. Accordingly, our accounting estimates may change from period to period. These factors could cause management to conclude that impairment indicators exist and require that tests be performed, which could result in a determination that the value of long-lived assets is impaired, resulting in a writedown to fair value.

Our initial indicator that store assets are considered to be recoverable is that the estimated undiscounted cash flows for the remaining lease term, assuming zero growth over current year store performance, exceed the carrying value of the assets. This evaluation is performed on stores open longer than 36 months (unless significant impairment indicators exist), as we consider a store to become mature after that time period. Any stores that do not meet the initial criteria are further evaluated taking into consideration the estimated undiscounted store-specific cash flows for the remaining lease term compared to the carrying value of the assets. To estimate store-specific future cash flows, management must make assumptions about key store variables, including sales, growth rate, gross margin, payroll and other controllable expenses. Furthermore, management considers other factors when evaluating stores for impairment, including the individual store's execution of its operating plan and other local market conditions.

An impairment is recognized once all the factors noted above are taken into consideration and it is determined that the carrying amount of the store's assets are not recoverable. The impairment is based on estimated fair value of the assets. We recorded an immaterial impairment charge in fiscal 2010, \$2 million in fiscal 2009, and \$3 million in fiscal 2008. In addition to recording impairment charges on certain stores based on the previously discussed criteria, we maintain a list of stores we consider at risk and monitor those stores closely. As of January 29, 2011, we did not have any stores we considered at risk for impairment.

Reserve for Closed Facilities We maintain a reserve for future rental obligations, carrying costs, and other closing costs related to closed facilities, primarily closed and relocated stores. In accordance with Accounting Standards Codification (ASC or Codification) 420, Exit or Disposal Cost Obligations, we recognize exit costs for any store closures at the time the store is closed. Such costs are recorded within the Cost of sales and occupancy expense line item on our Consolidated Statements of Operations.

The cost of closing a store or facility is calculated as the lesser of the present value of future rental obligations remaining under the lease (less estimated sublease rental income) or the lease termination fee. The determination of the reserves is dependent on our ability to make reasonable estimates of costs to be incurred post-closure and of rental income to be received from subleases. In planning our store closures, we try to time our exits as close to the lease termination date as possible to minimize any remaining lease obligation. As of January 29, 2011 our reserve for closed facilities, including discontinued operations, was \$5 million. The reserves could differ materially if market conditions were to vary significantly from our assumptions.

Self-Insurance We have insurance coverage for losses in excess of self-insurance limits for medical liability, general liability and workers compensation claims. Health care reserves are based on actual claims experience and an estimate of claims incurred but not reported. Reserves for general liability and worker s compensation are determined through the use of actuarial studies. Due to the significant judgments and estimates utilized for determining these reserves, they are subject to a high degree of variability. In the event our insurance carriers are unable to pay claims submitted to them, we would record a liability for such estimated payments we expect to incur. A 10% change in our self-insurance liability would have affected net income by approximately \$4 million for fiscal 2010.

Revenue Recognition Revenue from sales of our merchandise is recognized when the customer takes possession of the merchandise. Revenue is presented net of sales taxes collected. Sales related to custom framing are deferred until the order is picked

up by the customer, which we estimate based on historical customer behavior. We deferred 13 days of custom framing revenue at the end of fiscal 2010, 2009 and 2008. A one day change in our custom frame deferral would have had an immaterial impact on our fiscal 2010 net income. As of January 29, 2011 and January 30, 2010, our deferred framing revenue was approximately \$10 million and \$8 million, respectively.

We allow for merchandise to be returned under most circumstances and provide a reserve for estimated returns. We use historical customer return behavior to estimate our reserve requirements. As of January 29, 2011 and January 30, 2010, our sales returns reserve was approximately \$3 million.

We record a gift card liability on the date we issue the gift card to the customer. We record revenue and reduce the gift card liability as the customer redeems the gift card. The deferred revenue associated with outstanding gift cards increased \$2 million from January 30, 2010, to \$26 million as of January 29, 2011. We escheat the value of unredeemed gift cards where required by law. Any remaining liabilities not subject to escheatment are evaluated to determine whether the likelihood of the gift card being redeemed is remote (gift card breakage). We recognize gift card breakage as revenue, by applying our estimate of the rate of gift card breakage over the period of estimated performance. Our estimates of the gift card breakage rate are applied to the estimated amount of gift cards that are expected to go unused and that are not subject to escheatment, and such estimates are based on customers' historical redemption rates and patterns. We do not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions we use to recognize income related to unredeemed gift cards. However, if actual results are not consistent with our assumptions, we may record additional income or expense.

Share-Based Compensation Expenses ASC 718, *Stock Compensation*, requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements, based on their fair value, over the requisite service period. Compensation cost is based on the grant date fair value of the award and ratably recognized as an expense over the effective vesting period. We estimate the fair value of stock option awards using a Black-Scholes option value model.

Because we are privately held and there is no public market for our Common Stock, the fair value of our equity is estimated by our Board of Directors at the time option grants are awarded. In estimating the fair value of our Common Stock, the Board of Directors considers factors that it believes are material to the valuation process including the Company's actual and projected financial results, the principal amount of the Company's indebtedness and formal valuations of the Company. In fiscal 2010, valuations completed relied on projections of our future performance, estimates of our weighted average cost of capital, and metrics based on the performance of a peer group of similar companies, including valuation multiples and stock price volatility. However, due to the economic deterioration that occurred during fiscal 2008, the traditional approaches outlined above did not yield an answer that was considered to be representative of the fair value of the Company's equity. Accordingly, as of the end of fiscal 2008 and fiscal 2009, the Company also completed a valuation based on a Black-Scholes option model, which utilized the fair value of the Company's assets, the book value of the Company's debt, an estimated time to a liquidity event, the asset volatility of a peer group of companies and the risk free rate. In future valuations, we will consider traditional approaches and, to the extent necessary, the Black-Scholes option model for valuing our Common Stock.

Other assumptions used in the option value model for estimating the fair value of stock option awards include expected volatility of our Common Stock share price, expected terms of the options, expected dividends, and forfeitures. The expected volatility rate is based on both historical volatility as well as implied volatilities from the exchange-traded options on the common stock of a peer group of companies. We utilize historical exercise and post-vesting employment behavior to estimate the expected terms of the options and do not use a dividend rate assumption. Our forfeitures assumption was estimated based on historical experience and anticipated events. The risk-free interest rate is based on the yields of U.S. Treasury instruments with approximately the same term as the expected life of the stock option award. We update our assumptions regularly based on historical trends and current market observations.

Edgar Filing: MICHAELS STORES INC - Form 10-K

As of January 29, 2011, compensation cost not yet recognized related to nonvested awards totaled \$21 million and is expected to be recognized over a weighted average period of 3.2 years. A 10% change in the fair value of stock option awards granted in fiscal 2010 would have had an immaterial impact on our fiscal 2010 net income and impacted compensation cost not yet recognized by \$2 million.

Income Taxes We record income tax expense using the liability method for taxes and are subject to income tax in many jurisdictions, including the United States, various states and localities, and Canada. A current tax liability or asset is recognized for the estimated taxes payable or refundable on the tax returns for the current year and a deferred tax liability or asset is recognized for the estimated future tax effects attributable to temporary differences and carryforwards. Deferred tax assets and liabilities are measured using enacted income tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of a change in tax rates is recognized as income or expense in the period that includes the

Edgar Filing: MICHAELS STORES INC - Form 10-K

enactment date. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets unless it is more likely than not that such assets will be realized. In evaluating our ability to realize our deferred tax asset, we considered the following sources of future taxable income:

- Future reversals of existing taxable temporary differences;
- Future taxable income, exclusive of reversing temporary differences and carryforwards;
- Taxable income in prior carryback years; and
- Tax-planning strategies.

Our evaluation regarding whether a valuation allowance is required or should be adjusted also considers, among other things, the nature, frequency, and severity of recent losses, forecasts of future profitability and the duration of statutory carryforward periods. Our forecasts of future profitability represents our best estimate of these future events. After conducting this assessment, the valuation allowance recorded against our deferred tax assets was \$15 million and \$14 million as of January 29, 2011 and January 30, 2010, respectively. If actual results differ from estimated results, or if we adjust these assumptions in the future, we may need to adjust our deferred tax assets or liabilities, which could impact our effective tax rate.

The amount of income taxes we pay is subject to ongoing audits in the taxing jurisdictions in which we operate. During these audits, the taxing authorities may challenge items on our tax returns. Because the tax matters challenged by tax authorities are typically complex, the ultimate outcome of these challenges is uncertain. We recognize tax benefits for uncertain positions only to the extent that we believe it is more likely than not that the tax position will be sustained. Our future results may include favorable or unfavorable adjustments to our unrecognized tax benefits due to closure of income tax audits, new regulatory or judicial pronouncements, or other relevant events. As a result, our effective tax rate may fluctuate significantly on a quarterly and annual basis.

Results of Operations

The following table sets forth the percentage relationship to net sales of each line item of our Consolidated Statements of Operations. This table should be read in conjunction with the following discussion and with our consolidated financial statements, including the related notes.

	Fiscal Year		
	2010	2009	2008
Net sales	100.0%	100.0%	100.0%
Cost of sales and occupancy expense	61.2	62.3	63.7
Gross profit	38.8	37.7	36.3
Selling, general, and administrative expense	26.3	27.1	27.8
Related party expenses	0.3	0.4	0.4
Store pre-opening costs	0.1	0.1	0.1
Operating income	12.1	10.1	8.0
Interest expense	6.8	6.6	7.9
Loss on early extinguishment of debt	1.3		
Other (income) and expense, net	0.2	(0.4)	0.1

Edgar Filing: MICHAELS STORES INC - Form 10-K

Income before income taxes	3.8	3.9	
Provision for income taxes	1.3	1.3	0.1
Net income (loss)	2.5%	2.6%	(0.1)%

Fiscal 2010 Compared to Fiscal 2009

Net Sales Net sales increased for fiscal 2010 by \$143 million, or 3.7%, from fiscal 2009 due primarily to a \$96 million increase in comparable store sales. Comparable store sales increased 2.5% due to an increase in customer transactions of 1.3% and an increase in the average ticket of 1.2%. The fluctuation in the exchange rates between the United States and Canadian dollars positively impacted the average ticket by 70 basis points. Comparable store sales growth was strongest in our bakeware, kid's crafts, and custom framing categories. In addition, sales from our non-comparable new stores provided incremental revenue of \$47 million.

Cost of Sales and Occupancy Expense Cost of sales and occupancy expense increased \$44 million to \$2.467 billion from \$2.423 billion in fiscal 2009 as a result of the 2.5% increase in comparable store sales and an increase in sales from non-comparable new stores. Cost of sales and occupancy expense decreased 110 basis points as a percentage of net sales. Merchandise costs, as a percentage of net sales, improved 60 basis points driven by our direct import initiative and improved pricing and promotion

Edgar Filing: MICHAELS STORES INC - Form 10-K

management. In addition, occupancy costs decreased 50 basis points due in part to 30 basis points of increased leverage on higher comparable store sales. Further, continued focus on cost management and lower occupancy amortization, due to reduced capital expenditures in recent years, each contributed a 10 basis point reduction to occupancy expense.

Selling, General and Administrative Expense Selling, general and administrative expense was \$1.059 billion, or 26.3% of net sales, in fiscal 2010 compared to \$1.052 billion, or 27.1% of net sales, in fiscal 2009. Selling, general and administrative expense increased \$7 million driven by a \$16 million increase in store costs related to operating 22 additional Michaels Stores during the year, as well as a \$5 million increase in advertising expense. These amounts were partially offset by a \$7 million decrease in group insurance due to careful cost management and a \$6 million decrease in depreciation expense as a result of lower capital expenditures over the last several years. As a percentage of net sales, selling, general and administrative expense decreased 80 basis points due to increased payroll leverage of 30 basis points on higher comparable store sales and a 20 basis point decrease in both group insurance and depreciation expense for the reasons indicated above.

Related Party Expenses Related party expenses were \$14 million for each of fiscal 2010 and fiscal 2009, consisting of management fees and associated expenses paid to our Sponsors and Highfields Capital Management, LP.

Interest Expense Interest expense increased from \$257 million in fiscal 2009 to \$276 million in fiscal 2010, as a result of increased interest rates associated with our amended credit facilities.

Loss on Early Extinguishment of Debt We recorded a loss of \$53 million related to the early extinguishment of our 2014 Senior Notes during fiscal 2010. The \$53 million loss is comprised of \$41 million of tender and call premiums and \$12 million to write off the remaining unamortized debt issuance costs. See Note 3 to the consolidated financial statements for further discussion.

Other (Income) and Expense, net Other expense for fiscal 2010 related to a \$12 million loss in the fair value of the interest rate derivative (the interest rate cap) that we purchased in the first quarter of fiscal 2009 to cap our exposure to interest rate increases on our senior secured term loan facility, as more fully described in Note 7 to the consolidated financial statements, partially offset by \$2 million of foreign exchange rate gains. Other income for fiscal 2009 related primarily to a \$10 million gain in the fair value of the interest rate cap and \$5 million of foreign exchange rate gains.

Provision for Income Taxes The effective tax rate for fiscal 2010 was 34.4%. The rate was lower than the federal tax rate due primarily to favorable impacts of 2.8% from audit settlements with taxing authorities, 1.1% from federal manufacturing deductions and 1.1% from our ability to utilize federal tax credits. These amounts are partially offset by a 3.3% unfavorable impact from the state deferred tax liability correction recorded during the first quarter of fiscal 2010. The effective tax rate for fiscal 2009 of 31.6% was lower than the federal tax rate due primarily to favorable impacts of 3.1% related to the correction of a state deferred tax liability pool, 2.0% from the ability to utilize tax credits, which had been limited in prior years, and 0.9% of tax return to provision adjustments.

Fiscal 2009 Compared to Fiscal 2008

Net Sales Net sales increased for fiscal 2009 by \$71 million, or 1.9%, from fiscal 2008 due primarily to sales from non-comparable new stores, which provided incremental revenue of \$64 million. Our comparable store sales increased 0.2% due to an increase in customer traffic of 3.2%.

Edgar Filing: MICHAELS STORES INC - Form 10-K

partially offset by a decrease in the average ticket of 2.9% and an adverse impact of 0.1% related to the change in deferred custom framing revenue. Comparable store sales growth was the strongest in our jewelry, impulse, and bakeware categories. The fluctuation in the exchange rates between the United States and Canadian dollars did not have a significant impact on comparable store sales for fiscal 2009.

Cost of Sales and Occupancy Expense Cost of sales and occupancy expense decreased \$8 million to \$2.423 billion in fiscal 2009 from \$2.431 billion in fiscal 2008 due to \$24 million lower freight and distribution costs and a \$5 million reduction in shrink, partially offset by a \$16 million decrease in vendor allowances and additional merchandise costs associated with higher sales. In addition, occupancy costs increased by \$4 million as a result of opening new stores. Cost of sales and occupancy expense decreased 140 basis points as a percentage of net sales. Merchandise costs decreased 120 basis points driven by improved management of promotional and clearance markdowns and lower fuel and distribution costs. In addition, occupancy expense decreased 20 basis points due to increased focus on cost management.

Selling, General and Administrative Expense Selling, general and administrative expense was \$1.052 billion, or 27.1% of net sales, in fiscal 2009 compared to \$1.060 billion, or 27.8% of net sales, in fiscal 2008. Selling, general and administrative expense decreased \$8 million, or 70 basis points, driven by a \$22 million or 90 basis point decrease in store expenses related to improved payroll and cost management, as well as a \$10 million or 30 basis point decrease in both advertising and severance expense. Additionally, prior year amounts included \$7 million or 20 basis points of consulting expenses for studies related to consumer insights

and other strategic initiatives. These reductions were partially offset by a \$38 million or 100 basis point increase in performance based bonus expense.

Related Party Expenses Related party expenses were \$14 million for fiscal 2009 compared to \$16 million in fiscal 2008 consisting of \$14 million of management fees and associated expenses paid to our Sponsors and Highfields Capital Management, LP. Also included in the related party expenses in fiscal 2008 was approximately \$2 million of amortization expense related to the Wyllys separation agreements.

Interest Expense Interest expense decreased from \$302 million in fiscal 2008 to \$257 million in fiscal 2009, due to a lower average interest rate related to our variable-rate debt and lower average debt levels.

Other (Income) and Expense, net Other income for fiscal 2009 related to a \$10 million gain in the fair value of the interest rate cap, as more fully described in Note 7 to the consolidated financial statements, and \$5 million of foreign exchange rate gains. In fiscal 2008, other expense related to foreign exchange rate losses.

Provision for Income Taxes The effective tax rate for fiscal 2009 was 31.6%. The rate was lower than the federal tax rate due to the favorable impact of tax return to provision adjustments, the ability to utilize foreign tax credits, which had been limited in prior years, and the correction of a state deferred tax liability pool. The effective tax rate for fiscal 2008 was unfavorably impacted by non-deductible severance payments.

Liquidity and Capital Resources

We require cash principally for day-to-day operations, to finance capital investments, to purchase inventory, to service our outstanding debt, and for seasonal working capital needs. We expect that our available cash, cash flow generated from operating activities, and funds available under our senior secured asset-based revolving credit facility will be sufficient to fund planned capital expenditures, working capital requirements, debt repayments, debt service requirements and anticipated growth for the foreseeable future. Our senior secured asset-based revolving credit facility provides senior secured financing of up to \$900 million, subject to a borrowing base. As of January 29, 2011, the borrowing base was \$653 million, which supported \$49 million of outstanding letters of credit and provided \$604 million of excess availability. Our cash and equivalents increased \$102 million from \$217 million at January 30, 2010 to \$319 million at January 29, 2011.

We and our subsidiaries, affiliates, and significant stockholders may from time to time seek to retire or purchase our outstanding debt (including publicly issued debt) through cash purchases and/or exchanges, in open market purchases, privately negotiated transactions, by tender offer or otherwise. Such repurchases or exchanges, if any, will depend on prevailing market conditions, liquidity requirements, contractual restrictions and other factors.

Cash Flow from Operating Activities

Cash flow provided by operating activities in fiscal 2010 was \$438 million compared to \$405 million in fiscal 2009. The \$33 million change was primarily due to improved net income of \$44 million before consideration of the \$53 million loss on the early extinguishment of the 2014 Senior

Edgar Filing: MICHAELS STORES INC - Form 10-K

Notes and a \$30 million favorable impact from improved accounts payable leveraging. The improvement was partially offset by a \$42 million unfavorable impact in our accrued performance based bonus expense as a result of higher bonus payments made in fiscal 2010 compared to fiscal 2009.

Cash Flow from Investing Activities

Cash flow used in investing activities represents the following capital expenditures:

	2010	Fiscal Year 2009 (In millions)	2008
New and relocated stores and stores not yet opened (1)	\$ 23	\$ 14	\$ 31
Existing stores	24	13	26
Information systems	27	12	24
Corporate and other	7	4	4
	\$ 81	\$ 43	\$ 85

(1) In fiscal 2010, we incurred capital expenditures related to the opening of 23 Michaels stores in addition to the relocation of ten Michaels stores. In fiscal 2009, we incurred capital expenditures related to the opening of 18 Michaels stores and the relocation of five Michaels stores. In fiscal 2008, we incurred capital expenditures related to the opening of 51 Michaels stores and the relocation of 11 Michaels stores and two Aaron Brothers stores.

In fiscal 2009, we opened the majority of our stores in locations where the landlord paid to build the stores to our specifications. During fiscal 2010, we have opened a greater number of stores in locations where we paid to build the stores to our specifications. As a result, our capital expenditures for new and relocated stores have increased in fiscal 2010 compared to fiscal 2009. This trend may continue in future years.

During the third quarter of fiscal 2010, we purchased certain assets of ScrapHD, LLC. See Note 13 to the consolidated financial statements for further information.

We currently estimate that our capital expenditures will be increased to between \$115 million and \$125 million in fiscal 2011. We plan to open 35 to 40 stores, including 10 to 15 relocations, and invest in the infrastructure required to support our long-term goals.

Cash Flow from Financing Activities

Cash flow used in financing activities during fiscal 2010 was \$253 million compared to \$178 million during fiscal 2009. During fiscal 2010, we made an excess cash flow payment and voluntary prepayments on our senior secured term loan facility totaling \$228 million. In addition, we retired our 2014 Senior Notes (as defined below) during the third quarter of fiscal 2010 and issued the 2018 Senior Notes (as defined below), which required us to pay \$41 million in tender and call premiums. We also paid debt issuance costs related to the 2018 Senior Notes and costs to amend our senior secured asset-based revolving credit facility of \$15 million and \$19 million, respectively. Further, we did not have any borrowings in excess of repayments under our senior secured asset-based revolving credit facility during fiscal 2010, while in fiscal 2009, our repayments were in excess of our borrowings by \$148 million.

Debt

To finance the Merger, we issued the 2014 Senior Notes, the Senior Subordinated Notes (as defined below), and the Subordinated Discount Notes (as defined below) (collectively, the Notes). We also executed a senior secured asset-based revolving credit facility as well as a senior secured term loan facility (collectively, and as subsequently amended, the Senior Credit Facilities). Borrowings under our senior secured asset-based revolving credit facility are influenced by a number of factors as more fully described below.

Notes

On October 31, 2006, we issued (i) \$750 million in principal amount of 10% Senior Notes due November 1, 2014 (the 2014 Senior Notes); (ii) \$400 million in principal amount at maturity of 113/8% Senior Subordinated Notes due November 1, 2016 (the Senior Subordinated Notes);

Edgar Filing: MICHAELS STORES INC - Form 10-K

and (iii) \$469 million in principal amount of 13% Subordinated Discount Notes due November 1, 2016 (the "Subordinated Discount Notes"). During the third quarter of fiscal 2010, we retired the 2014 Senior Notes and issued \$800 million of 7¾% Senior Notes due November 1, 2018 (the "2018 Senior Notes"), at a discounted price of 99.262% of face value, resulting in an effective interest rate of 77/8%. Interest on the 2018 Senior Notes and the Senior Subordinated Notes is payable semi-annually in arrears on each May 1 and November 1, commencing on May 1, 2011 and May 1, 2007, respectively. No cash interest is payable on the Subordinated Discount Notes prior to November 1, 2011. Beginning on November 1, 2011, cash interest will accrue on the Subordinated Discount Notes and is payable semi-annually in arrears on each May 1 and November 1 (the first cash interest payment is May 1, 2012). The 2018 Senior Notes are guaranteed, jointly and severally, on an unsecured basis, the Senior Subordinated Notes are guaranteed, jointly and severally, on an unsecured senior subordinated basis, and the Subordinated Discount Notes are guaranteed, jointly and severally, on an unsecured subordinated basis, in each case, by our subsidiaries (each of which is directly or indirectly owned 100% by Michaels Stores, Inc.), other than certain immaterial subsidiaries.

The indentures governing the Notes contain covenants limiting, among other things, the Company's ability and the ability of the Company's restricted subsidiaries to:

- incur additional debt;
- pay dividends or distributions on the Company's capital stock or repurchase the Company's capital stock;
- issue stock of subsidiaries;
- make certain investments;
- create liens on the Company's assets to secure debt;
- enter into transactions with affiliates;
- merge or consolidate with another company; and
- sell or otherwise transfer assets.

Senior Secured Asset-based Revolving Credit Facility

On February 18, 2010, we entered into an agreement to amend and restate various terms of the then existing asset-based revolving credit facility, dated as of October 31, 2006 (the senior secured asset based revolving credit facility). As of January 29, 2011, the borrowing base was \$653 million, of which we had no outstanding borrowings. Borrowing capacity is available for letters of credit and borrowings on same-day notice.

The senior secured asset-based revolving credit facility extended an aggregate amount of \$850 million of the tranche A commitments and \$50 million of the FILO (as defined below) commitments, with respect to certain lenders (the Extending Lenders), from October 31, 2011 to the earlier of April 15, 2014, or 45 days prior to the maturity date of any class of term loans in the Company's senior secured term loan facility (the Extended Maturity Date). The remaining \$202 million of commitments from the other lenders under the existing asset-based revolving credit facility (the Non-Extending Lenders) were scheduled to terminate on October 31, 2011. On October 1, 2010, we elected to permanently terminate the \$202 million of commitments from the Non-Extending Lenders. The \$850 million of the tranche A commitments and \$50 million of the FILO commitments remain unaffected.

Simultaneously with entering into the Asset-based revolving credit facility, the Company exercised its ability to increase tranche A commitments in the aggregate amount of \$152 million.

The borrowing base on the senior secured asset-based revolving credit facility equals the sum of (i) 90% of eligible credit card receivables and debit card receivables; (ii) between 85% and 87.5% of the appraised net orderly liquidation value of eligible inventory and of eligible letters of credit; (iii) a percentage of eligible in-transit inventory, less certain reserves; and (iv) the sum of an additional 5% of the appraised net orderly liquidation value of eligible inventory and of eligible letters of credit plus an additional 5% of eligible credit card receivables and debit card receivables under a last out tranche (collectively, the first in last out tranche FILO), up to a maximum amount of \$50 million.

The senior secured asset-based revolving credit facility provides us with the right to request up to \$200 million of additional commitments under this facility, of which \$48 million remains available, prior to October 31, 2011. The lenders under this facility are not under any obligation to provide any such additional commitments, and any increase in commitments is subject to customary conditions precedent. If we were to request any such additional commitments, and the existing lenders or new lenders were to agree to provide such commitments, on or after October 31, 2011, the tranche A commitments under the senior secured asset-based revolving credit facility could be increased to up to \$1.2 billion less the FILO commitments. However, our ability to borrow under this facility would still be limited by the amount of the borrowing base.

Borrowings under the senior secured asset-based revolving credit facility bear interest at a rate per annum equal to, at our option, either (a) a base rate determined by reference to the highest of (1) the prime rate of Bank of America, N.A., (2) the federal funds effective rate plus 0.50% and (3) a LIBOR rate subject to certain adjustments plus 1.00% or (b) a LIBOR rate subject to certain adjustments, in each case plus an applicable margin. The initial applicable margin is (a) 2.50% for non-FILO base rate borrowings and 3.50% for non-FILO LIBOR borrowings and (b) 4.50% for FILO base rate borrowings and 5.50% for FILO LIBOR borrowings. The applicable margin is subject to adjustment each fiscal quarter based on the excess availability under the senior secured asset-based revolving credit facility. Same-day borrowings bear interest at a rate per annum equal to a base rate determined by reference to the highest of (a) the prime rate of Bank of America, N.A., (b) the federal funds effective rate plus 0.50% and (c) a LIBOR rate subject to certain adjustments plus 1.00%, in each case, plus an applicable margin. The initial applicable margin with respect to same-day borrowings is 2.50%.

Edgar Filing: MICHAELS STORES INC - Form 10-K

We are required to pay a commitment fee of 0.625% per annum on the unutilized commitments under the senior secured asset-based revolving credit facility. We must also pay customary letter of credit fees and agency fees.

If, at any time, the aggregate amount of outstanding loans, unreimbursed letter of credit drawings and undrawn letters of credit under the senior secured asset-based revolving credit facility exceeds the lesser of (i) the commitment amount and (ii) the borrowing base, we will be required to repay outstanding loans and cash collateralize letters of credit in an aggregate amount equal to such excess, with no reduction of the commitment amount. If the amount available under the senior secured asset-based revolving credit facility is less than \$75 million at any time, or for five consecutive business days is less than the greater of \$100 million or 15% of the lesser of the (i) then borrowing base and (ii) Revolving Credit Ceiling (as defined below), or if certain events of default have occurred, we will be required to repay outstanding loans and cash collateralize letters of credit with the cash we are required to deposit daily in a collection account maintained with the agent under the senior secured asset-based revolving credit facility. We may voluntarily reduce the unutilized portion of the commitment amount and repay outstanding loans at any time without premium or penalty other than customary breakage costs with respect to LIBOR loans. There is no scheduled amortization under the senior secured asset-based revolving credit facility; the principal amount of the loans outstanding is due and payable in full on the Extended Maturity Date.

We must not permit excess availability at any time to be less than the greater of (a) \$75 million and (b) 10% of the lesser of (1) the then borrowing base under the senior secured asset-based revolving credit facility or (2) \$900 million (as reduced or increased in accordance with the terms of the senior secured asset-based revolving credit facility, the "Revolving Credit Ceiling"). In addition, (a) for the period of thirty consecutive days preceding our termination of the tranche A commitments of the Non-Extending Lenders and (b) on a projected pro forma basis, giving effect to such termination of commitments, for the six-month period following such termination of commitments, we must not permit excess availability at any time to be less than \$125 million. Excess availability under the senior secured asset-based revolving credit facility means the lesser of (a) the Revolving Credit Ceiling minus the outstanding credit extensions and (b) the then borrowing base minus the outstanding credit extensions.

Although the senior secured asset-based revolving credit facility does not require us to comply with any financial ratio maintenance covenants, it does contain a number of covenants that, among other things and subject to certain exceptions, restrict the Company's ability and the ability of its subsidiaries to:

- incur additional indebtedness;
- pay dividends on the Company's capital stock or redeem, repurchase or retire the Company's capital stock or its other indebtedness;
- make investments, loans, advances and acquisitions;
- create restrictions on the payment of dividends or other amounts to the Company from its restricted subsidiaries;
- engage in transactions with affiliates of the Company;
- sell assets, including capital stock of the Company's subsidiaries;
- consolidate or merge; and
- create liens.

The covenants limiting dividends and other restricted payments; investments, loans, advances and acquisitions; and prepayments or redemptions of indebtedness, each permit the restricted actions in an unlimited amount, subject to the satisfaction of certain payment conditions, principally that we must meet certain specified excess availability requirements and minimum consolidated fixed charge coverage ratios, to be tested on a pro forma and 12 months projected basis. Adjusted EBITDA is used in the calculation of the consolidated fixed charge coverage ratios. The senior secured asset-based revolving credit facility also contains certain customary affirmative covenants and events of default.

Senior Secured Term Loan Facility

On October 31, 2006, we executed a \$2.4 billion senior secured term loan facility (the "senior secured term loan facility") with Deutsche Bank Securities Inc., and other lenders. The full amount was borrowed on October 31, 2006, with the balance payable on October 31, 2013. Borrowings under the senior secured term loan facility bear interest at a rate per annum equal to, at our option, either (a) a base rate determined by reference to the higher of (1) the prime rate of Deutsche Bank and (2) the federal funds effective rate plus 1/2 of 1% or (b) a LIBOR rate, subject to certain adjustments, in each case plus an applicable margin. The applicable margin is 3.50% for base rate borrowings and 4.50% for LIBOR borrowings.

