

MICHAELS  
ANNUAL  
REPORT  
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In the arts and crafts marketplace there is really one market leader — Michaels Stores.

Last year our performance — sales up more than 13 percent to \$411 million and earnings growing more than 80 percent to a new high of \$10.7 million — earned Michaels recognition as *the* Arts and Crafts store. We've done it with an extraordinary assortment of home decoration and arts and crafts items — picture framing materials, silk and dried flowers, hobby and art supplies, creative crafts, and party, seasonal and holiday merchandise for every special day of the year . . . including a few we create ourselves.

At the end of fiscal 1991 there were 140 Michaels stores in 19 states, generally about 17,000 square feet in size, and stocking more than 30,000 items, extending from California to the Carolinas.

Michaels' customers are both numerous and intensely loyal. We get their interest with great merchandise and great prices. We keep them with tremendous service. We cater to their creative impulses and to the country's changing demographics and lifestyle.

In 1991, Michaels built on a talented young management team, adding more industry experience, greater diversity of skills and depth in all key positions.

This Annual Report is about that exceptional year, 1991, and it's about the people who work and shop at Michaels Stores, who made the year what it was . . . and Michaels what it is.

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Annual  
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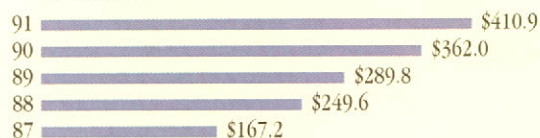
**FINANCIAL HIGHLIGHTS***(In thousands except per share and store data)**Michaels Stores, Inc.*

	1991	1990 <sup>(1)</sup>	Fiscal year 1989	1988	1987
<b>Results of Operations:</b>					
Net sales	\$410,899	\$362,028	\$289,754	\$249,632	\$167,186
Operating income	25,643	20,694	14,900	17,372	12,368
Income before extraordinary item	10,739	5,855	13	5,190	4,897
Earnings per share	.87	.57	.00	.50	.50
<b>Stores Open at End of Period</b>	<b>140</b>	<b>137</b>	<b>122</b>	<b>106</b>	<b>97</b>
<b>Balance Sheet Data<sup>(2)</sup>:</b>					
Current assets	\$125,873	\$ 84,572	\$ 92,133	\$ 79,290	\$ 56,887
Total assets	180,913	144,238	150,817	134,921	102,915
Working capital	74,786	44,080	58,680	58,041	35,436
Long-term debt	—	52,983	73,168	71,070	45,638
Total liabilities	54,614	97,623	110,440	95,644	69,493
Shareholders' equity	126,299	46,615	40,377	39,277	33,422

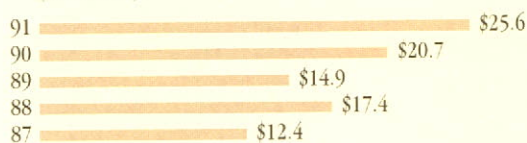
*(1) Fiscal 1990 was a 53-week fiscal year.**(2) Prior years have been restated to conform to the 1991 presentation.*



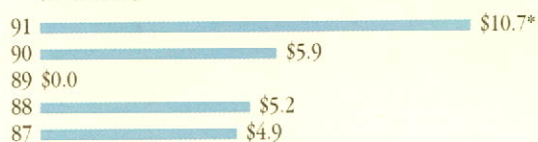
**NET SALES**  
(in millions)



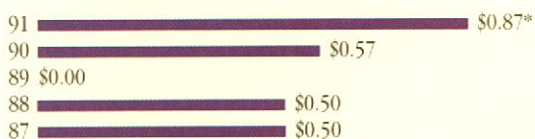
**OPERATING INCOME**  
(in millions)



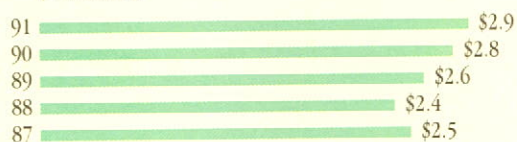
**NET INCOME**  
(in millions)



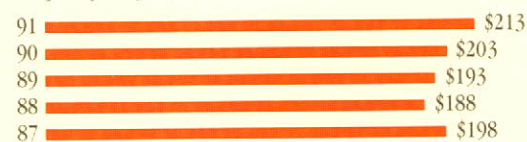
**EARNINGS PER SHARE**



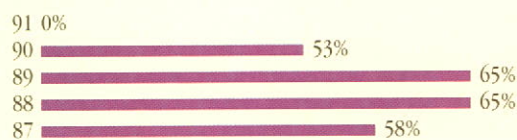
**AVERAGE SALES PER FULL YEAR STORE**  
(in millions)



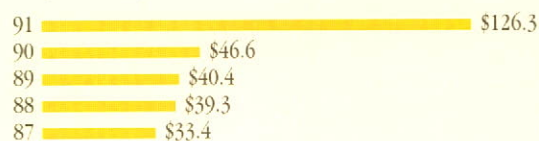
**AVERAGE FULL YEAR SALES**  
(per square foot)



**RATIO OF DEBT TO TOTAL CAPITAL**



**TOTAL EQUITY**  
(in millions)



\*Before extraordinary item



## FELLOW SHAREHOLDERS:

**F**or America's retailers 1991 was the most dismal of years; war in the Gulf and the recession combined to keep confidence down and shoppers out of stores.

For Michaels Stores, it was a year to remember.

