UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q/A

(Mark One)

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

For the quarterly period ended May 4, 2013

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 incorporation or organization)	(I.R.S. employer identification number)

8000 Bent Branch Drive

Irving, Texas 75063

(Address of principal executive offices, including zip code)

(972) 409-1300

(Registrant s telephone number, including area code)

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.* Yes 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 x 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 May 21, 2013, 118,687,391 shares of the Registrant s Common Stock were outstanding.

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

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Explanatory Note

Michaels Stores, Inc. (Company) is filing this Amendment No. 1 (Form 10-Q/A) to its Quarterly Report on Form 10-Q for the quarter ended May 4, 2013, filed with the Securities and Exchange Commission (SEC) on May 24, 2013 (the Form 10-Q), for the purpose of correcting historical share-based compensation expense caused by the Company s repurchase of shares that had not been held for at least six months following the exercise of stock options under its equity incentive plans. Since the participants held such shares for less than six months following exercise (immature shares), liability accounting applies to the plan.

The Company has determined its previously issued unaudited interim consolidated financial statements for the three month periods ended May 4, 2013 and April 28, 2012 contained an error with respect to ASC 718, *Compensation Stock Compensation.* Specifically, former participants in the Company s Equity Incentive Plan and its successor Plan (The Michaels Companies, Inc. (Parent) Equity Incentive Plan, together the Plan) exercised stock options upon their termination from the Company, and the Company repurchased the immature shares. The Company consistently repurchased shares in this manner and therefore, under accounting rules, established a pattern of repurchasing immature shares during the third quarter of 2011. The Company determined all stock options should have been treated as liability awards in accordance with the rules of ASC 718-10-25-9. Under liability accounting, the Company re-measures the fair value of stock compensation each period and recognizes changes in fair value as awards vest and until the award is settled. The Company originally recognized expense ratably over the vesting period based on the grant date fair value of the option in accordance with the fixed method of accounting. The Company determined the accounting error was material to fiscal 2011 and fiscal 2012 financial statements and those financial statements required restatement. As a result, the Company is also restating its financial statements for the three months ended May 4, 2013 and April 28, 2012. The non-cash impact to share-based compensation cost for the three months ended May 4, 2013 and April 28, 2012, was $5 million ($3, net of tax) million and $3 million ($1, net of tax) million, respectively. As part of the restatement, the Company also recorded other adjustments related to merchandise inventories and the reserve for closed facilities which were previously determined to be immaterial to the respective periods. In total, the adjustments resulted in a decline of net income by $1 million for the three months ended May 4, 2013, and $2 million for the three months ended April 28, 2012.

In connection with the restatement of our consolidated financial statements described herein, management re-evaluated the Company s internal controls over financial reporting and disclosure controls and share repurchase procedures. It was determined a material weakness existed beginning in the third quarter of 2011 due to management s failure to identify the accounting implications under ASC 718 related to the Company s practice of repurchasing immature shares following option exercises by employees upon termination of employment, as well as its failure to follow internal controls relating to the repurchase of shares. For a discussion of management s consideration of the Company s internal control over financial reporting and the material weakness identified, see Item 4.

For convenience of the reader, this amended filing sets forth the original filing, in its entirety. The following items have been amended principally as a result of, and to reflect, the restatement:

Part I, Item 1	- Financial Statements (unaudited)
Part I, Item 2	- Management s Discussion and Analysis of Financial Condition and Results of Operations
Part I, Item 4	- Controls and Procedures

In accordance with applicable SEC rules, this Amended Filing includes new certifications as required by Rule 12b-15 under the Securities Exchange Act of 1934, as amended (the Exchange Act) from our Chief Executive Officer and Chief Financial Officer dated as of the date of filing of this Amended Filing.

The remaining items contained within this amended report consist of all other items originally contained in the Form 10-Q and are included for the convenience of the reader. The sections of the Form 10-Q which were not amended are unchanged and continue in full force and effect as originally filed. This amended report speaks as of the date of the original filing and has not been updated to reflect events occurring subsequent to the original filing other than those associated with the restatement of our financial statements.

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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)

	May 4, 2013 (Restated)	February 2, 2013 (Restated)	April 28, 2012 (Restated)
ASSETS			
Current assets:			
Cash and equivalents	$ 55	$ 56	$ 385
Merchandise inventories	843	862	880
Prepaid expenses and other	85	86	77
Deferred income taxes	37	37	42
Income tax receivable	8	3	5
Total current assets	1,028	1,044	1,389
Property and equipment, at cost	1,527	1,502	1,405
Less accumulated depreciation and amortization	(1,186)	(1,164)	(1,095)
Property and equipment, net	341	338	310
Goodwill	94	94	95
Debt issuance costs, net of accumulated amortization of $52, $54, and $78, respectively	42	46	55
Deferred income taxes	28	30	31
Other assets	2	3	4
Total non-current assets	166	173	185
Total assets	$ 1,535	$ 1,555	$ 1,884
LIABILITIES AND STOCKHOLDERS DEFICIT			
Current liabilities:			
Accounts payable	$ 232	$ 263	$ 280
Accrued liabilities and other	300	367	388
Share based compensation liability	36	35	28
Current portion of long-term debt	198	150	127
Deferred income taxes	4	4	1
Income taxes payable	27	37	27
Total current liabilities	797	856	851
Long-term debt	2,887	2,891	3,363
Deferred income taxes	2	2	11
Share based compensation liability	28	27	22

