UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-K

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

EXCHANGE ACT OF 1934

For the fiscal year ended February 2, 2019

Commission file number 001-36501

THE MICHAELS COMPANIES, INC.

A Delaware Corporation

IRS Employer Identification No. 37-1737959

8000 Bent Branch Drive

Irving, Texas 75063

(972) 409-1300

The Michaels Companies, Inc.'s common stock, par value $0.06775 per share, is registered pursuant to Section 12(b) of the Securities Exchange Act of 1934 (the "Act) and is listed on the NASDAQ Global Select Market. The Michaels Companies, Inc. does not have any securities registered under Section 12(g) of the Act.

The Michaels Companies, Inc. is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

The Michaels Companies, Inc. (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.

The Michaels Companies, Inc. has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

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

The Michaels Companies, Inc. is a large accelerated filer.

The Michaels Companies, Inc. is not (1) a shell company, (2) a small reporting company or (3) an emerging growth company (as defined in Rule 12b-2 of the Exchange Act).

The aggregate market value of The Michaels Companies, Inc.'s common stock held by non-affiliates as of August 4, 2018 was approximately $1,978,572,495 based upon the closing sales price of $20.24 quoted on The NASDAQ Global Select Market as of August 3, 2018. For this purpose, directors and officers have been assumed to be affiliates.

As of March 12, 2019, 157,773,090 shares of The Michaels Companies, Inc.'s common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

The registrant will incorporate by reference information required in response to Part III, items 10-14, from its definitive proxy statement for its annual meeting of shareholders, to be held on June 11, 2019.

Table of Contents

THE MICHAELS COMPANIES, INC.

TABLE OF CONTENTS

Part I.	Page
Item 1. Business	3
Item 1A. Risk Factors	8
Item 1B. Unresolved Staff Comments	18
Item 2. Properties	19
Item 3. Legal Proceedings	21
Item 4. Mine Safety Disclosures	21
Part II.	
Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	21
Item 6. Selected Financial Data	23
Item 7. Management Discussion and Analysis of Financial Condition and Results of Operations	24
Item 7A. Quantitative and Qualitative Disclosures about Market Risk	37
Item 8. Consolidated Financial Statements and Supplementary Data	38
Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	38
Item 9A. Controls and Procedures	38
Part III.	
Item 10. Directors, Executive Officers and Corporate Governance	39
Item 11. Executive Compensation	39
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	39

Item 13. Certain Relationships and Related Transactions, and Director Independence	40
Item 14. Principal Accounting Fees and Services	40
Part IV.	
Item 15. Exhibits and Financial Statement Schedules	40
Item 16. Form 10-K Summary	40

Table of Contents

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", "intends", a 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, share repurchases, store openings, capital expenditures and working capital requirements. 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", "our Company", "the Company", and "Michaels" mean T Michaels Companies, Inc., together with its subsidiaries.

General

Michaels Stores, Inc. ("MSI") is headquartered in Irving, Texas and was incorporated in the state of Delaware in 1983. In July 2013, MSI was reorganized into a holding company structure and The Michaels Companies, Inc. was incorporated in the state of Delaware in connection with the reorganization.

With $5,271.9 million in sales in fiscal 2018, the Company is the largest arts and crafts specialty retailer in North America (based on store count) providing materials, project ideas and education for creative activities. Our mission is to inspire and enable customer creativity, create a fun and rewarding place to work, foster meaningful connections with our communities and lead the industry in growth and innovation. With crafting classes, store events, store displays, mobile applications and online videos, we offer an omnichannel shopping experience that can inspire creativity and build confidence in our customers' artistic abilities.

As of February 2, 2019, we operated 1,258 Michaels retail stores in 49 states and Canada, with approximately 18,000 average square feet of selling space per store.

In March 2018, we made the decision to close substantially all of our Aaron Brothers stores and in January 2019 we closed all 36 of our Pat Catan's stores. As a result of the store closures, we recorded restructure charges of $98.9 million in fiscal 2018. The restructure charges are primarily related to the transfer of the rights to sell inventory and other assets to a third party to facilitate the store closures and assist with the disposition of our remaining lease obligations, the impairment of goodwill and employee-related expenses. We believe restructuring activities will be substantially completed in fiscal 2019 and expect to record additional charges of approximately $6 million.

In addition, we recorded $5.3 million of employee-related charges as a result of certain organizational changes made to streamline our operations at our corporate support center.

For fiscal 2018 and fiscal 2017, Aaron Brothers net sales totaled $12.9 million and $110.4 million, respectively, and Pat Catan's net sales totaled $109.6 million and $113.4 million, respectively. Excluding the restructure charges, Aaron Brothers and Pat Catan's did not have a material impact on the Company's operating income in all fiscal periods presented in the consolidated financial statements.

Table of Contents

Merchandising

Michaels. Each Michaels store offers approximately 45,000 basic and seasonal stock-keeping units (“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 net sales:

	Fiscal Year		
	2018	2017	2016
General crafts	48 %	49 %	50 %
Home décor and seasonal	24	23	22
Custom and ready-made framing	16	16	17
Papercrafting	12	12	11
	100 %	100 %	100 %

We have product development, sourcing and design teams focused on quality, innovation and cost mitigation. Our internal product development and global sourcing teams position us to deliver a differentiated level of innovation, quality and value to our customers. Our global sourcing network allows us to control new product introductions, maintain quality standards, monitor delivery times, and manage product costs and inventory levels to enhance profitability. In an industry with few well-known national brands, our private brands are recognized as a leader in many categories. We continue to expand our private brands and improve the selection of products we design, develop and deliver to our customers. Our private brands totaled approximately 60% of net sales in fiscal 2018 and include, among others, Recollections®, Studio Decor®, Bead Landing®, Creatology®, Ashland®, Celebrate It®, ArtMinds®, Artist’s Loft®, Craft Smart®, Loops & Threads®, Make Market®, Foamies®, LockerLookz®, Imagin8® and Sticky Sticks®.

We continue to search for ways to leverage our position as a market leader by establishing strategic partnerships and exclusive product relationships to provide our customers with exciting merchandise. We have partnerships with popular brands such as Crayola, Elmer’s and Cricut. We will continue to explore opportunities to form future partnerships and exclusive product associations.

Darice. We operate an international wholesale business under the Darice brand name (“Darice”). Darice sources products from domestic and foreign suppliers for resale to a variety of retail outlets worldwide, including our Michaels stores. Darice offers approximately 56,000 SKUs consisting of a wide range of craft and hobby items. We also develop Darice branded products carried by both Michaels and third-party stores reflecting the breadth of our product line and our ability to distribute and source quality products at competitive prices.

E-commerce. While we expect e-commerce to remain a relatively small portion of our business, with over 100,000 basic and seasonal SKUs, we believe it provides an important avenue to communicate with our customers in an interactive way that reinforces the Michaels brand and drives traffic to our stores and websites. We continue to strengthen our omnichannel offering with the expansion of our buy online, pick up in store capabilities and through continuous enhancements to our existing platforms to improve discoverability and product content that will deliver a superior customer experience. Our online platforms currently include Michaels.com, ConsumerCrafts.com, Darice.com, AaronBrothers.com (our online custom framing solution) and our Michaels app, which connects our store and online experiences.

Purchasing and Inventory Management

We purchase merchandise from a variety of different vendors primarily through our wholly-owned subsidiary, Michaels Stores Procurement Company, Inc. We believe our buying power and ability to make centralized purchases enable us to acquire products on favorable terms. Centralized merchandising management teams negotiate with vendors in an attempt to obtain the lowest net merchandise costs and to improve product mix and inventory levels. In fiscal 2018, there were no vendors or sourcing agents who accounted for more than 10% of total purchases.

We continue to develop our direct sourcing capabilities through our wholly-owned subsidiary, Darice International Sourcing Group. We believe our direct sourcing operation allows us to maintain greater control over the manufacturing process resulting in improved product quality and lower costs. In addition, our stores purchase custom frames, framing supplies and mats from our wholly-owned subsidiary, Artistree, Inc. (“Artistree”), which consists of a manufacturing facility and three regional processing centers.

Table of Contents

The majority of the products sold in our stores are manufactured in Asia. Goods manufactured in Asia generally require long lead times and are ordered three to four months in advance of delivery. Those products are either imported directly by us or acquired from distributors based in the U.S.

Our automated replenishment system uses perpetual inventory records to analyze on-hand SKU quantities by store, 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. These systems also allow us to react more quickly to sales trends and allow our store team members to devote more time to customer service, thereby improving inventory productivity and sales opportunities.

Artistree

We own and operate Artistree, a vertically-integrated framing operation which supplies precut mats and high quality custom framing merchandise in our stores and aaronbrothers.com. We believe Artistree provides a competitive advantage and gives us quality control over the entire framing process. Custom framing orders are processed and shipped to our stores where the custom frame order is completed for customer pick-up.

Our moulding manufacturing plant, located in Kernersville, North Carolina, converts lumber into finished frame moulding that is used at our regional processing centers to fulfill custom framing orders for our customers. We manufacture approximately 39% of the moulding that we process and import approximately 55% from quality manufacturers in Brazil, Indonesia, Malaysia, China and Italy. The remaining mouldings are purchased from domestic manufacturers.

We operate three regional processing centers located in DFW Airport, Texas; Kernersville, North Carolina; and Mississauga, Ontario. Combined, these facilities occupy approximately 489,000 square feet and, in fiscal 2018, processed 25.1 million linear feet of frame moulding and 3.8 million individual custom cut mats and foam boards for our customers. Our precut mats and custom frame supplies are packaged and distributed out of our DFW Airport regional processing center.

Distribution

We currently operate seven distribution centers to supply our stores with merchandise. Approximately 92% of our stores' merchandise receipts are shipped through the distribution network with the remainder shipped directly from vendors to stores. Our distribution centers are located in California, Florida, Illinois, Ohio, Pennsylvania, Texas and Washington. We also utilize a third-party fulfillment center for a portion of our e-commerce merchandise. In fiscal 2018, we began developing an internal process to fulfill e-commerce orders though our distribution center in Haslet, Texas. The transition to our internal fulfillment center is expected to be completed in fiscal 2019 and will allow us to maintain greater control over, and lower our costs associated with, our e-commerce order fulfillment process.

Our distribution facilities use warehouse management and control software systems to maintain and support product purchase decisions. Store replenishment order selection is performed using pick-to-light and radio frequency processing technologies. Product is delivered to stores using both a dedicated fleet of trucks and contract carriers.

Marketing

We employ a multi-faceted marketing strategy to increase brand awareness, acquire new customers, improve customer retention and increase frequency of shopping. We communicate with our current and prospective customers through multiple vehicles, including direct mail, email, newspaper inserts, television and digital advertising.

We continue to develop and leverage our customer data analytic capabilities to drive a more customer-centric strategy through targeted marketing and promotions. We believe that targeted marketing and promotions play an important role in today's retail environment by improving the impact of digital media, email, coupons and promotional events. In July 2016, we launched our rewards program, Michaels Rewards, in the U.S. and in July 2018, we launched the program in Canada. Michaels Rewards is an important tool to increase retention of existing customers and enhance their loyalty to

Table of Contents

the Michaels brand. Michaels Rewards continues to grow and has surpassed 34 million customers. Michaels Rewards offers customers tailored, exclusive offers and events such as sneak peeks for new product, early alerts for big sales and receipt-free returns. The program adds to our customer database and, we believe, will allow us to further target our marketing and promotions more effectively.

Seasonality

Our business is highly seasonal, with higher sales in the third and fourth fiscal quarters. Our fourth quarter, which includes the Holiday selling season, has on average accounted for approximately 34% of our net sales and approximately 46% of our operating income.

Our Industry

According to internal market research, approximately 53% of U.S. households participated in at least one crafting project during 2018, which represented approximately 67 million households. This research indicated that crafting activities continue to enjoy broad based popularity and market size has been stable, valued at approximately $36 billion. We believe the broad, multi-generational appeal, high personal attachment and the low-cost, project-based nature of crafting creates a loyal, resilient following.

Store Expansion and Relocation

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

	Fiscal Year				
	2018	2017	2016	2015	2014
Michaels stores:					
Open at beginning of period	1,238	1,223	1,196	1,168	1,136
New stores	24	17	32	30	32
Relocated stores opened	21	12	14	17	13
Closed stores	(4)	(2)	(5)	(2)	—
Relocated stores closed	(21)	(12)	(14)	(17)	(13)
Open at end of period	1,258	1,238	1,223	1,196	1,168
Aaron Brothers stores:					

Open at beginning of period	97	109	117	120	121
New stores	—	—	1	—	5
Closed stores	(97)	(12)	(9)	(3)	(6)
Open at end of period	—	97	109	117	120
Pat Catan's stores:					
Open at beginning of period	36	35	—	—	—
Acquired stores	—	—	32	—	—
New stores	—	1	3	—	—
Relocated stores opened	—	—	1	—	—
Closed stores	(36)	—	—	—	—
Relocated stores closed	—	—	(1)	—	—
Open at end of period	—	36	35	—	—
Total store count at end of period	1,258	1,371	1,367	1,313	1,288

We believe, based on an internal real estate and market penetration study of Michaels stores, that the combined U.S. and Canadian markets can support between 1,400 and 1,500 Michaels stores. We plan to open approximately 37 Michaels stores, including approximately 13 relocations and up to 12 rebranded Pat Catan’s stores, in fiscal 2019. We continue to pursue a store relocation program to improve the real estate location quality and performance of our store base. During fiscal 2019, we plan to close up to 10 Michaels stores. Many of our store closings are stores that have reached the end of their lease term. We believe our ongoing store evaluation process results in strong performance across our store base.

Our store operating model, which is based on historical store performance, assumes an average store size of approximately 18,000 selling square feet. Our fiscal 2018 average initial net investment, which varies by site and specific store characteristics, was $1.3 million per store, including store build-out costs, pre-opening expenses and average first year inventory.

Employees

As of February 2, 2019, we employed approximately 47,000 team members, approximately 35,000 of whom were employed on a part-time basis. The number of part-time team members substantially increases during the Holiday selling season. Of our full-time team members, approximately 4,400 are engaged in various executive, operating, training, distribution and administrative functions in our support center, division offices, administrative offices and distribution centers and the remainder are engaged in store operations. None of our team members are subject to a collective bargaining agreement.

Competition

We are the largest arts and crafts specialty retailer in North America based on store count. The market in which we compete is highly fragmented and includes stores across the U.S. and Canada 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:

- Multi-store chains. This category consists of several multi-store chains, each operating more than 100 stores, including: Hobby Lobby Stores, Inc., which operates approximately 840 stores in 47 states; Jo-Ann Stores, Inc., which operates approximately 880 stores in 49 states; and A.C. Moore Arts & Crafts, Inc., which operates approximately 150 stores primarily in the Eastern U.S. We believe all of these chains are smaller than Michaels with respect to net sales.

- Mass merchandisers. This category of retailers typically dedicate a portion of their selling space to a limited selection of home décor, arts and crafts supplies and seasonal merchandise, but they do seek to capitalize on the latest trends by stocking products that are complementary to those trends and their current merchandise offerings. These mass merchandisers generally have limited customer service staffs with minimal experience in crafting projects.

- Small, local specialty retailers. This category includes local independent arts and crafts retailers and custom framing shops. Typically, these stores 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.

· Internet. This category includes all internet-based retailers that sell arts and crafts merchandise, completed projects and online custom framing. Our internet competition is inclusive of those companies discussed in the categories above, as well as others that may only sell products online. These retailers provide consumers with the ability to search and compare products and prices without having to visit a physical store. These sellers generally offer a wide variety of products but do not offer product expertise or project advice.

Trademarks and Service Marks

As of February 2, 2019, we own or have rights to trademarks, service marks or trade names we use in connection with the operation of our business, including "Aaron Brothers", "Artistree", "Darice", "Lamrite", "Michaels", "Michaels the Arts an Crafts Store", "Pat Catan's", "Recollections", "Make Creativity Happen", "Where Creativity Happens", and the stylized Michaels logo. We have registered our primary private brands including Recollections®, Studio Decor®, Bead Landing®, Creatology®, Ashland®, Celebrate It®, ArtMinds®, Artist's Loft®, Craft Smart®, Loops & Threads®, Make Market®, Foamies®, LockerLookz®, Imagin8® and Sticky Sticks® and various sub-brands associated with these primary marks. Solely for convenience, some of the trademarks, service marks and trade names referred to in this Annual Report on Form 10-K are listed without the copyright, trademark and registered trademark symbols, but we will assert, to the fullest extent under applicable law, our rights to our copyrights, trademarks, service marks, trade names and domain names.

Table of Contents

Available Information

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, and other documents filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), on our internet website, free of charge, at www.michaels.com under the heading "Investor Relations". These reports are available after we electronically file them with the Securities and Exchange Commission ("SEC") through the SEC's EDGAR system at www.sec.gov.

We use our website (www.michaels.com) as a means of disclosing material non-public information and for complying with our disclosure obligations under Regulation Fair Disclosure promulgated by the SEC. These disclosures are included on our website in the "Investor Relations" section. Accordingly, investors should monitor this portion of our website, in addition to following our press releases, SEC filings, public conference calls and webcasts.

We webcast our earnings calls and certain events we participate in or host with members of the investment community on the investor relations section of our website. Additionally, we provide notifications of news or announcements regarding press and earnings releases as part of the investor relations section of our website. The contents of our website are not part of this Annual Report on Form 10-K, or any other report we file with, or furnish to, the SEC.

ITEM 1A. RISK FACTORS.

Our business is subject to various risks and uncertainties. The risks described below are those we believe are the material risks we face. Any of the risk factors described below, as well as risks not currently known to us, could significantly and adversely affect our business, cash flows, financial condition, results of operations, liquidity or access to sources of financing.

We face risks related to the effect of economic uncertainty.

In the event of an economic downturn or slow recovery, our growth, prospects, 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 are viewed as discretionary items. Pressure on discretionary income brought on by economic downturns and slow recoveries, including housing market declines, rising energy prices and weak labor markets, may cause consumers to reduce the amount they spend on discretionary items. The inherent uncertainty related to predicting economic conditions makes 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 limit our ability to satisfy customer demand and potentially lose market share.

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. As of February 2, 2019, we had total outstanding debt of $2,717.5 million, of which $2,207.5 million was subject to variable interest rates and $510.0 million was subject to fixed interest rates. In April 2018, we executed two interest rate swap agreements with an aggregate notional value of $1.0 billion which are intended to mitigate interest rate risk associated with future changes in interest rates for borrowings under our Amended and Restated Term Loan Credit Facility. As a result of these interest rate swaps, our exposure to interest rate volatility for $1.0 billion of our Amended and Restated Term Loan Credit Facility was eliminated beginning in the second quarter of fiscal 2018. As of February 2, 2019, we had $742.7 million of additional borrowing capacity (after giving effect to $107.3 million of letters of credit then outstanding) under our Amended Revolving Credit Facility (as defined below). Our substantial indebtedness could have important consequences to us, including:

- making it more difficult for us to satisfy our obligations with respect to our debt, and any failure to comply with the obligations under our debt instruments, including restrictive covenants, could result in an event of default under the agreements governing our indebtedness;

- increasing our vulnerability to general economic and industry conditions;

Table of Contents

- requiring a substantial portion of our 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, selling and marketing efforts, product development, future business opportunities and other purposes;

- exposing us to the risk of increased interest rates as certain of our borrowings, including borrowings under our Senior Secured Credit Facilities (as defined below), which consist of the Amended Revolving Credit Facility and the Amended and Restated Term Loan Credit Facility, 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; or

- limiting our ability to plan for, or adjust to, changing market conditions and placing us at a competitive disadvantage compared to our competitors who may be less highly leveraged.

The occurrence of any one of these events could have an adverse effect on our business, financial condition, results of operations, and ability to satisfy our obligations under our indebtedness.

Further, a substantial portion of our long-term indebtedness bears interest at fluctuating interest rates, primarily based on the London interbank offered rate ("LIBOR"). On July 27, 2017, the Financial Conduct Authority (the authority that regulates LIBOR) announced that it intends to stop compelling banks to submit rates for the calculation of LIBOR after 2021. It is unclear whether new methods of calculating LIBOR will be established such that it continues to exist after 2021. The Alternative Reference Rates Committee has proposed the Secured Overnight Financing Rate ("SOFR") as its recommended alternative to LIBOR, and the Federal Reserve Bank of New York began publishing SOFR rates in April 2018. SOFR is intended to be a broad measure of the cost of borrowing cash overnight collateralized by U.S. Treasury securities. It is unknown whether SOFR or any potential alternative reference rate will attain market acceptance as replacements for LIBOR and, as such, the potential effect on our results from operations is unknown.

We and our subsidiaries may be able to incur substantial additional indebtedness in the future, subject, in the case of MSI and Michaels Funding, Inc. ("Holdings") and their subsidiaries, to the restrictions contained in our Senior Secured Credit Facilities and the indenture governing our notes. In addition, our Senior Secured Credit Facilities and indenture governing our notes do not restrict us from creating new holding companies that may be able to incur indebtedness without regard to the restrictions set forth in our Senior Secured Credit Facilities and indenture governing our notes. 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 indenture governing our notes contain various covenants that limit our ability to engage in specified types of transactions. These covenants limit the ability of the relevant borrowers, issuers, guarantors and their restricted subsidiaries to, among other things:

- incur or guarantee additional debt;
- pay dividends or distributions on their capital stock or redeem, repurchase or retire their capital stock or indebtedness;
- issue stock of subsidiaries;
- make certain investments, loans, advances and acquisitions;
- create liens on our assets to secure debt;
- enter into transactions with affiliates;

Table of Contents

· merge or consolidate with another company; or

· sell or otherwise transfer assets.

In addition, under the Amended and Restated Term Loan Credit Facility and the Amended Revolving Credit Facility, MSI is required to meet specified financial ratios in order to undertake certain actions, and under certain circumstances, MSI may be required to maintain a specified fixed charge coverage ratio under the Amended Revolving Credit Facility. Our ability to meet those tests can be affected by events beyond our control, and we cannot assure you we will meet them. A breach of any of these covenants could result in a default under our Senior Secured Credit Facilities, which could also lead to an event of default under our notes if any of the Senior Secured Credit Facilities were accelerated. 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 such indebtedness. Holdings, MSI and certain of MSI's subsidiaries have pledged substantially all of their assets, including the capital stock of MSI and certain of its subsidiaries, as collateral under our Senior Secured Credit Facilities. If the indebtedness under our Senior Secured Credit Facilities or our notes were to be accelerated, our assets may not be sufficient to repay such indebtedness in full.