Our earnings, before an extraordinary item, soared more than 80 percent above the 1990 record to a new high of \$10.7 million, or \$0.87 per share. While retail sales for others were sliding, Michaels posted 13 percent growth in its sales, to \$411 million, with same store sales increasing over 9 percent.

We began the year determined to build sales at our existing stores and to get more from the current business before continuing our expansion program. We did just that — Michaels grew progressively stronger as the year went on.

During the third quarter, comparable stores were averaging better than 17 percent gains. In the Fall/Christmas selling season — specifically Labor Day through December — the company posted same store sales nearly 16 percent above 1990's.

During the final quarter, fourth period profits surged nearly 60 percent to \$7.6 million, on sales that increased 15 percent to \$144 million.

Another major objective as we entered fiscal 1991 was strengthening the balance sheet: reducing bank debt and raising shareholders' equity. By year-end, Michaels was debt free.

Through a secondary offering of 3,450,000 shares in January 1992, the company raised over \$61 million in new equity.

Shareholders' equity nearly tripled to \$126 million. By year's end, having eliminated all of our bank debt, redeemed \$42 million in senior subordinated notes, and put over \$27 million in the bank, we became a rarity among companies in our industry — financially powerful.

Sam Wylly





Jack Bush

Michaels has become the number one specialty retailer in the large and rapidly growing arts and crafts market.

We've significantly strengthened our merchandising groups. We are working on new merchandise ideas directly with vendors, not just so we can buy more effectively, but so we can establish real partnerships with selected suppliers. We're getting better training, better recruitment and better systems in the stores. We've focused our corporate and warehouse functions on their support for the stores, and we've focused our stores on their service to customers.



Our stores have become more consistent and more competitive. Our emphasis on serving customers is apparent in stores that are tastefully merchandised and in stock, and associates who are friendly and knowledgeable. Every day of every week, our stores set out to inform and delight customers with product demonstrations and creative classes.

Having described Michaels' results for 1991, let's focus on our priorities for 1992.

Our highest priority is the customer. We intend to give the most intensive customer service in our retail niche. That means all 5,000 of our associates working on this every day.

Marketing at Michaels involves everyone. We've won the loyalty of customers with quality products, competitive prices and knowledgeable, attentive service. This year we'll launch exciting new marketing programs to reward that loyalty.

Technology is being carefully phased into our operations. We've long benefitted from sophisticated merchandise tracking and tight financial control systems. Today, all of our stores use point-of-sale equipment and a growing number are adding scanners.

We're also expanding our product mix. Michaels is one of the nation's biggest framers of pictures and sellers of silk flowers. Both categories are growing rapidly. But we're also increas-





Charles Wyly

ing our mix of merchandise with new products directed at a growing universe of shoppers. From tee-shirts to tennis shoes — our customers personalize them with paints, beads and other embellishments. Wearable art will represent a more than \$20 million business for Michaels in 1992.

Equipped with the strongest financial condition in our history, a superb management team and appealing market conditions, we are aggressively adding stores again in 1992. Current plans call for over 20 new stores this year and 40 or more in 1993. We've started early by buying the rights to the Seattle market and two successful stores from our only franchisee.

We are proud of what we've accomplished this past year, turning what was the worst of times for our industry into the best of times for Michaels' customers, associates, vendors and owners.

Respectfully,

*Sam Wyly*

Sam Wyly

*Chairman & Chief Executive Officer*

*Jack E. Bush*

Jack E. Bush

*President & Chief Operating Officer*

March 10, 1992







## WHAT WE DO ... WHO WE ARE

On the next several pages, we provide a look at stores in distinctly different parts of the country — California, Georgia, Illinois and Texas. We've also sought to convey a sense of who we are, what we do and how we feel — all expressed from the very personal perspectives of the people who know us best, Michaels' own employees.

Whether or not they appear in it, every one of Michaels' people deserves our thanks for making this year's report possible. For taking the extra time from their busy schedules to offer their comments, special appreciation is due from our store managers Sandy Foster in Houston, Bob Dinardi in Tucson, John Boudro from the Overland Park store, Ron Mapp in Charlotte, Ken Royster in Little Rock, and most of the team from Tucker, Georgia led by manager Paul Schenkman.

Admittedly, they're only a few of the people responsible for Michaels' success. But, somehow, we have a feeling they speak for us all.









## MANAGERS' COMMENTS

**I**'ve seen plenty of changes in 11 years with Michaels . . . we've grown from five stores to 140 and done it very successfully. How? Most importantly, by concentrating on our customers. We listen to what they want, and we respond."

**W**hen a customer walks into a store, we not only want to sell her the products she needs, we want to sell her on Michaels. I make a point of listening to all my employees' suggestions and ideas . . . we work together to build on them. We hold weekly meetings and walk the departments every day, constantly talking about what we need to do to make ourselves better."

**A**nother thing we do well is planning for future events in our community — the special occasions and the new seasons. We look ahead. And, our customers know they can count on someone being here who can show them the new products and make useful suggestions about new trends."









## MANAGERS' COMMENTS

"**M**ichaels mystery shopper visited our store in late November and judged us on several categories. First, The 10 Foot Rule — if anybody comes within 10 feet of you, you say "Hello" and offer to help them. On courtesy, we were tops ... likewise in neatness, merchandise knowledge and customer assistance."

"**I**991 was a great year for our store ... there were so many new and exciting things happening. Like our Moonlight Madness and the Customer Appreciation Day sales. At the Halloween event, we all wore costumes, served punch and cookies and really enjoyed ourselves. Customers felt more like they were at a party than shopping in a store."

