Empire State Realty Trust, Inc.
Form 10-Q
May 05, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended March 31, 2016
o 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: 001-36105
EMPIRE STATE REALTY TRUST, INC.

(Exact name of Registrant as specified in its charter)

Maryland	37-1645259
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

One Grand Central Place
60 East 42nd Street
New York, New York 10165
(Address of principal executive offices) (Zip Code)
(212) 687-8700
(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 x No o

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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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 definition of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class A Common Stock, par value $0.01 per share	121,146,924
Class B Common Stock, par value $0.01 per share	1,104,173
(Class)	(Outstanding on May 2, 2016)

EMPIRE STATE REALTY TRUST, INC.
FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 2016
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ITEM 1. FINANCIAL STATEMENTS
Empire State Realty Trust, Inc.
Condensed Consolidated Balance Sheets
(amounts in thousands, except share and per share amounts)

	March 31, 2016 (unaudited)	December 31, 2015
ASSETS		
Commercial real estate properties, at cost:		
Land	$ 201,196	$ 201,196
Development costs	7,931	7,498
Building and improvements	2,089,792	2,067,636
	2,298,919	2,276,330
Less: accumulated depreciation	(490,427)	(465,584)
Commercial real estate properties, net	1,808,492	1,810,746
Cash and cash equivalents	44,440	46,685
Restricted cash	60,165	65,880
Tenant and other receivables, net of allowance of $3,364 and $2,792 in 2016 and 2015, respectively	14,828	18,782
Deferred rent receivables, net of allowance of $231 and $245 in 2016 and 2015, respectively	127,148	122,048
Prepaid expenses and other assets	29,908	50,460
Deferred costs, net	304,977	310,679
Acquired below-market ground leases, net	381,934	383,891
Goodwill	491,479	491,479
Total assets	$ 3,263,371	$ 3,300,650
LIABILITIES AND EQUITY		
Liabilities:		
Mortgage notes payable, net	$ 772,015	$ 747,661
Senior unsecured notes, net	587,861	587,018
Unsecured term loan facility, net	262,640	262,545
Unsecured revolving credit facility, net	—	35,192
Accounts payable and accrued expenses	119,104	111,099
Acquired below-market leases, net	96,245	104,171
Deferred revenue and other liabilities	26,802	31,388
Tenants’ security deposits	49,729	48,890
Total liabilities	1,914,396	1,927,964
Commitments and contingencies		
Equity:		
Empire State Realty Trust, Inc. stockholders' equity:		
Preferred stock, $0.01 par value per share, 50,000,000 shares authorized, none issued or outstanding	—	—
Class A common stock, $0.01 par value per share, 400,000,000 shares authorized, 120,639,410 shares issued and outstanding and 118,903,312 shares issued and outstanding in 2016 and 2015, respectively	1,206	1,189
Class B common stock, $0.01 par value per share, 50,000,000 shares authorized, 1,107,290 and 1,120,067 shares issued and outstanding in 2016 and 2015, respectively	11	11
Additional paid-in capital	476,107	469,152
Accumulated other comprehensive loss	(9,626)	(883)

Retained earnings	52,370	55,260
Total Empire State Realty Trust, Inc.'s stockholders' equity	520,068	524,729
Non-controlling interests in operating partnership	820,903	839,953
Private perpetual preferred units, $16.62 per unit liquidation preference, 1,560,360 issued and outstanding in 2016 and 2015	8,004	8,004
Total equity	1,348,975	1,372,686
Total liabilities and equity	$ 3,263,371	$ 3,300,650

The accompanying notes are an integral part of these financial statements

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Empire State Realty Trust, Inc.
Condensed Consolidated Statements of Income
(unaudited)
(amounts in thousands, except per share amounts)

	Three Months Ended March 31,	
	2016	2015
Revenues:		
Rental revenue	$114,908	$110,058
Tenant expense reimbursement	18,120	18,200
Observatory revenue	21,181	18,223
Construction revenue	—	1,607
Third-party management and other fees	545	446
Other revenue and fees	2,320	3,348
Total revenues	157,074	151,882
Operating expenses:		
Property operating expenses	39,104	42,027
Ground rent expenses	2,333	2,331
General and administrative expenses	10,918	9,100
Observatory expenses	7,755	7,402
Construction expenses	—	2,869
Real estate taxes	23,525	22,978
Acquisition expenses	98	—
Depreciation and amortization	39,227	41,418
Total operating expenses	122,960	128,125
Total operating income	34,114	23,757
Interest expense	(17,951)	(16,047)
Income before income taxes	16,163	7,710
Income tax benefit	542	178
Net income	16,705	7,888
Private perpetual preferred unit distributions	(234)	(234)
Net income attributable to non-controlling interests	(9,043)	(4,516)
Net income attributable to common stockholders	$7,428	$3,138
Total weighted average shares:		
Basic	120,778	109,400
Diluted	266,641	265,810
Earnings per share attributable to common stockholders:		
Basic	$0.06	$0.03
Diluted	$0.06	$0.03
Dividends per share	$0.085	$0.085

The accompanying notes are an integral part of these financial statements

Empire State Realty Trust, Inc.
Condensed Consolidated Statements of Comprehensive Income (Loss)
(unaudited)
(amounts in thousands)

	Three Months Ended March 31,	
	2016	2015
Net income	$16,705	$7,888
Other comprehensive loss:		
Change in unrealized loss on valuation of interest rate swap agreements	(19,371)	—
Other comprehensive loss	(19,371)	—
Comprehensive income (loss)	(2,666)	7,888
Net income attributable to non-controlling interests and private perpetual preferred unitholders	(9,277)	(4,750)
Other comprehensive loss attributable to non-controlling interests	10,640	—
Comprehensive income (loss) attributable to common stockholders	$(1,303)	$3,138

The accompanying notes are an integral part of these financial statements

Empire State Realty Trust, Inc.
Condensed Consolidated Statements of Stockholders' Equity
For The Three Months Ended March 31, 2016
(unaudited)
(amounts in thousands)

	Number of Class A Common Shares	Class A Common Stock	Number of Class B Common Shares	Class B Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders' Equity	Non-controlling Interests	Private Perpetual Preferred Units	Total Equity
Balance at December 31, 2015	118,903	$1,189	1,120	$11	$469,152	$(883)	$55,260	$524,729	$839,953	$8,004	$1,372,686
Conversion of operating partnership units and Class B shares to Class A shares	1,723	17	(13)	—	6,858	(12)	—	6,863	(6,863)	—	—
Equity compensation:											
LTIP units	—	—	—	—	—	—	—	—	2,000	—	2,000
Restricted stock, net of forfeitures	14	—	—	—	97	—	—	97	—	—	97
Dividends and distributions	—	—	—	—	—	—	(10,318)	(10,318)	(12,590)	(234)	(23,142)
Net income	—	—	—	—	—	—	7,428	7,428	9,043	234	16,705
Unrealized loss on valuation of interest rate swap agreements	—	—	—	—	—	(8,731)	—	(8,731)	(10,640)	—	(19,371)
Balance at March 31, 2016	120,640	$1,206	1,107	$11	$476,107	$(9,626)	$52,370	$520,068	$820,903	$8,004	$1,348,975

The accompanying notes are an integral part of these financial statements

Empire State Realty Trust, Inc.
Condensed Consolidated Statements of Cash Flows
(unaudited)
(amounts in thousands)

	Three Months Ended March 31,	
	2016	2015
Cash Flows From Operating Activities		
Net income	$16,705	$7,888
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	39,227	41,418
Amortization of deferred finance costs and debt premiums and discount	220	1,220
Amortization of acquired above- and below-market leases, net	(4,231)	(5,291)
Amortization of acquired below-market ground leases	1,957	1,958
Straight-lining of rental revenue	(5,081)	(4,102)
Equity based compensation	2,097	1,694
Increase (decrease) in cash flows due to changes in operating assets and liabilities:		
Restricted cash	1,474	3,179
Tenant and other receivables	3,954	10,986
Deferred leasing costs	(6,335)	(16,396)
Prepaid expenses and other assets	20,553	17,789
Accounts payable and accrued expenses	(6,415)	(6,057)
Deferred revenue and other liabilities	(4,586)	(6,905)
Net cash provided by operating activities	59,539	47,381
Cash Flows From Investing Activities		
Decrease in restricted cash for investing activities	5,081	28
Development costs	(433)	(346)
Additions to building and improvements	(28,752)	(27,717)
Net cash used in investing activities	(24,104)	(28,035)

The accompanying notes are an integral part of these financial statements

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Empire State Realty Trust, Inc.
Condensed Consolidated Statements of Cash Flows (continued)
(unaudited)
(amounts in thousands)

	Three Months Ended March 31,	
	2016	2015
Cash Flows From Financing Activities		
Proceeds from mortgage notes payable	50,000	—
Repayment of mortgage notes payable	(23,252)	(47,084)
Proceeds from unsecured revolving credit facility	—	495,000
Repayments of unsecured revolving credit facility	(40,000)	(330,000)
Repayments of term loan and credit facility	—	(470,000)
Proceeds from senior unsecured notes	—	350,000
Deferred financing costs	(1,286)	(3,558)
Private perpetual preferred unit distributions	(234)	(234)
Dividends paid to common stockholders	(10,318)	(9,406)
Distributions paid to non-controlling interests in the operating partnership	(12,590)	(13,333)
Net cash used in financing activities	(37,680)	(28,615)
Net decrease in cash and cash equivalents	(2,245)	(9,269)
Cash and cash equivalents—beginning of period	46,685	45,732
Cash and cash equivalents—end of period	$44,440	$36,463
Supplemental disclosures of cash flow information:		
Cash paid for interest	$18,909	$15,742
Cash paid for income taxes	$657	$1,434
Non-cash investing and financing activities:		
Building and improvements included in accounts payable and accrued expenses	$45,594	$47,533
Derivative instruments at fair values included in accounts payable and accrued expenses	19,371	—
Conversion of operating partnership units and Class B shares to Class A shares	6,863	19,538

The accompanying notes are an integral part of these financial statements

Empire State Realty Trust, Inc.
Notes to Condensed Consolidated Financial Statements
(unaudited)

1. Description of Business and Organization

As used in these condensed consolidated financial statements, unless the context otherwise requires, “we,” “us,” “our,” the “company,” and "ESRT" mean Empire State Realty Trust, Inc. and its consolidated subsidiaries.

We are a self-administered and self-managed real estate investment trust, or REIT, that owns, manages, operates, acquires, redevelops and repositions office and retail properties in Manhattan and the greater New York metropolitan area.

As of March 31, 2016, our total portfolio contained 10.1 million rentable square feet of office and retail space. We owned 14 office properties (including three long-term ground leasehold interests) encompassing approximately 9.4 million rentable square feet of office space. Nine of these properties are located in the midtown Manhattan market and aggregate approximately 7.5 million rentable square feet of office space, including the Empire State Building. Our Manhattan office properties also contain an aggregate of 516,201 rentable square feet of retail space on their ground floor and/or contiguous levels. Our remaining five office properties are located in Fairfield County, Connecticut and Westchester County, New York, encompassing in the aggregate approximately 1.9 million rentable square feet. The majority of square footage for these five properties is located in densely populated metropolitan communities with immediate access to mass transportation. Additionally, we have entitled land at the Stamford Transportation Center in Stamford, Connecticut, adjacent to one of our office properties, that will support the development of an approximately 380,000 rentable square foot office building and garage, which we refer to herein as Metro Tower. As of March 31, 2016, our portfolio included four standalone retail properties located in Manhattan and two standalone retail properties located in the city center of Westport, Connecticut, encompassing 204,452 rentable square feet in the aggregate.

We were organized as a Maryland corporation on July 29, 2011 and commenced operations upon completion of our initial public offering and related formation transactions on October 7, 2013. Our operating partnership, Empire State Realty OP, L.P., holds substantially all of our assets and conducts substantially all of our business. As of March 31, 2016, we owned approximately 45.2% of the aggregate operating partnership units in our operating partnership. Our company, as the sole general partner in our operating partnership, has responsibility and discretion in the management and control in our operating partnership, and the limited partners in our operating partnership, in such capacity, have no authority to transact business for, or participate in the management activities of, our operating partnership. Accordingly, our operating partnership has been consolidated by us. We elected to be taxed as a REIT and operate in a manner that we believe allows us to qualify as a REIT for federal income tax purposes commencing with our taxable year ended December 31, 2013.

2. Summary of Significant Accounting Policies

There have been no material changes to the summary of significant accounting policies included in the section entitled "Summary of Significant Accounting Policies" in our December 31, 2015 Annual Report on Form 10-K.

Basis of Quarterly Presentation and Principles of Consolidation

The accompanying unaudited condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”), for interim financial information, and with the rules and regulations of the Securities and Exchange Commission (the "SEC"). Accordingly, certain information and footnote disclosures required by GAAP for complete financial statements have been condensed or omitted in accordance with such rules and regulations. In the opinion of management, all adjustments and eliminations (including intercompany balances and transactions), consisting of normal recurring adjustments, considered necessary for the fair presentation of the financial statements have been included.

For purposes of comparison, certain items shown in the 2015 unaudited condensed consolidated financial statements have been reclassified to conform to the presentation used for 2016. For all periods presented, certain Empire State

Building public relations costs previously included in property operating expenses are included in observatory expenses. For the three months ended March 31, 2016 and 2015, these costs were $1.0 million and $0.4 million, respectively.

The results of operations for the periods presented are not necessarily indicative of the results that may be expected for the corresponding full years. These financial statements should be read in conjunction with the financial statements and accompanying notes included in the financial statements for the year ended December 31, 2015 contained in our Annual Report on Form 10-K. We do not consider our business to be subject to material seasonal fluctuations, except that our observatory business is subject to tourism seasonality. During the past ten years, approximately 16.0% to 18.0% of our annual observatory revenue was realized in the first quarter, 26.0% to 28.0% was realized in the second quarter, 31.0% to 33.0% was realized in the third quarter and 23.0% to 25.0% was realized in the fourth quarter.

We consolidate entities in which we have a controlling financial interest. In determining whether we have a controlling financial interest in a partially owned entity and the requirement to consolidate the accounts of that entity, we consider factors such as ownership interest, board representation, management representation, authority to make decisions, and contractual and substantive participating rights of the partners/members as well as whether the entity is a variable interest entity (“VIE”) and we are the primary beneficiary. The primary beneficiary of a VIE is the entity that has (i) the power to direct the activities that most significantly impact the entity's economic performance and (ii) the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could be significant to the VIE. The primary beneficiary is required to consolidate the VIE.

On January 1, 2016, we adopted accounting guidance under the Financial Accounting Standards Board ("FASB")Accounting Standards Codification Topic 810, Consolidation, modifying the analysis we must perform to determine whether we should consolidate certain types of legal entities. The guidance does not amend the existing disclosure requirements for variable interest entities or voting interest model entities. The guidance, however, modified the requirements to qualify under the voting interest model. Under the revised guidance, our operating partnership, Empire State Realty OP, L.P., is a variable interest entity of our company, Empire State Realty Trust, Inc. As the operating partnership is already consolidated in the balance sheets of Empire State Realty Trust, Inc., the identification of this entity as a variable interest entity had no impact on our consolidated financial statements. There were no other legal entities qualifying under the scope of the revised guidance that were consolidated as a result of the adoption.

We will assess the accounting treatment for each investment we may have in the future. This assessment will include a review of each entity’s organizational agreement to determine which party has what rights and whether those rights are protective or participating. For all VIEs, we will review such agreements in order to determine which party has the power to direct the activities that most significantly impact the entity’s economic performance and benefit. In situations where we or our partner could approve, among other things, the annual budget, or leases that cover more than a nominal amount of space relative to the total rentable space at each property, we would not consolidate the investment as we consider these to be substantive participation rights that result in shared power of the activities that would most significantly impact the performance and benefit of such joint venture investment.

A non-controlling interest in a consolidated subsidiary is defined as the portion of the equity (net assets) in a subsidiary not attributable, directly or indirectly, to a parent. Non-controlling interests are required to be presented as a separate component of equity in the condensed consolidated balance sheets and in the condensed consolidated statements of income by requiring earnings and other comprehensive income to be attributed to controlling and non-controlling interests.

Accounting Estimates

The preparation of the condensed consolidated financial statements in accordance with GAAP requires management to use estimates and assumptions that in certain circumstances affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Significant items subject to such estimates and assumptions include allocation of the purchase price of acquired real estate properties among tangible and intangible assets, determination of the useful life of real estate properties and other long-lived assets, valuation and impairment analysis of commercial real estate properties and other long-lived assets, estimate of percentage of completion on construction contracts, valuation of the allowance for doubtful accounts, and valuation of derivative instruments, senior unsecured notes and equity based compensation. These estimates are prepared using management’s best judgment, after considering past, current, and expected events and economic conditions. Actual results could differ from those estimates.

Derivative Instruments

We are exposed to the effect of interest rate changes and manage these risks by following policies and procedures including the use of derivatives. To manage exposure to interest rates, derivatives are used primarily to fix the rate on debt based on floating-rate indices. We record all derivatives on the balance sheet at fair value. We incorporate credit valuation adjustments to appropriately reflect both our own nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements. We measure the credit risk of our derivative instruments that are subject to master netting agreements on a net basis by counterparty portfolio. For derivatives that qualify as cash flow hedges, we report the effective portion of changes in the fair value of a derivative designated as a hedge as part of other comprehensive income (loss) and subsequently reclassify the effective portion into income in the period that the hedged item affects income. We account for the ineffective portion of changes in the fair value of a derivative directly in income. Reported net income and equity may increase or decrease prospectively, depending on future levels of interest rates and other variables affecting the fair values of derivative instruments and hedged items, but will have no effect on cash flows.

