

MICHAELS STORES INC
Form 10-Q
December 10, 2013
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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended November 2, 2013

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.

(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)

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 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
(Do not check if a smaller reporting company)

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

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As of December 6, 2013, 100 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.

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MICHAELS STORES, INC.

Part I FINANCIAL INFORMATION

Item 1. Financial Statements. MICHAELS STORES, INC.

CONSOLIDATED BALANCE SHEETS

(in millions, except share data)

(Unaudited)

	November 2, 2013	February 2, 2013 (Restated)	October 27, 2012 (Restated)
ASSETS			
Current assets:			
Cash and equivalents	\$ 68	\$ 56	\$ 161
Merchandise inventories	1,119	862	1,078
Prepaid expenses and other	99	86	91
Receivable from Parent	1		
Deferred income taxes	38	37	42
Income tax receivable	20	3	17
Total current assets	1,345	1,044	1,389
Property and equipment, at cost	1,570	1,502	1,478
Less accumulated depreciation and amortization	(1,217)	(1,164)	(1,134)
Property and equipment, net	353	338	344
Goodwill	94	94	95
Debt issuance costs, net of accumulated amortization of \$57, \$54, and \$77, respectively	38	46	53
Deferred income taxes	29	30	32
Long-term receivable from Parent	5		
Other assets	2	3	4
Total non-current assets	168	173	184
Total assets	\$ 1,866	\$ 1,555	\$ 1,917
LIABILITIES AND STOCKHOLDERS DEFICIT			
Current liabilities:			
Accounts payable	\$ 467	\$ 263	\$ 374
Accrued liabilities and other	342	367	424
Share-based compensation	21	35	30
Current portion of long-term debt	203	150	180
Deferred income taxes	4	4	1
Income taxes payable	6	37	6
Total current liabilities	1,043	856	1,015
Long-term debt	2,878	2,891	3,188
Deferred income taxes	2	2	11
Share-based compensation	28	27	24
Other long-term liabilities	86	83	86
Total long-term liabilities	2,994	3,003	3,309
Total liabilities	4,037	3,859	4,324

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Commitments and contingencies Stockholders deficit:

Common Stock, \$0.10 par value, 100 shares authorized; 100 shares issued and outstanding

Additional paid-in capital	63	49	51
Accumulated deficit	(2,238)	(2,359)	(2,464)
Accumulated other comprehensive income	4	6	6
Total stockholders deficit	(2,171)	(2,304)	(2,407)
Total liabilities and stockholders deficit	\$ 1,866	\$ 1,555	\$ 1,917

See accompanying notes to consolidated financial statements.

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MICHAELS STORES, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in millions)

(Unaudited)

	Quarter Ended		Nine Months Ended	
	November 2, 2013	October 27, 2012 (Restated)	November 2, 2013	October 27, 2012 (Restated)
Net sales	\$ 1,118	\$ 1,014	\$ 3,015	\$ 2,884
Cost of sales and occupancy expense	665	612	1,816	1,736
Gross profit	453	402	1,199	1,148
Selling, general, and administrative expense	309	277	835	787
Share-based compensation expense	4	2	15	9
Related party expenses	3	3	10	10
Store pre-opening costs	2	3	5	5
Operating income	135	117	334	337
Interest expense	45	60	137	187
Refinancing costs and losses on early extinguishment of debt		3	7	3
Other (income) and expense, net			1	(1)
Income before income taxes	90	54	189	148
Provision for income taxes	32	19	68	53
Net income	58	35	121	95
Other comprehensive income, net of tax:				
Foreign currency translation adjustment and other			(2)	
Comprehensive income	\$ 58	\$ 35	\$ 119	\$ 95

See accompanying notes to consolidated financial statements.

