

The Michaels Companies (MIK)

\$2.28 (As of 03/25/20)

Price Target (6-12 Months): **\$2.25**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 03/24/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

5-Strong Sell

Zacks Style Scores:

VGM:A

Value: A

Growth: B

Momentum: F

Summary

Shares of Michaels have slid and lagged the industry in the past three months. Despite earnings beat, the company's top line missed the Zacks Consensus Estimate in fourth-quarter fiscal 2019. Both the metrics declined year over year. Results were affected by a shorter holiday selling season. Although it did not provide fiscal 2020 view due to uncertain COVID-19 impact, it witnessed lower sales in few product categories and marginal increase in conversions at e-commerce business. Further, the company forecasts cost and tariff headwinds to continue in fiscal 2020. However, management remains optimistic about its Maker strategy and expects positive trends in fiscal 2020 and beyond. Moreover, the buyout of AC Moore stores is likely to be accretive in the future. Also, the company's e-commerce operations are gaining from the BOPUS facility.

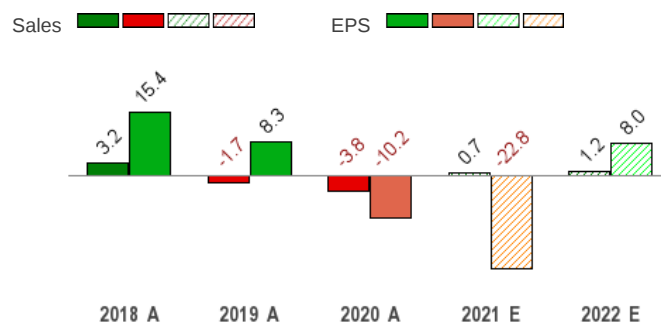
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$13.08 - \$1.00
20 Day Average Volume (sh)	6,069,963
Market Cap	\$334.8 M
YTD Price Change	-71.8%
Beta	1.13
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Retail - Miscellaneous
Zacks Industry Rank	Bottom 15% (215 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	0.8%
Last Sales Surprise	-0.1%
EPS F1 Est- 4 week change	-26.6%
Expected Report Date	06/04/2020
Earnings ESP	-18.3%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2022	1,111 E	1,051 E	1,240 E	1,766 E	5,171 E
2021	1,078 E	1,026 E	1,233 E	1,764 E	5,109 E
2020	1,094 A	1,034 A	1,222 A	1,723 A	5,072 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2022	\$0.32 E	\$0.15 E	\$0.42 E	\$1.39 E	\$1.76 E
2021	\$0.20 E	\$0.01 E	\$0.36 E	\$1.23 E	\$1.63 E
2020	\$0.31 A	\$0.19 A	\$0.40 A	\$1.26 A	\$2.11 A

*Quarterly figures may not add up to annual.

P/E TTM	1.1
P/E F1	1.4
PEG F1	0.2
P/S TTM	0.1

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 03/25/2020. The reports text is as of 03/26/2020.

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.

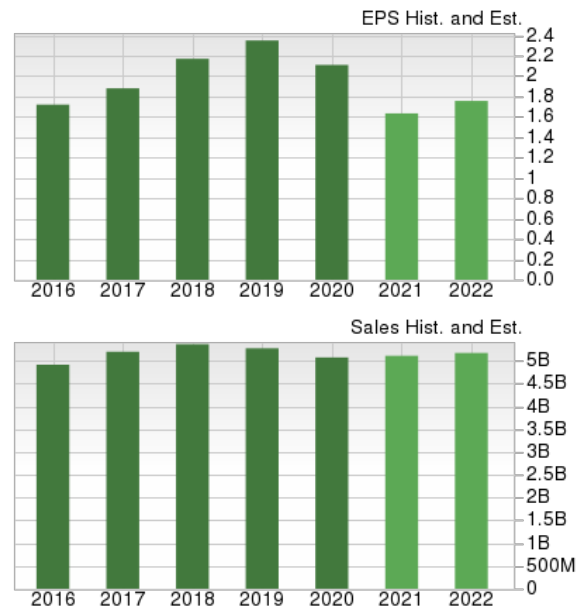
The company's stores offer stock-keeping units (SKUs) in arts, crafts, floral, framing, home decor and seasonal merchandise, and do-it-yourself home decorator. It produces exclusive private brands, which include Recollections, Studio Decor, Ashland, Bead Landing, Creatology, Celebrate It, Art Minds, 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 Feb 1, 2020, 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:

