UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended July 29, 2017

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. (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 and posted on its corporate website every Interactive Data File required to be submitted and posted 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).

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

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

As of August 17, 2017, 180,986,344 shares of The Michaels Companies, Inc.'s common stock were outstanding.

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Part I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

THE MICHAELS COMPANIES, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands, except per share data)

(Unaudited)

	13 Weeks Ended		26 Weeks Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Net sales	$ 1,072,593	$ 1,060,353	$ 2,231,156	$ 2,219,233
Cost of sales and occupancy expense	670,082	669,656	1,361,012	1,363,785
Gross profit	402,511	390,697	870,144	855,448
Selling, general and administrative	313,867	302,712	641,263	620,512
Store pre-opening costs	662	908	1,640	2,534
Operating income	87,982	87,077	227,241	232,402
Interest expense	31,051	31,954	61,488	64,173
Losses on early extinguishments of debt and refinancing costs	—	405	—	405
Other expense (income), net	1,353	(515)	1,309	(69)
Income before income taxes	55,578	55,233	164,444	167,893
Income taxes	20,016	19,616	56,674	61,511
Net income	$ 35,562	$ 35,617	$ 107,770	$ 106,382
Other comprehensive income, net of tax:				
Foreign currency translation adjustment and other	13,944	(4,759)	8,672	9,450
Comprehensive income	$ 49,506	$ 30,858	$ 116,442	$ 115,832
Earnings per common share:				
Basic	$ 0.19	$ 0.17	$ 0.57	$ 0.51
Diluted	$ 0.19	$ 0.17	$ 0.57	$ 0.51
Weighted-average common shares outstanding:				
Basic	186,886	205,881	187,927	206,437
Diluted	187,931	207,547	189,171	208,269

See accompanying notes to consolidated financial statements.

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THE MICHAELS COMPANIES, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

(Unaudited)

ASSETS	July 29, 2017	January 28, 2017	July 30, 2016
Current Assets:			
Cash and equivalents	$ 134,119	$ 298,813	$ 114,849
Merchandise inventories	1,195,495	1,127,777	1,145,422
Prepaid expenses and other	87,176	87,175	85,482
Accounts receivable, net	24,311	23,215	26,920
Income taxes receivable	20,085	5,825	42,676
Total current assets	1,461,186	1,542,805	1,415,349
Property and equipment, at cost	1,530,622	1,488,136	1,724,291
Less accumulated depreciation and amortization	(1,122,928)	(1,074,972)	(1,325,603)
Property and equipment, net	407,694	413,164	398,688
Goodwill	119,074	119,074	119,074
Other intangible assets, net	22,736	23,702	23,703
Deferred income taxes	37,137	36,834	39,780
Other assets	12,202	12,061	12,387
Total assets	$ 2,060,029	$ 2,147,640	$ 2,008,981
LIABILITIES AND STOCKHOLDERS' DEFICIT			
Current Liabilities:			
Accounts payable	$ 510,818	$ 517,268	$ 462,099
Accrued liabilities and other	391,784	397,497	355,359
Current portion of long-term debt	112,125	31,125	66,900
Income taxes payable	823	78,334	—
Total current liabilities	1,015,550	1,024,224	884,358
Long-term debt	2,712,475	2,723,187	2,735,187
Other liabilities	99,997	98,655	97,232
Total liabilities	3,828,022	3,846,066	3,716,777
Commitments and contingencies			
Stockholders' Deficit:			
Common stock, $0.06775 par value, 350,000 shares authorized; 183,414 shares issued and outstanding at July 29, 2017; 193,311 shares issued and outstanding at January 28, 2017; and 205,824 shares issued and outstanding at July 30, 2016	12,330	12,948	13,770
Additional paid-in-capital	59,099	233,129	493,096
Treasury stock	(11,361)	—	—
Accumulated deficit	(1,822,509)	(1,930,279)	(2,202,056)

Accumulated other comprehensive loss	(5,552)	(14,224)	(12,606)
Total stockholders' deficit	(1,767,993)	(1,698,426)	(1,707,796)
Total liabilities and stockholders' deficit	$ 2,060,029	$ 2,147,640	$ 2,008,981

See accompanying notes to consolidated financial statements.

