EURONET WORLDWIDE INC
Form 10-Q
May 09, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

For the quarterly period ended March 31, 2008

OR

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

Commission File Number: 001-31648
EURONET WORLDWIDE, INC.
(Exact name of the registrant as specified in its charter)

Delaware	**74-2806888**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. employer identification no.)**

4601 COLLEGE BOULEVARD, SUITE 300
LEAWOOD, KANSAS 66211
(Address of principal executive offices)
(913) 327-4200
(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 þ 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. (Check one):

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

The number of shares of the issuer s common stock, $0.02 par value, outstanding as of April 30, 2008 was 49,035,026 shares.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

EURONET WORLDWIDE, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(In thousands, except share and per share data)

	As of	
	March 31, 2008 (unaudited)	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 237,097	$ 267,591
Restricted cash	87,594	140,222
Inventory PINs and other	50,654	50,265
Trade accounts receivable, net of allowances for doubtful accounts of $7,289 at March 31, 2008 and $6,248 at December 31, 2007	273,272	290,378
Deferred income taxes, net	14,298	13,570
Prepaid expenses and other current assets	48,391	40,458
Total current assets	711,306	802,484
Property and equipment, net of accumulated depreciation of $133,796 at March 31, 2008 and $119,742 at December 31, 2007	97,623	88,984
Goodwill	798,731	762,723
Acquired intangible assets, net of accumulated amortization of $53,750 at March 31, 2008 and $45,561 at December 31, 2007	155,889	156,751
Deferred income taxes, net	36,879	30,822
Other assets, net of accumulated amortization of $14,682 at March 31, 2008 and $13,270 at December 31, 2007	22,393	44,392
Total assets	$ 1,822,821	$ 1,886,156
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Trade accounts payable	$ 235,538	$ 307,108
Accrued expenses and other current liabilities	194,552	169,246
Current portion of capital lease obligations	5,414	5,079
Short-term debt obligations and current maturities of long-term debt obligations	1,900	1,910
Income taxes payable	12,589	15,619
Deferred income taxes	7,991	7,609
Deferred revenue	16,262	16,603
Total current liabilities	474,246	523,174
Debt obligations, net of current portion	479,987	539,303
Capital lease obligations, net of current portion	11,169	11,520
Deferred income taxes	87,323	74,641

Other long-term liabilities	8,894	4,641
Minority interest	10,323	8,975
Total liabilities	1,071,942	1,162,254
Stockholders equity:		
Preferred Stock, $0.02 par value. Authorized 10,000,000 shares; none issued		
Common Stock, $0.02 par value. 90,000,000 shares authorized; 49,210,963 issued at March 31, 2008 and 49,159,968 issued at December 31, 2007	984	983
Additional paid-in-capital	661,530	658,047
Treasury stock, at cost, 210,298 shares at March 31, 2008 and 207,065 shares at December 31, 2007	(493)	(379)
Accumulated deficit	(12,741)	(5,905)
Restricted reserve	1,001	957
Accumulated other comprehensive income	100,598	70,199
Total stockholders equity	750,879	723,902
Total liabilities and stockholders equity	$ 1,822,821	$ 1,886,156

See accompanying notes to the consolidated financial statements.

EURONET WORLDWIDE, INC. AND SUBSIDIARIES
Consolidated Statements of Operations and Comprehensive Income
(Unaudited, in thousands, except share and per share data)

	Three Months Ended March 31,	
	2008	**2007**
Revenues:		
EFT Processing Segment	$ 50,506	$ 42,047
Prepaid Processing Segment	144,225	127,581
Money Transfer Segment	52,332	789
Total revenues	247,063	170,417
Operating expenses:		
Direct operating costs	165,953	120,664
Salaries and benefits	32,933	18,929
Selling, general and administrative	21,621	10,802
Depreciation and amortization	14,450	8,105
Total operating expenses	234,957	158,500
Operating income	12,106	11,917
Other income (expense):		
Interest income	3,826	4,345
Interest expense	(6,867)	(3,581)
Income from unconsolidated affiliates	243	240
Impairment loss on investment securities	(17,502)	
Loss on early retirement of debt	(155)	
Foreign currency exchange gain, net	13,073	433
Total other income (expense)	(7,382)	1,437
Income from continuing operations before income taxes and minority interest	4,724	13,354
Income tax expense	(10,997)	(3,884)
Minority interest	(563)	(353)
Income (loss) from continuing operations	(6,836)	9,117
Gain from discontinued operations		344
Net income (loss)	(6,836)	9,461
Translation adjustment	31,722	2,615
Unrealized loss on interest rate swaps	(751)	
Impairment loss on investment securities	(572)	

Comprehensive income	$	23,563	$	12,076
Earnings (loss) per share basic:				
Continuing operations	$	(0.14)	$	0.24
Discontinued operations				0.01
Total	$	(0.14)	$	0.25
Basic weighted average shares outstanding		48,956,945		38,434,178
Earnings (loss) per share diluted:				
Continuing operations	$	(0.14)	$	0.22
Discontinued operations			$	0.01
Total	$	(0.14)	$	0.23
Diluted weighted average shares outstanding		48,956,945		43,688,014

See accompanying notes to the consolidated financial statements.

EURONET WORLDWIDE, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(Unaudited, in thousands)

	Three Months Ended March 31,	
	2008	**2007**
Net income (loss)	$ (6,836)	$ 9,461
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	14,450	8,105
Share-based compensation	2,907	1,874
Foreign exchange (gain) loss, net	(13,073)	1,044
Non-cash impairment of investment securities	17,502	
Gain from discontinued operations		(344)
Deferred income tax expense (benefit)	4,657	(348)
Income assigned to minority interest	563	353
Income from unconsolidated affiliates	(243)	(240)
Amortization of debt obligations issuance expense	725	283
Changes in working capital, net of amounts acquired:		
Income taxes payable, net	(1,579)	2,677
Restricted cash	27,484	(1,564)
Inventory PINs and other	1,821	1,567
Trade accounts receivable	25,987	12,267
Prepaid expenses and other current assets	(3,531)	(3,995)
Trade accounts payable	(75,877)	(28,253)
Deferred revenue	(624)	1,201
Accrued expenses and other current liabilities	19,368	3,318
Other, net	892	84
Net cash provided by operating activities	14,593	7,490
Cash flows from investing activities:		
Acquisitions, net of cash acquired	(1,786)	(14,959)
Acquisition escrow	26,000	(26,000)
Purchases of property and equipment	(10,001)	(3,384)
Purchases of other long-term assets	(938)	(2,008)
Other, net	182	51
Net cash provided (used) by investing activities	13,457	(46,300)
Cash flows from financing activities:		
Proceeds from issuance of shares	462	160,432
Net repayments of short-term debt obligations and revolving credit agreements classified as current liabilities	(215)	
	23,500	9,000

Borrowings from revolving credit agreements classified as non-current liabilities		
Repayments of revolving credit agreements classified as non-current liabilities	(74,143)	(28,157)
Repayments of long-term debt obligations	(10,000)	
Repayments of capital lease obligations	(2,263)	(2,839)
Cash dividends paid to minority interest stockholders		(1,572)
Other, net	67	11
Net cash provided (used) by financing activities	(62,592)	136,875
Effect of exchange differences on cash	4,048	366
Increase (decrease) in cash and cash equivalents	(30,494)	98,431
Cash and cash equivalents at beginning of period	267,591	321,058
Cash and cash equivalents at end of period	$ 237,097	$ 419,489
Interest paid during the period	$ 4,149	$ 1,153
Income taxes paid during the period	6,881	2,075

See accompanying notes to the consolidated financial statements.

EURONET WORLDWIDE, INC. AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(1) GENERAL

Organization

Euronet Worldwide, Inc. and its subsidiaries (the Company or Euronet) is an industry leader in processing secure electronic financial transactions. Euronet s Prepaid Processing Segment is one of the world s largest providers of top-up services for prepaid products, primarily prepaid mobile airtime. The EFT Processing Segment provides end-to-end solutions relating to operations of automated teller machine (ATM) and Point of Sale (POS) networks, and debit and credit card processing in Europe, the Middle East and Asia. The Money Transfer Segment, comprised primarily of the Company s RIA Envia, Inc. (RIA) subsidiary and its operating subsidiaries, is the third-largest global money transfer company based upon revenues and volumes and provides services through a sending network of agents and Company-owned stores in the U.S., the Caribbean, Europe and Asia, disbursing money transfers through a worldwide payer network.

Basis of presentation

The accompanying unaudited consolidated financial statements have been prepared from the records of the Company, in conformity with accounting principles generally accepted in the U.S. (U.S. GAAP) and pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). In the opinion of management, such unaudited consolidated financial statements contain all adjustments (consisting of normal interim closing procedures) necessary to present fairly the financial position of the Company as of March 31, 2008, and the results of its operations and cash flows for the three-month periods ended March 31, 2008 and 2007.

The unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements of Euronet for the year ended December 31, 2007, including the notes thereto, set forth in the Company s 2007 Annual Report on Form 10-K.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The results of operations for the three-month period ended March 31, 2008 are not necessarily indicative of the results to be expected for the full year ending December 31, 2008. Certain amounts in prior years have been reclassified to conform to current period presentation.

Goodwill and acquired intangible translation adjustment

During the third quarter 2007, the Company corrected an immaterial error related to foreign currency translation adjustments for goodwill and acquired intangible assets recorded in connection with acquisitions completed during periods prior to December 31, 2006. The impact of this correction on the Company s Unaudited Statements of Operations and Comprehensive Income was to increase depreciation and amortization expense by $0.2 million, decrease operating income by $0.2 million, reduce net income by $0.1 million and decrease diluted earnings per share by $0.01 for the three months ended March 31, 2007. Due primarily to the impact of the correction on the Company s foreign currency translation adjustment, total comprehensive income increased by $1.3 million for the three months ended March 31, 2007. This correction did not impact the Company s cash flows from operating, financing or investing activities.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND PRACTICES

Fair Value Measurements

Effective January 1, 2008, the Company adopted the provisions of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements for financial assets and liabilities. This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The Statement applies whenever other accounting pronouncements require or permit fair value measurements. Accordingly, this Statement does not require any new fair value measurements.

Additionally, FASB Staff Position No. 157-2, Effective Date of FASB Statement No. 157, delayed the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008 for certain nonfinancial assets and liabilities. Beginning January 1, 2009, the Company will adopt the provisions for those nonfinancial assets and liabilities, which include those measured at fair value in goodwill impairment testing, indefinite-lived intangible assets measured at fair

value for impairment assessment, nonfinancial long-lived assets measured at fair value for impairment assessment and investments in unconsolidated subsidiaries. The Company does not expect the provisions of SFAS No. 157 related to these items to have a material impact on its consolidated financial statements. See Note 9, Fair Value Measurements, for the required fair value disclosures.

Investment in MoneyGram International, Inc.

The Company s investment in MoneyGram International, Inc. (MoneyGram) was classified as available-for-sale as of December 31, 2007 and was recorded in other assets on the Company s Consolidated Balance Sheet. During the first quarter 2008, the Company decided not to pursue the acquisition of MoneyGram. Also, during the first quarter 2008, the value of the Company s investment in MoneyGram declined and the Company determined the decline to be other than temporary. Accordingly, the Company recognized $17.5 million in

impairment losses associated with the investment and reversed the $0.6 million gain recorded during 2007 in other comprehensive income. Because of the Company s decision not to submit a proposal to acquire MoneyGram, the investment was reclassified to other current assets on the Company s Unaudited Consolidated Balance Sheet as of March 31, 2008. During the first quarter 2008, the Company also recorded acquisition related expenses totaling $3.0 million, which are included in selling, general and administrative expenses.

Money transfer settlement obligations

Money transfer settlement obligations are recorded in accrued expenses and other current liabilities on the Company s Unaudited Consolidated Balance Sheets and consist of amounts owed by Euronet to money transfer recipients. As of March 31, 2008, the Company s money transfer settlement obligations were $39.8 million.

Accounting for derivative instruments and hedging activities

The Company accounts for derivative instruments and hedging activities in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended (SFAS No. 133), which requires that all derivative instruments be recognized as either assets or liabilities on the balance sheet at fair value. During the second quarter 2007, the Company entered into derivative instruments to manage exposure to interest rate risk that are considered cash flow hedges under the provisions of SFAS No. 133. To qualify for hedge accounting under SFAS No. 133, the details for the hedging relationship must be formally documented at the inception of the arrangement, including the Company s hedging strategy, risk management objective, the specific risk being hedged, the derivative instrument being used, the item being hedged, an assessment of hedge effectiveness and how effectiveness will continue to be assessed and measured. For the effective portion of a cash flow hedge, changes in the value of the hedge instrument are recorded temporarily in stockholders equity as a component of other comprehensive income and then recognized as an adjustment to interest expense over the term of the hedging instrument.

In the Money Transfer Segment, the Company enters into foreign currency forward contracts to offset foreign currency exposure related to the notional value of money transfer transactions collected or paid in currencies other than the U.S. dollar. These forward contracts are considered derivative instruments under the provisions of SFAS No. 133, however, the Company does not designate such instruments as hedges. Accordingly, changes in the value of these contracts are recognized immediately as a component of foreign currency exchange gain, net in the Unaudited Consolidated Statements of Operations and Comprehensive Income. The impact of changes in value of these forward contracts, together with the impact of the change in value of the related foreign currency denominated receivable or payable, on the Company s Unaudited Consolidated Statements of Operations and Comprehensive Income is not significant.

Cash flows resulting from derivative instruments are classified as cash flows from operating activities in the Company s Unaudited Consolidated Statements of Cash Flows. The Company enters into derivative instruments with highly credit-worthy financial institutions and does not use derivative instruments for trading or speculative purposes. See Note 6, Derivative Instruments and Hedging Activities, for further discussion of derivative instruments.

Recent accounting pronouncements

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, which requires enhanced disclosures about an entity s derivative and hedging activities, including: (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. This Statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. This Statement encourages, but does not require, comparative disclosures for earlier periods at initial adoption. Management of the Company is still evaluating the impact of the adoption of SFAS No. 161; however, the impact is not expected to be material.