▼ **Q4 Results & Soft View Hurt Stock:** Shares of Michaels plunged 71.5% in the past three months as compared to the industry's loss of 34.2%. Despite earnings beat, the company's top line missed the Zacks Consensus Estimate during fourth-quarter fiscal 2019. Moreover, both the metrics declined year over year. Results were affected by a shorter holiday selling season. The decline in earnings can be mainly attributed to lower sales and margins, somewhat offset by a fall in SG&A expenses. Meanwhile, net sales were marred by the closure of Pat Catan's stores in fourth-quarter fiscal 2018, coupled with a 2.4% fall in comparable store sales (comps) and lower wholesale revenues. The decline was partly compensated by incremental sales from the addition of 16 net flagship stores since the end of fourth-quarter fiscal 2018.

Michaels expects \$45 million of tariff-related headwinds and \$22 million increase in SG&A expenses during fiscal 2020. These are likely to mar margins and the bottom line.

However, management did not provide any fiscal 2020 guidance due to the uncertain impacts of the ongoing COVID-19 outbreak. Although the company doesn't foresee any supply-chain disruptions in the fiscal first quarter, it is making efforts to reduce adverse impacts on its supply chain during the second quarter and thereafter. Further, lower sales in certain product categories and a marginal rise in conversion in its e-commerce business remain concerns. Meanwhile, it issued a fiscal first-quarter view, which doesn't consider any impact from the pandemic. For first-quarter fiscal 2020, the company projects sales to be \$1.08-\$1.1 billion with comparable store sales down 1.5% to flat.

▼ **Sluggish Margins, A Worry:** Michaels has been witnessing weakness in margins for the past few quarters. Notably, gross profit declined 9.6% year over year and gross margin contracted 250 basis points (bps) in fourth-quarter fiscal 2019. Lower gross margin can be attributed to aggressive pricing actions in seasonal products during the winter clearance sale. This also led to a 16.4% decline in adjusted operating income. Prior to this, gross margin contracted 150 bps in the preceding quarter. In fiscal 2020, adjusted operating income is estimated to plunge roughly 50% year over year due to higher margins witnessed before the imposition of tariffs in fiscal 2019.

▼ **Tariffs Impact Inventory Per Store & Margins:** Michaels' total merchandise inventory fell 1% to \$1,097.1 million at the end of fiscal 2019. This can be attributable to decline in wholesale inventory stemming from soft demand. However, excess inventory related to addition of 16 Michaels stores drove the increase. Average inventory per Michaels store, inclusive of distribution centers, inventory in-transit and inventory for its e-commerce site, decreased 1.9%. This included the adverse impacts of tariff. Moreover, tariff-related headwinds led to a decline in merchandise margin in the quarter. Further, the company expects tariff-related headwinds to the tune of \$45 million to be incurred in fiscal 2020.

▼ **Higher SG&A Expenses to Linger in FY20:** Although SG&A expenses, including pre-opening costs, decreased 2.7% in the fiscal fourth quarter, it increased 20 bps, as a percentage of sales. Moreover, the company envisions cost headwinds to persist in fiscal 2020. The company expects SG&A expenses to increase \$22 million in fiscal 2020.

▼ **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.

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. In this regard, it opened its first Maker store in McKinney, TX. The store offers personalized assortment, better layout, improved services and a host of omni-channel capabilities. Going ahead, the company plans to open more such stores in fiscal 2020. Management remains optimistic about Maker strategy and foresees positive momentum in fiscal 2020 and beyond. Additionally, the company tested a rewards program in the fourth quarter and received positive feedback for the same. This program is expected to be rolled out in April.