"**D**isplays and demonstrations are a very important part of our business. We have got several very talented people doing them, and they derive a great deal of satisfaction from their creative efforts. More to the point, they also win our customers' approval, and that reflects favorably on the entire company's image."









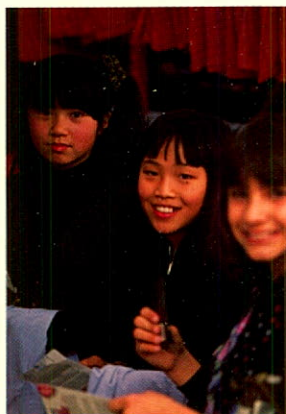
## MANAGERS' COMMENTS

“**G**reat idea by an employee: we made the felt Fun Craft mouse out of art foam and stuck a lollipop tail on him. He looked great. The customers loved him . . . and we sold 500 sheets of art foam.”

“**K**ids birthday parties at Michaels are becoming a popular thing. We're using original fun crafts to make the parties a crafting success . . . in addition to the ever popular shirt painting.”

“**T**hank goodness for School Days. We act as a craft consultant and provide materials to 25 local schools. They drop off their lists, and we pull the merchandise.”

“**T**hanksgiving week-end, customers were lined up at all the registers waiting to spend their Turkey Bucks while munching donuts and drinking coffee. It was good to hear customers, as they'd leave the store, saying it was nice to meet you . . . see you again.”









## MANAGERS' COMMENTS

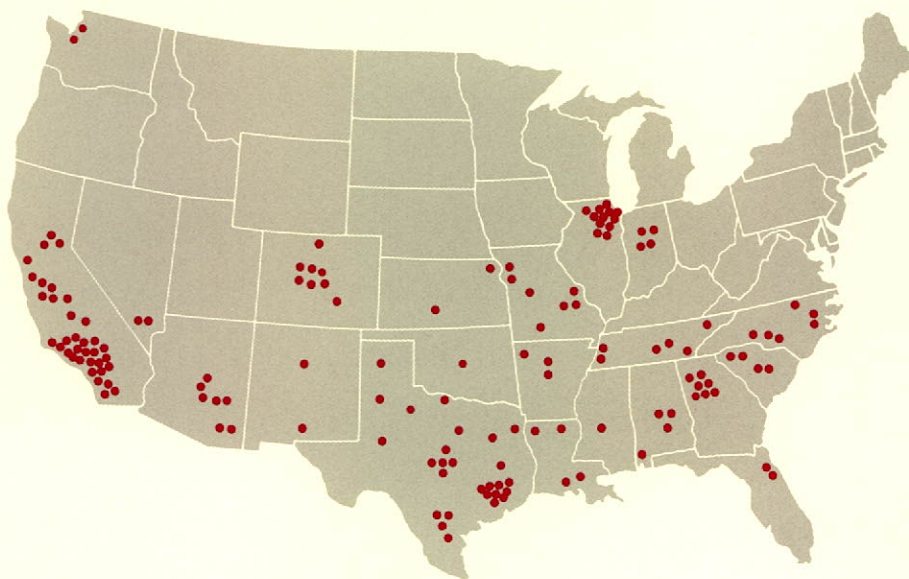
“**H**ow do you fill a 15,000 square foot Michaels store with customers? We did it with promotional flyers, Moonlight Madness sales, balloons, clowns, classes and, mostly, terrific customer service. It was like we'd opened the floodgates.”

“**E**very morning I walk my store from the front sidewalk to the back door, aisle by aisle, top to bottom. That's when I set the goals for the day. Then we review them, break them down by department and go over our notes ... so that everyone clearly understands what's expected. But the most valuable part is hearing my associates' ideas. They're the ones who make us successful. They know what's hot, and they take great pride in everything we do. You have to build a team that really enjoys working together ... that's the important thing.”





# MICHAELS STORES AS OF MAY 1, 1992



ALABAMA  
Birmingham  
Hoover  
Mobile  
Montgomery

ARIZONA  
Phoenix (2)  
Chandler  
Scottsdale  
Tucson (2)  
Tempe

ARKANSAS  
Ft. Smith  
Little Rock (2)

CALIFORNIA  
Alameda  
Bakersfield  
Cerritos  
City of Industry  
Covina  
Cupertino  
Escondido  
Fresno  
Fullerton  
Garden Grove  
Huntington Beach  
La Mirada  
La Verne

Lancaster  
Los Angeles (2)  
Milpitas  
Moreno Valley  
Newark  
Oceanside  
Orange  
Poway  
Rancho Cordova  
Rancho Cucamonga  
Riverside  
Rosemead  
Roseville  
Sacramento  
San Diego  
San Jose (2)  
Santa Monica  
Simi Valley  
Tarzana  
Torrance

COLORADO  
Arvada  
Aurora  
Boulder  
Colorado Springs  
Denver (2)  
Ft. Collins  
Littleton

FLORIDA  
Jacksonville (2)

GEORGIA  
Douglasville  
Duluth  
Dunwoody  
Marietta  
Stone Mountain  
Kennesaw  
Tucker

ILLINOIS  
Downers Grove  
Elgin  
Glendale Heights  
Hoffman Estates  
Joliet  
Orland Park  
Matteson  
Mt. Prospect  
Niles  
Palatine  
Rockford  
Vernon Hills

INDIANA  
Indianapolis (4)

