

WESTPEAK RESEARCH ASSOCIATION

The Michaels Companies Inc – Target (MIK) Apollo Global Management Inc – Financial Sponsor (APO)

Consumer Cyclical – Specialty Retail, Fabric Craft & Sewing

Research Title

December 7, 2021

LBO deal summary for the acquisition of the Michaels Companies Inc. by Apollo Global Management at \$22 per share, a 47% premium to the closing share price prior to announcement on February 26, 2021

The Michaels Company (Target) Strategic Objectives

Michaels is the largest arts and crafts specialty retailer in North America. The company announced positive FY2020 results, partially fueled by an unexpected increase in demand for crafts products in light of the COVID-19 pandemic. These results also validate the efforts of Michaels' new management team and the initial success of their turnaround strategy, after underperformance and share price lows in 2019. Moving forward, Michaels is investing heavily in e-commerce and omnichannel capabilities in order to continue performing strongly post-pandemic.

Apollo Global Management Strategic Objectives

Apollo is purchasing Michaels before the company's turnaround strategy is fully realized, while the company is still being traded at a discount. Through this purchase, Apollo signals that it expects consumers will not lose interest in the arts and crafts segment post-pandemic, and that Michaels can carry their momentum from the past year.

Synergies

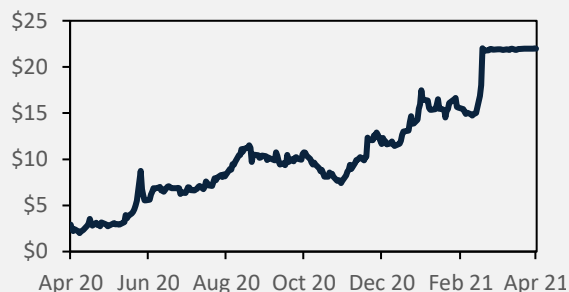
One notable synergy is Apollo's ownership of Shutterfly, a photography and image sharing company. Possible areas for collaboration between the two portfolio companies may strengthen Shutterfly's photography product offerings as well as Michaels' department for photography and framing.

Analysts: Lucas Lazzaroni, Matias Canofari, Alex McKenzie, Cathie Ji
contact@westpeakresearch.com

Key Statistics – MIK (Target)

52 Week H/L	\$22.0/\$2.0
Market Capitalization	\$3,110M
Average Daily Trading Volume	3.89M
Net Debt	\$2,500.4M
Enterprise Value	\$4,534.6M
Net Debt/EBITDA	8.3x
Diluted Shares Outstanding	147.8M
Dividend Yield	n/a

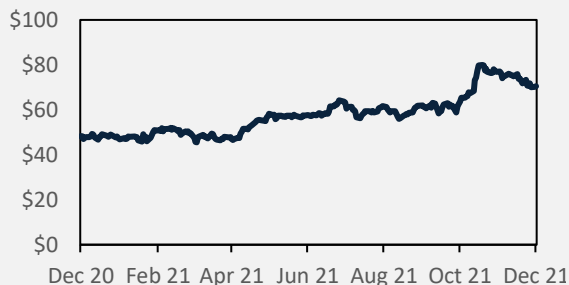
1-Year Price Performance



Key Statistics – APO (Financial Sponsor)

52 Week H/L	\$81.1/\$45.0
Market Capitalization	\$31.3B
Average Daily Trading Volume	2.7M
Net Debt	\$17.7B
Enterprise Value	\$29.2B
Net Debt/EBITDA	1.9x
Diluted Shares Outstanding	231M
Dividend Yield	2.8%

1-Year Price Performance



Business Overview – Michaels Companies Inc

Company Overview

Michaels operates more than 1,250 Michael stores across Canada and the United States, selling over 45,000 different products. The company has three distinct revenue segments, general craft products, home décor and seasonal products, and framing and papercutting, making up 45%, 25%, and 30% of revenue, respectively.

Michaels also owns a portfolio of private in-house art supplies brands, including Artist's Loft, Art Minds, Craft Smart, and many other smaller brands. These brands are primarily sold at Michaels stores North America-wide and comprise 57% of Michaels' net sales.

Net sales decreased by 4% from 2018 to 2019. The bulk of this decrease, however, resulted from the closure of subsidiary stores of Pat Catan's and Aaron Brothers. Pat Catan operated 36 arts and craft retail stores in the Midwest United States. About a third of the closed Pat Catan stores reopened under the Michaels brand name. Aaron Brothers comprised of 94 framing and art supplies stores primarily on the West Coast of the United States. Many of these brick-and-mortar locations had been suffering financially and unable to compete with online alternatives.

