



KASE Investing Conference Discussion  
A Dead Man's Hand?

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# Cruiser Capital

<b>Concentrated Portfolio</b>	Concentrated portfolio both long and short Generally focus on: 8-12 long and 6-10 short positions
<b>Leadership &amp; People Matter</b>	Experience and perspective give Cruiser differentiated views Sector concentrations allow us to have unique insights into management capabilities.  We spend a lot of time researching and evaluating Management teams  For example: The recent availability of capital provides objective data points on evaluating CEOs on their capital allocation decisions and provides objective reviews of management quality
<b>Research &amp; Value Philosophy</b>	Cash and patience are our allies Strive to capitalize on price dislocations  “Value Plays vs. Value Traps”
<b>Competitive Positioning/Organic Exit Strategies</b>	Strive to study the competitive landscape so that multiple exit strategies are evident

# Dealt a Bad Hand



# Michael's(MIK) Overview

## The Michaels Companies



- #1 arts & crafts specialty retailer in North America<sup>(1)</sup>
- # 1 custom framer
- 1,243 stores across U.S. and Canada<sup>(1)</sup>
- Average store size: 18,000 sqft



- Broad assortment of arts & crafts supplies, and DIY home décor
- 36 stores across Ohio Valley<sup>(1)</sup>
- Average store size: 32,000 sqft



- #1 wholesale distributor in the arts & crafts, gift and decor industry
- Sell through 36,000 doors



- Omnichannel custom framing solution
- Online custom framing platform
- Store-within-a-store concept within Michaels Stores



- Offices in Ningbo and Hong Kong
- -120 Team Members



- Largest manufacturer of high-quality, custom and specialty frames

Sources: MIK June 2018 Investor Presentation

<sup>(1)</sup>Based on store count as of May 5, 2018

# **Why MIK IS ATTRACTIVE**

**#1 Customer Destination for Making**

**Strong Financial Position:  
Retail-Leading Margins,  
ROIC, and Cash Flow**

**#1 Player in a Slow Growth,  
Fragmented Industry**

**Opportunity to Win Greater  
Share**

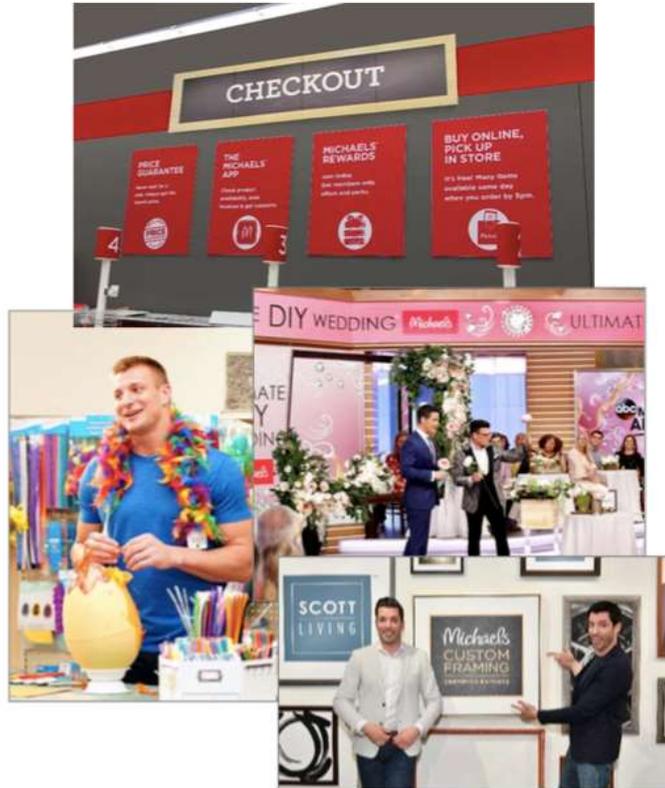
**Financially Disciplined**

Sources: MIK June 2018 Investor Presentation

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Sources: Images from MIK June 2018 Investor Presentation, pages 28-29

# Secular Headwinds



“As we've discussed for a few quarters now, all of our data continues to suggest that the growth trends in core arts and crafts products remain soft. Despite this challenging environment, we delivered operating income and EPS for the second quarter that were slightly better than the guidance we provided in June.”

