

CATO CORP
Form 10-Q
November 30, 2018

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

FORM 10-Q

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

For the quarterly period ended November 3, 2018

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 1-31340

THE CATO CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

56-0484485
(I.R.S. Employer Identification No.)

8100 Denmark Road, Charlotte, North Carolina 28273-5975
(Address of principal executive offices)

(Zip Code)

(704) 554-8510
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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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 every Interactive Data File required to be submitted 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 such files).

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 November 3, 2018, there were 22,844,871 shares of Class A common stock and 1,763,652 shares of Class B common stock outstanding.

THE CATO CORPORATION

FORM 10-Q

Quarter Ended November 3, 2018

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

THE CATO CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (UNAUDITED)

	Three Months Ended		Nine Months Ended	
	November 3, 2018	October 28, 2017	November 3, 2018	October 28, 2017
	(Dollars in thousands, except per share data)			
REVENUES				
Retail sales	\$ 187,892	\$ 188,368	\$ 630,765	\$ 631,049
Other revenue (principally finance charges, late fees and layaway charges)	2,120	1,905	6,464	5,926
Total revenues	190,012	190,273	637,229	636,975
COSTS AND EXPENSES, NET				
Cost of goods sold (exclusive of depreciation shown below)	123,014	124,462	395,102	411,503
Selling, general and administrative (exclusive of depreciation shown below)	61,765	62,100	196,616	190,162
Depreciation	4,094	5,047	12,470	14,989
Interest and other income	(1,374)	(1,200)	(3,559)	(3,472)
Cost and expenses, net	187,499	190,409	600,629	613,182
Income/(Loss) before income taxes	2,513	(136)	36,600	23,793

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Income tax (benefit)/expense		(1,287)		(2,830)		2,907		(252)
Net income/(loss)	\$	3,800	\$	2,694	\$	33,693	\$	24,045
Basic earnings/(loss) per share	\$	0.16	\$	0.11	\$	1.36	\$	0.93
Diluted earnings/(loss) per share	\$	0.16	\$	0.11	\$	1.36	\$	0.93
Dividends per share	\$	0.33	\$	0.33	\$	0.99	\$	0.99
Comprehensive income:								
Net income/(loss)	\$	3,800	\$	2,694	\$	33,693	\$	24,045
Unrealized gain (loss) on available-for-sale securities, net of deferred income taxes of (\$117) and (\$141) for the three and nine months ended November 3, 2018 and (\$101) and \$272 for the three and nine months ended October 28, 2017, respectively		(373)		(170)		(451)		455
Comprehensive income/(loss)	\$	3,427	\$	2,524	\$	33,242	\$	24,500

See notes to condensed consolidated financial statements (unaudited).

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THE CATO CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

	November 3, 2018	February 3, 2018
ASSETS	(Dollars in thousands)	
Current Assets:		
Cash and cash equivalents	\$ 26,668	\$ 78,047
Short-term investments	183,241	118,836
Restricted cash	3,662	3,217
Restricted short-term investments	106	505
Accounts receivable, net of allowance for doubtful accounts of \$849 and \$1,148 at November 3, 2018 and February 3, 2018, respectively	37,016	28,018
Merchandise inventories	113,046	121,535
Prepaid expenses and other current assets	11,195	22,322
Total Current Assets	374,934	372,480
Property and equipment – net	99,308	109,368
Noncurrent deferred income taxes	11,155	12,570
Other assets	21,496	21,658
Total Assets	\$ 506,893	\$ 516,076
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	\$ 72,606	\$ 82,605
Accrued expenses	54,395	52,825
Accrued bonus and benefits	10,333	2,971
Accrued income taxes	779	680
Total Current Liabilities	138,113	139,081
Other noncurrent liabilities	42,580	50,642
Stockholders' Equity:		
Preferred stock, \$100 par value per share, 100,000 shares authorized, none issued	-	-
Class A common stock, \$.033 par value per share, 50,000,000 shares authorized; issued 22,844,871 shares and 23,045,039 shares		

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at November 3, 2018 and February 3, 2018, respectively	767	774
Convertible Class B common stock, \$.033 par value per share, 15,000,000 shares authorized; issued 1,763,652 shares and 1,755,601 shares		
at November 3, 2018 and February 3, 2018, respectively	59	58
Additional paid-in capital	104,300	99,948
Retained earnings	221,846	225,894
Accumulated other comprehensive income/(loss)	(772)	(321)
Total Stockholders' Equity	326,200	326,353
Total Liabilities and Stockholders' Equity	\$ 506,893	\$ 516,076

See notes to condensed consolidated financial statements (unaudited).

