MICHAELS STORES INC
Form 10-Q
September 04, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended August 1, 2009

OR

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

For the transition period from to

Commission file number 001-09338

MICHAELS STORES, INC.

(Exact name of registrant as specified in its charter)

Delaware	**75-1943604**
(State or other jurisdiction of	(I.R.S. employer

incorporation or organization)	identification number)

8000 Bent Branch Drive

Irving, Texas 75063

(Address of principal executive offices, including zip code)

(972) 409-1300

(Registrant s telephone number, including area code)

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.* Yes o No o

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

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

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

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

As of August 31, 2009, 118,942,246 shares of the Registrant s Common Stock were outstanding.

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

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MICHAELS STORES, INC.

FORM 10-Q

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MICHAELS STORES, INC.

Part I FINANCIAL INFORMATION

Item 1. Financial Statements.

MICHAELS STORES, INC.

CONSOLIDATED BALANCE SHEETS

(In millions, except share data)

(Unaudited)

	August 1, 2009	January 31, 2009	August 2, 2008
ASSETS			
Current assets:			
Cash and equivalents	$ 36	$ 33	$ 45
Merchandise inventories	950	900	938
Prepaid expenses and other	75	73	71
Deferred income taxes	41	41	31
Income tax receivable	16	2	42
Total current assets	1,118	1,049	1,127
Property and equipment, at cost	1,228	1,214	1,187
Less accumulated depreciation	(883)	(832)	(777)
	345	382	410
Goodwill	94	94	94
Debt issuance costs, net of accumulated amortization of $47, $39, and $30, respectively	78	86	95
Deferred income taxes	14	12	
Other assets	26	2	2
	212	194	191
Total assets	$ 1,675	$ 1,625	$ 1,728
LIABILITIES AND STOCKHOLDERS DEFICIT			
Current liabilities:			
Accounts payable	$ 216	$ 230	$ 244
Accrued liabilities and other	288	275	304
Current portion of long-term debt	198	173	286
Income taxes payable		2	
Current liabilities - discontinued operations	1	1	2
Total current liabilities	703	681	836
Long-term debt	3,766	3,756	3,748
Deferred income taxes			4
Other long-term liabilities	79	74	78
Long-term liabilities - discontinued operations	1	1	1
Total long-term liabilities	3,846	3,831	3,831

		4,549		4,512		4,667
Commitments and contingencies						
Stockholders deficit:						
Common Stock, $0.10 par value, 220,000,000 shares authorized; 118,387,229 shares issued and outstanding at August 1, 2009; 118,376,402 shares issued and outstanding at January 31, 2009; 118,382,402 shares issued and outstanding at August 2, 2008		12		12		12
Additional paid-in capital		32		27		15
Accumulated deficit		(2,925)		(2,931)		(2,976)
Accumulated other comprehensive income		7		5		10
Total stockholders deficit		(2,874)		(2,887)		(2,939)
Total liabilities and stockholders deficit	$	1,675	$	1,625	$	1,728

See accompanying notes to consolidated financial statements.

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MICHAELS STORES, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In millions)

(Unaudited)

	Quarter Ended		Six Months Ended	
	August 1, 2009	August 2, 2008	August 1, 2009	August 2, 2008
Net sales	$ 807	$ 796	$ 1,659	$ 1,643
Cost of sales and occupancy expense	521	518	1,058	1,039
Gross profit	286	278	601	604
Selling, general, and administrative expense	232	246	478	518
Related party expenses	3	4	7	8
Store pre-opening costs	1	1	2	3
Operating income	50	27	114	75
Interest expense	62	76	125	154
Other (income) and expense, net	(14)		(20)	
Income (loss) before income taxes	2	(49)	9	(79)
Provision (benefit) for income taxes		(19)	3	(29)
Net income (loss)	$ 2	$ (30)	$ 6	$ (50)

See accompanying notes to consolidated financial statements.