Other long-term liabilities		79		83		85
Total long-term liabilities		2,996		3,003		3,481
Total liabilities		3,793		3,859		4,332
Commitments and contingencies						
Stockholders deficit:						
Common Stock, $0.10 par value, 220,000,000 shares authorized; 118,417,069 shares issued and outstanding at May 4, 2013; 118,414,727 shares issued and outstanding at February 2, 2013; 118,420,253 shares issued and outstanding at April 28, 2012		12		12		12
Additional paid-in capital		38		37		40
Accumulated deficit		(2,313)		(2,359)		(2,508)
Accumulated other comprehensive income		5		6		8
Total stockholders deficit		(2,258)		(2,304)		(2,448)
Total liabilities and stockholders deficit	$	1,535	$	1,555	$	1,884

See accompanying notes to consolidated financial statements.

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MICHAELS STORES, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in millions)

(Unaudited)

	Quarter Ended	
	May 4, 2013	April 28, 2012 (Restated)
Net sales	$ 993	$ 978
Cost of sales and occupancy expense	584	567
Gross profit	409	411
Selling, general, and administrative expense	272	259
Share-based compensation	3	4
Related party expenses	4	3
Store pre-opening costs	2	1
Operating income	128	144
Interest expense	47	66
Refinancing costs and losses on early extinguishment of debt	7	
Other (income) and expense, net		(1)
Income before income taxes	74	79
Provision for income taxes	28	28
Net income	46	51
Other comprehensive income, net of tax:		
Foreign currency translation adjustment and other	(1)	2
Comprehensive income	$ 45	$ 53

See accompanying notes to consolidated financial statements.

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MICHAELS STORES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)

(Unaudited)

	Quarter Ended	
	May 4, 2013 (Restated)	April 28, 2012
Operating activities:		
Net income	$ 46	$ 51
Adjustments:		
Depreciation and amortization	25	24
Share-based compensation	4	4
Debt issuance costs amortization	2	4
Refinancing costs expensed and losses on early extinguishment of debt	7	
Changes in assets and liabilities:		
Merchandise inventories	20	(33)
Prepaid expenses and other	1	3
Accounts payable	(14)	(15)
Accrued interest	(30)	37
Accrued liabilities and other	(41)	(37)
Income taxes	(14)	3
Other long-term liabilities	(4)	
Net cash provided by operating activities	2	41
Investing activities:		
Additions to property and equipment	(22)	(18)
Net cash used in investing activities	(22)	(18)
Financing activities:		
Redemption of senior subordinated notes due 2016	(142)	
Borrowings on asset-based revolving credit facility	306	
Payments on asset-based revolving credit facility	(125)	
Payment of capital leases	(1)	
Change in cash overdraft	(19)	(9)
Net cash provided by (used in) financing activities	19	(9)
Net (decrease) increase in cash and equivalents	(1)	14
Cash and equivalents at beginning of period	56	371
Cash and equivalents at end of period	$ 55	$ 385
Supplemental Cash Flow Information:		
Cash paid for interest	$ 75	$ 25
Cash paid for income taxes	$ 44	$ 24

See accompanying notes to consolidated financial statements.

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MICHAELS STORES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Quarter Ended May 4, 2013

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

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

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

Because of the seasonal nature of our business, the results of operations for the quarter ended May 4, 2013 are not indicative of the results to be expected for the entire year.

We report on the basis of a 52- or 53-week fiscal year, which ends on the Saturday closest to January 31. All references herein to fiscal 2013 relate to the 52 weeks ending February 1, 2014, and all references to fiscal 2012 relate to the 53 weeks ended February 2, 2013. In addition, all references herein to the first quarter of fiscal 2013 relate to the 13 weeks ended May 4, 2013, and all references to the first quarter of fiscal 2012 relate to the 13 weeks ended April 28, 2012.

Recent Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) No. 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*, an amendment to Accounting Standards Codification (ASC) 220, *Comprehensive Income.* ASU No. 2013-02 requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. GAAP to be reclassified in its entirety to net income. For other items not reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under GAAP that provide additional detail about those amounts. This standard, which is prospective, is effective for reporting periods beginning after December 15, 2012, with earlier adoption permitted. We adopted all requirements of this standard on February 3, 2013, the beginning of fiscal 2013.