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THE CATO CORPORATION**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(UNAUDITED)**

	Nine Months Ended	
	November 3, 2018	October 28, 2017
	(Dollars in thousands)	
Operating Activities:		
Net income	\$ 33,693	\$ 24,045
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	12,470	14,989
Provision for doubtful accounts	301	466
Purchase premium and premium amortization of investments	420	2,747
Share-based compensation	3,697	3,002
Deferred income taxes	1,556	1,015
Loss on disposal of property and equipment	530	611
Changes in operating assets and liabilities which provided (used) cash:		
Accounts receivable	(9,288)	(497)
Merchandise inventories	8,489	17,919
Prepaid and other assets	11,115	(1,232)
Accrued income taxes	99	-
Accounts payable, accrued expenses and other liabilities	(8,855)	(24,752)
Net cash provided by operating activities	54,227	38,313
Investing Activities:		
Expenditures for property and equipment	(3,224)	(8,762)
Purchase of short-term investments	(122,819)	(15,771)
Sales of short-term investments	58,113	79,764
Purchase of other assets	(143)	(657)
Sales of other assets	4	6
Net cash (used)/provided in investing activities	(68,069)	54,580
Financing Activities:		
Dividends paid	(24,455)	(25,466)
Repurchase of common stock	(13,344)	(35,708)
Proceeds from line of credit	-	21,000
Payments to line of credit	-	(21,000)
Proceeds from employee stock purchase plan	518	443
Proceeds from stock options exercised	189	95

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Net cash used in financing activities	(37,092)	(60,636)
Net increase/(decrease) in cash, cash equivalents, and restricted cash	(50,934)	32,257
Cash, cash equivalents, and restricted cash at beginning of period	81,264	49,618
Effect of exchange rate on cash	-	-
Cash, cash equivalents, and restricted cash at end of period	\$ 30,330	\$ 81,875
Non-cash activity:		
Accrued other assets and property and equipment	\$ 360	\$ 1,012
Accrued treasury stock	-	195

See notes to condensed consolidated financial statements (unaudited).

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THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)
FOR THE THREE MONTHS AND NINE MONTHS ENDED NOVEMBER 3, 2018 AND OCTOBER 28,
2017

NOTE 1 - GENERAL:

The condensed consolidated financial statements have been prepared from the accounting records of The Cato Corporation and its wholly-owned subsidiaries (the “Company”), and all amounts shown as of and for the periods ended November 3, 2018 and October 28, 2017 are unaudited. In the opinion of management, all adjustments considered necessary for a fair statement have been included. All such adjustments are of a normal, recurring nature unless otherwise noted. The results of the interim period may not be indicative of the results expected for the entire year.

The interim financial statements should be read in conjunction with the consolidated financial statements and notes thereto, included in the Company’s Annual Report on Form 10-K for the fiscal year ended February 3, 2018. Amounts as of February 3, 2018 have been derived from the audited balance sheet, but do not include all disclosures required by accounting principles generally accepted in the United States of America.

On November 20, 2018, the Board of Directors maintained the quarterly dividend at \$0.33 per share and increased, by 2 million shares, the authorization to purchase shares under the Company’s share repurchase program.

Recently Adopted Accounting Policies

In May 2014, the Financial Accounting Standards Board (“FASB”) issued ASU 2014-09, “Revenue from Contracts with Customers (Topic 606),” that supersedes most current revenue recognition guidance and modifies the accounting treatment for certain costs associated with revenue generation. The core principle of the revised revenue recognition standard is that an entity should recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those good or services, and provides several steps to apply to achieve that principle. In addition, the new guidance enhances disclosure requirements to include more information about specific revenue contracts entered into by the entity. Effective at the beginning of fiscal 2018 the Company adopted this new standard.