(3) EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share has been computed by dividing earnings (loss) available to common stockholders by the weighted average number of common shares outstanding during the respective period. Diluted earnings (loss) per share has been computed by dividing earnings (loss) available to common stockholders by the weighted-average shares outstanding during the respective period, after adjusting for the potential dilution of the assumed conversion of

the Company s convertible debentures, shares issuable in connection with acquisition obligations, restricted stock and options to purchase the Company s common stock. The following table provides a reconciliation of net income to earnings available to common stockholders and the computation of diluted weighted average number of common shares outstanding:

(dollar amounts in thousands)	Three Months Ended March 31, 2007
Reconciliation of net income to earnings available to common stockholders:	
Net income	$ 9,461
Add: interest expense related to 1.625% convertible debentures	737
Earnings available to common stockholders	$ 10,198
Computation of diluted weighted average shares outstanding:	
Basic weighted average shares outstanding	38,434,178
Additional shares from assumed conversion of 1.625% convertible debentures	4,163,488
Incremental shares from assumed conversion of stock options and restricted stock	1,090,348
Potentially diluted weighted average shares outstanding	43,688,014

The table includes all stock options and restricted stock that are dilutive to Euronet s weighted average common shares outstanding during the period. For the three months ended March 31, 2008, the Company incurred a net loss; therefore, diluted loss per share is the same as basic loss per share. For the three-month periods ended March 31, 2008 and 2007, the calculation of diluted earnings (loss) per share excludes approximately 3,192,000 and 295,000, respectively, stock options or shares of restricted stock that are anti-dilutive to the Company s weighted average common shares outstanding. Additionally, for the three months ended March 31, 2008, the calculation of diluted loss per share excludes approximately 953,000 shares issuable in connection with acquisition obligations that are anti-dilutive to the Company s weighted average common shares outstanding.

The Company has $140 million of 1.625% convertible debentures due 2024 and $175 million of 3.50% convertible debentures due 2025 outstanding that, if converted, would have a potentially dilutive effect on the Company s stock. These debentures are convertible into 4.2 million shares of Common Stock for the $140 million 1.625% issue, and 4.3 million shares of Common Stock for the $175 million 3.50% issue only upon the occurrence of certain conditions. As required by EITF Issue No. 04-8, The Effect of Contingently Convertible Debt on Diluted Earnings per Share, if dilutive, the impact of the contingently issuable shares must be included in the calculation of diluted earnings per share under the if-converted method, regardless of whether the conditions upon which the debentures would be convertible into shares of the Company s Common Stock have been met. Under the if-converted method, the assumed conversion of the 1.625% convertible debentures was anti-dilutive for the three months ended March 31, 2008 and dilutive for the three months ended March 31, 2007. Under the if-converted method, the assumed conversion of the 3.50% convertible debentures was anti-dilutive for both three-month periods ended March 31, 2008 and 2007.

(4) GOODWILL AND ACQUIRED INTANGIBLE ASSETS, NET

A summary of acquired intangible assets and goodwill activity for the three-month period ended March 31, 2008 is presented below:

(in thousands)	Acquired Intangible Assets	Goodwill	Total Intangible Assets
Balance as of December 31, 2007	$ 156,751	$ 762,723	$ 919,474
Increases (decreases):			

Adjustment to acquisition of RIA		132	132
Amortization	(6,354)		(6,354)
Other (primarily changes in foreign currency exchange rates)	5,492	35,876	41,368
Balance as of March 31, 2008	$ 155,889	$ 798,731	$ 954,620

Estimated annual amortization expense on intangible assets with finite lives, before income taxes, as of March 31, 2008, is expected to total $25.6 million for 2008, $25.5 million for 2009, $25.0 million for 2010, $19.9 million for 2011, $17.3 million for 2012 and $12.2 million for 2013.

The Company s annual goodwill impairment test is performed during the fourth quarter. The Company s annual impairment test for the year ended December 31, 2007 indicated that there were no impairments. Determining the fair value of reporting units requires significant management judgment in estimating future cash flows and assessing potential market and economic conditions. It is reasonably possible that the Company s operations will not perform as expected, or that estimates or assumptions could change, which may result in the Company recording material non-cash impairment charges during the year in which these changes take place.

(5) DEBT OBLIGATIONS

A summary of debt obligation activity for the three-month period ended March 31, 2008 is presented below:

(in thousands)	Revolving Credit Facilities	Other Debt Obligations	Capital Leases	1.625% Convertible Debentures Due 2024	3.50% Convertible Debentures Due 2025	Term Loan	Total
Balance at December 31, 2007	$ 62,203	$ 10	$ 16,599	$ 140,000	$ 175,000	$ 164,000	$ 557,812
Increases (decreases):							
Net repayments	(50,643)	(215)	(1,612)			(10,000)	(62,470)
Capital lease interest			387				387
Foreign exchange gain	1,327	205	1,209				2,741
Balance at March 31, 2008	12,887		16,583	140,000	175,000	154,000	498,470
Less current maturities			(5,414)			(1,900)	(7,314)
Long-term obligations at March 31, 2008	$ 12,887	$	$ 11,169	$ 140,000	$ 175,000	$ 152,100	$ 491,156

During the three months ended March 31, 2008, the Company repaid $10.0 million of the term loan, of which $0.5 million was a scheduled repayment. The remaining $9.5 million represents prepayment of amounts not yet due and resulted in the Company recognizing a $0.2 million pre-tax loss on early retirement of debt.

(6) DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

During 2007, the Company entered into interest rate swap agreements for a total notional amount of $50 million to manage interest rate exposure related to a portion of the term loan, which currently bears interest at LIBOR plus 200 basis points. The interest rate swap agreements are determined to be cash flow hedges and effectively convert $50 million of the term loan to a fixed interest rate of 7.3% through the May 2009 maturity date of the swap agreements. As of March 31, 2008, the Company has recorded a liability of $1.7 million in the other long-term liabilities caption on the Company s Unaudited Consolidated Balance Sheet to recognize the fair value of the swap agreements. The impact to accumulated other comprehensive income for the first quarter 2008 was a loss of $0.8 million. The fair value of swap agreements is based on the London Inter-Bank Offered Rate ("LIBOR") swap rate, credit spreads and other relevant market conditions.

As of March 31, 2008, the Company had foreign currency forward contracts outstanding with a notional value of $52.9 million, primarily in euros, which were not designated as hedges and had a weighted average maturity of six days.

(7) STOCK PLANS

During the first quarter 2008, the Company granted 147,402 shares of performance-based restricted stock to executives, having a total value of $2.9 million on the grant date. The shares shall vest during the years 2009 through 2013 upon the attainment of certain financial performance goals, combined with continued employment on the vesting date. Additionally, 22,651 shares of restricted stock were granted or accelerated during the first quarter 2008, having a value of $0.5 million on the date the shares were granted or accelerated, in connection with severance benefits due to an executive officer of the Company who resigned during the first quarter 2008.

(8) SEGMENT INFORMATION

Euronet s reportable operating segments have been determined in accordance with SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information. The Company currently operates in the following three reportable operating segments.

1) Through the EFT Processing Segment, the Company processes transactions for a network of ATMs and POS terminals across Europe, Asia and Africa. The Company provides comprehensive electronic payment solutions consisting of ATM network participation, outsourced ATM and POS management solutions, credit and debit card outsourcing and electronic recharge services for prepaid mobile airtime. Through this segment, the Company also offers a suite of integrated electronic financial transaction (EFT) software solutions for electronic payment, merchant acquiring, card issuing and transaction delivery systems.

2) Through the Prepaid Processing Segment, the Company provides distribution of prepaid mobile airtime and other prepaid products and collection services in the U.S., Europe, Africa, Asia Pacific and the Middle-East.

3) Through the Money Transfer Segment, the Company provides global money transfer and bill payment services through a sending network of agents and Company-owned stores primarily in North America, the Caribbean, Europe and Asia Pacific, disbursing money transfers through a worldwide payer network.

In addition, in its administrative division, Corporate Services, Eliminations and Other, the Company accounts for non-operating activity, certain intersegment eliminations and the costs of providing corporate and other administrative services to the three segments. These services are not directly identifiable with the Company s reportable operating segments. The following tables present the segment results of the Company s operations for the three-month periods ended March 31, 2008 and 2007:

	For the Three Months Ended March 31, 2008				
(in thousands)	**EFT Processing**	**Prepaid Processing**	**Money Transfer**	**Corporate Services, Eliminations and Other**	**Consolidated**
Total revenues	$ 50,506	$ 144,225	$ 52,332	$	$ 247,063
Operating expenses:					
Direct operating costs	21,752	117,856	26,345		165,953
Salaries and benefits	10,147	6,568	11,757	4,461	32,933
Selling, general and administrative	4,450	5,275	7,452	4,444	21,621
Depreciation and amortization	5,137	4,192	4,827	294	14,450
Total operating expenses	41,486	133,891	50,381	9,199	234,957
Operating income (loss)	$ 9,020	$ 10,334	$ 1,951	$ (9,199)	$ 12,106

	For the Three Months Ended March 31, 2007				
(in thousands)	**EFT Processing**	**Prepaid Processing**	**Money Transfer**	**Corporate Services, Eliminations and Other**	**Consolidated**
Total revenues	$ 42,047	$ 127,581	$ 789	$	$ 170,417
Operating expenses:					
Direct operating costs	16,923	103,230	511		120,664
Salaries and benefits	9,254	6,385	590	2,700	18,929
Selling, general and administrative	4,864	4,577	451	910	10,802
Depreciation and amortization	4,068	3,873	104	60	8,105
Total operating expenses	35,109	118,065	1,656	3,670	158,500
Operating income (loss)	$ 6,938	$ 9,516	$ (867)	$ (3,670)	$ 11,917

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(9) FAIR VALUE MEASUREMENTS

The Company s assets and liabilities recorded at fair value on a recurring basis are set forth in the following table:

	Fair Value Measurements as of March 31, 2008 Using	
(in thousands)	Quoted Prices in Active Markets for Identical Assets	Signifcant Other Observable Inputs
Available for sale investment securities	$ 2,488	$
Interest rate swaps related to floating rate debt		(1,745)
Foreign currency derivative contracts		(258)

The Company values available for sale investment securities using quoted prices from the securities primary exchange. Interest rate swaps are valued using present value measurements based on the LIBOR swap rate, credit spreads and other relevant market conditions. Foreign currency derivative contracts are valued using foreign currency quotes for similar assets and liabilities.

(10) NONCASH FINANCING AND INVESTING ACTIVITIES

Capital lease obligations of $0.7 million and $1.5 million were incurred during the first quarter 2008 and 2007, respectively. The Company issued Euronet common stock valued at $7.6 million for an acquisition completed during the first quarter 2007.

(11) CONTINGENCIES

On January 12, 2007, the Company signed a stock purchase agreement to acquire La Nacional and certain of its affiliates (La Nacional), subject to regulatory approvals and other customary closing conditions. In connection with this agreement, on January 16, 2007, the Company deposited $26 million in an escrow account created for the proposed acquisition. The escrowed funds were not permitted to be released except upon mutual agreement of the Company and La Nacional s stockholder or through legal remedies available in the agreement.

On April 5, 2007, the Company gave notice to the stockholder of La Nacional of the termination of the stock purchase agreement, alleging certain breaches of the terms thereof by La Nacional and requested the release of the $26 million held in escrow under the terms of the agreement. La Nacional s stockholder denied such breaches occurred, contested such termination and did not consent to our request for release of the escrowed funds. While pursuing all legal remedies available to us, we engaged in negotiations with La Nacional and its stockholder to determine whether the dispute could be resolved through revised terms for the acquisition or some other mutually agreeable method.

On January 10, 2008, the Company entered into a settlement agreement with La Nacional and its stockholder evidencing the parties mutual agreement not to consummate the acquisition of La Nacional, in exchange for payment by Euronet of a portion of the legal fees incurred by La Nacional. Among other terms and conditions, the settlement agreement contains mutual releases in connection with litigation and provided for the release to the Company in the first quarter 2008 of the $26 million held in escrow, plus interest earned on the escrowed funds.

(12) FEDERAL EXCISE TAX REFUND

During 2006, the Internal Revenue Service (IRS) announced that Internal Revenue Code Section 4251 (relating to communications excise tax) will no longer apply to, among other services, prepaid mobile airtime services such as those offered by the Company s Prepaid Processing Segment s U.S. operations. Additionally, companies that paid this excise tax during the period beginning on March 1, 2003 and ending on July 31, 2006, are entitled to a credit or refund of amounts paid in conjunction with the filing of 2006 federal income tax returns. During the fourth quarter 2007, the IRS completed an initial field examination confirming the amount of the claim and, therefore, the Company recorded $12.2 million for the amount of the refund claimed as a reduction to operating expenses of the Prepaid Processing

Segment and as an other current asset. In addition, the Company will receive approximately $1.2 million in interest on the amount claimed, which was recorded as interest income in the first quarter 2008.

(13) GUARANTEES

As of March 31, 2008, the Company had $33.5 million of stand-by letters of credit/bank guarantees issued on its behalf, of which $1.8 million are collateralized by cash deposits held by the respective issuing banks.

Euronet regularly grants guarantees in support of obligations of subsidiaries. As of March 31, 2008, the Company granted off balance sheet guarantees for cash in various ATM networks amounting to $25.9 million over the terms of the cash supply agreements and performance guarantees amounting to approximately $28.1 million over the terms of the agreements with the customers.

From time to time, Euronet enters into agreements with unaffiliated parties that contain indemnification provisions, the terms of which may vary depending on the negotiated terms of each respective agreement. The amount of such potential obligations is generally not stated in the agreements. Our liability under such indemnification provisions may be mitigated by relevant insurance coverage and may be subject to time and materiality limitations, monetary caps and other conditions and defenses. Such indemnification obligations include the following:

- In connection with contracts with financial institutions in the EFT Processing Segment, the Company is responsible for damages to ATMs and theft of ATM network cash that, generally, is not recorded on the Company s Consolidated Balance Sheet. As of March 31, 2008, the balance of ATM network cash for which the Company was responsible was approximately $300 million. The Company maintains insurance policies to mitigate this exposure;
- In connection with the license of proprietary systems to customers, Euronet provides certain warranties and infringement indemnities to the licensee, which generally warrant that such systems do not infringe on intellectual property owned by third parties and that the systems will perform in accordance with their specifications;
- Euronet has entered into purchase and service agreements with vendors and consulting agreements with providers of consulting services, pursuant to which the Company has agreed to indemnify certain of such vendors and consultants, respectively, against third-party claims arising from the Company s use of the vendor s product or the services of the vendor or consultant;
- In connection with acquisitions and dispositions of subsidiaries, operating units and business assets, the Company has entered into agreements containing indemnification provisions, which can be generally described as follows: (i) in connection with acquisitions made by Euronet, the Company has agreed to indemnify the seller against third party claims made against the seller relating to the subject subsidiary, operating unit or asset and arising after the closing of the transaction, and (ii) in connection with dispositions made by Euronet, Euronet has agreed to indemnify the buyer against damages incurred by the buyer due to the buyer s reliance on representations and warranties relating to the subject subsidiary, operating unit or business assets in the disposition agreement if such representations or warranties were untrue when made;
- Euronet has entered into agreements with certain third parties, including banks that provide fiduciary and other services to Euronet or to the Company s benefit plans. Under such agreements, the Company has agreed to indemnify such service providers for third party claims relating to the carrying out of their respective duties under such agreements; and
- The Company has obtained surety bonds in compliance with money transfer licensing requirements of the applicable governmental authorities and has agreed to reimburse the surety for any amounts that they are required to pay in connection with such bonds.