Recently Issued or Adopted Accounting Standards

During February 2016, the FASB issued Accounting Standards Update ("ASU") No. 2016-02, Leases (Topic 842), which requires that a lessee recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. ASU No. 2016-02 leaves the accounting for leases by lessors largely unchanged from previous GAAP. ASU No. 2016-02 will be effective for fiscal years beginning after December 15, 2018 and subsequent interim periods. The new standard must be adopted using a modified retrospective transition, and provides for certain practical expedients. Transition will require application of the new guidance at the beginning of the earliest comparative period presented. We are evaluating the impact of adopting this new accounting standard on our consolidated financial statements.

During January 2016, the FASB issued ASU No. 2016-01, Financial Instruments - Overall (Subtopic 825-10) - Recognition and Measurement of Financial Assets and Liabilities, which makes targeted improvements to existing generally accepted accounting principles by requiring, among others, i) equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income, and ii) public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, iii) separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements. ASU No. 2016-01 will take effect for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. We are evaluating the impact of adopting this new accounting standard on our consolidated financial statements.

During September 2015, the FASB issued ASU No. 2015-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments, which requires an acquirer to recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. Previously, adjustments to provisional amounts were applied retrospectively. This update requires an entity to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. ASU No. 2015-16 will be effective for fiscal years beginning January 1, 2016 and subsequent interim periods. The implementation of this update did not cause any material changes to our consolidated financial statements.

During June 2015, the FASB issued ASU No. 2015-10, Technical Corrections and Improvements, which contains amendments that represent changes to clarify the FASB Accounting Standards Codification ("Codification"), correct unintended application of guidance, or make minor improvements to the Codification that are not expected to have a significant effect on current accounting practice or create a significant administrative cost to most entities. The amendments in ASU No. 2015-10 that require transition guidance are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. All other amendments will be effective upon its issuance. The implementation of this update did not and is not expected to cause any material changes to our consolidated financial statements.

During April 2015, the FASB issued ASU No. 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, which amends the requirements for the presentation of debt issuance costs and requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. ASU No. 2015-03 is effective for fiscal years, beginning after December 15, 2015 and interim periods within those fiscal years. ASU No. 2015-03 was amended in August 2015 by ASU No. 2015-15, Interest - Imputation of Interest (Subtopic 835-30) - Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements, to add to the Codification SEC staff guidance that the SEC staff will not object to an entity presenting the costs of securing line-of-credit arrangements as an asset, regardless of whether there are any outstanding borrowings. The SEC Observer to the Emerging Issues Task Force announced the staff guidance in response to questions that arose after the FASB issued ASU No. 2015-03. We adopted ASU 2015-03 as of December 31, 2015.

During February 2015, the FASB issued ASU No. 2015-02, Consolidation (Topic 810) - Amendments to the Consolidation Analysis, which amends the criteria for determining which entities are considered VIEs, amends the criteria for determining if a service provider possesses a variable interest in a VIE and ends the deferral granted to investment companies for application of the VIE consolidation model. ASU No. 2015-02 is effective for fiscal years, beginning after December 15, 2015 and interim periods within those fiscal years. The implementation of this update did not cause any material changes to our consolidated financial statements.

During May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which will replace all current GAAP guidance related to revenue recognition and eliminate all industry-specific guidance. The new revenue recognition standard provides a unified model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This guidance will be effective beginning in 2017 and can be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. ASU No. 2014-09 was amended in August 2015 by ASU No. 2015-14 Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which defers the effective date of ASU No. 2014-09 for all entities by one year. Public business entities, certain not-for-profit entities, and certain employee benefit plans should apply the guidance in ASU No. 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. We are evaluating the impact of adopting this new accounting standard on our consolidated financial statements.

3. Deferred Costs, Acquired Lease Intangibles and Goodwill

Deferred costs, net consisted of the following as of March 31, 2016 and December 31, 2015 (amounts in thousands):

	March 31, 2016	December 31, 2015
Leasing costs	$127,886	$ 121,864
Acquired in-place lease value and deferred leasing costs	283,557	285,902
Acquired above-market leases	79,618	81,680
	491,061	489,446
Less: accumulated amortization	(190,502)	(178,767)
Total deferred costs, net, excluding net deferred financing costs	$300,559	$ 310,679

At March 31, 2016, there were no outstanding borrowings on our unsecured revolving credit facility. Consequently, $4.4 million of net deferred financing costs associated with the unsecured revolving credit facility was included in deferred costs, net on the condensed consolidated balance sheet at March 31, 2016.

Amortization expense related to deferred leasing costs and acquired deferred leasing costs was $5.8 million and $5.9 million for the three months ended March 31, 2016 and 2015, respectively. Amortization expense related to acquired lease intangibles was $7.7 million and $10.3 million for the three months ended March 31, 2016 and 2015, respectively.

Amortizing acquired intangible assets and liabilities consisted of the following as of March 31, 2016 and December 31, 2015 (amounts in thousands):

	March 31, 2016	December 31, 2015
Acquired below-market ground leases	$396,916	$ 396,916
Less: accumulated amortization	(14,982)	(13,025)
Acquired below-market ground leases, net	$381,934	$ 383,891

	March 31, 2016	December 31, 2015
Acquired below-market leases	$(162,314)	$(163,290)
Less: accumulated amortization	66,069	59,119
Acquired below-market leases, net	$(96,245)	$(104,171)

Rental revenue related to the amortization of below-market leases, net of above-market leases, was $4.2 million and $5.3 million for the three months ended March 31, 2016 and 2015, respectively.

As of March 31, 2016, we had goodwill of $491.5 million. Goodwill was allocated $227.5 million to the observatory reportable segment and $264.0 million to the real estate segment.

4. Debt

Debt consisted of the following as of March 31, 2016 and December 31, 2015 (amounts in thousands):

			As of March 31, 2016		
	Principal Balance as of March 31, 2016	Principal Balance as of December 31, 2015	Stated Rate	Effective Rate(1)	Maturity Date(2)
Mortgage debt collateralized by:					
Fixed rate mortgage debt					
10 Bank Street	$ 32,050	$ 32,214	5.72%	6.22 %	6/1/2017
1542 Third Avenue	18,117	18,222	5.90%	6.58 %	6/1/2017
First Stamford Place	237,842	238,765	5.65%	6.15 %	7/5/2017
1010 Third Avenue and 77 West 55th Street	26,926	27,064	5.69%	6.39 %	7/5/2017
383 Main Avenue	29,119	29,269	5.59%	6.04 %	7/5/2017
1333 Broadway	68,404	68,646	6.32%	3.77 %	1/5/2018
1400 Broadway					
(first lien mortgage loan)	68,483	68,732	6.12%	3.43 %	2/5/2018
(second lien mortgage loan)	9,548	9,600	3.35%	3.36 %	2/5/2018
112 West 34th Street					
(first lien mortgage loan)	76,126	76,406	6.01%	3.39 %	4/5/2018
(second lien mortgage loan)	9,608	9,640	6.56%	3.70 %	4/5/2018
1350 Broadway	38,205	38,348	5.87%	3.75 %	4/5/2018
Metro Center	97,465	97,950	3.59%	3.67 %	11/5/2024
10 Union Square (3)	50,000	20,289	3.70%	4.05 %	4/1/2026
Total mortgage debt	761,893	735,145			
Senior unsecured notes - exchangeable	250,000	250,000	2.63%	3.93 %	8/15/2019
Senior unsecured notes:					
Series A	100,000	100,000	3.93%	4.00 %	3/27/2025
Series B	125,000	125,000	4.09%	4.17 %	3/27/2027
Series C	125,000	125,000	4.18%	4.26 %	3/27/2030
Unsecured revolving credit facility	—	40,000	(4)	(4)	1/23/2019
Unsecured term loan facility	265,000	265,000	(5)	(5)	8/24/2022
Total principal	1,626,893	1,640,145			
Unamortized premiums, net of unamortized discount	4,112	5,181			
Deferred financing costs, net	(8,489)	(12,910)			

Total	$ 1,622,516	$ 1,632,416

(1) The effective rate is the yield as of March 31, 2016, including the effects of debt issuance costs and the amortization of the fair value of debt adjustment.
(2) Pre-payment is generally allowed for each loan upon payment of a customary pre-payment penalty.
(3) The mortgage loan collateralized by 10 Union Square was refinanced during the three months ended March 31, 2016.
(4) At March 31, 2016, the unsecured revolving credit facility bears a floating rate at 30 day LIBOR plus 1.15%. The rate at March 31, 2016 was 1.58%.
(5) The unsecured term loan facility bears a floating rate at 30 day LIBOR plus 1.60%. The rate at March 31, 2016 was 2.03%. Pursuant to a forward interest rate swap agreement, the LIBOR rate was fixed at 2.1485% for the period beginning on August 31, 2017 through maturity.

Principal Payments

Aggregate required principal payments at March 31, 2016 are as follows (amounts in thousands):

Year	Amortization	Maturities	Total
2016	$ 9,053	$—	$9,053
2017	9,904	336,009	345,913
2018	2,880	262,210	265,090
2019	2,188	250,000	252,188
2020	2,268	—	2,268
Thereafter	9,706	742,675	752,381
Total	$ 35,999	$1,590,894	$1,626,893

Deferred Financing Costs

Deferred financing costs, net, consisted of the following at March 31, 2016 and December 31, 2015 (amounts in thousands):

	March 31, 2016	December 31, 2015
Financing costs	$21,425	$20,882
Less: accumulated amortization	(8,518)	(7,972)
Total deferred financing costs, net	$12,907	$12,910

Amortization expense related to deferred financing costs was $1.3 million and $2.4 million for the three months ended March 31, 2016 and 2015, respectively, and was included in interest expense. At March 31, 2016, there were no outstanding borrowings on our unsecured revolving credit facility. Consequently, $4.4 million of net deferred financing costs associated with the unsecured revolving credit facility was included in deferred costs, net on the condensed consolidated balance sheet at March 31, 2016.

Unsecured Revolving Credit Facility

On January 23, 2015, we entered into an unsecured revolving credit agreement, which is referred to herein as the “unsecured revolving credit facility,” with Bank of America, Merrill Lynch, Goldman Sachs and the other lenders party thereto. Merrill Lynch acted as joint lead arranger; Bank of America acted as administrative agent; and Goldman Sachs acted as syndication agent and joint lead arranger.

Concurrently with entering into the unsecured revolving credit facility, on January 23, 2015, we terminated our secured revolving and term credit facility and wrote off $1.3 million of deferred financing costs. In connection with the termination of the secured revolving and term credit facility, all of the guarantors thereunder were released from their guaranty obligations, all liens created thereby were terminated, and all collateral pledged thereunder was released.

The unsecured revolving credit facility is comprised of a revolving credit facility in the maximum original principal amount of $800.0 million. The unsecured revolving credit facility contains an accordion feature that would allow us to increase the maximum aggregate principal amount to $1.25 billion under specified circumstances. As of March 31, 2016, the unsecured revolving credit facility did not have an outstanding balance.

Amounts outstanding under the unsecured revolving credit facility bear interest at a floating rate equal to, at our election, (x) a Eurodollar rate, plus a spread that ranges from 0.875% to 1.600% depending upon our leverage ratio and credit rating; or (y) a base rate, plus a spread that ranges from 0.000% to 0.600% depending upon our leverage ratio and credit rating. In addition, the unsecured revolving credit facility permits us to borrow at competitive bid rates determined in accordance with procedures described in the unsecured revolving credit facility agreement. We paid certain customary fees and expense reimbursements to enter into the unsecured revolving credit facility.

The initial maturity of the unsecured revolving credit facility is January 2019. We have the option to extend the initial term for up to two additional 6-month periods, subject to certain conditions, including the payment of an extension fee equal to 0.075% of the then outstanding commitments under the unsecured revolving credit facility.

The unsecured revolving credit facility includes the following financial covenants: (i) maximum leverage ratio of total indebtedness to total asset value of the loan parties and their consolidated subsidiaries will not exceed 60%, (ii) consolidated secured indebtedness will not exceed 40% of total asset value, (iii) tangible net worth will not be less than $745.4 million plus 75% of net equity proceeds received by us (other than proceeds received within ninety (90) days after the redemption, retirement or repurchase of ownership or equity interests in us up to the amount paid by us in connection with such redemption, retirement or repurchase, where, the net effect is that we shall not have increased our net worth as a result of any such proceeds), (iv) adjusted EBITDA (as defined in the unsecured revolving credit facility) to consolidated fixed charges will not be less than 1.50x, (v) the aggregate net operating income with respect to all unencumbered eligible properties to the portion of interest expense attributable to unsecured indebtedness will not be less than 1.75x, (vi) the ratio of total unsecured indebtedness to unencumbered asset value will not exceed 60%, and (vii) consolidated secured recourse indebtedness will not exceed 10% of total asset value (provided, however, this covenant shall not apply at any time after we achieve debt ratings from at least two of Moody's, S&P and Fitch, and such debt ratings are Baa3 or better (in the case of a rating by Moody's) or BBB- or better (in the case of a rating by S&P or Fitch)).

The unsecured revolving credit facility contains customary covenants, including limitations on liens, investment, debt, fundamental changes, and transactions with affiliates, and requires certain customary financial reports. The unsecured revolving credit facility contains customary events of default (subject in certain cases to specified cure periods), including but not limited to non-payment, breach of covenants, representations or warranties, cross-defaults, bankruptcy or other insolvency events, judgments, ERISA events, invalidity of loan documents, loss of real estate investment trust qualification, and occurrence of a change of control (as defined in the agreement for the unsecured credit facility).

As of March 31, 2016, we were in compliance with the covenants under the unsecured revolving credit facility.

Senior Unsecured Notes

Exchangeable Senior Notes

During August 2014, we issued $250.0 million principal amount of 2.625% Exchangeable Senior Notes ("2.625% Exchangeable Senior Notes") due August 15, 2019. For the three months ended March 31, 2016 and 2015, total interest expense related to the 2.625% Exchangeable Senior Notes was $2.4 million consisting of (i) the contractual interest expense of $1.6 million, (ii) the additional non-cash interest expense of $0.7 million relating to the accretion of the debt discount, and (iii) the amortization of deferred financing costs of $0.1 million.

Series A, Series B, and Series C Senior Notes
During March 2015, we issued and sold an aggregate principal amount of $350 million senior unsecured notes consisting of $100 million of 3.93% Series A Senior Notes due 2025, $125 million of 4.09% Series B Senior Notes due 2027, and $125 million of 4.18% Series C Senior Notes due 2030 (together, the "Series A, B and C Senior Notes"). Interest on the Series A, B and C Senior Notes is payable quarterly.

The terms of the Series A, B and C Senior Notes agreement include customary covenants, including limitations on liens, investment, debt, fundamental changes, and transactions with affiliates and require certain customary financial reports. The Series A, B and C Senior Notes also require compliance with financial ratios consistent with our unsecured revolving credit facility including a maximum leverage ratio, a maximum secured leverage ratio, a minimum amount of tangible net worth, a minimum fixed charge coverage ratio, a minimum unencumbered interest coverage ratio, a maximum unsecured leverage ratio and a maximum amount of secured recourse indebtedness.

The proceeds from the issuance of the Series A, B and C Senior Notes were used to repay outstanding mortgage debt, reduce amounts outstanding under the unsecured revolving credit facility and for other general corporate purposes. As of March 31, 2016, we were in compliance with the covenants under the Series A, B and C Senior Notes.

Senior Unsecured Term Loan Facility

During August 2015, we entered into a $265.0 million senior unsecured term loan facility, which is referred to herein as the "term loan facility" with Wells Fargo Bank, National Association, as administrative agent, Capital One, National Association, as syndication agent, PNC Bank, National Association, as documentation agent, and the lenders from time to time party thereto.

Amounts outstanding under the term loan facility bear interest at a floating rate equal to, at our election, (x) a LIBOR rate, plus a spread that ranges from 1.400% to 2.350% depending upon our leverage ratio and credit rating; or (y) a base rate, plus a spread that ranges from 0.400% to 1.350% depending upon our leverage ratio and credit rating. Pursuant to a forward interest rate swap agreement, we effectively fixed LIBOR at 2.1485% for $265.0 million of the term loan facility for the period beginning on August 31, 2017 through maturity. In connection with the closing of the term loan facility, we paid certain customary fees and expense reimbursements.

The term loan facility matures on August 24, 2022. We may prepay loans under the term loan facility at any time, subject to certain notice requirements. To the extent that we prepay all or any portion of a loan on or prior to August 24, 2017, we will pay a prepayment premium equal to (i) if such prepayment occurs on or prior to August 24, 2016, 2.00% of the principal amount so prepaid, and (ii) if such prepayment occurs after August 24, 2016 but on or prior to August 24, 2017, 1.00% of the principal amount so prepaid.

The terms of the term loan facility agreement include customary covenants, including limitations on liens, investment, debt, fundamental changes, and transactions with affiliates and require certain customary financial reports. The term loan facility requires compliance with financial ratios including a maximum leverage ratio, a maximum secured leverage ratio, a minimum amount of tangible net worth, a minimum fixed charge coverage ratio, a minimum unencumbered interest coverage ratio, a maximum unsecured leverage ratio and a maximum amount of secured recourse indebtedness. It also contains customary events of default (subject in certain cases to specified cure periods). These terms in the term loan facility agreement are consistent with the terms in our unsecured revolving credit facility agreement.

The proceeds from the term loan facility were used to repay borrowings made under the unsecured revolving credit facility. As of March 31, 2016, we were in compliance with the covenants under the term loan facility.

5. Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses consist of the following as of March 31, 2016 and December 31, 2015 (amounts in thousands):

	March 31, 2016	December 31, 2015
Accounts payable and accrued expenses	$74,166	$ 83,352
Payable to the estate of Leona M. Helmsley [1]	18,367	18,367
Interest rate swap agreements liability	21,294	1,922
Accrued interest payable	3,808	5,555
Due to affiliated companies	1,469	1,903
Accounts payable and accrued expenses	$119,104	$ 111,099

(1) Reflects a payable to the estate of Leona M. Helmsley in the amount of New York City transfer taxes which would have been payable in absence of the estate's exemption from such tax.

