

MICHAELS STORES INC
Form 10-Q
August 30, 2013
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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended August 3, 2013

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number 001-09338

MICHAELS STORES, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

75-1943604
(I.R.S. employer
identification number)

8000 Bent Branch Drive

Irving, Texas 75063

(Address of principal executive offices, including zip code)

(972) 409-1300

(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.* Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer <input type="radio"/>	Accelerated filer <input type="radio"/>
Non-accelerated filer <input checked="" type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="radio"/>

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of August 26, 2013, 100 shares of the Registrant's Common Stock were outstanding.

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*The Registrant has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934, but is not required to file such reports under such sections.

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MICHAELS STORES, INC.

Part I FINANCIAL INFORMATION

Item 1. Financial Statements.

MICHAELS STORES, INC.

CONSOLIDATED BALANCE SHEETS

(in millions, except share data)

(Unaudited)

	August 3, 2013	February 2, 2013	July 28, 2012
ASSETS			
Current assets:			
Cash and equivalents	\$ 51	\$ 56	\$ 113
Merchandise inventories	905	865	922
Prepaid expenses and other	96	86	89
Deferred income taxes	37	37	42
Income tax receivable	34	3	27
Total current assets	1,123	1,047	1,193
Property and equipment, at cost			
Less accumulated depreciation and amortization	(1,195)	(1,164)	(1,112)
Property and equipment, net	347	338	326
Goodwill			
Goodwill	94	94	95
Debt issuance costs, net of accumulated amortization of \$54, \$54, and \$82, respectively			
	40	46	51
Deferred income taxes			
	13	13	18
Other assets			
	5	3	3
Total non-current assets	152	156	167
Total assets	\$ 1,622	\$ 1,541	\$ 1,686
LIABILITIES AND STOCKHOLDERS DEFICIT			
Current liabilities:			
Accounts payable	\$ 289	\$ 263	\$ 277
Accrued liabilities and other	338	367	351
Current portion of long-term debt	238	150	1
Deferred income taxes	4	4	1
Income taxes payable	1	40	2
Total current liabilities	870	824	632
Long-term debt			
	2,882	2,891	3,363
Deferred income taxes			
	2	2	11
Other long-term liabilities			
	81	83	86
Total long-term liabilities	2,965	2,976	3,460
Total liabilities	3,835	3,800	4,092

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Commitments and contingencies

Stockholders' deficit:

Common Stock, \$0.10 par value, 100 shares authorized; 100 shares issued and outstanding

Additional paid-in capital	60	61	62
Accumulated deficit	(2,277)	(2,326)	(2,474)
Accumulated other comprehensive income	4	6	6
Total stockholders' deficit	(2,213)	(2,259)	(2,406)
Total liabilities and stockholders' deficit	\$ 1,622	\$ 1,541	\$ 1,686

See accompanying notes to consolidated financial statements.

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MICHAELS STORES, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in millions)

(Unaudited)

	Quarter Ended		Six Months Ended	
	August 3, 2013	July 28, 2012	August 3, 2013	July 28, 2012
Net sales	\$ 904	\$ 892	\$ 1,897	\$ 1,870
Cost of sales and occupancy expense	567	553	1,153	1,119
Gross profit	337	339	744	751
Selling, general, and administrative expense	258	252	529	512
Related party expenses	3	4	7	7
Store pre-opening costs	1	1	3	2
Operating income	75	82	205	230
Interest expense	45	61	92	127
Refinancing costs and losses on early extinguishment of debt			7	
Other (income) and expense, net	1		1	(1)
Income before income taxes	29	21	105	104
Provision for income taxes	9	8	38	38
Net income	20	13	67	66
Other comprehensive income, net of tax:				
Foreign currency translation adjustment	(2)	(2)	(2)	
Actuarial gain on pension plan	1			
Comprehensive income	\$ 19	\$ 11	\$ 65	\$ 66

See accompanying notes to consolidated financial statements.