Edgar Filing: MICHAELS STORES INC - Form 10-K

On August 20, 2009, we amended the senior secured term loan facility to permit the issuance or incurrence of indebtedness for the purpose of the repayment of existing term loans under the senior secured term loan facility, which new indebtedness could take the form of additional term loans under the senior secured term loan facility or secured or unsecured bonds or other loans.

On November 5, 2009, we amended the senior secured term loan facility to extend \$1.0 billion of existing term loans (the B-2 Term Loans) to July 31, 2016, with the remaining \$1.28 billion of existing term loans (the B-1 Term Loans and together with the B-2 Term Loans, the Term Loans) keeping the original maturity date of October 31, 2013. The B-2 Term Loans are subject to a minimum increase in interest rates on the B-2 Term Loans in connection with any future extensions of term loans to the extent that any such future extension has an increase in effective yield in excess of 0.25% above the effective yield of the B-2 Term Loans.

The senior secured term loan facility requires us to prepay outstanding term loans with (a) 100% of the net proceeds of any debt issued by us or our subsidiaries (with exceptions for certain debt permitted to be incurred under the senior secured term loan facility) and (b) 50% (which percentage will be reduced to 25% if our total leverage ratio, as defined in the senior secured term loan facility, is less than 6.00:1.00 and will be reduced to 0% if our total leverage ratio is less than 5.00:1.00) of our annual Excess Cash Flow (as defined in the senior secured term loan facility). We must also offer to prepay outstanding term loans at 100% of the principal amount to be prepaid, plus accrued and unpaid interest, with the proceeds of certain asset sales or casualty events under certain circumstances. We may voluntarily prepay outstanding loans under the senior secured term loan facility at any time without premium or penalty other than customary breakage costs with respect to LIBOR loans.

Our voluntary prepayments in fiscal 2010 of \$110 million more than offset the payment required from our annual Excess Cash Flow, which resulted in none of our senior secured term loan facility being classified as current debt as of January 29, 2011. Under the facilities, excess cash flow payments and voluntary prepayments serve to reduce future scheduled quarterly principal payments. The excess cash flow payment and voluntary prepayments made in fiscal 2010 effectively satisfied all scheduled quarterly principal payments until maturity of the Term Loans.

The senior secured term loan facility contains a number of negative covenants that are substantially similar to, but more restrictive in certain respects than, those governing the Notes as well as certain other customary affirmative and negative covenants and events of default. As of January 29, 2011, we were in compliance with all covenants.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements as defined in Item 303(a)(4)(ii) of Regulation S-K.

Non-GAAP Measures

The following table sets forth the Company's Earnings before Interest, Taxes, Depreciation and Amortization (EBITDA). The Company defines EBITDA as net income before interest, income taxes, discontinued operations, depreciation and amortization. Additionally, the table presents Adjusted Earnings before Interest, Taxes, Depreciation and Amortization (Adjusted EBITDA). The Company defines Adjusted EBITDA as EBITDA adjusted for certain defined amounts that are added to, or subtracted from, EBITDA (collectively, the Adjustments) in accordance with the Company's \$2.4 billion senior secured term loan facility and \$900 million Asset-based revolving credit facility. The Adjustments are described in further detail in the table, and the footnotes to the table below.

The Company has presented EBITDA and Adjusted EBITDA to provide investors with additional information to evaluate our operating performance and our ability to service our debt. The Company uses EBITDA, among other metrics, to evaluate operating performance, to plan and forecast future periods' operating performance and as an element of its incentive compensation targets. Adjusted EBITDA is a required calculation under the Company's Senior secured term loan facility and its asset-based revolving credit facility. As it relates to the senior secured term loan facility, Adjusted EBITDA is used in the calculations of fixed charge coverage and leverage ratios, which, under certain circumstances may result in limitations on the Company's ability to make restricted payments as well as the determination of mandatory repayments of the loans. Under the asset-based revolving facility, Adjusted EBITDA is used in the calculation of fixed charge coverage ratios, which under certain circumstances may restrict the Company's ability to make certain payments (characterized as restricted payments), investments (including acquisitions) and debt repayments.

As EBITDA and Adjusted EBITDA are not measures of operating performance or liquidity calculated in accordance with U.S. generally accepted accounting principles (GAAP), these measures should not be considered in isolation of, or as a substitute for, net income, as an indicator of operating performance, or net cash provided by operating activities, as an indicator of liquidity. Our computation of EBITDA and Adjusted EBITDA may differ from similarly titled measures used by other companies. As EBITDA and Adjusted EBITDA exclude certain financial information compared with net income and net cash provided by operating activities, the most directly comparable GAAP financial measures, users of this financial information should consider the types of events and transactions which are excluded.

Edgar Filing: MICHAELS STORES INC - Form 10-K

The table below shows a reconciliation of EBITDA and Adjusted EBITDA to net income and net cash provided by operating activities.

Edgar Filing: MICHAELS STORES INC - Form 10-K

	2010	Fiscal Year 2009	2008
Net cash provided by operating activities	\$ 438	\$ 405	\$ 59
Depreciation and amortization	(103)	(116)	(129)
Share-based compensation	(8)	(8)	(8)
Deferred financing cost amortization	(20)	(17)	(17)
Accretion of subordinated discount notes	(50)	(45)	(39)
Change in fair value of interest rate cap	(12)	10	
Loss on early extinguishment of debt	(53)		
Changes in assets and liabilities	(94)	(122)	129
Net income (loss)	98	107	(5)
Interest expense	276	257	302
Loss on early extinguishment of debt	53		
Income tax provision	51	50	3
Depreciation and amortization	103	116	129
EBITDA	581	530	429
Adjustments:			
Share-based compensation	8	8	8
Sponsor Fees	14	14	14
Termination expense	1	4	15
Pre-opening costs	3	2	6
Multi-year initiatives (1)			3
Foreign currency translation gains	(2)	(5)	5
Store closing costs	2	5	3
Loss (gain) on interest rate cap	12	(10)	
Other (2)	3	(4)	6
Adjusted EBITDA	\$ 622	\$ 544	\$ 489

(1) Multi-year initiatives relate to store remodel costs.

(2) Other adjustments relate to items such as moving and relocation expenses, franchise taxes, foreign currency hedge, and certain legal expenses.

Contractual Obligations

All of our significant contractual obligations are recorded on our Consolidated Balance Sheets or disclosed in our Notes to Consolidated Financial Statements.

We do not typically enter into off-balance sheet arrangements, except for arrangements related to operating lease commitments, service contract commitments, and trade letters of credit, as disclosed in the table below. Neither Michaels nor its subsidiaries typically guaranty the obligations of unrelated parties.

As of January 29, 2011, our contractual obligations were as follows:

	Total	Payments Due By Fiscal Year			
		Less Than 1 Year	1-3 Years (In millions)	3-5 Years	More Than 5 Years
Operating lease commitments (1)	\$ 1,647	\$ 346	\$ 582	\$ 371	\$ 348
Other commitments (2)	98	73	17	8	
Total debt (3)	3,716	1	1,343	4	2,368
Interest payments (4)	1,215	189	451	308	267
	\$ 6,676	\$ 609	\$ 2,393	\$ 691	\$ 2,983

(1) Our operating lease commitments generally include non-cancelable leases for property and equipment used in our operations. Excluded from our operating lease commitments are amounts related to insurance, taxes, and common area maintenance associated with property and equipment. Such amounts historically represented approximately 33% of the total lease obligation over the previous three fiscal years.

(2) Other commitments include trade letters of credit and service contract obligations. Our service contract obligations were calculated based on the time period remaining in the contract or to the earliest possible date of termination, if permitted to be terminated by Michaels upon notice, whichever is shorter.

(3) Included in Total debt are \$42 million of additional interest accretion related to our Subordinated Discount Notes and \$6 million of discount accretion on the 2018 Senior Notes, which have not been recognized as of January 29, 2011. See Note 3 to the consolidated financial statements.

(4) Debt associated with our senior secured term loan facility was approximately \$2.0 billion at January 29, 2011, and is subject to variable interest rates. The amounts included in interest payments in the table for the senior secured term loan facility were based on the indexed interest rate in effect at January 29, 2011. Approximately \$1.6 billion of debt was subject to fixed interest rates. We did not have any outstanding borrowings under our senior secured asset-based revolving credit facility at January 29, 2011. Under our senior secured asset-based revolving credit facility, we are required to pay a commitment fee of 0.625% per year on the unutilized commitments. The amounts included in interest

payments for the senior secured asset-based revolving credit facility were based on these annual commitment fees.

Additional information regarding our long-term debt and commitments and contingencies is provided in Note 3 and Note 10, respectively, of Notes to Consolidated Financial Statements.

Recent Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-06, *Improving Disclosures About Fair Value Measurements* an amendment to ASC topic 820, *Fair Value Measurements and Disclosures*. ASU 2010-06 expands disclosure requirements related to fair value measurements including (i) separately disclosing the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describing the reasons for the transfers and (ii) presenting separate information for Level 3 activity pertaining to gross purchases, sales, issuances, and settlements. The new disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the Level 3 activity disclosures, which are effective for fiscal years beginning after December 15, 2010. We adopted all requirements of ASU 2010-06 related to significant transfers in and out of Level 1 and Level 2 fair value measurements on January 31, 2010, with no material impact on our consolidated financial statements. See Note 8 for further information regarding fair value measurements. We will adopt the new disclosure requirements related to the Level 3 activity on January 30, 2011, with no material impact expected on our consolidated financial statements.

ITEM 7A. Quantitative and Qualitative Disclosures about Market Risk.

We are exposed to fluctuations in exchange rates between the US and Canadian dollar, which is the functional currency of our Canadian subsidiary. Our sales, costs and expenses of our Canadian subsidiary, when translated into US dollars, can fluctuate due to exchange rate movement. As of January 29, 2011, a 10% increase or decrease in the exchange rate of the US and Canadian dollar would increase or decrease net income by approximately \$4 million.

We have market risk exposure arising from changes in interest rates on our Senior Credit Facilities. See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources for further detail. The interest rates on our Senior Credit Facilities will reprice periodically, which will impact our earnings and cash flow. The interest rates on our Notes are fixed. Based on our overall interest rate exposure to variable rate debt outstanding as of January 29, 2011, a 1% increase or decrease in interest rates would increase or decrease income before income taxes by approximately \$20 million. A 1% increase in interest rates would decrease the fair value of our long-term fixed rate debt by approximately \$53 million. A 1% decrease in interest rates would increase the fair value of our long-term fixed rate debt by approximately \$57 million. A change in interest rates would not materially affect the fair value of our variable rate debt as the debt reprices periodically.

During the first quarter of fiscal 2009, we purchased an interest rate cap to limit the variability of cash flows associated with our interest payments on our senior secured term loan facility that result from fluctuations in the three-month LIBOR rate. The cap limits our interest exposure on a notional value of \$2.0 billion to the lesser of the three-month LIBOR rate or 7.0%. The term of the cap is from April 15, 2009 through April 15, 2015. The fair value of the cap as of January 29, 2011 was \$6 million and is included in Other assets on the Consolidated Balance Sheets. The change in fair value of the cap for year ended January 29, 2011 resulted in a loss of \$12 million, and is recorded in Other (income) and expense, net in the Consolidated Statements of Operations. A 1% increase in the interest rates would increase income before income taxes by approximately \$11 million. A 1% decrease in the interest rates would decrease income before income taxes by approximately \$5 million.

We invest cash balances in excess of operating requirements primarily in money market mutual funds and short-term interest-bearing securities, generally with maturities of 90 days or less. Due to the short-term nature of our investments, the fair value of our cash and equivalents at January 29, 2011 approximated carrying value.

ITEM 8. Consolidated Financial Statements and Supplementary Data.

The Consolidated Financial Statements and Supplementary Data are included as an annex to this Annual Report on Form 10-K and incorporated herein by reference. See the Index to Consolidated Financial Statements and Supplementary Data on page F-1.

ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

ITEM 9A. Controls and Procedures.

Included in this Annual Report on Form 10-K are certifications of our Chief Executive Officer and our Chief Financial Officer, which are required in accordance with Rule 15d-14 of the Securities Exchange Act of 1934. This section includes information concerning the controls and controls evaluation referred to in the certifications. Page F-3 of this Report includes the attestation report of Ernst & Young LLP, our independent registered public accounting firm, regarding its audit of the effectiveness of our internal control over financial reporting. This section should be read in conjunction with the Ernst & Young attestation for a complete understanding of this section.

Evaluation of Disclosure Controls and Procedures

We maintain a set of disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated by the SEC under the Securities Exchange Act of 1934) that are designed to provide reasonable assurance that information, which is required to be timely disclosed, is accumulated and communicated to management in a timely fashion. We note that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

An evaluation was carried out under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as of the end of the period

covered by this report. Based on that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls are effective to provide reasonable assurance that information required to be disclosed in the reports that we file or submit under the Securities and Exchange Act of 1934 is accumulated and communicated to management, including our Chief Executive Officer and our Chief Financial Officer, to allow timely decisions regarding required disclosure and are effective to provide reasonable assurance that such information is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms.

Change in Internal Control over Financial Reporting

There has not been any change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) as promulgated by the SEC under the Securities Exchange Act of 1934) during our most recently completed fiscal quarter, the fourth quarter of fiscal 2010, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Management Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. Internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with authorizations of management and directors of the company, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Due to its inherent limitations, internal control over financial reporting may not prevent or detect misstatements and, even when determined to be effective, can only provide reasonable, not absolute, assurance with respect to financial statement preparation and presentation. Projections of any evaluation of effectiveness to future periods are subject to risk that controls may become inadequate as a result of changes in conditions or deterioration in the degree of compliance.

Management assessed the effectiveness of our internal control over financial reporting as of January 29, 2011. Management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in its *Internal Control - Integrated Framework*. Management's assessment included the evaluation of such elements as the design and operating effectiveness of financial reporting controls, process documentation, accounting policies, and the overall control environment. This assessment is supported by testing and monitoring performed or supervised by our Internal Control organization.

Based on our assessment, we maintained effective internal control over financial reporting as of January 29, 2011, the end of the fiscal year. The independent registered public accounting firm, Ernst & Young LLP, issued an attestation report on the effectiveness of our internal control over financial reporting. The Ernst & Young LLP report is included on Page F-3 of this Annual Report on Form 10-K.

ITEM 9B. Other Information

Fiscal Year 2011 Bonus Plan

On March 23, 2011, the Board of Directors of the Company approved the fiscal year 2011 bonus plan (the 2011 Bonus Plan) under which the named executive officers of the Company set forth below, participate. A copy of the 2011 Bonus Plan is attached to this Annual Report on Form 10-K as Exhibit 10.5 and is incorporated by reference into this Item 9B.

Name	Position
John B. Menzer	Chief Executive Officer
Charles M. Sonsteby	Chief Administrative Officer and Chief Financial Officer
Philo T. Pappas	Executive Vice President Category Management
Paula A. Puleo	Senior Vice President Chief Marketing Officer
John J. Wyatt	Senior Vice President Corporate Development
Richard S. Jablonski	Vice President Financial Planning & Analysis

ITEM 10. Directors, Executive Officers and Corporate Governance

DIRECTORS AND EXECUTIVE OFFICERS

Directors

Our current directors serve until their successors are duly elected and qualified or until the earlier of their resignation, death or removal.

Four of our current directors are affiliates of Bain Capital Partners, LLC (Bain), while the remaining four are affiliates of The Blackstone Group (Blackstone). Directors are chosen by Bain and Blackstone respectively, based on their general business experience and their experience working with other private equity owned companies or other retailers (as further detailed in the biographies below). Our Board has not determined any of our directors to be independent under the standards adopted by the New York Stock Exchange, which do not apply to us as we are a privately held corporation.

Edgar Filing: MICHAELS STORES INC - Form 10-K

Set forth below is information concerning each of our directors, including their ages as of March 21, 2011, present principal occupations, other business experiences during the last five years, membership on committees of the Board, public company directorships held during the last five years and certain other directorships. Except for Messrs. Murphy and Wallace, each of the directors listed below has served on our Board since October 31, 2006. The stockholders of the Company elected Mr. Murphy to the Board on January 13, 2009 and elected Mr. Wallace to the Board on March 11, 2009, in each case to fill a vacancy created by the resignation of a former director.

Name	Age	Position	Committee Membership
Josh Bekenstein	52	Director	
Michael S. Chae	42	Director	
Todd M. Cook	39	Director	Audit Committee
Lewis S. Klessel	43	Director	Audit Committee
Matthew S. Levin	44	Director	Compensation Committee
Gerry M. Murphy	55	Director	
James A. Quella	61	Director	Audit Committee
Peter F. Wallace	35	Director	Audit Committee; Compensation Committee

Mr. Bekenstein is a managing director at Bain Capital Partners. Prior to joining Bain Capital Partners in 1984, Mr. Bekenstein spent several years at Bain & Company, where he was involved with companies in a variety of industries. Mr. Bekenstein received an M.B.A. from Harvard Business School and a B.A. from Yale University. Mr. Bekenstein serves as a director of Bombardier Recreational Products Inc., Dollarama Capital Corporation, Toys R Us, Inc., Burlington Coat Factory Warehouse Corporation, Bright Horizons Family Solutions Inc. and Waters Corporation.

Mr. Chae is a senior managing director and Head of Private Equity for Asia/Pacific at The Blackstone Group. Prior to becoming a senior managing director in January 2005, Mr. Chae was a Principal of Blackstone from 2000 to 2004. Mr. Chae graduated magna cum laude from Harvard College, and received an M.Phil from Cambridge University and a J.D. from Yale Law School. He serves as a Director of Hilton Hotels Corp., Universal Orlando, The Nielsen Company and The Weather Channel Companies.

Mr. Cook is a managing director of Bain Capital Partners. Prior to becoming a managing director in December 2008, Mr. Cook served in various capacities, most recently as a principal of Bain Capital Partners from 2003 to 2008. Prior to joining Bain Capital Partners in 1996, Mr. Cook was a consultant at Bain & Company. Mr. Cook received an M.B.A. from Stanford University Graduate School of Business where he was an Arjay Miller Scholar. He also holds a B.E. in electrical engineering and a B.A. in economics from Dartmouth College. Mr. Cook serves as a director of Dunkin Brands, Inc. Mr. Cook was formerly a director of Dollarama Capital Corporation.

Mr. Klessel is an operating partner at Bain Capital Partners. Prior to joining Bain Capital Partners, Mr. Klessel held a variety of operating and strategy leadership positions from 1997 to 2005 at The Home Depot, Inc., most recently as President of Maintenance Warehouse, a wholly-owned subsidiary that distributed maintenance products to facility management customers in the multi-housing, lodging, health-care and commercial sectors. Mr. Klessel received an M.B.A. from Harvard Business School where he was a Baker Scholar, and a B.S. from the Wharton School at the University of Pennsylvania. Mr. Klessel serves as a director of HD Supply, Inc. and Guitar Center, Inc.

Mr. Levin is a managing director at Bain Capital Partners. Prior to joining Bain Capital Partners in 2000, Mr. Levin was a consultant at Bain & Company in the consumer products and manufacturing industries. Mr. Levin received an M.B.A. from Harvard Business School where he was a Baker Scholar. He received a B.S. from the University of California at Berkeley. Mr. Levin serves as a board member of Bombardier Recreational Products Inc., Dollarama Capital Corporation, Edcon Holdings Pty. Ltd., Guitar Center, Inc., Lilliput Kidswear Ltd., Nutco Products, Toys R Us, Inc. and Unisource Worldwide, Inc.

Mr. Murphy is a senior managing director at The Blackstone Group in the private equity group, which he joined in 2008. Before joining Blackstone, Mr. Murphy spent five years as CEO of Kingfisher, a FTSE 100 company and the leading home improvement retailer in Europe and Asia. He has also served as CEO of Carlton Communications plc, Exel plc and Greencore Group plc. Mr. Murphy received his BSc and PhD in food technology from University College Cork and a 1st Class MBS in marketing from University College Dublin. Mr. Murphy serves as a director of United Biscuits Topco Limited, Kleopatra Acquisition Corp., British American Tobacco plc, The Blackstone Group International Limited and for the Advisory Board of KP Germany Zweite GmbH. Mr. Murphy was formerly a director of Abbey National plc, Reckitt Benckiser Group plc and Hornbach Holding AG.

Edgar Filing: MICHAELS STORES INC - Form 10-K

Mr. Quella is a senior managing director and senior operating partner at The Blackstone Group in the private equity group. Prior to joining Blackstone in 2004, Mr. Quella was a managing director and senior operating partner with DLJ Merchant Banking Partners-CSFB Private Equity from 2000 to 2004. Prior to that, Mr. Quella worked at Mercer Management Consulting and Strategic Planning Associates. Mr. Quella received a B.A. in International Studies from the University of Chicago/University of Wisconsin-Madison and an M.B.A. from the University of Chicago. Mr. Quella serves as a director of Catalent Pharma Solutions, Inc. and Vanguard Health Systems, Inc. Mr. Quella was formerly a director of Freescale Semiconductor, Inc., Graham Packaging Company, L.P., The Nielsen Company and Intelnet Global Services.

Mr. Wallace is a senior managing director at The Blackstone Group in the private equity group, which he joined in 1997. Mr. Wallace received a B.A. in Government from Harvard College. Mr. Wallace serves on the board of directors of AlliedBarton Security Services, SeaWorld Parks & Entertainment, Pelmorex Media and The Weather Channel Companies. Mr. Wallace was formerly a director of Crestwood Midstream Partners and New Skies Satellites.

Executive Officers

Our current executive officers, their ages as of March 21, 2011, and their business experience during at least the past five years are set forth below.

Name	Age	Position
John B. Menzer	59	Chief Executive Officer
Charles M. Sonstebly	58	Chief Administrative Officer and Chief Financial Officer
Nicholas E. Crombie	60	Executive Vice President Store Operations
Thomas C. DeCaro	56	Executive Vice President Supply Chain
Philo T. Pappas	52	Executive Vice President Category Management
Weizhong Wilson Zhu	58	Executive Vice President Private Brands & Global Sourcing
Shawn E. Hearn	45	Senior Vice President Human Resources
Paula A. Puleo	45	Senior Vice President Chief Marketing Officer
Michael J. Veitenheimer	54	Senior Vice President General Counsel and Secretary
John J. Wyatt	59	Senior Vice President Corporate Development

Mr. Menzer was named Chief Executive Officer in April 2009. Prior to joining Michaels, he served as Vice Chairman and Chief Administrative Officer of Wal-Mart Stores, Inc. from September 2005 to March 2008, President and Chief Executive Officer of Wal-Mart International from June 1999 to September 2005 and Executive Vice President and Chief Financial Officer of Wal-Mart Stores, Inc. from September 1995 to June 1999. Mr. Menzer serves as a director of Emerson Electric Co.

Mr. Sonstebly was named Chief Administrative Officer and Chief Financial Officer in October 2010. Prior to joining Michaels, Mr. Sonstebly served in various capacities at Brinker International, Inc. since March 1990, including as Executive Vice President and Chief Financial Officer since May 2001, as Senior Vice President of Finance from 1997 to 2001 and as Vice President and Treasurer from 1994 to 1997. Mr. Sonstebly was formerly a director of Zale Corporation.

Mr. Crombie was promoted to Executive Vice President Store Operations in May 2007. Prior to his promotion, he served as Zone Vice President of Stores for Michaels Stores, Inc. since January 2002. Prior to joining the Company, Mr. Crombie was Area Vice President, Mid-South for CVS from February 1999 to January 2002. From January 1996 until February 1999, he was employed by Caldor, Inc. with store operations responsibilities, including Regional Vice President. From November 1988 to January 1996, he was Director of Sales and Marketing and General

Edgar Filing: MICHAELS STORES INC - Form 10-K

Merchandising Manager for Major Appliances at Lechmere, Inc.

Mr. DeCaro was promoted to Executive Vice President Supply Chain in June 2005. Prior to his promotion, Mr. DeCaro had served as Senior Vice President Inventory Management since joining Michaels in August 2000. From April 1998 until joining the Company, he was Vice President Merchandise for The Walt Disney Company. Prior to this, he held the position of Senior Vice President Merchandise Planning and Allocation for Kohl's Department Stores from February 1996 to April 1998. In addition, Mr. DeCaro has held various positions in Merchandise Planning and Allocation and Finance for The Disney Store, The Limited Stores, May Department Stores, and Sanger Harris Department Stores.

Mr. Pappas was named Executive Vice President Category Management in February 2009. Prior to joining Michaels, he served as Chief Merchandising Officer at Tweeter Home Entertainment Group, Inc. from April 2003 to October 2008. On June 11, 2007, Tweeter and each of its subsidiaries filed voluntary petitions for reorganization under Chapter 11 of the U.S. Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware in Wilmington, Delaware. Prior to joining Tweeter, Mr. Pappas served in

Edgar Filing: MICHAELS STORES INC - Form 10-K

various management positions at Staples, Inc. from November 1994 to April 2003, most recently as Senior Vice President of Merchandising.

Mr. Zhu was promoted to Executive Vice President Private Brands & Global Sourcing in July 2009. Prior to his promotion, Mr. Zhu had served as Executive Vice President Global Sourcing since May 2008 and Senior Vice President Strategic Sourcing since joining the Company in April 2007. From March 2003 until April 2007, he was Vice President, Private Brand Development and Global Sourcing at Office Depot, Inc. Prior to joining Office Depot, Mr. Zhu served as Vice President, Global Sourcing for Hudson's Bay Company in Canada from March 2001 to March 2003. In addition, Mr. Zhu has held various management positions at Saks, Inc., Edison Brothers Stores, and Nulook Fashions.

Mr. Hearn was named Senior Vice President Human Resources in February 2007. Prior to his promotion, Mr. Hearn had served as Vice President, Field Human Resources since joining Michaels in November 2002. Prior to joining Michaels, he served in various operations, marketing, and human resource management positions at KMart Corporation from August 1981 to October 2002, most recently as Vice President, Advertising.

Ms. Puleo was named Senior Vice President Chief Marketing Officer in March 2010. Prior to joining Michaels, she served in various management positions at RAPP Worldwide, including Executive Vice President Strategy & Enablement from February 2006 to February 2010 and Senior Vice President Account Management from December 2005 to January 2006. Prior to joining RAPP, Ms. Puleo served as Director of CRM at Limited Brands, Inc. from February 2003 to December 2005.

Mr. Veitenheimer was named Senior Vice President General Counsel and Secretary in January 2008. Prior to joining Michaels, Mr. Veitenheimer served as Senior Vice President of Law and Human Resources of The Bombay Company, Inc., from June 2007 to December 2007 after having served as a Senior Vice President since February 2006, its Secretary since July 1985 and its General Counsel since November 1983. On September 20, 2007, The Bombay Company, Inc. and its U.S. wholly-owned subsidiaries filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court, Northern District of Texas, Fort Worth Division. Prior to joining The Bombay Company, Mr. Veitenheimer was in private practice of law in Fort Worth, Texas.

Mr. Wyatt was named Senior Vice President Corporate Development in June 2010. Prior to joining Michaels, he served as Vice President Real Estate, Development and Facilities at Bob Evans Farms, Inc. from April 2009 to June 2010. Prior to joining Bob Evans, Mr. Wyatt served as Vice President Real Estate & Development at Brinker International, Inc. from May 2004 to February 2008. Prior to joining Brinker International, Mr. Wyatt was a venture partner at 1024 Partners, LLC. In addition, Mr. Wyatt has held various management positions at Starbucks Corporation, Nike, Inc. and The Spiegel Group Companies.

CORPORATE GOVERNANCE

Our Board is responsible for governing Michaels' business and affairs. Highlights of Michaels' corporate governance practices are described below.

Board Committees

Edgar Filing: MICHAELS STORES INC - Form 10-K

Currently, our Board has two active standing committees, each of which is required by its charter to consist of no fewer than two directors. The four members of the Audit Committee are Todd Cook (Chairman), Lewis Klessel, James Quella and Peter Wallace. The two members of the Compensation Committee are Matthew Levin and Peter Wallace.

As a result of the Merger, the Company's Common Stock is held by a small number of stockholders, including funds managed by Bain and Blackstone (and other private equity funds) and certain current and former members of our senior management. In addition, Bain and Blackstone have agreed that they will each have the right to proportional representation on our Board, which has resulted in half of our Board being associated with Bain, with the remaining half being associated with Blackstone. As the Company is now privately held and the members of our Board are selected by our Sponsors, the Board does not maintain policies and procedures by which Michaels' stockholders may submit director candidates to the Board or the stockholders for consideration.

Compensation Committee

Please see Item 11. Executive Compensation Compensation Discussion and Analysis for a description of the roles and responsibilities of our Compensation Committee.

Audit Committee

Our Board of Directors has a separately designated Audit Committee. The current members of the Audit Committee are as follows:

Audit Committee

Todd M. Cook (Chairman)

Lewis S. Klessel

James A. Quella

Peter F. Wallace

Our Board has determined that each member of the Audit Committee is financially literate and has sufficient business and financial expertise to effectively perform his duties as a member of the Audit Committee. As the Company is now privately held and controlled by our Sponsors, our Board has determined that it is not necessary to designate one or more of our Audit Committee members as an audit committee financial expert at this time. None of our Audit Committee members is an independent director due to their affiliations with the Sponsors.

Under its charter, the Audit Committee is generally responsible for overseeing Michaels' financial reporting process and assists the Board in fulfilling the Board's oversight responsibilities with respect to: (i) the integrity of Michaels' financial statements; (ii) Michaels' compliance with legal and regulatory requirements; (iii) the qualifications and independence of Michaels' independent registered public accounting firm; and (iv) the performance of the independent registered public accounting firm and of Michaels' internal audit function.

Code of Business Conduct and Ethics

We adopted a Code of Business Conduct and Ethics that applies to, among others, our principal executive officer, principal financial officer, and principal accounting officer or controller, or persons performing similar functions. A copy of our Code of Business Conduct and Ethics is available on our Internet website at www.michaels.com under Corporate Information. We will post any amendments to our Code of Business Conduct and Ethics, or waivers of the Code for our executive officers, on our Internet website at www.michaels.com under Corporate Information.

ITEM 11. Executive Compensation.

COMPENSATION DISCUSSION AND ANALYSIS

Introduction

The following Compensation Discussion and Analysis relates to compensation paid to our executive officers named in the Summary Compensation Table for fiscal 2010. From the completion of the Merger to March 2011, our Compensation Committee was comprised of two members: Michael S. Chae and Matthew S. Levin. In March 2011, Peter F. Wallace was appointed to the Compensation Committee to fill a vacancy created by the resignation of Mr. Chae from the Committee. Each of the members of our Compensation Committee is affiliated with our Sponsors and has not been deemed an independent director. During fiscal 2010, several events occurred which impacted management and compensation decisions. These included the hiring of a new Chief Administrative Officer and Chief Financial Officer, a new Senior Vice President Chief Marketing Officer, a new Senior Vice President Corporate Development, and the departure of the Company's former Senior Vice President Controller, who also served as Chief Financial Officer for a portion of the fiscal year. Each of these events is more fully discussed below.

