

The Michaels Companies (MIK)

\$4.93 (As of 01/31/20)

Price Target (6-12 Months): **\$4.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 01/24/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

5-Strong Sell

Zacks Style Scores:

VGM:A

Value: A

Growth: C

Momentum: A

Summary

Shares of Michaels have lagged the industry in the past three months. The company reported lower-than-expected results in the third quarter of fiscal 2019 due to soft margins and store closures along with soft comps and lower wholesale revenues. Tariff-related headwinds hurt merchandise margin in the fiscal third quarter. Management cut sales and earnings view for fiscal 2019. However, the stock decline was slightly cushioned by the recent appointment of former Walmart executive as its CEO. Investors are optimistic about the new appointment. Moreover, the company's plans to improve marketing productivity are likely to reduce expenses in the fiscal fourth quarter. Also, the buyout of AC Moore stores is expected to be accretive in the future. These apart, the company's e-commerce operations are benefiting from the BOPUS facility.

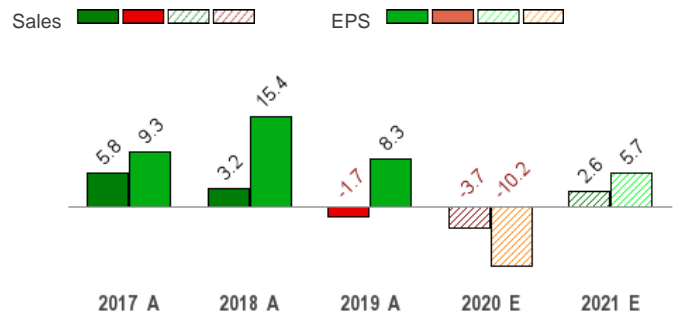
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$14.47 - \$4.80
20 Day Average Volume (sh)	4,683,135
Market Cap	\$723.7 M
YTD Price Change	-39.1%
Beta	1.05
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Retail - Miscellaneous
Zacks Industry Rank	Bottom 22% (198 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-18.4%
Last Sales Surprise	-2.9%
EPS F1 Est- 4 week change	0.8%
Expected Report Date	03/17/2020
Earnings ESP	-0.6%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,102 E	1,042 E	1,231 E	1,751 E	5,206 E
2020	1,094 A	1,034 A	1,222 A	1,729 E	5,076 E
2019	1,156 A	1,053 A	1,274 A	1,789 A	5,272 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.29 E	\$0.16 E	\$0.41 E	\$1.37 E	\$2.23 E
2020	\$0.31 A	\$0.19 A	\$0.40 A	\$1.26 E	\$2.11 E
2019	\$0.39 A	\$0.15 A	\$0.48 A	\$1.44 A	\$2.35 A

*Quarterly figures may not add up to annual.

P/E TTM	2.1
P/E F1	2.3
PEG F1	0.4
P/S TTM	0.1

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/31/2020. The reports text is as of 02/03/2020.

Overview

Based in Irving, TX, The Michaels Companies, Inc. is one of the leading arts and crafts specialty retailers in North America on the basis of store count. The company provides materials, project ideas and education for creative activities. It delivered \$5.3 billion in sales in fiscal 2018.

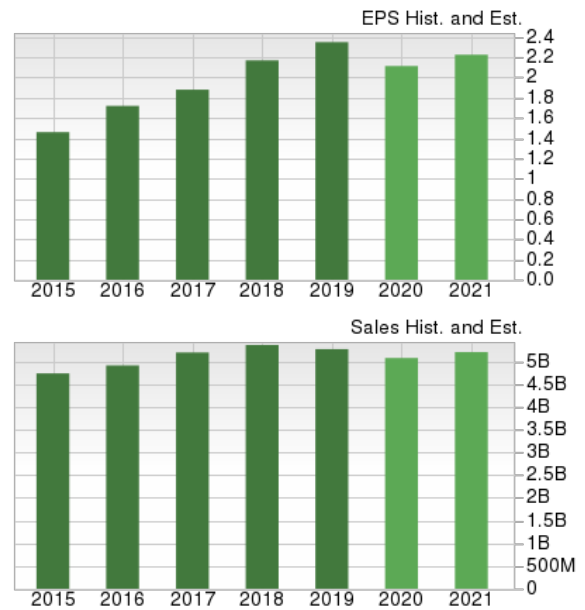
The company's stores offer stock-keeping units (SKUs) in arts, crafts, floral, framing, home decor and seasonal merchandise, and do-it-yourself home decorator. It produces exclusive private brands, which include Recollections, Studio Decor, Ashland, Bead Landing, Creatology, Celebrate It, Art Minds, Artist's Loft, Craft Smart, Loops & Threads, Imagin8, among others. Michaels' private brands contributed about 60% to net sales in fiscal 2018.