Note 2. Restatement Share-based Compensation

The Company has determined its previously issued unaudited interim consolidated financial statements for the three month periods ended May 4, 2013 and April 28, 2012, contained an error with respect to ASC 718, *Compensation Stock Compensation.* Specifically, former participants in the Company s Equity Incentive Plan and its successor Plan (The Michaels Companies, Inc. (Parent) Equity Incentive Plan, together the Plan) exercised stock options upon their termination from the Company, and the Company repurchased the immature shares. The Company consistently repurchased shares in this manner and therefore, under accounting rules, established a pattern of repurchasing immature shares during the third quarter of 2011. The Company determined all stock options should have been treated as liability awards in accordance with the rules of ASC 718-10-25-9. Under liability accounting, the Company re-measures the fair value of stock compensation each period and recognizes changes in fair value as awards vest and until the award is settled. The Company originally recognized expense ratably over the vesting period based on the grant date fair value of the option in accordance with the fixed method of accounting. The Company determined the accounting error was material to fiscal 2011 and fiscal 2012 financial statements and those financial statements required restatement. As a result, the Company is also restating its financial statements for the three months ended May 4, 2013 and April 28, 2012. The impact to share-based compensation cost for the three months ended May 4, 2013 and April 28, 2012, was $5 million ($3, net of tax) and $3 million ($1, net of tax), respectively. As part of the restatement, the Company also recorded other adjustments related to merchandise inventories and the reserve for closed facilities which were previously determined to be immaterial to the respective periods. In total, the adjustments resulted in a decline of Net income by $1 million for the three months ended May 4, 2013, and $2 million for the three months ended April 28, 2012.

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The following footnotes have been restated:

- Note 6 Income Taxes
- Note 8 Segments and Geographic Information
- Note 10 Condensed Consolidating Financial Information

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

Consolidated Balance Sheet
May 4, 2013

	As Reported	Share-based compensation Adjustment	Other Adjustments	As Restated
Merchandise inventories	$ 842	$ 2	$ (1)	$ 843
Total current assets	1,027	2	(1)	1,028
Deferred income taxes	13	15		28
Total non-current assets	151	15		166
Share-based compensation liability		36		36
Income taxes payable	31	(4)		27
Total current liabilities	765	32		797
Share-based compensation liability		28		28
Total long-term liabilities	2,968	28		2,996
Additional paid-in capital	48	(10)		38
Accumulated deficit	(2,279)	(33)	(1)	(2,313)
Total stockholders deficit	(2,214)	(43)	(1)	(2,258)

Consolidated Balance Sheet
April 28, 2012

	As Reported	Share-based compensation Adjustment	Other Adjustments	As Restated
Merchandise inventories	$ 874	$ 6	$	$ 880
Total current assets	1,383	6		1,389
Deferred income taxes	18	13		31
Total non-current assets	172	13		185
Share-based compensation liability		28		28
Income taxes payable	28	(1)		27
Total current liabilities	824	27		851
Share-based compensation liability		22		22
Total long-term liabilities	3,459	22		3,481

Additional paid-in capital	49	(9)	40
Accumulated deficit	(2,487)	(21)	(2,508)
Total stockholders deficit	(2,418)	(30)	(2,448)

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	Consolidated Statements of Comprehensive Income Quarter Ended May 4, 2013			
	As Reported	Share-based compensation Adjustment	Other Adjustments	As Restated
Cost of sales and occupancy expense	$ 586	$ 1	$ (3)	$ 584
Gross Profit	407	(1)	3	409
Selling, general and administrative expense	271	1		272
Share-based compensation		3		3
Operating income	130	(5)	3	128
Income before income taxes	76	(5)	3	74
Provision for income taxes	29	(2)	1	28
Net income	47	(3)	2	46
Comprehensive income	46	(3)	2	45

	Consolidated Statements of Comprehensive Income Quarter Ended April 28, 2012			
	As Reported	Share-based compensation Adjustment	Other Adjustments	As Restated
Cost of sales and occupancy expense	$ 566	$	$ 1	$ 567
Gross Profit	412		(1)	411
Selling, general and administrative expense	260	(1)		259
Share-based compensation		4		4
Operating income	148	(3)	(1)	144
Income before income taxes	83	(3)	(1)	79
Provision for income taxes	30	(2)		28
Net income	53	(1)	(1)	51
Comprehensive income	55	(1)	(1)	53

	Cash Flow Data Quarter Ended May 4, 2013			
	As Reported	Share-based compensation Adjustment	Other Adjustments	As Restated
Operating Activities:				
Net income	$ 47	(3)	2	$ 46
Share-based compensation	(1)	5		4
Merchandise inventories	23		(3)	20
Accrued liabilities and other	(39)	(2)		(41)
Income taxes	(15)		1	(14)

	Cash Flow Data Quarter Ended April 28, 2012			
	As Reported	Share-based compensation Adjustment	Other Adjustments	As Restated
Operating Activities:				
Net income	$ 53	(1)	(1)	$ 51
Share-based compensation	1	3		4
Merchandise inventories	(34)		1	(33)
Income taxes	5	(2)		3

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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.

