MICHAELS STORES INC
Form 424B3
December 07, 2012
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Registration No. 333-185020

Michaels Stores, Inc.

Offer to Exchange

up to $200,000,000 principal amount of our 7¾% Senior Notes due November 1, 2018, which has been registered under the Securities Act of 1933, as amended (the Securities Act), for any and all of our outstanding 7¾% Senior Notes due November 1, 2018 issued on September 27, 2012.

Exchange Offer

We are offering to exchange, upon the terms and subject to the conditions set forth in this prospectus and the accompanying letter of transmittal, our new 7¾% Senior Notes due November 1, 2018 (the exchange notes), for all of our outstanding 7¾% Senior Notes due November 1, 2018 that were issued on September 27, 2012 (the outstanding notes and, together with the exchange notes, the notes). The outstanding notes were issued under the indenture (the indenture or the indenture governing the senior notes) governing our 7¾% Senior Notes due 2018 that we issued on October 21, 2010 (the initial notes and, together with the notes, the senior notes). The outstanding notes are treated as a single series with the initial notes, vote as one class under the indenture and have the same terms as those of the initial notes, except that (i) the outstanding notes are subject to a separate registration rights agreement and (ii) the outstanding notes were issued under a CUSIP number different from the initial notes. We are conducting the exchange offer in order to provide you with an opportunity to exchange your unregistered outstanding notes for freely tradable exchange notes that have been registered under the Securities Act and that are expected to share a single CUSIP number and be fungible with the initial notes.

The principal features of the exchange offer are as follows:

- We will exchange all outstanding notes that are validly tendered and not validly withdrawn for an equal principal amount of exchange notes that are freely tradable.

- You may withdraw tenders of outstanding notes at any time prior to the expiration date of the exchange offer.

- The exchange offer expires at 5:00 p.m., New York City time, on January 15, 2013 (the 21st business day on which the exchange offer will be open), unless extended. We do not currently intend to extend the expiration date.

- The exchange of outstanding notes for exchange notes in the exchange offer will not be a taxable event for U.S. federal income tax purposes.

- The terms of the exchange notes to be issued in the exchange offer are substantially identical to the outstanding notes, except that the exchange notes will be freely tradable and the exchange notes will be free of any covenants regarding registration rights.

- We do not intend to apply for listing of the exchange notes on any securities exchange or to arrange for them to be quoted on any quotation system.

- Broker-dealers who receive new securities pursuant to the exchange offer acknowledge that they will deliver a prospectus in connection with any resale of new securities; and

- Broker-dealers who acquired the old securities as a result of market-making or other trading activities may use the prospectus for the exchange offer, as supplemented or amended, in connection with resales of the new securities. We have agreed that, for a period of 180 days after the consummation of the exchange offer, we will make this prospectus, as amended or supplemented, available to any broker-dealer for use in connection with any such resale. See Plan of Distribution.

Results of the Exchange Offer

The exchange notes may be sold in the over-the-counter market, in negotiated transactions or through a combination of such methods. All untendered outstanding notes will continue to be subject to the restrictions on transfer set forth in the outstanding notes and in the indenture. In general, the outstanding notes may not be offered or sold, unless registered under the Securities Act, except pursuant to an exemption from, or in a transaction not subject to, the Securities Act and applicable state securities laws. Other than in connection with the exchange offer, we do not currently anticipate that we will register the outstanding notes under the Securities Act.

You should consider carefully the risk factors beginning on page 14 of this prospectus before participating in the exchange offer.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined that this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is December 5, 2012.

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This prospectus contains summaries of the terms of several material documents. These summaries include the terms that we believe to be material, but we urge you to review these documents in their entirety. We will make copies of these documents available to you at your request.

This prospectus incorporates important business and financial information about the company that is not included or delivered with the document. All such business and financial information incorporated but not included in this prospectus is available without charge to security holders upon written or oral request directed to Navin Rao, Vice President and Assistant General Counsel, 8000 Bent Branch Drive, Irving, Texas 75063 (Telephone: (972) 409-1300). To obtain timely delivery, you must request this information no later than five business days before the date on which you expect to make your decision with respect to the exchange offer. In any event, you must request this information prior to January 8, 2013.

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus contains forward-looking statements within the meaning of the federal securities laws, which involve risks and uncertainties. You can identify forward-looking statements because they contain words such as believes, expects, may, will, should, could, seeks, approximately, intends, plans, estimates, or anticipates or similar expressions that concern our strategy, plans or intentions. All statements w make relating to our estimated and projected earnings, margins, costs, expenditures, cash flows, growth rates and financial results are forward-looking statements. In addition, we, through our senior management, from time to time make forward-looking public statements concerning our expected future operations and performances and other developments. These forward-looking statements are subject to risks and uncertainties that may change at any time, and, therefore our actual results may differ materially from those that we expected. We derive many of our forward-looking statements from our operating budgets and forecasts, which are based upon many detailed assumptions. While we believe that our assumptions are reasonable, we caution that it is very difficult to predict the impact of known factors, and it is impossible for us to anticipate all factors that could affect our actual results.

Important factors that could cause actual results to differ materially from our expectations (cautionary statements) are disclosed under Risk Factors and elsewhere in this prospectus, including, without limitation, in conjunction with the forward-looking statements included in this prospectus. All subsequent written and oral forward-looking statements attributable to us, or persons acting on our behalf, are expressly qualified in their entirety by the cautionary statements. Some of the factors that we believe could affect our results include:

- risks related to our substantial indebtedness, as our leverage 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 variable rate debt and prevent us from meeting our obligations under our outstanding debt;

- restrictions in our debt agreements that limit our flexibility in operating our business, as our Senior Secured Credit Facilities (as defined below) and the indentures governing our senior notes and outstanding Senior Subordinated Notes (as defined below) 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;

- risks related to general economic conditions; if recovery from the economic downturn continues to be slow or prolonged, it could continue to adversely affect consumer confidence and retail spending, decreasing demand for our merchandise and adversely impact our results of operations, cash flows and financial condition;

- our reliance on foreign suppliers increases our risk of obtaining adequate, timely, and cost-effective product supplies;

- our ability to open new stores and increase comparable store sales growth, as our growth depends on our strategy of increasing the number and productivity of our 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;

- our suppliers may fail us;

- risks associated with the vendors from whom our products are sourced could materially adversely affect our revenue and gross profit;

- 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;

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

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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 flow and financial condition;
- improvements to our supply chain may not be fully successful;
- changes in customer demand could materially adversely affect our sales, results of operations, and cash flow;
- how well we manage our business;
- competition could negatively impact our business;
- failure to adequately maintain security and prevent unauthorized access to electronic and other confidential information and data breaches could materially adversely affect our financial condition and results of operations;
- our information systems may prove inadequate;
- we are dependent upon the services of our senior management team, and our inability to identify, hire and subsequently integrate a new Chief Executive Officer could adversely impact our business;
- a weak fourth quarter would materially adversely affect our results of operations;
- changes in newspaper subscription rates may result in reduced exposure to our circular advertisements;
- changes in regulations or enforcement may adversely impact our business;
- 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 subsidiary;

- failure to attract and retain quality sales, distribution center and other associates 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; and

- the interests of our controlling stockholders may conflict with the interests of our creditors.

The foregoing factors are not exhaustive and new factors may emerge or changes to the foregoing factors may occur that could impact our business. In addition, there may be other factors not presently known to us or which we currently consider to be immaterial that may cause our actual results to differ materially from the forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statements whether as a result of new information, future events or otherwise. You should review carefully the section captioned Risk Factors in this prospectus for a more complete discussion of the risks of an investment in the exchange notes.

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INDUSTRY AND MARKET DATA

Industry and market data included in this prospectus were obtained from our own internal data, data from industry trade publications and groups, consumer research and marketing studies and, in some cases, are management estimates based on industry and other knowledge and experience in the markets in which we operate. Our estimates have been based on information obtained from our suppliers, customers, trade and business organizations and other contacts in the markets in which we operate, including the Craft & Hobby Association and Interbrand. We believe these estimates to be accurate as of the date of this prospectus.

TRADEMARKS AND SERVICE MARKS

We own or have rights to trademarks, service marks or trade names that we use in connection with the operation of our business, including, without limitation, Aaron Brothers , Aaron Brothers Art & Framing , Artistree , Michaels , Michaels the Arts and Crafts Store , Recollections stylized Timeframe logo, Where Creativity Happens , and the stylized Michaels logos. We are registering or have registered our primary private brands including Artist s Loft, ArtMinds, Celebrate It, Creatology, Craft Smart, Recollections, Loops & Threads, Studio Décor, Bead Landing, Imagin8, MiDesign@Michaels, and Ashland, and various sub-brands associated with these primary marks. Solely for convenience, some of the trademarks, service marks and trade names referred to in this prospectus are listed without the ©, ® and symbols, but we will assert, to the fullest extent under applicable law, our rights to our copyrights, trademarks, service marks, trade names and domain names. The trademarks, service marks and trade names of other companies appearing in this prospectus are, to our knowledge, the property of their respective owners.

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PROSPECTUS SUMMARY

This summary contains basic information about Michaels Stores, Inc. and the exchange offer. This summary is not complete and does not contain all of the information that you should consider before investing in the exchange notes. You should carefully read the entire prospectus, including the financial data and related notes and the section entitled Risk Factors. Unless the context otherwise requires, references in this registration statement to Michaels Stores, Michaels, we, our, us and the Company refer to Michaels Stores, Inc. and its consolidated subsidiaries, references to Michaels stores refers to our arts and crafts retail chain using the Michaels name, and references to the Issuer refer to Michaels Stores, Inc.

We report on the basis of a 52 or 53-week fiscal year, which ends on the Saturday closest to January 31. References to fiscal year mean the year in which that fiscal year began. Fiscal 2012 is the 53-week period ending February 2, 2013. Fiscal 2011 ended on January 28, 2012, fiscal 2010 ended on January 29, 2011, fiscal 2009 ended on January 30, 2010 and fiscal 2008 ended on January 31, 2009. Fiscal years 2011, 2010, 2009 and 2008 contained 52 weeks. References to the third quarter of fiscal 2012 relate to the 13 weeks ended October 27, 2012, and references to the third quarter of fiscal 2011 relate to the 13 weeks ended October 29, 2011. References to the nine months ended October 27, 2012 relate to the 39 weeks ended October 27, 2012, and the nine months ended October 29, 2011 relate to the 39 weeks ended October 29, 2011.

Our Company

We believe Michaels is where creativity happens. With 1,226 stores (consisting of 1,099 Michaels stores and 127 Aaron Brothers stores) as of October 27, 2012 and $4.2 billion in fiscal 2011 sales, Michaels is the largest arts and crafts specialty retailer in North America. We have approximately as many stores as our two largest direct competitors combined, who have 790 stores and 524 stores, respectively. Our mission is to inspire and enable customer creativity, create a fun and rewarding place to work, foster meaningful connections with our communities and lead the industry in growth and innovation. With crafting classes, store events, project sheets, store displays, mobile applications and proprietary online content, we believe we offer the most complete arts and crafts experience and are the preferred destination in the industry.

We focus on building strong customer relationships through our innovative merchandise offering, engaging store experience and multi-channel marketing. Our stores are at the heart of our customer engagement strategy, showcasing our artistic and creative products and providing an opportunity for our knowledgeable store associates to interact with customers and help them develop creative ideas. We carry a broad and deep assortment of approximately 35,000 stock-keeping units (SKUs) in arts, crafts, scrapbooking, floral, framing, home décor, seasonal offerings and children s hobbies that enable us to satisfy the diverse needs of our customers. In recent years, we have capitalized on our market-leading scale to create a team and infrastructure dedicated to designing, sourcing and delivering high quality, on-trend merchandise, including a growing number of products under our portfolio of private brands. These private branded products, which represented approximately 44% of total Net sales in fiscal 2011, are only available at Michaels and allow us to further differentiate our merchandise while enhancing product margins. We believe our compelling store experience and broad product offering distinguish us from our competitors, drive customer loyalty, increase the frequency of customer visits and position Michaels as the brand that defines arts and crafts.

In recent years, our experienced management team has undertaken a series of transformative initiatives designed to enhance the strength of our business and our potential for future growth. Our primary initiatives include:

- Enhancing our store experience
- Initiating a comprehensive digital marketing campaign
- Reinventing our approach to merchandising and sourcing to introduce on-trend products and improve margins
- Launching numerous high-quality private branded product lines
- Developing new store formats to facilitate expansion
- Building an online platform to strengthen customer engagement

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Financial Performance

We believe the strength of our business model and the impact of our initiatives have delivered accelerating sales growth and operating margin improvement. We believe these strong results place us among the best performers in the specialty retail sector and create a foundation for future growth.

- Our sales in fiscal 2011 reached $4.2 billion, an increase of 4.4% over fiscal 2010, driven by comparable store sales growth of 3.2%. Our strong sales growth in fiscal 2011 followed positive trends in fiscal 2010, when sales increased 3.7% over fiscal 2009, including comparable store sales growth of 2.5%. Sales have grown at a 4.1% compound annual growth rate (CAGR) since fiscal 2009.

- Our resilient business model has generated positive year-over-year sales growth in 19 of the last 23 quarters.

- During fiscal 2011, we achieved operating income of $569 million, an improvement of 16.6% from fiscal 2010, which was 22.9% higher than fiscal 2009. Operating income has grown at a 19.7% CAGR since fiscal 2009.

- Operating margin expanded by 140 basis points from fiscal 2010 to fiscal 2011. Since fiscal 2009, operating margin has improved by 340 basis points, driven by growth in private brand sales, strategic sourcing and pricing initiatives, improved inventory management and expense control.

Our Industry and Our Customer

We operate within the large, growing and fragmented arts and crafts industry. According to the Craft & Hobby Association s (CHA) 2011 Attitude & Usage Study, the arts and crafts industry generated approximately $30.3 billion in sales for the twelve months ended June 30, 2011, up from $27.3 billion in sales for the twelve months ended December 31, 2008, representing a CAGR of 4.3%. Separately, we estimate the total size of the U.S. framing industry in 2011 was approximately $3.0 billion. According to CHA, our industry remains highly fragmented as craft chain and fabric stores (multi-store chains) only comprise approximately 39% of the market. The balance consists of discounters, independent operators and online retailers. According to data from CHA, these multi-store chains, of which Michaels is the largest, increased their market share by approximately 3% in 2011 compared to 2010.

Our core customer is an important driver of our success. Based on an internal study, we believe our typical customer is female (77% are women), spans a broad age range (69% are under 56, with 50% between the ages of 36 and 55), and has a median household income of approximately $75,000.

According to CHA, 56% to 57% of U.S. households participated in at least one crafting project during the years from 2006 to 2010, before increasing to 58% for the twelve months ended June 30, 2011, which represented over 66 million households. We believe the broad, multi-generational appeal, high personal attachment and the low-cost, project-based nature of crafting creates a loyal, resilient following.

Our Competitive Strengths

Leading Market Position in an Attractive Industry. We believe our leading market position provides us with a number of advantages relative to our competitors and positions us to continue to capture market share. First, our scale allows us to invest in product sourcing and innovation as well as proprietary store and online content, which we believe differentiates us from local and regional arts and crafts retailers. Second, the breadth and depth of our assortment, combined with a large share of private branded products, strengthens our competitive position relative to mass merchants, which devote only a small portion of shelf space to the category. Third, the desire of arts and crafts customers to view and handle our products before purchase while engaging with our store associates provides us with an advantage over e-commerce competitors.

Sophisticated Global Sourcing and Innovation Capabilities. Our infrastructure and internal product development and global sourcing team position us to continue delivering a differentiated level of innovation, quality and value to our customers. Through constant interaction with our customers, we are able to anticipate and respond to their needs by introducing fresh and inspirational products in a timely manner. Our global sourcing network allows us to control new product introductions, maintain quality standards, monitor delivery times, and manage product costs and inventory levels in order to enhance profitability. Further, through our wholly-owned subsidiary Artistree, we operate a vertically integrated custom frame design and manufacturing business, which delivers high-quality framing products at competitive prices while capturing both manufacturing and retail margins.

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Industry Defining Brands. We believe Michaels is the leading brand in the arts and crafts category. We are the only arts and crafts retailer named on Interbrand s list of Best Retail Brands in the U.S., ranking 27th in 2012.

The strength of the Michaels brand reflects, in part, our ability to offer unique merchandise at a compelling value. We believe products offered under our internally developed portfolio of 11 private brands are of equal or better quality than third party branded products and generate higher gross margins. In fiscal 2011, sales of our private brands exceeded $1.8 billion, representing approximately 44% of total Net sales.

Highly Effective Customer Engagement Strategy. We engage with our customers through a data-driven, multi-channel communication strategy. Our marketing approach has expanded beyond the primary use of newspaper circulars to an integrated strategy using multiple forms of media, including digital display, search, social media, direct marketing and high profile television tie-ins. Our nationally coordinated store classroom program offers a broad curriculum of hands-on instruction. We successfully grew total classroom participation to 355,000 in fiscal 2011 from 257,000 in fiscal 2009. We enhanced our sales associate training program to improve their product knowledge and customer engagement skills, and we re-engineered the store labor model to increase time spent with customers. We also launched new business initiatives that provide additional outlets to purchase our products, including BuyTheBunch, a special order platform designed to accommodate large quantity orders, and MiDesign@Michaels, which includes our online Photo Creations and Custom Invites applications.

Our customer engagement strategy provides us with a deep understanding of customers buying criteria, including assortment, brand and price. This strategy enables us to be a source of ideas and creativity, which ultimately increases loyalty and comparable store sales growth. Further, we believe our use of the Internet as both a targeted marketing tool and design platform complements our store experience and opens up additional avenues to engage with our customers. The initial success of these strategies is reflected in improved customer satisfaction scores as measured through our internal customer satisfaction surveys.

Strong Cash Flow Generation. Our ability to deliver consistent financial performance, including the generation of annual net cash from operations in excess of $400 million in each of the last three fiscal years, allows us to take advantage of the opportunities listed above, as well as invest in new initiatives to drive continued growth.

Experienced Management Team. Our current management team has developed and led the execution of recent strategic and operating initiatives that have driven our strong performance. This team has a unique combination of leadership and experience across multiple retail operations and consumer product companies.

Our Business Strategy

We intend to strengthen our position in the marketplace by executing store, marketing and merchandising initiatives through the following strategies:

Drive Comparable Store Sales Growth

Engaging with Our Customers. We will continue to enhance our customer engagement strategy to improve our brand positioning, increase traffic to our stores, build customer loyalty and generate sustainable long-term sales growth. For example, we analyze transaction information to develop tailored product offerings and communications to better serve our customers. We also develop multi-channel marketing solutions based on customer-specific behavior and capitalize on our growing database of customers to offer targeted e-mail and loyalty initiatives. This e-mail database has grown to more than 10 million customers at the end of fiscal 2011 from six million one year prior.

Compelling Store Experience. We will further enhance our store experience in order to drive increases in store visits and units per transaction, as well as expand our customer base. Our new store labor model realigns tasks to create dedicated customer service teams without adding ongoing labor hours. These teams are able to engage with customers more directly to deliver value-added services, project ideas and product-based solutions. Furthermore, our stores and classrooms have increasingly become a popular destination for a variety of events such as birthday parties, children s seasonal crafting programs and school field trips. These initiatives strengthen our relationship with customers, create new opportunities to visit our stores and attract new customers to the Michaels experience.

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Providing Differentiated and Inspiring Merchandise. We will continue to leverage our 117-person internal product development and global sourcing team to consistently introduce new and on-trend products, drive customers to our stores and increase sales. This includes working with our vendor partners to introduce a significant amount of new product into our assortment on a consistent basis, with more than 50 major merchandise resets and approximately 20% new product each year.

Expanding Connections with Growing and Attractive Customer Segments. We will expand our business by engaging with growing and attractive customer segments by building connections with the Michaels brand through tailored products and marketing initiatives. For example, we are expanding our offering to the growing Hispanic customer base with culturally relevant products, multilingual packaging, classes in Spanish and celebrating key events such as Quinceañeras. We are also increasing our focus on customers between the ages of eight and 18 (Tweens and Teens) by introducing products in categories that appeal to this age group such as jewelry, apparel and scrapbooking, while hosting store events catering to this segment.

Expand Multi-Channel Business Platform

Driving Store Growth. Based on our detailed market-by-market analysis, we believe there is a significant opportunity for continued new store growth, with the potential for at least 1,500 Michaels stores in our existing formats in North America. Over the past five years, we have opened 214 stores, including 52 relocations, and expanded our store format beyond the traditional suburban box to include two new store prototypes focused on urban and smaller markets. These new prototypes allow us to open locations in markets we had not previously targeted. Based on the performance of recently opened stores, we believe our new traditional-format stores will produce attractive returns on our investment with a pre-tax payback period of approximately three years.

During fiscal 2012, we anticipate opening 45 to 50 new Michaels stores, which includes 10 to 15 relocations, 5 to 10 new urban and small-market formats, as well as seven stores in Québec. We will continue to monitor the success of our new store formats and evaluate opportunities to further penetrate existing markets. We expect our future store openings will be funded primarily by our strong cash flow.

Building New Businesses. We continue to create new business lines to enhance our offering, create new opportunities to engage customers and generate incremental sales. For example, in fiscal 2011, we launched two new multi- channel business offerings: BuyTheBunch and MiDesign@Michaels. BuyTheBunch is our new special order platform that offers customers the opportunity to place large quantity orders at their local store. MiDesign@Michaels is a multi-channel complement to our stores featuring Photo Creations, which includes our digital scrapbooking application, and Custom Invites, which offers creative invitations and custom accessories. These offerings represent initial steps toward building a transaction-based e-commerce presence to capitalize on the strength of the Michaels brand.

Enhance Operating Margins and Cash Flow

Private Brand and Global Sourcing Initiatives. We plan to increase the penetration of our private branded products assortment and believe additional opportunities exist through global sourcing and product design to reduce costs and balance value, selection and new product introductions. We will continue to replace third party offerings with our private branded products to enhance our gross margin. In addition to capitalizing on our direct sourcing capabilities, increasing our private brand offerings will allow us to more effectively tailor our products to customer tastes, control costs and manage our supply chain.

Pricing and Promotional Strategies. We will continue to leverage our sophisticated understanding of customer demands and improve our merchandising systems to deliver promotions that enhance customer value and improve margin. Our refined promotional models can be customized at the store level to better capture the price elasticity of our products and target promotional messages to customers. Our analytically-based promotional strategy allows us to optimize offer types to our mass and targeted marketing channels.

Operating Leverage. As we continue to grow, we will seek to further benefit from our scale and the infrastructure and capabilities we have developed to support our store network. Since fiscal 2009, we have been able to leverage our scale to reduce Selling, general and administrative expenses as a percentage of sales by 100 basis points.

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Summary Risk Factors

The fragmented arts and crafts industry can be highly competitive, specifically in regards to comparable products sold online or by mass merchandisers, and we may face intense competition in the future that could impact our planned growth and results of operations as discussed in the Risk Factors section of this prospectus. You should carefully consider all of the information set forth in this prospectus and, in particular, you should evaluate the risk factors in the Risk Factors section of this prospectus before deciding whether to invest the notes. Among the important risks relating to our business and our ability to successfully execute our business strategy are the following:

- General economic factors and changes in consumer preference may adversely affect our performance, such as the impact of the economic factors on consumer discretionary income, which contributed to a decrease in our total Net sales from $3,862 million in fiscal 2007 to $3,817 million in fiscal 2008, despite adding a number of new stores;

- Our significant reliance on foreign suppliers, particularly those located in China, increases our risk of obtaining adequate, timely, and cost-effective product supplies;

- Our substantial debt, of which $3,368 million was outstanding at October 27, 2012, 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 associated with our $1,787 million in variable rate debt, prevent us from meeting our obligations under our outstanding debt and limit our flexibility in operating our business;

- One of our key business strategies is to expand our base of retail stores, and if we are unable to continue this strategy, our ability to increase our sales, profitability, and cash flow would depend significantly on our ability to reduce our costs as a percentage of our sales;

- We are controlled by the Sponsors, who currently indirectly own approximately 93% of our common stock in the aggregate, whose interests as an equity holder may conflict with yours as a creditor;

- Damage to the reputations (whether or not justified) of our brand names could arise from product failures, litigation or various forms of adverse publicity, especially in social media outlets, and may generate negative customer sentiment, potentially resulting in a reduction in our sales and earnings;

- If a supplier fails us, transitioning to other qualified vendors could affect our revenue and gross profit;

- Product recalls or product liability could adversely impact our financial condition;

- Our cost of merchandise could be adversely affected by significant increases in inflation or commodity prices; and

- Competition, including Internet-based competition, could negatively impact our business.

The risks described above and other risks we face are described in further detail under the Risk Factors section of this prospectus, which you should carefully review.

Recent Financing Transaction

Redemption of Subordinated Discount Notes. On November 1, 2012, we redeemed our outstanding 13% Subordinated Discount Notes due 2016 (the Subordinated Discount Notes), an aggregate principal amount of $180 million of which was outstanding as of October 27, 2012, with borrowings made under our amended and restated senior secured asset-based revolving credit facility (the Restated Revolving Credit Facility and, together with our senior secured term loan facility (the Senior Secured Term Loan Facility), the Senior Secured Credit Facilities) for an aggregate redemption price (including the applicable redemption premium and accrued and unpaid interest) of $199 million.

Our History

Michaels Stores, Inc. was incorporated in Delaware in 1983 and is headquartered in Irving, Texas. On October 31, 2006, substantially all of the common stock of Michaels Stores, Inc. was acquired through a merger transaction (the Merger) by affiliates of two investment firms, Bain Capital Partners, LLC and The Blackstone Group L.P. (collectively, together with their applicable affiliates, the Sponsors), with certain shares retained by affiliate investment funds managed by Highfields Capital Management LP (then-existing shareholders of Michaels Stores, Inc.). As a result of the Merger, Michaels Holdings LLC, an entity controlled by our Sponsors, currently owns approximately 93% of our outstanding common stock.

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The Sponsors

Bain Capital

Bain Capital, LLC (Bain Capital) (*www.baincapital.com*) is a global private investment firm that, together with its affiliates (including Bain Capital Partners, LLC) manages several pools of capital including private equity, venture capital, public equity, credit products and absolute return with approximately $66 billion in assets under management. Since its inception in 1984, Bain Capital has made private equity investments and add-on acquisitions in more than 350 companies in a variety of industries around the world. Bain Capital consumer and retail private equity investments have included such leading businesses as Toys R Us, Bright Horizons Family Solutions, Dollarama, Burlington Coat Factory, Dunkin Brands and Gymboree. Headquartered in Boston, Bain Capital has offices in New York, Chicago, London, Munich, Hong Kong, Palo Alto, Shanghai, Tokyo and Mumbai.

The Blackstone Group

The Blackstone Group L.P. (The Blackstone Group) is one of the world s leading investment and advisory firms. The Blackstone Group seeks to create positive economic impact and long-term value for its investors, the companies it invests in, the companies it advises and the broader global economy. The Blackstone Group does this through the commitment of its extraordinary people and flexible capital. The Blackstone Group s alternative asset management businesses, which collectively had total assets under management of $204.6 billion as of September 30, 2012, include the management of private equity funds, real estate funds, hedge fund solutions, and credit businesses. Assets under management in The Blackstone Group private equity funds totaled $53.5 billion as of September 30, 2012. The Blackstone Group also provides various financial advisory services, including financial and strategic advisory, restructuring and reorganization advisory and fund placement services. Further information is available at *www.blackstone.com*.

Corporate Information

Our principal executive offices are located at 8000 Bent Branch Drive, Irving, Texas 75603. Our telephone number is (972) 409-1300. We provide links to our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the Exchange Act), on our Internet website at *www.michaels.com* under the heading Investor Relations. These links are automatically updated so the filings are available immediately after they are made publicly available by the Securities and Exchange Commission (SEC). These filings are also available through the SEC s EDGAR system at *www.sec.gov*. The information on our website does not constitute part of this registration statement, and you should rely only on the information contained in this registration statement when making a decision as to whether to invest in the exchange notes. All website addresses in this prospectus are intended to be inactive textual references only.

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THE EXCHANGE OFFER

On September 27, 2012, we issued $200.0 million aggregate principal amount of 7¾% Senior Notes due November 1, 2018 (CUSIP Nos. 594087 AS7 and U59329 AD1; ISINs US594087AS71 and USU59329AD16) (the outstanding notes), which were exempt from registration under the Securities Act of 1933, as amended (the Securities Act). We are offering to exchange, upon the terms and subject to the conditions set forth in this prospectus and the accompanying letter of transmittal, our new 7¾% Senior Notes due November 1, 2018 (CUSIP No. 594087 AR9; ISIN US594087AR98) (the exchange notes and, together with the outstanding notes, the notes), for all of our outstanding notes. The outstanding notes were issued under the indenture (the indenture or the indenture governing the senior notes) governing our 7¾% Senior Notes due 2018 that we issued on October 21, 2010 (CUSIP No. 594087 AR9; ISIN US594087AR98) (the initial notes and, together with the notes, the senior notes). The outstanding notes are treated as a single series with the initial notes, vote as one class under the indenture and have the same terms as those of the initial notes, except that (i) the outstanding notes are subject to a separate registration rights agreement and (ii) the outstanding notes were issued under a CUSIP number different from the initial notes. We are conducting the exchange offer in order to provide you with an opportunity to exchange your unregistered outstanding notes for freely tradable exchange notes that have been registered under the Securities Act and that are expected to share a single CUSIP number and be fungible with the initial notes.

If we and the subsidiary guarantors are not able to effect the exchange offer contemplated by this prospectus, we and the subsidiary guarantors will use reasonable best efforts to file and cause to become effective a shelf registration statement relating to the resale of the outstanding notes. We may be required to pay additional interest on the notes in certain circumstances.

The following is a brief summary of the terms of the exchange offer. For a more complete description of the exchange offer, see The Exchange Offer.

General	In connection with the private offering, Michaels Stores, Inc. and the guarantors of the outstanding notes entered into a registration rights agreement with the initial purchasers in which we agreed, among other things, to deliver this prospectus to you and to complete the exchange offer within 360 days after the date of original issuance of the outstanding notes. You are entitled to exchange in the exchange offer your outstanding notes for exchange notes which are identical in all material respects to the outstanding notes except: • the exchange notes have been registered under the Securities Act; • the exchange notes are not entitled to registration rights which are applicable to the outstanding notes under the registration rights agreement; and • the liquidated damages provisions of the registration rights agreement are no longer applicable.
Exchange Offer	Michaels is offering to exchange up to $200.0 million aggregate principal amount of the exchange notes which have been registered under the Securities Act for any and all of its outstanding notes. You may only exchange outstanding notes in a principal amount equal to $2,000 and in integral multiples of $1,000 principal amount thereafter.
Resale	

Based upon interpretations by the Staff of the SEC set forth in no-action letters issued to unrelated third-parties, we believe that the exchange notes may be offered for resale, resold or otherwise transferred by you without compliance with the registration and prospectus delivery requirements of the Securities Act, unless you:

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- are an affiliate of ours within the meaning of Rule 405 under the Securities Act;
- are a broker-dealer who purchased the notes directly from us for resale under Rule 144A, Regulation S or any other available exemption under the Securities Act;
- acquired the exchange notes other than in the ordinary course of your business;
- have an arrangement with any person to engage in the distribution of the exchange notes; or
- are prohibited by law or policy of the SEC from participating in the exchange offer.

However, we have not submitted a no-action letter, and there can be no assurance that the SEC will make a similar determination with respect to the exchange offer. Furthermore, in order to participate in the exchange offer, you must make the representations set forth in the letter of transmittal that we are sending you with this prospectus.

Expiration Date	The exchange offer will expire at 5:00 p.m., New York City time, on January 15, 2013, the 21st business day on which the exchange offer will be open (the expiration date), unless we, in our sole discretion, extend it. We currently do not intend to extend the expiration date.
Conditions to the Exchange Offer	The exchange offer is subject to certain customary conditions, some of which may be waived by us. See The Exchange Offer Conditions to the Exchange Offer.
Procedure for Tendering Outstanding Notes	If you wish to tender your outstanding notes for exchange pursuant to the exchange offer, you must transmit to Law Debenture Trust Company of New York, as exchange agent, on or prior to the expiration date, either:

- a properly completed and duly executed copy of the letter of transmittal accompanying this prospectus, or a facsimile of the letter of transmittal, together with your outstanding notes and any other documentation required by the letter of transmittal, at the address set forth on the cover page of the letter of transmittal; or
- if you are effecting delivery by book-entry transfer, a computer-generated message transmitted by means of the Automated Tender Offer Program System of The Depository Trust Company (DTC) in which you acknowledge and agree to be bound by the terms of the letter of transmittal and which, when received by the exchange agent, forms a part of a confirmation of book-entry transfer.

In addition, you must deliver to the exchange agent on or prior to the expiration date, if you are effecting delivery by book-entry transfer, a timely confirmation of book- entry transfer of your outstanding notes into the account of the exchange agent at DTC pursuant to the procedures for book-entry transfers described in this prospectus under the heading The Exchange Offer Procedures for Tendering Outstanding Notes.