Changes in customer demand could materially adversely affect our sales, results of operations and cash flow.

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, or experience shortages of key items, either of which could have a material adverse impact on our operating results and cash flow. In addition, adverse weather conditions, economic instability and consumer confidence volatility could have material adverse impacts on our sales and operating results.

Competition, including internet-based competition, could negatively impact our business.

The retail arts and crafts industry, including custom framing, is competitive, which could result in pressure to reduce prices and losses in our market share. We must remain competitive in the areas of quality, price, breadth of selection, customer service and convenience to retain and grow our market share. We compete with mass merchants, which 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 retailers, which include Hobby Lobby Stores, Inc., A.C. Moore Arts & Crafts, Inc. and Jo Ann Stores, Inc. Some of our competitors, particularly the mass merchants, are larger and have greater financial resources than we do. We also face competition from internet based retailers, such as Amazon.com, Inc., in addition to traditional store based retailers, who may be larger, more experienced and able to offer products we cannot. This could result in increased price competition since our customers could more readily search and compare non private brand products. Furthermore, we ultimately compete with alternative sources of entertainment and leisure for our customers.

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 third fiscal quarter 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.

Unexpected or unfavorable consumer responses to our promotional or merchandising programs could have a materially adverse effect on 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

Table of Contents

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. If we experience poor execution of changes to our merchandise offering or experience unexpected consumer responses to changes in our merchandise offering, our sales, results of operations and cash flow could be materially adversely affected.

Evolving foreign trade policy (including tariffs imposed on certain foreign-made goods) may adversely affect our business.

Our products are sourced from a wide variety of suppliers, including from suppliers overseas, particularly in China. In addition, some of the products that we purchase from vendors in the U.S. also depend, in whole or in part, on suppliers located outside the U.S. On September 18, 2018, the Office of the U.S. Trade Representative announced that, effective September 24, 2018, the U.S. would impose a 10% tariff on approximately $200 billion worth of imports from China into the U.S. Certain of our products are subject to these tariffs. The U.S. has also stated that if a trade agreement with China is not reached, the 10% tariff will be increased to 25%. Further, tariffs may be imposed on additional products sourced from China if a trade agreement is not reached.

If additional tariffs are imposed on our products, or other retaliatory trade measures are taken, our costs could increase and we may be required to raise our prices, which could result in the loss of customers and adversely affect our operating performance. To mitigate tariff risks with China, we may also seek to shift production outside of China, which could result in increased costs and disruption to our operations.

Our reliance on foreign suppliers increases our risk of not obtaining adequate, timely and cost-effective product supplies.

To a significant extent, we rely on foreign manufacturers for our merchandise, particularly manufacturers located in 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 a natural disaster), transportation delays (including dock strikes and other work stoppages), restrictive actions by foreign governments, or changes in U.S. laws and regulations affecting imports or domestic distribution. Reliance on foreign manufacturers also increases our exposure to trade infringement claims and reduces our ability to return product for various reasons.

We are at a risk for 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, which could have a material adverse effect on our profit margins and profitability.

All of our products manufactured overseas and imported into the U.S. are subject to duties collected by the U.S. Customs Service. We may be subjected to additional duties or tariffs, 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.

Our results may be adversely affected by serious disruptions or catastrophic events, including geo-political events and weather.

Unforeseen public health issues, such as pandemics and epidemics, and geo political events, such as civil unrest in a country in which our suppliers are located or terrorist or military activities disrupting transportation, communication or utility systems, as well as natural disasters such as hurricanes, tornadoes, floods, earthquakes and other adverse weather and climate conditions, whether occurring in the U.S. or abroad, particularly during peak seasonal periods, could disrupt our operations or the operations of one or more of our vendors, or could severely damage or destroy one or more of our stores or distribution facilities located in the affected areas. For example, day to day operations, particularly our ability to receive products from our vendors or transport products to our stores, could be adversely affected, or we could be required to close stores or distribution centers in the affected areas or in areas served by the affected distribution center. These factors could also cause consumer confidence and spending to decrease or result in increased volatility in the U.S. and global financial markets and economy. Such occurrences could significantly impact our operating results and financial performance. For example, during fiscal 2017, more than 100 of our stores were impacted by weather related to Hurricane Harvey and Irma, resulting in closures and an estimated $10 million in lost sales.

We have experienced a data breach in the past and any future failure to adequately maintain security and prevent unauthorized access to electronic and other confidential information could result in an additional data breach which could materially adversely affect our reputation, financial condition and operating results.

The protection of our customer, team members and Company data is critically important to us. Our customers and team members have a high expectation that we will adequately safeguard and protect their sensitive personal information. We have become increasingly centralized and dependent upon automated information technology processes. In addition, a large portion of our business operations is conducted electronically, increasing the risk of attack or interception that could cause loss or misuse of data, system failures or disruption of operations. This risk has increased with the launch of our e commerce platform in fiscal 2014. Improper activities by third parties, exploitation of encryption technology, new data hacking tools and discoveries and other events or developments may result in a future compromise or breach of our networks, payment card terminals or other payment systems. In particular, the techniques used by criminals to obtain unauthorized access to sensitive data change frequently and often are not recognized until launched against a target; accordingly, we may be unable to anticipate these techniques or implement adequate preventative measures. Any failure to maintain the security of our customers' sensitive information, or data belonging to ourselves or our suppliers, could put us at a competitive disadvantage, result in deterioration of 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. While we maintain insurance coverage that may, subject to policy terms and conditions, cover certain aspects of cyber risks, such insurance coverage may be insufficient to cover all losses and would not remedy damage to our reputation. There can be no assurance that we will not suffer a criminal attack in the future, that unauthorized parties will not gain access to personal information, or that any such incident will be discovered in a timely manner.

We may be subject to information technology system failures or network disruptions, or our information systems may prove inadequate, resulting in damage to our reputation, business operations and financial condition.

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, analyze and record our inventory. The Company may be subject to information technology system failures and network disruptions. These may be caused by natural disasters, accidents, power disruptions, telecommunications failures, acts of terrorism or war, denial of service attacks, computer viruses, physical or electronic break ins, or similar events or disruptions. System redundancy may be ineffective or inadequate, and the Company's disaster recovery planning may not be sufficient for all eventualities. Such failures or disruptions could prevent access to our online services and preclude store transactions. System failures and disruptions could also impede the manufacturing and shipping of products, transactions processing and financial reporting. Additionally, we may be materially adversely affected if we are unable to adequately upgrade, maintain and expand our systems.

Our growth depends on our ability to increase comparable store sales and to open new stores.

We anticipate our sales growth will primarily come from increasing comparable store sales. Profitability growth would then depend significantly on our ability to improve gross margin. Another business strategy is to continue to expand our base of retail stores. 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 team members. If we are unable to accomplish these strategies, our ability to increase our sales, profitability and cash flow could be impaired.

Damage to the reputation of the Michaels brand or our private and exclusive brands could adversely affect our sales.

We believe the Michaels brand name and many of our private and exclusive brand names are powerful sales and marketing tools and we devote significant resources to promoting and protecting them. To be successful in the future, we must continue to preserve, grow and utilize the value of Michaels reputation. Reputational value is based in large part on perceptions of subjective qualities, and even isolated incidents may erode trust and confidence. In addition, we develop and promote private and exclusive brands, which we believe have national recognition. Our Michaels private brands totaled approximately 60% of net sales in fiscal 2018. Damage to the reputations (whether or not justified) of our brand names could arise from product failures, data privacy or security incidents, litigation or various forms of adverse publicity

Table of Contents

(including adverse publicity generated as a result of a vendor's or a supplier's failure to comply with general social accountability practices), especially in social media outlets, and may generate negative customer sentiment, potentially resulting in a reduction in our sales and earnings.

We face risks associated with the suppliers from whom our products are sourced and transitioning to other qualified vendors could materially adversely affect our revenue and profit growth.

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 transitioning vendors could adversely affect our revenue and gross profit.

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. These suppliers may also 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 to supply products in the quantities we desire. This long lead time may limit our ability to respond timely to shifts in demand.

Changes in regulations or enforcement, or our failure to comply with existing or future regulations, may adversely impact our business.

We are subject to federal, state and local regulations with respect to our operations in the U.S. We are further subject to federal, provincial and local regulations internationally, including in Canada and China, each of which are distinct from those in the U.S., and may be subject to greater international regulation as our business expands. There are a number of legislative and regulatory initiatives that could adversely impact our business if they are enacted or enforced. Those initiatives include wage or workforce issues (such as minimum wage requirements, overtime and other working conditions and citizenship requirements), collective bargaining matters, environmental regulation, price and promotion regulation, trade regulations and others.

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. New accounting pronouncements and interpretations of existing accounting rules and practices have occurred and may occur in the future. A change in accounting standards or tax regulations can have a significant effect on our reported results of operations.

Failure to comply with legal requirements could result in, among other things, increased litigation risk that could affect us adversely by subjecting us to significant monetary damages and other remedies or by increasing our litigation expenses, administrative enforcement actions, fines and civil and criminal liability. We are currently subject to various class action lawsuits alleging violations of wage and workforce laws and similar matters. If such issues become more expensive to address, or if new issues arise, they could increase our expenses, generate negative publicity, or otherwise adversely affect us.

Significant increases in inflation or commodity prices, such as petroleum, natural gas, electricity, steel, wood and paper, may adversely affect our costs, including cost of merchandise.

Significant future increases in commodity prices or inflation could 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.

Table of Contents

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, direct sourcing initiatives and receipt processing. We continue to implement enhancements to our distribution systems and processes, which are designed to improve efficiency throughout the supply chain and at our stores. If we are unable to successfully implement significant changes, this could disrupt our supply chain, which could have a material adverse impact on our results of operations.

We are exposed to fluctuations in exchange rates between the U.S. and Canadian dollar, which is the functional currency of our Canadian subsidiaries.

Our Canadian operating subsidiaries purchase inventory in U.S. dollars, which is sold in Canadian dollars and exposes us to foreign exchange rate fluctuations. In addition, our customers at border locations can be sensitive to cross border price differences. Substantial foreign currency fluctuations could adversely affect our business. In fiscal 2018, exchange rates had a negative impact on our consolidated operating results due to a 5% decrease in the Canadian exchange rate.

The Company’s ability to execute its strategic initiatives could be impaired if it fails to identify a permanent Chief Executive Officer and retain its senior management team.

Carl S. Rubin transitioned out of his role as Chief Executive Officer, effective February 28, 2019, and is expected to transition out of his role as Chairman of the Board of Directors by April 1, 2019. The Board has appointed Mark S. Cosby to act as the Company’s Interim Chief Executive Officer while the Company conducts a search for a permanent CEO. Leadership transitions can be inherently difficult to manage, and an inadequate transition to a permanent CEO may cause disruption to our business due to, among other things, diverting management’s attention away from the Company’s financial and operational goals or causing a deterioration in morale. In addition, if we are unable to attract and retain a qualified candidate to become our permanent CEO in a timely manner, as well as retain our key senior executives, our ability to meet our financial and operational goals and strategic plans may be adversely impacted, as well as our financial performance.

Any difficulty executing or integrating an acquisition, a business combination or a major business initiative could adversely affect our business or results of operations.

Any difficulty in executing or integrating an acquisition, a business combination or a major business initiative may result in our inability to achieve anticipated benefits from these transactions in the time frame that we anticipate, or at all, which could adversely affect our business or results of operations. Such transactions may also disrupt the operation of our current activities and divert management's attention from other business matters. In addition, the Company's current credit agreements place certain limited constraints on our ability to make an acquisition or enter into a business combination, and future borrowing agreements could place tighter constraints on such actions.

Our marketing programs, e-commerce initiatives and use of consumer information are governed by an evolving set of laws and enforcement trends and unfavorable changes in those laws or trends, or our failure to comply with existing or future laws, could substantially harm our business and results of operations.

We collect, maintain and use data provided to us through our loyalty program, online activities and other customer interactions in our business. Our current and future marketing programs depend on our ability to collect, maintain and use this information, and our ability to do so is subject to certain contractual restrictions in third party contracts as well as evolving international, federal and state laws and enforcement trends. We strive to comply with all applicable laws and other legal obligations relating to privacy, data protection and consumer protection, including those relating to the use of data for marketing purposes. It is possible, however, that these requirements may be interpreted and applied in a manner that is inconsistent from one jurisdiction to another, may conflict with other rules or may conflict with our practices. If so, we may suffer damage to our reputation and be subject to proceedings or actions against us by governmental entities or others. Any such proceeding or action could hurt our reputation, force us to spend significant amounts to defend our practices, distract our management, increase our costs of doing business and result in monetary liability.

Table of Contents

In addition, as data privacy and marketing laws change, we may incur additional costs to ensure we remain in compliance with such laws. If applicable data privacy and marketing laws become more restrictive at the international, federal or state level, our compliance costs may increase, our ability to effectively engage customers via personalized marketing may decrease, our investment in our e commerce platform may not be fully realized, our opportunities for growth may be curtailed by our compliance capabilities or reputational harm and our potential liability for security breaches may increase.

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 2018, we purchased merchandise from approximately 700 vendors. Since a majority of our merchandise is manufactured in foreign countries, one or more of our vendors may not adhere to product safety requirements or our quality control standards, and we may 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 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 or regulators do not believe we are complying with current regulations applicable to us, significant fines or penalties could result and could adversely affect our reputation, results of operations, cash flow and financial condition.

Our total assets include intangible assets, goodwill and substantial amounts of property and equipment. Changes in estimates or projections used to assess the fair value of these assets, or operating results that are lower than our current estimates at certain store locations, may cause us to incur impairment charges that could adversely affect our results of operation.

Our total assets include intangible assets, goodwill and substantial amounts of property and equipment. We make certain estimates and projections in connection with impairment analyses for these long-lived assets, in accordance with Financial Accounting Standards Board Accounting Standards Codification ("ASC") 360, "Property, Plant and Equipment", and ASC 350, "Intangibles—Goodwill and Other". We also review the carrying value of these assets for impairment on an annual basis and whenever events or changes in circumstances indicate that the carrying value of the asset may not be recoverable. We will record an impairment loss when the carrying value of the underlying asset,

asset group or reporting unit exceeds its fair value. These calculations require us to make a number of estimates and projections of future results. If these estimates or projections change, we may be required to record additional impairment charges on certain of these assets. If these impairment charges are significant, our results of operations would be adversely affected.

Disruptions in the capital markets could increase our costs of doing business.

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 flow and financial condition.

Our real estate leases generally obligate us for long periods, which subject us to various financial risks.

We lease virtually all of our store, distribution center and administrative locations, generally for long terms. While we have the right to terminate some of our leases under specified conditions by making specified payments, we may not be able to terminate a particular lease if or when we would like to do so. If we decide to close stores, we are generally required to continue paying rent and operating expenses for the balance of the lease term, or pay to exercise rights to terminate, and the performance of any of these obligations may be costly. When we assign or sublease vacated locations, we may remain liable on the lease obligations if the assignee or sublessee does not perform. In addition, when leases for the stores in our ongoing operations expire, we may be unable to negotiate renewals, either on commercially acceptable terms, or at all, which could cause us to close stores. Accordingly, we are subject to the risks associated with leasing real estate, which can have a material adverse effect on our results.

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 third party providers 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, manage our costs and seek additional cost savings. These functions are generally performed in offshore locations. As a result, we rely 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 suppliers. 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 U.S. laws and regulations.

Failure to attract and retain quality sales, distribution center and other team members in appropriate numbers as well as experienced buying and management personnel could adversely affect our performance.

Our performance depends on recruiting, developing, training and retaining quality sales, distribution center and other team members in large numbers as well as experienced buying and management personnel. Many of our store level team members are in entry level or part time positions with historically high rates of turnover. Our ability to meet our labor needs while controlling labor costs is subject to external factors such as unemployment levels, prevailing wage rates, minimum wage legislation, changing demographics, health and other insurance costs and governmental labor and employment requirements. In the event of increasing wage rates, if we fail to increase our wages competitively, the quality of our workforce could decline, causing our customer service to suffer, while increasing our wages could cause our earnings to decrease. The market for retail management is highly competitive and, similar to other retailers, we face challenges in securing sufficient management talent. If we do not continue to attract, train and retain quality team members, our performance could be adversely affected.

The Sponsors have significant influence over us and their interest may conflict with yours or those of our Company.

Affiliates of, or funds advised by, Bain Capital Partners, LLC and The Blackstone Group L.P. (together the “Sponsors”) beneficially owned approximately 46% of our outstanding common stock as of February 2, 2019. As long as the Sponsors continue to hold a significant portion of our outstanding common stock, they will be able to strongly influence or effectively control our decisions, and their interests may conflict with yours or those of our Company.

Because our executive officers hold or may hold restricted shares or option awards that will vest upon a change of control, these officers may have interests in us that conflict with yours.

Our executive officers hold or may hold restricted shares and options to purchase shares that would automatically vest upon a change of control. As a result, these officers may view certain change of control transactions more favorably than an investor due to the vesting opportunities available to them and, as a result, may have an economic incentive to support a transaction that may not be viewed as favorable by other stockholders.

Table of Contents

Our holding company structure makes us, and certain of our direct and indirect subsidiaries, dependent on the operations of our, and their, subsidiaries to meet our financial obligations.

We, and certain of our direct and indirect subsidiaries, have no significant assets other than the interest in direct and indirect subsidiaries, including MSI. As a result, we, and certain of our direct and indirect subsidiaries, rely exclusively upon payments, dividends and distributions from direct and indirect subsidiaries' cash flows. Our ability to pay dividends, if any are declared, to our shareholders is dependent on the ability of our subsidiaries to generate sufficient net income and cash flows to pay upstream dividends and make loans or loan repayments.

Our common stock price has been and may continue to be volatile, which may result in losses to our stockholders.

The stock market in general has been extremely volatile and companies have recently experienced sharp share price and trading volume changes. The trading price of our common stock is likely to be volatile and could fluctuate widely in response to, among other things, the risk factors described in this report and other factors beyond our control such as fluctuations in the operations or valuations of companies perceived by investors to be comparable to us, our ability to meet analysts' expectations, our trading volume, the impact of any stock repurchase program or conditions or trends in the retail industry. General economic and political conditions unrelated to our performance may also adversely affect the price of our common stock. As a result, the market price of our common stock is likely to be similarly volatile and investors in our common stock may experience a decrease, which could be substantial, in the value of their stock, including decreases unrelated to our operating performance or prospects, and could lose part or all of their investment. Since listing our common stock on The NASDAQ Global Select Market in June 2014 in connection with our initial public offering ("IPO"), the price of our common stock has ranged from a low of $12.48 on December 24, 2018 to a high of $31.37 on June 6, 2016.

In the past, securities class action litigation has often been initiated against companies following periods of volatility in their stock price. This type of litigation could result in substantial costs and divert our management's attention and resources, and could also require us to make substantial payments to satisfy judgments or to settle litigation.

Provisions in our charter documents and Delaware law may deter takeover efforts that may be beneficial to stockholder value.

Delaware law and provisions in our certificate of incorporation and bylaws could make it harder for a third party to acquire us, even if doing so might be beneficial to our stockholders. These provisions include limitations on our stockholders' ability to act by written consent. In addition, our Board has the right to issue preferred stock without stockholder approval that could be used to dilute a potential hostile acquirer. Our certificate of incorporation imposes some restrictions on mergers and other business combinations between us and any holder of 15% or more of our outstanding common stock other than the Sponsors, who own approximately 46% of our outstanding common stock as of February 2, 2019. As a result, you may lose your ability to sell your stock for a price in excess of the prevailing market price due to these protective measures and efforts by stockholders to change the direction or management of the Company may be unsuccessful.

Our certificate of incorporation designates the Court of Chancery of the State of Delaware as the sole and exclusive forum for certain types of actions and proceedings that may be initiated by our stockholders, which could limit our stockholders' ability to obtain a favorable judicial forum for disputes with us or our directors, officers or employees.

Our certificate of incorporation provides that, subject to limited exceptions, the Court of Chancery of the State of Delaware will be the sole and exclusive forum for (i) any derivative action or proceeding brought on our behalf, (ii) any action asserting a claim of breach of a fiduciary duty owed by any director, officer or other employee to us or our stockholders, (iii) any action asserting a claim against us arising pursuant to any provision of the Delaware General Corporation Law or our certificate of incorporation or the bylaws or (iv) any action asserting a claim against us governed by the internal affairs doctrine. Any person or entity purchasing or otherwise acquiring any interest in shares of our capital stock shall be deemed to have notice of and to have consented to the provisions of our certificate of incorporation described above. This choice of forum provision may limit a stockholder's ability to bring a claim in a judicial forum that it finds favorable for disputes with us or our directors, officers or other employees, which may discourage such lawsuits against us and our directors, officers and employees. Alternatively, if a court were to find these provisions of our certificate of incorporation inapplicable to, or unenforceable in respect of, one or more of the specified types of actions or proceedings, we may incur additional costs associated with resolving such matters in other jurisdictions, which could adversely affect our business and financial condition.

Table of Contents

Because we have no current plans to pay cash dividends on our common stock for the foreseeable future, you may not receive any return on investment unless you sell your common stock for a price greater than you paid.

We plan to retain future earnings, if any, for future operation, expansion and debt repayment and have no current plans to pay any cash dividends for the foreseeable future. Any decision to declare and pay dividends in the future will be made at the discretion of our Board and will depend on, among other things, our results of operations, financial condition, cash requirements, contractual restrictions and other factors that our Board may deem relevant. In addition, our ability to pay dividends may be limited by covenants of any existing and future outstanding indebtedness we or our subsidiaries incur, including our Senior Secured Credit Facilities. As a result, you may not receive any return on an investment in our common stock unless you sell our common stock for a price greater than you paid.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

Not applicable.

Table of Contents

ITEM 2. PROPERTIES

We lease substantially all of the sites for our 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 February 2, 2019, in connection with stores that we plan to open or relocate in future fiscal years, we had signed 36 leases. Management believes our facilities are suitable and adequate for our business as presently conducted.