The Company is also required to meet minimum capitalization and cash requirements of various regulatory authorities in the jurisdictions in which the Company has money transfer operations. To date, the Company is not aware of any significant claims made by the indemnified parties or third parties to guarantee agreements with the Company and, accordingly, no liabilities were recorded as of March 31, 2008 or December 31, 2007.

(14) INCOME TAXES

The Company s effective tax rate, after consideration of minority interest, was 264.3% and 29.9% for the three-month periods ended March 31, 2008 and 2007, respectively. The net loss for the first quarter 2008 reflects an unrealized capital loss of $17.5 million recorded in connection with the Company s investment in MoneyGram, for which an associated tax benefit was not recorded because of the uncertainty surrounding the Company s future ability to have offsetting capital gains.

Excluding the impact of this unrealized capital loss, the Company s income tax rate was 50.8% for the first quarter 2008, compared to 29.9% for the first quarter 2007. This increase in the effective tax rate primarily relates to the

recognition of deferred income tax expense in the U.S. attributable to pre-tax income generated by the Company s U.S. operations from foreign currency gains and interest income earned on loans to foreign subsidiaries. For U.S. federal income tax purposes, however, the Company has significant net operating losses that will offset taxable income generated in future periods from pre-tax income produced by our U.S. operations and the recognition of the future tax effects of temporary differences recorded as deferred tax liabilities. The first quarter 2008 effective tax rate was also unfavorably impacted by the acquisition of RIA, which operates in jurisdictions that have tax rates that are higher than the Company s historical effective tax rate.

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(15) SUBSEQUENT EVENTS

During April 2008, the Company entered into an amendment to its secured syndicated credit facility to change, among other items, the definition of one of the financial covenants contained in the original agreement. Euronet incurred costs of $0.6 million in connection with the amendment, which will be recognized as additional interest expense over the remaining 48 month term of the credit facility.

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

OVERVIEW

COMPANY OVERVIEW, GEOGRAPHIC LOCATIONS AND PRINCIPAL PRODUCTS AND SERVICES

Euronet Worldwide, Inc. (together with our subsidiaries, we, us, Euronet or the Company) is a leading electronic payments provider, offering automated teller machine (ATM) and point-of-sale (POS) and card outsourcing services, card issuing and merchant acquiring services, integrated electronic financial transaction (EFT) software, network gateways, electronic distribution of top-up services for prepaid mobile airtime and other prepaid products, electronic consumer money transfer and bill payment services to financial institutions, mobile operators, retailers and individual customers. As of March 31, 2008, we operate in the following three principal business segments.

An EFT Processing Segment, which processes transactions for a network of 11,917 ATMs and approximately 51,000 POS terminals across Europe, Asia and the Middle-East. We provide comprehensive electronic payment solutions consisting of ATM network participation, outsourced ATM and POS management solutions, credit and debit card outsourcing and electronic recharge services for prepaid mobile airtime. Through this segment, we also offer a suite of integrated EFT software solutions for electronic payment, merchant acquiring, card issuing and transaction delivery systems.

A Prepaid Processing Segment, which provides distribution of prepaid mobile airtime and other prepaid products and collection services for various prepaid products, cards and services. Including terminals operated by unconsolidated subsidiaries, we operate a network of approximately 394,000 POS terminals providing electronic processing of prepaid mobile airtime top-up services in the U.S., Europe, Africa, Asia Pacific and the Middle-East.

A Money Transfer Segment, which provides global money transfer and bill payment services through a sending network of agents and Company-owned stores primarily in North America, the Caribbean, Europe and Asia-Pacific, disbursing money transfers through a worldwide payer network. Bill payment services are offered primarily in the U.S. The Money Transfer Segment originates and terminates transactions through a network of more than 68,000 locations, which include sending agents and Company-owned stores, and an extensive payer network across 100 countries.

We have six processing centers in Europe, two in Asia and two in the U.S. We have 22 principal offices in Europe, five in the Asia-Pacific region, three in the U.S. and one each in the Middle East and Latin America. Our executive offices are located in Leawood, Kansas, USA.

SOURCES OF REVENUES AND CASH FLOW

Euronet earns revenues and income based on ATM management fees, transaction fees and commissions, professional services, software licensing fees and software maintenance agreements. Each business segment s sources of revenue are described below.

EFT Processing Segment Revenue in the EFT Processing Segment, which represented approximately 21% of total consolidated revenue for the first quarter 2008, is derived from fees charged for transactions effected by cardholders on our proprietary network of ATMs, as well as fixed management fees and transaction fees we charge to banks for operating ATMs and processing credit cards under outsourcing agreements. Through our proprietary network, we generally charge fees for four types of ATM transactions: i) cash withdrawals, ii) balance inquiries, iii) transactions not completed because the relevant card issuer does not give authorization, and iv) prepaid telecommunication recharges. Revenue in this segment is also derived from license fees, professional services and maintenance fees for software and sales of related hardware. Software license fees are the fees we charge to license our proprietary application software to customers. Professional service fees consist of charges for customization, installation and consulting services to customers. Software maintenance revenue represents the ongoing fees charged for maintenance and support for customers software products. Hardware sales are derived from the sale of computer equipment necessary for the respective software solution.

Prepaid Processing Segment Revenue in the Prepaid Processing Segment, which represented approximately 58% of total consolidated revenue for the first quarter 2008, is primarily derived from commissions or processing fees received from telecommunications service providers for the sale and distribution of prepaid mobile airtime. We also generate revenue from commissions earned from the distribution of other prepaid products. Due to certain provisions in our mobile phone operator agreements, the operators have the ability to reduce the overall commission paid on each top-up transaction. However, by virtue of our agreements with retailers (distributors where POS terminals are located) in certain markets, not all of these reductions are absorbed by us because we are able to pass a significant portion of the reductions to retailers. Accordingly, under certain retailer agreements, the effect is to reduce revenues and reduce our direct operating costs resulting in only a small impact on gross margin and operating income. In some markets, reductions in commissions can significantly impact our results as it may not be possible, either contractually or commercially in the concerned market, to pass a reduction in commissions to the retailers. In Australia, certain retailers negotiate directly with the mobile phone operators for their own commission rates, which also limits our ability to pass through reductions in commissions. Agreements with mobile operators are important to the success of our business. These agreements permit us to distribute prepaid mobile airtime to the mobile operators

customers. Other products offered by this segment include prepaid long distance calling card plans, prepaid internet plans, prepaid debit cards, prepaid gift cards and prepaid mobile content such as ring tones and games.

Money Transfer Segment Revenue in the Money Transfer Segment, which represents approximately 21% of total consolidated revenue for the first quarter 2008, is primarily derived through the charging of a transaction fee, as well as the difference between purchasing foreign currency at wholesale exchange rates and selling the foreign currency to consumers at retail exchange rates. We have an origination network in place comprised of agents and company-owned stores primarily in North America, the Caribbean, Europe and Asia-Pacific and a worldwide network of distribution agents, consisting primarily of financial institutions in the transfer destination countries. Origination and distribution agents each earn fees for cash collection and distribution services. These fees are recognized as direct operating costs at the time of sale.

OPPORTUNITIES AND CHALLENGES

EFT Processing Segment The continued expansion and development of our EFT Processing Segment business will depend on various factors including, but not necessarily limited to, the following:

- the impact of competition by banks and other ATM operators and service providers in our current target markets;
- the demand for our ATM outsourcing services in our current target markets;
- the ability to develop products or services to drive increases in transactions;
- the expansion of our various business lines in markets where we operate and in new markets;
- the entrance into additional card acceptance and ATM management agreements with banks;
- the ability to obtain required licenses in markets we intend to enter or expand services;
- the availability of financing for expansion;
- the ability to efficiently install ATMs contracted under newly awarded outsourcing agreements;
- the successful entry into the cross-border merchant processing and acquiring business;
- the successful entry into the card issuing and outsourcing business; and
- the continued development and implementation of our software products and their ability to interact with other leading products.

Prepaid Processing Segment The continued expansion and development of the Prepaid Processing Segment business will depend on various factors, including, but not necessarily limited to, the following:

- the ability to negotiate new agreements in additional markets with mobile phone operators, agent financial institutions and retailers;
- the ability to use existing expertise and relationships with mobile operators and retailers to our advantage;
- the continuation of the trend towards conversion from scratch card solutions to electronic processing solutions for prepaid mobile airtime among mobile phone users and the continued use of third party providers such as ourselves to supply this service;
- the development of mobile phone networks in these markets and the increase in the number of mobile phone users;

the overall pace of growth in the prepaid mobile phone market;

our market share of the retail distribution capacity;

the level of commission that is paid to the various intermediaries in the prepaid mobile airtime distribution chain;

our ability to add new and differentiated prepaid products in addition to those offered by mobile operators;

the ability to take advantage of cross-selling opportunities with our Money Transfer Segment, including providing money transfer services through our prepaid locations;

the availability of financing for further expansion; and

our ability to successfully integrate newly acquired operations with our existing operations.

Money Transfer Segment The expansion and development of our money transfer business will depend on various factors, including, but not necessarily limited to, the following:

the continued growth in worker migration and employment opportunities;

the mitigation of economic and political factors that have had an adverse impact on money transfer volumes, such as the immigration developments in the U.S. that started in 2006 and changes in the economic sectors in which immigrants work;

the continuation of the trend of increased use of electronic money transfer and bill payment services among immigrant workers and the unbanked population in our markets;

the ability to maintain our agent and correspondent networks;

the ability to offer our products and services or develop new products and services at competitive prices to drive increases in transactions;

the expansion of our services in markets where we operate and in new markets;

the ability to strengthen our brands;

our ability to fund working capital requirements;

- our ability to maintain compliance with the regulatory requirements of the jurisdictions in which we operate or plan to operate;

- the ability to take advantage of cross-selling opportunities with our Prepaid Processing Segment, including providing prepaid services through RIA s stores and agents worldwide;

- the ability to leverage our banking and merchant/retailer relationships to expand money transfer corridors to Europe and Asia, including high growth corridors to Central and Eastern European countries; and

- our ability to continue to successfully integrate RIA with our existing operations.

Corporate Services, Eliminations and Other In addition to operating in our principal business segments described above, our Corporate Services, Elimination and Other division includes non-operating activity, certain inter-segment eliminations and the cost of providing corporate and other administrative services to the business segments, including share-based compensation expense related to most stock option and restricted stock grants. These services are not directly identifiable with our business segments. The impact of share-based compensation is recorded as an expense of the Corporate Services division.

SEGMENT SUMMARY RESULTS OF OPERATIONS

Revenue and operating income by segment for the three-month periods ended March 31, 2008 and 2007 are summarized in the tables below:

	Revenues for the Three Months Ended March 31,		Year-over-Year Change		Operating Income (Loss) for the Three Months Ended March 31,		Year-over-Year Change	
(dollar amounts in thousands)	**2008**	**2007**	**Increase Amount**	**Increase Percent**	**2008**	**2007**	**Increase Amount**	**Increase Percent**
EFT Processing	$ 50,506	$ 42,047	$ 8,459	20%	$ 9,020	$ 6,938	$ 2,082	30%
Prepaid Processing	144,225	127,581	16,644	13%	10,334	9,516	818	9%
Money Transfer	52,332	789	51,543	6533%	1,951	(867)	2,818	n/m
Total	247,063	170,417	76,646	45%	21,305	15,587	5,718	37%
Corporate services					(9,199)	(3,670)	(5,529)	151%
Total	$ 247,063	$ 170,417	$ 76,646	45%	$ 12,106	$ 11,917	$ 189	2%

n/m - Not meaningful.

Impact of changes in foreign currency exchange rates

Throughout 2007 and into 2008, the U.S. dollar has weakened compared to most of the currencies of the countries in which we operate. Because our revenues and local expenses are recorded in the functional currencies of our operating entities, amounts we earned for the first quarter 2008 are positively impacted by the weakening of the U.S. dollar. We estimate that, depending on the mix of countries and currencies, our operating income for the first quarter 2008 benefited by approximately 10% to 15% when compared to the first quarter 2007.

COMPARISON OF OPERATING RESULTS FOR THE THREE- MONTH PERIODS ENDED MARCH 31, 2008 AND 2007

EFT PROCESSING SEGMENT

The following table presents the results of operations for the three-month periods ended March 31, 2008 and 2007 for our EFT Processing Segment:

	Three Months Ended March 31,		Year-over-Year Change	
(dollar amounts in thousands)	2008	2007	Increase (Decrease) Amount	Increase (Decrease) Percent
Total revenues	$ 50,506	$ 42,047	$ 8,459	20%
Operating expenses:				
Direct operating costs	21,752	16,923	4,829	29%
Salaries and benefits	10,147	9,254	893	10%
Selling, general and administrative	4,450	4,864	(414)	(9%)
Depreciation and amortization	5,137	4,068	1,069	26%
Total operating expenses	41,486	35,109	6,377	18%
Operating income	$ 9,020	$ 6,938	$ 2,082	30%
Transactions processed (millions)	168.4	130.7	37.7	29%
ATMs as of March 31	11,917	9,182	2,735	30%
Average ATMs	11,771	9,040	2,731	30%

Revenues

Our revenue for the first quarter 2008 increased when compared to the first quarter 2007 primarily due to increases in the number of ATMs operated and, for owned ATMs, the number of transactions processed. These increases were attributable to many of our operations, but primarily our operations in Poland and India. Additionally, for the first quarter 2008, the U.S. dollar has weakened compared to the first quarter 2007 relative to the currencies of most of the countries in which we operate. Because our revenues are recorded in the functional currencies of our operating entities, amounts we earn in foreign currencies are positively impacted by the weakening of the U.S. dollar. Partially offsetting these improvements were decreases in revenue associated with our operations in Romania and our software business. The reduction in Romania is due to a decrease in the per transaction fee structure of a contract with a customer which we granted in exchange for an extension of the term of the contract. The decrease in revenue associated with our software business was primarily due to heavy implementation activity on two major contracts that generated significant revenue during the first quarter 2007.