Carl Rubin, CEO, August 30, 2018

# Framing: Source of Cash Flow

Traditionally  
a Great  
Business

=

Pricing Power

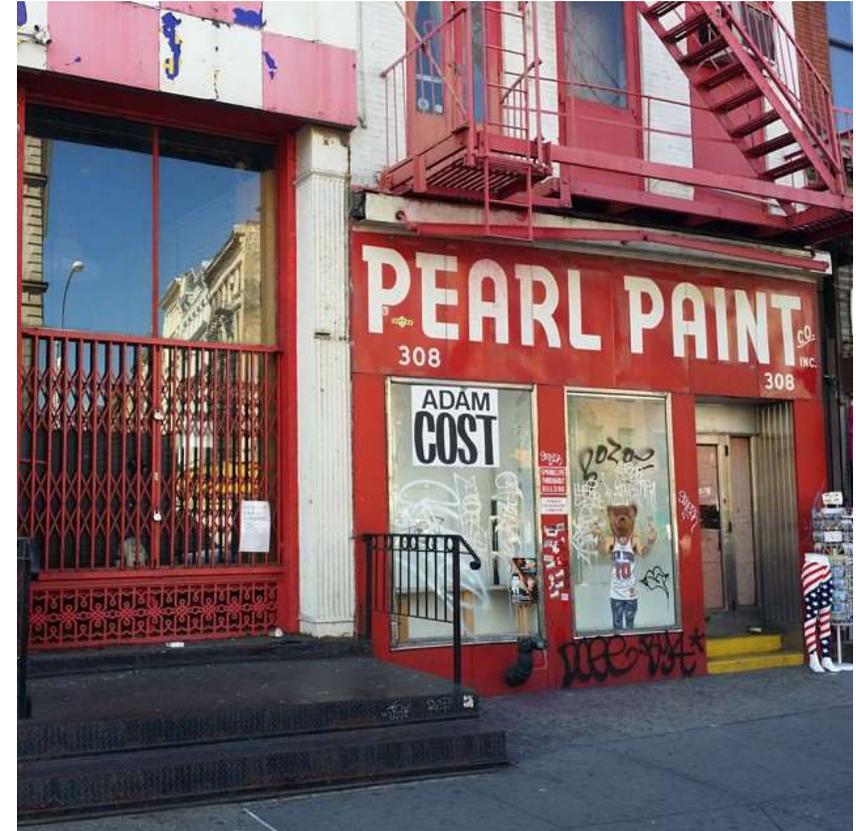
1. Highly Customizable
2. Traditionally Required Personalized Attention
3. Lots of Upsell Opportunity
4. HIGH MARGINS

Michael's is the Largest Custom Framer in the World.

Framing Represents ~ 15%+ of Sales and we estimate ~ 33+% of its Operating Income.

Unfortunately, online eliminates a lot of the Pricing Power

# Lots of People Saw This as a Great Business



# Life online.....

## Amazon Prime – Craig Frames



Craig Frames 1WB3BK 18 by 24-Inch Wall Decor Frame, Smooth Finish, 1-Inch Wide, Matte Black

by Craig Frames

★★★★☆ 879 customer reviews | 105 answered questions

Amazon's Choice for "18x24 frame"

Price: **\$26.29** ✓prime

## Aaron Brothers



Frame Width: 1.39"  
Finished Size: 19.8" X 25.8"

QTY:

TOTAL: **\$32.00**

Images from sites: amazon.com, aaronbrothers.com

# Framing Options Available

custom online framing

All Shopping News Images Videos More Settings Tools

About 151,000,000 results (0.66 seconds)

