

MICHAELS STORES INC
Form DEF 14A
May 06, 2004

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

**SCHEDULE 14A
(RULE 14A-101)**

**INFORMATION REQUIRED IN PROXY STATEMENT
SCHEDULE 14A INFORMATION**

**PROXY STATEMENT PURSUANT TO SECTION 14(a) OF
THE SECURITIES EXCHANGE ACT OF 1934 (AMENDMENT NO.)**

Filed by the Registrant x

Filed by a Party other than the Registrant o

Check the appropriate box:

- o Preliminary Proxy Statement
- o Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
- x Definitive Proxy Statement
- o Definitive Additional Materials
- o Soliciting Material Pursuant to §240.14a-12

Michaels Stores, Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- x No fee required.
- o Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

1) Title of each class of securities to which transaction applies:

2) Aggregate number of securities to which transaction applies:

3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

4) Proposed maximum aggregate value of transaction:

5) Total fee paid:

- o Fee paid previously with preliminary materials:
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- o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

1) Amount previously paid:

2) Form, Schedule or Registration Statement No.:

3) Filing Party:

4) Date Filed:

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Michaels Stores, Inc.

**8000 Bent Branch Drive
Irving, Texas 75063**

May 6, 2004

Dear Stockholder:

You are cordially invited to attend the Annual Meeting of Stockholders of Michaels Stores, Inc. to be held at the Four Seasons Resort and Club, 4150 North MacArthur Boulevard, Irving, Texas 75038 on Thursday, June 17, 2004, at 10:30 a.m., central daylight savings time.

The attached Notice of Annual Meeting of Stockholders and Proxy Statement describe fully the formal business to be transacted at the Annual Meeting. During the Annual Meeting, stockholders will consider and vote upon the election of six members to the Board of Directors, the ratification of the selection of Ernst & Young LLP as our independent auditors and an amendment to the Restated Certificate of Incorporation to increase the number of shares of common stock authorized for issuance.

Certain directors and officers will be present at the Annual Meeting and will be available to respond to any questions you may have. I hope you will be able to attend.

We urge you to review carefully the accompanying material and to return the enclosed proxy card promptly. Please sign, date and return the enclosed proxy card without delay. If you attend the Annual Meeting, you may vote in person even if you have previously mailed a proxy.

Sincerely,

CHARLES J. WYLY, JR.
Chairman of the Board

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Michaels Stores, Inc.

**8000 Bent Branch Drive
Irving, Texas 75063**

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

To Be Held On June 17, 2004

NOTICE IS HEREBY GIVEN that the Annual Meeting of Stockholders (the Annual Meeting) of Michaels Stores, Inc. will be held at the Four Seasons Resort and Club, 4150 North MacArthur Boulevard, Irving, Texas 75038 on Thursday, June 17, 2004, at 10:30 a.m., central daylight savings time, for the following purposes:

- (1) To elect six members to our Board of Directors to serve until the next annual meeting of stockholders and until their successors have been elected and qualified.
- (2) To ratify the selection of Ernst & Young LLP as our independent auditors for fiscal 2004.
- (3) To approve an amendment to our Restated Certificate of Incorporation to increase the number of shares of our common stock authorized for issuance.
- (4) To consider such other business as may properly come before the Annual Meeting or any adjournments thereof.

Information concerning the matters to be acted upon at the Annual Meeting is set forth in the accompanying Proxy Statement.

The close of business on April 26, 2004 has been fixed as the record date for determining the stockholders entitled to notice of, and to vote at, the Annual Meeting or any adjournments thereof. For a period of at least 10 days prior to the Annual Meeting, a complete list of stockholders entitled to vote at the Annual Meeting will be open for examination by any stockholder during ordinary business hours at our offices at 8000 Bent Branch Drive, Irving, Texas 75063.

We urge stockholders to complete, date, sign and return the enclosed proxy card in the accompanying envelope, which does not require postage if mailed in the United States.

By Order of the Board of Directors,

MARK V. BEASLEY
Secretary

Irving, Texas
May 6, 2004

PROXY STATEMENT

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Michaels Stores, Inc.

8000 Bent Branch Drive
Irving, Texas 75063

PROXY STATEMENT

**For
ANNUAL MEETING OF STOCKHOLDERS
To Be Held On June 17, 2004**

GENERAL QUESTIONS AND ANSWERS

Q: When is the Proxy Statement being mailed?

A: This Proxy Statement is first being mailed on or about May 6, 2004 to our stockholders by our Board of Directors to solicit proxies for our use at the Annual Meeting.

Q: When is the Annual Meeting and where will it be held?

A: The Annual Meeting will be held on Thursday, June 17, 2004, at 10:30 a.m., central daylight savings time, at the Four Seasons Resort and Club, 4150 North MacArthur Boulevard, Irving, Texas 75038.

Q: Who may attend the Annual Meeting?

A: All of our stockholders may attend the Annual Meeting.

Q: Who is entitled to vote?

A: Stockholders as of the close of business on April 26, 2004 are entitled to vote at the Annual Meeting. Each share of our common stock is entitled to one vote.

Q: On what am I voting?

A: You will be voting on:

The election of six members to our Board of Directors to serve until the next annual meeting of stockholders and until their successors have been elected and qualified;

The ratification of the selection of Ernst & Young LLP as our independent auditors;

The approval of an amendment to our Restated Certificate of Incorporation to increase the number of shares of our common stock authorized for issuance; and

Such other business as may properly come before the Annual Meeting or any adjournments thereof.

Q: How do I vote?