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 2019 to shift from a task-based store culture to serving customers and selling. Further, it is progressing well to maximize marketing productivity through its media-mix model, wherein it will shift to higher productivity media options such as digital and addressable TV, without increasing the spending. Michaels also implemented a pricing and promotion strategy, which is likely to help in optimizing discounts and improving customers' perception of the value it offers through discounts, coupons and other promotional activities.

- **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 fourth quarter. As part of store-optimization efforts, Michaels introduced 21 flagship stores, shuttered five and relocated 13 stores in 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. Further, it leased a distribution facility in New Jersey along with 19 store locations, as part of the deal. Most of these locations are expected to reopen under its own brand name in second-quarter fiscal 2020. Moreover, the company intends to open 45 net flagship outlets and relocate nearly 16 Michaels stores in fiscal 2020. Meanwhile, 10 flagship stores are expected to be closed in the fiscal year.
- **Enhancing Omni-Channel Experience:** Michaels remains focused on integrating its e-commerce and in-store operations to enhance the omni-channel experience. Notably, the e-commerce platform has been a growing contributor to sales since its launch in 2014. In fourth-quarter fiscal 2019, sales from the e-commerce business remained sturdy, backed by higher traffic and conversion rate. Moreover, it continues to gain from omni-channel capabilities like "Buy Online Pick Up in Store" (BOPUS), which is a cost-effective way of fulfilling online orders as it eliminates shipping costs. In the fiscal fourth quarter, BOPUS contributed nearly 45% to online sales. In the third quarter, it launched e-commerce operations in Canada, following which e-commerce sales in the region grew. Management had earlier stated e-commerce sales in Canada to act as a major growth driver in fiscal 2020. Moreover, the company is also putting together additional data analytics into its supply chain, inventory, and marketing programs, which should help expand operating margins over time. These apart, efforts such as optimizing digital spending, enhancing web capabilities and customizing website as per consumer preferences bode well.
- **Disciplined Capital Allocation:** Michaels' ability to generate optimum operating cash flow aid management to execute strategies such as enhancement of product and brand offerings and building operational infrastructure. Additionally, the company remains committed toward enhancing shareholder returns. The company ended third-quarter fiscal 2019 with \$410 million in cash on its balance sheet and \$768.1 million available under revolver. Total debt as of Feb 1, 2020, was \$1.4 billion. For fiscal 2019, it incurred capital expenditure of \$120.5 million associated with the opening of 34 Michaels stores, including the relocation of 13 stores. In fiscal 2019, the company repurchased 11.6 million shares for \$105.1 million, under its current authorization. Following this, Michaels had an outstanding repurchase authorization of roughly \$293.5 million.

Last Earnings Report

Michaels' Q4 Earnings Surpass Estimates, Sales Miss

Michaels' fourth-quarter fiscal 2019 bottom line surpassed the Zacks Consensus Estimate, while sales lagged the same. Further, both metrics declined on a year-over-year basis. Although results were affected by a shorter holiday selling season, the company witnessed a robust performance during Black Friday, Cyber Week and post-holiday clearance sale.

Also, Michaels is progressing well with the implementation of the Maker strategy and expects to gain from this initiative in the upcoming quarters. Keeping in these lines, the company recently opened its first Maker store in Texas, which comes with curated products, enhanced layout and signage, improved services and better omnichannel capabilities. Moving ahead, it intends to open more such stores in 2020.

However, management did not provide any fiscal 2020 guidance due to the uncertain impacts of the ongoing COVID-19 outbreak. Meanwhile, it issued a fiscal first-quarter view, which doesn't consider any impact from the pandemic. Moreover, the company doesn't foresee any supply-chain disruption, stemming from the virus spread, for the first quarter.

Moving on, it is making efforts to reduce adverse impacts on its supply chain during the second quarter and thereafter. Further, lower sales in certain product categories and a marginal rise in conversion in its e-commerce business remain concerns. That said, the company noted that sales and store traffic starting February till Mar 10 remained in line with their expectations.

Q4 Numbers

Michaels' adjusted earnings of \$1.26 per share exceeded the Zacks Consensus Estimate of \$1.25 but declined 12.5% from the prior-year quarter. This downside can be mainly attributed to lower sales and margins, somewhat offset by a fall in SG&A expenses.