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MICHAELS STORES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

(Unaudited)

	Six Months Ended	
	August 1, 2009	**August 2, 2008**
Operating activities:		
Net income (loss)	$ 6	$ (50)
Adjustments:		
Depreciation and amortization	58	63
Share-based compensation	4	4
Deferred financing costs amortization	8	8
Accretion of subordinated discount notes	22	19
Change in fair value of interest rate cap	(15)	
Changes in assets and liabilities:		
Merchandise inventories	(43)	(94)
Prepaid expenses and other	(5)	
Deferred income taxes and other	(8)	2
Accounts payable	7	18
Accrued interest	1	(34)
Accrued liabilities and other	7	6
Income taxes receivable	(17)	(37)
Other long-term liabilities	5	(3)
Net cash provided by (used in) operating activities	30	(98)
Investing activities:		
Additions to property and equipment	(17)	(39)
Net cash used in investing activities	(17)	(39)
Financing activities:		
Borrowings on asset-based revolving credit facility	441	506
Payments on asset-based revolving credit facility	(415)	(341)
Repayments on senior secured term loan facility	(12)	(12)
Repurchase of new Common Stock		(1)
Payments of capital leases		(4)
Change in cash overdraft	(23)	6
Other	(1)	(1)
Net cash (used in) provided by financing activities	(10)	153
Net increase in cash and equivalents	3	16
Cash and equivalents at beginning of period	33	29
Cash and equivalents at end of period	$ 36	$ 45
Supplemental Cash Flow Information:		
Cash paid for interest	$ 93	$ 160
Cash paid for income taxes	$ 19	$ 11

See accompanying notes to consolidated financial statements.

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MICHAELS STORES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Six Months Ended August 1, 2009

(Unaudited)

Note 1. Summary of Significant Accounting Policies

Basis of Presentation

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

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles 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 31, 2009. We have evaluated all subsequent events through the issuance of the financial statements, which occurred on September 4, 2009.

The balance sheet at January 31, 2009 has been derived from the audited financial statements at that date but does not include all of the information and notes required by generally accepted accounting principles for complete financial statements. For further information, refer to the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended January 31, 2009.

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

Because of the seasonal nature of our business, the results of operations for the three and six months ended August 1, 2009 are not indicative of the results to be expected for the entire year.

We report on the basis of a 52 or 53-week fiscal year, which ends on the Saturday closest to January 31. All references herein to fiscal 2009 relate to the 52 weeks ending January 30, 2010, and all references to fiscal 2008 relate to the 52 weeks ended January 31, 2009. In addition, all references herein to the second quarter of fiscal 2009 relate to the 13 weeks ended August 1, 2009 and all references to the second quarter of fiscal 2008 relate to the 13 weeks ended August 2, 2008. Finally, all references to the six months ended August 1, 2009 relate to the 26 weeks ended August 1, 2009, and the six months ended August 2, 2008 relate to the 26 weeks ended August 2, 2008.

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements*, which is intended to increase consistency and comparability in fair value measurements by defining fair value, establishing a framework for measuring fair value and expanding disclosures about fair value measurements. SFAS 157 was originally effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. In November 2007, the FASB placed a one year deferral for the implementation of SFAS 157 for nonfinancial assets and liabilities; however, SFAS 157 is effective for fiscal years beginning after November 15, 2007 for financial assets and liabilities, as well as for any other assets and liabilities that are carried at fair value on a recurring basis in financial statements. On February 3, 2008, we adopted the provisions of SFAS 157 related to financial assets and liabilities and on February 1, 2009, we adopted the provisions related to nonfinancial assets and liabilities that are not required or permitted to be measured at fair value on a recurring basis. These adoptions had no impact on our consolidated financial statements. See Note 6 for further information regarding fair value measurements. Additionally, in April 2009, the FASB issued FASB Staff Position (FSP) No. FAS 107-1 and APB 28-1, *Interim Disclosures About Fair Value of Financial Instruments,* which collectively provide additional guidance and require additional disclosure regarding determining and reporting fair values for certain assets and liabilities. We adopted FSP FAS 107-1 in the second quarter of fiscal 2009 as reflected in Note 3.