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THE MICHAELS COMPANIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	26 Weeks Ended	
	July 29, 2017	July 30, 2016
Cash flows from operating activities:		
Net income	$ 107,770	$ 106,382
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	57,423	58,468
Share-based compensation	10,557	6,590
Debt issuance costs amortization	2,549	3,760
Accretion of long-term debt, net	(252)	(124)
Deferred income taxes	(225)	619
Losses on early extinguishments of debt and refinancing costs	—	405
Losses on disposition of property and equipment	—	35
Excess tax benefits from share-based compensation	—	(7,271)
Changes in assets and liabilities, excluding acquired net assets:		
Merchandise inventories	(67,218)	(58,612)
Prepaid expenses and other	(1)	639
Accounts receivable	(1,096)	4,858
Other assets	(700)	(445)
Accounts payable	(11,841)	(20,171)
Accrued interest	(7,691)	(5,045)
Accrued liabilities and other	(2,811)	(35,091)
Income taxes	(91,771)	(78,816)
Other liabilities	1,272	(605)
Net cash used in operating activities	(4,035)	(24,424)
Cash flows from investing activities:		
Additions to property and equipment	(43,120)	(38,395)
Acquisition of Lamrite West, net of cash acquired	—	(151,100)
Net cash used in investing activities	(43,120)	(189,495)
Cash flows from financing activities:		
Common stock repurchased	(191,164)	(129,039)
Payments on term loan credit facility	(12,450)	(12,450)
Borrowings on asset-based revolving credit facility	139,100	42,000
Payments on asset-based revolving credit facility	(58,100)	—

Payment of debt issuance costs	—	(3,048)
Payment of dividends	(408)	(415)
Proceeds from stock options exercised	5,483	15,058
Excess tax benefits from share-based compensation	—	7,271
Net cash used in financing activities	(117,539)	(80,623)
Net change in cash and equivalents	(164,694)	(294,542)
Cash and equivalents at beginning of period	298,813	409,391
Cash and equivalents at end of period	$ 134,119	$ 114,849
Supplemental cash flow information:		
Cash paid for interest	$ 67,453	$ 65,634
Cash paid for taxes	$ 148,187	$ 138,394

See accompanying notes to consolidated financial statements.

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THE MICHAELS COMPANIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. BASIS OF PRESENTATION

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.

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions to Form 10 Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. Therefore, these financial statements should be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended January 28, 2017 filed with the Securities and Exchange Commission (“SEC”) pursuant to Section 13 or 15(d) under the Securities Exchange Act of 1934. In the opinion of management, all adjustments (consisting of normal recurring accruals and other items) considered necessary for a fair presentation have been included.

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 2017” relate to the 53 weeks ending February 3, 2018 and references to “fiscal 2016” relate to the 52 weeks ended January 28, 2017. In addition, all references to “the second quarter of fiscal 2017” relate to the 13 weeks ended July 29, 2017 and all references to “the second quarter of fiscal 2016” relate to the 13 weeks ended July 30, 2016. Finally, all references to “the six months ended July 29, 2017” relate to the 26 weeks ended July 29, 2017 and all references to “the six months ended July 30, 2016” relate to the 26 weeks ended July 30, 2016. Because of the seasonal nature of our business, the results of operations for the 13 and 26 weeks ended July 29, 2017 are not indicative of the results to be expected for the entire year.

Certain prior year amounts have been reclassified in the accompanying consolidated financial statements to conform to our fiscal 2017 presentation.

Share Repurchase Program

In June 2017, 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. 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. During the six months ended July 29, 2017, we repurchased 10.3 million shares under our share repurchase programs for an aggregate amount of $200.8 million, including $99.4 million repurchased under our previous authorization. As of July 29, 2017, we had $398.6 million of availability remaining under our current program.