**Framebridge - Custom Framing | The Online Framing Experts**  
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Professional Custom Framing Made Ridiculously Easy. Upload Your Photos or Mail In Your Art...  
Instagram - from \$39.00 - Printed at 5x5 · More

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Start Framing · Instagram Framing · Jersey Framing · The Art of Framing

Screenshot from Google

# Google “Custom Framing”

A screenshot of a Google search for "custom framing". The search bar at the top contains the text "custom framing" and a magnifying glass icon. Below the search bar are navigation tabs for "All", "Maps", "Shopping", "Images", "News", "More", "Settings", and "Tools". The "All" tab is selected. Below the tabs, it says "About 250,000,000 results (0.51 seconds)". There are four search results listed, each with a title, a URL, a star rating, and a short description.

custom framing

All Maps Shopping Images News More Settings Tools

About 250,000,000 results (0.51 seconds)

**Framebridge - Custom Frames | Custom Cut, Crafted, and Built**  
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**Online custom picture framing that's easy, affordable, & fast**  
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★★★★★ Rating for frameiteasy.com: 4.9 - 1,775 reviews  
High quality frames & affordable prices. Ships in days. Guaranteed!  
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Find **Custom Picture Frames** Online. Fast Shipping, 51+ Years Experience! 48 Hour Turn Around.

Screenshot from Google

# Framebridge vs. Michaels

## Framebridge



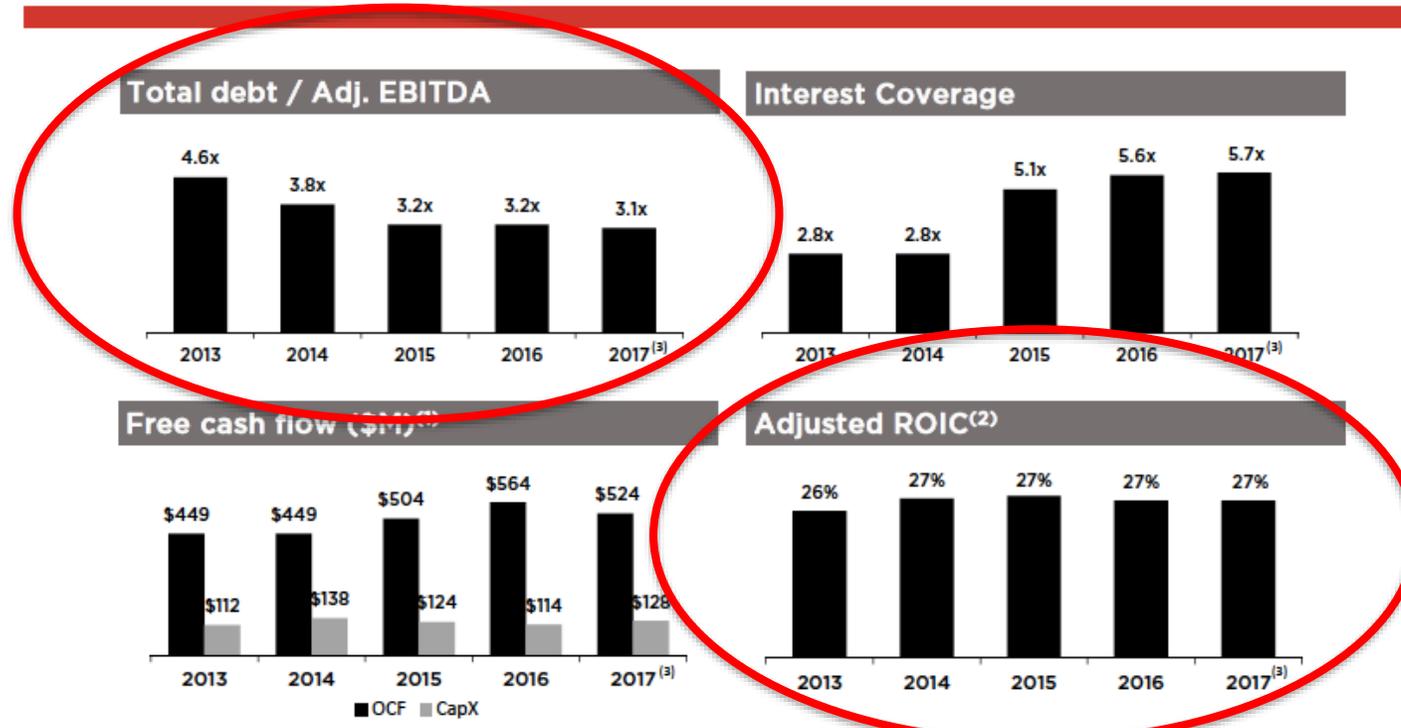
Framebridge has raised ~\$50mm from serious backers: NEA, T. Rowe Price, Crate & Barrel co-founder, Rent the Runway chairperson, etc.