6. Financial Instruments and Fair Values

Derivative Financial Instruments

We use derivative financial instruments primarily to manage interest rate risk and such derivatives are not considered speculative. These derivative instruments are typically in the form of interest rate swap and forward agreements and the primary objective is to minimize interest rate risks associated with investing and financing activities. The counterparties of these arrangements are major financial institutions with which we may also have other financial relationships. We are exposed to credit risk in the event of non-performance by these counterparties; however, we currently do not anticipate that any of the counterparties will fail to meet their obligations.

We have agreements with our derivative counterparties that contain a provision where if we either default or are capable of being declared in default on any of our indebtedness, then we could also be declared in default on our derivative obligations. As of March 31, 2016, the fair value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for nonperformance risk, related to these agreements was $22.3 million. If we had breached any of these provisions at March 31, 2016, we could have been required to settle our obligations under the agreements at their termination value of $22.3 million.

As of March 31, 2016, we had three interest rate LIBOR swaps with an aggregate notional value of $465.0 million. The notional value does not represent exposure to credit, interest rate or market risks. The fair value of these derivative instruments, which is included in accounts payable and accrued expenses on the condensed consolidated balance sheet, amounted to $21.3 million at March 31, 2016. These interest rate swaps have been designated as cash flow hedges and hedge the future cash outflows on our mortgage debt and also on our term loan facility that is subject to a floating interest rate. As of March 31, 2016, these cash flow hedges are deemed effective and an unrealized loss of $19.4 million is reflected in the condensed consolidated statements of comprehensive income (loss) for the three months ended March 31, 2016. Amounts reported in accumulated other comprehensive income (loss) related to derivatives will be reclassified to interest expense as interest payments are made on the debt. We estimate that no amount of the current balance held in accumulated other comprehensive income (loss) will be reclassified into interest expense within the next 12 months.
The table below summarizes the terms of agreements and the fair values of our derivative financial instruments as of March 31, 2016 and December 31, 2015 (dollar amounts in thousands):

	As of March 31, 2016					March 31, 2016		December 31, 2015	
Derivative	Notional Amount	Receive Rate	Pay Rate	Effective Date	Expiration Date	Asset	Liability	Asset	Liability
Interest rate swap	$ 265,000	1 Month LIBOR	2.1485 %	August 31, 2017	August 24, 2022	$ —	$ (9,295)	$ —	$ (1,620)
Interest rate swap	100,000	3 Month LIBOR	2.5050 %	July 5, 2017	July 5, 2027	—	(5,998)	—	(148)
Interest rate swap	100,000	3 Month LIBOR	2.5050 %	July 5, 2017	July 5, 2027	—	(6,001)	—	(154)
						$ —	$ (21,294)	$ —	$ (1,922)

The table below shows the effect of our derivative financial instruments designated as cash flow hedges for the three months ended March 31, 2016 and 2015 (amounts in thousands):

Effects of Cash Flow Hedges	Three Months Ended March 31, 2016	Three Months Ended March 31, 2015
Amount of gain (loss) recognized in other comprehensive income (loss) - effective portion	$ (19,371)	$ —
Amount of gain (loss) reclassified from accumulated other comprehensive income (loss) into interest expense - effective portion	—	—
Amount of gain (loss) recognized in other income/expense - ineffective portion	—	—

Fair Valuation

The estimated fair values at March 31, 2016 and December 31, 2015 were determined by management, using available market information and appropriate valuation methodologies. Considerable judgment is necessary to interpret market data and develop estimated fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts we could realize on disposition of the financial instruments. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The fair value of derivative instruments, which is classified as Level 2, and measured on a recurring basis, is determined using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities. The fair values of interest rate swaps are determined using the market standard methodology of netting the discounted future fixed cash receipts (or payments) and the discounted expected variable cash payments (or receipts). The variable cash payments (or receipts) are based on an expectation of future interest rates (forward curves) derived from observable market interest rate curves.

The fair value of borrowings, which is classified as Level 3, is estimated by discounting the contractual cash flows of each debt to their present value using adjusted market interest rates, which is provided by a third-party specialist.

The following tables summarize the carrying estimated fair values as of our financial instruments as of March 31, 2016 and December 31, 2015 (amounts in thousands):

	March 31, 2016				
	Carrying Value	Total	Level 1	Level 2	Level 3
Interest rate swaps included in accounts payable and accrued expenses	$21,294	$21,294	$ —	$21,294	$ —
Mortgage notes payable	772,015	780,126	—	—	780,126
Senior unsecured notes - Exchangeable	239,025	251,669	—	—	251,669
Senior unsecured notes - Series A, B, and C	348,836	360,602	—	—	360,602
Unsecured term loan facility	262,640	265,000	—	—	265,000
Unsecured revolving credit facility	—	—	—	—	—

	December 31, 2015				
	Carrying Value	Total	Level 1	Level 2	Level 3
Interest rate swaps included in accounts payable and accrued expenses	$1,922	$1,922	$ —	$1,922	$ —
Mortgage notes payable	747,661	752,350	—	—	752,350
Senior unsecured notes - Exchangeable	238,208	251,391	—	—	251,391
Senior unsecured notes - Series A, B, and C	348,810	344,501	—	—	344,501
Unsecured term loan facility	262,545	265,000	—	—	265,000
Unsecured revolving credit facility	35,192	40,000	—	—	40,000

Disclosure about fair value of financial instruments is based on pertinent information available to us as of March 31, 2016 and December 31, 2015. Although we are not aware of any factors that would significantly affect the reasonableness of these fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since that date and current estimates of fair value may differ significantly from the amounts presented herein.

7. Rental Income

We lease various office spaces to tenants over terms ranging from one to 16 years. Certain leases have renewal options for additional terms. The leases provide for base monthly rentals and reimbursements for real estate taxes, escalations linked to the consumer price index or common area maintenance known as operating expense escalation. Operating expense reimbursements are reflected in our condensed consolidated statements of income as tenant expense reimbursement.

8. Commitments and Contingencies

Legal Proceedings

Except as described below, as of March 31, 2016, we were not involved in any material litigation, nor, to our knowledge, was any material litigation threatened against us or our properties, other than routine litigation arising in the ordinary course of business such as disputes with tenants. We believe that the costs and related liabilities, if any, which may result from such actions will not materially affect our condensed consolidated financial position, operating results or liquidity.

In March 2012, five putative class actions, or the "Original Class Actions," were filed in New York State Supreme Court, New York County by investors in certain of the existing entities (constituting the predecessor and the non-controlled entities) (the "Existing Entities") on March 1, 2012, March 7, 2012, March 12, 2012, March 14, 2012 and March 19, 2012. The plaintiffs asserted claims against our predecessor's management companies, Anthony E. Malkin, Peter L. Malkin, the estate of

Leona M. Helmsley, our operating partnership and us for breach of fiduciary duty, unjust enrichment and/or aiding and abetting breach of fiduciary duty. They alleged, among other things, that the terms of the consolidation and the process by which it was structured (including the valuation that was employed) are unfair to the investors in the Existing Entities, the consolidation provides excessive benefits to Malkin Holdings LLC (now our subsidiary) and its affiliates and the then-draft prospectus/consent solicitation with respect to the consolidation filed with the SEC failed to make adequate disclosure to permit a fully-informed decision about the consolidation. The complaints sought money damages and injunctive relief preventing the consolidation. The Original Class Actions were consolidated and co-lead plaintiffs' counsel were appointed by the New York State Supreme Court by order dated June 26, 2012. Further, an underlying premise of the Original Class Actions, as noted in discussions among plaintiffs' counsel and defendants' counsel, was that the consolidation had been structured in such a manner that would cause investors in Empire State Building Associates L.L.C., 60 East 42nd St. Associates L.L.C. and 250 West 57th St. Associates L.L.C. (the "subject LLCs") immediately to incur substantial tax liabilities.

The parties entered into a Stipulation of Settlement dated September 28, 2012, resolving the Original Class Actions. The Stipulation of Settlement recites that the consolidation was approved by overwhelming consent of the investors in the Existing Entities. The Stipulation of Settlement states that counsel for the plaintiff class satisfied themselves that they have received adequate access to relevant information, including the independent valuer's valuation process and methodology, that the disclosures in the Registration Statement on Form S-4, as amended, are appropriate, that the consolidation presents potential benefits, including the opportunity for liquidity and capital appreciation, that merit the investors' serious consideration and that each of the named class representatives intends to support the consolidation as modified. The Stipulation of Settlement further states that counsel for the plaintiff class are satisfied that the claims regarding tax implications, enhanced disclosures, appraisals and exchange values of the properties that would be consolidated into our company, and the interests of the investors in the Existing Entities, have been addressed adequately, and they have concluded that the settlement pursuant to the Stipulation of Settlement and opportunity to consider the proposed consolidation on the basis of revised consent solicitations are fair, reasonable, adequate and in the best interests of the plaintiff class.

The defendants in the Stipulation of Settlement denied that they committed any violation of law or breached any of their duties and did not admit that they had any liability to the plaintiffs.

The terms of the settlement include, among other things (i) a payment of $55.0 million, with a minimum of 80% in cash and maximum of 20% in freely-tradable shares of common stock and/or freely-tradable operating partnership units to be distributed, after reimbursement of plaintiffs' counsel's court-approved expenses and payment of plaintiffs' counsel's court-approved attorneys' fees (which are included within the $55.0 million settlement payment) and, in the case of shares of common stock and/or operating partnership units, after the termination of specified lock-up periods, to investors in the Existing Entities pursuant to a plan of allocation to be prepared by counsel for plaintiffs; (ii) defendants' agreement that (a) the Offering would be on the basis of a firm commitment underwriting; (b) if, during the solicitation period, any of the three subject LLCs' percentage of total exchange value is lower than what was stated in the final prospectus/consent solicitation with respect to the consolidation by 10% or more, such decrease would be promptly disclosed by defendants to investors in the subject LLCs; and (c) unless total gross proceeds of $600.0 million are raised in the Offering, defendants will not proceed with the consolidation without further approval of the subject LLCs; and (iii) defendants' agreement to make additional disclosures in the prospectus/consent solicitation with respect to the consolidation regarding certain matters (which are included therein). Investors in the Existing Entities will not be required to bear any portion of the settlement payment. The payment in settlement of the Original Class Actions will be made by the estate of Leona M. Helmsley and affiliates of Malkin Holdings LLC (provided that none of Malkin Holdings LLC's affiliates that would become our direct or indirect subsidiary in the consolidation will have any liability for such payment) and certain investors in the Existing Entities who agree to contribute. We will not bear any of the settlement payment.

The settlement further provides for the certification of a class of investors in the Existing Entities, other than defendants and other related persons and entities, and a release of any claims of the members of the class against the defendants and related persons and entities, as well as underwriters and other advisors. The release in the settlement excludes certain claims, including but not limited to, claims arising from or related to any supplement to the

Registration Statement on Form S-4 that is declared effective to which the plaintiffs' counsel objects in writing, which objection will not be unreasonably made or delayed, so long as plaintiffs' counsel has had adequate opportunity to review such supplement. There was no such supplement that plaintiff's counsel objected to in writing. The settlement was subject to court approval. It was not effective until such court approval is final, including the resolution of any appeal. Defendants continue to deny any wrongdoing or liability in connection with the allegations in the Original Class Actions.

On January 18, 2013, the parties jointly moved for preliminary approval of the settlement, for permission to send notice of the settlement to the class, and for the scheduling of a final settlement hearing. On January 28, 2013, six of the investors in Empire State Building Associates L.L.C. filed an objection to preliminary approval, and cross-moved to intervene in the Original Class Actions and for permission to file a separate complaint on behalf of the investors in Empire State Building Associates L.L.C. On February 21, 2013, the court denied the cross motion of such objecting investors, and the court denied permission for such objecting investors to file a separate complaint as part of the Original Class Actions, but permitted them to file a brief solely to support their allegation that the buyout would deprive non-consenting investors in Empire State Building Associates L.L.C. of “fair value” in violation of the New York Limited Liability Company Law. The court rejected the objecting investors’ assertion that preliminary approval be denied and granted preliminary approval of the settlement.

Pursuant to a decision issued on April 30, 2013, the court rejected the allegation regarding the New York Limited Liability Company Law and ruled in Malkin Holdings LLC’s favor, holding that such buyout provisions are legally binding and enforceable and that investors do not have the rights they claimed under the New York Limited Liability Company Law.

On May 2, 2013, the court held a hearing regarding final approval of the Original Class Actions settlement, at the conclusion of which the court stated that it intended to approve the settlement. On May 17, 2013, the court issued its Opinion and Order. The court rejected the objections by all objectors and upheld the settlement in its entirety. Of the approximately 4,500 class members who are investors in all of the Existing Entities included in the consolidation, 12 opted out of the settlement. Those who opted out will not receive any share of the settlement proceeds, but can pursue separate claims for monetary damages.

Also on May 17, 2013, the court issued its Opinion and Order on attorneys’ fees. Class counsel applied for an award of $15.0 million in fees and $295,895 in expenses, which the court reduced to $11.59 million in fees and $265,282 in expenses (which are included within the $55.0 million settlement payment).

The investors who challenged the buyout provision filed a notice of appeal of the court’s April 30, 2013 decision and moved before the appellate court for a stay of all proceedings relating to the settlement, including such a stay as immediate interim relief. On May 1, 2013, their request for immediate interim relief was denied. On May 13, 2013, Malkin Holdings LLC filed its brief in opposition to the motion for the stay. On June 18, 2013, the appellate court denied the motion for the stay. On July 16, 2013, these investors filed their brief and other supporting papers on their appeal of the April 30, 2013 decision, which are required to perfect the appeal. On September 4, 2013, Malkin Holdings LLC filed its brief on the appeal, and also moved to dismiss the appeal on the grounds that these investors lack standing to pursue it. Malkin Holdings LLC contended that these investors were not entitled to appraisal under the New York Limited Liability Company Law because, among other reasons (i) they are not members of Empire State Building Associates L.L.C., and only members have such rights; (ii) the transaction in question is not a merger or consolidation as defined by statute, and appraisal only applies in those transactions; and (iii) when Empire State Building Associates L.L.C. was converted into a limited liability company, the parties agreed that no appraisal would apply. Moreover, Malkin Holdings LLC contended that only the 12 investors who opted out of the class action settlement could pursue appraisal, because that settlement contains a broad release of (and there is an associated bar order from the court preventing) any such claims. Malkin Holdings LLC further noted that of the six investors attempting to pursue the appeal, only two had in fact opted out of the class action settlement. On September 13, 2013, these investors filed their reply brief on the appeal, and opposed the motion to dismiss. On September 19, 2013, Malkin Holdings LLC filed its reply brief on the motion to dismiss. On October 3, 2013, the appeals court denied the motion to dismiss without prejudice to address the matter directly on the appeal, effectively referring the issues raised in the motion to the panel that was to hear the appeal itself. The appeals court heard argument on November 21, 2013, and in a Decision and Order dated February 25, 2014, it affirmed the trial court’s ruling.

In addition, on June 20, 2013, these same investors, and one additional investor who also opposed the settlement of the Original Class Action, filed additional notices of appeal from the trial court’s rulings in the Original Class Actions. These notices of appeal related to (i) the order entered February 22, 2013 granting preliminary approval of the Original Class Action settlement and setting a hearing for final approval; (ii) the order entered February 26, 2013, refusing to sign a proposed order to show cause for a preliminary injunction regarding the consolidation; (iii) an order entered April 2, 2013, denying the motion to intervene and to file a separate class action on behalf of Empire State Building Associates L.L.C. investors; (iv) the order entered April 10, 2013, refusing to sign the order to show cause seeking to extend the deadline for class members to opt out of the Original Class Action settlement; (v) the Final Judgment and Order entered May 17, 2013; (vi) the order entered May 17, 2013 approving the Original Class Action settlement; and (vii) the order entered May 17, 2013 awarding class counsel attorneys’ fees and costs. On January 6, 2014, Class counsel moved to dismiss these additional appeals on the grounds that they were not timely perfected by filing an appellate brief and record. On February 6, 2014, the appeals court granted the motion unless the appeals were perfected by March 17, 2014.

On March 27, 2014, the investors who challenged the buyout provision moved in the appellate court for reargument or in the alternative for leave to appeal the appeals court's ruling to the New York Court of Appeals. Opposition to the motion was filed on April 7, 2014. The appellate court denied the motion on May 22, 2014. The investors moved in the New York Court of Appeals for leave to appeal on June 26, 2014. Opposition to this motion was filed on July 11, 2014 and the court dismissed the motion by order dated September 18, 2014. On October 20, 2014, the investors moved to re-argue that dismissal. That motion was denied on December 17, 2014, and counsel for these investors has represented that the investors do not intend to pursue further appellate review of the court's April 30, 2013 ruling rejecting the challenge to the buyout provision. On March 3, 2015, plaintiffs' counsel filed a motion with the court for its approval of distribution of the net settlement fund. In that motion plaintiffs' counsel also asked for additional fees and expenses to be paid out of the fund. On March 20, 2015, Malkin Holdings LLC filed a response to that motion in which it supported distribution of the fund and took no position on additional fees and expenses. No opposition to the motion was filed and the court granted the motion. Substantially all of the net settlement fund has been distributed to the class, but a small amount remains outstanding.

On March 14, 2014, one of the investors who had filed a notice of appeal from the trial court's rulings in the Original Class Actions noted above perfected an appeal from the court's May 17, 2013 Final Judgment and Order and orders approving the Original Class Action Settlement and awarding class counsel attorneys' fees and costs. By stipulation of all counsel to the appeal dated September 12, 2014, the appeal was dismissed with prejudice. No other appeals were filed by the March 17, 2014 deadline set by the appeals court in its February 6, 2014 order. The Original Class Actions Settlement is final and non-appealable.