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MICHAELS STORES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)

(Unaudited)

	Six Months Ended	
	August 3, 2013	July 28, 2012
Operating activities:		
Net income	\$ 67	\$ 66
Adjustments:		
Depreciation and amortization	50	46
Share-based compensation and other	1	3
Debt issuance costs amortization	4	8
Refinancing costs and losses on early extinguishment of debt	7	
Changes in assets and liabilities:		
Merchandise inventories	(40)	(82)
Prepaid expenses and other	(13)	(9)
Accounts payable	43	(23)
Accrued interest	(2)	(4)
Accrued liabilities and other	(38)	(42)
Income taxes	(71)	(43)
Other long-term liabilities	(2)	1
Net cash provided by (used in) operating activities	6	(79)
Investing activities:		
Additions to property and equipment	(50)	(45)
Net cash used in investing activities	(50)	(45)
Financing activities:		
Redemption of senior subordinated notes due 2016	(142)	
Repurchase of subordinated discount notes due 2016		(127)
Repayments on senior secured term loan facility	(4)	
Borrowings on asset-based revolving credit facility	375	
Payments on asset-based revolving credit facility	(154)	
Repurchase of common stock	(45)	(3)
Proceeds from stock options exercised	25	2
Payment of capital leases	(2)	(1)
Change in cash overdraft	(14)	(5)
Net cash provided by (used in) financing activities	39	(134)
Net decrease in cash and equivalents	(5)	(258)
Cash and equivalents at beginning of period	56	371
Cash and equivalents at end of period	\$ 51	\$ 113
Supplemental Cash Flow Information:		
Cash paid for interest	\$ 89	\$ 122
Cash paid for income taxes	\$ 109	\$ 80

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See accompanying notes to consolidated financial statements.

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MICHAELS STORES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Quarter and Six Months Ended August 3, 2013

(Unaudited)

Note 1. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements include the accounts of Michaels Stores, Inc. and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated. All expressions of the Company, Michaels, us, we, our, and all similar expressions are references to Michaels Stores, Inc. and its consolidated, wholly-owned subsidiaries, unless otherwise expressly stated or the context otherwise requires.

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. Therefore, these financial statements should be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended February 2, 2013.

The balance sheet at February 2, 2013 has been derived from the audited financial statements at that date, but does not include all of the information and notes required by GAAP for complete financial statements.

In the opinion of management, all adjustments (consisting of normal recurring accruals and other items) considered necessary for a fair presentation have been included.

Because of the seasonal nature of our business, the results of operations for the quarter ended August 3, 2013 are not indicative of the results to be expected for the entire year.

We report on the basis of a 52- or 53-week fiscal year, which ends on the Saturday closest to January 31. All references herein to fiscal 2013 relate to the 52 weeks ending February 1, 2014, and all references to fiscal 2012 relate to the 53 weeks ended February 2, 2013. In addition, all references herein to the second quarter of fiscal 2013 relate to the 13 weeks ended August 3, 2013, and all references to the second quarter of fiscal 2012 relate to the 13 weeks ended July 28, 2012. Finally, all references to the six months ended August 3, 2013 relate to the 26 weeks ended August 3, 2013, and the six months ended July 28, 2012 relate to the 26 weeks ended July 28, 2012.

Recent Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss or a Tax Credit Carryforward Exists. ASU 2013-11 requires unrecognized tax benefits to be presented as a decrease in a net operating loss, similar tax loss or tax credit carryforward if certain criteria are met. ASU 2013-11, which is prospective, is effective for reporting periods beginning after December 15, 2013, with earlier adoption permitted. Retrospective application is also permitted. We are still evaluating the standard to determine when we will adopt the standard but we do not believe the implementation of this standard will result in a material impact to our financial statements.

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Our outstanding debt is detailed in the table below. We were in compliance with the terms and conditions of all debt agreements for all periods presented.