The Company has elected the modified retrospective approach to transition to Topic 606. As required by this expedient, the Company assessed its open contracts with customers at February 3, 2018 to determine the cumulative effect of initially applying this standard. The Company concluded that the cumulative effect of initially applying this standard is not material. In addition, the Company assessed the financial line items impacted by adopting this standard compared to the previous revenue guidance. The Company concluded that any differences in financial statement line items are not material. Please refer to Note 11, Revenue Recognition, for incremental disclosures related to this adoption.

In November 2016, the FASB issued ASU 2016-18, "Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force)." This standard requires that restricted cash and restricted cash equivalents be included in cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown in the statement of cash flows. The Company adopted the provisions of ASU 2016-18 in the first quarter of 2018 using the retrospective transition method. The new guidance did not have a material impact on the financial statements.

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NOTE 2 - EARNINGS PER SHARE:

Accounting Standard Codification (“ASC”) 260 – *Earnings Per Share* requires dual presentation of basic and diluted Earnings Per Share (“EPS”) on the face of all income statements for all entities with complex capital structures. The Company has presented one basic EPS and one diluted EPS amount for all common shares in the accompanying Condensed Consolidated Statements of Income and Comprehensive Income. While the Company’s certificate of incorporation provides the right for the Board of Directors to declare dividends on Class A shares without declaration of commensurate dividends on Class B shares, the Company has historically paid the same dividends to both Class A and Class B shareholders and the Board of Directors has resolved to continue this practice. Accordingly, the Company’s allocation of income for purposes of the EPS computation is the same for Class A and Class B shares and the EPS amounts reported herein are applicable to both Class A and Class B shares.

Basic EPS is computed as net income less earnings allocated to non-vested equity awards divided by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur from common shares issuable through stock options and the Employee Stock Purchase Plan.

	Three Months Ended		Nine Months Ended	
	November	October	November	October
	3, 2018	28, 2017	3, 2018	28, 2017
	(Dollars in thousands)			
Numerator				
Net earnings/(loss)	\$ 3,800	\$ 2,694	\$ 33,693	\$ 24,045
Earnings/(loss) allocated to non-vested equity awards	(107)	(56)	(951)	(531)
Net earnings/(loss) available to common stockholders	\$ 3,693	\$ 2,638	\$ 32,742	\$ 23,514
Denominator				
Basic weighted average common shares outstanding	23,820,477	24,537,974	24,051,185	25,150,377
Diluted weighted average common shares outstanding	23,820,477	24,537,974	24,051,185	25,150,377
Net income/(loss) per common share				
Basic earnings/(loss) per share	\$ 0.16	\$ 0.11	\$ 1.36	\$ 0.93
Diluted earnings/(loss) per share	\$ 0.16	\$ 0.11	\$ 1.36	\$ 0.93

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2017

NOTE 3 – ACCUMULATED OTHER COMPREHENSIVE INCOME:

The following table sets forth information regarding the reclassification out of Accumulated other comprehensive income (in thousands) for the three months ended November 3, 2018:

		Changes in Accumulated Other Comprehensive Income (a) Unrealized Gains and (Losses) on Available-for-Sale Securities
Beginning Balance at August 4, 2018	\$	(399)
Other comprehensive income before reclassification		(373)
Amounts reclassified from accumulated other comprehensive income (b)		-
Net current-period other comprehensive income		(373)
Ending Balance at November 3, 2018	\$	(772)

(a) All amounts are net-of-tax. Amounts in parentheses indicate a debit/reduction to other comprehensive income.

(b) Includes \$0 impact of accumulated other comprehensive income reclassifications into Interest and other income for net gains on available-for-sale securities. The tax impact of this reclassification was \$0.

The following table sets forth information regarding the reclassification out of Accumulated other comprehensive income (in thousands) for the nine months ended November 3, 2018:

		Changes in Accumulated Other Comprehensive Income (a) Unrealized Gains and (Losses) on Available-for-Sale Securities
Beginning Balance at February 3, 2018	\$	(321)
Other comprehensive income before reclassification		(504)
Amounts reclassified from accumulated other comprehensive income (b)		53
Net current-period other comprehensive income		(451)
Ending Balance at November 3, 2018	\$	(772)

(a) All amounts are net-of-tax. Amounts in parentheses indicate a debit/reduction to other comprehensive income.