As of February 2, 2019, we leased the following non-store facilities:

Locations	Square Footage
Distribution centers:	
Hazleton, Pennsylvania	692,000
Jacksonville, Florida	506,000
Lancaster, California	763,000
Centralia, Washington	718,000
New Lenox, Illinois	693,000
Haslet, Texas	433,000
Strongsville, Ohio (Darice warehouse)	287,000
	4,092,000
Artistree:	
DFW Airport, Texas (regional processing and fulfillment operations center)	271,000
Kernersville, North Carolina (manufacturing plant and regional processing center)	156,000
Mississauga, Ontario (regional processing center)	62,000
	489,000
Office space:	
Irving, Texas (corporate office support center)	296,000
Strongsville, Ohio (Lamrite office support center)	557,000
Atlanta, Georgia (Darice showroom)	6,000
Mississauga, Ontario (Canadian regional office)	3,000
Kowloon Bay, Hong Kong (regional sourcing office)	4,000
Ningbo, China (regional sourcing office)	22,000
	888,000
Coppell, Texas (new store staging warehouse)	82,000
	5,551,000

Table of Contents

The following table indicates the number of our retail stores located in each state or province as of February 2, 2019:

State/Province	Number of Michaels Stores
Alabama	13
Alaska	4
Alberta	23
Arizona	28
Arkansas	5
British Columbia	17
California	135
Colorado	23
Connecticut	22
Delaware	5
District of Columbia	1
Florida	85
Georgia	35
Idaho	7
Illinois	43
Indiana	18
Iowa	8
Kansas	8
Kentucky	12
Louisiana	16
Maine	3
Manitoba	4
Maryland	27
Massachusetts	32
Michigan	35
Minnesota	23
Mississippi	7
Missouri	21
Montana	5
Nebraska	6
Nevada	10
New Brunswick	3
New Hampshire	11
New Jersey	32
New Mexico	4
New York	64
Newfoundland and Labrador	1
North Carolina	37
North Dakota	3
Nova Scotia	7
Ohio	33
Oklahoma	8
Ontario	59

Oregon	15
Pennsylvania	50
Prince Edward Island	1
Quebec	16
Rhode Island	4
Saskatchewan	3
South Carolina	16
South Dakota	2
Tennessee	16
Texas	90
Utah	14
Vermont	2
Virginia	39
Washington	25
West Virginia	4
Wisconsin	17
Wyoming	1
Total	1,258

Table of Contents

ITEM 3. LEGAL PROCEEDINGS.

Information regarding legal proceedings is incorporated by reference from Note 14 to the consolidated financial statements.

ITEM 4. MINE SAFETY DISCLOSURES.

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Common Stock

Our common stock is listed on The NASDAQ Global Select Market under the symbol “MIK”. As of February 2, 2019, there were approximately 380 holders of record of our common stock.

Dividends

The Company does not anticipate paying any cash dividends in the near future. We anticipate that all of our earnings for the foreseeable future will be used to repay debt, to repurchase outstanding shares, for working capital, to support our operations and to finance the growth and development of our business. Any future determination to pay dividends will be at the discretion of our Board, subject to compliance with applicable law and any contractual provisions, including under agreements for indebtedness, that restrict or limit our ability to pay dividends, and will depend upon, among other factors, our results of operations, financial condition, earnings, capital requirements and other factors that our Board may deem relevant. For additional information concerning restrictions relating to agreements for indebtedness, see Note 7 to the consolidated financial statements.

Unregistered Sales of Securities

The following table provides certain information with respect to our purchases of shares of the Company's common stock during the fourth quarter of fiscal 2018:

Period	Total Number of Shares Purchased (a)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan (b)	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plan (b) (in thousands)
November 4, 2018 - December 1, 2018	1,023,067	$ 17.26	1,022,023	$ 398,353
December 2, 2018 - January 5, 2019	2,512	14.64	—	398,353
January 6, 2019 - February 2, 2019	165	13.86	—	398,353
Total	1,025,744	$ 17.25	1,022,023	$ 398,353

[a] These amounts reflect the following transactions during the fourth quarter of fiscal 2018: (i) the repurchase of shares as part of our publicly announced share repurchase program and (ii) the surrender of shares of common stock to the Company to satisfy tax withholding obligations in connection with the vesting of employee restricted stock equity awards.

[b] In September 2018, the Board of Directors authorized the Company to purchase up to $500.0 million of the Company's common stock on the open market or through accelerated share repurchase transactions. The share repurchase program does not have an expiration date. The Company has retired and intends to continue to retire shares repurchased under the program.

Table of Contents

Performance Graph

The following graph shows a comparison of cumulative total return to holders of The Michaels Companies, Inc.'s common shares against the cumulative total return of the S&P 500 Index and S&P 500 Retail Index from June 27, 2014 (the date the Company's stock commenced trading on the NASDAQ Global Select Market) through February 2, 2019. The comparison of the cumulative total returns for each investment assumes that $100 was invested in The Michaels Companies, Inc. common shares and the respective indices on June 27, 2014 through February 2, 2019 including reinvestment of any dividends. Historical share price performance should not be relied upon as an indication of future share price performance.

	6/27/2014	1/31/2015	1/30/2016	1/28/2017	2/3/2018	2/2/2019
The Michaels Companies, Inc.	$ 100.00	$ 151.76	$ 128.24	$ 115.06	$ 153.71	$ 80.06
S&P 500 Index	100.00	103.10	102.41	123.78	152.05	151.96
S&P 500 Retail Index	100.00	108.50	97.18	102.61	111.11	108.68

Table of Contents

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.

	Fiscal Year(1)				
	2018	2017	2016(2)	2015	2014
	(in thousands, except earnings per share, other operating and store count data)				
Results of Operations Data:					
Net sales	$ 5,271,944	$ 5,361,960	$ 5,197,292	$ 4,912,782	$ 4,738,144
Restructure charges (3)	104,238	—	—	—	—
Operating income (4)	563,612	735,390	715,280	720,604	626,529
Interest expense	147,085	129,116	126,270	139,405	198,409
Losses on early extinguishments of debt and refinancing costs	1,835	—	7,292	8,485	74,312
Net income (5)	319,545	390,498	378,159	362,912	217,395
Earnings per common share:					
Basic	$ 1.87	$ 2.11	$ 1.84	$ 1.75	$ 1.07
Diluted	$ 1.86	$ 2.10	$ 1.82	$ 1.72	$ 1.05
Weighted-average common shares outstanding:					
Basic	170,610	184,281	204,735	206,845	203,229
Diluted	171,378	185,566	206,354	209,346	207,101
Balance Sheet Data:					
Cash and equivalents	$ 245,887	$ 425,896	$ 298,813	$ 409,391	$ 378,295

Merchandise inventories	1,108,715	1,123,288	1,127,777	1,002,607	958,171
Total current assets	1,515,524	1,676,982	1,542,805	1,507,723	1,423,778
Total assets	2,128,336	2,300,215	2,147,640	2,031,287	1,961,108
Total current liabilities	932,553	957,945	1,024,224	912,860	889,632
Current portion of long-term debt	24,900	24,900	31,125	24,900	24,900
Long-term debt	2,681,000	2,701,764	2,723,187	2,744,942	3,089,781
Total liabilities	3,754,531	3,809,710	3,846,066	3,755,382	4,072,633
Stockholders’ deficit	(1,626,195)	(1,509,495)	(1,698,426)	(1,724,095)	(2,111,525)
Other Operating Data:					
Average net sales per selling square foot (6)	$ 227	$ 224	$ 223	$ 223	$ 220
Comparable store sales	0.8 %	0.9 %	(0.5) %	1.8 %	1.7 %
Comparable store sales, at constant currency	0.9 %	0.7 %	(0.4) %	3.2 %	2.4 %
Total selling square footage (in thousands)	22,339	23,749	23,539	22,068	21,605
Stores Open at End of Year:					
Michaels	1,258	1,238	1,223	1,196	1,168
Aaron Brothers	—	97	109	117	120
Pat Catan's	—	36	35	—	—
Total stores open at end of year	1,258	1,371	1,367	1,313	1,288

(1) Fiscal 2017 consisted of 53 weeks while all other periods presented consisted of 52 weeks.

(2) Fiscal 2016 results of operations includes $11.4 million of non-recurring purchase accounting adjustments and integration costs related to the acquisition of Lamrite West, Inc. and certain of its affiliates and subsidiaries (“Lamrite”) on February 2, 2016.

(3) The restructure charges primarily relate to the closure of substantially all of our Aaron Brothers stores and the closure of all of our Pat Catan’s stores.

(4) Fiscal 2014 operating income includes a $32.3 million charge associated with the IPO primarily related to a $30.2 million fee paid to certain related parties to terminate our management agreement.

(5) Net income for fiscal 2018 and fiscal 2017 includes $1.0 million and $8.5 million, respectively, of net additional income tax expense as a result of the Tax Cuts and Jobs Act of 2017.

(6) The calculation of average net sales per selling square foot includes only Michaels comparable stores.

Table of Contents

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

We report on the basis of a 52- or 53-week fiscal year, which ends on the Saturday closest to January 31. All references to fiscal year mean the year in which that fiscal year began. References to "fiscal 2018" relate to the 52 weeks ended February 2, 2019, references to "fiscal 2017" relate to the 53 weeks ended February 3, 2018 and references to "fiscal 2016" relate to the 52 weeks ended January 28, 2017.

Michaels Stores, Inc. ("MSI") is headquartered in Irving, Texas and was incorporated in the state of Delaware in 1983. In July 2013, MSI was reorganized into a holding company structure and The Michaels Companies, Inc. (the "Company") was incorporated in the state of Delaware in connection with the reorganization.

Fiscal 2018 Overview

With $5,271.9 million in net sales in fiscal 2018, we are the largest arts and crafts specialty retailer in North America (based on store count) providing materials, project ideas and education for creative activities, primarily under the Michaels retail brand. We also operate a wholesale business under the Darice brand name and a market-leading vertically-integrated custom framing business under the Artistree brand name. At February 2, 2019, we operated 1,258 Michaels stores.

Financial highlights for fiscal 2018 include the following:

- Net sales decreased to $5,271.9 million, a 1.7% decrease compared to last year, primarily due to the closure of substantially all of our Aaron Brothers stores and $78.6 million associated with the 53rd week in fiscal 2017.

- Comparable store sales increased 0.8%, or 0.9% at constant exchange rates.

- Our Michaels retail stores' private brand merchandise drove approximately 60% of net sales in fiscal 2018 compared to 58% of net sales in fiscal 2017.

- We recorded restructure charges totaling $104.2 million consisting of $41.7 million related to the closure of substantially all of our Aaron Brothers stores, $57.2 million related to the closure of all of our Pat Catan's stores and $5.3 million of employee-related charges as a result of certain organizational changes made to streamline our operations at our corporate support center.

· We reported operating income of $563.6 million, a decrease of 23.4% from the prior year and net income of $319.5 million, a decrease of 18.2% from the prior year. The decreases are primarily due to restructure charges recorded in fiscal 2018 and the 53rd week of operations in fiscal 2017.

· Adjusted EBITDA, a non-GAAP measure that is a required calculation in our debt agreements, decreased by 6.1%, from $888.5 million in fiscal 2017 to $834.6 million in fiscal 2018 (see "Management Discussion and Analysis of Financial Condition and Results of Operations - Non-GAAP Measures").

· We recognized approximately $40 million of cost savings in fiscal 2018 as a result of sourcing initiatives that began in fiscal 2016.

· We refinanced our amended term loan credit facility and entered into two interest rate swaps associated with that facility.

· In June 2018, we executed a $250 million accelerated share repurchase agreement ("ASR Agreement') for delivery of 12.4 million shares of our common stock.

· We repurchased 24.6 million shares under our share repurchase programs for an aggregate amount of $451.9 million, including shares repurchased under the ASR Agreement.

Table of Contents

In fiscal 2018, we made significant progress implementing our strategic initiatives, including:

- repositioning our Aaron Brothers brand as a store-within-a-store to provide custom framing services in all Michaels stores and rebranding Framerspointe.com to AaronBrothers.com;
- creating flexible merchandising space in an additional 238 stores to highlight new product and present stronger, more cohesive seasonal product statements to customers;
- strengthening our omnichannel offering with improvements to the Michaels app and the expansion of our buy online, pick up in store and ship-from-store programs;
- supporting the growth of our e-commerce business by retro-fitting our DFW distribution center to support e-commerce fulfillment, allowing us to maintain greater control over, and lower our costs associated with, our e-commerce order fulfillment process;
- launching a new promotional tool to manage discounts more effectively through the use of targeted offers and serialized coupons;
- customizing our digital communications to customers by using new data analytics capabilities to drive customer insights; and
- generating meaningful cost savings through our ongoing Fuel for Growth and sourcing efforts.

Fiscal 2019 Outlook

In fiscal 2019, we intend to continue to expand our industry leadership through innovation and strategic initiatives such as:

- enhancing our digital platforms and tools to deliver a more seamless, omnichannel customer experience;
- expanding our e-commerce businesses and diversifying our fulfillment processes to drive increased profitability;
- leveraging new data analytical capabilities to help us identify actionable customer insights, create more effective customer communications and enhance our assortment;

- continuing to leverage our size and scale to curate our assortment, both in-store and online, to offer customers more newness, more exclusives and trend-right product; and

- generating meaningful cost savings through our ongoing Fuel for Growth efforts and product sourcing.

Comparable Store Sales

Comparable store sales represents the change in net sales for stores open the same number of months in the comparable period of the previous year, including stores that were relocated or expanded during either period, as well as e-commerce sales. 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 two weeks is not considered comparable during the month it is closed. If a store is closed longer than two weeks but less than two months, it becomes comparable in the month in which it reopens, subject to a mid-month convention. A store closed longer than two months becomes comparable in its 14th month of operation after its reopening. Comparable store sales exclude the impact of the 53rd week in fiscal 2017. All Aaron Brothers stores have been excluded from comparable stores sales in fiscal 2018.

Table of Contents

Results of Operations

The following table sets forth the percentage relationship to net sales of line items in our consolidated statements of comprehensive income. This table should be read in conjunction with the following discussion and with our consolidated financial statements, including the related notes.

	Fiscal Year		
	2018	2017	2016
Net sales	100.0 %	100.0 %	100.0 %
Cost of sales and occupancy expense	61.6	60.3	61.0
Gross profit	38.4	39.7	39.0
Selling, general and administrative	25.6	25.9	25.2
Restructure charges	2.0	—	—
Store pre-opening costs	0.1	0.1	0.1
Operating income	10.7	13.7	13.8
Interest expense	2.8	2.4	2.4
Losses on early extinguishments of debt and refinancing costs	—	—	0.1
Other (income) expense, net	—	—	—
Income before income taxes	7.9	11.3	11.2
Income taxes	1.8	4.0	3.9
Net income	6.1 %	7.3 %	7.3 %

Fiscal 2018 Compared to Fiscal 2017

Net Sales. Net sales decreased $90.0 million in fiscal 2018, or 1.7%, compared to fiscal 2017. The decrease in net sales was due to a $95.3 million decrease related to the closure of substantially all of our Aaron Brothers stores, a $78.6 million decrease associated with the 53rd week in fiscal 2017 and a $4.6 million decrease in wholesale revenue. The decrease was partially offset by a $49.4 million increase related to 20 additional Michaels stores opened (net of closures) since February 3, 2018 and a $37.9 million increase in comparable store sales. Comparable store sales increased 0.8%, or 0.9% at constant exchange rates, compared to fiscal 2017 due to an increase in average ticket, partially offset by a decrease in customer transactions.

Gross Profit. Gross profit was 38.4% of net sales in fiscal 2018 compared to 39.7% in fiscal 2017. The 130 basis point decrease was primarily due to higher distribution related costs, a change in sales mix, occupancy cost deleverage due to the 53rd week in the prior year and an increase in shrink. The decrease was partially offset by benefits from our ongoing sourcing initiatives.

Selling, General and Administrative. Selling, general and administrative ("SG&A") was 25.6% of net sales in fiscal 2018 compared to 25.9% in fiscal 2017. SG&A decreased $39.0 million to $1,351.4 million in fiscal 2018. The decrease was primarily due to a $34.7 million decrease related to the Aaron Brothers store closures in fiscal 2018 and a $15.5 million decrease in payroll related expenses primarily due to the 53rd week in fiscal 2017. The decrease was partially offset by a $7.4 million increase associated with operating 20 additional Michaels stores (net of closures).

Restructure Charges. We recorded restructure charges totaling $104.2 million in fiscal 2018 consisting of $41.7 million related to the closure of substantially all of our Aaron Brothers stores, $57.2 million related to the closure of all of our Pat Catan's stores and $5.3 million of employee-related charges as a result of certain organizational changes made to streamline our operations at our corporate support center.

Interest Expense. Interest expense increased $18.0 million to $147.1 million in fiscal 2018 compared to fiscal 2017. The increase was primarily due to $13.2 million as a result of a higher interest rate on our amended and restated term loan credit facility and $4.6 million related to settlement payments associated with our interest rate swaps.

Losses on Early Extinguishments of Debt and Refinancing Costs. We recorded a loss on the early extinguishment of debt of $1.8 million in fiscal 2018 related to the refinancing of our amended and restated term loan credit facility.

Income Taxes. The effective tax rate was 23.4% for fiscal 2018 compared to 35.5% for fiscal 2017. The effective tax rate for fiscal 2018 was lower than the same period in the prior year due to benefits recognized related to the Tax Cuts and Jobs Act of 2017 (the "Tax Act"), including a decrease in the federal statutory rate from 35% to 21%.

Fiscal 2017 Compared to Fiscal 2016

Net Sales. Net sales increased $164.7 million in fiscal 2017, or 3.2%, compared to fiscal 2016. The increase in net sales was due to $78.6 million associated with the 53rd week in fiscal 2017, a $49.9 million increase related to 15 additional Michaels stores opened (net of closures) since January 28, 2017 and a $47.8 million increase in comparable store sales. Comparable store sales increased 0.9% compared to fiscal 2016, or 0.7% at constant exchange rates, due to an increase in average ticket and an increase in customer transactions. Wholesale revenue decreased $11.3 million primarily due to the timing differences between new customer acquisitions and the expected decline in sales from legacy customers as a result of the Lamrite acquisition in fiscal 2016.

Gross Profit. Gross profit was 39.7% of net sales in fiscal 2017 compared to 39.0% in fiscal 2016. The 70 basis point increase was primarily due to our sourcing initiatives that began in fiscal 2016, occupancy cost leverage as a result of the 53rd week in fiscal 2017 and $4.0 million of non-recurring purchase accounting adjustments related to inventory recorded in the prior year. The increase was partially offset by an increase in shrink and distribution related costs.

Selling, General and Administrative. SG&A was 25.9% of net sales in fiscal 2017 compared to 25.2% in fiscal 2016. SG&A increased $82.3 million to $1,390.4 million in fiscal 2017. The increase was due to a $37.6 million increase in incentive-based compensation, a $23.5 million increase in payroll related expenses primarily due to the 53rd week in fiscal 2017, $9.9 million of higher healthcare costs, a $5.3 million increase in marketing expenses and $3.5 million of expenses primarily associated with operating 15 additional Michaels stores (net of closures). The increase was partially offset by $7.4 million of Lamrite integration costs recorded in the prior year.

Interest Expense. Interest expense increased $2.8 million to $129.1 million in fiscal 2017 compared to fiscal 2016. The increase was primarily due to $4.4 million in additional interest related to the 53rd week in fiscal 2017 and a higher interest rate on our term loan credit facility. The increase was partially offset by $1.1 million of interest savings due to the refinancing of our term loan credit facility in the third quarter of fiscal 2016 and $0.4 million in interest savings related to the refinancing of the senior secured asset-based revolving credit facility in the second quarter of fiscal 2016.

Losses on Early Extinguishments of Debt and Refinancing Costs. We recorded a loss on the early extinguishment of debt of $7.3 million during fiscal 2016, consisting of $6.9 million related to the amendment of our term loan credit facility and $0.4 million related to the refinancing of our senior secured asset-based revolving credit facility.

Income Taxes. The effective tax rate for fiscal 2017 was 35.5% compared to 35.0% in the prior year. The effective tax rate for fiscal 2017 was higher than the prior year due to an $8.5 million charge as a result of the enactment of the Tax Act. The charge consists of adjustments totaling $14.6 million related to repatriation taxes for accumulated earnings of foreign subsidiaries and the revaluation of net deferred tax assets, partially offset by a $6.1 million benefit due to a decrease in the federal statutory tax rate from 35% to 21%. In addition, we realized tax benefits associated with our direct sourcing initiatives that began in the second half of fiscal 2016 and $3.2 million of excess tax benefits in fiscal 2017 associated with the adoption of a new accounting standard related to share-based compensation.

Liquidity and Capital Resources

We require cash principally for day-to-day operations, to finance capital investments, purchase inventory, 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 Amended Revolving Credit Facility (as defined below) will be sufficient to fund planned capital expenditures, working capital requirements, debt repayments, debt service requirements and anticipated growth for the foreseeable future. Our ability to satisfy our liquidity needs and continue to refinance or reduce debt could be adversely affected by the occurrence of any of the events described under “Item 1A. Risk Factors” or our failure to meet our debt covenants as described below. Our Amended Revolving Credit Facility provides senior secured financing of up to $850.0 million, subject to a borrowing base. As of February 2, 2019, the borrowing base was $850.0 million, of which we had no outstanding borrowings, $107.3 million of outstanding standby letters of credit and $742.7 million of unused borrowing capacity. Our cash and cash equivalents totaled $245.9 million at February 2, 2019.

Table of Contents

In September 2018, the Board of Directors authorized a new share repurchase program for the Company to purchase $500.0 million of the Company's common stock on the open market or through accelerated share repurchase transactions. The share repurchase program does not have an expiration date, and the timing and number of repurchase transactions under the program will depend on market conditions, corporate considerations, debt agreements and regulatory requirements. Shares repurchased under the program are held as treasury shares until retired. In June 2018, the Company entered into an ASR Agreement with JPMorgan Chase Bank, N.A. ("JPMorgan"). Under the ASR Agreement, we paid JPMorgan a purchase price of $250.0 million for delivery of 12.4 million shares of our common stock. The total number of shares repurchased was based upon a volume weighted average price of our stock over a predetermined period. The ASR agreement was completed on August 30, 2018. During the year ended February 2, 2019, we repurchased 24.6 million shares under our share repurchase programs for an aggregate amount of $451.9 million, inclusive of the ASR Agreement. As of February 2, 2019, we had $398.4 million of availability remaining under our current share repurchase program.