A: You may vote by either attending the Annual Meeting or signing and dating each proxy card you receive and returning it in the enclosed prepaid envelope. We encourage you to complete and send in your proxy card. All shares represented by valid proxies, unless the

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stockholder otherwise specifies, will be voted:

FOR the election of each of the persons identified in Proposal For Election of Directors as nominees for election as directors;

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FOR the ratification of the selection of Ernst & Young LLP as our independent auditors for fiscal 2004;

FOR the amendment to our Restated Certificate of Incorporation to increase the number of shares of our common stock authorized for issuance; and

At the discretion of the proxy holders with regard to any other matter that may properly come before the Annual Meeting.

If you properly specify how your proxy is to be voted, your proxy will be voted accordingly. If you sign and send in your proxy but do not indicate how you want to vote, your proxy will be counted as a vote for each of the nominees for election as directors, for the ratification of the selection of Ernst & Young LLP as our independent auditors for fiscal 2004 and for the amendment to our Restated Certificate of Incorporation to increase the number of shares of our common stock authorized for issuance.

Q: If I abstain from voting or withhold authority to vote on any proposal or withhold authority to vote for any director nominee, will my shares be counted in the vote?

A: If you abstain from voting on the Proposal For Election of Directors, your shares will not be counted in the vote for any director nominee, and if you withhold authority to vote for any director nominee, your shares will not be counted in the vote for that nominee. If you abstain from voting or withhold authority to vote on the Proposal For Ratification of the Selection of our Independent Auditors, your shares will not be counted in the vote for that proposal. If you abstain from voting or withhold authority to vote on the Proposal For the Adoption of the Amendment to the Restated Certificate of Incorporation, your shares will effectively be counted as votes against that proposal.

Q: If my shares are held in street name by my broker, will my broker vote my shares for me?

A: Your broker has limited discretion to vote street name shares without your instructions. For example, your broker could vote your shares without your instructions on each of the proposals but is not required to do so. To be sure your shares are voted, you should instruct your broker to vote your shares using the instructions provided by your broker. If you do not instruct your broker on how to vote your shares, your shares may not be counted in the vote on the Proposal For Election of Directors or the Proposal For Ratification of the Selection of our Independent Auditors and may be counted effectively as votes against the Proposal For the Adoption of the Amendment to the Restated Certificate of Incorporation.

Q: Can I change my vote after I mail my proxy?

A: Yes. You can change your vote at any time before your proxy is voted at the Annual Meeting. You may revoke your proxy by:

delivering, no later than 5:00 p.m., central daylight savings time, on June 16, 2004, written notice of revocation to Computershare Investor Services, L.L.C., 3020 Legacy Drive, Suite 100-307, Plano, Texas 75023; or

attending the Annual Meeting and voting in person. Your attendance alone will not revoke your proxy. You must also vote in person at the Annual Meeting.

If you instruct a broker to vote your shares, you must follow your broker's directions for changing those instructions.

Q: What does it mean if I receive more than one proxy card?

A: If you receive more than one proxy card, it is because your shares are in more than one account. You will need to sign and return all proxy cards to ensure that all of your shares are voted.

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Q: Who will count the vote?

A: Representatives of Computershare Investor Services, L.L.C., our transfer agent, will tabulate the votes and act as inspectors of election.

Q: What constitutes a quorum?

A: As of April 26, 2004, the record date, 68,726,358 shares of our common stock were issued and outstanding. A majority of the issued and outstanding shares, present or represented by proxy, will constitute a quorum for the transaction of business at the Annual Meeting. If you submit a properly executed proxy card, then your shares will be counted as part of the quorum. Abstentions or votes that are withheld and broker non-votes will be counted towards a quorum but will be excluded from applicable votes.

Q: What is the required vote for election of each director?

A: The required vote for election of each director is a plurality of the votes of the shares of common stock having voting power present or represented by proxy at the Annual Meeting.

Q: What is the required vote for ratification of the selection of Ernst & Young LLP as our independent auditors for fiscal 2004?

A: The approval of the holders of a majority of the total number of outstanding shares of our common stock having voting power present or represented by proxy at the Annual Meeting and actually voted on the proposal is necessary to ratify the selection of Ernst & Young LLP as our independent auditors for fiscal 2004. However, pursuant to the Audit Committee Charter, our Audit Committee has sole authority to appoint our independent auditors, and our Audit Committee will not be bound by the ratification of, or failure to ratify, the selection of Ernst & Young LLP as our independent auditors for fiscal 2004. The Audit Committee will, however, consider any failure to ratify the selection of Ernst & Young LLP in connection with the appointment of the independent auditor the following fiscal year.

Q: What is the required vote for adoption of the amendment to our Restated Certificate of Incorporation?

A: The amendment must be approved by the holders of a majority of the total number of outstanding shares of our common stock. As a result, abstentions from this vote, withheld authority to vote and broker non-votes effectively will be votes against this proposal.

Q: How much will this proxy solicitation cost?

A: We have hired Morrow & Co., Inc. to assist us in the distribution of proxy materials and solicitation of votes at a cost of approximately \$7,500, plus out-of-pocket expenses. We will reimburse brokerage firms and other custodians, nominees and fiduciaries for their reasonable out-of-pocket expenses for forwarding proxy and solicitation materials to the owners of our common stock. Our officers and regular employees may also solicit proxies, but they will not be specifically compensated for these services.

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Our Board of Directors has six members, a majority of whom are independent directors. All directors serve until the next annual meeting of stockholders and until their successor is duly elected and qualified or until the earlier of their resignation, death or removal. In order to be elected as a director, a nominee must receive a plurality of the votes of the shares of common stock having voting power present or represented by proxy at the Annual Meeting.