Additionally, the company has partnerships with popular brands such as Crayola, Elmer's and Cricut. It also owns Artistree, a producer of top-quality custom and framing merchandise; and Darice which is a premier wholesale distributor in the craft, gift and decor industry.

Further, the company has online platforms, namely, Michaels.com, ConsumerCrafts.com, Darice.com, AaronBrothers.com and the Michaels app.

As of Nov 2, 2019, it operated 1,274 Michaels stores across 49 states and Canada.

In March 2018, Michaels decided to close all of its Aaron Brothers stores. In January 2019, it closed all 36 of Pat Catan's stores.



Reasons To Sell:

- ▼ **Dismal Q3 & Soft FY19 View:** Michaels' delivered dismal third-quarter fiscal 2019 results, wherein both top and bottom lines missed the Zacks Consensus Estimate. Earnings and sales also declined on a year-over-year basis. The earnings decline mainly resulted from lower sales and margins. Sales were hurt by the closure of Pat Catan's store in fiscal 2018 coupled with a 2.2% fall in comparable store sales (comps) and lower wholesale revenues. Consequently, management trimmed sales and earnings view for fiscal 2019.

Net sales are now projected to be \$5.06-\$5.08 billion for fiscal 2019, down from \$5.16-\$5.19 billion mentioned earlier. Notably, it generated net sales of \$5.27 billion in fiscal 2018. Comps are now anticipated to decline 2% compared with earlier mentioned flat comps. Further, the company now estimates adjusted operating income of \$565-\$575, down from previously stated \$625-\$645 million. Adjusted earnings per share are now envisioned to be \$2.07-\$2.12, down from \$2.31-\$2.42 mentioned earlier. Consequently, shares of the company have declined 41.2% in the past three months against the industry's growth 2.7%.

Michaels trimmed sales and earnings view for fiscal 2019, following lower-than-expected results in the fiscal third quarter. Also, tariff headwinds led to a decline in merchandise margin in the quarter.

- ▼ **Tariffs Impact Inventory Per Store & Margins:** Michaels' total merchandise inventory fell 1.2% to \$1,423.4 million at the end of the fiscal third quarter. However, average inventory per Michaels store, inclusive of distribution centers, inventory in-transit and inventory for its e-commerce site, grew 2.9%. This included the adverse impacts of tariff. Also, tariff headwinds led to a decline in merchandise margin in the quarter. This resulted from increased promotional activity, higher inventory from China and change in the sales mix, somewhat offset by pricing actions and sourcing initiatives.
 - ▼ **Competitive Pressure:** Michaels operates in a highly fragmented market, which comprises stores in the United States and Canada. As a result, Michaels faces intense competition from multi-store chains, mass merchandisers, independent and local specialty players, as well as online retailers. It competes with these players on grounds of pricing strategies, store location, availability of financial, distribution and marketing resources, breadth of selection and, quality of merchandise and customer service. The company's inability to stay afloat amid such competition may result in loss of market share and adversely impact its business.
 - ▼ **Seasonal Risk:** Michaels' business remains highly exposed to seasonal risks. The company witnesses greater sales in the third and fourth quarters of the fiscal years. For instance, the company's fourth quarter, which covers the holiday season, accounted for nearly 34% of the net sales and 46% of operating income on an average basis. As a result, it delivers relatively lower sales in the fiscal first and second quarters, thus impacting its bottom-line results and overall financial condition.
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Risks

- **Strategic Initiatives:** Michaels has embarked on a customer-centric, core 'Maker' strategy which aims at building the business better, leveraging digital and data, and repositioning the business. The company is shifting to store selling culture, crafting a customer-centric assortment, optimizing pricing and promotions, and maximizing marketing productivity to build a better business. It launched a store-selling initiative in August to shift from a task-based store culture to serving customers and selling. Further, the company is progressing well to maximize marketing productivity through the recently completed media-mix model, wherein it will shift to higher productivity media options such as digital and addressable TV, without increasing the spending. This will lower marketing spending in the fiscal fourth quarter and beyond. Michaels also implemented a pricing and promotion strategy in the third quarter. This will likely help in optimizing discounts and improving customers' perception of the value that the company offers through discounts, coupons and other promotional activities. Early results from the initiative have been promising, with higher productivity promotions. The company expects this capability to drive growth in 2020.
- **Efforts to Boost In-Store Operations:** Michaels remains committed to store-expansion and remodeling efforts to elevate margins and boost profitability. This will also lead to higher comparable store sales (comps), thus generating greater sales and capturing market share. The company has been focused on expanding its store base and introducing technological advancements to enhance services for its patrons. The company also remains focused on expanding assortments in key growth-driving categories while de-emphasizing on slower moving categories. The company's recent shift in assortment to the maker categories — including technology, craft storage and fine art — performed well in the fiscal third quarter.

