NETWORK 1 SECURITY SOLUTIONS INC
Form S-3
June 21, 2005

As filed with the Securities and Exchange Commission on June 21, 2005

REGISTRATION NO. 333-______

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM S-3

REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

NETWORK-1 SECURITY SOLUTIONS, INC.
(Exact Name of Registrant as Specified in its Charter)

DELAWARE	11-3027591
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification number)

445 PARK AVENUE, SUITE 1028
NEW YORK, NEW YORK 10022
(212) 829-5700
(Address, including zip code, and telephone number, including area code, of Registrant's principal executive offices)

COREY M. HOROWITZ
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
445 PARK AVENUE, SUITE 1028
NEW YORK, NEW YORK 10022
(212) 829-5700
(Name, address, including zip code, and telephone number, including area code, of agent for service)

COPIES TO:
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845 THIRD AVENUE
NEW YORK, NEW YORK 10022
(212) 752-1000

APPROXIMATE DATE OF COMMENCEMENT OF PROPOSED SALE TO PUBLIC: From time to time after the effective date of this Registration Statement.

If the only securities being registered on this form are being offered pursuant to dividend or interest reinvestment plans, please check the following box: |_|

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1993, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box: |X|

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering: |_| __________

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering: |_| __________

If the delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box: |_|

CALCULATION OF REGISTRATION FEE

TITLE OF EACH CLASS OF SECURITIES TO BE REGISTERED	AMOUNT TO BE REGISTERED(2)	PROPOSED MAXIMUM PER SHARE OFFERING PRICE (3)	PROPOSED MAXIMUM AGGREGATE OFFERING PRICE (3)	AMOUNT OF REGISTRATIO FEE
Common Stock, par value $.01 per share	16,836,267(1)	$.73	$12,240,475	$1,446.59

(1) Includes the registration for resale of the following: (i) 2,685,000 shares of common stock and 2,063,750 shares of common stock issuable upon exercise of warrants issued in a private offering in December 2004 and January 2005, (ii) 8,471,679 shares of common stock, (iii) 1,352,152 shares of common stock issuable upon exercise of warrants issued as part of a private offering in December 1999 and (iv) 2,263,686 shares of common stock issuable upon exercise of certain other outstanding warrants and options.

(2) Pursuant to Rule 416 promulgated under the Securities Act of 1933, as amended, this Registration Statement includes an indeterminate number of additional shares of common stock as from time to time become issuable upon the exercise of certain warrants by reason of stock splits, stock dividends and other similar transactions.

(3) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(c) under the Securities Act of 1933, as amended, and based on the average of the bid and asked prices of the common stock on the OTC Bulletin Board on June 15, 2005 in accordance with Rule 457(c) under the Securities Act of 1933, as amended.

THE REGISTRANT HEREBY AMENDS THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY ITS EFFECTIVE DATE UNTIL THE REGISTRANT SHALL FILE A FURTHER AMENDMENT WHICH SPECIFICALLY STATES THAT THIS REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(A) OF THE SECURITIES ACT OF 1933 OR UNTIL THE REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE SECURITIES AND EXCHANGE COMMISSION, ACTING PURSUANT TO SAID SECTION 8(A), MAY DETERMINE.

NETWORK-1 SECURITY SOLUTIONS, INC.

16,836,267 SHARES OF COMMON STOCK

- The selling stockholders listed on pages 14 to 18 of this Prospectus are offering and selling up to 16,836,267 shares of our common stock.
- We will not receive any proceeds from the sale of these shares of common stock. We will receive proceeds if warrants and options to purchase common stock are exercised by payment of cash and those proceeds will be used for our general corporate purposes.
- Our common stock is traded on the OTC Bulletin Board under the symbol "NSSI.OB".
- On June 15, 2005, the average of the bid and ask prices for our common stock was $.73.
- This prospectus relates to the resale from time to time of:
  - 2,685,000 shares of common stock and 2,063,750 shares of common stock issuable upon exercise of warrants issued in our private offering in December 2004 and January 2005;
  - 8,471,679 shares of common stock owned by certain of our stockholders;
  - 1,352,152 shares of common stock issuable upon the exercise of outstanding warrants issued as part of our private offering in December 1999; and
  - 2,263,686 shares of common stock issuable upon exercise of certain other warrants and options.

THE SECURITIES OFFERED IN THIS PROSPECTUS INVOLVE A HIGH DEGREE OF RISK. YOU SHOULD CAREFULLY CONSIDER THE FACTORS DESCRIBED UNDER THE HEADING "RISK FACTORS" BEGINNING ON PAGE 7 OF THIS PROSPECTUS.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR PASSED UPON THE ADEQUACY OR ACCURACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

THE DATE OF THIS PROSPECTUS IS JUNE _____, 2005

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PROSPECTUS SUMMARY

This summary represents a summary of all material terms of the offering and only highlights the more detailed information that appears elsewhere, or is incorporated by reference, in this prospectus. This prospectus may not contain all the information important to you as an investor. Accordingly, you should carefully read this entire prospectus together with all other information incorporated by reference in this prospectus before deciding whether to invest in our common stock, especially the risks of investing in our common stock discussed under the caption "Risk Factors".

Unless the context otherwise requires, all references to "we," "us," "our," or the "Company" in this prospectus refer to Network-1 Security Solutions, Inc., a Delaware corporation.

THE COMPANY

Our principal business is the acquisition, development, licensing and protection of our intellectual property. We presently own six patents covering various telecommunications and data networking technologies. Our strategy is to pursue licensing and strategic business alliances with companies in industries that manufacture and sell products that make use of the technologies underlying our patents as well as with other users of the technologies who benefit directly from the technologies including corporate, educational and governmental entities.

On November 18, 2003, we acquired a portfolio of telecommunications and data networking patents (the "Patent Portfolio") from Merlot Communications, Inc., a broadband communications solutions provider. The Patent Portfolio consists of six patents issued by the U.S. Patent Office that relate to various telecommunications and data networking technologies and includes, among other things, patents covering (i) the control of power delivery over Ethernet networks for the purpose of remotely powering network devices and (ii) systems and methods for the transmission of audio, video and data over local area networks (LANs) in order to achieve higher quality of service.

Our future success is largely dependent upon our proprietary technologies, our ability to protect our intellectual property rights and enter into license agreements for our technology. The complexity of patent and common law, combined with our limited resources, create risk that our efforts to protect our proprietary technologies may not be successful. We cannot be assured that our patents will be upheld, or that third parties will not invalidate our patents. In March 2004, PowerDsine Inc. commenced litigation against us seeking, among other things, a declaratory judgment that our patent covering remote delivery of power over Ethernet cables (U.S. Patent No. 6,218,930) is invalid (See "Risk Factors - We face uncertainty as to the outcome of litigation with PowerDsine").

In February 2004, we initiated licensing efforts relating to our patent (U.S. Patent No. 6,218,930) covering the control of power delivery over Ethernet cables (the "Remote Power Patent"). The Remote Power Patent application was filed on March 11, 1999 and the patent was granted by the U.S. Office of Patent and Trademark on April 21, 2001. The Remote Power Patent expires on March 11, 2019. The Remote Power Patent relates to, among other things, several key technologies underlying the IEEE 802.3af Power Over Ethernet ("PoE") standard

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that was approved on June 13, 2003 by the Institute of Electrical and Electronic Engineers ("IEEE"). This standard governs the delivery of power over Ethernet cables in order to remotely power network connected devices, including wireless switches, wireless access points, FRID card readers, VOIP telephones, enterprise LAN switches and network cameras.

On November 30, 2004, we entered into a Master Services Agreement (the "Agreement") with ThinkFire Services USA, Ltd. ("ThinkFire") pursuant to which we granted ThinkFire the exclusive (except for our direct efforts) worldwide rights to negotiate license agreements for our Remote Power Patent with respect to certain potential licensees agreed to between the parties. We or ThinkFire may terminate the Agreement upon 60 days notice for any reason or upon 30 days notice in the event of a material breach. We have agreed to pay ThinkFire a fee not to exceed 20% of the royalty payments received from license agreements consummated by ThinkFire on its behalf.

As of May 31, 2005, we transmitted letters to approximately 85 companies offering licenses to the Remote Power Patent. To date we have not entered into any license agreements with third parties with respect to our Remote Power Patent or any of our other patents.

MARKET OVERVIEW

We have determined that our initial licensing efforts will be focused on our Remote Power Patent. Our Remote Power Patent relates to several technologies that describe a methodology for controlling the delivery of power to certain devices over an Ethernet network.

The Institute of Electrical and Electronic Engineers (IEEE) is a non-profit, technical professional association of more than 360,000 individual members in approximately 175 countries. The Standards Association of the IEEE is responsible for the creation of global industry standards for a broad range of technology industries. In 1999, at the urging of several industry vendors, the IEEE formed a task force to facilitate the adoption of a standardized methodology for the delivery of remote power over Ethernet networks which would insure interoperability among vendors of switches and terminal devices. On June 13, 2003 the IEEE Standards Association approved the 802.3af Power Over Ethernet standard (the "Standard"), which covers technologies deployed in delivering power over Ethernet cables. The Standard provides for the Power Sourcing Equipment (PSE) to be deployed in switches or as standalone midspan hubs to provide power to remote devices such as wireless access points, IP phones and network based cameras. The technology is commonly referred to as Power Over Ethernet ("PoE"). We believe our Remote Power Patent covers several of the key technologies covered by the Standard.

Ethernet is the leading local area networking technology in use today. PoE technology allows for the delivery of power over Ethernet cables rather than by separate power cords. As a result, a variety of network devices, including IP telephones, wireless LAN Access Points, web-based network security cameras, data collection terminals and other network devices, will be able to receive power over existing data cables without the need to modify the existing infrastructure to facilitate the provision of power for such devices through traditional AC outlets. Advantages such as lower installation costs, remote management capabilities, lower maintenance costs, centralized power backup, and flexibility of device location as well as the advent of worldwide power compatibility create the possibility of PoE becoming widely adopted in networks throughout the world.

PoE provides numerous benefits including quantifiable returns on investment. The cost of hiring electricians to pull power cable to remote locations used for access points or security cameras can rival or exceed the cost of the devices. Another key benefit is the need for Voice over IP power reliability in the face of power failures. Using PoE enables data center UPS systems to ensure on-going power - a function that would be difficult and expensive to implement if each phone required AC outlets.

These and other advantages such as remote management capabilities, lower maintenance costs, and flexibility of device location have led to forecasts that PoE will be widely adopted in networks throughout the world. International Data Corporation (IDC) forecasts that annual PoE sales will reach 134 million PSE switch ports (not including midspan ports) by 2008, which equates to a 5 year compound annual growth rate of 63%. A recent Gartner report estimates that PoE port shipments more than tripled in 2004 and that price premiums for such ports ranged from $45 to $65 per port and that 18% of all wiring closet switch ports shipped in 2004 were PoE-enabled.

The VOIP market is currently one of the fastest growing segments in the telecommunications industry. VOIP traffic has steadily increased over the last several years and is being deployed by service providers and carriers worldwide. IDC, a market research firm, estimates that worldwide IP telephone unit sales are set to grow from 1.5 million units in 2003 to nearly 5 million units in 2007 and overall voice-over IP equipment, which in 2003 represented a market of $3.3 billion, is expected to grow at a compound annual growth rate of 45.0% to $15.1 billion by 2007.

The ability to supply power to end-devices through Ethernet cables can be applied to other end-devices, such as advanced security cameras, RFID card readers, laptop computers, personal digital assistants and portable digital music players. As the desire to connect more end-devices to the Ethernet network grows, we believe that PoE technology will become more widely used as a method to power these end-devices.

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We also own five (5) additional patents covering various methodologies that provide for allocating bandwidth and establishing Quality of Service for delay sensitive data, such as voice, on packet data networks. Quality of Service issues become important when data networks carry packets that contain audio and video which may require priority over data packets traveling over the same network. Covered within these patents are also technologies that establish bi-directional communications control channels between network-connected devices in order to support advanced applications on traditional data networks. We believe that potential licensees of the technologies contained in these patents would be vendors deploying applications that require the low latency transport of delay sensitive data such as video over data networks.

We were incorporated under the laws of the State of Delaware in July 1990. Our executive offices are located at 445 Park Avenue, Suite 1028, New York, New York 10022 and our telephone number at that address is (212) 829-5700. Our web site can be found at http://www.network-1.com.

SHARES BEING OFFERED

This prospectus relates to the offering by the selling shareholders of an aggregate of 16,836,267 shares of our common stock, consisting of (i) 2,685,000 shares of our common stock and 2,063,750 shares of our common stock issuable upon exercise of warrants issued in our private offering in December 2004 and January 2005, (ii) 8,471,679 shares of common stock owned by certain of our stockholders, (iii) 1,352,152 shares of our common stock issuable upon exercise of warrants issued to such selling stockholders as part of our private offering in December 1999 and (iv) 2,263,686 shares of our common stock issuable upon exercise of certain other outstanding warrants and options.