COVID-19 Impacts

Michaels experienced a strong tailwind from COVID-19 as consumers turned to pass times such as crafts and redecorating during lockdowns, particularly once economic stimulus kicked in and consumer spending rebounded. The result for Michaels was a significant increase in revenue throughout FY2020. The company's equity fell along with the broader market upon the outset of 2020 but recovered by June as they continued to beat earnings estimates.

E-Commerce Strategy

Michaels Store's new CEO Ashley Buchanan launched a plan upon his instalment to close the gap between Michaels e-commerce capabilities with its competitors by the end of 2020. In 2020, the company had reached in store pickup availability at approximately 80% of its stores and same-day delivery in approximately 60% of stores and increased the speed and ease-of-use of its e-commerce platform. These developments were cost-effective for Michaels as they were able to implement these capabilities at or below their typical spend rate. The company plans to add two seasonal distribution centers in 2021 to support omnichannel sales growth.

Business Overview – Apollo Global Management Inc.

Overview

Apollo Global Management is an investment management firm based in New York. Its \$455.5 billion in assets under management (AUM) are divided between their credit, private equity, and real estate assets, making up \$439 billion, \$81 billion, and \$46 billion AUM respectively. Apollo Global Management focuses its investments across nine industry sectors, with those being chemicals, manufacturing and industrial, natural resources, consumer and retail, consumer services,

business services, financial services, leisure, and technology, media, and telecommunications. The firm mainly seeks investments based in North America and Europe. Apollo employs a combination of contrarian, value, and distressed strategies to make its investments. The firm has many competitors in all of its business lines but its most notable competitors are other top tier private equity firms including The Blackstone Group, KKR & Co Inc., and the Carlyle Group.

Industry Analysis

Overview

Michaels is a market leader in the fabric, crafts, and sewing supplies (FC&S) industry in North America. Industry players primarily retail fabric, patterns, sewing supplies, yarns, needlecraft supplies, seasonal decorations, and craft machines. The combined market size for Canada and the United States is \$4.4 an billion and there are 29,428 businesses in operation. Majority of these businesses are small, independently owned operators with a few major retailers commanding majority of the market share.

Key Trends & Drivers

Increasing Median Age of the Population

One of the key drivers of the FC&S industry is the increasing median age of the population of the United States. The United States Census Bureau projects the number of people over the age of 65 to grow at an annual rate of 1.7% from 15.0% of the population in 2020 to 23% of the population in 2026 as seen in Figure 1. This shift to an older demographic will positively impact industry revenue as typically older people are the primary customers of the FC&S industry.

This leads into a trend that has been dramatically impacting the industry in recent history where female baby boomers have been taking over as the leading demographic of consumers. Currently, female baby boomers make up 10.0% of total industry sales, however, with the expected increase in the median age it is expected to grow. Furthermore, as baby boomers continue to retire, they will have more time available to spend on their hobbies. Combining this newfound leisure time and their retirement savings, baby boomers are expected to continue to be the key consumer of the industry.

Increased Competition from E-commerce

Key players in the FC&S industry will expect to see high competition from pure online retailers. E-commerce websites are able to provide a relatively higher selection of products at lower prices, incentivizing consumers to switch from shopping at

United States 65 Years & Older
Population Growth Projections

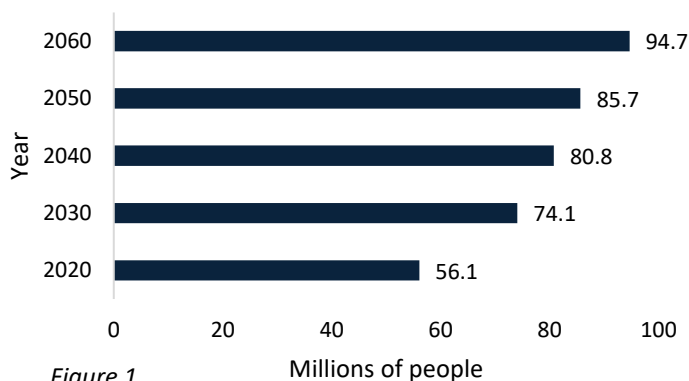


Figure 1

Source: United States Census Bureau

traditional brick-and-mortar stores to online websites. Michaels has already identified this threat and has dramatically increased its omnichannel offerings in FY2020 in response to the COVID-19 pandemic. During this period, Michaels alongside other retailers experienced store closures due to lockdown measures. Michaels was able to experience a 150% increase in e-commerce sales during FY2020, increasing e-commerce share of revenues from 5% in FY2019 to 13% in FY2020. However, physical retail stores seem to still hold an advantage, most likely because they allow customers to touch and feel products to assess quality and texture before purchasing. After lockdown measures eased, shoppers in the FC&S industry were seen to have returned to brick-and-mortar stores. For Michaels, this was shown as e-commerce sales declined 49% in the beginning of FY2021. Strengthening this channel to engage customers will partially mitigate pressure from online retailers.