As part of store-optimization efforts, Michaels introduced 13 flagship stores, 11 of these were former Pat Catan's outlets converted to the Michaels brand. Simultaneously, it shuttered one and relocated five stores in third-quarter fiscal 2019. As part of the asset purchase agreement with AC Moore, the company acquired up to 40 stores for \$58 million, of which few store locations are expected to be reopened under the Michaels brand in fiscal 2020. Also, it is on track to build a comprehensive sales transfer program to retain the vast AC Moore customer base. For fiscal 2019, the company intends to open 16 net flagship outlets that include 12 rebranded Pat Catan's stores. Also, it expects to relocate 13 Michaels stores.

Last Earnings Report

Michaels Misses on Q3 Earnings & Sales, Lowers FY19 View

Quarter Ending **10/2019**

Michaels reported dismal third-quarter fiscal 2019 results, wherein both top and bottom lines missed the Zacks Consensus Estimate. Earnings and sales also declined on a year-over-year basis.

Report Date	Dec 05, 2019
Sales Surprise	-2.85%
EPS Surprise	-18.37%
Quarterly EPS	0.40
Annual EPS (TTM)	2.34

Consequently, management trimmed sales and earnings view for fiscal 2019. Net sales are now projected to be \$5.06-\$5.08 billion for fiscal 2019, down from \$5.16-\$5.19 billion mentioned earlier. Notably, it generated net sales of \$5.27 billion in fiscal 2018. Comps are now anticipated to decline 2% compared with earlier mentioned flat comps.

Further, the company now estimates adjusted operating income of \$565-\$575, down from previously mentioned \$625-\$645 million. Interest expenses are expected to be \$152 million in the current fiscal year, with effective tax rate of 23-24%. Adjusted earnings per share are now envisioned to be \$2.07-\$2.12, down from \$2.31-\$2.42 stated earlier. However, we note that the company is making efforts to get back on the growth track. It has been implementing initiatives to support its 'Maker' strategy, which is expected to boost its business.

Michaels' adjusted earnings of 40 cents per share lagged the Zacks Consensus Estimate of 49 cents and declined 16.7% from the prior-year quarter. The downside can be mainly attributed to lower sales and margins, somewhat offset by a fall in SG&A expenses.

Net sales of the arts and crafts specialty retailer dipped 4.1% year over year to \$1,222.7 million and lagged the Zacks Consensus Estimate of \$1,256 million. Sales declined year over year on the impacts of Pat Catan's store closures in fiscal 2018 coupled with a 2.2% fall in comparable store sales (comps) and lower wholesale revenues. The decline was partly compensated by incremental sales from the addition of 18 net flagship stores since the end of third-quarter fiscal 2018.

Comps fell due to lower customer transactions, partly mitigated by rise in average ticket. However, the company delivered strong e-commerce sales again in the reported quarter, fueled by higher traffic and conversion rates.

Gross profit slipped 7.8% year over year to \$441.6 million and gross margin contracted 150 basis points (bps) to 36.1%. Lower gross margin can be attributed to a decline in merchandise margin along with occupancy and distribution expense deleverage, which were partly offset by a decrease in inventory reserves.

SG&A expenses, including pre-opening costs, decreased 5.1% to \$324.2 million. The decline mainly resulted from lower payroll-related costs that include performance-based compensation and expenses related to Pat Catan's store closure. As a percentage of sales, SG&A expenses, including pre-opening costs, decreased 30 bps to 26.5%. Adjusted operating income fell 16.9% to \$117.4 million due to lower gross profit, somewhat offset by a decline in SG&A expenses.

Store Update

During the fiscal third quarter, the company opened 13 flagship stores, 11 of these were former Pat Catan's outlets converted to the Michaels brand. Simultaneously, it shuttered one Michaels outlet and relocated five flagship stores during the same period. As of Nov 2, 2019, it operated 1,274 Michaels stores.