By executing and delivering the accompanying letter of transmittal or effecting delivery by book-entry transfer, you are representing to us that, among other things:

- neither the holder nor any other person receiving the exchange notes pursuant to the exchange offer is an affiliate of ours within the meaning of Rule 405 under the Securities Act; and

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	• if you are a broker-dealer that will receive exchange notes for your own account in exchange for outstanding notes that were acquired as a result of market-making or other trading activities, then you will deliver a prospectus in connection with any resale of such exchange notes. • the person receiving the exchange notes pursuant to the exchange offer, whether or not this person is the holder, is receiving them in the ordinary course of business; and • neither the holder nor any other person receiving the exchange notes pursuant to the exchange offer has an arrangement or understanding with any person to participate in the distribution of such exchange notes and that such holder is not engaged in, and does not intend to engage in, a distribution of the exchange notes. See The Exchange Offer Procedures for Tendering Outstanding Notes and Plan of Distribution.
Special Procedure for Beneficial Owners	If you are the beneficial owner of outstanding notes and your name does not appear on a security listing of DTC as the holder of those outstanding notes or if you are a beneficial owner of outstanding notes that are registered in the name of a broker, dealer, commercial bank, trust company or other nominee and you wish to tender those outstanding notes in the exchange offer, you should promptly contact the person in whose name your outstanding notes are registered and instruct that person to tender on your behalf. If you, as a beneficial holder, wish to tender on your own behalf you must, prior to completing and executing the letter of transmittal and delivering your outstanding notes, either make appropriate arrangements to register ownership of the outstanding notes in your name or obtain a properly completed bond power from the registered holder. The transfer of record ownership may take considerable time.
Guaranteed Delivery Procedures	If you wish to tender your outstanding notes and your outstanding notes are not immediately available or you cannot deliver your outstanding notes, the letter of transmittal or any other documents required by the letter of transmittal prior to the expiration date or you cannot comply with the procedures of the Automated Tender Offer Program System of DTC prior to the expiration date, you must tender your outstanding notes according to the guaranteed delivery procedures set forth in this prospectus under The Exchange Offer Guaranteed Delivery Procedures.
Withdrawal Rights	The tender of the outstanding notes pursuant to the exchange offer may be withdrawn at any time prior to 5:00 p.m., New York City time, on the expiration date.
Acceptance of Outstanding Notes and Delivery of Exchange Notes	Subject to customary conditions, we will accept outstanding notes that are properly tendered in the exchange offer and not withdrawn prior to the expiration date. The exchange notes will be delivered promptly following the expiration date.
Effect of Not Tendering in the Exchange Offer	Any outstanding notes that are not tendered or that are tendered but not accepted will remain subject to the restrictions on transfer. Since the outstanding notes have not been registered under the federal securities laws, they bear a legend restricting their transfer absent registration or the availability of a specific exemption from registration. Upon the completion of the exchange offer, we will have no further obligations, except under limited circumstances, to provide for registration of the outstanding notes under the federal securities laws. See The Exchange Offer Effect of Not Tendering.

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Dissenters Rights	Holders of outstanding notes do not have any appraisal or dissenters rights in connection with the exchange offer. We intend to conduct the exchange offer in accordance with the applicable requirements of the Exchange Act and the rules and regulations of the SEC.
Interest on the Exchange Notes and the Outstanding Notes	The exchange notes will bear interest from the most recent interest payment date to which interest has been paid on the outstanding notes. Holders whose outstanding notes are accepted for exchange will be deemed to have waived the right to receive interest accrued on the outstanding notes.
Broker-Dealers	Each broker-dealer that receives exchange notes for its own account in exchange for outstanding notes, where such outstanding notes were acquired by such broker-dealer as a result of market-making activities or other trading activities, must acknowledge that it will deliver a prospectus in connection with any resale of such exchange notes. See Plan of Distribution.
Material United States Federal Income Tax Considerations	The exchange of outstanding notes for exchange notes by tendering holders will not be a taxable exchange for United States federal income tax purposes, and such holders will not recognize any taxable gain or loss or any interest income for United States federal income tax purposes as a result of such exchange. See Material United States Federal Income Tax Considerations.
Exchange Agent	Law Debenture Trust Company of New York, the trustee under the indenture governing the senior notes (the indenture), is serving as exchange agent in connection with the exchange offer.
Use of Proceeds	We will not receive any proceeds from the issuance of exchange notes pursuant to the exchange offer.

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THE EXCHANGE NOTES

The following is a brief summary of the terms of the exchange notes. For a more complete description of the terms of the exchange notes, see Description of Exchange Notes.

Issuer	Michaels Stores, Inc.
Securities Offered	Up to $200.0 million in aggregate principal amount of 7¾% Senior Notes due November 1, 2018.
Maturity Date	The exchange notes will mature on November 1, 2018.
Interest Rate	The exchange notes will bear interest at a rate of 7¾% per annum.
Interest Payment Dates	Interest on the exchange notes will accrue from and including November 1, 2012, the first day of the current interest period for the existing notes, and will be payable semiannually in arrears on May 1 and November 1 of each year, commencing on May 1, 2013.
Guarantees	The exchange notes will be unconditionally guaranteed by our subsidiaries that guarantee our indebtedness under our Senior Secured Credit Facilities. Three of our subsidiaries are considered immaterial subsidiaries under these facilities and will not guarantee the exchange notes. Subject to certain exceptions, if we create or acquire a new wholly owned domestic subsidiary that guarantees our debt or debt of a guarantor, it will guarantee the exchange notes unless we designate the subsidiary an unrestricted subsidiary under the indenture. See Description of Exchange Notes Guarantees.
Ranking	The exchange notes will be our senior unsecured obligations and will: • rank senior in right of payment to all of our existing and future debt and other obligations that are, by their terms, expressly subordinated in right of payment to the exchange notes; • rank equally in right of payment to all of our existing and future senior debt, including the initial notes and any outstanding notes not exchanged in this exchange offer, and other obligations that are not, by their terms, expressly subordinated in right of payment to the exchange notes; • be effectively subordinated in right of payment to all of our existing and future secured debt (including under our Senior Secured Credit Facilities), to the extent of the value of the assets securing such debt; and • be structurally subordinated to all obligations of each of our subsidiaries that is not a guarantor of the exchange notes. Similarly, the exchange note guarantees will be unsecured senior obligations of the guarantors and will:

- rank senior in right of payment to all of the applicable guarantor s existing and future debt and other obligations that are, by their terms, expressly subordinated in right of payment to the exchange notes;

- rank equally in right of payment to all of the applicable guarantor s existing and future senior debt, including guarantees of the initial notes and any outstanding notes not exchanged in this exchange offer, and other obligations that are not, by their terms, expressly subordinated in right of payment to the exchange notes;

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	• be effectively subordinated in right of payment to all of the applicable guarantor s existing and future secured debt (including such guarantor s guarantee under our Senior Secured Credit Facilities), to the extent of the value of the assets securing such debt; and
	• be structurally subordinated to all obligations of any subsidiary of a guarantor that is not also a guarantor of the exchange notes.
	As of October 27, 2012, the notes and related guarantees ranked effectively junior to approximately $1,787 million of senior secured indebtedness (excluding $61 million of outstanding standby letters of credit), consisting entirely of senior secured indebtedness under our Senior Secured Credit Facilities. In addition, as of October 27, 2012, we had approximately $589 million of unused borrowing capacity under our Restated Revolving Credit Facility. On November 1, 2012, we borrowed $216 million under the Restated Revolving Credit Facility to fund the redemption of our outstanding Subordinated Discount Notes as well as other working capital needs, resulting in $373 million of unused borrowing capacity under the Restated Revolving Credit Facility as of such date.
Optional Redemption	Prior to November 1, 2014, we may redeem some or all of the exchange notes for cash at a redemption price equal to 100% of their principal amount plus an applicable make-whole premium (as described in Description of Exchange Notes Optional Redemption) plus accrued and unpaid interest, if any, to the redemption date. Beginning on November 1, 2014, we may redeem some or all of the exchange notes at the redemption prices listed under Description of Exchange Notes Optional Redemption plus accrued and unpaid interest, if any, to the redemption date.
Optional Redemption After Certain Equity Offerings	At any time (which may be more than once) until November 1, 2013, we can choose to redeem up to 35% of the outstanding senior notes (including any senior notes, including the exchange notes, issued after October 21, 2010) with money that we raise in certain equity offerings, so long as:
	• we pay 107.750% of the face amount of the exchange notes, plus accrued and unpaid interest, if any, to the redemption date;
	• we redeem the senior notes within 90 days of completing such equity offering; and
	• at least 50% of the aggregate principal amount of the senior notes (including any senior notes, including the exchange notes, issued after October 21, 2010) remains outstanding afterwards.
	See Description of Exchange Notes Optional Redemption.
Change of Control	If we experience a change in control, we must give holders of the senior notes the opportunity to sell us senior notes at 101% of their face amount, plus accrued and unpaid interest, if any. See Description of Exchange Notes Repurchase at the Option of Holders Change of Control.
	We might not be able to pay you the required price for exchange notes you present to us at the time of a change of control, because we might not have enough funds at that time or the terms of our senior debt may prevent us from paying.

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Asset Sale Proceeds	If we or our subsidiaries engage in asset sales, we generally must either invest the net cash proceeds from such sales in our business within a period of time, prepay senior secured debt or make an offer to purchase a principal amount of the senior notes equal to the excess net cash proceeds, subject to certain exceptions. The purchase price of the senior notes will be 100% of their principal amount, plus accrued and unpaid interest, if any, to the purchase date. See Description of Exchange Notes Repurchase at the Option of Holders Asset Sales.
Certain Covenants	The indenture governing the senior notes contains covenants limiting our ability and the ability of our restricted subsidiaries to, among other things: • incur additional debt; • pay dividends or distributions on our capital stock or repurchase our capital stock; • issue stock of subsidiaries; • make certain investments; • create liens on our assets to secure debt; • enter into transactions with affiliates; • merge or consolidate with another company; and • sell or otherwise transfer assets. These covenants are subject to a number of important limitations and exceptions, and the requirement to comply with certain covenants may be suspended upon achievement of investment grade ratings for the senior notes. See Description of Exchange Notes.
No Public Market	The exchange notes will be freely transferable but will be new securities for which there will not initially be an established market. Accordingly, we cannot assure you whether a market for the exchange notes will develop or as to the liquidity of any market. The initial purchasers in the private offering of the outstanding notes have advised us that they currently intend to make a market in the exchange notes. The initial purchasers are not obligated, however, to make a market in the exchange notes, and any such market-making may be discontinued by the initial purchasers in their discretion at any time without notice. Accordingly, we cannot assure you that a liquid market for the exchange notes will develop or be maintained.
Risk Factors	Participating in the exchange offer and investing in the exchange notes involves substantial risks. See Risk Factors for a description of certain of the risks you should consider before investing in the exchange notes.

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RISK FACTORS

Risks Related to the Exchange Offer

There may be adverse consequences if you do not exchange your outstanding notes.

If you do not exchange your outstanding notes for exchange notes in the exchange offer, you will continue to be subject to restrictions on transfer of your outstanding notes as set forth in the offering memorandum distributed in connection with the private offering of the outstanding notes. In general, the outstanding notes may not be offered or sold unless they are registered or exempt from registration under the Securities Act and applicable state securities laws. Except as required by the registration rights agreement, we do not intend to register resales of the outstanding notes under the Securities Act. You should refer to Summary The Exchange Offer and The Exchange Offer for information about how to tender your outstanding notes.

The tender of outstanding notes under the exchange offer will reduce the outstanding amount of each series of the outstanding notes, which may have an adverse effect upon, and increase the volatility of, the market prices of the outstanding notes due to a reduction in liquidity.

Risks Related to the Exchange Notes and Our Other Indebtedness

We Face Risks Related to Our Substantial Indebtedness

Our substantial leverage 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 associated with our variable rate debt and prevent us from meeting our obligations under our senior notes, Senior Subordinated Notes and Senior Secured Credit Facilities. As of October 27, 2012, we had $3,368 million of indebtedness outstanding, of which approximately $1,787 million was subject to variable interest rates and $1,581 million was subject to fixed interest rates. In addition, as of October 27, 2012, we had approximately $589 million of unused borrowing capacity under our Restated Revolving Credit Facility. On November 1, 2012, we borrowed $216 million under the Restated Revolving Credit Facility to fund the redemption of our outstanding Subordinated Discount Notes and other working capital needs, resulting in $373 million of unused borrowing capacity under the Restated Revolving Credit Facility as of such date.

Our high degree of leverage could have important consequences to us, including:

- making it more difficult for us to make payments on our debt;

- increasing our vulnerability to general economic and industry conditions;

- requiring a substantial portion of cash flow from operations to be dedicated to the payment of principal and interest on our debt, thereby reducing our ability to use our cash flow to fund our operations, capital expenditures, and future business opportunities;

- exposing us to the risk of increased interest rates as certain of our borrowings under our Senior Secured Credit Facilities are at variable rates;

- restricting us from making strategic acquisitions or causing us to make non-strategic divestitures;

- limiting our ability to obtain additional financing for working capital, capital expenditures, product development, debt service requirements, acquisitions, and general corporate or other purposes; and

- limiting our ability to adjust to changing market conditions and placing us at a competitive disadvantage compared to our competitors who may be less highly leveraged.

We and our subsidiaries may be able to incur substantial additional indebtedness in the future, subject to the restrictions contained in our Senior Secured Credit Facilities and the indentures governing our senior notes and Senior Subordinated Notes. In addition, our Senior Secured Credit Facilities and indentures governing our senior notes and Senior Subordinated Notes do not restrict our owners from creating new holding companies that may be able to incur indebtedness without regard to the restrictions set forth in our credit facilities and indentures. If new indebtedness is added to our current debt levels, the related risks that we now face could intensify.

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Our Debt Agreements Contain Restrictions That Limit our Flexibility in Operating our Business

Our Senior Secured Credit Facilities and the indentures governing our senior notes and Senior Subordinated Notes, contain various covenants that limit our ability to engage in specified types of transactions. These covenants limit our ability and the ability of our restricted subsidiaries to, among other things:

- incur additional debt;
- pay dividends or distributions on our capital stock or repurchase our capital stock;
- issue stock of subsidiaries;
- make certain investments;
- create liens on our assets to secure debt;
- enter into transactions with affiliates;
- merge or consolidate with another company; and
- sell or otherwise transfer assets.

In addition, under our Senior Secured Term Loan Facility, we are required to meet specified financial ratios in order to undertake certain actions, and under our Restated Revolving Credit Facility, we are required to meet specified financial ratios in order to undertake certain actions, and under certain circumstances, we may be required to maintain a specified fixed charge coverage ratio. Our ability to meet those tests can be affected by events beyond our control, and we cannot assure you that we will meet them. A breach of any of these covenants or any other covenant could result in a default under our Senior Secured Credit Facilities. Upon the occurrence of an event of default under our Senior Secured Credit Facilities, the lenders could elect to declare all amounts outstanding under our Senior Secured Credit Facilities to be immediately due and payable and terminate all commitments to extend further credit. If we were unable to repay those amounts, the lenders under our Senior Secured Credit Facilities could proceed against the collateral granted to them to secure such indebtedness. We have pledged substantially all of our assets as collateral under our Senior Secured Credit Facilities. If the lenders under our Senior Secured Credit Facilities accelerate the repayment of borrowings, we cannot assure you that we will have sufficient assets to repay our Senior Secured Credit Facilities, as well as our unsecured indebtedness, including the notes.

We may not be able to generate sufficient cash to service all of our indebtedness, including the exchange notes, and may be forced to take other actions to satisfy our obligations under our indebtedness, which may not be successful.

Our ability to make scheduled payments on or to refinance our debt obligations depends on our financial condition and operating performance, which are subject to prevailing economic and competitive conditions and to certain financial, business and other factors beyond our control. We cannot assure you that we will maintain a level of cash flows from operating activities sufficient to permit us to pay the principal, premium, if any, and interest on our indebtedness, including the exchange notes.

If our cash flows and capital resources are insufficient to fund our debt service obligations, we may be forced to reduce or delay investments and capital expenditures, or to sell assets, seek additional capital or restructure or refinance our indebtedness, including the exchange notes. These alternative measures may not be successful and may not permit us to meet our scheduled debt service obligations. In the absence of such operating results and resources, we could face substantial liquidity problems and might be required to dispose of material assets or operations to meet our debt service and other obligations. Our Senior Secured Credit Facilities and the indentures governing the senior notes and Senior Subordinated Notes restrict our ability to dispose of assets and use the proceeds from the disposition. We may not be able to consummate those dispositions or to obtain the proceeds that we could realize from them and these proceeds may not be adequate to meet any debt service obligations then due.

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Your right to receive payments on the exchange notes is effectively junior to those lenders who have a security interest in our assets.

Our obligations under the exchange notes and our guarantors obligations under their guarantees of the exchange notes are unsecured, but our obligations under our Senior Secured Credit Facilities and each guarantor s obligations under their respective guarantees of the Senior Secured Credit Facilities are secured by a security interest in substantially all of our tangible and intangible assets, including the stock of our current and certain future wholly-owned U.S. subsidiaries, the assets of our current and certain future wholly-owned material U.S. subsidiaries, the stock and the assets of Michaels of Canada, ULC and a portion of the stock of certain of our U.S. guarantor subsidiaries non-U.S. subsidiaries. If we are declared bankrupt or insolvent, or if we default under our Senior Secured Credit Facilities, the lenders could declare all of the funds borrowed thereunder, together with accrued interest, immediately due and payable. If we were unable to repay such indebtedness, the lenders could foreclose on the pledged assets to the exclusion of holders of the exchange notes, even if an event of default exists under the indenture governing the senior notes at such time.

Furthermore, if the lenders foreclose and sell the pledged equity interests in any subsidiary guarantor under the exchange notes, then that guarantor will be released from its guarantee of the notes automatically and immediately upon such sale. In any such event, because the exchange notes will not be secured by any of our assets or the equity interests in subsidiary guarantors, it is possible that there would be no assets remaining from which your claims could be satisfied or, if any assets remained, they might be insufficient to satisfy your claims fully. See Description of Other Indebtedness. As of October 27, 2012, we had total secured indebtedness of approximately $1,787 million (excluding $61 million of outstanding standby letters of credit), consisting entirely of senior secured indebtedness under our Senior Secured Credit Facilities.

The indenture governing the senior notes permits us and our restricted subsidiaries to incur substantial additional indebtedness in the future, including senior secured indebtedness.

Your claims to our assets will be structurally subordinated to all of the creditors of any non-guarantor subsidiaries.

In general, our foreign subsidiaries, unrestricted subsidiaries, non-wholly owned subsidiaries and other subsidiaries that do not guarantee our indebtedness or indebtedness of a guarantor of the exchange notes are not required to guarantee the exchange notes. Accordingly, claims of holders of the exchange notes will be structurally subordinated to the claims of creditors of these non-guarantor subsidiaries, including trade creditors. All obligations of our non-guarantor subsidiaries will have to be satisfied before any of the assets of such subsidiaries would be available for distribution, upon a liquidation or otherwise, to us or a guarantor of the exchange notes.

If we default on our obligations to pay our indebtedness, we may not be able to make payments on the exchange notes.

Any default under the agreements governing our indebtedness, including a default under the Senior Secured Credit Facilities that is not waived by the required lenders, and the remedies sought by the holders of such indebtedness, could prevent us from paying principal, premium, if any, and interest on the exchange notes and substantially decrease the market value of the exchange notes. If we are unable to generate sufficient cash flow and are otherwise unable to obtain funds necessary to meet required payments of principal, premium, if any, and interest on our indebtedness, or if we otherwise fail to comply with the various covenants, including financial and operating covenants, in the instruments governing our indebtedness (including covenants in our Senior Secured Credit Facilities and the indentures governing the senior notes and the

Senior Subordinated Notes), we could be in default under the terms of the agreements governing such indebtedness, including our Senior Secured Credit Facilities and the indentures governing the senior notes and the Senior Subordinated Notes. In the event of such default, the holders of such indebtedness could elect to declare all the funds borrowed thereunder to be due and payable, together with accrued and unpaid interest, the lenders under our Senior Secured Credit Facilities could elect to terminate their commitments thereunder, cease making further loans and institute foreclosure proceedings against our assets, and we could be forced into bankruptcy or liquidation. If our operating performance declines, we may in the future need to obtain waivers from the required lenders under our Senior Secured Credit Facilities to avoid being in default. If we breach our covenants under our Senior Secured Credit Facilities and seek a waiver, we may not be able to obtain a waiver from the required lenders. If this occurs, we would be in default under our Senior Secured Credit Facilities, the lenders could exercise their rights, as described above, and we could be forced into bankruptcy or liquidation.

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We may not be able to repurchase the exchange notes upon a change of control.

Upon the occurrence of specific kinds of change of control events, we will be required to offer to repurchase all senior notes at 101% of their principal amount plus accrued and unpaid interest. The source of funds for any such purchase of the senior notes will be our available cash or cash generated from our subsidiaries operations or other sources, including borrowings, sales of assets or sales of equity. We may not be able to repurchase the senior notes upon a change of control because we may not have sufficient financial resources to purchase all of the senior notes that are tendered upon a change of control. Further, we will be contractually restricted under the terms of our Senior Secured Credit Facilities from repurchasing all of the senior notes tendered by holders upon a change of control. Accordingly, we may not be able to satisfy our obligations to purchase the senior notes unless we are able to refinance or obtain waivers under our Senior Secured Credit Facilities. Our failure to repurchase the senior notes upon a change of control would cause a default under the indenture governing the senior notes and a cross-default under the Senior Secured Credit Facilities. The Senior Secured Credit Facilities also provide that a change of control will be a default that permits lenders to accelerate the maturity of borrowings thereunder. Any of our future debt agreements may contain similar provisions.

The lenders under the Senior Secured Credit Facilities will have the discretion to release the guarantors under the Senior Secured Credit Facilities in a variety of circumstances, which will cause those guarantors to be released from their guarantees of the exchange notes.

While any obligations under the Senior Secured Credit Facilities remain outstanding, any guarantee of the exchange notes may be released without action by, or consent of, any holder of the exchange notes or the trustee under the indenture governing the senior notes, at the discretion of lenders under the Senior Secured Credit Facilities, if the related guarantor is no longer a guarantor of obligations under the Senior Secured Credit Facilities or any other indebtedness. See Description of Exchange Notes Guarantees. The lenders under the Senior Secured Credit Facilities will have the discretion to release the guarantees under the Senior Secured Credit Facilities in a variety of circumstances. You will not have a claim as a creditor against any subsidiary that is no longer a guarantor of the exchange notes, and the indebtedness and other liabilities, including trade payables, whether secured or unsecured, of those subsidiaries will effectively be senior to claims of noteholders.

Because each guarantor s liability under its guarantees may be reduced to zero, avoided or released under certain circumstances, you may not receive any payments from some or all of the guarantors.

You have the benefit of the guarantees of the subsidiary guarantors. However, the guarantees by the subsidiary guarantors are limited to the maximum amount that the subsidiary guarantors are permitted to guarantee under applicable law. As a result, a subsidiary guarantor s liability under its guarantee could be reduced to zero, depending upon the amount of other obligations of such subsidiary guarantor. Further, under the circumstances discussed more fully below, a court under federal and state fraudulent conveyance and transfer statutes could void the obligations under a guarantee or further subordinate it to all other obligations of the guarantor. See Federal and state fraudulent transfer laws may permit a court to void the guarantees, and, if that occurs, you may not receive any payments on the exchange notes. In addition, you will lose the benefit of a particular guarantee if it is released under certain circumstances described under Description of Exchange Notes Guarantees.

Federal and state fraudulent transfer laws may permit a court to void the guarantees, and, if that occurs, you may not receive any payments on the exchange notes.

Federal and state fraudulent transfer and conveyance statutes may apply to the issuance of the exchange notes and the incurrence of the guarantees. Under federal bankruptcy law and comparable provisions of state fraudulent transfer or conveyance laws, which may vary from state to state, the exchange notes or guarantees could be voided as a fraudulent transfer or conveyance if (1) we or any of the guarantors, as applicable, issued the exchange notes or incurred the guarantees with the intent of hindering, delaying or defrauding creditors or (2) we or any of the guarantors, as applicable, received less than reasonably equivalent value or fair consideration in return for either issuing the exchange notes or incurring the guarantees and, in the case of (2) only, one of the following is also true at the time thereof:

- we or any of the guarantors, as applicable, were insolvent or rendered insolvent by reason of the issuance of the exchange notes or the incurrence of the guarantees;

- the issuance of the exchange notes or the incurrence of the guarantees left us or any of the guarantors, as applicable, with an unreasonably small amount of capital to carry on the business;

- we or any of the guarantors intended to, or believed that we or such guarantor would, incur debts beyond our or such guarantor s ability to pay as they mature; or

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- we or any of the guarantors was a defendant in an action for money damages, or had a judgment for money damages docketed against us or such guarantor if, in either case, after final judgment, the judgment is unsatisfied.

If a court were to find that the issuance of the exchange notes or the incurrence of the guarantee was a fraudulent transfer or conveyance, the court could void the payment obligations under the exchange notes or such guarantee, or subordinate the exchange notes or such guarantee to presently existing and future indebtedness of ours or of the related guarantor, or require the holders of the exchange notes to repay any amounts received. In the event of a finding that a fraudulent transfer or conveyance occurred, you may not receive any payment on the exchange notes. As a general matter, value is given for a transfer or an obligation if, in exchange for the transfer or obligation, property is transferred or an antecedent debt is secured or satisfied. A debtor will generally not be considered to have received value in connection with a debt offering if the debtor uses the proceeds of that offering to make a dividend payment or otherwise retire or redeem equity securities issued by the debtor.

We cannot be certain as to the standards a court would use to determine whether or not we or the guarantors were solvent at the relevant time or, regardless of the standard that a court uses, that the exchange notes or the guarantees would not be subordinated to our or any of our guarantors other debt.

Your ability to transfer the exchange notes may be limited by the absence of an active trading market, and an active trading market for the exchange notes may not develop.

The exchange notes are new issues of securities for which there is no established public market. Upon the consummation of the exchange offer contemplated herein, we expect that the notes offered hereby will share a single CUSIP number with the initial notes and we expect that such notes and the initial notes will thereafter be fungible. However, in the event that we are unable to exchange the notes for notes sharing a single CUSIP number with the initial notes, the exchange notes offered hereby will continue to trade under a separate CUSIP number. We do not intend to have the initial notes, the outstanding notes or any exchange notes listed on a national securities exchange or to arrange for quotation on any automated dealer quotation systems. Accordingly, the development or liquidity of any market for the exchange notes is uncertain.

The initial purchasers have advised us that they intend to make a market in the outstanding notes, and the exchange notes, if issued, as permitted by applicable laws and regulations; however, the initial purchasers are not obligated to make a market in any of the senior notes, and they may discontinue their market-making activities at any time without notice.

Therefore, an active market for any of the senior notes may not develop, and if a market for any of the senior notes does develop, that market may not continue. Historically, the market for non-investment grade debt has been subject to disruptions that have caused substantial volatility in the prices of securities similar to the senior notes. The market, if any, for any of the senior notes may be subject to similar disruptions, and any such disruptions may adversely affect the prices at which you may sell your exchange notes. In addition, subsequent to their initial issuance, the exchange notes may trade at a discount from their initial offering price, depending upon prevailing interest rates, the market for similar notes, our performance and other factors.

Risks Related to Our Company

We face risks related to the effect of economic uncertainty

If recovery from the economic downturn continues to be slow or prolonged, our growth, prospects, results of operations, cash flows and financial condition could be adversely impacted. Our stores offer arts and crafts supplies and products for the crafter, and custom framing for the do-it-yourself home decorator, which some customers may perceive as discretionary. Pressure on discretionary income brought on by economic downturns and slow recoveries, including housing market declines, rising energy prices and weak labor markets, may cause consumers to reduce the amount they spend on discretionary items. For example, as a result of the recession during fiscal 2007 and fiscal 2008, despite adding a number of new stores, our total Net sales decreased from $3,862 million to $3,817 million. The current economic environment may continue to adversely affect consumer confidence and retail spending, decreasing demand for our merchandise. Current economic conditions also make it difficult for us to accurately forecast future demand trends, which could cause us to purchase excess inventories, resulting in increases in our inventory carrying cost, or insufficient inventories, resulting in our inability to satisfy our customer demand and potentially lose market share.

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Our reliance on foreign suppliers increases our risk of obtaining adequate, timely, and cost-effective product supplies.

We rely to a significant extent on foreign manufacturers of various products that we sell, particularly manufacturers located in China. In addition, many of our domestic suppliers purchase a portion of their products from foreign sources. This reliance increases the risk that we will not have adequate and timely supplies of various products due to local political, economic, social, or environmental conditions (including acts of terrorism, the outbreak of war, or the occurrence of natural disaster), transportation delays (including dock strikes and other work stoppages), restrictive actions by foreign governments, or changes in U.S. laws and regulations affecting imports or domestic distribution. Reliance on foreign manufacturers also increases our exposure to trade infringement claims and reduces our ability to return product for various reasons.

Additionally, the costs of labor and wage taxes have increased in China, which means we are at risk of higher costs associated with goods manufactured in China. Significant increases in wages or wage taxes paid by contract facilities may increase the cost of goods manufactured, which could have a material adverse effect on our profit margins and profitability.

All of our products manufactured overseas and imported into the U.S. are subject to duties collected by the U.S. Customs Service. We may be subjected to additional duties, significant monetary penalties, the seizure and forfeiture of the products we are attempting to import, or the loss of import privileges if we or our suppliers are found to be in violation of U.S. laws and regulations applicable to the importation of our products.

Our growth depends on our ability to open new stores and increase comparable store sales.

One of our key business strategies is to expand our base of retail stores. If we are unable to continue this strategy, our ability to increase our sales, profitability and cash flow could be impaired. To the extent we are unable to open new stores as we anticipate, our sales growth would come only from increases in comparable store sales. Growth in profitability in that case would depend significantly on our ability to reduce our costs as a percentage of our sales. We may be unable to continue our store growth strategy if we cannot identify suitable sites for additional stores, negotiate acceptable leases, access sufficient capital to support store growth, or hire and train a sufficient number of qualified associates.

Damage to the reputation of the Michaels brand or our private and exclusive brands could adversely affect our sales.

We believe the Michaels brand name and many of our private and exclusive brand names are powerful sales and marketing tools and we devote significant resources to promoting and protecting them. To be successful in the future, we must continue to preserve, grow and utilize the value of Michaels   reputation. Reputational value is based in large part on perceptions of subjective qualities, and even isolated incidents may erode trust and confidence. In addition, we develop and promote private and exclusive brands, which we believe have generated national recognition. Our private label brands amounted to approximately 44% of total Net sales in fiscal 2011, and represent a growing portion of our overall sales. Damage to the reputations (whether or not justified) of our brand names, could arise from product failures, litigation or various forms of adverse publicity, especially in social media outlets, and may generate negative customer sentiment, potentially resulting in a reduction in our sales and earnings.

Our suppliers may fail us.

Many of our suppliers are small firms that produce a limited number of items. Given their limited resources, these firms are susceptible to cash flow issues, access to capital, production difficulties, quality control issues and problems in delivering agreed-upon quantities on schedule. We may not be able, if necessary, to return products to these suppliers and obtain refunds of our purchase price or obtain reimbursement or indemnification from them if their products prove defective. These suppliers may also be unable to withstand a downturn in economic conditions. Significant failures on the part of our key suppliers could have a material adverse effect on our results of operations.

In addition, many of these suppliers require extensive advance notice of our requirements in order to supply products in the quantities we desire. This long lead time requires us to place orders far in advance of the time when certain products will be offered for sale, exposing us to risk of shifts in demand.

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Risks associated with the vendors from whom our products are sourced could materially adversely affect our revenue and gross profit.

The products we sell are sourced from a wide variety of domestic and international vendors. Global sourcing has become an increasingly important part of our business, as we have undertaken efforts to increase the amount of product we source directly from overseas manufacturers. Our ability to find qualified vendors who meet our standards and supply products in a timely and efficient manner is a significant challenge, especially with respect to goods sourced from outside the U.S. Any issues related to transitioning vendors could adversely affect our revenue and gross profit.

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 operations, cash flow and financial condition.

We are subject to regulations by a variety of federal, state and international regulatory authorities, including the Consumer Product Safety Commission. In fiscal 2011, we purchased merchandise from approximately 600 vendors. Since a majority of our merchandise is manufactured in foreign countries, one or more of our vendors might not adhere to product safety requirements or our quality control standards, and we might not identify the deficiency before merchandise ships to our stores. Any issues of product safety, including but not limited to those manufactured in foreign countries, could cause us to recall some of those products. If our vendors fail to manufacture or import merchandise that adheres to our quality control standards, our reputation and brands could be damaged, potentially leading to increases in customer litigation against us. Furthermore, to the extent we are unable to replace any recalled products, we may have to reduce our merchandise offerings, resulting in a decrease in sales, especially if a recall occurs near or during a seasonal period. If our vendors are unable or unwilling to recall products failing to meet our quality standards, we may be required to recall those products at a substantial cost to us. Moreover, changes in product safety or other consumer protection laws could lead to increased costs to us for certain merchandise, or additional labor costs associated with readying merchandise for sale. Long lead times on merchandise ordering cycles increase the difficulty for us to plan and prepare for potential changes to applicable laws. The Consumer Product Safety Improvement Act of 2008 imposes significant requirements on manufacturing, importing, testing and labeling requirements for our products. In the event that we are unable to timely comply with regulatory changes, significant fines or penalties could result, and could adversely affect our reputation, results of operations, cash flow and financial condition.