Average monthly revenue per ATM was $1,430 for the first quarter 2008, compared to $1,550 for the first quarter 2007 and revenue per transaction was $0.30 for the first quarter 2008, compared to $0.32 for the first quarter 2007. The decrease in revenues per ATM and revenues per transaction was due to the addition of ATMs in India and China, where revenues per ATM have been historically lower than Central and Eastern Europe generally due to lower labor costs, and the reduction of revenue in Romania and our software business discussed above.

Direct operating costs

Direct operating costs consist primarily of site rental fees, cash delivery costs, cash supply costs, maintenance, insurance, telecommunications and the cost of data center operations-related personnel, as well as the processing centers facility related costs and other processing center related expenses. The increase in direct operating cost for the first quarter 2008, compared to the first quarter 2007, is attributed to the increase in the number of ATMs under operation.

Gross margin

Gross margin, which is calculated as revenues less direct operating costs, increased to $28.8 million for the first quarter 2008 from $25.1 million for the first quarter 2007. This increase is attributable to the increase in revenues discussed above. Gross margin as a percentage of revenues was 57% for the first quarter 2008 compared to 60% for the first quarter 2007. The slight decrease in gross margin as a percentage of revenues is due to the impact of the contract extension in Romania and software business discussed above, as well as the

increased contributions of our subsidiaries in India and China, which have historically earned a lower gross margin than our other operations.

Salaries and benefits

The increase in salaries and benefits for the first quarter 2008 compared to the first quarter 2007 was due to staffing costs to support growth in ATMs managed and transactions processed and for new products, such as POS, card processing and cross-border merchant processing and acquiring. Salaries and benefits also increased as a result of general merit increases awarded to employees. As a percentage of revenue, however, these costs decreased to 20% of revenues for the first quarter 2008 compared to 22% for the first quarter 2007.

Selling, general and administrative

The decrease in selling, general and administrative expenses for the first quarter 2008 compared to the first quarter 2007 is due primarily to the first quarter 2007 $1.2 million arbitration loss awarded by a tribunal in Budapest, Hungary arising from a claim by a former cash supply contractor in Central Europe. The cash supply contractor claimed it provided us with cash during the fourth quarter 1999 and first quarter 2000 that was not returned. Excluding this loss, the $0.7 million increase in selling, general and administrative expenses was to support segment growth. Excluding the impact of the arbitration loss, as a percentage of revenue, selling, general and administrative expenses were flat at 9% for both the first quarter 2008 and first quarter 2007.

Depreciation and amortization

The increase in depreciation and amortization expense for the first quarter 2008 compared to the first quarter 2007 is due primarily to additional ATMs in Poland, India and China, additional equipment and software for the expansion of our Hungarian processing center and additional software amortization recorded related to our Essentis software product. As a percentage of revenue, these expenses were flat at 10% for the first quarters 2008 and 2007.

Operating income

The increase in operating income was primarily due to the increases in revenues described above and the impact of the first quarter 2007 arbitration loss. Excluding the impact of the arbitration loss from the first quarter 2007, operating income as a percentage of revenues for the first quarter 2008 was 18%, compared to 19% for the first quarter 2007, and operating income per transaction was $0.05 for the first quarter 2008, compared to $0.06 per transaction for the first quarter 2007. The decreases in operating income as a percent of revenues and operating income per transaction are due to the contract extension in Romania and the reduced revenues recorded by our software business discussed above. Additionally, the first quarter 2008 includes approximately $0.4 million in operating losses incurred to develop processing systems and capabilities in preparation for our entry into the cross-border merchant acquiring business.

Expiration of contract

In January 2003, we sold 100% of our shares in our U.K. subsidiary, Euronet Services (U.K.) Ltd. (Euronet U.K.), to Bridgepoint Capital Limited (Bridgepoint), which subsequently became Bank Machine Limited (Bank Machine). Simultaneous with this transaction, Euronet and Bank Machine signed an ATM and Gateway Services Agreement (the Services Agreement) under which a wholly-owned subsidiary of Euronet provided ATM operating, monitoring, and transaction processing services to Bank Machine through December 31, 2007. Management allocated $4.5 million of the total sale proceeds to the Services Agreement, which was recorded as revenues on a straight-line basis over the five-year contract term. During the first quarter 2008, the Service Agreement expired and was not renewed. As a result of this development, beginning in the second quarter 2008, the number of ATMs operated, quarterly revenue and quarterly operating income for the EFT Processing Segment will decrease by approximately 2,400 ATMs, $0.8 million and $0.8 million, respectively.

PREPAID PROCESSING SEGMENT

The following table presents the results of operations for the three-month periods ended March 31, 2008 and 2007 for our Prepaid Processing Segment:

	Three Months Ended March 31,		Year-over-Year Change	
(dollar amounts in thousands)	2008	2007	Increase Amount	Increase Percent
Total revenues	$ 144,225	$ 127,581	$ 16,644	13%
Operating expenses:				
Direct operating costs	117,856	103,230	14,626	14%
Salaries and benefits	6,568	6,385	183	3%
Selling, general and administrative	5,275	4,577	698	15%
Depreciation and amortization	4,192	3,873	319	8%
Total operating expenses	133,891	118,065	15,826	13%
Operating income	$ 10,334	$ 9,516	$ 818	9%
Transactions processed (millions)	167.3	139.4	27.9	20%

Revenues

The increase in revenues for 2008 compared to 2007 was generally attributable to the increase in total transactions processed across all of our Prepaid Processing Segment operations, particularly Australia and Poland, and additional revenue from Omega Logic Ltd. (Omega Logic) which was acquired in February 2007. Additionally, for the first quarter 2008 the U.S. dollar has weakened compared to the first quarter 2007 relative to the currencies of most of the countries in which we operate. Because our revenues are recorded in the functional currencies of our operating entities, amounts we earn in foreign currencies are positively impacted by the weakening of the U.S. dollar.

In certain more mature markets, such as the U.K., New Zealand and Spain, our revenue growth has slowed substantially and, in some cases, revenues have decreased because conversion from scratch cards to electronic top-up is substantially complete and certain mobile operators and retailers are driving competitive reductions in pricing and margins. We expect most of our future revenue growth to be derived from: (i) developing markets or markets in which there is organic growth in the prepaid sector overall, (ii) from continued conversion from scratch cards to electronic top-up in less mature markets, (iii) from additional products sold over the base of prepaid processing terminals, and (iv) possibly from acquisitions.

Revenues per transaction decreased to $0.86 for the first quarter 2008 from $0.92 for the first quarter 2007 due primarily to the growth in revenues and transactions recorded by our ATX subsidiary. ATX provides only transaction processing services without significant direct costs and other operating costs generally associated with installing and managing terminals; therefore, the revenue we recognize from these transactions is a fraction of that recognized on average transactions but with very low cost. Transaction volumes for ATX in the first quarter 2008 increased over 50% compared to first quarter 2007. Partially offsetting this decrease was the growth in both volumes and revenues in Australia and the U.S., which generally have higher revenues per transaction, but also pay higher commission rates to retailers, than our other Prepaid Processing subsidiaries.

Direct operating costs

Direct operating costs in the Prepaid Processing Segment include the commissions we pay to retail merchants for the distribution and sale of prepaid mobile airtime and other prepaid products, as well as expenses required to operate POS terminals. Because of their nature, these expenditures generally fluctuate directly with revenues and processed transactions. The increase in direct operating costs is generally attributable to the increase in total transactions processed and foreign currency translations to the U.S. dollar compared to the prior year.

Gross margin

Gross margin, which represents revenues less direct costs, was $26.4 million for the first quarter 2008 compared to $24.4 million for the first quarter 2007. Gross margin as a percentage of revenues decreased slightly to 18% for the first quarter 2008 compared to 19% for the

first quarter 2007 and gross margin per transaction also decreased slightly to $0.16 for the first quarter 2008 compared to $0.17 for the first quarter 2007. The primary cause of the reduction in gross margin per transaction is due to the growth of revenues and transactions at our ATX subsidiary and the general maturity of the prepaid mobile airtime business in many of our markets.

Salaries and benefits

The increase in salaries and benefits for first quarter 2008 compared to the first quarter 2007 is primarily the result of additional overhead to support development in new and growing markets, particularly in Italy. As a percentage of revenue, salaries and benefits decreased to 4.6% for first quarter 2008 from 5.0% for first quarter 2007.

Selling, general and administrative

The increase in selling, general and administrative expenses for the first quarter 2008 compared to the first quarter 2007 is the result of additional overhead to support development in other new and growing markets. As a percentage of revenues, these expenses remained relatively flat at 3.7% for first quarter 2008 compared to 3.6% for the first quarter 2007.

Depreciation and amortization

Depreciation and amortization expense primarily represents amortization of acquired intangibles and the depreciation of POS terminals we install in retail stores. Depreciation and amortization expense remained relatively flat for the first quarter 2008, compared to the first quarter 2007 and, as a percentage of revenues, decreased slightly to 2.9% for the first quarter 2008 from 3.0% for the first quarter 2007.

Goodwill and acquired intangible translation adjustment

During the third quarter 2007, we corrected an immaterial error related to foreign currency translation adjustments for goodwill and acquired intangible assets recorded in connection with acquisitions completed during periods prior to 2007. The impact of this correction on the Prepaid Processing Segment was to increase depreciation and amortization expense and decrease operating income by $0.2 million for the three months ended March 31, 2007.

Operating income

The improvement in operating income for the first quarter 2008 compared to the first quarter 2007 was due to the significant growth in revenues and transactions processed and the benefit of foreign currency translations to the U.S. dollar, partially offset by the costs of development in Italy and other new and growing markets.

Operating income as a percentage of revenues was 7.2% for the first quarter 2008 compared to 7.5% for the first quarter 2007. The decrease is primarily due to the decreases in gross margin described above and operating expenses incurred to support development in new and growing markets. Operating income per transaction was $0.06 for the first quarter 2008 compared to $0.07 for the first quarter 2007. The decrease in operating income per transaction is due to the decreases in gross margins described above and the growth in revenues and transactions at our ATX subsidiary.

MONEY TRANSFER SEGMENT

The Money Transfer Segment was established during April 2007 with the acquisition of RIA. To assist with understanding the results of the Money Transfer Segment, unaudited pro forma results have been provided as if RIA s results were included in our consolidated results of operations beginning January 1, 2007. Because our results of operations for the three months ended March 31, 2007 were insignificant, and fluctuations when compared to the three months ended March 31, 2008 are nearly entirely due to the acquisition of RIA, the following discussion and analysis will focus on pro forma results of operations. The pro forma financial information is not intended to represent, or be indicative of, the consolidated results of operations or financial condition that would have been reported had the RIA acquisition been completed as of the beginning of the periods presented. Moreover, the pro forma financial information should not be considered as representative of our future consolidated results of operations or financial condition. The following tables present the actual and pro forma results of operations for the three-month periods ended March 31, 2008 and 2007 for the Money Transfer Segment:

	As Reported Three Months Ended March 31,		Year-over-Year
(dollar amounts in thousands)	**2008**	**2007**	**Increase**
Total revenues	$ 52,332	$ 789	$ 51,543
Operating expenses:			
Direct operating costs	26,345	511	25,834
Salaries and benefits	11,757	590	11,167
Selling, general and administrative	7,452	451	7,001
Depreciation and amortization	4,827	104	4,723
Total operating expenses	50,381	1,656	48,725
Operating income (loss)	$ 1,951	$ (867)	$ 2,818
Transactions processed (millions)	3.8	0.1	3.7

Total assets

$

2,000,971

$

2,023,277

$

1,818,869

LIABILITIES AND STOCKHOLDERS’ DEFICIT

Current Liabilities:

Accounts payable

$

462,099

$

457,704

$

418,745

Accrued liabilities and other

347,349

377,606

349,777

Current portion of long-term debt

66,900

24,900

48,900

Income taxes payable

—

44,640

873

Total current liabilities

876,348

904,850

818,295

Long-term debt

2,735,187

2,744,942

2,902,099

Other liabilities

97,232

97,580

91,032

Total liabilities

3,708,767

3,747,372

3,811,426

Commitments and contingencies

Stockholders’ Deficit:

Common stock, $0.06775 par value, 350,000 shares authorized; 205,824 shares issued and outstanding at July 30, 2016; 208,996 shares issued and outstanding at January 30, 2016; and 208,011 shares issued and outstanding at August 1, 2015

13,770

13,979

13,952

Additional paid-in-capital

493,096

592,420

577,104

Accumulated deficit

(2,202,056)

(2,308,438)

(2,568,901)

Accumulated other comprehensive loss

(12,606)

(22,056)

(14,712)

Total stockholders' deficit

(1,707,796)

(1,724,095)

(1,992,557)

Total liabilities and stockholders’ deficit

$

2,000,971

$

2,023,277

$

1,818,869

See accompanying notes to consolidated financial statements.