	August 3, 2013	February 2, 2013 (in millions)	July 28, 2012	Interest Rate
Senior secured term loan	\$ 1,636	\$ 1,640	\$ 1,996	Variable
Senior notes	1,007	1,007	795	7.750%
Senior subordinated notes	255	393	393	11.375%
Subordinated discount notes			180	13.000%
Asset-based revolving credit facility	222	1		Variable
Total debt	3,120	3,041	3,364	
Less current portion	238	150	1	
Long-term debt	\$ 2,882	\$ 2,891	\$ 3,363	

113/8% Senior Subordinated Notes due 2016

On January 28, 2013, we caused to be delivered to the holders of our outstanding 113/8% Senior Subordinated Notes due November 1, 2016 (the Senior Subordinated Notes) an irrevocable notice relating to the redemption of \$137 million in aggregate principal amount of the Senior Subordinated Notes. On February 27, 2013, we redeemed the \$137 million of Senior Subordinated Notes at a redemption price equal to 103.792%. In accordance with Accounting Standards Codification (ASC) 470 *Debt*, we recorded a loss on early extinguishment of debt of approximately \$7 million related to the partial redemption of our Senior Subordinated Notes. The \$7 million loss is comprised of a \$5 million redemption premium and \$2 million to write off related debt issuance costs.

Restated Revolving Credit Facility

As of August 3, 2013, the borrowing base of our restated senior secured asset-based revolving credit facility (the Restated Revolving Credit Facility) was \$650 million, of which we had \$222 million in borrowings, \$61 million of outstanding letters of credit and the unused borrowing capacity was \$367 million.

Restated Term Loan Credit Facility

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The Company is required to make scheduled quarterly payments, each equal to 0.25% of the original principal amount of the term loans, subject to adjustments relating to the incurrence of additional term loans under the Restated Term Loan Credit Facility, for the first six years and three quarters, with the balance paid on January 28, 2020. The Company paid \$4 million for the quarter ended August 3, 2013 and the current portion of debt includes \$16 million that will be paid during the next four quarters.

Note 3. Comprehensive Income

Accumulated other comprehensive income, net of tax, is reflected in the Consolidated Balance Sheets as follows:

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	Foreign Currency Translation and Other (in millions)	
Balance at February 2, 2013	\$	6
Foreign currency translation adjustment		(2)
Balance at August 3, 2013	\$	4

Note 4. Fair Value Measurements

As defined in ASC 820, *Fair Value Measurements and Disclosures*, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 establishes a three-level valuation hierarchy for fair value measurements. These valuation techniques are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect less transparent active market data, as well as internal assumptions. These two types of inputs create the following fair value hierarchy:

- Level 1 Quoted prices for *identical* instruments in active markets;
- Level 2 Quoted prices for *similar* instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose significant inputs are observable; and
- Level 3 Instruments with significant unobservable inputs.

We apply fair value techniques on a non-recurring basis for the establishment of potential impairment loss related to goodwill pursuant to ASC 350, *Intangibles Goodwill and Other* and determining the fair value of long-lived assets pursuant to ASC 360, *Property, Plant, and Equipment*. During the quarter and six months ended August 3, 2013, there were no material events or changes in circumstances indicating the carrying amounts of our goodwill or long-lived assets may not be recoverable.

The table below provides the carrying and fair values of our senior secured term loan facility (Restated Term Loan Credit Facility), our 7 3/4% Senior Notes that mature in 2018 (2018 Senior Notes) and our Senior Subordinated Notes, (together, with our 2018 Senior Notes, our notes) as of August 3, 2013. The fair value of our Restated Term Loan Credit Facility was determined based on quoted market prices of similar instruments which are considered Level 2 inputs within the fair value hierarchy. The fair value of our notes was determined based on recent trades which are considered Level 1 inputs within the fair value hierarchy.

	Carrying Value		Fair Value	
	(in millions)			
Senior secured term loan	\$	1,636	\$	1,645
Senior notes		1,007		1,079
Senior subordinated notes		255		267

Note 5. Income Taxes

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The effective tax rate was 31.0% for the second quarter of fiscal 2013. The effective tax rate was 40.1% for the second quarter of fiscal 2012. The current year tax rate is lower than the prior year tax rate due primarily to the realization of state tax credits this year.