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

Significant future increases in commodity prices or inflation could adversely affect our costs, including cost of merchandise and distribution costs. Furthermore, the transportation industry may experience a shortage or reduction of capacity, which could be exacerbated by higher fuel prices. Our results of operations may be adversely affected if we are unable to secure, or are able to secure only at significantly higher costs, adequate transportation resources to fulfill our receipt of goods or delivery schedules to the stores.

Unexpected or unfavorable consumer responses to our promotional or merchandising programs could materially adversely affect our sales, results of operations, cash flow and financial condition.

Brand recognition, quality and price have a significant influence on consumers choices among competing products and brands. Advertising, promotion, merchandising and the cadence of new product introductions also have a significant impact on consumers buying decisions. If we misjudge consumer responses to our existing or future promotional activities, this could have a material adverse impact on our sales, results of operations, cash flow and financial condition.

We believe improvements in our merchandise offering help drive sales at our stores. We could be materially adversely affected by poor execution of changes to our merchandise offering or by unexpected consumer responses to changes in our merchandise offering.

Improvements to our supply chain may not be fully successful.

An important part of our efforts to achieve efficiencies, cost reductions, and sales and cash flow growth is the identification and implementation of improvements to our supply chain, including merchandise ordering, transportation, and receipt processing. During the remainder of fiscal 2012 and in fiscal 2013, we plan to continue to implement enhancements to our distribution systems and processes, which are designed to improve efficiency through the supply chain and at our stores. Significant changes to our supply chain could have a material adverse impact on our results of operations.

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Changes in customer demands could materially adversely affect our sales, results of operations and cash flow.

Our success depends on our ability to anticipate and respond in a timely manner to changing customer demands and preferences for products and supplies used in creative activities. If we misjudge the market, we may significantly overstock unpopular products and be forced to take significant inventory markdowns, or experience shortages of key items, either of which could have a material adverse impact on our operating results and cash flow. In addition, adverse weather conditions, economic instability, and consumer confidence volatility could have a material adverse impact on our sales and operating results.

Our success will depend on how well we manage our business.

Even if we are able to substantially continue our strategy of expanding our store base, or additionally, to expand our business through acquisitions or vertical integration opportunities, we may experience problems, which may adversely impact profitability or cash flow. For example:

- the costs of opening and operating new stores may offset the increased sales generated by the additional stores

- the closure of unsuccessful stores may result in the retention of liability for expensive leases

- a significant portion of our management s time and energy may be consumed with issues unrelated to advancing our core business strategies

- the implementation of future operational efficiency initiatives, which may include the consolidation of certain operations and/or the possible co-sourcing of additional selected functions, may not produce the desired reduction in costs and may result in disruptions arising from such actions

- we may be unable to hire, train and retain qualified employees, including management and senior executives, and significant turnover could be disruptive to our business strategies and operations

- failure to maintain stable relations with our labor force

- our suppliers may be unable to meet the increased demand of additional stores in a timely manner

- we may be unable to expand our existing distribution centers or use third party distribution centers on a cost-effective basis to provide merchandise for sale by our new stores

Competition, including Internet-based competition, could negatively impact our business.

The retail arts and crafts industry is competitive, which could result in the reduction of our prices and loss of our market share. We must remain competitive in the areas of quality, price, breadth of selection, customer service, and convenience. We compete with mass merchants (*e.g*., Wal-Mart Stores, Inc. and Target Corporation), which dedicate a portion of their selling space to a limited selection of craft supplies and seasonal and holiday merchandise, along with national and regional chains and local merchants. We also compete with specialty retailers, which include Hobby Lobby Stores, Inc., A.C. Moore Arts & Crafts, Inc., Jo-Ann Stores, Inc. and Garden Ridge Corporation. Some of our competitors, particularly the mass merchants, are larger and have greater financial resources than we do. The Company also faces competition from Internet-based retailers, in addition to traditional store-based retailers. This could result in increased price competition since our customers could more readily search and compare non-private brand products. This could also lead to additional competitors, who may exploit a convenience advantage in the event we cannot offer a similar line of products online in the future. Furthermore, we ultimately compete with alternative sources of entertainment and leisure for our customers.

Failure to adequately maintain security and prevent unauthorized access to electronic and other confidential information and data breaches could materially adversely affect our financial condition and operating results.

We have become increasingly centralized and dependent upon automated information technology processes. In addition, a portion of our business operations is conducted over the Internet, increasing the risk of viruses that could cause system failures and disruptions of operations. Any failure to maintain the security of our customers confidential information, or data belonging to ourselves or our suppliers, could put us at a competitive disadvantage, result in deterioration in our customers confidence in us, and subject us to potential litigation, liability, fines and penalties, resulting in a possible material adverse impact on our financial condition and results of operations.

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On May 3, 2011, we were advised by the U.S. Secret Service that they were investigating certain fraudulent debit card transactions that occurred on accounts that had been used for legitimate purchases in selected Michaels stores. A subsequent internal investigation revealed that approximately 90 payment card terminals in certain Michaels stores had been physically tampered with, potentially resulting in the compromise of customer debit and credit card information. The Company fully cooperated with various governmental entities and law enforcement authorities in investigating the payment card terminal tampering, and we believe we have taken appropriate steps to stop the use of the stolen information. Multiple consumer class action lawsuits were filed against the Company as a result of the tampering and additional litigation may be filed (see Business Legal Proceedings Data Breach Claims). Various other claims may be otherwise asserted against us for which we may be responsible, on behalf of customers, banks, payment card companies and others seeking damages allegedly arising out of the payment card terminal tampering and other related relief. In addition, the major card brands may seek to impose assessments and fines by reason of the tampering. To date, MasterCard has assessed approximately $400,000 of reissuance fees and alleged fraud losses, which the Company is disputing. We do not have sufficient information to reasonably estimate other losses we may incur arising from the payment card terminal tampering, but we do not believe such losses would be material to our results of operations and financial condition.

Improper activities by third parties, advances in technical capabilities and encryption technology, new tools and discoveries and other events or developments may facilitate or result in a further compromise or breach of our payment card terminals or other payment systems. Any such further compromises or breaches could cause interruptions in our operations, damage to our reputation and customers willingness to shop in our stores, and subject us to additional costs and potential litigation, liability, fines and penalties, resulting in a possible material adverse impact on our financial condition and results of operations.

The Company may be subject to information technology system failures or network disruptions, or our information systems may prove inadequate, resulting in damage to the Company s reputation, business operations and financial conditions.

We depend on our management information systems for many aspects of our business, including our perpetual inventory, automated replenishment, and weighted average cost stock ledger systems which are necessary to properly forecast, manage, and analyze our inventory. The Company may be subject to information technology system failures and network disruptions. These may be caused by natural disasters, accidents, power disruptions, telecommunications failures, acts of terrorism or war, computer viruses, physical or electronic break-ins, or similar events or disruptions. System redundancy may be ineffective or inadequate, and the Company s disaster recovery planning may not be sufficient for all eventualities. Such failures or disruptions could prevent access to the Company s online services and preclude store transactions. System failures and disruptions could also impede the manufacturing and shipping of products, transactions processing and financial reporting. Additionally, we will be materially adversely affected if we are unable to improve, upgrade, maintain, and expand our systems.

We are dependent upon the services of our senior management team, and the failure to attract and retain such individuals could adversely affect our operations.

We are dependent on the services, abilities and experience of our executive officers. The permanent loss of the services of any of these senior executives and any change in the composition of our senior management team could have a negative impact on our ability to execute on our business and operating strategies.

We have recently experienced a significant change in our executive leadership. On July 19, 2012, John B. Menzer resigned as Chief Executive Officer to focus on recovery and rehabilitation from the stroke he suffered in April. Previously, the Board of Directors of the Company established an interim Office of the Chief Executive Officer (the CEO Office) comprised of Charles M. Sonsteby and Lewis S. Klessel, and temporarily transferred Mr. Menzer s responsibilities to the CEO Office. Messrs. Sonsteby and Klessel will continue to execute the responsibilities of the Company s principal executive officer through the CEO Office, until the Company s search for a new Chief Executive Officer is completed. Our inability to identify, hire and subsequently integrate a new Chief Executive Officer could adversely impact our business, financial condition and results of operations.

A weak fourth quarter would materially adversely affect our result of operations.

Our business is highly seasonal. Our inventories and short-term borrowings may grow in the third fiscal quarter as we prepare for our peak selling season in the third and fourth fiscal quarters. Our most important quarter in terms of sales, profitability, and cash flow historically has been the fourth fiscal quarter. If for any reason our fourth fiscal quarter results were substantially below expectations, our operating results for the full year would be materially adversely affected, and we could have substantial excess inventory, especially in seasonal merchandise, that is difficult to liquidate.

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Changes in newspaper subscription rates may result in reduced exposure to our circular advertisements.

A substantial portion of our promotional activities utilize circular advertisements in local newspapers. A continued decline in consumer subscriptions of these newspapers could reduce the frequency with which consumers receive our circular advertisements, thereby negatively affecting sales, results of operations and cash flow.

Changes in regulations or enforcement, or our failure to comply with existing or future regulations, may adversely impact our business.

We are subject to federal, state, provincial and local regulations with respect to our operations in the U.S. and Canada. There are a number of legislative and regulatory initiatives that could adversely impact our business if they are enacted or enforced. Those initiatives include wage or workforce issues (such as minimum-wage requirements, overtime and other working conditions and citizenship requirements), collective bargaining matters, environmental regulation, price and promotion regulation, trade regulations and others. For example, we recently settled a pricing and promotion investigation by the New York State Attorney General s office through the payment of a fine and other consideration pursuant to an Assurance of Discontinuance, and could be subject to similar investigations, as well as lawsuits, in the future. We are currently subject to multiple class action lawsuits alleging violations of wage and workforce laws and to a purported class action lawsuit alleging violations of Ohio state law in relation to our advertising and pricing practices (see Business Legal Proceedings).

In addition, we expect that the Patient Protection and Affordable Care Act, which was signed into law on March 23, 2010, will increase our annual associate health care costs, with the most significant increases coming in 2014. Proposed changes in tax regulations may also change our effective tax rate as our business is subject to a combination of applicable tax rates in the various countries, states and other jurisdictions in which we operate. New accounting pronouncements and interpretations of existing accounting rules and practices have occurred and may occur in the future. A change in accounting standards or practices can have a significant effect on our reported results of operations. Failure to comply with legal requirements could result in, among other things, increased litigation risk that could affect us adversely by subjecting us to significant monetary damages and other remedies or by increasing our litigation expenses, administrative enforcement actions, fines and civil and criminal liability. If such issues become more expensive to address, or if new issues arise, they could increase our expenses, generate negative publicity, or otherwise adversely affect us.

Disruptions in the capital markets could increase our costs of doing business.

Any disruption in the capital markets could make it difficult for us to raise additional capital when needed, or to eventually refinance our existing indebtedness on acceptable terms or at all. Similarly, if our suppliers face challenges in obtaining credit when needed, or otherwise face difficult business conditions, they may become unable to offer us the merchandise we use in our business thereby causing reductions in our revenues, or they may demand more favorable payment terms, all of which could adversely affect our results of operations, cash flows and financial condition.

Our real estate leases generally obligate us for long periods, which subjects us to various financial risks.

We lease virtually all of our store, distribution center, and administrative locations, generally for long terms. While we have the right to terminate some of our leases under specified conditions by making specified payments, we may not be able to terminate a particular lease if or when we would like to do so. If we decide to close stores, we are generally required to continue to perform obligations under the applicable leases, which generally includes, among other things, paying rent and operating expenses for the balance of the lease term, or paying to exercise rights to terminate, and the performance of any of these obligations may be expensive. When we assign or sublease vacated locations, we may remain liable on the lease obligations if the assignee or sublessee does not perform. In addition, when leases for the stores in our ongoing operations expire, we may be unable to negotiate renewals, either on commercially acceptable terms, or at all, which could cause us to close stores. Accordingly, we are subject to the risks associated with leasing real estate, which can have a material adverse effect on our results.

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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 place significant reliance on a third party provider for the co-sourcing of certain of our information technology (IT), accounts payable, payroll, accounting, and human resources functions. This co-sourcing initiative is a component of our ongoing strategy to increase efficiencies, increase our IT capabilities, monitor our costs and seek additional cost savings. These functions are generally performed in an offshore location, with Michaels oversight. As a result, we are relying on third parties to ensure that certain functional needs are sufficiently met. This reliance subjects us to risks arising from the loss of control over these processes, changes in pricing that may affect our operating results, and potentially, termination of provision of these services by our supplier. If our service providers fail to perform, we may have difficulty arranging for an alternate supplier or rebuilding our own internal resources, and we could incur significant costs, all of which may have a significant adverse effect on our business. We may co-source other administrative functions in the future, which would further increase our reliance on third parties. Further, the use of offshore service providers may expose us to risks related to local political, economic, social or environmental conditions (including acts of terrorism, the outbreak of war, or the occurrence of natural disaster), restrictive actions by foreign governments or changes in U.S. laws and regulations.

We are exposed to fluctuations in exchange rates between the U.S. and Canadian dollar, which is the functional currency of our Canadian subsidiary.

Our Canadian subsidiary purchases inventory in U.S. dollars, which is sold in Canadian dollars and exposes us to foreign exchange rate fluctuations. As well, our stores customers at border locations can be sensitive to cross-border price differences. Substantial foreign currency fluctuations could adversely affect our business.

Failure to attract and retain quality sales, distribution center and other associates in appropriate numbers as well as experienced buying and management personnel could adversely affect our performance.

Our performance depends on recruiting, developing, training and retaining quality sales, distribution center and other associates in large numbers as well as experienced buying and management personnel. Many of our store level associates are in entry level or part-time positions with historically high rates of turnover. Our ability to meet our labor needs while controlling labor costs is subject to external factors such as unemployment levels, prevailing wage rates, minimum wage legislation, changing demographics, health and other insurance costs and governmental labor and employment requirements. In the event of increasing wage rates, if we fail to increase our wages competitively, the quality of our workforce could decline, causing our customer service to suffer, while increasing our wages could cause our earnings to decrease. The market for retail management is highly competitive and, in common with other retailers, we face challenges in securing sufficient management talent. If we do not continue to attract, train and retain quality associates and management personnel, our performance could be adversely affected.

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

Unforeseen public health issues, such as pandemics and epidemics, and geo-political events, such as civil unrest in a country in which our suppliers are located or terrorist or military activities disrupting transportation, communication or utility systems, as well as natural disasters such as hurricanes, tornadoes, floods, earthquakes and other adverse weather and climate conditions, whether occurring in the U.S. or abroad, particularly during peak seasonal periods, could disrupt our operations or the operations of one or more of our vendors or could severely damage or destroy one or more of our stores or distribution facilities located in the affected areas. Day to day operations, particularly our ability to receive products from our vendors or transport products to our stores could be adversely affected, or we could be required to close stores or distribution centers in the affected areas or in areas served by the affected distribution center. These factors could also cause consumer confidence and spending to decrease or result in increased volatility in the U.S. and global financial markets and economy. Such occurrences could significantly impact our operating results and financial performance. As a result, our business could be adversely affected.

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We are controlled by the Sponsors, whose interests as an equity holder may conflict with yours as a creditor.

We are controlled by the Sponsors, who currently indirectly own approximately 93% of our common stock in the aggregate. The Sponsors control the election of our directors and thereby have the power to control our affairs and policies, including the appointment of management, the issuance of additional equity and the declaration and payment of dividends if allowed under the terms of the credit agreement governing our Senior Secured Credit Facilities, the terms of the indenture governing the senior notes and the terms of our other indebtedness outstanding at the time. The Sponsors do not have any liability for any obligations under or relating to the notes offered hereby and their respective interests may be in conflict with yours. For example, if we encounter financial difficulties or are unable to pay our debts as they mature, the Sponsors may pursue strategies that favor equity investors over debt investors. In addition, our equity holders may have an interest in pursuing acquisitions, divestitures, financing or other transactions that, in their judgment, could enhance their equity investments, even though such transactions may involve risk to you as a holder of the notes. Additionally, the Sponsors may make investments in businesses that directly or indirectly compete with us, or may pursue acquisition opportunities that may be complementary to our business and, as a result, those acquisition opportunities may not be available to us. For information concerning our arrangements with the Sponsors, see Management and Certain Relationships and Related Party Transactions.

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THE EXCHANGE OFFER

Purpose and Effect of the Exchange Offer

Michaels and the guarantors of the outstanding notes have entered into a registration rights agreement with the initial purchasers of the outstanding notes in which we agreed, under certain circumstances, to use our reasonable best efforts to file a registration statement relating to the offer to exchange the outstanding notes for exchange notes and thereafter cause the registration statement to become effective under the Securities Act no later than 360 days following the closing date of the issuances of the outstanding notes. The exchange notes will have terms identical in all material respects to the outstanding notes, except that the exchange notes will not contain terms with respect to transfer restrictions, registration rights and additional interest for failure to observe certain obligations in the registration rights agreement. The outstanding notes that will be exchanged in this exchange offer were issued on September 27, 2012.

Under the circumstances set forth below, Michaels and the guarantors will use their reasonable best efforts to cause the SEC to declare effective a shelf registration statement with respect to the resale of the outstanding notes within the time periods and subject to the provisions specified in the registration rights agreement and keep the statement effective for up to two years after the effective date of the shelf registration statement. These circumstances include:

- if, because of any change in law or in currently prevailing interpretations of the staff of the SEC, we are not permitted to effect the exchange offer as contemplated by the registration rights agreement;

- if the exchange offer is not consummated within 360 days after the date of issuance of the outstanding notes;

- if any initial purchaser of outstanding notes acquired by them that have the status of an unsold allotment in the initial distribution of exchange notes so requests in writing to us at any time within 30 days after the consummation of the exchange offer; or

- if in the case of any holder that participates in the exchange offer, such holder does not receive exchange notes on the date of the exchange that may be freely sold without restriction under state and federal securities laws (other than due solely to the status of such holder as an affiliate of the Company within the meaning of the Securities Act) and so notifies us within 30 days after such holder first becomes aware of the restrictions.

If (A) we have neither (i) exchanged the exchange notes for all outstanding notes validly tendered in accordance with the terms of the exchange offer nor (ii) had a shelf registration declared effective, in either case on or prior to the 360th day after the original issue date of the outstanding notes, (B) notwithstanding clause (A), are required to file a shelf registration statement and such shelf registration statement is not declared effective on or prior to the 360th day after the date such filing was requested or required or (C) if applicable, a shelf registration statement has been declared effective and such shelf registration statement ceases to be effective at any time during the shelf registration period (subject to certain exceptions) (each, a registration default), then additional interest shall accrue on the principal amount of the applicable outstanding notes at a rate of 0.25% per annum (which rate will be increased by an additional 0.25% per annum for each subsequent 90-day period that such additional interest continues to accrue, provided that the rate at which such additional interest accrues may in no event exceed 1.00% per annum) commencing on (x) the 361st day after the original issue date of the outstanding notes, in the case of (A) above, (y) the 361st day after such shelf registration statement filing was requested or required, in the case of (B) above or (z) the day such shelf registration statement ceases to be effective, in the case of (C) above; provided, however, that upon the exchange of exchange notes for all outstanding notes tendered (in the case of clause (A) above), upon effectiveness of the applicable shelf registration statement (in the case of clause (B) above), or upon the effectiveness of a shelf registration statement that had ceased to remain effective (in the case of clause (C) above), additional interest on such outstanding notes as a result of such clause, as the case may be, shall cease to accrue. The amount of additional interest payable will not increase because more than one registration default has occurred and is continuing and a holder of the outstanding notes or any broker-dealer of exchange notes received by such broker-dealer in the exchange offer that is not entitled to the benefits of the shelf registration shall not be entitled to additional interest with respect to any registration default that pertains to the shelf registration.

If you wish to exchange your outstanding notes for exchange notes in the exchange offer, you will be required to make the following written representations:

- any exchange notes acquired in exchange for outstanding notes tendered are being acquired in the ordinary course of business;

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- at the time of commencement or consummation of the exchange offer, the holder has no arrangement or understanding with any person to participate in the distribution (within the meaning of the Securities Act) of the exchange notes in violation of the provisions of the Securities Act;

- the holder is not an affiliate (as defined in Rule 405 under the Securities Act) of ours, or, if it is an affiliate of ours, it will comply with the registration and prospectus delivery requirements of the Securities Act;

- if the holder is not a broker-dealer, the holder is not engaged and does not intend to engage in distribution of the exchange notes; and

- if the holder is a broker-dealer, the holder will receive exchange notes for its own account in exchange for outstanding notes that were acquired as a result of market-making activities or other trading activities, and that it will comply with the applicable provisions of the Securities Act, including the delivery of a prospectus in connection with any resale of such exchange notes.

Each broker-dealer that receives exchange notes for its own account in exchange for outstanding notes, where the broker-dealer acquired the outstanding notes as a result of market-making activities or other trading activities, must acknowledge that it will deliver a prospectus in connection with any resale of such exchange notes. Please see Plan of Distribution.

Resale of Exchange Notes

Based on an interpretation by the SEC set forth in no-action letters issued to third-parties unrelated to us, we believe that, with the exceptions set forth below, exchange notes issued in the exchange offer may be offered for resale, resold and otherwise transferred by the holder of exchange notes without compliance with the registration and prospectus delivery requirements of the Securities Act, unless the holder:

- is an affiliate, within the meaning of Rule 405 under the Securities Act, of the Issuer or any subsidiary guarantor;

- is a broker-dealer who purchased outstanding notes directly from us for resale under Rule 144A or Regulation S or any other available exemption under the Securities Act;

- acquired the exchange notes other than in the ordinary course of the holder s business;

- has an arrangement with any person to engage in the distribution of the exchange notes; or

- is prohibited by any law or policy of the SEC from participating in the exchange offer.

Any holder who tenders in the exchange offer for the purpose of participating in a distribution of the exchange notes cannot rely on this interpretation by the SEC and must comply with the registration and prospectus delivery requirements of the Securities Act in connection with a secondary resale transaction. Each broker-dealer that receives exchange notes for its own account in exchange for outstanding notes, where such outstanding notes were acquired by such broker-dealer as a result of market making activities or other trading activities, must acknowledge that it will deliver a prospectus in connection with any resale of such exchange note. Please read Plan of Distribution for more details regarding the transfer of exchange notes. Broker-dealers who acquired outstanding notes directly from us and not as a result of market making activities or other trading activities may not rely on the SEC s interpretations discussed above or participate in the exchange offer, and must comply with the prospectus delivery requirements of the Securities Act in order to sell the outstanding notes.

Under certain circumstances specified in the registration rights agreement, we may be required to file a shelf registration statement for a continuous offer in connection with the outstanding notes pursuant to Rule 415 under the Securities Act.

Terms of the Exchange Offer

On the terms and subject to the conditions set forth in this prospectus and in the accompanying letters of transmittal, Michaels will accept for exchange in the exchange offer any outstanding notes that are validly tendered and not validly withdrawn prior to the applicable expiration date. Outstanding notes may only be tendered in a principal amount equal to $2,000 and in multiples of $1,000 thereafter. Michaels will issue $1,000 principal amount of exchange notes in exchange for each $1,000 principal amount of outstanding notes surrendered in the exchange offer.

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The form and terms of the exchange notes will be identical in all material respects to the form and terms of the outstanding notes except the exchange notes will be registered under the Securities Act, will not bear legends restricting their transfer and will not provide for any additional interest upon our failure to fulfill our obligations under the registration rights agreement to complete the exchange offer, or file, and cause to be effective, a shelf registration statement, if required thereby, within the specified time period. The exchange notes will evidence the same debt as the outstanding notes. The exchange notes will be issued under and entitled to the benefits of the same indenture that authorized the issuance of the outstanding notes. For a description of the indenture, see Description of Exchange Notes .

The exchange offer is not conditioned upon any minimum aggregate principal amount of outstanding notes being tendered for exchange.

As of the date of this prospectus, $200 million aggregate principal amount of the 7¾% Senior Notes due 2018 issued on September 27, 2012 are outstanding. This prospectus and the letters of transmittal are being sent to all registered holders of outstanding notes. There will be no fixed record date for determining registered holders of outstanding notes entitled to participate in the exchange offer. Michaels intends to conduct the exchange offer in accordance with the provisions of the registration rights agreement, the applicable requirements of the Securities Act and the Exchange Act and the rules and regulations of the SEC. Outstanding notes that are not tendered for exchange in the exchange offer will remain outstanding and continue to accrue interest and will be entitled to the rights and benefits such holders have under the indenture relating to such holders series of outstanding notes and the registration rights agreement except we will not have any further obligation to you to provide for the registration of the outstanding notes under the registration rights agreement.

Michaels will be deemed to have accepted for exchange properly tendered outstanding notes when it has given oral or written notice of the acceptance to the exchange agent. The exchange agent will act as agent for the tendering holders for the purposes of receiving the exchange notes from us and delivering exchange notes to holders. Subject to the terms of the registration rights agreement, Michaels expressly reserves the right to amend or terminate the exchange offer and to refuse to accept the occurrence of any of the conditions specified below under Conditions to the Exchange Offer.

If you tender your outstanding notes in the exchange offer, you will not be required to pay brokerage commissions or fees or, subject to the instructions in the applicable letter of transmittal, transfer taxes with respect to the exchange of outstanding notes. We will pay all charges and expenses, other than certain applicable taxes described below in connection with the exchange offer. It is important that you read Fees and Expenses below for more details regarding fees and expenses incurred in the exchange offer.

Expiration Date; Extensions, Amendments

As used in this prospectus, the term expiration date means 5:00 p.m., New York City time, on January 15, 2013 (the 21st business day on which the exchange offer will be open). However, if we, in our sole discretion, extend the period of time for which the exchange offer is open, the term expiration date will mean the latest time and date to which we shall have extended the expiration of the exchange offer.

To extend the period of time during which the exchange offer is open, we will notify the exchange agent of any extension by oral or written notice, followed by notification by press release or other public announcement to the registered holders of the outstanding notes no later than 9:00 a.m., New York City time, on the next business day after the previously scheduled expiration date. Any such announcement will include the approximate number of securities deposited as of the date of extension.

Michaels reserves the right, in its sole discretion:

- to delay accepting for exchange any outstanding notes (if we amend or extend the exchange offer);
- to extend the exchange offer or to terminate the exchange offer if any of the conditions set forth below under Conditions to the Exchange Offer have not been satisfied, by giving oral or written notice of such delay, extension or termination to the exchange agent; and
- subject to the terms of the registration rights agreement, to amend the terms of the exchange offer in any manner.

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Any delay in acceptance, extension, termination or amendment will be followed as promptly as practicable by oral or written notice to the registered holders of the outstanding notes. If Michaels amends the exchange offer in a manner that we determine to constitute a material change, including the waiver of a material condition, it will promptly disclose the amendment in a manner reasonably calculated to inform the holders of outstanding notes of that amendment, and it will extend the offer period, if necessary, so that at least five business days remain in the offer following notice of the material change.

Conditions to the Exchange Offer

Despite any other term of the exchange offer, Michaels will not be required to accept for exchange, or to issue exchange notes in exchange for, any outstanding notes and it may terminate or amend the exchange offer as provided in this prospectus prior to the expiration date if in its reasonable judgment:

- the exchange offer or the making of any exchange by a holder violates any applicable law or interpretation of the SEC;
- any action or proceeding has been instituted or threatened in any court or by or before any governmental agency with respect to the exchange offer that, in our judgment, would be expected to materially impair our ability to proceed with the exchange offer, or a material adverse development shall have occurred in any existing action or proceeding with respect to the Issuer; or
- any government approvals, which we deem to be necessary for the consummation of the exchange offer, have not been obtained.

In addition, Michaels will not be obligated to accept for exchange the outstanding notes of any holder that has not made to us:

- the representations described under Purpose and Effect of the Exchange Offer, Procedures for Tendering Outstanding Notes and Plan of Distribution; or
- any other representations as may be reasonably necessary under applicable SEC rules, regulations, or interpretations to make available to us an appropriate form for registration of the exchange notes under the Securities Act.

Michaels expressly reserves the right at any time or at various times to extend the period of time during which the exchange offer is open. Consequently, Michaels may delay acceptance of any outstanding notes by giving oral or written notice of such extension to their holders. Michaels will return any outstanding notes that it does not accept for exchange for any reason without expense to their tendering holder promptly after the expiration or termination of the exchange offer.

Michaels expressly reserves the right to amend or terminate the exchange offer and to reject for exchange any outstanding notes not previously accepted for exchange, upon the occurrence of any of the conditions of the exchange offer specified above. Michaels will give oral or written notice of any extension, amendment, non-acceptance or termination to the holders of the outstanding notes as promptly as practicable. In the case of any extension, such notice will be issued no later than 9:00 a.m., New York City time, on the next business day after the previously scheduled expiration date.

These conditions are for our sole benefit and Michaels may assert them regardless of the circumstances that may give rise to them or waive them in whole or in part at any or at various times prior to the expiration date in our sole discretion. If Michaels fails at any time to exercise any of the foregoing rights, this failure will not constitute a waiver of such right. Each such right will be deemed an ongoing right that it may assert at any time or at various times prior to the expiration date.

In addition, Michaels will not accept for exchange any outstanding notes tendered, and will not issue exchange notes in exchange for any such outstanding notes, if at such time any stop order is threatened or in effect with respect to the registration statement of which this prospectus constitutes a part or the qualification of the indenture under the Trust Indenture Act of 1939, as amended (the TIA).

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Procedures for Tendering Outstanding Notes

To tender your outstanding notes in the exchange offer, you must comply with either of the following:

- complete, sign and date the letter of transmittal, or a facsimile of the letter of transmittal, have the signature(s) on the letter of transmittal guaranteed if required by the letter of transmittal and mail or deliver such letter of transmittal or facsimile thereof to the exchange agent at the address set forth below under Exchange Agent Notes prior to the expiration date; or

- comply with DTC s Automated Tender Offer Program procedures described below.

In addition, either:

- the exchange agent must receive certificates for outstanding notes along with the applicable letter of transmittal prior to the expiration date;

- the exchange agent must receive a timely confirmation of book-entry transfer of outstanding notes into the exchange agent s account at DTC according to the procedures for book-entry transfer described below or a properly transmitted agent s message prior to the expiration date; or

- you must comply with the guaranteed delivery procedures described below.

Your tender, if not withdrawn prior to the expiration date, constitutes an agreement between us and you upon the terms and subject to the conditions described in this prospectus and in the applicable letter of transmittal.

The method of delivery of outstanding notes, letters of transmittal, and all other required documents to the exchange agent is at your election and risk. We recommend that instead of delivery by mail, you use an overnight or hand delivery service, properly insured. In all cases, you should allow sufficient time to assure timely delivery to the exchange agent before the expiration date. You should not send letters of transmittal or certificates representing outstanding notes to us. You may request that your broker, dealer, commercial bank, trust company or nominee effect the above transactions for you.

If you are a beneficial owner whose outstanding notes are registered in the name of a broker, dealer, commercial bank, trust company, or other nominee and you wish to tender your outstanding notes, you should promptly contact the registered holder and instruct the registered holder to tender on your behalf. If you wish to tender the outstanding notes yourself, you must, prior to completing and executing the applicable letter of transmittal and delivering your outstanding notes, either:

- make appropriate arrangements to register ownership of the outstanding notes in your name; or
- obtain a properly completed bond power from the registered holder of outstanding notes.

The transfer of registered ownership may take considerable time and may not be able to be completed prior to the expiration date.

Signatures on the applicable letter of transmittal or a notice of withdrawal, as the case may be, must be guaranteed by a member firm of a registered national securities exchange or of the National Association of Securities Dealers, Inc., a commercial bank or trust company having an office or correspondent in the United States or another eligible guarantor institution within the meaning of Rule 17A(d)-15 under the Exchange Act unless the outstanding notes surrendered for exchange are tendered:

- by a registered holder of the outstanding notes who has not completed the box entitled Special Registration Instructions or Special Delivery Instructions on the applicable letter of transmittal; or
- for the account of an eligible guarantor institution.

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If the applicable letter of transmittal is signed by a person other than the registered holder of any outstanding notes listed on the outstanding notes, such outstanding notes must be endorsed or accompanied by a properly completed bond power. The bond power must be signed by the registered holder as the registered holder s name appears on the outstanding notes and an eligible guarantor institution must guarantee the signature on the bond power.

If the applicable letter of transmittal or any certificates representing outstanding notes, or bond powers are signed by trustees, executors, administrators, guardians, attorneys-in-fact, officers of corporations, or others acting in a fiduciary or representative capacity, those persons should also indicate when signing and, unless waived by us, they should also submit evidence satisfactory to us of their authority to so act.

The exchange agent and DTC have confirmed that any financial institution that is a participant in DTC s system may use DTC s Automated Tender Offer Program to tender. Participants in the program may, instead of physically completing and signing the applicable letter of transmittal and delivering it to the exchange agent, electronically transmit their acceptance of the exchange by causing DTC to transfer the outstanding notes to the exchange agent in accordance with DTC s Automated Tender Offer Program procedures for transfer. DTC will then send an agent s message to the exchange agent. The term agent s message means a message transmitted by DTC, received by the exchange agent and forming part of the book-entry confirmation, which states that:

- DTC has received an express acknowledgment from a participant in its Automated Tender Offer Program that is tendering outstanding notes that are the subject of the book-entry confirmation;

- the participant has received and agrees to be bound by the terms of the applicable letter of transmittal, or in the case of an agent s message relating to guaranteed delivery, that such participant has received and agrees to be bound by the applicable notice of guaranteed delivery; and

- we may enforce that agreement against such participant.