KANSAS  
Overland Park  
Wichita

LOUISIANA  
Baton Rouge  
Lafayette  
Monroe  
Shreveport

MISSISSIPPI  
Jackson

MISSOURI  
Columbia  
Des Peres  
Kansas City (2)  
Springfield  
St. Charles  
St. Louis

NEVADA  
Las Vegas (2)

NEW MEXICO  
Albuquerque  
Las Cruces

NORTH CAROLINA  
Charlotte (2)  
Gastonia  
Greensboro  
Raleigh (2)

OKLAHOMA  
Oklahoma City

SOUTH CAROLINA  
Columbia (2)  
Greenville  
Spartanburg

TENNESSEE  
Antioch  
Bartlett  
Chattanooga  
Germantown  
Knoxville  
Madison

TEXAS  
Abilene  
Amarillo  
Austin (4)  
Conroe  
Corpus Christi  
Grapevine  
Houston (4)  
Humble  
Longview  
Lubbock  
Odessa  
San Antonio (3)  
Stafford  
Sugar Land  
Temple  
Tomball  
Tyler  
Webster  
Wichita Falls

WASHINGTON  
Federal Way  
Tukwila



## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### RESULTS OF OPERATIONS

The following table shows the percentage of net sales that each item in the Statements of Income represents. This table should be read in conjunction with the following discussion and with the Company's Financial Statements, including the notes.

	<i>Fiscal year</i>		
	1991	1990	1989
Net sales	100.0%	100.0%	100.0%
Cost of sales and occupancy expense	66.8	68.1	67.6
Selling, general and administrative expense	27.0	26.2	27.3
Operating income	6.2	5.7	5.1
Interest expense	1.7	2.7	3.4
Other expense, net	0.2	0.3	1.5
Income before income taxes and extraordinary item	4.3	2.7	0.2
Provision for income taxes	1.7	1.1	0.2
Income before extraordinary item	2.6	1.6	0.0
Extraordinary item	0.9	0.0	0.0
Net income	1.7%	1.6%	0.0%

In the discussion below, all percentages given for expense items are calculated as a percentage of sales for the applicable year.

#### FOR FISCAL 1991 COMPARED TO FISCAL 1990

Net sales in fiscal 1991 (the 52-week period ended February 2, 1992, or "1991") increased \$48.9 million, or 13.5%, over fiscal 1990 (the 53-week period ended February 3, 1991, or "1990"). (In accordance with its fiscal reporting procedures, the Company reported sales for 53 weeks in 1990, with the additional week included in the fourth quarter.) The results for 1991 included sales of four new stores opened during 1991 and 17 new stores opened during 1990. During 1991, sales of these 21 newer stores accounted for \$26.9 million of the increase. Comparable store sales increased 9.1% in 1991 from the similar 52-week

period in 1990. The Company attributes the increase in comparable store sales to increased advertising, increased customer traffic and increased sales of Halloween, Fall and Christmas seasonal merchandise. In fiscal 1992 and beyond, the aggregate sales increase for new stores will depend in part on the rate of development of new stores and the Company's ability to hire and train qualified managers.

Cost of sales and occupancy expense for 1991 decreased by 1.3% compared to 1990 due primarily to efforts initiated late in 1990 to improve gross margin through adjustments to the Company's merchandising and pricing strategies, partially offset by the use of vendor financing in 1991.

Selling, general and administrative expense increased by 0.8% in 1991 from 1990. The increase resulted from more intensive advertising and a special project of remodeling and updating merchandise displays in approximately 80 stores.

Interest expense for 1991 decreased by 1.0% compared to 1990 as a result of the combined effects of the decrease in the average outstanding borrowings and lower interest rates.

Income before an extraordinary item for 1991 was \$10.7 million compared to \$5.9 million for 1990, an increase of 83%. In 1991 an extraordinary charge of \$3.8 million, net of income tax benefits of \$2.3 million, resulted from the early redemption of the Company's 12¾% Senior Subordinated Notes (the "Notes"). The charge represented the excess of the redemption price over the recorded value as of January 27, 1992, including unamortized debt issuance costs.

#### FOR FISCAL 1990 COMPARED TO FISCAL 1989

Net sales in 1990 increased \$72.3 million, or 25%, over fiscal 1989 (the 52-week period ended January 28, 1990, or "1989"). The results for 1990 included sales of 17 stores opened during 1990 and 18 stores opened during 1989. During 1990, sales of these 35 newer stores accounted for \$46.5 million of the increase. Sales increased 9.1% for stores in operation for the 52 weeks ending February 3, 1991 compared to the 52-week period ending February 4, 1990.



Cost of sales and occupancy expense for 1990 increased by 0.5% due to the impact of efforts to stimulate sales with lower margin promotional goods in the earlier months of 1990, partially offset by a decrease in amounts set aside as reserves for closed store expenses.

Selling, general and administrative expense decreased by 1.1% in 1990 from 1989. Payroll-related expenses declined by 0.3% due primarily to operational efficiencies. Pre-opening expenses also declined by 0.3% as the Company opened one less store and lowered its pre-opening costs per store in 1990. General and administrative expense decreased by 0.2% as a result of the Company's cost-cutting efforts during a period of significant revenue growth.

Interest expense for 1990 decreased by 0.7% compared to 1989 because the effect of increased average outstanding bank borrowings in 1990 was more than offset by the increase in sales and the decrease in interest rates from 1989 to 1990.

The Company's effective tax rate for financial reporting purposes remained higher than statutory federal and state rates due to the effect of non-deductible amortization related to the Company's previous acquisitions.