The Governance and Nominating Committee has recommended, and our Board has approved, the nomination of the six nominees listed below. The nominees have indicated their willingness to serve as members of the Board if elected; however, in case any nominee becomes unavailable for election to the Board for any reason not presently known or contemplated, the proxy holders have discretionary authority to vote proxies for a substitute nominee or nominees. Proxies cannot be voted for more than six nominees.

Set forth below is information as to the nominees for election at the Annual Meeting, including their ages, present principal occupations, other business experiences during the last five years, membership on committees of the Board and directorships in other companies.

Name	Age	Position
Charles J. Wyly, Jr.	70	Chairman of the Board of Directors
Sam Wyly	69	Vice Chairman of the Board of Directors
Richard E. Hanlon (1)	56	Director
Richard C. Marcus (2)	65	Director
Liz Minyard (3)	50	Director
Cece Smith (4)	59	Director

- (1) Member of the Compensation Committee and the Governance and Nominating Committee.
- (2) Member of the Audit Committee, the Compensation Committee and the Governance and Nominating Committee.
- (3) Member of the Audit Committee and the Compensation Committee.
- (4) Member of the Audit Committee and the Governance and Nominating Committee.

Mr. Charles J. Wyly, Jr. became a director of Michaels in 1984. He served as Vice Chairman of the Board of Michaels from 1985 until 2001 when he became Chairman of the Board. He co-founded Sterling Software, Inc., a worldwide supplier of software products, in 1981 and, until its acquisition in 2000 by another company, had served as a director and since 1984 as Vice Chairman of the Board. Mr. Wyly served as a director of Sterling Commerce, Inc., a worldwide provider of electronic commerce software and services, from December 1995 until its acquisition in 2000 by another company. Mr. Wyly was a director of Scottish Annuity & Life Holdings, Ltd., a variable life insurance and reinsurance company, from October 1998 until November 2000. Mr. Wyly served from 1964 to 1975 as an officer and director, including serving as President from 1969 to 1973, of University Computing Company. Mr. Wyly and his brother, Sam Wyly, founded Earth Resources Company, an oil refining and silver mining company, and Charles J. Wyly, Jr. served as Chairman of the Board of that company from 1968 to 1980. He was also a founding partner of Maverick Capital, Ltd., a manager of equity hedge funds.

Mr. Sam Wyly has served as Vice Chairman of the Board of Michaels since July 2001 and a director of Michaels since 1984. He served as Chairman of the Board from 1984 until July 2001. Mr. Wyly is an entrepreneur who has created and managed several public and private companies. He is a manager of Ranger Capital, Ltd., a Dallas-based hedge fund management company. He founded Maverick Capital, Ltd., another hedge fund manager, in 1990. Mr. Wyly is also a director of Green Mountain Energy Company, a clean energy provider. He founded University Computing Company, which became one of the first computer utility networks and one of the first software product companies. He was a founder and, until its acquisition in 2000 by another company, was Chairman and a director of Sterling Software, Inc. He also was Chairman of the Executive Committee and a director of Sterling Commerce, Inc., until its

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acquisition in 2000 by another company, and was Chairman and a director of Scottish Annuity & Life Holdings, Ltd. from October 1998 until June 2000.

Mr. Hanlon has served as a director of Michaels since April 1990. He retired as Senior Vice President – Investor Relations from AOL Time Warner, Inc. in September 2002, having held that position since January 2001 when that media and communications company was formed. From February 1995 until January 2001, he was a senior executive of America Online, Inc., the world’s largest provider of Internet online services. From March 1993 until February 1995, Mr. Hanlon was President of Hanlon & Co., which provided consulting services in shareholder and investor relations, and from 1988 until 1993 was Vice President – Corporate Communications and Secretary of LEGENT Corporation, an enterprise software company.

Mr. Marcus became a director of Michaels in July 1999. He currently serves as a management consultant to various organizations and, since January 1997, has served as Senior Advisor to Peter J. Solomon Company, an investment banking company. From December 1994 through December 1995, Mr. Marcus served as Chief Executive Officer of Plaid Clothing Group, a manufacturer of men’s tailored clothing. Prior to these activities, Mr. Marcus was with Neiman Marcus for 27 years and served as Chairman and Chief Executive Officer from 1979 through 1988. He is currently on the board of directors of Zale Corporation and, effective July 31, 2004, he will become the Chairman of the Board.

Ms. Minyard became a director of Michaels in March 2002. Since 1988, Ms. Minyard has served as Co-Chairman of the Board and, since 1998, as Co-Chief Executive Officer of Minyard Food Stores, Inc., a grocery retailer. She is currently an advisory director to TXU Corp.

Ms. Smith became a director of Michaels in October 2002. She is Managing General Partner of Phillips-Smith-Machens Venture Partners, a venture capital firm that invests in retail and consumer businesses and that she co-founded in 1986. She is currently on the boards of directors of Brinker International, Inc. and Beautyco, Inc. Ms. Smith served as a director from 1992 to 1997 and as Chairman from 1994 to 1996 of the Federal Reserve Bank of Dallas.

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The following table sets forth information as of March 31, 2004 regarding the beneficial ownership of common stock by each person known by Michaels to own 5% or more of the outstanding shares of common stock, each director of Michaels, each Named Executive (as defined in Management Compensation Summary Compensation Table herein), and the directors and executive officers of Michaels as a group. The persons named in the table have sole voting and investment power with respect to all shares of common stock owned by them, unless otherwise noted. The percentage of beneficial ownership is calculated based on 68,336,733 shares of common stock outstanding as of March 31, 2004.