DTC is referred to herein as a book-entry transfer facility.

Acceptance of Exchange Notes

In all cases, Michaels will promptly issue exchange notes for outstanding notes that it has accepted for exchange under the exchange offer only after the exchange agent timely receives:

- outstanding notes or a timely book-entry confirmation of such outstanding notes into the exchange agent s account at the book-entry transfer facility; and

- a properly completed and duly executed letter of transmittal and all other required documents or a properly transmitted agent s message.

By tendering outstanding notes pursuant to the exchange offer, you will represent to us that, among other things:

- you are not our affiliate or an affiliate of any guarantor within the meaning of Rule 405 under the Securities Act;
- if you are not a broker-dealer, you are not engaged in and do not intend to engage in a distribution of the exchange notes;
- you do not have an arrangement or understanding with any person or entity to participate in a distribution of the exchange notes; and
- you are acquiring the exchange notes in the ordinary course of your business.

In addition, each broker-dealer that is to receive exchange notes for its own account in exchange for outstanding notes must represent that such outstanding notes were acquired by that broker-dealer as a result of market-making activities or other trading activities and must acknowledge that it will deliver a prospectus that meets the requirements of the Securities Act in connection with any resale of the exchange notes. The letter of transmittal states that by so acknowledging and by delivering a prospectus, a broker-dealer will not be deemed to admit that it is an underwriter within the meaning of the Securities Act. See Plan of Distribution.

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Michaels will interpret the terms and conditions of the exchange offer, including the letter of transmittal and the instructions to the letter of transmittal, and will resolve all questions as to the validity, form, eligibility, including time of receipt, and acceptance of outstanding notes tendered for exchange. Our determinations in this regard will be final and binding on all parties. Michaels reserves the absolute right to reject any and all tenders of any particular outstanding notes not properly tendered or to not accept any particular outstanding notes if the acceptance might, in its or its counsel s judgment, be unlawful. We also reserve the absolute right to waive any defects or irregularities as to any particular outstanding notes prior to the expiration date.

Unless waived, any defects or irregularities in connection with tenders of outstanding notes for exchange must be cured within such reasonable period of time as we determine. Neither Michaels, the exchange agent, nor any other person will be under any duty to give notification of any defect or irregularity with respect to any tender of outstanding notes for exchange, nor will any of them incur any liability for any failure to give notification. Any outstanding notes received by the exchange agent that are not properly tendered and as to which the irregularities have not been cured or waived will be returned by the exchange agent to the tendering holder, unless otherwise provided in the applicable letter of transmittal, promptly after the expiration date.

Book-Entry Delivery Procedures

Promptly after the date of this prospectus, the exchange agent will establish an account with respect to the outstanding notes at DTC and, as the book-entry transfer facility, for purposes of the exchange offer. Any financial institution that is a participant in the book-entry transfer facility s system may make book-entry delivery of the outstanding notes by causing the book-entry transfer facility to transfer those outstanding notes into the exchange agent s account at the facility in accordance with the facility s procedures for such transfer. To be timely, book-entry delivery of outstanding notes requires receipt of a confirmation of a book-entry transfer, a book-entry confirmation, prior to the expiration date. In addition, although delivery of outstanding notes may be effected through book-entry transfer into the exchange agent s account at the book-entry transfer facility, the applicable letter of transmittal or a manually signed facsimile thereof, together with any required signature guarantees and any other required documents, or an agent s message, as defined below, in connection with a book-entry transfer, must, in any case, be delivered or transmitted to and received by the exchange agent at its address set forth on the cover page of the applicable letter of transmittal prior to the expiration date to receive exchange notes for tendered outstanding notes, or the guaranteed delivery procedure described below must be complied with. Tender will not be deemed made until such documents are received by the exchange agent. Delivery of documents to the book-entry transfer facility does not constitute delivery to the exchange agent.

Holders of outstanding notes who are unable to deliver confirmation of the book-entry tender of their outstanding notes into the exchange agent s account at the book-entry transfer facility or all other documents required by the applicable letter of transmittal to the exchange agent on or prior to the expiration date must tender their outstanding notes according to the guaranteed delivery procedures described below.

Guaranteed Delivery Procedures

If you wish to tender your outstanding notes but your outstanding notes are not immediately available or you cannot deliver your outstanding notes, the applicable letter of transmittal or any other required documents to the exchange agent or comply with the procedures under DTC s Automatic Tender Offer Program in the case of outstanding notes, prior to the expiration date, you may still tender if:

- the tender is made through an eligible guarantor institution;

- prior to the expiration date, the exchange agent receives from such eligible guarantor institution either a properly completed and duly executed notice of guaranteed delivery, by facsimile transmission, mail, or hand delivery or a properly transmitted agent s message and notice of guaranteed delivery, that (1) sets forth your name and address, the certificate number(s) of such outstanding notes and the principal amount of outstanding notes tendered; (2) states that the tender is being made thereby; and (3) guarantees that, within three New York Stock Exchange trading days after the expiration date, the letter of transmittal, or facsimile thereof, together with the outstanding notes or a book-entry confirmation, and any other documents required by the letter of transmittal, will be deposited by the eligible guarantor institution with the exchange agent; and

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- the exchange agent receives the properly completed and executed letter of transmittal or facsimile thereof, as well as certificate(s) representing all tendered outstanding notes in proper form for transfer or a book-entry confirmation of transfer of the outstanding notes into the exchange agent s account at DTC all other documents required by the letter of transmittal within three New York Stock Exchange trading days after the expiration date.

Upon request, the exchange agent will send to you a notice of guaranteed delivery if you wish to tender your outstanding notes according to the guaranteed delivery procedures.

Withdrawal Rights

Except as otherwise provided in this prospectus, you may withdraw your tender of outstanding notes at any time prior to 5:00 p.m., New York City time, on the expiration date.

For a withdrawal to be effective:

- the exchange agent must receive a written notice, which may be by telegram, telex, facsimile or letter, of withdrawal at its address set forth below under Exchange Agent ; or

- you must comply with the appropriate procedures of DTC s Automated Tender Offer Program system.

Any notice of withdrawal must:

- specify the name of the person who tendered the outstanding notes to be withdrawn;

- identify the outstanding notes to be withdrawn, including the certificate numbers and principal amount of the outstanding notes; and

- where certificates for outstanding notes have been transmitted, specify the name in which such outstanding notes were registered, if different from that of the withdrawing holder.

If certificates for outstanding notes have been delivered or otherwise identified to the exchange agent, then, prior to the release of such certificates, you must also submit:

- the serial numbers of the particular certificates to be withdrawn; and
- a signed notice of withdrawal with signatures guaranteed by an eligible institution unless you are an eligible guarantor institution.

If outstanding notes have been tendered pursuant to the procedures for book-entry transfer described above, any notice of withdrawal must specify the name and number of the account at the book-entry transfer facility to be credited with the withdrawn outstanding notes and otherwise comply with the procedures of the facility. We will determine all questions as to the validity, form, and eligibility, including time of receipt of notices of withdrawal and our determination will be final and binding on all parties. Any outstanding notes so withdrawn will be deemed not to have been validly tendered for exchange for purposes of the exchange offer. Any outstanding notes that have been tendered for exchange but that are not exchanged for any reason will be returned to their holder, without cost to the holder, or, in the case of book-entry transfer, the outstanding notes will be credited to an account at the book-entry transfer facility, promptly after withdrawal, rejection of tender or termination of the exchange offer. Properly withdrawn outstanding notes may be retendered by following the procedures described under Procedures for Tendering Outstanding Notes above at any time on or prior to the expiration date.

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Exchange Agent

Law Debenture Trust Company of New York has been appointed as the exchange agent for the exchange offer. Law Debenture Trust Company of New York also acts as trustee under the indenture governing the senior notes. You should direct all executed letters of transmittal and all questions and requests for assistance, requests for additional copies of this prospectus or of the letters of transmittal, and requests for notices of guaranteed delivery to the exchange agent addressed as follows:

By Registered & Certified Mail:	*By Regular Mail or Overnight Courier:*	*In Person by Hand Only:*	*By Facsimile (for Eligible Institutions only):*
Law Debenture Trust Company of New York 400 Madison Ave. 4th Floor New York, New York 10017 ATTN: Michaels Stores Exchange Offer	Law Debenture Trust Company of New York 400 Madison Ave. 4th Floor New York, New York 10017 ATTN: Michaels Stores Exchange Offer	Law Debenture Trust Company of New York 400 Madison Ave. 4th Floor New York, New York 10017 ATTN: Michaels Stores Exchange Offer	(212) 750-1361 *For Confirmation by Telephone:* (212) 750 6474

If you deliver the letter of transmittal to an address other than the one set forth above or transmit instructions via facsimile other than the one set forth above, that delivery or those instructions will not be effective.

Fees and Expenses

The registration rights agreement provides that we will bear all expenses in connection with the performance of our obligations relating to the registration of the exchange notes and the conduct of the exchange offer. These expenses include registration and filing fees, accounting and legal fees and printing costs, among others. We will pay the exchange agent reasonable and customary fees for its services and reasonable out-of-pocket expenses. We will also reimburse brokerage houses and other custodians, nominees and fiduciaries for customary mailing and handling expenses incurred by them in forwarding this prospectus and related documents to their clients that are holders of outstanding notes and for handling or tendering for such clients.

We have not retained any dealer-manager in connection with the exchange offer and will not pay any fee or commission to any broker, dealer, nominee or other person, other than the exchange agent, for soliciting tenders of outstanding notes pursuant to the exchange offer.

Accounting Treatment

We will record the exchange notes in our accounting records at the same carrying value as the outstanding notes, which is the aggregate principal amount as reflected in our accounting records on the date of exchange. Accordingly, we will not recognize any gain or loss for accounting purposes upon the consummation of the exchange offer. We will record the expenses of the exchange offer as deferred debt issuance costs and amortize over the life of the notes.

Transfer Taxes

We will generally pay all transfer taxes, if any, applicable to the exchanges of outstanding notes under the exchange offer. The tendering holder, however, will be required to pay any transfer taxes, whether imposed on the registered holder or any other person, if:

- certificates representing outstanding notes for principal amounts not tendered or accepted for exchange are to be delivered to, or are to be issued in the name of, any person other than the registered holder of outstanding notes tendered;

- tendered outstanding notes are registered in the name of any person other than the person signing the letter of transmittal; or

- a transfer tax is imposed for any reason other than the exchange of outstanding notes under the exchange offer.

If satisfactory evidence of payment of such taxes is not submitted with the letter of transmittal, the amount of such transfer taxes will be billed to that tendering holder.

Consequences of Failure to Exchange

If you do not exchange your outstanding notes for exchange notes under the exchange offer, your outstanding notes will remain subject to the restrictions on transfer of such outstanding notes:

- as set forth in the legend printed on the outstanding notes as a consequence of the issuance of the outstanding notes pursuant to the exemptions from, or in transactions not subject to, the registration requirements of the Securities Act and applicable state securities laws; and

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- as otherwise set forth in the offering memorandum distributed in connection with the private offering of the outstanding notes.

In general, you may not offer or sell your outstanding notes unless they are registered under the Securities Act or if the offer or sale is exempt from registration under the Securities Act and applicable state securities laws. Except as required by the registration rights agreement, we do not intend to register resales of the outstanding notes under the Securities Act.

After completion of this exchange offer, we will have no further obligation to provide for the registration under the Securities Act of the outstanding notes except in the limited circumstances when we are required to use our reasonable best efforts to cause the SEC to declare effective a shelf registration statement, as described under Purpose and Effect of the Exchange Offer above.

Other

Participating in the exchange offer is voluntary, and you should carefully consider whether to accept. You are urged to consult your financial and tax advisors in making your own decision on what action to take.

We may in the future seek to acquire untendered outstanding notes in open market or privately negotiated transactions, through subsequent exchange offers or otherwise. We have no present plans to acquire any outstanding notes that are not tendered in the exchange offer or to file a registration statement to permit resales of any untendered outstanding notes.

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USE OF PROCEEDS

The outstanding notes were issued and sold on September 27, 2012. The net proceeds from the offering of the outstanding notes were used to repay a portion of the indebtedness outstanding under the B-1 Term Loans under our Senior Secured Term Loan Facility and to pay related fees and expenses.

The exchange offer is intended to satisfy our obligations under the registration rights agreement, dated as of September 27, 2012, by and among us, the subsidiary guarantors party thereto and the initial purchasers of the outstanding notes. We will not receive any proceeds from the issuance of the exchange notes in the exchange offer. Instead, we will receive in exchange outstanding notes in like principal amount. We will retire or cancel all of the outstanding notes tendered in the exchange offer.

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CAPITALIZATION

The following table sets forth our capitalization as of October 27, 2012. The exchange offer will not affect our capitalization on a pro forma basis. The information should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations, Use of Proceeds and our consolidated financial statements and related notes included elsewhere in this registration statement.

(In millions)		As of October 27, 2012 (Dollars in millions)
Cash and equivalents	$	161
Debt		
Senior Secured Term Loan Facility	$	1,787
Restated Revolving Credit Facility (1)		
Senior Notes due 2018		1,008
Senior Subordinated Notes due 2016		393
Subordinated Discount Notes due 2016 (1)		180
Total debt		3,368
Stockholders deficit:		
Common Stock, $0.10 par value, 220,000,000 shares authorized; 118,414,727 shares issued and outstanding at October 27, 2012		12
Additional paid-in capital		49
Accumulated deficit		(2,438)
Accumulated other comprehensive income		6
Total stockholders deficit		(2,371)
Total capitalization	$	997

(1) On November 1, 2012, we borrowed $216 million under the Restated Revolving Credit Facility to fund the redemption of our outstanding Subordinated Discount Notes and other working capital needs. All of the outstanding Subordinated Discount Notes were redeemed effective as of such date.

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SELECTED FINANCIAL DATA

The following table sets forth our selected consolidated financial and operating data as of the dates and for the periods indicated. Our selected consolidated balance sheet data as of January 28, 2012 and January 29, 2011, and our consolidated results of operations data and cash flow data for each of the three years ended January 28, 2012, January 29, 2011 and January 30, 2010, respectively, have been derived from our audited Consolidated Financial Statements, which are included elsewhere in this prospectus. The consolidated results of operations data and cash flow data for each of the years ended January 31, 2009 and February 2, 2008 and the consolidated balance sheet data as of January 30, 2010, January 31, 2009, and February 2, 2008 have been derived from our historical unaudited financial statements for such years, which are not included in this prospectus. These financial statements are unaudited because certain amounts have been restated, as further discussed in Management s Discussion and Analysis of Financial Condition and Results of Operations Restatement Accounting for Income Taxes. Other Operating data included in the following table is unaudited for all periods presented. The summary historical statement of operations, statement of cash flow and balance sheet data presented as of and for the nine months ended October 27, 2012 and October 29, 2011 are derived from our Unaudited Consolidated Financial statements appearing elsewhere in this prospectus. The results of operations for any period are not necessarily indicative of the results to be expected for any future period.

We operate on a fiscal calendar, which in a given fiscal year consists of a 52- or 53-week period ending on the Saturday closest to January 31st. Fiscal 2012 is the 53-week period ending February 2, 2013. Fiscal 2011 ended on January 28, 2012, fiscal 2010 ended on January 29, 2011, fiscal 2009 ended on January 30, 2010, fiscal 2008 ended on January 31, 2009, and fiscal 2007 ended on February 2, 2008. Each of these fiscal years contained 52 weeks. References to the third quarter of fiscal 2012 relate to the 13 weeks ended October 27, 2012, and references to the third quarter of fiscal 2011 relate to the 13 weeks ended October 29, 2011. References to the nine months ended October 27, 2012 relate to the 39 weeks ended October 27, 2012, and the nine months ended October 29, 2011 relate to the 39 weeks ended October 29, 2011.

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The historical results presented below are not necessarily indicative of the results to be expected for any future period. The following summaries of our consolidated financial and operating data for the periods presented should be read in conjunction with Risk Factors , Capitalization , Management s Discussion and Analysis of Financial Condition and Results of Operations and our Consolidated Financial Statements and the related notes, which are included elsewhere in this prospectus.

	Fiscal Year					Nine Months Ended	
(In millions, except operating and store count data)	2011	2010 (Restated)	2009 (Restated)	2008 (Restated)	2007 (Restated)	October 27, 2012	October 29, 2011
Results of Operations Data:							
Net sales	$ 4,210	$ 4,031	$ 3,888	$ 3,817	$ 3,862	2,884	2,806
Operating income	569	488	397	304	354	349	335
Interest expense	254	276	257	302	378	187	188
Loss on early extinguishment of debt(1)	18	53				3	16
Income (loss) before discontinued operations	176	103	103	(7)	(19)	102	79
Discontinued operations loss, net of income tax					(10)		
Net income (loss)	176	103	103	(7)	(29)	102	79
Comprehensive income (loss)	175	104	104	(12)	(26)	102	79
Balance Sheet Data:							
Cash and equivalents	$ 371	$ 319	$ 217	$ 33	$ 29	161	111
Merchandise inventories	840	826	873	900	845	1,076	1,019
Total current assets	1,334	1,271	1,199	1,047	982	1,387	1,274
Total assets	1,822	1,780	1,722	1,639	1,634	1,901	1,780
Total current liabilities	837	685	719	683	683	987	893
Current debt	127	1	119	173	122	180	135
Long-term debt	3,363	3,667	3,684	3,756	3,741	3,188	3,376
Total liabilities	4,296	4,434	4,488	4,517	4,515	4,272	4,352
Stockholders deficit	(2,474)	(2,654)	(2,766)	(2,878)	(2,881)	(2,371)	(2,572)
Cash Flow Data:							
Cash flows provided by operating activities	$ 413	$ 438	$ 405	$ 59	$ 268	16	99
Cash flows used in investing activities	(109)	(83)	(43)	(85)	(100)	(85)	(84)
Cash flow (used in) provided by financing activities	(252)	(253)	(178)	30	(169)	(141)	(223)
Other Operating Data:							
Average net sales per selling square foot(2)	$ 212	$ 205	$ 201	$ 202	$ 213	214	212
Comparable store sales increase (decrease)(3)	3.2%	2.5%	0.2%	(4.6)%	(0.7)%	(0.2)%	1.4%
Total selling square footage (in millions)	20.1	19.9	19.6	19.4	18.6	20.6	20.1
Stores Open at End of Period:							
Michaels	1,064	1,045	1,023	1,009	963	1,099	1,063
Aaron Brothers	134	137	152	161	166	127	135
Total stores open at end of period	1,198	1,182	1,175	1,170	1,129	1,226	1,198

(1) Fiscal 2011 loss on early extinguishment of debt includes an $18 million loss related to the early extinguishment of $163 million face value, or $155 million accreted value, of our outstanding Subordinated Discount Notes and $7 million face value of our 113/8% Senior Subordinated Notes due 2016. Fiscal 2010 loss on early extinguishment of debt includes a $53 million loss related to the early extinguishment of our 10% Senior Notes due November 1, 2014 (the 2014 Senior Notes). Loss on early extinguishment of debt for the nine months ended October 27, 2012 includes a $2 million loss for the write-off of debt issuance costs related to our Restated Revolving Credit Facility and a $1 million loss for the write-off of debt issuance costs associated with the partial prepayment of our B-1 Term Loans. Loss on early extinguishment of debt for the nine months ended October 29, 2011 includes a $16 million loss related to the early extinguishment of $142 million face value, or $134 million accreted value, of our then outstanding Subordinated Discount Notes.

(2) The calculation of average net sales per selling square foot includes only Michaels comparable stores, as defined below. Aaron Brothers, which is a smaller store model, is excluded from the calculation. Average net sales per selling square foot has been annualized for the nine months ended October 27, 2012 and October 29, 2011.

(3) Comparable store sales increase (decrease) represents the increase (decrease) in net sales for stores open the same number of months in the indicated and comparable period of the previous year, including stores that were relocated or expanded during either period. A store is deemed to become comparable in its 14th month of operation in order to eliminate grand opening sales distortions. A store temporarily closed more than two weeks is not considered comparable during the month it is closed. If a store is closed longer than two weeks but less than two months, it becomes comparable in the month in which it reopens, subject to a mid-month convention. A store closed longer than two months becomes comparable in its 14th month of operation after its reopening.

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RATIO OF EARNINGS TO FIXED CHARGES

The following table sets forth our ratio of earnings to fixed charges for each of the periods shown.

	Nine Months Ended		Fiscal Year Ended				
	October 27, 2012	October 29, 2011	Jan. 28, 2012	Jan. 29, 2011	Jan. 30, 2010	Jan. 31, 2009	Feb. 2, 2008
Ratio of Earnings to Fixed Charges	1.6x	1.5x	1.8x	1.4x	1.4x		

These ratios are computed by dividing the total earnings by the total fixed charges. Earnings are defined as income (loss) before income taxes and discontinued operations, plus fixed charges. Fixed charges are defined as total interest expense plus an estimate of the interest component within rent expense. For the fiscal years ended January 31, 2009 and February 2, 2008, earnings were insufficient to cover fixed charges by $2 million and $17 million, respectively.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion of our financial condition and results of operations with Selected Historical Consolidated Financial and Operating Data and the historical Consolidated Financial Statements and related notes included elsewhere in this prospectus. This discussion contains forward-looking statements about our plans, estimates and beliefs. We based these statements on assumptions that we consider reasonable. Actual results may differ materially from those suggested by our forward-looking statements for various reasons including those discussed under the headings Risk Factors and Forward-Looking Statements elsewhere in this prospectus. Those sections expressly qualify all subsequent oral and written forward-looking statements attributable to us or persons acting on our behalf. We do not have any intention or obligation to update forward-looking statements included in this prospectus.

We report on the basis of a 52- or 53-week fiscal year, which ends on the Saturday closest to January 31. References to fiscal year mean the year in which that fiscal year began. All references to fiscal 2012 relate to the 53-week period ending February 2, 2013. Fiscal 2011 ended on January 28, 2012, fiscal 2010 ended on January 29, 2011 and fiscal 2009 ended on January 30, 2010. Each of these three fiscal years contained 52 weeks. References to the third quarter of fiscal 2012 relate to the 13 weeks ended October 27, 2012, and references to the third quarter of fiscal 2011 relate to the 13 weeks ended October 29, 2011. References to the nine months ended October 27, 2012 relate to the 39 weeks ended October 27, 2012, and the nine months ended October 29, 2011 relate to the 39 weeks ended October 29, 2011.

How We Assess the Performance of our Business

In assessing our performance, we consider a variety of performance and financial measures. The key measures we assess to evaluate the performance of our business are set forth below:

Net Sales Our Net sales are comprised of gross sales, net of merchandise returns, coupons and discounts.

Comparable Store Sales A store is included in comparable store sales in its 14th month of operation, which is when we believe comparability is achieved. When a store that is included in comparable store sales is relocated or remodeled, we continue to consider sales from that store to be comparable store sales at the time of opening. 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 mid-month convention. A store closed longer than two months becomes comparable in its 14th month of operation after its reopening. There may be variations in the way that our competitors calculate comparable or same store sales. As a result, data in this prospectus regarding our comparable store sales may not be comparable to similar data made available by other retailers.

Various factors may affect comparable store sales, including:

- the number of customer transactions
- changes in our merchandise mix
- changes in product pricing including promotional activities
- the level of customer service that we provide in our stores
- our store events
- our ability to source and receive products accurately and efficiently
- our opening of new stores in the vicinity of our existing stores
- the number of stores we open, remodel or relocate in any period
- consumer preferences and buying trends
- our competitors   opening or closing stores near our stores

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- overall economic trends and conditions

As we continue to pursue our growth strategy, we expect a portion of our Net sales will continue to come from new stores not included in comparable store sales. Accordingly, comparable store sales is only one measure we use to assess our performance.

Gross Profit Gross profit is equal to our Net sales less our Cost of sales and occupancy expense. Gross margin measures gross profit as a percentage of Net sales.

The following Cost of sales is included in merchandise inventories and expensed as the merchandise is sold:

- purchase price of merchandise, net of shrink, damages, vendor allowances and rebates
- inbound freight, inspection costs, duties and import agent commissions
- warehousing, handling and transportation costs (including internal transfer costs and related systems such as distribution center-to-store freight costs) and purchasing and receiving costs
- internal costs of sourcing and design (including technology)
- share-based compensation costs for those employees involved in preparing inventory for sale

Included in our occupancy expense is the following:

- store expenses such as rent, insurance, taxes, common area maintenance, utilities, repairs and maintenance
- amortization of store buildings and leasehold improvements

- store closure costs

- store remodel costs

We record rent expense ratably over the term of the lease beginning with the date we take possession of or control the physical access to the premises. We record leasehold improvement reimbursements as a liability and ratably adjust the liability as a reduction to rent expense over the lease term beginning with either the date we take possession, or control of, the physical access to the premises.

The components of our Cost of sales and occupancy expense may not be comparable to our competitors. As a result, data in this prospectus regarding our gross profit and gross margin may not be comparable to similar data made available by our competitors.

Selling, General and Administrative Expense Included in our Selling, general, and administrative costs are store personnel costs (including share-based compensation), store operating expenses, advertising expenses, store depreciation expense and corporate overhead costs.

Operating Income Operating income consists of Gross profit less Selling, general and administrative expense, Related party expenses and Store pre-opening costs.

Executive Overview

We believe Michaels is where creativity happens. With over $4.2 billion in sales, we are the largest arts and crafts specialty retailer in North America. Our primary business is the operation of 1,099 Michaels stores across the U.S. and Canada. We also operate 127 Aaron Brothers stores, a custom frame, framing, and art supply chain (all store counts are as of October 27, 2012).

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Highlights for fiscal 2011 include the following:

• sales increased to $4,210 million, a 4.4% improvement over last year, driven by a 3.2% increase in comparable store sales as well as the opening of 25 new stores. Our new store growth included one urban market format store as well as four small market format stores. In addition, we completed 15 store relocations during the year

• our private brand merchandise represented 44% of total Net sales, up from 32% in fiscal 2010

• direct imports, as a percent of total receipts, increased to 26% compared to 23% in fiscal 2010

• gross margin improved by 120 basis points to 40.0% for fiscal 2011

• we reported record Operating income of $569 million, an increase of 16.6% from prior year

• net cash provided by operating activities decreased $25 million, or 5.7%, and Net income increased by $73 million to $176 million. Adjusted EBITDA, a non-GAAP measure that is a required calculation in our debt agreements, improved by 13.5%, from $622 million in fiscal 2010 to $706 million fiscal 2011 (see Non-GAAP Measures below)

• we reduced our outstanding indebtedness by $178 million, including open market repurchases of our 13% Subordinated Discount Notes due November 1, 2016, totaling $163 million face value, or $155 million accreted value, and $7 million of outstanding 113/8% Senior Subordinated Notes due November 1, 2016

• we amended our Senior Secured Term Loan Facility to extend $619 million of term loans, due to mature on October 31, 2013, to now mature on July 31, 2016. We also prepaid $50 million on our Senior Secured Term Loan Facility

• we launched two new multi-channel business offerings: BuyTheBunch, our customer special order program, which provides our U.S. stores a systematic way to fulfill large quantity and special orders; and MiDesign@Michaels, an e-commerce complement to our stores, which allows customers to design digital scrapbooks, custom invitations and other custom accessories online

- we continued to build our relationship with our customers through our marketing vehicles, Internet site, mobile platform, store experience and social media outlets

Highlights through October 27, 2012 include the following:

- sales for the first nine months of fiscal 2012 increased to $2,884 million, a 2.8% improvement over last year, driven by a 1.4% increase in comparable store sales as well as operating 36 additional Michaels stores

- issued an irrevocable redemption notice on all of our remaining outstanding Subordinated Discount Notes for settlement on November 1, 2012

- amended and restated our senior secured asset-based Revolving Credit Facility on September 17, 2012

- opened 49 new stores, including 13 relocations

- completed of our trilingual packaging initiative culminating with September openings of seven new stores in Québec

- deepened our customer relationship through store experiences and multi- channel marketing, including sponsoring the television series, Craft Wars

In the remainder of fiscal 2012, we will continue to lead industry growth and innovation through strategic initiatives such as:

- offering inspirational new products through frequent merchandise resets

- capitalizing on customization and new business channels

- growing private brand penetration

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- continuing to improve pricing and promotional strategies

- continuously improving processes to achieve cost savings and cash flow increases

Restatement Accounting for Income Taxes

During fiscal 2009, we recorded a $5 million adjustment to a state deferred tax liability pool. In fiscal 2010, we identified that the 2009 adjustment was made in error, and we reversed the adjustment and disclosed the correction in our Consolidated Financial Statements. As result of this adjustment, the Provision for income taxes in the Consolidated Statements of Operations was understated in fiscal 2009 and overstated in fiscal 2010 by $5 million, which we concluded was not material to the Consolidated Financial Statements.

In response to this error, we performed a detailed re-examination of our deferred income tax pools. The re-examination of the deferred pool for property and equipment was completed during the fourth quarter of fiscal 2011. In connection with these procedures, we performed detailed reconciliations of the deferred tax pool for property and equipment for each of the last five years and identified errors in the manner in which we were tracking deferred taxes for property and equipment and the underlying differences between book and tax basis. Consequently, we concluded that the ending deferred tax liability for property and equipment was overstated by $8 million in each period since at least February 3, 2007 through January 29, 2011. We also identified an error in the calculation of our deferred taxes related to foreign currency translation for fiscal 2007, fiscal 2008, and fiscal 2009 which we are correcting as part of this restatement. We have corrected these errors by restating our Consolidated Financial Statements for each respective period. Our restatement also includes the correction of the $5 million state deferred tax liability error identified in fiscal 2010, the effects of which were previously considered immaterial to each respective period. The effect of the restatement had no impact on reported net cash flows or income before taxes in any periods. We have also recorded reclassifications to properly adjust the noncurrent portion of our deferred taxes from current Deferred tax assets to noncurrent Deferred tax assets.

The tables below provide a reconciliation of certain line items affected within our Consolidated Statements of Operations, Consolidated Balance Sheets, and Consolidated Statements of Cash Flows for fiscal 2007 through fiscal 2010, from amounts previously reported to the restated amounts:

	Statement of Operations Fiscal 2010		
(In millions)	**As Reported**	**State Deferred Tax Adjustment**	**As Restated**
Provision for income taxes	$ 51	$ (5)	$ 46
Net income	98	5	103

	Statement of Operations Fiscal 2009			
(In millions)	**As Reported**	**State Deferred Tax Adjustment**	**Currency Translation Deferred Tax Adjustment**	**As Restated**
Provision for income taxes	$ 50	$ 5	(1)	$ 54

Net income	107	(5)	1	103

(In millions)	As Reported	Statement of Operations Fiscal 2008 Currency Translation Deferred Tax Adjustment	As Restated
Provision for income taxes	$ 3	$ 2	$ 5
Net loss	(5)	(2)	(7)

(In millions)	As Reported	Statement of Operations Fiscal 2007 Currency Translation Deferred Tax Adjustment	As Restated
Provision for income taxes	$ 5	$ (3)	$ 2
Loss before discontinued operations	(22)	3	(19)
Net loss	(32)	3	(29)

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Balance Sheet
For the year ended January 29, 2011

(In millions)	As Reported	Fixed Asset Deferred Tax Adjustment	Currency Translation Deferred Tax Adjustment	Reclassification Adjustments	As Restated
Deferred income taxes asset (current)	$ 56	$	$ 4	$ (8)	$ 52
Total current assets	1,275		4	(8)	1,271
Deferred income taxes asset (noncurrent)	18	8	(2)	8	32
Total assets	1,770	8	2		1,780
Accumulated deficit	(2,726)	8	2		(2,716)
Total stockholders deficit	(2,664)	8	2		(2,654)

Balance Sheet
For the year ended January 30, 2010
(In millions)

	As Reported	Fixed Asset Deferred Tax Adjustment	State Deferred Tax Adjustment	Currency Translation Deferred Tax Adjustment	Reclassification Adjustments	As Restated
Deferred income taxes asset (current)	$ 45	$	$ (5)	3	$ (6)	$ 37
Total current assets	1,207		(5)	3	(6)	1,199
Deferred income taxes asset (noncurrent)	1	8			12	21
Total assets	1,710	8	(5)	3	6	1,722
Deferred income taxes liability (current)					2	2
Total current liabilities	717				2	719
Deferred income taxes liability (noncurrent)				1	4	5
Total liabilities	4,481			1	6	4,488
Accumulated deficit	(2,824)	8	(5)	2		(2,819)
Total stockholders deficit	(2,771)	8	(5)	2		(2,766)

Balance Sheet
For the year ended January 31, 2009
(In millions)

	As Reported	Fixed Asset Deferred Tax Adjustment	Currency Translation Deferred Tax Adjustment	Reclassification Adjustments	As Restated
Deferred income taxes asset (current)	$ 41	$	$ 1	$ (3)	$ 39
Total current assets	1,049		1	(3)	1,047
Deferred income taxes asset (noncurrent)	12	8		8	28
Total assets	1,625	8	1	5	1,639
Deferred income taxes liability (current)			0	2	2
Total current liabilities	681			2	683
Deferred income taxes liability (noncurrent)				3	3
Total liabilities	4,512			5	4,517
Accumulated deficit	(2,931)	8	1		(2,922)
Total stockholders deficit	(2,887)	8	1		(2,878)

Balance Sheet
For the year ended February 2, 2008
(In millions)

	As Reported	Fixed Asset Deferred Tax Adjustment	Currency Translation Deferred Tax Adjustment	Reclassification Adjustments	As Restated
Deferred income taxes asset (current)	$ 31	$	$ 2	$	$ 33
Total current assets	980		2		982
Deferred income taxes asset (noncurrent)		8		10	18
Total assets	1,614	8	2	10	1,634
Deferred income taxes liability (current)				4	4
Total current liabilities	679			4	683
Deferred income taxes liability (noncurrent)	4		(1)	6	9
Total liabilities	4,506		(1)	10	4,515
Accumulated deficit	(2,926)	8	3		(2,915)
Total stockholders deficit	(2,892)	8	3		(2,881)

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	Cash Flow Data Fiscal 2010 (In millions)		
	As Reported	Fixed Asset Deferred Tax Adjustment	As Restated
Operating Activities:			
Net income	$ 98	$ 5	$ 103
Deferred income taxes	(23)	(5)	(28)

	Cash Flow Data Fiscal 2009 (In millions)			
	As Reported	Fixed Asset Deferred Tax Adjustment	Currency Translation Deferred Tax Adjustment	As Restated
Operating Activities:				
Net income	$ 107	$ (5)	1	$ 103
Deferred income taxes	(4)	5	(1)	

	Cash Flow Data Fiscal 2008 (In millions)		
	As Reported	Currency Translation Deferred Tax Adjustment	As Reported
Operating Activities:			
Net loss	$ (5)	$ (2)	$ (7)
Deferred income taxes	(24)	2	(22)

	Cash Flow Data Fiscal 2007 (In millions)		
	As Reported	Currency Translation Deferred Tax Adjustment	As Reported
Operating Activities:			
Net loss	$ (32)	$ 3	$ (29)
Deferred income taxes	(19)	(3)	(22)

Critical Accounting Policies and Estimates

We have prepared our financial statements in conformity with U.S. generally accepted accounting principles, and these financial statements necessarily include some amounts that are based on our informed judgments and estimates. Our senior management has discussed the development and selection of these critical accounting estimates, and the disclosure in this section of this prospectus regarding them, with the Audit Committee of our Board. Our significant accounting policies are discussed in Note 1 to the Consolidated Financial Statements for the fiscal years ended January 28, 2012, January 29, 2011, and January 30, 2010. Our critical accounting policies represent those policies that are subject to judgments and uncertainties. As discussed below, our financial position and results of operations may be materially different when reported under different conditions or when using different assumptions in the application of these policies. In the event estimates or assumptions prove to be different from actual amounts, adjustments are made in subsequent periods to reflect more current information. Our critical accounting policies include:

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Merchandise Inventories Merchandise inventories are valued at the lower of cost or market, with cost determined using a weighted average method. Cost is calculated based upon the price paid for an item at the time it is received by us, and also includes the cost of warehousing, handling, purchasing, and importing the inventory, as well as inbound and outbound transportation, partially offset by vendor allowances. This net inventory cost is recognized through Cost of sales when the inventory is sold. It is impractical for us to assign specific allocated overhead costs and vendor allowances to individual units of inventory. As such, to match net inventory costs against the related revenues, we estimate the net inventory costs to be deferred and recognized each period as the inventory is sold.