Net income for 1990 was \$5.9 million compared to \$13,000 for 1989. Net income for 1989 included certain non-recurring fourth quarter charges, including costs amounting to \$2.4 million (\$4.0 million pre-tax) associated with a proposed buyout of the Company.

## LIQUIDITY AND CAPITAL RESOURCES

Additions to property and equipment, which primarily included expenditures relating to store remodeling, relocation and new store activities, amounted to about \$5.5 million during 1991. These were financed with cash flow provided by operating activities during 1991 of \$19.0 million.

During the fourth quarter of 1991 the Company sold 3,450,000 shares of common stock to the public, generating \$61.2 million. Outstanding warrants to purchase common stock were exercised during the quarter, from which the Company received cash proceeds of \$5.8 million. The Notes were redeemed, thereby reducing annual interest expense by over \$6.0 million.

Much of the Company's seasonal working capital requirements in prior years was financed with bank credit, although in 1991 the Company relied on its vendors to supply a substantial portion of its seasonal requirements. The Company intends to use cash on hand, cash flow from operations, and short-term bank borrowings to satisfy seasonal working capital needs in the future.

The Company plans to open more than 20 new stores during fiscal 1992. The cost will be about \$450,000 per store, which includes leasehold improvements, furniture, fixtures, equipment, and pre-opening expenses. The cost of the typical new store will be higher than in prior years because the Company will pay for a larger portion of leasehold improvements directly as opposed to financing them through the lessors. The inventory investment in the new stores will range from approximately \$350,000 to \$500,000 depending on the store size and date opened; however, due to the Company's typical payment terms and inventory turnover, the Company's vendors, in effect, will finance a significant portion of this inventory investment.

As of February 2, 1992, the Company had \$20 million in unused credit capacity under a new unsecured short-term line of credit and had working capital of \$74.8 million, compared to \$44.1 million at February 3, 1991. Working capital at March 29, 1992 was \$77.4 million. Management believes that the Company has sufficient working capital and cash flow from operating activities to sustain current growth plans.

## OTHER MATTERS

The Company's business is seasonal in nature with higher store sales in the third and fourth quarters. Historically, the fourth quarter, which includes the Christmas selling season, has accounted for approximately 35% of the Company's sales and approximately 50% of its operating income.

Management considers the effect of inflation on 1991 results and its projected effect on fiscal 1992 financial results to be nominal.

See "Income Taxes" in Notes to Financial Statements regarding Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes."



**BALANCE SHEETS***(In thousands except share data)*

	February 2, 1992	February 3, 1991
<b>ASSETS</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 27,356	\$ 108
Merchandise inventories	89,348	79,329
Prepaid expenses and other	9,169	5,135
Total current assets	125,873	84,572
<b>Property and equipment, at cost</b>	52,995	50,091
Less accumulated depreciation	(24,045)	(19,407)
	28,950	30,684
<b>Costs in excess of net assets of acquired operations, net</b>	22,375	23,035
<b>Other assets</b>	3,715	5,947
	26,090	28,982
	<u>\$180,913</u>	<u>\$144,238</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities:</b>		
Accounts payable	\$ 19,942	\$ 15,211
Income taxes payable	4,268	2,727
Accrued liabilities and other	26,877	22,554
Total current liabilities	51,087	40,492
<b>Senior subordinated notes, net of original issue discount of \$1,917 in fiscal 1990</b>	—	42,983
<b>Bank debt</b>	—	10,000
<b>Deferred income taxes and other</b>	3,527	4,148
Total long-term liabilities	3,527	57,131
	<u>54,614</u>	<u>97,623</u>
<b>Commitments and contingencies</b>		
<b>Shareholders' equity:</b>		
Preferred stock, \$.10 par value, 2,000,000 shares authorized, none issued	—	—
Common stock, \$.10 par value, 20,000,000 shares authorized, 15,058,756 issued (9,888,894 in fiscal 1990) and 15,058,756 outstanding (9,859,050 in fiscal 1990)	1,506	989
Additional paid-in capital	94,881	22,695
Retained earnings	29,912	23,016
Treasury stock, at cost	—	(85)
Total shareholders' equity	126,299	46,615
	<u>\$180,913</u>	<u>\$144,238</u>

*See accompanying notes to financial statements.*



**STATEMENTS OF INCOME***(In thousands except per share data)**Michaels Stores, Inc.*

	<i>Fiscal Year</i>		
	1991	1990	1989
<b>Net sales</b>	<b>\$410,899</b>	\$362,028	\$289,754
Cost of sales and occupancy expense	<b>274,375</b>	246,656	195,864
Selling, general and administrative expense	<b>110,881</b>	94,678	78,990
<b>Operating income</b>	<b>25,643</b>	20,694	14,900
Interest expense	<b>6,971</b>	9,739	9,896
Other expense, net	<b>913</b>	1,213	4,444
<b>Income before income taxes and extraordinary item</b>	<b>17,759</b>	9,742	560
Provision for income taxes	<b>7,020</b>	3,887	547
<b>Income before extraordinary item</b>	<b>10,739</b>	5,855	13
Extraordinary item — early redemption of debt, net of income tax of \$2,335	<b>3,843</b>	—	—
<b>Net income</b>	<b>\$ 6,896</b>	<b>\$ 5,855</b>	<b>\$ 13</b>