Name of Beneficial Owner	Amount and Nature of Beneficial Ownership(1)	Percent of Class
Charles J. Wyly, Jr.	1,479,859 (2)	2.2%
Sam Wyly	1,357,333 (3)	2.0%
Richard E. Hanlon	101,300 (4)	*
Richard C. Marcus	77,000 (5)	*
Liz Minyard	52,500 (6)	*
Cece Smith	35,000 (7)	*
R. Michael Rouleau	534,693 (8)	*
Jeffrey N. Boyer	25,000 (9)	*
Edward F. Sadler	129,166 (10)	*
Ronald S. Staffieri	33,333 (11)	*
Capital Research and Management Company 333 South Hope Street Los Angeles, California 90071	9,528,000 (12)	13.9%
First Pacific Advisors, Inc. 11400 West Olympic Boulevard Suite 1200 Los Angeles, California 90064	3,618,700 (13)	5.3%
Putnam, LLC d/b/a Putnam Investments One Post Office Square Boston, Massachusetts 02109	4,496,106 (14)	6.6%
Wellington Management Company, LLP 75 State Street Boston, Massachusetts 02109	6,234,780 (15)	9.1%
All current directors and executive officers as a group (22 persons)	4,083,311 (16)	5.8%

* Less than one percent.

- (1) Pursuant to Rule 13d-3 under the Securities Exchange Act of 1934, a person has beneficial ownership of any securities as to which such person, directly or indirectly, through any contract, arrangement, undertaking, relationship or otherwise has or shares voting power and/or investment power or as to which such person has the right to acquire such voting and/or investment power within 60 days. Percentage of beneficial ownership by a person as of a particular date is calculated by dividing the number of shares beneficially owned by such person by the sum of the number of shares outstanding as of such date and the number of unissued shares as to which such person has the right to acquire voting and/or investment power within 60 days. The number of shares shown includes outstanding shares of common stock owned as of March 31, 2004 by the person indicated and shares underlying options owned by such person on March 31, 2004 that are exercisable within 60 days of that date. Persons holding shares of common stock pursuant to the Michaels Stores, Inc. Employees 401(k) Plan, as amended and restated, have sole voting power and investment power with respect to such shares.

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- (2) Includes 336,666 shares under options; 380,205 shares held of record by Stargate, Ltd. (a limited partnership, the general partner of which is a trust of which Mr. Wyly is one of the trustees); 207,604 shares held of record by Shadywood USA, Ltd. (a limited partnership of which Mr. Wyly is the general partner); and 555,284 shares held of record by family trusts of which Mr. Wyly is the trustee.
- (3) Includes 353,332 shares under options; 200,000 shares held of record by Tallulah, Ltd. (a limited partnership of which Mr. Wyly is the general partner); 149,572 shares held of record by family trusts of which Mr. Wyly is the trustee; and 14,020 shares owned by Mr. Wyly's spouse.
- (4) Includes 70,000 shares under options and 10,167 shares held of record by a family trust of which Mr. Hanlon is a co-trustee.
- (5) Includes 70,000 shares under options.
- (6) Includes 52,500 shares under options.
- (7) Includes 35,000 shares under options.
- (8) Includes 466,666 shares under options; 6,039 shares owned pursuant to our 401(k) Plan; and 20,000 shares which Mr. Rouleau owns jointly with his spouse.
- (9) Includes 25,000 shares under options.
- (10) Includes 129,166 shares under options.
- (11) Includes 33,333 shares under options.
- (12) Based on an amendment to a Schedule 13G filed with the Securities and Exchange Commission, dated February 10, 2004, Capital Research and Management Company, a registered investment adviser, has the sole power to dispose or direct the disposition of 9,528,000 shares of common stock but has no power to vote or direct the vote of such shares.
- (13) Based on a Schedule 13G filed with the Securities and Exchange Commission, dated February 5, 2004, First Pacific Advisors, Inc., an investment advisor, shares the power to vote or direct the vote of 1,496,100 shares of common stock and shares the power to dispose or direct the disposition of 3,618,700 shares of common stock.
- (14) Based on an amendment to a Schedule 13G filed with the Securities and Exchange Commission, dated February 9, 2004, Putnam, LLC d/b/a Putnam Investments, on behalf of itself and its parent and wholly-owned subsidiaries in their various capacities, shares the power to vote or direct the vote of 303,405 shares of common stock and shares the power to dispose or direct the disposition of 4,496,106 shares of common stock.
- (15) Based on a Schedule 13G filed with the Securities and Exchange Commission, dated February 13, 2004, Wellington Management Company, LLP, an investment advisor, shares the power to vote or direct the vote of 4,895,660 shares of common stock and shares the power to dispose or direct the disposition of 6,234,780 shares of common stock.
- (16) Includes 1,794,243 shares under options; 10,848 shares owned pursuant to our 401(k) Plan held by executive officers, some of whom are not named in the table; and 1,080 shares an executive officer not named in the table owns jointly with his spouse.

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CORPORATE GOVERNANCE

In 2001, Michaels announced several new initiatives designed to further enhance accountability to our stockholders. These initiatives included:

the dissolution of the Executive Committee, resulting in key corporate issues being reviewed by the full Board;

the replacement of what was previously known as the Nominating Committee with the Governance and Nominating Committee, which became responsible for developing corporate governance guidelines as well as considering and making recommendations to the Board regarding nominees for election to the Board;

a plan to expand the Board and fill the new positions with independent directors, which subsequently resulted in Liz Minyard and Cece Smith joining the Board; and

the amendment of Michaels' Restated Certificate of Incorporation to eliminate the staggered election of Board members.