Compensation Program

Generally, our compensation program has continued the overall approach of our pre-Merger compensation program, modified as appropriate to reflect that we are now a privately-owned company with public debt. The principal guiding objectives of our compensation program are:

- attracting and retaining highly qualified individuals who make contributions that result in Michaels meeting its financial and strategic goals;
- motivating associates to exceptional levels of operating and financial performance; and
- aligning associate interests with the long-term goals of our stockholders.

Currently, the total compensation for our officers at the Vice President level and above, including our executive officers, consists of three main components: base salary, annual cash incentive bonuses and long-term equity-based incentive compensation awards. The philosophy and the strategy of the cash incentive compensation program for our officers are to provide higher annual cash incentive compensation for exceptional corporate and financial performance. While the Compensation Committee takes into account tax and accounting considerations in structuring the components of our compensation program, these considerations are secondary to the primary objectives of the compensation program described above.

Compensation Strategy

The Compensation Committee approves and recommends to the Board the compensation for all executive officers at the level of Executive Vice President and above. The Board is ultimately responsible for determining the compensation of our executive officers at the level of Executive Vice President and above. The members of the Compensation Committee are ultimately responsible for determining the compensation of our executive officers at the Senior Vice President level, although the initial compensation for these officers is approved by the Board. Under our certificate of incorporation equity-based awards must also be approved by a majority of our stockholders. Both the Compensation Committee and the Board receive recommendations with respect to decisions regarding the executive officers, other than the Chief Executive Officer, by senior management, principally the Chief Executive Officer and the Senior Vice President - Human Resources. In determining compensation levels for the executive officers, the Compensation Committee considers the scope of an individual's responsibilities, an individual's performance and prior experience, the performance of the Company and the attainment of planned financial and strategic initiatives. These factors are evaluated by the Compensation Committee and the Board with no particular weight given to any one factor. The Compensation Committee considers overall past compensation and incentives in determining the compensation of executive officers and seeks to assure that the executives have appropriate incentives to achieve high levels of Company performance. The Compensation Committee, through its members' involvement in numerous other portfolio companies, has access to compensation-related information to assist the Committee with respect to the Company's overall compensation program for associates generally, as well as compensation for executive officers. Approvals by the Compensation Committee and recommendations to the Board by the Compensation Committee are therefore predominantly based on the experience of the members of the Compensation Committee and alignment with the overall strategic direction and goals of the Company.

Named Executive Officers

According to SEC rules, the Summary Compensation Table that immediately follows this Compensation Discussion and Analysis must include specific information for each of the following persons: (i) all individuals serving as principal executive officer or acting in a similar capacity during the last completed fiscal year; (ii) all individuals serving as principal financial officer or acting in a similar capacity during the last completed fiscal year; (iii) the three most highly compensated executive officers other than the principal executive officer and principal financial officer who were serving as executive officers at the end of the last completed fiscal year; and (iv) up to two additional individuals for whom disclosure would have been provided but for the fact that the individual was not serving as an executive officer at the end of the last completed fiscal year. These individuals include: John B. Menzer, Chief Executive Officer (who served as principal executive officer); Charles M. Sonstebly, Chief Administrative Officer and Chief Financial Officer (who, beginning on October 4, 2010, served as principal financial officer); Philo T. Pappas, Executive Vice President Category Management, Paula A. Puleo, Senior Vice President Chief Marketing Officer, and John J. Wyatt, Senior Vice President Corporate Development (the three other most highly compensated individuals who were serving as executive officers at the end of fiscal 2010); Richard S. Jablonski, Vice President Financial Planning & Analysis (who performed the functions of principal financial officer during a portion of fiscal 2010); and Elaine D. Crowley, who served as Senior Vice President Controller and as Chief Financial Officer (and therefore, as principal financial officer) for part of fiscal 2010. These officers are referred to as our Named Executive Officers. This Compensation Discussion and Analysis and the executive compensation discussion and tables that immediately follow describe the process, strategy and elements of the Company's compensation plan as applied to our Named Executive Officers.

Compensation Elements

Base Salaries

Base salaries for our executive officers are established based on the scope of their responsibilities, individual performance and prior experience, Michaels' operating and financial performance and the attainment of planned financial and strategic initiatives, taking into account the knowledge of the members of the Compensation Committee regarding competitive market compensation paid by companies for similar positions. The Compensation Committee recommends, and the Board sets, base salaries at a level designed to attract and retain highly qualified individuals who make contributions that result in Michaels meeting its operating and financial goals. Base salaries are reviewed and adjusted annually as deemed appropriate by the Compensation Committee and the Board. The Compensation Committee and the Board have discretion to adjust base salary during the fiscal year and exercised that discretion in fiscal 2010, as described below.

On October 4, 2010, Mr. Sonstebly was named Chief Administrative Officer and Chief Financial Officer of the Company. Pursuant to his offer letter with the Company, Mr. Sonstebly's base salary was set at \$650,000, with salary increases to be consistent with our policy of advancement on an individual merit basis. In recommending Mr. Sonstebly's base salary that was approved by the Board, the Committee considered Mr. Sonstebly's compensation at his prior employer, the scope and responsibilities of his position at Michaels, the competitive market salary at comparable companies and the level of compensation needed to recruit Mr. Sonstebly to the Company.

On March 8, 2010, Ms. Puleo was named Senior Vice President Chief Marketing Officer of the Company. Pursuant to her offer letter with the Company, Ms. Puleo's base salary was set at \$300,000, with salary increases to be consistent with our policy of advancement on an individual merit basis. In recommending Ms. Puleo's base salary that was approved by the Board, the Committee considered Ms. Puleo's compensation at her prior employer, the scope and responsibilities of her position at Michaels, the competitive market salary at comparable companies and the level of compensation needed to recruit Ms. Puleo to the Company. Ms. Puleo also received a signing bonus of \$35,000 pursuant to her offer letter, which in the judgment of the Committee was instrumental to the Company's successful recruiting of her as Senior Vice President Chief Marketing Officer.

On June 21, 2010, Mr. Wyatt was named Senior Vice President - Corporate Development of the Company. Pursuant to his offer letter with the Company, Mr. Wyatt's base salary was set at \$275,000, with salary increases to be consistent with our policy of advancement on an individual merit basis. In recommending Mr. Wyatt's base salary that was approved by the Board, the Committee considered Mr. Wyatt's compensation at his prior employer, the scope and responsibilities of his position at Michaels, the competitive market salary at comparable companies and the level of compensation needed to recruit Mr. Wyatt to the Company. Mr. Wyatt also received a signing bonus of \$50,000 pursuant to his offer letter, which in the judgment of the Committee was instrumental to the Company's successful recruiting of him as Senior Vice President - Corporate Development.

Mr. Jablonski is not an executive officer of the Company. His original base salary was established based on the scope of his responsibilities, individual performance and prior experience, Michaels' operating and financial performance and the attainment of planned financial and strategic initiatives, and competitive market compensation paid by companies for similar positions. Mr. Jablonski's base salary is reviewed on an annual basis by the Chief Financial Officer, who assigns Mr. Jablonski a proposed

Edgar Filing: MICHAELS STORES INC - Form 10-K

merit-based increase based upon job performance and Company merit guidelines. Final approval to any increases to Mr. Jablonski's base salary is made by the Chief Executive Officer, based upon input and recommendations by the Chief Financial Officer and the Senior Vice President Human Resources.

In March 2010, the Compensation Committee reviewed recommendations regarding 2010 annual base salary rates for the executive officer group based on the criteria set forth under Compensation Discussion and Analysis Compensation Strategies. Merit guidelines are determined by reviewing and participating in surveys of market data, as well as giving consideration to the Company's overall budget for associate compensation. Based upon this information, the Company utilized an annual merit rate of 2.75% for fiscal 2010.

Base salaries for the Named Executive Officers for fiscal 2009 and 2010, which reflects increases between the two fiscal years, are reflected below.

Name	2009 Base Salary	2010 Base Salary
John B. Menzer	\$ 1,000,000	\$ 1,027,000
Charles M. Sonsteby (1)	N/A	650,000
Philo T. Pappas	375,000	386,251
Paula A. Puleo (1)	N/A	300,000
John J. Wyatt (1)	N/A	275,000
Richard S. Jablonski	210,000	213,675
Elaine D. Crowley	300,000	306,000

(1) The Named Executive Officer joined the Company in fiscal 2010.

Annual Bonuses

In March 2010, the Compensation Committee recommended that the Board approve the Company's Bonus Plan for executive officers (including the Named Executive Officers, excluding Mr. Jablonski) for fiscal 2010 (the Bonus Plan) to provide financial incentives to those and other members of management who were in positions to make important contributions to Michaels' success. The Board subsequently approved the Bonus Plan. The structure of the Bonus Plan and the specific objectives relating to bonus payments were proposed by the Company's Chief Executive Officer and Senior Vice President Human Resources and were reviewed and adjusted by the Compensation Committee. Mr. Jablonski participated in a bonus plan with the same terms as the Bonus Plan, which was approved by the Chief Executive Officer, with input from the Senior Vice President Human Resources. For Messrs. Menzer, Sonsteby and Wyatt, and Ms. Crowley, the Bonus Plan tied 80% of the available bonus to Michaels' attainment of a financial objective (consolidated earnings before interest, taxes, depreciation and amortization (EBITDA), less an inventory charge), and up to 20% of the available bonus to the individual's job performance. For Mr. Pappas and Ms. Puleo, the Bonus Plan tied 50% of the available bonus to Michaels' attainment of a financial objective (EBITDA, less an inventory charge), 15% to a business unit sales objective (U.S. and Canada sales for all Company stores), 15% to a business unit buyer contribution objective (scan margin, less shrink at cost, plus entitlements, less average monthly inventory at cost with a multiplier, less an inventory charge), and up to 20% of the available bonus to the individual's job performance. Mr. Jablonski's bonus plan tied 80% of the available bonus to Michaels' attainment of the same financial objective set forth in the Bonus Plan, and up to 20% of the available bonus to his individual job performance. Under the Bonus Plan and Mr. Jablonski's bonus plan, before any business unit or individual performance payout would be earned, the actual results of the financial objective (EBITDA, less an inventory charge) were required to meet the threshold established by the Compensation Committee. Each participating Named Executive Officer was entitled to a bonus equal to a certain percentage of that executive officer's base salary, depending on the achievement of the target, threshold or maximum performance level. The Compensation Committee set threshold, target and maximum performance levels for all officers of the Company. The final award depended on the actual level of performance achieved; however, the Compensation Committee retains the right to make adjustments in its sole discretion. The target levels of performance for the bonus goals were

Edgar Filing: MICHAELS STORES INC - Form 10-K

set at levels that the Compensation Committee and the Board believed to be reasonably achievable in view of Michaels' historical annual performance. Additional specific information regarding the targets and objectives is set forth below.

The target percentages set for fiscal 2010 and the threshold, target and maximum payments for each of the Named Executive Officers for fiscal 2010 were as follows:

Edgar Filing: MICHAELS STORES INC - Form 10-K

	John B. Menzer	Charles M. Sonstebly (1)	Philo T. Pappas	Paula A. Puleo (2)	John J. Wyatt (3)	Richard S. Jabloski	Elaine D. Crowley (4)
Percentage of Base Salary							
Target	100%	70%	50%	40%	40%	35%	50%
Threshold	18%	12.6%	9%	7.2%	7.2%	6.3%	9%
Maximum	200%	140%	100%	80%	80%	70%	100%
Financial Weightings							
Overall Company Results	80%	80%	50%	50%	80%	80%	80%
Company Sales			15%	15%			
Buyer Contribution							
Less Inventory Charge			15%	15%			
Individual Performance	20%	20%	20%	20%	20%	20%	20%

- (1) Pursuant to Mr. Sonstebly's offer letter from the Company, Mr. Sonstebly's target annual bonus opportunity pursuant to the Bonus Plan was set at 70% of base salary (with a maximum bonus at 140% of his base salary), prorated to the commencement of his employment. Further, the Company agreed to pay Mr. Sonstebly an additional three incremental periods (1/12th) of bonus payments to any pro-rated bonus earned by him in fiscal 2010, to offset the three months of bonus forfeited with his former employer.
- (2) Pursuant to Ms. Puleo's offer letter from the Company, Ms. Puleo's target annual bonus opportunity pursuant to the Bonus Plan was set at 40% of base salary (with a maximum bonus at 80% of her base salary), prorated to the commencement of her employment.
- (3) Pursuant to Mr. Wyatt's offer letter from the Company, Mr. Wyatt's target annual bonus opportunity pursuant to the Bonus Plan was set at 40% of base salary (with a maximum bonus at 80% of his base salary), prorated to the commencement of his employment.
- (4) Ms. Crowley separated from the Company on August 6, 2010.

Provided that the financial objective threshold is met, individual performance accounts for up to 20% of the maximum bonus for each of the Named Executive Officers. Each officer is evaluated annually based upon competencies and pre-established individual objectives. Performance against these measures is determined by the Compensation Committee (the Chief Financial Officer and Senior Vice President Human Resources in the case of Mr. Jabloski), based upon input and recommendations by the Chief Executive Officer (except in the case of Mr. Jabloski), on a scaled rating of Exceeds Expectations, Meets Expectations High, Meets Expectations Low or Needs Development. No specified weight is given to each measure and considerable discretion resides with the Compensation Committee (the Chief Financial Officer and Senior Vice President Human Resources in the case of Mr. Jabloski) in its evaluation of personal performances.

In March 2011, the Compensation Committee reviewed the Company's financial results as applicable to the pre-established fiscal 2010 annual bonus opportunities for the Named Executive Officers. As described previously, the financial objective of Company performance that was applicable to all the Named Executive Officers was EBITDA, less an inventory charge. At the beginning of fiscal 2010, the Compensation Committee established, and the Board approved, the EBITDA, less an inventory charge, goal for target-level bonuses at \$492.5 million, with a maximum at \$550.5 million, and for threshold bonuses at \$456.5 million, which represented approximately 94% of target. For the fiscal year, the Company's financial performance was between target and maximum. As a result, bonuses above target were earned for the Company performance element of the plan.

Edgar Filing: MICHAELS STORES INC - Form 10-K

The Compensation Committee, based upon input and recommendations by the Chief Executive Officer also evaluated the individual performance of each of the Named Executive Officers (other than the Chief Executive Officer and Mr. Jablonski) for purposes of determining bonuses based on individual performance. Additionally, the Compensation Committee evaluated the

Edgar Filing: MICHAELS STORES INC - Form 10-K

individual performance of the Chief Executive Officer for purposes of determining his bonus. The Chief Financial Officer and Senior Vice President Human Resources evaluated the individual performance of Mr. Jablonski, with final approval made by the Chief Executive Officer, for purposes of determining his bonus based on individual performance.

Actual amounts paid to the Named Executive Officers for fiscal 2010 are listed in the Summary Compensation Table.

Long-Term Equity-Based Compensation

On February 15, 2007, our Board and stockholders approved the Michaels Stores, Inc. 2006 Equity Incentive Plan, as well as certain specific grants under the plan to key associates. In addition, the stockholders granted the Board authority to make plan grants to other eligible participants in the future. The plan was established to advance the interests of Michaels and its affiliates by providing for the grant of equity-based awards to eligible participants (key associates and directors of, and consultants and advisors to, Michaels or its affiliates). Awards under the plan are intended to align the long-term incentives of our executives and stockholders. Grants are awarded when an executive is hired and are adjusted for subsequent promotions. Grants are made at or above fair market value.

Each option is divided into three tranches with escalating exercise prices. Each tranche vests 20% on each of the first through fifth anniversaries of the grant date and all unvested options vest immediately upon a Change of Control, as defined in the Amended and Restated Stockholders Agreement dated February 16, 2007 among Michaels and its stockholders. The tranche structure of the option awards, with increasing exercise prices in each tranche, is designed to incentivize long-term performance by tying the value of the options to long-term increases in the value of our Common Stock.

The following options were granted to Named Executive Officers in fiscal 2010:

Name	Total Shares	Number of Shares of Common Stock Underlying Stock Options			
		Tranche 0 (Exercise Price \$11.55 Per Share)	Tranche 0 (Exercise Price \$14.47 Per Share)	Tranche 1 (Exercise Price \$15.00 Per Share)	Tranche 2 (Exercise Price \$22.50 Per Share)
Charles M. Sonsteby	567,648		189,216	189,216	189,216
Paula A. Puleo	283,872	94,624		94,624	94,624
John J. Wyatt	227,098	75,700		75,699	75,699

The amounts of awards were based on each Named Executive Officer's position at Michaels and the total target compensation packages deemed appropriate for such positions. The Compensation Committee and the Board felt these awards were reasonable and consistent with the nature of the individuals' responsibilities and satisfied the goals of competitive compensation and the retention of key executive officers.

Mr. Sonsteby was also granted a restricted stock award pursuant to the 2006 Equity Incentive Plan in fiscal 2010. Mr. Sonsteby's restricted stock award covers 38,200 shares with 20% vesting on each of the first through fifth anniversaries from October 4, 2010 (vesting of all shares would accelerate upon a Change of Control (as defined in the Stockholders Agreement) or in the event of Mr. Sonsteby's death, disability or termination by the Company without cause). In the judgment of the Compensation Committee and the Board, the restricted stock award was appropriate for

Edgar Filing: MICHAELS STORES INC - Form 10-K

Mr. Sonstebly's position and was instrumental to the Company's successful recruiting of Mr. Sonstebly as Chief Administrative Officer and Chief Financial Officer.

Other Benefits and Perquisites

Our Named Executive Officers also receive certain other benefits and perquisites. During fiscal 2010, these benefits included contributions to 401(k) accounts, the payment of life insurance premiums, Company-paid medical benefits and, in some cases, reimbursement for income taxes on taxable benefits. Our Chief Executive Officer is also entitled to the use of a Company-owned or leased automobile. The Compensation Committee and the Board believe these benefits and perquisites are reasonable and consistent with the nature of the individual's responsibilities, provide a competitive level of total compensation to our executives and serve as an important element in retaining those individuals. The cost to Michaels of these benefits to the Named Executive Officers is set forth in the Summary Compensation Table under the column "All Other Compensation" and detail about each element is set forth in the table presented in footnote 4 to the Summary Compensation Table.

Employment and Severance Agreements

Mr. Menzer has an employment agreement with Michaels that was entered at the time of his appointment which includes certain severance benefits in the event of termination other than for cause or by Mr. Menzer for good reason, as such terms are defined in the agreement. The specific terms of Mr. Menzer's employment agreement are discussed in the section entitled "Menzer Employment Agreement" following the Grants of Plan-Based Awards Table and under "Executive and Director Compensation - Potential Payments Upon Termination or Change of Control."

In April 2008, the Board approved the Company's Officer Severance Pay Plan (the "OSPP"), which was amended in July 2008. The OSPP was established by the Company to provide certain severance benefits, subject to the terms and conditions of the OSPP, to designated officers (those with a position of Vice President or above, or an equivalent title as approved by the Compensation Committee, and excluding the Chief Executive Officer) in the event that their employment is permanently terminated as a result of a "Qualifying Termination" (as defined in the OSPP and described below). A more detailed description of the OSPP may be found under "Executive and Director Compensation - Potential Payments Upon a Change of Control."

IRS Limits on Deductibility

Following the Merger, the equity securities of Michaels are no longer publicly traded; accordingly, Section 162(m) of the Internal Revenue Code no longer applies to Michaels.

COMPENSATION COMMITTEE REPORT

The Compensation Committee has reviewed and discussed the Compensation Discussion and Analysis required by Item 402(b) of Regulation S-K with management and, based on such review and discussion, the Compensation Committee recommended to the Board that the Compensation Discussion and Analysis be included in this Annual Report on Form 10-K.

THE COMPENSATION COMMITTEE

Matthew S. Levin
Peter F. Wallace

EXECUTIVE AND DIRECTOR COMPENSATION

Summary Compensation Table

According to SEC rules, the Summary Compensation Table must include specific information for each of the following persons: (i) all individuals serving as principal executive officer or acting in a similar capacity during the last completed fiscal year; (ii) all individuals serving as principal financial officer or acting in a similar capacity during the last completed fiscal year; (iii) the three most highly compensated executive officers other than the principal executive officer and principal financial officer who were serving as executive officers at the end of the last completed fiscal year; and (iv) up to two additional individuals for whom disclosure would have been provided but for the fact that the individual was not serving as an executive officer at the end of the last completed fiscal year. The following table summarizes the compensation for the fiscal years indicated paid to or earned by the following persons who were previously defined as Named Executive Officers: John B. Menzer (who served as principal executive officer), Charles M. Sonstebly (who, beginning on October 4, 2010, served as principal financial officer), Philo T. Pappas, Paula A. Puleo and John J. Wyatt (the three other most highly compensated individuals who were serving as executive officers at the end of fiscal 2010), Richard S. Jablonski (who performed the functions of principal financial officer during a portion of fiscal 2010), and Elaine D. Crowley (who served as principal financial officer during a portion of fiscal 2010).

Name and Principal Position	Year	Salary (\$)	Bonus (\$)	Stock Awards (\$ (1))	Option Awards (\$ (2))	Non-Equity Incentive Plan Compensation (\$ (3))	All Other Compensation (\$ (4))	Total (\$)
John B. Menzer <i>Chief Executive Officer (5)</i>	2010	1,022,846				1,507,431	76,931	2,607,208
	2009	807,692		2,135,000	2,407,750	1,644,500	115,952	7,110,894
Charles M. Sonstebly <i>Chief Administrative Officer and Chief Financial Officer (6)</i>	2010	200,000		552,754	2,696,082	336,510(7)	16,579	3,801,925
Philo T. Pappas <i>Executive Vice President (8)</i>	2010	384,520				235,188	86,785	706,493
	2009	359,135	20,000	50,002	341,924	239,663	126,777	1,137,501
Paula A. Puleo <i>Senior Vice President Chief Marketing Officer(9)</i>	2010	265,385	35,000(10)		1,207,440	133,980	23,295	1,665,100
John J. Wyatt <i>Senior Vice President Corporate Development (11)</i>	2010	163,942	50,000(12)		965,954	74,931	29,028	1,283,855
Richard S. Jablonski <i>Vice President Financial Planning & Analysis</i>	2010	213,110				94,808	53,620	361,538
Elaine D. Crowley <i>Former Chief Financial Officer (13)</i>	2010	163,846					32,071	195,917
	2009	300,000			172,618	190,410	52,824	715,852
	2008	132,692	150,000		1,992,556		117,039	2,392,287

- (1) The amounts in this column represent the aggregate grant date fair value of restricted stock awards calculated in accordance with ASC 718, based on the assumptions set forth in Note 6 to the consolidated financial statements. Because the Company is a privately-held company and there is no market for our Common Stock, the fair market value of our Common Stock is determined by our Board of Directors based on available information that is material to the value of our Common Stock, including any third party valuation reports, the principal amount of the Company's indebtedness, the Company's actual and projected financial results, and fluctuations in the market value of publicly-traded companies in the retail industry.

Edgar Filing: MICHAELS STORES INC - Form 10-K

- (2) Represents the aggregate grant date fair value of the option awards on the date of the grant as calculated in accordance with ASC 718, based on the assumptions set forth in Note 6 to the consolidated financial statements. Because the Company is a

Edgar Filing: MICHAELS STORES INC - Form 10-K

privately-held company and there is no market for our Common Stock, the fair market value of our Common Stock is determined by our Board of Directors based on available information that is material to the value of our Common Stock, including any third party valuation reports, the principal amount of the Company's indebtedness, the Company's actual and projected financial results, and fluctuations in the market value of publicly-traded companies in the retail industry.

- (3) The amounts in this column for fiscal 2010 reflect the cash awards to Named Executive Officers under the Bonus Plan, which are discussed in further detail in the preceding section Compensation Discussion and Analysis Compensation Elements Annual Bonuses. The amounts in this column for fiscal 2009 reflect the cash awards to Named Executive Officers under the Company's Bonus Plan for executive officers for fiscal 2009.
- (4) The table below reflects the fiscal 2010 components of this column.

	John B. Menzer	Charles M. Sonstebly	Philo T. Pappas	Paula A. Puleo	John J. Wyatt	Richard S. Jablonski	Elaine D. Crowley
Medical Benefits (\$)	39,112	14,563	48,997	20,346	25,484	48,997	27,153
Insurance Premiums (\$)	5,889	1,895	3,495	1,720	3,325	1,714	2,178
Company Contributions to 401(k) and Group Universal Life Plan (\$)			3,026	865		2,450	2,450
Tax Reimbursement (\$) (a)	16,386	121	31,267	364	219	359	290
Auto (\$)	15,544						
Other (\$)						100(b)	
Total Other	76,931	16,579	86,785	23,295	29,028	53,620	32,071

(a) Reimbursement of income taxes is related to relocation, executive gifts, long-term disability insurance premiums and medical expenses.

(b) The amounts in this row reflect for Mr. Jablonski the cost attributable to a gift card won in a holiday contest.

- (5) Mr. Menzer became our Chief Executive Officer on April 6, 2009, and his base salary for fiscal 2009 reflects a partial fiscal year.
- (6) Mr. Sonstebly joined the Company as Chief Administrative Officer and Chief Financial Officer on October 4, 2010, and his compensation for fiscal 2010 reflects a partial fiscal year.
- (7) Pursuant to Mr. Sonstebly's offer letter, his annual incentive bonus opportunity was equal to (i) 12.6% to 140% of his fiscal 2010 base salary, prorated to the commencement of his employment, plus the addition of (ii) three incremental periods (1/12th) of bonus payments to any pro-rated bonus earned by him in fiscal 2010, to offset the three months of bonus forfeited with his former employer.
- (8) Mr. Pappas joined the Company as Executive Vice President - Category Management on February 23, 2009, and his compensation for fiscal 2009 reflects a partial fiscal year.
- (9) Ms. Puleo joined the Company as Senior Vice President - Chief Marketing Officer on March 8, 2010, and her compensation for fiscal 2010 reflects a partial fiscal year.
- (10) Represents signing bonus provided to Ms. Puleo pursuant to her offer letter.
- (11) Mr. Wyatt joined the Company as Senior Vice President - Corporate Development on June 21, 2010, and his compensation for fiscal 2010 reflects a partial fiscal year.
- (12) Represents signing bonus provided to Mr. Wyatt pursuant to his offer letter.

Edgar Filing: MICHAELS STORES INC - Form 10-K

- (13) Ms. Crowley joined the Company as Executive Vice President – Chief Financial Officer on August 18, 2008, and her compensation for fiscal 2008 reflects a partial fiscal year. Ms. Crowley assumed the role of Senior Vice President – Controller and Chief Financial Officer on April 12, 2010 and served in that position until August 6, 2010, when she separated from the Company.

Grants of Plan-Based Awards for Fiscal 2010

The following table sets forth the plan-based awards granted to Named Executive Officers pursuant to Company plans during fiscal 2010.

Grants of Plan-Based Awards

Name and Principal Position	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan			All Other Stock Awards: Number of Shares of Stock (2)	All Other Option Awards: Number of Securities Underlying Options (2)	Exercise or Base Price of Option Awards (\$/Sh)(3)	Grant Date Fair Value of Stock and Option Awards \$(4)
		Threshold (\$)	Target (\$)	Maximum (\$)	(#)	(#)		
John B. Menzer Chief Executive Officer	N/A	184,860	1,027,000	2,054,000				
Charles M. Sonstebly Chief Administrative Officer and Chief Financial Officer (5)	N/A	27,300	151,667	303,333	38,200			
	1/5/2011					189,216	14.47	1,036,828
	1/5/2011					189,216	15.00	1,003,904
	1/5/2011					189,216	22.50	655,350
Philo T. Pappas Executive Vice President Category Management	N/A	34,763	193,125	386,251				
Paula A. Puleo Senior Vice President Chief Marketing Officer(6)	N/A	19,800	110,000	220,000				
	7/26/2010					94,624	11.55	441,213
	7/26/2010					94,624	15.00	444,250
	7/26/2010					94,624	22.50	321,977
John J. Wyatt Senior Vice President Corporate Development (7)	N/A	11,550	64,167	128,333				
	7/26/2010					75,700	11.55	352,974
	7/26/2010					75,699	15.00	355,399
	7/26/2010					75,699	22.50	257,581
Richard S. Jablonski Vice President Financial Planning & Analysis	N/A	13,462	74,786	149,573				
Elaine D. Crowley Former Chief Financial Officer (8)	N/A	13,770	76,500	153,000				

(1) The threshold, target and maximum amounts in these columns have been provided in accordance with Item 402(d) of Regulation S-K and show the range of payouts targeted for fiscal 2010 for performance under the Bonus Plan as discussed in further detail in Compensation Discussion and Analysis Compensation Elements Annual Bonuses. For Mr. Sonsteby, Ms. Puleo, Mr. Wyatt and Ms. Crowley, these amounts reflect pro rated values for the partial year each executive was employed. Bonuses were recommended by the Compensation Committee, and approved by the Board, as applicable, in March 2011 and are expected to be paid in April 2011, as reflected in the Summary Compensation Table in the column entitled Non-Equity Incentive Plan Compensation.

(2) All equity awards noted below were granted under the 2006 Equity Incentive Plan.

(3) All grants of stock options under the 2006 Equity Incentive Plan have an exercise price equal to or greater than the fair market value of our Common Stock on the date of grant. Because the Company is a privately-held company and there is no market for our Common Stock, the fair market value of our Common Stock is determined by our Board of Directors based on available information that is material to the value of our Common Stock, including any third party valuation reports, the principal amount of the Company's indebtedness, the Company's actual and projected financial results, and fluctuations in the market value of publicly-traded companies in the retail industry.

(4) The amounts in this column represent the aggregate grant date fair value of the stock options as calculated in accordance with ASC 718.

(5) Stock options were granted to Mr. Sonsteby on January 5, 2011, vesting at the rate of 20% per year on each of the first through fifth anniversaries of October 4, 2010, or immediately upon a Change of Control (as defined in the Stockholders Agreement). Mr. Sonsteby's restricted stock awards vest 20% on each of October 4, 2011, October 4, 2012, October 4, 2013, October 4, 2014 and October 4, 2015 (vesting of the shares would accelerate upon a Change of Control (as defined in the Stockholders Agreement) or in the event of Mr. Sonsteby's death, disability or termination by the Company without cause). Mr. Sonsteby will receive all dividends and distributions, if any, paid with respect to the shares of restricted stock he holds, but if any such dividends or distributions are paid in shares of our capital stock, such shares will be subject to the same restrictions on transferability as are the shares of restricted stock with respect to which they were paid.