The effective tax rate was 36.2% for the first six months of fiscal 2013. The effective tax rate was 36.6% for the first six months of fiscal 2012. The rate was lower than the prior year six month tax rate due primarily to the realization of state tax credits this year partly offset by the prior year favorable impact related to our reserve for uncertain tax positions. We currently estimate our annualized effective tax rate for fiscal 2013 to be 37.4%.

Note 6. Commitments and Contingencies

We are involved in ongoing legal and regulatory proceedings. Other than those described in the following paragraphs, there were no material changes to our disclosures of commitments and contingencies from our Annual Report on Form 10-K for the fiscal year ended February 2, 2013 and our Quarterly Report on Form 10-Q for the quarterly period ended May 4, 2013.

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Consumer Class Action Claims

Massachusetts Zip Code Claims

Relying in part on the California Supreme Court decision, an additional purported class action lawsuit was filed on May 20, 2011 against the Company: *Melissa Tyler v. Michaels Stores, Inc.* in the U.S. District Court-District of Massachusetts, alleging violation of a Massachusetts statute regarding the collection of personally identification information in connection with a credit card transaction. On March 11, 2013, the Massachusetts Supreme Judicial Court ruled on certified questions on the interpretation of the statute and remanded the case to the U.S. District Court for further proceedings. Following the Judicial Court's decision, an additional purported class action lawsuit asserting the same allegations in *Tyler* was filed in the U.S. District Court-District of Massachusetts by Susan D. Esposito, and the two cases have been consolidated. On August 12, 2013, a tentative settlement that is subject to Court approval was reached for an amount that will not have a material effect on our Consolidated Financial Statements.

Governmental inquiries and related matters

Non-U.S. trust inquiry

In early 2005, the District Attorney's office of the County of New York and the SEC opened inquiries concerning non-U.S. trusts that directly or indirectly held shares of Michaels common stock and common stock options. On July 29, 2010, the SEC filed a civil enforcement action in federal district court for the Southern District of New York against Charles Wyly, Sam Wyly, the Wylys' attorney Michael French, and others alleging, among other things, violations of various federal securities laws, including those governing ownership reporting and trading of securities, in connection with the non-U.S. trusts and their subsidiaries. Additional information may be obtained at the SEC's website. Sam Wyly, the estate of Charles Wyly and Mr. French, also a former director of the Company, have requested indemnification from the Company for certain legal costs with respect to these matters. The Company has resolved all claims with regards to Sam Wyly and the estate of Charles Wyly for an immaterial amount.

On April 12, 2012, Mr. French filed a lawsuit against the Company and the non-U.S. trusts in the District Court of Dallas County, Texas. The matter was dismissed as to the non-U.S. trusts. Mr. French seeks damages from the Company for breach of contract, attorneys' fees and costs related to the Company's alleged indemnification obligations to Mr. French and attorneys' fees and costs related to the lawsuit. On August 9, 2013, the dispute was settled for an amount that will not have a material effect on our Consolidated Financial Statements.

General

In addition to the litigation discussed above, we are, and in the future, may be involved in various other lawsuits, claims and proceedings incident to the ordinary course of business. The results of litigation are inherently unpredictable. Any claims against us, whether meritorious or not, could be time consuming, result in costly litigation, require significant amounts of management time and result in diversion of significant resources.