**Earnings per common and common equivalent share:**

Income before extraordinary item:			
Primary	<b>\$ .90</b>	\$ .57	\$ .00
Fully-diluted	<b>.87</b>	.57	.00
Net income:			
Primary	<b>.58</b>	.57	.00
Fully-diluted	<b>.56</b>	.57	.00
<b>Weighted average common and common equivalent shares outstanding:</b>			
Primary	<b>11,883</b>	10,229	10,645
Fully-diluted	<b>12,411</b>	10,312	10,775

*See accompanying notes to financial statements.*



## STATEMENTS OF CASH FLOWS

(In thousands)

	Fiscal Year		
	1991	1990	1989
<b>Operating activities:</b>			
Income before extraordinary item	\$ 10,739	\$ 5,855	\$ 13
Adjustments:			
Depreciation and amortization	9,228	8,050	7,492
Other	270	716	293
Change in assets and liabilities:			
Merchandise inventories	(10,019)	7,106	(12,019)
Prepaid expenses and other	(1,699)	(1,305)	(993)
Other assets	(459)	(617)	(361)
Accounts payable	4,731	5,380	1,891
Income taxes payable	1,541	2,727	(977)
Accrued liabilities and other	5,181	1,095	8,268
Deferred income taxes and other	(556)	499	625
Net change in assets and liabilities	(1,280)	14,885	(3,566)
Net cash provided by operating activities	18,957	29,506	4,232
<b>Investing activities:</b>			
Additions to property and equipment	(5,505)	(6,812)	(9,484)
Other	—	(805)	(222)
Net cash used in investing activities	(5,505)	(7,617)	(9,706)
<b>Financing activities:</b>			
Borrowings under revolving credit facilities	57,300	124,200	85,100
Payments under revolving credit facilities	(67,800)	(147,200)	(80,100)
Redemption of senior subordinated notes	(47,099)	—	—
Payment of other long-term liabilities	(196)	(145)	(127)
Proceeds from issuance of common stock	71,591	126	432
Net cash provided by (used in) financing activities	13,796	(23,019)	5,305
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>27,248</b>	<b>(1,130)</b>	<b>(169)</b>
<b>Cash and cash equivalents at beginning of year</b>	<b>108</b>	<b>1,238</b>	<b>1,407</b>
<b>Cash and cash equivalents at end of year</b>	<b>\$ 27,356</b>	<b>\$ 108</b>	<b>\$ 1,238</b>
Cash payments for interest and income taxes were as follows:			
Interest	\$ 6,851	\$ 10,248	\$ 9,206
Income taxes	4,863	849	1,703

See accompanying notes to financial statements.



# STATEMENTS OF SHAREHOLDERS' EQUITY

Michaels Stores, Inc.

For the Three Years Ended February 2, 1992

(In thousands except share data)

	Number of shares	Common stock	Additional paid-in capital	Retained earnings	Treasury stock and other	Total
<b>Balance at January 29, 1989</b>	9,695,558	\$ 973	\$21,950	\$17,148	\$(794)	\$ 39,277
Exercise of stock options and warrants	127,992	12	602	—	—	614
Proceeds from notes receivable for sale of common stock	—	—	—	—	473	473
Net income	—	—	—	13	—	13
<b>Balance at January 28, 1990</b>	9,823,550	985	22,552	17,161	(321)	40,377
Exercise of stock options	35,500	4	143	—	—	147
Cancellation of notes receivable	—	—	—	—	236	236
Net income	—	—	—	5,855	—	5,855
<b>Balance at February 3, 1991</b>	9,859,050	989	22,695	23,016	(85)	46,615
Exercise of stock options and warrants, and issuance of shares in an exchange offer and under the 401(k) plan	1,749,706	172	11,332	—	85	11,589
Proceeds from stock offering	3,450,000	345	60,854	—	—	61,199
Net income	—	—	—	6,896	—	6,896
<b>Balance at February 2, 1992</b>	<u>15,058,756</u>	<u>\$1,506</u>	<u>\$94,881</u>	<u>\$29,912</u>	<u>\$ —</u>	<u>\$126,299</u>

See accompanying notes to financial statements.



## NOTES TO FINANCIAL STATEMENTS

### SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Michaels Stores, Inc. (the "Company") owns and operates a chain of specialty retail stores. The Company reports on a 52/53-week fiscal year which ends on the Sunday closest to January 31. Accordingly, fiscal 1990 had 53 weeks.

#### *Cash and Cash Equivalents*

For purposes of the Statement of Cash Flows, the Company considers all highly liquid debt instruments purchased with original maturities of three months or less to be cash equivalents.

#### *Merchandise Inventories*

Store merchandise inventories are valued at the lower of average cost (determined by a retail method) or market. Distribution center inventories are valued at the lower of cost (determined by the first-in, first-out method) or market.

#### *Property and Equipment*

Depreciation is provided on a straight-line basis over the estimated useful lives of the assets.

#### *Costs in Excess of Net Assets of Acquired Operations*

Costs in excess of net assets of acquired operations are being amortized over 40 years on a straight-line basis. Accumulated amortization was \$3,748,000 and \$3,094,000 as of the end of fiscal 1991 and 1990, respectively.

#### *Store Pre-Opening Costs*

Store pre-opening costs are expensed in the fiscal year incurred. In fiscal 1991, 1990 and 1989, the Company incurred \$195,000, \$1,115,000 and \$1,781,000, respectively, of store pre-opening costs.

#### *Earnings Per Share*

Primary and fully-diluted earnings per share data are based on the weighted average number of shares outstanding, including common stock equivalents, using the treasury stock method. Common stock equivalents include stock options and warrants.