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In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* (SFAS 141R). SFAS 141R replaces SFAS No. 141, *Business Combinations*. The statement retains the purchase method of accounting used in business combinations, but replaces SFAS 141 by establishing principles and requirements for the recognition and measurement of assets, liabilities and goodwill, including the requirement that most transaction costs and restructuring costs be expensed. In addition, the statement requires disclosures to enable users to evaluate the nature and financial effects of the business combination. SFAS 141R is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. We will apply the provisions of SFAS 141R to any business combinations occurring on or after February 1, 2009.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133*. SFAS 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative data about the fair value of and gains and losses on derivative contracts, and details of credit-risk-related contingent features in hedged positions. The statement also requires enhanced disclosures regarding how and why entities use derivative instruments, how derivative instruments and related hedged items are accounted for in accordance with SFAS 133 and its related interpretation, and how derivative instruments and related hedged items affect entity s financial position, financial performance, and cash flows. SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008. We adopted the new disclosure requirements of SFAS 161 in the first quarter of 2009 as reflected in Note 5.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events*. SFAS 165 is intended to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued or available to be issued. This standard sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. SFAS 165 is effective for fiscal years and interim periods ending after June 15, 2009. We adopted SFAS 165 during the second quarter of fiscal 2009, but the impact of the adoption will depend on the nature and the extent of transactions that occur subsequent to our interim and annual reporting periods.

In June 2009, the FASB issued SFAS No. 168, *FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162.* SFAS 168 establishes the FASB Accounting Standards Codification (the Codification) as the source of authoritative accounting principles recognized by the FASB to be applied by non-governmental entities in the preparation of financial statements in conformity with generally accepted accounting principles. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative guidance for SEC registrants. All guidance contained in the Codification carries an equal level of authority. The U.S. GAAP hierarchy will be modified to include two levels of GAAP: authoritative and nonauthoritative. SFAS 168 is effective for financial statements issued for interim and annual periods ended after September 15, 2009. The adoption of SFAS 168 is not expected to have a material impact on our consolidated financial statements.

Note 2. Share-Based Compensation

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

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

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

The fair value for options granted under SFAS No. 123(R) was estimated at the date of grant using the Black-Scholes-Merton option valuation model. Prior year assumptions are not reflected due to all options being cancelled as part of the Exchange Offer and new options granted. The following assumptions were used to estimate the fair value of options granted during the quarter ended August 1, 2009:

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Assumptions (1)		
Risk-free interest rates (2)		2.4% - 3.3%
Expected dividend yield		0.0%
Expected volatility rates of our Common Stock (3)		44.3% - 45.9%
Expected life of options (in years) (4)		5.5 - 8.0
Weighted average fair value of options granted	$	0.93

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(1) Forfeitures were estimated based on historical experience and anticipated events.

(2) Based on constant maturity interest rates for U.S. Treasury instruments with terms consistent with the expected lives of the awards.

(3) We considered both the historical volatility as well as implied volatilities from the exchange-traded options on the common stock from a peer group of companies.

(4) Expected lives were based on an analysis of historical exercise and post-vesting employment termination behavior.

As of August 1, 2009, there were 632,511 shares of restricted stock outstanding, 10.4 million share-based awards outstanding and up to 3.2 million shares of Common Stock remaining available for grant under the 2006 Plan. The table below sets forth a summary of stock option activity and other summary data for the six months ended August 1, 2009.

	Number of Shares (in millions)		Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)
Outstanding at January 31, 2009	10.1	$	26.25	
Grants (1)	10.8		15.50	
Canceled/Forfeited (1)	(10.5)		26.25	
Outstanding at August 1, 2009	10.4	$	15.03	7.5
Vested and Exercisable at August 1, 2009	1.8	$	18.75	6.0

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(1) The number of options granted and canceled/forfeited includes options granted and canceled in connection with the Exchange Offer.

As of August 1, 2009, the total fair value of vested options, subsequent to the Exchange Offer, was $1.4 million. As of August 1, 2009, there were 8.5 million nonvested options with a weighted average fair value of $0.96 per share.