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ASC 450, *Contingencies*, governs the disclosure and recognition of loss contingencies, including potential losses from litigation and regulatory matters. It imposes different requirements for the recognition and disclosure of loss contingencies based on the likelihood of occurrence of the contingent future event or events. It distinguishes among degrees of likelihood using the following three terms: probable, meaning that the future event or events are likely to occur; remote, meaning that the chance of the future event or events occurring is slight; and reasonably possible, meaning that the chance of the future event or events occurring is more than remote but less than likely. In accordance with ASC 450, the Company accrues for a loss contingency when we conclude that the likelihood of a loss is probable and the amount of the loss can be reasonably estimated. When the loss cannot be reasonably estimated we estimate the range of amounts, and if no amount in the range constitutes a better estimate than any other amount, we accrue for the amount at the low end of the range. We adjust our accruals from time to time as we receive additional information, but the loss we incur may be significantly greater than or less than the amount we have accrued. We disclose loss contingencies if there is at least a reasonable possibility that a material loss has been incurred. No accrual or disclosure is required for losses that are remote.

For some of the matters disclosed above, as well as other matters previously disclosed in the Company's filings with the Securities and Exchange Commission (SEC), the Company is currently able to estimate a reasonably possible loss or range of loss in excess of amounts accrued (if any). For some of the matters included within this estimation, an accrual has been made because a loss is believed to be both probable and reasonably estimable, but an exposure to loss exists in excess of the amount accrued; in these cases, the estimate reflects the reasonably possible range of loss in excess of the accrued amount. For other matters included within this estimation, no accrual has been made because a loss, although estimable, is believed to be reasonably possible, but not probable; in these cases the estimate reflects the reasonably possible loss or range of loss within the ranges identified. For the various ranges identified, the aggregate of these estimated amounts is approximately \$10 million, which is also inclusive of amounts accrued by the Company.

For other matters disclosed above or as previously disclosed in the Company's filings with the SEC, the Company is not currently able to estimate the reasonably possible loss or range of loss, and has indicated such. Many of these matters remain in preliminary stages (even in some cases where a substantial period of time has passed since the commencement of the matter), with few or no substantive legal decisions by the court defining the scope of the claims, the class (if any), or the potentially available damages, and fact discovery is still in progress or has not yet begun. For all these reasons, the Company cannot at this time estimate the reasonably possible loss or range of loss, if any, for these matters.

It is the opinion of the Company's management, based on current knowledge and after taking into account its current legal accruals, the eventual outcome of all matters described in this Note would not be likely to have a material impact on the consolidated financial condition of the Company. Nonetheless, given the substantial or indeterminate amounts sought in certain of these matters, and the inherent unpredictability of such matters, an adverse outcome in certain of these matters could, from time to time, have a material effect on the Company's consolidated results of operations or cash flows in particular quarterly or annual periods.

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Note 7. The Michaels Companies and its Subsidiaries

In July 2013, Michaels was reorganized into a holding company structure (Reorganization). The Michaels Companies, Inc. (Parent), Michaels FinCo Holdings, LLC (FinCo Holdings), Michaels FinCo, Inc. (FinCo Inc) and Michaels Funding, Inc. (Holdings) and Michaels Stores Merger Co, Inc. (MergerCo) were formed in connection with the Reorganization: (i) MergerCo was merged with and into Michaels with Michaels being the surviving corporation; (ii) each share of Michaels common stock was converted into the right to receive one share of Parent common stock, subject to the same vesting conditions, if any, as applied to the share so converted, and each such share of Michaels common stock was cancelled and retired and ceased to exist; and (iii) each option to purchase one or more shares of common stock of Michaels was assumed by Parent and converted into an option to purchase an equivalent number of shares of common stock of Parent with the remaining terms of each such option remaining unchanged except as was necessary to reflect the Reorganization. Approximately 118 million shares of Michaels common stock were converted into Parent common stock. The Michaels shares were then cancelled and retired and an amount equal to the par value of the original shares was transferred from the common stock account to paid-in capital. Michaels then issued 100 shares of stock with a \$0.10 par value to Holdings. In addition, common stock issued and outstanding and additional paid-in capital for February 2, 2013 and July 28, 2012 on the Consolidated Balance Sheets have been adjusted to reflect this transaction as if it happened prior to those dates.

As a result of the Reorganization, FinCo Holdings is wholly owned by the Parent. FinCo Inc and Holdings are wholly owned by FinCo Holdings. Michaels is wholly owned by Holdings.