In 2003, in the wake of the corporate governance reforms initiated by Congress in passing the Sarbanes-Oxley Act of 2002 and by the Securities and Exchange Commission and the New York Stock Exchange in response to the Sarbanes-Oxley Act, Michaels initiated a corporate governance program to comply as soon as practicable with applicable current requirements newly imposed, as well as most of the proposed rules published, by the Securities and Exchange Commission and the New York Stock Exchange with respect to corporate governance. In undertaking this program, Michaels made the decision to conform its corporate governance to these requirements whether or not the legally effective date of the requirements had occurred and whether or not the rules were still in the proposal stage. In this regard, Michaels adopted Corporate Governance Guidelines, a revised Code of Business Conduct and Ethics, a revised Audit Committee Charter, a Compensation Committee Charter and a Governance and Nominating Committee Charter. In 2004, in response to the New York Stock Exchange's adoption of final rules, as well as the Securities and Exchange Commission's adoption of other rules, Michaels revised its Corporate Governance Guidelines, Code of Business Conduct and Ethics, Audit Committee Charter, Compensation Committee Charter and Governance and Nominating Committee Charter.

A copy of the current charter for each of our Audit Committee, Governance and Nominating Committee and Compensation Committee and a copy of our Corporate Governance Guidelines and Code of Business Conduct and Ethics are available on our Internet website at www.michaels.com under Corporate Information. Copies are also available to stockholders upon request from our Investor Relations Department. Our revised Audit Committee Charter is also attached to this Proxy Statement as Exhibit A. Furthermore, Michaels will post any amendments to our Code of Business Conduct and Ethics, or waivers of the Code for its directors or executive officers, on our Internet website at www.michaels.com under Corporate Information.

Stockholders may communicate with the Board by mail, with an envelope containing the communication addressed as follows: Board Communication, c/o Secretary, Michaels Stores, Inc., 8000 Bent Branch Drive, Irving, Texas 75063. The Secretary of the Company will review all such communications and will, within a reasonable period of time after receiving the communications, forward all such communications to the Chairman of the Board, other than those communications that are merely solicitations for products or services or relate to matters that are of a type which render them improper or irrelevant to the functioning of the Board and the Company. The Chairman of the Board will relay to the full Board those communications that have been forwarded to him.

During fiscal 2003, our Board held nine meetings and acted by unanimous written consent eight times. In addition to meetings of the full Board, directors attended meetings of Board committees. All incumbent directors attended at least 75% of the aggregate number of meetings of the Board and all applicable committee meetings. Michaels expects its directors to attend its annual meetings of stockholders. In 2003, all members of the Board attended the annual meeting of stockholders.

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Director Independence

Our Corporate Governance Guidelines require that a majority of the members of our Board of Directors satisfy the independence requirements set forth in the rules of the New York Stock Exchange. Our Board has adopted categorical independence standards for determining the independence of our directors. Those standards reflect the specific independence requirements of the New York Stock Exchange rules. The standards provide that an independent director is a director who:

has not been employed by, and none of whose immediate family members has been an executive officer of, Michaels at any time within the three years preceding the date of the determination of independence;

has not received, and none of whose immediate family members has received at any time within the three years preceding the date of the determination of independence, more than \$100,000 per year in direct compensation from Michaels, other than director and committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not contingent in any way on continued service) and excluding compensation received by an immediate family member for services as a non-executive employee of Michaels;

has not been affiliated with or employed by, and none of whose immediate family members has been affiliated with or employed in a professional capacity by, a present or former internal or external auditor of Michaels at any time within the three years preceding the date of the determination of independence;

has not been, and none of whose immediate family members has been, within three years from the date of the determination of independence, employed as an executive officer of another company where any of Michaels' present executive officers concurrently served on that company's compensation committee at any time within the three years preceding the date of the determination of independence; and

is not an executive officer or an employee, and none of whose immediate family members is an executive officer, of another company (other than a charitable organization) that, during the current fiscal year or last three completed fiscal years, made payments to, or received payments from, Michaels for property or services in an amount which, in any single fiscal year, exceeds the greater of 2% or \$1 million of such other company's consolidated gross revenues.

While there is a three-year lookback provision in each of the above standards, only a one-year look-back will apply prior to November 4, 2004.

The categorical independence standards also provide that, in making a determination regarding a director's independence, any interest or relationship of a director of a type described in Item 404 of Regulation S-K promulgated by the Securities and Exchange Commission that is not required to be disclosed pursuant to Item 404 shall be presumed not to be inconsistent with the independence of such director, except to the extent otherwise expressly provided with respect to a particular interest or relationship set forth in the rules of the New York Stock Exchange and under applicable law.

Our Board has determined that each of our four independent directors, Richard E. Hanlon, Richard C. Marcus, Liz Minyard and Cece Smith, meets the categorical independence standards set forth above.

Meetings of Non-Management and Independent Directors

Our Corporate Governance Guidelines require our non-management directors to meet at regularly scheduled executive sessions without management. Our Corporate Governance Guidelines provide that the position of presiding director for executive sessions of non-management directors shall be rotated for each meeting among the non-management directors on an alphabetical basis. If one or more non-management directors do not satisfy applicable independence requirements set forth in the rules of the New York Stock Exchange and under applicable law, then at least once each year an executive session including only independent directors will be held. Stockholders may communicate with the non-management directors by

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mail, with an envelope containing the communication addressed as follows: Non-Management Directors, c/o Secretary, Michaels Stores, Inc., 8000 Bent Branch Drive, Irving, Texas 75063. The Secretary of the Company will review all such communications and will, within a reasonable period of time after receiving the communications, forward all such communications to the non-management directors, other than those communications that are merely solicitations for products or services or relate to matters that are of a type which render them improper or irrelevant to the functioning of the Board and the Company.