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RISK FACTORS

AN INVESTMENT IN OUR COMMON STOCK INVOLVES A HIGH DEGREE OF RISK. THE RISK FACTORS LISTED BELOW ARE THOSE THAT WE CONSIDER TO BE MATERIAL TO AN INVESTMENT IN OUR COMMON STOCK AND THOSE WHICH, IF REALIZED, COULD HAVE MATERIAL ADVERSE EFFECTS ON OUR BUSINESS, FINANCIAL CONDITION OR RESULTS OF OPERATIONS AS SPECIFICALLY DISCUSSED BELOW. IN SUCH AN EVENT, THE TRADING PRICE OF OUR COMMON STOCK COULD DECLINE, AND YOU COULD LOSE ALL OR PART OF YOUR INVESTMENT. BEFORE YOU INVEST IN OUR COMMON STOCK, YOU SHOULD BE AWARE OF VARIOUS RISKS, INCLUDING THOSE DESCRIBED BELOW. YOU SHOULD CAREFULLY CONSIDER THESE RISK FACTORS, TOGETHER WITH ALL OF THE OTHER INFORMATION INCLUDED OR INCORPORATED BY REFERENCE IN THIS PROSPECTUS, BEFORE YOU DECIDE WHETHER TO PURCHASE OUR COMMON STOCK. THIS SECTION INCLUDES OR REFERS TO CERTAIN FORWARD-LOOKING STATEMENTS. YOU SHOULD REFER TO THE EXPLANATION OF THE QUALIFICATIONS AND LIMITATIONS ON SUCH FORWARD-LOOKING STATEMENTS DISCUSSED ON PAGE 13.

WE HAVE A HISTORY OF LOSSES AND NO REVENUE FROM CURRENT OPERATIONS.

We have incurred substantial operating losses since our inception, which has resulted in an accumulated deficit of $(43,720,000) as of March 31, 2005. For the years ended December 31, 2004 and 2003, we incurred net losses of $(1,953,000) and $(614,000), respectively. For the three months ended March 31, 2005, we incurred a net loss of $(731,000). We have financed our operations primarily by sales of equity securities as well as the sale of our CyberWall PLUS security software technology in May 2003. Since December 2002, when we discontinued our security software products and following the commencement of our new technology licensing business in November 2003, we have not had material revenue from operations and for the year ended December 31, 2004 and the three months ended March 31, 2005, we had no revenue from operations. Our ability to achieve revenue and generate positive cash flow from operations is dependent upon consummating licensing agreements with respect to our patented technology. We may not be successful in achieving licensing agreements with third parties and our failure to do so would have a material adverse effect on our business, financial condition and results of operations. We may not be able to achieve revenue or generate positive cash flow from operations from our new licensing business.

WE COULD BE REQUIRED TO STOP OPERATIONS IF WE ARE UNABLE TO DEVELOP OUR TECHNOLOGY LICENSING BUSINESS OR RAISE CAPITAL WHEN NEEDED.

We anticipate, based on our currently proposed plans and assumptions relating to our operations (including the timetable of costs and expenses associated with our continued operations), that our current cash position will more likely than not be sufficient to satisfy our operations and capital requirements until September 2006. However, we may expend our funds prior thereto. In the event our plans change, or our assumptions change or prove to be inaccurate (due to unanticipated expenses, difficulties, delays or otherwise), we could have insufficient funds to support our operations prior to September 2006. Our inability to obtain additional financing when needed, absent generating sufficient cash from licensing arrangements, would have a material adverse effect on the Company, requiring us to curtail or possibly cease our operations. In addition, any additional equity financing may involve substantial dilution to the interests of our then existing stockholders.

OUR NEW LICENSING BUSINESS MAY NOT BE SUCCESSFUL.

In November 2003, we entered the technology licensing business following our acquisition of six patents relating to various telecommunications and data networking technologies including, among others, patents covering the delivery of remote power over Ethernet and the transmission of audio, video and data over computer and telephony networks. Accordingly, we have a very limited history in the technology licensing business upon which an evaluation of our prospects and future performance can be made. Our prospects must be considered in light of the risks, expenses and difficulties frequently encountered in the development, operation and expansion of a new business based on patented technologies in a highly specialized and competitive market. We may not be able to achieve revenue or profitable operations from our new licensing business.

OUR FUTURE SOURCE OF LICENSING REVENUE IS UNCERTAIN.

In February 2004, we initiated our first licensing efforts relating to the technologies in our remote power patent (U.S. Patent No. 6,218,930) (the "Remote Power Patent"). To date, we have not entered into any licensing agreements with third parties with respect to our Remote Power Patent or our other patented technologies. Our inability to consummate licensing agreements and achieve revenue from our patented technologies would have a material adverse effect on our operations and our ability to continue our business. In addition, in the event we consummate license arrangements with third parties, such arrangements are not likely to produce a stable or predictable stream of revenue in the foreseeable future. Furthermore, the success of our licensing efforts depends upon the strength of our intellectual property rights.

WE ARE CURRENTLY RELYING UPON THE EFFORTS OF THINKFIRE TO CONSUMMATE LICENSING AGREEMENTS FOR OUR REMOTE POWER PATENT WITH CERTAIN SELECT POTENTIAL LICENSEES.

On November 30, 2004, we entered into a Master Services Agreement (the "Agreement") with ThinkFire Services USA, Ltd. ("ThinkFire") pursuant to which we granted ThinkFire the exclusive (except for us and related companies) worldwide rights to negotiate license agreements for the Remote Power Patent with respect to certain potential licensees agreed between the parties. Either we or ThinkFire can terminate the Agreement upon 60 days notice for any reason or upon 30 days notice in the event of a material breach. We have agreed to pay ThinkFire a fee not to exceed 20% of the royalty payments received from license agreements consummated by ThinkFire on our behalf. ThinkFire may not be successful in consummating license agreements on our behalf or even if it does, such license agreements may not result in significant royalty payments to us.

OUR SUCCESS IS DEPENDENT UPON OUR ABILITY TO PROTECT OUR PROPRIETARY TECHNOLOGIES.

Our success is substantially dependent upon our proprietary technologies and our ability to protect our intellectual property rights. We currently hold 6 patents issued by the U.S. Patent Office that relate to various telecommunications and data networking technologies and include

among other things, patents covering the transmission of audio, voice and data over computer and telephony networks and the delivery of remote PoE networks. We rely upon our patents and trade secret laws, non-disclosure agreements with our employees, consultants and third parties to protect our intellectual property rights. The complexity of patent and common law, combined with our limited resources, create risk that our efforts to protect our proprietary technologies may not be successful. We cannot assure you that our patents will be upheld or that third parties will not invalidate our patent rights. In the event our intellectual property rights are not upheld, such an event would have a material adverse effect on our company.

ANY LITIGATION TO PROTECT OUR INTELLECTUAL PROPERTY OR ANY THIRD PARTY CLAIMS TO INVALIDATE OUR PATENTS COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS.

Our success depends on our ability to protect our intellectual property rights. In the future, it may be necessary for us to commence patent litigation against third parties whom we believe require a license to our patents. In addition, we may be subject to third-party claims seeking to invalidate our patents, as is the case with the action commenced by PowerDsine relating to our Remote Power Patent as discussed below. These types of claims may subject us to costly litigation. In addition, based on our limited financial resources, we may not be able to pursue litigation as aggressively as others with substantially greater financial resources. Based on our limited financial resources, it may be necessary for us to engage third party professionals on a contingency basis pursuant to which such parties would be entitled to share in the proceeds of any successful enforcement of our intellectual property rights. If third parties making claims against us seeking to invalidate our patent are successful, they may be able to obtain injunctive or other equitable relief, which effectively could block our ability to license or otherwise capitalize on our proprietary technologies. Successful litigation against us resulting in a determination that our patents are invalid would have a material adverse effect on our company.

WE FACE UNCERTAINTY AS TO THE OUTCOME OF LITIGATION WITH POWERDSINE.

On March 31, 2004, PowerDsine Inc. ("PowerDsine") commenced an action against us in the United District Court, Southern District of New York (Civil Action No. 04 CV 2502) seeking a declaratory judgment that our Remote Power Patent is invalid and is not infringed by PowerDsine and/or its customers. PowerDsine further seeks an order permanently enjoining us (i) from making any claims to any person or entity that PowerDsine's products infringe the Remote Power Patent or contribute to infringement of the patent, (ii) from interfering with or threatening to interfere with the importation, sale, license or use of PowerDsine's PoE components or products, and (iii) from instituting or prosecuting any lawsuit or proceeding placing at issue the right of PowerDsine, its customers, licensees, successors, or assigns to import, use or sell PowerDsine's PoE components or products. We believe our Remote Power Patent is valid and that we have meritorious defenses to the action. On December 1, 2004, we moved to dismiss the declaratory judgment action asserting, among other things, that there is no actual case or controversy because PowerDsine did not have reasonable apprehension of suit at the time the case was filed, and therefore, the court lacks jurisdiction over the matter. On January 21, 2005 our motion to dismiss was denied. We have engaged in settlement discussions with PowerDsine in an effort to resolve the litigation. In the event that we are unable to settle the litigation, we intend to vigorously defend the lawsuit and take whatever actions are necessary to protect our intellectual property. In the event, however, that the Court granted the declaratory

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judgment sought by PowerDsine and our Remote Power Patent was determined to be invalid, such a determination would have a material adverse effect on us. Regardless of the outcome, this litigation may subject us to significant costs and diversion of management time.

MATERIAL LICENSING REVENUES FROM OUR REMOTE POWER PATENT MAY BE DEPENDENT UPON THE APPLICABILITY OF THE IEEE STANDARD.

The Institute of Electrical and Electronic Engineers (IEEE) is a non-profit, technical professional association of more than 360,000 individual members in approximately 175 countries. The Standards Association of the IEEE is responsible for the creation of global industry standards for a broad range of technology industries. In 1999, at the urging of several industry vendors, the IEEE formed a task force to facilitate the adoption of a standardized methodology for the delivery of remote power over Ethernet networks which would insure interoperability among vendors of switches and terminal devices. In June 2003, the IEEE Standards Association approved the 802.3af Power Over Ethernet standard (the "Standard"), which covers technologies deployed in delivering power over Ethernet cables including whether deployed in switches or as standalone midspan hubs both of which provide power to remote devices including wireless access points, IP phones and network based cameras. The technology is commonly referred to as Power Over Ethernet ("PoE"). We believe our Remote Power Patent covers several of the key technologies covered by the Standard. However, there is a risk that as a result of litigation a court may determine otherwise and such a determination would have a material adverse effect on our ability to enter into license agreements and achieve revenue and profits from our Remote Power Patent.

WE FACE INTENSE COMPETITION AND WE MAY NOT BE ABLE TO SUCCESSFULLY COMPETE.

The telecommunications and data networking market is characterized by intense competition and rapidly changing business conditions, customer requirements and technologies. Our current and potential competitors have longer operating histories, greater name recognition and possess substantially greater financial, technical, marketing and other competitive resources than us. Although we believe that we have rights to enforceable patents relating to telecommunications and data networking, there can be no assurance that third parties will not invalidate any or all of our patents. In addition, the telecommunications and data networking industries may develop technologies that may be more effective than our proprietary technologies or that render our technologies less marketable or obsolete.

OUR MARKETS ARE SUBJECT TO RAPID TECHNOLOGICAL CHANGE AND OUR TECHNOLOGIES FACE POTENTIAL TECHNOLOGY OBSOLESCENCE.

The telecommunications and data networking technology market including, transmission of audio, video and data over computer and telephony networks and the delivery of remote power over Ethernet markets, are characterized by rapid technological changes, changing customer requirements, frequent new product introductions and enhancements, and evolving industry standards. The introduction of products embodying new technologies and the emergence of new industry standards may render our technologies obsolete or less marketable. To the extent we are able to achieve revenue in the future, such revenue will be derived from licensing our technologies based on existing and evolving industry standards.

DEPENDENCE UPON CEO AND CHAIRMAN.

Our success will largely be dependent upon the personal efforts of Corey M. Horowitz, Chairman and Chief Executive Officer and Chairman of the Board of Directors. On November 26, 2004, we entered into a two (2) year employment agreement with Mr. Horowitz pursuant to which he serves as our Chairman and Chief Executive Officer. We do not maintain key man life insurance on the life of Mr. Horowitz. The loss of the services of Mr. Horowitz would have a material adverse effect on our business and prospects.

RISKS RELATED TO LOW PRICED STOCKS.

Our common stock currently trades on the OTC Bulletin Board under the symbol NSSI.OB. Since the trading price of our common stock is below $5.00 per share, our common stock is considered a penny stock. SEC regulations generally define a penny stock to be an equity security that is not listed on Nasdaq or a national securities exchange and that has a market value of less than $5.00 per share, subject to certain exceptions. SEC regulations require broker-dealers to deliver to a purchaser of our common stock a disclosure schedule explaining the penny stock market and the risks associated with it. Various sales practice requirements are also imposed on broker-dealers who sell penny stocks to persons other than established customers and accredited investors (generally institutions). Broker-dealers must also provide the customer with current bid and offer quotations for the penny stock, the compensation of the broker-dealer and monthly account statements disclosing recent price information for the penny stock held in the customer's account.