	May 4, 2013	February 2, 2013 (in millions)	April 28, 2012	Interest Rate
Senior secured term loan	$ 1,640	$ 1,640	$ 1,996	Variable
Senior notes	1,007	1,007	795	7.750%
Senior subordinated notes	256	393	393	11.375%
Subordinated discount notes			306	13.000%
Asset-based revolving credit facility	182	1		Variable
Total debt	3,085	3,041	3,490	
Less current portion	198	150	127	
Long-term debt	$ 2,887	$ 2,891	$ 3,363	

113/8% Senior Subordinated Notes due 2016

On January 28, 2013, we caused to be delivered to the holders of our outstanding 113/8% Senior Subordinated Notes due November 1, 2016 (the Senior Subordinated Notes) an irrevocable notice relating to the redemption of $137 million in aggregate principal amount of the Senior Subordinated Notes. On February 27, 2013, we redeemed the $137 million of Senior Subordinated Notes at a redemption price equal to 103.792%. In accordance with ASC 470 *Debt*, we recorded a loss on early extinguishment of debt of approximately $7 million related to the partial redemption of our Senior Subordinated Notes. The $7 million loss is comprised of a $5 million redemption premium and $2 million to write off related debt issuance costs.

Restated Revolving Credit Facility

As of May 4, 2013, the borrowing base of our restated senior secured asset-based revolving credit facility (the Restated Revolving Credit Facility) was $650 million, of which we had $182 million in borrowings, $62 million of outstanding letters of credit and the unused borrowing capacity was $406 million.

Note 4. Comprehensive Income

Accumulated other comprehensive income, net of tax, is reflected in the Consolidated Balance Sheets as follows:

		Foreign Currency Translation and Other (in millions)
Balance at February 2, 2013	$	6
Foreign currency translation adjustment and other		(1)
Balance at May 4, 2013	$	5

Note 5. Fair Value Measurements

As defined in ASC 820, *Fair Value Measurements and Disclosures*, 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.

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We apply fair value techniques on a non-recurring basis for the establishment of potential impairment loss related to goodwill pursuant to ASC 350, *Intangibles Goodwill and Other* and determining the fair value of long-lived assets pursuant to ASC 360, *Property, Plant, and Equipment.* During the quarter ended May 4, 2013, there were no events or changes in circumstances indicating the carrying amounts of our goodwill or long-lived assets may not be recoverable.

The table below provides the carrying and fair values of our senior secured term loan facility (Restated Term Loan Credit Facility), our 73/4% Senior Notes that mature in 2018 (2018 Senior Notes) and our Senior Subordinated Notes, (together, with our 2018 Senior Notes, our notes) as of May 4, 2013. The fair value of our Restated Term Loan Credit Facility was determined based on quoted market prices of similar instruments which are considered Level 2 inputs within the fair value hierarchy. The fair value of our notes was determined based on recent trades which are considered Level 1 inputs within the fair value hierarchy.

	Carrying Value	Fair Value
	(in millions)	
Senior secured term loan	$ 1,640	$ 1,661
Senior notes	1,007	1,100
Senior subordinated notes	256	269

Note 6. Income Taxes

The effective tax rate was 37.8% for the first quarter of fiscal 2013. The effective tax rate was 35.4% for the first quarter of fiscal 2012. The current year tax rate is higher than the prior year tax rate due primarily to the prior year favorable impact related to our reserve for uncertain tax positions. We currently estimate our annualized effective tax rate for fiscal 2013 to be 37.7%.

Note 7. Commitments and Contingencies

We are involved in ongoing legal and regulatory proceedings. Other than those described in the following paragraphs, 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 February 2, 2013.

Employee Claims

Adams Claim

On March 20, 2009, 114 individuals commenced an action against the Company styled Adams, et al. v. Michaels Stores, Inc. in the U.S. District Court for the Central District of California. The complaint was later amended to add 15 additional plaintiffs. In 2010, two additional lawsuits making the same allegations were filed in the Central District Court by eight additional plaintiffs, styled Borgen, et al. v. Michaels Stores, Inc. and Langstaff v. Michaels Stores, Inc., and were later consolidated with the Adams suit. The Adams consolidated suit (Adams) alleges that the plaintiffs, certain former and current store managers in California, were improperly classified as exempt employees and, as such, Michaels failed to pay overtime wages, provide meal and rest periods (or compensation in lieu thereof), accurately record hours worked and provide itemized employee wage statements. The Adams suit additionally alleges that the foregoing conduct was in breach of California s unfair competition law. The plaintiffs seek injunctive relief, damages for unpaid wages, penalties, restitution, interest, and attorneys fees and costs. We have entered into settlement agreements with virtually all of the individual plaintiffs for an amount that will not have a material effect on our consolidated financial statements.