#### *Reclassification*

Certain amounts for fiscal 1990 and 1989 have been reclassified to conform to the fiscal 1991 presentation.

### DETAIL OF CERTAIN BALANCE SHEET ACCOUNTS

	Fiscal Year	
	1991	1990
	(In thousands)	
Property and equipment:		
Fixtures and equipment	\$43,430	\$41,348
Leasehold improvements	9,565	8,743
	<u>\$52,995</u>	<u>\$50,091</u>
Accrued liabilities and other:		
Salaries, bonuses and other payroll-related costs	\$12,987	\$11,257
Rent	5,616	3,976
Taxes, other than income and payroll	3,988	3,099
Other	4,286	4,222
	<u>\$26,877</u>	<u>\$22,554</u>

### EXTRAORDINARY ITEM

In January 1992 the Company called for redemption all outstanding 12¾% Senior Subordinated Notes (the "Notes"). The redemption premium paid for the Notes and the accelerated amortization of debt issuance costs totalled \$3.8 million (net of an income tax benefit of \$2.3 million) which has been accounted for as an extraordinary item. If at the beginning of the year the Notes had been redeemed and shares of common stock issued in an amount equivalent to the redemption price, fiscal 1991 earnings per share before extraordinary item would have increased by \$.10 and net income per share would have increased by \$.13.

### OTHER EXPENSE

In fiscal 1989, the Company incurred approximately \$4.0 million in expenses related to a proposed buyout transaction which was terminated in January 1990.

### 401(K) PLAN

The Company has a 401(k) plan for all eligible employees under which the Company contributes an amount equal to 50 cents for each dollar of contribution by the employee. The Company incurred expenses of \$710,000, \$686,000 and \$532,000, respectively, in connection with the 401(k) plan during fiscal 1991, 1990 and 1989, respectively.



# INCOME TAXES

	Fiscal Year		
	1991	1990	1989
	(In thousands)		
Income tax provision:			
Current	\$ 8,594	\$3,944	\$ 780
Deferred	(1,574)	(57)	(233)
	<u>\$ 7,020</u>	<u>\$3,887</u>	<u>\$ 547</u>
Deferred income tax provision:			
Tax depreciation greater (lower) than book depreciation	\$ (448)	\$ 55	\$ 538
Tax inventory lower (greater) than book inventory	(558)	(240)	33
Accrued expenses not deductible until paid	(573)	(110)	(665)
Alternative minimum tax	—	226	(79)
Other	5	12	(60)
	<u>\$ (1,574)</u>	<u>\$ (57)</u>	<u>\$ (233)</u>
Reconciliation of income tax provision to statutory rate:			
Income tax expense at statutory rate	\$ 6,038	\$3,312	\$ 190
State income taxes, net of federal income tax benefit	545	380	86
Amortization of intangibles	236	236	241
Other	201	(41)	30
	<u>\$ 7,020</u>	<u>\$3,887</u>	<u>\$ 547</u>

Beginning in fiscal 1993, the Company will be subject to the provisions of Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" (SFAS No. 109). The Company has not quantified the impact of SFAS No. 109 or determined whether, at the time of adoption, prior years will be restated.

# COMMITMENTS AND CONTINGENCIES

## Commitments

The Company operates stores and uses distribution facilities and equipment leased under noncancellable operating leases, the majority of which provide for renewal options. Future minimum rentals for all noncancellable operating leases as of February 2, 1992 are as follows:

	Net Rent
	(In thousands)
1992	\$ 23,217
1993	22,712
1994	21,334
1995	19,595
1996	16,907
1997 and thereafter	31,691
	<u>\$135,456</u>

Rental expense applicable to operating leases was \$24,445,000, \$21,664,000 and \$19,536,000 in fiscal 1991, 1990 and 1989, respectively.

## Contingencies

Management of the Company believes that any uninsured losses related to various lawsuits or claims pending against the Company will be immaterial; accordingly, no provision has been recorded in the financial statements.

# STOCK OPTIONS AND WARRANTS

All full-time employees are eligible to participate in the Michaels Stores, Inc. Key Employee Stock Compensation Program under which 1,500,000 shares of common stock were authorized for issuance. In addition, non-Program options have been granted to certain directors and key advisors. The exercise price of all options granted was the fair market value on the date of grant.

	Shares	Exercise price per share
Exercised during 1989	82,500	\$2½ to \$5¼
Exercised during 1990	35,500	\$3½ to \$4
Exercised during 1991	733,865	\$3
Outstanding at February 2, 1992	1,865,985	\$3 to \$17½
Exercisable at February 2, 1992	1,065,730	\$3 to \$17½

The Company had outstanding as of February 2, 1992 a warrant for 150,000 shares at \$3.00, expiring in November 1994.



## REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Shareholders

We have audited the accompanying balance sheets of Michaels Stores, Inc. as of February 2, 1992 and February 3, 1991, and the related statements of income, cash flows, and shareholders' equity for each of the three years in the period ended February 2, 1992. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Michaels Stores, Inc. at February 2, 1992, and February 3, 1991, and the results of its operations and its cash flows for each of the three years in the period ended February 2, 1992, in conformity with generally accepted accounting principles.