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MICHAELS STORES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)

(Unaudited)

	Nine Months Ended	
	November 2, 2013	October 27, 2012 (Restated)
Operating activities:		
Net income	\$ 121	\$ 95
Adjustments:		
Depreciation and amortization	74	71
Share-based compensation expense	19	15
Debt issuance costs amortization	6	12
Accretion of long-term debt	(1)	
Refinancing costs and losses on early extinguishment of debt	7	3
Changes in assets and liabilities:		
Merchandise inventories	(254)	(233)
Prepaid expenses and other	(13)	(11)
Accounts payable	211	72
Accrued interest	(29)	36
Accrued liabilities and other	(21)	(15)
Income taxes	(49)	(33)
Other long-term liabilities	3	1
Net cash provided by operating activities	74	13
Investing activities:		
Additions to property and equipment	(82)	(85)
Net cash used in investing activities	(82)	(85)
Financing activities:		
Issuance of senior notes due 2018		213
Redemption of senior subordinated notes due 2016		(127)
Repurchase of subordinated discount notes due 2016	(142)	
Repayments on senior secured term loan facility	(8)	(209)
Borrowings on asset-based revolving credit facility	389	
Payments on asset-based revolving credit facility	(203)	
Payments of debt issuance costs		(8)
Payment of capital leases		(2)
Change in cash overdraft	(9)	(5)
Payments on behalf of Parent	(7)	
Net cash provided by (used in) financing activities	20	(138)
Net increase (decrease) in cash and equivalents	12	(210)
Cash and equivalents at beginning of period	56	371
Cash and equivalents at end of period	\$ 68	\$ 161
Supplemental Cash Flow Information:		
Cash paid for interest	\$ 160	\$ 138
Cash paid for income taxes	\$ 115	\$ 85

See accompanying notes to consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Quarter and Nine Months Ended November 2, 2013

(Unaudited)

Note 1. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements include the accounts of Michaels Stores, Inc. and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated. All expressions of the Company, Michaels, us, we, our, and all similar expressions are references to Michaels Stores, Inc. and its consolidated, wholly-owned subsidiaries, unless otherwise expressly stated or the context otherwise requires.

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. Therefore, these financial statements should be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended February 2, 2013.

The balance sheet at February 2, 2013 has been derived from the audited financial statements at that date, but does not include all of the information and notes required by GAAP for complete financial statements.

In the opinion of management, all adjustments (consisting of normal recurring accruals and other items) considered necessary for a fair presentation have been included.

Because of the seasonal nature of our business, the results of operations for the quarter and nine months ended November 2, 2013 are not indicative of the results to be expected for the entire year.

We report on the basis of a 52- or 53-week fiscal year, which ends on the Saturday closest to January 31. All references herein to fiscal 2013 relate to the 52 weeks ending February 1, 2014, and all references to fiscal 2012 relate to the 53 weeks ended February 2, 2013. In addition, all references herein to the third quarter of fiscal 2013 relate to the 13 weeks ended November 2, 2013, and all references to the third quarter of fiscal 2012 relate to the 13 weeks ended October 27, 2012. Finally, all references to the nine months ended November 2, 2013 relate to the 39 weeks ended November 2, 2013, and the nine months ended October 27, 2012 relate to the 39 weeks ended October 27, 2012.

Recent Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss or a Tax Credit Carryforward Exists. ASU 2013-11 requires unrecognized tax benefits to be presented as a decrease in a net operating loss, similar tax loss or tax credit carryforward if certain criteria are met. ASU 2013-11, which is prospective, is effective for reporting periods beginning after December 15, 2013, with earlier adoption permitted. Beginning with the fourth quarter of fiscal year 2012, the Company has reported unrecognized tax benefits consistent with ASU No. 2013-11.

Note 2. Restatement Share-based Compensation

The Company determined its previously issued unaudited interim consolidated financial statements for the three and nine months ended October 27, 2012, contained an error with respect to ASC 718, Compensation Stock Compensation. The accounting error was material to fiscal 2011 and fiscal 2012 financial statements and those financial statements required restatement. As a result, the Company is also restating its financial statements for the three and nine months ended October 27, 2012. Specifically, former participants in the Company's Equity Incentive Plan and its successor Plan (The Michaels Companies, Inc. (Parent) Equity Incentive Plan, together the Plan) exercised stock options upon their termination from the Company, and the Company repurchased the immature shares. Immature shares are defined as shares held for less than six months following exercise. The Company consistently repurchased shares in this manner and therefore, under accounting rules, established a pattern of repurchasing immature shares during the third quarter of 2011. The Company determined all stock options should have been treated as liability awards in accordance with the rules of ASC 718-10-25-9. Under liability accounting, the Company re-measures the fair value of stock compensation each period and recognizes changes in fair value as awards vest and until the award is settled. The Company originally

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recognized expense ratably over the vesting period based on the grant date fair value of the option in accordance with the fixed method of accounting. The impact to share-based compensation cost for the three and nine months ended October 27, 2012, was \$2 million (\$1, net of tax) and \$12 million (\$7, net of tax), respectively.