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THE MICHAELS COMPANIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	26 Weeks Ended	
	July 30, 2016	August 1, 2015
Cash flows from operating activities:		
Net income	$ 106,382	$ 102,449
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	58,468	55,949
Share-based compensation	6,590	6,225
Debt issuance costs amortization	3,760	4,366
Accretion of long-term debt, net	(124)	(66)
Deferred income taxes	619	6,514
Losses on early extinguishments of debt and refinancing costs	405	6,072
Losses on disposition of property and equipment	35	—
Excess tax benefits from share-based compensation	(7,271)	(12,952)
Changes in assets and liabilities, excluding acquired net assets:		
Merchandise inventories	(58,612)	(115,198)
Prepaid expenses and other	639	(2,875)
Accounts receivable	4,858	4,534
Other assets	(445)	(86)
Accounts payable	(20,171)	(19,546)
Accrued interest	(5,045)	89
Accrued liabilities and other	(35,091)	(53,634)
Income taxes	(78,816)	(62,845)
Other liabilities	(605)	(2,067)
Net cash used in operating activities	(24,424)	(83,071)
Cash flows from investing activities:		
Additions to property and equipment	(38,395)	(63,241)
Acquisition of Lamrite West, net of cash acquired	(151,100)	—
Net cash used in investing activities	(189,495)	(63,241)
Cash flows from financing activities:		
Payment of PIK notes	—	(184,467)
Payments on restated term loan credit facility	(12,450)	(12,450)
Borrowings on asset-based revolving credit facility	42,000	24,000
Payment of debt issuance costs	(3,048)	—
Payment of dividends	(415)	(443)
Proceeds from stock options exercised	15,058	19,586
Excess tax benefits from share-based compensation	7,271	12,952
Common stock repurchased	(129,039)	(19,822)

Other financing activities	—	(971)
Net cash used in financing activities	(80,623)	(161,615)
Net change in cash and equivalents	(294,542)	(307,927)
Cash and equivalents at beginning of period	409,391	378,295
Cash and equivalents at end of period	$ 114,849	$ 70,368
Supplemental cash flow information:		
Cash paid for interest	$ 65,634	$ 67,707
Cash paid for taxes	$ 138,394	$ 116,713

See accompanying notes to consolidated financial statements.

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THE MICHAELS COMPANIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. BASIS OF PRESENTATION

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

On February 2, 2016, the Company completed the acquisition of Lamrite West, Inc. and certain of its affiliates and subsidiaries (“Lamrite”) for $150.0 million, prior to certain purchase price adjustments, utilizing our cash on hand. Lamrite operates an international wholesale business under the Darice brand name (“Darice”) and 35 arts and crafts retail stores, located primarily in Ohio and the surrounding states, under the Pat Catan’s brand name (“Pat Catan’s”). See Note 10 for further information.

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. Therefore, these financial statements should be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended January 30, 2016 filed with the Securities and Exchange Commission (“SEC”) pursuant to section 13 or 15(d) under the Securities Exchange Act of 1934. In the opinion of management, all adjustments (consisting of normal recurring accruals and other items) considered necessary for a fair presentation have been included.

We report on the basis of a 52- or 53-week fiscal year, which ends on the Saturday closest to January 31. All references to fiscal year mean the year in which that fiscal year began. References to “fiscal 2016” relate to the 52 weeks ended January 28, 2017 and references to “fiscal 2015” relate to the 52 weeks ended January 30, 2016. In addition, all references to “the second quarter of fiscal 2016” relate to the 13 weeks ended July 30, 2016 and all references to “the second quarter of fiscal 2015” relate to the 13 weeks ended August 1, 2015. Finally, all references to “the six months ended July 30, 2016” relate to the 26 weeks ended July 30, 2016 and all references to “the six months ended August 1, 2015” relate to the 26 weeks ended August 1, 2015. Because of the seasonal nature of our business, the results of operations for the 13 and 26 weeks ended July 30, 2016 are not indicative of the results to be expected for the entire year.

Certain prior year amounts have been reclassified in the accompanying consolidated financial statements to conform to our fiscal 2016 presentation, including the reclassification of current deferred income taxes to non-current deferred income taxes and the reclassification of certain unamortized debt issuance costs from non-current assets to a direct reduction of the related long-term debt obligation as a result of new accounting standards adopted in the fourth quarter of fiscal 2015.

Share Repurchase Program

In March 2016, the Board of Directors authorized the Company to purchase $200.0 million of the Company’s common stock on the open market. The share repurchase program does not have an expiration date, and the timing and number of repurchase transactions under the program will depend on market conditions, corporate considerations, debt agreements and regulatory requirements. Shares repurchased under the program are held as treasury shares until retired. As of July 30, 2016, we have repurchased 4.7 million shares for an aggregate amount of $126.9 million and have $73.1 million of availability remaining under our share repurchase program.

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Accounting Pronouncements Recently Adopted

In April 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2015-05, "Intangibles — Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement" ("ASU 2015-05"). ASU 2015-05 provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The new guidance does not change the accounting for a customer's accounting for service contracts. The Company adopted ASU 2015-05 in the first quarter of fiscal 2016 and its adoption did not have a material impact on the Company's consolidated financial statements.

Recent Accounting Pronouncements Not Yet Adopted

In March 2016, the FASB issued ASU No. 2016-09, "Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting" ("ASU 2016-09"). ASU 2016-09 identifies areas for simplification involving several aspects of accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, an option to recognize gross stock compensation expense with actual forfeitures recognized as they occur, as well as certain classifications on the statement of cash flows. ASU 2016-09 is effective for annual periods beginning after December 15, 2016, including interim periods within that reporting period, with early adoption permitted. We are currently evaluating the impact that ASU 2016-09 will have on the consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-04, "Liabilities – Extinguishment of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored-Value Products" ("ASU 2016-04"). ASU 2016-04 requires that breakage on prepaid stored-value product liabilities (for example, prepaid gift cards) be accounted for consistent with the breakage guidance in Topic 606: Revenue from Contracts with Customers. ASU 2016-04 is effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period, with early adoption permitted. This standard is to be applied either using a modified retrospective approach or retrospectively to each period presented. We have evaluated the new standard and it will not have a material impact to the consolidated financial statements once implemented.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)" ("ASU 2016-02"). Under ASU 2016-02, an entity will be required to recognize right-of-use assets and lease liabilities on its balance sheet and disclose key information about leasing arrangements. ASU 2016-02 offers specific accounting guidance for a lessee, a lessor and sale and leaseback transactions. Lessees and lessors are required to disclose qualitative and quantitative information about leasing arrangements to enable a user of the financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period, with early adoption permitted. At adoption, this update

will be applied using a modified retrospective approach. We are currently evaluating the impact that ASU 2016-02 will have on the consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers” (“ASU 2014-09”). ASU 2014-09 supersedes the revenue recognition requirements in “Revenue Recognition (Topic 605)”, and requires entities to recognize revenue in a way that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. In July 2015, the FASB decided to delay the effective date of ASU 2014-09 by one year. ASU 2014-09 is now effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. The standard is to be applied retrospectively, with early application permitted for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. In March 2016, the FASB issued ASU No. 2016-08, “Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus

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Net)" ("ASU 2016-08") which is intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations. In April 2016, the FASB issued ASU No. 2016-10, "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing" ("ASU 2016-10") which provides further guidance on identifying performance obligations and improves the operability and understandability of the licensing implementation guidance. In May 2016, the FASB issued ASU No. 2016-12, "Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients" ("ASU 2016-12") which narrowly amended the revenue recognition guidance regarding collectability, noncash consideration, presentation of sales tax and transition. ASU 2016-08, ASU 2016-10 and ASU 2016-12 have the same effective date and transition requirements as ASU 2014-09. We are currently evaluating the new standards but do not anticipate a material impact to the consolidated financial statements once implemented.

2. FAIR VALUE MEASUREMENTS

As defined in Accounting Standards Codification ("ASC") 820, Fair Value Measurements ("ASC 820"), fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 establishes a three-level valuation hierarchy for fair value measurements. These valuation techniques are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect less transparent active market data, as well as internal assumptions. These two types of inputs create the following fair value hierarchy:

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

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

The table below provides the carrying and fair values of our senior secured term loan facility ("Restated Term Loan Credit Facility") and our 5.875% senior subordinated notes maturing in 2020 ("2020 Senior Subordinated Notes") as of July 30, 2016. The fair values of our Restated Term Loan Credit Facility and our 2020 Senior Subordinated Notes were determined based on quoted market prices which are considered Level 2 inputs within the fair value hierarchy.

	Notional Value	Fair Value
	(in thousands)	
Restated term loan credit facility	$ 2,269,700	$ 2,277,082
Senior subordinated notes	510,000	530,400

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3. DEBT

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

	Interest Rate		July 30, 2016	January 30, 2016	August 1, 2015
Restated term loan credit facility	Variable		$ 2,269,700	$ 2,282,150	$ 2,444,600
Asset-based revolving credit facility	Variable		42,000	—	24,000
Senior subordinated notes	5.875	%	510,000	510,000	510,000
Total debt			2,821,700	2,792,150	2,978,600
Less unamortized discount/premium and debt costs			(19,613)	(22,308)	(27,601)
Total debt, net			2,802,087	2,769,842	2,950,999
Less current portion			(66,900)	(24,900)	(48,900)
Long-term debt			$ 2,735,187	$ 2,744,942	$ 2,902,099

Revolving Credit Facility

On May 27, 2016, Michaels Stores, Inc. (“MSI”) entered into an amended and restated credit agreement with Wells Fargo Bank, National Association and other lenders to amend various terms of our senior secured asset-based revolving credit facility (“Restated Revolving Credit Facility”). The amended credit agreement, together with the related security, guarantee and other agreements, is referred to as the “Amended Revolving Credit Facility”. The Amended Revolving Credit Facility provides for senior secured financing of up to $850.0 million, subject to a borrowing base, with the right to request up to $200.0 million of additional commitments. The borrowing base under the Amended Revolving Credit Facility equals the sum of: (i) 90% of eligible credit card receivables, (ii) 85% of eligible trade receivables, (iii) 90% to 92.5% of the appraised value of eligible inventory, plus (iv) 90% to 92.5% of the lesser of (a) the appraised value of eligible inventory supported by letters of credit, and (b) the face amount of the letters of credit, less (v) certain reserves. The Amended Revolving Credit Facility matures in May 2021, subject to a springing maturity date if certain of our outstanding indebtedness has not been repaid, redeemed, refinanced, cash collateralized or if the necessary availability reserves have not been established prior to such time. Our obligations under the Amended Revolving Credit Facility are secured by (subject to certain exceptions) a first priority security interest in the current assets of the borrowers and facility guarantors and a second priority security interest in all other assets.

As of July 30, 2016 and August 1, 2015, the borrowing base under our senior secured asset-based revolving credit facility was $696.4 million and $650.0 million, respectively, of which MSI had unused borrowing capacity of $597.1 million and $564.0 million, respectively. As of July 30, 2016 and August 1, 2015, outstanding standby letters of credit, which reduce our borrowing base, totaled $57.3 million and $62.0 million, respectively. As of July 30, 2016 and August 1, 2015, borrowings under our senior secured asset-based revolving credit facility were $42.0 million and $24.0 million, respectively.

Debt Issuance Costs

Accumulated amortization of debt issuance costs was $61.0 million, $61.0 million and $57.6 million as of July 30, 2016, January 30, 2016 and August 1, 2015, respectively.

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4. ACCUMULATED OTHER COMPREHENSIVE LOSS

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

	13 Weeks Ended		26 Weeks Ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
Beginning of period	$ (7,847)	$ (7,489)	$ (22,056)	$ (11,805)
Foreign currency translation adjustment and other	(4,759)	(7,223)	9,450	(2,907)
End of period	$ (12,606)	$ (14,712)	$ (12,606)	$ (14,712)

5. EARNINGS PER SHARE

The Company’s unvested restricted stock awards contain non-forfeitable rights to dividends and meet the criteria of a participating security as defined by ASC 260, “Earnings Per Share.” Under the two-class method, net income per share is computed by dividing net income allocated to common shareholders by the weighted average number of common shares outstanding for the period. In applying the two-class method, net income is allocated to both common and participating securities based on their respective weighted-average shares outstanding for the period. Diluted earnings per share is computed by dividing income available to common stockholders by the weighted-average common shares outstanding plus the potential dilutive impact from the exercise of stock options and restricted stock units. Common equivalent shares are excluded from the computation if their effect is anti-dilutive. There were 1.4 million and 0.4 million anti-dilutive shares during the second quarters of fiscal 2016 and fiscal 2015, respectively. There were 1.8 million and 0.3 million anti-dilutive shares during the six months ended July 30, 2016 and August 1, 2015, respectively.

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

	13 Weeks Ended		26 Weeks Ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
Basic earnings per common share:				
Net income	$ 35,617	$ 35,711	$ 106,382	$ 102,449
Less income related to unvested restricted shares	(234)	(150)	(707)	(438)
Income available to common stockholders - Basic	$ 35,383	$ 35,561	$ 105,675	$ 102,011
Weighted-average common shares outstanding - Basic	205,881	206,941	206,437	206,283
Basic earnings per common share	$ 0.17	$ 0.17	$ 0.51	$ 0.49
Diluted earnings per common share:				
Net income	$ 35,617	$ 35,711	$ 106,382	$ 102,449
Less income related to unvested restricted shares	(232)	(148)	(701)	(431)
Income available to common shareholders - Diluted	$ 35,385	$ 35,563	$ 105,681	$ 102,018
Weighted-average common shares outstanding - Basic	205,881	206,941	206,437	206,283
Effect of dilutive stock options and restricted stock units	1,666	2,482	1,832	2,957
Weighted-average common shares outstanding - Diluted	207,547	209,423	208,269	209,240
Diluted earnings per common share	$ 0.17	$ 0.17	$ 0.51	$ 0.49

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6. SEGMENTS AND GEOGRAPHIC INFORMATION

We consider Michaels-U.S., Michaels-Canada, Aaron Brothers, Pat Catan’s and Darice to be our operating segments for purposes of determining reportable segments based on the criteria of ASC 280, Segment Reporting (“ASC 280”). We determined that Michaels-U.S., Michaels-Canada, Aaron Brothers and Pat Catan’s have similar economic characteristics and meet the aggregation criteria set forth in ASC 280. Therefore, we combine these operating segments into one reporting segment. Darice does not meet the materiality criteria in ASC 280 and, therefore, is not disclosed as a reportable segment.