Images from sites: framebridge.com, aaronbrothers.com

## Aaron Brothers



# Strong Financial Position



<sup>(1)</sup>FCF defined as cash flows from operations less capital expenditures, excludes acquisitions.

<sup>(2)</sup>ROIC - Adjusted Net Income + After-tax interest expense + After-tax Operating Lease Expense / Average Common Equity + Average Net Debt + Capitalized Operating Leases (5x); Adjustments made for IPO expense, Lamrite integration, Loss on Early Debt Retirement, and associated tax expense.

<sup>(3)</sup>2017 was a 53-week year

Sources: MIK June 2018 Investor Presentation

# A Terrific Business?

	2013	2014	2015	2016	2017
Adj. Net Income	270	304	363	390	405
After Tax Interest Expense	135	132	91	83	84
After Tax Operating Lease Expense	234	250	252	274	277
	639	685	705	746	767
Avg. Common Equity	(2,686)	(2,390)	(1,916)	(1,695)	(1,657)
Avg. Net Debt	3,220	3,096	2,548	2,408	2,378
Capitalized Op. Leases	5.0x	1,850	1,885	1,941	2,081
	2,384	2,591	2,573	2,794	2,849
<b>ROIC</b>	<b>27%</b>	<b>26%</b>	<b>27%</b>	<b>27%</b>	<b>27%</b>

Data compiled from company filings,  
Bloomberg LP and Analyst

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# Rule of 8

		2013	2014	2015	2016	2017
Adj. Net Income		270	304	363	390	405
After Tax Interest Expense		135	132	91	83	84
After Tax Operating Lease Expense		234	250	252	274	277
		639	685	705	746	767
Avg. Common Equity		-	-	-	-	-
Avg. Net Debt		3,220	3,096	2,548	2,408	2,378
Capitalized Op. Leases	8.0x	2,960	3,016	3,105	3,330	3,404
		6,180	6,112	5,653	5,738	5,782
<b>ROIC</b>		<b>10%</b>	<b>11%</b>	<b>12%</b>	<b>13%</b>	<b>13%</b>

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# Impact Negative Operating Leverage

	<b>2017</b>	<b>2017</b>	<b>2018E</b>	<b>2018E</b>
Net Revenue	5,362	5,362	5,191	5,191
Gross Profit	2,248	2,194	2,019	1,967
Gross Margin %	42%	41%	39%	38%
EBIT	735	682	557	505
ROIC	13%	12%	12%	11%

Assuming fixed costs a 1% drop in GM results in a 9% drop in EBIT (2018E)

Data compiled from company filings,  
Bloomberg LP and Analyst

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# Where Did the Cash Go?