Increased Per Capita Disposable Income

Purchases in the FC&S industry are discretionary and hobby-related, hence, an increase in per capita disposable income will drive demand for industry products. In 2020, government stimulus funds to aid economic recovery spiked per capita disposable income. As the economy begins to recover from the coronavirus, per capita disposable income is projected to increase at an annualized rate of 0.8%.

Competitive Landscape

Market Share of US Fabric, Crafts, and Sewing Stores in 2021

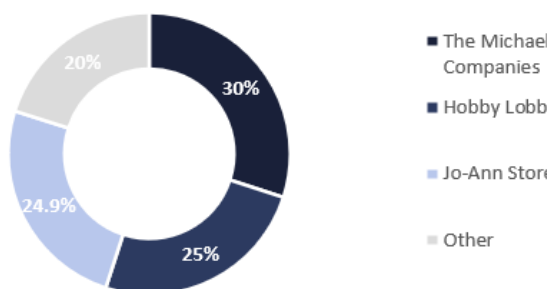


Figure 2
Source: IBISWorld

Market Share of Canadian Fabric, Crafts, and Sewing Stores in 2021

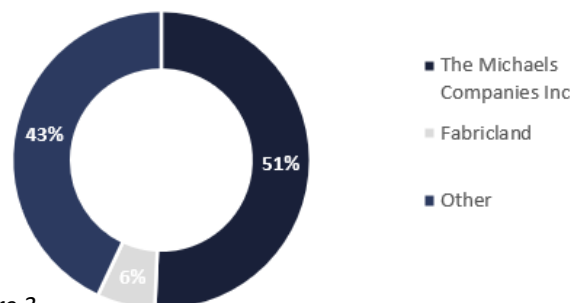


Figure 3
Source: IBISWorld

FC&S industry is oligopolistic in nature, with three major players accounting for 80% of market share in 2021. The remaining 20% is extremely fragmented, with revenue generated by small, independent operators that provide niche offerings. Market share concentration has been high for the past five years and has remained relatively stable due to acquisition activity. Michaels has been acquisitive historically, leveraging economies of scale to lower costs and capture more market share. The trend for consolidation is expected to continue in the future as large players continue to seek acquisition opportunities and smaller operators are forced to close down shop due to pricing pressures. To succeed in the space, small businesses need to focus on customer relationships, product selection and presentation, proximity to key markets, and inventory management. There are no significant foreign-owned operators in the industry, and many smaller operators

serve local communities. Notably only Michaels, as a major operator, has international operations within North America due to its size and scale.

Overview of Key Players

Hobby Lobby Stores Inc

Hobby Lobby is the third-largest fabric and craft retailer in the United States with 25% market share and over 900 locations across the country. The company sells supplies for arts and crafts, jewelry making, needlework and scrapbooking, as well as sewing machines, home accents, fabric, and patterns. Hobby Lobby's main growth activities are through expansion of new brick-and-mortar establishments, despite other retailers in the industry closing down physical stores.

Jo-Ann Stores, LLC (NASDAQ: JOAN)

Jo-Ann Stores follows closely behind Hobby Lobby with a 25% market share in the United States. It is the second-largest craft retailer in the United State based on store count of 855 locations. The company sells a range of fabrics used in crafting, quilting, and apparel sewing, as well as products for home decoration projects, craft components, artificial and dried flowers and finished seasonal merchandise. The company sought to boost sales by improving operational efficiencies. This includes implementing a new point-of-sale system for better promotions and improved inventory management of all stores. Jo-Ann IPO'd NASDAQ in early 2021, after being taken private in 2011.

Fabricland

Fabricland is a Canadian retailer with 6.3% market share and over 100 stores across Canada. The company offers a wide selection of fabrics and sewing accessories, ensuring customers can acquire all their crafting needs. Fabricland is a subsidiary of House of Fabrics Inc, a company owned by Jo-Ann Stores Inc.