We had total outstanding debt of $2,717.5 million at February 2, 2019, of which $2,207.5 million was subject to variable interest rates and $510.0 million was subject to fixed interest rates. In April 2018, we executed two interest rate swaps with an aggregate notional value of $1.0 billion associated with our outstanding Amended Term Loan Credit Facility (as defined below). The swaps replaced the one-month LIBOR with a fixed interest rate of 2.7765%.

Our substantial indebtedness could adversely affect our ability to raise additional capital, limit our ability to react to changes in the economy or our industry, expose us to interest rate risk and prevent us from meeting our obligations. Management reacts strategically to changes in economic conditions and monitors compliance with debt covenants to seek to mitigate any potential material impacts to our financial condition and flexibility.

We intend to use excess operating cash flows to invest in growth opportunities, repurchase outstanding shares and repay portions of our indebtedness, depending on prevailing market conditions, liquidity requirements, contractual restrictions and other factors. As such, we and our subsidiaries, affiliates and significant shareholders 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. If we use our excess cash flows to repay our debt, it will reduce the amount of excess cash available for additional capital expenditures.

Cash Flow from Operating Activities

Cash flows provided by operating activities were $444.3 million in fiscal 2018, a decrease of $79.4 million from fiscal 2017. The decrease was primarily due to lower operating income in fiscal 2018, including the impact of the 53rd week in the prior year, investments in inventory associated with our wholesale business and increased duties. The decrease was partially offset by a reduction in cash paid for taxes.

Inventory decreased 1.3% to $1,108.7 million at February 2, 2019, from $1,123.3 million at February 3, 2018. The decrease was primarily due to the Aaron Brothers and Pat Catan’s store closures in fiscal 2018. The decrease was partially offset by additional inventory associated with the operation of 20 additional Michaels stores (net of closures) since February 3, 2018 and investments in inventory associated with our wholesale business. Average inventory per Michaels store (inclusive of distribution centers, in-transit and inventory for the Company’s e commerce site) increased 2.7% to $832,000 at February 2, 2019, from $810,000 at February 3, 2018.

Table of Contents

Cash Flow from Investing Activities

The following table includes capital expenditures paid during the periods presented (in thousands):

	Fiscal Year		
	2018	2017	2016
New and relocated stores and stores not yet opened (1)	$ 32,153	$ 19,419	$ 22,489
Existing stores	39,524	35,940	47,290
Information systems	54,794	47,894	27,584
Corporate and other	18,916	24,577	17,099
	$ 145,387	$ 127,830	$ 114,462

(1) In fiscal 2018, we incurred capital expenditures related to the opening of 45 Michaels stores, including the relocation of 21 stores. In fiscal 2017, we incurred capital expenditures related to the opening of 29 Michaels stores, including the relocation of 12 stores, and the opening of one Pat Catan's store. In fiscal 2016, we incurred capital expenditures related to the opening of 46 Michaels stores, including the relocation of 14 stores, and the opening of one Aaron Brothers store and four Pat Catan's stores, including the relocation of one Pat Catan's store.

We currently estimate that our capital expenditures will be approximately $135 million in fiscal 2019. We plan to invest in the infrastructure necessary to support the further development of our business, including investments in information technology related to our e-commerce business, enhancing our digital platforms and tools, and improving our data analytical capabilities to gain additional customer insights. In addition, we will continue to invest in new store openings and store remodels. In fiscal 2019, we plan to open approximately 37 new Michaels stores, including approximately 13 relocations, and up to 12 rebranded Pat Catan's stores.

Term Loan Credit Facility

On January 28, 2013, MSI entered into an amended and restated credit agreement maturing on January 28, 2020 (the "Credit Agreement") to amend various terms of MSI's then existing term loan credit agreement with Deutsche Bank AG New York Branch ("Deutsche Bank") and other lenders. The Credit Agreement, together with the related security, guarantee and other agreements, is referred to as the "Term Loan Credit Facility".

On July 2, 2014, MSI issued an additional $850.0 million of debt under the Term Loan Credit Facility maturing in 2020 ("Additional Term Loan"). The Additional Term Loan was issued at 99.5% of face value, resulting in an effective interest rate of 4.02%.

On September 28, 2016, MSI entered into an amendment with Deutsche Bank and other lenders to amend and restate our Term Loan Credit Facility. The amended and restated credit agreement, together with the related security, guarantee and other agreements, is referred to as the "Amended Term Loan Credit Facility".

On May 23, 2018, MSI entered into an amendment with JPMorgan, as successor administrative agent and successor collateral agent, and other lenders to amend and restate our Amended Term Loan Credit Facility. The amended and restated credit agreement, together with the related security, guarantee and other agreements, is referred to as the "Amended and Restated Term Loan Credit Facility". Borrowings under the Amended and Restated Term Loan Credit Facility bear interest at a rate per annum, at MSI's option, of either (a) a margin of 1.50% plus a base rate defined as the highest of (1) the prime rate of JPMorgan, (2) the federal funds effective rate plus 0.5%, and (3) the one-month London Interbank Offered Rate ("LIBOR") plus 1% or (b) a margin of 2.50% plus the applicable LIBOR. The Amended Term Loan Credit Facility matures on January 28, 2023.

As of February 2, 2019, the Amended and Restated Term Loan Credit Facility provides for senior secured financing of $2,207.5 million. MSI has the right under the Amended and Restated Term Loan Credit Facility to request additional term loans (a) in the aggregate amount of up to $750.0 million or (b) at MSI's election, an amount of additional term loans if the consolidated secured debt ratio (as defined in the Amended and Restated Term Loan Credit Facility) is no more than 3.25 to 1.00 on a pro forma basis as of the last day of the most recently ended four quarter period, subject to certain adjustments. The lenders under the Amended and Restated Term Loan Credit Facility will not be under any obligation to provide any such additional term loans, and the incurrence of any such additional term loans is subject to customary conditions.

There are no limitations on dividends and certain other restricted payments so long as (a) no event of default shall have occurred and be continuing and (b) immediately after giving pro forma effect to such restricted payment(s) and the application of proceeds therefrom, the consolidated total leverage ratio is less than or equal to 3.75 to 1.00.

MSI must offer to prepay outstanding term loans at 100% of the principal amount, plus any unpaid interest, with the proceeds of certain asset sales or casualty events under certain circumstances. MSI may voluntarily prepay outstanding loans under the Amended and Restated Term Loan Credit Facility at any time without premium or penalty other than customary breakage costs with respect to LIBOR loans.

MSI is required to make scheduled quarterly payments equal to 0.25% of the original principal amount of the term loans (subject to adjustments relating to the incurrence of additional term loans) for the first four years and two quarters of the Amended and Restated Term Loan Credit Facility, with the balance to be paid on January 28, 2023.

All obligations under the Amended and Restated Term Loan Credit Facility are unconditionally guaranteed, jointly and severally, by Michaels Funding, Inc. ("Holdings") and all of MSI's existing domestic material subsidiaries and are required to be guaranteed by certain of MSI's future domestic wholly-owned material subsidiaries ("the Subsidiary Guarantors"). All obligations under the Amended and Restated Term Loan Credit Facility, and the guarantees of those obligations, are secured, subject to certain exceptions, by substantially all of the assets of Holdings, MSI and the Subsidiary Guarantors, including:

· a first-priority pledge of MSI's capital stock and all of the capital stock held directly by MSI and the Subsidiary Guarantors (which pledge, in the case of any foreign subsidiary or foreign subsidiary holding company, is limited to 65% of the voting stock of such foreign subsidiary or foreign subsidiary holding company 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 Holdings, MSI and each Subsidiary Guarantor, including substantially all of MSI's and the Subsidiary Guarantors owned real property and equipment, but excluding, among other things, the collateral described below; and

· a second-priority security interest in personal property consisting of inventory and related accounts, cash, deposit accounts, all payments received by Holdings, MSI 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 Holdings, MSI and the Subsidiary Guarantors, and certain related assets and proceeds of the foregoing.

The Amended and Restated Term Loan Credit Facility contains a number of negative covenants that are substantially similar to, but more restrictive in certain respects than, those governing the 2020 Senior Subordinated Notes (as defined below), as well as certain other customary representations and warranties, affirmative and negative covenants and events of default. As of February 2, 2019, MSI was in compliance with all covenants.

Interest Rate Swaps

In April 2018, we executed two interest rate swaps with an aggregate notional value of $1.0 billion associated with our outstanding Amended Term Loan Credit Facility. The interest rate swaps have a maturity date of April 30, 2021 and were executed for risk management and are not held for trading purposes. The objective of the interest rate swaps is to hedge the variability of cash flows resulting from fluctuations in the one-month LIBOR. The swaps replaced the one-month LIBOR with a fixed interest rate of 2.7765% and payments are settled monthly. The swaps qualify as cash flow hedges and changes in the fair values are recorded in accumulated other comprehensive income in the consolidated balance sheet. The changes in fair value are reclassified from accumulated other comprehensive income to interest expense in the same period that the hedged items affect earnings. We reclassified $4.6 million from accumulated other comprehensive income to interest expense during fiscal 2018. As of February 2, 2019, the fair value of the interest rate swaps was a liability of $6.4 million, consisting of $3.8 million recorded in other liabilities and $2.6 million recorded in accrued liabilities in our consolidated balance sheets.

Table of Contents

5.875% Senior Subordinated Notes due 2020

On December 19, 2013, MSI issued $260.0 million in principal amount of 5.875% senior subordinated notes maturing in 2020 (“2020 Senior Subordinated Notes”). On June 16, 2014, MSI issued an additional $250.0 million of the 2020 Senior Subordinated Notes at 102% of face value, resulting in an effective interest rate of 5.76%. Interest is payable semi-annually on June 15 and December 15 of each year.

The 2020 Senior Subordinated Notes are guaranteed, jointly and severally, fully and unconditionally, on an unsecured senior subordinated basis, by each of MSI’s subsidiaries that guarantee indebtedness under the Amended Revolving Credit Facility and the Amended and Restated Term Loan Credit Facility (collectively defined as the “Senior Secured Credit Facilities”).

The 2020 Senior Subordinated Notes and the related guarantees are MSI’s and the guarantors’ unsecured senior subordinated obligations and are (i) subordinated in right of payment to all of MSI’s and the guarantors’ existing and future senior debt, including the Senior Secured Credit Facilities; (ii) rank equally in right of payment to all of MSI’s and the guarantors’ future senior subordinated debt; (iii) effectively subordinated to all of MSI’s 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; (iv) rank senior in right of payment to all of the MSI’s and the guarantors’ existing and future debt and other obligations that are, by their terms, expressly subordinated in right of payment to the 2020 Senior Subordinated Notes; and (v) are structurally subordinated to all obligations of MSI’s subsidiaries that are not guarantors of the 2020 Senior Subordinated Notes.

MSI may redeem all or part of the 2020 Senior Subordinated Notes, upon notice, at 100.00% of the principal amount of the 2020 Senior Subordinated Notes to be redeemed, plus any unpaid interest through the applicable date of redemption.

Upon a change in control, MSI is required to offer to purchase all of the 2020 Senior Subordinated Notes at a price in cash equal to 101% of the aggregate principal amount, plus any unpaid interest. The indenture governing the 2020 Senior Subordinated Notes (“2020 Senior Subordinated Indenture”) contains covenants limiting MSI’s ability, and the ability of MSI’s restricted subsidiaries, to incur or guarantee additional debt, prepay debt that is subordinated to the 2020 Senior Subordinated Notes, issue stock of subsidiaries, make certain investments, loans, advances and acquisitions, create liens on MSI’s and such subsidiaries’ assets to secure debt, enter into transactions with affiliates, merge or consolidate with another company; and sell or otherwise transfer assets. The covenants also limit MSI’s ability, and the ability of MSI’s restricted subsidiaries, to pay dividends or distributions on MSI’s capital stock or repurchase MSI’s capital stock, subject to certain exceptions, including dividends, distributions and repurchases up to an amount in excess of (i) $100.0 million plus (ii) a basket that builds based on 50% of MSI’s consolidated net income (as defined in the 2020 Senior Subordinated Indenture) and certain other amounts, in each case, to the extent such payment capacity is not applied as otherwise permitted under the 2020 Senior Subordinated Indenture and subject to certain conditions. However, there are no limitations on dividends and certain other restricted payments so long as (a) no default shall have occurred and be continuing and (b) immediately after giving pro forma effect to such restricted payment(s) and the application of proceeds therefrom, the consolidated total leverage ratio is less than or equal to 3.25 to 1.00. As of February 2, 2019, the permitted restricted payment amount was $1,097.5 million. As of February 2, 2019, MSI was in compliance with all covenants.

Revolving Credit Facility

On September 17, 2012, MSI entered into a second amended and restated credit agreement (the “Credit Agreement”) with Wells Fargo Bank, National Association (“Wells Fargo”) and other lenders to amend various terms of MSI’s then existing senior secured asset-based revolving credit facility. The Credit Agreement, together with related security, guarantee and other agreements, is referred to as the “Revolving Credit Facility”. On May 27, 2016, MSI entered into an amended and restated credit agreement with Wells Fargo and other lenders to, among other things, increase the availability and extend the maturity date of our Revolving Credit Facility. The amended credit agreement, together with the related security, guarantee and other agreements, is referred to as the “Amended Revolving Credit Facility”.

The Amended Revolving Credit Facility provides for senior secured financing of up to $850.0 million, subject to a borrowing base. The borrowing base under the Amended Revolving Credit Facility equals the sum of: (i) 90% of eligible credit card receivables, (ii) 85% of eligible trade receivables, (iii) 90% to 92.5% of the appraised value of eligible inventory, plus (iv) 90% to 92.5% of the lesser of (a) the appraised value of eligible inventory supported by letters of credit, and (b) the face amount of the letters of credit, less (v) certain reserves. The Amended Revolving Credit Facility matures in May 2021, subject to a springing maturity date if certain of our outstanding indebtedness has not been repaid, redeemed, refinanced, cash collateralized or if the necessary availability reserves have not been established prior to such time (the “ABL Maturity Date”).

As of February 2, 2019, the borrowing base was $850.0 million of which MSI had availability of $742.7 million. Borrowing capacity is available for letters of credit and borrowings on same-day notice. Outstanding standby letters of credit as of February 2, 2019 totaled $107.3 million.

The Amended Revolving Credit Facility also provides MSI with the right to request up to $200.0 million of additional commitments. The lenders will not be under any obligation to provide any such additional commitments, and any increase in commitments is subject to customary conditions. If we were to request additional commitments, and the lenders were to agree to provide such commitments, the facility size could be increased up to $1,050.0 million, however, MSI’s ability to borrow would still be limited by the borrowing base.

Borrowings under the Amended 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 Wells Fargo, (2) the federal funds effective rate plus 0.50% and (3) LIBOR subject to certain adjustments plus 1.00% or (b) LIBOR subject to certain adjustments, in each case plus an applicable margin. The initial applicable margin is (a) 0.25% for prime rate borrowings and 1.25% for LIBOR borrowings. The applicable margin is subject to adjustment each fiscal quarter based on the excess availability under the Amended Revolving Credit Facility. Excess availability is defined as the Loan Cap (as defined below) plus certain unrestricted cash of Holdings, MSI and the Subsidiary Guarantors, less the outstanding credit extensions. Same-day borrowings bear interest at the base rate plus the applicable margin.

MSI is required to pay a commitment fee on the unutilized commitments under the Amended Revolving Credit Facility, which is 0.25% per annum. In addition, MSI must pay customary letter of credit fees and agency fees.

All obligations under the Amended Revolving Credit Facility are unconditionally guaranteed, jointly and severally, by Holdings and the Subsidiary Guarantors. All obligations under the Amended Revolving Credit Facility, and the guarantees of those obligations, are secured, subject to certain exceptions, by substantially all of the assets of Holdings, MSI and 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 Holdings, MSI 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 Holdings, MSI and the Subsidiary Guarantors, and certain related assets and proceeds of the foregoing;

- a second-priority pledge of all of MSI's capital stock and the capital stock held directly by MSI and the Subsidiary Guarantors (which pledge, in the case of the capital stock of any foreign subsidiary or foreign subsidiary holding company, is limited to 65% of the voting stock of such foreign subsidiary or foreign subsidiary holding company 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 Holdings, MSI and each Subsidiary Guarantor, including substantially all of MSI's and the Subsidiary Guarantors owned real property and equipment.

If, at any time, the aggregate amount of outstanding loans, unreimbursed letter of credit drawings and undrawn letters of credit under the Amended Revolving Credit Facility exceeds the lesser of (i) the commitment amount and (ii) the borrowing base (the "Loan Cap"), MSI 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 availability under the Amended Revolving Credit Facility is less than the greater of (i) 10.0% of the Loan Cap and (ii) $50.0 million for five consecutive business days, or, if certain events of default have occurred, MSI will be required to repay outstanding loans and cash collateralize letters of credit with the cash MSI would be required to deposit daily in a collection account maintained with the agent under the Amended Revolving Credit Facility. Availability under the Amended Revolving Credit Facility means the Loan Cap minus the outstanding credit extensions. MSI may voluntarily reduce the unutilized

Table of Contents

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. The principal amount of the loans outstanding is due and payable in full on the ABL Maturity Date.

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 MSI must meet specified excess availability requirements and minimum consolidated fixed charge coverage ratios, to be tested on a pro forma basis as of the date of the restricted action and for the 90-day period preceding such restricted action. Adjusted EBITDA, as defined in the Amended Revolving Credit Facility, is used in the calculation of the consolidated fixed charge coverage ratios.

From the time when MSI has excess availability less than the greater of (a) 10.0% of the Loan Cap and (b) $50.0 million, until the time when MSI has excess availability more than the greater of (a) 10.0% of the Loan Cap and (b) $50.0 million for 30 consecutive days, the Amended Revolving Credit Facility will require MSI to maintain a consolidated fixed charge coverage ratio of at least 1.0 to 1.0. The Amended Revolving Credit Facility also contains certain customary representations and warranties, affirmative covenants and provisions relating to events of default (including change of control and cross-default to material indebtedness).

The Amended Revolving Credit Facility contains a number of covenants that, among other things and subject to certain exceptions, restrict MSI’s ability, and the ability of its restricted subsidiaries, to:

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

- consolidate or merge; and

- create liens.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements as defined in Item 303(a)(4)(ii) of Regulation S-K. 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 contractual obligations table below. Neither we nor our subsidiaries typically guarantee the obligations of unrelated parties.

Table of Contents

Contractual Obligations

As of February 2, 2019, our contractual obligations were as follows (in thousands):

	Payments Due By Fiscal Year				
	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Total debt (1)	$ 2,717,450	$ 24,900	$ 553,575	$ 2,138,975	$ —
Operating lease commitments (2)	2,129,465	428,698	717,498	475,091	508,178
Interest payments (3)	448,250	120,276	195,011	132,963	—
Other commitments (4)	155,647	114,315	31,145	10,187	—
	$ 5,450,812	$ 688,189	$ 1,497,229	$ 2,757,216	$ 508,178

(1) Total debt only includes principal payments owed on the 2020 Senior Subordinated Notes and the Amended and Restated Term Loan Credit Facility. The amounts shown above do not include unamortized premiums/discounts and deferred debt issuance costs reflected in the Company's consolidated balance sheets since they do not represent contractual obligations.

(2) 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 35% of the total lease obligation over the previous three fiscal years.

(3) Debt associated with our Amended and Restated Term Loan Credit Facility was $2,207.5 million at February 2, 2019 and is subject to variable interest rates. The amounts included in interest payments in the table for the Amended and Restated Term Loan Credit Facility were based on the indexed interest rate in effect at February 2, 2019. In April 2018, we executed two interest rate swap agreements with an aggregate notional value of $1.0 billion which are intended to mitigate interest rate risk associated with future changes in interest rates for borrowings under our Amended and Restated Term Loan Credit Facility. As a result, our exposure to interest rate volatility for $1.0 billion of our Amended and Restated Term Loan Credit Facility was eliminated beginning in the second quarter of fiscal 2018. Debt associated with the 2020 Senior Subordinated Notes was $510.0 million at February 2, 2019 and was subject to fixed interest rates. We had no outstanding borrowings under our Amended Revolving Credit Facility at February 2, 2019. Under our Amended Revolving Credit Facility, we are required to pay a commitment fee of 0.25% per year on the unutilized commitments. The amounts included in interest payments for the Amended Revolving Credit Facility were based on this annual commitment fee.

(4) 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.

Non-GAAP Measures

The following table sets forth certain non-GAAP measures used by the Company to manage our performance and measure compliance with certain debt covenants. The Company defines “EBITDA” as net income before interest, income taxes, depreciation and amortization. The Company defines “Adjusted EBITDA” as EBITDA adjusted for certain defined amounts in accordance with the Company’s Amended and Restated Term Loan Credit Facility and Amended Revolving Credit Facility (together the “Senior Secured Credit Facilities”).

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. Adjusted EBITDA is a required calculation under the Company’s Senior Secured Credit Facilities that is used in the calculations of fixed charge coverage and leverage ratios, which, under certain circumstances determine mandatory repayments or maintenance covenants and 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 liquidity calculated in accordance with U.S. generally accepted accounting principles (“GAAP”), these measures should not be considered in isolation of, or as substitutes for, 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.

Table of Contents

The following table shows a reconciliation of EBITDA and Adjusted EBITDA to net income and net cash provided by operating activities (in thousands):

	Fiscal Year		
	2018	2017	2016
Net cash provided by operating activities	$ 444,256	$ 523,610	$ 564,417
Depreciation and amortization	(124,271)	(118,912)	(115,801)
Share-based compensation	(27,082)	(24,264)	(16,506)
Debt issuance costs amortization	(4,997)	(5,098)	(6,583)
Accretion of long-term debt, net	518	505	334
Restructure charges	(104,238)	—	—
Deferred income taxes	(8,131)	(4,348)	(4,570)
Losses on early extinguishments of debt and refinancing costs	(1,835)	—	(7,292)
Losses on disposition of property and equipment	—	—	(120)
Excess tax benefits from share-based compensation	—	—	10,027
Changes in assets and liabilities	145,325	19,005	(45,747)
Net income	319,545	390,498	378,159
Interest expense	147,085	129,116	126,270
Income taxes	97,509	215,243	203,614
Depreciation and amortization	124,271	118,912	115,801
Interest income	(3,160)	(1,326)	(820)
EBITDA	685,250	852,443	823,024
Adjustments:			
Losses on early extinguishments of debt and refinancing costs	1,835	—	7,292
Share-based compensation	27,082	24,264	16,506
Restructure charges	104,238	—	—
Severance costs	902	1,274	6,113
Store pre-opening costs	4,417	2,999	4,484
Store remodel costs	5,153	1,773	895
Foreign currency transaction (gains) losses	(278)	1,486	667
Store closing costs	3,134	1,382	2,877
Lamrite integration costs	—	—	7,390
Other (1)	2,916	2,920	3,452
Adjusted EBITDA	$ 834,649	$ 888,541	$ 872,700

(1) Other adjustments primarily relate to items such as moving and relocation expenses, franchise taxes and sign on bonuses.