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

	13 Weeks Ended		26 Weeks Ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
United States	$ 970,367	$ 896,004	$ 2,034,204	$ 1,879,264
Canada	89,986	88,266	185,029	182,606
Total	$ 1,060,353	$ 984,270	$ 2,219,233	$ 2,061,870

Our chief operating decision makers evaluate historical operating performance and forecast future periods’ operating performance based on operating income and earnings before interest, income taxes, depreciation, amortization and losses on early extinguishments of debt and refinancing costs (“EBITDA (excluding losses on early extinguishments of debt and refinancing costs)”). We believe these metrics more closely reflect the operating effectiveness of factors over which management has control. A reconciliation of EBITDA (excluding losses on early extinguishments of debt and refinancing costs) to net income is presented below (in thousands):

	13 Weeks Ended		26 Weeks Ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015

Net income	$ 35,617	$ 35,711	$ 106,382	$ 102,449
Interest expense	31,954	34,311	64,173	72,127
Losses on early extinguishments of debt and refinancing costs	405	6,072	405	6,072
Provision for income taxes	19,616	20,624	61,511	59,857
Depreciation and amortization	28,998	28,004	58,468	55,949
Interest income	(173)	(57)	(453)	(180)
EBITDA (excluding losses on early extinguishments of debt and refinancing costs)	$ 116,417	$ 124,665	$ 290,486	$ 296,274

7. CONTINGENCIES

Rea Claim

On September 15, 2011, MSI was served with a lawsuit filed in the California Superior Court in and for the County of Orange (“Superior Court”) by four former store managers as a class action proceeding on behalf of themselves and certain former and current store managers employed by MSI in California. The lawsuit alleged that MSI improperly classified its store managers as exempt employees and as such failed to pay all wages, overtime, waiting time penalties and failed to provide accurate wage statements. The lawsuit also alleged that the foregoing conduct was in breach of various laws, including California’s unfair competition law. On December 3, 2013, the Superior Court entered an order certifying a class of approximately 200 members. MSI successfully removed the case to the United States District Court for the Central District of California and on May 8, 2014, the class was decertified. The named plaintiffs’ claims were resolved in September 2014, but the individual claims of 26 former class members remain pending in the Central District

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of California. In addition, a separate representative action brought on behalf of store managers throughout the state is pending in the California Superior Court, County of San Diego. We believe we have meritorious defenses and intend to defend the lawsuits vigorously. We do not believe the resolution of the lawsuits will have a material effect on our consolidated financial statements.

Fair Credit Reporting Claim

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

Following the filing of the Graham case in New Jersey, five additional purported class action lawsuits with six plaintiffs were filed, Michele Castro and Janice Bercut v. Michaels Stores, Inc., in the U.S. District Court for the Northern District of Texas, Michelle Bercut v. Michaels Stores, Inc. in the Superior Court of California for Sonoma County, Raini Burnside v. Michaels Stores, Inc., in the U.S. District Court for the Western District of Missouri, Sue Gettings v. Michaels Stores, Inc., in the U.S. District Court for the Southern District of New York, and Barbara Horton v. Michaels Stores, Inc., in the U.S. District Court for the Central District of California. All of the plaintiffs alleged violations of the FCRA. In addition, the Castro, Horton and Janice Bercut lawsuits also alleged violations of California's unfair competition law. The Burnside, Horton and Gettings lawsuits, as well as the claims by Michele Castro, have been dismissed. The Graham, Janice Bercut and Michelle Bercut lawsuits were transferred for centralized pretrial proceedings to the District of New Jersey.

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

Data Security Incident

Five putative class actions were filed against MSI relating to the January 2014 data breach. The plaintiffs generally alleged that MSI failed to secure and safeguard customers' private information including credit and debit card information, and as such, breached an implied contract, and violated the Illinois Consumer Fraud Act (and other states' similar laws) and are seeking damages including declaratory relief, actual damages, punitive damages, statutory damages, attorneys' fees, litigation costs, remedial action, pre and post judgment interest, and other relief as available. The cases are as follows: Christina Moyer v. Michaels Stores, Inc., was filed on January 27, 2014; Michael and Jessica Gouwens v. Michaels Stores, Inc., was filed on January 29, 2014; Nancy Maize and Jessica Gordon v. Michaels Stores, Inc., was filed on February 21, 2014; and Daniel Ripes v. Michaels Stores, Inc., was filed on March 14, 2014. These four cases were filed in the United States District Court for the Northern District of Illinois, Eastern Division. On March 18, 2014, an additional putative class action was filed in the United States District Court for the Eastern District of New York, Mary Jane Whalen v. Michaels Stores, Inc., but was voluntarily dismissed by the plaintiff on April 11, 2014 without prejudice to her right to re file a complaint. On April 16, 2014, an order was entered consolidating the Illinois actions. On July 14, 2014, the Company's motion to dismiss the consolidated complaint was granted.

On December 2, 2014, Whalen filed a new lawsuit against MSI related to the data breach in the United States District Court for the Eastern District of New York, Mary Jane Whalen v. Michaels Stores, Inc., seeking damages including declaratory relief, monetary damages, statutory damages, punitive damages, attorneys' fees and costs, injunctive relief, pre and post judgment interest, and other relief as available. The Company filed a motion to dismiss which was granted on December 28, 2015, and judgment was entered in favor of the Company on January 8, 2016. Plaintiff filed a notice of

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appeal on January 27, 2016, appealing the judgment to the United States Court of Appeals for the Second Circuit. The appeal is pending.

The Company intends to defend this lawsuit vigorously. We cannot reasonably estimate the potential loss, or range of loss, related to the lawsuit, if any.

In connection with the breach, payment card companies and associations assessed us for unauthorized card charges and costs. We have also incurred other costs associated with the data breach, including legal fees, investigative fees, costs of communications with customers and credit monitoring services provided to our customers. The assessments and other charges and costs are immaterial to the consolidated financial statements. In addition, various states' attorneys general investigated events related to the data breach, including how it occurred, its consequences and our responses. We fully cooperated in these investigations and we do not expect any further action.

Consumer Product Safety Commission Claim

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

General

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

For some of the matters disclosed above, as well as other lawsuits involving the Company, we are able to estimate a range of losses in excess of the amounts recorded, if any, in the accompanying consolidated financial statements. As of July 30, 2016, the aggregate estimated loss is approximately $13 million, which includes amounts recorded by the Company.

8. RELATED PARTY TRANSACTIONS

Affiliates of, or funds advised by, Bain Capital Partners, LLC ("Bain Capital") and The Blackstone Group L.P. ("The Blackstone Group", together with Bain Capital and their applicable affiliates, the "Sponsors") own approximately 50% of our outstanding common stock as of July 30, 2016.

The Blackstone Group owns a majority equity position in RGIS, a vendor we utilize to count our store inventory. Payments associated with this vendor during the second quarters of fiscal 2016 and fiscal 2015 were $1.7 million and $1.5 million, respectively. Payments made during the six months ended July 30, 2016 and August 1, 2015 were $3.7 million and $3.4 million, respectively. These expenses are included in selling, general and administrative ("SG&A") in the consolidated statements of comprehensive income.

The Blackstone Group owns an equity position in Vistar, a vendor we utilize for all of the candy-type items in our stores. Payments associated with this vendor during the second quarters of fiscal 2016 and fiscal 2015 were $6.6 million and $5.7 million, respectively. Payments made during each of the six months ended July 30, 2016 and August 1, 2015

were $12.9 million. These expenses are recognized in cost of sales and occupancy expense in the consolidated statements of comprehensive income as the sales are incurred.

The Blackstone Group owns an equity position in Brixmor Properties Group, Excel Trust, Inc., Blackstone Real Estate DDR Retail Holdings III, LLC. and Blackstone Real Estate RC Retail Holdings, LLC., vendors we utilize to lease certain properties. Payments associated with these vendors during the second quarters of fiscal 2016 and fiscal 2015 were $2.9 million and $2.3 million, respectively. Payments made during the six months ended July 30, 2016 and August 1, 2015 were $5.3 million and $4.7 million, respectively. These expenses are included in cost of sales and occupancy expense in the consolidated statements of comprehensive income.

Certain affiliates of The Blackstone Group have significant influence over US Xpress Enterprises, Inc., a vendor we utilize for transportation services. Payments associated with this vendor during the second quarters of fiscal 2016 and fiscal 2015 were $0.2 million and $0.4 million, respectively. Payments made during the six months ended July 30, 2016 and August 1, 2015 were $0.5 million. These expenses are recognized in cost of sales and occupancy expense in the consolidated statements of comprehensive income as the sales are incurred.

Four of our current directors, Joshua Bekenstein, Nadim El Gabbani, Lewis S. Klessel and Peter F. Wallace, are affiliates of Bain Capital or The Blackstone Group. As such, some or all of such directors may have an indirect material interest in payments with respect to debt securities of the Company that have been purchased by affiliates of Bain Capital and The Blackstone Group. As of July 30, 2016, affiliates of The Blackstone Group held $86.0 million of our Restated Term Loan Credit Facility.

9. CONDENSED CONSOLIDATED FINANCIAL INFORMATION

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

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Michaels Stores, Inc.

Condensed Consolidated Balance Sheets

(in thousands)

ASSETS	July 30, 2016	January 30, 2016	August 1, 2015
Current assets:			
Cash and equivalents	$ 110,100	$ 404,650	$ 65,631
Merchandise inventories	1,145,422	1,002,607	1,073,722
Prepaid expenses and other current assets	104,326	87,573	100,437
Total current assets	1,359,848	1,494,830	1,239,790
Property and equipment, net	398,688	378,507	394,686
Goodwill	119,074	94,290	94,290
Other assets	77,503	56,004	55,619
Total assets	$ 1,955,113	$ 2,023,631	$ 1,784,385
LIABILITIES AND STOCKHOLDERS' DEFICIT			
Current liabilities:			
Accounts payable	$ 462,099	$ 457,704	$ 418,745
Accrued liabilities and other	345,844	375,992	347,983
Current portion of long-term debt	66,900	24,900	48,900
Other current liabilities	3,087	89,996	2,885
Total current liabilities	877,930	948,592	818,513
Long-term debt	2,735,187	2,744,942	2,902,099
Other liabilities	103,296	95,400	91,032
Total stockholders' deficit	(1,761,300)	(1,765,303)	(2,027,259)
Total liabilities and stockholders' deficit	$ 1,955,113	$ 2,023,631	$ 1,784,385

Michaels Stores, Inc.

Condensed Consolidated Statements of Comprehensive Income

(in thousands)

	13 Weeks Ended		26 Weeks Ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015

Net sales	$ 1,060,353	$ 984,270	$ 2,219,233	$ 2,061,870
Cost of sales and occupancy expense	669,656	610,949	1,363,785	1,246,752
Gross profit	390,697	373,321	855,448	815,118
Selling, general and administrative	302,146	275,380	619,411	570,729
Other operating expense	908	1,040	2,534	3,284
Operating income	87,643	96,901	233,503	241,105
Interest and other expense	31,849	34,063	64,519	68,415
Income before income taxes	55,794	62,838	168,984	172,690
Provision for income taxes	19,825	23,034	61,917	63,705
Net income	$ 35,969	$ 39,804	$ 107,067	$ 108,985
Other comprehensive income, net of tax:				
Foreign currency translation adjustment and other	(4,759)	(7,223)	9,450	(2,907)
Comprehensive income	$ 31,210	$ 32,581	$ 116,517	$ 106,078

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Michaels Stores, Inc.

Condensed Consolidated Statements of Cash Flows

(in thousands)

	26 Weeks Ended	
	July 30, 2016	August 1, 2015
Cash flows from operating activities:		
Net cash used in operating activities	$ (11,866)	$ (80,172)
Cash flows from investing activities:		
Additions to property and equipment	(38,395)	(63,241)
Acquisition of Lamrite West, net of cash acquired	(151,100)	—
Net cash used in investing activities	(189,495)	(63,241)
Cash flows from financing activities:		
Net repayments of debt	(12,450)	(12,450)
Net borrowings of debt	42,000	24,000
Payment of dividend to Michaels Funding, Inc.	(126,962)	(188,046)
Other financing costs	4,223	11,981
Net cash used in financing activities	(93,189)	(164,515)
Net change in cash and equivalents	(294,550)	(307,928)
Cash and equivalents at beginning of period	404,650	373,559
Cash and equivalents at end of period	$ 110,100	$ 65,631

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10. ACQUISITION

On February 2, 2016, we acquired Lamrite for $150.0 million, prior to certain purchase price adjustments, utilizing our cash on hand. Lamrite operates an international wholesale business under the Darice brand name and 35 arts and crafts retail stores (32 as of the acquisition date), located primarily in Ohio and the surrounding states, under the Pat Catan's brand name. We incurred integration related costs of $1.9 million during the second quarter of fiscal 2016 and $6.0 million during the six months ended July 30, 2016. These expenses have been included in SG&A in the consolidated statements of comprehensive income.

The acquisition was accounted for using the purchase method of accounting in accordance with ASC 805, Business Combinations. The acquisition resulted in goodwill primarily related to the expected benefits resulting from enhancements to our private brand development capability, direct sourcing initiatives and business-to-business capabilities, as well as the value of the existing Lamrite workforce. The goodwill recognized is expected to be deductible for tax purposes.

The fair values of the intangible assets acquired were primarily determined by using the income approach. The income approach indicates value for a subject based on the present value of cash flows expected to be generated by the asset. Projected cash flows are discounted at a market rate of return that reflects the relative risk of achieving the cash flows and the time value of money. The fair value of inventory was determined based on the estimated selling price of the inventory less the expected costs of selling efforts and a reasonable profit margin.

The following table summarizes the cash consideration for the acquisition of Lamrite (in thousands):

Purchase contract amount	$ 150,000
Additional consideration to Lamrite shareholders for taxes	6,500
Working capital and other adjustments	(3,090)
Total purchase consideration	$ 153,410

The following table summarizes the fair values of the assets acquired and liabilities assumed from the acquisition of Lamrite as of February 2, 2016 (in thousands):

Cash and cash equivalents	$ 2,310

Trade accounts receivable	22,254
Merchandise inventory	83,700
Other current assets	1,202
Property, plant and equipment	25,367
Net favorable leases	2,450
Intangible assets (1)	21,800
Other assets	306
Current liabilities (2)	(30,490)
Other long-term liabilities	(273)
Fair value of net assets acquired	128,626
Goodwill	24,784
Total purchase consideration	$ 153,410

(1) Includes customer relationships, trade and brand names and proprietary product designs. Intangible assets include $9.4 million of assets that are being amortized over a range of 6 to 18 years.
(2) Includes accounts payable, accrued expenses, accrued payroll and accrued taxes.

Since the date of acquisition, the results of Lamrite's operations have been included in the Company's results of operations. The Company has not presented pro forma financial information for prior periods because the impact on our previously reported consolidated financial statements would not have been material.