Other Small Operators

The remainder of the hobby and crafts industry is extremely fragmented and characterized by many small operators. In 2021, IBISWorld estimates there are around 28,041 specialty operators, many of which are small businesses. These smaller operators differentiate their offerings from larger players by focusing on superior customer service, niche offerings, and higher-quality goods.

Industry Outlook

Despite the positive impacts of the growing demographics, the spike in sales seen from COVID-19 is expected to fall off and return to pre-pandemic levels as seen in Figure 4. Longer term growth projections are positive given the upward shifting median age, however, it is unlikely that the growth will reach the levels seen during the pandemic due to the threat of e-commerce and larger online marketplaces.

United States FC&S Revenue Projections (\$m)

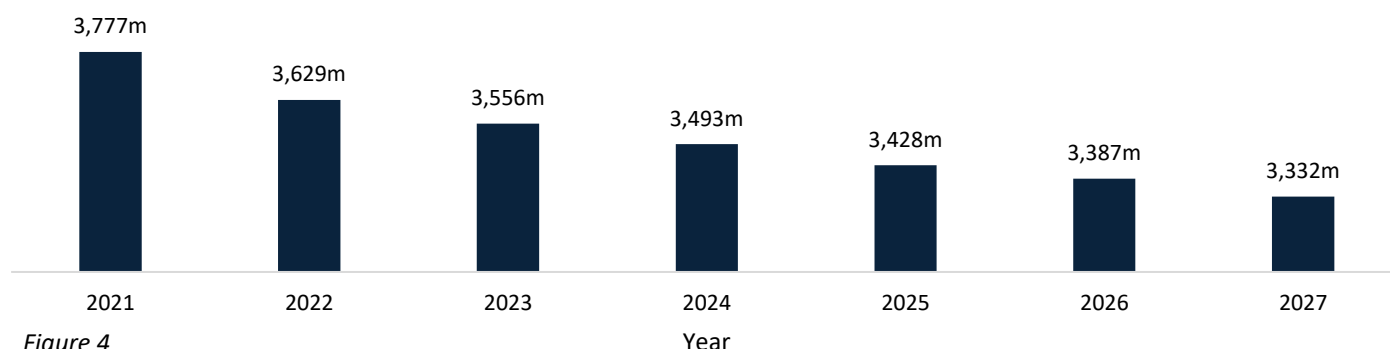


Figure 4

Source: IBISWorld

LBO Rationale

Strategic Objectives

Apollo is purchasing Michaels at the brink of Michaels' turnaround strategy while the company is still being traded at a discount, relative to their 2016 high of above \$30 per share. Michaels' poor retail performance in 2019 was highlighted by an 86.1% plunge in their share price within one year, leading to share price lows of \$1.56 in March 2020 when the COVID-19 pandemic first shocked the markets. The pandemic unexpectedly benefited Michaels, though, as consumers across the continent developed new hobbies while stuck at home, such as arts & crafts or home décor, which, in turn, improved Michaels' bottom line. Apollo expects that consumers will not lose interest in their crafty hobbies, as the pandemic slowly fades, and that Michaels can carry their momentum from the past year.

Michaels initiated its turnaround plan in 2020 by welcoming Ashley Buchanan as the new CEO, previously a Chief Merchandising Officer at Walmart U.S. e-commerce. Alongside a new executive team, Mr. Buchanan developed a plan to revitalize the business through an improved retail presence and strengthened e-commerce and omnichannel capabilities. Traditionally, Michaels had been very weak in e-commerce, with a minimal online presence, slow delivery times, and only 5% of sales coming from e-commerce. Even pre-pandemic, Michaels' e-commerce sales trended upwards, but the early 2020 lockdowns had them skyrocket, with temporary boost of over 300% to e-commerce sales. Apollo will hope to improve Michaels' omnichannel presence, supporting consumers that continue to shift towards online shopping as well as those that still rely on traditional brick-and-mortar stores.

The turnaround concept was partially validated in Michaels' Q4 2020 earnings – the last publicly released earnings before going private. Positive performance was recorded for FY2020, with an increase of 3.9% in net sales, 4.8% increase in comparable store sales, and 8.2% increase in net income compared to FY2019. Apollo has an opportunity to use its network and resources to improve Michaels operations and continue this success into the future.

Synergies

Given Apollo is a financial sponsor, it is unlikely the buyer will benefit from the same synergies that a strategic acquirer would. One notable exception is Apollo's ownership of Shutterfly, whom they acquired in late 2019. Shutterfly sells photography products, including photo books, prints, and novelty items such as personalized calendars. Michaels also operates a department for photography and framing, which could stand to benefit from collaboration with Shutterfly.