Accounting Pronouncements Recently Adopted

In March 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-09, "Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting" ("ASU 2016-09"). ASU 2016-09 identifies areas for simplification involving several aspects of accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, an option to recognize gross stock compensation expense with actual forfeitures recognized as they occur, as well as certain classifications on the statement of cash flows. We adopted the new guidance on a prospective basis in the

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first quarter of fiscal 2017. As a result of the adoption, we recognized $0.1 million of excess tax benefits related to share-based compensation in income tax expense for the second quarter of fiscal 2017 and $1.0 million for the six months ended July 29, 2017. Excess tax benefits were historically recorded in additional paid-in capital. In addition, cash flows related to excess tax benefits are now classified as an operating activity. Cash flows were historically classified as a financing activity. We have elected to continue to estimate forfeitures expected to occur to determine the amount of compensation cost to be recognized each period. None of the other provisions in this amended guidance had a material impact on our consolidated financial statements.

Recent Accounting Pronouncements Not Yet Adopted

In May 2017, the FASB issued ASU 2017-09, "Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting" ("ASU 2107-09"). ASU 2017-09 provides clarity on when a change to the terms or conditions of a share-based payment award would require an entity to apply modification accounting. ASU 2017-09 is effective on a prospective basis for reporting periods beginning after December 15, 2017, with early adoption permitted. We do not anticipate a material impact to the consolidated financial statements once implemented.

In January 2017, the FASB issued 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 performed after January 1, 2017. The standard is to be applied on a prospective basis. We do not anticipate a material impact to the consolidated financial statements once implemented.

In October 2016, the FASB issued ASU No. 2016-16, "Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other than Inventory" ("ASU 2016-16"). ASU 2016-16 requires entities to recognize income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. ASU 2016-16 is effective for annual periods beginning after December 15, 2017, including interim reporting periods within that reporting period, with early adoption permitted. We are currently evaluating the new standard but do not anticipate a material impact to the consolidated financial statements once implemented.

In August 2016, the FASB issued ASU No. 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments" ("ASU 2016-15"). ASU 2016-15 clarifies how companies should present and classify certain cash receipts and cash payments in the statement of cash flows. ASU 2016-15 is effective for annual periods beginning after December 15, 2017, including interim reporting periods within that reporting period, with early adoption permitted. We have evaluated the new standard and it will not have a material impact to the consolidated financial statements once implemented.

In February 2016, the FASB issued ASU No. 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. ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period, with early adoption permitted. At adoption, this update will be applied using a modified retrospective approach. We are currently evaluating the impact that ASU 2016-02 will have on the consolidated financial statements and related disclosures. We believe the most significant impact relates to our accounting for real estate leases, which will be recorded as right-of-use assets and lease liabilities on our balance sheet upon adoption.

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In May 2014, the FASB issued ASU No. 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 No. 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 No. 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 No. 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. The guidance under each of these standards is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. We plan to adopt the standard using the modified retrospective approach. While we continue to assess all potential impacts of the guidance, our focus has been on vendor arrangements in which we act as either a principal or agent and customer incentive arrangements. Based on our preliminary assessment, we do not anticipate that the adoption of ASU 2014-09 will result in a material adjustment on the date of implementation nor will it have an ongoing material impact on our consolidated financial statements once implemented.

2. FAIR VALUE MEASUREMENTS

As defined in Accounting Standards Codification ("ASC") 820, Fair Value Measurements ("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.

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The table below provides the fair values of our senior secured term loan facility ("Amended Term Loan Credit Facility") and our 5.875% senior subordinated notes maturing in 2020 ("2020 Senior Subordinated Notes). The fair values of our Amended Term Loan Credit Facility and our 2020 Senior Subordinated Notes were determined based on quoted market prices which are considered Level 2 inputs within the fair value hierarchy.