Ragano Claim

On July 11, 2011, the Company was served with a lawsuit filed in the California Superior Court in and for the County of San Mateo by Anita Ragano, as a purported class action proceeding on behalf of herself and all current and former hourly retail employees employed by Michaels stores in California. We removed the matter to the U.S. District Court for the Northern District of California on August 9, 2011. The complaint was subsequently amended to add an additional named plaintiff, Terri McDonald. The lawsuit alleges that Michaels stores failed to pay all wages and overtime, failed to provide its hourly employees with adequate meal and rest breaks (or compensation in lieu thereof), failed to timely pay final wages, unlawfully withheld wages and failed to provide accurate wage statements and further alleges that the foregoing conduct was in breach of various laws, including California s unfair competition law. The plaintiffs sought injunctive relief, compensatory damages, meal and rest break penalties, waiting time penalties, interest, and attorneys fees and costs. On August 10, 2012, we reached a class-wide settlement with plaintiffs and the Court granted final approval on April 22, 2013. The settlement will not have a material effect on our consolidated financial statements.

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Consumer Class Action Claims

California Zip Code Claims

On August 15, 2008, Linda Carson, a consumer, filed a purported class action proceeding against Michaels Stores, Inc. in the Superior Court of California, County of San Diego (San Diego Superior Court), on behalf of herself and all similarly-situated California consumers. The Carson lawsuit alleges that Michaels unlawfully requested and recorded personally identifiable information (i.e., her zip code) as part of a credit card transaction. The plaintiff sought statutory penalties, costs, interest, and attorneys fees. We contested certification of this claim as a class action and filed a motion to dismiss the claim. On March 9, 2009, the Court dismissed the case with prejudice. The plaintiff appealed this decision to the California Court of Appeals for the Fourth District, San Diego. On July 22, 2010, the Court of Appeals upheld the dismissal of the case. The plaintiff appealed this decision to the Supreme Court of California (California Supreme Court). On September 29, 2010, the California Supreme Court granted the plaintiff s petition for review; however, it stayed any further proceedings in the case until another similar zip code case pending before the court, Pineda v. Williams-Sonoma, was decided. On February 10, 2011, the California Supreme Court ruled, in the Williams-Sonoma case, that zip codes are personally identifiable information and therefore the Song-Beverly Credit Card Act of 1971, as amended (Song Act), prohibits businesses from requesting or requiring zip codes in connection with a credit card transaction. On or about April 6, 2011, the Supreme Court transferred the Carson case back to the Court of Appeals with directions to the Court to reconsider its decision in light of the Pineda decision. Upon reconsideration, the Court of Appeals remanded the case back to the San Diego Superior Court on May 31, 2011.

Additionally, since the California Supreme Court decision on February 10, 2011, three additional purported class action lawsuits alleging violations of the Song Act have been filed against the Company: Carolyn Austin v. Michaels Stores, Inc. and Tiffany Heon v. Michaels Stores, Inc., both in the San Diego Superior Court and Sandra A. Rubinstein v. Michaels Stores, Inc. in the Superior Court of California, County of Los Angeles, Central Division. The Rubinstein case was transferred to the San Diego Superior Court. An order coordinating the cases has been entered and plaintiffs filed a Consolidated Complaint on April 24, 2012. Plaintiffs seek damages, civil penalties, common settlement fund recovery, attorney fees, costs of suit and prejudgment interest. The parties mediated the matter in March and a tentative settlement has been reached for an amount that will not have a material effect on our consolidated financial statements.

Massachusetts Zip Code Claims

Relying in part on the California Supreme Court decision, an additional purported class action lawsuit was filed on May 20, 2011 against the Company: Melissa Tyler v. Michaels Stores, Inc. in the U.S. District Court-District of Massachusetts, alleging violation of a Massachusetts statute regarding the collection of personally identification information in connection with a credit card transaction. On March 11, 2013, the Massachusetts Supreme Judicial Court ruled on certified questions on the interpretation of the statute and remanded the case to the U.S. District Court for further proceedings. Following the Judicial Court s decision, an additional purported class action lawsuit asserting the same allegations in Tyler was filed in the U.S. District Court-District of Massachusetts by Susan D Esposito, and the two cases have been consolidated. We believe we have meritorious defenses to the claims and we are unable, at this time, to estimate a range of loss, if any.

Pricing and Promotion

On April 30, 2012, William J. Henry, a consumer, filed a purported class action proceeding against Michaels Stores, Inc. in the Court of Common Pleas, Lake County, Ohio, on behalf of himself and all similarly-situated Ohio consumers who purchased framing products and/or services from Michaels during weeks where Michaels was advertising a discount for framing products and/or services. The lawsuit alleges that Michaels advertised discounts on its framing products and/or services without actually providing a discount to its customers. The plaintiff is claiming violation of Ohio law ORC 1345.01 et seq., unjust enrichment and fraud. The plaintiff has alleged damages, penalties and fees not to exceed $5 million, exclusive of interest and costs. We believe we have meritorious defenses and intend to defend the lawsuit vigorously. We do not believe the resolution of this lawsuit will have a material effect on our consolidated financial statements.