Share-based compensation expense was $2.1 million and $0.9 million for the second quarter of fiscal 2009 and 2008, respectively, and $4.2 million and $3.8 million for the six months ended August 1, 2009 and August 2, 2008, respectively. As a result of the Exchange Offer, share-based compensation expense for fiscal 2009 is expected to decline by $0.5 million, of which $0.1 million was recognized during the 2nd quarter. Share-based compensation expense is expected to increase by $3.5 million over the life of the options granted from the Exchange Offer.

As of August 1, 2009, compensation cost not yet recognized related to nonvested awards totaled $23.4 million and is expected to be recognized over a weighted average period of 4.9 years. To the extent the actual forfeiture rate is different from what we have anticipated, share-based compensation related to these awards will be different from our expectations.

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Note 3. Debt

Our outstanding debt is detailed in the table below. We were in compliance with the terms and conditions of all debt agreements for all periods presented.

	August 1, 2009	January 31, 2009 (in millions)	August 2, 2008	Interest Rate
Senior notes	$ 750	$ 750	$ 750	10.000%
Senior subordinated notes	400	400	400	11.375%
Subordinated discount notes	354	332	312	13.000%
Senior secured term loan	2,285	2,297	2,309	Variable
Asset-based revolving credit facility	174	148	262	Variable
Other	1	2	1	Variable
Total debt	3,964	3,929	4,034	
Less current portion	198	173	286	
Long-term debt	$ 3,766	$ 3,756	$ 3,748	

Asset-based revolving credit facility

Our senior secured asset-based revolving credit facility, which we entered into on October 31, 2006, with Banc of America, N.A. and other lenders (the Asset-based revolving credit facility) provides senior secured financing of up to $1.0 billion, subject to a borrowing base as described in our Annual Report on Form 10-K. As of August 1, 2009, the borrowing base was $749 million, of which we had unused standby letters of credit of $49 million and $526 million of unused availability.

Senior secured term loan facility

Borrowings under our senior secured term loan facility, which we entered into on October 31, 2006, with Deutsche Bank A.G. New York Branch, and other lenders, (the Senior secured term loan facility) bear interest at a rate per annum equal to, at our option, either (a) a base rate determined by reference to the higher of (1) the prime rate of Deutsche Bank and (2) the federal funds effective rate plus ½ of 1% or (b) a LIBOR rate, subject to certain adjustments, in each case plus an applicable margin. The applicable margin is subject to downward adjustment based on the ratings threshold set forth in the Senior secured term loan facility agreement. At August 1, 2009, the margin was 1.25% with respect to base rate borrowings and 2.25% with respect to LIBOR borrowings.

The table below provides the carrying and fair values of our Senior and Subordinated term loan and notes. The fair value of these debt instruments was determined based on quoted market prices.

	Carrying Value	Fair Value
	(in millions)	
Senior Secured Term Loan	$ 2,285	$ 1,868
Senior Notes	750	698
Senior Subordinated Notes	400	316
Subordinated Discount Notes	354	142

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Note 4. Comprehensive (Loss) Income

Our comprehensive (loss) income, net of related tax, is as follows:

	Quarter Ended		Six Months Ended	
	August 1, 2009	August 2, 2008	August 1, 2009	August 2, 2008
	(in millions)			
Net income (loss)	$ 2	$ (30)	$ 6	$ (50)
Other comprehensive income (loss):				
Derivative gain	1	2	3	2
Foreign currency translation adjustment and other	(4)	(1)	(5)	(2)
Comprehensive (loss) income	$ (1)	$ (29)	$ 4	$ (50)

Note 5. Derivative Instruments

We are exposed to fluctuations in interest rates on our Senior secured term loan. During the first quarter of fiscal 2009, we purchased an interest rate cap to mitigate the effects of interest rate fluctuations. The objective of the cap is to hedge the variability of cash flows associated with our interest payments on our Senior secured term loan that result from fluctuations in the three-month LIBOR rate and does not qualify for hedge accounting under SFAS 133. The cap limits our interest exposure on a notional value of $2.0 billion to the lesser of the three-month LIBOR rate or 7.0%. The term of the cap extends to the first quarter of fiscal 2015. The fair value of the cap as of August 1, 2009 was $24 million and is included in Other assets on the Consolidated Balance Sheet. The change in fair value of the cap for the quarter and six months ended August 1, 2009, was $11 million and $15 million, respectively, and is recorded in Other (income) and expense, net in the Consolidated Statement of Operations.