	July 29, 2017	January 28, 2017	July 30, 2016
	(in thousands)		
Term loan credit facility	$ 2,251,025	$ 2,266,304	$ 2,277,082
Senior subordinated notes	522,750	526,575	530,400

3. DEBT

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

	Interest Rate		July 29, 2017	January 28, 2017	July 30, 2016
Term loan credit facility	Variable		$ 2,251,025	$ 2,263,475	$ 2,269,700
Asset-based revolving credit facility	Variable		81,000	—	42,000
Senior subordinated notes	5.875	%	510,000	510,000	510,000

Total debt	2,842,025	2,773,475	2,821,700
Less unamortized discount/premium and debt costs	(17,425)	(19,163)	(19,613)
Total debt, net	2,824,600	2,754,312	2,802,087
Less current portion	(112,125)	(31,125)	(66,900)
Long-term debt	$ 2,712,475	$ 2,723,187	$ 2,735,187

Revolving Credit Facility

As of July 29, 2017 and July 30, 2016, the borrowing base under our senior secured asset-based revolving credit facility was $827.7 million and $696.4 million, respectively, of which Michaels Stores, Inc. (“MSI”) had unused borrowing capacity of $681.4 million and $597.1 million, respectively. As of July 29, 2017 and July 30, 2016, outstanding standby letters of credit, which reduce our borrowing base, totaled $65.3 million and $57.3 million, respectively.

Debt Issuance Costs

Accumulated amortization of debt issuance costs was $66.2 million, $63.7 million and $61.0 million as of July 29, 2017, January 28, 2017 and July 30, 2016, respectively.

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4. ACCUMULATED OTHER COMPREHENSIVE LOSS

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

	13 Weeks Ended		26 Weeks Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Beginning of period	$ (19,496)	$ (7,847)	$ (14,224)	$ (22,056)
Foreign currency translation adjustment and other	13,944	(4,759)	8,672	9,450
End of period	$ (5,552)	$ (12,606)	$ (5,552)	$ (12,606)

5. INCOME TAXES

The effective tax rate was 36.0% in the second quarter of fiscal 2017 compared to 35.5% for the second quarter of fiscal 2016 and 34.5% for the six months ended July 29, 2017 compared to 36.6% for the same period in the prior year. The effective tax rate for both periods of fiscal 2017 include benefits realized associated with our direct sourcing initiatives that began in the second half of fiscal 2016. The sourcing benefits in the second quarter of fiscal 2017 were offset by a $1.4 million charge related to the reduction of certain federal tax credits.

6. 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 6.7 million and 1.4 million anti-dilutive shares during the second quarters of fiscal 2017 and fiscal 2016, respectively. There were 5.9 million and 1.8 million anti-dilutive shares during the six months ended July 29, 2017 and July 30, 2016, respectively.

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

	13 Weeks Ended		26 Weeks Ended	
	July 29, 2017	July 29 2016	July 29, 2017	July 29 2016
Basic earnings per common share:				
Net income	$ 35,562	$ 35,617	$ 107,770	$ 106,382
Less income related to unvested restricted shares	(150)	(234)	(478)	(707)
Income available to common shareholders - Basic	$ 35,412	$ 35,383	$ 107,292	$ 105,675
Weighted-average common shares outstanding - Basic	186,886	205,881	187,927	206,437
Basic earnings per common share	$ 0.19	$ 0.17	$ 0.57	$ 0.51
Diluted earnings per common share:				
Net income	$ 35,562	$ 35,617	$ 107,770	$ 106,382
Less income related to unvested restricted shares	(149)	(232)	(475)	(701)
Income available to common shareholders - Diluted	$ 35,413	$ 35,385	$ 107,295	$ 105,681
Weighted-average common shares outstanding - Basic	186,886	205,881	187,927	206,437
Effect of dilutive stock options and restricted stock units	1,045	1,666	1,244	1,832
Weighted-average common shares outstanding - Diluted	187,931	207,547	189,171	208,269
Diluted earnings per common share	$ 0.19	$ 0.17	$ 0.57	$ 0.51

7. 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 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 are as follows (in thousands):

	13 Weeks Ended		26 Weeks Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
United States	$ 977,779	$ 970,367	$ 2,034,422	$ 2,034,204
Canada	94,814	89,986	196,734	185,029
Total	$ 1,072,593	$ 1,060,353	$ 2,231,156	$ 2,219,233