Critical Accounting Policies and Estimates

We have prepared our consolidated financial statements in conformity with U.S. GAAP. These consolidated financial statements include some amounts that are based on our informed judgments and estimates. Our significant accounting policies are discussed in Note 1 to the consolidated financial statements. Our critical accounting policies represent those policies that are subject to judgments and uncertainties. The following discussion addresses our most critical accounting policies, which are those that are both important to the portrayal of our financial condition and results of operations and that require significant judgment or use of complex estimates.

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 purchase price of an item at the time it is received by us and also includes the cost of warehousing, handling, purchasing, and importing, 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.

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

Table of Contents

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 reserve would have affected net income by $1.8 million for fiscal 2018. 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 $0.7 million in fiscal 2018.

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.

Goodwill and Other Indefinite-Lived Intangible Assets. We review goodwill and other indefinite-lived intangible assets for impairment each year in the fourth quarter, or more frequently if events occur which indicate the carrying value may not be recoverable. We performed a qualitative assessment for our Michaels-U.S. reporting unit to determine whether it is more likely than not (that is, a likelihood of more than 50 percent) that the fair value of the reporting unit is less than its carrying value, including goodwill. Factors used in our qualitative assessment include, but are not limited to, macroeconomic conditions, industry and market conditions, cost factors, overall financial performance and Company and reporting unit specific events. If, based on our qualitative assessment, we determine that it is more likely than not that the estimated fair value of the reporting unit is less than the carrying amount, including goodwill, we will calculate the fair value of the Michaels-U.S. reporting unit using the present value of future cash flows expected to be generated by the reporting unit. If the carrying value of the reporting unit exceeds its estimated fair value, an impairment loss will be recognized not to exceed the total amount of goodwill allocated to the reporting unit.

For all other reporting units, we estimated the fair value of each reporting unit using the present value of future cash flows expected to be generated by the reporting units. If the carrying value of the reporting unit or indefinite-lived intangible assets exceeds the estimated fair value, an impairment charge is recorded to write the assets down to their estimated fair value. We estimate fair value using the present value of future cash flows expected to be generated by the reporting unit using a weighted-average cost of capital, terminal values and updated financial projections for the next five years.

Based on the results of our impairment review in fiscal 2018, we recorded impairment charges of $7.0 million and $2.5 million related to Pat Catan's goodwill and certain product tradenames, respectively. There were no impairments recorded for fiscal 2017 and fiscal 2016 in the consolidated financial statements. If our actual results are not consistent with the estimates and assumptions used to calculate fair value, we could be required to recognize additional impairments in a future period.

Long-Lived Assets. Long-lived assets other than goodwill and assets with indefinite lives, such as property and equipment and intangible assets subject to amortization, are evaluated for indicators of impairment whenever events or changes in circumstances indicate their carrying amounts may not be recoverable. For store assets, we evaluate the performance of individual stores for indicators of impairment and underperforming stores are selected for further evaluation to determine whether their carrying amounts are recoverable.

Our initial indicator that store assets are considered to be recoverable is that the estimated undiscounted cash flows for the remaining lease term exceed the carrying value of the assets. If the evaluation indicates that the carrying value of the asset may not be recoverable, the potential impairment is measured based on a projected discounted cash flow method using 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. If the carrying value exceeds the fair value, an impairment is recorded.

Our evaluation requires consideration of a number of factors including changes in consumer demographics, key store level assumptions and other uncertain future events. Accordingly, our accounting estimates may change from period to period. These factors could cause management to conclude 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 write down to fair value.

Table of Contents

Self-Insurance. We have insurance coverage for losses in excess of self-insurance limits for medical claims, general liability and workers' compensation claims. Our liability represents an estimate of the ultimate cost of claims incurred as of the balance sheet dates. The estimated liability is not discounted and is established based upon analysis of historical data and actuarial estimates. While we believe these estimates are reasonable based on the information currently available, if actual trends, including the severity or frequency of claims, medical cost inflation, or fluctuations in premiums differ from our estimates, our results of operations could be impacted. A 10% change in our self-insurance reserves would have affected net income by $4.8 million in fiscal 2018.

Share-Based Compensation. ASC 718, Stock Compensation ("ASC 718") requires all share-based payments to employees, including grants of employee stock options and restricted shares, to be recognized using the fair value method of accounting. Time-based awards are recognized ratably over the requisite service period and performance-based awards vest over the estimated time to achieve predetermined financial and operational targets. All grants of our stock options have an exercise price equal to the closing market price of our common stock on the date of grant.

We estimate the grant date fair value of stock options using a Black-Scholes valuation model. Assumptions used in the Black-Scholes valuation model include expected volatility of our common stock share price, expected terms of the options, expected dividends and risk-free interest rates. The expected volatility rate is based on our historical and implied 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 assume a zero dividend rate. 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 quarterly based on historical trends and current market observations. Our forfeiture assumptions are updated semiannually and are estimated based on historical experience and anticipated events.

Income Taxes. Deferred tax assets, including the benefit of net operating loss and tax credit carryforwards, are evaluated based on the guidelines for realization and are reduced by a valuation allowance if it is deemed more likely than not that such assets will not be realized. We consider several factors in evaluating the realizability of our deferred tax assets, including the nature, frequency and severity of recent losses, the remaining years available for carryforward, changes in tax laws, the future profitability of the operations in the jurisdiction, and tax planning strategies. Our judgments and estimates concerning realizability of deferred tax assets could change if any of the evaluation factors change, resulting in an increase or decrease to income tax expense in any period.

We record a liability for uncertain tax positions to the extent a tax position taken or expected to be taken in a tax return does not meet certain recognition or measurement criteria. Considerable management judgment is necessary to assess the inherent uncertainties related to the interpretations of complex tax laws, regulations and taxing authority rulings, as well as to the expiration of statutes of limitations in the numerous and varied jurisdictions in which we operate. Our judgments and estimates may change as a result of evaluation of new information, such as the outcome of tax audits or changes to or further interpretations of tax laws and regulations, resulting in an increase or decrease to income tax expense in any period.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Foreign Currency Risk

We are exposed to fluctuations in exchange rates between the U.S. and Canadian dollar, which is the functional currency of our Canadian subsidiaries. Our sales, costs and expenses of our Canadian subsidiaries, when translated into U.S. dollars, can fluctuate due to exchange rate movement. A 10% increase or decrease in the exchange rate of the Canadian dollar would have increased or decreased net income by approximately $16 million for fiscal 2018.

Interest Rate Risk

We have market risk exposure arising from changes in interest rates on our Amended and Restated Term Loan Credit Facility and our Amended Revolving Credit Facility. See “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources — Debt” for further detail. The interest rates on our Amended and Restated Term Loan Credit Facility and our Amended Revolving Credit Facility will reprice periodically, which will impact our earnings and cash flow. In April 2018, we executed two interest rate swap agreements with an aggregate notional value of $1.0 billion which are intended to mitigate interest rate risk associated with future

Table of Contents

changes in interest rates for borrowings under our Amended and Restated Term Loan Credit Facility. As a result of these interest rate swaps, our exposure to interest rate volatility for $1.0 billion of our Amended and Restated Term Loan Credit Facility was eliminated beginning in the second quarter of fiscal 2018. The interest rate on our 2020 Senior Subordinated Notes is fixed. Based on our overall interest rate exposure to variable rate debt outstanding as of February 2, 2019, a 100 basis point change in interest rates would impact income before income taxes by approximately $12 million for fiscal 2018. A 100 basis point change in interest rates would impact the fair value of our long-term fixed rate debt by approximately $22 million. A change in interest rates would not materially affect the fair value of our variable rate debt as the debt reprices periodically.

Inflation Risk

We do not believe inflation and changing commodity prices have had a material impact on our net sales, income from continuing operations, plans for expansion or other capital expenditures for any year during the three-year period ended February 2, 2019. However, we cannot be sure inflation and changing commodity prices will not have an adverse impact on our operating results, financial condition, plans for expansion or other capital expenditures in future periods.

ITEM 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

See the Index to Consolidated Financial Statements and Supplementary Data on page F-1. The Consolidated Financial Statements and Supplementary Data are included on pages F-2 through F-33 and are incorporated herein by reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES.

Included in this Annual Report on Form 10-K are certifications by our Interim Chief Executive Officer and our Chief Financial Officer, which are required in accordance with Rule 13a-14 of the Securities Exchange Act of 1934, as amended. This section includes information concerning the controls and controls evaluation referred to in the certifications. Page F - 2 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 LLP 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) 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 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 Interim 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 Interim 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, as amended, is accumulated and communicated to management, including our Interim 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.

Table of Contents

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal controls over financial reporting during the quarter ended February 2, 2019 that 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, as amended. 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 February 2, 2019. Management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in its Internal Control—Integrated Framework (2013). 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 Audit organization.

Based on management's assessment, management has concluded that the Company's internal control over financial reporting was effective as of February 2, 2019. 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-2 of this Annual Report on Form 10-K.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

The information required by this item will be contained in our Definitive Proxy Statement and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION.

The information required by this item will be contained in our Definitive Proxy Statement and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

The information required by this item will be contained in our Definitive Proxy Statement and is incorporated herein by reference.

Table of Contents

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.

The information required by this item will be contained in our Definitive Proxy Statement and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.

The information required by this item will be contained in our Definitive Proxy Statement and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.

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) Financial Statement Schedules:

All financial statement schedules are omitted because they are not required or are not applicable, or the required information is provided in the consolidated financial statements or notes described in 15(1) above.

(3) 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.

ITEM 16. FORM 10-K SUMMARY.

None.

Table of Contents

THE MICHAELS COMPANIES, INC.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

	Page
Reports of Independent Registered Public Accounting Firm	F-2
Consolidated Statements of Comprehensive Income for the fiscal years ended February 2, 2019, February 3, 2018 and January 28, 2017	F-4
Consolidated Balance Sheets at February 2, 2019 and February 3, 2018	F-5
Consolidated Statements of Cash Flows for the fiscal years ended February 2, 2019, February 3, 2018 and January 28, 2017	F-6
Consolidated Statements of Stockholders' Deficit for the fiscal years ended February 2, 2019, February 3, 2018 and January 28, 2017	F-7
Notes to Consolidated Financial Statements	F-8

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders

The Michaels Companies, Inc.

Opinion on Internal Control over Financial Reporting

We have audited The Michaels Companies, Inc.'s internal control over financial reporting as of February 2, 2019, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). In our opinion, The Michaels Companies, Inc. (the Company) maintained, in all material respects, effective internal control over financial reporting as of February 2, 2019, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of The Michaels Companies, Inc. as of February 2, 2019 and February 3, 2018, the related consolidated statements of comprehensive income, stockholders' deficit and cash flows for each of the three years in the period ended February 2, 2019, and the related notes and our report dated March 19, 2019 expressed an unqualified opinion thereon.

Basis for Opinion

The Company'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's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. 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.

Definition and Limitations of Internal Control Over Financial Reporting

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.

/s/ Ernst & Young LLP

Dallas, Texas

March 19, 2019

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders

The Michaels Companies, Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of The Michaels Companies, Inc. (the Company) as of February 2, 2019 and February 3, 2018, and the related consolidated statements of comprehensive income, stockholders' deficit and cash flows for each of the three years in the period ended February 2, 2019 and the related notes (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company at February 2, 2019 and February 3, 2018, and the results of its operations and its cash flows for each of the three years in the period ended February 2, 2019, 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) (PCAOB), the Company's internal control over financial reporting as of February 2, 2019, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated March 19, 2019 expressed an unqualified opinion thereon.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Ernst & Young LLP

We have served as the Company's auditor since 1984.

Dallas, Texas

March 19, 2019

Table of Contents

THE MICHAELS COMPANIES, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands, except per share data)

	Fiscal Year 2018	2017	2016
Net sales	$ 5,271,944	$ 5,361,960	$ 5,197,292
Cost of sales and occupancy expense	3,248,276	3,233,171	3,169,476
Gross profit	2,023,668	2,128,789	2,027,816
Selling, general and administrative	1,351,401	1,390,400	1,308,052
Restructure charges	104,238	—	—
Store pre-opening costs	4,417	2,999	4,484
Operating income	563,612	735,390	715,280
Interest expense	147,085	129,116	126,270
Losses on early extinguishments of debt and refinancing costs	1,835	—	7,292
Other (income) expense, net	(2,362)	533	(55)
Income before income taxes	417,054	605,741	581,773
Income taxes	97,509	215,243	203,614
Net income	$ 319,545	$ 390,498	$ 378,159
Other comprehensive income, net of tax:			
Foreign currency translation adjustment and other	(10,898)	10,564	7,832
Comprehensive income	$ 308,647	$ 401,062	$ 385,991
Earnings per common share:			
Basic	$ 1.87	$ 2.11	$ 1.84
Diluted	$ 1.86	$ 2.10	$ 1.82
Weighted-average common shares outstanding:			
Basic	170,610	184,281	204,735
Diluted	171,378	185,566	206,354

See accompanying notes to consolidated financial statements.

Table of Contents

THE MICHAELS COMPANIES, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

ASSETS	February 2, 2019	February 3, 2018
Current Assets:		
Cash and equivalents	$ 245,887	$ 425,896
Merchandise inventories	1,108,715	1,123,288
Prepaid expenses and other	98,659	97,830
Accounts receivable, net	57,328	26,207
Income taxes receivable	4,935	3,761
Total current assets	1,515,524	1,676,982
Property and equipment, net	439,077	420,020
Goodwill	112,069	119,074
Other intangible assets, net	17,238	21,769
Deferred income taxes	25,005	34,538
Other assets	19,423	27,832
Total assets	$ 2,128,336	$ 2,300,215
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current Liabilities:		
Accounts payable	$ 485,004	$ 483,002
Accrued liabilities and other	378,742	370,457
Current portion of long-term debt	24,900	24,900
Income taxes payable	43,907	79,586
Total current liabilities	932,553	957,945
Long-term debt	2,681,000	2,701,764
Other liabilities	140,978	150,001
Total liabilities	3,754,531	3,809,710
Commitments and contingencies		
Stockholders' Deficit:		
Common stock, $0.06775 par value, 350,000 shares authorized; 157,774 shares issued and outstanding at February 2, 2019 and 181,919 shares issued and outstanding at February 3, 2018	10,594	12,206
Additional paid-in-capital	5,954	21,740
Accumulated deficit	(1,628,185)	(1,539,781)
Accumulated other comprehensive loss	(14,558)	(3,660)
Total stockholders' deficit	(1,626,195)	(1,509,495)
Total liabilities and stockholders' deficit	$ 2,128,336	$ 2,300,215

See accompanying notes to consolidated financial statements.

Table of Contents

THE MICHAELS COMPANIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Fiscal Year 2018	2017	2016
Cash flows from operating activities:			
Net income	$ 319,545	$ 390,498	$ 378,159
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	124,271	118,912	115,801
Share-based compensation	27,082	24,264	16,506
Debt issuance costs amortization	4,997	5,098	6,583
Accretion of long-term debt, net	(518)	(505)	(334)
Restructure charges	104,238	—	—
Deferred income taxes	8,131	4,348	4,570
Losses on early extinguishments of debt and refinancing costs	1,835	—	7,292
Losses on disposition of property and equipment	—	—	120
Excess tax benefits from share-based compensation	—	—	(10,027)
Changes in assets and liabilities, excluding acquired net assets:			
Merchandise inventories	(63,890)	5,281	(40,800)
Prepaid expenses and other	3,576	(7,785)	(1,004)
Accounts receivable	(14,100)	(2,992)	8,948
Other assets	(1,497)	(1,765)	(711)
Accounts payable	(10,461)	(38,025)	38,248
Accrued interest	(691)	(12,040)	7,015
Accrued liabilities and other	(17,225)	3,174	(4,806)
Income taxes	(44,532)	28,388	37,276
Other liabilities	3,495	6,759	1,581
Net cash provided by operating activities	444,256	523,610	564,417
Cash flows from investing activities:			
Additions to property and equipment	(145,387)	(127,830)	(114,462)
Acquisition of Lamrite West, net of cash acquired	—	—	(151,100)
Purchases of long-term investments	—	—	(1,325)
Net cash used in investing activities	(145,387)	(127,830)	(266,887)
Cash flows from financing activities:			
Common stock repurchased	(456,585)	(253,752)	(404,971)
Payments on term loan credit facility	(24,900)	(31,125)	(18,675)
Borrowings on asset-based revolving credit facility	355,400	382,200	42,000
Payments on asset-based revolving credit facility	(355,400)	(382,200)	(42,000)
Payment of debt refinancing costs	(1,117)	—	—
Payment of debt issuance costs	—	—	(11,326)

Payment of dividends	(317)	(408)	(415)
Proceeds from stock options exercised	4,041	16,588	17,252
Excess tax benefits from share-based compensation	—	—	10,027
Net cash used in financing activities	(478,878)	(268,697)	(408,108)
Net change in cash and equivalents	(180,009)	127,083	(110,578)
Cash and equivalents at beginning of period	425,896	298,813	409,391
Cash and equivalents at end of period	$ 245,887	$ 425,896	$ 298,813

See accompanying notes to consolidated financial statements.

Table of Contents

THE MICHAELS COMPANIES, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT

For the Three Years Ended February 2, 2019

(in thousands)

	Number of Common Shares	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total
Balance at January 30, 2016	208,996	$ 13,979	$ 592,420	$ (2,308,438)	$ (22,056)	$ (1,724,095)
Net income	—	—	—	378,159	—	378,159
Foreign currency translation and other	—	—	—	—	7,832	7,832
Share-based compensation	—	—	17,379	—	—	17,379
Exercise of stock options and other awards	2,160	147	27,132	—	—	27,279
Repurchase of stock and retirements	(17,845)	(1,178)	(403,802)	—	—	(404,980)
Balance at January 28, 2017	193,311	12,948	233,129	(1,930,279)	(14,224)	(1,698,426)
Net income	—	—	—	390,498	—	390,498
Foreign currency translation and other	—	—	—	—	10,564	10,564
Share-based compensation	—	—	25,033	—	—	25,033
Exercise of stock options and other awards	1,930	131	16,457	—	—	16,588
Repurchase of stock and retirements	(13,322)	(873)	(252,879)	—	—	(253,752)
Balance at February 3, 2018	181,919	12,206	21,740	(1,539,781)	(3,660)	(1,509,495)
Net income	—	—	—	319,545	—	319,545
Foreign currency translation and other	—	—	—	—	(10,898)	(10,898)
Share-based compensation	—	—	27,197	—	—	27,197
Exercise of stock options and other awards	1,066	72	3,969	—	—	4,041
Repurchase of stock and retirements	(25,211)	(1,684)	(46,952)	(407,949)	—	(456,585)
	157,774	$ 10,594	$ 5,954	$ (1,628,185)	$ (14,558)	$ (1,626,195)

Balance at February 2,
2019

See accompanying notes to consolidated financial statements.

Table of Contents

THE MICHAELS COMPANIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business

The Michaels Companies, Inc. owns and operates specialty retail stores in 49 states and Canada featuring arts, crafts, framing, floral, home décor and seasonal merchandise for the hobbyist and do-it-yourself home decorator. All expressions of the “Company”, “us”, “we”, “our”, and all similar expressions are references to The Michaels Companies, Inc. and our consolidated, wholly-owned subsidiaries, unless otherwise expressly stated or the context otherwise requires. Our consolidated financial statements include the accounts of The Michaels Companies, Inc. and our wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated.

Michaels Stores, Inc. (“MSI”) is headquartered in Irving, Texas and was incorporated in the state of Delaware in 1983. In July 2013, MSI was reorganized into a holding company structure and The Michaels Companies, Inc. was incorporated in the state of Delaware in connection with the reorganization.

Fiscal Year

We report on the basis of a 52-week or 53-week fiscal year, which ends on the Saturday closest to January 31. All references to fiscal year mean the year in which that fiscal year began. References to “fiscal 2018” relate to the 52 weeks ended February 2, 2019, references to “fiscal 2017” relate to the 53 weeks ended February 3, 2018 and references to “fiscal 2016” relate to the 52 weeks ended January 28, 2017.

Preferred Shares

The Company’s Board of Directors has authorized the issuance of 50.0 million shares of preferred stock under The Michaels Companies, Inc. Certificate of Incorporation. No preferred shares have been issued as of February 2, 2019.

Share Repurchase Program

In September 2018, the Board of Directors authorized a new share repurchase program for the Company to purchase $500.0 million of the Company's common stock on the open market or through accelerated share repurchase transactions. The share repurchase program does not have an expiration date, and the timing and number of repurchase transactions under the program will depend on market conditions, corporate considerations, debt agreements and regulatory requirements. Shares repurchased under the program are held as treasury shares until retired. In June 2018, the Company entered into an accelerated share repurchase agreement ("ASR Agreement") with JPMorgan Chase Bank, N.A. ("JPMorgan"). Under the ASR Agreement, we paid JPMorgan a purchase price of $250.0 million for delivery of 12.4 million shares of our common stock. The total number of shares repurchased was based upon a volume weighted average price of our stock over a predetermined period. The ASR agreement was completed on August 30, 2018. During fiscal 2018, we repurchased 24.6 million shares under our share repurchase programs for an aggregate amount of $451.9 million, inclusive of the ASR Agreement. As of February 2, 2019, we had $398.4 million of availability remaining under our current share repurchase program.