	<b>FY2014</b>	<b>FY2015</b>	<b>FY2016</b>	<b>FY2017</b>	<b>1H2018</b>
<b>CFO before WC</b>	446.0	503.6	518.7	542.6	174.9
<b>Net CFO</b>	442.0	504.0	564.4	523.6	(86.6)
<b>Net CFI: Capex &amp; M&amp;A</b>	(137.8)	(128.9)	(266.9)	(127.8)	(69.9)
Payment of PIK notes	(627.1)	(184.5)	-	-	-
Net Borrowings on asset-based revolving credit facility	-	-	-	-	118.0
Net Borrowings on restated term loan credit facility	825.1	(174.9)	(18.7)	(31.1)	(11.8)
Net Issuance of common stock	424.1	(22.0)	(405.0)	(253.8)	(252.5)
<b>Net CFF</b>	(164.8)	(344.0)	(408.1)	(268.7)	(146.2)
<b>Net Change in Cash</b>	139.4	31.1	(110.6)	127.1	(302.7)

Data from company filings and Analyst

# Guess who's selling?

Bain sold \$740m @ avg price \$25.81

Blackstone sold \$1.44B @ avg price \$23.62

	Date	Price per Share (\$)	Gross Proceeds (\$mm)	Net Proceeds to Company (\$mm)	Insiders
1	26-Jun-14	17.00	472	446	-
2	22-Jan-15	23.52	442	-	424
3	9-Jul-15	26.60	333	-	331
4	22-Mar-16 *	26.08	443	-	443
5	13-Jul-16 *	27.85	279	-	277
6	12-Dec-16 *	22.04	220	-	220
7	24-Jan-17 *	21.28	383	-	383
Total				\$446	\$2,080

\* MIK purchased \$300m at an average price of \$22.64

Data from CapIQ, company filings

# Who Buys You Out?

Take-out Risk?