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8. CONTINGENCIES

Rea Claim

On September 15, 2011, MSI was served with a lawsuit filed in the California Superior Court in and for the County of Orange ("Superior Court") by four former store managers as a class action proceeding on behalf of themselves and certain former and current store managers employed by MSI in California. The lawsuit alleged that MSI improperly classified its store managers as exempt employees and as such failed to pay all wages, overtime and waiting time penalties and failed to provide accurate wage statements. The lawsuit also alleged that the foregoing conduct was in breach of various laws, including California's unfair competition law. On December 3, 2013, the Superior Court entered an order certifying a class of approximately 200 members. MSI successfully removed the case to the U.S. District Court for the Central District of California and on May 8, 2014, the class was decertified. Three of the four named plaintiffs' claims were resolved in September 2014 and the remaining one is set for trial on December 12, 2017. The individual claims of 26 former class members remain pending in the Central District of California. In addition, a separate representative action brought on behalf of store managers throughout the state is pending in the California Superior Court, County of San Diego. We believe we have meritorious defenses and intend to defend the lawsuits vigorously. We do not believe the resolution of the lawsuits will have a material effect on our consolidated financial statements.

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 seek statutory and punitive damages as well as attorneys' fees and costs.

Following the filing of the Graham 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 Company intends to defend the remaining lawsuits vigorously. We cannot reasonably estimate the potential loss, or range of loss, related to the lawsuits, if any.

Data Security Incident

Five putative class actions were filed against MSI relating to the January 2014 data breach. The plaintiffs generally alleged that MSI failed to secure and safeguard customers' private information including credit and debit card information, and as such, breached an implied contract and violated the Illinois Consumer Fraud Act (and other states' similar laws). The plaintiffs were seeking damages including declaratory relief, actual damages, punitive damages, statutory damages,

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attorneys' fees, litigation costs, remedial action, pre and post judgment interest, and other relief as available. The cases were as follows: Christina Moyer v. Michaels Stores, Inc., was filed on January 27, 2014; Michael and Jessica Gouwens v. Michaels Stores, Inc., was filed on January 29, 2014; Nancy Maize and Jessica Gordon v. Michaels Stores, Inc., was filed on February 21, 2014; and Daniel Ripes v. Michaels Stores, Inc., was filed on March 14, 2014. These four cases were filed in the U.S. District Court for the Northern District of Illinois, Eastern Division. On March 18, 2014, an additional putative class action was filed in the U.S. District Court for the Eastern District of New York, Mary Jane Whalen v. Michaels Stores, Inc., but was voluntarily dismissed by the plaintiff on April 11, 2014 without prejudice to her right to re file a complaint. On April 16, 2014, an order was entered consolidating the Illinois actions. On July 14, 2014, the Company's motion to dismiss the consolidated complaint was granted.

On December 2, 2014, Whalen filed a new lawsuit against MSI related to the data breach in the U.S. District Court for the Eastern District of New York, Mary Jane Whalen v. Michaels Stores, Inc., seeking damages including declaratory relief, monetary damages, statutory damages, punitive damages, attorneys' fees and costs, injunctive relief, pre and post judgment interest, and other relief as available. The Company filed a motion to dismiss which was granted on December 28, 2015, and judgment was entered in favor of the Company on January 8, 2016. Plaintiff appealed the judgment to the U.S. Court of Appeals for the Second Circuit and on May 2, 2017, the Second Circuit affirmed the dismissal and Whalen did not appeal further, thereby concluding the matter.

Consumer Product Safety Commission Claim

On April 21, 2015, the U.S. Department of Justice, on behalf of the Consumer Product Safety Commission (the "CPSC"), filed a complaint against MSI and Michaels Stores Procurement Company, Inc. ("MSPC") in the U.S. District Court for the Northern District of Texas. The complaint seeks civil penalties for an alleged failure to timely report a potential product safety hazard to the CPSC related to the breakage of certain glass vases. The complaint also alleges the report contained a material misrepresentation and seeks injunctive relief requiring MSI and MSPC to, among other things, establish internal recordkeeping and compliance monitoring systems. On April 4, 2017, the CPSC filed an amended complaint eliminating their misrepresentation claim. We believe we have meritorious defenses and intend to defend the lawsuit vigorously. We do not believe the resolution of the lawsuit will 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.