Vendor allowances, which primarily represent volume rebates and cooperative advertising funds, are recorded as a reduction of the cost of the merchandise inventories and a subsequent reduction in Cost of sales when the inventory is sold. We generally earn vendor allowances as a percentage of certain merchandise purchases with no minimum purchase requirements. Typically, our vendor allowance programs extend for a period of 12 months. We recognized vendor allowances of $115 million, or 2.7% of Net sales, in fiscal 2011, $112 million, or 2.8% of Net sales, in fiscal 2010, and $133 million, or 3.4% of Net sales, in fiscal 2009. During the three fiscal years ended January 28, 2012, the number of vendors from which vendor allowances were received ranged from approximately 650 to 740. As a result of our increased direct import penetration, vendor allowances, as a percentage of sales, have been declining and we expect this trend to continue in future years.

We utilize perpetual inventory records to value inventory in our stores. Physical inventory counts are performed in a significant number of stores during each fiscal quarter by a third party inventory counting service. Substantially all stores open longer than one year are subject to at least one count each fiscal year. We adjust our perpetual records based on the results of the physical counts. We maintain a provision for estimated shrinkage based on the actual historical results of our physical inventories. We compare our estimates to the actual results of the physical inventory counts as they are taken and adjust the shrink estimates accordingly. A 10% change in our estimated shrinkage would have affected Net income by $1 million for fiscal 2011. We also evaluate our merchandise to ensure that the expected net realizable value of the merchandise held at the end of a fiscal period exceeds cost. In the event that the expected net realizable value is less than cost, we reduce the value of that inventory accordingly. A 10% change in our inventory valuation reserve would have affected Net income by $1 million for fiscal 2011.

Goodwill We review goodwill for impairment each year in the fourth quarter, or more frequently if required. Beginning in fiscal 2011, in conducting our impairment review, we elect to first perform a qualitative assessment to determine whether it is more likely than not (that is, a likelihood of more than 50 percent) the fair value of our reporting unit is less than its carrying value. Factors used in our qualitative assessment include, but are not limited to, macroeconomic conditions, industry and market conditions, cost factors, overall financial performance, company and reporting unit specific events, and the margin between the fair value and carrying value of each reporting unit in recent valuations.

If, after assessing the totality of events or circumstances such as those described above, we determine that it is more likely than not that the fair value of our reporting unit is greater than its carrying amount, no further action is required. If we determine that it is more likely than not that the fair value of our reporting unit is less than its carrying amount, we will compare each reporting unit s carrying value to its estimated fair value, determined through estimated discounted future cash flows and market-based methodologies. If the carrying value exceeds the estimated fair value, we determine the fair value of all assets and liabilities of the reporting unit, including the implied fair value of goodwill. If the carrying value of goodwill exceeds the implied fair value, we recognize an impairment charge equal to the difference.

Factors used in the valuation of goodwill include, but are not limited to, management s plans for future operations, recent operating results and discounted projected future cash flows. Material assumptions used in our impairment analysis include the weighted average cost of capital percentage, terminal growth rate and forecasted long-term sales growth. During fiscal 2011, fiscal 2010, and fiscal 2009, there was no impairment charge taken on our goodwill.

Impairment of Long-Lived Assets We evaluate long-lived assets, other than goodwill and assets with indefinite lives, for indicators of impairment whenever events or changes in circumstances indicate their carrying amounts may not be recoverable. Additionally, for store assets, we evaluate the performance of individual stores for indicators of impairment and underperforming stores are selected for further evaluation of the recoverability of the carrying amounts. The evaluation of long-lived assets is performed at the lowest level of identifiable cash flows, which is at the individual store level.

Our evaluation requires consideration of a number of factors including changes in consumer demographics and uncertain future events. Accordingly, our accounting estimates may change from period to period. These factors could cause management to conclude that impairment indicators exist and require that tests be performed, which could result in a determination that the value of long-lived assets is impaired, resulting in a writedown to fair value.

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Our initial indicator that store assets are considered to be recoverable is that the estimated undiscounted cash flows for the remaining lease term, assuming zero growth over current year store performance, exceed the carrying value of the assets. This evaluation is performed on stores open longer than 36 months (unless significant impairment indicators exist), as we consider a store to become mature after that time period. Any stores that do not meet the initial criteria are further evaluated taking into consideration the estimated undiscounted store-specific cash flows for the remaining lease term compared to the carrying value of the assets. To estimate store-specific future cash flows, management must make assumptions about key store variables, including sales, growth rate, gross margin, payroll and other controllable expenses. Furthermore, management considers other factors when evaluating stores for impairment, including the individual store s execution of its operating plan and other local market conditions.

An impairment is recognized once all the factors noted above are taken into consideration and it is determined that the carrying amount of the store s assets are not recoverable. The impairment is based on estimated fair value of the assets, excluding assets that can be redeployed. We recorded an impairment charge, net of tax, of less than $1 million in each of fiscal 2011 and fiscal 2010, and $2 million in fiscal 2009. In addition to recording impairment charges on certain stores based on the previously discussed criteria, we maintain a list of stores we consider at risk and monitor those stores closely. As of January 28, 2012, we had one store we considered at risk for impairment with a minimal carrying value of assets.

Reserve for Closed Facilities We maintain a reserve for future rental obligations, carrying costs, and other closing costs related to closed facilities, primarily closed and relocated stores. In accordance with Accounting Standards Codification (ASC) 420, *Exit or Disposal Cost Obligations*, we recognize exit costs for any store closures at the time the store is closed. Such costs are recorded within the Cost of sales and occupancy expense line item on our Consolidated Statements of Operations.

The cost of closing a store or facility is calculated as the lesser of the present value of future rental obligations remaining under the lease (less estimated sublease rental income) or the lease termination fee. The determination of the reserves is dependent on our ability to make reasonable estimates of costs to be incurred post-closure and of rental income to be received from subleases. In planning our store closures, we try to time our exits as close to the lease termination date as possible to minimize any remaining lease obligation. As of January 28, 2012 our reserve for closed facilities was $9 million. The reserves could differ materially if market conditions were to vary significantly from our assumptions.

Self-Insurance We have insurance coverage for losses in excess of self-insurance limits for medical liability, general liability and workers compensation claims. Health care reserves are based on actual claims experience and an estimate of claims incurred but not reported. Reserves for general liability and workers compensation are determined through the use of actuarial studies. Due to the significant judgments and estimates utilized for determining these reserves, they are subject to a high degree of variability. In the event our insurance carriers are unable to pay claims submitted to them, we would record a liability for such estimated payments we expect to incur. A 10% change in our self-insurance liability would have affected Net income by approximately $4 million for fiscal 2011.

Revenue Recognition Revenue from sales of our merchandise is recognized when the customer takes possession of the merchandise. Revenue is presented net of sales taxes collected. Sales related to custom framing are deferred until the order is picked up by the customer, which we estimate based on historical customer behavior. We deferred 13 days of custom framing revenue at the end of fiscal 2011, 2010 and 2009. A one day change in our custom frame deferral would have had a minimal impact on our fiscal 2011 Net income. As of January 28, 2012 and January 29, 2011, our deferred framing revenue was approximately $10 million.

We allow for merchandise to be returned under most circumstances and provide a reserve for estimated returns. We use historical customer return behavior to estimate our reserve requirements. As of January 28, 2012 and January 29, 2011, our sales returns reserve was approximately

$3 million.

We record a gift card liability on the date we issue the gift card to the customer. We record revenue and reduce the gift card liability as the customer redeems the gift card. The deferred revenue associated with outstanding gift cards increased $4 million from $26 million at January 29, 2011, to $30 million as of January 28, 2012. We escheat the value of unredeemed gift cards where required by law. Any remaining liabilities not subject to escheatment are evaluated to determine whether the likelihood of the gift card being redeemed is remote (gift card breakage). We recognize gift card breakage as revenue, by applying our estimate of the rate of gift card breakage over the period of estimated performance. Our estimates of the gift card breakage rate are applied to the estimated amount of gift cards that are expected to go unused and that are not subject to escheatment, and such estimates are based on customers historical redemption rates and patterns. We do not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions we use to recognize income related to unredeemed gift cards. However, if actual results are not consistent with our assumptions, we may record additional income or expense.

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Share-Based Compensation Expenses ASC 718, *Stock Compensation,* requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements, based on their grant date fair value, ratably recognized as an expense over the requisite service period. We estimate the fair value of stock option awards using a Black-Scholes option value model.

All grants of our stock options have an exercise price equal to or greater than the fair market value of our common stock on the date of grant. Because we were privately held in fiscal 2011 and there was no public market for our common stock, the fair value of our equity was estimated by a third party valuation firm and approved by our Board at the time option grants are awarded. In estimating the fair value of our common stock, the Board considers factors it believes are material to the valuation process including the Company s actual and projected financial results, the principal amount of the Company s indebtedness and formal valuations of the Company. In fiscal 2011 and fiscal 2010, valuations completed relied on projections of our future performance, estimates of our weighted average cost of capital, and metrics based on the performance of a peer group of similar companies, including valuation multiples and stock price volatility. However, due to the economic deterioration that occurred during fiscal 2008, the traditional approaches outlined above did not yield an answer that was considered to be representative of the fair value of the Company s equity. Accordingly, as of the end of fiscal 2009, the Company completed a valuation based on a Black-Scholes option model, which utilized the fair value of the Company s assets, the book value of the Company s debt, an estimated time to a liquidity event, the asset volatility of a peer group of companies and the risk free rate. In future valuations, we will consider traditional approaches and, to the extent necessary, the Black-Scholes option model for valuing our common stock.

From January 29, 2011 to January 28, 2012, the estimated fair value of common stock increased from $15.22 to $24.09 per share. The price per share increased over the period primarily due to the following factors: reduction in the amount of our outstanding debt, improved Adjusted EBITDA and revenue performance, improved market multiples of our peer companies, decline in our weighted average cost of capital, and greater clarity regarding the likelihood and timing of our initial public offering and the resulting liquidity of our common stock.

Other assumptions used in the option value models for estimating the fair value of stock option awards include expected volatility of our common stock share price, expected terms of the options, expected dividends, and forfeitures. The expected volatility rate is based on both historical volatility as well as implied volatilities from the exchange-traded options on the common stock of a peer group of companies. We utilize historical exercise and post-vesting employment behavior to estimate the expected terms of the options and do not use a dividend rate assumption. Our forfeitures assumption was estimated based on historical experience and anticipated events. The risk-free interest rate is based on the yields of U.S. Treasury instruments with approximately the same term as the expected life of the stock option award. We update our assumptions regularly based on historical trends and current market observations.

As of January 28, 2012, compensation cost not yet recognized related to nonvested awards totaled $13 million and is expected to be recognized over a weighted average period of 2.9 years. In the event of a Change in Control (as defined in the Stockholders Agreement), all nonvested awards will vest and the $13 million would be immediately recognized. A 10% change in the fair value of stock option awards granted in fiscal 2011 would have had an immaterial impact on our fiscal 2011 Net income and compensation cost not yet recognized.

Income Taxes We record income tax expense using the liability method for taxes and are subject to income tax in many jurisdictions, including the U.S., various states and localities, and Canada. A current tax liability or asset is recognized for the estimated taxes payable or refundable on the tax returns for the current year and a deferred tax liability or asset is recognized for the estimated future tax effects attributable to temporary differences and carryforwards. Deferred tax assets and liabilities are measured using enacted income tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of a change in tax rates is recognized as income or expense in the period that includes the enactment date. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets unless it is more likely than not that such assets will be realized. In evaluating our ability to realize our deferred tax asset, we considered the following sources of future taxable income:

- future reversals of existing taxable temporary differences

- future taxable income, exclusive of reversing temporary differences and carryforwards

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- taxable income in prior carryback years
- tax-planning strategies

Our evaluation regarding whether a valuation allowance is required or should be adjusted also considers, among other things, the nature, frequency, and severity of recent losses, forecasts of future profitability and the duration of statutory carryforward periods. Our forecasts of future profitability represents our best estimate of these future events. After conducting this assessment, the valuation allowance recorded against our deferred tax assets was $14 million and $15 million as of January 28, 2012 and January 29, 2011, respectively. If actual results differ from estimated results, or if we adjust these assumptions in the future, we may need to adjust our deferred tax assets or liabilities, which could impact our effective tax rate.

The amount of income taxes we pay is subject to ongoing audits in the taxing jurisdictions in which we operate. During these audits, the taxing authorities may challenge items on our tax returns. Because the tax matters challenged by tax authorities are typically complex, the ultimate outcome of these challenges is uncertain. We recognize tax benefits for uncertain positions only to the extent that we believe it is more likely than not that the tax position will be sustained. Our future results may include favorable or unfavorable adjustments to our unrecognized tax benefits due to closure of income tax audits, new regulatory or judicial pronouncements, or other relevant events. As a result, our effective tax rate may fluctuate significantly on a quarterly and annual basis.

Results of Operations

The following table sets forth the percentage relationship to Net sales of each line item of our unaudited consolidated statements of operations. This table should be read in conjunction with the following discussion and with our Consolidated Financial Statements, including the related notes, contained herein.

	Nine Months Ended	
	October 27, 2012	**October 29, 2011**
Net sales	100.0%	100.0%
Cost of sales and occupancy expense	60.0	60.0
Gross profit	40.0	40.0
Selling, general, and administrative expense	27.4	27.6
Related party expenses	0.3	0.4
Store pre-opening costs	0.2	0.1
Operating income	12.1	11.9
Interest expense	6.5	6.7
Loss on early extinguishment of debt	0.1	0.6
Other (income) and expense, net		0.1
Income before income taxes	5.5	4.5
Provision for income taxes	2.0	1.7
Net income	3.5%	2.8%

The following table sets forth the percentage relationship to Net sales of each line item of our Consolidated Statements of Operations. This table should be read in conjunction with the following discussion and with our consolidated financial statements, including the related notes, contained herein.

	Fiscal Year		
	2011	**2010**	**2009**
Net sales	100.0%	100.0%	100.0%
Cost of sales and occupancy expense	60.0	61.2	62.3
Gross profit	40.0	38.8	37.7
Selling, general, and administrative expense	26.1	26.3	27.1
Related party expenses	0.3	0.3	0.4
Store pre-opening costs	0.1	0.1	0.1
Operating income	13.5	12.1	10.1
Interest expense	6.0	6.8	6.6
Loss on early extinguishment of debt	0.4	1.3	
Other (income) and expense, net	0.2	0.2	(0.4)
Income before income taxes	6.9	3.8	3.9
Provision for income taxes	2.7	1.2	1.3
Net income	4.2%	2.6%	2.6%

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Nine Months Ended October 27, 2012 Compared to the Nine Months Ended October 29, 2011

Net Sales Net sales increased for the first nine months of fiscal 2012 by $78 million, or 2.8%, over the first nine months of fiscal 2011 due in part to a $38 million increase in comparable store sales. Comparable store sales increased 1.4% due to an increase in customer transactions. We experienced our strongest sales increase for the first nine months of fiscal 2012 in decorative art within our general and children s crafts department. In addition, sales from our non-comparable stores provided incremental revenue of $40 million.

Cost of Sales and Occupancy Expense Cost of sales and occupancy expense increased $47 million to $1,730 million for the first nine months of fiscal 2012 from $1,683 million for the first nine months of fiscal 2011 due primarily to a $19 million increase in merchandise costs associated with higher sales, an $8 million increase in freight and distribution costs, and $4 million of favorable shrink experience in the first nine months of fiscal 2011 compared to more normal levels in the first nine months of fiscal 2012. In addition, we had a $4 million increase from the recognition of vendor allowances compared to prior year and a $9 million increase from new store rent and related expenses.

Cost of sales and occupancy expense for the first nine months of fiscal 2012 was consistent with last year as a percentage of Net sales at 60.0%. Merchandise cost decreased 60 basis points driven by our direct import and private brand initiatives, as well as improved pricing and promotion management. This was partially offset by a 30 basis point increase in freight and distribution costs and a 20 basis point increase from the recognition of vendor allowances.

Selling, General, and Administrative Expense Selling, general and administrative expense was $790 million for the first nine months of fiscal 2012 compared to $774 million for the first nine months of fiscal 2011. Selling, general and administrative expense increased $16 million driven by $14 million of incremental store costs for operating 36 additional Michaels stores. In addition, we had a $6 million increase in store payroll from a higher average hourly wage rate and a $3 million increase in group insurance claims. Finally, workers compensation expense increased $2 million due to favorable claims experience in the third quarter of fiscal 2011 and payroll tax increased $2 million from an increase in unemployment insurance rates compared to last year. These amounts were partially offset by a $12 million decrease in bonus expense due to a lower anticipated payout recognized during the first nine months of fiscal 2012 compared to the first nine months of fiscal 2011.

As a percentage of Net sales, Selling, general and administrative expense decreased 20 basis points due to a 50 basis point decrease in bonus expense from the lower anticipated payout recognized during the first nine months of fiscal 2012 compared to the first nine months of fiscal 2011, partially offset by a 20 basis point increase in store payroll as discussed above.

Related Party Expenses Related party expenses were $10 million for the first nine months of each of fiscal 2012 and fiscal 2011, consisting of management fees and associated expenses paid to our Sponsors and Highfields Capital Management, LP.

Interest Expense Interest expense decreased $1 million for the first nine months of fiscal 2012 compared to the first nine months of 2011 due to a $143 million reduction in our total debt outstanding, partially offset by a higher average interest rate associated with our amended Senior Secured Term Loan Facility.

Loss on Early Extinguishment of Debt During the first nine months of fiscal 2012, we recorded a loss on the early extinguishment of debt of $3 million, consisting of $2 million to write off debt issuance costs related to our Restated Revolving Credit Facilty and $1 million to write off debt issuance costs associated with the partial prepayment of our B-1 Term Loans. See Note 2 to the consolidated financial statements for further discussion. During the first nine months of fiscal 2011, we recorded a loss of $16 million related to the early extinguishment of $142 million face value, or $134 million accreted value, of our 13% Subordinated Discount Notes. The $16 million loss is comprised of $10 million to recognize the unrealized interest accretion and write off of related debt issuance costs, as well as $6 million of purchase premiums.

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Other (Income) and Expense, net Other income for the first nine months of fiscal 2012 is related to foreign exchange transaction gains. Other expense for the first nine months of fiscal 2011 is related to a $4 million unfavorable change in the fair value of our interest rate cap.

Provision for Income Taxes The effective tax rate was 36.3% for the first nine months of fiscal 2012. The effective tax rate was 37.8% for the first nine months of fiscal 2011. The rate was lower than the prior year nine month tax rate due primarily to a favorable impact related to discrete items. We currently estimate our annualized effective tax rate for fiscal 2012 to be 37.1%.

Fiscal 2011 Compared to Fiscal 2010

Net Sales Net sales increased for fiscal 2011 by $179 million, or 4.4%, over fiscal 2010 due primarily to a $128 million increase in comparable store sales. Comparable store sales increased 3.2% driven by an increase in transactions of 2.0% and an increase in the average ticket of 1.2%. The fluctuation in the exchange rates between the U.S. and Canadian dollars positively impacted the average ticket by 20 basis points. Comparable store sales growth was strongest in our bakeware, ribbon, and yarn categories. In addition, sales from our non-comparable new stores provided incremental revenue of $51 million.

Cost of Sales and Occupancy Expense Cost of sales and occupancy expense increased $59 million to $2,526 million in fiscal 2011 from $2,467 million in fiscal 2010 due primarily to a $50 million increase in merchandise costs associated with higher sales and an $11 million increase in freight and distribution costs. In addition, occupancy costs increased $24 million, including $7 million from new stores opened in fiscal 2011. These amounts were partially offset by a $16 million reduction from improved inventory management and $8 million from improved efficiencies in our vertically integrated framing operation.

Cost of sales and occupancy expense decreased 120 basis points, as a percentage of Net sales, to 60.0% in fiscal 2011 from 61.2% in fiscal 2010. Merchandise cost decreased 90 basis points driven by our direct import penetration, private brand initiative, and improved pricing and promotion management, while increased focus on inventory management contributed an additional 50 basis points to the reduction in cost of sales; these initiatives more than offset the impact of increases in inflation during the period. These improvements were partially offset by a 30 basis point increase from the recognition of freight and distribution costs.

Selling, General, and Administrative Expense Selling, general and administrative expense was $1,098 million in fiscal 2011 compared to $1,059 million in fiscal 2010. Selling, general and administrative expense increased $39 million driven by an $11 million increase in payroll from existing stores, including $3 million of one-time training cost related to our new store labor model. In addition, we had $9 million in costs for new stores opened in fiscal 2011 and a $6 million increase from a full year of expense for stores opened in fiscal 2010. Finally, advertising increased $11 million from digital and targeted marketing campaigns that did not occur last year. As a percentage of Net sales, Selling, general and administrative expense decreased 20 basis points due to increased leverage of payroll and benefits from higher comparable store sales.

Related Party Expenses Related party expenses were $13 million and $14 million for fiscal 2011 and fiscal 2010, respectively, consisting of management fees and associated expenses paid to our Sponsors and Highfields.

Interest Expense Interest expense decreased from $276 million in fiscal 2010 to $254 million in fiscal 2011, as a result of a lower average interest rate and a $178 million reduction in our total debt outstanding.

Loss on Early Extinguishment of Debt We recorded a loss of $18 million related to the early extinguishment of $163 million face value, or $155 million accreted value, of our 13% Subordinated Discount Notes during fiscal 2011 and $7 million face value of our 113/8% Senior Subordinated Notes. The $18 million loss is comprised of $11 million to recognize the unrealized interest accretion and the write off of related debt issuance costs, as well as $7 million of purchase premiums. See Note 4 to the Consolidated Financial Statements for the fiscal years ended January 28, 2012, January 29, 2011, and January 30, 2010 for further discussion. During fiscal 2010, we recorded a loss of $53 million related to the early extinguishment of our 2014 Senior Notes. The $53 million loss was comprised of $41 million of tender and call premiums and $12 million to write off the remaining unamortized debt issuance costs.

Other (Income) and Expense, Net Other expense for fiscal 2011 is related to a $5 million unfavorable change in the fair value of the interest rate cap, as more fully described in Note 8 to the Consolidated Financial Statements for the fiscal years ended January 28, 2012, January 29, 2011, and January 30, 2010, and $4 million in foreign exchange rate losses. Other expense for fiscal 2010 related to a $12 million loss in the fair value of the interest rate cap, partially offset by $2 million of foreign exchange rate gains.

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Provision for Income Taxes The effective tax rate for fiscal 2011 was 38.8%. The effective tax rate for fiscal 2010 was 30.9%. The rate was lower than the federal tax rate due primarily to favorable impacts of 2.8% from audit settlements with taxing authorities, 1.1% from federal manufacturing deductions and 1.1% from our ability to utilize federal tax credits.

Fiscal 2010 Compared to Fiscal 2009

Net Sales Net sales increased for fiscal 2010 by $143 million, or 3.7%, from fiscal 2009 due primarily to a $96 million increase in comparable store sales. Comparable store sales increased 2.5% due to an increase in customer transactions of 1.3% and an increase in the average ticket of 1.2%. The fluctuation in the exchange rates between the U.S. and Canadian dollars positively impacted the average ticket by 70 basis points. Comparable store sales growth was strongest in our bakeware, kid s crafts, and custom framing categories. In addition, sales from our non-comparable new stores provided incremental revenue of $47 million.

Cost of Sales and Occupancy Expense Cost of sales and occupancy expense increased $44 million to $2,467 million from $2,423 million in fiscal 2009 as a result of the 2.5% increase in comparable store sales and an increase in sales from non-comparable new stores. Cost of sales and occupancy expense decreased 110 basis points as a percentage of Net sales. Merchandise costs, as a percentage of Net sales, improved 60 basis points driven by our direct import initiative and improved pricing and promotion management; these initiatives more than offset the impact of increases in inflation during the period. In addition, occupancy costs decreased 50 basis points due in part to 30 basis points of increased leverage on higher comparable store sales. Further, continued focus on cost management and lower occupancy amortization, due to reduced capital expenditures in recent years, each contributed a 10 basis point reduction to occupancy expense.

Selling, General and Administrative Expense Selling, general and administrative expense was $1,059 million, or 26.3% of Net sales, in fiscal 2010 compared to $1,052 million, or 27.1% of Net sales, in fiscal 2009. Selling, general and administrative expense increased $7 million driven by a $16 million increase in store costs related to operating 22 additional Michaels Stores during the year, as well as a $5 million increase in advertising expense. These amounts were partially offset by a $7 million decrease in group insurance due to careful cost management and a $6 million decrease in depreciation expense as a result of lower capital expenditures over the last several years. As a percentage of Net sales, Selling, general and administrative expense decreased 80 basis points due to increased payroll leverage of 30 basis points on higher comparable store sales and a 20 basis point decrease in both group insurance and depreciation expense for the reasons indicated above.

Related Party Expenses Related party expenses were $14 million for each of fiscal 2010 and fiscal 2009, consisting of management fees and associated expenses paid to our Sponsors and Highfields.

Interest Expense Interest expense increased from $257 million in fiscal 2009 to $276 million in fiscal 2010, as a result of increased interest rates associated with our amended credit facilities.

Loss on Early Extinguishment of Debt We recorded a loss of $53 million related to the early extinguishment of our 2014 Senior Notes during fiscal 2010. The $53 million loss is comprised of $41 million of tender and call premiums and $12 million to write off the remaining unamortized debt issuance costs. See Note 4 to the Consolidated Financial Statements for the fiscal years ended January 28, 2012, January 29, 2011, and January 30, 2010 for further discussion.

Other (Income) and Expense, Net Other expense for fiscal 2010 related to a $12 million loss in the fair value of the interest rate cap, partially offset by $2 million of foreign exchange rate gains. Other income for fiscal 2009 related primarily to a $10 million gain in the fair value of the interest rate cap and $5 million of foreign exchange rate gains.

Provision for Income Taxes The effective tax rate for fiscal 2010 was 30.9%. The rate was lower than the federal tax rate due primarily to favorable impacts of 2.8% from audit settlements with taxing authorities, 1.1% from federal manufacturing deductions and 1.1% from our ability to utilize federal tax credits. The effective tax rate for fiscal 2009 of 34.4% was lower than the federal tax rate due primarily to favorable impacts of 2.0% from the ability to utilize tax credits, which had been limited in prior years, and 0.9% of tax return to provision adjustments.

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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 Restated Revolving Credit Facility 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 continue to refinance or reduce debt could be adversely affected by the occurrence of any of the events described under Risk Factors or our failure to meet our debt covenants as described in Liquidity and Capital Resources Cash Flow from Financing Activities.

To finance the Merger, we issued the 2014 Senior Notes, Senior Subordinated Notes and Subordinated Discount Notes and executed a Senior Secured Term Loan Facility and a senior secured asset-based Revolving Credit Facility. 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.

The Company intends to use excess operating cash flows to repay portions or to extend the terms of its indebtedness, depending on market conditions and growth opportunities. If the Company uses its excess cash flows to repay its debt, it will reduce the amount of excess cash available for additional capital expenditures, and if the Company extends the terms of the Notes, it will continue to be required to use cash for interest and obligatory debt payments.

As of October 27, 2012, $292 million and $1,495 million of our Senior Secured Term Loan Facility are scheduled to mature in October 2013 and July 2016, respectively. In addition, as of October 27, 2012, an aggregate principal amount of $573 million of our Senior Subordinated Notes and Subordinated Discount Notes was scheduled to mature in November 2016. On November 1, 2012, we redeemed our outstanding Subordinated Discount Notes with borrowings made under our Restated Revolving Credit Facility for an aggregate redemption price (including the applicable redemption premium and accrued and unpaid interest) of $199 million. The senior notes mature in 2018. Although no assurance can be given, depending on market conditions and other factors, we plan to repay or refinance such indebtedness prior to maturity.

We, and our subsidiaries, may be able to incur substantial additional indebtedness in the future, subject to the restrictions contained in our Senior Secured Credit Facilities and the indentures governing our senior notes and Senior Subordinated Notes. If new indebtedness is added to our current debt levels, the related risks we now face could intensify.

Our Restated Revolving Credit Facility provides senior secured financing of up to $650 million, subject to a borrowing base. We had $3,368 million of indebtedness outstanding at October 27, 2012, of which approximately $1,787 million was subject to variable interest rates and $1,581 million was subject to fixed interest rates.As of October 27, 2012, our Restated Revolving Credit Facility provided for an aggregate amount of $650 million in commitments, subject to a borrowing base, which supported $61 million of outstanding standby letters of credit and provided $589 million of unused borrowing capacity. On November 1, 2012, we borrowed $216 million under the Restated Revolving Credit Facility to fund the redemption of our outstanding Subordinated Discount Notes and other working capital needs, resulting in $373 million of unused borrowing capacity thereunder as of such date. Our cash and equivalents decreased $210 million from $371 million at January 28, 2012, to $161 million at October 27, 2012. Our cash and equivalents increased $52 million from $319 million at the end of fiscal 2010 to $371 million at the end of fiscal 2011.

We and our subsidiaries, affiliates, and significant stockholders 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. Such repurchases or exchanges, if any, will depend on prevailing market conditions, liquidity requirements, contractual restrictions and other factors.

Cash Flow from Operating Activities

Cash flow provided by operating activities during the first nine months of fiscal 2012 was $16 million compared to $99 million during the first nine months of fiscal 2011. The $83 million change was primarily due to a $43 million decrease from the timing of inventory purchases and a $35 million decrease in non-cash accretion as our Subordinated Discount Notes were fully accreted as of November 1, 2011. In addition, we had a $13 million decrease from the timing of accounts payable and a $15 million decrease related to accrued bonus expense. The decrease in accrued bonus expense was due to a lower anticipated payout recognized during the first nine months of fiscal 2012 compared to the first nine months of fiscal 2011.

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These amounts were partially offset by an increase of $20 million from the timing of interest payments and a $10 million increase in Net income before the consideration of the $3 million and $16 million loss on the early extinguishment of debt for the first nine months of fiscal 2012 and fiscal 2011, respectively.

Average inventory per Michaels store (including supporting distribution centers) increased 2.4% from $922,000 at October 29, 2011 to $944,000 at October 27, 2012 primarily due to lower than expected sales during the first nine months of fiscal 2012, as well as strategic purchases for our peak selling season.