Board Committees

As required by our Corporate Governance Guidelines, our Board has three active standing committees, each of which is required by its charter to consist of no fewer than three directors satisfying the applicable current independence criteria of the New York Stock Exchange. The three members of the Governance and Nominating Committee are Richard E. Hanlon (Chairman), Richard C. Marcus and Cece Smith. The three members of the Compensation Committee are Richard E. Hanlon (Chairman), Richard C. Marcus and Liz Minyard. The three members of the Audit Committee are Richard C. Marcus (Chairman), Liz Minyard and Cece Smith.

Governance and Nominating Committee

Michaels believes that placing the responsibility for nominating directors in the hands of an independent committee, along with charging that committee with the responsibility of taking a leadership role in shaping Michaels' corporate governance matters, enhances the independence and quality of its Board and of its corporate governance practices. Therefore, under the terms of its amended and restated charter, the Governance and Nominating Committee is charged with the responsibility of identifying individuals qualified to become Board members by recommending to the Board candidates to fill vacancies and newly-created positions on the Board and recommending to the Board director nominees for election by the stockholders at the annual stockholder meeting, including recommendations as to whether incumbent members of the Board should be nominated for re-election to the Board. The Governance and Nominating Committee reviews qualifications of, and makes recommendations to the Board concerning, director nominees submitted by stockholders. At any annual meeting, stockholders may nominate a person for election as a director but only upon notice to the Secretary of Michaels given in accordance with the notice provisions in the Restated Certificate of Incorporation.

The Governance and Nominating Committee has also adopted policies and procedures by which Michaels' stockholders may submit director candidates to the Governance and Nominating Committee for consideration. If the Governance and Nominating Committee receives, by a date not later than the 120th calendar day before the anniversary of the date that Michaels' proxy statement was released to its stockholders in connection with its previous year's annual meeting, a recommendation for a director nominee (a Director Candidate) from a stockholder or group of stockholders that beneficially owned more than 5% of Michaels' outstanding common stock for at least one year as of the date of the recommendation, then such Director Candidate will be considered and evaluated by the Governance and Nominating Committee for the annual meeting immediately succeeding the date that proper written notice was timely delivered to and received by the Governance and Nominating Committee. Where the date of Michaels' annual meeting of stockholders changes by more than 30 calendar days from the previous year's annual meeting, such written notice of the recommendation for the Director Candidate will be considered timely if, and only if, it is received by the Governance and Nominating Committee no later than the close of business on the 10th calendar day following the first day on which notice of the date of the upcoming annual meeting is publicly disclosed by Michaels, unless such notice specifies a different date for stockholder recommendations for a Director Candidate to be timely.

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Written notice from an eligible stockholder or group of eligible stockholders to the Governance and Nominating Committee recommending a Director Candidate must contain or be accompanied by:

proof that the stockholder or group of stockholders submitting the recommendation has beneficially owned, for the required one-year period, a number of shares of Michaels common stock necessary to qualify the stockholder or group of stockholders to make such a recommendation;

a written statement that the stockholder or group of stockholders intend to continue to beneficially own the number of shares of the Michaels common stock necessary to qualify such stockholder or group of stockholders to make a Director Candidate recommendation through the date of the next annual meeting of the stockholders of Michaels;

the name of each stockholder submitting the Director Candidate for consideration, the name of the individual recommended as a Director Candidate, and the written consent of each such stockholder and the Director Candidate to be publicly identified, and with respect to the Director Candidate, a written consent agreeing to (i) be named in Michaels proxy materials and (ii) serve as a member of the Board (and any committee of the Board to which the Director Candidate is assigned to serve by the Board) if elected;

with respect to the Director Candidate, his or her name, age, business and residential address, principal occupation or employment, number of shares of Michaels common stock beneficially owned, a resume or similar document detailing personal and professional experiences and accomplishments, and all other information relating to the Director Candidate that would be required to be disclosed in a proxy statement or other filing made in connection with the solicitation of proxies for the election of directors pursuant to the Securities Exchange Act of 1934, the rules of the Securities and Exchange Commission and the listing requirements and other criteria of the New York Stock Exchange; and

a written statement that each submitting stockholder and the Director Candidate will make available to the Governance and Nominating Committee all information reasonably requested in connection with the Governance and Nominating Committee's evaluation of the Director Candidate.

To ensure flexibility with respect to the director nominee evaluation process, the Governance and Nominating Committee has not established specific, minimum qualifications that an individual must meet in order to become a member of the Board. However, the Governance and Nominating Committee believes that Michaels is best served when the members of the Board:

provide the Board with a variety of experiences and backgrounds to draw from;

exhibit strong leadership in their particular field or area of expertise;

possess the ability to exercise sound business judgment;

have strong educational backgrounds or equivalent life experiences;

have substantial experience both in the business community and outside the business community;

contribute positively to the existing collaborative culture among Board members;

represent the best interests of all of Michaels stockholders and not just one particular constituency;

have experience as a senior manager, executive or director of an organization of significant size, complexity or prominence (or experience with such an organization in a similar capacity, however designated);

consistently demonstrate integrity and ethics in their personal and professional life; and

have the time and ability to participate fully in Board activities, including attendance at, and active participation in, meetings of the Board and the committee or committees of which they are a member.