Additionally, the takeover of Michaels adds industry diversification to Apollo's portfolio that may act as risk diversification. Michaels' strong performance during the COVID-19 pandemic contrasts the struggle of business in other discretionary industries. This has shown that Michaels' product offerings can be able to withstand and even thrive in an unprecedented environment.

Valuation

Comps

For the comp analysis, four companies were chosen based on them operating in the retail industry, similar business models to Michaels, and being primarily based in North America. In addition to this, all have brick and mortar stores generating the majority of their revenue, similarly to Michaels further strengthening them as candidates.

Bed Bath & Beyond (NASDAQ: BBBY)

Bed Bath & Beyond and its subsidiaries operate with two segments, North American Retail and Institutional Sales. Here they sell bed linens, bath items, kitchen supplies, and furnishings through both in-store and online means. Bed Bath & Beyond operates in the United States and Canada with most of their revenue and store locations being in the United States.

Williams Sonoma (NYSE: WSM)

Williams Sonoma operates as a retail business for kitchen and kitchen related supplies ranging from cookware, cutlery, tables, and cookbooks. Additionally, Williams Sonoma has a home furnishing brand called Williams Sonoma Home where they offer furniture, bedding, lights, and other home furnishings. Williams Sonoma generates the majority of their revenue from brick-and-mortar locations in the United States.

Jo-Ann Inc. (NASDAQ: JOAN)

Jo-Ann operates as a retailer of arts and crafts and sewing supplies in the United States. Specific products include fabrics, tools, buttons, yarns, and needlecraft supplies. Jo-ann has a total of 855 retail locations across 49 states in the United States.

Dick's Sporting Goods (NYSE: DKS)

Dick's Sporting Goods and its subsidiaries operates as a sporting goods retailer in the United States. Products they carry include fitness, hunting, and fishing equipment as well as apparel. Dick's also has a portfolio of specialty including Gold Galaxy and Field & Stream, each specializing in a specific niche. The majority of Dick's locations are located in the east of the United States.

Precedent Transactions

The nature of Michaels' business is cyclical and niche. Thus, we chose to include precedent transactions involving private placement or M&A of companies within subsections of the specialty retail industry including home improvement retail, specialty stores, and home furnishing retail. These businesses are driven by a similar set of factors as Michaels' stores including per capita disposable income and consumer sentiment.

Cabela's Incorporated

Cabela's is a specialty hunting and fishing retailer that operates in the United States and Canada. As of December 2021, the company operates 85 locations. Locations tend to be extremely large and offer an incredibly diverse range of products.

At Home Group Inc.

At Home Group Inc. operates home décor specialty stores in the United States. The company carries items such as furniture, mirrors, rugs, and wall art. As of June 23, 2021 the company operated 228 stores.

Mattress Firm Holding Corp.

Mattress Firm Holding Corp. operates as a specialty retailer of mattresses and related bedding products in the United States. It has both owned and franchised retail locations as well as an e-commerce platform.

Rona Inc.

Rona is involved in the distribution and retail of hardware, building materials, and home renovation products in Canada. In addition to retailing, the company also offers installation and delivery services. As of 2016, it operated approximately 500 corporate and independent affiliate dealer stores across Canada.

Risks

Unsuccessful Transition to E-commerce

Michaels Stores' reliance on e-commerce has been increasing throughout the last few years, most notably during the COVID-19 pandemic. The company notes that if their efforts to successfully deliver an efficient omnichannel shopping experience to their customers fails they could see a significant decrease in revenue. This risk is partially mitigated through Michaels' success during the pandemic in providing a seamless option for customers to order online and pick up merchandise in stores.

Uncertain Post-Pandemic Demand

It is uncertain whether the spur in demand fueled by the pandemic will endure into the future. Michaels was one example of a company that benefited due to the COVID-19 pandemic, experiencing an increase in sales and profitability due to an

increase in demand for arts and crafts products. Despite its positive performance, it is unclear how sustainable this demand will be as pandemic restrictions continue to ease. Apollo is essentially taking the burden of Michaels' uncertain future through this acquisition. Michaels has already taken efforts to mitigate this risk by improving e-commerce efforts, deepening customer relationships through specialized classes, and strengthening its retail operations to improve customer experience.