In addition, commencing December 24, 2013, four putative class actions, or the "Second Class Actions," were filed in New York State Supreme Court, New York County, against Malkin Holdings LLC, Peter L. Malkin, Anthony E. Malkin and Thomas N. Keltner, Jr. on behalf of former investors in Empire State Building Associates L.L.C. Generally, the Second Class Actions alleged that the defendants breached their fiduciary duties and were unjustly enriched. One of the Second Class Actions named us and our operating partnership as defendants, alleging that they aided and abetted the breaches of fiduciary duty. The Second Class Actions were consolidated on consent, and co-lead class counsel was appointed by order dated February 11, 2014. A Consolidated Amended Complaint was filed February 7, 2014, which did not name us or our operating partnership as defendants. It seeks monetary damages. On March 7, 2014, defendants filed a motion to dismiss the Second Class Actions, which the plaintiffs opposed and was fully submitted to the court on April 28, 2014. The court heard oral arguments on the motion on July 7, 2014, and the motion to dismiss was granted in a ruling entered July 21, 2014. The plaintiffs filed a notice of appeal on August 8, 2014. On January 12, 2015, the plaintiffs filed a motion to supplement the record on appeal to include additional materials from the Original Class Action, which the defendants opposed. The motion was denied on March 5, 2015. The plaintiffs perfected this appeal by filing their brief and the appellate record with the court on March 23, 2015. Oral argument on the appeal was held on October 28, 2015. On November 25, 2015, the appellate court affirmed dismissal of the Second Class Actions. The plaintiffs moved the appellate court for leave to appeal to the New York Court of Appeals. On March 1, 2016, the appellate court denied the motion. On March 31, 2016, the plaintiffs moved for leave to appeal in the New York Court of Appeals. That motion is fully submitted and awaiting a ruling from the Court of Appeals.

We will incur costs in connection with this litigation. If an appeal were successful and the court were ultimately to rule against the defendants there is a risk that it could have a material adverse effect on us, which could take the form of monetary damages or other equitable relief. At this time, due to the spectrum of remedies which may result from the outcome of the matter and the difficulty in calculating and allocating damages (if any) among the defendants, we cannot reasonably assess the timing or outcome of this litigation and any related indemnification obligations, estimate the amount of loss, or assess their effect, if any, on our financial statements.

On or about October 14, 2014, the 12 investors (out of approximately 4,500 investors covered by the Original Class Actions) who opted out of the Original Class Actions filed an arbitration with the American Arbitration Association against Peter L. Malkin, Anthony E. Malkin, Thomas N. Keltner, Jr., and Malkin Holdings LLC, as respondents, alleging breach of fiduciary duty and related claims in connection with the consolidation. The statement of claim in that arbitration seeks monetary damages and declaratory relief. The respondents filed an answering statement and counterclaims. On December 18, 2014, these claimants also filed a complaint in the United States District Court for the Southern District of New York alleging the same claims that they asserted in the arbitration. As alleged in the complaint, the claimants filed this lawsuit to toll the statute of limitations on their claims in the event it is determined that the claims are not subject to arbitration, and they plan to move to stay the lawsuit in favor of the pending arbitration. On February 2, 2015, the claimants filed an amended complaint adding an additional claim and making other non-substantive modifications to the original complaint. On March 12, 2015, the court stayed the action on consent of all parties pending the arbitration. The arbitration hearings are scheduled to commence May 24, 2016. As with the prior claims challenging the consolidation and related matters, the defendants believe the allegations in the arbitration are entirely without merit, and they intend to defend vigorously.

In connection with the Offering and formation transactions, we entered into indemnification agreements with our directors, executive officers and chairman emeritus, providing for the indemnification by us for certain liabilities and expenses incurred as a result of actions brought, or threatened to be brought, against them. As a result, Anthony E. Malkin, Peter L. Malkin and Thomas N. Keltner, Jr. have defense and indemnity rights from us with respect to the Second Class Actions and the above-referenced arbitration.

Additionally, there is a risk that other third parties will assert claims against us, Malkin Holdings LLC, or any other party entitled to defense and indemnity from us, including, without limitation, claims that Malkin Holdings LLC breached its fiduciary duties to investors in the Existing Entities or that the consolidation violates the relevant operating agreements, and third parties may commence litigation related to such claims. As a result, we may incur costs associated with defending or settling such litigation or paying any judgment if we lose.

Unfunded Capital Expenditures

At March 31, 2016, we estimate that we will incur approximately $59.5 million of capital expenditures (including tenant improvements and leasing commissions) on our consolidated properties pursuant to existing lease agreements. We expect to fund these capital expenditures with operating cash flow, additional property level mortgage financings, our unsecured revolving credit facility, other issuances of debt, and cash on hand. Future property acquisitions may require substantial capital investments for refurbishment and leasing costs. We expect that these financing requirements will be met in a similar fashion.

Ground Leases

Aggregate required payments on ground leases at March 31, 2016 are as follows (amounts in thousands):

2016	$1,139
2017	1,518
2018	1,518
2019	1,518
2020	1,518
Thereafter	56,730
	$63,941

Concentration of Credit Risk

Financial instruments that subject us to credit risk consist primarily of cash, restricted cash, tenant and other receivables and deferred rent receivables. At March 31, 2016, we held on deposit at various major financial institutions cash and cash equivalents and restricted cash balances in excess of amounts insured by the Federal Deposit Insurance Corporation.

Asset Retirement Obligations

We are required to accrue costs that we are legally obligated to incur on retirement of our properties which result from acquisition, construction, development and/or normal operation of such properties. Retirement includes sale, abandonment or disposal of a property. Under that standard, a conditional asset retirement obligation represents a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement is conditional on a future event that may or may not be within a company’s control and a liability for a conditional asset retirement obligation must be recorded if the fair value of the obligation can be reasonably estimated. Environmental site assessments and investigations have identified asbestos or asbestos-containing building materials in certain of our properties. As of March 31, 2016, management has no plans to remove or alter these properties in a manner that would trigger federal and other applicable regulations for asbestos removal, and accordingly, the obligations to remove the asbestos or asbestos-containing building materials from these properties have indeterminable settlement dates. As such, we are unable to reasonably estimate the fair value of the associated conditional asset retirement obligation. However ongoing asbestos abatement, maintenance programs and other required documentation are carried out as required and related costs are expensed as incurred.

Other Environmental Matters

Certain of our properties have been inspected for soil contamination due to pollutants, which may have occurred prior to our ownership of these properties or subsequently in connection with its development and/or its use. Required remediation to such properties has been completed, and as of March 31, 2016, our management believes that there are no obligations related to environmental remediation other than maintaining the affected sites in conformity with the relevant authority's mandates and filing the required documents. All such maintenance costs are expensed as incurred. We expect that resolution of the environmental matters relating to the above will not have a material impact on our business, assets, consolidated financial condition, results of operations or liquidity. However, we cannot be certain that we have identified all environmental liabilities at our properties, that all necessary remediation actions have been or will be undertaken at our properties or that we will be indemnified, in full or at all, in the event that such environmental liabilities arise.

Insurance Coverage

We carry insurance coverage on our properties of types and in amounts with deductibles that we believe are in line with coverage customarily obtained by owners of similar properties.

9. Equity

Shares and Units

An operating partnership unit ("OP Unit") and a share of our common stock have essentially the same economic characteristics as they receive the same per unit profit distributions of our operating partnership. On the one-year anniversary of issuance, an OP Unit may be tendered for redemption for cash; however, we have sole and absolute discretion, and the authorized common stock, to exchange OP Units for shares of common stock on a one-for-one basis instead of cash.

Long-term incentive plan ("LTIP") units are a special class of partnership interests in our operating partnership. Each LTIP unit awarded will be deemed equivalent to an award of one share of stock under the Empire State Realty Trust, Inc. and Empire State OP, L.P. 2013 Equity Incentive Plan ("2013 Plan"), reducing the availability for other equity awards on a one-for-one basis. The vesting period for LTIP units, if any, will be determined at the time of issuance. Under the terms of the LTIP units, our operating partnership will revalue for tax purposes its assets upon the occurrence of certain specified events, and any increase in valuation from the time of grant until such event will be allocated first to the holders of LTIP units to equalize the capital accounts of such holders with the capital accounts of OP unitholders. Subject to any agreed upon exceptions, once vested and having achieved parity with OP unitholders, LTIP units are convertible into OP Units in our operating partnership on a one-for-one basis.

With the exception of performance based LTIP units granted in 2016, all LTIP units issued in connection with annual equity awards, whether vested or not, receive the same per unit distributions as operating partnership units, which equal per share dividends (both regular and special) on our common stock. Performance based LTIP units granted in 2016 will receive 10% of such distributions currently, unless and until such LTIP units are earned based on performance, at which time they will receive the accrued and unpaid 90% and will commence receiving 100% of such distributions.

The following is net income attributable to common stockholders and the issuance of our Class A shares in exchange for the conversion of OP Units into common stock (amounts in thousands):

	Three Months Ended March 31, 2016	Three Months Ended March 31, 2015
Net income attributable to common stockholders	$7,428	$3,138
Increase in additional paid-in capital for the conversion of OP Units into common stock	6,858	19,493
Change from net income attributable to common stockholders and transfers from noncontrolling interests	$14,286	$22,631

As of March 31, 2016, there were 269,438,815 OP Units outstanding, of which 121,746,700, or 45.2%, were owned by us and 147,692,115, or 54.8%, were owned by other limited partners, including certain directors, officers and other members of executive management.

Dividends and Distributions

Total dividends paid to common stockholders were $10.3 million and $9.4 million for the three months ended March 31, 2016 and 2015, respectively. Total distributions paid to OP unitholders, excluding inter-company distributions, were $12.6 million and $13.3 million for the three months ended March 31, 2016 and 2015, respectively.

Total distributions paid to preferred unitholders were $0.2 million for the three months ended March 31, 2016 and 2015.

Incentive and Share-Based Compensation

The 2013 Plan provides for grants to directors, employees and consultants consisting of stock options, restricted stock, dividend equivalents, stock payments, performance shares, LTIP units, stock appreciation rights and other incentive awards. An aggregate of 12.2 million shares of our common stock is authorized for issuance under awards granted pursuant to the 2013 Plan, and as of March 31, 2016, 8.3 million shares of common stock remain available for future issuance.

In January 2015, we made a grant of LTIP units to an employee under the 2013 Plan. We granted a total of 9,531 LTIP units with a fair market value of $0.2 million. The award is subject to time-based vesting and all LTIP units vest on April 1, 2020, subject generally to the grantee's continued employment.

In February 2015, we made grants of LTIP units to executive officers under the 2013 Plan. At such time, we granted a total of 168,033 LTIP units that are subject to time-based vesting and 154,266 LTIP units that are subject to performance-based vesting, with fair market values of $2.9 million for the time-based vesting awards and $1.3 million for the performance-based vesting awards. The awards subject to time-based vesting vest ratably over four years from January 1, 2015, subject generally to the grantee's continued employment. The first installment vests on the first-year anniversary date of January 1, 2015 and the remainder will vest thereafter in three equal annual installments. The vesting of the LTIP units subject to performance-based vesting is based on the achievement of absolute and relative total stockholder return hurdles over a three-year performance period, commencing on January 1, 2015. Following the completion of the three-year performance period, our compensation committee will determine the number of LTIP units to which the grantee is entitled based on our performance relative to the performance hurdles set forth in the LTIP unit award agreements the grantee entered into in connection with the award grant. These units then vest in two installments, with the first installment vesting on January 1, 2018 and the second installment vesting on January 1, 2019, subject generally to the grantee's continued employment on those dates.

In February 2015, we made grants of LTIP units and restricted stock to certain other employees under the 2013 Plan. At such time, we granted a total of 33,398 LTIP units and 14,315 shares of restricted stock that are subject to time-based vesting and 33,398 LTIP units and 14,315 shares of restricted stock that are subject to performance-based vesting, with fair market values of $0.8 million for the time-based vesting awards and $0.4 million for the performance-based vesting awards. The awards subject to time-based vesting vest ratably over four years from January 1, 2015, subject generally to the grantee's continued employment. The first installment vests on the first-year anniversary date of January 1, 2015 and the remainder will vest thereafter in three equal annual installments. The vesting of the awards subject to performance-based vesting is based on the achievement of absolute and relative total stockholder return hurdles over a three-year performance period, commencing on January 1, 2015. Following the completion of the three-year performance period, our compensation committee will determine the number of LTIP units or shares to which the grantee is entitled based on our performance relative to the performance hurdles set forth in the award agreements the grantee entered into in connection with the award grant. These units and shares then vest in two installments, with the first installment vesting on January 1, 2018 and the second installment vesting on January 1, 2019, subject generally to the grantee's continued employment on those dates.

In February 2015, we made a grant of LTIP units to an executive officer under the 2013 Plan. At such time, we granted a total of 13,736 LTIP units that are subject to time-based vesting and 13,736 LTIP units that are subject to performance-based vesting, with fair market values of $0.2 million for the time-based vesting awards and $0.1 million for the performance-based vesting awards. The awards subject to time-based vesting vest ratably over four years from the date of the grant, subject generally to the grantee's continued employment. The first installment vests on the first-year anniversary date of the grant and the remainder will vest thereafter in three equal annual installments. The vesting of the LTIP units subject to performance-based vesting is based on the achievement of absolute and relative total stockholder return hurdles over a three-year performance period, commencing on February 1, 2015. Following the completion of the three-year performance period, our compensation committee will determine the number of LTIP units to which the grantee is entitled based on our performance relative to the performance hurdles set forth in the LTIP unit award agreements the grantee entered into in connection with the award grant. These units then vest in two installments, with the first installment vesting on February 1, 2018 and the second installment vesting on February 1, 2019, subject generally to the grantee's continued employment on those dates.

In June 2015, we made grants of LTIP units to our non-employee directors under the 2013 Plan. At such time, we granted a total of 35,082 LTIP units that are subject to time-based vesting, with fair market values of $0.6 million. The awards vest ratably over three years from the date of the grant, subject generally to the director's continued service on our Board of Directors.

We have made other grants during 2015 with fair market values of less than $0.1 million in the aggregate.

In February 2016, we made grants of LTIP units to executive officers under the 2013 Plan. At such time, we granted a total of 368,225 LTIP units that are subject to time-based vesting and 1,230,228 LTIP units that are subject to performance-based vesting, with fair market values of $5.6 million for the time-based vesting awards and $8.8 million for the performance-based vesting awards. The awards subject to time-based vesting vest ratably over four years from January 1, 2016, subject generally to the grantee's continued employment. The first installment vests on January 1, 2017 and the remainder will vest thereafter in three equal annual installments. The vesting of the LTIP units subject to performance-based vesting is based on the achievement of absolute and relative total stockholder return hurdles over a three-year performance period, commencing on January 1, 2016. Following the completion of the three-year performance period, our compensation committee will determine the number of LTIP units to which the grantee is entitled based on our performance relative to the performance hurdles set forth in the LTIP unit award agreements the grantee entered into in connection with the award grant. These units then vest in two installments, with the first installment vesting on January 1, 2019 and the second installment vesting on January 1, 2020, subject generally to the grantee's continued employment on those dates.

In February 2016, we made a grant of LTIP units to an executive officer under the 2013 Plan. We granted a total of 62,814 LTIP units with a fair market value of $1.0 million. The award is subject to time-based vesting of 30% after three years, 30% after four years, and 40% after five years, subject to the grantee's continued employment.

In February 2016, we made grants of LTIP units and restricted stock to certain other employees under the 2013 Plan. At such time, we granted a total of 47,168 LTIP units and 44,198 shares of restricted stock that are subject to time-based vesting and 112,925 LTIP units that are subject to performance-based vesting, with fair market values of $1.4 million for the time-based vesting awards and $0.8 million for the performance-based vesting awards. The awards subject to time-based vesting vest ratably over four years from January 1, 2016, subject generally to the grantee's continued employment. The first installment vests on January 1, 2017 and the remainder will vest thereafter in three equal annual installments. The vesting of the awards subject to performance-based vesting is based on the achievement of absolute and relative total stockholder return hurdles over a three-year performance period, commencing on January 1, 2016. Following the completion of the three-year performance period, our compensation committee will determine the number of LTIP units to which the grantee is entitled based on our performance relative to the performance hurdles set forth in the award agreements the grantee entered into in connection with the award grant. These units and shares then vest in two installments, with the first installment vesting on January 1, 2019 and the second installment vesting on January 1, 2020, subject generally to the grantee's continued employment on those dates.

Share-based compensation is measured at the fair value of the award on the date of grant and recognized as an expense on a straight-line basis over the vesting period. For the performance-based LTIP units and restricted stock awards, the fair value of the awards was estimated using a Monte Carlo Simulation model. Our stock price, along with the prices of the comparative indexes, is assumed to follow the Geometric Brownian Motion Process. Geometric Brownian Motion is a common assumption when modeling in financial markets, as it allows the modeled quantity (in this case the stock price) to vary randomly from its current value and take any value greater than zero. The volatilities of the returns on our stock price and the comparative indexes were estimated based on implied volatilities and historical volatilities using a six-year look-back period. The expected growth rate of the stock prices over the performance period is determined with consideration of the risk free rate as of the grant date. For LTIP units and restricted stock grants that are time-vesting, we estimate the stock compensation expense based on the fair value of the stock at the grant date.

Share-based compensation expense has been adjusted by an amount of estimated forfeitures. Forfeitures are estimated based on historical experience at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Based on an analysis of historical data, we have calculated a 0% annual forfeiture rate for members of the Board of Directors, a 0% annual forfeiture rate for executive officers, and for all other employees a 5% annual forfeiture rate. We reevaluate this analysis periodically and adjust these estimated forfeiture rates as necessary. To the extent actual results or updated estimates differ from our current estimates, such amounts will be recorded as a cumulative adjustment in the period estimates are revised.