For some of the matters disclosed above, as well as other lawsuits involving the Company, we are able to estimate a range of losses in excess of the amounts recorded, if any, in the accompanying consolidated financial statements. As of July 29, 2017, the aggregate estimated loss was approximately $12 million, which includes amounts recorded by the Company.

9. 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 40% of our outstanding common stock as of July 29, 2017.

The Blackstone Group owns a majority equity position in RGIS, a vendor we utilize to count our store inventory. Payments associated with this vendor during the second quarters of fiscal 2017 and fiscal 2016 were $1.7 million. Payments made during the six months ended July 29, 2017 and July 30, 2016 were $3.7 million. These expenses are included in selling, general and administrative ("SG&A") in the consolidated statements of comprehensive income.

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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 the second quarters of fiscal 2017 and fiscal 2016 were $1.5 million and $1.3 million, respectively. Payments made during the six months ended July 29, 2017 and July 30, 2016 were $3.2 million and $2.1 million, respectively. These expenses are included in cost of sales and occupancy expense in the consolidated statements of comprehensive income.

Certain affiliates of The Blackstone Group have significant influence over US Xpress Enterprises, Inc., a vendor we utilize for transportation services. Payments associated with this vendor during the second quarters of fiscal 2017 and fiscal 2016 were $0.2 million. Payments made during the six months ended July 29, 2017 and July 30, 2016 were $0.4 million and $0.5 million, respectively. These expenses are recognized in cost of sales and occupancy expense in the consolidated statements of comprehensive income as the sales are incurred.

Three of our current directors, Joshua Bekenstein, Lewis S. Klessel 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 July 29, 2017, affiliates of The Blackstone Group held $55.1 million of our Amended Term Loan Credit Facility.

10. 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.

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Michaels Stores, Inc.

Condensed Consolidated Balance Sheets

(in thousands)

ASSETS	July 29, 2017	January 28, 2017	July 30, 2016
Current assets:			
Cash and equivalents	$ 133,356	$ 294,054	$ 110,100
Merchandise inventories	1,195,495	1,127,777	1,145,422
Prepaid expenses and other current assets	115,662	116,072	112,336
Total current assets	1,444,513	1,537,903	1,367,858
Property and equipment, net	407,694	413,164	398,688
Goodwill	119,074	119,074	119,074
Other assets	72,679	73,201	77,503
Total assets	$ 2,043,960	$ 2,143,342	$ 1,963,123
LIABILITIES AND STOCKHOLDERS' DEFICIT			
Current liabilities:			
Accounts payable	$ 510,818	$ 517,268	$ 462,099
Accrued liabilities and other	391,047	395,745	353,854
Current portion of long-term debt	112,125	31,125	66,900
Other current liabilities	30,022	123,258	3,087
Total current liabilities	1,044,012	1,067,396	885,940
Long-term debt	2,712,475	2,723,187	2,735,187
Other liabilities	107,853	103,972	103,296
Total stockholders' deficit	(1,820,380)	(1,751,213)	(1,761,300)
Total liabilities and stockholders' deficit	$ 2,043,960	$ 2,143,342	$ 1,963,123

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Michaels Stores, Inc.

Condensed Consolidated Statements of Comprehensive Income

(in thousands)

	13 Weeks Ended		26 Weeks Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Net sales	$ 1,072,593	$ 1,060,353	$ 2,231,156	$ 2,219,233
Cost of sales and occupancy expense	670,082	669,656	1,361,012	1,363,785
Gross profit	402,511	390,697	870,144	855,448
Selling, general and administrative	313,473	302,146	640,938	619,411
Other operating expense	662	908	1,640	2,534
Operating income	88,376	87,643	227,566	233,503
Interest and other expense	32,405	31,849	62,801	64,519
Income before income taxes	55,971	55,794	164,765	168,984
Income taxes	20,162	19,825	56,795	61,917
Net income	$ 35,809	$ 35,969	$ 107,970	$ 107,067
Other comprehensive income, net of tax:				
Foreign currency translation adjustment and other	13,944	(4,759)	8,672	9,450
Comprehensive income	$ 49,753	$ 31,210	$ 116,642	$ 116,517

Michaels Stores, Inc.