(6) Stock options were granted to Ms. Puleo on July 26, 2010, vesting at the rate of 20% per year on each of the first through fifth anniversaries of March 8, 2010, or immediately upon a Change of Control (as defined in the Stockholders Agreement).

(7) Stock options were granted to Mr. Wyatt on July 26, 2010, vesting at the rate of 20% per year on each of the first through fifth anniversaries of June 21, 2010, or immediately upon a Change of Control (as defined in the Stockholders Agreement).

(8) Ms. Crowley separated from the Company on August 6, 2010. Based on her voluntary resignation from the Company, Ms. Crowley is not entitled to receive a bonus for fiscal 2010.

Employment Agreements with Certain Named Executive Officers

Menzer Employment Agreement

The compensation for John B. Menzer described in the Summary Compensation Table and the Grants of Plan-Based Awards Table above were in accordance with the terms of his employment agreement, as amended, with Michaels, pursuant to which he serves as Chief Executive Officer. The agreement became effective April 6, 2009. The agreement provides for an annual base salary of \$1,000,000, subject to increase in the sole discretion of the Board. Mr. Menzer is eligible for an annual bonus for each fiscal year during his employment, with a target amount of 100% of his base salary and a maximum bonus potential of 200% of his base salary, based on performance targets established by the Board, with the actual amount of any bonus being in the sole discretion of the Board. In addition, in connection with the commencement of his employment, Mr. Menzer was granted 500,000 shares of restricted stock and an option to purchase 2,500,000 shares of Common Stock. For a more detailed description of the restricted stock and options grants, see Compensation Discussion and Analysis Compensation Elements Long-Term Equity-Based Compensation, and the Outstanding Equity Awards at Fiscal Year-End table below. Mr. Menzer is also entitled to a Company leased automobile, and is entitled to participate in benefit plans standard for Michaels executive officers, including life insurance plans.

Outstanding Equity Awards at Fiscal Year-End 2010

The following table sets forth information regarding equity awards held by our Named Executive Officers as of January 29, 2011.

Name and Principal Position	Option Awards				Stock Awards	
	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price (\$)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested \$(1)
John B. Menzer <i>Chief Executive Officer</i> (2)					500,000	7,610,000
	166,666	666,668	7.50	6/1/2017		
	166,666	666,667	15.00	6/1/2017		
	166,666	666,667	22.50	6/1/2017		
Charles M. Sonstebly <i>Chief Administrative Officer and Chief Financial Officer</i> (3)					38,200	581,404
		189,216	14.47	1/4/2019		
		189,216	15.00	1/4/2019		
		189,216	22.50	1/4/2019		
Philo T. Pappas <i>Executive Vice President Category Management</i> (4)					9,368	142,581
	30,279	121,117	7.50	7/1/2017		
	6,309		15.00	4/16/2017		
	29,017	116,072	15.00	7/1/2017		
	6,309		22.50	4/16/2017		
	29,017	116,072	22.50	7/1/2017		
Paula A. Puleo <i>Senior Vice President Chief Marketing Office</i> (5)						
		94,624	11.55	7/25/2018		
		94,624	15.00	7/25/2018		
		94,624	22.50	7/25/2018		
John J. Wyatt <i>Senior Vice President Corporate Development</i> (6)						
		75,700	11.55	7/25/2018		
		75,699	15.00	7/25/2018		
		75,699	22.50	7/25/2018		
Richard S. Jablonski <i>Vice President Financial Planning & Analysis</i> (7)	5,677	22,711	7.50	7/1/2017		
	7,192		15.00	3/25/2016		
	4,239	16,956	15.00	7/1/2017		
	7,192		22.50	3/25/2016		
	4,239	16,956	22.50	7/1/2017		

Elaine D. Crowley
Former Chief Financial Officer (8)

-
- (1) Because the Company is a privately-held company and there is no market for our Common Stock, the fair market value of our Common Stock is determined by our Board of Directors based on available information that is material to the value of our Common Stock, including any third party valuation reports, the principal amount of the Company's indebtedness, the Company's actual and projected financial results, and fluctuations in the market value of publicly-traded companies in the

Edgar Filing: MICHAELS STORES INC - Form 10-K

retail industry. The shares were valued based on a price per share of \$15.22, which was the fair market value of our Common Stock on January 29, 2011, the last day of fiscal 2010.

- (2) Stock options were granted to Mr. Menzer on June 2, 2009, vesting at the rate of 20% on each of April 6, 2010, April 6, 2011, April 6, 2012, April 6, 2013 and April 6, 2014, or immediately upon a Change of Control (as defined in the Stockholders Agreement). Mr. Menzer's restricted stock awards vest 25% on each of April 6, 2011, April 6, 2012, April 6, 2013 and April 6, 2014 (vesting of all shares would accelerate upon a Change of Control (as defined in the Stockholders Agreement) and vesting of 133,333 shares would accelerate in the event that Mr. Menzer's employment is terminated without cause or by him for good reason, or in the event of Mr. Menzer's death or disability, prior to April 6, 2011). Mr. Menzer will receive all dividends and distributions, if any, paid with respect to the shares of restricted stock he holds, but if any such dividends or distributions are paid in shares of our capital stock, such shares will be subject to the same restrictions on transferability as are the shares of restricted stock with respect to which they were paid.
- (3) Stock options were granted to Mr. Sonstebly on January 5, 2011, vesting at the rate of 20% on each of October 4, 2011, October 4, 2012, October 4, 2013, October 4, 2014 and October 4, 2015, or immediately upon a Change of Control (as defined in the Stockholders Agreement). Mr. Sonstebly's restricted stock awards vest 20% on each of October 4, 2011, October 4, 2012, October 4, 2013, October 4, 2014 and October 4, 2015 (vesting of the shares would accelerate upon a Change of Control (as defined in the Stockholders Agreement) or in the event of Mr. Sonstebly's death, disability or termination by the Company without cause). Mr. Sonstebly will receive all dividends and distributions, if any, paid with respect to the shares of restricted stock he holds, but if any such dividends or distributions are paid in shares of our capital stock, such shares will be subject to the same restrictions on transferability as are the shares of restricted stock with respect to which they were paid.
- (4) Stock options were granted to Mr. Pappas on July 2, 2009 in connection with the Company's Exchange Offer, with 12,618 of these options immediately exercisable on the grant date based on the period of time that his exchanged options had been held in relation to the total term of the option and the remaining options vest at the rate of 20% on each of July 2, 2010, July 2, 2011, July 2, 2012, July 2, 2013 and July 2, 2014, or immediately upon a Change of Control (as defined in the Stockholders Agreement). For more information regarding the Exchange Offer, see Note 6 to the consolidated financial statements. Mr. Pappas's restricted stock awards vest 20% on each of April 17, 2010, April 17, 2011, April 17, 2012, April 17, 2013 and April 17, 2014 (vesting of the shares would accelerate upon Change of Control (as defined in the Stockholders Agreement) or in the event of Mr. Pappas's death, disability or termination by the Company without cause). Mr. Pappas will receive all dividends and distributions, if any, paid with respect to the shares of restricted stock he holds, but if any such dividends or distributions are paid in shares of our capital stock, such shares will be subject to the same restrictions on transferability as are the shares of restricted stock with respect to which they were paid.
- (5) Stock options were granted to Ms. Puleo on July 26, 2010, vesting at the rate of 20% on each of March 8, 2011, March 8, 2012, March 8, 2013, March 8, 2014 and March 8, 2015, or immediately upon a Change of Control (as defined in the Stockholders Agreement).
- (6) Stock options were granted to Mr. Wyatt on July 26, 2010, vesting at the rate of 20% on each of June 21, 2011, June 21, 2012, June 21, 2013, June 21, 2014 and June 21, 2015, or immediately upon a Change of Control (as defined in the Stockholders Agreement).
- (7) Stock options were granted to Mr. Jablonski on July 2, 2009 in connection with the Company's Exchange Offer, with 14,384 of these options immediately exercisable on the grant date based on the period of time that his exchanged options had been held in relation to the total term of the option and the remaining options vest at the rate of 20% on each of July 2, 2010, July 2, 2011, July 2, 2012, July 2, 2013 and July 2, 2014, or immediately upon a Change of Control (as defined in the Stockholders Agreement). For more information regarding the Exchange Offer, see Note 6 to the consolidated financial statements.
- (8) Ms. Crowley separated from the Company on August 6, 2010, and exercised 30,279 vested options within 60 days of her departure. In accordance with the terms of the 2006 Equity Incentive Plan and her option agreement, all remaining options previously granted to her have been cancelled.

Option Exercises and Stock Vested for Fiscal 2010

The following table shows the number of stock options exercised by our Named Executive Officers, and stock awards held by our Named Executive Officers that vested, during fiscal year 2010.

Edgar Filing: MICHAELS STORES INC - Form 10-K

Name	Option Awards		Stock Awards	
	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise (\$)(1)	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting (\$)(1)
John B. Menzer <i>Chief Executive Officer</i>				
Charles M. Sonstebly <i>Chief Administrative Officer and Chief Financial Officer</i>				
Philo T. Pappas <i>Executive Vice President Category Management</i>			2,342	27,050(2)
Paula A. Puleo <i>Senior Vice President Chief Marketing Officer</i>				
John J. Wyatt <i>Senior Vice President Corporate Development</i>				
Richard S. Jablonski <i>Vice President Financial Planning & Analysis</i>				
Elaine D. Crowley <i>Former Chief Financial Officer</i>	30,279	122,630(3)		

(1) Because the Company is a privately-held company and there is no market for our Common Stock, the fair market value of our Common Stock is determined by our Board of Directors based on available information that is material to the value of our Common Stock, including any third party valuation reports, the principal amount of the Company's indebtedness, the Company's actual and projected financial results, and fluctuations in the market value of publicly-traded companies in the retail industry.

(2) The shares were valued on the April 17, 2010 vesting date for Mr. Pappas's restricted shares.

(3) The dollar value reflects the difference in the fair market value of our Common Stock at the time of exercise and the option's exercise price. Ms. Crowley did not realize this amount, as she retained ownership of the shares received upon exercise.

Pension Benefits for Fiscal 2010

The Company has no pension plans.

Nonqualified Deferred Compensation for Fiscal 2010

The Company has no nonqualified deferred compensation plans.

Potential Payments upon Termination or Change of Control

Mr. Menzer's employment contract, as amended, which commenced April 6, 2009, specifies certain benefits that are payable to him in the event of termination. Mr. Sonstebly, Mr. Pappas, Ms. Puleo, Mr. Wyatt and Mr. Jablonski participate in the OSPP, adopted by the Board in April 2008 and amended in July 2008. Prior to her resignation effective August 6, 2010, Ms. Crowley was entitled to participate in the OSPP. In addition, each of the Named Executive Officers may be entitled to acceleration of their equity awards in the event of a termination or Change of Control, depending on the specific circumstance as set forth below.

The payments for which the Named Executive Officers are eligible under various circumstances related to termination or a Change of Control are detailed below, except for Ms. Crowley, whose actual payments received upon her separation from the Company are described below under Rights and Potential Payments on Termination for Cause, Death, Disability and Voluntary Resignation - Voluntary Resignation.

Rights and Potential Payments on Termination for Cause, Death, Disability and Voluntary Resignation

Cause. Each of the respective agreements and the OSPP provide that no payments or benefits are due to the Named Executive Officer in the event of a termination for cause except amounts accrued and payable to such executive through the termination date.

Death. Each Named Executive Officer is provided a life insurance policy by the Company with a \$1,000,000 benefit (\$500,000 in the case of Mr. Jablonski), which would be payable to the executive's beneficiaries upon such executive's death. Under his employment agreement, Mr. Menzer's beneficiaries are further entitled to an amount equal to his pro-rated bonus for the year in which death occurs. Under the 2006 Equity Incentive Plan, the executive's estate has the option to exercise any vested stock options held by the Named Executive Officer prior to his death. Under the Stockholders Agreement, upon any termination of a Named Executive Officer's employment by reason of the executive's death, the executive's estate has the option to sell to the Company all or any portion of the vested shares of the Common Stock owned by the Named Executive Officer within 60 days after the date of termination, at the fair market value of the shares as of the date they are repurchased. In addition, pursuant to their restricted stock agreements, upon death 133,333 shares of Mr. Menzer's unvested restricted stock and all of Messrs. Sonstebly's and Pappas's unvested restricted stock would vest. Assuming the executive's death on January 29, 2011, the last day of our fiscal year, and that the executive's estate exercised its option to exercise any vested stock options held by the Named Executive Officer at such time and to sell to the Company all of the shares owned by the Named Executive Officer, the estate of each Named Executive Officer would have realized, based on the fair market value of the Common Stock as of fiscal year end (\$15.22), the following amounts for his or her shares: John B. Menzer, \$3,352,656; Charles M. Sonstebly, \$581,404; Philo T. Pappas, \$419,752; Paula A. Puleo, \$0; John J. Wyatt, \$0; and Richard S. Jablonski, \$46,341.

Disability. The Company provides each Named Executive Officer with an executive long-term disability policy for the benefit of such executives which would provide disability benefits after 90 days of the executive becoming disabled in the amount of 67% of monthly compensation up to \$20,000 per month. This benefit generally continues until the disability is resolved or age 65. Mr. Menzer is further entitled to his full salary for the 90 days prior to the commencement of disability benefits, which equates to \$253,233 (based on his fiscal 2010 base salary), paid in accordance with the Company's normal payroll practices. Under the Stockholders Agreement, upon any termination of a Named Executive Officer's employment by reason of the executive's disability, the executive has the option to sell to the Company all or any portion of the vested shares of the Common Stock owned by the Named Executive Officer within 60 days after the date of termination, at the fair market value of the shares as of the date they are repurchased. In addition, pursuant to their restricted stock agreements, upon disability 133,333 shares of Mr. Menzer's unvested restricted stock and all of Messrs. Sonstebly's and Pappas's unvested restricted stock would vest. Assuming the executive exercised his or her option to sell to the Company all of the shares owned by the Named Executive Officer upon disability on the last day of fiscal 2010, the Named Executive Officer would have received, based on the fair market value of the Common Stock as of fiscal year end (\$15.22), the following amounts for his or her shares: John B. Menzer, \$2,029,328; Charles M. Sonstebly, \$581,404; Philo T. Pappas, \$178,226;

Edgar Filing: MICHAELS STORES INC - Form 10-K

Paula A. Puleo, \$0; John J. Wyatt, \$0; and Richard S. Jablonski, \$0.

Voluntary Resignation. In the event of a voluntary resignation of any of the Named Executive Officers, there are no payments or benefits that continue beyond what is accrued and payable through the termination date. Mr. Menzer's agreement states that he is required to give the Company 60 days prior written notice of resignation and the Board may, at its election, choose to waive Mr. Menzer's notice obligation but is still required to pay him for the applicable notice period. Ms. Crowley resigned effective August 6, 2010, and exercised 30,279 vested options within 60 days of her departure. Based on the fair market value of the Common Stock as of fiscal year end (\$15.22), if Ms. Crowley had sold her shares on January 29, 2011, the last day of our fiscal year, she would have realized a gain on her shares of \$233,754. In accordance with the terms of the 2006 Equity Incentive Plan and her option agreement, all remaining options previously granted to her have been cancelled.

Rights and Potential Payment Upon a Change of Control or Termination Without Cause or With Good Reason

Menzer Employment Agreement

Mr. Menzer's employment agreement provides benefits to him in the event of a termination of his employment without cause or by him for good reason, as defined below. In either circumstance, for the two-year period following the date of termination he would be entitled to receive a severance benefit equal to (i) his base salary at the rate in effect on the date of termination, (ii) the amount of his annual target bonus for the year of termination and (iii) continued medical benefits. These benefits are contingent on Mr. Menzer signing and returning to the Company a release of claims in the form provided by the Company. The severance pay is payable on a pro-rated basis at the Company's regular payroll periods and in accordance with its normal payroll practices.

Pursuant to Mr. Menzer's agreement, "cause" means the following events or conditions, as determined by the Board in its reasonable judgment: (i) the refusal or failure to perform (other than by reason of disability), or material negligence in the performance of, his duties and responsibilities to the Company or any of its Affiliates (as defined in Mr. Menzer's agreement), or refusal or failure to follow or carry out any reasonable direction of the Board, and the continuance of such refusal, failure or negligence for a period of 10 days after notice; (ii) the material breach of any provision of any material agreement between Mr. Menzer and the Company or any of its Affiliates; (iii) fraud, embezzlement, theft or other dishonesty with respect to the Company or any of its Affiliates; (iv) the conviction of, or plea of nolo contendere to any felony or any other crime involving dishonesty or moral turpitude; and (v) any other conduct that involves a breach of fiduciary obligation.

The term "good reason" is defined as (i) removal without Mr. Menzer's consent from the position of Chief Executive Officer; (ii) a material diminution in the nature or scope of his responsibilities, duties or authority, provided however that the Company's failure to continue Mr. Menzer's appointment or election as a director or officer of any of its Affiliates, a change in reporting relationships resulting from the direct or indirect control of the Company (or successor corporation) by another corporation or other entity and any diminution of the business of the Company or any of its Affiliates or any sale or transfer of equity, property or other assets of the Company or any of its Affiliates does not constitute "good reason"; or (iii) the material failure of the Company to provide him the base salary and benefits in accordance with the terms of the agreement. To qualify as a termination for good reason under the agreement, notice to the Company must be given by Mr. Menzer and the Company must have failed to cure the good reason within thirty days of receiving notice.

In addition to an employment agreement, Mr. Menzer entered into agreements providing for his restricted stock grant and his stock option grant. These agreements provide that in the event Mr. Menzer's employment is terminated without cause or by him for good reason (as defined in his employment agreement), before April 6, 2011, 133,333 shares of Mr. Menzer's unvested restricted stock will vest. In addition, in the event of a Change of Control, all of Mr. Menzer's restricted stock and stock options immediately vest. Had a Change of Control occurred on the last day of fiscal 2010, the vested stock options would have a value of \$6,616,672 which is the difference in (i) the fair market value of the Common Stock as of fiscal year end (\$15.22) and \$7.50 per share, with respect to 833,334 shares exercisable, and (ii) the fair market value of the Common Stock as of fiscal year end (\$15.22) and \$15.00 per share, with respect to 833,333 shares exercisable. Mr. Menzer's remaining 833,333 shares are priced at exercise prices above the fair market value of the Common Stock and therefore have no value. Had a Change of Control occurred on the last day of fiscal 2010, Mr. Menzer's unvested restricted stock would have a value of \$7,610,000.

Mr. Menzer is subject to confidentiality covenants. In addition, Mr. Menzer is subject to non-competition and non-solicitation restrictions for a period of two years following resignation. The employment agreement provides no Change of Control severance benefits.

Officer Severance Pay Plan

In April 2008, the Board approved the OSPP, which was amended in July 2008. The OSPP was established by the Company to provide certain severance benefits, subject to the terms and conditions of the OSPP, to designated officers (those with a position of Vice President or above, or an equivalent title as approved by the Compensation Committee, and excluding the Chief Executive Officer) in the event that their employment is permanently terminated as a result of a Qualifying Termination. For purposes of the OSPP, an executive is subject to a Qualifying Termination if:

- the executive is on active payroll or is on an approved leave of absence with a right to reinstatement at the time his or her employment terminates;
- the executive's employment is terminated by the Company other than for Cause (which includes a failure to perform - or material negligence in the performance of - the executive's duties, a material breach of a material agreement between the executive and the Company, fraud, embezzlement, theft, other dishonesty, the conviction of or plea of guilty or *nolo contendere* to a crime involving dishonesty of moral turpitude, breach of a fiduciary duty to the Company or violation of Company policy that inflicts damage to the Company) and other than a result of death or disability;
- the executive is not offered, nor has accepted, other employment with (1) an affiliate of the Company, (2) a successor of the Company, or (3) a purchaser of some or all of the assets of the Company, in each case: (a) in a position which the executive is qualified to perform regardless of whether the executive is subject to, among other things, a new job title, different reporting relationships or a modification of the executive's duties and responsibilities; (b) in a position that, when compared with the executive's last position with the Company, provides a comparable base salary and bonus opportunity; and (c) where there is no change in the executive's principal place of employment to a location more than 35 miles from the executive's principal place of employment immediately prior to the Qualifying Termination; and
- the executive continues employment until the termination date designated by the Company or such earlier date to which the Company agrees, and, during the period from the date the executive receives notice of termination until the termination date, the executive continues to perform to the reasonable satisfaction of the Company.

Executives subject to a Qualifying Termination are entitled to the following benefits:

- severance pay, payable in accordance with the Company's normal payroll practices, at the following levels: (i) for the position of Vice President with less than two years of service, six months of base salary continuation; (ii) for the position of Vice President with two or more years of service, twelve months of base salary continuation; (iii) for the position of Senior Vice President, Executive Vice President or President with less than two years of service, twelve months of base salary continuation; and (iv) for the position of Senior Vice President, Executive Vice President or President with two or more years of service, eighteen months of base salary continuation;
- a prorated target annual bonus for the year of termination; and

- the continuation of welfare and fringe benefits for the salary continuation period.

In order to obtain severance benefits under the OSPP, an executive must first execute a severance agreement and release with Michaels that includes a waiver and release of any and all claims against Michaels and a commitment that, for one year following termination, the executive will not solicit or hire any associate or distributor or vendor of Michaels or its subsidiaries and will not directly or indirectly compete with, or join an organization that directly or indirectly competes with, Michaels. Additionally, an executive officer will not be eligible for benefits under the OSPP if he or she is eligible for severance pay or other termination benefits (other than incidental perquisites such as continued use of a Company vehicle or an air travel allowance) under any other severance pay plan or under any employment agreement or other agreement with the Company or any of its affiliates.

Equity Plans

As with our Chief Executive Officer, each of the other Named Executive Officers currently employed with the Company have entered into stock option agreements that provide for vesting upon a Change of Control. Additionally, Messrs. Sonstebly and Pappas have restricted stock agreements that provide that all their restricted stock shall vest upon a Change of Control. Had a Change of

Control occurred on the last day of fiscal 2010, each Named Executive Officer would have realized the following values for their vested options (based on the spread, if any, of the fair market value of the Common Stock as of fiscal year end (\$15.22) over the value of the applicable exercise prices for the options) : Charles M. Sonstebly \$183,540; Philo T. Pappas, \$1,202,085; Paula A. Puleo, \$368,087; John J. Wyatt, \$294,473; and Richard S. Jablonski, \$225,401. Had a Change of Control occurred on the last day of fiscal 2010, Mr. Sonstebly's and Mr. Pappas's unvested restricted stock would have values of \$581,404 and \$142,581, respectively.

Estimated Separation Payments

The table below reflects the amount of compensation payable in the event of an involuntary termination without cause or resignation for good reason (1) to Mr. Menzer under his employment agreement (including his restricted stock agreement) and (2) under the OSPP described above to each of the other Named Executive Officers. The amounts shown in the table for the Named Executive Officers, other than Ms. Crowley, assume that the executive's termination was effective as of the last day of the prior fiscal year, January 29, 2011 (Ms. Crowley, did not receive any separation payments in connection with her voluntary resignation from the Company effective August 6, 2010, as described above under Rights and Potential Payments on Termination for Cause, Death, Disability and Voluntary Resignation - Voluntary Resignation). The actual amounts, or value, to be paid to these Named Executive Officers can only be determined at the time of such executive's separation from the Company.

**Executive Payments and Benefits upon
Termination Without Cause or by
Executive with Good Reason (\$)**

<i>John B. Menzer</i>	
Salary	2,054,000
Bonus	2,054,000
Restricted Stock	7,610,000
Welfare Benefits	80,034(1)
Automobile	27,077(2)
Total	11,825,111
<i>Charles M. Sonstebly</i>	
Salary	650,000
Bonus	148,342(3)
Restricted Stock	581,404
Welfare Benefits	46,746(4)
Total	1,426,492
<i>Philo T. Pappas</i>	
Salary	386,251
Bonus	193,125
Restricted Stock	142,581
Welfare Benefits	46,746(4)
Total	768,703
<i>Paula A. Puleo</i>	
Salary	300,000
Bonus	112,767(3)
Welfare Benefits	24,289(4)
Total	437,056
<i>John J. Wyatt</i>	
Salary	275,000
Bonus	67,507(3)
Welfare Benefits	46,746(4)
Total	389,253
<i>Richard S. Jablonski</i>	
Salary	213,675
Bonus	74,786
Welfare Benefits	46,746(4)
Total	335,207

(1) Represents estimated value of two years of continued benefits, including medical, long-term disability, life insurance, and executive and spouse physicals.

(2) Represents personal use of automobile for 24 months.

Edgar Filing: MICHAELS STORES INC - Form 10-K

(3) Represents the value of a prorated target bonus for fiscal 2010, based on the number of days the Named Executive Officer was employed with the Company during fiscal 2010.

(4) Represents the value of total fiscal 2010 medical, dental and vision actual costs plus an estimated annual increase of 12% associated with providing these benefits for 12 months.

Share Repurchase Rights

As described above, under the Stockholders Agreement, upon any termination of a Named Executive Officer's employment by reason of the executive's death or disability, the executive or his/her estate has the option to sell to the Company all or any portion of the vested shares of the Common Stock owned by the Named Executive Officer within 60 days after the date of termination, at the fair market value of the shares as of the date they are repurchased.

In addition, upon termination of a Named Executive Officer's employment for any reason, the Company has the option to purchase all or any portion of the executive's shares that were originally purchased from the Company, at the fair market value of the shares. If the Company elects to purchase the executive's shares, it must deliver notice to the executive no later than 240 days after (but not before the date that is one day after the six-month anniversary of) the later of (i) the date of termination or (ii) the exercise of any option originally granted to the executive or the date upon which any unvested shares granted to the executive become vested shares. With respect to those shares issued to a Named Executive Officer directly or indirectly pursuant to an incentive plan, the Company may purchase all or any portion of the executive's shares at the fair market value of the shares (upon delivery of the notice as described in the immediately preceding sentence), if the executive's employment is terminated due to death, disability, by the Company without cause or by the executive for good reason (or in circumstances in which the Company would have no grounds to terminate the executive for cause). If the Named Executive Officer's employment is terminated by the Company for cause, the Company may purchase all or any portion of the executive's shares at the lesser of the cost or the fair market value of the shares.

Assuming the Company exercised its option to repurchase the vested or purchased shares held by the Named Executive Officers on the last day of fiscal 2010, the Named Executive Officers would have received, based on the fair market value of the Common Stock as of fiscal year end (\$15.22), the following amounts for their shares: John B. Menzer, \$0; Charles M. Sonstebly, \$0; Philo T. Pappas, \$35,645; Paula A. Puleo, \$0; John J. Wyatt, \$0; Richard S. Jablonski, \$0; and Elaine D. Crowley, \$460,846.

Director Compensation for Fiscal 2010

The current directors are not paid any fees for services as directors, and they do not receive reimbursement for their expenses.

Compensation Committee Interlocks and Insider Participation

From the completion of the Merger to March 2011, our Compensation Committee was comprised of two members: Michael S. Chae and Matthew S. Levin. In March 2011, Peter F. Wallace was appointed to the Compensation Committee to fill a vacancy created by the resignation of Mr. Chae from the Committee. Each of the members of our Compensation Committee is affiliated with our Sponsors and has not been deemed an independent director. No executive officer of the Company served on the compensation committee (or equivalent), or the board of directors, of another entity whose executive officer(s) served on our Compensation Committee or Board.

PART III

ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

PRINCIPAL STOCKHOLDERS AND MANAGEMENT OWNERSHIP

The following table presents information regarding the number of shares of Michaels Common Stock beneficially owned as of March 21, 2011 (unless otherwise indicated) by each of Michaels' directors and the Named Executive Officers (as defined in Item 11. Executive Compensation Compensation Discussion and Analysis Executive and Director Compensation Summary Compensation Table), and the current directors and executive officers of Michaels as a group. In addition, the table presents information about each person or entity known to Michaels to beneficially own 5% or more of Michaels Common Stock. Unless otherwise indicated by footnote, the beneficial owner exercises sole voting and investment power over the shares noted below. The percentage of beneficial ownership for our directors and executive officers, both individually and as a group, is calculated based on 118,967,418 shares of Michaels Common Stock outstanding as of March 21, 2011, and the number of unissued shares as to which such person or persons has the right to acquire voting and/or investment power within 60 days. Other than beneficial ownership information relating to the Company's executive officers, the beneficial ownership information set forth below was provided by or on behalf of our Directors, our Sponsors, and Highfields, and the Company has not independently verified the accuracy or completeness of the information so provided.

Edgar Filing: MICHAELS STORES INC - Form 10-K

Name of Beneficial Owner	Amount and Nature of Beneficial Ownership (1)	Percent of Class (1)
Josh Bekenstein (2)		*
Michaels S. Chae (3)		*
Todd M. Cook (2)		*
Lewis S. Klessel (2)		*
Matthew S. Levin (2)		*
Gerry M. Murphy (3)		*
James A. Quella (3)		*
Peter F. Wallace (3)		*
John B. Menzer	1,500,000(4)	1.3%
Charles M. Sonsteby	38,200	*
Philo T. Pappas	112,641(5)	*
Paula A. Puleo	56,774(6)	*
John J. Wyatt		*
Richard S. Jablonski	28,539(7)	*
Elaine D. Crowley	30,279(8)	*
Michaels Holdings, LLC (2) (3)	110,373,482	92.8%
Bain Capital Investors, LLC and related funds (2)	110,373,482	92.8%
Affiliates of The Blackstone Group, L.P. (3)	110,373,482	92.8%
Highfields Capital Management, L.P. and related funds (9)	7,333,250	6.2%
All current directors and executive officers as a group (18 persons)	2,537,648(10)	2.1%

* Less than one percent.

(1) Pursuant to Rule 13d-3 under the Securities Exchange Act of 1934, a person has beneficial ownership of any securities as to which such person, directly or indirectly, through any contract, arrangement, undertaking, relationship or otherwise has or shares voting power and/or investment power or as to which such person has the right to acquire such voting and/or investment power within 60 days. Percentage of beneficial ownership by a person as of a particular date is calculated by dividing the number of shares beneficially owned by such person by the sum of the number of shares outstanding as of such date and the number of unissued shares as to which such person has the right to acquire voting and/or investment power within 60 days. Unless otherwise indicated, the number of shares shown includes outstanding shares of Common Stock owned as of March 21, 2011 by the person indicated.