LTIP units and restricted stock issued during the three months ended March 31, 2016 were valued at $17.5 million. The weighted-average per unit or share fair value was $9.38 for grants issued in 2016. The per unit or share granted in 2016 was estimated on the respective dates of grant using the following assumptions: an expected life of 2.8 years, a dividend rate of 2.10%, a risk-free interest rate of 0.84% and an expected price volatility of 24.0%.

No other stock options, dividend equivalents, or stock appreciation rights were issued or outstanding in 2016.
The following is a summary of restricted stock and LTIP unit activity for the three months ended March 31, 2016:

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	Restricted Stock	LTIP Units	Weighted Average Grant Price
Unvested balance at December 31, 2015	97,592	1,415,895	$ 15.20
Vested	(4,350)	(100,595)	16.52
Granted	44,198	1,821,360	15.92
Forfeited	—	—	—
Unvested balance at March 31, 2016	137,440	3,136,660	$ 15.57

The LTIP unit and restricted stock awards will immediately vest upon the later of (i) the date the grantee attains the age of 60 and (ii) the date on which grantee has first completed ten years of continuous service with our company or its affiliates. For award agreements that qualify, we recognize noncash compensation expense on the grant date for the time-based awards and ratably over the vesting period for the performance-based awards, and accordingly, we recognized $0.4 million for the three months ended March 31, 2016 and $0.5 million for the three months ended March 31, 2015. Unrecognized compensation expense was $0.7 million at March 31, 2016, which will be recognized over a period of 2.5 years.

For the remainder of the LTIP unit and restricted stock awards, we recognize noncash compensation expense ratably over the vesting period, and accordingly, we recognized noncash compensation expense of $1.7 million for the three months ended March 31, 2016 and $1.2 million for the three months ended March 31, 2015. Unrecognized compensation expense was $25.1 million at March 31, 2016, which will be recognized over a weighted average period of 3.0 years.

Earnings Per Share

Earnings per share for the three months ended March 31, 2016 and 2015 is computed as follows (amounts in thousands, except per share amounts):

	Three Months Ended March 31, 2016	March 31, 2015
Numerator - Basic:		
Net income	$16,705	$ 7,888
Private perpetual preferred unit distributions	(234)	(234)
Net income attributable to non-controlling interests	(9,043)	(4,516)
Earnings allocated to unvested shares	(8)	(7)
Net income attributable to common stockholders - basic	$7,420	$ 3,131
Numerator - Diluted:		
Net income	$16,705	$ 7,888
Private perpetual preferred unit distributions	(234)	(234)
Earnings allocated to unvested shares and LTIP units	(172)	(144)
Net income attributable to common stockholders - diluted	$16,299	$ 7,510
Denominator:		
Weighted average shares outstanding - basic	120,778	109,400
Operating partnership units	145,356	156,410
Effect of dilutive securities -		
Stock-based compensation plans	507	—
Weighted average shares outstanding - diluted	266,641	265,810
Earnings per share:		

Basic	$0.06	$ 0.03
Diluted	$0.06	$ 0.03

There were no antidilutive shares and LTIP units and 630,843 antidilutive shares and LTIP units for the three months ended March 31, 2016 and March 31, 2015, respectively.

10. Related Party Transactions

Supervisory Fee Revenue

We earned supervisory fees from affiliated entities not included in our condensed consolidated financial statements of $0.4 million for the three months ended March 31, 2016 and 2015. These fees are included within third-party management and other fees.

Property Management Fee Revenue

We earned property management fees from affiliated entities not included in our condensed consolidated financial statements of $0.1 million for the three months ended March 31, 2016 and 2015. These fees are included within third-party management and other fees.

Other

We are reimbursed at allocable cost for 647 square feet of shared office space, equipment, and administrative support, as was done prior to our formation, and we receive rent generally at market rental rate for 3,074 square feet of leased space, from entities affiliated with Anthony E. Malkin at one of our properties aggregating $0.05 million for the three months ended March 31, 2016 and 2015. In each case the space is expected to be temporary, and such affiliate has the right to cancel such lease without special payment on 90 days’ notice.

One of our directors is a general partner in an investment fund, which owns more than a 10% economic and voting interest in one of our tenants with an annualized rent of $5.8 million as of March 31, 2016.

11. Segment Reporting

We have identified two reportable segments: (1) real estate and (2) observatory. Our real estate segment includes all activities related to the ownership, management, operation, acquisition, redevelopment, repositioning and disposition of our real estate assets. Our observatory segment includes the operation of the 86th and 102nd floor observatories at the Empire State Building. These two lines of businesses are managed separately because each business requires different support infrastructures, provides different services and has dissimilar economic characteristics such as investments needed, stream of revenues and marketing strategies. We account for intersegment sales and transfers as if the sales or transfers were to third parties, that is, at current market prices. We include our historical construction operation in "Other," and it includes all activities related to providing construction services to tenants and to other entities within and outside our company. As of March 27, 2015, we no longer solicited new business for our construction management business. We completed all projects that were in progress.

The following tables provide components of segment profit for each segment for the three months ended March 31, 2016 and 2015 (amounts in thousands):

	Three Months Ended March 31, 2016			
	Real Estate	Observatory	Intersegment Elimination	Total
Revenues:				
Rental revenue	$114,908	$—	$ —	$114,908
Intercompany rental revenue	13,718	—	(13,718)	—
Tenant expense reimbursement	18,120	—	—	18,120
Observatory revenue	—	21,181	—	21,181
Third-party management and other fees	545	—	—	545
Other revenue and fees	2,320	—	—	2,320
Total revenues	149,611	21,181	(13,718)	157,074
Operating expenses:				
Property operating expenses	39,104	—	—	39,104
Intercompany rent expense	—	13,718	(13,718)	—
Ground rent expense	2,333	—	—	2,333
General and administrative expenses	10,918	—	—	10,918
Observatory expenses	—	7,755	—	7,755
Real estate taxes	23,525	—	—	23,525
Acquisition expenses	98	—	—	98
Depreciation and amortization	39,130	97	—	39,227
Total operating expenses	115,108	21,570	(13,718)	122,960
Total operating income (loss)	34,503	(389)	—	34,114
Interest expense	(17,951)	—	—	(17,951)
Income (loss) before income taxes	16,552	(389)	—	16,163
Income tax benefit (expense)	(405)	947	—	542
Net income	$16,147	$558	$ —	$16,705
Segment assets	$3,015,802	$247,569	$ —	$3,263,371
Expenditures for segment assets	$23,458	$—	$ —	$23,458

	Three Months Ended March 31, 2015	
	Real Estate	Observatory
Revenues:		
Rental revenue	$ 110,058	$ —
Intercompany rental revenue	11,664	—
Tenant expense reimbursement	18,200	—
Observatory revenue	—	18,223
Construction revenue	—	—
Third-party management and other fees	446	—
Other revenue and fees	3,348	—
Total revenues	143,716	18,223

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Deferred income tax expense (benefit)	550	4,363	(2,532
Other non-cash expenses	44	138	109
Changes in operating assets and liabilities:			
Inventories	(56,599)	(32,589)	(6,079
Prepaid income taxes	927	(1,277)	(211
Prepaid expenses and other assets	(15,655)	(16,366)	(14,875
Accounts payable	32,866	19,809	(5,451
Income taxes payable	(4,649)	1,902	11,997
Accrued salaries and wages	1,680	12,112	3,133
Deferred rent	12,143	15,886	7,855
Other accrued expenses	9,712	11,338	2,252
Net cash provided by operating activities	184,133	167,381	106,622
Investing activities:			
Purchases of investment securities	(117,371)	(234,856)	(119,746
	191,619	163,501	77,776

Sales, maturities, and redemptions of investment securities			
Capital expenditures	(113,720)	(67,795)	(44,794
Net cash used in investing activities	(39,472)	(139,150)	(86,764
Financing activities:			
Net proceeds from issuance of common stock	365	251	208
Repurchase and retirement of common stock	(1,987)	—	—
Proceeds from exercise of options to purchase common stock and vesting of restricted and performance-based restricted stock units	4,030	9,603	3,290
Common shares withheld for taxes	(7,990)	(1,504)	(1,904
Excess tax benefit related to exercises of stock options and vesting of restricted and performance-based restricted stock units	—	—	1,555
Net cash (used in) provided by financing activities	(5,582)	8,350	3,149
Net increase in cash and cash equivalents	139,079	36,581	23,007
Cash and cash equivalents at beginning of year	112,669	76,088	53,081
Cash and cash equivalents at end of year	$251,748	$112,669	$
Supplemental disclosures of cash flow information:			
Interest paid	$3	$4	$

Income taxes paid	$45,589	$51,405	$
Non-cash investing activities			
Increase in accounts payable and accrued purchases of property and equipment	$48,723	$3,093	$

See accompanying notes to consolidated financial statements.

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FIVE BELOW, INC.
Notes to Consolidated Financial Statements

(1) Summary of Significant Accounting Policies
(a) Description of Business
Five Below, Inc. (collectively with its wholly owned subsidiary as the "Company") is a specialty value retailer offering merchandise targeted at the tween and teen demographic. The Company offers an edited assortment of products, priced at $5 and below. The Company’s edited assortment of products includes select brands and licensed merchandise. The Company believes its merchandise is readily available and that there are a number of potential vendors that could be utilized, if necessary, under approximately the same terms the Company is currently receiving; thus, it is not dependent on a single vendor or a group of vendors.
The Company is incorporated in the Commonwealth of Pennsylvania and, as of February 2, 2019, operated in 33 states that include Pennsylvania, New Jersey, Delaware, Maryland, Virginia, Massachusetts, New Hampshire, West Virginia, North Carolina, New York, Connecticut, Rhode Island, Ohio, Illinois, Indiana, Michigan, Missouri, Georgia, Texas, Tennessee, Maine, Alabama, Kentucky, Kansas, Florida, South Carolina, Mississippi, Louisiana, Wisconsin, Oklahoma, Minnesota, California and Arkansas. As of February 2, 2019 and February 3, 2018, the Company operated 750 stores and 625 stores, respectively, each operating under the name “Five Below”, and in August 2016, the Company commenced selling merchandise on the internet, through the Company's fivebelow.com e-commerce website.
The Company's consolidated financial statements include the accounts of Five Below, Inc. and its subsidiary (1616 Holdings, Inc., formerly known as Five Below Merchandising, Inc.). All intercompany transactions and accounts are eliminated in the consolidation of the Company's and subsidiary's financial statements.
(b) Fiscal Year
The Company operates on a 52/53-week fiscal year ending on the Saturday closest to January 31. References to "fiscal year 2018" or "fiscal 2018" refer to the period from February 4, 2018 to February 2, 2019, which consists of a 52-week fiscal year. References to "fiscal year 2017" or "fiscal 2017" refer to the period from January 29, 2017 to February 3, 2018, which consists of a 53-week fiscal year. References to "fiscal year 2016" or "fiscal 2016" refer to the period from January 31, 2016 to January 28, 2017, which consists of a 52-week fiscal year.
(c) Cash and Cash Equivalents
The Company considers all highly liquid investments purchased with a maturity date of three months or less when purchased to be cash equivalents. Our cash equivalents consist of credit and debit card receivables, money market funds, corporate bonds and municipal bonds, which are classified as cash and cash equivalents in the accompanying consolidated balance sheets. The majority of payments due from banks for third-party credit card and debit card transactions resulting from customer purchases at the Company’s retail stores process within 24 to 48 hours, except for transactions occurring on a Friday, which are generally processed the following Monday. Amounts due from banks for these transactions classified as cash equivalents totaled $7.4 million and $6.0 million as of February 2, 2019 and February 3, 2018, respectively. Book overdrafts, which are outstanding checks in excess of funds on deposit, are recorded within accounts payable in the accompanying consolidated balance sheets and within operating activities in the accompanying consolidated statements of cash flows. As of February 2, 2019 and February 3, 2018, the Company had cash equivalents of $215.7 million and $91.2 million, respectively.
(d) Fair Value of Financial Instruments
Fair value is defined as 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. Assets and liabilities measured at fair value are classified using the following hierarchy, which is based upon the transparency of inputs to the valuation at the measurement date:
Level 1: Quoted market prices in active markets for identical assets or liabilities.
Level 2: Inputs, other than Level 1, that are either directly or indirectly observable.
Level 3: Unobservable inputs developed using the Company’s estimates and assumptions which reflect those that market participants would use.
The classification of fair value measurements within the hierarchy is based upon the lowest level of input that is significant to the measurement.

The Company’s financial instruments consist primarily of cash equivalents, short-term and long-term investment securities, accounts payable, and borrowings under a line of credit (as defined in note 4). The Company believes that: (1) the carrying value of cash equivalents and accounts payable are representative of their respective fair value due to the short-term nature of these instruments; and (2) the carrying value of the any current or future borrowings under the line of credit approximates their fair value because the line of credit’s interest rates vary with market interest rates. Under the fair value hierarchy, the fair market values of the investments in corporate bonds are level 1 while the investments in municipal bonds are level 2. The fair market values of level 2 investments are determined by management with the assistance of a third party pricing service. Since quoted prices in active markets for identical assets are not available, these prices are determined by the third party pricing service using observable market information such as quotes from less active markets and quoted prices of similar securities.
As of February 2, 2019 and February 3, 2018, the Company's short-term and long-term investment securities are classified as held-to-maturity since the Company has the intent and ability to hold the investments to maturity. Such securities are carried at amortized cost plus accrued interest and consist of the following (in thousands):

	As of February 2, 2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Market Value
Short-term:				
Corporate bonds	$83,128	$ —	$ 63	$83,065
Municipal bonds	2,284	—	2	2,282
Total	$85,412	$ —	$ 65	$85,347

	As of February 3, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Market Value
Short-term:				
Corporate bonds	$117,373	$ —	$ 177	$117,196
Municipal bonds	14,585	—	—	14,585
Total	$131,958	$ —	$ 177	$131,781
Long-term:				
Corporate bonds	$25,465	$ —	$ 170	$25,295
Municipal bonds	2,237	—	2	2,235
Total	$27,702	$ —	$ 172	$27,530

Short-term investment securities as of February 2, 2019 and February 3, 2018 all mature in one year or less.
Long-term investment securities as of February 3, 2018 all mature after one year but in less than three years.

(e) Inventories

Inventories consist of finished goods purchased for resale, including freight, and are stated at the lower of cost and net realizable value, at the individual product level. Cost is determined on a weighted average cost method. Management of the Company reviews inventory levels in order to identify slow-moving merchandise and uses markdowns to clear merchandise. Inventory cost is reduced when the selling price less costs of disposal is below cost. The Company accrues an estimate for inventory shrink for the period between the last physical count and the balance sheet date. The shrink estimate can be affected by changes in merchandise mix and changes in actual shrink trends.

(f) Prepaid Expenses and Other Current Assets

Prepaid expenses in fiscal 2018 and fiscal 2017 were $26.1 million and $17.8 million, respectively. Other current assets in fiscal 2018 and fiscal 2017 were $34.0 million and $27.6 million, respectively.

(g) Property and Equipment

Property and equipment are stated at cost. Additions and improvements are capitalized, while repairs and maintenance are charged to expense as incurred.

Depreciation and amortization is recorded using the straight-line method over the shorter of the estimated useful lives of the assets or the terms of the respective leases, if applicable. The estimated useful lives are three to ten years for furniture and fixtures and computers and equipment. Store leasehold improvements are amortized over the shorter of the useful life or the lease term plus assumed extensions, which is generally 10 years. Leasehold improvements located in the distribution centers and the new corporate headquarters are amortized over the shorter of the useful life or the lease term. Depreciation and amortization expense for property and equipment, which is included in selling, general and administrative expenses in the accompanying consolidated statements of operations, was $41.5 million, $33.2 million and $26.6 million in fiscal 2018, fiscal 2017 and fiscal 2016, respectively.

Property and equipment, net, consists of the following (in thousands):

	February 2, 2019	February 3, 2018
Land	$7,150	$—
Furniture and fixtures	145,254	114,394
Leasehold improvements	166,374	133,460
Computers and equipment	69,739	44,923
Construction in process	81,368	15,251
Property and equipment, gross	469,885	308,028
Less: Accumulated depreciation and amortization	(168,588)	(127,679)
Property and equipment, net	$301,297	$180,349

(h) Impairment of Long-Lived Assets

Long-lived assets, such as property and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. Assets are grouped and evaluated for impairment at the lowest level of which there are identifiable cash flows, which is generally at a store level. Assets are reviewed for impairment using factors including, but not limited to, the Company's future operating plans and projected cash flows. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of the asset exceeds its estimated undiscounted future cash flows, then an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Fair value is based on discounted future cash flows of the asset using a discount rate commensurate with the risk. In the event of a store closure, the Company will record an impairment charge, if appropriate, or accelerate depreciation over the revised useful life of the asset. Based on its Company's most recent analysis, management believes that no impairment of long-lived assets exists for the period ended February 2, 2019.

(i) Deferred Financing Costs

Deferred financing costs are amortized to interest expense over the term of the related credit agreement. Amortization expense in fiscal 2017 and fiscal 2016 was $40.4 thousand and $27.0 thousand, respectively. As of February 2, 2019 and February 3, 2018, the Company had an immaterial balance remaining on the balance sheet.

(j) Operating Leases

The Company leases store locations, distribution centers, the corporate headquarters and equipment used in its operations and evaluates and classifies its leases as operating or capital leases for financial reporting purposes. Any assets held under a capital lease are included in property and equipment, net.