Note 6. Fair Value Measurements

As defined in SFAS No. 157, 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. SFAS No. 157 establishes a three-level valuation hierarchy for fair value measurements. These valuation techniques are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our market assumptions. These two types of inputs create the following fair value hierarchy:

- Level 1 Quoted prices for *identical* instruments in active markets;
- Level 2 Quoted prices for *similar* instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose significant inputs are observable; and
- Level 3 Instruments whose significant inputs are *unobservable.*

The following table presents net financial assets (liabilities) accounted for at fair value on a recurring basis as of August 1, 2009 (in millions):

	Level 1	Level 2	Level 3	Total
Cash equivalents	$ 4	$	$	$ 4
Interest Rate Cap		24		24

Cash equivalents consist of highly liquid investments, with a maturity of 90 days or less at the date of purchase, including U.S. Treasury bills, various government obligations, and money market funds. We carry cash equivalents at cost, which approximates fair value.

Derivatives in Level 2 are measured based on a variety of pricing factors, which include the market price of the derivative instrument available in the dealer-market, which have been corroborated with market data. See Note 5 for additional information on our derivative instruments.

We generally apply fair value techniques on a non-recurring basis for the establishment of potential impairment loss related to goodwill pursuant to SFAS 142 and determining the fair value of long-lived assets pursuant to SFAS 144.

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Note 7. Commitments and Contingencies

We are involved in ongoing legal and regulatory proceedings. There were no material changes to our disclosures of commitments and contingencies from our Annual Report on Form 10-K for the fiscal year ended January 31, 2009 and our Quarterly Report on Form 10-Q for the quarterly period ended May 2, 2009.

Note 8. Segments

We consider our Michaels and Aaron Brothers operations to be our operating segments for purposes of determining reportable segments based on the criteria of SFAS No. 131, *Disclosures About Segments of an Enterprise and Related Information*. We determined that our Michaels and Aaron Brothers operating segments have similar economic characteristics and meet the aggregation criteria set forth in paragraph 17 of SFAS No. 131. Therefore, we combine both operating segments into one reporting segment.

Our chief operating decision makers evaluate historical operating performance, plan and forecast future periods operating performance based on earnings before interest, income taxes, depreciation and amortization (EBITDA). In addition, an element of base incentive compensation targets for certain management personnel are based on EBITDA. A reconciliation of EBITDA to income (loss) before income taxes is presented below.

	Quarter Ended		Six Months Ended	
	August 1, 2009	August 2, 2008	August 1, 2009	August 2, 2008
	(in millions)			
Income (loss) before income taxes	$ 2	$ (49)	$ 9	$ (79)
Interest expense	62	76	125	154
Depreciation and amortization	28	32	58	63
EBITDA	$ 92	$ 59	$ 192	$ 138

Our sales and assets by country are as follows:

	Net Sales	Total Assets
	(in millions)	
Quarter ended August 1, 2009:		
United States	$ 744	$ 1,578
Canada	63	97
Consolidated Total	$ 807	$ 1,675
Quarter ended August 2, 2008:		
United States	$ 731	$ 1,616
Canada	65	112
Consolidated Total	$ 796	$ 1,728
Six Months ended August 1, 2009:		

United States	$	1,536	$	1,578
Canada		123		97
Consolidated Total	$	1,659	$	1,675
Six Months ended August 2, 2008:				
United States	$	1,509	$	1,616
Canada		134		112
Consolidated Total	$	1,643	$	1,728

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

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Note 9. Related Party Transactions