Condensed Consolidated Statements of Cash Flows

(in thousands)

	26 Weeks Ended	
	July 29, 2017	July 30, 2016
Cash flows from operating activities:		
Net cash used in operating activities	$ (644)	$ (11,866)
Cash flows from investing activities:		
Additions to property and equipment	(43,120)	(38,395)
Acquisition of Lamrite West, net of cash acquired	—	(151,100)
Net cash used in investing activities	(43,120)	(189,495)
Cash flows from financing activities:		
Net repayments of debt	(70,550)	(12,450)
Net borrowings of debt	139,100	42,000
Payment of dividend to Michaels Funding, Inc.	(185,484)	(126,962)
Other financing activities	—	4,223
Net cash used in financing activities	(116,934)	(93,189)
Net change in cash and equivalents	(160,698)	(294,550)
Cash and equivalents at beginning of period	294,054	404,650
Cash and equivalents at end of period	$ 133,356	$ 110,100

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ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion and analysis should be read in conjunction with the unaudited consolidated financial statements of the Company (and the related notes thereto included elsewhere in this quarterly report), the audited consolidated financial statements of the Company (and the related notes thereto) and the Management’s Discussion and Analysis of Financial Condition and Results of Operations in the Company’s Annual Report on Form 10-K for the fiscal year ended January 28, 2017 (“Annual Report”) filed with the Securities and Exchange Commission (“SEC”) pursuant to Section 13 or 15(d) under the Securities Exchange Act of 1934 on March 7, 2017.

All of the “Company”, “us”, “we”, “our”, and similar expressions are references to The Michaels Companies, Inc. (“Michaels” and our consolidated wholly-owned subsidiaries, unless otherwise expressly stated or the context otherwise requires.

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 2017” relate to the 53 weeks ending February 3, 2018 and references to “fiscal 2016” relate to the 52 weeks ended January 28, 2017. In addition, all references to “the second quarter of fiscal 2017” relate to the 13 weeks ended July 29, 2017 and all references to “the second quarter of fiscal 2016” relate to the 13 weeks ended July 30, 2016. Finally, all references to “the six months ended July 29, 2017” relate to the 26 weeks ended July 29, 2017 and all references to “the six months ended July 30, 2016” relate to the 26 weeks ended July 30, 2016. Because of the seasonal nature of our business, the results of operations for the 13 and 26 weeks ended July 29, 2017 are not indicative of the results to be expected for the entire year.

Overview

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 under the retail brands of Michaels, Aaron Brothers and Pat Catan’s. We also operate an international wholesale business under the Darice brand name and a market-leading vertically-integrated custom framing business under the Artistree brand name. As of July 29, 2017, we operated 1,230 Michaels stores, 101 Aaron Brothers stores and 35 Pat Catan’s stores.

Net sales for the second quarter of fiscal 2017 increased 1.2% compared to the same period in the prior year. The increase in net sales was due to the opening of 10 additional stores (net of closures) since July 30, 2016 and a 0.6% increase in comparable store sales, or 0.8% at constant exchange rates. Gross profit as a percent of net sales increased 70 basis points to 37.5% during the second quarter of fiscal 2017 due to our sourcing initiatives that began in fiscal 2016 and the timing of distribution related costs, partially offset by an increase in inventory shrink. Operating income as a percent of net sales for the second quarter of fiscal 2017 remained flat at 8.2% compared to the same period in the prior year.

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.

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Operating Information

The following table sets forth certain operating data:

	13 Weeks Ended		26 Weeks Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Michaels stores:				
Open at beginning of period	1,225	1,204	1,223	1,196
New stores	5	5	8	16
Relocated stores opened	1	4	8	10
Closed stores	—	—	(1)	(3)
Relocated stores closed	(1)	(4)	(8)	(10)
Open at end of period	1,230	1,209	1,230	1,209
Aaron Brothers stores:				
Open at beginning of period	104	115	109	117
Closed stores	(3)	(3)	(8)	(5)
Open at end of period	101	112	101	112
Pat Catan's stores:				
Open at beginning of period	35	33		