Operating lease expense is recorded on a straight-line basis over the lease term. At the inception of a lease, the Company determines the lease term, which includes periods under the exercise of renewal options that are reasonably assured. Renewal options are exercised at the Company's sole discretion. In September 2016, the Company signed a 15 year lease for a new corporate headquarters location in Philadelphia, Pennsylvania. The Company currently occupies approximately 117,000 square feet of office space and will expand into approximately 50,000 square feet of additional office space by no later than 2020. The lease agreement expires in early 2033 with three successive options to renew for additional term up to approximately fifteen years. The distribution center in Olive Branch, Mississippi is leased under a lease agreement expiring in 2022 with options to renew for three successive five-year periods. The distribution center in Pedricktown, New Jersey is leased under a lease agreement expiring in 2025 with options to renew for three successive five-year periods. Generally, the Company's store leases have expected lease terms of ten years, which are comprised of an initial term of ten years or an initial term of five years and one assumed five-year extension, resulting in a ten-year life. The expected lease term is used to determine whether a lease is capital or operating and to calculate straight-line rent expense.

Substantially all of the Company's leases include options that allow the Company to renew or extend the lease term beyond the initial lease period, subject to terms and conditions agreed upon at the inception of the lease. Such terms and conditions include rental rates agreed upon at the inception of the lease that could represent below or above market rental rates later in the life of the lease, depending upon market conditions at the time of such renewal or extension. In addition, the Company's leases may include early termination options.

(k) Capital Leases

The Company establishes assets and liabilities for the estimated construction costs incurred under lease arrangements where the Company is considered the owner for accounting purposes only, or build-to-suit leases, to the extent the Company is involved in the construction of structural improvements or takes construction risk prior to commencement of a lease. Upon occupancy of facilities under build-to-suit leases, the Company assesses whether these arrangements qualify for sales recognition under the sale-leaseback accounting guidance. If the transaction does not qualify for sales recognition under the sale-leaseback accounting guidance, the Company continues to be the deemed accounting owner. As of February 2, 2019, the Company had approximately $7 million of a capital lease land asset and liability. There were no material capital leases as of February 3, 2018.

(l) Other Accrued Expenses

Other accrued expenses include accrued capital expenditures of $54.2 million and $5.0 million in fiscal 2018 and fiscal 2017, respectively.

(m) Deferred Rent and Other

Certain of the Company's operating leases contain either rent holidays and/or predetermined fixed escalations of minimum rental payments during the original and/or extended lease terms. For these leases, the Company recognizes the related rent expense on a straight-line basis over the life of the lease and records the difference between the amounts charged to operations and amounts paid as deferred rent. The life of the lease is the initial term plus assumed extensions. The Company also receives certain lease incentives in conjunction with entering into operating leases. These lease incentives are recorded as deferred rent at the beginning of the lease term and recognized as a reduction of rent expense over the lease term. In addition, certain of the Company's leases contain future contingent increases in rents. Such increases in rent expense are recorded in the period in which such contingent increases to the rents take place.

The following table summarizes the Company's deferred rent and other long-term liabilities balances (in thousands):

	February 2, 2019	February 3, 2018
Current:		
Deferred rent [1]	$8,228	$5,707
Total current liabilities	$8,228	$5,707
Long-term:		
Deferred rent	$84,065	$72,547
Other	—	143

Total long-term liabilities $84,065 $72,690

(1) The current portion of deferred rent is included in the other accrued expenses line item in the accompanying consolidated balance sheets.

(n) Share-Based Compensation

The Company measures the cost of employee services received in exchange for share-based compensation based on the grant date fair value of the employee stock award. The Company recognizes compensation expense generally on a straight-line basis over the employee's requisite service period (generally the vesting period of the equity grant) based on the estimated grant date fair value of restricted stock units ("RSUs") and performance-based restricted stock units ("PSUs") and uses the Black-Scholes option-pricing model for grants of stock options.

The fair value of restricted stock awards are based on the closing price of the Company's common stock on the grant date and the fair value of stock options are based on the Black-Scholes option-pricing model utilizing the closing price of the Company's common stock on the grant date as the fair value of common stock in the model. Future share-based compensation cost will increase when the Company grants additional equity awards. Modifications, cancellations or repurchases of awards after the grant date may require the Company to accelerate any remaining unearned share-based compensation cost or incur incremental compensation costs. Share-based compensation cost recognized and included in expenses for fiscal 2018, fiscal 2017 and fiscal 2016, was $12.0 million, $16.4 million and $12.0 million, respectively.

(o) Revenue Recognition

Revenue is recognized at the point of sale when control of the product is transferred to the customer at such time. Internet sales, through the Company's fivebelow.com e-commerce website, are recognized when the consumer receives the product as control transfers upon delivery. Returns are accepted under certain conditions within 14 days of purchase. Returns subsequent to the period end are immaterial; accordingly, no reserve has been recorded. Gift card sales to customers are initially recorded as liabilities and recognized as sales upon redemption for merchandise or as breakage revenue in proportion to the pattern of redemption of the gift cards by the consumer in net sales. Sales tax collected from customers and remitted to governmental authorities are accounted for on a net basis and, therefore, excluded from sales in the accompanying consolidated statements of operations.

(p) Shipping and Handling Revenues and Costs

The Company includes all shipping and handling revenue from e-commerce sales in net sales. Shipping and handling costs, which are included in cost of goods sold in the accompanying consolidated statements of operations, include both internal and third-party fulfillment and shipping costs related to the Company's e-commerce operations.

(q) Cost of Goods Sold

Cost of goods sold reflects the direct costs of purchased merchandise and inbound freight, as well as store occupancy, distribution and buying expenses. Store occupancy costs include rent, common area maintenance, utilities and property taxes for all store locations. Distribution costs include costs for receiving, processing, warehousing and shipping of merchandise to or from the Company's distribution centers and between store locations. Buying costs include compensation expense for the Company's internal buying organization.

(r) Selling, General and Administrative Expenses

Selling, general and administrative expenses include payroll and other compensation, marketing and advertising expense, depreciation and amortization expense, and other selling and administrative expenses.

(s) Vendor Allowances

The Company receives various incentives in the form of allowances, free product and promotional funds from its vendors based on product purchases and advertising activities. The amounts received are subject to changes in market conditions, vendor marketing strategies and changes in the profitability or sell-through of the related merchandise for the Company. Merchandise allowances are recorded in cost of goods and recognized in the period the related merchandise is sold. Marketing allowances are recorded in selling, general and administrative expenses and are recognized in the period the related advertising occurs to the extent the allowance is a reimbursement that is specific and incremental, and identifiable costs have been incurred by the Company to sell the vendor’s products. To the extent these conditions are not met, these allowances are recorded as merchandise allowances.

(t) Store Pre-Opening Costs

Costs incurred between completion of a new store location's construction and its opening (pre-opening costs) are charged to expense as incurred. Pre-opening costs were $6.5 million, $6.2 million and $5.1 million in fiscal 2018, fiscal 2017, and fiscal 2016, respectively, and are recorded in the accompanying consolidated statements of operations based on the nature of the expense.

(u) Advertising Costs

Advertising costs are charged to expense the first time the advertising takes place. Advertising expenses were $42.2 million, $30.8 million and $27.4 million in fiscal 2018, fiscal 2017 and fiscal 2016, respectively, and are included in selling, general and administrative expenses in the accompanying consolidated statements of operations.

(v) Income Taxes

Income taxes are accounted for under the asset-and-liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The Company recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. The Company records a valuation allowance to reduce its deferred tax assets when uncertainty regarding their realizability exists. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment.

For the fiscal year ended February 3, 2018, the Company recorded a provisional net tax benefit of $0.5 million related to the impact of the Tax Cuts and Jobs Act ("TCJA"). This provisional tax benefit included a one-time $1.5 million remeasurement charge of the net U.S. deferred tax assets to the lower enacted U.S. corporate tax rate of 21% and a $2.0 million tax benefit related to the Company's 2017 blended rate of 33.7% as a result of Section 15 of the Internal Revenue Code. December 22, 2018 marked the end of the measurement period for purposes of SAB 118. As such, the Company has completed the analysis based on legislative updates relating to the U.S. TCJA currently available and recorded no additional tax impacts for the year ended February 2, 2019. While the Company has completed its accounting of the income tax effects of the U.S. TCJA under SAB 118, the related tax impacts may differ, possibly materially, due to changes in interpretations and assumptions that the Company has made, additional guidance that may be issued by regulatory bodies, and actions and related accounting policy decisions the Company may take as a result of the new legislation.

(w) Commitments and Contingencies

Liabilities for loss contingencies arising from claims, assessments, litigation, fines and penalties, and other sources are recorded when it is probable that a liability has been incurred and the amount of the assessment can be reasonably estimated. Legal costs incurred in connection with loss contingencies are expensed as incurred.

(x) Use of Estimates

The preparation of consolidated financial statements requires management of the Company to make estimates and assumptions that affect the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include valuation allowances for inventories, income taxes and share-based compensation expense.

(y) Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)." ASU 2014-09 clarifies the principles for recognizing revenue from contracts with customers and outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The effective date of this pronouncement is for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. On February 4, 2018, the Company adopted the pronouncement using the modified retrospective method by recognizing the cumulative effect of gift card breakage as an adjustment to retained earnings resulting in a $0.5 million increase to retained earnings. The comparative information for the years ended prior to February 4, 2018 was not restated to comply with the pronouncement.

In February 2016, the FASB issued ASU 2016-02, "Leases." ASU 2016-02 requires that lease arrangements longer than 12 months result in an entity recognizing an asset and a liability. The updated guidance is effective for interim and annual periods beginning after December 15, 2018, and early adoption is permitted. The standard requires use of the modified retrospective transition approach. The Company plans to adopt this pronouncement in the first quarter of fiscal 2019, coinciding with the pronouncement's effective date. The Company's ability to adopt this standard depends on various factors including system readiness and completing an analysis of information necessary to quantify the financial statement impact. The Company has established a cross-functional team to implement the pronouncement and the Company has finalized its implementation of a leasing software solution, its assessment of the practical expedients and policy elections offered by the standard, and changes to its business processes, systems and controls to support the adoption of this standard. Additionally, the Company is in the process of developing drafts of its new footnote disclosures required under the new pronouncement that will be disclosed in the Company's Form 10-Q for the first fiscal quarter of 2019. Although the Company is still finalizing the quantitative effects of ASU 2016-02, this pronouncement will impact its statement of operations with additional expenses primarily as it relates to the treatment of certain initial direct lease costs that were previously capitalizable. The Company also expects a significant increase of approximately $600 million to $800 million in total assets and total liabilities on its consolidated balance sheets in the period of adoption given that the Company has a significant number of leases for its stores.

In March 2016, the FASB issued ASU 2016-09, "Improvements to Employee Share-Based Payment Accounting." ASU 2016-09 affects all entities that issue share-based payment awards to their employees. This accounting standards update makes several modifications to the accounting for employee share-based payment transactions, including the requirement that the excess income tax benefits or deficiencies that arise when the tax consequences of share-based compensation differ from amounts previously recognized in the consolidated statement of operations be recognized as income tax benefit or expense in the consolidated statement of operations rather than as additional paid-in capital in the consolidated balance sheets. The guidance also clarifies the classification of components of share-based awards on the consolidated statement of cash flows such that excess income tax benefits should not be presented separately from other income taxes in the consolidated statement of cash flows and, thus, should be classified as an operating activity rather than a financing activity as they are under the current guidance. ASU 2016-09 is effective for financial statements issued for annual reporting periods beginning after December 15, 2016 and interim periods within those years. The Company adopted this standard prospectively in the first quarter of fiscal 2017. This standard will result in a decrease or increase to the Company's effective tax rate, net income, and earnings per share based upon the requirement to recognize the excess income tax benefits or deficiencies in the consolidated statements of operations and change the Company's earnings per share calculation to exclude excess tax benefits previously assumed under the treasury stock method. No changes were required related to the classification of employee taxes paid for withheld shares in the Company's consolidated statements of cash flows since the Company has historically classified these within financing cash flows.

In August 2018, the FASB issued ASU 2018-15, "Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract." ASU 2018-15 requires implementation costs incurred by customers in cloud computing arrangements to be deferred over the noncancellable term of the cloud computing arrangements plus any optional renewal periods (1) that are reasonably certain to be exercised by the customer or (2) for which exercise of the renewal option is controlled by the cloud service provider. The effective date of this pronouncement is for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years, and early adoption is permitted. The standard can be adopted either using the prospective or retrospective transition approach. During the third quarter of fiscal 2018, the Company adopted the pronouncement using the prospective transition method and it did not have a significant impact on the Company's financial statements.

(2) Revenue from Contracts with Customers

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)." ASU 2014-09 clarifies the principles for recognizing revenue from contracts with customers. The Company adopted the standard on February 4, 2018 using the modified retrospective method by recognizing the cumulative effect as an adjustment to retained earnings.

Revenue Transactions

Revenue from store operations are recognized at the point of sale when control of the product is transferred to the customer at such time. Internet sales, through the Company's fivebelow.com e-commerce website, are recognized when the consumer receives the product as control transfers upon delivery. Returns subsequent to the period end are immaterial; accordingly, no reserve has been recorded. Gift card sales to customers are initially recorded as liabilities and recognized as sales upon redemption for merchandise or as breakage revenue in proportion to the pattern of redemption of the gift cards by the customer in net sales.

The transaction price for the Company’s sales are based on the item’s stated price. To the extent that the Company charges customers for shipping and handling on e-commerce sales, the Company records such amounts in net sales. Shipping and handling costs, which include fulfillment and shipping costs related to the Company's e-commerce operations, are included in costs of goods sold. The Company has chosen the pronouncement's policy election which allows it to exclude all sales taxes from net sales in the accompanying consolidated statements of operations.

Disaggregation of Revenue

The following table provides information about disaggregated revenue by groups of products: leisure, fashion and home, and party and snack (in thousands):

	Fiscal Year 2018			Fiscal Year 2017			Fiscal Year 2016		
	Amount	Percentage of Net Sales		Amount	Percentage of Net Sales		Amount	Percentage of Net Sales	
Leisure	$793,180	50.9	%	$640,961	50.1	%	$499,967	50.0	%
Fashion and home	482,424	30.9	%	402,888	31.6	%	311,994	31.2	%
Party and snack	283,959	18.2	%	234,359	18.3	%	188,449	18.8	%
Total	$1,559,563	100.0	%	$1,278,208	100.0	%	$1,000,410	100.0	%

Financial Statement Impact of Adopting ASU 2014-09

All of the Company's revenue is recognized from contracts with customers and, therefore, is subject to ASU 2014-09. The Company adopted ASU 2014-09 using a modified retrospective approach during the thirteen weeks ended May 5, 2018 and recognized the cumulative effect as an adjustment by increasing retained earnings by $0.5 million and income taxes payable by $0.1 million, and reducing accrued expenses by $0.7 million and deferred tax asset by $0.1 million. The cumulative adjustment was related to the recognition of gift card breakage. The adoption of ASU 2014-09 had an immaterial impact on the Company’s financial statements for the fifty-two weeks ended February 2, 2019.

(3) Income Per Common Share

Basic income per common share amounts are calculated using the weighted-average number of common shares outstanding for the period. Diluted income per common share amounts are calculated using the weighted-average number of common shares outstanding for the period and include the dilutive impact of exercise of stock options as well as assumed lapse of restrictions on restricted stock awards and shares currently available for purchase under the Company's Employee Stock Purchase Plan, using the treasury stock method. Performance-based restricted stock units are considered contingently issuable shares for diluted income per common share purposes and the dilutive impact, if any, is not included in the weighted-average shares until the performance conditions are met.

The following table reconciles net income and the weighted average common shares outstanding used in the computations of basic and diluted income per common share (in thousands, except for share and per share data):

	Fiscal Year		
	2018	2017	2016
Numerator:			
Net income	$149,645	$ 102,451	$ 71,840
Denominator:			
Weighted average common shares outstanding - basic	55,763,034	55,208,246	54,845,708
Dilutive impact of options, restricted stock units, and employee stock purchase plan	457,830	353,226	283,162
Weighted average common shares outstanding - diluted	56,220,864	55,561,472	55,128,870
Per common share:			
Basic income per common share	$2.68	$ 1.86	$ 1.31
Diluted income per common share	$2.66	$ 1.84	$ 1.30

The effects of the assumed exercise of stock options outstanding as of February 3, 2018 and January 28, 2017 for 66,624 and 164,440 shares of common stock, respectively, were excluded from the fiscal 2017 and fiscal 2016 calculation of diluted income per common share as their impact would have been anti-dilutive.

The effects of restricted stock units outstanding as of February 2, 2019, February 3, 2018 and January 28, 2017 for 2,315, 13,323 and 3,600 shares of common stock, respectively, were excluded from the fiscal 2018, fiscal 2017 and fiscal 2016 calculation of diluted income per common share as their impact would have been anti-dilutive.

The aforementioned excluded shares do not reflect the impact of any incremental repurchases under the treasury stock method.

(4) Line of Credit

In 2006, the Company entered into a Loan and Security Agreement (the "Loan and Security Agreement") with Wells Fargo Bank, National Association that included a revolving line of credit with advances tied to a borrowing base. The Loan and Security Agreement was amended and/or restated several times, (as amended and restated, the "Revolving Credit Facility").

The Revolving Credit Facility allows maximum borrowings of $20.0 million with advances tied to a borrowing base and expires on the earliest to occur of (i) May 16, 2017 or (ii) upon the occurrence of an event of default. The Revolving Credit Facility may be increased to $30.0 million upon certain conditions. The Revolving Credit Facility includes a $5.0 million sub-limit for the issuance of letters of credit. The borrowing base is 90% of eligible credit card receivables plus 90% of the net recovery percentage of eligible inventory less established reserves.