(2) Includes the 110,373,482 shares owned by Michaels Holdings LLC over which Bain Capital Investors, LLC and related funds may be deemed, as a result of their ownership of 50% of Michaels Holdings LLC's total outstanding shares and certain provisions of Michaels Holdings LLC's operating agreement, to have shared voting and dispositive power. Bain Capital Investors, LLC (BCI) is the administrative member of and makes investment and voting decisions on behalf of Bain Capital Integral Investors 2006, LLC. Investment and voting decisions by BCI are made jointly by three or more individuals who are managing directors of the entity, and therefore no individual managing director of BCI is the beneficial owner of the shares ultimately of Michaels Common Stock directly owned by Michaels Holdings LLC. Messrs. Bekenstein, Cook and Levin are Managing Directors and Members of BCI, and they may therefore be deemed to share voting and dispositive power with respect to all the shares of Common Stock beneficially owned by Bain Capital Integral Investors 2006, LLC. Messrs. Bekenstein, Cook and Levin disclaim beneficial ownership of any shares beneficially owned by BCI. Mr. Klessel does not have voting or dispositive power over any shares of Common Stock that may be deemed to be beneficially owned by BCI. The address of Messrs. Bekenstein, Cook and Levin, and each of the Bain entities is c/o Bain Capital Partners, LLC, 111 Huntington Avenue, Boston, Massachusetts 02199.

(3) Includes the 110,373,482 shares owned by Michaels Holdings LLC over which affiliates of The Blackstone Group L.P. may be deemed, as a result of their ownership of 50% of Michaels Holdings LLC's total outstanding shares and certain provisions of Michaels Holdings LLC's operating agreement, to have shared voting and dispositive power. Affiliates of The Blackstone Group L.P. include Blackstone Capital

Edgar Filing: MICHAELS STORES INC - Form 10-K

Partners V L.P., BCP V-S L.P., Blackstone Family Investment Partnership V L.P., Blackstone Family Investment Partnership V-A L.P., Blackstone Participation Partnership V L.P. and BCP V Co-Investors L.P. (collectively, the Blackstone Funds). Blackstone Management Associates V L.L.C. (BMA V) is the general partner of each of the Blackstone Funds. BMA V L.L.C. (BMA) is the sole member of BMA V, and may, therefore, be deemed to have shared

Edgar Filing: MICHAELS STORES INC - Form 10-K

voting and investment power over the shares. Investment and voting decisions by BMA are made jointly by three or more individuals who are managing directors, and therefore no individual managing director of BMA is the beneficial owner of the shares of Michaels Common Stock directly owned by Michaels Holdings LLC. Messrs. Chae, Murphy, Quella and Wallace are members of BMA, and they may therefore be deemed to share voting and dispositive power with respect to the shares. Messrs. Chae, Murphy, Quella and Wallace disclaim any beneficial ownership of any shares beneficially owned by BMA. The address of Messrs. Chae, Murphy, Quella and Wallace, and each of the Blackstone entities is c/o The Blackstone Group, L.P., 345 Park Avenue, New York, New York 10154.

- (4) Includes 500,000 stock options that vested on April 6, 2010 and 500,000 stock options that will vest on April 6, 2011.
- (5) Includes 12,618 stock options that vested on July 2, 2009 and 88,313 stock options that vested on July 2, 2010.
- (6) Includes 56,774 stock options that vested on March 8, 2011.
- (7) Includes 14,384 stock options that vested on July 2, 2009 and 14,155 stock options that vested on July 2, 2010.
- (8) Ms. Crowley separated from the Company on August 6, 2010.
- (9) The address of Highfields Capital Management, LP and its related funds is 200 Clarendon Street, Boston, Massachusetts 02116.
- (10) Consistent with the disclaimers of beneficial ownership of Messrs. Bekenstein, Cook, Levin, Chae, Murphy, Quella and Wallace contained in notes (2) and (3) above, this number does not include the 110,373,482 shares of Michaels Common Stock that may be deemed to be beneficially owned by each of (a) Bain Capital Investors, LLC and related funds and (b) Affiliates of The Blackstone Group. The total includes 1,935,736 vested options or options that will vest within 60 days of March 21, 2011, held by executive officers of the Company.

EQUITY COMPENSATION PLAN INFORMATION

On February 15, 2007, the Board of Directors and stockholders approved the 2006 Equity Incentive Plan, as well as certain specific grants under the plan to key employees. In addition, the stockholders granted the Board authority to make plan grants to other eligible participants in the future, which has occurred. The following table gives information about equity awards under the above-mentioned plan as of March 21, 2011.

Plan Category	Number of securities to be issued	Weighted-average exercise	Number of securities remaining available for future
----------------------	--	----------------------------------	--

Edgar Filing: MICHAELS STORES INC - Form 10-K

	upon exercise of outstanding options, warrants and rights (a)	price of outstanding options, warrants and rights (b)	issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity Compensation plans approved by security holders	11,360,380	15.41	2,789,017
Equity compensation not approved by security holders	N/A	N/A	N/A
Total	11,360,380	15.41	2,789,017

ITEM 13. Certain Relationships and Related Transactions, and Director Independence.

In connection with the completion of the Merger, we entered into management agreements with each of the Sponsors pursuant to which the Sponsors will provide management services to us until December 31, 2016, with evergreen extensions thereafter. Pursuant to these agreements, the Sponsors receive an aggregate annual management fee in the amount of \$12 million and reimbursement for out-of-pocket expenses in connection with the provisions of services pursuant to the agreements. The management agreements also provide that the Sponsors are entitled to receive fees in connection with certain subsequent financing, acquisition, disposition and change of control transactions of 1% of the gross value of any such transaction. The management agreements contain customary exculpation and indemnification provisions in favor of the Sponsors. The management agreements may be terminated by the Sponsors at any time and terminate automatically upon an initial public offering or a change of control unless we and the Sponsors determine otherwise. Upon termination, each provider of management services will be entitled to a termination fee calculated based on the present value of the annual fees due during the remaining period from the date of termination to October 31, 2016.

In connection with the completion of the Merger, we entered into a management agreement with Highfields Capital Management LP, an affiliate of Highfields Capital Partners, that provides for an annual management fee of \$1.0 million for services that Highfields Capital Management LP renders to us.

We have a participation agreement with CoreTrust Purchasing Group (CPG), a division of HealthTrust Purchasing, designating CPG as our exclusive group purchasing organization for the purchase of certain non-merchandise products and services from third party vendors. CPG secures from vendors pricing terms for goods and services that are believed to be more favorable than participants in the group purchasing organization could obtain for themselves on an individual basis. In connection with purchases by its participants (including us), CPG receives a commission from the vendors in respect of such purchases. Although CPG is not affiliated with Blackstone, in consideration for Blackstone facilitating our participation in CPG and monitoring the services CPG provides to us, CPG remits a portion of the commissions received from vendors in respect of our purchases under the agreement to an affiliate of Blackstone.

Bain owns an approximate 58% equity position in an external vendor we utilize to print our circular advertisements. Payments associated with this vendor during fiscal 2010 were \$39.1 million. We currently anticipate our payments to this vendor in fiscal 2011 will be \$6.0 million.

Bain owns an approximate 51% equity position in an external vendor we entered into an agreement with in the fourth quarter of fiscal 2010 to provide print procurement services. We currently anticipate our payments to this vendor in fiscal 2011 will be \$4.0 million.

Blackstone owns an approximate 68% equity position in an external vendor we utilize to count our store inventory. Payments associated with this vendor during fiscal 2010 were \$5.9 million. We currently anticipate that our payments to this vendor in fiscal 2011 will be commensurate with those in fiscal 2010.

Blackstone owns an approximate 71% equity position in an external vendor we utilize for all of the candy-type items in our stores. Payments associated with this vendor during fiscal 2010 were \$19.1 million. We currently anticipate that our payments to this vendor in fiscal 2011 will be commensurate with those in fiscal 2010.

Edgar Filing: MICHAELS STORES INC - Form 10-K

During the second quarter of fiscal 2008, the Company entered into an employer health program agreement with Equity Healthcare LLC (Equity Healthcare), an affiliate of Blackstone. Equity Healthcare negotiates with providers of standard administrative services for health benefit plans as well as other related services for cost discounts and quality of service monitoring capability by Equity Healthcare. Because of the combined purchasing power of its client participants, Equity Healthcare is able to negotiate pricing terms for providers that are believed to be more favorable than the companies could obtain for themselves on an individual basis. In consideration for Equity Healthcare's provision of access to these favorable arrangements and its monitoring of the contracted third parties' delivery of contracted services to us, we pay Equity Healthcare a fee of \$2 per participating employee per month (PEPM Fee). As we had approximately 5,700 employees enrolled in health and welfare benefit plans as of January 29, 2011, the annual amount payable under the agreement would be approximately \$0.1 million.

Equity Healthcare may also receive a fee (Health Plan Fees) from one or more of the health plans with whom Equity Healthcare has contractual arrangements if the total number of employees joining such health plans from participating companies exceeds specified thresholds. If and when Equity Healthcare reaches the point at which the aggregate of its receipts from the PEPM Fee and the Health Plan Fees have covered all of its allocated costs, it will apply the incremental revenues derived from all

Edgar Filing: MICHAELS STORES INC - Form 10-K

such fees to (a) reduce the PEPM Fee otherwise payable by us; (b) avoid or reduce an increase in the PEPM Fee that might otherwise have occurred on contract renewal; or (c) arrange for additional services to us at no cost or reduced cost.

Blackstone owns an approximate 6% equity position in an external vendor we utilize for waste management services. Payments associated with this vendor during fiscal 2010 were \$4.6 million. We currently anticipate that our payments to this vendor in fiscal 2011 will be commensurate with those in fiscal 2010.

Blackstone owns an approximate 99% equity position in an external vendor we utilize for hospitality services. Payments associated with this vendor during fiscal 2010 were \$1.1 million. We currently anticipate that our payments to this vendor in fiscal 2011 will be commensurate with those in fiscal 2010.

Blackstone owns an approximate 99% equity position in an external vendor we utilize as our preferred hotel provider. Payments associated with this vendor during fiscal 2010 were \$0.2 million. We currently anticipate that our payments to this vendor in fiscal 2011 will be commensurate with those in fiscal 2010.

Blackstone owns an approximate 12% equity position in an external vendor we utilize for certain integrated software and processing services. Payments associated with this vendor during fiscal 2010 were \$0.2 million. We currently anticipate that our payments to this vendor in fiscal 2011 will be commensurate with those in fiscal 2010.

Our current directors are affiliates of Bain or Blackstone. As such, some or all of our directors may have an indirect material interest in payments with respect to debt securities of the Company that have been purchased, or for which transactions are pending, by affiliates of Bain and Blackstone. As of the date hereof, such affiliates did not hold any of our debt securities.

The Company, to date, has not adopted any formal policies or procedures for the review, approval or ratification of certain related-party transactions that may be required to be reported under the SEC disclosure rules. However, the Board believes that the transactions described in this Item 13 were on an arms-length basis and in the best interests of the stockholders.

As discussed in Item 10 above, each of the members of our Board is affiliated with the Sponsors and our Board has not determined any of our directors to be independent. See Item 10. Directors and Executive Officers of the Registrant.

ITEM 14. Principal Accountant Fees and Services.

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM S FEES

Edgar Filing: MICHAELS STORES INC - Form 10-K

The following table presents fees for professional audit services rendered by Ernst & Young LLP for the audit of Michaels' annual financial statements for each of fiscal 2010 and 2009, and fees billed for other services rendered by Ernst & Young LLP (in thousands).

	2010		2009	
Audit Fees (1)	\$	1,246	\$	1,134
Audit-Related Fees (2)		58		49
Tax Fees (3)		8		25

(1) Audit Fees consist principally of fees for the audit of our annual financial statements and review of our financial statements included in our quarterly reports on Form 10-Q for those years and audit services provided in connection with compliance with the requirements of the Sarbanes-Oxley Act of 2002.

(2) Audit-Related Fees for fiscal 2010 and fiscal 2009 consist principally of fees related to employee benefit plans and statutory audits.

(3) Tax Fees consist principally of tax compliance fees.

The Audit Committee Charter requires that the Audit Committee pre-approve all audit and non-audit engagements, fees, terms and services in a manner consistent with the Sarbanes-Oxley Act of 2002 and all rules and applicable listing standards promulgated by the SEC, except that such non-audit services need not be pre-approved if (i) the aggregate amount of all such non-audit services provided to Michaels constitutes not more than 5% of the total amount of fees paid by Michaels to its independent registered public

accounting firm during the fiscal year in which the non-audit services are provided, (ii) such services were not recognized by Michaels at the time of engagement to be non-audit services, and (iii) such services were promptly brought to the attention of the Audit Committee and approved by the Audit Committee prior to completion of the audit. The Audit Committee Charter permits the Audit Committee, at the time of the annual audit engagement, to pre-approve audit fees of up to 15% of the engagement fees for unanticipated additional audit costs within the scope of the audit, subject to the approval, before or after such additional costs are incurred, by the Chairman of the Audit Committee or any other member of the Audit Committee to whom the Audit Committee delegates such authority. The services performed by Ernst & Young LLP in fiscal 2010 and 2009 were approved in accordance with the policies and procedures established by the Audit Committee.

PART IV

ITEM 15. Exhibits and Financial Statement Schedules.

a) The following documents are filed as a part of this report:

(1) Consolidated Financial Statements:

See Index to Consolidated Financial Statements and Supplementary Data on page F-1.

(2) Exhibits:

The exhibits listed in the accompanying Index to Exhibits attached hereto are filed or incorporated by reference into this Annual Report on Form 10-K.

MICHAELS STORES, INC.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following Consolidated Financial Statements of Michaels Stores, Inc. are included in response to Item 8:

<u>Reports of Independent Registered Public Accounting Firm</u>	F-2
<u>Consolidated Balance Sheets at January 29, 2011 and January 30, 2010</u>	F-4
<u>Consolidated Statements of Operations for the fiscal years ended January 29, 2011, January 30, 2010, and January 31, 2009</u>	F-5
<u>Consolidated Statements of Cash Flows for the fiscal years ended January 29, 2011, January 30, 2010, and January 31, 2009</u>	F-6
<u>Consolidated Statements of Stockholders' (Deficit) Equity for the fiscal years ended January 29, 2011, January 30, 2010, and January 31, 2009</u>	F-7
<u>Notes to Consolidated Financial Statements for the fiscal years ended January 29, 2011, January 30, 2010, and January 31, 2009</u>	F-8
<u>Unaudited Supplemental Quarterly Financial Data for the fiscal years ended January 29, 2011 and January 30, 2010</u>	F-37

All schedules have been omitted because they are not applicable or the required information is included in the financial statements or the notes thereto.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders

Michaels Stores, Inc.

We have audited the accompanying consolidated balance sheets of Michaels Stores, Inc. (the Company) as of January 29, 2011 and January 30, 2010, and the related consolidated statements of operations, stockholders' (deficit) equity, and cash flows for each of the three years in the period ended January 29, 2011. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Michaels Stores, Inc. at January 29, 2011 and January 30, 2010 and the consolidated results of its operations and its cash flows for each of the three years in the period ended January 29, 2011, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Michaels Stores, Inc.'s internal control over financial reporting as of January 29, 2011, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 24, 2011 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Dallas, TX

March 24, 2011

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders

Michaels Stores, Inc.

We have audited Michaels Stores, Inc.'s (the Company) internal control over financial reporting as of January 29, 2011, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Michaels Stores, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management Report on Internal Control over Financial Reporting (see Item 9A). Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Michaels Stores, Inc. maintained, in all material respects, effective internal control over financial reporting as of January 29, 2011, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Michaels Stores, Inc. as of January 29, 2011 and January 30, 2010, and the related consolidated statements of operations, stockholders' (deficit) equity, and cash flows for each of the three years in the period ended January 29, 2011 of Michaels Stores, Inc. and our report dated March 24, 2011 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Dallas, TX

March 24, 2011

F-3

MICHAELS STORES, INC.

CONSOLIDATED BALANCE SHEETS

(In millions except share data)

	January 29, 2011	January 30, 2010
ASSETS		
Current assets:		
Cash and equivalents	\$ 319	\$ 217
Merchandise inventories	826	873
Prepaid expenses and other	73	72
Deferred income taxes	56	45
Income tax receivable	1	
Total current assets	1,275	1,207
Property and equipment, at cost		
	1,329	1,257
Less accumulated depreciation	(1,028)	(940)
Property and equipment, net	301	317
Goodwill		
	95	94
Debt issuance costs, net of accumulated amortization of \$60 at January 29, 2011 and \$56 at January 30, 2010		
	72	70
Deferred income taxes		
	18	1
Other assets		
	9	21
Total non-current assets	194	186
Total assets	\$ 1,770	\$ 1,710
LIABILITIES AND STOCKHOLDERS DEFICIT		
Current liabilities:		
Accounts payable	\$ 273	\$ 231
Accrued liabilities and other	384	356
Current portion of long-term debt	1	119
Income taxes payable	29	11
Total current liabilities	687	717
Long-term debt		
	3,667	3,684
Deferred income taxes		
	4	
Other long-term liabilities		
	76	80
Total long-term liabilities	3,747	3,764
Total liabilities	4,434	4,481
Commitments and contingencies		
Stockholders deficit:		
Common Stock, \$0.10 par value, 220,000,000 shares authorized; 118,419,850 shares issued and outstanding at January 31, 2011; 118,387,229 shares issued and outstanding at January 30, 2010	12	12
Additional paid-in capital	43	35
Accumulated deficit	(2,726)	(2,824)
Accumulated other comprehensive income	7	6
Total stockholders deficit	(2,664)	(2,771)
Total liabilities and stockholders deficit	\$ 1,770	\$ 1,710

See accompanying Notes to Consolidated Financial Statements.

MICHAELS STORES, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In millions)

	2010	Fiscal Year 2009	2008
Net sales	\$ 4,031	\$ 3,888	\$ 3,817
Cost of sales and occupancy expense	2,467	2,423	2,431
Gross profit	1,564	1,465	1,386
Selling, general, and administrative expense	1,059	1,052	1,060
Related party expenses	14	14	16
Store pre-opening costs	3	2	6
Operating income	488	397	304
Interest expense	276	257	302
Loss on early extinguishment of debt	53		
Other (income) and expense, net	10	(17)	4
Income (loss) before income taxes	149	157	(2)
Provision for income taxes	51	50	3
Net income (loss)	\$ 98	\$ 107	\$ (5)

See accompanying Notes to Consolidated Financial Statements.

MICHAELS STORES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

	2010	Fiscal Year 2009	2008
Operating activities:			
Net income (loss)	\$ 98	\$ 107	\$ (5)
Adjustments:			
Depreciation and amortization	103	116	129
Share-based compensation	8	8	8
Debt issuance costs amortization	20	17	17
Accretion of subordinated discount notes	50	45	39
Change in fair value of interest rate cap	12	(10)	
Loss on early extinguishment of debt	53		
Changes in assets and liabilities:			
Merchandise inventories	47	34	(67)
Prepaid expenses and other	(1)	(2)	3
Deferred income taxes and other	(23)	(4)	(24)
Accounts payable	36	6	5
Accrued interest	(4)	15	(40)
Accrued liabilities and other	31	56	(4)
Income taxes payable	16	12	5
Other long-term liabilities	(8)	5	(7)
Net cash provided by operating activities	438	405	59
Investing activities:			
Business acquisition	(2)		
Additions to property and equipment	(81)	(43)	(85)
Net cash used in investing activities	(83)	(43)	(85)
Financing activities:			
Issuance of senior notes due 2018	794		
Repayments on senior notes due 2014	(791)		
Repayments on senior secured term loan facility	(228)	(23)	(24)
Borrowings on asset-based revolving credit facility	48	725	922
Payments on asset-based revolving credit facility	(48)	(873)	(871)
Payment of debt issuance costs	(34)		
Repurchase of Common Stock			(2)
Tax benefits from stock options			9
Payment of capital leases			(4)
Change in cash overdraft	6	(7)	
Net cash (used in) provided by financing activities	(253)	(178)	30
Net increase in cash and equivalents	102	184	4
Cash and equivalents at beginning of period	217	33	29
Cash and equivalents at end of period	\$ 319	\$ 217	\$ 33
Supplemental Cash Flow Information:			
Cash paid for interest	\$ 208	\$ 180	\$ 285
Cash paid for income taxes	\$ 64	\$ 26	\$ 15
Non-cash investing activity:			
Contingent consideration liability	\$ 4	\$	\$

See accompanying Notes to Consolidated Financial Statements.

MICHAELS STORES, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS (DEFICIT) EQUITY

For the Three Years Ended January 29, 2011

(In millions except share data)

	Number of Shares	Common Stock	Additional Paid-in Capital	Accumulated (Deficit)/ Retained Earnings	Accumulated Other Comprehensive Income/ (Loss)	Total
Balance at February 2, 2008	118,421,069	\$ 12	\$ 12	\$ (2,926)	\$ 10	\$ (2,892)
Comprehensive loss:						
Net loss				(5)		(5)
Foreign currency translation and other					(5)	(5)
Total comprehensive loss						(10)
Share based compensation and other				7		7
Tax benefit from stock options				9		9
Repurchase of stock	(111,334)			(2)		(2)
Issuance of stock	66,667			1		1
Balance at January 31, 2009	118,376,402	12	27	(2,931)	5	(2,887)
Comprehensive income:						
Net income				107		107
Foreign currency translation and other					1	1
Total comprehensive income						108
Share based compensation and other				8		8
Issuance of stock	10,827					
Balance at January 30, 2010	118,387,229	12	35	(2,824)	6	(2,771)
Comprehensive income:						
Net income				98		98
Foreign currency translation and other					1	1
Total comprehensive income						99
Exercise of stock options	37,848					
Share based compensation and other				8		8
Repurchase of stock	(7,569)					
Issuance of stock	2,342					
Balance at January 29, 2011	118,419,850	\$ 12	\$ 43	\$ (2,726)	\$ 7	\$ (2,664)

See accompanying Notes to Consolidated Financial Statements.

MICHAELS STORES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

Description of Business

Michaels Stores, Inc. (together with its subsidiaries, unless the text otherwise indicates) owns and operates a chain of specialty retail stores in 49 states and Canada featuring arts, crafts, framing, floral, home, and seasonal merchandise for the hobbyist and do-it-yourself home decorator. Our wholly-owned subsidiary, Aaron Brothers, Inc., operates a chain of framing and art supply stores located in 9 states.

Fiscal Year

We report on the basis of a 52 or 53-week fiscal year, which ends on the Saturday closest to January 31. References to fiscal year mean the year in which that fiscal year began. Fiscal 2010 ended on January 29, 2011, fiscal 2009 ended on January 30, 2010, and fiscal 2008 ended on January 31, 2009. Each of these three fiscal years contained 52 weeks.

Consolidation

Our consolidated financial statements include the accounts of Michaels Stores, Inc. and all wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated.

Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires us to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Foreign Currency Translation

Edgar Filing: MICHAELS STORES INC - Form 10-K

The functional currency of our Canadian operations is the Canadian dollar. Translation adjustments result from translating our Canadian subsidiary's financial statements into U.S. dollars. Balance sheet accounts are translated at exchange rates in effect at the balance sheet date. Income statement accounts are translated at average exchange rates during the year. Resulting translation adjustments are recorded as a component of accumulated other comprehensive income (loss) in our Consolidated Statements of Stockholders' (Deficit) Equity and as a part of other (income) and expense, net in our Consolidated Statements of Operations. The cumulative translation adjustment in fiscal 2010 was \$7 million, net of deferred taxes of \$5 million, while in fiscal 2009, the cumulative translation adjustment was \$6 million, net of deferred taxes of \$3 million. In fiscal 2010 and fiscal 2009, transaction gains of \$2 million and \$5 million, respectively, related to foreign currency exchange rates while fiscal 2008 results include transaction losses of \$4 million.

Cash and Equivalents

Cash and equivalents are comprised of highly liquid instruments with original maturities of three months or less and \$20 million and \$17 million of credit card clearing accounts as of January 29, 2011, and January 30, 2010, respectively. Cash equivalents are carried at cost, which approximates fair value. We record interest income earned from our cash and equivalents as a component of other (income) and expense, net, in our financial statements. In fiscal 2010, fiscal 2009 and fiscal 2008, we had an immaterial amount of interest income.

Merchandise Inventories

Merchandise inventories are valued at the lower of cost or market, with cost determined using a weighted average method. Cost is calculated based upon the price paid for an item at the time it is received by us, and also includes the cost of warehousing, handling, purchasing, and importing the inventory, as well as inbound and outbound transportation, partially offset by vendor allowances. This net inventory cost is recognized through Cost of sales when the inventory is sold. It is impractical for us to assign specific allocated overhead costs and vendor allowances to individual units of inventory. As such, to match net inventory costs against the related revenues, we estimate the net inventory costs to be deferred and recognized each period as the inventory is sold.

Vendor allowances, which primarily represent volume rebates and cooperative advertising funds, are recorded as a reduction of the cost of the merchandise inventories and a subsequent reduction in Cost of sales when the inventory is sold. We generally earn vendor allowances as a percentage of certain merchandise purchases with no minimum purchase requirements. Typically, our vendor allowance programs extend for a period of 12 months. We recognized vendor allowances of \$112 million, or 2.8% of net sales, in fiscal 2010, \$133 million, or 3.4% of net sales, in fiscal 2009, and \$149 million, or 3.9% of net sales, in fiscal 2008. During the three fiscal years ended January 29, 2011, the number of vendors from which vendor allowances were received ranged from approximately 670 to 770.

We utilize perpetual inventory records to value inventory in our stores. Physical inventory counts are performed in a significant number of stores during each fiscal quarter by a third party inventory counting service, with substantially all stores open longer than one year subject to at least one count each fiscal year. We adjust our perpetual records based on the results of the physical counts. We maintain a provision for estimated shrinkage based on the actual historical results of our physical inventories. We compare our estimates to the actual results of the physical inventory counts as they are taken and adjust the shrink estimates accordingly. We also evaluate our merchandise to ensure that the expected net realizable value of the merchandise held at the end of a fiscal period exceeds cost. In the event that the expected net realizable value is less than cost, we reduce the value of that inventory accordingly.

Property and Equipment

Property and equipment is recorded at cost. Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets. Amortization of property under capital leases is on a straight-line basis over the lease term and is included in depreciation expense. We expense repairs and maintenance costs as incurred. We capitalize and depreciate significant renewals or betterments that substantially extend the life of the asset. Useful lives are generally estimated as follows (in years):

Buildings	30
Leasehold improvements	10*
Fixtures and equipment	8
Computer equipment	5

* We amortize leasehold improvements over the lesser of 10 years or the remaining lease term of the underlying facility.

Capitalized Software Costs

We capitalize certain costs related to the acquisition and development of internal use software that is expected to benefit future periods. These costs are being amortized on a straight-line basis over the estimated useful life, which is generally five years. As of January 29, 2011 and January 30, 2010, we had unamortized capitalized software costs of \$46 million and \$42 million, respectively. These amounts are included in Property and equipment, net on the Consolidated Balance Sheets. Amortization of capitalized software costs totaled approximately \$14 million, \$22 million and \$23 million in fiscal year 2010, 2009 and 2008, respectively.

Goodwill

Edgar Filing: MICHAELS STORES INC - Form 10-K

Under the provisions of ASC 350, *Intangibles - Goodwill and Other*, we review goodwill for impairment each year in the fourth quarter, or more frequently if certain events occur or circumstances change. The impairment review is performed by comparing each reporting unit's carrying value to its estimated fair value, determined through estimated discounted future cash flows and market-based methodologies. If the carrying value exceeds the estimated fair value, we determine the fair value of all assets and liabilities of the reporting unit, including the implied fair value of goodwill. If the carrying value of goodwill exceeds the implied fair value, we recognize an impairment charge equal to the difference. There are assumptions and estimates underlying the determination of fair value and any resulting impairment loss. Significant changes in these assumptions, or another estimate using different, but still reasonable, assumptions could produce different results. We have performed the required impairment tests of goodwill, and the tests have not resulted in an impairment charge in fiscal 2010, fiscal 2009 or fiscal 2008.

Impairment of Long-Lived Assets

We evaluate long-lived assets, other than goodwill and assets with indefinite lives, for indicators of impairment whenever events or changes in circumstances indicate their carrying amounts may not be recoverable. Our evaluation compares the carrying value of the assets with their estimated future undiscounted cash flows. If it is determined that an impairment loss has occurred, the loss would be recognized during that period based on the estimated fair value of the assets. Our impairment analysis contains management assumptions about key store variables including sales, growth rate, gross margin, payroll and other controllable expenses. If actual results differ from these estimates, we may be exposed to additional impairment losses that may be material.

Reserve for Closed Facilities

We maintain a reserve for future rental obligations, carrying costs, and other closing costs related to closed facilities, primarily closed and relocated stores. In accordance with ASC 420, Exit or Disposal Cost Obligations, we recognize exit costs for any store closures at the time the store is closed. Such costs are recorded within the Cost of sales and occupancy expense line item on our Consolidated Statements of Operations.

The cost of closing a store or facility is recorded at the estimated fair value of expected cash flows which we calculate as the lesser of the present value of future rental obligations remaining under the lease (less estimated sublease rental income) or the lease termination fee. The determination of the reserves is dependent on our ability to make reasonable estimates of costs to be incurred post-closure and of rental income to be received from subleases. In planning our store closures, we generally try to time our exits as close to the lease termination date as possible to minimize any remaining lease obligation.

The following is a detail of account activity related to closed facilities:

	2010		Fiscal Year 2009 (In millions)		2008
Balance at beginning of fiscal year	\$ 7	\$	7	\$	5
Additions charged to costs and expenses			4		3
Payment of rental obligations and other	(2)		(4)		(1)
Balance at end of fiscal year	\$ 5	\$	7	\$	7

Insurance Liabilities

We have insurance coverage for losses in excess of self-insurance limits for medical liability, general liability and workers' compensation claims. Health care reserves are based on actual claims experience and an estimate of claims incurred but not reported. Reserves for general liability and workers' compensation are determined through the use of actuarial studies. Due to the significant judgments and estimates utilized for determining these reserves, they are subject to a high degree of variability. In the event our insurance carriers are unable to pay claims submitted to them, we would record a liability for such estimated payments we expect to incur.

Revenue Recognition

Revenue from sales of our merchandise is recognized when the customer takes possession of the merchandise. Revenue is presented net of sales taxes collected. Sales related to custom framing are deferred until the order is picked up by the customer, which we estimate based on historical customer behavior. We deferred 13 days of custom framing revenue at the end of fiscal 2010, 2009 and 2008. As of January 29, 2011 and January 30, 2010, our deferred framing revenue was approximately \$10 million and \$8 million, respectively.

Edgar Filing: MICHAELS STORES INC - Form 10-K

We allow for merchandise to be returned under most circumstances and provide a reserve for estimated returns. We use historical customer return behavior to estimate our reserve requirements. As of January 29, 2011 and January 30, 2010, our sales returns reserve was approximately \$3 million.