Foreign Currency

The functional currency of our Canadian operations is the Canadian dollar. Translation adjustments result from translating our Canadian subsidiaries' financial statements into U.S. dollars. Balance sheet accounts are generally translated at exchange rates in effect at the balance sheet date. Income statement accounts are translated at average exchange rates during the year. Translation adjustments are recorded as a component of accumulated other comprehensive income in our consolidated statements of stockholders' deficit. The translation adjustments recorded in accumulated other comprehensive loss, net of taxes, was a loss of $6.2 million in fiscal 2018, and gains of $10.6 million and $7.8 million in fiscal 2017 and fiscal 2016, respectively. Transaction gains and losses are recorded as a part of other (income) expense, net in our consolidated statements of comprehensive income and were immaterial for all fiscal periods presented.

Cash and Equivalents

Cash and equivalents are comprised of cash, money market mutual funds and short-term interest bearing securities with original maturities of three months or less. Cash and equivalents also include proceeds due from credit card transactions with settlement terms of less than five days. The carrying amount of cash equivalents approximates fair value due to the short-term maturity of those instruments.

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 purchase price of an item at the time it is received by us and also includes the cost of warehousing, handling, purchasing, and importing, 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.

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.

Vendor allowances, which primarily represent volume rebates and cooperative advertising funds, are recorded as a reduction to 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. We recognized vendor allowances of $74.6 million, or 1.4% of net sales, in fiscal 2018, $84.9 million, or 1.6% of net sales, in fiscal 2017, and $83.1 million, or 1.6% of net sales, in fiscal 2016.

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 stock keeping units (“SKUs”) that are candidates for repricing are identified using our perpetual inventory data. In each case, the appropriate repricing is determined centrally at our store support center. 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.

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.

Accounts Receivable, net

Accounts receivable consist primarily of trade receivables related to our international wholesale business, amounts due from certain service providers and amounts due from taxing authorities. The Company assesses the collectability of all receivables on an ongoing basis and establishes an allowance for doubtful accounts, if necessary. Factors such as payment terms, historical loss experience and economic conditions are generally considered in determining the allowance for doubtful accounts. The allowance for doubtful accounts was immaterial for all fiscal periods presented in the consolidated financial statements.

Table of Contents

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. 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:

	Years
Buildings	30
Leasehold improvements (a)	10
Fixtures and equipment	8
Computer equipment and software	3-7

(a) We amortize leasehold improvements over the lesser of the useful life of the asset 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. We also capitalize certain implementation costs related to the development of hosting arrangements. These costs are being amortized on a straight-line basis over the estimated useful life or the term of the hosting arrangement. As of February 2, 2019 and February 3, 2018, we had unamortized capitalized software costs of $96.3 million and $90.0 million, respectively. These amounts are included in property and equipment, net in the consolidated balance sheets. Amortization expense related to capitalized software costs totaled $31.2 million, $29.1 million and $29.9 million in fiscal 2018, fiscal 2017 and fiscal 2016, respectively.

Goodwill and Other Indefinite-Lived Intangible Assets

Under the provisions of Accounting Standards Codification (“ASC”) 350, Intangibles—Goodwill and Other, we review goodwill and other indefinite-lived intangible assets for impairment each year in the fourth quarter, or more frequently if events occur which indicate the carrying value may not be recoverable. We performed a qualitative assessment for our Michaels-U.S. reporting unit to determine whether it is more likely than not (that is, a likelihood of more than 50 percent) that the fair value of the reporting unit is less than its carrying value, including goodwill. Factors used in our qualitative assessment include, but are not limited to, macroeconomic conditions, industry and market conditions, cost factors, overall financial performance and Company and reporting unit specific events. For all other reporting units, we estimated the fair value of each reporting unit using the present value of future cash flows expected to be generated using a weighted-average cost of capital, terminal values and updated financial projections for the next five years, all of which are Level 3 fair value inputs. As a result of the closure of all 36 Pat Catan’s stores in fiscal 2018, we recorded impairment charges of $7.0 million and $2.5 million related to Pat Catan's goodwill and certain product tradenames, respectively. There were no impairments recorded for fiscal 2017 and fiscal 2016 in the consolidated financial statements. If our actual results are not consistent with the estimates and assumptions used to calculate fair value, we could be required to recognize additional impairments in a future period.

Long-Lived Assets

Long-lived assets other than goodwill and assets with indefinite lives, such as property and equipment and intangible assets subject to amortization, are evaluated 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 based on the estimated fair value of the assets. Our impairment analysis contains management assumptions about key 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. As a result of our impairment review, there were no material impairment charges recorded in the fiscal periods presented in the consolidated financial statements.

Restructure Charges and Reserve for Closed Facilities

In March 2018, we made the decision to close substantially all of our Aaron Brothers stores and in January 2019 we closed all 36 of our Pat Catan's stores. As a result of the closures, we recorded restructure charges of $98.9 million in

Table of Contents

fiscal 2018. The restructure charges are primarily related to the transfer of the rights to sell inventory and other assets to a third party to facilitate the store closures and assist with the disposition of our remaining lease obligations, the impairment of goodwill and employee-related expenses. We believe restructuring activities will be substantially completed in fiscal 2019 and expect to record additional charges of approximately $6 million.

In addition, we recorded $5.3 million of employee-related charges as a result of certain organizational changes made to streamline our operations at our corporate support center.

For fiscal 2018 and fiscal 2017, Aaron Brothers net sales totaled $12.9 million and $110.4 million, respectively, and Pat Catan’s net sales totaled $109.6 million and $113.4 million, respectively. Excluding the restructure charges, Aaron Brothers and Pat Catan’s did not have a material impact on the Company’s operating income in all fiscal periods presented in the consolidated financial statements.

We maintain a reserve for future rental obligations, carrying costs and other closing costs related to closed facilities, which consists primarily of 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.

The cost of closing a store or facility is recorded at the estimated fair value of expected cash flows which we calculate as the present value of future rental obligations remaining under the lease (less estimated sublease rental income) or the lease termination fee (if an executed termination agreement exists). The determination of the reserves is dependent on our ability to make reasonable estimates of costs to be incurred after closure and of rental income to be received from subleases.

The following is activity related to closed facilities (in thousands):

	Fiscal Year		
	2018 (1)	2017	2016
Balance at beginning of fiscal year	$ 2,030	$ 2,254	$ 915
Additions charged to expense	22,234	1,382	2,877
Payment of rent related obligations	(16,772)	(1,606)	(1,538)
Balance at end of fiscal year	$ 7,492	$ 2,030	$ 2,254

(1) In fiscal 2018, we closed substantially all of our Aaron Brothers stores and all of our Pat Catan’s stores.

Self-Insurance

We have insurance coverage for losses in excess of self-insurance limits for medical claims, general liability and workers' compensation claims. Our liability represents an estimate of the ultimate cost of claims incurred as of the balance sheet dates. The estimated liability is not discounted and is established based upon analysis of historical data and actuarial estimates. While we believe these estimates are reasonable based on the information currently available, if actual trends, including the severity or frequency of claims, medical cost inflation, or fluctuations in premiums differ from our estimates, our results of operations could be impacted.

Revenue Recognition

Revenue from sales of our merchandise is recognized when the customer takes possession of the merchandise. Revenue is measured based on the amount of consideration that we expect to receive, reduced by estimates for return allowances, point-of-sale coupons and discounts. Revenue also excludes any amounts collected on behalf of third parties, including sales tax. Sales related to custom framing are recognized when the order is picked up by the customer. We allow for merchandise to be returned under most circumstances up to 180 days after purchase and provide a reserve for estimated returns. We use historical customer return behavior to estimate our reserve requirements.

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 or when the likelihood of redemption by the customer is remote ("gift card breakage"). We estimate gift card breakage using the expected value method based on customers' historical redemption rates and patterns. Gift card breakage income is recorded in net sales in the consolidated statements of

Table of Contents

comprehensive income over the estimated redemption period. The gift card liability is included in accrued liabilities and other in the consolidated balance sheets.

Costs of Sales and Occupancy Expense

The costs of merchandise sales are expensed as the merchandise is sold. Included in our costs of sales are the following:

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

Occupancy expenses are recognized in the period in which they are incurred. 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.

Rent is recognized on a straight-line basis, including consideration of rent holidays, tenant improvement allowances received from the landlords and applicable rent escalations over the term of the lease. The commencement date of the lease term is the earlier of the date when we become legally obligated for the rent payments or the date when we take possession of the building for construction purposes.

Selling, General and Administrative

Included in selling, general and administrative (“SG&A”) are store personnel costs, store operating expenses, advertising, store depreciation and corporate overhead costs. Advertising costs are expensed in the period in which the advertising first occurs. Advertising costs totaled $194.9 million, $200.1 million and $194.6 million in fiscal 2018, fiscal 2017 and fiscal 2016, respectively.

Store Pre-Opening Costs

We expense all start-up activity costs as incurred. Store pre-opening costs consist primarily of payroll-related costs incurred prior to the store opening.

Income Taxes

We record income tax expense using the liability method and are subject to income tax in many jurisdictions, including the U.S., numerous states and localities, Canada, and other foreign countries. Income taxes payable or receivable are recorded for tax liabilities or refunds reflected on filed, or expected to be filed, tax returns. Deferred income taxes arise from temporary differences between amounts recorded in the consolidated statements of comprehensive income and the tax bases of assets and liabilities measured using enacted tax rates in effect for the years in which the differences are expected to reverse. The effect of a change in tax rates is recognized as income tax expense or benefit in the period of the enactment date. Deferred tax assets, including the benefit of net operating loss and tax credit carryforwards, are evaluated

Table of Contents

based on the guidelines for realization and are reduced by a valuation allowance if it is deemed more likely than not that such assets will not be realized.

We recognize the income tax benefit from an uncertain tax position when it is more likely than not that, based on technical merits, the position will be sustained upon examination, including resolutions of any related appeals or litigation processes. We recognize accrued interest and penalties related to uncertain tax positions as a component of income tax expense.

Share-Based Compensation

ASC 718, Stock Compensation (“ASC 718”), requires all share-based compensation to employees, including grants of employee stock options and restricted shares, to be recognized using the fair value method of accounting. Share-based awards are recognized ratably over the requisite service period or over the estimated time to achieve predetermined financial and operational performance targets.

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.

Accounting Pronouncements Recently Adopted

In October 2018, the Financial Accounting Standards Board (“FASB”) issued ASU 2018-16, “Derivatives and Hedging (Topic 815): Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes” (“ASU 2018-16”). ASU 2018-16 allows for the use of the Overnight Index Swap ("OIS") rate based on the Secured Overnight Financing Rate ("SOFR") as a U.S. benchmark interest rate for purposes of applying hedge accounting under ASC 815, Derivatives and Hedging. ASU 2018-16 is effective for fiscal years beginning after December 15, 2018, with early adoption permitted. We adopted ASU 2018-16 in the fourth quarter of fiscal 2018 on a prospective basis. Its adoption did not have a material impact to the consolidated financial statements.

In August 2018, the FASB issued ASU 2018-15, “Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract” (“ASU 2018-15”). ASU 2018-15 aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). ASU 2018-15 is effective for annual reporting periods beginning after December 15, 2019, including interim periods within that reporting period, with early adoption permitted. The standard is to be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption. We adopted ASU 2018-15 in the fourth quarter of fiscal 2018 on a prospective basis. Its adoption did not have a material impact to the consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, “Fair Value Measurement (Topic 820): Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement” (“ASU 2018-13”). ASU 2018-13 removes, modifies and adds certain disclosure requirements for fair value measurements under ASC 820, Fair Value Measurements (“ASC 820”). ASU 2018-13 is effective for annual reporting periods beginning after December 15, 2019, including interim periods within that reporting period, with early adoption permitted. We adopted ASU 2018-13 in the fourth quarter of fiscal 2018 on a prospective basis. Its adoption did not have a material impact to the consolidated financial statements.

In January 2017, the FASB issued Accounting Standards Update (“ASU”) 2017-04, “Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment” (“ASU 2017-04”). ASU 2017-04 simplifies the measurement of goodwill impairment by removing the second step of the goodwill impairment test, which requires the determination of the fair value of individual assets and liabilities of a reporting unit. Under ASU 2017-04, goodwill impairment is to be measured as the amount by which a reporting unit’s carrying value exceeds its fair value with the loss recognized not to exceed the total amount of goodwill allocated to the reporting unit. ASU 2017-04 is effective for fiscal years beginning after December 15, 2019, with early adoption permitted for interim or annual goodwill impairment tests

Table of Contents

performed after January 1, 2017. We adopted ASU 2017-04 in the fourth quarter of fiscal 2018 on a prospective basis. Its adoption did not have a material impact to the consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers" ("ASU 2014 09"). ASU 2014-09 supersedes the revenue recognition requirements in "Revenue Recognition (Topic 605)" and requires entities to recognize revenue in a way that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. In March 2016, the FASB issued ASU 2016-08, "Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)" which is intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations. In April 2016, the FASB issued ASU 2016-10, "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing" which provides further guidance on identifying performance obligations and improves the operability and understandability of the licensing implementation guidance. In May 2016, the FASB issued ASU 2016-12, "Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients" which narrowly amended the revenue recognition guidance regarding collectability, noncash consideration, presentation of sales tax and transition. We used the modified retrospective transition method to adopt ASU 2014-09 in the first quarter of fiscal 2018 with no adjustments required to our opening retained earnings. The adoption did not have a material impact to the consolidated financial statements.

Recent Accounting Pronouncements Not Yet Adopted

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)" ("ASU 2016-02"). Under ASU 2016 02, an entity will be required to recognize right-of-use assets and lease liabilities on its balance sheet and disclose key information about leasing arrangements. ASU 2016-02 offers specific accounting guidance for a lessee, a lessor and sale and leaseback transactions. Lessees and lessors are required to disclose qualitative and quantitative information about leasing arrangements to enable a user of the financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. The lease standard requires companies to use a modified retrospective transition approach as of the beginning of the earliest comparable period presented in the company's financial statements. In July 2018, the FASB issued ASU 2018-11, "Leases (Topic 842): Targeted Improvements" which provided an additional transition option that allows companies to continue applying the guidance under the current lease standard in the comparative periods presented in the consolidated financial statements. The Company has elected to adopt this transition option and will record a cumulative-effect adjustment to the opening balance of retained earnings on the date of adoption. The guidance under these standards is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period, with early adoption permitted. We have concluded our assessment and will be adopting these standards in the first quarter of fiscal 2019. We expect the adoption of the new standard to result in the recording of right of use assets and lease liabilities of approximately $1.7 billion. We do not expect a material impact on our consolidated statements of comprehensive income or our consolidated statements of cash flows once implemented.

2. REVENUE RECOGNITION

Our revenue is primarily associated with sales of merchandise to customers within our stores, customers utilizing our e-commerce platforms and through our Darice wholesale business. Revenue from sales of our merchandise is recognized when the customer takes possession of the merchandise. Payment for our retail sales is typically due at the time of the sale.

Right of Return

A sales return reserve is established using historical customer return behavior and reduces both revenue and cost of goods sold. Historically, the sales returns reserve was presented net of cost of sales in other current liabilities in the consolidated balance sheets. As a result of adopting ASU 2014-09, the Company presents the gross sales return reserve in other current liabilities and the estimated value of the merchandise expected to be returned in prepaid expenses and other in the consolidated balance sheets. The change did not have a material impact on our consolidated balance sheet as of February 2, 2019.

Table of Contents

Customer Receivables

As of February 2, 2019 and February 3, 2018, receivables from customers, which consist primarily of trade receivables related to our international wholesale business, were approximately $32.1 million and $19.2 million, respectively, and are included in accounts receivable, net in the consolidated balance sheets.

Gift Cards

The following table includes activity related to gift cards (in thousands):

	Fiscal Years	
	2018	2017
Balance at beginning of period	$ 56,729	$ 49,869
Issuance of gift cards	76,854	76,860
Revenue recognized (1)	(67,912)	(68,284)
Gift card breakage	(4,600)	(1,716)
Balance at end of period	$ 61,071	$ 56,729

(1) Revenue recognized from the beginning liability during fiscal 2018 and fiscal 2017 totaled $24.0 million and $24.5 million, respectively.

3. FAIR VALUE MEASUREMENTS

As defined in ASC 820, 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 less transparent active market data, as well as internal 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

- Level 3—Instruments with significant unobservable inputs.

Impairment losses related to store-level property and equipment are calculated using significant unobservable inputs including the present value of future cash flows expected to be generated using a risk-adjusted weighted-average cost of capital and comparable store sales growth assumptions, and therefore, are classified as a Level 3 measurement in the fair value hierarchy.

The carrying value of cash and cash equivalents, accounts receivable and accounts payable approximates their estimated fair values due to the short maturities of these instruments.

The following table below provides the fair values of our term loan credit facility, our senior subordinated notes and our interest rate swaps executed in April 2018 (in thousands).

	February 2, 2019	February 3, 2018
Term loan credit facility	$ 2,177,098	$ 2,246,302
Senior subordinated notes	511,913	518,288
Interest rate swaps	6,366	—

The fair values of our term loan credit facility and our senior subordinated notes were determined based on quoted market prices which are considered Level 1 inputs within the fair value hierarchy.

Table of Contents

The fair value of our interest rate swaps was calculated using significant observable inputs including the present value of estimated future cash flows using the applicable interest rate curves, and therefore, were classified as Level 2 inputs within the fair value hierarchy.

4. PROPERTY AND EQUIPMENT, NET

Property and equipment consists of the following (in thousands):

	February 2, 2019	February 3, 2018
Buildings and leasehold improvements	$ 534,578	$ 532,045
Fixtures and equipment	847,356	826,066
Capitalized software	234,711	182,456
Construction in progress	39,453	53,116
	1,656,098	1,593,683
Less accumulated depreciation and amortization	(1,217,021)	(1,173,663)
	$ 439,077	$ 420,020

5. GOODWILL AND INTANGIBLE ASSETS

The gross carrying amounts and accumulated amortization of our intangible assets are as follows (in thousands):

	February 2, 2019				
	Amortization Period (in years)	Weighted Average Remaining Amortization Period (in years)	Gross Carrying Amount	Accumulated Amortization/ Impairment Charges	Net Carrying Value
Definite-lived intangible assets:					
Customer relationships	16-18	14.95	$ 5,600	$ (1,789)	$ 3,811

Proprietary product designs	7	3.99	3,400	(2,633)	767
Other intangible assets	4-21	11.71	4,229	(2,794)	1,435
			13,229	(7,216)	6,013
Indefinite-lived intangible assets:					
Product tradenames			13,725	(2,500)	11,225
Total intangible assets			$ 26,954	$ (9,716)	$ 17,238

	February 3, 2018				
	Amortization Period (in years)	Weighted Average Remaining Amortization Period (in years)	Gross Carrying Amount	Accumulated Amortization/ Impairment Charges	Net Carrying Value
Definite-lived intangible assets:					
Customer relationships	16-18	15.94	$ 5,600	$ (1,278)	$ 4,322
Proprietary product designs	7	5.00	3,400	(1,750)	1,650
Other intangible assets	2-23	10.62	4,229	(2,157)	2,072
			13,229	(5,185)	8,044
Indefinite-lived intangible assets:					
Product tradenames			13,725		13,725
Total intangible assets			$ 26,954	$ (5,185)	$ 21,769

Table of Contents

In fiscal 2018, fiscal 2017 and fiscal 2016, we recognized amortization expense of $1.6 million, $1.9 million and $2.4 million, respectively, related to definite-lived intangible assets. As of February 2, 2019, the amortization expense related to our definite-lived intangible assets for the next five years will be approximately $0.5 million to $1.0 million each year.

On February 2, 2016, we acquired Lamrite West, Inc. and certain of its affiliates and subsidiaries ("Lamrite") for $151.1 million, net of certain purchase price adjustments. Lamrite operated an international wholesale business under the Darice brand name and 36 arts and crafts retail stores under the Pat Catan's brand name. In January 2019, we closed all 36 of our Pat Catan's stores. As a result of the store closures, we recorded a $7.0 million impairment charge related to goodwill and a $3.0 million impairment charge primarily related to product tradenames. These amounts are included in restructure charges in our consolidated statements of comprehensive income.

As of February 2, 2019, goodwill totaled $112.1 million, including $94.3 million related to Michaels-U.S. and $17.8 million related to the acquisition of Lamrite on February 2, 2016.

6. ACCRUED LIABILITIES AND OTHER

Accrued liabilities and other consists of the following (in thousands):

	February 2, 2019	February 3, 2018
Accrued payroll	$ 73,180	$ 78,822
Self-insurance	70,200	71,399
Property, sales and use taxes	68,182	70,643
Gift card liability	61,071	56,729
Accrued and straight-line rent	30,332	26,084
Accrued advertising	14,093	15,904
Other	61,684	50,876
	$ 378,742	$ 370,457

7. DEBT

Long-term debt consists of the following (in thousands):

	Interest Rate		February 2, 2019	February 3, 2018
Term loan credit facility	Variable		$ 2,207,450	$ 2,232,350
Senior subordinated notes	5.875	%	510,000	510,000
Total debt			2,717,450	2,742,350
Less unamortized discount/premium and debt costs			(11,550)	(15,686)
Total debt, net			2,705,900	2,726,664
Less current portion			(24,900)	(24,900)
Long-term debt			$ 2,681,000	$ 2,701,764

The aggregate amount of scheduled debt payments through maturity are as follows (in thousands):

Fiscal Year	
2019	$ 24,900
2020	534,900
2021	18,675
2022	2,138,975
Total debt payments	$ 2,717,450

As of February 2, 2019 and February 3, 2018, the weighted-average interest rate of the variable debt was 5.00% and 4.32%, respectively. Cash paid for interest totaled $144.3 million, $137.6 million and $113.3 million in fiscal 2018, fiscal 2017 and fiscal 2016, respectively.

Table of Contents

As of February 2, 2019, net debt issuance costs totaled $14.6 million. We amortize debt issuance costs using the straight-line method over the terms of the respective debt agreements (which range from five to seven years). Amortization expense related to debt issuance costs is recorded in interest expense in the accompanying consolidated statements of comprehensive income. The straight-line method produces results materially consistent with the effective interest method. Our expected amortization expense related to the debt issuance costs for the remaining term of the debt agreements is as follows (in thousands):

Fiscal Year	
2019	$ 4,951
2020	4,818
2021	2,605
2022	2,233
Total amortization expense	$ 14,607

Term Loan Credit Facility

On January 28, 2013, MSI entered into an amended and restated credit agreement maturing on January 28, 2020 (the "Credit Agreement") to amend various terms of MSI's then existing term loan credit agreement with Deutsche Bank AG New York Branch ("Deutsche Bank") and other lenders. The Credit Agreement, together with the related security, guarantee and other agreements, is referred to as the "Term Loan Credit Facility".