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The Governance and Nominating Committee is also charged with the responsibility of developing and recommending corporate governance principles applicable to Board members and Michaels employees. The Governance and Nominating Committee Charter requires the committee to develop and recommend guidelines for that purpose consistent with federal and state law and the rules of the Securities and Exchange Commission and the New York Stock Exchange, giving appropriate attention to best corporate governance practices. In response to that requirement, the Governance and Nominating Committee developed and recommended, and the Board has adopted, the amended and restated Corporate Governance Guidelines available on our Internet website. The Governance and Nominating Committee also (i) oversees the evaluation of the performance of the Board and Michaels management against the Corporate Governance Guidelines and (ii) reviews possible conflicts of interest. During fiscal 2003, the Governance and Nominating Committee met one time and acted by unanimous written consent one time.

Compensation Committee

To further enhance the independence and effectiveness of Michaels corporate policies and practices, under the terms of its amended and restated charter, the Compensation Committee reviews, approves and administers Michaels policies, programs, procedures and objectives for compensating its executive officers. The Compensation Committee determines and approves the compensation of Michaels Chief Executive Officer and reports that determination to the Board. The Compensation Committee reviews and approves the compensation levels of all other executive officers. The Compensation Committee also makes recommendations to the Board with respect to the approval and adoption of all cash- and equity-based incentive compensation plans in which any of Michaels executive officers participate. The Compensation Committee also reviews Board compensation policies, but only the Board may determine compensation for directors. The Compensation Committee acts as the committee of the Board that administers the Amended and Restated 1997 Employees Stock Purchase Plan, the Amended and Restated 1997 Stock Option Plan, the Second Amended and Restated 2001 Employee Stock Option Plan and the Amended and Restated 2001 General Stock Option Plan. With respect to the 1997 Stock Option Plan, the 2001 Employee Stock Option Plan and the 2001 General Stock Option Plan, the Compensation Committee has the power to grant options and determine the number of shares to be covered by each option under each of those plans. Additionally, with respect to the 1997 Stock Option Plan, the Compensation Committee determines when options will be exercisable under that plan. During fiscal 2003, the Compensation Committee met three times and acted by unanimous written consent 17 times.

Compensation Committee Interlocks and Insider Participation

During fiscal 2003, Richard E. Hanlon, Richard C. Marcus and Liz Minyard served as members of the Compensation Committee, and none of them were or have been employees of Michaels.

Audit Committee

The revised Audit Committee Charter requires that all members of the Audit Committee satisfy the independence criteria of the New York Stock Exchange and Securities Exchange Act of 1934 and all rules and applicable standards promulgated by the Securities and Exchange Commission or the New York Stock Exchange. It also requires that the Audit Committee members meet the financial literacy requirements of the New York Stock Exchange rules and that at least one Audit Committee member satisfies the accounting or related financial management expertise standards of the New York Stock Exchange rules and that either that member or another member satisfies the criteria for an audit committee financial expert, as that term is defined in Securities and Exchange Commission rules. All three members of the Audit Committee meet the independence requirements and the financial literacy requirements of the New York Stock Exchange and the independence requirements of the Securities Exchange Act of 1934. Our Board has determined that Cece Smith, a member of the Audit Committee, satisfies the accounting or related financial management expertise standards of the New York Stock Exchange and satisfies the criteria adopted by the Securities and Exchange Commission to serve as the audit committee financial expert of Michaels.

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Under its charter, the Audit Committee is generally responsible for overseeing Michaels' financial reporting process and assists the Board in fulfilling the Board's oversight responsibilities with respect to: (i) the integrity of Michaels' financial statements; (ii) Michaels' compliance with legal and regulatory requirements; (iii) the independent auditors' qualifications and independence; and (iv) the performance of the independent auditors and of Michaels' internal audit function. In fulfilling its obligations, the Audit Committee directly appoints, retains, terminates and determines the compensation of the independent auditors. The Audit Committee is also responsible for the resolution of disagreements between management and the independent auditors along with the pre-approval and approval of all audit and non-audit engagement fees, terms and services with the independent auditors in a manner consistent with the Sarbanes-Oxley Act of 2002 and all rules and applicable standards promulgated by the Securities and Exchange Commission or the New York Stock Exchange. Michaels' independent auditors are required to report directly to the Audit Committee concerning, among other things, the auditors' internal quality control procedures, the independence of the auditors and the plans for, and the scope and conduct of, annual audits. The Audit Committee has developed procedures for (i) receiving and dealing with complaints regarding accounting, internal accounting controls or auditing matters and (ii) the confidential submission by employees of concerns regarding questionable accounting or auditing matters. These procedures are disclosed on Michaels' website at www.michaels.com under Corporate Information. During fiscal 2003, the Audit Committee met 11 times and acted by unanimous written consent one time.

PROPOSAL FOR RATIFICATION OF THE SELECTION OF OUR INDEPENDENT AUDITORS

Pursuant to the Audit Committee Charter, the Audit Committee has the sole authority to retain the independent auditors. The Board requests that the stockholders ratify the Audit Committee's selection of Ernst & Young LLP as Michaels' independent auditors for fiscal 2004.

The Audit Committee will not be bound by the ratification of, or failure to ratify, the selection of Ernst & Young LLP as Michaels' independent auditors for fiscal 2004, but the Audit Committee will consider any failure to ratify the selection of Ernst & Young LLP in connection with the appointment of the independent auditor in the following fiscal year.

The Board recommends a vote FOR ratification of the Audit Committee's selection of Ernst & Young LLP as Michaels' independent auditors for fiscal 2004.