The Revolving Credit Facility provides for interest on borrowings, at the Company's option, at (a) a prime rate plus a margin of (i) 0.75% if excess availability is greater than or equal to 75%, (ii) 1.0% if excess availability is less than 75% but greater than or equal to 33% or (iii) 1.25% if excess availability is less than 33% or (b) a LIBOR-based rate plus a margin of (i) 1.75% if excess availability is greater than or equal to 75%, (ii) 2.00% if excess availability is less than 75% but greater than or equal to 33% or (iii) 2.25% if excess availability is less than 33%. The Revolving Credit Facility further provides for a letter of credit fee equal to the LIBOR-based rate plus (i) 1.75% if excess availability is greater than or equal to 75%, (ii) 2.00% if excess availability is less than 75% but greater than or equal to 33% or (iii) 2.25% if excess availability is less than 33%. The Revolving Credit Facility also contains an unused credit facility fee of 0.375% per annum and is subject to a servicing fee of approximately $12.0 thousand per year.

The Revolving Credit Facility includes a covenant which requires the Company to maintain minimum excess collateral availability of no less than the greater of (i) 10% of the then effective maximum credit and (ii) $3.0 million. The Revolving Credit Facility also includes customary negative and affirmative covenants including, among others, limitations on the Company's ability to (i) incur additional debt; (ii) create liens; (iii) make certain investments, loans and advances; (iv) sell assets; (v) pay dividends or make distributions or other restricted payments; (vi) engage in mergers or consolidations; or (vii) change the Company's business.

Additionally, the Revolving Credit Facility is subject to payment upon the receipt of certain proceeds, including those from the sale of certain assets, and is subject to an increase in the interest rate on borrowings and the letter of credit fee of 2.0% upon an event of default. Amounts under the Revolving Credit Facility may become due upon certain events of default including, among others, failure to comply with the Revolving Credit Facility's covenants, bankruptcy, default on certain other indebtedness or a change in control.

On May 10, 2017, the Company entered into a Fourth Amended and Restated Loan and Security Agreement (the "Amended Loan and Security Agreement"), among the Company, 1616 Holdings, Inc. and Wells Fargo Bank, National Association. The Amended Loan and Security Agreement amends and restates the Third Amended and Restated Loan and Security Agreement, dated June 12, 2013, among the Company, 1616 Holdings, Inc. and Wells Fargo Bank, National Association, which governed the Revolving Credit Facility.

The Amended Loan and Security Agreement includes a revolving line of credit in the amount of up to $20.0 million (the "Amended Revolving Credit Facility"). Pursuant to the Amended Loan and Security Agreement, advances under the Amended Revolving Credit Facility are no longer tied to a borrowing base; however, the Company is required to maintain eligible inventory at all times in an amount equal to at least $100.0 million. The Amended Revolving Credit Facility expires on the earliest to occur of (i) May 10, 2022 or (ii) an event of default. The Amended Revolving Credit Facility may be increased to up to $50.0 million, subject to certain conditions. The Amended Revolving Credit Facility also includes a $20.0 million sub limit for the issuance of letters of credit.

The Amended Loan and Security Agreement reduces the interest rate payable on borrowings to be, at the Company's option, a per annum rate equal to (a) a prime rate or (b) a LIBOR-based rate plus a margin of 1.00%. Letter of credit fees are equal to the interest rate payable on LIBOR-based loans. The interest rate and letter of credit fees under the Amended Loan and Security Agreement are subject to an increase of 2.00% per annum upon an event of default.

The Amended Loan and Security Agreement removes restrictions on the Company's ability to pay or make dividends and distributions or repurchase its stock, but the Amended Loan and Security Agreement continues to include other customary negative and affirmative covenants including, among other things, limitations on the Company's ability to (i) incur additional debt; (ii) create liens; (iii) make certain investments, loans and advances; (iv) sell assets; (v) engage in mergers or consolidations; or (vi) change its business.

The Amended Loan and Security Agreement also removes the provisions that required the Company to make prepayments on outstanding Amended Revolving Credit Facility balances upon the receipt of certain proceeds, including those from the sale of certain assets. Amounts under the Amended Revolving Credit Facility may become due upon certain events of default including, among other things, the Company's failure to comply with the Amended Revolving Credit Facility's covenants, bankruptcy, default on certain other indebtedness or a change in control.

Under the Amended Loan and Security Agreement, all obligations under the Amended Revolving Credit Facility continue to be guaranteed by 1616 Holdings, Inc., a wholly-owned subsidiary of the Company, and are secured by substantially all of the assets of the Company and 1616 Holdings, Inc.

During fiscal 2018 and fiscal 2017, the Company had no borrowings or interest expense under the Amended Revolving Credit Facility. During fiscal 2016, the Company had no borrowings or interest expense under the Revolving Credit Facility.

As of February 2, 2019 and February 3, 2018, the Company had approximately $20.0 million available on the line of credit. As of January 28, 2017, the Company had approximately $20.0 million available on the line of credit of which $19.7 million was available and $0.3 million was issued on an outstanding letter of credit obligation.

All obligations under the Amended Revolving Credit Facility and Revolving Credit Facility are secured by substantially all of the Company's assets and are guaranteed by the subsidiary. As of February 2, 2019 and February 3, 2018, the Company was in compliance with the covenants applicable to it under the Amended Revolving Credit Facility and Revolving Credit Facility.

(5) Commitments and Contingencies

Commitments

Leases

The Company leases property and equipment under non-cancelable operating leases. Certain retail store lease agreements provide for contingent rental payments if the store's net sales exceed stated levels (percentage rents) and/or contain escalation clauses, which provide for increases in base rental payments for increases in future operating costs.

Many of the Company’s leases provide for one or more renewal options for periods of five years. As of February 2, 2019, the Company’s operating lease agreements, including assumed extensions, which are generally those that take the lease to a ten-year term, expire through fiscal 2033.

The Company's minimum rental commitments under operating lease agreements, including assumed extensions, as of February 2, 2019, are as follows (in thousands):

Fiscal Year	Retail stores	Corporate office, distribution centers and other	Total
2019	$ 136,858	$ 10,529	$ 147,387
2020	139,892	11,885	151,777
2021	133,356	11,834	145,190
2022	123,858	11,441	135,299
2023	115,229	9,897	125,126
Thereafter	379,150	55,071	434,221
	$ 1,028,343	$ 110,657	$ 1,139,000

Rent expense, including base and contingent rent under operating leases, was $119.0 million, $98.2 million and $78.5 million in fiscal 2018, fiscal 2017 and fiscal 2016, respectively. Contingent rents were $0.6 million, $0.6 million and $0.5 million in fiscal 2018, fiscal 2017 and fiscal 2016, respectively.

From February 3, 2019 to March 28, 2019, the Company committed to 19 new store leases with terms of 10 years that have future minimum lease payments of approximately $35.2 million.

Other contractual commitments

The Company has an executive severance plan that is applicable to certain key employees that provide for, among other things, salary, bonus, severance, and change-in-control provisions.

As of February 2, 2019, the Company has other purchase commitments of approximately $7.4 million consisting of purchase agreements for materials that will be used in the construction of new stores.

Contingencies

Legal Matters

From time to time, the Company is involved in certain legal actions arising in the ordinary course of business. In management's opinion, the outcome of such actions will not have a material adverse effect on the Company's financial condition or results of operations.

(6) Shareholders' Equity

As of February 2, 2019, the Company is authorized to issue 120,000,000 shares of $0.01 par value common stock and 5,000,000 shares of $0.01 par value preferred stock. The holders of the common stock are entitled to one vote per share of common stock and are entitled to receive dividends if declared by the board of directors. The preferred stock may be issued from time to time in series as designated by the board of directors. The designations, powers, preferences, voting rights, privileges, options, conversion rights, and other special rights of the shares of each such series and the qualifications, limitations and restrictions thereof shall be designated by the board of directors.

Common Stock

The Company and certain of its pre-IPO shareholders are parties to an Amended and Restated Investor Rights Agreement, which provides for, among other things, certain registration rights, requiring the Company to register shares of our common stock held by such shareholders in the event the Company registers for sale, either for the Company's own account or for the account of others, shares of the Company's common stock in certain offerings.

The Five Below, Inc. 2012 Employee Stock Purchase Plan (the "ESPP") is intended to be qualified as an "employee stock purchase plan" within the meaning of Section 423 of the Internal Revenue Code of 1986. The number of shares of common stock reserved for issuance, which is subject to other limitations, is 500,000 shares. The ESPP allows eligible employees the opportunity to purchase, subject to limitations, shares of the Company's common stock through payroll deductions at a discount of 10% of the fair market value of such shares on the purchase date. In fiscal 2018, the Company issued 3,413 shares of common stock under the ESPP resulting in proceeds of $0.4 million and recorded share-based compensation expense of $32.4 thousand in connection with the ESPP related to the amount of the discount. In fiscal 2017, the Company issued 4,465 shares of common stock under the ESPP resulting in proceeds of $0.3 million and recorded share-based compensation expense of $21.3 thousand in connection with the ESPP related to the amount of the discount. In fiscal 2016, the Company issued 5,087 shares of common stock under the ESPP resulting in proceeds of $0.2 million and recorded share-based compensation expense of $19.0 thousand in connection with the ESPP related to the amount of the discount.

(7) Share-Based Compensation

Equity Incentive Plan

Pursuant to the Company's 2002 Equity Incentive Plan (the “Plan”), the Company’s board of directors may grant stock options, restricted shares and restricted stock units to officers, directors, key employees and professional service providers. The Plan, as amended, allows for the issuance of up to a total of 7,600,000 shares under the Plan. As of February 2, 2019, 3,229,566 stock options, restricted shares, or restricted stock units were available for grant.

Common Stock Options

All stock options have a term not greater than ten years. Stock options vest and become exercisable in whole or in part, in accordance with vesting conditions set by the Company’s board of directors. Options granted to date generally vest over four years from the date of grant.

Stock option activity under the Plan was as follows:

	Options outstanding	Weighted average exercise price	Weighted average remaining contractual term
Balance as of January 30, 2016	1,088,674	$ 26.31	7.5
Granted	51,611	39.30	
Forfeited	(47,881)	36.18	
Exercised	(225,767)	14.55	
Balance as of January 28, 2017	866,637	29.60	6.7
Granted	—	—	
Forfeited	(19,172)	37.13	
Exercised	(327,980)	29.27	
Balance as of February 3, 2018	519,485	29.53	5.9
Granted	—	—	
Forfeited	(71)	4.95	
Exercised	(145,157)	27.73	
Balance as of February 2, 2019	374,257	30.23	5.1
Exercisable as of February 2, 2019	326,464	$ 29.82	4.9

The Company did not grant any stock options in fiscal 2018 and fiscal 2017. The fair value of each option award granted to employees in fiscal 2016, including outside directors, is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	Fiscal Year 2016	
Expected volatility	47.6	%
Risk-free interest rate	1.6	%
Expected life of options	6.4 years	
Expected dividend yield	—	%

The Company uses the simplified method to estimate the expected term of the option. The expected volatility incorporates historical and implied volatility of similar entities whose share prices are publicly available. The risk-free rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

The per-share weighted average grant-date fair value of stock options granted to employees in fiscal 2016 was $18.89. The total intrinsic value of stock options exercised during fiscal 2018, fiscal 2017 and fiscal 2016 was $9.9 million, $9.7 million and $6.4 million, respectively. The aggregate intrinsic value of stock options exercisable and stock options outstanding as of February 2, 2019 was $31.0 million and $35.3 million, respectively. In fiscal 2018, fiscal 2017 and fiscal 2016, the Company received cash from the exercise of options of $4.0 million, $9.6 million and $3.3 million, respectively. In fiscal 2016 excess tax benefits from option exercises and vesting of restricted and performance-based restricted stock units were $1.6 million. Upon option exercise, the Company issued new shares of common stock.

Restricted Stock Units and Performance-Based Restricted Stock Units

All RSUs and PSUs vest in accordance with vesting conditions set by the compensation committee of the Company's board of directors. RSUs granted to date have vesting periods ranging from less than one year to five years from the date of grant. PSUs granted to date have vesting periods ranging from one year to five years from the date of grant, including grants that have a cumulative three year performance period, subject to satisfaction of the applicable performance goals established for the respective grant. The Company periodically assesses the probability of achievement of the performance criteria and adjusts the amount of compensation expense accordingly. Compensation is recognized over the vesting period and adjusted for the probability of achievement of the performance criteria.

RSU and PSU activity under the Plan was as follows:

	Restricted Stock Units		Performance-Based Restricted Stock Units	
	Number	Weighted-Average Grant Date Fair Value	Number	Weighted-Average Grant Date Fair Value
Non-vested balance as of January 30, 2016	211,682	$ 33.47	477,463	$ 36.48
Granted	127,787	41.33	127,160	39.22
Vested	(46,168)	37.95	(77,260)	38.83
Forfeited	(18,125)	34.84	(22,807)	34.20
Non-vested balance as of January 28, 2017	275,176	36.27	504,556	36.91
Granted	158,304	40.52	147,552	39.65
Vested	(88,550)	34.21	(141,003)	38.15
Forfeited	(35,376)	41.11	(15,446)	35.20
Non-vested balance as of February 3, 2018	309,554	38.48	495,659	37.43
Granted	115,411	77.28	121,333	69.59
Vested	(107,695)	37.98	(197,534)	35.69
Forfeited	(24,382)	43.75	(3,258)	69.03
Non-vested balance as of February 2, 2019	292,888	$ 53.52	416,200	$ 47.38

In connection with the vesting of RSUs and PSUs during fiscal 2018, the Company withheld 113,058 shares with an aggregate value of $8.0 million in satisfaction of minimum tax withholding obligations due upon vesting. In connection with the vesting of RSUs during fiscal 2017, the Company withheld 33,327 shares with an aggregate value of $1.5 million in satisfaction of minimum tax withholding obligations due upon vesting. In connection with the vesting of RSUs during fiscal 2016, the Company withheld 46,750 shares with an aggregate value of $1.9 million in satisfaction of minimum tax withholding obligations due upon vesting.

As of February 2, 2019, there was $16.1 million of total unrecognized compensation costs related to non-vested share-based compensation arrangements (including stock options, RSUs and PSUs) granted under the Plan. The cost is expected to be recognized over a weighted average vesting period of 2.3 years.

(8) Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon generation of future taxable income during the periods in which temporary differences representing net future deductible amounts become deductible.

As of February 2, 2019, no valuation allowance has been provided for net deferred tax assets as management believes that it is more likely than not that the Company will realize all deferred tax assets as of February 2, 2019.
For the fiscal year ended February 3, 2018, the Company recorded a provisional net tax benefit of $0.5 million related to the impact of the TCJA. This provisional tax benefit included a one-time $1.5 million remeasurement charge of the net U.S. deferred tax assets to the lower enacted U.S. corporate tax rate of 21% and a $2.0 million tax benefit related to the Company's 2017 blended rate of 33.7% as a result of Section 15 of the Internal Revenue Code. December 22, 2018 marked the end of the measurement period for purposes of SAB 118. As such, the Company has completed its analysis based on legislative updates relating to the U.S. TCJA currently available and recorded no additional tax impacts for the year ended February 2, 2019. While the Company has completed its accounting of the income tax effects of the U.S. TCJA under SAB 118, the related tax impacts may differ, possibly materially, due to changes in interpretations and assumptions that the Company has made, additional guidance that may be issued by regulatory bodies, and actions and related accounting policy decisions the Company may take as a result of the new legislation.
The components of the income tax expense are as follows (in thousands):

	Fiscal Year		
	2018	2017	2016
Current:			
Federal	$33,297	$45,867	$40,053
State	8,315	6,168	4,900
	41,612	52,035	44,953
Deferred:			
Federal	2,000	4,606	(1,772)
State	(1,450)	(243)	(760)
	550	4,363	(2,532)
Income tax expense	$42,162	$56,398	$42,421

The reconciliation of the statutory federal income tax rate to the Company's effective income tax rate is as follows:

	Fiscal Year		
	2018	2017	2016
Statutory federal tax rate	21.0 %	33.7 %	35.0 %
State taxes, net of federal benefit	2.8	2.4	2.4
Other (1)	(1.8)	(0.6)	(0.3)
	22.0	35.5	37.1

(1) Other line includes excess tax benefits relating to share-based payment accounting.

The effective tax rate for fiscal 2018 compared to fiscal 2017 was primarily driven by the impact of tax reform as a result of the TCJA and the adoption of ASU 2016-09, "Improvements to Employee Share-Based Payment Accounting," with respect to the requirement to recognize excess income tax benefits or deficiencies as income tax benefit or expense in the consolidated statements of operations rather than as additional paid-in capital in the consolidated balance sheets. The effective tax rate for fiscal 2017 compared to fiscal 2016 was primarily driven by discrete items, which included the impact of the adoption of ASU 2016-09 and the impact of tax reform as a result of the TCJA.

The tax effects of temporary differences that give rise to deferred tax assets and liabilities are (in thousands):

	February 2, 2019	February 3, 2018
Deferred tax assets:		
Inventories	$9,633	$7,370
Deferred revenue	472	387
Accrued bonus	3,553	595
Deferred rent	24,136	20,353
Other	4,848	5,114
Deferred tax assets	42,642	33,819
Deferred tax liabilities:		
Property and equipment	(35,642)	(25,843)
Other	(874)	(1,300)
Deferred tax liabilities	(36,516)	(27,143)
	$6,126	$6,676

The Company had no material accrual for uncertain tax positions or interest or penalties related to income taxes on the Company's balance sheets as of February 2, 2019 and February 3, 2018, and has not recognized any material uncertain tax positions or interest and/or penalties related to income taxes in the consolidated statements of operations for fiscal 2018, fiscal 2017, or fiscal 2016.

The Company files a federal income tax return as well as state tax returns. The Company's U.S. federal income tax returns for the fiscal years ended January 31, 2015 and thereafter remain subject to examination by the U.S. Internal Revenue Service. State returns are filed in various state jurisdictions, as appropriate, with varying statutes of limitation and remain subject to examination for varying periods up to three to four years depending on the state.