THE SIGNIFICANT NUMBER OF OPTIONS AND WARRANTS OUTSTANDING MAY ADVERSELY EFFECT THE MARKET PRICE FOR OUR COMMON STOCK.

As of May 31, 2005, there are outstanding (i) options and warrants to purchase an aggregate of 11,017,244 shares of our common stock at exercise prices ranging from $.12 to $10.13, and (ii) 207,630 additional shares of our common stock which may be issued in the future under our stock option plan. To the extent that outstanding options and warrants are exercised, stockholder percentage ownership will be diluted and any sales in the public market of the common stock underlying such options may adversely affect prevailing market prices for our common stock.

WE HAVE A SIGNIFICANT AMOUNT OF AUTHORIZED BUT UNISSUED PREFERRED STOCK, WHICH MAY AFFECT THE LIKELIHOOD OF A CHANGE OF CONTROL IN OUR COMPANY.

Our Board of Directors has the authority, without further action by the stockholders, to issue 10,000,000 shares of preferred stock on such terms and with such rights, preferences and designations as our Board of Directors may determine. Such terms may include restricting dividends on our common stock, dilution of the voting power of our common stock or impairing the liquidation rights of the holders of our common stock. Issuance of such preferred stock, depending on the rights, preferences and designations thereof, may have the effect of delaying, deterring or preventing a change in control. In addition, certain "anti-takeover" provisions in

Delaware law may restrict the ability of our stockholders to authorize a merger, business combination or change of control.

WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and current reports, proxy statements and other information with the SEC. You may read and copy any document we file at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. The SEC has prescribed rates for copying. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Our SEC filings are also available to you on the SEC's Internet site at http://www.sec.gov.

This prospectus is part of a Registration Statement on Form S-3 filed by us with the SEC under the Securities Act and therefore omits certain information in the Registration Statement. We have also filed exhibits with the Registration Statement that are not included in this prospectus, and you should refer to the applicable exhibit for a complete description of any statement referring to any document. You can inspect a copy of the Registration Statement and its exhibits, without charge, at the SEC's Public Reference Room, and can copy such material upon paying the SEC's prescribed rates.

INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE

The SEC allows us to incorporate by reference the information we file with them, which means that we can disclose important information to you by referring you to those documents. The information we incorporate by reference is considered to be part of this prospectus, and information that we file later with the SEC will automatically update and supersede the information in this prospectus. Accordingly, we incorporate by reference the documents listed below and any future filings we make with the SEC under Sections 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934:

1. our Annual Report on Form 10-KSB for the year ended December 31, 2004 (filed April 14, 2005);

2. our Quarterly Report on Form 10-QSB for the three months ended March 31, 2005 (filed May 16, 2005);

3. our Quarterly Report on Form 10-QSB/A for the three months ended March 31 2005 (filed June 14, 2005);

4. our Current Report on Form 8-K/A (filed January 24, 2005);

5. our Current Report on Form 8-K (filed January 20, 2005); and

6. the description of our common stock incorporated by reference in our Registration Statement on Form 8-A (filed October 9, 1998), as amended on November 3, 1998.

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We will provide at no cost to each person to whom this prospectus is delivered, upon written or oral request, a copy of any of these filings including any and all information that has been incorporated by reference in this Prospectus. You should direct such requests to us at 445 Park Avenue, Suite 1028, New York, New York 10022, attention: Corey M. Horowitz, Chairman and Chief Executive Officer, telephone number (212) 829-5700.

You should rely only on the information and representations provided in this prospectus or on the information incorporated by reference in this prospectus. Neither we nor the selling stockholders have authorized anyone to provide you with different information. Neither we nor the selling stockholders are making an offer of these securities in any state where the offer is not permitted. You should not assume that the information in this prospectus is accurate as of any date other than the date on the front of this document.

NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus contains certain forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. Forward-looking statements are statements that include information based upon beliefs of our management, as well as assumptions made by and information available to our management. Statements containing terms such as "believes," "expects," "anticipates," "intends" or similar words are intended to identify forward-looking statements.

Our management, based upon assumptions they consider reasonable, has compiled these forward-looking statements. Such statements reflect our current views with respect to future events. These statements involve known and unknown risks and uncertainties that may cause our actual results in future periods to differ materially from what is currently anticipated. We make cautionary statements in certain sections of this prospectus, including under "Risk Factors." You should read these cautionary statements as being applicable to all related forward-looking statements wherever they appear in this prospectus, the materials referred to in this prospectus or the materials incorporated by reference into this prospectus.

You are cautioned that no forward-looking statement is a guarantee of future performance and you should not place undue reliance on any forward-looking statement. Such statements speak only as of the date of this prospectus and we are not undertaking any obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date of this prospectus or to reflect the occurrence of unanticipated events.

USE OF PROCEEDS

We will not receive any proceeds from the sale of the shares of our common stock by the selling stockholders. All proceeds from the sale of such shares will be for the accounts of the selling stockholders. We will receive approximately $8,079,119 in proceeds, equal to the aggregate exercise price of all warrants and options to purchase an aggregate of 5,679,588 shares of our common stock, if the holders of all of the warrants and options referenced in this prospectus exercise such securities into shares of our common stock for cash. Warrants to purchase 550,000

shares of our common stock at an aggregate exercise price of $580,000 may be exercised on a cashless basis (by payment of the exercise price in shares rather than a cash payment). Any cash proceeds that we may receive upon exercise of the warrants and options will be used for working capital purposes.

SELLING STOCKHOLDERS

The following table sets forth information, as of June 15, 2005, with respect to the common stock beneficially owned by each selling stockholder. The selling stockholders are not obligated to sell any of the shares offered by this prospectus. The number of shares sold by each selling stockholder may depend on a number of factors, such as the market price of our common stock.

We are registering 16,836,267 shares of our common stock for resale by the selling stockholders. We agreed to file a registration statement under the Securities Act of 1933, as amended (the "Securities Act") with the Securities and Exchange Commission, of which this prospectus is a part, with respect to the resale of:

- 2,685,000 shares of our common stock and 2,063,750 shares of our common stock issuable upon exercise of warrants issued in our private offering completed in December 2004 and January 2005;

- 8,471,679 additional shares of our common stock issued to certain of our stockholders, and

- 1,352,152 shares of our common stock issuable upon the exercise of warrants issued as part of our private offering completed in December 1999; and

- 2,263,686 shares of our common stock issuable upon exercise of certain other outstanding warrants and options, all as disclosed in the table below.

The number of shares of our common stock shown in the following table as being offered by the selling stockholders do not include such presently indeterminate number of additional shares of our common stock that may be issuable as a result of stock splits, stock dividends and similar transactions. Pursuant to Rule 416 under the Securities Act, however, such shares are included in the Registration Statement of which this prospectus is a part.

The selling stockholders may sell any or all of their shares listed below from time to time. Accordingly, we cannot estimate how many shares the selling stockholders will own upon consummation of any such sales. Also, the selling stockholders may have sold, transferred or otherwise disposed of all or a portion of their shares since the date on which the information was provided in transactions exempt from the registration requirements of the Securities Act.

None of the selling stockholders has had a material relationship with us within the past three years other than as a result of the ownership of our securities except: (i) Corey M. Horowitz is our Chairman and Chief Executive

Officer and (ii) CHM Capital Management Corp., the sole shareholder, director and officer of which is Mr. Horowitz, performed consulting services for us prior to Mr. Horowitz becoming our Chairman and Chief Executive Officer in December 2003.

NAME	NUMBER OF SHARES BENEFICIALLY OWNED PRIOR TO OFFERING(1)	NUMBER OF SHARES BEING OFFERED	NUMBER OF SH BENEFICIALLY AFTER OFFERING
Barry Rubenstein	3,792,915 (3)	3,745,415	47,50
Irwin Lieber	2,098,002 (4)	2,050,502	47,50
Barry Fingerhut	2,008,598 (5)	2,008,598	
Seth Lieber	1,632,300 (6)	1,632,300	
Jonathan Lieber	1,630,748 (7)	1,630,748	
Wheatley Partners II, L.P.	1,280,207 (8)	1,280,207	
Wheatley Partners, L.P.	194,280	194,280	
Wheatley Foreign Partners, L.P.	16,868	16,868	
Woodland Venture Fund	829,226	829,226	
Seneca Ventures	619,983	619,983	
Woodland Partners	309,316	309,316	
Brookwood Partners, L.P.	294,810	294,810	
Marilyn Rubenstein	1,049	1,049	
Corey M. Horowitz	8,591,945 (9)	4,854,084	3,737,86
CMH Capital Management Corp.	4,167,800 (10)	4,167,800	
Donna Slavitt	78,720	78,720	
Logan Zev Horowitz 1999 Trust	15,000	15,000	
Dylan Max Horowitz 1989 Trust	15,000	15,000	
Corey M. Horowitz Custodian for Zachary Jordon Horowitz	15,000	15,000	
FalconStor Software, Inc.	650,000 (11)	650,000	
Emigrant Capital Corporation	1,312,500 (12)	1,312,500	

NAME	NUMBER OF SHARES BENEFICIALLY OWNED PRIOR TO OFFERING(1)	NUMBER OF SHARES BEING OFFERED	NUMBER OF SH BENEFICIALLY AFTER OFFERING

NAME	NUMBER OF SHARES BENEFICIALLY OWNED PRIOR TO OFFERING(1)	NUMBER OF SHARES BEING OFFERED	NUMBER OF SH BENEFICIALLY AFTER OFFERING
Singer Opportunity Fund, L.P.	784,125 (13)	625,625	158,50
Singer Fund, L.P.	282,355 (14)	249,375	32,98
David M. Seldin	474,000 (15)	455,000	19,00
Robert Graifman	279,777 (16)	175,000	104,77
Gilbert S. Stein	175,000 (17)	175,000	
John R. Hart	175,000 (18)	175,000	
Granite Bridge Fund, L.P.	131,250 (19)	131,250	
CGA Resources, LLC	87,500 (20)	87,500	
Barry S. Friedberg	87,500 (21)	87,500	
Dasa Sada, LLC	87,500 (22)	87,500	
Steven Ackerman	87,500 (23)	87,500	
Francis May	43,750 (24)	43,750	
Matthew Balk	17,500 (25)	17,500	
Kenneth L. Walters	17,500 (26)	17,500	
Jeb Investment Ltd.	175,450 (27)	166,250	9,20
Jeb Partners, L.P.	175,050 (28)	166,250	8,80
Manchester Explorer Limited Partnership	115,200 (29)	105,000	10,20
Steve Heinman	175,000 (30)	175,000	
Brian Eng	112,500 (31)	87,500	25,00
Brad Reifler	13,125 (32)	13,125	
Steven Goldfarb	8,750 (33)	8,750	
Hilary Bergman	13,125 (34)	13,125	
Samuel Solomon	17,500 (35)	17,500	
Jeffrey Finkle	105,000 (36)	105,000	
Edward Sussi	35,000 (37)	35,000	

NAME	NUMBER OF SHARES BENEFICIALLY OWNED PRIOR TO OFFERING(1)	NUMBER OF SHARES BEING OFFERED	NUMBER OF SH BENEFICIALLY AFTER OFFERING

Alan Friedman	35,000 (38)	35,000	
Alan Weiner	43,750 (39)	43,750	
Laurent Ohana	50,000 (40)	50,000	
Philip Bloom	586,526 (41)	586,526	
New Dimensions Trading, LTD	114,554 (42)	114,554	
Eli Oxenhorn	95,073 (43)	95,073	
Aaron Wolfson	76,472 (44)	76,472	
Avi Fogel	44,857 (45)	44,857	
Jack Erlanger	44,855 (46)	44,855	
Abraham Wolfson	38,186 (47)	38,186	
William Walters	38,186 (48)	38,186	
Gerald Josephson	36,355 (49)	36,355	
MW Partnership	34,066 (50)	34,066	
Gyenes and Co.	31,139 (51)	22,707	8,43
Jeffrey Rubinstein	29,518 (52)	29,518	
Sandler Company Investment Partners	24,665 (53)	24,665	
Maurice Shamah	22,707 (54)	22,707	
Larry Altman	22,707 (55)	22,707	
G.E.R. Family Partnership	16,862 (56)	16,862	
Patrick McBrien	12,267 (57)	12,267	
Scott Zelnick	12,267 (58)	12,267	
Levitan Family Charitable Trust	12,154 (59)	12,153	
Abbey Oxenhorn	11,351 (60)	11,351	
Seth Oxenhorn	11,351 (61)	11,351	
Emanuel Pearlman	8,677 (62)	4,098	4,57

NAME	NUMBER OF SHARES BENEFICIALLY OWNED PRIOR TO OFFERING(1)	NUMBER OF SHARES BEING OFFERED	NUMBER OF SH BENEFICIALLY AFTER OFFERING
Brad Zelnick	4,812 (63)	4,812	

Sage Alliances Inc.	135,462 (64)	135,462	
Jim McNeil	37,248 (65)	37,248	
Sam Schwartz	38,412 (66)	2,328	36,08
Roy Martin	2,328 (67)	2,328	
Malcolm Taub	2,328 (68)	2,328	

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* Less than 1%

(1) Except as otherwise indicated, the address for each beneficial owner is c/o Network-1 Security Solutions, Inc., 445 Park Avenue, Suite 1028, New York, New York 10022.