AUDIT COMMITTEE REPORT

The Audit Committee operates under a written charter adopted by the Board of Directors, which was reviewed and revised in March 2004 and is attached to this Proxy Statement as Exhibit A. The Audit Committee Charter requires our Audit Committee to undertake a variety of activities designed to assist our Board in fulfilling its oversight role regarding our auditors' independence, our financial reporting process, our systems of internal controls and our compliance with applicable laws, rules and regulations. These activities are briefly summarized in this Proxy Statement under the caption Corporate Governance Audit Committee. The Audit Committee Charter also makes it clear that the independent auditors are ultimately accountable to the Board and the Audit Committee, not management.

The internal accountants of Michaels prepare its consolidated financial statements and Michaels' independent auditors are responsible for auditing those financial statements. The Audit Committee monitors and reviews the financial reporting processes implemented by management but does not conduct any auditing or accounting reviews. The members of the Audit Committee are not employees of Michaels and do not represent themselves as experts in the field of accounting or auditing. Instead, the Audit Committee relies, without independent verification, on management's representation that the financial statements have been prepared in conformity with generally accepted accounting principles and on the representations of our independent auditors included in their report on our financial statements. The Audit Committee's oversight does not provide them with an independent basis for determining whether management has maintained appropriate accounting and financial reporting principles or policies or

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appropriate internal controls and procedures designed to assure compliance with accounting standards and applicable laws and regulations. Furthermore, the Audit Committee's discussions with management and its auditors do not ensure that the financial statements are presented in accordance with generally accepted accounting principles, that the audit of the financial statements has been carried out in accordance with generally accepted auditing standards or that the independent accountants are in fact independent.

We have engaged Ernst & Young LLP as independent auditors to audit and report to our stockholders on our financial statements for fiscal 2004. During fiscal 2003, there were no disagreements with Ernst & Young LLP on any matter of accounting principle or practice, financial statement disclosure or auditing scope or procedure, which, if not resolved to the satisfaction of Ernst & Young LLP, would have caused them to make a reference to the subject matter of the disagreement in connection with its reports.

The Audit Committee has reviewed and discussed with our management and Ernst & Young LLP, our independent auditors, the audited financial statements of Michaels contained in our Annual Report on Form 10-K for the fiscal year ended January 31, 2004. The Audit Committee has also discussed with our independent auditors the matters required to be discussed pursuant to SAS No. 61 (Codification of Statements on Auditing Standards, *Communication with Audit Committees*), as amended by SAS No. 90 (*Audit Committee Communications*).

The Audit Committee has also received and reviewed the written disclosures and the letter from Ernst & Young LLP required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees) and has discussed with Ernst & Young LLP their independence.

Based on the review and discussions referred to above, the Audit Committee recommended to the Board of Directors that the audited financial statements be included in our Annual Report on Form 10-K for the fiscal year ended January 31, 2004, as filed with the Securities and Exchange Commission.

The Audit Committee considered whether, and concluded that, the provision by Ernst & Young LLP of the services referred to under Tax Fees and All Other Fees is compatible with maintaining the independence of Ernst & Young LLP.

This report is submitted by the members of the Audit Committee of the Board of Directors:

Audit Committee

Richard C. Marcus

Liz Minyard

Cece Smith

INDEPENDENT AUDITORS' FEES

The following table presents fees for professional audit services rendered by Ernst & Young LLP for the audit of Michaels' annual financial statements for each of fiscal 2002 and 2003, and fees billed for other services rendered by Ernst & Young LLP.

	<u>2002</u>	<u>2003</u>
Audit Fees(1)	\$533,000	\$577,300
Audit-Related Fees(2)	\$106,000	\$ 61,000
Tax Fees(3)	\$102,000	\$187,300
All Other Fees(4)		\$ 27,500

(1) Audit Fees consist principally of fees for the audit of our annual financial statements and review of our financial statements included in our quarterly reports on Form 10-Q for those years and fees incurred in connection with the filing of registration statements with the Securities and Exchange Commission.

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- (2) Audit-Related Fees consist principally of fees for pension and statutory audits, as well as consultations regarding Michaels implementation of the requirements of Section 404 of the Sarbanes-Oxley Act.
- (3) Tax Fees consist principally of fees for tax compliance and preparation, tax advice and tax planning. In the table above, under Tax Fees, \$46,418 and \$37,317 constituted tax compliance and preparation fees in 2002 and 2003, respectively.
- (4) All other fees consist of fees for online research software, as well as consultations regarding our Deferred Compensation Plan.

The Audit Committee Charter requires that the Audit Committee pre-approve all audit and non-audit engagements, fees, terms and services in a manner consistent with the Sarbanes-Oxley Act of 2002 and all rules and applicable listing standards promulgated by the Securities and Exchange Commission and the New York Stock Exchange; provided, however, that such non-audit services need not be pre-approved if (i) the aggregate amount of all such non-audit services provided to Michaels constitutes not more than 5% of the total amount of fees paid by Michaels to its independent auditors during the fiscal year in which the non-audit services are provided, (ii) such services were not recognized by Michaels at the time of engagement to be non-audit services, and (iii) such services were promptly brought to the attention of the Audit Committee and approved by the Audit Committee or by one or more members of the Audit Committee to whom authority to grant such approvals has been delegated by the Audit Committee. The Audit Committee may delegate the authority to grant any pre-approvals to one or more members of the Audit Committee, provided that such member(s) reports any pre-approvals to the Audit Committee at its next scheduled meeting. The Audit Committee has delegated pre-approval authority to Richard C. Marcus, the Chairman of the Audit Committee.

Representatives of Ernst & Young LLP are expected to be present at the Annual Meeting and will have the opportunity to make a statement if they desire to do so and will be available to respond to appropriate questions.

COMPENSATION OF DIRECTORS

During fiscal 2003, Michaels compensated Charles J. Wyly, Jr. for his service as Chairman of the Board as indicated und