On July 2, 2014, MSI issued an additional $850.0 million of debt under the Term Loan Credit Facility maturing in 2020 ("Additional Term Loan"). The Additional Term Loan was issued at 99.5% of face value, resulting in an effective interest rate of 4.02%.

On September 28, 2016, MSI entered into an amendment with Deutsche Bank and other lenders to amend and restate our Term Loan Credit Facility. The amended and restated credit agreement, together with the related security, guarantee and other agreements, is referred to as the "Amended Term Loan Credit Facility".

On May 23, 2018, MSI entered into an amendment with JPMorgan, as successor administrative agent and successor collateral agent, and other lenders to amend and restate our Amended Term Loan Credit Facility. The amended and restated credit agreement, together with the related security, guarantee and other agreements, is referred to as the "Amended and Restated Term Loan Credit Facility". Borrowings under the Amended and Restated Term Loan Credit Facility bear interest at a rate per annum, at MSI's option, of either (a) a margin of 1.50% plus a base rate defined as the highest of (1) the prime rate of JPMorgan, (2) the federal funds effective rate plus 0.5%, and (3) the one-month London Interbank Offered Rate ("LIBOR") plus 1% or (b) a margin of 2.50% plus the applicable LIBOR. The Amended Term Loan Credit Facility matures on January 28, 2023.

As of February 2, 2019, the Amended and Restated Term Loan Credit Facility provides for senior secured financing of $2,207.5 million. MSI has the right under the Amended and Restated Term Loan Credit Facility to request additional term loans (a) in the aggregate amount of up to $750.0 million or (b) at MSI's election, an amount of additional term loans if the consolidated secured debt ratio (as defined in the Amended and Restated Term Loan Credit Facility) is no more than 3.25 to 1.00 on a pro forma basis as of the last day of the most recently ended four quarter period, subject to certain adjustments. The lenders under the Amended and Restated Term Loan Credit Facility will not be under any obligation to provide any such additional term loans, and the incurrence of any such additional term loans is subject to customary conditions.

There are no limitations on dividends and certain other restricted payments so long as (a) no event of default shall have occurred and be continuing and (b) immediately after giving pro forma effect to such restricted payment(s) and the application of proceeds therefrom, the consolidated total leverage ratio is less than or equal to 3.75 to 1.00.

MSI must offer to prepay outstanding term loans at 100% of the principal amount, plus any unpaid interest, with the proceeds of certain asset sales or casualty events under certain circumstances. MSI may voluntarily prepay outstanding loans under the Amended and Restated Term Loan Credit Facility at any time without premium or penalty other than customary breakage costs with respect to LIBOR loans.

Table of Contents

MSI is required to make scheduled quarterly payments equal to 0.25% of the original principal amount of the term loans (subject to adjustments relating to the incurrence of additional term loans) for the first four years and two quarters of the Amended and Restated Term Loan Credit Facility, with the balance to be paid on January 28, 2023.

All obligations under the Amended and Restated Term Loan Credit Facility are unconditionally guaranteed, jointly and severally, by Michaels Funding, Inc. (“Holdings”) and all of MSI’s existing domestic material subsidiaries and are required to be guaranteed by certain of MSI’s future domestic wholly-owned material subsidiaries (“the Subsidiary Guarantors”). All obligations under the Amended and Restated Term Loan Credit Facility, and the guarantees of those obligations, are secured, subject to certain exceptions, by substantially all of the assets of Holdings, MSI and the Subsidiary Guarantors, including:

- a first-priority pledge of MSI’s capital stock and all of the capital stock held directly by MSI and the Subsidiary Guarantors (which pledge, in the case of any foreign subsidiary or foreign subsidiary holding company, is limited to 65% of the voting stock of such foreign subsidiary or foreign subsidiary holding company 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 Holdings, MSI and each Subsidiary Guarantor, including substantially all of MSI’s and the Subsidiary Guarantors owned real property and equipment, but excluding, among other things, the collateral described below; and

- a second-priority security interest in personal property consisting of inventory and related accounts, cash, deposit accounts, all payments received by Holdings, MSI 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 Holdings, MSI and the Subsidiary Guarantors, and certain related assets and proceeds of the foregoing.

The Amended and Restated Term Loan Credit Facility contains a number of negative covenants that are substantially similar to, but more restrictive in certain respects than, those governing the 2020 Senior Subordinated Notes (as defined below), as well as certain other customary representations and warranties, affirmative and negative covenants and events of default. As of February 2, 2019, MSI was in compliance with all covenants.

As of February 2, 2019, net debt issuance costs totaled $8.9 million and are being amortized as interest expense over the life of the Amended and Restated Term Loan Credit Facility. Debt issuance costs related to this facility are reflected as a reduction from the carrying value of debt in the consolidated balance sheets. As a result of the refinancing of our Term Loan Credit Facility on May 23, 2018 and September 28, 2016, MSI recorded a loss on the early extinguishment of debt of $1.8 million and $6.9 million, respectively.

Interest Rate Swaps

In April 2018, we executed two interest rate swaps with an aggregate notional value of $1.0 billion associated with our outstanding Amended Term Loan Credit Facility. The interest rate swaps have a maturity date of April 30, 2021 and were executed for risk management and are not held for trading purposes. The objective of the interest rate swaps is to hedge the variability of cash flows resulting from fluctuations in the one-month LIBOR. The swaps replaced the one-month LIBOR with a fixed interest rate of 2.7765% and payments are settled monthly. The swaps qualify as cash flow hedges and changes in the fair values are recorded in accumulated other comprehensive income in the consolidated balance sheet. The changes in fair value are reclassified from accumulated other comprehensive income to interest expense in the same period that the hedged items affect earnings. We reclassified $4.6 million from accumulated other comprehensive income to interest expense during fiscal 2018. As of February 2, 2019, the fair value of the interest rate swaps was a liability of $6.4 million, consisting of $3.8 million recorded in other liabilities and $2.6 million recorded in accrued liabilities in our consolidated balance sheets.

5.875% Senior Subordinated Notes due 2020

On December 19, 2013, MSI issued $260.0 million in principal amount of 5.875% senior subordinated notes maturing in 2020 (“2020 Senior Subordinated Notes”). On June 16, 2014, MSI issued an additional $250.0 million of the

2020 Senior Subordinated Notes at 102% of face value, resulting in an effective interest rate of 5.76%. Interest is payable semi-annually on June 15 and December 15 of each year.

The 2020 Senior Subordinated Notes are guaranteed, jointly and severally, fully and unconditionally, on an unsecured senior subordinated basis, by each of MSI's subsidiaries that guarantee indebtedness under the Amended Revolving Credit Facility and the Amended and Restated Term Loan Credit Facility (collectively defined as the "Senior Secured Credit Facilities").

The 2020 Senior Subordinated Notes and the related guarantees are MSI's and the guarantors' unsecured senior subordinated obligations and are (i) subordinated in right of payment to all of MSI's and the guarantors' existing and future senior debt, including the Senior Secured Credit Facilities; (ii) rank equally in right of payment to all of MSI's and the guarantors' future senior subordinated debt; (iii) effectively subordinated to all of MSI's 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; (iv) rank senior in right of payment to all of the MSI's and the guarantors' existing and future debt and other obligations that are, by their terms, expressly subordinated in right of payment to the 2020 Senior Subordinated Notes; and (v) are structurally subordinated to all obligations of MSI's subsidiaries that are not guarantors of the 2020 Senior Subordinated Notes.

MSI may redeem all or part of the 2020 Senior Subordinated Notes, upon notice, at 100.00% of the principal amount of the 2020 Senior Subordinated Notes to be redeemed, plus any unpaid interest through the applicable date of redemption.

Upon a change in control, MSI is required to offer to purchase all of the 2020 Senior Subordinated Notes at a price in cash equal to 101% of the aggregate principal amount, plus any unpaid interest. The indenture governing the 2020 Senior Subordinated Notes ("2020 Senior Subordinated Indenture") contains covenants limiting MSI's ability, and the ability of MSI's restricted subsidiaries, to incur or guarantee additional debt, prepay debt that is subordinated to the 2020 Senior Subordinated Notes, issue stock of subsidiaries, make certain investments, loans, advances and acquisitions, create liens on MSI's and such subsidiaries' assets to secure debt, enter into transactions with affiliates, merge or consolidate with another company; and sell or otherwise transfer assets. The covenants also limit MSI's ability, and the ability of MSI's restricted subsidiaries, to pay dividends or distributions on MSI's capital stock or repurchase MSI's capital stock, subject to certain exceptions, including dividends, distributions and repurchases up to an amount in excess of (i) $100.0 million plus (ii) a basket that builds based on 50% of MSI's consolidated net income (as defined in the 2020 Senior Subordinated Indenture) and certain other amounts, in each case, to the extent such payment capacity is not applied as otherwise permitted under the 2020 Senior Subordinated Indenture and subject to certain conditions. However, there are no limitations on dividends and certain other restricted payments so long as (a) no default shall have occurred and be continuing and (b) immediately after giving pro forma effect to such restricted payment(s) and the application of proceeds therefrom, the consolidated total leverage ratio is less than or equal to 3.25 to 1.00. As of February 2, 2019, the permitted restricted payment amount was $1,097.5 million. As of February 2, 2019, MSI was in compliance with all covenants.

As of February 2, 2019, net debt issuance costs totaled $3.1 million and are being amortized as interest expense over the life of the 2020 Senior Subordinated Notes. Debt issuance costs related to these notes are reflected as a reduction from the carrying value of debt in the consolidated balance sheets.

Revolving Credit Facility

On September 17, 2012, MSI entered into a second amended and restated credit agreement (the "Credit Agreement") with Wells Fargo Bank, National Association ("Wells Fargo") and other lenders to amend various terms of MSI's then existing senior secured asset-based revolving credit facility. The Credit Agreement, together with related security, guarantee and other agreements, is referred to as the "Revolving Credit Facility". On May 27, 2016, MSI entered into an amended and restated credit agreement with Wells Fargo and other lenders to, among other things, increase the availability and extend the maturity date of our Revolving Credit Facility. The amended credit agreement, together with the related security, guarantee and other agreements, is referred to as the "Amended Revolving Credit Facility".

The Amended Revolving Credit Facility provides for senior secured financing of up to $850.0 million, subject to a borrowing base. The borrowing base under the Amended Revolving Credit Facility equals the sum of: (i) 90% of eligible credit card receivables, (ii) 85% of eligible trade receivables, (iii) 90% to 92.5% of the appraised value of eligible inventory, plus (iv) 90% to 92.5% of the lesser of (a) the appraised value of eligible inventory supported by letters of credit,

Table of Contents

and (b) the face amount of the letters of credit, less (v) certain reserves. The Amended Revolving Credit Facility matures in May 2021, subject to a springing maturity date if certain of our outstanding indebtedness has not been repaid, redeemed, refinanced, cash collateralized or if the necessary availability reserves have not been established prior to such time (the "ABL Maturity Date").

As of February 2, 2019, the borrowing base was $850.0 million of which MSI had availability of $742.7 million. Borrowing capacity is available for letters of credit and borrowings on same-day notice. Outstanding standby letters of credit as of February 2, 2019 totaled $107.3 million.

The Amended Revolving Credit Facility also provides MSI with the right to request up to $200.0 million of additional commitments. The lenders will not be under any obligation to provide any such additional commitments, and any increase in commitments is subject to customary conditions. If we were to request additional commitments, and the lenders were to agree to provide such commitments, the facility size could be increased up to $1,050.0 million, however, MSI's ability to borrow would still be limited by the borrowing base.

Borrowings under the Amended 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 Wells Fargo, (2) the federal funds effective rate plus 0.50% and (3) LIBOR subject to certain adjustments plus 1.00% or (b) LIBOR subject to certain adjustments, in each case plus an applicable margin. The initial applicable margin is (a) 0.25% for prime rate borrowings and 1.25% for LIBOR borrowings. The applicable margin is subject to adjustment each fiscal quarter based on the excess availability under the Amended Revolving Credit Facility. Excess availability is defined as the Loan Cap (as defined below) plus certain unrestricted cash of Holdings, MSI and the Subsidiary Guarantors, less the outstanding credit extensions. Same-day borrowings bear interest at the base rate plus the applicable margin.

MSI is required to pay a commitment fee on the unutilized commitments under the Amended Revolving Credit Facility, which is 0.25% per annum. In addition, MSI must pay customary letter of credit fees and agency fees.

All obligations under the Amended Revolving Credit Facility are unconditionally guaranteed, jointly and severally, by Holdings and the Subsidiary Guarantors. All obligations under the Amended Revolving Credit Facility, and the guarantees of those obligations, are secured, subject to certain exceptions, by substantially all of the assets of Holdings, MSI and 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 Holdings, MSI 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 Holdings, MSI and the Subsidiary Guarantors, and certain related assets and proceeds of the foregoing;

- a second-priority pledge of all of MSI's capital stock and the capital stock held directly by MSI and the Subsidiary Guarantors (which pledge, in the case of the capital stock of any foreign subsidiary or foreign subsidiary holding company, is limited to 65% of the voting stock of such foreign subsidiary or foreign subsidiary holding company 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 Holdings, MSI and each Subsidiary Guarantor, including substantially all of MSI's and the Subsidiary Guarantors owned real property and equipment.

If, at any time, the aggregate amount of outstanding loans, unreimbursed letter of credit drawings and undrawn letters of credit under the Amended Revolving Credit Facility exceeds the lesser of (i) the commitment amount and (ii) the borrowing base (the "Loan Cap"), MSI 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 availability under the Amended Revolving Credit Facility is less than the greater of (i) 10.0% of the Loan Cap and (ii) $50.0 million for five consecutive business days, or, if certain events of default have occurred, MSI will be required to repay outstanding loans and cash collateralize letters of credit with the cash MSI would be required to deposit daily in a collection account maintained with the agent under the Amended Revolving Credit Facility. Availability under the Amended Revolving Credit Facility means the Loan Cap minus the outstanding credit extensions. MSI may voluntarily reduce the unutilized portion of the commitment amount and repay outstanding loans at any time without premium or penalty, other than

Table of Contents

customary breakage costs with respect to LIBOR loans. The principal amount of the loans outstanding is due and payable in full on the ABL Maturity Date.

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 MSI must meet specified excess availability requirements and minimum consolidated fixed charge coverage ratios, to be tested on a pro forma basis as of the date of the restricted action and for the 90-day period preceding such restricted action. Adjusted EBITDA, as defined in the Amended Revolving Credit Facility, is used in the calculation of the consolidated fixed charge coverage ratios.

From the time when MSI has excess availability less than the greater of (a) 10.0% of the Loan Cap and (b) $50.0 million, until the time when MSI has excess availability more than the greater of (a) 10.0% of the Loan Cap and (b) $50.0 million for 30 consecutive days, the Amended Revolving Credit Facility will require MSI to maintain a consolidated fixed charge coverage ratio of at least 1.0 to 1.0. The Amended Revolving Credit Facility also contains certain customary representations and warranties, affirmative covenants and provisions relating to events of default (including change of control and cross-default to material indebtedness).

The Amended Revolving Credit Facility contains a number of covenants that, among other things and subject to certain exceptions, restrict MSI's ability, and the ability of its restricted subsidiaries, to:

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

- consolidate or merge; and

- create liens.

As of February 2, 2019, net debt issuance costs totaled $2.6 million and are being amortized as interest expense over the life of the Amended Revolving Credit Facility. Debt issuance costs related to this facility are reflected as an asset within the consolidated balance sheets. As a result of the refinancing of our Restated Revolving Credit Facility on May 27, 2016, MSI recorded a loss on the early extinguishment of debt of $0.4 million related to the write-off of net debt issuance costs.

Table of Contents

8. LEASES

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 February 2, 2019 are as follows (in thousands):

Fiscal Year	
2019	$ 428,698
2020	386,466
2021	331,032
2022	268,667
2023	206,424
Thereafter	508,178
Total minimum rental commitments	$ 2,129,465

Rent expense applicable to non-cancelable operating leases was $423.8 million, $425.5 million and $416.2 million in fiscal 2018, fiscal 2017 and fiscal 2016, respectively.

9. INCOME TAXES

The reconciliation of income tax expense computed at the U.S. federal statutory tax rate to income tax expense reported in our consolidated statements of comprehensive income is as follows (in thousands):

	Fiscal Year					
	2018		2017		2016	
Income taxes at statutory rate	$ 87,581	21.0 %	$ 204,256	33.7 %	$ 203,621	35.0 %
State income taxes, net of federal benefit	13,095	3.1	18,224	3.0	10,665	1.8
Foreign tax rate differential	(22,718)	(5.4)	(31,570)	(5.2)	(8,820)	(1.5)
Tax Act adjustments	987	0.2	14,557	2.4	—	—
Tax on global intangible low-taxed income, net	3,799	0.9	—	—	—	—
Taxing authority examinations	5,861	1.4	—	—	—	—
Other	8,904	2.2	9,776	1.6	(1,852)	(0.3)
Total	$ 97,509	23.4 %	$ 215,243	35.5 %	$ 203,614	35.0 %

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 (the “Tax Act”) was enacted in the U.S. The Tax Act included a number of changes to U.S. tax laws that impact the Company, including the reduction of the federal statutory tax rate from 35% to 21% effective January 1, 2018. As a result of the Tax Act, we recorded an $8.5 million charge in fiscal 2017. The charge consists of adjustments totaling $14.6 million related to repatriation taxes for accumulated earnings of foreign subsidiaries and the revaluation of net deferred tax assets, partially offset by a $6.1 million benefit due to the decrease in the federal statutory tax rate. The Tax Act adjustments were not material to the consolidated financial statements in fiscal 2018.

The Tax Act subjects us to a tax on global intangible low-taxed income (“GILTI”) earned by our foreign subsidiaries. FASB Topic 740, Accounting for Global Intangible Low-Taxed Income, allows us to make a policy election to either defer GILTI taxes to future years or provide for the tax expense in the year the tax is incurred. We have elected to record the GILTI tax in the year it is incurred.

Table of Contents

The components of our income tax expense are as follows (in thousands):

	Fiscal Year 2018	2017	2016
Current:			
Federal	$ 61,910	$ 186,784	$ 171,934
State	15,502	26,434	15,970
Foreign	12,626	(2,027)	8,487
Total current income tax expense	90,038	211,191	196,391
Deferred:			
Federal	9,200	3,961	4,055
State	1,073	(966)	1,139
Foreign	(2,802)	1,057	2,029
Total deferred income tax expense	7,471	4,052	7,223
Income taxes	$ 97,509	$ 215,243	$ 203,614

The pretax income from foreign operations for fiscal 2018, fiscal 2017 and fiscal 2016 totaled $109.9 million, $119.9 million and $48.2 million, respectively.

Significant components of deferred income tax assets and liabilities are as follows (in thousands):

	February 2, 2019	February 3, 2018
Deferred income tax assets:		
Accrued liabilities	$ 13,031	$ 12,378
Self-insurance	14,028	14,740
Deferred rent	14,529	14,108
Gift cards	8,784	8,392
Share-based compensation	8,255	7,119
Original issue discount	—	2,829
State income taxes	3,949	5,033
State and foreign net operating losses	7,286	6,247
Tax credits and deferred interest	3,833	2,657
Other	3,739	1,783
Total gross deferred income tax assets	77,434	75,286
Valuation allowance	(5,430)	(2,640)
Total deferred income tax assets, net of valuation allowance	72,004	72,646

Deferred income tax liabilities:		
Property and equipment	(39,046)	(25,398)
Merchandise inventories	(3,198)	(8,447)
Prepaid expenses	(4,755)	(2,538)
Cancellation of debt	—	(4,783)
Total deferred income tax liabilities	(46,999)	(41,166)
Net deferred income tax assets	$ 25,005	$ 31,480

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 assets we considered sources of future taxable income, including future reversals of existing taxable temporary differences, forecast of future profitability and tax-planning strategies.

At February 2, 2019, we had state net operating loss carryforwards to reduce future taxable income of $7.1 million, net of federal tax benefits, and $0.2 million of foreign net operating loss carryforwards expiring at various dates between

Table of Contents

fiscal 2019 and fiscal 2038. Cash paid for income taxes totaled $134.4 million, $181.3 million and $162.4 million in fiscal 2018, fiscal 2017 and fiscal 2016, respectively.

Unrecognized Tax Benefits

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. In accordance with ASC 740, Income Taxes, we recognize these tax benefits in our consolidated financial statements only after determining that it is more likely than not that the tax benefits will be sustained.

A reconciliation of gross unrecognized tax benefits from the end of fiscal 2017 through the end of fiscal 2018 is as follows (in thousands):

Balance at beginning of year	$ 46,894
Additions related to the current year	6,556
Additions related to prior years	12,870
Reductions related to prior years	(4,937)
Settlement of tax positions	(2,355)
Expiration of applicable statute of limitations	(208)
Balance at end of year	$ 58,820

Included in the balance of unrecognized tax benefits at February 2, 2019 is $36.1 million which, if recognized, would affect income tax expense. We do not expect any material changes to our liability for uncertain tax positions during the next 12 months. At February 2, 2019 and February 3, 2018, the total amount of interest accrued within the tax liability was $4.9 million and $3.0 million, respectively. There was no material interest or penalty expense recognized in the consolidated statements of comprehensive income in fiscal 2018, fiscal 2017 or fiscal 2016.

Our income tax returns are subject to examination by taxing authorities in the jurisdictions in which we operate. The periods subject to examination for our U.S. federal returns are fiscal 2013 to fiscal 2017 and fiscal 2011 to fiscal 2017 for our Canadian returns. State and provincial income tax returns are generally subject to examination for a period of three to seven years after filing. We have various state and provincial income tax returns in the process of examination, appeals or settlements. Our income tax returns for fiscal 2011 and fiscal 2012 are currently under examination by the Canadian tax authorities. Our federal returns for fiscal 2013 and fiscal 2014 are currently under examination by the Internal Revenue Service. We are not aware of any issues which would result in a material assessment of net tax obligations.