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

This discussion and analysis should be read in conjunction with the unaudited consolidated financial statements of the Company (and the related notes thereto included elsewhere in this quarterly report), and the audited consolidated financial statements of the Company (and the related notes thereto) and the Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's Annual Report on Form 10-K for the fiscal year ended January 30, 2016 ("Annual Report") filed with the Securities and Exchange Commission ("SEC") pursuant to Section 13 or 15(d) under the Securities Act of 1934 on March 17, 2016.

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

We report on the basis of a 52- or 53-week fiscal year, which ends on the Saturday closest to January 31. All references to fiscal year mean the year in which that fiscal year began. References to "fiscal 2016" relate to the 52 weeks ended January 28, 2017 and references to "fiscal 2015" relate to the 52 weeks ended January 30, 2016. In addition, all references to "the second quarter of fiscal 2016" relate to the 13 weeks ended July 30, 2016 and all references to "the second quarter of fiscal 2015" relate to the 13 weeks ended August 1, 2015. Finally, all references to "the six months ended July 30, 2016" relate to the 26 weeks ended July 30, 2016 and all references to "the six months ended August 1, 2015" relate to the 26 weeks ended August 1, 2015. Because of the seasonal nature of our business, the results of operations for the 13 and 26 weeks ended July 30, 2016 are not indicative of the results to be expected for the entire

year.

Overview

We are the largest arts and crafts specialty retailer in North America (based on store count) providing materials, project ideas and education for creative activities under the retail brands of Michaels, Aaron Brothers and Pat Catan’s. We also operate an international wholesale business under the Darice brand name and a market-leading vertically-integrated custom framing business. At July 30, 2016, we operated 1,209 Michaels stores, 112 Aaron Brothers stores and 35 Pat Catan’s stores.

On February 2, 2016, the Company completed the acquisition of Lamrite West, Inc. and certain of its affiliates and subsidiaries (“Lamrite”) for $150.0 million, prior to certain purchase price adjustments, utilizing our cash on hand. Lamrite operates an international wholesale business under the Darice brand name (“Darice”) and 35 arts and crafts retail stores, located primarily in Ohio and the surrounding states, under the Pat Catan’s brand name (“Pat Catan’s”). We expect Lamrite to generate revenues of more than $200 million in fiscal 2016 and the retail stores have approximately 32,000 average square feet of selling space per store. The acquisition is expected to enhance our private brand development capabilities, accelerate our direct sourcing initiatives and strengthen our business-to-business capabilities.

Net sales for the second quarter of fiscal 2016 increased 7.7% compared to the same period in the prior year. The increase in net sales was primarily due to a $54.3 million increase related to the acquisition of Lamrite in February 2016 and the opening of 17 additional stores (net of closures) since August 1, 2015. Comparable stores sales increased 0.7% during the second quarter of fiscal 2016, or 1.0% at constant exchange rates. Gross profit as a percent of net sales decreased 110 basis points to 36.8% during the second quarter of fiscal 2016 primarily due to lower margins associated with Lamrite’s wholesale business. Operating income as a percent of net sales decreased 1.6% to 8.2% for the second quarter of fiscal 2016 as compared to 9.8% in the same period in the prior year. The decrease is due primarily to the acquisition of Lamrite, including $0.5 million of integration costs and non-recurring purchase accounting adjustments, and an increase in professional fees.

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Comparable Store Sales

Comparable store sales represents the change in net sales for stores open the same number of months in the comparable period of the previous year, including stores that were relocated or expanded during either period, as well as e-commerce sales. A store is deemed to become comparable in its 14th month of operation in order to eliminate grand opening sales distortions. A store temporarily closed more than two weeks is not considered comparable during the month it is closed. If a store is closed longer than two weeks but less than two months, it becomes comparable in the month in which it reopens, subject to a mid-month convention. A store closed longer than two months becomes comparable in its 14th month of operation after its reopening. Pat Catan’s stores will not be included in comparable store sales until the 14th month after the acquisition.

Operating Information

The following table sets forth certain operating data:

	13 Weeks Ended		26 Weeks Ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
Michaels stores:				
Open at beginning of period	1,204	1,177	1,196	1,168
New stores	5	9	16	19
Relocated stores opened	4	3	10	13
Closed stores	—	—	(3)	(1)
Relocated stores closed	(4)	(3)	(10)	(13)
Open at end of period	1,209	1,186	1,209	1,186
Aaron Brothers stores:				
Open at beginning of period	115	118	117	120
Closed stores	(3)	—	(5)	(2)
Open at end of period	112	118	112	118
Pat Catan's stores:				
Open at beginning of period	33	—	—	—
Acquired stores	—	—	32	—
New stores	2	—	3	—
Open at end of period	35	—	35	—
Total store count at end of period	1,356	1,304	1,356	1,304

Other Operating Data:				
Average inventory per Michaels store (in thousands) (1)	$ 846	$ 880	$ 846	$ 880
Comparable store sales	0.7 %	1.6 %	0.8 %	0.9 %
Comparable store sales, at constant currency	1.0 %	2.9 %	1.2 %	2.1 %

(1) The calculation of average inventory per Michaels store excludes our Aaron Brothers and Pat Catan's stores.

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Results of Operations

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

	13 Weeks Ended				26 Weeks Ended			
	July 30, 2016		August 1, 2015		July 30, 2016		August 1, 2015	
Net sales	100.0	%	100.0	%	100.0	%	100.0	%
Cost of sales and occupancy expense	63.2		62.1		61.5		60.5	
Gross profit	36.8		37.9		38.5		39.5	
Selling, general and administrative	28.5		28.0		28.0		27.7	
Store pre-opening costs	0.1		0.1		0.1		0.2	
Operating income	8.2		9.8		10.5		11.7	
Interest expense	3.0		3.5		2.9		3.5	
Losses on early extinguishments of debt and refinancing costs	—		0.6		—		0.3	
Other (income) expense, net	—		—		—		—	
Income before income taxes	5.2		5.7		7.6		7.9	
Provision for income taxes	1.8		2.1		2.8		2.9	
Net income	3.4	%	3.6	%	4.8	%	5.0	%

13 Weeks Ended July 30, 2016 Compared to the 13 Weeks Ended August 1, 2015

Net Sales. Net sales increased $76.1 million in the second quarter of fiscal 2016, or 7.7%, compared to the second quarter of fiscal 2015. The increase in net sales was due to a $54.3 million increase related to the acquisition of Lamrite in fiscal 2016, a $15.2 million increase related to 17 additional stores opened (net of closures) since August 1, 2015, and a $6.6 million increase in comparable store sales. Comparable store sales increased 0.7%, or 1.0% at constant exchange rates, due primarily to an increase in customer transactions.

Gross Profit. Gross profit was 36.8% of net sales in the second quarter of fiscal 2016 compared to 37.9% in the second quarter of fiscal 2015. The 110 basis point decline was primarily due to lower margins associated with Lamrite's wholesale business, timing associated with distribution related costs and an increase in promotional activity. The decline was partially offset by an increase in retail prices, sourcing efficiencies and a $1.4 million benefit associated with non-recurring purchase accounting adjustments related to inventory.

Selling, General and Administrative. Selling, general and administrative (“SG&A”) was 28.5% of net sales for the second quarter of fiscal 2016 compared to 28.0% for the second quarter of fiscal 2015. SG&A increased $27.0 million to $302.7 million for the second quarter of fiscal 2016. The increase was due primarily to $15.5 million of expenses attributable to Lamrite’s operations, a $3.4 million increase associated with operating 17 additional stores (net of closures), $1.9 million of Lamrite integration costs and an increase in professional fees.

Interest Expense. Interest expense decreased $2.4 million to $32.0 million in the second quarter of fiscal 2016 compared to the second quarter of fiscal 2015. The decrease was primarily attributable to $1.7 million of interest savings from the partial redemption of our senior secured term loan facility (“Restated Term Loan Credit Facility”) in the fourth quarter of fiscal 2015 and $0.3 million of interest savings due to the refinancing of our senior secured asset-based revolving credit facility (“Restated Revolving Credit Facility”) in the second quarter of fiscal 2016.

Losses on Early Extinguishments of Debt and Refinancing Costs. We recorded a loss on the early extinguishment of debt of $0.4 million during the second quarter of fiscal 2016 related to the refinancing of our Restated Revolving Credit Facility. We recorded a loss on the early extinguishment of debt of $6.1 million during the second quarter

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of fiscal 2015 related to the redemption of our remaining outstanding 7.50%/8.25% PIK Toggle Notes due 2018 (“PIK Notes”), consisting of $3.6 million of redemption premiums and $2.5 million to write off related debt issuance costs.

26 Weeks Ended July 30, 2016 Compared to the 26 Weeks Ended August 1, 2015

Net Sales. Net sales increased $157.4 million in the first six months of fiscal 2016, or 7.6%, compared to the first six months of fiscal 2015. The increase in net sales was due to a $107.5 million increase related to the acquisition of Lamrite in fiscal 2016, a $33.8 million increase related to 17 additional stores opened (net of closures) since August 1, 2015, and a $16.1 million increase in comparable store sales. Comparable store sales increased 0.8%, or 1.2% at constant exchange rates, due primarily to an increase in customer transactions.

Gross Profit. Gross profit was 38.5% of net sales for the first six months of fiscal 2016 compared to 39.5% for the first six months of fiscal 2015. The 100 basis point decline was primarily due to lower margins associated with Lamrite’s wholesale business, $2.2 million of non-recurring purchase accounting adjustments related to inventory and an increase in promotional activity. The decline was partially offset by an increase in retail prices and sourcing efficiencies.

Selling, General and Administrative. SG&A was 28.0% of net sales for the first six months of fiscal 2016 compared to 27.7% in the first six months of fiscal 2015. SG&A increased $49.2 million to $620.5 million for the first six months of fiscal 2016. The increase was due primarily to $30.7 million of expenses attributable to Lamrite’s operations, a $7.8 million increase associated with operating 17 additional stores (net of closures), $6.0 million of Lamrite integration costs and an increase in professional fees.

Interest Expense. Interest expense decreased $8.0 million to $64.2 million in the first six months of fiscal 2016 compared to the first six months of fiscal 2015. The decrease was primarily attributable to $3.6 million of interest savings from the redemption of the PIK Notes during the second quarter of fiscal 2015, $3.5 million of interest savings from the partial redemption of our Restated Term Loan Credit Facility in the fourth quarter of fiscal 2015 and $0.3 million of interest savings from the refinancing of our Restated Revolving Credit Facility in the second quarter of fiscal 2016.

Losses on Early Extinguishments of Debt and Refinancing Costs. We recorded a loss on the early extinguishment of debt of $0.4 million in the first six months of fiscal 2016 related to the refinancing of our Restated Revolving Credit Facility. We recorded a loss on the early extinguishment of debt of $6.1 million in the first six months of fiscal 2015 related to the redemption of our remaining outstanding PIK Notes, consisting of $3.6 million of redemption premiums and $2.5 million to write off related debt issuance costs.

Liquidity and Capital Resources

We require cash principally for day-to-day operations, to finance capital investments, to purchase inventory, to service our outstanding debt and for seasonal working capital needs. We expect that our available cash, cash flow generated from operating activities and funds available under our Amended Revolving Credit Facility (as defined below) will be sufficient to fund planned capital expenditures, working capital requirements, debt repayments, debt service requirements and anticipated growth for the foreseeable future. Our ability to satisfy our liquidity needs and to continue to refinance or reduce debt could be adversely affected by the occurrence of any of the events described under Item 1A. Risk Factors of our Annual Report on Form 10-K for the fiscal year ended January 30, 2016 or our failure to meet our debt covenants. Our Amended Revolving Credit Facility provides senior secured financing of up to $850.0 million, subject to a borrowing base. As of July 30, 2016, the borrowing base was $696.4 million, of which we had $57.3 million of outstanding standby letters of credit, $42.0 million in borrowings and $597.1 million of unused borrowing capacity. Our cash and cash equivalents totaled $114.8 million at July 30, 2016, of which $33.0 million was held by our foreign subsidiaries. If it were necessary to repatriate these funds for use in the U.S., we would be required to pay U.S. taxes on the amount of undistributed earnings in our foreign subsidiaries. However, it is our intent to indefinitely reinvest these funds outside the U.S.

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On February 2, 2016, the Company completed the acquisition of Lamrite for $150.0 million, prior to certain purchase price adjustments, utilizing our cash on hand. Lamrite operates an international wholesale business under the Darice brand name and 35 arts and crafts retail stores, located primarily in Ohio and the surrounding states, under the Pat Catan's brand name. We expect Lamrite to generate revenues of more than $200 million in fiscal 2016 and the retail stores have approximately 32,000 average square feet of selling space per store. The acquisition is expected to enhance our private brand development capabilities, accelerate our direct sourcing initiatives and strengthen our business-to-business capabilities.

In March 2016, the Board of Directors authorized the Company to purchase $200.0 million of the Company's common stock on the open market. The share repurchase program does not have an expiration date, and the timing and number of repurchase transactions under the program will depend on market conditions, corporate considerations, debt agreements and regulatory requirements. Shares repurchased under the program are held as treasury shares until retired. As of July 30, 2016, we have repurchased 4.7 million shares for an aggregate amount of $126.9 million and have $73.1 million of availability remaining under our share repurchase program.

On May 27, 2016, Michaels Stores, Inc. ("MSI") entered into an amended and restated credit agreement with Wells Fargo Bank, National Association and other lenders to amend various terms of our Restated Revolving Credit Facility. The amended credit agreement, together with the related security, guarantee and other agreements, is referred to as the "Amended Revolving Credit Facility". The Amended Revolving Credit Facility provides for senior secured financing of up to $850.0 million, subject to a borrowing base, with the right to request up to $200.0 million of additional commitments. The borrowing base under the Amended Revolving Credit Facility equals the sum of: (i) 90% of eligible credit card receivables, (ii) 85% of eligible trade receivables, (iii) 90% to 92.5% of the appraised value of eligible inventory, plus (iv) 90% to 92.5% of the lesser of (a) the appraised value of eligible inventory supported by letters of credit and (b) the face amount of the letters of credit, less (v) certain reserves. The Amended Revolving Credit Facility matures in May 2021, subject to a springing maturity date if certain of our outstanding indebtedness has not been repaid, redeemed, refinanced, cash collateralized or if the necessary availability reserves have not been established prior to such time. Our obligations under the Amended Revolving Credit Facility are secured by (subject to certain exceptions) a first priority security interest in the current assets of the borrowers and facility guarantors and a second priority security interest in all other assets.