Appendix 1: Comparable Company Analysis

(Figures in mm USD)

Company	Ticker	Share Price	Diluted Shares Outstanding	Equity Value	Enterprise Value	EV/EBITDA Multiple			P/E Multiple		
						2020A EV/EBITDA	2021A EV/EBITDA	2022E EV/EBITDA	2020A P/E	2021A P/E	2022E P/E
Bed Bath & Beyond	(NASDAQ: BBBY)	\$ 18.58	122.9	2,283.2	3,935.2	25.9 x	16.8 x	7.6 x	n/a	n/a	15.2 x
Williams Sonoma	(NYSE: WSM)	\$ 177.47	79.0	14,020.1	14,790.7	22.6 x	13.5 x	14.2 x	39.5 x	20.6 x	23.0 x
JOANN	(NASDAQ: JOAN)	\$ 9.38	40.5	380.1	2,149.2	6.7 x	5.5 x	8.5 x	2.1 x	1.8 x	4.4 x
Dick's Sporting Goods	(NYSE: DKS)	\$ 106.84	96.6	10,317.6	12,357.7	17.8 x	11.4 x	12.7 x	32.0 x	18.7 x	21.0 x
The Michaels Companies Inc	(NASDAQ: MIK)	\$ 21.97	147.8	3,248.0	4,534.6	7.1 x	7.1 x	7.2 x	12.3 x	11.1 x	9.1 x
Median						20.2 x	12.4 x	10.6 x	32.0 x	18.7 x	21.0 x
Mean						18.3 x	11.8 x	10.8 x	24.5 x	13.7 x	16.1 x
High						25.9 x	16.8 x	14.2 x	39.5 x	20.6 x	23.0 x
Low						6.7 x	5.5 x	7.6 x	2.1 x	1.8 x	4.4 x
						EV/EBITDA Implied Price			P/E Implied Price		
Median						\$ 78.04	\$ 45.19	\$ 36.25	\$ 56.94	\$ 36.98	\$ 50.80
Mean						\$ 69.66	\$ 42.43	\$ 36.89	\$ 43.68	\$ 27.11	\$ 39.04
High						\$ 102.70	\$ 64.11	\$ 51.52	\$ 70.36	\$ 40.81	\$ 55.70
Low						\$ 19.87	\$ 15.26	\$ 23.54	\$ 3.74	\$ 3.53	\$ 10.61

Appendix 2: Precedent Transactions

(Figures in mm USD)

Acquirer Name	Target Name	Announcement Date	Transaction Enterprise Value	Valuation Multiples	
				EV / LTM Revenue	EV / LTM EBITDA
Ontario Steel Investment Limited	Essar Steel Algoma Inc.	2016-07-10	\$ 903.00	0.5 x	NM
BlueScope Steel Limited	North Star BlueScope Steel, LLC	2015-10-26	\$ 1,481.00	1.3 x	8.0 x
Nucor Corporation	Gallatin Steel Company	2014-09-15	\$ 770.00	N/A	N/A
Hitachi Metals, Ltd.	Waupaca Foundry, Inc.	2014-08-19	\$ 1,337.80	0.8 x	8.3 x
Steel Dynamics Inc.	Severstal Columbus, LLC	2014-07-21	\$ 1,625.00	0.8 x	11.2 x
AK Steel Corporation	Severstal Dearborn, Inc.	2014-07-21	\$ 707.00	0.4 x	29.4 x
Trinity Industries Inc.	Meyer Steel Structures	2014-06-27	\$ 600.00	3.0 x	19.1 x
ArcelorMittal and Nippon Steel & Sumitomo Metal Corporation	ThyssenKrupp Steel USA, LLC	2013-11-29	\$ 1,550.00	0.9 x	19.3 x
Reliance Steel & Aluminum Co.	Metals USA Holdings Corp.	2013-02-06	\$ 1,216.48	0.6 x	8.5 x
Nucor Corporation	Skyline Steel L.L.C.	2012-05-17	\$ 684.00	0.8 x	N/A
Winsway Coking Coal Holdings Limited & Marubeni Corporation	Grande Cache Coal Corporation	2011-10-31	\$ 1,028.42	3.6 x	13.9 x
Maximum			\$ 1,625.00	3.6 x	29.4 x
75th Percentile			\$ 1,409.40	1.2 x	19.2 x
Median			\$ 1,028.42	0.8 x	12.5 x
25th Percentile			\$ 738.50	0.7 x	8.4 x
Minimum			\$ 600.00	0.4 x	8.0 x

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Matias Canofari
Senior Analyst

WestPeak Research Association
contact@westpeakresearch.com