For fiscal 2019, the company intends to open 16 net flagship outlets that include 12 rebranded Pat Catan's stores. Also, it expects to relocate 13 Michaels stores.

Financial Position

Michaels had cash and equivalents of \$118.4 million, long-term debt of \$2,649.8 million, and total stockholders' deficit of \$1,631.8 million as of Nov 2, 2019. Total merchandise inventory fell 1.2% to \$1,423.4 million at the end of the fiscal third quarter. However, average inventory per Michaels store, inclusive of distribution centers, inventory in-transit and inventory for its e-commerce site, grew 2.9%.

Moreover, the company incurred capital expenditure of \$32 million in third-quarter fiscal 2019 mainly due to investments in technology projects, including e-commerce and store-growth initiatives. In the first nine months of the fiscal year, it spent \$90 million in capital expenditure. For fiscal 2019, Michaels expects to incur capital expenditure of \$125 million.

In the fiscal third quarter, the company bought back 8.6 million shares worth nearly \$80 million, under its share-repurchase authorization. Following this, Michaels had an outstanding repurchase authorization of roughly \$294 million.

Guidance

Apart from lowering the fiscal 2019 view, the company outlined its guidance for the fourth quarter. For the fiscal fourth quarter, it projects 2-3% comps decline on existing business trends, a shorter holiday selling season in the same quarter and a potential adverse impact from the liquidation of A.C. Moore retail stores.

Adjusted operating income is estimated to be \$271-\$281 million. Moreover, net interest expenses are estimated to be \$38 million. The effective tax rate is likely to be between 23% and 24%. Further, adjusted earnings are envisioned to be \$1.21-\$1.27 per share.

Recent News

Michaels Appoints Walmart Executive as CEO – Dec 27, 2019

Michaels Companies named Ashley Buchanan, an experienced retail executive from Walmart, as the new President and Chief Executive Officer (CEO) Designate and also as a member of its Board of Directors, effective January 6, 2020. Buchanan will succeed mark Cobsy as the CEO after the completion of his tenure on April 1, 2020. Further, the company notes that Cobsy will continue to be a member of the board after the CEO transition.

Michaels' Partnership With UPS to Boost Stores Footfall – Oct 7, 2019

Michaels Companies is focused on integrating its e-commerce and in-store operations to enhance customer shopping experience. Recently, the company announced a collaboration under which it rolled out the UPS Access Point locations into more than 1,100 of its outlets. This is likely to make shipping or receiving UPS packages easy for customers. At the same time, this tie-up should drive footfall at Michaels stores as the UPS Access Point locations are likely to provide increased convenience to shoppers while picking their craft and decoration needs.

Following this latest rollout, shoppers can now ship UPS packages directly to Michaels' outlet and drop pre-labeled shipments. Additionally, customers can make easy returns to online retailers providing the UPS drop-off facility.

For further ease of customers looking to set delivery preferences to a particular nearby Michaels' store, the UPS My Choice for home solution provides automatic rerouting of packages to the desired store location. This latest collaboration allows shoppers to regulate their e-commerce deliveries and returns at their convenient Michaels outlet, quickly and expediently.

We note that UPS is currently working with merchants to offer customers a selection of the nearest UPS Access Point location during their checkouts.

Valuation

Michaels shares are down 63.7% in the trailing 12-month period. Over the past year, the Zacks sub-industry is down 12.7% but the Zacks Retail-Wholesale sector is up 15.2%.

The S&P 500 index is up 17.4% in the past year.

The stock is currently trading at 2.33X forward 12-month earnings, which compares to 15.31X for the Zacks sub-industry, 24.92X for the Zacks sector and 18.5X for the S&P 500 index.

Over the past five years, the stock has traded as high as 5.7X and as low as 2.09X, with a 5-year median of 3.71X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our \$4 price target reflects 1.89X forward 12-month earnings.