(2) Unless otherwise indicated, the Company believes that all persons named in the above table have sole voting and investment power with respect to all shares of common stock beneficially owned by them. A person is deemed to be the beneficial owner of securities that can be acquired by such person within 60 days from the date hereof upon the exercise of options, warrants or convertible securities. Each beneficial owner's percentage ownership is determined by assuming that options, warrants and convertible securities held by such person (but not those held by any other person) and which are exercisable or convertible within 60 days have been exercised and converted. Assumes a base of 17,697,572 shares of common stock outstanding.

(3) Includes (i) 1,280,207 shares of common stock held by Wheatley Partners II, L.P., (ii) 194,280 shares of common stock held by Wheatley Partners, L.P., (iii) 16,868 shares of common stock held by Wheatley Foreign Partners, L.P., (iv) 150,012 shares of common stock held by Mr. Rubenstein, (v) 47,500 shares of common stock subject to currently exercisable stock options held by Mr. Rubenstein, (vi) 49,664 shares of common stock subject to currently exercisable warrants held by Mr. Rubenstein, (vii) 829,226, 619,983, 309,316, 294,810 and 1,049 shares of common stock held by Woodland Venture Fund, Seneca Ventures, Woodland Partners, Brookwood Partners, L.P. and Marilyn Rubenstein, respectively. Does not include options to purchase 11,875 shares of common stock held by Mr. Rubenstein which are not currently exercisable. The aforementioned beneficial ownership by Mr. Rubenstein is based upon Amendment No. 6 to Schedule 13D jointly filed by Mr. Rubenstein and related parties with the Securities and Exchange Commission on January 3, 2005 and Form 4s filed by Mr. Rubenstein with the Securities and Exchange Commission on December 21, 2004 and February 17, 2005. Barry Rubenstein is a general partner of Wheatley Partners II, L.P. and a member of the general partner of

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each of Wheatley Partners, L.P. and Wheatley Foreign Partners, L.P. Barry Rubenstein and Woodland Services Corp. are the general partners of Woodland Venture Fund and Seneca Ventures. Barry Rubenstein is the President and sole director of Woodland Services Corp. Marilyn Rubenstein is the wife of Barry Rubenstein. Mr. Rubenstein disclaims beneficial ownership of the shares of common stock held by Wheatley Partners II, L.P., Wheatley Partners, L.P. and Wheatley Foreign Partners, L.P., except to the extent of his equity interest therein.

The address of Barry Rubenstein is 68 Wheatley Road, Brookville, New York 11545. The address of Wheatley Partners II, L.P. and Wheatley Partners, L.P. is 60 Cuttermill Road, Great Neck, New York 11021. The address of Wheatley Foreign Partners, L.P. is c/o Fiduciary Trust, One Capital Place, Snedden Road, P.O. Box 162, Grand Cayman, British West Indies. The address for Woodland Venture Fund, Seneca Ventures, Brookwood Partners, L.P. and Woodland Partners is c/o Barry Rubenstein, 68 Wheatley Road, Brookville, New York 11545.

(4) Includes (i) 1,280,207 shares of common stock held by Wheatley Partners II, L.P., (ii) 194,280 shares of common stock held by Wheatley Partners, L.P., (iii) 16,868 shares of common stock held by Wheatley Foreign Partners, L.P., (iv) 509,483 shares of common stock owned by Mr. Lieber, (v) 47,500 shares of common stock subject to currently exercisable stock options owned by Mr. Lieber, and (vi) 49,664 shares of common stock subject to currently exercisable warrants owned by Mr. Lieber. Does not include options to purchase 11,875 shares of Common stock owned by Mr. Lieber which are not currently exercisable. The aforementioned beneficial ownership by Mr. Lieber is based upon Amendment No. 6 to Schedule 13D jointly filed by Mr. Lieber and related parties with Securities and Exchange Commission on January 3, 2005 and Form 4s filed with the Securities and Exchange Commission on December 21, 2004 and February 17, 2005. Mr. Lieber disclaims beneficial ownership of the shares of Common stock held by Wheatley Partners II, L.P., Wheatley Partners, L.P. and Wheatley Foreign Partners, L.P., except to the extent of his equity interest therein. The address of Irwin Lieber is c/o Wheatley Partners, II, L.P., 80 Cuttermill Road, Great Neck, New York 11021.

(5) Includes (i) 1,280,207 shares of common stock held by Wheatley Partners, II, L.P., (ii) 194,280 shares of common stock held by Wheatley Partners, L.P., (iii) 16,868 shares of common stock held by Wheatley Foreign Partners, L.P., and (iv) 517,243 shares of common stock owned by Mr. Fingerhut. Mr. Fingerhut disclaims beneficial ownership of the shares of common stock held by Wheatley Partners II, L.P., Wheatley Partners, L.P. and Wheatley Foreign Partners, L.P., except to the extent of his equity interest therein. The address of Barry Fingerhut is c/o Wheatley Partners, II, L.P., 80 Cuttermill Road, Great Neck, New York 11021.

(6) Includes (i) 1,280,207 shares of common stock held by Wheatley Partners, II, L.P., (ii) 194,280 shares of common stock held by Wheatley Partners, L.P., (iii) 16,868 shares of common stock held by Wheatley Foreign Partners, L.P., and (iv)140,945 shares of common stock owned by Mr. Lieber. Mr. Lieber disclaims beneficial ownership of the shares of common stock held by Wheatley Partners II, L.P., Wheatley Partners, L.P. and Wheatley Foreign Partners, L.P., except to the extent of his equity interest therein. The address of Seth Lieber is c/o Wheatley Partners, II, L.P., 80 Cuttermill Road, Great Neck, New York 11021.

(7) Includes (i) 1,280,207 shares of common stock held by Wheatley Partners, II, L.P., (ii) 194,280 shares of common stock held by Wheatley Partners, L.P., (iii) 16,868 shares of common stock held by Wheatley Foreign Partners, L.P., and (iv)139,393 shares of common stock owned by Mr. Lieber. Mr. Lieber disclaims beneficial ownership of the shares of common stock held by Wheatley Partners II, L.P., Wheatley Partners, L.P. and Wheatley Foreign Partners, L.P., except to the extent of his equity interest therein. The address of Jonathan

Lieber is c/o Wheatley Partners, II, L.P., 80 Cuttermill Road, Great Neck, New York 11021.

(8) Includes 1,280,207 shares of common stock. Wheatley Partners II, L.P.'s business address is 80 Cuttermill Road, Great Neck, New York 11021.

(9) Includes (i) 475,053 shares of common stock held by Mr. Horowitz, (ii) 3,737,861 shares of common stock subject to currently exercisable stock options held by Mr. Horowitz, (iii) 2,867,800 shares of common stock held by CMH Capital Management Corp. ("CMH"), (iv) 550,000 shares of common stock subject to currently exercisable warrants held by CMH, (v) 750,000 shares of common stock subject to currently exercisable options held by CMH, (vi) 85,220 shares of common stock subject to currently exercisable warrants held by Mr. Horowitz, (vii) 78,720 shares of common stock owned by Donna Slavitt, the wife of Mr. Horowitz (viii) 45,000 shares of common stock held by two trusts and a custodian account for the benefit of Mr. Horowitz's three children and (ix) 2,291 shares of common stock held by Horowitz Partners, a general partnership of which Mr. Horowitz is a partner. Does not include options to purchase 610,625 shares of common stock which are not currently exercisable. The address of CMH Capital Management Corp. is 445 Park Avenue, New York, New York 10022.

(10) Includes (i) 2,867,800 shares of common stock, (ii) 550,000 shares of common stock subject to currently exercisable warrants and (iii) 750,000 shares of common stock subject to currently exercisable options.

(11) Includes 650,000 shares of common stock subject to currently exercisable warrants. The address of FalconStor Software, Inc. is 2 Huntington Quadrangle, Suite 2500, Melville, New York 11747.

(12) Includes (i) 750,000 shares of common stock and (ii) 562,500 shares of common stock subject to currently exercisable warrants. The address of Emigrant Capital Corporation is 6 East 43rd Street, New York, New York 10017.

(13) Includes (i) 516,000 shares of Common Stock and (ii) 268,125 shares of Common Stock subject to currently exercisable warrants owned by Singer Opportunity Fund, L.P. The address of Singer Opportunity Fund, L.P. is 650 Fifth Avenue, New York, New York 10019.

(14) Includes (i) 175,480 shares of Common Stock and (ii) 106,875 shares of Common Stock subject to currently exercisable warrants owned by Singer Fund, L.P., The address of Singer Fund, L.P. is 650 Fifth Avenue, New York, New York 10019.

(15) Includes (i) 279,000 shares of common stock and (ii) 195,000 shares of common stock subject to currently exercisable warrants.

(16) Includes (i) 154,777 shares of common stock and (ii) 75,000 shares of common stock subject to currently exercisable warrants and (iii) 50,000 shares subject to currently exercisable stock options.

(17) Includes (i) 100,000 shares of common stock and (ii) 75,000 shares of common stock subject to currently exercisable warrants.

(18) Includes (i) 100,000 shares of common stock and (ii) 75,000 shares of

common stock subject to currently exercisable warrants.

(19) Includes (i) 75,000 shares of common stock and (ii) 56,250 shares of common stock subject to currently exercisable warrants.

(20) Includes (i) 50,000 shares of common stock and (ii) 37,500 shares of common stock subject to currently exercisable warrants.

(21) Includes (i) 50,000 shares of common stock and (ii) 37,500 shares of common stock subject to currently exercisable warrants.

(22) Includes (i) 50,000 shares of common stock and (ii) 37,500 shares of common stock subject to currently exercisable warrants.

(23) Includes (i) 50,000 shares of common stock and (ii) 37,500 shares of common stock subject to currently exercisable warrants.

(24) Includes (i) 25,000 shares of common stock and (ii) 18,750 shares of common stock subject to currently exercisable warrants.

(25) Includes (i) 10,000 shares of common stock and (ii) 7,500 shares of common stock subject to currently exercisable warrants.

(26) Includes (i) 10,000 shares of common stock and (ii) 7,500 shares of common stock subject to currently exercisable warrants.

(27) Includes (i) 104,200 shares of common stock and (ii) 71,250 shares of common stock subject to currently exercisable warrants.

(28) Includes (i) 103,800 shares of common stock and (ii) 71,250 shares of common stock subject to currently exercisable warrants.

(29) Includes (i) 70,200 shares of common stock and (ii) 45,000 shares of common stock subject to currently exercisable warrants.

(30) Includes (i) 100,000 shares of common stock and (ii) 75,000 shares of common stock subject to currently exercisable warrants.

(31) Includes (i) 75,000 shares of common stock and (ii) 37,500 shares of common stock subject to currently exercisable warrants.

(32) Includes (i) 7,500 shares of common stock and (ii) 5,625 shares of common stock subject to currently exercisable warrants.

(33) Includes (i) 5,000 shares of common stock and (ii) 3,750 shares of common stock subject to currently exercisable warrants.

(34) Includes (i) 7,500 shares of common stock and (ii) 5,625 shares of common stock subject to currently exercisable warrants.

(35) Includes (i) 10,000 shares of common stock and (ii) 7,500 shares of common stock subject to currently exercisable warrants.

(36) Includes (i) 60,000 shares of common stock and (ii) 45,000 shares of common stock subject to currently exercisable warrants.

(37) Includes (i) 20,000 shares of common stock and (ii) 15,000 shares of common stock subject to currently exercisable warrants.

(38) Includes (i) 20,000 shares of common stock and (ii) 15,000 shares of common stock subject to currently exercisable warrants.

(39) Includes (i) 25,000 shares of common stock and (ii) 18,750 shares of common stock subject to currently exercisable warrants.

(40) Includes 50,000 shares of common stock subject to currently exercisable warrants.

(41) Includes 586,526 shares of common stock subject to currently exercisable warrants.

(42) Includes 114,554 shares of common stock subject to currently exercisable warrants.

(43) Includes 95,073 shares of common stock subject to currently exercisable warrants.

(44) Includes 76,472 shares of common stock subject to currently exercisable warrants.

(45) Includes 44,857 shares of common stock subject to currently exercisable warrants.

(46) Includes 44,855 shares of common stock subject to currently exercisable warrants.

(47) Includes 38,186 shares of common stock subject to currently exercisable warrants.

(48) Includes 38,186 shares of common stock subject to currently exercisable warrants.

(49) Includes 36,355 shares of common stock subject to currently exercisable warrants.