We had total outstanding debt of $2,821.7 million at July 30, 2016, of which $2,311.7 million was subject to variable interest rates and $510.0 million was subject to fixed interest rates.

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

We intend to use excess operating cash flows to invest in growth opportunities, to repurchase outstanding shares and to repay portions of our indebtedness, depending on prevailing market conditions, liquidity requirements, contractual restrictions and other factors. As such, we and our subsidiaries, affiliates and significant shareholders may, from time to time, seek to retire or purchase our outstanding debt (including publicly issued debt) through cash purchases and/or exchanges, in open market purchases, privately negotiated transactions, by tender offer or otherwise. If we use our excess cash flows to repay our debt, it will reduce the amount of excess cash available for additional capital expenditures.

Cash Flow from Operating Activities

Cash flows used in operating activities was $24.4 million in the first six months of fiscal 2016 compared to $83.1 million in the first six months of fiscal 2015. The improvement was primarily due to the strategic decision to maintain higher inventory levels in fiscal 2015, partially offset by integration costs incurred as a result of the acquisition of Lamrite on February 2, 2016.

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Average inventory per Michaels store (including e-commerce and distribution centers) decreased 3.9% to $846,000 at July 30, 2016 from $880,000 at August 1, 2015. The decrease is primarily due to higher inventory levels in the prior year resulting from an effort to mitigate the impact of third-party shipping delays.

Cash Flow from Investing Activities

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

	26 Weeks Ended	
	July 30, 2016	August 1, 2015
New and relocated stores and stores not yet opened (1)	$ 10,663	$ 13,890
Existing stores	10,052	26,670
Information systems	10,972	18,557
Corporate and other	6,708	4,124
	$ 38,395	$ 63,241

(1) In the first six months of fiscal 2016, we incurred capital expenditures related to the opening of 26 Michaels stores, including the relocation of 10 stores, and three Pat Catan's stores. In the first six months of fiscal 2015, we incurred capital expenditures related to the opening of 32 Michaels stores, including the relocation of 13 stores.

Contractual Obligations

The Company acquired $76.9 million of Lamrite's lease commitments in connection with the acquisition. There have been no other material changes to our contractual obligations described in our Annual Report.

Non-GAAP Measures

The following table sets forth certain non-GAAP measures the Company uses to manage our performance and measure compliance with certain debt covenants. The Company defines "EBITDA (excluding losses on early

extinguishments of debt and refinancing costs)" as net income before interest, income taxes, depreciation, amortization and losses on early extinguishments of debt and refinancing costs. The Company defines "Adjusted EBITDA" as EBITDA (excluding losses on early extinguishments of debt and refinancing costs) adjusted for certain defined amounts in accordance with the Company's Restated Term Loan Credit Facility and Amended Revolving Credit Facility (collectively, the "Adjustments").

The Company has presented EBITDA (excluding losses on early extinguishments of debt and refinancing costs) and Adjusted EBITDA to provide investors with additional information to evaluate our operating performance and our ability to service our debt. Adjusted EBITDA is a required calculation under the Company's Restated Term Loan Credit Facility and its Amended Revolving Credit Facility (together the "Senior Secured Credit Facilities"). As it relates to the Senior Secured Credit Facilities, Adjusted EBITDA is used in the calculations of fixed charge coverage and leverage ratios, which, under certain circumstances determine mandatory repayments or maintenance covenants and may restrict the Company's ability to make certain payments (characterized as restricted payments), investments (including acquisitions) and debt repayments.

As EBITDA (excluding losses on early extinguishments of debt and refinancing costs) and Adjusted EBITDA are not measures of operating performance or liquidity calculated in accordance with U.S. generally accepted accounting principles ("GAAP"), these measures should not be considered in isolation of, or as a substitute for, net income, as an indicator of operating performance, or net cash provided by operating activities as an indicator of liquidity. Our

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computation of EBITDA (excluding losses on early extinguishments of debt and refinancing costs) and Adjusted EBITDA may differ from similarly titled measures used by other companies.

The following table shows a reconciliation of EBITDA (excluding losses on early extinguishments of debt and refinancing costs) and Adjusted EBITDA to net income and net cash used in operating activities (in thousands):

	13 Weeks Ended		26 Weeks Ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
Net cash used in operating activities	$ (561)	$ (11,194)	$ (24,424)	$ (83,071)
Depreciation and amortization	(28,998)	(28,004)	(58,468)	(55,949)
Share-based compensation	(3,461)	(3,505)	(6,590)	(6,225)
Debt issuance costs amortization	(1,786)	(2,089)	(3,760)	(4,366)
Accretion of long-term debt, net	62	33	124	66
Deferred income taxes	(4,610)	(1,410)	(619)	(6,514)
Losses on early extinguishments of debt and refinancing costs	(405)	(6,072)	(405)	(6,072)
Losses on disposition of property and equipment	(3)	—	(35)	—
Excess tax benefits from share-based compensation	2,672	2,753	7,271	12,952
Changes in assets and liabilities	72,707	85,199	193,288	251,628
Net income	35,617	35,711	106,382	102,449
Interest expense	31,954	34,311	64,173	72,127
Losses on early extinguishments of debt and refinancing costs	405	6,072	405	6,072
Provision for income taxes	19,616	20,624	61,511	59,857
Depreciation and amortization	28,998	28,004	58,468	55,949
Interest income	(173)	(57)	(453)	(180)
EBITDA (excluding losses on early extinguishments of debt and refinancing costs)	116,417	124,665	290,486	296,274
Adjustments:				
Share-based compensation	3,461	3,505	6,590	6,225
Severance costs	174	302	920	1,162
Store pre-opening costs	939	1,047	2,568	3,310
Store remodel costs	71	1,167	(10)	1,827
Foreign currency transaction (gains) losses	(388)	14	548	(23)
Store closing costs	1,054	332	2,152	(361)
Lamrite integration costs	1,874	—	6,019	—
Other (1)	748	1,449	1,526	2,476
Adjusted EBITDA	$ 124,350	$ 132,481	$ 310,799	$ 310,890

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

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Disclosure Regarding Forward-Looking Information

The above discussion, as well as other portions of this Quarterly Report on Form 10-Q, contains forward-looking statements that reflect our plans, estimates and beliefs. Any statements contained herein (including, but not limited to, statements to the effect that Michaels or its management “anticipates”, “plans”, “estimates”, “expects”, “believes”, “intends” ar
other similar expressions) that are not statements of historical fact should be considered forward-looking statements and should be read in conjunction with our Annual Report. Such forward-looking statements are based upon management’s current knowledge and assumptions about future events and involve risks and uncertainties that could cause actual results, performance or achievements to be materially different from anticipated results, prospects, performance or achievements expressed or implied by such forward-looking statements. Such risks and uncertainties include, but are not limited to the following:

· risks related to the effect of economic uncertainty;

· our substantial outstanding indebtedness of $2.8 billion could adversely affect our ability to raise additional capital to fund our operations, limit our ability to react to changes in the economy or our industry, expose us to interest rate risk to the extent of our $2.3 billion variable rate debt and prevent us from meeting our obligations under our notes and credit facilities;

· restrictions in our debt agreements that limit our flexibility in operating our business, as our senior secured credit facilities and the indenture governing our notes contain various covenants that limit our ability to engage in specified types of transactions and require that we maintain specified financial ratios upon the occurrence of certain events;

· changes in customer demand could materially adversely affect our sales, results of operations and cash flow;

· our failure to adequately maintain security and prevent unauthorized access to electronic and other confidential information, which could result in an additional data breach, could materially adversely affect our financial condition and operating results;

· competition, including internet-based competition, could negatively impact our business;

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

· how well we manage our business;

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our ability to open new stores and increase comparable store sales growth, as our growth depends on our strategy of expanding our base of retail stores; and, if we are unable to continue this strategy, our ability to increase our sales, profitability and cash flow could be impaired;

· damage to the reputation of the Michaels brand or our private and exclusive brands could adversely affect our sales;

· a weak fourth quarter would materially adversely affect our results of operations;

· risks associated with the suppliers from whom our products are sourced may fail us and transitioning to other qualified vendors could materially adversely affect our revenue and profit growth;

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- unexpected or unfavorable consumer responses to our promotional or merchandising programs could materially adversely affect our sales, results of operations, cash flows and financial condition;

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

- product recalls and/or product liability, as well as changes in product safety and other consumer protection laws, may adversely impact our operations, merchandise offerings, reputation, results of operation, cash flow, and financial condition;

- changes in regulations or enforcement, or our failure to comply with existing or future regulations, may adversely impact our business;

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

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

- improvements to our supply chain may not be fully successful;

- changes in newspaper subscription rates may result in reduced exposure to our circular advertisements;

- disruptions in the capital markets could increase our costs of doing business;

- our real estate leases generally obligate us for long periods, which subjects us to various financial risks;

- we have co-sourced certain of our information technology, accounts payable, payroll, accounting and human resources functions, and may co-source other administrative functions, which makes us more dependent upon third parties;

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

- we are dependent upon the services of our senior management team;

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

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

- any difficulty executing or integrating an acquisition, a business combination or a major business initiative could adversely affect our business or results of operations;

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

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- investment funds affiliated with the Sponsors own approximately 50% of the outstanding shares of our common stock and as a result will have the ability to control the outcome of matters submitted for stockholder approval, including the ability to direct the election of all of the members of our Board of Directors, and they may have interests that differ from those of other stockholders.

For more details on factors that may cause actual results to differ materially from such forward-looking statements, please see the Risk Factors section of our Annual Report. Except as required by applicable law, we disclaim any intention to, and undertake no obligation to, update or revise any forward-looking statement.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency Risk

We are exposed to fluctuations in exchange rates between the U.S. and Canadian dollar, which is the functional currency of our Canadian subsidiaries. Our sales, costs and expenses of our Canadian subsidiaries, when translated into U.S. dollars, can fluctuate due to exchange rate movement. A 10% increase or decrease in the exchange rate of the Canadian dollar would have increased or decreased net income by approximately $4 million for the 26 weeks ended July 30, 2016.

Interest Rate Risk

We have market risk exposure arising from changes in interest rates on our Restated Term Loan Credit Facility and our Amended Revolving Credit Facility. The interest rates on our Restated Term Loan Credit Facility and our Amended Revolving Credit Facility will reprice periodically, which will impact our earnings and cash flow. The interest rate on our 2020 Senior Subordinated Notes is fixed. Based on our overall interest rate exposure to variable rate debt outstanding as of July 30, 2016, a 1% change in interest rates would impact income before income taxes by approximately $23 million for fiscal 2016. A 1% change in interest rates would impact the fair value of our long-term fixed rate debt by approximately $13 million. A change in interest rates would not materially affect the fair value of our variable rate debt as the debt reprices periodically.

Inflation Risk

We do not believe inflation and changing commodity prices have had a material impact on our net sales, income from continuing operations, plans for expansion or other capital expenditures for any period presented in this report.

However, we cannot be sure inflation and changing commodity prices will not have an adverse impact on our operating results, financial condition, plans for expansion or other capital expenditures in future periods.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain a set of disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated by the SEC under the Securities Exchange Act of 1934) designed to provide reasonable assurance that information, which is required to be timely disclosed, is accumulated and communicated to management in a timely fashion. We note the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

An evaluation was carried out under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls are effective to provide reasonable assurance that information

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required to be disclosed in the reports that we file or submit under the Securities and Exchange Act of 1934, as amended, is accumulated and communicated to management, including our Chief Executive Officer and our Chief Financial Officer, to allow timely decisions regarding required disclosure and are effective to provide reasonable assurance that such information is recorded, processed, summarized, and reported within the time periods specified by the SEC's rules and forms.

Change in Internal Control Over Financial Reporting

There have been no changes in our internal controls over financial reporting during the quarter ended July 30, 2016 that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Part II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Information regarding legal proceedings is incorporated by reference from Note 7 to the consolidated financial statements.

ITEM 1A. RISK FACTORS

There have been no material changes to the Risk Factors described in the Annual Report on Form 10-K.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table provides certain information with respect to our purchases of shares of the Company's common stock during the second quarter of fiscal 2016:

Period	Total Number of Shares Purchased (a)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan (b)	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plan (b) (in thousands)
May 1, 2016 - May 28, 2016	215,666	$ 28.49	215,666	$ 134,517
May 29, 2016 - July 2, 2016	1,032,559	27.20	1,024,444	106,677
July 3, 2016 - July 30, 2016	1,216,849	27.80	1,208,910	73,071
Total	2,465,074	$ 27.61	2,449,020	$ 73,071

(a) These amounts reflect the following transactions during the second quarter of fiscal 2016: (i) the repurchase of 2,449,020 shares as part of our publicly announced share repurchase program and (ii) the surrender of shares of common stock to the Company to satisfy tax withholding obligations in connection with the vesting of employee restricted stock awards.

(b) In March 2016, the Board of Directors authorized the Company to purchase up to $200.0 million of the Company's common stock on the open market. The share repurchase program does not have an expiration date. The Company intends to retire shares repurchased under the program.

ITEM 5. OTHER INFORMATION

Iran Threat Reduction and Syria Human Rights Act of 2012

Pursuant to Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012, which added Section 13(r) of the Exchange Act, the Company hereby incorporates by reference herein Exhibit 99.1 of this Quarterly

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Report on Form 10-Q, which includes disclosures publicly filed and/or provided to The Blackstone Group L.P., one of our Sponsors, by NCR Corporation, which may be considered its affiliate.

ITEM 6. EXHIBITS

(a) Exhibits:

Exhibit Number	Description of Exhibit
31.1	Certifications of Carl S. Rubin pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to §302 of the Sarbanes-Oxley Act of 2002
31.2	Certifications of Charles M. Sonsteby pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to §302 of the Sarbanes-Oxley Act of 2002
32.1	Certification pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002
99.1	Section 13(r) Disclosure
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

THE MICHAELS COMPANIES, INC.

By: /s/ Carl S. Rubin
Carl S. Rubin
Chairman and Chief Executive Officer
(Principal Executive Officer)

By: /s/ Charles M. Sonsteby
Charles M. Sonsteby
Vice Chairman and Chief Financial Officer

(Principal Financial Officer)

Date: August 26, 2016

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