10. ACCUMULATED OTHER COMPREHENSIVE LOSS

The following table includes detail regarding changes in the composition of accumulated other comprehensive loss (in thousands):

	Fiscal Years Ended	
	February 2, 2019	February 3, 2018
Beginning of period	$ (3,660)	$ (14,224)
Foreign currency translation adjustment and other	(6,188)	10,564
Interest rate swaps	(4,710)	—
End of period	$ (14,558)	$ (3,660)

11. SHARE-BASED COMPENSATION

The Michaels Companies, Inc. Second Amended and Restated 2014 Omnibus Long-Term Incentive Plan provides for the grant of share-based awards for up to 28.6 million shares of common stock. As of February 2, 2019, there were 7.5 million shares of common stock remaining available for grant. Generally, time-based share awards vest ratably over four or five years and stock options expire eight to ten years from the grant date. Restricted awards that are performance-based are expected to vest between one to four years from the grant date. As of February 2, 2019, unrecognized

Table of Contents

compensation cost for all unvested share-based awards totaled $68.2 million and is expected to be recognized over a weighted-average period of 2.5 years. Share-based compensation expense totaled $27.1 million in fiscal 2018, $24.3 million in fiscal 2017 and $16.5 million in fiscal 2016 and is recorded in cost of sales and occupancy expense and SG&A in the consolidated statements of comprehensive income.

Stock Options

The fair value of each stock option is estimated using the Black-Scholes option pricing model. The following table presents the weighted-average assumptions used during fiscal years 2018, 2017 and 2016:

	Fiscal Year		
	2018	2017	2016
Risk-free interest rates (1)	2.5 %	1.7 %	1.1 %
Expected dividend yield	0.0 %	0.0 %	0.0 %
Expected volatility (2)	32.8 %	29.9 %	29.8 %
Expected life of options in years (3)	4.1	4.1	4.1

(1) Based on interest rates for U.S. Treasury instruments with terms consistent with the expected lives of the awards.
(2) We considered our historical and implied volatility as well as the implied volatilities for exchange-traded options of a peer group of companies.
(3) Expected lives were based on an analysis of historical exercise and post-vesting employment termination.

The stock option activity during the fiscal year ended February 2, 2019 was as follows:

	Number of Shares (in thousands)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding at beginning of year	7,976	$ 19.81		
Granted	2,088	19.38		
Exercised	(369)	10.81		
Expired/Forfeited	(1,151)	22.50		
Outstanding at end of year	8,544	$ 19.73	6.6	$ 490
Shares exercisable at end of year	4,588	$ 18.41	4.9	$ 490

The total grant date fair value of options that vested during fiscal 2018, fiscal 2017 and fiscal 2016 was $9.5 million, $8.3 million and $7.4 million, respectively. The intrinsic value for options that vested during fiscal 2018, fiscal 2017 and fiscal 2016 was $4.1 million, $5.4 million and $13.1 million, respectively. The intrinsic value for options exercised during fiscal 2018, fiscal 2017 and fiscal 2016 was $2.6 million, $15.7 million and $30.8 million, respectively. As of the beginning of fiscal 2018, there were 4.5 million nonvested options with a weighted-average fair value of $5.77 per share. As of the end of fiscal 2018, there were 4.0 million nonvested options with a weighted-average fair value of $5.93 per share. The weighted-average fair value of options granted during fiscal 2018, fiscal 2017 and fiscal 2016 was $5.85, $5.88 and $6.27, respectively. During fiscal 2018, there were 1.8 million options that vested and 1.2 million options that were cancelled with a weighted-average fair value of $5.40 and $5.97 per share, respectively.

Restricted Shares

The Company issues restricted shares to certain key employees and its Board of Directors. Restricted share units awarded to employees that are time-based vest ratably over four or five years. Restricted share units that are performance-based vest based on predetermined financial and operational targets and are expected to vest between one to four years from the grant date. Restricted shares awarded to Board of Director members vest ratably over one year. Compensation expense for all time-based restricted stock awards and restricted stock units is based on the amortization of the fair market value at the date of grant over the vesting period. Compensation expense for performance-based restricted share units is based on the estimated timing of the achievement of predetermined financial and operational targets.

Table of Contents

Restricted stock unit activity during the fiscal year ended February 2, 2019 was as follows:

	Number of Shares (in thousands)	Weighted-Average Fair Value
Outstanding at beginning of year	1,460	$ 22.81
Granted (1)	2,663	18.49
Vested	(407)	22.87
Forfeited	(418)	21.14
Outstanding at end of year	3,298	$ 19.53

(1) Includes 1.1 million awards granted with vesting subject to performance conditions, with a weighted average fair value of $17.38 per share.

Restricted stock award activity during the fiscal year ended February 2, 2019 was as follows:

	Number of Shares (in thousands)	Weighted-Average Fair Value
Outstanding at beginning of year	521	$ 22.84
Vested	(289)	21.41
Forfeited	(60)	24.37
Outstanding at end of year	172	$ 24.60

12. EARNINGS PER SHARE

The Company’s unvested restricted stock awards contain non-forfeitable rights to dividends and meet the criteria of a participating security as defined by ASC 260, “Earnings Per Share”. In applying the two-class method, net income is allocated to both common and participating securities based on their respective weighted-average shares outstanding for the period. Basic earnings per share is computed by dividing net income allocated to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share is computed by dividing income available to common shareholders by the weighted-average common shares outstanding plus the potential dilutive impact from the exercise of stock options and restricted stock units. Common equivalent shares are excluded from the computation if their effect is anti-dilutive. There were 7.2 million, 5.5 million and 2.3 million anti-dilutive shares in fiscal 2018, fiscal 2017 and fiscal 2016, respectively.

Table of Contents

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share data):

	Fiscal Year		
	2018	2017	2016
Basic earnings per common share:			
Net income	$ 319,545	$ 390,498	$ 378,159
Less income related to unvested restricted shares	(595)	(1,519)	(2,323)
Income available to common shareholders - Basic	$ 318,950	$ 388,979	$ 375,836
Weighted-average common shares outstanding - Basic	170,610	184,281	204,735
Basic earnings per common share	$ 1.87	$ 2.11	$ 1.84
Diluted earnings per common share:			
Net income	$ 319,545	$ 390,498	$ 378,159
Less income related to unvested restricted shares	(593)	(1,508)	(2,305)
Income available to common shareholders - Diluted	$ 318,952	$ 388,990	$ 375,854
Weighted-average common shares outstanding - Basic	170,610	184,281	204,735
Effect of dilutive stock options and restricted stock units	768	1,285	1,619
Weighted-average common shares outstanding - Diluted	171,378	185,566	206,354
Diluted earnings per common share	$ 1.86	$ 2.10	$ 1.82

13. SEGMENTS AND GEOGRAPHIC INFORMATION

We consider Michaels-U.S., Michaels-Canada, Aaron Brothers, Pat Catan's and Darice to be our operating segments for purposes of determining reportable segments based on the criteria of ASC 280, Segment Reporting ("ASC 280"). We determined that Michaels-U.S., Michaels-Canada, Aaron Brothers and Pat Catan's have similar economic characteristics and meet the aggregation criteria set forth in ASC 280. Therefore, we combine these operating segments into one reporting segment. Darice does not meet the materiality criteria in ASC 280 and, therefore, is not disclosed separately as a reportable segment. Our chief operating decision makers evaluate historical operating performance and forecast future periods' operating performance based on operating income.

Our net sales by country and sales by product category are as follows (in thousands):

	Fiscal Year 2018	2017	2016
Net Sales:			
United States (1)	$ 4,783,903	$ 4,856,275	$ 4,736,578
Canada	488,041	505,685	460,714
Total	$ 5,271,944	$ 5,361,960	$ 5,197,292
Sales by Product Category:			
General crafts	$ 2,604,905	$ 2,685,787	$ 2,634,743
Home décor and seasonal	1,230,054	1,177,069	1,088,989
Custom and ready-made framing	801,075	875,944	898,798
Papercrafting	635,910	623,160	574,762
Total	$ 5,271,944	$ 5,361,960	$ 5,197,292

(1) In March 2018, we closed substantially all of our Aaron Brothers stores. For fiscal 2018, fiscal 2017 and fiscal 2016, Aaron Brothers net sales totaled approximately $12.9 million, $110.4 million and $120.5 million, respectively.

Table of Contents

Our total assets by country are as follows (in thousands):

	Fiscal Year 2018	2017
Total Assets:		
United States (1)	$ 1,949,836	$ 2,145,244
Canada	178,500	154,971
Total	$ 2,128,336	$ 2,300,215

(1) In fiscal 2018, we wrote off approximately $97.8 million of assets in connection with the closure of substantially all of our Aaron Brothers stores and the closure of all our Pat Catan's stores.

Assets are categorized based on their geographic location. Certain assets located in the U.S. are also used to support our Canadian operations but are not allocated to Canada.

14. CONTINGENCIES

Fair Credit Reporting Claim

On December 11, 2014, MSI was served with a lawsuit, Christina Graham v. Michaels Stores, Inc., filed in the U.S. District Court for the District of New Jersey by a former employee. The lawsuit is a purported class action, bringing plaintiff's individual claims, as well as claims on behalf of a putative class of applicants who applied for employment with Michaels through an online application, and on whom a background check for employment was procured. The lawsuit alleges that MSI violated the Fair Credit Reporting Act ("FCRA") and the New Jersey Fair Credit Reporting Act by failing to provide the proper disclosure and obtain the proper authorization to conduct background checks. Since the initial filing, another named plaintiff joined the lawsuit, which was amended in February 2015, Christina Graham and Gary Anderson v. Michaels Stores, Inc., with substantially similar allegations. The plaintiffs sought statutory and punitive damages as well as attorneys' fees and costs.

Following the filing of the case in New Jersey, five additional purported class action lawsuits with six plaintiffs were filed, Michele Castro and Janice Bercut v. Michaels Stores, Inc., in the U.S. District Court for the Northern District of Texas, Michelle Bercut v. Michaels Stores, Inc. in the Superior Court of California for Sonoma County, Raini Burnside v. Michaels Stores, Inc., in the U.S. District Court for the Western District of Missouri, Sue Gettings v. Michaels Stores, Inc., in the U.S. District Court for the Southern District of New York, and Barbara Horton v. Michaels Stores, Inc., in the U.S. District Court for the Central District of California. All of the plaintiffs alleged violations of the FCRA. In addition, the Castro, Horton and Janice Bercut lawsuits also alleged violations of California's unfair competition law. The Burnside, Horton and Gettings lawsuits, as well as the claims by Michele Castro, have been dismissed. The Graham, Janice Bercut and Michelle Bercut lawsuits were transferred for centralized pretrial proceedings to the District of New Jersey. On January 24, 2017, the Company's motion to dismiss for lack of standing was granted, and the court declined to rule on the merits of plaintiffs' claims. The dismissal order was stayed for 30 days to allow the plaintiffs to amend their complaints. Because there were no amendments filed, two of the three centralized cases were dismissed and subsequently appealed to the U.S. Court of Appeals for the Third Circuit, and the remaining case (Michelle Bercut) was remanded to California Superior Court. The parties reached a class settlement which was approved by the California Superior Court on October 10, 2018. The resolution of the lawsuits did not have a material effect on our consolidated financial statements.

General

In addition to the litigation discussed above, we are now, and may be in the future, involved in various other lawsuits, claims and proceedings incident to the ordinary course of business. The results of litigation are inherently unpredictable. Any claims against us, whether meritorious or not, could be time consuming, result in costly litigation, require significant amounts of management time and result in diversion of significant resources.

15. 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 at least 21 years of age and has completed three months of full-time service or one year of part-time service. 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

Table of Contents

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 compensation for the year. Matching contributions vest to the participants based on years of service, with 100% vesting after three years. Our matching contribution expense was $4.8 million, $4.7 million and $4.4 million in fiscal 2018, fiscal 2017 and fiscal 2016, respectively.

During fiscal 2016, the Company established a nonqualified deferred compensation plan for certain executives and other highly compensated employees. The deferred compensation plan provides participants with the opportunity to defer up to 75% of their base salary and up to 100% of their annual earned bonus. Participants are 100% vested in these deferrals and the associated investment returns. The Company does not currently make any matching cash contributions to the participant accounts. As of February 2, 2019 and February 3, 2018, liabilities associated with the deferred compensation plan, which are included in long-term other liabilities in the consolidated balance sheets, were $4.7 million and $2.3 million, respectively. The Company established a rabbi trust to fund the deferred compensation plan's obligations. As of February 2, 2019 and February 3, 2018, assets of the rabbi trust, which consist primarily of mutual funds and are subject to the claims of our creditors, were $4.0 million and $2.1 million, respectively, and are included in other assets in the consolidated balance sheets.

16. RELATED PARTY TRANSACTIONS

Affiliates of, or funds advised by, Bain Capital Partners, LLC ("Bain Capital") and The Blackstone Group L.P. ("The Blackstone Group", together with Bain Capital and their applicable affiliates, the "Sponsors") owned approximately 46% of our outstanding common stock as of February 2, 2019.

The Blackstone Group owns a majority equity position in RGIS, a vendor we utilized until February 2018 to count our store inventory. Payments associated with this vendor during fiscal 2018, fiscal 2017 and fiscal 2016 were $0.7 million, $6.3 million and $6.0 million, respectively, and are included in SG&A in the consolidated statements of comprehensive income.

The Blackstone Group owns a majority equity position in Excel Trust, Inc., Blackstone Real Estate DDR Retail Holdings III, LLC and Blackstone Real Estate RC Retail Holdings, LLC, vendors we utilize to lease certain properties. Payments associated with these vendors during fiscal 2018, fiscal 2017 and fiscal 2016 were $6.1 million, $7.6 million and $5.2 million, respectively. These expenses are included in cost of sales and occupancy expense in the consolidated statements of comprehensive income.

The Blackstone Group owns a majority equity position in JDA Software Group, Inc., a vendor we utilize for transportation and supply chain software. Payments associated with this vendor during fiscal 2018, fiscal 2017 and fiscal 2016 were $3.0 million, $1.3 million and $1.5 million, respectively. These expenses are included in SG&A in the consolidated statements of comprehensive income.

Three of our current directors, Joshua Bekenstein, Ryan Cotton and Peter F. Wallace, are affiliates of Bain Capital or The Blackstone Group. As such, some or all of such 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 Capital and The Blackstone Group. As of February 2, 2019, affiliates of The Blackstone Group held $91.6 million of our Amended and Restated Term Loan Credit Facility.

17. CONDENSED CONSOLIDATED FINANCIAL INFORMATION

Our debt covenants restrict MSI, and certain subsidiaries of MSI, from various activities including the incurrence of additional debt, payment of dividends and the repurchase of MSI's capital stock (subject to certain exceptions), among other things. The following condensed consolidated financial information represents the financial information of MSI and its wholly-owned subsidiaries subject to these restrictions. The information is presented in accordance with the requirements of Rule 12-04 under the SEC's Regulation S-X.

Table of Contents

Michaels Stores, Inc.

Condensed Consolidated Balance Sheets

(in thousands)

ASSETS	February 2, 2019	February 3, 2018
Current assets:		
Cash and equivalents	$ 245,108	$ 425,129
Merchandise inventories	1,108,715	1,123,288
Prepaid expenses and other current assets	160,767	127,656
Total current assets	1,514,590	1,676,073
Property and equipment, net	439,077	420,020
Goodwill	112,069	119,074
Other assets	61,667	84,537
Total assets	$ 2,127,403	$ 2,299,704
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable	$ 485,004	$ 483,002
Accrued liabilities and other	378,313	369,647
Current portion of long-term debt	24,900	24,900
Other current liabilities	43,907	124,881
Total current liabilities	932,124	1,002,430
Long-term debt	2,681,000	2,701,764
Other liabilities	199,705	165,662
Total stockholders' deficit	(1,685,426)	(1,570,152)
Total liabilities and stockholders' deficit	$ 2,127,403	$ 2,299,704

Michaels Stores, Inc.

Condensed Consolidated Statements of Comprehensive Income

(in thousands)

	Fiscal Year		
	2018	2017	2016
Net sales	$ 5,271,944	$ 5,361,960	$ 5,197,292
Cost of sales and occupancy expense	3,248,276	3,233,171	3,169,476
Gross profit	2,023,668	2,128,789	2,027,816

Selling, general and administrative	1,350,371	1,389,334	1,305,855
Restructure charges	104,238	—	—
Store pre-opening costs	4,417	2,999	4,484
Operating income	564,642	736,456	717,477
Interest and other expense	146,572	129,657	133,529
Income before income taxes	418,070	606,799	583,948
Income taxes	97,751	215,820	204,247
Net income	$ 320,319	$ 390,979	$ 379,701
Other comprehensive income, net of tax:			
Foreign currency translation adjustment and other	(10,898)	10,564	7,832
Comprehensive income	$ 309,421	$ 401,543	$ 387,533

Table of Contents

Michaels Stores, Inc.

Condensed Consolidated Statements of Cash Flows

(in thousands)

	Fiscal Year 2018	2017	2016
Cash flows from operating activities:			
Net cash provided by operating activities	$ 443,275	$ 535,544	$ 577,088
Cash flows from investing activities:			
Additions to property and equipment	(145,387)	(127,830)	(114,462)
Acquisition of Lamrite West, net of cash acquired	—	—	(151,100)
Purchases of long-term investments	—	—	(1,325)
Net cash used in investing activities	(145,387)	(127,830)	(266,887)
Cash flows from financing activities:			
Net repayments of debt	(380,300)	(413,325)	(60,675)
Net borrowings of debt	355,400	382,200	42,000
Payment of dividend to Michaels Funding, Inc.	(451,892)	(245,514)	(400,823)
Other financing activities	(1,117)	—	(1,299)
Net cash used in financing activities	(477,909)	(276,639)	(420,797)
Net change in cash and equivalents	(180,021)	131,075	(110,596)
Cash and equivalents at beginning of period	425,129	294,054	404,650
Cash and equivalents at end of period	$ 245,108	$ 425,129	$ 294,054

Table of Contents

18. QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

Unaudited quarterly results of operations for fiscal 2018 and fiscal 2017 were as follows (in thousands, except per share data):

	Fiscal 2018			
	First Quarter (1)	Second Quarter	Third Quarter (2)	Fourth Quarter
Net sales (3)	$ 1,155,511	$ 1,053,267	$ 1,274,058	$ 1,789,109
Cost of sales and occupancy expense	698,948	679,938	795,104	1,074,285
Gross profit	456,563	373,329	478,954	714,824
Selling, general and administrative	328,617	300,981	340,593	381,211
Restructure charges (4)	47,498	(3,220)	—	59,960
Operating income	78,943	74,273	137,165	273,230
Net income	26,885	27,488	83,769	181,403
Diluted earnings per common share	$ 0.15	$ 0.15	$ 0.50	$ 1.15

	Fiscal 2017			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter (5)
Net sales (6)	$ 1,158,563	$ 1,072,593	$ 1,240,196	$ 1,890,608
Cost of sales and occupancy expense	690,929	670,082	756,088	1,116,072
Gross profit	467,634	402,511	484,108	774,536
Selling, general and administrative	327,396	313,867	329,298	419,839
Operating income	139,260	87,982	153,858	354,290
Net income	72,208	35,562	79,760	202,968
Diluted earnings per common share	$ 0.38	$ 0.19	$ 0.44	$ 1.11

(1) Net income for the first quarter of fiscal 2018 includes $8.1 million of additional income tax expense as a result of the Tax Act.

(2) Net income for the third quarter of fiscal 2018 includes an income tax benefit of $7.1 million as a result of the Tax Act.

(3) Net sales for Aaron Brothers were $12.9 million in the first quarter of fiscal 2018. There were no Aaron Brothers net sales in the second, third and fourth quarters of fiscal 2018.

(4) Includes restructure charges primarily related to the closure of substantially all of our Aaron Brothers stores in the first quarter of fiscal 2018 and all of our Pat Catan’s stores in the fourth quarter of fiscal 2018.

(5) Net income for the fourth quarter of fiscal 2017 includes $8.5 million of additional income tax expense as a result of the Tax Act.

(6) Net sales of Aaron Brothers during fiscal 2017 were $25.5 million, $27.3 million, $25.2 million and $32.4 million for the first, second, third and fourth quarter, respectively.

We report on the basis of a 52-week or 53-week fiscal year, which ends on the Saturday closest to January 31. Our interim periods each contain 13 weeks ending on the Saturday closest to April 30, July 31 and October 31, with the exception of the 4th quarter of fiscal 2017, which consisted of 14 weeks.

Table of Contents

EXHIBIT INDEX

Exhibit Number	Description of Exhibit
3.1	Second Amended and Restated Certificate of Incorporation of The Michaels Companies, Inc. (previously filed as Exhibit 3.2 to Form S-1 filed by the Company on June 9, 2014, SEC File No. 333-193000).
3.2	Amended and Restated Bylaws of The Michaels Companies, Inc. (previously filed as Exhibit 3.4 to Form S-1 filed by the Company on June 2, 2014, SEC File No. 333-193000).
4.1	Form of Specimen Common Stock Certificate of The Michaels Companies, Inc. (previously filed as Exhibit 4.1 to Form S-1 filed by the Company on June 16, 2014, SEC File No. 333-193000).
4.2	Form of Amended and Restated Registration Rights Agreement (previously filed as Exhibit 4.2 to Form S-1 filed by the Company on June 2, 2014, SEC File No. 333-193000).
4.3	Form of Investor Agreement (previously filed as Exhibit 4.3 to Form S-1 filed by the Company on June 2, 2014, SEC File No. 333-193000).
4.4	Indenture, dated as of December 19, 2013, by and among Michaels Stores, Inc., the guarantors named therein and Wells Fargo Bank, National Association, as trustee (previously filed as Exhibit 4.1 to Form 8-K filed by Michaels Stores, Inc. on December 19, 2013, SEC File No. 001-09338).
4.5	Supplemental Indenture, dated as of June 16, 2014, by and among Michaels Stores, Inc., the guarantors named therein and Wells Fargo Bank, National Association, as trustee (previously filed as Exhibit 4.11 to Form S-1 filed by the Company on June 16, 2014, SEC File No. 333-193000).
4.6	Indenture, dated as of July 29, 2013, among Michaels FinCo Holdings, LLC, Michaels FinCo, Inc. and Law Debenture Trust Company of New York, as trustee (previously filed as Exhibit 4.12 to Form S-1 filed by the Company on June 16, 2014, SEC File No. 333-193000).
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 Michaels Stores, Inc. on December 7, 2006, SEC File No. 001-09338).
4.8	