The table below shows summary valuation data for MIK

Valuation Multiples - MIK					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	2.33	15.31	24.92	18.5
	5-Year High	5.7	17.63	25.21	19.34
	5-Year Low	2.09	13.8	22.57	15.18
	5-Year Median	3.71	15.53	24.24	17.46
P/S F12M	Current	0.14	1.09	1.06	3.43
	5-Year High	0.43	1.35	1.06	3.43
	5-Year Low	0.14	1.03	0.93	2.54
	5-Year Median	0.27	1.15	1	3
EV/EBITDA TTM	Current	5.06	14.86	15.29	11.95
	5-Year High	7.12	17.58	15.37	12.85
	5-Year Low	5.06	14.42	11.98	8.49
	5-Year Median	5.8	15.63	13.07	10.66

As of 01/31/2020

Industry Analysis Zacks Industry Rank: Bottom 22% (198 out of 255)



Top Peers

DICKS Sporting Goods, Inc. (DKS)	Outperform
MarineMax, Inc. (HZO)	Outperform
Five Below, Inc. (FIVE)	Neutral
KAR Auction Services, Inc (KAR)	Neutral
Regis Corporation (RGS)	Neutral
Sally Beauty Holdings, Inc. (SBH)	Neutral
Tractor Supply Company (TSCO)	Neutral
Ulta Beauty Inc. (ULTA)	Neutral

Industry Comparison Industry: Retail - Miscellaneous				Industry Peers		
	MIK Underperform	X Industry	S&P 500	KAR Neutral	SBH Neutral	ULTA Neutral
VGM Score	A	-	-	B	A	C
Market Cap	723.65 M	1.21 B	23.55 B	2.71 B	1.79 B	15.31 B
# of Analysts	5	4	13	7	8	12
Dividend Yield	0.00%	0.00%	1.81%	3.62%	0.00%	0.00%
Value Score	A	-	-	A	A	C
Cash/Price	0.13	0.09	0.04	0.19	0.04	0.01
EV/EBITDA	6.73	7.13	13.97	4.84	5.82	14.77
PEG Ratio	0.39	1.59	1.97	1.44	1.75	1.40
Price/Book (P/B)	NA	1.36	3.21	1.72	NA	8.54
Price/Cash Flow (P/CF)	1.47	6.14	13.36	4.15	4.83	17.04
P/E (F1)	2.42	12.22	18.42	14.76	6.55	22.36
Price/Sales (P/S)	0.14	0.36	2.60	0.80	0.46	2.12
Earnings Yield	42.80%	8.19%	5.43%	6.76%	15.31%	4.47%
Debt/Equity	-2.47	0.86	0.72	1.36	-26.43	0.92
Cash Flow (\$/share)	3.35	3.35	6.92	5.07	3.18	15.72
Growth Score	C	-	-	D	B	B
Hist. EPS Growth (3-5 yrs)	11.36%	11.48%	10.68%	12.78%	9.31%	27.52%
Proj. EPS Growth (F1/F0)	-10.04%	10.88%	7.59%	25.05%	3.76%	10.41%
Curr. Cash Flow Growth	0.85%	8.16%	10.81%	10.02%	0.84%	22.98%
Hist. Cash Flow Growth (3-5 yrs)	8.72%	8.72%	8.78%	16.85%	2.83%	24.61%
Current Ratio	1.19	1.41	1.22	1.29	2.55	1.67
Debt/Capital	NA%	51.52%	42.99%	57.62%	NA	48.03%
Net Margin	5.30%	3.82%	11.69%	6.95%	7.01%	9.67%
Return on Equity	-22.75%	11.33%	17.33%	16.67%	-221.38%	36.91%
Sales/Assets	1.54	1.54	0.55	0.48	1.84	1.64
Proj. Sales Growth (F1/F0)	-3.72%	0.36%	4.12%	4.03%	1.10%	9.92%
Momentum Score	A	-	-	C	A	F
Daily Price Chg	-4.27%	-2.38%	-1.98%	-2.55%	0.46%	-2.40%
1 Week Price Chg	-3.44%	-0.07%	-1.09%	-0.14%	4.65%	0.03%
4 Week Price Chg	-41.79%	-6.54%	-2.11%	-6.12%	-14.82%	5.25%
12 Week Price Chg	-46.90%	0.36%	2.15%	-3.00%	-23.25%	9.90%
52 Week Price Chg	-64.43%	-10.71%	14.15%	-59.58%	-10.86%	-8.22%
20 Day Average Volume	4,683,135	498,200	1,808,632	1,645,591	1,313,340	995,579
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.79%	-0.66%	0.00%	-1.73%	0.81%	-0.01%
(F1) EPS Est 12 week change	-11.18%	-1.34%	-0.09%	-6.56%	7.57%	0.19%
(Q1) EPS Est Mthly Chg	1.62%	-1.43%	0.00%	-2.67%	0.76%	-0.20%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	A
Growth Score	C
Momentum Score	A
VGM Score	A

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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