(50) Includes 34,066 shares of common stock subject to currently exercisable warrants.

(51) Includes (i) 8,432 shares of common stock and (ii) 22,707 shares of common stock subject to currently exercisable warrants.

(52) Includes 29,518 shares of common stock subject to currently exercisable warrants.

(53) Includes 24,665 shares of common stock subject to currently exercisable warrants.

(54) Includes 22,707 shares of common stock subject to currently exercisable warrants.

(55) Includes 22,707 shares of common stock subject to currently exercisable warrants.

(56) Includes 16,862 shares of common stock subject to currently exercisable warrants.

(57) Includes 12,267 shares of common stock subject to currently exercisable warrants.

(58) Includes 12,267 shares of common stock subject to currently exercisable warrants.

(59) Includes 12,154 shares of common stock subject to currently exercisable warrants.

(60) Includes 11,351 shares of common stock subject to currently exercisable warrants.

(61) Includes 11,351 shares of common stock subject to currently exercisable warrants.

(62) Includes (i) 4,579 shares of common stock and (ii) 4,098 shares of common stock subject to currently exercisable warrants.

(63) Includes 4,812 shares of common stock subject to currently exercisable warrants.

(64) Includes 135,462 shares of common stock subject to currently exercisable warrants.

(65) Includes 37,248 shares of common stock subject to currently exercisable warrants.

(66) Includes (i) 23,584 shares of common stock and (ii) 14,828 shares subject to currently exercisable options and warrants.

(67) Includes 2,328 shares of common stock subject to currently exercisable warrants.

(68) Includes 2,328 shares of common stock subject to currently exercisable warrants.

PLAN OF DISTRIBUTION

This offering is self-underwritten; neither we nor the selling stockholders have employed an underwriter for the sale of common stock by the selling stockholders. We will bear all expenses in connection with the preparation of this prospectus. The selling stockholders will bear all expenses associated with the sale of their common stock.

The selling stockholders may offer their shares of common stock directly or through pledgees, donees, transferees or other successors in interest in one or more of the following transactions:

- ordinary brokerage transactions in which the broker-dealer solicits purchasers;

- block trades in which the broker-dealer will attempt to sell the shares as agent but may position and resell a portion of the block as principal to facilitate the transaction;

- purchases by a broker-dealer as principal and resale by the broker-dealer for its account;

- an exchange distribution in accordance with the rules of the applicable exchange;

- privately negotiated transactions;

- broker-dealers may agree with the selling stockholders to sell a specified number of such shares at a stipulated price per share;

- a combination of any such methods of sale; and

- any other method permitted pursuant to applicable law.

The selling stockholders may offer their shares of common stock at any of the following prices:

- fixed prices that may be changed;

- market prices prevailing at the time of sale;

- prices related to such prevailing market prices; and

- at negotiated prices.

The selling stockholders may effect transactions by selling shares to or through broker-dealers, and all such broker-dealers may receive compensation in the form of discounts, concessions, or commissions from the selling stockholders and/or the purchasers of shares of common stock for whom such broker-dealers may act as agents or to whom they sell as principals, or both (which compensation as to a particular broker-dealer might be in excess of customary commissions).

Any broker-dealer acquiring common stock from the selling stockholders may sell the shares either directly, in its normal market-making activities, through or to other brokers on a principal or agency basis or to its customers. Any such sales may be at prices then prevailing on the OTC Bulletin Board or at prices related to such prevailing market prices or at negotiated prices to its customers or a combination of such methods. The selling stockholders and any broker-dealers that act in connection with the sale of the common stock hereunder might be deemed to be "underwriters" within the meaning of Section 2(11) of the Securities Act; any commission received by them and any profit on the resale of shares as principal might be deemed to be underwriting discounts and commissions under the Securities Act. Any such commissions, as well as other expenses incurred by the selling stockholders and applicable transfer taxes, are payable by the selling stockholders.

The selling stockholders reserve the right to accept, and together with any agent of the selling stockholder, to reject in whole or in part any proposed purchase of the shares of common stock. The selling stockholders will pay any sales commissions or other seller's compensation applicable to such transactions.

We have not registered or qualified offers and sales of shares of the common stock under the laws of any country other than the United States. To comply with certain states' securities laws, if applicable, the selling stockholders will offer and sell their shares of common stock in such jurisdictions only through registered or licensed brokers or dealers. In addition, in certain states the selling stockholders may not offer or sell shares of common stock unless we have registered or qualified such shares for sale in such states or we have complied with an available exemption from registration or qualification.

The selling stockholders with respect to any purchase or sale of shares of common stock are required to comply with Regulation M promulgated under the Securities Exchange Act of 1934, as amended. In general, Rule 102 under Regulation M prohibits any person connected with a distribution of securities (the "Distribution") from directly or indirectly bidding for, or purchasing for any account in which he or she has a beneficial interest, any of such securities or any right to purchase such securities, for a period of one business day before and after completion of his or her participation in the Distribution (we refer to that time period as the "Distribution Period").

During the Distribution Period, Rule 104 under Regulation M prohibits the selling stockholders and any other persons engaged in the Distribution from engaging in any stabilizing bid or purchasing of our common stock except for the purpose of preventing or retarding a decline in the open market price of our common stock. No such person may effect any stabilizing transaction to facilitate any offering at the market. Inasmuch as the selling shareholders will be reoffering and reselling our common stock at the market, Rule 104 prohibits them from effecting any stabilizing transaction in contravention of Rule 104 with respect of our common stock.

There can be no assurance that the selling stockholders will sell any or all of the shares offered by them hereunder or otherwise.

LEGAL MATTERS

The validity of the securities offered hereby will be passed upon for us by the law firm of Eiseman Levine Lehrhaupt & Kakoyiannis, P.C., 845 Third Avenue, New York, New York. Sam Schwartz, a member of such firm, owns 23,584 shares of our common stock and owns warrants and options to purchase 14,828 shares of our common stock as of the date of this prospectus.

EXPERTS

The financial statements incorporated in this prospectus by reference to the Annual Report on Form 10-KSB for the year ended December 31, 2004 have been so incorporated in reliance on the report of Eisner LLP, independent registered public accounting firm, given on the authority of said firm as experts in accounting and auditing.

DISCLOSURE OF COMMISSION POSITION ON INDEMNIFICATION FOR SECURITIES ACT LIABILITIES

Our Certificate of Incorporation and Bylaws provide our directors with protection for breaches of their fiduciary duties to us and our shareholders. Insofar as indemnification for liabilities arising under the Securities Act may be permitted to our directors, officers or persons controlling us, we have been advised that it is the SEC's opinion that such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable.

In the event that a claim for indemnification against such liabilities (other than the payment by us of expenses incurred or paid by a director, officer or controlling person in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, we will, unless in the opinion of our counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

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NETWORK-1 SECURITY SOLUTIONS, INC.

16,836,267 SHARES
OF
COMMON STOCK

PROSPECTUS

JUNE __, 2005

YOU SHOULD RELY ONLY ON THE INFORMATION CONTAINED IN THIS PROSPECTUS. NO DEALER, SALESPERSON OR OTHER PERSON IS AUTHORIZED TO GIVE INFORMATION THAT IS NOT CONTAINED IN THIS PROSPECTUS. THIS PROSPECTUS IS NOT AN OFFER TO SELL NOR IS IT SEEKING AN OFFER TO BUY THESE SECURITIES IN ANY JURISDICTION WHERE THE OFFER OR SALE IS NOT PERMITTED. THE INFORMATION CONTAINED IN THIS PROSPECTUS IS CORRECT ONLY AS OF THE DATE OF THIS PROSPECTUS, REGARDLESS OF THE TIME OF THE DELIVERY OF THIS PROSPECTUS OR ANY SALE OF THESE SECURITIES.

PART II.

INFORMATION NOT REQUIRED IN PROSPECTUS

ITEM 14. OTHER EXPENSES OF ISSUANCE AND DISTRIBUTION.

The following table sets forth the expenses in connection with the offering described in the Registration Statement, all of which will be borne by the Company.

SEC registration fee	$ 1,446.59
Legal fees and expenses*	$15,000.00
Accounting fees and expenses*	$ 2,500.00
Miscellaneous expenses*	$ 1,000.00
TOTAL	$19,946.59

* Estimated.

ITEM 15. INDEMNIFICATION OF DIRECTORS AND OFFICERS

Section 145 of the Delaware General Corporations Law (the "DGCL") contains provisions entitling the Company's directors and officers to indemnification from judgments, fines, amounts paid in settlement, and reasonable expenses (including attorneys' fees) as the result of an action or proceeding in which they may be involved by reason of having been a director or officer of the Company. In its Certificate of Incorporation, the Company has included a provision that limits, to the fullest extent now or hereafter permitted by the DGCL, the personal liability of its directors to the Company or its stockholders for monetary damages arising from a breach of their fiduciary duties as directors. Under the DGCL as currently in effect, this provision limits a director's liability except where such director (i) breaches his duty of loyalty to the Company or its stockholders, (ii) fails to act in good faith or engages in intentional misconduct or a knowing violation of law, (iii) authorizes payment of an unlawful dividend or stock purchase or redemption as provided in Section 174 of the DGCL, or (iv) obtains an improper personal benefit. This provision does not prevent the Company or its stockholders from seeking equitable remedies, such as injunctive relief or rescission. If equitable remedies are found not to be available to stockholders in any particular case, stockholders may not have any effective remedy against actions taken by directors that constitute negligence or gross negligence.

The Certificate of Incorporation also includes provisions to the effect that (subject to certain exceptions) the Company shall, to the maximum extent permitted from time to time under the law of the State of Delaware, indemnify, and upon request shall advance expenses to, any director or officer to the extent that such indemnification and advancement of expenses is permitted under such law, as it may from time to time be in effect. In addition, the Bylaws require the Company to indemnify, to the full extent permitted by law, any director, office, employee or agent of the

Company for acts which such person reasonably believes are not in violation of the Company's corporate purposes as set forth in the Certificate of Incorporation. At present, the DGCL provides that, in order to be entitled to indemnification, an individual must have acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the Company's best interests.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of the Company pursuant to any charter, provision, by-law, contract, arrangement, statute or otherwise, the Company has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable.

ITEM 16. EXHIBITS

NO.	DESCRIPTION
4.1	Form of Warrant, dated December 21, 2004, issued to certain investors pursuant to the Securities Purchase Agreement, dated December 21, 2004, between the Company and the investors listed therein. Previously filed as an exhibit to Exhibit 10.1 to the Current Report on Form 8-K filed on December 28, 2004.
4.2	Form of Warrant, dated January 13, 2005, issued to certain investors pursuant to the Securities Purchase Agreement, dated January 13, 2005, between the Company the investors listed therein. Previously filed as an exhibit to Exhibit 10.2 to the Current Report on Form 8-K filed January 20, 2005, and incorporated herein by reference.
4.3	Form of Warrant, dated December 22, 1999, issued by the Company to the holder listed thereon. Previously filed as Exhibit B to Exhibit 10.28 to the Form 8-K filed January 4, 2000, and incorporated herein by reference.
4.4	Form of Warrant issued by the Company for services rendered. Previously filed as Exhibit 4.3 to the Form S-3 Registration Statement (Registration No. 333-96189) declared effective by the SEC on March 21, 2000.
5.1	Opinion of Eiseman Levine Lehrhaupt & Kakoyiannis, P.C. regarding legality of securities being registered.
23.1	Consent of Eisner LLP, independent registered public accounting firm.
23.2	Consent of Eiseman Levine Lehrhaupt & Kakoyiannis, P.C. (included within Exhibit 5.1).
24.1	No person has signed this Registration Statement under a power of attorney. A power of attorney relating to the signing of amendments hereto is incorporated in the signature page hereof.

ITEM 17. UNDERTAKINGS

(1) The undersigned Registrant hereby undertakes that it will:

(a) File, during any period in which offers or sales are being made, a post-effective amendment to this Registration Statement to include any additional or changed material information on the plan of distribution.

(b) For determining liability under the Securities Act, treat each post-effective amendment as a new Registration Statement of the securities offered, and the offering of securities at that time to be the initial BONA FIDE offering.

(c) File a post-effective amendment to remove from registration any of the securities that remain unsold at the end of this offering.

(2) The undersigned Registrant hereby undertakes that, for purposes of determining any liability under the Securities Act of 1933, each filing of the registrant's annual report pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934(and, where applicable, each filing of an employee benefit plan's annual report pursuant to Section 15(d) of the Securities Exchange Act of 1934) that is incorporated by reference in the registration statement shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial BONA FIDE offering thereof.

(2) Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of the Registrant, pursuant to the foregoing provisions, or otherwise, the Registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the Registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

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SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, the Registrant certifies that it has reasonable grounds to believe that it meets all of the requirements for filing on Form S-3 and has duly caused this Registration Statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of New York, State of New York.

Dated: June 21, 2005

NETWORK-1 SECURITY SOLUTIONS, INC.