As previously disclosed, on October 31, 2006, substantially all of the Common Stock of Michaels Stores, Inc. was acquired through a merger transaction (the Merger) by affiliates of Bain Capital Partners, LLC and The Blackstone Group. We pay annual management fees to Bain Capital Partners, LLC and The Blackstone Group (collectively, together with their applicable affiliates, the Sponsors) and Highfields Capital Management LP in the amount of $12 million and $1 million, respectively. We recognized $3 million of expense related to annual management fees during the second quarter of fiscal 2009 and fiscal 2008, and $7 million during the six months ended August 1, 2009 and August 2, 2008. These expenses are included in related party expenses on the Consolidated Statements of Operations.

Bain Capital owns a majority ownership stake in an external vendor we utilize to print our circular advertisements. Payments associated with this vendor during the second quarter of each of fiscal 2009 and fiscal 2008 were $6 million, and $14 million and $16 million for the six months ended August 1, 2009 and August 2, 2008, respectively. These expenses are included in selling, general and administrative expense on the Consolidated Statements of Operations.

Bain Capital owns a majority ownership stake in an external vendor we utilize for non-merchandise supplies. Payments associated with this vendor during the second quarter of fiscal 2008 were $1 million. Payments for the six months ended August 1, 2009 and August 2, 2008 were $1 million and $2 million, respectively. These expenses are included in selling, general and administrative expense on the Consolidated Statements of Operations.

The Blackstone Group owns a majority ownership stake in an external vendor we utilize to count our store inventory. Payments associated with this vendor during the second quarter of fiscal 2009 and 2008 were $2 million and $1 million, respectively. Payments for the six months ended August 1, 2009 and August 2, 2008 were $4 million and $3 million, respectively. These expenses are included in selling, general and administrative expense on the Consolidated Statements of Operations.

During fiscal 2008, we began utilizing an external vendor for waste management services that is partially owned by The Blackstone Group. Payments associated with this vendor during the second quarter of fiscal 2009 and fiscal 2008 were $2 million and $1 million, respectively, and $4 million and $1 million for the six months ended August 1, 2009 and August 2, 2008, respectively. These expenses are included in selling, general and administrative expense on the Consolidated Statements of Operations.

During the first quarter of fiscal 2008, The Blackstone Group acquired an ownership stake in an external vendor we utilize for all of the candy-type items in our stores. Payments associated with this vendor during the second quarter of fiscal 2009 and fiscal 2008 were $6 million and $4 million, respectively, and $9 million and $8 million for the six months ended August 1, 2009 and August 2, 2008, respectively. These expenses are recognized in cost of sales as the sales are incurred.

The Blackstone Group owns a partial ownership stake in an external vendor we utilize for newspaper advertisements. Payments associated with this vendor were $1 million during each of the six months ended August 1, 2009 and August 2, 2008. These expenses are included in selling, general and administrative expense on the Consolidated Statements of Operations.

Our current directors are affiliates of Bain Capital or The Blackstone Group. As such, some or all of our directors may have an indirect material interest in payments with respect to debt securities of the Company that have been purchased by affiliates of Bain Capital and The Blackstone Group. Such affiliates beneficially own approximately $239 million face amount of our Subordinated Discount Notes due 2016.

The Company periodically provides officers of Michaels Stores, Inc. and its subsidiaries the opportunity to purchase shares of our Common Stock. There were no shares sold to officers during first six months of each of fiscal 2009 and fiscal 2008. Also, during the second quarter of fiscal 2008 and the six months ended August 2, 2008, we repurchased 100,000 and 105,334 shares, respectively, from officers who are no longer with the Company. There have been no shares repurchased during the first six months of fiscal 2009.

In connection with the consummation of the Merger, the Company entered into a Separation Agreement with each of Charles Wyly and Sam Wyly, executive officers and directors of the Company prior to the Merger. Under the Separation Agreements, each of Charles Wyly and Sam Wyly received a lump sum payment of $3.0 million in exchange for his agreement to adhere to certain non-competition, non-solicitation and confidentiality restrictions. We amortized these Separation Agreements over the two year period ended October 31, 2008. These expenses are included in related party expenses on the Consolidated Statements of Operations.