We record a gift card liability on the date we issue the gift card to the customer. We record revenue and reduce the gift card liability as the customer redeems the gift card. The deferred revenue associated with outstanding gift cards increased \$2 million from \$24 million at January 30, 2010, to \$26 million as of January 29, 2011. We escheat the value of unredeemed gift cards where required by law. Any remaining liabilities not subject to escheatment are evaluated to determine whether the likelihood of the gift card being redeemed is remote (gift card breakage). We recognize gift card breakage as revenue, by applying our estimate of the rate of gift card breakage over the period of estimated performance. Our estimates of the gift card breakage rate are applied to the estimated amount of gift cards that are expected to go unused, that are not subject to escheatment, and are based on customers' historical redemption rates and patterns, which may not be indicative of future redemption rates and patterns. We recognized revenue of approximately \$3 million in fiscal 2010 and \$2 million in both fiscal 2009 and fiscal 2008, related to such gift card balances.

Costs of Sales and Occupancy Expenses

Included in our costs of sales are the following:

- purchase price of merchandise, net of vendor allowances and rebates;
- inbound freight, inspection costs, duties and import agent commissions;
- warehousing, handling, and transportation costs (including internal transfer costs such as distribution center to store freight costs) and purchasing and receiving costs; and
- share-based compensation costs for those employees involved in preparing inventory for sale.

These costs are included in merchandise inventories and expensed as the merchandise is sold.

Included in our occupancy expenses are the following:

- store expenses such as rent, insurance, taxes, common area maintenance, utilities, repairs and maintenance;
- amortization of store buildings and leasehold improvements;
- store closure costs; and
- store remodel costs.

We record rent expense ratably over the term of the lease beginning with the date we take possession of or control the physical access to the premises. We record leasehold improvement reimbursements as a liability and ratably adjust the liability as a reduction to rent expense over the lease term beginning with the date we take possession of or control the physical access to the premises. At times, we receive landlord reimbursements for leasehold improvements made during the lease term, which we record as a liability and ratably adjust as a reduction to rent expense over the remaining lease term.

Selling, General, and Administrative Costs

Included in our selling, general, and administrative costs are store personnel costs (including share-based compensation), store operating expenses, advertising expenses, store depreciation expense, and corporate overhead costs.

Advertising costs are expensed in the period in which the advertising first occurs. Our cooperative advertising allowances are accounted for as a reduction in the purchase price of merchandise since an obligation to advertise specific product does not exist in our cooperative advertising arrangements.

Advertising expenses were \$172 million, \$167 million, and \$176 million for fiscal 2010, 2009, and 2008, respectively.

Store Pre-Opening Costs

We expense all start-up activity costs as incurred. Rent expense incurred prior to the store opening is recorded in Cost of sales and occupancy expense on our Consolidated Statement of Operations.

Income Taxes

We record income tax expense using the liability method for taxes and are subject to income tax in many jurisdictions, including the United States, various states and localities, and Canada. A current tax liability or asset is recognized for the estimated taxes payable or refundable on the tax returns for the current year and a deferred tax liability or asset is recognized for the estimated future tax effects attributable to temporary differences and carryforwards. Deferred tax assets and liabilities are measured using enacted income tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of a change in tax rates is recognized as income or expense in the period that includes the enactment date. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets unless it is more likely than not that such assets will be realized. In evaluating our ability to realize our deferred tax asset, we considered the following sources of future taxable income:

- future reversals of existing taxable temporary differences;
- future taxable income, exclusive of reversing temporary differences and carryforwards;
- taxable income in prior carryback years; and
- tax-planning strategies.

Our evaluation regarding whether a valuation allowance is required or should be adjusted also considers, among other things, the nature, frequency, and severity of recent losses, forecasts of future profitability and the duration of statutory carryforward periods. Our forecasts of future profitability represents our best estimate of these future events. After conducting this assessment, the valuation allowance recorded against our deferred tax assets was \$15 million and \$14 million as of January 29, 2011 and January 30, 2010, respectively. If actual results differ from estimated results or if we adjust these assumptions in the future, we may need to adjust our deferred tax assets or liabilities, which could impact our effective tax rate.

The amount of income taxes we pay is subject to ongoing audits in the taxing jurisdictions in which we operate. During these audits, the taxing authorities may challenge items on our tax returns. Because the tax matters challenged by tax authorities are typically complex, the ultimate outcome of these challenges is uncertain. We recognize tax benefits for uncertain positions only to the extent that we believe it is more likely than not that the tax position will be sustained. Our future results may include favorable or unfavorable adjustments to our unrecognized tax benefits due to closure of income tax audits, new regulatory or judicial pronouncements, or other relevant events. As a result, our effective tax rate may fluctuate significantly on a quarterly and annual basis.

Share-Based Compensation

ASC 718, *Stock Compensation*, requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements, based on their fair value, over the requisite service period. Compensation cost is based on the grant date fair value of the award and ratably recognized as an expense over the effective vesting period. We estimate the fair value of stock option awards using a Black-Scholes option value model.

Beginning with our adoption of ASC 718, we report excess tax benefits as a cash inflow in the financing section of our statement of cash flows and would record a tax deficiency, if any, as a cash outflow from operating activities. For fiscal 2010 and fiscal 2009, we did not have any tax benefits or tax deficiencies associated with share-based awards. For fiscal 2008, we reported \$9 million of excess tax benefits as a cash inflow to financing activities. The fiscal 2008 benefits relate to a favorable tax settlement with the IRS regarding stock options matters from prior years.

Recent Accounting Pronouncements

In January 2010, the FASB issued ASU No. 2010-06, *Improving Disclosures About Fair Value Measurements* an amendment to ASC topic 820, *Fair Value Measurements and Disclosures*. ASU 2010-06 expands disclosure requirements related to fair value measurements including (i) separately disclosing the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describing the reasons for the transfers and (ii) presenting separate information for Level 3 activity pertaining to gross purchases, sales, issuances, and settlements. The new disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the Level 3 activity disclosures, which are effective for fiscal years beginning after December 15, 2010. We adopted all requirements of ASU 2010-06 related to significant transfers in and out of Level 1 and Level 2 fair value measurements on January 31, 2010, with no material impact on our consolidated financial statements. See Note 8 for further information regarding fair value measurements. We will adopt the new disclosure requirements related to the Level 3 activity on January 30, 2011, with no material impact expected on our consolidated financial statements.

Note 2. Detail of Certain Balance Sheet Accounts

	January 29, 2011		January 30, 2010
	(In millions)		
Property and equipment:			
Land and buildings	\$	2	\$ 2
Fixtures and equipment		1,004	946
Leasehold improvements		323	309
	\$	1,329	\$ 1,257
Accrued liabilities and other:			
Salaries, bonuses, and other payroll-related costs	\$	109	\$ 99
Insurance Liabilities		67	68
Accrued interest		44	48
Taxes, other than income and payroll		64	46
Gift certificate and gift card liability		26	24
Other		74	71
	\$	384	\$ 356

Note 3. Debt

Our debt consisted of the following for fiscal 2010 and fiscal 2009:

	Interest Rate	Fiscal 2010	Fiscal 2009
		(In millions)	
Senior secured term loan	Variable	\$ 2,046	\$ 2,274
Senior notes due 2014	10.000%		750
Senior notes due 2018	7.750%	794	
Senior subordinated notes	11.375%	400	400
Subordinated discount notes	13.000%	427	377
Asset-based revolving credit facility	Variable		
Other	5.970%	1	2
Total debt		3,668	3,803
Less current portion		1	119
Long-term debt		\$ 3,667	\$ 3,684

We capitalized \$132 million of costs, net of write-offs, related to our issuance of various debt instruments. We amortize these deferred financing costs over the lives of the respective debt agreements (which range from five to ten years) and record the amortization to interest expense. Our expected amortization expense pertaining to the deferred financing costs for each of the next five fiscal years and thereafter is as follows:

	2011	2012	2013	2014	2015	Thereafter
Amortization Expense	\$ 19	\$ 19	\$ 17	\$ 6	\$ 5	\$ 6

The aggregate amounts of scheduled maturities of our debt for the next five years and thereafter are as follows:

F-13

Edgar Filing: MICHAELS STORES INC - Form 10-K

Fiscal Year	Amount (In millions)
2011	\$ 1
2012	194
2013	1,149
2014	2
2015	2
Thereafter	2,368
Total debt payments	3,716
Less unrealized discount and interest accretion	48
Total debt balance as of January 29, 2011	\$ 3,668

As of January 29, 2011 and January 30, 2010, there were no outstanding short-term borrowings.

10% Senior Notes due 2014

On October 6, 2010, we commenced a tender offer and consent solicitation related to our 10% Senior Notes due 2014 (2014 Senior Notes). Pursuant to the consent solicitation, we received tenders and consents from the holders of \$658,593,000, or approximately 87.81%, of the 2014 Senior Notes before the consent payment deadline, October 20, 2010, at 5:00 p.m. Eastern time (the Consent Date). The consents received exceeded the number needed to approve the proposed amendments to the indenture governing the 2014 Senior Notes (the 2014 Senior Indenture). The amendments to the 2014 Senior Indenture eliminated substantially all of the affirmative and restrictive covenants contained in the 2014 Senior Indenture and the 2014 Senior Notes (other than, among other covenants, the covenant to pay interest and premium, if any, on, and principal of, the 2014 Senior Notes when due) and certain events of default, and modified or eliminated certain other provisions contained in the 2014 Senior Indenture and the 2014 Senior Notes.

Pursuant to the terms of the tender offer, we accepted for payment all 2014 Senior Notes tendered on or prior to the Consent Date, and holders who tendered such 2014 Senior Notes received \$1,055.00 per \$1,000 in principal amount of the 2014 Senior Notes validly tendered. On October 21, 2010, we also (i) instructed the trustee under the 2014 Senior Indenture (the 2014 Senior Notes Trustee) to deliver a notice of redemption to the holders of the remaining outstanding 2014 Senior Notes and (ii) deposited cash with the 2014 Senior Notes Trustee to satisfy and discharge the 2014 Senior Indenture and to fund the redemption of the remaining outstanding 2014 Senior Notes at a price equal to 105% plus the payment of accrued interest through the date of redemption, November 22, 2010. As a result, the 2014 Senior Indenture was discharged.

In accordance with ASC 470, *Debt*, we recorded a loss of \$53 million related to the early extinguishment of our 2014 Senior Notes. The \$53 million loss is comprised of \$41 million tender and call premiums and the write-off of \$12 million for the remaining unamortized debt issuance costs.

7¾% Senior Notes due 2018

On October 21, 2010, we issued \$800.0 million aggregate principal amount of 7¾% Senior Notes that mature on November 1, 2018 (the 2018 Senior Notes) and were sold at a discounted price of 99.262% of face value, resulting in an effective interest rate of 77/8%. The 2018 Senior Notes are guaranteed, jointly and severally, on an unsecured senior basis, by each of our subsidiaries that guarantee indebtedness under our senior secured asset-based revolving credit facility and senior secured term loan facility (the Senior Secured Credit Facilities).

The 2018 Senior Notes and the guarantees thereof are our and the guarantors' unsecured senior obligations and rank senior in right of payment to all of our and the guarantors' existing and future debt and other obligations that are, by their terms, expressly subordinated in right of payment to the 2018 Senior Notes (including the senior subordinated notes due 2016 and the subordinated discount notes due 2016, as described below); rank equally in right of payment to all of our and the guarantors' existing and future debt and other obligations that are not, by their terms, expressly subordinated in right of payment to the 2018 Senior Notes; and are effectively subordinated in right of payment to all of our and the guarantors' existing and future secured debt (including obligations under the Senior Secured Credit Facilities), to the extent of the value of the assets securing such debt, and are structurally subordinated to all obligations of our subsidiaries that are not guarantors of the 2018 Senior Notes.

At any time prior to November 1, 2014, we may redeem all or a part of the 2018 Senior Notes at a redemption price equal to 100% of the principal amount of the 2018 Senior Notes redeemed plus the Applicable Premium (as defined in the indenture governing the 2018 Senior Notes (the "2018 Senior Indenture")) and accrued and unpaid interest and Additional Interest (as defined in the 2018

Edgar Filing: MICHAELS STORES INC - Form 10-K

Senior Indenture), if any, to the date of redemption, subject to the right of holders of record on the relevant record date to receive interest due on the relevant interest payment date.

On and after November 1, 2014, the Company may redeem the 2018 Senior Notes, in whole or in part, upon notice, at the redemption prices (expressed as percentages of principal amount of the 2018 Senior Notes to be redeemed) set forth below, plus accrued and unpaid interest thereon and Additional Interest, if any, to the applicable date of redemption if redeemed during the twelve-month period beginning on November 1 of each of the years indicated below:

Year	Percentage
2014	103.875%
2015	101.938%
2016 and thereafter	100.000%

In addition, until November 1, 2013, we may, at our option, on one or more occasions redeem up to 35% of the aggregate principal amount of the 2018 Senior Notes (including the aggregate principal amount of the 2018 Senior Notes issued after the issue date) at a redemption price equal to 107.750% of the aggregate principal amount thereof, plus accrued and unpaid interest thereon and Additional Interest, if any, to the applicable date of redemption, subject to the right of holders of record on the relevant record date to receive interest due on the relevant interest payment date, with the net cash proceeds of one or more Equity Offerings (as defined in the 2018 Senior Indenture); provided that at least 50% of the sum of the aggregate principal amount of the 2018 Senior Notes originally issued under the 2018 Senior Indenture and any 2018 Senior Notes that are issued under the 2018 Senior Indenture after the issue date remains outstanding immediately after the occurrence of each such redemption; and provided further that each such redemption occurs within 90 days of the date of closing of each such Equity Offering.

Upon a change in control we are required to offer to purchase all of the 2018 Senior Notes at a price in cash equal to 101% of the aggregate principal amount thereof, plus accrued and unpaid interest.

The 2018 Senior Indenture contains covenants limiting, among other things, the Company's ability and the ability of the Company's restricted subsidiaries to:

- incur additional debt;
- pay dividends or distributions on the Company's capital stock or repurchase the Company's capital stock;
- issue stock of subsidiaries;
- make certain investments;
- create liens on the Company's assets to secure debt;
- enter into transactions with affiliates;
- merge or consolidate with another company; and

- sell or otherwise transfer assets.

The 2018 Senior Indenture also provides for events of default, which, if certain of them occur, would permit the trustee under the 2018 Senior Indenture or holders of at least 25% in principal amount of the then outstanding 2018 Senior Notes to declare the principal, premium, if any, interest and any other monetary obligations on all the then outstanding 2018 Senior Notes to be due and payable immediately.

In accordance with ASC 470, we recorded \$15 million in debt issuance costs that will be amortized as interest expense over the life of the 2018 Senior Notes.

113/8% Senior Subordinated Notes due 2016

On October 31, 2006, we issued \$400 million in principal amount of 113/8% Senior Subordinated Notes due November 1, 2016 (the Senior Subordinated Notes). Interest is payable semi-annually in arrears on each May 1 and November 1, commencing on May 1, 2007. The Senior Subordinated Notes are guaranteed, jointly and severally, on an unsecured senior subordinated basis, by each of our subsidiaries, other than certain immaterial subsidiaries.

The Senior Subordinated Notes and the guarantees thereof are our and the guarantors' unsecured senior subordinated obligations and (i) are subordinated in right of payment to all of our and the guarantors' existing and future senior debt, including the Senior Secured Credit Facilities and the 2018 Senior Notes; (ii) rank equally in right of payment to all of our and the guarantors' future senior subordinated debt; (iii) are effectively subordinated to all of our and the guarantors' existing and future secured debt (including the Senior Secured Credit Facilities) to the extent of the value of the assets securing such debt; and (iv) rank senior in right of payment to

all of our and the guarantors' existing and future debt and other obligations that are, by their terms, expressly subordinated in right of payment to the Senior Subordinated Notes, including the Subordinated Discount Notes.

At any time prior to November 1, 2011, we may redeem all or a part of the Senior Subordinated Notes, at a redemption price equal to the sum of (i) 100% of the principal amount of Senior Subordinated Notes redeemed; (ii) the Applicable Premium (as defined in the indenture governing the Senior Subordinated Notes); and (iii) accrued and unpaid interest to the date of redemption, subject to the right of holders of record on the relevant record date to receive interest due on the interest payment date.

On and after November 1, 2011, we may redeem all or part of the Senior Subordinated Notes, upon notice, at the redemption prices (expressed as percentages of principal amount of the Senior Subordinated Notes to be redeemed) set forth below, plus accrued and unpaid interest thereon to the applicable date of redemption if redeemed during the twelve-month period beginning on November 1 of each of the years indicated below:

Year	Percentage
2011	105.688%
2012	103.792%
2013	101.896%
2014 and thereafter	100.000%

Upon a change in control, we are required to offer to purchase all of the Senior Subordinated Notes at a price in cash equal to 101% of the aggregate principal amount thereof, plus accrued and unpaid interest. The indenture governing the Senior Subordinated Notes contains restrictive covenants substantially similar to those of the 2018 Senior Notes described above.

13% Subordinated Discount Notes due 2016

On October 31, 2006, we issued \$469 million in principal amount at maturity of 13% Subordinated Discount Notes due on November 1, 2016 (the Subordinated Discount Notes). No cash interest is payable on the Subordinated Discount Notes prior to November 1, 2011. Beginning on November 1, 2011, cash interest will accrue and is payable semi-annually in arrears on each May 1 and November 1 (the first cash interest payment date is May 1, 2012). The Subordinated Discount Notes are guaranteed, jointly and severally, on an unsecured subordinated basis, by each of our subsidiaries, other than certain immaterial subsidiaries.

The Subordinated Discount Notes and the guarantees thereof are our and the guarantors' unsecured subordinated obligations and (i) are subordinated in right of payment to all of our and the guarantors' existing and future senior debt (including the Senior Secured Credit Facilities, the 2018 Senior Notes and the Senior Subordinated Notes); and (ii) are effectively subordinated to all of our and the guarantors' secured debt (including the Senior Secured Credit Facilities) to the extent of the value of the assets securing such debt.

At any time prior to November 1, 2011, we may redeem all or part of the Subordinated Discount Notes at a redemption price equal to the sum of 100% of the Accreted Value (as defined in the indenture governing the Subordinated Discount Notes) of the Subordinated Discount Notes redeemed plus the Applicable Premium (as defined in the indenture governing the Subordinated Discount Notes) as of the date of redemption.

Edgar Filing: MICHAELS STORES INC - Form 10-K

On and after November 1, 2011, we may redeem all or part of the Subordinated Discount Notes, upon notice, at the redemption prices (expressed as percentages of Accreted Value of the Subordinated Discount Notes to be redeemed) set forth below, plus accrued and unpaid interest thereon (to the extent not already included in Accreted Value) as of the applicable date of redemption (if redeemed during the twelve-month period beginning on November 1 of each of the years indicated below):

Year	Percentage
2011	106.500%
2012	104.333%
2013	102.167%
2014 and thereafter	100.000%

On May 1, 2012, and, if necessary, any interest payment date thereafter prior to the maturity date of the Subordinated Discount Notes, we are required to redeem a portion of each Subordinated Discount Note outstanding on such date equal to an amount sufficient, but not in excess of the amount necessary, to ensure that such Subordinated Discount Note will not be an applicable high yield discount obligation within the meaning of Section 163(i)(1) of the Internal Revenue Code of 1986, as amended. These redemptions are to be at a price equal to 100% of the Accreted Value of such portion as of the date of redemption.

Upon a change in control, we are required to offer to purchase all of the Subordinated Discount Notes at a price in cash equal to

101% of the Accreted Value, plus accrued and unpaid interest. The Subordinated Discount indenture contains restrictive covenants substantially similar to those of the Senior Notes described above.

Asset-based Revolving Credit Facility

On February 18, 2010, we entered into an agreement to amend and restate various terms of the then existing asset-based revolving credit facility, dated as of October 31, 2006 (the "Asset based revolving credit facility"). As of January 29, 2011, the borrowing base was \$653 million, of which we had no outstanding borrowings. Borrowing capacity is available for letters of credit and borrowings on same-day notice.

The Asset-based revolving credit facility extended an aggregate amount of \$850 million of the tranche A commitments and \$50 million of the FILO (as defined below) commitments, with respect to certain lenders (the "Extending Lenders"), from October 31, 2011 to the earlier of April 15, 2014, or 45 days prior to the maturity date of any class of term loans in the Company's senior secured term loan facility (the "Extended Maturity Date"). The remaining \$202 million of commitments from the other lenders under the existing asset-based revolving credit facility (the "Non-Extending Lenders") were scheduled to terminate on October 31, 2011. On October 1, 2010, we elected to permanently terminate the \$202 million of commitments from the Non-Extending Lenders. The \$850 million of the tranche A commitments and \$50 million of the FILO commitments remain unaffected.

Simultaneously with entering into the Asset-based revolving credit facility, the Company exercised its ability to increase tranche A commitments in the aggregate amount of \$152 million.

The borrowing base on the Asset-based revolving credit facility equals the sum of (i) 90% of eligible credit card receivables and debit card receivables; (ii) between 85% and 87.5% of the appraised net orderly liquidation value of eligible inventory and of eligible letters of credit; (iii) a percentage of eligible in-transit inventory, less certain reserves; and (iv) the sum of an additional 5% of the appraised net orderly liquidation value of eligible inventory and of eligible letters of credit plus an additional 5% of eligible credit card receivables and debit card receivables under a last out tranche (collectively, the first in last out tranche "FILO"), up to a maximum amount of \$50 million.

The Asset-based revolving credit facility provides us with the right to request up to \$200 million of additional commitments under this facility, of which \$48 million remains available, prior to October 31, 2011. The lenders under this facility are not under any obligation to provide any such additional commitments, and any increase in commitments is subject to customary conditions precedent. If we were to request any such additional commitments, and the existing lenders or new lenders were to agree to provide such commitments, on or after October 31, 2011, the tranche A commitments under the Asset-based revolving credit facility could be increased to up to \$1.2 billion less the FILO commitments. However, our ability to borrow under this facility would still be limited by the amount of the borrowing base.

Borrowings under the Asset-based revolving credit facility bear interest at a rate per annum equal to, at our option, either (a) a base rate determined by reference to the highest of (1) the prime rate of Bank of America, N.A., (2) the federal funds effective rate plus 0.50% and (3) a LIBOR rate subject to certain adjustments plus 1.00% or (b) a LIBOR rate subject to certain adjustments, in each case plus an applicable margin. The initial applicable margin is (a) 2.50% for non-FILO base rate borrowings and 3.50% for non-FILO LIBOR borrowings and (b) 4.50% for FILO base rate borrowings and 5.50% for FILO LIBOR borrowings. The applicable margin is subject to adjustment each fiscal quarter based on the excess availability under the Asset-based revolving credit facility. Same-day borrowings bear interest at a rate per annum equal to a base rate determined by reference to the highest of (a) the prime rate of Bank of America, N.A., (b) the federal funds effective rate plus 0.50% and (c) a LIBOR rate subject to certain adjustments plus 1.00%, in each case, plus and applicable margin. The initial applicable margin with respect to same-day borrowings is 2.50%.

Edgar Filing: MICHAELS STORES INC - Form 10-K

We are required to pay a commitment fee of 0.625% per annum on the unutilized commitments under the Asset-based revolving credit facility. We must also pay customary letter of credit fees and agency fees.

If, at any time, the aggregate amount of outstanding loans, unreimbursed letter of credit drawings and undrawn letters of credit under the Asset-based revolving credit facility exceeds the lesser of (i) the commitment amount or (ii) the borrowing base, we will be required to repay outstanding loans and cash collateralize letters of credit in an aggregate amount equal to such excess, with no reduction of the commitment amount. If the amount available under the Asset-based revolving credit facility is less than \$75 million at any time, or for five consecutive business days is less than the greater of \$100 million or 15% of the lesser of the (i) then borrowing base and (ii) Revolving Credit Ceiling (as defined below), or if certain events of default have occurred, we will be required to repay outstanding loans and cash collateralize letters of credit with the cash we are required to deposit daily in a collection account maintained with the agent under the Asset-based revolving credit facility. We may voluntarily reduce the unutilized portion of the commitment amount and repay outstanding loans at any time without premium or penalty other than customary breakage costs with

F-17

respect to LIBOR loans. There is no scheduled amortization under the Asset-based revolving credit facility; the principal amount of the loans outstanding is due and payable in full on the Extended Maturity Date.

We must not permit excess availability at any time to be less than the greater of (a) \$75 million and (b) 10% of the lesser of (1) the then borrowing base under the Asset-based revolving credit facility or (2) \$900 million (as reduced or increased in accordance with the terms of the Asset-based revolving credit facility, the Revolving Credit Ceiling). In addition, (a) for the period of thirty consecutive days preceding our termination of the tranche A commitments of the Non-Extending Lenders and (b) on a projected pro forma basis, giving effect to such termination of commitments, for the six-month period following such termination of commitments, we must not permit excess availability at any time to be less than \$125 million. Excess availability under the Asset-based revolving credit facility means the lesser of (a) the Revolving Credit Ceiling minus the outstanding credit extensions and (b) the then borrowing base minus the outstanding credit extensions.

All obligations under the Asset-based revolving credit facility are unconditionally guaranteed, jointly and severally, by all of our existing material subsidiaries and are required to be guaranteed by certain of our future domestic wholly-owned material subsidiaries. All obligations under the Asset-based revolving credit facility, and the guarantees of those obligations, are secured, subject to certain exceptions, by substantially all of our assets and the assets of our material subsidiaries (the Subsidiary Guarantors), including:

- a first-priority security interest in personal property consisting of inventory and related accounts, cash, deposit accounts, all payments received by us or the Subsidiary Guarantors from credit card clearinghouses and processors or otherwise in respect of all credit card charges and debit card charges for sales of inventory by us and the Subsidiary Guarantors, and certain related assets and proceeds of the foregoing;
- a second-priority pledge of all of the capital stock held by us (excluding the stock of Michaels of Canada, ULC) and our Subsidiary Guarantors (which pledge, in the case of the capital stock of any foreign subsidiary, is limited to 65% of the voting stock of such foreign subsidiary and 100% of the non-voting stock of such subsidiary); and
- a second-priority security interest in, and mortgages on, substantially all other tangible and intangible assets of us and each Subsidiary Guarantor, including substantially all of our owned real property and equipment.

Although the Asset-based revolving credit facility does not require us to comply with any financial ratio maintenance covenants, it does contain a number of covenants that, among other things and subject to certain exceptions, restrict the Company's ability and the ability of its subsidiaries to:

- incur additional indebtedness;
- pay dividends on the Company's capital stock or redeem, repurchase or retire the Company's capital stock or its other indebtedness;
- make investments, loans, advances and acquisitions;
- create restrictions on the payment of dividends or other amounts to the Company from its restricted subsidiaries;

Edgar Filing: MICHAELS STORES INC - Form 10-K

- engage in transactions with affiliates of the Company;
- sell assets, including capital stock of the Company's subsidiaries;
- consolidate or merge; and
- create liens.

The covenants limiting dividends and other restricted payments; investments, loans, advances and acquisitions; and prepayments or redemptions of indebtedness, each permit the restricted actions in an unlimited amount, subject to the satisfaction of certain payment conditions, principally that we must meet certain specified excess availability requirements and minimum consolidated fixed charge coverage ratios, to be tested on a pro forma and 12 months projected basis. Adjusted EBITDA is used in the calculation of the consolidated fixed charge coverage ratios. The Asset-based revolving credit facility also contains certain customary affirmative covenants and events of default.

In the first quarter of fiscal 2010, we recorded \$19 million in debt issuance costs related to the amendment to the asset-based revolving credit facility that is being amortized as interest expense over the life of the Asset-based revolving credit facility in accordance with ASC 470. In addition, we are amortizing \$5 million of the unamortized debt issuance costs related to the asset-based revolving credit facility over the revised life.

As of January 29, 2011 and January 30, 2010, the borrowing base was \$653 million and \$724 million, respectively, of which we had availability of \$604 million and \$674 million, respectively. Borrowing capacity is available for letters of credit and borrowings on same-day notice. Outstanding letters of credit as of January 29, 2011 totaled \$68 million, of which \$49 million relate to standby letters of credit.

Senior Secured Term Loan Facility

On October 31, 2006, we executed a \$2.4 billion senior secured term loan facility (the "senior secured term loan facility") with Deutsche Bank A.G. New York Branch, and other lenders. The full amount was borrowed on October 31, 2006, with the balance payable on October 31, 2013.

Borrowings under the senior secured term loan facility bear interest at a rate per annum equal to, at our option, either (a) a base rate determined by reference to the higher of (1) the prime rate of Deutsche Bank and (2) the federal funds effective rate plus 0.5% or (b) a LIBOR rate, subject to certain adjustments, in each case plus an applicable margin. The applicable margin is 3.50% for base rate borrowings and 4.50% for LIBOR borrowings.

The senior secured term loan facility requires us to prepay outstanding term loans with (a) 100% of the net proceeds of any debt issued by us or our subsidiaries (with exceptions for certain debt permitted to be incurred under the senior secured term loan facility) and (b) commencing with the fiscal year ending February 2, 2008, 50% (which percentage will be reduced to 25% if our total leverage ratio (as defined in the senior secured term loan facility) is less than 6.00:1.00 and will be reduced to 0% if our total leverage ratio is less than 5.00:1.00) of our annual Excess Cash Flow (as defined in the senior secured term loan facility). We must also offer to prepay outstanding term loans at 100% of the principal amount to be prepaid, plus accrued and unpaid interest, with the proceeds of certain asset sales or casualty events under certain circumstances. We may voluntarily prepay outstanding loans under the senior secured term loan facility at any time without premium or penalty other than customary breakage costs with respect to LIBOR loans.

All obligations under the senior secured term loan facility are unconditionally guaranteed by each direct and indirect wholly-owned subsidiary that guarantees the obligations of the Company under the Asset-based revolving credit facility. All obligations under the senior secured term loan facility, and the guarantees of those obligations, are secured, subject to certain exceptions, by substantially all of our assets and the assets of the Subsidiary Guarantors, including:

- a first-priority pledge of all of the capital stock held by us (excluding the stock of Michaels of Canada, ULC) and the Subsidiary Guarantors (which pledge, in the case of any foreign subsidiary, is limited to 65% of the voting stock of such foreign subsidiary and 100% of the non-voting stock of such subsidiary);
- a first-priority security interest in, and mortgages on, substantially all other tangible and intangible assets of us and each Subsidiary Guarantor, including substantially all of our owned real property and equipment, but excluding, among other things, the collateral described in the following bullet point; and
- a second-priority security interest in personal property consisting of inventory and related accounts, cash, deposit accounts, all payments received by us or the Subsidiary Guarantors from credit card clearinghouses and processors or otherwise in respect of all credit card charges and debit card charges for sales of inventory by us and the Subsidiary Guarantors, and certain related assets and proceeds of the foregoing.