Data Breach Claims

Payment Card Terminal Tampering

On May 3, 2011, we were advised by the U.S. Secret Service that they were investigating certain fraudulent debit card transactions that occurred on accounts that had been used for legitimate purchases in selected Michaels stores. A subsequent internal investigation revealed that approximately 90 payment card terminals in certain Michaels stores had been physically tampered with, potentially resulting in customer debit and credit card information to be compromised. We have since removed and replaced approximately 7,100 payment card terminals comparable to the identified tampered payment card terminals from our Michaels stores.

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On May 18, 2011, Brandi F. Ramundo, a consumer, filed a purported class action proceeding against Michaels Stores, Inc. in the U.S. District Court for the Northern District of Illinois, on behalf of herself and all similarly- situated U.S. consumers alleging that Michaels failed to take commercially reasonable steps to protect consumer financial data, and was in breach of contract and laws, including the Federal Stored Communications Act and the Illinois Consumer Fraud and Deceptive Practices Act. A number of additional purported class action lawsuits significantly mirroring the claims in the Ramundo complaint were filed against the Company, and subsequently these cases and the Ramundo case were consolidated and transferred to the Northern District of Illinois.

On August 20, 2012, we reached a tentative class-wide settlement with plaintiffs for an amount that will not have a material effect on our consolidated financial statements and the Court granted final approval on April 17, 2013.

General

In addition to the litigation discussed above, we are, and in the future, may be 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.

ASC 450, *Contingencies,* governs the disclosure and recognition of loss contingencies, including potential losses from litigation and regulatory matters. It imposes different requirements for the recognition and disclosure of loss contingencies based on the likelihood of occurrence of the contingent future event or events. It distinguishes among degrees of likelihood using the following three terms: probable , meaning that the future event or events are likely to occur ; remote , meaning that the chance of the future event or events occurring is slight ; and reasonably possible , meaning that the chance of the future event or events occurring is more than remote but less than likely . In accordance with ASC 450, the Company accrues for a loss contingency when we conclude that the likelihood of a loss is probable and the amount of the loss can be reasonably estimated. When the loss cannot be reasonably estimated we estimate the range of amounts, and if no amount in the range constitutes a better estimate than any other amount, we accrue for the amount at the low end of the range. We adjust our accruals from time to time as we receive additional information, but the loss we incur may be significantly greater than or less than the amount we have accrued. We disclose loss contingencies if there is at least a reasonable possibility that a material loss has been incurred. No accrual or disclosure is required for losses that are remote.

For some of the matters disclosed above, as well as other matters previously disclosed in the Company s filings with the Securities and Exchange Commission (SEC), the Company is currently able to estimate a reasonably possible loss or range of loss in excess of amounts accrued (if any). For some of the matters included within this estimation, an accrual has been made because a loss is believed to be both probable and reasonably estimable, but an exposure to loss exists in excess of the amount accrued; in these cases, the estimate reflects the reasonably possible range of loss in excess of the accrued amount. For other matters included within this estimation, no accrual has been made because a loss, although estimable, is believed to be reasonably possible, but not probable; in these cases the estimate reflects the reasonably possible loss or range of loss within the ranges identified. For the various ranges identified, the aggregate of these estimated amounts is approximately $14 million, which is also inclusive of amounts accrued by the Company.

For other matters disclosed above or as previously disclosed in the Company s filings with the SEC, the Company is not currently able to estimate the reasonably possible loss or range of loss, and has indicated such. Many of these matters remain in preliminary stages (even in some cases where a substantial period of time has passed since the commencement of the matter), with few or no substantive legal decisions by the court defining the scope of the claims, the class (if any), or the potentially available damages, and fact discovery is still in progress or has not yet begun. For all these reasons, the Company cannot at this time estimate the reasonably possible loss or range of loss, if any, for these matters.

It is the opinion of the Company s management, based on current knowledge and after taking into account its current legal accruals, the eventual outcome of all matters described in this Note would not be likely to have a material impact on the consolidated financial condition of the Company. Nonetheless, given the substantial or indeterminate amounts sought in certain of these matters, and the inherent unpredictability of such matters, an adverse outcome in certain of these matters could, from time to time, have a material effect on the Company s consolidated results of operations or cash flows in particular quarterly or annual periods.

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Note 8. Segments and Geographic Information

We consider our Michaels U.S., Michaels Canada, Aaron Brothers and online scrapbooking business operations to be our operating segments for purposes of determining reportable segments based on the criteria of ASC 280, *Segment Reporting*. We determined that our Michaels U.S., Michaels Canada, and Aaron Brothers operating segments have similar economic characteristics and meet the aggregation criteria set forth in ASC 280. Therefore, we combine those operating segments into one reporting segment. As of May 4, 2013, the online scrapbooking business operating segment was immaterial to the financial statements as a whole. Accordingly, we will report in two reportable segments if Net sales, Operating income or loss, or Total assets of the online scrapbooking operating segment exceeds 10% of the consolidated amounts.