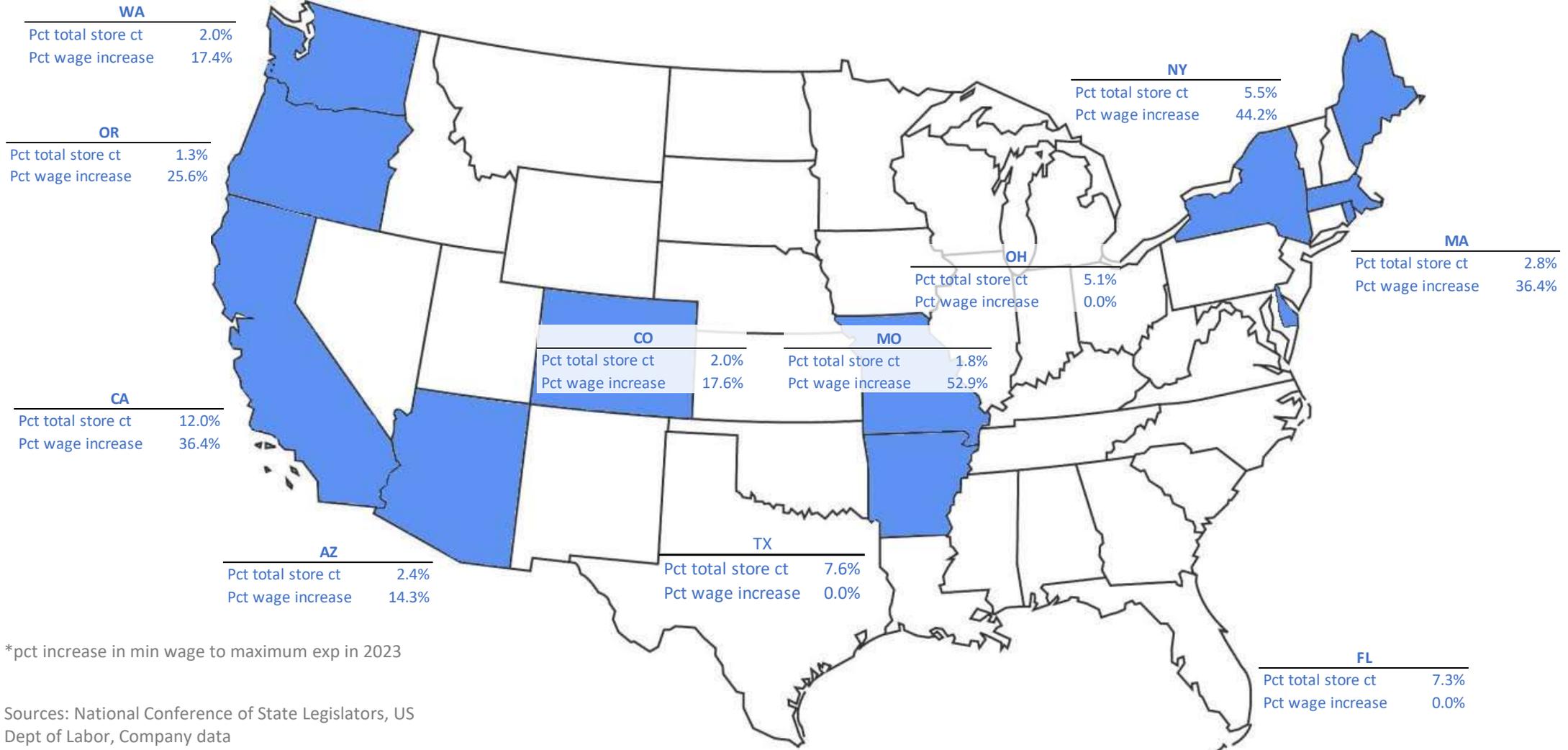


Bain currently holds ~31% of the Shares

Blackstone currently holds ~11% of the Shares

Shout out to VSLR – Vivant Solar

# Wage Increase Headwinds



\*pct increase in min wage to maximum exp in 2023

Sources: National Conference of State Legislators, US Dept of Labor, Company data

# Stock Performance



Image from Bloomberg

# Short Interest Rises Into Earnings



Image from Bloomberg

# Cheap Business?

	2013	2014	2015	2016	2017
<b>Unadjusted Metrics</b>					
EV/EBITDA	4.5x	8.2x	9.0x	9.0x	7.2x
Debt/EBITDA	4.8x	3.9x	3.3x	3.2x	3.1x
<b>Adjusted Metrics</b>					
Adj. EV/EBITDAR	5.7x	8.2x	8.7x	8.7x	7.4x
Adj. Debt/EBITDAR	5.9x	5.2x	4.7x	4.8x	4.7x

Adjustments made using 8x capitalization rate

Data compiled from company filings, Bloomberg LP and Canalyst

# Comparable Valuations

	Last 4 Qtrs	Next 4 Qtrs	Last 4 Qtrs	Next 4 Qtrs
	P/E	P/E (E)	EV/EBITDA	EV/EBITDA (E)
<b>Michaels (MIK)</b>	<b>7.8x</b>	<b>7.0x</b>	<b>7.2x</b>	<b>7.0x</b>
Bed Bath & Beyond (BBBY)	5.0x	6.8x	2.4x	3.1x
Party City (PRTY)	8.8x	7.0x	8.6x	7.7x
Gamestop (GME)	4.4x	4.6x	-	3.5x
<b>Average</b>	<b>6.5x</b>	<b>6.4x</b>	<b>4.5x</b>	<b>5.3x</b>

Data and estimates from Bloomberg  
Consensus, Cap IQ, and Analyst.

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# Where's this Going?

	2018E	
Multiple	5.3x	4.0x
EBITDA	796	796
Enterprise Value	4,218	3,184
Debt	2,695	2,695
Cash	411	411
Equity Value	1,934	900
Shares	171	171
<b>Implied Share Price</b>	<b>\$11.29</b>	<b>\$5.25</b>

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# Some Considerations

## Risks to the Thesis

1. Good management team
  - a. Refresh, Remodel & Relocate
2. High Short Interest
3. SSS +?
4. Cheap Valuation?

5.



# Final Thoughts

1. Secular Short
  - a. “Can’t be Amazon’d?”
2. Framing and Top Sellers online
3. Cost of Capital and ROIC = look closely
4. Lease Trends Unfavorable = increasing?
5. Consistent “Private Equity Put”
6. Cheap Stock.....