(b) Includes \$70 impact of accumulated other comprehensive income reclassifications into Interest and other

income for net gains on available-for-sale securities. The tax impact of this reclassification was \$17.

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2017

NOTE 3 – ACCUMULATED OTHER COMPREHENSIVE INCOME (CONTINUED):

The following table sets forth information regarding the reclassification out of Accumulated other comprehensive income (in thousands) for the three months ended October 28, 2017:

		Changes in Accumulated Other Comprehensive Income (a) Unrealized Gains and (Losses) on Available-for-Sale Securities
Beginning Balance at July 29, 2017	\$	411
Other comprehensive income before reclassifications		(144)
Amounts reclassified from accumulated other comprehensive income (b)		(26)
Net current-period other comprehensive income		(170)
Ending Balance at October 28, 2017	\$	241

(a) All amounts are net-of-tax. Amounts in parentheses indicate a debit/reduction to other comprehensive income.

(b) Includes (\$41) impact of Accumulated other comprehensive income reclassifications into Interest and other

income for net gains on available-for-sale securities. The tax impact of this reclassification was (\$15).

The following table sets forth information regarding the reclassification out of Accumulated other comprehensive income (in thousands) for the nine months ended October 28, 2017:

**Changes in Accumulated Other
Comprehensive Income (a)
Unrealized Gains
and (Losses) on
Available-for-Sale
Securities**

Beginning Balance at January 28, 2017	\$	(214)
Other comprehensive income before reclassifications		478
Amounts reclassified from accumulated other comprehensive income (b)		(23)
Net current-period other comprehensive income		455
Ending Balance at October 28, 2017	\$	241

(a) All amounts are net-of-tax. Amounts in parentheses indicate a debit/reduction to other comprehensive income.

(b) Includes (\$36) impact of Accumulated other comprehensive income reclassifications into Interest and other

income for net gains on available-for-sale securities. The tax impact of this reclassification was (\$13).

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NOTE 4 – FINANCING ARRANGEMENTS:

As of November 3, 2018, the Company had an unsecured revolving credit agreement to borrow \$35.0 million less the balance of any revocable letters of credit as discussed below. The revolving credit agreement is committed until August 2019. The credit agreement contains various financial covenants and limitations, including the maintenance of specific financial ratios with which the Company was in compliance as of November 3, 2018. There were no borrowings outstanding under this credit facility during the periods ended November 3, 2018 or February 3, 2018. The weighted average interest rate under the credit facility was zero at November 3, 2018 due to no borrowings outstanding.

At November 3, 2018 and February 3, 2018, the Company had no outstanding revocable letters of credit relating to purchase commitments.

NOTE 5 – REPORTABLE SEGMENT INFORMATION:

The Company has determined that it has four operating segments, as defined under ASC 280-10, including Cato, It's Fashion, Versona and Credit. As outlined in ASC 280-10, the Company has two reportable segments: Retail and Credit. The Company has aggregated its three retail operating segments, including e-commerce, based on the aggregation criteria outlined in ASC 280-10, which states that two or more operating segments may be aggregated into a single reportable segment if aggregation is consistent with the objective and basic principles of ASC 280-10, which require the segments to have similar economic characteristics, products, production processes, clients and methods of distribution.

The Company's retail operating segments have similar economic characteristics and similar operating, financial and competitive risks. They are similar in nature of product, as they all offer women's apparel, shoes and accessories. Merchandise inventory for the Company's retail operating segments is sourced from the same countries and some of

the same vendors, using similar production processes. Merchandise for the Company's operating segments is distributed to retail stores in a similar manner through the Company's single distribution center and is subsequently distributed to clients in a similar manner.

The Company operates its women's fashion specialty retail stores in 33 states as of November 3, 2018, principally in the southeastern United States. The Company offers its own credit card to its customers and all credit authorizations, payment processing and collection efforts are performed by a separate subsidiary of the Company.