Our sales and assets by country are as follows:

	Quarter Ended May 4, 2013	April 28, 2012
	(in millions)	
Net Sales:		
United States	$ 899	$ 891
Canada	94	87
Consolidated Total	$ 993	$ 978

	May 4, 2013 (Restated)	February 2, 2013 (Restated) (in millions)	April 28, 2012 (Restated)
Total Assets:			
United States	$ 1,443	$ 1,446	$ 1,769
Canada	92	109	115
Consolidated Total	$ 1,535	$ 1,555	$ 1,884

Our chief operating decision makers evaluate historical operating performance, plan and forecast future periods operating performance based on earnings before interest, income taxes, depreciation, amortization, and refinancing costs and losses on early extinguishment of debt (EBITDA (excluding refinancing costs and losses on early extinguishment of debt)). We believe EBITDA (excluding refinancing costs and losses on early extinguishment of debt) represents the financial measure that more closely reflects the operating effectiveness of factors over which management has control. As such, an element of base incentive compensation targets for certain management personnel are based on EBITDA (excluding refinancing costs and losses on early extinguishment of debt). A reconciliation of EBITDA (excluding refinancing costs and losses on early extinguishment of debt) to Net income is presented below.

	Quarter Ended May 4, 2013	April 28, 2012 Restated
	(in millions)	
Net income	$ 46	$ 51
Interest expense	47	66
Refinancing costs and losses on early extinguishments of debt	7	
Provision for income taxes	28	28
Depreciation and amortization	25	24

EBITDA (excluding refinancing costs and losses on early extinguishments of debt)	$ 153	$ 169

Note 9. Related Party Transactions

We pay annual management fees to Bain Capital Partners, LLC (Bain Capital) and The Blackstone Group L.P. (The Blackstone Group and, together with Bain Capital, the Sponsors) and Highfields Capital Management LP in the amount of $12 million and $1 million, respectively. We recognized $4 million and $3 million of expense related to annual management fees

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during the first quarter of fiscal 2013 and fiscal 2012, respectively. These expenses are included in related party expenses on the Consolidated Statements of Comprehensive Income.

Bain Capital owns a majority equity position in LogicSource, an external vendor we utilize for print procurement services. Payments associated with this vendor during each of the first quarters of fiscal 2013 and fiscal 2012 were $1 million and $2 million, respectively. These expenses are included in Selling, general and administrative expense on the Consolidated Statements of Comprehensive Income.

The Blackstone Group owns a majority equity position in Brixmor Properties Group, a vendor we utilize to lease certain properties. Payments associated with this vendor during each of the first quarters of fiscal 2013 and fiscal 2012 were $1 million. These expenses are included in Cost of sales and occupancy expense in the Consolidated Statements of Comprehensive Income.

The Blackstone Group owns a majority equity position in RGIS, an external vendor we utilize to count our store inventory. Payments associated with this vendor during the first quarters of fiscal 2013 and fiscal 2012 were $1 million and $2 million, respectively. These expenses are included in Selling, general and administrative expense on the Consolidated Statements of Comprehensive Income.

The Blackstone Group owns a majority equity position in Vistar, an external vendor we utilize for all of the candy-type items in our stores. Payments associated with this vendor during the first quarter of fiscal 2013 and fiscal 2012 were $6 million and $5 million, respectively. These expenses are recognized in cost of sales as the sales are recorded.

Our current directors (other than Jill A. Greenthal) 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 May 4, 2013, affiliates of The Blackstone Group held $34 million of our senior secured term loan.

Note 10. Condensed Consolidating Financial Information

All obligations of Michaels Stores, Inc. under our notes, the Restated Revolving Credit Facility and the Rested Term Loan Credit Facility are guaranteed by each of our subsidiaries other than Aaron Brothers Card Services, LLC, Artistree of Canada, ULC and Michaels Stores of Puerto Rico, LLC. As of May 4, 2013, the financial statements of Aaron Brothers Card Services, LLC, Artistree of Canada, ULC and Michaels Stores of Puerto Rico, LLC were immaterial. Each subsidiary guarantor is 100% owned by the parent and all guarantees are joint and several and full and unconditional.

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.

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Supplemental Condensed Consolidating Balance Sheet

	May 4, 2013			
	Parent Company (Restated)	Guarantor Subsidiaries (Restated)	Eliminations (Restated)	Consolidated (Restated)
	(in millions)			
ASSETS				
Current assets:				
Cash and equivalents	$ 32	$ 23	$	$ 55
Merchandise inventories	588	255		843
Intercompany receivables		442	(442)	
Other	108	22		130
Total current assets	728	742	(442)	1,028
Property and equipment, net	272	69		341
Goodwill	94			94
Investment in subsidiaries	430		(430)	
Other assets	69	3		72
Total assets	$ 1,593	$ 814	$ (872)	$ 1,535
LIABILITIES AND STOCKHOLDERS DEFICIT				
Current liabilities:				
Accounts payable	$ 4	$ 228	$	$ 232
Accrued liabilities and other	177	123		300
Share-based compensation	23	13		36
Current portion of long-term debt	198			198
Intercompany payable	442		(442)	
Other	31			31
Total current liabilities	875	364	(442)	797
Long-term debt	2,887			2,887
Share-based compensation	19	9		28
Other long-term liabilities	70	11		81
Total stockholders deficit	(2,258)	430	(430)	(2,258)
Total liabilities and stockholders deficit	$ 1,593	$ 814	$ (872)	$ 1,535