Net sales of this arts and crafts specialty retailer dipped 3.7% year over year to \$1,722.6 million and fell short of the Zacks Consensus Estimate of \$1,724 million. Sales declined year over year due to the impact of Pat Catan's store closures in fourth-quarter fiscal 2018 coupled with a 2.4% fall in comparable store sales (comps) and lower wholesale revenues. The decline was partly compensated by incremental sales from the addition of 16 net flagship stores since the end of fourth-quarter fiscal 2018.

Gross profit declined 9.6% year over year to \$646 million and gross margin contracted 250 basis points (bps) to 37.5%. Lower gross margin can be attributed to aggressive pricing actions in seasonal products during the winter clearance sale.

SG&A expenses, including pre-opening costs, decreased 2.7% to \$370.8 million. As a percentage of sales, SG&A expenses, including pre-opening costs, increased 20 bps to 21.5%.

Adjusted operating income fell 16.4% to \$278.6 million due to lower gross profit, somewhat offset by a decline in SG&A expenses.

Financial Position

Michaels had cash and equivalents of \$410 million, long-term debt of \$2,644.5 million and total stockholders' deficit of \$1,446.5 million as of Feb1, 2020. Total merchandise inventory fell 1% to \$1,097.1 million at the end of fiscal 2019.

In fiscal 2019, the company repurchased 11.6 million shares for \$105.1 million, under its current authorization. Following this, Michaels had an outstanding repurchase authorization of roughly \$293.5 million.

Guidance

For first-quarter fiscal 2020, the company projects sales to be \$1.08-\$1.1 billion with comparable store sales down 1.5% to flat. Further, adjusted operating income is anticipated to be \$74-\$82 million.

Going ahead into fiscal 2020, adjusted operating income is estimated to plunge roughly 50% year over year due to higher margins witnessed before the imposition of tariffs in fiscal 2019. Further, the company forecasts cost and tariff headwinds to continue in the fiscal year. In this regard, a full-year impact of tariffs to the tune of \$45 million and a rise of \$22 million in SG&A expenses are likely to be incurred in fiscal 2020.

Management expects an improvement in the second half of fiscal 2020, driven by gains from the A.C. Moore transaction. Notably, the company had leased a distribution facility in New Jersey along with 19 store locations, as part of the deal. Most of these locations are expected to reopen under its own brand name in the fiscal second quarter. Also, few existing flagship stores are touted to be relocated in this process.

Quarter Ending 01/2020

Report Date	Mar 17, 2020
Sales Surprise	-0.09%
EPS Surprise	0.80%
Quarterly EPS	1.26
Annual EPS (TTM)	2.16

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.

Valuation

Michaels shares are down 71.9% in the year-to-date period and 81% for the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Retail-Wholesale sector are down 34.8% and 14.2% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are down 44.5% and 5.6%, respectively.

The S&P 500 index is up 23.1% in the year-to-date period and 12.5% in the past year.

The stock is currently trading at 1.38X forward 12-month earnings, which compares to 11X for the Zacks sub-industry, 22.01X for the Zacks sector and 14.93X for the S&P 500 index.

Over the past five years, the stock has traded as high as 16.14X and as low as 0.66X, with a 5-year median of 9.3X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$2.25 price target reflects 1.36X 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	1.38	11	22.01	14.93
	5-Year High	16.14	20.24	26.2	19.34
	5-Year Low	0.66	11	19.06	14.93
	5-Year Median	9.3	16.08	23	17.42
P/S F12M	Current	0.07	0.72	0.88	2.68
	5-Year High	1.18	1.36	1.11	3.43
	5-Year Low	0.04	0.72	0.8	2.54
	5-Year Median	0.72	1.15	0.92	3
EV/EBITDA TTM	Current	6.16	11.22	13.35	9.16
	5-Year High	10.67	17.71	16.22	12.88
	5-Year Low	5.1	9.74	10.83	8.27
	5-Year Median	7.71	15.12	12.51	10.78