Cash flow provided by operating activities in fiscal 2011 was $413 million compared to $438 million in fiscal 2010. The $25 million change was primarily due to a $61 million decrease from the timing of inventory purchases and a $44 million decrease as a result of the timing of sales and income tax payments. Average inventory per Michaels store (including supporting distribution centers) was $757,000, down from last year s balance of $758,000. In addition, non-cash accretion decreased $15 million due to the repurchases of $163 million face value, or $155 million accreted value, of our Subordinated Discount Notes as well as the Subordinated Discount Notes being fully accreted as of November 1, 2011. These decreases were partially offset by a $60 million increase in Deferred income taxes and an increase in Net income of $38 million before the consideration of the $18 million and $53 million loss on the early extinguishment of debt in fiscal 2011 and fiscal 2010, respectively.

Cash Flow from Investing Activities

Cash flow used in investing activities represents the following capital expenditures:

	Fiscal Year			Nine Months Ended	
(In millions)	**2011**	**2010**	**2009**	**October 27, 2012**	**October 29, 2011**
New and relocated stores and stores not yet opened(1)	$ 28	$ 23	$ 14	$ 31	$ 23
Existing stores	25	24	13	19	19
Information systems(2)	45	27	12	24	32
Corporate and other	11	7	4	11	10
	$ 109	$ 81	$ 43	$ 85	$ 84

(1) In fiscal 2011, we incurred capital expenditures related to the opening of 25 Michaels stores in addition to the relocation of 15 Michaels stores. In fiscal 2010, we incurred capital expenditures related to the opening of 23 Michaels stores and the relocation of 10 Michaels stores. In fiscal 2009, we incurred capital expenditures related to the opening of 18 Michaels stores and the relocation of five Michaels stores. In the first nine months of fiscal 2012, we incurred capital expenditures related to the opening of 36 Michaels stores in addition to the relocation of 13 Michaels stores. In the first nine months of fiscal 2011, we incurred capital expenditures related to the opening of 23 Michaels stores in addition to the relocation of 14 Michaels stores.

(2) Our fiscal 2011 information systems capital expenditures increased mainly due to the launch of MiDesign@Michaels and the replacement of approximately 7,100 payment card terminals, as well as other infrastructure projects to support future growth.

In fiscal 2009, we opened the majority of our stores in locations where the landlord paid to build the stores to our specifications. During fiscal 2011 and fiscal 2010, we have opened a greater number of stores in locations where we paid to build the stores to our specifications. As a result, our capital expenditures for new and relocated stores have increased in fiscal 2011 and fiscal 2010 compared to fiscal 2009. This trend may continue in future years.

We currently estimate that our capital expenditures will be increased to between $120 million and $130 million in fiscal 2012. We plan to invest in the infrastructure necessary to support the further development of our business and continued growth. In fiscal 2012, we plan to open 45 to 50 stores, including 10 to 15 relocations. We expect our capital expenditures will be financed with cash from operations.

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Cash Flow from Financing Activities

Cash flow used in financing activities during the first nine months of fiscal 2012 was $141 million compared to $223 million during the first nine months of fiscal 2011. Cash flow used in financing activities for the first nine months of fiscal 2012 was impacted by the $209 million prepayment on our Senior Secured Term Loan Facility and the issuance of $200 million of additional Senior Notes due 2018 at a premium, for which we received $213 million in proceeds. In addition, we made a $127 million AHYDO payment on our Subordinated Discount Notes during the second quarter of fiscal 2012.

During the first nine months of fiscal 2011, we repurchased $142 million face value of our Subordinated Discount Notes and $7 million face value of our 113/8% Senior Subordinated Notes, for which we paid $6 million in purchase premiums and third party fees. In addition, we made a voluntary prepayment of $50 million on our Senior Secured Term Loan Facility during the first quarter of fiscal 2011.

Cash flow used in financing activities during fiscal 2011 was $252 million compared to $253 million during fiscal 2010. Cash flow used in financing activities for fiscal 2011 was impacted by the repurchases of $163 million face value, or $155 million accreted value, of our Subordinated Discount Notes and $7 million face value of our Senior Subordinated Notes, for which we paid $7 million in purchase premiums. We also made a voluntary prepayment of $50 million on our Senior Secured Term Loan Facility during the first quarter of fiscal 2011.

During fiscal 2010, we made an excess cash flow payment and voluntary prepayments on our Senior Secured Term Loan Facility totaling $228 million and paid $19 million in debt issuance costs related to the amendment of the then existing senior secured asset-based Revolving Credit Facility. In addition, we retired our 2014 Senior Notes during the third quarter of fiscal 2010 and issued our initial notes, for which we paid $41 million in tender and call premiums and $15 million in debt issuance costs.

We used the net proceeds from the offering of the outstanding notes to repay a portion of the indebtedness outstanding under the B-1 Term Loan (under which an aggregate amount of $292 million was outstanding as of October 27, 2012), together with related fees and expenses. Borrowings under the B-1 Term Loan are due October 31, 2013 and bear interest at a floating rate per annum equal to, at our option, either (a) a base rate determined by reference to the higher of (1) the prime rate of Deutsche Bank and (2) the federal funds effective rate plus ½ of 1% or (b) a LIBOR, subject to certain adjustments, in each case plus an applicable margin of 1.25% for base rate borrowings and 2.25% for LIBOR borrowings. The applicable margin is subject to a 0.25% decrease based on our corporate family rating assigned by Moody s Investors Service, Inc. Following the completion of the offering of the outstanding notes, we issued a redemption notice to the holders of our outstanding Subordinated Discount Notes (an aggregate amount of $180 million of which was outstanding as of October 27, 2012) to redeem all of such Subordinated Discount Notes on November 1, 2012. On November 1, 2012, we redeemed our outstanding Subordinated Discount Notes with borrowings made under our Restated Revolving Credit Facility for an aggregate redemption price (including the applicable redemption premium and accrued and unpaid interest to the redemption date) of $199 million.

Debt

We currently have outstanding indebtedness consisting of senior notes and Senior Subordinated Notes (collectively, the Notes), as well as the Senior Secured Term Loan Facility and the Restated Revolving Credit Facility. The borrowings under the Restated Revolving Credit Facility are influenced by a number of factors as more fully described below.

Notes

On October 31, 2006, we issued (i) $750 million in principal amount of our 2014 Senior Notes; (ii) $400 million in principal amount of 113/8 Senior Subordinated Notes due November 1, 2016 (the Senior Subordinated Notes); and (iii) $469 million in principal amount at maturity of our Subordinated Discount Notes. During the third quarter of fiscal 2010, we retired the 2014 Senior Notes and issued $800 million of our initial notes at a discounted price of 99.262% of face value, resulting in an effective interest rate of 77/8%. Interest on the initial notes and the Senior Subordinated Notes is payable semi-annually in arrears on each May 1 and November 1, commencing on May 1, 2011 and May 1, 2007, respectively. No cash interest was payable on the Subordinated Discount Notes prior to November 1, 2011.

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Beginning on November 1, 2011, cash interest began accruing on the Subordinated Discount Notes and was payable semi-annually in arrears on each May 1 and November 1, commencing on May 1, 2012. On May 1, 2012, as required pursuant to the indenture governing our Subordinated Discount Notes (Subordinated Discount Notes Indenture), we redeemed that portion of each Subordinated Discount Note outstanding on such date equal to the amount sufficient, but not in excess of the amount necessary, to ensure that such Subordinated Discount Note will not be an applicable high yield discount obligation (AHYDO) within the meaning of Section 163(i)(1) of the Internal Revenue Code of 1986, as amended. These redemptions were at a price equal to 100% of the Accreted Value (as defined in the Subordinated Discount Notes Indenture) of such portion as of the date of redemption. The aggregate payment of $127 million made on May 1, 2012, was required to ensure the Subordinated Discount Notes would not be AHYDO instruments. On November 1, 2012, we redeemed our outstanding Subordinated Discount Notes with borrowings made under our Restated Revolving Credit Facility for an aggregate redemption price (including the applicable redemption premium and accrued and unpaid interest) of $199 million. We redeemed a portion of the Subordinated Discount Notes (which consisted of $0.4 million in aggregate principal amount) equal to the AHYDO Amount (as defined in the Subordinated Discount Notes Indenture) at a redemption price equal to 100% and the remaining Subordinated Discount Notes (which consisted of $179.6 million in aggregate principal amount) at a redemption price equal to 104.333%, in each case plus accrued but unpaid interest up to, but not including, the redemption date.

The senior notes are guaranteed, jointly and severally, fully and unconditionally, on an unsecured senior basis and the Senior Subordinated Notes are guaranteed, jointly and severally, fully and unconditionally, on an unsecured senior subordinated basis, in each case, by each of our subsidiaries that guarantees our indebtedness under our Senior Secured Term Loan Facility and Restated Revolving Credit Facility.

The indentures governing the senior notes and the Senior Subordinated Notes contain covenants limiting, among other things, the Company s ability and the ability of the Company s restricted subsidiaries to:

- incur additional debt;
- pay dividends or distributions on the Company s capital stock or repurchase the Company s capital stock;
- issue stock of subsidiaries;
- make certain investments;
- create liens on the Company s assets to secure debt;
- enter into transactions with affiliates;

- merge or consolidate with another company; and
- sell or otherwise transfer assets.

On and after November 1, 2011, we may redeem our outstanding Senior Subordinated Notes, in whole or in part, at the redemption prices (expressed as percentages of principal amount of Senior Subordinated Notes to be redeemed) set forth below, plus accrued and unpaid interest thereon:

Year	**Percentage**
2011	105.688%
2012	103.792%
2013	101.896%
2014 and thereafter	100.000%

At any time prior to November 1, 2014, we may redeem our senior notes, in whole or in part, at a redemption price equal to 100% of the principal amount thereof redeemed, plus a make-whole premium plus accrued and unpaid interest to the date of redemption.

On and after November 1, 2014, we may redeem our senior notes, in whole or in part, at the redemption prices (expressed as percentages of principal amount of exchange notes to be redeemed) set forth below, plus accrued and unpaid interest thereon:

Year	**Percentage**
2014	103.875%
2015	101.938%
2016 and thereafter	100.000%

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If we experience a change in control, we must give holders of our senior notes and Senior Subordinated Notes the opportunity to sell us their senior notes and Senior Subordinated Notes at 101% of their face amount, plus accrued and unpaid interest.

If we or our subsidiaries engage in asset sales, we generally must either invest the net cash proceeds from such sales in our business within a period of time, prepay senior secured debt or make an offer to purchase a principal amount of our senior notes and Senior Subordinated Notes equal to the excess net cash proceeds, subject to certain exceptions. The purchase price of the senior notes and Senior Subordinated Notes will be 100% of their principal amount, plus accrued and unpaid interest.

Senior Secured Asset-based Revolving Credit Facility

On February 18, 2010, we entered into an agreement to amend and restate various terms of the then existing senior secured asset-based Revolving Credit Facility, dated as of October 31, 2006. On September 17, 2012, we entered into an agreement with Wells Fargo and other financial institutions for a second amendment and restatement of the senior secured asset-based Revolving Credit Facility. As of October 27, 2012, it provided for an aggregate amount of $650 million in commitments, subject to a borrowing base, which supported $61 million of outstanding standby letters of credit and provided $589 million of unused borrowing capacity. On November 1, 2012, we borrowed $216 million under the Restated Revolving Credit Facility to fund the redemption of all of our outstanding Subordinated Discount Notes and other working capital needs, resulting in $373 million of unused borrowing capacity thereunder as of such date. Borrowing capacity is available for letters of credit and borrowings on same-day or other specified notice.

The Restated Revolving Credit Facility provides an aggregate amount of $650 million in commitments, subject to a borrowing base, which are scheduled to terminate on the ABL Maturity Date. The borrowing base under the Restated Revolving Credit Facility equals the sum of (i) 90% of eligible credit card receivables and debit card receivables, plus (ii) 90% of the appraised net orderly liquidation value of eligible inventory, plus (iii) the lesser of (x) 90% of the appraised net orderly liquidation value of inventory supported by eligible letters of credit and (y) 90% of the face amount of eligible letters of credit, minus (iv) certain reserves.

The Restated Revolving Credit Facility provides us with the right to request up to $200 million of additional commitments under this facility at any time. The lenders under this facility are not under any obligation to provide any such additional commitments, and any increase in commitments is subject to customary conditions precedent. If we were to request any additional commitments and the existing lenders or new lenders were to agree to provide such commitments, the facility size could be increased to up to $850 million, but our ability to borrow under this facility would still be limited by the borrowing base.

Borrowings under the Restated Revolving Credit Facility bear interest at a rate per annum equal to, at our option, either (a) a base rate determined by reference to the highest of (1) the prime rate of Wells Fargo, (2) the federal funds effective rate plus 0.50% and (3) a LIBOR subject to certain adjustments plus 1.00% or (b) a LIBOR subject to certain adjustments, in each case plus an applicable margin. The initial applicable margin is (a) 0.75% for prime rate borrowings and 1.75% for LIBOR borrowings. The applicable margin is subject to adjustment each fiscal quarter based on the excess availability under the Restated Revolving Credit Facility. Same-day borrowings bear interest at the base rate plus the applicable margin.

We are required to pay a commitment fee on the unutilized commitments under the Restated Revolving Credit Facility, which initially is 0.375% per annum. The commitment fee is subject to adjustment each fiscal quarter. If average daily excess availability is less than or equal to 50% of the total commitments, the commitment fee will be 0.25% per annum, and if average daily excess availability is greater than 50% of the total commitments, the commitment fee will be 0.375%. We must also pay customary letter of credit fees and agency fees.

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If, at any time, the aggregate amount of outstanding loans, unreimbursed letter of credit drawings and undrawn letters of credit under the Restated Revolving Credit Facility exceeds the lesser of (i) the commitment amount and (ii) the borrowing base (the Loan Cap), we will be required to repay outstanding loans and cash collateralize letters of credit in an aggregate amount equal to such excess, with no reduction of the commitment amount. If excess availability under the Restated Revolving Credit Facility is less than (i) 12.5% of the Loan Cap, for five consecutive business days or (ii) $65 million, at any time, or if certain events of default have occurred, we will be required to repay outstanding loans and cash collateralize letters of credit with the cash we are required to deposit daily in a collection account maintained with the agent under the Restated Revolving Credit Facility. Excess availability under the Restated Revolving Credit Facility means the lesser of the Loan Cap minus the outstanding credit extensions. We may voluntarily reduce the unutilized portion of the commitment amount and repay outstanding loans at any time without premium or penalty other than customary breakage costs with respect to LIBOR loans. There is no scheduled amortization under the Restated Revolving Credit Facility; the principal amount of the loans outstanding is due and payable in full on the ABL Maturity Date.

All obligations under the Restated Revolving Credit Facility are unconditionally guaranteed, jointly and severally, by all of our existing material subsidiaries and are required to be guaranteed by certain of our future domestic wholly-owned material subsidiaries. All obligations under the Restated Revolving Credit Facility, and the guarantees of those obligations, are secured, subject to certain exceptions, by substantially all of our assets and the assets of our material subsidiaries (the Subsidiary Guarantors), including:

- a first-priority security interest in personal property consisting of inventory and related accounts, cash, deposit accounts, all payments received by us or the Subsidiary Guarantors from credit card clearinghouses and processors or otherwise in respect of all credit card charges and debit card charges for sales of inventory by us and the Subsidiary Guarantors, and certain related assets and proceeds of the foregoing;

- a second-priority pledge of all of the capital stock held by us (excluding the stock of Michaels of Canada, ULC) and our Subsidiary Guarantors (which pledge, in the case of the capital stock of any foreign subsidiary, is limited to 65% of the voting stock of such foreign subsidiary and 100% of the non-voting stock of such subsidiary); and

- a second-priority security interest in, and mortgages on, substantially all other tangible and intangible assets of us and each Subsidiary Guarantor, including substantially all of our owned real property and equipment.

The Restated Revolving Credit Facility contains a number of covenants that, among other things and subject to certain exceptions, restrict the Company s ability and the ability of its subsidiaries to:

- incur additional indebtedness;

- pay dividends on the Company s capital stock or redeem, repurchase or retire the Company s capital stock or its other indebtedness;

- make investments, loans, advances and acquisitions;

- create restrictions on the payment of dividends or other amounts to the Company from its restricted subsidiaries;
- engage in transactions with affiliates of the Company;
- sell assets, including capital stock of the Company s subsidiaries;
- consolidate or merge; and
- create liens.

The covenants limiting dividends and other restricted payments, investments, loans, advances and acquisitions, and prepayments or redemptions of indebtedness, each permit the restricted actions in an unlimited amount, subject to the satisfaction of certain payment conditions, principally that we must meet certain specified excess availability requirements and minimum consolidated fixed charge coverage ratios, to be tested on a pro forma and 6 months projected basis. Adjusted EBITDA is used in the calculation of the consolidated fixed charge coverage ratios. The Restated Revolving Credit Facility also contains certain customary affirmative covenants and events of default. As of October 27, 2012, we were in compliance with all covenants.

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From the time when we have excess availability less than the greater of (a) 10% of the Loan Cap and (b) $50 million, until the time when we have excess availability greater than the greater of (a) 10% of the Loan Cap and (b) $50 million for 30 consecutive days, the Restated Revolving Credit Facility will require us to maintain a consolidated fixed charge coverage ratio of at least 1.0 to 1.0.

Senior Secured Term Loan Facility

On October 31, 2006, we executed the Senior Secured Term Loan Facility with Deutsche Bank AG New York Branch, and other lenders. The full amount was initially borrowed on October 31, 2006, with the balance payable on October 31, 2013. On November 5, 2009, and December 15, 2011, we amended the Senior Secured Term Loan Facility to extend $1.0 billion and $619 million, respectively, of existing term loans (the B-2 Term Loans and B-3 Term Loans , respectively) to July 31, 2016, with the remaining $501 million of existing term loans (the B-1 Term Loans and, together with the B-2 Term Loans and the B-3 Term Loans, the Term Loans) keeping the original maturity date of October 31, 2013. On September 27, 2012, we used the net proceeds from the offering of the outstanding notes to repay $209 million of the indebtedness outstanding under the B-1 Term Loan, together with related fees.

Borrowings under the Senior Secured Term Loan Facility bear interest at a rate per annum equal to, at our option, either (a) a base rate determined by reference to the higher of (1) the prime rate of Deutsche Bank and (2) the federal funds effective rate plus ½ of 1% or (b) a LIBOR, subject to certain adjustments, in each case plus an applicable margin. The applicable margin is (i) with respect to B-1 Term Loans, 1.25% for base rate borrowings and 2.25% for LIBOR borrowings; and (ii) with respect to B-2 Term Loans and B-3 Term Loans, 3.50% for base rate borrowings and 4.50% for LIBOR borrowings. In addition, the applicable margin is subject to a 0.25% decrease based on our corporate family rating assigned by Moody s Investors Service, Inc.

The B-2 Term Loans and B-3 Term Loans are subject to a minimum increase in interest rates in connection with any future extensions of term loans to the extent that any such future extension has an increase in effective yield in excess of 0.25% above the effective yield of the B-2 Term Loans or B-3 Term Loans.

The Senior Secured Term Loan Facility requires us to prepay outstanding term loans with (a) 100% of the net proceeds of any debt issued by us or our subsidiaries (with exceptions for certain debt permitted to be incurred under the Senior Secured Term Loan Facility) and (b) 50% (which percentage will be reduced to 25% if our total leverage ratio, as defined in the Senior Secured Term Loan Facility, is less than 6.00:1.00 and will be reduced to 0% if our total leverage ratio is less than 5.00:1.00) of our annual Excess Cash Flow (as defined in the Senior Secured Term Loan Facility). We must also offer to prepay outstanding term loans at 100% of the principal amount to be prepaid, plus accrued and unpaid interest, with the proceeds of certain asset sales or casualty events under certain circumstances. We may voluntarily prepay outstanding loans under the Senior Secured Term Loan Facility at any time without premium or penalty other than customary breakage costs with respect to LIBOR loans.

Our total leverage ratio at January 28, 2012 was less than 5.00:1.00, and as a result, there was no required Excess Cash Flow payment for fiscal 2011. However, during fiscal 2011, we made a voluntary prepayment of $50 million. Our voluntary prepayment of $110 million in fiscal 2010 more than offset the payment required from our annual Excess Cash Flow. Under the Senior Secured Term Loan Facility, excess cash flow payments and voluntary prepayments serve to reduce future scheduled quarterly principal payments. The voluntary prepayments made in fiscal 2011 and fiscal 2010 effectively satisfied all scheduled quarterly principal payments until maturity of the Term Loans.

All obligations under the Senior Secured Term Loan Facility are unconditionally guaranteed, jointly and severally, by each direct and indirect wholly-owned subsidiary that guarantees the obligations of the Company under the Restated Revolving Credit Facility. All obligations under the Senior Secured Term Loan Facility, and the guarantees of those obligations, are secured, subject to certain exceptions, by substantially all of our assets and the assets of the Subsidiary Guarantors, including:

- a first-priority pledge of all of the capital stock held by us (excluding the stock of Michaels of Canada, ULC) and the Subsidiary Guarantors (which pledge, in the case of any foreign subsidiary, is limited to 65% of the voting stock of such foreign subsidiary and 100% of the non-voting stock of such subsidiary);

- a first-priority security interest in, and mortgages on, substantially all other tangible and intangible assets of us and each Subsidiary Guarantor, including substantially all of our owned real property and equipment, but excluding, among other things, the collateral described in the following bullet point; and

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- a second-priority security interest in personal property consisting of inventory and related accounts, cash, deposit accounts, all payments received by us or the Subsidiary Guarantors from credit card clearinghouses and processors or otherwise in respect of all credit card charges and debit card charges for sales of inventory by us and the Subsidiary Guarantors, and certain related assets and proceeds of the foregoing.

The Senior Secured Term Loan Facility contains a number of negative covenants that are substantially similar to, but more restrictive in certain respects than, those governing the senior notes and the Senior Subordinated Notes as well as certain other customary affirmative and negative covenants and events of default. As of October 27, 2012, we were in compliance with all covenants.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements as defined in Item 303(a)(4)(ii) of Regulation S-K. We do not typically enter into off-balance sheet arrangements, except for arrangements related to operating lease commitments, service contract commitments, and trade letters of credit, as disclosed in the contractual obligations table below. Neither Michaels nor its subsidiaries typically guarantee the obligations of unrelated parties.

Contractual Obligations

All of our significant contractual obligations are recorded on our Consolidated Balance Sheets or disclosed in our Notes to Consolidated Financial Statements.

As of January 28, 2012, our contractual obligations were as follows:

		Payments Due By Fiscal Year			
(In millions)	**Total**	**Less Than 1 Year**	**1 - 3 Years**	**3 - 5 Years**	**More Than 5 Years**
Operating lease commitments(1)	$ 1,788	$ 355	$ 616	$ 399	$ 418
Other commitments(2)	84	68	12	4	
Total debt(3)	3,495	127	502	2,066	800
Interest payments(4)	1,258	243	483	408	124
	$ 6,625	$ 793	$ 1,613	$ 2,877	$ 1,342

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(1) Our operating lease commitments generally include non-cancelable leases for property and equipment used in our operations. Excluded from our operating lease commitments are amounts related to insurance, taxes, and common area maintenance associated with property and equipment. Such amounts historically represented approximately 32% of the total lease obligation over the previous three fiscal years.

(2) Other commitments include trade letters of credit and service contract obligations. Our service contract obligations were calculated based on the time period remaining in the contract or to the earliest possible date of termination, if permitted to be terminated by Michaels upon notice, whichever is shorter.

(3) Included in total debt is $5 million of unamortized discount accretion on the initial notes, which had not been recognized as of January 28, 2012. See Note 4 to the Consolidated Financial Statements for the fiscal years ended January 28, 2012, January 29, 2011, and January 30, 2010.

(4) Debt associated with our Senior Secured Term Loan Facility was approximately $2.0 billion at January 28, 2012, and is subject to variable interest rates. The amounts included in interest payments in the table for the Senior Secured Term Loan Facility were based on the indexed interest rate in effect at January 28, 2012. Approximately $1.5 billion of debt was subject to fixed interest rates. We did not have any outstanding borrowings under our senior secured asset-based Revolving Credit Facility at January 28, 2012. Under our senior secured asset-based Revolving Credit Facility, we were required to pay a commitment fee of 0.625% per year on the unutilized commitments. The amounts included in interest payments were based on these annual commitment fees.

Additional information regarding our long-term debt and commitments and contingencies is provided in Note 4 and Note 11, respectively, to the Consolidated Financial Statements for the fiscal years ended January 28, 2012, January 29, 2011, and January 30, 2010.

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Non-GAAP Measures

The following table sets forth the Company s Earnings before Interest, Taxes, Depreciation, Amortization, and Loss on early extinguishment of debt (EBITDA excluding loss on early extinguishment of debt). The Company defines EBITDA (excluding loss on early extinguishment of debt) as Net income before interest, income taxes, depreciation, amortization and loss on early extinguishment of debt. Additionally, the table presents Adjusted Earnings before Interest, Taxes, Depreciation and Amortization (Adjusted EBITDA). The Company defines Adjusted EBITDA as EBITDA (excluding loss on early extinguishment of debt) adjusted for certain defined amounts that are added to, or subtracted from, EBITDA (excluding loss on early extinguishment of debt) (collectively, the Adjustments) in accordance with the Company s Senior Secured Term Loan Facility and Restated Revolving Credit Facility. The Adjustments are described in further detail in the table, and the footnotes to the table below.

The Company has presented EBITDA (excluding loss on early extinguishment of debt) and Adjusted EBITDA to provide investors with additional information to evaluate our operating performance and our ability to service our debt. The Company uses EBITDA (excluding loss on early extinguishment of debt), among other metrics, to evaluate operating performance, to plan and forecast future periods operating performance and as an element of its incentive compensation targets. Adjusted EBITDA is a required calculation under the Company s Senior Secured Term Loan Facility and its Restated Revolving Credit Facility. As it relates to the Senior Secured Term Loan Facility, Adjusted EBITDA is used in the calculations of fixed charge coverage and leverage ratios, which, under certain circumstances may result in limitations on the Company s ability to make restricted payments as well as the determination of mandatory repayments of the loans. Under the Restated Revolving Credit Facility, Adjusted EBITDA is used in the calculation of fixed charge coverage ratios. If a triggering event based on excess availability occurs, the Company is required to maintain a minimum fixed charge coverage ratio under the Restated Revolving Credit Facility. In addition, under certain circumstances, the fixed charge coverage ratio may restrict the Company s ability to make certain payments (characterized as restricted payments), investments (including acquisitions) and debt repayments.

As EBITDA (excluding loss on early extinguishment of debt) and Adjusted EBITDA are not measures of operating performance or liquidity calculated in accordance with 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 computation of EBITDA (excluding loss on early extinguishment of debt) and Adjusted EBITDA may differ from similarly titled measures used by other companies. As EBITDA (excluding loss on early extinguishment of debt) and Adjusted EBITDA exclude certain financial information compared with Net income and Net cash provided by operating activities, the most directly comparable GAAP financial measures, users of this financial information should consider the types of events and transactions which are excluded.

The table below shows a reconciliation of EBITDA (excluding loss on early extinguishment of debt) and Adjusted EBITDA to Net income and Net cash provided by operating activities.

	Nine Months Ended	
	October 27, 2012	October 29, 2011
	(in millions)	
Net cash provided by operating activities	$ 16	$ 99
Depreciation and amortization	(71)	(75)
Share-based compensation	(4)	(7)
Debt issuance costs amortization	(12)	(13)
Accretion of long-term debt		(35)
Change in fair value of interest rate cap		(4)

Change in fair value of contingent consideration		1
Loss on early extinguishment of debt	(3)	(16)
Changes in assets and liabilities	176	129
Net income	102	79
Interest expense	187	188
Loss on early extinguishment of debt	3	16
Provision for income taxes	58	48
Depreciation and amortization	71	75
EBITDA (excluding loss on early extinguishment of debt)	421	406
Adjustments:		
Share-based compensation	4	7
Sponsor fees	10	10
Termination expense	1	1
Store pre-opening costs	5	4
Store remodel costs	1	1
Foreign currency transaction gains	(1)	
Store closing costs	2	3
Gain on contingent consideration		(1)
Loss on interest rate cap		4
Other(1)	2	3
Adjusted EBITDA	445	438

(1) Other adjustments relate to items such as the moving & relocation expenses, franchise taxes, foreign currency hedge and legal settlements.

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Quantitative and Qualitative Disclosures about Market 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. As of October 27, 2012, a 10% increase or decrease in the exchange rate of the U.S. and Canadian dollar would have a $2 million impact on net income.

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 the nine months ended October 27, 2012 or any year during the three-year period ended January 28, 2012. 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.

We have market risk exposure arising from changes in interest rates on our Senior Secured Term Loan Facility and Restated Revolving Credit Facility. The interest rates on our Senior Secured Credit Facilities will reprice periodically, which will impact our earnings and cash flow. The interest rates on our notes are fixed. Based on our overall interest rate exposure to variable rate debt outstanding as of October 27, 2012, a 1% increase or decrease in interest rates would increase or decrease income before income taxes by $18 million. A 1% increase in interest rates would decrease the fair value of our long-term fixed rate debt by $37 million. A 1% decrease in interest rates would increase the fair value of our long-term fixed rate debt by $38 million. A change in interest rates would not materially affect the fair value of our variable rate debt as the debt reprices periodically.

We invest cash balances in excess of our operating requirements primarily in money market mutual funds and short-term interest bearing securities, generally with maturities of 90 days or less. Due to the short-term nature of our investments, the fair value of our cash and equivalents at October 27, 2012 approximated carrying value.

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BUSINESS

The following discussion, as well as other portions of this registration statement, 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, and other similar expressions) that are not statements of historical fact should be considered forward-looking statements. Our actual results could materially differ from those discussed in these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed below and elsewhere in this prospectus, and particularly in Risk Factors and Management s Discussion and Analysis of Financial Condition and Results of Operations. Unless the context otherwise indicates, references in this registration statement to we, our, us, the Company and Michaels means Michaels Stores, Inc., together with its subsidiaries.

General

With over $4.2 billion in fiscal 2011 sales, Michaels Stores, Inc., together with its subsidiaries, is the largest arts and crafts specialty retailer in North America providing materials, project ideas and education for creative activities. Our mission is to inspire and enable customer creativity, create a fun and rewarding place to work, foster meaningful connections with our communities and lead the industry in growth and innovation. With crafting classes, store events, project sheets, store displays, mobile applications and online videos, we offer a shopping experience that can inspire creativity and confidence in our customers artistic abilities.

Michaels Stores, Inc. was incorporated in Delaware in 1983, and as of October 27, 2012, we operate 1,099 Michaels retail stores in 49 states, as well as in Canada, with approximately 18,100 average square feet of selling space per store. We also operate 127 Aaron Brothers stores as of October 27, 2012, in nine states, with approximately 5,600 average square feet of selling space per store, offering photo frames, a full line of ready-made frames, custom framing services, and a wide selection of art supplies.

On October 31, 2006, substantially all of the common stock of Michaels Stores, Inc. was acquired through a merger transaction by affiliates of two investment firms: Bain Capital Partners, LLC and The Blackstone Group L.P., with certain shares retained by investment funds managed by Highfields Capital Management LP (then-existing stockholders of Michaels Stores, Inc.) (the Highfields Funds). As a result of the Merger, Michaels Holdings LLC, an entity controlled by the Sponsors, currently owns approximately 93% of our outstanding common stock, which is not publicly traded.

We provide links to our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports, and other documents filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the Exchange Act), on our Internet website at *www.michaels.com* under the heading Investor Relations. These links are automatically updated, so the filings are available immediately after they are made publicly available by the SEC. These filings are also available through the SEC s EDGAR system at *www.sec.gov*. Our website, and the information contained on our website, is not part of this prospectus.

Merchandising

Each Michaels store offers approximately 35,000 basic SKUs in a number of product categories. The following table shows a breakdown of sales for Michaels stores by department as a percentage of total sales:

	Fiscal Year		
	2011	**2010**	**2009**
General and children s crafts	47%	46%	44%
Home décor and seasonal	20	20	21
Framing	17	18	17
Scrapbooking	16	16	18
	100%	100%	100%

We have a product design team focused on quality, innovation and cost mitigation. Through constant interaction with our customers, we are able to anticipate and respond to their needs by introducing fresh and inspirational products in a timely manner.

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We have developed a portfolio of 11 private brands to deliver quality products while providing value and on-trend products to our consumer. These brands have been formulated around category lines to build brand recognition and increase profitability. In fiscal 2011, our private brand sales exceeded $1.8 billion, representing approximately 44% of our total Net sales.

We continue to search for ways to leverage our position as a market leader by establishing strategic partnerships and exclusive product relationships that will provide our customers with exciting merchandise. During fiscal 2011, we partnered with popular celebrities and brands such as Chef Duff Goldman, Tori Spelling, Crayola, American Girl Crafts, Girl Scouts and Martha Stewart Crafts. For fiscal 2012, we are exploring opportunities to form future partnerships and exclusive product associations.

We routinely identify merchandise that requires some price reduction to accelerate sales of the product. The need for this reduction is generally attributable to clearance of seasonal merchandise or product that is being displaced from its assigned location in the store to make room for new merchandise. Additional SKUs that are candidates for repricing are identified using our perpetual inventory data. In each case, the appropriate repricing is determined by our category management team. Price changes are transmitted electronically to the store and instructions are provided to our stores regarding product placement, signage, and display to ensure the product is effectively cleared.