By: /s/ Corey M. Horowitz

Corey M. Horowitz, Chairman and
Chief Executive Officer

KNOW ALL MEN BY THESE PRESENTS, that each director and officer whose signature appears below constitutes and appoints Corey M. Horowitz his true and lawful attorney-in-fact and agent, with full power and substitution and re-substitution, to sign in any and all capacities any and all amendments or post-effective amendments to this Registration Statement on Form S-3 and to file the same with all exhibits thereto and other documents in connection therewith with the Securities and Exchange Commission, granting to such attorney-in-fact and agent, full power and authority to do all such other acts and execute all such other documents as he may deem necessary or desirable in connection with the foregoing, as fully as the undersigned might or could do in person, hereby ratifying and confirming all that such attorney-in-fact and agent may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Act of 1933, this Registration Statement has been signed by the following persons in the capacities and on the dates indicated:

Signature	Title	Date
/s/ Corey M.. Horowitz --------------------------- Corey M. Horowitz	Chairman and Chief Executive Officer (principal executive officer)	June 21, 2005
/s/ David C. Kahn --------------------------- David C. Kahn	Chief Financial Officer (principal financial and accounting officer)	June 21, 2005
/s/ Robert Graifman --------------------------- Robert Graifman	Director	June 21, 2005
/s/ Robert Pons --------------------------- Robert Pons	Director	June 21, 2005

INDEX TO EXHIBITS

NO.	DESCRIPTION
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5.1	Opinion of Eiseman Levine Lehrhaupt & Kakoyiannis, P.C. regarding legality of securities being registered.
23.1	Consent of Eisner LLP, independent registered public accounting firm.

23.2	Consent of Eiseman Levine Lehrhaupt & Kakoyiannis, P.C. (included within Exhibit 5.1).
24.1	No person has signed this Registration Statement under a power of attorney. A power of attorney relating to the signing of amendments hereto is incorporated in the signature page hereof.

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:10pt;">

1,107

1,058

Other short-term borrowings

233,800

—

—

Federal and state income taxes

—

41,920

—

Total current liabilities

1,084,183

1,049,235

1,136,064

Long-term debt

365,498

365,429

365,359

Capital lease obligations

2,287

2,880

3,447

Other liabilities

241,037

240,173

238,907

Deferred income taxes

15,151

116,831

216,219

Subordinated debentures

200,000

200,000

200,000

Commitments and contingencies

Stockholders’ equity:

Common stock

1,239

1,239

1,238

Additional paid-in capital

947,125

946,147

944,401

Accumulated other comprehensive loss

(17,785

)

(15,444
)

(11,137
)
Retained earnings

4,370,780

4,365,219

4,198,855

Less treasury stock, at cost

(3,626,885
)

(3,589,006
)

(3,530,636
)

Total stockholders' equity

1,674,474

1,708,155

1,602,721

Total liabilities and stockholders' equity

$
3,582,630

$
3,682,703

$
3,762,717

(1) See Note 1, Basis of Presentation, and Note 2, Accounting Standards.
See notes to condensed consolidated financial statements.

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DILLARD'S, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS
(Unaudited)
(In Thousands, Except Per Share Data)

	Three Months Ended		Six Months Ended	
	August 4, 2018	July 29, 2017 As Adjusted[1]	August 4, 2018	July 29, 2017 As Adjusted[1]
Net sales	$1,468,023	$1,427,280	$2,926,285	$2,845,740
Service charges and other income	32,684	36,530	65,842	70,944
	1,500,707	1,463,810	2,992,127	2,916,684
Cost of sales	1,017,177	1,007,054	1,920,918	1,877,139
Selling, general and administrative expenses	408,362	399,890	814,232	796,535
Depreciation and amortization	56,221	59,868	112,224	119,879
Rentals	6,556	6,456	13,105	12,658
Interest and debt expense, net	14,321	15,798	28,343	31,480
Other expense	1,915	1,808	3,830	3,615
(Gain) loss on disposal of assets	(17)	(23)	65	(42)
(Loss) income before income taxes and income on and equity in earnings of joint ventures	(3,828)	(27,041)	99,410	75,420
Income taxes (benefit)	(960)	(9,950)	21,730	26,220
Income on and equity in earnings of joint ventures	—	11	—	22
Net (loss) income	(2,868)	(17,080)	77,680	49,222
Retained earnings at beginning of period	4,376,408	4,217,972	4,365,219	4,153,844
Cumulative effect adjustment due to adoption of ASU No. 2016-16 and ASU No. 2018-02	—	—	(66,574)	—
Cash dividends declared	(2,760)	(2,037)	(5,545)	(4,211)
Retained earnings at end of period	$4,370,780	$4,198,855	$4,370,780	$4,198,855
(Loss) earnings per share:				
Basic and diluted	$(0.10)	$(0.58)	$2.80	$1.62
Cash dividends declared per common share	$0.10	$0.07	$0.20	$0.14

[1] See Note 1, Basis of Presentation, and Note 2, Accounting Standards.
See notes to condensed consolidated financial statements.

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DILLARD'S, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited)
(In Thousands)

	Three Months Ended		Six Months Ended	
	August 4, 2018	July 29, 2017	August 4, 2018	July 29, 2017
Net (loss) income	$(2,868)	$(17,080)	$77,680	$49,222
Other comprehensive income:				
Amortization of retirement plan and other retiree benefit adjustments (net of tax of $31, $0, $63, and $0, respectively)	101	—	201	—
Comprehensive (loss) income	$(2,767)	$(17,080)	$77,881	$49,222

See notes to condensed consolidated financial statements.

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DILLARD'S, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In Thousands)

	Six Months Ended	
	August 4, 2018	July 29, 2017 As Adjusted(1)
Operating activities:		
Net income	$77,680	$49,222
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization of property and other deferred cost	113,174	121,033
Loss (gain) on disposal of assets	65	(42)
Changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable	(14,709)	8,969
Increase in merchandise inventories	(139,722)	(120,982)
Increase in other current assets	(12,670)	(3,667)
(Increase) decrease in other assets	(5,382)	2,366
Increase in trade accounts payable and accrued expenses and other liabilities	19,471	38,909
Decrease in income taxes	(53,337)	(73,652)
Net cash (used in) provided by operating activities	(15,430)	22,156
Investing activities:		
Purchases of property and equipment	(85,952)	(65,979)
Proceeds from disposal of assets	1,956	3,090
Proceeds from insurance	—	1,875
Distribution from joint venture	2,145	855
Net cash used in investing activities	(81,851)	(60,159)
Financing activities:		
Principal payments on long-term debt and capital lease obligations	(161,499)	(2,764)
Increase in short-term borrowings	233,800	—
Cash dividends paid	(5,622)	(4,486)
Purchase of treasury stock	(39,879)	(166,643)
Net cash provided by (used in) financing activities	26,800	(173,893)
Decrease in cash and cash equivalents	(70,481)	(211,896)
Cash and cash equivalents, beginning of period	187,028	346,985
Cash and cash equivalents, end of period	$116,547	$135,089
Non-cash transactions:		
Accrued capital expenditures	$7,746	$3,900
Stock awards	978	934

[1] See Note 1, Basis of Presentation, and Note 2, Accounting Standards.
See notes to condensed consolidated financial statements.

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DILLARD'S, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. Basis of Presentation

The accompanying unaudited interim condensed consolidated financial statements of Dillard's, Inc. (the "Company") have been prepared in accordance with the rules of the Securities and Exchange Commission ("SEC"). Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America ("GAAP") for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six months ended August 4, 2018 are not necessarily indicative of the results that may be expected for the fiscal year ending February 2, 2019 due to, among other factors, the seasonal nature of the business.

These unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended February 3, 2018 filed with the SEC on March 30, 2018.

Effective February 4, 2018, we adopted the requirements of Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606), and all related amendments using the full retrospective method and adopted the requirements of ASU No. 2017-07, Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost retrospectively as discussed in Note 2, Accounting Standards. All amounts and disclosures set forth in this Form 10-Q have been updated to comply with the new standards.
Reclassifications—Certain items have been reclassified from their prior year classifications to conform to the current year presentation. These reclassifications had no effect on net income or stockholders' equity as previously reported.

Note 2. Accounting Standards

Recently Adopted Accounting Pronouncements

Revenue from Contracts with Customers

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which stipulates that an entity 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. To achieve this core principle, an entity should apply the following steps: (1) identify the contract(s) with a customer, (2) identify the performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the performance obligations in the contract and (5) recognize revenue when (or as) the entity satisfies a performance obligation. This ASU was supplemented by amendments which clarify the guidance of the initial ASU. We refer to this ASU and related amendments as the "new standard."

We adopted the requirements of the new standard as of February 4, 2018, utilizing the full retrospective method of transition. Adoption of the new standard resulted in changes to our accounting policies for revenue recognition, as further described in Note 3, Significant Accounting Policies Updates. We applied the new standard using the following practical expedients: (1) for a completed contract for which all (or substantially all) of the revenue was recognized in accordance with revenue guidance that is in effect before the date of initial application, an entity need not restate contracts that begin and end within the same annual reporting period; (2) for completed contracts that have variable consideration, an entity may use the transaction price at the date the contract was completed, rather than estimating variable consideration amounts in the comparative reporting periods; (3) for all reporting periods presented before the date of initial application, February 4, 2018, an entity is not required to disclose the amount of the transaction price allocated to the remaining performance obligations or when the entity expects to recognize that amount as revenue; and (4) for contracts modified prior to the beginning of fiscal year 2016, an entity can reflect the aggregate effect of all contract modifications that occurred before the beginning of the earliest period presented under the new standard when identifying the satisfied and unsatisfied performance obligations, determining the transaction price and allocating the transaction price to the satisfied and unsatisfied performance obligations for the modified contract at transition. The application of these practical expedients primarily impacted our evaluation of the revenue recognition of our construction segment.

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Through our analysis of the new standard, we considered the presentation of sales returns, the deferral of revenue related to our loyalty program, the deferral of revenue related to internet sales, credit card income, gift card breakage, principal versus agent considerations and revenue from our construction segment contracts. The impact of adopting the new standard on our fiscal 2017 and 2016 revenues was not material.

We adjusted our condensed consolidated financial statements from amounts previously reported due to the adoption of the new standard. The Company's net sales are recorded net of anticipated returns of merchandise. Under the new standard, both a return asset and an allowance for sales returns are recorded, which differs from the historical presentation of a net allowance for sales returns. The return asset and the allowance for sales returns are recorded in the condensed consolidated balance sheets in other current assets and trade accounts payable and accrued expenses, respectively. Additionally, we reclassified contract assets related to our construction segment from accounts receivable to other current assets in our condensed consolidated balance sheets.

Select condensed consolidated balance sheet line items, which reflect the adoption of the new standard, are as follows (in thousands):

	July 29, 2017		
	As previously reported	Adjustments	As adjusted
Assets			
Accounts receivable	$39,191	$ (852)	$38,339
Other current assets	37,906	14,234	52,140
Liabilities and stockholders' equity			
Trade accounts payable and accrued expenses	873,553	13,382	886,935

	February 3, 2018		
	As previously reported	Adjustments	As adjusted
Assets			
Accounts receivable	$39,650	$ (1,213)	$38,437
Other current assets	39,612	10,747	50,359
Liabilities and stockholders' equity			
Trade accounts payable and accrued expenses	835,747	9,534	845,281

Select condensed consolidated statement of income line items, including net sales and service charges and other income, reflect the adoption of the new standard. The impact of the adoption on the condensed consolidated statements of income and retained earnings for the three and six months ended July 29, 2017 was not material.

Select condensed consolidated statement of cash flow line items within operating activities reflect the adoption of the new standard. The impact on the condensed consolidated statements of cash flows for the six months ended July 29, 2017 was not material.

The Company operates in two reportable segments: the operation of retail department stores ("retail operations") and a general contracting construction company ("construction"). The Company determined that the presentation of the percentage of net sales by segment and major product line was consistent with the disaggregation of revenue required by the new standard. See Note 4, Business Segments. For the retail operations segment, total assets increased by $13.4 million as of July 29, 2017.

Construction contracts give rise to accounts receivable, contract assets and contract liabilities. We record accounts receivable based on amounts billed to customers. We also record costs and estimated earnings in excess of billings on uncompleted contracts (contract assets) and billings in excess of costs and estimated earnings on uncompleted contracts (contract liabilities) in other current assets and trade accounts payable and accrued expenses in the condensed consolidated balance sheets, respectively. The amounts included in the condensed consolidated balance sheets are as follows:

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(in thousands of dollars)	Construction February 3, 2018	August 4, 2018	January 28, 2017	July 29, 2017
Accounts receivable	$20,136	$38,200	$30,190	$27,377
Costs and estimated earnings in excess of billings on uncompleted contracts	1,213	951	922	852
Billings in excess of costs and estimated earnings on uncompleted contracts	5,503	6,437	8,826	7,592

During the six months ended August 4, 2018 and July 29, 2017, the Company recorded $4.6 million and $8.2 million, respectively, in revenue that was previously included in billings in excess of costs and estimated earnings on uncompleted contracts of $5.5 million and $8.8 million at February 3, 2018 and January 28, 2017, respectively.

Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost

In March 2017, the FASB issued ASU No. 2017-07, Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost,to improve the presentation of net periodic pension cost in the income statement. We adopted the requirements of ASU No. 2017-07 as of February 4, 2018 and applied the amendments retrospectively, as required. As a result of the adoption of ASU No. 2017-07, the service cost component of net periodic benefit costs is included in selling, general and administrative expenses, and the interest costs and net actuarial loss components are included in other expense in the condensed consolidated statements of operations and retained earnings. For the three and six months ended July 29, 2017, $1.8 million and $3.6 million has been reclassified from selling, general and administrative expenses to other expense. See Note 7, Benefit Plans.

Intra-Entity Transfers of Assets Other Than Inventory

In October 2016, the FASB issued ASU No. 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory, as part of its initiative to reduce complexity in accounting standards. Under these amendments, an entity is required to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. The amendments within ASU No. 2016-16 were effective for the Company beginning in the first quarter of fiscal 2018.

At February 3, 2018, other assets included a deferred charge related to the income tax effects of the intra-entity transfer pursuant to the previously disclosed REIT Transaction. During the fourth quarter of 2017, the Company terminated REIT status of its subsidiary, which did not have a material impact to the Company’s fiscal 2017 consolidated financial statements. Prior to the adoption of ASU No. 2016-16, income tax consequences of the intra-entity transfer remained recorded as a deferred charge, which was not subject to remeasurement for the lower tax rates enacted through tax reform.

The Company adopted the standard at the beginning of the first quarter of fiscal 2018, at which time the deferred charge was removed through a cumulative-effect adjustment directly to retained earnings, resulting in a decrease to other assets of approximately $173.7 million. A deferred tax asset of approximately $104.6 million was recorded through a cumulative-effect adjustment directly to retained earnings to reflect future income tax benefits of the intra-entity transfer at newly-enacted tax rates, resulting in a reduction to net deferred tax liabilities. These adjustments resulted in a net decrease to retained earnings of approximately $69.1 million.

Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income

In February 2018, the FASB issued ASU No. 2018-02, Income Statement-Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, to improve the usefulness of information reported to financial statement users by allowing a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. The Company adopted ASU No. 2018-02 during the first quarter of fiscal 2018 and applied the amendments in the period of adoption. The adoption of ASU No. 2018-02 resulted in an increase of approximately $2.5 million to both accumulated other comprehensive loss and retained earnings in the Company’s condensed consolidated financial statements.

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Recently Issued Accounting Pronouncements

Leases: Amendments to the FASB Accounting Standards Codification
In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842): Amendments to the FASB Accounting Standards Codification, to increase transparency and comparability among organizations by recognizing lease assets and liabilities on the balance sheet and disclosing key information about leasing arrangements. Under these amendments, lessees are required to recognize lease assets and lease liabilities for leases classified as operating leases under ASC 840. Subsequent to the issuance of ASC No. 2016-02, the FASB issued additional amendments related to ASU No. 2016-02: (1) ASU No. 2018-01, Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842; (2) ASU No. 2018-10: Codification Improvements to Topic 842, Leases; and (3) ASU No. 2018-11, Leases (Topic 842): Targeted Improvements. ASU No. 2016-02 and related amendments are effective for financial statements issued for fiscal years beginning after December 15, 2018, and early adoption is permitted. The Company's operating leases include building and equipment leases. The Company is evaluating our current operating leases and expects that the majority of these current operating leases will be impacted by this ASU and related amendments resulting in increases in assets and liabilities in the Company's consolidated financial statements. The Company intends to adopt these amendments during the first quarter of fiscal 2019.
Note 3. Significant Accounting Policies Updates

Revenue Recognition—The Company's retail operations segment recognizes merchandise revenue at the "point of sale." Allowance for sales returns and a return asset are recorded as components of net sales in the period in which the related sales are recorded. Sales taxes collected from customers are excluded from revenue and are recorded in trade accounts payable and accrued expenses until remitted to the taxing authorities.
Wells Fargo Bank, N.A. ("Wells Fargo") owns and manages Dillard's private label credit cards under a long-term marketing and servicing alliance pursuant to a 10-year agreement ("Wells Fargo Alliance"). The Company's share of income earned under the Wells Fargo Alliance is included as a component of service charges and other income. The Company recorded income of approximately $22 million and $24 million from the alliance during the three months ended August 4, 2018 and July 29, 2017, respectively, and approximately $43 million and $45 million from the alliance during the six months ended August 4, 2018 and July 29, 2017, respectively. The Company participates in the marketing of the private label credit cards, which includes the cost of customer reward programs. Through the reward programs, customers earn points that are redeemable for discounts on future purchases. The Company defers a portion of its net sales upon the sale of merchandise to its customer reward program members that is recognized in net sales when the reward is redeemed or expired at a future date.The Company accepts payments on the private label cards in its stores as a convenience to customers who prefer to pay in person rather than by paying online or by mailing their payments to Wells Fargo.
Revenue from construction segment contracts is generally recognized by applying percentages of completion for each period to the total estimated profits for the respective contracts. The length of each contract varies but is typically nine to eighteen months. The percentages of completion are determined by relating the actual costs of work performed to date to the current estimated total costs of the respective contracts. When the estimate on a contract indicates a loss, the entire loss is recorded in the current period.

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Note 4. Business Segments

The Company operates in two reportable segments: the operation of retail department stores ("retail operations") and a general contracting construction company ("construction").

For the Company's retail operations, the Company determined its operating segments on a store by store basis. Each store's operating performance has been aggregated into one reportable segment. The Company's operating segments are aggregated for financial reporting purposes because they are similar in each of the following areas: economic characteristics, class of consumer, nature of products and distribution methods. Revenues from external customers are derived from merchandise sales, and the Company does not rely on any major customers as a source of revenue. Across all stores, the Company operates one store format under the Dillard's name where each store offers the same general mix of merchandise with similar categories and similar customers. The Company believes that disaggregating its operating segments would not provide meaningful additional information.
The following table summarizes the percentage of net sales by segment and major product line:

	Three Months Ended		Six Months Ended	
	August 4, 2018	July 29, 2017	August 4, 2018	July 29, 2017
Retail operations segment				
Cosmetics	13 %	13 %	13 %	13 %
Ladies' apparel	24	25	24	25
Ladies' accessories and lingerie	16	16	15	15
Juniors' and children's apparel	8	8	9	9
Men's apparel and accessories	18	17	17	16
Shoes	14	15	15	16
Home and furniture	3	3	3	3
	96	97	96	97
Construction segment	4	3	4	3
Total	100 %	100 %	100 %	100 %

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The following tables summarize certain segment information, including the reconciliation of those items to the Company's consolidated operations:

(in thousands of dollars)	Retail Operations	Construction	Consolidated
Three Months Ended August 4, 2018:			
Net sales from external customers	$1,408,803	$ 59,220	$1,468,023
Gross profit	448,910	1,936	450,846
Depreciation and amortization	56,064	157	56,221
Interest and debt expense (income), net	14,333	(12)	14,321
(Loss) income before income taxes and income on and equity in earnings of joint ventures	(4,482)	654	(3,828)
Total assets	3,531,148	51,482	3,582,630
Three Months Ended July 29, 2017:			
Net sales from external customers	$1,384,623	$ 42,657	$1,427,280
Gross profit	418,561	1,665	420,226
Depreciation and amortization	59,701	167	59,868
Interest and debt expense (income), net	15,817	(19)	15,798
(Loss) income before income taxes and income on and equity in earnings of joint ventures	(27,683)	642	(27,041)
Income on and equity in earnings of joint ventures	11	—	11
Total assets	3,721,281	41,436	3,762,717
Six Months Ended August 4, 2018:			
Net sales from external customers	$2,820,147	$ 106,138	$2,926,285
Gross profit	1,001,775	3,592	1,005,367
Depreciation and amortization	111,908	316	112,224
Interest and debt expense (income), net	28,363	(20)	28,343
Income before income taxes and income on and equity in earnings of joint ventures	98,922	488	99,410
Total assets	3,531,148	51,482	3,582,630
Six Months Ended July 29, 2017:			
Net sales from external customers	$2,770,492	$ 75,248	$2,845,740
Gross profit	965,410	3,191	968,601
Depreciation and amortization	119,544	335	119,879
Interest and debt expense (income), net	31,520	(40)	31,480
Income before income taxes and income on and equity in earnings of joint ventures	74,677	743	75,420
Income on and equity in earnings of joint ventures	22	—	22
Total assets	3,721,281	41,436	3,762,717

Intersegment construction revenues of $6.7 million and $12.6 million for the three months ended August 4, 2018 and July 29, 2017, respectively, and $12.1 million and $21.6 million for the six months ended August 4, 2018 and July 29, 2017, respectively, were eliminated during consolidation and have been excluded from net sales for the respective periods.

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Note 5. Earnings Per Share Data

The following table sets forth the computation of basic and diluted earnings per share for the periods indicated (in thousands, except per share data).

	Three Months Ended		Six Months Ended	
	August 4, 2018	July 29, 2017	August 4, 2018	July 29, 2017
Net (loss) income	$(2,868)	$(17,080)	$77,680	$49,222
Weighted average shares of common stock outstanding	27,607	29,363	27,728	30,310
Basic and diluted (loss) earnings per share	$(0.10)	$(0.58)	$2.80	$1.62

The Company maintains a capital structure in which common stock is the only equity security issued and outstanding, and there were no shares of preferred stock, stock options, other dilutive securities or potentially dilutive securities issued or outstanding during the three or six months ended August 4, 2018 and July 29, 2017.

Note 6. Commitments and Contingencies

Various legal proceedings, in the form of lawsuits and claims, which occur in the normal course of business, are pending against the Company and its subsidiaries. In the opinion of management, disposition of these matters, individually or in the aggregate, is not expected to have a material adverse effect on the Company’s financial position, cash flows or results of operations.

At August 4, 2018, letters of credit totaling $24.8 million were issued under the Company’s revolving credit facility.

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Note 7. Benefit Plans

The Company has an unfunded, nonqualified defined benefit plan ("Pension Plan") for its officers. The Pension Plan is noncontributory and provides benefits based on years of service and compensation during employment. The Company determines pension expense using an actuarial cost method to estimate the total benefits ultimately payable to officers and allocates this cost to service periods. The actuarial assumptions used to calculate pension costs are reviewed annually. The Company contributed $1.3 million and $2.6 million to the Pension Plan during the three and six months ended August 4, 2018, respectively, and expects to make additional contributions to the Pension Plan of approximately $2.5 million during the remainder of fiscal 2018.

The components of net periodic benefit costs are as follows (in thousands):

	Three Months Ended		Six Months Ended	
	August 4, 2018	July 29, 2017	August 4, 2018	July 29, 2017
Components of net periodic benefit costs:				
Service cost	$922	$873	$1,844	$1,746
Interest cost	1,783	1,808	3,566	3,615
Net actuarial loss	132	—	264	—
Net periodic benefit costs	$2,837	$2,681	$5,674	$5,361

The service cost component of net periodic benefit costs is included in selling, general and administrative expenses, and the interest cost and net actuarial loss components are included in other expense.

Note 8. Revolving Credit Agreement

At August 4, 2018, the Company maintained an unsecured revolving credit facility that provides a borrowing capacity of $800 million with a $200 million expansion option and matures on August 9, 2022 ("credit agreement"). The credit agreement is available to the Company for general corporate purposes including, among other uses, working capital financing, the issuance of letters of credit, capital expenditures and, subject to certain restrictions, the repayment of existing indebtedness and share repurchases. The Company pays a variable rate of interest on borrowings under the credit agreement and a commitment fee to the participating banks based on the Company's debt rating. The rate of interest on borrowings is LIBOR plus 1.375%, and the commitment fee for unused borrowings is 0.20% per annum.

At August 4, 2018, $233.8 million in borrowings were outstanding, and letters of credit totaling $24.8 million were issued under the credit agreement leaving unutilized availability under the facility of $541.4 million.

To be in compliance with the financial covenants of the credit agreement, the Company's total leverage ratio cannot exceed 3.5 to 1.0, and the coverage ratio cannot be less than 2.5 to 1.0, as defined in the credit agreement. At August 4, 2018, the Company was in compliance with all financial covenants related to the credit agreement.

Note 9. Stock Repurchase Program

The Company's Board of Directors has authorized the Company to repurchase the Company's Class A Common Stock pursuant to open-ended stock repurchase plans. These authorizations permit the Company to repurchase its Class A Common Stock in the open market, pursuant to preset trading plans meeting the requirements of Rule 10b5-1 under the Securities Exchange Act of 1934 or through privately negotiated transactions. The authorizations have no expiration date.