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Supplemental Condensed Consolidating Balance Sheet

	February 2, 2013			
	Parent Company	Guarantor Subsidiaries	Eliminations	Consolidated
	(Restated) (In millions)			
ASSETS				
Current assets:				
Cash and equivalents	$ 37	$ 19	$	$ 56
Merchandise inventories	591	271		862
Intercompany receivables		329	(329)	
Other	105	21		126
Total current assets	733	640	(329)	1,044
Property and equipment, net	271	67		338
Goodwill, net	94			94
Investment in subsidiaries	284		(284)	
Other assets	76	3		79
Total assets	$ 1,458	$ 710	$ (613)	$ 1,555
LIABILITIES AND STOCKHOLDERS DEFICIT				
Current liabilities:				
Accounts payable	5	258		263
Accrued liabilities and other	235	132		367
Share-based Compensation	22	13		35
Current portion of long-term debt	150			150
Intercompany payable	329		(329)	
Other	36	5		41
Total current liabilities	777	408	(329)	856
Long-term debt	2,891			2,891
Other long-term liabilities	73	12		85
Shared based Compensation	21	6		27
Total stockholders deficit	(2,304)	284	(284)	(2,304)
Total liabilities and stockholders deficit	$ 1,458	$ 710	$ (613)	$ 1,555

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Supplemental Condensed Consolidating Balance Sheet

	April 28, 2012			
	Parent Company (Restated)	Guarantor Subsidiaries (Restated)	Eliminations (Restated)	Consolidated (Restated)
	(in millions)			
ASSETS				
Current assets:				
Cash and equivalents	$ 372	$ 13	$	$ 385
Merchandise inventories	577	303		880
Intercompany receivables		570	(570)	
Other	104	20		124
Total current assets	1,053	906	(570)	1,389
Property and equipment, net	250	60		310
Goodwill	95			95
Investment in subsidiaries	552		(552)	
Other assets	87	3		90
Total assets	$ 2,037	$ 969	$ (1,122)	$ 1,884
LIABILITIES AND STOCKHOLDERS DEFICIT				
Current liabilities:				
Accounts payable	$ 10	$ 270	$	$ 280
Accrued liabilities and other	269	119		388
Share based compensation liability	18	10		28
Current portion of long-term debt	127			127
Intercompany payable	570		(570)	
Other	28			28
Total current liabilities	1,022	399	(570)	851
Long-term debt	3,363			3,363
Share based compensation liability	15	7		22
Other long-term liabilities	85	11		96
Total stockholders deficit	(2,448)	552	(552)	(2,448)
Total liabilities and stockholders deficit	$ 2,037	$ 969	$ (1,122)	$ 1,884

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Supplemental Condensed Consolidating Statement of Comprehensive Income

	Quarter Ended May 4, 2013			
	Parent Company (Restated)	Guarantor Subsidiaries (Restated)	Eliminations (Restated)	Consolidated (Restated)
	(in millions)			
Net sales	$ 869	$ 547	$ (423)	$ 993
Cost of sales and occupancy expense	555	452	(423)	584
Gross profit	314	95		409
Selling, general, and administrative expense	234	38		272
Share-based compensation	2	1		3
Related party expenses	4			4
Store pre-opening costs	2			2
Operating income	72	56		128
Interest expense	47			47
Refinancing costs and losses on early extinguishment of debt	7			7
Intercompany charges (income)	13	(13)		
Equity in earnings of subsidiaries	69		(69)	
Income before income taxes	74	69	(69)	74
Provision for income taxes	28	26	(26)	28
Net income	46	43	(43)	46
Other comprehensive income, net of tax:				
Foreign currency translation adjustment and other	(1)			(1)
Comprehensive income	$ 45	$ 43	$ (43)	$ 45

Supplemental Condensed Consolidating Statement of Comprehensive Income

	Quarter Ended April 28, 2012			
	Parent Company (Restated)	Guarantor Subsidiaries (Restated)	Eliminations (Restated)	Consolidated (Restated)
	(in millions)			
Net sales	$ 861	$ 549	$ (432)	$ 978
Cost of sales and occupancy expense	537	462	(432)	567
Gross profit	324	87		411
Selling, general, and administrative expense	224	35		259
Share-based compensation	4			4
Related party expenses	3			3
Store pre-opening costs	1			1
Operating income	92	52		144
Interest expense	66			66
Other (income) and expense, net	(1)			(1)
Intercompany charges (income)	17	(17)		
Equity in earnings of subsidiaries	69		(69)	
Income before income taxes	79	69	(69)	79

Provision for income taxes	28	25	(25)	28
Net income	51	44	(44)	51