Our Aaron Brothers stores offer on average approximately 7,400 SKUs, including photo frames, a full line of ready-made frames, art prints, framed art, art supplies and custom framing services. The merchandising strategy for our Aaron Brothers stores is to provide a unique, upscale framing assortment in an appealing environment with attentive customer service.

Seasonality

Our business is highly seasonal, with higher sales in the third and fourth fiscal quarters. Our fourth quarter, which includes the Christmas selling season, has on average accounted for approximately 34% of our Net sales and approximately 47% of our Operating income.

Product Sourcing and Inventory Management

We purchase merchandise from approximately 600 domestic and foreign vendors. We believe our buying power and ability to make centralized purchases enable us to acquire products on favorable terms. Centralized category management and global sourcing teams negotiate with vendors in an attempt to obtain the lowest net merchandise costs and improve product mix and inventory levels. Our global sourcing infrastructure allows us to control new product introductions and costs, as well as maintain high quality standards, monitor delivery times and manage inventory levels. In fiscal 2011, one vendor supplied approximately 10% of purchases, with no other vendor accounting for more than 3% of total purchases.

In addition to purchasing from outside vendors, our Michaels and Aaron Brothers stores purchase custom frames, framing supplies, mats, and art prints from our framing operation, Artistree, which consists of a manufacturing facility and four regional processing centers to support our retail stores.

Substantially all of the products sold in Michaels stores are manufactured in the U.S., Asia, Canada and Mexico. Goods manufactured in Asia generally require longer lead times and are ordered four to six months in advance of delivery. Those products are either imported directly by us or by domestic distributors and purchase prices are denominated in U.S. dollars.

Our automated replenishment system uses perpetual inventory records to analyze SKU on-hand quantities at each store, as well as other pertinent information such as sales forecasts, seasonal selling patterns, promotional events, and vendor lead times, to reorder merchandise. These recommended orders are reviewed daily and purchase orders are delivered electronically to our vendors and our distribution centers. In addition to improving our store in-stock position, these systems enable us to better forecast merchandise ordering quantities for our vendors and give us the ability to identify, order, and replenish the stores merchandise using less store associate labor. These systems also allow us to react more quickly to selling trends and allow our store associates to devote more time to customer service, thereby improving inventory productivity and sales opportunities. As mentioned above, we are developing processes and systems to improve inventory turnover. We are in the process of upgrading our replenishment and allocation systems and implementing a demand forecasting system.

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Artistree

We currently operate a vertically integrated framing operation that leverages Artistree, our wholly-owned manufacturing subsidiary, across our Michaels and Aaron Brothers store networks. Artistree supplies high quality custom and specialty framing merchandise, including art prints and precut mats. We believe Artistree provides a competitive advantage to our stores and allows us to capture both retail and manufacturing margins. Based on the benefits we have received from this vertically integrated solution, we continue to evaluate opportunities to further leverage our strong framing operations.

Our moulding manufacturing plant, located in Kernersville, North Carolina, converts lumber into finished frame moulding that is supplied to our regional processing centers for custom framing orders for our stores. We manufacture approximately 19% of the moulding we process, import another 51% from quality manufacturers in Indonesia, Malaysia, China, and Italy, and purchase the balance from distributors. We directly source metal moulding for processing in our regional centers. The custom framing orders are processed (frames cut and joined, along with cutting mats and foamboard backing) and shipped to our stores where the custom frame order is completed for customer pick-up.

During fiscal 2011, we operated four regional processing centers in City of Industry, California; Coppell, Texas; Kernersville, North Carolina; and Mississauga, Ontario. Our art prints and pre-cut mats, along with our custom frame supplies, are packaged and distributed out of our Coppell regional processing center. Combined, these facilities occupy approximately 538,000 square feet and, in fiscal 2011, processed over 29 million linear feet of frame moulding and over six million individually custom cut mats for our Michaels and Aaron Brothers stores.

In July 2012, Michaels completed the implementation of a modified pricing and promotion cadence for its custom framing business. The program establishes a rotational collection cadence to limit the percentage of days that custom framing SKUs are on promotion, to more fully comply with regulatory requirements in various jurisdictions. The program is generally the same as that approved for the Company by the Attorney General for the State of New York. Based on results of this implementation in New York and other jurisdictions, we do not believe that this pricing and promotion cadence will have a material impact on our results of operations.

Distribution

We currently operate a distribution network for supplying our stores with merchandise. Approximately 85% of Michaels stores merchandise receipts are shipped through the distribution network with the remainder shipped directly from vendors to stores. Approximately 55% of Aaron Brothers stores merchandise is shipped through the distribution network with the remainder shipped directly from vendors. Our seven distribution centers are located in California, Florida, Illinois, Pennsylvania, Texas, and Washington. In addition, we utilize a third party warehouse to store and supply our seasonal merchandise in preparation for the holiday season.

Michaels stores generally receive deliveries from the distribution centers weekly through a transportation network using a dedicated fleet of trucks and contract carriers. Aaron Brothers stores generally receive merchandise on a biweekly basis from a dedicated 174,000 square foot distribution center located in the Los Angeles, California area.

Store Expansion and Relocation

The following table shows our total store growth for the last five years:

	Fiscal Year				
	2011	2010	2009	2008	2007
Michaels stores:					
Retail stores open at beginning of year	1,045	1,023	1,009	963	921
Retail stores opened during the year	25	23	18	51	45
Retail stores opened relocations during the year	15	10	5	11	11
Retail stores closed during the year	(6)	(1)	(4)	(5)	(3)
Retail stores closed relocations during the year	(15)	(10)	(5)	(11)	(11)
Retail stores open at end of year	1,064	1,045	1,023	1,009	963
Aaron Brothers stores:					
Retail stores open at beginning of year	137	152	161	166	166
Retail stores opened during the year					2
Retail stores opened relocations during the year				1	
Retail stores closed during the year	(3)	(15)	(9)	(5)	(2)
Retail stores closed relocations during the year				(1)	
Retail stores open at end of year	134	137	152	161	166
Total store count at end of year	1,198	1,182	1,175	1,170	1,129

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We believe, based on an internal real estate and penetration study of Michaels stores, that the combined U.S. and Canadian markets can support at least 1,500 Michaels stores. We plan to open approximately 45 to 50 Michaels stores in fiscal 2012. Included in these openings are relocations of 10 to 15 Michaels stores. We continue to pursue a store relocation program to improve the real estate location quality and performance of our store base. During fiscal 2012, we anticipate closing 5 to 10 Michaels stores and 5 to 10 Aaron Brothers stores. We do not plan to open any new Aaron Brothers stores in 2012. Many of our store closings are stores that have reached the end of their lease term or are being relocated. We believe our ongoing store evaluation process results in strong performance across our store base.

We have developed a standardized procedure that allows for the efficient opening of new stores and their integration into our information and distribution systems. We develop the floor plan and merchandise layout and organize the advertising and promotions in connection with the opening of each new store. In addition, we maintain qualified store opening teams to provide new store personnel with store training.

Our new store operating model, which is based on historical store performance, assumes a target store size of approximately 18,000 selling square feet. Our average initial net investment, which varies by site and specific store characteristics, is approximately $1.3 million per store and consists of store build-out costs (net of tenant improvement allowances), pre-opening expenses and average first year inventory (net of payables). Based on our model, we expect our new stores to repay the initial net investment in approximately 3 years.

Competition

We are the largest arts and crafts specialty retailer within the estimated $30.3 billion arts and crafts industry and $3.0 billion framing industry. The market we compete in is highly fragmented, including stores across the nation operated primarily by small, independent retailers along with a few regional and national chains. We face competition from Internet-based retailers, in addition to traditional store-based retailers. We believe customers choose where to shop based upon store location, breadth of selection, price, quality of merchandise, availability of product, and customer service. We compete with many different types of retailers and classify our competition within the following categories:

- *Mass merchandisers.* This category includes companies such as Wal-Mart Stores, Inc., Target Corporation, and other mass merchandisers. These retailers typically dedicate only a small portion of their selling space to a limited selection of home décor, arts and crafts supplies, and seasonal merchandise, and they seek to capitalize on the latest trends by stocking products that are complementary to those trends and their current merchandise offerings. These mass merchandisers generally have limited customer service staffs with minimal amounts of experience in crafting projects.

- *Multi-store chains.* This category includes several multi-store chains, each operating more than 30 stores, and comprises: Hobby Lobby, which operates approximately 524 stores in 42 states, primarily in the Midwestern and Southern U.S.; Jo-Ann Stores, Inc., which operates approximately 790 stores in 49 states; A.C. Moore Arts & Crafts, Inc., which operates approximately 141 stores primarily in the mid-Atlantic and Northeast regions; and Garden Ridge Corporation, which operates approximately 56 stores in 19 states, primarily in the Midwestern and Southern U.S. We believe all of these chains are significantly smaller than Michaels with respect to Net sales.

- *Small, local specialty retailers.* This category includes local independent arts and crafts retailers and custom framing shops. Typically, these are single-store operations managed by the owner. These stores generally have limited resources for advertising, purchasing, and distribution. Many of these stores have established a loyal customer base within a given community and compete based on relationships and customer service.

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Foreign Sales

All of our current international business is in Canada, which accounted for approximately 9% of total sales in fiscal 2011 and fiscal 2010, and 8% of total sales in fiscal 2009. As of the end of the last three fiscal years less than 6% of our assets have been located outside of the U.S. See Note 13 to the Consolidated Financial Statements for the fiscal years ended January 28, 2012, January 29, 2011, and January 30, 2010 for Net sales and assets by country. Our international sales accounted for approximately 9% of total sales in each of the nine months ended October 27, 2012 and October 29, 2011. As of October 27, 2012 and October 29, 2011, less than 8% of our assets had been located outside of the U.S. See Note 8 to the Consolidated Financial Statements for the nine months ended October 27, 2012 for Net sales and assets by country.

Trademarks and Service Marks

We own or have rights to trademarks, service marks or trade names that we use in connection with the operation of our business, including, without limitation, Aaron Brothers , Artistree , Michaels , Michaels the Arts and Crafts Store , Recollections , Where Creativity Happens , an stylized Michaels logos. We are registering or have registered our primary private brands including Artist s Loft, ArtMinds, Celebrate It, Creatology, Craft Smart, Imagin8, Recollections, Loops & Threads, MiDesign@Michaels, Studio Décor, Bead Landing and Ashland, and various sub-brands associated with these primary marks.

Employees

As of October 27, 2012, we employed approximately 53,200 associates, approximately 42,500 of whom were employed on a part-time basis. The number of part-time associates substantially increases during the Christmas selling season. Of our full-time associates, approximately 3,000 are engaged in various executive, operating, training, distribution, and administrative functions in our corporate and division offices and distribution centers, and the remainder are engaged in store operations. None of our associates are subject to a collective bargaining agreement.

Legal Proceedings

Employee Claims

Adams Claim

On March 20, 2009, 114 individuals commenced an action against the Company styled Adams, et al. v. Michaels Stores, Inc. in the U.S. District Court for the Central District of California. The complaint was later amended to add 15 additional plaintiffs. In 2010, two additional lawsuits making the same allegations were filed in the Central District Court by eight additional plaintiffs, styled Borgen, et al. v. Michaels Stores, Inc. and Langstaff v. Michaels Stores, Inc., and were later consolidated with the Adams suit. The Adams consolidated suit (Adams) alleges that the plaintiffs, certain former and current store managers in California, were improperly classified as exempt employees and, as such, Michaels failed to pay overtime wages, provide meal and rest periods (or compensation in lieu thereof), accurately record hours worked and provide itemized employee wage statements. The Adams suit additionally alleges that the foregoing conduct was in breach of California s unfair competition law. The plaintiffs seek injunctive relief, damages for unpaid wages, penalties, restitution, interest, and attorneys fees and costs. A number of the individual plaintiff claims have been settled for immaterial amounts. A bench trial on one of the plaintiff s cases occurred in December 2010. The Court has orally advised that Michaels was successful at trial, but has not yet provided its decision in writing. A trial on another plaintiff s case is set for February 26, 2013. We believe we have meritorious defenses and intend to defend the remaining individual claims vigorously. We do not believe the resolution of these cases will have a material effect on our consolidated financial statements.

Ragano Claim

On July 11, 2011, the Company was served with a lawsuit filed in the California Superior Court in and for the County of San Mateo by Anita Ragano, as a purported class action proceeding on behalf of herself and all current and former hourly retail employees employed by Michaels stores in California. We removed the matter to the U.S. District Court for the Northern District of California on August 9, 2011. The complaint was subsequently amended to add an additional named plaintiff, Terri McDonald. The lawsuit alleges that Michaels stores failed to pay all wages and overtime, failed to provide its hourly employees with adequate meal and rest breaks (or compensation in lieu thereof), failed to timely pay final wages, unlawfully withheld wages and failed to provide accurate wage statements and further alleges that the foregoing conduct was in breach of various laws, including California s unfair competition law. The plaintiffs seek injunctive relief, compensatory damages, meal and rest break penalties, waiting time penalties, interest, and attorneys fees and costs. On August 10, 2012, we reached a tentative class-wide settlement with plaintiffs and the Court granted preliminary approval on October 26, 2012. A final approval hearing is scheduled for March 1, 2013. The settlement, if approval is granted, will not have a material effect on our consolidated financial statements, and was accrued as of October 27, 2012.

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Rea Claim

On September 15, 2011, the Company 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 purported class action proceeding on behalf of themselves and certain former and current store managers employed by Michaels stores in California. The lawsuit alleges that the Company stores 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 alleges that the foregoing conduct was in breach of various laws, including California s unfair competition law. The plaintiffs have pled less than five million dollars in damages, penalties, costs of suit and attorneys fees, exclusive of interest. We believe we have meritorious defenses and intend to defend the lawsuit vigorously. Based, in part, on the plaintiffs pleadings of less than $5 million dollars, we do not believe the resolution of the lawsuit will have a material effect on our Consolidated Financial Statements.

Tijero and Godfrey Consolidated Claim

On February 12, 2010, the Company and its wholly owned subsidiary, Aaron Brothers, was served with a lawsuit filed in the California Superior Court in and for the County of Alameda by Jose Tijero, a former assistant manager for Aaron Brothers, as a purported class action proceeding on behalf of himself and all current and former hourly retail employees employed by Aaron Brothers in California. On July 12, 2010, Aaron Brothers was served with a lawsuit filed in the California Superior Court in and for the County of Orange by Amanda Godfrey, a former Aaron Brothers hourly employee alleging similar allegations as in the Tijero suit. On October 15, 2010, the cases were consolidated against Aaron Brothers and re-filed in the U.S. District Court Northern District of California. These suits allege that Aaron Brothers failed to pay all wages and overtime, failed to provide its hourly employees with adequate meal and rest breaks (or compensation in lieu thereof), failed to timely pay final wages, unlawfully withheld wages and failed to provide accurate wage statements and further alleges that the foregoing conduct was in breach of various laws, including California s unfair competition law. The plaintiff seeks injunctive relief, compensatory damages, meal and rest break penalties, waiting time penalties, interest, and attorneys fees and costs. On April 4, 2012, we reached a class-wide settlement with plaintiffs that is subject to the Court s approval. The settlement, if approved, will not have a material effect on our consolidated financial statements, and was accrued as of October 27, 2012.

Irene Barreras Claim

On July 24, 2012, Irene Barreras, a former employee, filed a purported class action proceeding against Michaels Stores, Inc. in the Superior Court of the State of California for the County of Alameda (Alameda Superior Court), alleging unfair business competition and unjust enrichment, wrongful termination, disability discrimination, failure to prevent discrimination, failure to engage in the interactive process, and failure to accommodate mental or physical disabilities. The suit is brought on Ms. Barreras behalf and on behalf of a class of all retail store employees who were terminated from July 24, 2008 to the present, allegedly due to Michaels refusal to engage in the interactive process with, or provide accommodations to, the terminated employees who did not meet the qualifications for medical leaves. The plaintiff seeks injunctive relief, compensatory damages, punitive damages, consequential damages, general damages, interest, attorneys fees and costs. On August 24, 2012, we removed the case to the United States District Court, Northern District of California. Our motion to dismiss the case is pending. 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.

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Consumer Class Action Claims

Zip Code Claims

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

Additionally, since the California Supreme Court decision on February 10, 2011, three additional purported class action lawsuits alleging violations of the Song Act have been filed against the Company: Carolyn Austin v. Michaels Stores, Inc. and Tiffany Heon v. Michaels Stores, Inc., both in the San Diego Superior Court and Sandra A. Rubinstein v. Michaels Stores, Inc. in the Superior Court of California, County of Los Angeles, Central Division. The Rubinstein case was transferred to the San Diego Superior Court. An order coordinating the cases has been entered and plaintiffs filed a Consolidated Complaint on April 24, 2012. A hearing on Plaintiffs Motion for Certification is set for March 8, 2013. Plaintiffs seek damages, civil penalties, common settlement fund recovery, attorney fees, costs of suit and prejudgment interest.

Also, relying in part on the California Supreme Court decision, an additional purported class action lawsuit was filed on May 20, 2011 against the Company: Melissa Tyler v. Michaels Stores, Inc. in the U.S. District Court-District of Massachusetts, alleging violation of a similar Massachusetts statute, Mass. Gen. Laws ch. 93, section 105(a) (Statute), regarding the collection of personally identifiable information in connection with a credit card transaction. A hearing was held on October 20, 2011 on our Motion to Dismiss the claims. On January 6, 2012, the Court granted our Motion to Dismiss. However, the Court certified questions of law to the Massachusetts Supreme Judicial Court regarding the interpretation of the Statute. Oral arguments on the matter were held on November 6, 2012.

We intend to vigorously defend each of these zip code claim cases and we are unable, at this time, to estimate a range of loss, if any.

Pricing and Promotion

On April 30, 2012, William J. Henry, a consumer, filed a purported class action proceeding against Michaels Stores, Inc. in the Court of Common Pleas, Lake County, Ohio, on behalf of himself and all similarly-situated Ohio consumers who purchased framing products and/or services from Michaels during weeks where Michaels was advertising a discount for framing products and/or services. The lawsuit alleges that

Michaels advertised discounts on its framing products and/or services without actually providing a discount to its customers. The plaintiff claims violation of Ohio law ORC 1345.01 et seq., breach of contract, unjust enrichment and fraud. The plaintiff has alleged damages, penalties and fees not to exceed $5 million, exclusive of interest and costs. We filed a Motion to Dismiss on July 3, 2012. On October 23, 2012, the Court granted our Motion to Dismiss, in part, dismissing the Plaintiff s breach of contract claim and denying the motion as to the other claims. We believe we have meritorious defenses and intend to defend the lawsuit vigorously. We do not believe the resolution of this lawsuit will have a material effect on our consolidated financial statements.

Website Tracking and Coding

On June 19, 2012, Jerome Jurgens, a citizen of Missouri, filed a purported class action proceeding against Michaels Stores, Inc. in the 25th Judicial Circuit Court, Phelps County, Missouri, on behalf of himself, Wendy Poepsel and all other similarly-situated Missouri individuals who, on or after June 19, 2007, accessed the Michaels website and had Flash cookies attach to their computers. Plaintiffs allege that Michaels, through the use of its website, makes use of cookies in order to ascertain user s web browsing habits. Specifically, the plaintiffs allege violations of the Missouri Computer Tampering and Merchandising Practices Act statutes, as well as common law claims of conversion, trespass to chattels, invasion of privacy and unjust enrichment are alleging damages, penalties and fees not to exceed $5 million, inclusive of costs and attorneys fees.   We filed a Motion to Dismiss on August 8, 2012, which was subsequently denied. We believe we have meritorious defenses and intend to defend the lawsuit vigorously. We do not believe the resolution of this lawsuit will have a material effect on our consolidated financial statements.

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Data Breach Claims

Payment Card Terminal Tampering

On May 3, 2011, we were advised by the U.S. Secret Service that they were investigating certain fraudulent debit card transactions that occurred on accounts that had been used for legitimate purchases in selected Michaels stores. A subsequent internal investigation revealed that approximately 90 payment card terminals in certain Michaels stores had been physically tampered with, potentially resulting in customer debit and credit card information to be compromised. We have since removed and replaced approximately 7,100 payment card terminals comparable to the identified tampered payment card terminals from our Michaels stores. The Company continues to cooperate with various governmental entities and law enforcement authorities in investigating the payment card terminal tampering, but we do not know the full extent of any fraudulent use of such information.

On May 18, 2011, Brandi F. Ramundo, a consumer, filed a purported class action proceeding against Michaels Stores, Inc. in the U.S. District Court for the Northern District of Illinois, on behalf of herself and all similarly- situated U.S. consumers. The Ramundo lawsuit alleges that Michaels failed to take commercially reasonable steps to protect consumer financial data, and was in breach of contract and laws, including the Federal Stored Communications Act and the Illinois Consumer Fraud and Deceptive Practices Act. The plaintiff seeks compensatory, statutory and punitive damages, costs, credit card fraud monitoring services, interest and attorneys fees. Subsequently two additional purported class action lawsuits significantly mirroring the claims in the Ramundo complaint were filed against the Company: Mary Allen v. Michaels Stores, Inc., and Kimberly Siprut v. Michaels Stores, Inc., both in the U.S. District Court for the Northern District of Illinois. On June 8, 2011, an order was entered consolidating these matters, which also provided for consolidation of all related actions subsequently filed in or transferred to the Northern District of Illinois. On July 8, 2011, a Consolidated Amended Class Action Complaint styled In Re Michaels Stores Pin Pad Litigation (In Re Michaels Stores Consolidated Complaint) was filed in the U.S. District Court for the Northern District of Illinois. On August 8, 2011, we filed a Motion to Dismiss the In Re Michaels Stores Consolidated Complaint. On November 23, 2011, the Court dismissed the Stored Communications Act and negligence claims under Illinois law, but denied the motion as to the breach of implied contract and Illinois Consumer Fraud and Deceptive Practices Act claims.

Four other substantially similar putative class action lawsuits have also been filed. Jeremy Williams v. Michaels Stores, Inc. and Fred Sherry v. Michaels Stores, Inc., were filed in the U.S. District Court for the Northern District of Illinois. Sara Rosenfeld and Ilana Soffer v. Michaels Stores, Inc. and Lori Wilson v. Michaels Stores, Inc. were both filed in New Jersey state court, removed to the United States District Court for the District of New Jersey, and transferred to the United States District Court for the Northern District of Illinois. The New Jersey cases assert negligence and New Jersey Consumer Fraud Act claims. All four cases are subject to the consolidation order. The Court has held that Michaels is not required to respond to those complaints.

On August 20, 2012, we reached a tentative class-wide settlement with plaintiffs that is subject to the Court s approval. The settlement, will not have a material effect on our consolidated financial statements, and was accrued as of October 27, 2012.

Governmental Inquiries and Related Matters

Non-U.S. Trust Inquiry

In early 2005, the District Attorney s office of the County of New York and the SEC opened inquiries concerning non-U.S. trusts that directly or indirectly held shares of Michaels Common Stock and Common Stock options. On July 29, 2010, the SEC filed a civil enforcement action in federal district court for the Southern District of New York against Charles Wyly, Sam Wyly, the Wylys attorney - Michael French, and others alleging, among other things, violations of various federal securities laws, including those governing ownership reporting and trading of securities, in connection with the non-U.S. trusts and their subsidiaries. Additional information may be obtained at the SEC s website. Sam Wyly, the estate of Charles Wyly and Mr. French, also a former director of the Company, have requested indemnification from the Company for certain legal costs with respect to these matters. The Company has resolved all claims with regards to Sam Wyly and the estate of Charles Wyly for an immaterial amount.

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On April 12, 2012, Mr. French filed a lawsuit against the Company and the non-U.S. trusts in the District Court of Dallas County, Texas. Mr. French seeks damages from the Company for breach of contract, attorneys fees and costs related to the Company s alleged indemnification obligations to Mr. French and attorneys fees and costs related to the lawsuit itself. On May 18, 2012, the co-defendants removed the lawsuit to the United States District Court for the Northern District of Texas-Dallas division. We believe we have meritorious defenses and intend to defend the claims vigorously. We do not believe the resolution of this case will have a material effect on our Consolidated Financial Statements.

General

In addition to the litigation discussed above, we are, and in the future, may be involved in various other lawsuits, claims and proceedings incidental to the ordinary course of business.

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

For some of the matters disclosed above, the Company is currently able to estimate a reasonably possible loss or range of loss in excess of amounts accrued (if any). For some of the matters included within this estimation, an accrual has been made because a loss is believed to be both probable and reasonably estimable, but an exposure to loss exists in excess of the amount accrued; in these cases, the estimate reflects the reasonably possible range of loss in excess of the accrued amount. For other matters included within this estimation, no accrual has been made because a loss, although estimable, is believed to be reasonably possible, but not probable; in these cases the estimate reflects the reasonably possible loss or range of loss within the ranges identified. For the various ranges identified, the aggregate of these estimated amounts is approximately $15 million, which is also inclusive of amounts accrued by the Company.

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

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

Description of Property

We lease substantially all of the sites for our Michaels and Aaron Brothers stores, with the majority of our stores having initial lease terms of approximately 10 years. The leases are generally renewable, with increases in lease rental rates. Lessors have made leasehold improvements to prepare our stores for opening under a majority of our existing leases. As of January 28, 2012, in connection with stores that we plan to open or relocate in future fiscal years, we had signed 49 leases for Michaels stores.

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As of October 27, 2012, we lease the following non-store facilities:

	Square Footage
Distribution centers:	
Hazleton, Pennsylvania	1,005,000
Jacksonville, Florida	776,000
Lancaster, California	763,000
Centralia, Washington	718,000
New Lenox, Illinois	693,000
Tarrant County, Texas	433,000
City of Commerce, California (Aaron Brothers)	174,000
	4,562,000
Artistree:	
Coppell, Texas (regional processing and fulfillment operations center)	230,000
Kernersville, North Carolina (manufacturing plant and regional processing center)	156,000
City of Industry, California (regional processing center)	90,000
Mississauga, Ontario (regional processing center)	62,000
	538,000
Office space:	
Irving, Texas (corporate headquarters)	296,000
Coppell, Texas (corporate satellite office)	67,000
Mississauga, Ontario (Canadian regional office)	3,000
	366,000
Coppell, Texas (new store staging warehouse)	29,000
	5,495,000

The following table indicates the number of our retail stores located in each state or province as of October 27, 2012:

	Number of Stores		
State/Province	**Michaels**	**Aaron Brothers**	**Total**
Alabama	12		12
Alaska	3		3
Alberta	16		16
Arizona	28	5	33
Arkansas	4		4
British Columbia	17		17
California	130	84	214
Colorado	21	4	25
Connecticut	14		14
Delaware	4		4
Florida	75		75
Georgia	31	2	33
Idaho	6	1	7
Illinois	38		38
Indiana	17		17
Iowa	7		7
Kansas	8		8
Kentucky	10		10
Louisiana	12		12
Maine	3		3

Manitoba	3		3
Maryland	22		22
Massachusetts	26		26
Michigan	35		35
Minnesota	22		22
Mississippi	6		6
Missouri	21		21
Montana	4		4
Nebraska	4		4
Nevada	10	5	15
New Brunswick	3		3
Newfoundland and Labrador	1		1
New Hampshire	7		7
New Jersey	29		29
New Mexico	3		3
New York	53		53
North Carolina	33		33
North Dakota	2		2
Nova Scotia	4		4
Ohio	31		31
Oklahoma	8		8
Ontario	43		43
Oregon	15	2	17
Pennsylvania	47		47
Prince Edward Island	1		1
Quebec	7		7
Rhode Island	3		3
Saskatchewan	3		3
South Carolina	12		12
South Dakota	2		2
Tennessee	14		14
Texas	76	15	91
Utah	12		12
Vermont	2		2
Virginia	34		34
Washington	22	9	31
West Virginia	5		5
Wisconsin	17		17
Wyoming	1		1
Total	1,099	127	1,226

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MANAGEMENT

Directors

Set forth below is information concerning each of our directors, including their ages as of October 27, 2012, present principal occupations, other business experiences during at least the last five years, membership on committees of the Board, public company directorships held during the last five years and certain other directorships. Except for Messrs. Murphy and Wallace and Ms. Greenthal, each of the directors listed below has served on our Board since October 31, 2006. The stockholders of the Company elected Mr. Murphy to the Board on January 13, 2009, elected Mr. Wallace to the Board on March 11, 2009 and elected Ms. Greenthal to the Board on May 18, 2011, in each case to fill a vacancy created by the resignation of a former director.

Name	Age	Position	Committee Membership
Joshua Bekenstein	54	Director	
Todd M. Cook	41	Director	Audit Committee
Jill A. Greenthal	56	Director	Audit Committee
Lewis S. Klessel	45	Director*	Audit Committee
Matthew S. Levin	46	Director	Compensation Committee
Gerry M. Murphy	56	Director	
James A. Quella	62	Director	Audit Committee
Peter F. Wallace	37	Director	Compensation Committee

* Effective May 16, 2012, Mr. Klessel was appointed, along with the Company s Chief Administrative Officer and Chief Financial Officer, Charles M. Sonsteby, to the interim CEO Office. Effective as of such date, Mr. Klessel was also appointed to the newly-created position of interim Chief Operating Officer of the Company.

Because we have not listed any securities on a national securities exchange or on an inter-dealer quotation system, we are not required to have a board of directors comprised of a majority of independent directors under SEC rules or any listing standards. Accordingly, our board of directors has not made any determination as to whether our directors satisfy any independence requirements applicable to board members under the rules of the SEC or any national securities exchange, inter-dealer quotation system or any other independence definition.

Mr. Bekenstein is a managing director at Bain. Prior to joining Bain in 1984, Mr. Bekenstein spent several years at Bain & Company, where he was involved with companies in a variety of industries. Mr. Bekenstein received an M.B.A. from Harvard Business School and a B.A. from Yale University. Mr. Bekenstein serves as a director of Bombardier Recreational Products Inc., Dollarama Capital Corporation, Toys R Us, Inc., Burlington Coat Factory Warehouse Corporation, Bright Horizons Family Solutions Inc., The Gymboree Corporation and Waters Corporation. Mr. Bekenstein s many years of experience both as a senior executive of a large investment firm and as a director of companies in various business sectors make him highly qualified to serve on our Board.

Mr. Cook is a managing director at Bain. Prior to becoming a managing director in December 2008, Mr. Cook served in various capacities, most recently as a principal at Bain from 2003 to 2008. Prior to joining Bain in 1996, Mr. Cook was a consultant at Bain & Company. Mr. Cook received an M.B.A. from Stanford University Graduate School of Business where he was an Arjay Miller Scholar. He also holds a B.E. in electrical engineering and a B.A. in economics from Dartmouth College. Mr. Cook was formerly a director of Dollarama Capital Corporation and a director of Dunkin Brands, Inc. Mr. Cook s strong financial background combined with his experiences at Bain and as director of other companies put him in a position to provide important contributions to our Board.

Ms. Greenthal has been a senior advisor at The Blackstone Group in the private equity group since 2007. From 2003 until 2007, Ms. Greenthal was a senior managing director in Blackstone s advisory group. Prior to joining The Blackstone Group, Ms. Greenthal was Co-Head of the Global Media Investment Banking Group, a member of the Executive Board of Investment Banking, and Co-Head of the Boston office of Credit Suisse First Boston. Ms. Greenthal graduated as a member of The Academy from Simmons College and received an M.B.A. from Harvard Business School. Ms. Greenthal currently serves on the board of directors of Akamai Technologies, Inc., Orbitz Worldwide, Inc. and The Weather Channel Companies. Ms. Greenthal was formerly a director of Martha Stewart Omnimedia, Houghton Mifflin, Universal Orlando and Freedom Communications. Ms. Greenthal s background and understanding of capital markets and financial matters as well as her experiences described above enable her to provide valuable counsel to our management and Board.

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Mr. Klessel is a managing director at Bain. Prior to becoming a managing director in January 2012, Mr. Klessel served in various capacities, most recently as an operating partner at Bain from December 2007 to December 2011. Prior to joining Bain in October 2005, Mr. Klessel held a variety of operating and strategy leadership positions from 1997 to 2005 at The Home Depot, Inc., most recently as President of Maintenance Warehouse, a wholly- owned subsidiary that distributed maintenance products to facility management customers in the multi-housing, lodging, health-care and commercial sectors. Mr. Klessel received an M.B.A. from Harvard Business School and a B.S. from the Wharton School at the University of Pennsylvania. Mr. Klessel serves as a director of HD Supply, Inc. and Guitar Center, Inc. As a result of these and other professional experiences, Mr. Klessel brings to our Board extensive experience in operating and managing complex organizations, particularly in the retail industry, which strengthen the collective qualifications, skills and experience of our Board.

Mr. Levin is a managing director at Bain. Mr. Levin joined Bain Capital in 1992 and was promoted to managing director in 2000. Prior to joining Bain, Mr. Levin was a consultant at Bain & Company in the consumer products and manufacturing industries. Mr. Levin received an M.B.A. from Harvard Business School where he was a Baker Scholar. He received a B.S. from the University of California at Berkeley. Mr. Levin serves as a board member of Bombardier Recreational Products Inc., Dollarama Capital Corporation, Edcon Holdings Pty. Ltd., Guitar Center, Inc., Toys R Us, Inc. and Unisource Worldwide, Inc. Mr. Levin s significant experience in and knowledge of corporate finance and managing companies put him in a position to provide important contributions to our Board.