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NOTE 5 – REPORTABLE SEGMENT INFORMATION (CONTINUED):

The following schedule summarizes certain segment information (in thousands):

Three Months Ended				Nine Months Ended			
November 3, 2018				November 3, 2018			
	Retail	Credit	Total		Retail	Credit	Total
Revenues	\$189,055	\$957	\$190,012	Revenues	\$634,360	\$2,869	\$637,229
Depreciation	4,088	6	4,094	Depreciation	12,452	18	12,470
Interest and other income	(1,374)	-	(1,374)	Interest and other income	(3,559)	-	(3,559)
Income/(Loss) before income taxes	2,140	373	2,513	Income/(Loss) before income taxes	35,159	1,441	36,600
Capital expenditures	1,345	-	1,345	Capital expenditures	3,224	-	3,224
Three Months Ended				Nine Months Ended			
October 28, 2017				October 28, 2017			
	Retail	Credit	Total		Retail	Credit	Total
Revenues	\$189,263	\$1,010	\$190,273	Revenues	\$633,816	\$3,159	\$636,975
Depreciation	5,039	8	5,047	Depreciation	14,958	31	14,989
Interest and other income	(1,200)	-	(1,200)	Interest and other income	(3,472)	-	(3,472)
Income/(Loss) before income taxes	(313)	177	(136)	Income/(Loss) before income taxes	22,872	921	23,793
Capital expenditures	2,337	-	2,337	Capital expenditures	8,762	-	8,762

Capital
expenditures

	Retail	Credit	Total
Total assets as of November 3, 2018	\$437,711	\$69,182	\$506,893
Total assets as of February 3, 2018	469,652	46,424	516,076

The Company evaluates segment performance based on income before taxes. The Company does not allocate certain corporate expenses or income taxes to the credit segment.

The following schedule summarizes the direct expenses of the credit segment, which are reflected in Selling, general and administrative expenses (in thousands):

	Three Months Ended		Nine Months Ended	
	November 3, 2018	October 28, 2017	November 3, 2018	October 28, 2017
Bad debt expense \$	-	\$ 208	-	\$ 466
Payroll	179	210	571	654
Postage	128	133	379	406
Other expenses	271	274	460	681
Total expenses \$	578	\$ 825	1,410	\$ 2,207

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NOTE 6 – STOCK-BASED COMPENSATION:

As of November 3, 2018, the Company had four long-term compensation plans pursuant to which stock-based compensation was outstanding or could be granted. The Company's 1987 Non-Qualified Stock Option Plan is for the granting of options to officers and key employees. As of November 3, 2018, there were no available stock options for grant. The 2018 Incentive Compensation Plan, 2013 Incentive Compensation Plan and 2004 Amended and Restated Incentive Compensation Plan are for the granting of various forms of equity-based awards, including restricted stock and stock options for grant, to officers, directors and key employees. Effective May 24, 2018 and May 23, 2013, shares for grant were no longer available under the 2013 Incentive Compensation Plan and 2004 Amended and Restated Incentive Compensation Plan, respectively.

The following table presents the number of options and shares of restricted stock initially authorized and available for grant under each of the plans as of November 3, 2018:

	1987 Plan	2004 Plan	2013 Plan	2018 Plan	Total
Options and/or restricted stock initially authorized	5,850,000	1,350,000	1,500,000	4,725,000	13,425,000
Options and/or restricted stock available for grant: November 3, 2018	-	-	-	4,503,140	4,503,140

In accordance with ASC 718, the fair value of current restricted stock awards is estimated on the date of grant based on the market price of the Company's stock and is amortized to compensation expense on a straight-line basis over the related vesting periods. As of November 3, 2018 and February 3, 2018, there was \$13,373,000 and \$11,727,000, respectively, of total unrecognized compensation expense related to nonvested restricted stock awards, which had a remaining weighted-average vesting period of 2.4 years and 2.0 years, respectively. The total fair value of the shares recognized as compensation expense during the three and nine months ended November 3, 2018 was \$1,233,000 and \$3,601,000, respectively, compared to \$1,185,000 and \$2,911,000, respectively, for the three and nine months ended October 28, 2017. These expenses are classified as a component of Selling, general and administrative expenses in the Condensed Consolidated Statements of Income and Comprehensive Income.

The following summary shows the changes in the shares of unvested restricted stock outstanding during the nine months ended November 3, 2018:

Number of	Weighted Average Grant Date Fair
-----------	-------------------------------------