Edgar Filing: MICHAELS STORES INC - Form 10-K

On August 20, 2009, we amended the senior secured term loan facility to permit the issuance or incurrence of indebtedness for the purpose of the repayment of existing term loans under the senior secured term loan facility, which new indebtedness could take the form of additional term loans under the senior secured term loan facility or secured or unsecured bonds or other loans.

On November 5, 2009, we amended the senior secured term loan facility to extend \$1.0 billion of existing term loans (the B-2 Term Loans) to July 31, 2016, with the remaining \$1.28 billion of existing term loans (the B-1 Term Loans and together with the B-2 Term Loans, the Term Loans) keeping the original maturity date of October 31, 2013. The B-2 Term Loans are subject to a minimum increase in interest rates on the B-2 Term Loans in connection with any future extensions of term loans to the extent that any such future extension has an increase in effective yield in excess of 0.25% above the effective yield of the B-2 Term Loans.

We recorded an expense of \$3 million related to the amendment in accordance with ASC 470, *Debt*. We also recorded \$1 million in debt issuance costs that will be amortized as interest expense over the life of the B-2 Term Loans. The unamortized debt issuance costs related to the senior secured term loan facility were allocated proportionately between the Term Loans. The costs allocated to the B-2 Term Loans will be amortized over the revised life through July 31, 2014.

Our voluntary prepayments in fiscal 2010 of \$110 million more than offset the payment required from our annual Excess Cash Flow, which resulted in none of our senior secured term loan facility being classified as current debt as of January 29, 2011. Under the facilities, excess cash flow payments and voluntary prepayments serve to reduce future scheduled quarterly principal payments. The

Edgar Filing: MICHAELS STORES INC - Form 10-K

excess cash flow payment and voluntary prepayments made in fiscal 2010 effectively satisfied all scheduled quarterly principal payments until maturity of the Term Loans.

The senior secured term loan facility contains a number of negative covenants that are substantially similar to, but more restrictive in certain respects than, those governing the Notes as well as certain other customary affirmative and negative covenants and events of default. As of January 29, 2011, we were in compliance with all covenants.

Note 4. Comprehensive Income

Accumulated other comprehensive income, net of tax, is reflected in the Consolidated Balance Sheets as follows:

(in millions)	Foreign Currency Translation & Other	Foreign Currency Derivative	Total
Balance at February 2, 2008	\$ 11	\$ (1)	\$ 10
Foreign currency translation adjustment	(10)		(10)
Change in fair value of hedge instruments		5	5
Balance at January 31, 2009	1	4	5
Foreign currency translation adjustment	5		5
Reclassification of hedge instruments to earnings		(4)	(4)
Balance at January 30, 2010	6		6
Foreign currency translation adjustment	1		1
Balance at January 29, 2011	\$ 7	\$	\$ 7

Note 5. Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of deferred tax assets and liabilities as of the respective year-end balance sheets are as follows:

	Deferred Tax Asset (Liability)			
	January 29, 2011		January 30, 2010	
	Current	Noncurrent	Current	Noncurrent
	(In millions)			
Net operating loss, general business credit, foreign tax credit and alternative minimum tax credit carryforwards	\$	\$ 22	\$	\$ 22
Merchandise inventories	(4)		(14)	
Accrued expenses	10	1	10	1
State income taxes	20	2	14	
Vacation accrual	6		6	
Share-based compensation		10		7

Edgar Filing: MICHAELS STORES INC - Form 10-K

Deferred rent		15		15
Other deferred assets	7	2	10	1
State valuation allowance		(15)		(14)
Bonus accrual	5		4	
Gift cards	10		9	
Property and equipment		(18)		(23)
Translation adjustment		(4)		(1)
Workers compensation	16		16	
Cancellation of debt income		(37)		(37)
Original issue discount related to cancellation of debt income		37		37
Correction of state tax deferred liability pool	(5)		5	
Other deferred tax liabilities	(9)	(1)	(15)	(7)
	\$ 56	\$ 14	\$ 45	\$ 1
Net deferred tax assets		\$ 70		\$ 46

F-20

Edgar Filing: MICHAELS STORES INC - Form 10-K

The federal, state and international income tax provision is as follows:

	2010	Fiscal Year 2009 (In millions)	2008
Federal:			
Current	\$ 45	\$ 19	\$ 11
Deferred	(16)	6	(18)
Total federal income tax provision	29	25	(7)
State:			
Current	9	9	9
Deferred	(4)	(1)	(8)
Total state income tax provision	5	8	1
International:			
Current	17	17	13
Deferred			(4)
Total international income tax provision	17	17	9
Total income tax provision	\$ 51	\$ 50	\$ 3

The reconciliation between the actual income tax provision (benefit) and the income tax provision (benefit) calculated by applying the federal statutory tax rate is as follows:

	2010	Fiscal Year 2009 (In millions)	2008
Income tax provision (benefit) at statutory rate	\$ 52	\$ 55	\$ (1)
State income taxes, net of federal income tax effect	2	3	(3)
Interest income from settlement of IRS audit		(1)	
Federal tax credits	(2)		
Non-deductible severance payments			2
Unrecognized tax benefits	(4)		
Federal valuation allowance		(1)	(1)
State valuation allowance	1	2	4
Correction of state tax deduction deferred liability pool	5	(5)	
Other	(3)	(3)	2
Total income tax provision	\$ 51	\$ 50	\$ 3

At January 29, 2011, we had state net operating loss carryforwards to reduce future taxable income of approximately \$307 million expiring at various dates between fiscal 2011 and fiscal 2030. The valuation allowance related to state net operating loss carryforwards was increased to \$15 million in fiscal 2010 to reserve for state operating loss carryforwards, which we believe it is more likely than not that we will be unable to realize these amounts. In fiscal 2009, due to certainty of realization, we eliminated our valuation allowance related to foreign tax credit and reduced our valuation allowance by \$1 million to zero. Additionally in fiscal 2009, we recorded a \$5 million adjustment to the fiscal 2009 state tax deferred liability pool, which contributed to the lower effective rate. In fiscal 2010, we reversed this adjustment as a correction of an error.

Uncertain Tax Positions

We operate in a number of tax jurisdictions and are subject to examination of our income tax returns by tax authorities in those jurisdictions who may challenge any item on these tax returns. Because the tax matters challenged by tax authorities are typically complex, the ultimate outcome of these challenges is uncertain.

F-21

Edgar Filing: MICHAELS STORES INC - Form 10-K

In accordance with ASC 740, *Income Taxes*, we recognize the benefits of uncertain tax positions in our financial statements only after determining a more likely than not probability that the uncertain tax positions will be sustained. A reconciliation of unrecognized tax benefits from the end of fiscal year 2009 through the end of fiscal 2010 is as follows:

	Fiscal Year 2010 (In millions)
Balance at January 30, 2010	\$ 11
Additions based on tax positions related to the current year	1
Reductions for expiration of statute of limitations	(2)
Settlements with taxing authorities	(3)
Balance at January 29, 2011	\$ 7

Included in the balance of unrecognized tax benefits at January 29, 2011, is \$8 million in unrecognized tax benefits, the recognition of which would have an affect on the effective tax rate. This amount differs from the gross unrecognized tax benefits presented in the table above due to the increase in U.S. federal income taxes which would occur upon recognition of penalties and interest from uncertain tax positions, offset by the state tax benefits included therein.

Our policy is to classify all income tax related interest and penalties as income tax expense. During the year ended January 29, 2011, we recognized a benefit of less than \$1 million in income tax interest and penalties. As of January 29, 2011, we accrued \$3 million for potential payment of interest and penalties.

We identified our federal return, Canadian tax return, and state returns in California, Florida, Illinois, Michigan, New York, North Carolina, Pennsylvania, and Texas as major jurisdictions. The periods subject to examination for our federal return are fiscal 2006 to present, fiscal 2001 to present for our Canadian returns, and fiscal 2005 to present for all major state tax returns.

Note 6. Share-Based Compensation

The 2006 Equity Incentive Plan (2006 Plan) provides for the grant of share-based awards exercisable for up to 14.2 million shares of Common Stock. We plan to issue new shares of our Common Stock to satisfy share issuance upon option exercises. On June 3, 2009, the Company announced an offer to exchange certain employee stock options issued under the 2006 Plan (Exchange Offer) for new stock options granted on a one-for-one basis. On July 2, 2009, employees exchanged 8.0 million outstanding stock options under the following terms:

(1) outstanding vested or unvested options to purchase shares of Common Stock that had an exercise price per share of \$30.00, \$37.50, \$45.00 or \$52.50 for an equal number of new options to purchase shares of Common Stock with an exercise price equal to \$7.50 and a new five-year vesting schedule that commenced on July 2, 2009 and an eight-year term; and

Edgar Filing: MICHAELS STORES INC - Form 10-K

(2) outstanding options that had an exercise price per share of \$15.00 and \$22.50 were exchanged for an equal number of new options with the same exercise price. A portion of the new options were vested based on the period of time that the exchanged options had been held in relation to the total term of the option and have identical terms and conditions to the previously issued options, and the remaining new options have a new five-year vesting schedule that commenced on July 2, 2009 and an eight-year term.

The fair value for options granted under ASC 718, *Stock Compensation*, was estimated at the date of grant using the Black-Scholes option valuation model. The following assumptions were used to estimate the fair value of options granted during the year ended January 29, 2011:

F-22

Edgar Filing: MICHAELS STORES INC - Form 10-K

Assumptions (1)	Fiscal Year		
	2010	2009	2008
Risk-free interest rates (2)	1.5% - 2.5%	2.4% - 3.3%	1.9% - 3.6%
Expected dividend yield	0.0%	0.0%	0.0%
Expected volatility rates of our Common Stock (3)	39.4% - 41.5%	41.9% - 45.9%	31.1% - 43.6%
Expected life of options (in years) (4)	5.0 - 8.0	5.5 - 8.0	5.5 - 7.5
Weighted average fair value of options granted (5)	\$ 4.52	\$ 0.93	\$ 4.26

- (1) Forfeitures were estimated based on historical experience and anticipated events.
- (2) Based on constant maturity interest rates for U.S. Treasury instruments with terms consistent with the expected lives of the awards.
- (3) We considered both the historical volatility as well as implied volatilities from the exchange-traded options on the common stock from a peer group of companies.
- (4) Expected lives were based on an analysis of historical exercise and post-vesting employment termination behavior.
- (5) The Company's 2010 Common Stock valuations relied on projections of our future performance, estimates of our weighted average cost of capital, and metrics based on the performance of a peer group of similar companies, including valuation multiples and stock price volatility. However, due to the economic deterioration that occurred during fiscal 2008, the traditional approaches outlined above did not yield an answer that was considered to be representative of the fair value of the Company's equity. As a result, the Company's 2009 and 2008 valuations also considered a Black-Scholes option model, which utilized the fair value of the Company's assets, the book value of the Company's debt, an estimated time to a liquidity event, the asset volatility of a peer group of companies and the risk free rate. As of the date of the Exchange Offer, the fair value of our Common Stock, based on the methods outlined above, was determined to be \$4.27.

As of January 29, 2011, there were 10.9 million stock option awards outstanding. In addition, as of January 29, 2011, there were a total of 657,683 shares of restricted stock outstanding, of which 110,115 are vested. 2.6 million shares of Common Stock remain available for grant under the 2006 Plan. The table below sets forth a summary of stock option activity for the year ended January 29, 2011.

	Number of Shares (in millions)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in millions)
Outstanding at January 30, 2010	9.5	\$ 15.03		
Grants	2.3	16.92		
Canceled/Forfeited	(0.9)	15.58		
Outstanding at January 29, 2011	10.9	\$ 15.41	6.4	\$ 24
Vested and Exercisable at January 29, 2011	2.9	\$ 16.50	5.4	\$ 5

The total fair value of options that vested during fiscal 2010, fiscal 2009 and fiscal 2008 was \$2 million, \$1 million, and \$6 million, respectively. The intrinsic value for options that vested during 2010 was \$5 million. There was no intrinsic value for options that vested during each of fiscal 2009 and fiscal 2008. As of the beginning of fiscal 2010, there were 7.9 million nonvested options with a weighted average grant date fair value of \$0.96 per share. As of the end of fiscal 2010 there were 7.9 million nonvested options with a weighted average grant date fair value of \$1.95 per share. During fiscal 2010 there were 1.6 million options that vested and 0.9 million options that were canceled with a weighted average grant date fair value of \$1.08 and \$0.90 per share, respectively.

Share-based compensation expense for each of fiscal 2010, fiscal 2009, and fiscal 2008 was \$8 million. As a result of the Exchange Offer, share-based compensation expense will increase by \$2 million over the life of the options due to the incremental value ascribed to the new options that were issued at a lower exercise price. Share-based compensation expense for fiscal 2009 decreased by \$1 million as a result of the longer vesting period of the new options compared to the vesting period of the original grants.

As of January 29, 2011, compensation cost not yet recognized related to nonvested awards totaled \$21 million and is expected to be recognized over a weighted average period of 3.2 years. To the extent the actual forfeiture rate is different from what we have anticipated, share-based compensation related to these awards will be different from our expectations.

Note 7. Derivative Instruments

We are exposed to fluctuations in interest rates on our senior secured term loan facility. During the first quarter of fiscal 2009, we purchased an interest rate derivative with the objective to cap our exposure to interest rate increases on our senior secured term loan that result from fluctuations in the three-month LIBOR rate. The cap limits our interest exposure on a notional value of \$2.0 billion to the lesser of the three-month LIBOR rate or 7.0%. The term of the cap extends to the first quarter of fiscal 2015. The interest rate cap does not qualify for hedge accounting under ASC 815, *Derivatives and Hedging*. The fair value of the cap as of January 29, 2011, and January 30, 2010 was \$6 million and \$18 million, respectively, and is included in Other assets on the Consolidated Balance Sheets. The change in fair value of the cap for the year ended January 29, 2011 and January 30, 2010, resulted in a loss of \$12 million and a gain of \$10 million, respectively. These amounts are recorded in Other (income) and expense, net in the Consolidated Statements of Operations.

We are exposed to fluctuations in exchange rates between the US and Canadian dollar, which is the functional currency of our Canadian subsidiary. During the second quarter of fiscal 2008, we executed foreign currency forward contracts to mitigate the effects of currency fluctuations, which we designated as a cash flow hedge. The objective of the forward contracts was to hedge intercompany payments for forecasted purchases of inventory by our Canadian subsidiary, which are denominated in US dollars. The term of this cash flow hedge extended through the first quarter of fiscal 2009. To achieve our objective and to minimize the risk of ineffectiveness, the notional values represented a portion of our Canadian subsidiary's forecasted intercompany purchases. Hedge ineffectiveness was recorded in Other (income) and expense, net in the Consolidated Statement of Operations. For the year ended January 31, 2009, the ineffective portion of the hedge was immaterial. For the portion of the hedge that was effective, the change in fair value of the hedge was initially recorded in Accumulated other comprehensive income in the Consolidated Statement of (Deficit) Equity. As the underlying inventory was sold to our customers, amounts were reclassified from Accumulated other comprehensive income to Cost of sales and occupancy expense in the Consolidated Statement of Operations. We also classified the cash flows from derivative instruments in prepaid and other in the Consolidated Statement of Cash Flows. The change in fair value of the hedge for the year ended January 31, 2009 was \$2 million and we reclassified an immaterial amount from Accumulated other comprehensive income to Cost of sales and occupancy expense. During fiscal 2009, we reclassified \$6 million from Accumulated other comprehensive income to Cost of sales and occupancy expense.

Note 8. Fair Value Measurements

As defined in ASC 820, *Fair Value Measurements and Disclosures*, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 establishes a three-level valuation hierarchy for fair value measurements. These valuation techniques are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our market assumptions. These two types of inputs create the following fair value hierarchy:

- Level 1 Quoted prices for *identical* instruments in active markets;
- Level 2 Quoted prices for *similar* instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose significant inputs are observable; and

Edgar Filing: MICHAELS STORES INC - Form 10-K

- Level 3 Instruments whose significant inputs are *unobservable*.

The following table presents net financial assets (liabilities) accounted for at fair value on a recurring basis as of January 29, 2011 (in millions):

	Level 1	Level 2	Level 3	Total
Interest Rate Cap		6		6
Contingent Consideration			(4)	(4)

The interest rate cap is measured using widely accepted valuation techniques including a discounted cash flow analysis on the expected cash flows. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities. The fair value of the interest rate cap is determined using the market standard methodology of discounting the future expected variable cash receipts that would occur if variable interest rates rise above the strike rate of the cap. The variable cash receipts are based on an expectation of future interest rates (forward curves) derived from observable market interest rate curves. See Note 7 for additional information on our derivative instruments.

In connection with the acquisition of certain assets of ScrapHD (see Note 13), the Company has a contingent obligation, to be paid in cash, to the owners of ScrapHD based on future operating performance. The fair value of this contingent consideration is determined using an expected present value technique. Expected operating results are determined using the probability-weighted average of possible outcomes that would occur should certain financial metrics be reached. There is no market data available to use in valuing the contingent consideration; therefore, the Company developed its own assumptions related to the future financial performance of the business to estimate the fair value of the liability which was then discounted to present value using the weighted average cost of capital. The weighted average cost of capital was derived from comparable companies and management's estimates. The contingent consideration was established at the time of acquisition and will be evaluated at each reporting period. There have been no material changes to the fair value since the acquisition date of September 15, 2010. The liability is recorded in other long-term liabilities on the Consolidated Balance Sheets.

Long-lived assets held for use consists of stores tested for impairment as a result of our impairment review. The inputs used to measure the fair value of these long-lived assets include the calculation of undiscounted store-specific cash flows using management assumptions about key store variables including sales, growth rate, gross margin, payroll and other controllable expenses. As a result of our impairment review, we recorded an immaterial impairment of long-lived assets in fiscal 2010. In fiscal 2009, we recorded \$3 million in impairment charges for long-lived assets, of which \$2 million is reflected in Cost of sales and occupancy expense and \$1 million is reflected in selling, general and administrative expense on the Consolidated Statements of Operations. In fiscal 2008, we recorded \$5 million in impairment charges for long-lived assets, of which \$3 million is reflected in Cost of sales and occupancy expense and \$2 million is reflected in selling, general and administrative expense on the Consolidated Statements of Operations.

In accordance with ASC 350, we have performed the required impairment review related to goodwill. The impairment review is performed by comparing each reporting unit's carrying value to its estimated fair value. Our fair value assessment was based on a combination of estimated discounted future cash flows, observable earnings multiples of publicly-traded specialty retail companies, and use of earnings multiples resulting from market transactions of other specialty retail companies. Factors used in the valuation of goodwill include, but are not limited to, management's plans for future operations, recent operating results and discounted projected future cash flows. These factors are considered Level 3 inputs within the fair value hierarchy. Based on this review, the fair value of our reporting unit was substantially greater than its carrying value.

The table below provides the carrying and fair values of our loan and notes as of January 29, 2011. The fair value of these debt instruments were determined based on quoted market prices or recent trades.

	Carrying Value	Fair Value
	(In millions)	
Senior secured term loan	\$ 2,046	\$ 2,058
Senior notes	794	808
Senior subordinated notes	400	439
Subordinated discount notes	427	430

Note 9. Retirement Plans

We sponsor a 401(k) Savings Plan for our eligible employees and certain of our subsidiaries. Participation in the 401(k) Savings Plan is voluntary and available to any employee who is 21 years of age and has completed 500 hours of service in a six-month eligibility period. Participants may elect to contribute up to 80% of their compensation on a pre-tax basis and up to 10% on an after-tax basis. In accordance with the provisions of the 401(k) Savings Plan, we make a matching cash contribution to the account of each participant in an amount equal to 50% of the participant's pre-tax contributions that do not exceed 6% of the participant's considered compensation for the year. Matching contributions,

and the actual earnings thereon, vest to the participants based on years of service, with 100% vesting after three years. Our matching contribution expense, net of forfeitures, was \$3 million for each of fiscal 2010, 2009 and 2008.

Note 10. Commitments and Contingencies

Commitments

We operate stores and use distribution centers, office facilities, and equipment that are generally leased under non-cancelable operating leases, the majority of which provide for renewal options. Future minimum annual rental commitments for all non-cancelable operating leases as of January 29, 2011 are as follows (in millions):

F-25

Edgar Filing: MICHAELS STORES INC - Form 10-K

For the Fiscal Year:	Operating Leases	
2011	\$	346
2012		315
2013		267
2014		213
2015		158
Thereafter		348
Total minimum rental commitments	\$	1,647

Rental expense applicable to non-cancelable operating leases was \$327 million, \$319 million, and \$312 million, in fiscal 2010, 2009, and 2008, respectively.

Employee Claims

Adams Claim

On April 22, 2009, 129 individuals commenced an action against the Company styled Adams, et. al. v. Michaels Stores, Inc. in the United States District Court for the Central District of California. The Adams suit alleges that Michaels failed to pay overtime wages, provide meal and rest periods (or compensation in lieu thereof), accurately record hours worked and provide itemized employee wage statements. The Adams suit additionally alleges that the foregoing conduct was in breach of California's unfair competition law. Similar claims were subsequently filed by an additional eight individuals. The plaintiffs seek injunctive relief, damages for unpaid wages, penalties, restitution, interest, and attorneys' fees and costs. A number of the individual plaintiff claims have been settled for immaterial amounts. A bench trial on one of the plaintiff's case occurred in December 2010, and no decision has been rendered. We believe we have meritorious defenses and intend to defend the remaining individual claims vigorously. We do not believe the resolution of these cases will have a material effect on our business.

Tijero and Godfrey Consolidated Claim

On February 12, 2010, the Company was served with a lawsuit filed on May 7, 2009 by Jose Tijero, a former assistant manager for Aaron Brothers as a purported class action proceeding on behalf of himself and all current and former hourly retail employees employed by Aaron Brothers in California. On July 12, 2010, the Company was served with a lawsuit filed on July 9, 2010 by Amanda Godfrey, a former Aaron Brothers hourly employee alleging similar allegations as in the Tijero suit. On October 15, 2010, the cases were consolidated and refiled in the United States District Court-Northern District of California. These suits allege that Aaron Brothers failed to pay all wages and overtime, failed to provide its hourly employees with adequate meal and rest breaks (or compensation in lieu thereof), failed to timely pay final wages, unlawfully withheld wages and failed to provide accurate wage statements and further alleges that the foregoing conduct was in breach of various laws, including California's unfair competition law. The plaintiff seeks injunctive relief, compensatory damages, meal and rest break penalties, waiting time penalties, interest, and attorneys' fees and costs. The Company filed a Motion to Dismiss various claims and a hearing is set for March 29, 2011. We believe we have meritorious defenses and intend to defend the lawsuit vigorously. We are unable to estimate a range of loss, if any, in this case.

Consumer Class Action Claims

Edgar Filing: MICHAELS STORES INC - Form 10-K

Carson Claim

On August 15, 2008, Linda Carson, a consumer, filed a purported class action proceeding against Michaels Stores, Inc. in the Superior Court of California, County of San Diego (San Diego Superior Court), on behalf of herself and all similarly-situated

F-26

California consumers. The Carson suit alleges that Michaels unlawfully requested and recorded personally identifiable information (i.e., her zip code) as part of a credit card transaction. The plaintiff sought statutory penalties, costs, interest, and attorneys' fees. We contested certification of this claim as a class action and filed a motion to dismiss the claim. On March 9, 2009, the Court dismissed the case with prejudice. The plaintiff appealed this decision to the California Court of Appeal for the Fourth District, San Diego. On July 22, 2010, the Court of Appeal upheld the dismissal of the case. The plaintiff appealed this decision to the Supreme Court of California (California Supreme Court). On September 29, 2010, the California Supreme Court granted the plaintiff's petition for review; however, it stayed any further proceedings in the case until another similar zip code case pending before the court, *Pineda v. Williams-Sonoma*, was decided. On February 10, 2011, the California Supreme Court ruled, in the *Williams-Sonoma* case, that zip codes are personally identifiable information and therefore the Song-Beverly Credit Card Act of 1971, as amended (Song Act) prohibits businesses from requesting or requiring zip codes in connection with a credit card transaction. We anticipate that the Carson case will be remanded to the San Diego Superior Court for further proceedings consistent with the California Supreme Court decision. We are reviewing the matter in light of this recent decision and, at this time, we are unable to estimate a range of loss, if any, in this case. Additionally, since the California Supreme Court decision on February 10, 2011, three additional purported class action lawsuits alleging violations of the Song Act have been filed against the Company: *Carolyn Austin v. Michaels Stores, Inc.* and *Tiffany Heon v. Michaels Stores, Inc.*, both in the San Diego Superior Court and *Sandra A. Rubinstein v. Michaels Stores, Inc.* in the Superior Court of California, County of Los Angeles, Central Division. We intend to vigorously defend each of these cases and we are unable, at this time, to estimate a range of loss, if any.

Ratray Claim

On April 9, 2010, Ross Ratray, a consumer, filed a purported class action proceeding against Michaels Stores, Inc. in the San Diego Superior Court, on behalf of himself and all similarly-situated California consumers. The Ratray suit alleges causes of action for unlawful and unfair business practices and false advertising under the California Business and Professions Code, and a violation of the Consumer Legal Remedies Act, for misrepresentation that Michaels gift cards are not redeemable for cash and for failure to disclose that the plaintiff could redeem the unused cash balance on a gift card when the value fell below \$10.00. On March 15, 2011, the matter was mediated and a tentative settlement agreement was reached with the plaintiff for an immaterial amount, which is subject to Court approval.

Governmental Inquiries and Related Matters

Non-U.S. Trust Inquiry

In early 2005, the District Attorney's office of the County of New York and the SEC opened inquiries concerning non-U.S. trusts that directly or indirectly held shares of Michaels common stock and common stock options. A federal grand jury requested information with respect to the same facts. We are cooperating in these inquiries and have provided information in response to the requests.

Certain of these trusts and corporate subsidiaries of the trusts acquired securities of Michaels in transactions directly or indirectly with Charles J. Wyly, Jr. and Sam Wyly, who were, respectively, Chairman and Vice Chairman of the Board of Directors prior to the consummation of the Merger, or with other Wyly family members. In addition, subsidiaries of certain of these trusts acquired securities directly from us in private placement transactions in 1996 and 1997 and upon the exercise of stock options transferred, directly or indirectly, to the trusts or their subsidiaries by Charles Wyly, Sam Wyly, or other Wyly family members.

Edgar Filing: MICHAELS STORES INC - Form 10-K

We understand that Charles Wyly and Sam Wyly and/or certain of their family members are beneficiaries of irrevocable non-U.S. trusts. The 1996 and 1997 private placement sales by us of Michaels securities to subsidiaries of certain of these trusts were disclosed by us in filings with the SEC. The transfer by Charles Wyly and/or Sam Wyly (or by other Wyly family members or family-related entities) of Michaels securities to certain of these trusts and subsidiaries was also disclosed in filings with the SEC by us and/or by Charles Wyly and Sam Wyly. Based on information provided to us, our SEC filings prior to 2005 did not report securities owned by the non-U.S. trusts or their corporate subsidiaries as beneficially owned by Charles Wyly and Sam Wyly.

Charles Wyly and Sam Wyly filed an amended Schedule 13D with the SEC on April 8, 2005, stating that they may be deemed the beneficial owners of Michaels securities held directly or indirectly by the non-U.S. trusts. In our 2005 and 2006 proxy statements, we included the securities held in the non-U.S. trusts or their separate subsidiaries, as reported by the Wyllys, in the beneficial ownership table of our principal stockholders and management, with appropriate footnotes.

On July 29, 2010, the SEC filed a civil enforcement action in federal district court for the Southern District of New York against Charles Wyly, Sam Wyly and others alleging, among other things, violations of various federal securities laws, including those governing ownership reporting and trading of securities, in connection with the non-U.S. trusts and their subsidiaries. Additional information may be obtained at the SEC's website. Charles Wyly, Sam Wyly and their attorney Michael French, a former director of

the Company, have requested indemnification from the Company for certain legal costs with respect to these matters. The Company is currently assessing the Wylys' claim and French's claim.

Pricing and Promotions Inquiry

On or about February 11, 2011, the Company received a notice of investigation and a subpoena from the New York State Attorney General requiring the production of certain documents relating to the frequency of the Company's pricing promotions and advertisements. At this time, we are unable to determine the scope of the investigation, the relief which may be sought in any such proceeding or whether such proceeding could have a material adverse effect on our business.

General

We are a defendant from time to time in lawsuits incidental to our business. Based on currently available information, we believe that resolution of all known contingencies is uncertain. There can be no assurance that future costs of such litigation would not be material to our financial position, results of operations, or cash flows.

Note 11. Concentration of Credit Risk

We periodically invest our excess cash and equivalents in money market funds and trusts, which are not insured or guaranteed by the Federal Deposit Insurance Corporation or any other financial or government institution. We also deposit a portion of our cash and equivalents with numerous federally-insured financial institutions, the balances of which often exceed \$250,000. The Federal Deposit Insurance Corporation insures each account up to a maximum of \$250,000 of the aggregate account balance with each institution. We believe counterparty default risk is low as we only use financial institutions with investment grade ratings or funds and trusts that invest in securities with investment grade ratings and that possess the necessary liquidity to satisfy our redemption needs.

We have market risk exposure arising from changes in interest rates on our Senior Credit Facilities. The interest rates on our Senior Credit Facilities will reprice periodically, which will impact our earnings and cash flow. The interest rates on our Notes are fixed. Based on our overall interest rate exposure to variable rate debt outstanding as of January 29, 2011, a 1% increase or decrease in interest rates would increase or decrease income before income taxes by approximately \$20 million. A 1% increase in interest rates would decrease the fair value of our long-term fixed rate debt by approximately \$57 million. A 1% decrease in interest rates would increase the fair value of our long-term fixed rate debt by approximately \$53 million. A change in interest rates would not materially affect the fair value of our variable rate debt as the debt reprices periodically.

Note 12. Segments and Geographic Information

We consider our Michaels and Aaron Brothers operations to be our operating segments for purposes of determining reportable segments based on the criteria of ASC 280, *Segment Reporting*. We determined that our Michaels and Aaron Brothers operating segments have similar economic

Edgar Filing: MICHAELS STORES INC - Form 10-K

characteristics and meet the aggregation criteria set forth in ASC 280. Therefore, we combine both operating segments into one reporting segment.

The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies in Note 1.