Mr. Murphy is a senior managing director at The Blackstone Group in the private equity group, which he joined in 2008. Before joining The Blackstone Group, Mr. Murphy spent five years as CEO of Kingfisher, a FTSE 100 company and leading home improvement retailer in Europe and Asia. He has also served as CEO of Carlton Communications plc, Exel plc and Greencore Group plc. Mr. Murphy received his BSc and PhD in food technology from University College Cork and a 1st Class MBS in marketing from University College Dublin. Mr. Murphy serves as a director of United Biscuits Topco Limited, Kleopatra Acquisition Corp., British American Tobacco plc, The Blackstone Group International Limited and a member of the Advisory Board of KP Germany Zweite GmbH. Mr. Murphy was formerly a director of Abbey National plc, Reckitt Benckiser Group plc and Hornbach Holding AG. Mr. Murphy s experience as managing director of a large investment firm, director of several companies in various industries and chief executive officer of a company in the retail industry make him a qualified and valued member of our Board.

Mr. Quella is a senior managing director and senior operating partner at The Blackstone Group in the private equity group. Prior to joining The Blackstone Group in 2004, Mr. Quella was a managing director and senior operating partner with DLJ Merchant Banking Partners-CSFB Private Equity from 2000 to 2004. Prior to that, Mr. Quella worked at Mercer Management Consulting and Strategic Planning Associates. Mr. Quella received a B.A. in International Studies from the University of Chicago/University of Wisconsin-Madison and an M.B.A. from the University of Chicago. Mr. Quella serves as a director of Catalent Pharma Solutions, Inc. and Vanguard Health Systems, Inc. Mr. Quella was formerly a director of Freescale Semiconductor, Inc., Graham Packaging Company, L.P., The Nielsen Company and Intelenet Global Services. Due to contributions that Mr. Quella can provide to our Board resulting from his financial expertise, as well as his significant experience in working with companies controlled by private equity sponsors, he is qualified to be on and an asset to our Board.

Mr. Wallace is a senior managing director at The Blackstone Group in the private equity group, which he joined in 1997. Mr. Wallace received a B.A. in Government from Harvard College. Mr. Wallace serves on the board of directors of AlliedBarton Security Services, SeaWorld Parks & Entertainment, Pelmorex Media and The Weather Channel Companies. Mr. Wallace was formerly a director of Crestwood Midstream Partners and New Skies Satellites. These experiences and knowledge, along with his service on NYSE-listed company boards, enhance Mr. Wallace s contributions and value to our Board.

In connection with the Merger, the Sponsors entered into an agreement providing that Michaels Holdings LLC will vote its shares of the Company so that each board member of Michaels Holdings LLC will serve on the Board of the Company.

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Executive Officers

Our current executive officers, their ages as of October 27, 2012, and their business experience during at least the past five years are set forth below.

Name	Age	Position
Lewis S. Klessel	45	Member of the Interim Office of the Chief Executive Officer and Interim Chief Operating Officer; Director*
Charles M. Sonsteby	59	Member of the Interim Office of the Chief Executive Officer, Chief Administrative Officer and Chief Financial Officer*
Nicholas E. Crombie	62	Executive Vice President Store Operations
Thomas C. DeCaro	57	Executive Vice President Supply Chain
Philo T. Pappas	53	Executive Vice President Category Management
Weizhong Wilson Zhu	60	Executive Vice President Private Brands & Global Sourcing
Eric C. Gordon	49	Senior Vice President Chief Information Officer
Shawn E. Hearn	47	Senior Vice President Human Resources
Paula A. Puleo	47	Senior Vice President Chief Marketing Officer
Michael J. Veitenheimer	56	Senior Vice President General Counsel and Secretary

* Effective May 16, 2012, following hospitalization of John B. Menzer, our former Chief Executive Officer, who since resigned effective July 19, 2012 to focus on recovery and rehabilitation from a stroke he suffered, our Board established an interim CEO Office and transferred the responsibilities of the Company s Chief Executive Officer to the CEO Office. The CEO Office is comprised of the Company s current Chief Administrative Officer and Chief Financial Officer, Mr. Sonsteby, and current board member and interim Chief Operating Officer, Mr. Klessel. Each of these individuals has remained in his current position while carrying out his CEO Office responsibilities. The CEO Office reports to our Board.

Mr. Sonsteby was named Chief Administrative Officer and Chief Financial Officer in October 2010. Prior to joining Michaels, Mr. Sonsteby served in various capacities at Brinker International, Inc. (which owns and operates casual dining restaurants) beginning in March 1990, including as Executive Vice President and Chief Financial Officer from 2001 until 2010, as Senior Vice President of Finance from 1997 to 2001 and as Vice President and Treasurer from 1994 to 1997. Mr. Sonsteby was formerly a director of Zale Corporation.

Mr. Crombie was promoted to Executive Vice President Store Operations in May 2007. Prior to his promotion, he served as Zone Vice President of Stores for Michaels since January 2002. Prior to joining the Company, Mr. Crombie was Area Vice President, Mid-South for CVS (a retail pharmacy chain) from February 1999 to January 2002. From January 1996 until February 1999, he was employed by Caldor, Inc. (a discount department store retailer) with store operations responsibilities, including Regional Vice President.

Mr. DeCaro was promoted to Executive Vice President Supply Chain in June 2005. Prior to his promotion, Mr. DeCaro served as Senior Vice President Inventory Management since August 2000 when he joined Michaels. From April 1998 until joining the Company, he was Vice President Merchandise for The Walt Disney Company (a multi-national media conglomerate, which also operates retail stores and theme parks). Prior to this, he held the position of Senior Vice President Merchandise Planning and Allocation for Kohl s Department Stores (a U.S. department store chain) from February 1996 to April 1998. In addition, Mr. DeCaro has held various positions in Merchandise Planning and Allocation and Finance for The Disney Store, The Limited Stores, May Department Stores, and Sanger Harris Department Stores.

Mr. Pappas was named Executive Vice President Category Management in February 2009. Prior to joining Michaels, he served as Chief Merchandising Officer at Tweeter Home Entertainment Group, Inc. (a specialty consumer electronics retailer) from April 2003 to October 2008. On June 11, 2007, Tweeter and each of its subsidiaries filed voluntary petitions for reorganization under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware in Wilmington, Delaware. Prior to joining Tweeter, Mr. Pappas served in various management positions at Staples, Inc. (an office supply store chain) from November 1994 to April 2003, most recently as Senior Vice President of Merchandising.

Mr. Zhu was promoted to Executive Vice President Private Brands & Global Sourcing in July 2009. Prior to his promotion, Mr. Zhu served as our Executive Vice President Global Sourcing since May 2008 and Senior Vice President Strategic Sourcing since joining the Company in April 2007. From March 2003 until April 2007, he was Vice President, Private Brand Development and Global Sourcing at Office Depot, Inc. (a supplier of office products). Prior to joining Office Depot, Mr. Zhu served as Vice President, Global Sourcing for Hudson s Bay Company (a North American company operating several retail store chains) in Canada from March 2001 to March 2003. In addition, Mr. Zhu has held various management positions at Saks, Inc., Edison Brothers Stores, and Nulook Fashions.

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Mr. Gordon was named Senior Vice President Chief Information Officer in September 2011. Prior to joining Michaels, he served as Chief Information Officer and Division Senior Vice President at Collective Brands, Inc. (a specialty family footwear retailer) from January 2008 to August 2011. Prior to joining Collective Brands, Mr. Gordon served as Vice President, Solutions Delivery at Family Dollar Stores, Inc. (a regional chain of variety stores) from June 2003 to December 2007.

Mr. Hearn was named Senior Vice President Human Resources in February 2007. Prior to his promotion, Mr. Hearn served as our Vice President, Field Human Resources since joining Michaels in November 2002. Prior to joining Michaels, he served in various operations, marketing, and human resource management positions at KMart Corporation (a multi-national retailer) from August 1981 to October 2002, most recently as Vice President, Advertising.

Ms. Puleo was named Senior Vice President Chief Marketing Officer in March 2010. Prior to joining Michaels, she served in various management positions at RAPP Worldwide (a multi-channel marketing agency), including Executive Vice President Strategy & Enablement from February 2006 to February 2010 and Senior Vice President Account Management from December 2005 to January 2006. Prior to joining RAPP, Ms. Puleo served as Director of CRM at Limited Brands, Inc. (an apparel company with a series of retail brands) from February 2003 to December 2005.

Mr. Veitenheimer was named Senior Vice President General Counsel and Secretary in January 2008. Prior to joining Michaels, Mr. Veitenheimer served as Senior Vice President of Law and Human Resources of The Bombay Company, Inc. (a specialty retailer focused on home accessories, wall decor and furniture), from June 2007 to December 2007 after having served as a Senior Vice President since February 2006, its Secretary since July 1985 and its General Counsel since November 1983. On September 20, 2007, The Bombay Company, Inc. and its U.S. wholly-owed subsidiaries filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court, Northern District of Texas, Fort Worth Division. Prior to joining The Bombay Company, Mr. Veitenheimer was in private practice of law in Fort Worth, Texas.

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EXECUTIVE COMPENSATION

COMPENSATION DISCUSSION AND ANALYSIS

Introduction

The following Compensation Discussion and Analysis relates to compensation paid to our executive officers named in the Summary Compensation Table for fiscal 2011. From the completion of the Merger to March 2011, our Compensation Committee was comprised of two members: Michael S. Chae and Matthew S. Levin. In March 2011, Peter F. Wallace was appointed to the Compensation Committee to fill a vacancy created by the resignation of Mr. Chae from the Committee.

Named Executive Officers

According to SEC rules, the Summary Compensation Table that immediately follows this Compensation Discussion and Analysis must include specific information for each of the following persons: (i) all individuals serving as principal executive officer or acting in a similar capacity during the last completed fiscal year; (ii) all individuals serving as principal financial officer or acting in a similar capacity during the last completed fiscal year; (iii) the three most highly compensated executive officers other than the principal executive officer and principal financial officer who were serving as executive officers at the end of the last completed fiscal year; and (iv) up to two additional individuals for whom disclosure would have been provided but for the fact that the individual was not serving as an executive officer at the end of the last completed fiscal year. These individuals are: John B. Menzer, our former Chief Executive Officer (who served as principal executive officer); Charles M. Sonsteby, Chief Administrative Officer and Chief Financial Officer (who served as principal financial officer); Thomas C. DeCaro, Executive Vice President Supply Chain; Philo T. Pappas, Executive Vice President Category Management; and Eric C. Gordon, Senior Vice President Chief Information Officer (the three other most highly compensated individuals who were serving as executive officers at the end of fiscal 2011). These officers are referred to as our Named Executive Officers . This Compensation Discussion and Analysis and the executive compensation discussion and tables that immediately follow describe the process, strategy and elements of the Company s compensation plan as applied to our Named Executive Officers.

Compensation Program

The principal objectives of our compensation program are:

- attracting and retaining highly qualified individuals whose contributions result in Michaels meeting or exceeding its financial and strategic goals;

- motivating officers to achieve exceptional levels of operating and financial performance; and

- aligning officer interests with the long-term goals of our stockholders.

Currently, the total compensation for our officers at the Vice President level and above, including our Named Executive Officers, consists of three main components: base salary, annual cash incentive bonuses and long-term equity-based incentive compensation awards. The strategy of the cash incentive compensation program for our officers is to provide higher annual cash incentive compensation for exceptional corporate and business financial performance. We also believe that by placing a significant equity opportunity in the hands of executives who are capable of driving and sustaining growth, our stockholders will benefit along with the executives who helped create stockholder value. The table below includes the principal components of our pay-for-performance approach.

Component	**Purpose**	**Form**	**Pay for Performance**
Base Salary	Provide sufficient competitive pay to attract and retain experienced and successful executives; reward performance and business results.	Cash	Adjustments to base salary are based on individual performance, contributions to the business, competitive practices and internal comparisons.
Annual Bonuses	Provide financial incentives to members of management who are in positions to make important contributions to Michaels success.	Cash	The actual award amount varies with the degree to which we achieve our annual financial objectives, as well as the Named Executive Officer s individual job performance.

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Long-Term Equity-Based Compensation	Encourage and reward building long-term stockholder value and employment retention; engage executives in innovation and align them with stockholder interests. We currently provide two equity award types to balance specific objectives.		
	• Stock Options: Reward absolute stock price appreciation	Stock Options	The potential appreciation in our stock price above the option exercise price motivates our Named Executive Officers to build stockholder value. Named Executive Officers may realize value only if our stock price appreciates over the option term.
	• Restricted Stock Awards: Create retention value even during periods of short-term market volatility	Restricted Stock Awards	Retain certain Named Executive Officers and align them with stockholders interests by awarding a fixed number of common shares upon vesting, which creates the opportunity for stock ownership even during market downswings.

Compensation Strategy: Policies and Procedures

Role of Compensation Committee and Chief Executive Officer in Compensation Decisions

The Compensation Committee reviews and recommends to the Board for approval the compensation for all executive officers at the level of Executive Vice President and above. The Board is ultimately responsible for determining the compensation of our executive officers at the level of Executive Vice President and above. The members of the Compensation Committee and our Chief Executive Officer are ultimately responsible for determining the compensation of our executive officers at the Senior Vice President level. Under our certificate of incorporation, equity-based plans must also be approved by a majority of our stockholders. Both the Compensation Committee and the Board receive recommendations with respect to compensation-related decisions regarding our executive officers, other than the Chief Executive Officer, by senior management, principally the Chief Executive Officer and the Senior Vice President Human Resources. In determining compensation levels for the executive officers, the Compensation Committee considers the scope of an individual s responsibilities, the competitive market salary at comparable companies, an individual s performance and prior experience, the performance of the Company and the attainment of planned financial and strategic initiatives. These factors are evaluated by the Compensation Committee and the Board, with the attainment of planned financial and strategic initiatives given greater weight with respect to executive bonuses. The Compensation Committee considers overall past compensation and incentives in determining the compensation of executive officers and seeks to assure that the executives have appropriate incentives to achieve high levels of Company performance. The Compensation Committee, through its members involvement in other portfolio companies, has experience regarding compensation programs for executive officers. Approvals by the Compensation Committee and recommendations to the Board by the Compensation Committee are based on a number of factors, including a review of competitive market data (as described below) and executive performance (as described below), the experience of the members of the Compensation Committee and alignment of compensation with the overall strategic direction and goals of the Company.

Competitive Market Data and Use of Compensation Consultants

As part of the compensation review process and our preparation to become a public company, management and our human resources department provide the Compensation Committee with market survey data on executive compensation levels and general information regarding executive compensation practices in our industry, including information provided by The Hay Group, Inc., a compensation consulting firm engaged by the Company. The Hay Group s work in 2011 included a review of total compensation of our Chief Executive Officer and other executive officers in light of amounts paid and compensation targets at comparable companies gathered from its internal sources as well as from published executive compensation surveys. Our Compensation Committee believes that the results of this review demonstrated that the Company s executive compensation was generally competitive for like senior positions. Our Compensation Committee was satisfied that the information presented sufficiently confirmed the appropriateness of the Company s executive compensation program and targets. The Committee therefore did not deem it necessary to engage any further consultants for this purpose, nor did it believe that a formal benchmarking of total executive compensation or individual compensation elements against a peer group was warranted. The Compensation Committee did not aim to set total compensation, or any compensation element, at a specified level as compared to the survey and other data it reviewed, but rather used the data as guidelines for the overall executive compensation program.

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On September 26, 2011, the Company named Eric Gordon as Senior Vice President Chief Information Officer. In connection with the hiring of Mr. Gordon, the Compensation Committee considered the prior compensation level of Mr. Gordon and compensation data provided by management and our human resources department to obtain a general understanding of compensation trends when negotiating and ultimately setting the initial compensation level for Mr. Gordon.

Highlights of 2011 Performance

We achieved strong financial performance in fiscal 2011, and we believe that our Named Executive Officers were instrumental in helping us to achieve these results. Highlights of our fiscal 2011 performance include the following:

- sales increased to $4,210 million, a 4.4% improvement over last year, driven by a 3.2% increase in comparable store sales as well as the opening of 25 new stores and 15 store relocations during the year

- our private brand merchandise, as a percentage of total Net sales, increased to 44% from 32% in fiscal 2010

- gross margin improved by 1.2% to 40.0% for fiscal 2011

- we reported record Operating income of $569 million, an increase of 16.6% from prior year

- Adjusted EBITDA improved by 13.5%, from $622 million in fiscal 2010 to $706 million fiscal 2011. Net cash provided by operating activities decreased $25 million, or 5.7%, and Net income increased by $73 million to $176 million

This performance translated into financial results that exceeded our budgeted expectations and bonus threshold as described in Compensation Discussion and Analysis Annual Bonuses .

Compensation Elements

Base Salaries

Base salaries for our executive officers are established based on the scope of their responsibilities, individual performance and prior experience, Michaels operating and financial performance and the attainment of planned financial and strategic initiatives, taking into account the knowledge of the members of the Compensation Committee regarding competitive market compensation paid by companies for similar positions. The Compensation Committee recommends, and the Board sets, base salaries for officers at the level of Executive Vice President and above at a level designed to attract and retain highly qualified individuals who make contributions that result in Michaels meeting its operating and financial goals. The members of the Compensation Committee and our Chief Executive Officer use the same criteria when approving base salaries for executive officers at the Senior Vice President level. Base salaries are reviewed and adjusted annually as deemed appropriate by the Compensation Committee and the Board, as applicable, based on performance and business results, among other factors. The Compensation Committee and the Board have discretion to adjust base salaries during the fiscal year and exercised that discretion in fiscal 2011, as described below.

On September 26, 2011, Mr. Gordon was named Senior Vice President Chief Information Officer of the Company. Pursuant to his offer letter with the Company, Mr. Gordon s base salary was set at $300,000, with salary increases to be consistent with our policy of increases on an individual merit basis. Mr. Gordon also received a signing bonus of $3,000 to cover certain non-recurring benefit costs. In approving Mr. Gordon s base salary, the members of the Compensation Committee and our Chief Executive Officer considered Mr. Gordon s compensation at his prior employer, the scope and responsibilities of his position at Michaels, a competitive salary and the level of compensation needed to recruit Mr. Gordon to the Company.

In March 2011, the Compensation Committee reviewed recommendations regarding 2011 annual base salary rates for the executive officer group based on the criteria set forth under Compensation Strategy: Policy and Procedure . Merit guidelines are determined by reviewing surveys of market data provided by our management and human resources department, as well as giving consideration to the Company s overall budget for associate compensation. Based upon this information, the Company applied an annual merit rate increase of 3.0% for fiscal 2011 for its corporate associates, including our Named Executive Officers.

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In June 2011, the Compensation Committee and the Board reviewed the base salaries for the Named Executive Officers as part of a strategic review and realignment of compensation and benefits. The Board subsequently approved an additional base salary increase of $7,300 for each of the Named Executive Officers, effective July 2011.

Base salaries for the Named Executive Officers for fiscal 2010 and 2011, which reflect increases between the two fiscal years and the adjustments made during fiscal year 2011, are shown below.

Name		2010 Base Salary		2011 Base Salary
John B. Menzer	$	1,027,000	$	1,065,110
Charles M. Sonsteby		650,000		667,050
Thomas C. DeCaro		356,493		374,488
Philo T. Pappas		386,251		405,138
Eric C. Gordon(1)		N/A		300,000

(1) Mr. Gordon joined the Company in fiscal 2011.

Annual Bonuses

In March 2011, the Compensation Committee recommended that the Board approve the Company s Bonus Plan for executive officers, including the Named Executive Officers, for fiscal 2011 (the Bonus Plan) to provide financial incentives to these individuals and those other members of management who were in positions to make important contributions to Michaels success. The Board subsequently approved the Bonus Plan. The structure of the Bonus Plan and the specific objectives relating to bonus payments were proposed by the Company s Chief Executive Officer and Senior Vice President Human Resources and were reviewed by the Compensation Committee. For each of Messrs. Menzer, Sonsteby and Gordon, the Bonus Plan tied 80% of his respective bonus opportunity to Michaels attainment of a financial objective (EBITDA, less an inventory charge), and 20% to individual job performance. For each of Mr. DeCaro and Mr. Pappas, the Bonus Plan tied 50% of his respective bonus opportunity to Michaels attainment of a financial objective (EBITDA, less an inventory charge), 15% to a business unit sales objective (U.S. and Canada sales for all Company stores), 15% to a business unit buyer contribution objective (scan margin, less shrink at cost, plus entitlements, less average monthly inventory at cost with a multiplier, less an inventory charge), and 20% of his respective bonus opportunity to individual job performance. Individual management business objectives for Mr. Menzer were reviewed with and approved by the Compensation Committee in the early part of fiscal year 2011. Individual management business objectives for Messrs. Sonsteby and Pappas were reviewed with and approved by the Chief Executive Officer. For Mr. DeCaro, these objectives were reviewed and approved by the Chief Administrative Officer and Chief Financial Officer. Mr. Gordon joined the Company in September 2011, and his individual management business objectives were reviewed with and approved by the Chief Administrative Officer and Chief Financial Officer shortly thereafter.

Under the Bonus Plan, before any business unit or individual performance payout would be earned, the actual results of the financial objective (EBITDA, less an inventory charge) was required to meet the threshold established by the Compensation Committee, which represented approximately 93% of target. Each participating Named Executive Officer was entitled to a bonus equal to a certain percentage of that executive officer s base salary, depending on the achievement of the threshold, target and maximum performance level. The Compensation Committee set threshold, target and maximum performance levels for all officers of the Company. The final award depended on the actual level of performance achieved; however, the Compensation Committee retained the right to make adjustments in its sole discretion. The target levels of performance for the bonus goals were set at levels that the Compensation Committee and the Board believed to be reasonably achievable in view of Michaels historical annual performance. In the Compensation Committee s view, taking into account comparative data provided to the Committee by management and our human resources department, the compensation payable to the Named Executive Officers upon reaching target levels of performance, when added to their base salaries, creates a level of total cash compensation competitive with that paid by comparable companies for similar positions. Additional information regarding the targets and objectives is set forth below.

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The target bonus opportunity percentages set for fiscal 2011 and the threshold, target and maximum payments for each of the Named Executive Officers for fiscal 2011 were as follows:

	John B. Menzer	Charles M. Sonsteby	Thomas C. DeCaro	Philo T. Pappas	Eric C. Gordon(1)
Percentage of Base Salary					
Target	100%	70%	50%	50%	40%
Threshold	18%	12.6%	9%	9%	7.2%
Maximum	200%	140%	100%	100%	80%
Financial Weightings					
Company Objective Measures					
Overall Company Results	80%	80%	50%	50%	80%
Company Sales			15%	15%	
Buyer Contribution Less Inventory Charge			15%	15%	
Company Subjective Measures					
Individual Performance	20%	20%	20%	20%	20%

(1) Pursuant to Mr. Gordon s offer letter from the Company, Mr. Gordon s annual bonus was prorated to the commencement of his employment.

Company Objective Measures

In March 2012, the Compensation Committee reviewed the Company s financial results as applicable to the pre-established fiscal 2011 Bonus Plan objectives for the Named Executive Officers. As described previously, the financial objective of Company performance that was applicable to all the Named Executive Officers was EBITDA, less an inventory charge. At the beginning of fiscal 2011, the Compensation Committee established, and the Board approved, the EBITDA, less an inventory charge, goal for target-level bonuses at $571.6 million, with a maximum at $637.2 million and a threshold at $531 million. For the fiscal year, the Company achieved financial performance of $584.2 million, which was between target and maximum. As a result, bonuses above target were earned for the Company performance element of the plan.

At the beginning of fiscal 2011, the Compensation Committee approved a business unit sales objective goal for target level bonuses at $4,088.7 million, with a maximum at $4,293.1 million and a threshold at $3,986.4 million. The Compensation Committee also approved a business unit buyer contribution objective goal for target level bonuses at $1,998.4 million, with a maximum at $2,098.3 million and a threshold at $1,948.4 million. For the fiscal year, the Company achieved business unit sales of $4,069.9 million, which was between threshold and target, and a business unit buyer contribution of $1,998.5 million, which was between target and maximum. As a result, bonuses below target were earned for the business unit sales objective element of the plan and bonuses above target were earned for the business unit buyer contribution element of the plan. Among the Named Executive Officers, each of these components was only applicable to Messrs. Pappas and DeCaro.

Company Subjective Measures

Since the financial objective threshold that is applicable to all Named Executive Officers was met, in March 2012, the Compensation Committee, based upon input and recommendations by the Chief Executive Officer and the Chief Administrative Officer and Chief Financial Officer, as applicable, evaluated the individual performance of each of the Named Executive Officers for purposes of determining bonuses based on individual performance. The individual management business objectives are both quantitative and subjective, and are assessed in the aggregate to determine the individual s level of performance and bonus achieved. No specified weight is given to a single measure within the group of individual management business objectives, and the Committee s assessment of achievement reflects a generalized view of overall achievement of the group of measures. In addition, the individual management business objectives for all executives included an assessment of the executive s job knowledge and skills, communication skills, interpersonal skills, effectiveness of management, judgment and decision-making, drive and commitment, leadership and customer satisfaction. The Compensation Committee considers performance against all of the individual management business objectives as a whole in assessing the overall level of achievement of the group of metrics.

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For fiscal 2011, Mr. Menzer s group of individual management business objectives related to a number of aspects of the Company s strategic and operating plan. The Compensation Committee determined that Mr. Menzer achieved his individual objectives at 200% of target. Mr. Sonsteby s group of individual management business objectives were focused primarily on new store growth, expansion into new markets, direct import penetration, pricing and profit improvement, increasing cash flow and spend reduction, marketing efforts, new business lines and our customer special order program. The Compensation Committee determined that Mr. Sonsteby achieved his individual objectives at 100% of target. For Mr. Pappas, his group of individual management business objectives focused primarily on expansion into new markets, direct import penetration, pricing and profit improvement, increasing cash flow, new business lines, increasing scan margin and increasing sales from custom framing. The Compensation Committee determined that Mr. Pappas achieved his individual objectives at 200% of target. Mr. DeCaro s group of individual management business objectives focused primarily on expansion into new markets, direct import penetration, pricing and profit improvement, increasing cash flow and our customer special order program. The Compensation Committee determined that Mr. DeCaro achieved his individual objectives at 50% of target. As Senior Vice President Chief Information Officer, Mr. Gordon s group of individual management business objectives were primarily to help support operations during peak season from an IT perspective with minimal disruptions at the store level, appropriately prioritize IT projects and outline an IT strategy that transitions his department to a business driver. The Compensation Committee determined that Mr. Gordon achieved his individual objectives at 50% of target.

Actual Payouts

Actual payouts for the Named Executive Officers, as a percentage of target level bonus, were as follows:

	John B. Menzer	**Charles M. Sonsteby**	**Thomas C. DeCaro**	**Philo T. Pappas**	**Eric C. Gordon(1)**
Percent of Target	135%	115%	97%	127%	105%

(1) Pursuant to Mr. Gordon s offer letter from the Company, Mr. Gordon s annual bonus was prorated to the commencement of his employment.

Actual amounts paid to the Named Executive Officers for fiscal 2011 are listed in the Summary Compensation Table.

Bonus opportunities for our Named Executive Officers for fiscal 2012 will be administered pursuant to the Company s bonus plan for fiscal 2012.

Long-Term Equity-Based Compensation

On February 15, 2007, our Board and stockholders approved the Michaels Stores, Inc. 2006 Equity Incentive Plan (the Plan), as well as certain specific grants under the Plan to officers. In addition, the stockholders granted the Board authority to make Plan grants to other eligible participants in the future. The Plan was established to advance the interests of Michaels and its affiliates by providing for the grant of equity-based awards to eligible officers, associates, directors of, and consultants and advisors to, Michaels or its affiliates. Awards under the Plan are intended to align the long-term incentives of our executives and stockholders. Grants are awarded when an executive is hired and may be awarded for subsequent promotions. All stock option grants are made with exercise prices set at or above the grant date fair market value of the underlying stock as determined by our Board.

Each outstanding option under the Plan is divided into tranches with escalating exercise prices. The tranche structure of the option awards, with increasing exercise prices in each tranche, is designed to incentivize long-term performance by tying the value of the options to long-term increases in the value of our Common Stock. Historically, grants have not been made on an annual basis; rather, each initial grant has been intended to incentivize the executive for a 5-year period based on the vesting and exercise structure of the grant. Each tranche vests 20% on each of the first through fifth anniversaries of the grant date, and all unvested options vest immediately upon a Change of Control (as defined in the Stockholders Agreement). Detail regarding accelerated vesting with regards to options held by our Named Executive Officers is contained in the Grants of Plan-Based Awards for Fiscal 2011 table and the Outstanding Equity Awards at Fiscal Year-End 2011 table that follow this Compensation Discussion and Analysis.

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Other than grants of options to Mr. Gordon in connection with his hiring, no options were granted to Named Executive Officers in fiscal 2011. The following options were granted to Mr. Gordon on October 26, 2011:

		Number of Shares of Common Stock Underlying Stock Options	
Name	**Total Shares**	**Tranche 1 (Exercise Price $17.95 Per Share)**	**Tranche 2 (Exercise Price $22.50 Per Share)**
Eric Gordon	142,791	95,194	47,597

The amount of the award was based on Mr. Gordon s position as Senior Vice President Chief Information Officer at Michaels and the total target compensation package deemed appropriate for such position. The Compensation Committee and the Board determined this award to be reasonable and consistent with the nature of the Mr. Gordon s responsibilities and the goals of competitive compensation and retention of key executive officers.

Other Benefits and Perquisites

Our Named Executive Officers also receive certain other benefits and perquisites. During fiscal 2011, these benefits included contributions to 401(k) accounts, the payment of life insurance premiums, Company-paid medical benefits, car allowances and, in some cases, tax gross-ups and reimbursement for income taxes on taxable benefits. During fiscal 2011, the Company terminated its Executive Medical Plan and all officers of the Company were placed on the same medical plan as other corporate associates. Additionally, our Chief Executive Officer is also entitled to the use of a Company-owned or leased automobile. The Compensation Committee and the Board believe that these benefits and perquisites are reasonable and consistent with the nature of the executives responsibilities, provide a competitive level of total compensation to our executives and serve as an important element in retaining those individuals. The cost to Michaels of these benefits to the Named Executive Officers is set forth in the Summary Compensation Table under the column All Other Compensation and detail about each element is set forth in the table presented in footnote 4 to the Summary Compensation Table.

Employment and Severance Agreements

Mr. Menzer has an employment agreement with Michaels that was entered into at the time of his appointment, which included certain severance benefits in the event of termination other than for cause or by Mr. Menzer for good reason, as such terms were defined in the agreement. The specific terms of Mr. Menzer s employment agreement, including the provisions that have survived the termination of his employment, are discussed in the section entitled Menzer Employment Agreement following the Grants of Plan-Based Awards Table and under Executive Compensation Potential Payments Upon Termination or Change of Control .

In April 2008, the Board approved the Company s Officer Severance Pay Plan (the OSPP), which was amended in July 2008. The OSPP was established by the Company to provide certain severance benefits, subject to the terms and conditions of the OSPP, to designated officers (those with a position of Vice President or above, or an equivalent title as approved by the Compensation Committee, and excluding the Chief Executive Officer) in the event that their employment is terminated as a result of a Qualifying Termination (as defined in the OSPP and described below). A more detailed description of the OSPP may be found under Executive Compensation Potential Payments Upon a Change of Control .

Tax and Accounting Considerations

Deductibility of Executive Compensation. While the Compensation Committee takes into account tax and accounting considerations in structuring the components of the Company s compensation program, these considerations are secondary to the primary objectives of the program.

The Company s Compensation Policies and Practices as They Relate to Risk Management

In accordance with the applicable disclosure requirements, to the extent that risks may arise from the Company s compensation policies and practices that are reasonably likely to have a material adverse effect on the Company, the Company is required to discuss those policies and practices for compensating the employees of the Company (including employees that are not Named Executive Officers) as they relate to the Company s risk management practices and the possibility of incentivizing risk-taking.

The Compensation Committee has evaluated the policies and practices of compensating the Company s employees in light of the relevant factors, including the following:

- the financial performance targets of the Company s annual cash incentive program are the budgeted objectives that are reviewed and approved by the Board and/or the Compensation Committee

- bonus payouts are not based solely on corporate performance, but also require achievement of individual performance objectives

- bonus awards generally are not contractual entitlements, but are reviewed by the Compensation Committee and/or the Board and can be modified at their discretion

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- the financial opportunity in the Company s long-term equity-based compensation is best realized through long-term appreciation of the Company s stock price, which mitigates excessive short-term risk-taking

- the allocation of compensation between cash and equity awards and the focus on stock-based compensation, including options and restricted stock awards generally vesting over a period of years, thereby mitigating against short-term risk taking

Based on such evaluation, the Compensation Committee has determined that the Company s policies and practices are not reasonably likely to have a material adverse effect on the Company.

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EXECUTIVE AND DIRECTOR COMPENSATION

Summary Compensation Table

According to SEC rules, the Summary Compensation Table must include specific information for each of the Named Executive Officers previously identified in the Compensation Discussion and Analysis above.

Name and Principal Position	Year	Salary ($)	Bonus ($)	Stock Awards ($)(1)	Option Awards ($)(2)	Non-Equity Incentive Plan Compensation ($)(3)	All Other Compensation ($)(4)	Total ($)
John B. Menzer	2011							