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Note 10. Condensed Consolidating Financial Information

All obligations of Michaels Stores, Inc. under the Senior notes, Senior subordinated notes, Subordinated discount notes, Senior secured term loan, and Asset-based revolving credit facility are guaranteed by each of our subsidiaries other than Aaron Brothers Card Services, LLC and Canada Artistree, Inc. As of August 1, 2009, the financial statements of Aaron Brothers Card Services, LLC and Canada Artistree, Inc. were immaterial.

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

Supplemental Condensed Consolidating Balance Sheet

	August 1, 2009			
	Parent Company	Guarantor Subsidiaries	Eliminations	Consolidated
	(in millions)			
ASSETS				
Current assets:				
Cash and equivalents	$ 29	$ 7	$	$ 36
Merchandise inventories	633	317		950
Intercompany receivables		515	(515)	
Other	81	51		132
Total current assets	743	890	(515)	1,118
Property and equipment, net	257	88		345
Goodwill, net	94			94
Investment in subsidiaries	655		(655)	
Other assets	96	22		118
Total assets	$ 1,845	$ 1,000	$ (1,170)	$ 1,675
LIABILITIES AND STOCKHOLDERS (DEFICIT) EQUITY				
Current liabilities:				
Accounts payable	$ 13	$ 203	$	$ 216
Accrued liabilities and other	207	81		288
Current portion of long-term debt	198			198
Intercompany payable	515		(515)	
Other	(34)	35		1
Total current liabilities	899	319	(515)	703
Long-term debt	3,766			3,766
Other long-term liabilities	54	26		80
Total stockholders (deficit) equity	(2,874)	655	(655)	(2,874)
Total liabilities and stockholders (deficit) equity	$ 1,845	$ 1,000	$ (1,170)	$ 1,675

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Supplemental Condensed Consolidating Balance Sheet

	January 31, 2009			
	Parent Company	Guarantor Subsidiaries	Eliminations	Consolidated
	(in millions)			
ASSETS				
Current assets:				
Cash and equivalents	$ 26	$ 7	$	$ 33
Merchandise inventories	627	273		900
Intercompany receivables		387	(387)	
Other	62	54		116
Total current assets	715	721	(387)	1,049
Property and equipment, net	284	98		382
Goodwill, net	94			94
Investment in subsidiaries	488		(488)	
Other assets	80	20		100
Total assets	$ 1,661	$ 839	$ (875)	$ 1,625
LIABILITIES AND STOCKHOLDERS (DEFICIT) EQUITY				
Current liabilities:				
Accounts payable	$ 15	$ 215	$	$ 230
Accrued liabilities and other	200	75		275
Current portion of long-term debt	173			173
Intercompany payable	387		(387)	
Other	(32)	35		3
Total current liabilities	743	325	(387)	681
Long-term debt	3,756			3,756
Other long-term liabilities	49	26		75
Total stockholders (deficit) equity	(2,887)	488	(488)	(2,887)
Total liabilities and stockholders (deficit) equity	$ 1,661	$ 839	$ (875)	$ 1,625

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Supplemental Condensed Consolidating Balance Sheet

	August 2, 2008			
	Parent Company	Guarantor Subsidiaries	Eliminations	Consolidated
	(in millions)			
ASSETS				
Current assets:				
Cash and equivalents	$ 32	$ 13	$	$ 45
Merchandise inventories	665	273		938
Intercompany receivables		374	(374)	
Other	95	49		144
Total current assets	792	709	(374)	1,127
Property and equipment, net	294	116		410
Goodwill, net	94			94
Investment in subsidiaries	474		(474)	
Other assets	82	15		97
Total assets	$ 1,736	$ 840	$ (848)	$ 1,728
LIABILITIES AND STOCKHOLDERS (DEFICIT) EQUITY				
Current liabilities:				
Accounts payable	$ 18	$ 226	$	$ 244