Our chief operating decision makers evaluate historical operating performance, plan and forecast future periods' operating performance based on earnings before interest, income taxes, depreciation and amortization (EBITDA). We believe EBITDA represents the financial measure that more closely reflects the operating effectiveness of factors over which management has control. As such, an element of base incentive compensation targets for certain management personnel are based on EBITDA. A reconciliation of EBITDA to income (loss) before income taxes is presented below.

	Fiscal Year		
	2010	2009	2008
Income (loss) before income taxes	\$ 149	\$ 157	\$ (2)
Interest expense	276	257	302
Early extinguishment of debt	53		
Depreciation and amortization	103	116	129
EBITDA	\$ 581	\$ 530	\$ 429

F-28

Edgar Filing: MICHAELS STORES INC - Form 10-K

Our sales and assets by country are as follows:

	2010	Fiscal Year 2009 (in millions)		2008
Net Sales:				
United States	\$ 3,673	\$ 3,572	\$ 3,517	\$ 3,517
Canada	358	316	300	300
Consolidated Total	\$ 4,031	\$ 3,888	\$ 3,817	\$ 3,817
Total Assets:				
United States	\$ 1,689	\$ 1,635	\$ 1,535	\$ 1,535
Canada	81	75	90	90
Consolidated Total	\$ 1,770	\$ 1,710	\$ 1,625	\$ 1,625

We present assets based on their physical, geographic location. Certain assets located in the United States are also used to support our Canadian operations, but we do not allocate these assets to Canada.

Note 13. Business Combination

On September 15, 2010, the Company acquired certain assets related to the online scrapbooking application created by ScrapHD, LLC, an Illinois limited liability company (ScrapHD). The application allows customers to work online to create digital scrapbooks that they can print at home or have professionally bound into a book. Pursuant to the acquisition, we purchased 100% of the proprietary software and intellectual property assets necessary to operate the online scrapbooking application.

The total consideration for the ScrapHD acquisition is currently estimated at \$6 million, which is comprised of \$2 million cash consideration paid at closing and an additional contingent consideration arrangement currently valued at \$4 million. The potential payment that we could be required to make under the contingent consideration arrangement ranges from \$0 to \$10 million. The contingent consideration arrangement requires Michaels to pay the owners of ScrapHD an amount equal to (i) the operating performance of the ScrapHD business line for, at the owners' option, the 52 weeks ended January 28, 2012 (Fiscal 2011) or the 53 weeks ended February 3, 2013 (Fiscal 2012) minus (ii) the cash consideration paid at closing, up to a maximum amount of \$10 million. If the owners of ScrapHD elect to designate Fiscal 2012 as the designated fiscal year, the operating performance of the ScrapHD business line will be multiplied by a fraction, the numerator of which is 52 and the denominator of which is 53 due to Fiscal 2012 containing a 53rd week. As of January 29, 2011, services provided by the ScrapHD acquisition had not been placed into operation.

The total purchase price was allocated to the tangible and identifiable assets acquired based on their estimated fair value at the acquisition date. The ScrapHD acquisition resulted in \$1 million of goodwill, of which none is expected to be deductible for income tax purposes. The goodwill recognized is primarily the result of synergies and economies of scale expected to arise from combining the operations of the Company and ScrapHD.

The following table summarizes the acquisition date fair value of the assets acquired (in millions):

Software intangible asset	\$	4
Non-compete agreements		1
Goodwill		1
Assets acquired	\$	6

Note 14. Related Party Transactions

We pay annual management fees to the Sponsors in the amount of \$12 million and an annual management fee to Highfields Capital Management LP in the amount of \$1 million. We recognized \$14 million of expense in fiscal 2010, fiscal 2009 and fiscal 2008 related to annual management fees.

Bain owns a majority equity position in an external vendor we utilize to print our circular advertisements. Payments associated with this vendor during fiscal 2010, fiscal 2009 and fiscal 2008 were \$39 million, \$39 million and \$44 million,

Edgar Filing: MICHAELS STORES INC - Form 10-K

respectively, and are included in selling, general and administrative expense on the Consolidated Statements of Operations.

Bain owns a partial equity position in an external vendor we utilized for non-merchandise supplies. Payments associated with this vendor during fiscal 2009 and fiscal 2008 were approximately \$1 million and \$3 million, respectively, and are included in selling, general and administrative expense on the Consolidated Statements of Operations.

Blackstone owns a majority equity position in an external vendor we utilize to count our store inventory. Payments associated with this vendor during fiscal 2010, fiscal 2009 and fiscal 2008 were \$6 million, \$7 million and \$6 million, respectively, and are included in selling, general and administrative expense on the Consolidated Statements of Operations.

During fiscal 2008, we began utilizing an external vendor for waste management services that is partially owned by Blackstone. Payments associated with this vendor during fiscal 2010, fiscal 2009, and fiscal 2008 were \$5 million, \$7 million and \$3 million, respectively, and are included in selling, general and administrative expense on the Consolidated Statements of Operations.

During the first quarter of fiscal 2008, Blackstone acquired an equity position in an external vendor we utilize for all of the candy-type items in our stores. Payments associated with this vendor during fiscal 2010, fiscal 2009 and fiscal 2008 were \$19 million, \$18 million, and \$18 million, respectively, and are recognized in Cost of sales as the sales are incurred.

Blackstone owns a partially equity position in an external vendor we utilize for hospitality services. Payments associated with this vendor during fiscal 2010 were \$1 million, and are included in selling, general, and administrative expense on the Consolidated Statement of Operations.

Our current directors are affiliates of Bain or Blackstone. As such, some or all of our directors may have an indirect material interest in payments with respect to debt securities of the Company that have been purchased by affiliates of Bain and Blackstone. As of January 29, 2011, such affiliates did not hold any of our debt securities.

The Company periodically provides officers of Michaels Stores, Inc. and its subsidiaries the opportunity to purchase shares of our Common Stock. There were no shares sold to officers during fiscal 2010, fiscal 2009 and fiscal 2008. During fiscal 2008 we repurchased 111,334 shares from officers who are no longer with the Company. There have been no shares repurchased during fiscal 2010 and fiscal 2009.

Note 15. Condensed Consolidating Financial Information

All obligations of Michaels Stores, Inc. under the Senior notes, Senior subordinated notes, Subordinated discount notes, Senior secured term loan facility, and Asset-based revolving credit facility are guaranteed by each of our subsidiaries other than Aaron Brothers Card Services, LLC and Artistree of Canada, ULC. As of January 29, 2011, the financial statements of Aaron Brothers Card Services, LLC and Artistree of Canada, ULC were immaterial. Each subsidiary guarantor is 100% owned by the parent and all guarantees are joint and several.

Edgar Filing: MICHAELS STORES INC - Form 10-K

The following condensed consolidating financial information represents the financial information of Michaels Stores, Inc. and its wholly-owned subsidiary guarantors, prepared on the equity basis of accounting. The information is presented in accordance with the requirements of Rule 3-10 under the SEC's Regulation S-X. The financial information may not necessarily be indicative of results of operations, cash flows, or financial position had the subsidiary guarantors operated as independent entities.

F-30

Supplemental Condensed Consolidating Statement of Operations

	Fiscal Year 2010				Consolidated
	Parent Company	Guarantor Subsidiaries	Eliminations	(in millions)	
Net sales	\$ 3,530	\$ 2,294	\$ (1,793)	\$ 4,031	
Cost of sales and occupancy expense	2,341	1,919	(1,793)	2,467	
Gross profit	1,189	375		1,564	
Selling, general, and administrative expense	919	140		1,059	
Related party expenses	14			14	
Store pre-opening costs	3			3	
Operating income	253	235		488	
Interest expense	276			276	
Loss on early extinguishment of debt	53			53	
Other (income) and expense, net	12	(2)		10	
Intercompany charges (income)	73	(73)			
Equity in earnings of subsidiaries	310		(310)		
Income before income taxes	149	310	(310)	149	
Provision for income taxes	51	107	(107)	51	
Net income	\$ 98	\$ 203	\$ (203)	\$ 98	

Supplemental Condensed Consolidating Statement of Operations

	Fiscal Year 2009				Consolidated
	Parent Company	Guarantor Subsidiaries	Eliminations	(in millions)	
Net sales	\$ 3,428	\$ 2,233	\$ (1,773)	\$ 3,888	
Cost of sales and occupancy expense	2,350	1,846	(1,773)	2,423	
Gross profit	1,078	387		1,465	
Selling, general, and administrative expense	916	136		1,052	
Related party expenses	14			14	
Store pre-opening costs	2			2	
Operating income	146	251		397	
Interest expense	257			257	
Other (income) and expense, net	(11)	(6)		(17)	
Intercompany charges (income)	73	(73)			
Equity in earnings of subsidiaries	330		(330)		
Income before income taxes and	157	330	(330)	157	
Provision for income taxes	50	105	(105)	50	
Net income	\$ 107	\$ 225	\$ (225)	\$ 107	

Supplemental Condensed Consolidating Statement of Operations

	Fiscal Year 2008				Consolidated
	Parent Company	Guarantor Subsidiaries	Eliminations	(in millions)	
Net sales	\$ 3,356	\$ 2,206	\$ (1,745)	\$	3,817
Cost of sales and occupancy expense	2,342	1,834	(1,745)		2,431
Gross profit	1,014	372			1,386
Selling, general, and administrative expense	934	126			1,060
Related party expenses	16				16
Store pre-opening costs	6				6
Operating income	58	246			304
Interest expense	302				302
Other (income) and expense, net		4			4
Intercompany charges (income)	76	(76)			
Equity in earnings of subsidiaries	318		(318)		
(Loss) income before income taxes and	(2)	318	(318)		(2)
Provision (benefit) for income taxes	3	123	(123)		3
Net (loss) income	\$ (5)	\$ 195	\$ (195)	\$	(5)

Supplemental Condensed Consolidating Balance Sheet

	January 29, 2011				Consolidated
	Parent Company	Guarantor Subsidiaries	Eliminations (in millions)		
ASSETS					
Current assets:					
Cash and equivalents	\$ 309	\$ 10	\$	\$	319
Merchandise inventories	571	255			826
Intercompany receivables		348	(348)		
Other	113	17			130
Total current assets	993	630	(348)		1,275
Property and equipment, net	234	67			301
Goodwill, net	95				95
Investment in subsidiaries	295		(295)		
Other assets	98	1			99
Total assets	\$ 1,715	\$ 698	\$ (643)	\$	1,770
LIABILITIES AND STOCKHOLDERS (DEFICIT) EQUITY					
Current liabilities:					
Accounts payable	\$ 7	\$ 266	\$	\$	273
Accrued liabilities and other	262	122			384
Current portion of long-term debt	1				1
Intercompany payable	348		(348)		
Other	26	3			29
Total current liabilities	644	391	(348)		687
Long-term debt	3,667				3,667
Deferred income taxes	2	2			4
Other long-term liabilities	66	10			76
Total stockholders (deficit) equity	(2,664)	295	(295)		(2,664)
Total liabilities and stockholders equity (deficit)	\$ 1,715	\$ 698	\$ (643)	\$	1,770

Supplemental Condensed Consolidating Balance Sheet

	January 30, 2010				Consolidated
	Parent Company	Guarantor Subsidiaries	Eliminations (in millions)		
ASSETS					
Current assets:					
Cash and equivalents	\$ 207	\$ 10	\$	\$	217
Merchandise inventories	599	274			873
Intercompany receivables		243	(243)		
Other	103	14			117
Total current assets	909	541	(243)		1,207
Property and equipment, net	238	79			317
Goodwill, net	94				94
Investment in subsidiaries	288		(288)		
Other assets	90	2			92
Total assets	\$ 1,619	\$ 622	\$ (531)		\$ 1,710
LIABILITIES AND STOCKHOLDERS (DEFICIT) EQUITY					
Current liabilities:					
Accounts payable	\$ 10	\$ 221	\$	\$	231
Accrued liabilities and other	256	100			356
Current portion of long-term debt	119				119
Intercompany payable	243		(243)		
Other	11				11
Total current liabilities	639	321	(243)		717
Long-term debt	3,684				3,684
Other long-term liabilities	67	13			80
Total stockholders (deficit) equity	(2,771)	288	(288)		(2,771)
Total liabilities and stockholders equity (deficit)	\$ 1,619	\$ 622	\$ (531)		\$ 1,710

Supplemental Condensed Consolidating Statement of Cash Flows

	Fiscal Year 2010			
	Parent Company	Guarantor Subsidiaries	Eliminations	Consolidated
	(in millions)			
Operating Activities:				
Net cash provided by operating activities	\$ 426	\$ 301	\$ (289)	\$ 438
Investing Activities:				
Cost of business acquisition	(2)			(2)
Cash paid for property and equipment	(69)	(12)		(81)
Net cash used in investing activities	(71)	(12)		(83)
Financing Activities:				
Net repayments of long-term debt	(225)			(225)
Intercompany dividends		(289)	289	
Other financing activities	(28)			(28)
Net cash used in financing activities	(253)	(289)	289	(253)
Increase in cash and equivalents	102			102
Beginning cash and equivalents	207	10		217
Ending cash and equivalents	\$ 309	\$ 10	\$	\$ 319

Supplemental Condensed Consolidating Statement of Cash Flows

	Fiscal Year 2009			
	Parent Company	Guarantor Subsidiaries	Eliminations	Consolidated
	(in millions)			
Operating activities:				
Net cash provided by operating activities	\$ 397	\$ 525	\$ (517)	\$ 405
Investing activities:				
Cash paid for property and equipment	(38)	(5)		(43)
Net cash used in investing activities	(38)	(5)		(43)
Financing activities:				
Net borrowings of long-term debt	(171)			(171)
Intercompany dividends		(517)	517	
Other financing activities	(7)			(7)
Net cash used in financing activities	(178)	(517)	517	(178)
Increase in cash and equivalents	181	3		184
Beginning cash and equivalents	26	7		33
Ending cash and cash equivalents	\$ 207	\$ 10	\$	\$ 217

Supplemental Condensed Consolidating Statement of Cash Flows

	Fiscal Year 2008			
	Parent Company	Guarantor Subsidiaries	Eliminations	Consolidated
	(in millions)			
Operating activities:				
Net cash provided by operating activities	\$ 47	\$ 192	\$ (180)	\$ 59
Investing activities:				
Cash paid for property and equipment	(77)	(8)		(85)
Net cash used in investing activities	(77)	(8)		(85)
Financing activities:				
Net repayments of long-term debt	27			27
Intercompany dividends		(180)	180	
Other financing activities	3			3
Net cash provided by financing activities	30	(180)	180	30
Increase in cash and equivalents		4		4
Beginning cash and equivalents	26	3		29
Ending cash and equivalents	\$ 26	\$ 7	\$	\$ 33

MICHAELS STORES, INC.

UNAUDITED SUPPLEMENTAL QUARTERLY FINANCIAL DATA

(in millions)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Fiscal 2010:				
Net sales	\$ 901	\$ 831	\$ 968	\$ 1,331
Cost of sales and occupancy expense	547	520	592	808
Gross profit	354	311	376	523
Selling, general, and administrative expense	245	233	269	312
Operating income	105	74	102	207
Loss on early extinguishment of debt (1)			53	
Net income (loss)	13	(1)	(12)	98
Fiscal 2009:				
Net sales	\$ 852	\$ 807	\$ 929	\$ 1,300
Cost of sales and occupancy expense	537	521	582	783
Gross profit	315	286	347	517
Selling, general, and administrative expense	246	232	259	315
Operating income	64	50	84	199
Net income	4	2	15	86

We report on the basis of a 52 or 53-week fiscal year, which ends on the Saturday closest to January 31. Our interim periods each contain 13 weeks, with the first quarter ending on a Saturday 13 weeks after the end of our previous fiscal year. For fiscal years that contain 53 weeks, our fourth quarter contains 14 weeks.

(1) The \$53 million loss on early extinguishment of debt relates to the early extinguishment of our 2014 Notes.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Date: March 24, 2011

MICHAELS STORES, INC.

By:

/s/ Charles M. Sonsteby
 Charles M. Sonsteby
 Chief Administrative Officer & Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/ John B. Menzer John B. Menzer	Chief Executive Officer (Principal Executive Officer)	March 24, 2011
/s/ Charles M. Sonsteby Charles M. Sonsteby	Chief Administrative Officer & Chief Financial Officer (Principal Financial Officer)	March 24, 2011
/s/ Richard S. Jablonski Richard S. Jablonski	Vice President Financial Planning & Analysis and Interim Controller (Principal Accounting Officer)	March 24, 2011
Josh Bekenstein	Director	
/s/ Michael S. Chae Michael S. Chae	Director	March 24, 2011
/s/ Todd M. Cook Todd M. Cook	Director	March 24, 2011
/s/ Lewis S. Klessel Lewis S. Klessel	Director	March 24, 2011
Matthew S. Levin	Director	
/s/ Gerry M. Murphy Gerry M. Murphy	Director	March 24, 2011
/s/ James A. Quella James A. Quella	Director	March 24, 2011
/s/ Peter F. Wallace Peter F. Wallace	Director	March 24, 2011

EXHIBIT INDEX

Exhibit Number	Description of Exhibit
2.1	Agreement and Plan of Merger, dated as of June 30, 2006, among Bain Paste Mergerco, Inc., Blackstone Paste Mergerco, Inc., Bain Paste Finco, LLC, Blackstone Paste Finco, LLC and Michaels Stores, Inc. (previously filed as Exhibit 2.1 to Form 8-K filed by Company on July 6, 2006, SEC File No. 001-09338).
2.2	First Amendment to Agreement and Plan of Merger, dated as of September 1, 2006, among Bain Paste Mergerco, Inc., Blackstone Paste Mergerco, Inc., Bain Paste Finco, LLC, Blackstone Paste Finco, LLC and Michaels Stores, Inc. (previously filed as Exhibit 2.1 to Form 8-K filed by Company on September 5, 2006, SEC File No. 001-09338).
3.1	Amended and Restated Certificate of Incorporation of Michaels Stores, Inc. (previously filed as Exhibit 3.1 to Form 10-K filed by Company on May 3, 2007, SEC File No. 001-09338).
3.2	Amended and Restated Bylaws of Michaels Stores, Inc. (previously filed as Exhibit 3.2 to Form 8-K filed by Company on November 6, 2006, SEC File No. 001-09338).
4.1	Senior Indenture, dated as of October 31, 2006, among Michaels Stores, Inc., the guarantors named therein and Wells Fargo Bank, National Association, as trustee (previously filed as Exhibit 4.1 to Form 10-Q filed by Company on December 7, 2006, SEC File No. 001-09338).
4.2	Supplemental Indenture, dated as of October 20, 2010, by and among Michaels Stores, Inc. and Law Debenture Trust Company of New York, as trustee (previously filed as Exhibit 4.1 to Form 8-K filed by Company on October 26, 2010, SEC File No. 001-09338).
4.3	Indenture, dated as of October 21, 2010, by and among Michaels Stores, Inc., the guarantors named therein and Law Debenture Trust Company of New York, as trustee (previously filed as Exhibit 4.2 to Form 8-K filed by Company on October 26, 2010, SEC File No. 001-09338).
4.4	Senior Subordinated Indenture, dated as of October 31, 2006, among Michaels Stores, Inc., the guarantors named therein and Wells Fargo Bank, National Association, as trustee (previously filed as Exhibit 4.2 to Form 10-Q filed by Company on December 7, 2006, SEC File No. 001-09338).
4.5	Subordinated Discount Indenture, dated as of October 31, 2006, among Michaels Stores, Inc., the guarantors named therein and Wells Fargo Bank, National Association, as trustee (previously filed as Exhibit 4.3 to Form 10-Q filed by Company on December 7, 2006, SEC File No. 001-09338).
4.6	Purchase Agreement, dated October 7, 2010, by and among the Company, the Guarantors named therein and the Initial Purchasers named therein (previously filed as Exhibit 10.1 to Form 8-K filed by Company on October 14, 2010, SEC File No. 001-09338).
4.7	Registration Rights Agreement, dated as of October 31, 2006, among Michaels Stores, Inc. and certain stockholders thereof (previously filed as Exhibit 4.7 to Form 10-Q filed by Company on December 7, 2006, SEC File No. 001-09338).
4.8	Registration Rights Agreement, dated as of October 21, 2010, by and among Michaels Stores, Inc., the guarantors named therein and the Initial Purchasers named therein (previously filed as Exhibit 4.3 to Form 8-K filed by Company on October 26, 2010, SEC File No. 001-09338).
10.1	Michaels Stores, Inc. 2006 Equity Incentive Plan (previously filed as Exhibit 10.1 to Form 8-K filed by Company on February 21, 2007, SEC File No. 001-09338).*
10.2	Form of Stock Option Agreement under the Michaels Stores, Inc. 2006 Equity Incentive Plan (previously filed as Exhibit 10.2 to Form 8-K filed by Company on February 21, 2007, SEC File No. 001-09338).*
10.3	Amended form of Stock Option Agreement under Michaels Stores, Inc. 2006 Equity Incentive Plan (previously filed as Exhibit 10.1 to Form 10-Q filed by Company on September 4, 2009, SEC File No. 001-09338).*

Edgar Filing: MICHAELS STORES INC - Form 10-K

- 10.4 Form of Restricted Stock Award Agreement under the Michaels Stores, Inc. 2006 Equity Incentive Plan (previously filed as Exhibit 10.3 to Form 10-Q filed by the Company on June 6, 2008, SEC File No. 001-09338).*
- 10.5 Form of Fiscal Year 2011 Bonus Plan for Executive Officers (filed herewith).*
- 10.6 Employment Agreement, dated March 6, 2009, between Michaels Stores, Inc. and John B. Menzer (previously filed as Exhibit 10.1 to Form 10-Q filed by Company on June 5, 2009, SEC File No. 001-09338).*
- 10.7 Amendment to Employment Agreement, dated June 2, 2009, between Michaels Stores, Inc. and John B. Menzer (previously filed as Exhibit 10.2 to Form 10-Q filed by Company on June 5, 2009, SEC File No. 001-09338).*
- 10.8 Letter Agreement, dated September 15, 2010, between Michaels Stores, Inc. and Charles M. Sonstebly (previously filed as Exhibit 99.2 to Form 8-K filed by Company on September 17, 2010, SEC File No. 001-09338).*
- 10.9 Letter Agreement, dated February 5, 2010, between Michaels Stores, Inc. and Paula A. Puleo (filed herewith).*
- 10.10 Letter Agreement, dated May 26, 2010, between Michaels Stores, Inc. and John Wyatt (filed herewith).*
- 10.11 Restricted Stock Award Agreement, dated June 2, 2009, between Michaels Stores, Inc. and John B. Menzer (previously filed as Exhibit 10.3 to Form 10-Q filed by Company on June 5, 2009, SEC File No. 001-09338).*
- 10.12 Stock Option Agreement, dated June 2, 2009, between Michaels Stores, Inc. and John B. Menzer (previously filed as Exhibit 10.4 to Form 10-Q filed by Company on June 5, 2009, SEC File No. 001-09338).*
- 10.13 Stockholders Agreement, dated as of October 31, 2006, among Michaels Stores, Inc. and certain stockholders thereof (previously filed as Exhibit 10.1 to Form 10-Q filed by Company on December 7, 2006, SEC File No. 001-09338).
- 10.14 Amended and Restated Stockholders Agreement, dated as of February 16, 2007, among Michaels Stores, Inc. and certain stockholders thereof (previously filed as Exhibit 10.23 to Form 10-K filed by Company on May 3, 2007, SEC File No. 001-09338).
- 10.15 Management Agreement, dated as of October 31, 2006, among Michaels Stores, Inc., Bain Capital Partners, LLC and Blackstone Management Partners V LLC (previously filed as Exhibit 10.2 to Form 10-Q filed by Company on December 7, 2006, SEC File No. 001-09338).*
- 10.16 Management Agreement, dated as of October 31, 2006, between Michaels Stores, Inc. and Highfields Capital Management LP (previously filed as Exhibit 10.3 to Form 10-Q filed by Company on December 7, 2006, SEC File No. 001-09338).*
- 10.17 Michaels Stores, Inc. Amended Officer Severance Pay Plan (previously filed as Exhibit 10.17 to Form 10-K filed by Company on April 2, 2009, SEC File No. 001-09338).*
- 10.18 Form of Director Indemnification Agreement between Michaels Stores, Inc. and certain directors thereof (previously filed as Exhibit 10.36 to Form 10-K filed by Company on March 30, 2006, SEC File No. 001-09338).
- 10.19 Form of Officer Indemnification Agreement between Michaels Stores, Inc. and certain officers thereof (previously filed as Exhibit 10.37 to Form 10-K filed by Company on March 30, 2006, SEC File No. 001-09338).
- 10.20 Amended and Restated Credit Agreement, dated as of February 18, 2010, among Michaels Stores, Inc., as lead borrower, the borrowers named therein, the facility guarantors named therein, Bank of America, N.A., as administrative agent and collateral agent, the lenders party thereto (collectively, the Lenders), Wells Fargo Retail Finance, LLC, as syndication agent, Deutsche Bank Securities Inc., JPMorgan Chase Bank, N.A. and Credit Suisse, as co-documentation agents, General Electric Capital Corporation, UBS Securities LLC and RBS Business Capital, as senior managing agents, Banc of America Securities LLC, Wells Fargo Retail Finance, LLC and Deutsche Bank Securities Inc., as joint lead arrangers, and Banc of America Securities LLC, Wells Fargo Retail Finance, LLC, Deutsche Bank Securities Inc., J.P. Morgan Securities Inc. and Credit Suisse, as joint book runners (previously filed as Exhibit 10.1 to Form 8-K filed by Company on February 19, 2010, SEC File No. 001-09338).
- 10.21 Exhibits and Schedules to Amended and Restated Credit Agreement, dated as of February 18, 2010, among Michaels

Edgar Filing: MICHAELS STORES INC - Form 10-K

Stores, Inc., as lead borrower, the borrowers named therein, the facility guarantors named therein, Bank of America, N.A., as administrative agent and collateral agent, the lenders party thereto (collectively, the Lenders), Wells Fargo Retail Finance, LLC, as syndication agent, Deutsche Bank Securities Inc., JPMorgan Chase Bank, N.A. and Credit Suisse, as co-documentation agents, General Electric Capital Corporation, UBS Securities LLC and RBS Business Capital, as senior managing agents, Banc of America Securities LLC, Wells Fargo Retail Finance, LLC and Deutsche Bank Securities Inc., as joint lead arrangers, and Banc of America Securities LLC, Wells Fargo Retail Finance, LLC, Deutsche Bank Securities Inc., J.P. Morgan Securities Inc. and Credit Suisse, as joint book runners (previously filed as Exhibit 10.2 to Form 8-K filed by Company on May 28, 2010, SEC File No. 001-09338).

- 10.22 Credit Agreement, dated as of October 31, 2006, among Michaels Stores, Inc., Deutsche Bank AG New York Branch, as administrative agent, the other lenders named therein, JPMorgan Chase Bank, N.A., as syndication agent, and Bank of America, N.A. and Credit Suisse, as co-documentation agents, and Deutsche Bank Securities Inc., J.P. Morgan Securities Inc. and Banc of America Securities LLC as co-lead arrangers and joint bookrunners (previously filed as Exhibit 10.5 to Form 10-Q filed by Company on December 7, 2006, SEC File No. 001-09338).
- 10.23 First Amendment to Credit Agreement, dated as of January 19, 2007, to the Credit Agreement, dated as of October 31, 2006, among Michaels Stores, Inc., Deutsche Bank AG New York Branch, as administrative agent, the other lenders named therein, JPMorgan Chase Bank, N.A., as syndication agent, and Bank of America, N.A. and Credit Suisse, as co-documentation agents, and Deutsche Bank Securities Inc., J.P. Morgan Securities Inc. and Banc of America Securities LLC as co-lead arrangers and joint bookrunners (previously filed as Exhibit 10.1 to Form 8-K filed by Company on January 25, 2007, SEC File No. 001-09338).
- 10.24 Second Amendment to Credit Agreement, dated as of May 10, 2007, to the Credit Agreement, dated as of October 31, 2006, among Michaels Stores, Inc., Deutsche Bank AG New York Branch, as administrative agent, the other lenders named therein, JPMorgan Chase Bank, N.A., as syndication agent, and Bank of America, N.A. and Credit Suisse, as co-documentation agents, and Deutsche Bank Securities Inc., J.P. Morgan Securities Inc. and Banc of America Securities LLC as co-lead arrangers and joint bookrunners (previously filed as Exhibit 10.1 to Form 8-K filed by Company on May 11, 2007, SEC File No. 001-09338).
- 10.25 Third Amendment to Credit Agreement, dated as of August 20, 2009, to the Credit Agreement, dated as of October 31, 2006, among Michaels Stores, Inc., Deutsche Bank AG New York Branch, as administrative agent, the other lenders named therein, JPMorgan Chase Bank, N.A., as syndication agent, and Bank of America, N.A. and Credit Suisse, as co-documentation agents, and Deutsche Bank Securities Inc., J.P. Morgan Securities Inc. and Banc of America Securities LLC as co-lead arrangers and joint bookrunners (previously filed as Exhibit 10.3 to Form 10-Q filed by Company on September 4, 2009, SEC File No. 001-09338).
- 10.26 Fourth Amendment to Credit Agreement, dated as of November 5, 2009, to the Credit Agreement, dated as of October 31, 2006, among Michaels Stores, Inc., Deutsche Bank AG New York Branch, as administrative agent, the other lenders named therein, JPMorgan Chase Bank, N.A., as syndication agent, and Bank of America, N.A. and Credit Suisse, as co-documentation agents, and Deutsche Bank Securities Inc., J.P. Morgan Securities Inc. and Banc of America Securities LLC as co-lead arrangers and joint bookrunners (previously filed as Exhibit 10.1 to Form 8-K filed by Company on November 5, 2009 SEC File No. 001-09338).
- 10.27 Master Services Agreement, dated as of January 16, 2009, by and between Michaels Stores, Inc. and Tata America International Corporation (previously filed as Exhibit 10.29 to Form 10-K filed by Company on April 2, 2009, SEC File No. 001-09338).
- 10.28 Michaels Stores, Inc. Employees 401(k) Plan, effective March 1, 2009 (previously filed as Exhibit 10.30 to Form 10-K filed by Company on April 2, 2009, SEC File No. 001-09338).*
- 21.1 Subsidiaries of Michaels Stores, Inc. (previously filed as Exhibit 21.1 to Form 10-K filed by Company on April 11, 2005, SEC File No. 001-09338).
- 31.1 Certifications of John B. Menzer pursuant to §302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- 31.2 Certifications of Charles M. Sonstebly pursuant to §302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- 32.1 Certification pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002 (filed herewith).

* Management contract or compensatory plan or arrangement.