The following tables illustrate the correction as associated with certain line items in the unaudited interim consolidated financial statements (amounts in millions):

Consolidated Balance Sheet**As of October 27, 2012****(unaudited)****Share-based
compensation
Adjustment**

	As Reported		As Restated
Merchandise inventories	\$ 1,076	\$ 2	\$ 1,078
Total current assets	1,387	2	1,389
Deferred income taxes	18	14	32
Total non-current assets	170	14	184
Share-based compensation		30	30
Income taxes payable	8	(2)	6
Total current liabilities	987	28	1,015
Share-based compensation		24	24
Total long-term liabilities	3,285	24	3,309
Additional paid-in capital	61	(10)	51
Accumulated deficit	(2,438)	(26)	(2,464)
Total stockholders' deficit	(2,371)	(36)	(2,407)

Consolidated Statements of Comprehensive Income**Quarter Ended October 27, 2012****(unaudited)****Share-based
compensation
Adjustment**

	As Reported		As Restated
Cost of sales and occupancy expense	\$ 611	\$ 1	\$ 612
Gross Profit	403	(1)	402
Selling, general and administrative expense	278	(1)	277
Share-based compensation expense		2	2
Operating income	119	(2)	117
Income before income taxes	56	(2)	54
Provision for income taxes	20	(1)	19
Net income	36	(1)	35
Comprehensive income	36	(1)	35

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Consolidated Statements of Comprehensive Income
Nine Months Ended October 27, 2012

	As Reported	(unaudited) Share-based compensation Adjustment	As Restated
Cost of sales and occupancy expense	\$ 1,730	\$ 6	\$ 1,736
Gross Profit	1,154	(6)	1,148
Selling, general and administrative expense	790	(3)	787
Share-based compensation expense		9	9
Operating income	349	(12)	337
Income before income taxes	160	(12)	148
Provision for income taxes	58	(5)	53
Net income	102	(7)	95
Comprehensive income	102	(7)	95

Cash Flow Data
Nine Months Ended October 27, 2012

	As Reported	(unaudited) Share-based compensation Adjustment	As Restated
Operating Activities:			
Net income	\$ 102	(7)	\$ 95
Share-based compensation and other	4	11	15
Merchandise inventories	(236)	3	(233)
Accrued liabilities and other	(11)	(4)	(15)
Income taxes	(27)	(6)	(33)
Net cash provided by operating activities	16	(3)	13
Repurchase of Common Stock	(10)	10	
Proceeds from stock options exercised	7	(7)	
Net cash used in financing activities	(141)	3	(138)

Note 3. Debt

On November 22, 2013, the Audit Committee of our Board of Directors (the "Audit Committee"), after considering the recommendation of management and discussing with Ernst & Young LLP, our independent registered public accounting firm, concluded it was necessary to restate our previously issued consolidated financial statements for the fiscal years ended February 2, 2013 and January 28, 2012. In connection with the preparation of our Quarterly Report on Form 10-Q for the quarterly period ended November 2, 2013, we determined that we had incorrectly accounted for certain stock compensation transactions under the Financial Accounting Standards Board Accounting Standards Codification (ASC) Topic 718 *Compensation - Stock Compensation*. The Company's covenants for its outstanding debt require annual and quarterly financial statements prepared in accordance with GAAP to be provided within 45 or 90 days of the end of the period. As a result of the restatement described above and in Note 2 to the consolidated financial statements, the Company rescinded its previously issued financial statements for fiscal 2011 and fiscal 2012 and the first and second quarters of 2013. The Company believes it has cured the potential defect through the filing with the Securities and Exchange Commission of its amended fiscal 2011 and fiscal 2012 audited consolidated financial statements on December 2, 2013 and its unaudited quarterly financial statements for the first and second quarter of fiscal 2013 on December 9, 2013. The Company is in compliance with the other terms and conditions of all debt agreements for all periods presented. Our outstanding debt is detailed in the table below.

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	November 2, 2013	February 2, 2013 (in millions)	October 27, 2012	Interest Rate
Senior secured term loan	\$ 1,632	\$ 1,640		