Subsequent to the Reorganization, on July 29, 2013, FinCo Holdings and FinCo Inc issued \$800 million aggregate principal amount of 7.50%/8.25% PIK Toggle Notes due 2018 (PIK Notes). The PIK Notes were issued in a private transaction. Interest payments on the PIK Notes are due February 1 and August 1 of each year until maturity. The first two interest payments and the last interest payment are required to be paid entirely in cash. All other interest payments must be made in cash, except that all or a portion of the interest on the PIK Notes may be paid by increasing the principal amount of the outstanding PIK Notes or by issuing additional PIK Notes depending on the amount of cash dividends that can be paid by the Company under our credit agreements governing our Senior Secured Credit Facilities, the terms of the indentures governing our outstanding notes and the terms of our other indebtedness outstanding at the time. The proceeds from the debt issuance were about \$782 million, after deducting the initial purchasers discount and estimated fees and expenses. FinCo Holdings distributed the net proceeds to Parent and the proceeds were used to fund a cash dividend to the Parent s equity and equity-award holders and pay related fees and expenses.

The PIK Notes are senior unsecured obligations of FinCo Holdings and FinCo Inc and are not guaranteed by the Company or any of the Company s subsidiaries. In addition, neither the PIK Notes nor the dividend transaction is reflected in the financial statements of the Company. If interest on the PIK Notes is paid in cash, annual interest payments will total \$60 million or a total of approximately \$301 million from July 29, 2013 until August, 1, 2018, the maturity date. Any cash interest payments will be funded by the Company through a cash dividend to Holdings.

Note 8. Segments and Geographic Information

We consider our Michaels U.S., Michaels Canada, Aaron Brothers and online scrapbooking business operations to be our operating segments for purposes of determining reportable segments based on the criteria of ASC 280, *Segment Reporting*. We determined that our Michaels U.S., Michaels Canada, and Aaron Brothers operating segments have similar economic characteristics and meet the aggregation criteria set forth in ASC 280. Therefore, we combine those operating segments into one reporting segment. During the second quarter of 2013, the online scrapbooking business was discontinued; as an operating segment, it is immaterial to the financial statements as a whole.

Our sales and assets by country are as follows:

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	Quarter Ended		Six Months Ended	
	August 3, 2013	July 28, 2012	August 3, 2013	July 28, 2012
Net Sales:				
United States	\$ 819	\$ 812	\$ 1,717	\$ 1,703
Canada	85	80	180	167
Consolidated Total	\$ 904	\$ 892	\$ 1,897	\$ 1,870

	August 3, 2013	February 2, 2013	July 28, 2012
	(in millions)		
Total Assets:			
United States	\$ 1,499	\$ 1,432	\$ 1,569
Canada	123	109	117
Consolidated Total	\$ 1,622	\$ 1,541	\$ 1,686

Our chief operating decision makers evaluate historical operating performance, plan and forecast future periods operating performance based on earnings before interest, income taxes, depreciation, amortization, and refinancing costs and losses on early extinguishment of debt (EBITDA (excluding refinancing costs and losses on early extinguishment of debt)). We believe EBITDA (excluding refinancing costs and losses on early extinguishment of debt) represents the financial measure that more closely reflects the operating effectiveness of factors over which management has control. As such, an element of base incentive compensation targets for certain management personnel are based on EBITDA (excluding refinancing costs and losses on early extinguishment of debt). A reconciliation of EBITDA (excluding refinancing costs and losses on early extinguishment of debt) to Net income is presented below.

	Quarter Ended		Six Months Ended	
	August 3, 2013	July 28, 2012	August 3, 2013	July 28, 2012
	(in millions)			
Net income	\$ 20	\$ 13	\$ 67	\$ 66
Interest expense	45	61	92	127
Refinancing costs and losses on early extinguishments of debt			7	
Provision for income taxes	9	8	38	38
Depreciation and amortization	25	22	50	46