(9) Employee Benefit Plan

The Company has a 401(k) Retirement Savings Plan and employees can contribute up to the maximum amount allowed under law. The Company may make discretionary matching and profit sharing contributions, which vest over a period of five years from each employee's commencement of employment with the Company. During fiscal 2018, fiscal 2017 and fiscal 2016, the Company made matching contributions of $1.2 million, $0.5 million and $0.5 million, respectively.

(10) Segment Reporting

The Company evaluates performance internally and manages the business on the basis of one operating segment; therefore, it has only one reportable segment. All of the Company's identifiable assets are located in the United States. Set forth below is data for the following groups of products: leisure, fashion and home, and party and snack. The percentage of net sales represented by each product group for each of the last three fiscal years was as follows:

	Percentage of Net Sales Fiscal Year		
	2018	2017	2016
Leisure	50.9 %	50.1 %	50.0 %
Fashion and home	30.9 %	31.6 %	31.2 %
Party and snack	18.2 %	18.3 %	18.8 %
Total	100.0 %	100.0 %	100.0 %

Leisure includes items such as sporting goods, games, toys, tech, books, electronic accessories, and arts and crafts. Fashion and home includes items such as personal accessories, "attitude" t-shirts, beauty offerings, home goods and storage options. Party and snack includes items such as party and seasonal goods, greeting cards, candy and other snacks, and beverages.

(11) Quarterly Results of Operations and Seasonality (Unaudited)

Quarterly financial results for fiscal 2018 and fiscal 2017 were as follows: (in thousands except for per share data).

	Fiscal Year 2018 (1)				Fiscal Year 2017 (1) (2)			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Net sales	$602,684	$312,823	$347,734	$296,322	$504,832	$257,175	$283,320	$232,881
Gross profit	$244,005	$102,090	$121,752	$97,238	$207,490	$83,631	$98,506	$73,786
Net income	$89,262	$13,516	$25,063	$21,804	$67,377	$9,879	$16,804	$8,391
Basic income per common share	$1.60	$0.24	$0.45	$0.39	$1.22	$0.18	$0.30	$0.15
Diluted income per common share	$1.59	$0.24	$0.45	$0.39	$1.21	$0.18	$0.30	$0.15

(1) The sum of the quarterly per share amounts may not equal per share amounts reported for the fiscal year due to rounding.

(2) The Company operates on a fiscal calendar widely used by the retail industry that results in a given fiscal year consisting of a 52- or 53-week period ending on the Saturday closest to January 31 of the following year. Fiscal 2017 consists of a 53-week fiscal year and the fourth quarter of fiscal 2017 included an extra week, representing the 53rd week.

The Company's business is seasonal in nature and demand is generally the highest in the fourth fiscal quarter due to the fourth quarter holiday season and, therefore, operating results for any fiscal quarter are not necessarily indicative of results for the full fiscal year. To prepare for the holiday season, the Company must order and keep in stock more merchandise than it carries during other parts of the year. The Company expects inventory levels, along with an increase in accounts payable and accrued expenses, generally to reach their highest levels in the third and fourth fiscal quarters in anticipation of the increased net sales during the year-end holiday season. As a result of this seasonality, and generally because of variation in consumer spending habits, the Company experiences fluctuations in net sales and working capital requirements during the fiscal year.

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management has evaluated, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures, as defined in Rule 13a-15(e), as of the end of the period covered by this Annual Report on Form 10-K pursuant to Rule 13a-15(b) of the Exchange Act. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures as of the end of the period covered by this Annual Report on Form 10-K are effective at a reasonable assurance level in ensuring that information required to be disclosed in our Exchange Act reports is (1) recorded, processed, summarized and reported in a timely manner and (2) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures will prevent or detect all errors and all fraud. While our disclosure controls and procedures are designed to provide reasonable assurance of their effectiveness, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected.

Changes in Internal Control Over Financial Reporting

There were no changes to our internal control over financial reporting during the thirteen weeks ended February 2, 2019 that have materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

Management's Annual Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. The company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

Management, including the Chief Executive Officer and Chief Financial Officer, assessed the effectiveness of internal control over financial reporting as of February 2, 2019. Management based this assessment on criteria for effective internal control over financial reporting described in “Internal Control - Integrated Framework (2013)” issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management determined that, as of February 2, 2019, the company maintained effective internal control over financial reporting at a reasonable assurance level.

The effectiveness of the company’s internal control over financial reporting as of February 2, 2019 has been audited by KPMG LLP, our independent registered public accounting firm, as stated in their report dated March 28, 2019 that appears below.

Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors
Five Below, Inc.:

Opinion on Internal Control Over Financial Reporting

We have audited Five Below, Inc.'s (the Company) internal control over financial reporting as of February 2, 2019, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of February 2, 2019, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of the Company as of February 2, 2019 and February 3, 2018, the related consolidated statements of operations, changes in shareholders' equity, and cash flows for each of the fiscal years in the three-year period ended February 2, 2019, and the related notes (collectively, the consolidated financial statements), and our report dated March 28, 2019 expressed an unqualified opinion on those consolidated financial statements.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ KPMG LLP

Philadelphia, Pennsylvania
March 28, 2019

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ITEM 9B. OTHER INFORMATION
None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE
The information required by this Item 10 is included in the “Board of Directors–Nominees for Election to the Board of Directors for a Three-Year Term Expiring at the 2022 Annual Meeting,” “Board of Directors–Members of the Board of Directors Continuing in Office for a Term Expiring at the 2020 Annual Meeting,” “Board of Directors–Members of the Board of Directors Continuing in Office for a Term Expiring at the 2021 Annual Meeting,” “Executive Officers,” “Section 16(a) Beneficial Ownership Reporting Compliance,” “Board of Directors–Code of Business Conduct and Ethics,” “Board of Directors–Committees of the Board of Directors,” and “Board of Directors–Director Nomination Process” sections of our proxy statement for the 2019 annual meeting of shareholders, which will be filed with the Securities and Exchange Commission, and is incorporated by reference herein.
ITEM 11. EXECUTIVE COMPENSATION
The information required by this Item 11 is included in the “Compensation Discussion and Analysis,” “Executive Compensation,” “Board of Directors–Director Compensation,” “Board of Directors–Board Leadership Structure and Board’s Role in Risk Oversight,” “Board of Directors–Compensation Committee Interlocks and Insider Participation” and “Compensation Committee Report” sections of our proxy statement for the 2019 annual meeting of shareholders, which will be filed with the Securities and Exchange Commission, and is incorporated by reference herein.
ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS
The information required by this Item 12 is included in the “Security Ownership of Certain Beneficial Owners and Management” and “Equity Compensation Plan Information” sections of our proxy statement for the 2019 annual meeting of shareholders, which will be filed with the Securities and Exchange Commission, and is incorporated by reference herein.
ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this Item 13 is included in the “Certain Relationships and Related Party Transactions” and “Board of Directors–Director Independence” sections of our proxy statement for the 2019 annual meeting of shareholders, which will be filed with the Securities and Exchange Commission, and is incorporated by reference herein.
ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this Item 14 is included in the “Proposal 2, Ratification of Independent Registered Public Accounting Firm” section of our proxy statement for the 2019 annual meeting of shareholders, which will be filed with the Securities and Exchange Commission, and is incorporated by reference herein.

PART IV
ITEM 15. EXHIBITS AND CONSOLIDATED FINANCIAL STATEMENTS SCHEDULES

(a) 1. Consolidated Financial Statements
The consolidated financial statements of the Company filed as part of this Annual Report on Form 10-K are included in Part II, Item 8 beginning on page 44.
2. Consolidated Financial Statements Schedules
All schedules are omitted because they are not applicable or because the required information is either not material or is included in the Consolidated Financial Statements or Notes thereto.

3. Exhibits

Exhibit Number	Description
3.1	Amended and Restated Articles of Incorporation of Five Below, Inc., as currently in effect (incorporated by reference to Exhibit 3.1 of the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on September 3, 2015)
3.2	Amended and Restated Bylaws of Five Below, Inc., as currently in effect (incorporated by reference to Exhibit 3.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on October 5, 2018)
4.1	Form of Specimen Stock Certificate (incorporated by reference to Exhibit 4.1 of Amendment No. 3 to the Registration Statement on Form S-1 (File No. 333-180780) filed with the Securities and Exchange Commission on July 9, 2012)
10.1†	Five Below, Inc. 2012 Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.1 of the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on November 29, 2012)
10.2†	Five Below, Inc. Amended and Restated Equity Incentive Plan (incorporated by reference to Exhibit 10.1 of the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on September 1, 2016)
10.3†	Five Below, Inc. 2016 Performance Bonus Plan (incorporated by reference to Exhibit 10.2 of the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on September 1, 2016)
10.4a†	Form of Non-Qualified Stock Option Agreement (Employees) (used for options granted prior to May 21, 2013) (incorporated by reference to Exhibit 10.10 of the Registration Statement on Form S-1 (File No. 333-180780) filed with the Securities and Exchange Commission on April 18, 2012)
10.4b†	Form of Non-Qualified Stock Option Agreement (Employees) (used for options granted after May 21, 2013 and prior to June 30, 2014) (incorporated by reference to Exhibit 10.3 of the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on September 10, 2013)
10.4c†	Form of Non-Qualified Stock Option Agreement for Employees (used for options granted after June 30, 2014) (incorporated by reference to Exhibit 10.2 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on June 30, 2014)
10.5a†	Form of Non-Qualified Stock Option Agreement (Executives) (used for options granted prior to May 21, 2013) (incorporated by reference to Exhibit 10.11 of the Registration Statement on Form S-1 (File No. 333-180780)

filed with the Securities and Exchange Commission on April 18, 2012)

10.5b†	Form of Non-Qualified Stock Option Agreement (Executives) (used for options granted after May 21, 2013 and prior to June 30, 2014) (incorporated by reference to Exhibit 10.4 of the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on September 10, 2013)
10.5c†	Form of Non-Qualified Stock Option Agreement for Executives (used for options granted after June 30, 2014) (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on June 30, 2014)
10.6†	Form of Award Agreement for Restricted Shares under the Five Below, Inc. Equity Incentive Plan (Employees) (incorporated by reference to Exhibit 10.14 of Amendment No. 2 to the Registration Statement on Form S-1 (File No. 333-180780) filed with the Securities and Exchange Commission on June 12, 2012)
10.7†	Form of Award Agreement for Restricted Shares under the Five Below, Inc. Amended and Restated Equity Incentive Plan (Directors) (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on March 11, 2013)
10.8†	Form of Award Agreement for Restricted Stock Units (incorporated by reference to Exhibit 10.3 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on June 30, 2014)
10.9†	Form of Award Agreement for Restricted Stock Units (incorporated by reference to Exhibit 10.1 of the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on December 5, 2014)
10.10†	Form of Award Agreement for Restricted Stock Units (incorporated by reference to Exhibit 10.14 of the Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 24, 2016)
10.11†	Form of Award Agreement for Restricted Stock Units (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on October 5, 2018
10.12†	Form of Award Agreement for Performance-Based Restricted Stock Units (incorporated by reference to Exhibit 10.2 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on October 5, 2018
10.13†	Form of Director and Officer Indemnification Agreement (incorporated by reference to Exhibit 10.17 of Amendment No. 1 to the Registration Statement on Form S-1 (File No. 333-180780) filed with the Securities and Exchange Commission on May 24, 2012)
10.14†	Letter Employment Agreement, dated October 14, 2010, by and between Thomas Vellios and Five Below, Inc. (incorporated by reference to Exhibit 10.19 of the Registration Statement on Form S-1 (File No. 333-180780) filed with the Securities and Exchange Commission on April 18, 2012)
10.15†	Amendment to Employment Agreement, dated September 28, 2011, by and between Thomas Vellios and Five Below, Inc. (incorporated by reference to Exhibit 10.20 of the Registration Statement on Form S-1 (File No. 333-180780) filed with the Securities and Exchange Commission on April 18, 2012)
10.16†	Amendment, dated February 18, 2015, to Employment Letter, dated October 14, 2010, as amended, by and between Thomas Vellios and Five Below, Inc. (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on February 23, 2015)
10.17†	Letter Employment Agreement, dated April 16, 2012, by and between Kenneth R. Bull and Five Below, Inc. (incorporated by reference to Exhibit 10.21 of the Registration Statement on Form S-1 (File No. 333-180780) filed with the Securities and Exchange Commission on April 18, 2012)

10.18†	Letter Employment Agreement, dated December 10, 2014, by and between Michael Romanko and Five Below, Inc. (incorporated by reference to Exhibit 10.23 of the Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 26, 2015)
10.19†	Employment Letter and Non-Disclosure Agreement, each dated June 8, 2014, by and between Joel D. Anderson and Five Below, Inc. (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on June 12, 2014)

10.20†	Amendment to Employment Letter, dated December 4, 2014, by and between Joel D. Anderson and Five Below, Inc. (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on December 4, 2014)
10.21†	Second Amendment to Employment Letter, dated July 20, 2015, by and between Joel D. Anderson and Five Below, Inc. (incorporated by reference to Exhibit 10.1 of the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on September 3, 2015)
10.22†	Employment Letter and Non-Disclosure Agreement, each dated May 21, 2014, by and between Eric M. Specter and Five Below, Inc. (incorporated by reference to Exhibit 10.2 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on June 12, 2014)
10.23†	Amendment to Employment Letter, dated March 11, 2016, by and between Eric M. Specter and Five Below, Inc. (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on March 17, 2016)
10.24	Fourth Amended and Restated Loan and Security Agreement, dated May 10, 2017, among Five Below, Inc., 1616 Holdings, Inc., and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on May 11, 2017)
10.25†	Employment Letter, dated April 6, 2017, by and between George S. Hill and Five Below, Inc. (incorporated by reference to Exhibit 10.1 of the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on June 2, 2017)
10.26†	Five Below, Inc. Executive Severance Plan (incorporate by reference to Exhibit 10.2 of the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on June 2, 2017)
10.27†	Employment Letter, dated October 29, 2017, by and between David Makuen and Five Below, Inc. (incorporated by reference to Exhibit 10.1 of the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on December 1, 2017)
10.28†	Compensation Policy for Non-Employee Directors (incorporated by reference to Exhibit 10.28 of the Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 22, 2018)
10.29†	Employment Letter, dated February 19, 2019, and Non-Solicitation, Non-Disclosure, Non-Compete and Proprietary Information Agreement by and between Judy Werthauser and Five Below, Inc. (filed herewith)
21.1	List of Subsidiaries of the Company (filed herewith)
23.1	Consent of KPMG LLP (filed herewith)
31.1	Certification of Chief Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)
31.2	Certification of Chief Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith)

32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith)
101*	The following financial information from this Annual Report on Form 10-K, formatted in XBRL (Extensible Business Reporting Language) and furnished electronically herewith: (i) the Consolidated Balance Sheets as of February 2, 2019 and February 3, 2018; (ii) the Consolidated Statements of Operations for Fiscal Years

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2018, 2017, and 2016; (iii) the Consolidated Statements of Changes in Shareholders' Equity For Fiscal Years 2018, 2017, and 2016; (iv) the Consolidated Statements of Cash Flows for Fiscal Years 2018, 2017, and 2016 and (v) the Notes to Consolidated Financial Statements, in each case, tagged in detail.

† Management contract or compensatory plan or arrangement.

* Pursuant to applicable securities laws and regulations, this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under those sections.

ITEM 16. FORM 10-K SUMMARY

Optional disclosure not included in this report.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in Philadelphia, Pennsylvania, on the 28th day of March 2019.

FIVE BELOW, INC.

By: /s/ Joel D. Anderson
Name: Joel D. Anderson
Title: President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Thomas G. Vellios Thomas G. Vellios	Non-Executive Chairman of the Board	March 28, 2019
/s/ Joel D. Anderson Joel D. Anderson	President, Chief Executive Officer and Director (Principal Executive Officer)	March 28, 2019
/s/ Kenneth R. Bull Kenneth R. Bull	Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	March 28, 2019
/s/ Kathleen S. Barclay Kathleen S. Barclay	Director	March 28, 2019
/s/ Catherine E. Buggeln Catherine E. Buggeln	Director	March 28, 2019
/s/ Michael F. Devine III Michael F. Devine III	Director	March 28, 2019
/s/ Daniel J. Kaufman Daniel J. Kaufman	Director	March 28, 2019
/s/ Dinesh Lathi Dinesh Lathi	Director	March 28, 2019
/s/ Richard L. Markee Richard L. Markee	Director	March 28, 2019
/s/ Thomas M. Ryan Thomas M. Ryan	Director	March 28, 2019
/s/ Ronald L. Sargent Ronald L. Sargent	Director	March 28, 2019

Exhibit Index

No.	Description
10.29†	Employment Letter, dated February 19, 2019, and Non-Solicitation, Non-Disclosure, Non-Compete and Proprietary Information Agreement by and between Judy Werthauser and Five Below, Inc.
21.1	List of Subsidiaries of the Company
23.1	Consent of KPMG LLP
31.1	Certification of Chief Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101*	The following financial information from this Annual Report on Form 10-K, formatted in XBRL (Extensible Business Reporting Language) and furnished electronically herewith: (i) the Consolidated Balance Sheets as of February 2, 2019 and February 3, 2018; (ii) the Consolidated Statements of Operations for Fiscal Years 2018, 2017, and 2016; (iii) the Consolidated Statements of Changes in Shareholders' Equity For Fiscal Years 2018, 2017, and 2016; (iv) the Consolidated Statements of Cash Flows for Fiscal Years 2018, 2017, and 2016 and (v) the Notes to Consolidated Financial Statements, in each case, tagged in detail.

† Management contract or compensatory plan or arrangement

* Pursuant to applicable securities laws and regulations, this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under those sections.