As of 03/25/2020

Industry Analysis Zacks Industry Rank: Bottom 15% (215 out of 253)



Top Peers

DICKS Sporting Goods, Inc. (DKS)	Outperform
MarineMax, Inc. (HZO)	Outperform
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
Five Below, Inc. (FIVE)	Underperform

Industry Comparison Industry: Retail - Miscellaneous				Industry Peers		
	MIK Underperform	X Industry	S&P 500	KAR Neutral	SBH Neutral	ULTA Neutral
VGM Score	A	-	-	B	C	B
Market Cap	334.81 M	684.32 M	17.53 B	1.55 B	1.18 B	10.97 B
# of Analysts	5	4	13	8	7	13
Dividend Yield	0.00%	0.00%	2.47%	6.32%	0.00%	0.00%
Value Score	A	-	-	A	B	C
Cash/Price	1.79	0.21	0.07	0.36	0.06	0.06
EV/EBITDA	6.16	6.28	10.68	6.16	4.72	10.68
PEG Ratio	0.22	0.98	1.64	0.78	1.00	0.96
Price/Book (P/B)	NA	0.92	2.32	0.94	534.52	5.77
Price/Cash Flow (P/CF)	0.75	4.20	9.40	4.56	3.17	11.11
P/E (F1)	1.40	9.29	14.14	9.46	4.56	15.29
Price/Sales (P/S)	0.07	0.21	1.82	0.49	0.30	1.48
Earnings Yield	71.49%	10.77%	7.02%	10.57%	21.95%	6.54%
Debt/Equity	-2.77	1.22	0.70	1.35	717.80	0.89
Cash Flow (\$/share)	3.06	3.18	7.01	2.63	3.18	17.27
Growth Score	B	-	-	F	D	A
Hist. EPS Growth (3-5 yrs)	10.09%	9.66%	10.85%	8.42%	9.23%	26.69%
Proj. EPS Growth (F1/F0)	-22.56%	6.31%	3.53%	22.12%	-2.34%	5.36%
Curr. Cash Flow Growth	-14.92%	7.18%	5.93%	-41.97%	0.84%	5.84%
Hist. Cash Flow Growth (3-5 yrs)	1.68%	2.83%	8.55%	-4.24%	2.83%	20.48%
Current Ratio	1.34	1.42	1.23	1.29	2.00	1.81
Debt/Capital	NA%	57.36%	42.57%	57.36%	99.86%	47.18%
Net Margin	5.37%	3.40%	11.64%	6.00%	6.70%	9.54%
Return on Equity	-20.71%	11.33%	16.74%	12.57%	-376.67%	36.75%
Sales/Assets	1.35	1.44	0.54	0.45	1.73	1.54
Proj. Sales Growth (F1/F0)	0.72%	0.85%	2.51%	-6.66%	0.77%	7.21%
Momentum Score	F	-	-	B	C	F
Daily Price Chg	4.11%	3.79%	2.41%	16.70%	11.64%	8.05%
1 Week Price Chg	-41.13%	-19.24%	-16.96%	-31.29%	-16.03%	-28.49%
4 Week Price Chg	-45.84%	-31.42%	-23.98%	-41.39%	-17.93%	-29.65%
12 Week Price Chg	-71.82%	-39.93%	-27.80%	-44.84%	-44.82%	-24.20%
52 Week Price Chg	-81.00%	-47.35%	-18.55%	-75.67%	-45.45%	-44.55%
20 Day Average Volume	6,069,963	506,956	4,285,848	3,137,902	3,165,242	1,758,569
(F1) EPS Est 1 week change	0.00%	-0.46%	0.00%	0.00%	-3.38%	-0.76%
(F1) EPS Est 4 week change	-26.60%	-4.31%	-1.83%	-6.97%	-3.38%	-4.16%
(F1) EPS Est 12 week change	-26.26%	-5.20%	-2.90%	-14.51%	-4.66%	-4.27%
(Q1) EPS Est Mthly Chg	-29.83%	-7.66%	-1.37%	-2.31%	-6.35%	-6.53%

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	B
Momentum Score	F
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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