*Ernst & Young*

Dallas, Texas  
March 3, 1992



# UNAUDITED SUPPLEMENTAL QUARTERLY FINANCIAL DATA

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter <sup>(1)</sup>
<i>(In thousands except per share data)</i>				
<b>Fiscal 1991:</b>				
Net sales	\$82,802	\$80,265	\$103,637	\$144,195
Cost of sales and occupancy expense	55,289	54,131	70,020	94,935
Operating income	3,665	3,541	4,846	13,591
Income before extraordinary item	794	684	1,646	7,615
Net income	794	684	1,646	3,772
Earnings per common share:				
Income before extraordinary item	\$ .07	\$ .06	\$ .14	\$ .58
Extraordinary item	—	—	—	.29
Net income	<u>\$ .07</u>	<u>\$ .06</u>	<u>\$ .14</u>	<u>\$ .29</u>
Weighted average common and common equivalent shares outstanding	11,175	11,549	12,186	13,231
<b>Fiscal 1990:</b>				
Net sales	\$71,673	\$71,506	\$ 85,448	\$133,401
Cost of sales and occupancy expense	48,230	49,763	58,360	90,303
Operating income	3,398	2,875	3,875	10,546
Net income	444	17	578	4,816
Earnings per common share	\$ .04	\$ .00	\$ .06	\$ .45
Weighted average common and common equivalent shares outstanding	10,152	10,470	9,943	10,610

(1) According to the Company's fiscal reporting procedures, fiscal 1990 included a 14-week fourth quarter.



## DIRECTORS

Sam Wyly

*Chairman*

Charles J. Wyly, Jr.

*Vice Chairman*

Jack E. Bush

*President*

Richard E. Hanlon

*Vice President of Corporate*

*Communications and Secretary*

*LEGENT Corporation*

William O. Hunt

*Chairman and Chief Executive Officer*

*Alliance Telecommunications Corporation*

Dr. F. Jay Taylor

*President-Emeritus*

*Louisiana Tech University*

Donald G. Thomson

*Consultant and President-Emeritus of*

*Michaels Stores, Inc.*

## OFFICERS

Sam Wyly

*Chairman and Chief Executive Officer*

Charles J. Wyly, Jr.

*Vice Chairman*

Jack E. Bush

*President and Chief Operating Officer*

R. Don Morris

*Executive Vice President and Chief Financial Officer*

Douglas B. Sullivan

*Executive Vice President*

Robert H. Rudman

*Senior Vice President — Merchandising/Marketing*

Thomas D. Sigerstad

*Senior Vice President — Marketing*

Mark V. Beasley

*Vice President, General Counsel and Secretary*

Robert E. German

*Vice President — Customer and Associate Relations*

Kristen L. Magnuson

*Vice President — Finance and Business Planning*

Donald R. Miller, Jr.

*Vice President — Market Development*

Jerry R. Payton

*Vice President — Merchandising*

Donald C. Toby

*Vice President — Personnel*

Evan A. Wyly

*Vice President — Mergers and Acquisitions*

Stephen C. Yevich

*Controller*



## CORPORATE INFORMATION

### Executive Offices

5931 Campus Circle Drive  
Las Colinas Business Park  
Irving, Texas 75063

P. O. Box 619566  
DFW, Texas 75261-9566  
214/580-8242

### Transfer Agent and Registrar

Ameritrust Company N.A.

### Attorneys

Jackson & Walker

### Auditors

Ernst & Young

### Commercial Banking

NationsBank  
Bank of America  
Chemical Bank  
Continental Bank

### Dividend Policy

The Company's present policy is to retain earnings for the foreseeable future for use in the Company's business and the financing of its growth. The Company did not pay dividends on its Common Stock during fiscal 1990 and 1991.

### Ticker Symbol

Michaels Stores, Inc. Common Stock is quoted through The Nasdaq National Market System under the ticker symbol MIKE.

### Shareholders

As of April 7, 1992, there were 1,014 shareholders of record.

### Stock Prices

The following table sets forth for each quarter of the two most recent fiscal years of the Company the high and low sale prices of the Company's Common Stock.

<b>Fiscal 1991</b>	<i>High</i>	<i>Low</i>
First	\$ 8 <sup>7</sup> / <sub>8</sub>	\$ 4 <sup>1</sup> / <sub>2</sub>
Second	9 <sup>3</sup> / <sub>8</sub>	6 <sup>7</sup> / <sub>8</sub>
Third	15 <sup>3</sup> / <sub>8</sub>	8 <sup>5</sup> / <sub>8</sub>
Fourth	24	12 <sup>1</sup> / <sub>2</sub>

<b>Fiscal 1990</b>	<i>High</i>	<i>Low</i>
First	\$ 5 <sup>1</sup> / <sub>4</sub>	\$ 3 <sup>1</sup> / <sub>2</sub>
Second	6 <sup>1</sup> / <sub>2</sub>	4 <sup>3</sup> / <sub>8</sub>
Third	5 <sup>3</sup> / <sub>4</sub>	2 <sup>7</sup> / <sub>8</sub>
Fourth	4 <sup>7</sup> / <sub>8</sub>	3 <sup>1</sup> / <sub>4</sub>

### Form 10-K

Copies of Michaels Stores, Inc.'s annual report to the Securities and Exchange Commission on Form 10-K are available upon request. Requests should be directed to R. Don Morris, Executive Vice President and Chief Financial Officer, at the Company's executive offices.

### Annual Meeting

The Annual Meeting of Shareholders will be held on June 2, 1992 at 10 a.m. at the Marriott Mandalay Hotel, 221 East Las Colinas Boulevard, Irving, Texas. All shareholders are cordially invited to attend.





THE ARTS & CRAFTS STORE

Michaels Stores, Inc.  
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Irving, Texas 75063  
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