The following is a summary of share repurchase activity for the periods indicated (in thousands, except per share data):

	Three Months Ended		Six Months Ended	
	August 4, 2018	July 29, 2017	August 4, 2018	July 29, 2017
Cost of shares repurchased	$3,063	$69,508	$37,879	$160,642
Number of shares repurchased	39	1,390	518	3,084
Average price per share	$77.75	$50.00	$73.15	$52.08

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All repurchases of the Company's Class A Common Stock above were made at the market price at the trade date. Accordingly, all amounts paid to reacquire these shares were allocated to treasury stock. During the six months ended August 4, 2018, the Company completed the authorized purchases under the February 2016 $500 million stock repurchase plan. In March 2018, the Company's Board of Directors authorized a new $500 million stock repurchase plan (the "March 2018 Plan"). As of August 4, 2018, $496.9 million of authorization remained under the March 2018 Plan.

Note 10. Income Taxes

The Tax Cuts and Jobs Act (the "Act") was signed into law on December 22, 2017. The Act's primary impact to the Company's consolidated financial statements was its reduction of the federal corporate income tax rate from 35% to 21%, effective January 1, 2018. The Company determined a reasonable estimate of the income tax effects of the Act and recorded provisional amounts within its consolidated financial statements during fiscal 2017. During the six months ended August 4, 2018, no adjustments were made to the provisional amounts recorded. The Company continues to analyze additional information and guidance related to certain aspects of the Act, including, but not limited to, increased expensing of business assets, limitations on the deductibility of executive compensation, conformity or changes by state taxing authorities in response to the Act, and any impact on the final determination of the net deferred tax liabilities. The final income tax effects of the Act may differ from the provisional amounts recorded due to, among other factors, anticipated guidance to be released in the coming year, including IRS notices, and any resulting changes in the Company's interpretation and application of the Act. The Company will finalize its accounting for the income tax effects of the Act within the one-year measurement period provided under SEC Staff Accounting Bulletin No. 118.

During the three months ended August 4, 2018 and July 29, 2017, income tax benefit differed from what would be computed using the statutory federal tax rate primarily due to the effect of state and local income taxes and tax benefits recognized for federal tax credits.

During the six months ended August 4, 2018 and July 29, 2017, income tax expense differed from what would be computed using the statutory federal tax rate primarily due to the effect of state and local income taxes partially offset by tax benefits recognized for federal tax credits.

See Note 2, Accounting Standards, for the Company's adoption of ASU No. 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory, and the impact of the adoption on deferred taxes.

Note 11. Reclassifications from Accumulated Other Comprehensive Loss ("AOCL")

Reclassifications from AOCL are summarized as follows (in thousands):

Details about AOCL Components	Amount Reclassified from AOCL				Affected Line Item in the Statement Where Net Income Is Presented
	Three Months Ended		Six Months Ended		
	August 4, 2018	July 29, 2017	August 4, 2018	July 29, 2017	
Defined benefit pension plan items					
Amortization of actuarial losses	$132	$ —	$264	$ —	Total before tax (1)

31	—	63	—	Income tax expense
$ 101	$ —	$ 201	$ —	Total net of tax

For fiscal year 2017, there was no amortization of the net loss in AOCL as the net loss did not exceed 10% of the projected benefit obligation.

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(1) This item is included in the computation of net periodic pension cost. See Note 7, Benefit Plans, for additional information.

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Note 12. Changes in Accumulated Other Comprehensive Loss

Changes in AOCL by component (net of tax) are summarized as follows (in thousands):

	Defined Benefit Pension Plan Items			
	Three Months Ended		Six Months Ended	
	August 4, 2018	July 29, 2017	August 4, 2018	July 29, 2017
Beginning balance	$17,886	$11,137	$15,444	$11,137
Amounts reclassified from AOCL	(101)	—	(201)	—
Reclassification due to the adoption of ASU No. 2018-02	—	—	2,542	—
Ending balance	$17,785	$11,137	$17,785	$11,137

Note 13. Fair Value Disclosures

The estimated fair values of financial instruments presented herein have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required in interpreting market data to develop estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of amounts the Company could realize in a current market exchange.

The fair value of the Company’s long-term debt and subordinated debentures is based on market prices and are categorized as Level 1 in the fair value hierarchy.

The fair value of the Company’s cash and cash equivalents, accounts receivable, and other short term borrowings approximates their carrying values at August 4, 2018 due to the short-term maturities of these instruments. The fair value of the Company’s long-term debt at August 4, 2018 was approximately $396 million. The carrying value of the Company’s long-term debt at August 4, 2018 was $365.5 million. The fair value of the Company’s subordinated debentures at August 4, 2018 was approximately $221 million. The carrying value of the Company’s subordinated debentures at August 4, 2018 was $200 million.

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Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the condensed consolidated financial statements and the footnotes thereto included elsewhere in this report, as well as the financial and other information included in our Annual Report on Form 10-K for the year ended February 3, 2018.

EXECUTIVE OVERVIEW

The Company's second quarter performance of fiscal 2018 continued to reflect our positive sales momentum. During the three months ended August 4, 2018, comparable store sales increased 1% over last year's second quarter. Gross margin from retail operations increased 163 basis points of net sales. Selling, general and administrative expenses from retail operations increased 9 basis points of net sales. The Company reported a consolidated net loss of $2.9 million ($0.10 per share) for the current year second quarter compared to a consolidated net loss of $17.1 million ($0.58 per share) for the prior year second quarter.

During the three months ended August 4, 2018, the Company purchased $3.1 million of Class A Common Stock under its March 2018 $500 million repurchase plan. As of August 4, 2018, authorization of $496.9 million remained under the plan.

As of August 4, 2018, the Company had working capital of $770.0 million, cash and cash equivalents of $116.5 million and $799.3 million of total debt outstanding, excluding capital lease obligations. Cash flows used in operating activities were $15.4 million for the six months ended August 4, 2018.

The Company currently operates 267 Dillard's locations, 25 clearance centers and one internet store.

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Key Performance Indicators

We use a number of key indicators of financial condition and operating performance to evaluate our business, including the following:

	Three Months Ended	
	August 4, 2018	July 29, 2017
Net sales (in millions)	$1,468.0	$1,427.3
Retail stores sales trend	2 %	(1)%
Comparable retail stores sales trend	1 %	(1)%
Gross profit (in millions)	$450.8	$420.2
Gross profit as a percentage of net sales	30.7 %	29.4 %
Retail gross profit as a percentage of net sales	31.9 %	30.2 %
Selling, general and administrative expenses as a percentage of net sales	27.8 %	28.0 %
Cash flow (used in) provided by operations (in millions)	$(15.4)	$22.2
Total retail store count at end of period	292	293
Retail sales per square foot	$29	$29
Retail store inventory trend	5 %	2 %
Annualized retail merchandise inventory turnover	2.3	2.4

General

Net sales. Net sales includes merchandise sales of comparable and non-comparable stores and revenue recognized on contracts of CDI Contractors, LLC (“CDI”), the Company’s general contracting construction company. Comparable store sales includes sales for those stores which were in operation for a full period in both the current quarter and the corresponding quarter for the prior year. Comparable store sales excludes changes in the allowance for sales returns. Non-comparable store sales includes: sales in the current fiscal year from stores opened during the previous fiscal year before they are considered comparable stores; sales from new stores opened during the current fiscal year; sales in the previous fiscal year for stores closed during the current or previous fiscal year that are no longer considered comparable stores; sales in clearance centers; and changes in the allowance for sales returns.

Service charges and other income. Service charges and other income includes income generated through the long-term private label card alliance with Wells Fargo Bank, N.A. (“Wells Fargo Alliance”). Other income includes rental income, shipping and handling fees, gift card breakage and lease income on leased departments.

Cost of sales. Cost of sales includes the cost of merchandise sold (net of purchase discounts, non-specific margin maintenance allowances and merchandise margin maintenance allowances), bankcard fees, freight to the distribution centers, employee and promotional discounts, shipping to customers and direct payroll for salon personnel. Cost of sales also includes CDI contract costs, which comprise all direct material and labor costs, subcontract costs and those indirect costs related to contract performance, such as indirect labor, employee benefits and insurance program costs.

Selling, general and administrative expenses. Selling, general and administrative expenses include buying, occupancy, selling, distribution, warehousing, store and corporate expenses (including payroll and employee benefits), insurance, employment taxes, advertising, management information systems, legal and other corporate level expenses. Buying expenses consist of payroll, employee benefits and travel for design, buying and merchandising personnel.

Depreciation and amortization. Depreciation and amortization expenses include depreciation and amortization on property and equipment.

Rentals. Rentals includes expenses for store leases, including contingent rent, and data processing and other equipment rentals.

Interest and debt expense, net. Interest and debt expense includes interest, net of interest income and capitalized interest, relating to the Company's unsecured notes, subordinated debentures and borrowings under the Company's credit facility.

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Interest and debt expense also includes gains and losses on note repurchases, if any, amortization of financing costs and interest on capital lease obligations.

Other expense. Other expense includes the interest cost and net actuarial loss components of net periodic benefit costs related to the the Company's unfunded, nonqualified defined benefit plan and charges related to the write-off of deferred financing fees in connection with the amendment of the Company's senior unsecured revolving credit facility, if any.

Gain on disposal of assets. Gain on disposal of assets includes the net gain or loss on the sale or disposal of property and equipment, as well as gains from insurance proceeds in excess of the cost basis of insured assets, if any.

Income on and equity in earnings of joint ventures. Income on and equity in earnings of joint ventures includes the Company's portion of the income or loss as well as any distributions of excess cash (excluding returns of investments) of the Company's unconsolidated joint ventures.

Seasonality

Our business, like many other retailers, is subject to seasonal influences, with a significant portion of sales and income typically realized during the last quarter of our fiscal year due to the holiday season. Because of the seasonality of our business, results from any quarter are not necessarily indicative of the results that may be achieved for a full fiscal year.

RESULTS OF OPERATIONS

The following table sets forth the results of operations as a percentage of net sales for the periods indicated (percentages may not foot due to rounding):

	Three Months Ended		Six Months Ended	
	August 4, 2018	July 29, 2017	August 4, 2018	July 29, 2017
Net sales	100.0 %	100.0 %	100.0 %	100.0 %
Service charges and other income	2.2	2.6	2.3	2.5
	102.2	102.6	102.3	102.5
Cost of sales	69.3	70.6	65.6	66.0
Selling, general and administrative expenses	27.8	28.0	27.8	28.0
Depreciation and amortization	3.8	4.2	3.8	4.2
Rentals	0.4	0.5	0.4	0.4
Interest and debt expense, net	1.0	1.1	1.0	1.1
Other expense	0.1	0.1	0.1	0.1
(Gain) loss on disposal of assets	—	—	—	—
(Loss) income before income taxes and income on and equity in earnings of joint ventures	(0.3)	(1.9)	3.4	2.7
Income taxes	(0.1)	(0.7)	0.7	0.9
Income on and equity in earnings of joint ventures	—	—	—	—
Net (loss) income	(0.2)%	(1.2)%	2.7 %	1.7 %

Critical Accounting Policies and Estimates Updates

Revenue recognition. The Company's retail operations segment recognizes revenue upon the sale of merchandise to its customers, net of anticipated returns of merchandise. The asset and liability for sales returns are based on historical evidence of our return rate. We recorded a return asset of $12.4 million, $9.5 million and $13.4 million and an allowance for sales returns, of $18.8 million, $14.3 million and $19.6 million as of August 4, 2018, February 3, 2018 and July 29, 2017, respectively. The return asset and the allowance for sales returns are recorded in the condensed consolidated balance sheets in other current assets and trade accounts payable and accrued expenses, respectively. Adjustments to earnings resulting from revisions to estimates on our sales return provision were not material for the three and six months ended August 4, 2018 and July 29, 2017.

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The Company's share of income earned under the Wells Fargo Alliance involving the Dillard's branded private label credit cards is included as a component of service charges and other income. The Company participates in the marketing of the private label credit cards, which includes the cost of customer reward programs. Through the reward programs, customers earn points that are redeemable for discounts on future purchases. The Company defers a portion of its net sales upon the sale of merchandise to its customer reward program members that is recognized in net sales when the reward is redeemed or expired at a future date. The Company accepts payments on the private label credit cards in its stores as a convenience to customers who prefer to pay in person rather than by paying online or mailing their payments to Wells Fargo.

Revenues from CDI construction contracts are generally recognized by applying percentages of completion for each period to the total estimated revenue for the respective contracts. Some of our contracts with customers contain multiple performance obligations. For these contracts, we account for individual performance obligations separately if they are distinct. The transaction price is allocated to the separate performance obligations based on standalone selling prices. Construction contracts are often modified to account for changes in contract specifications and requirements. We consider contract modifications to exist when the modification either creates new or changes the existing enforceable rights and obligations. Most of our contract modifications are for goods and services that are not distinct from the existing contracts; therefore, the modifications are accounted for as if they were part of the existing contract. The effect of a contract modification on the transaction price and our measure of progress for the performance obligation for which it relates, is recognized as an adjustment to revenue on a cumulative catch-up basis. The length of each contract varies but is typically nine to eighteen months. The percentages of completion are determined by relating the actual costs of work performed to date to the current estimated total costs of the respective contracts. Any anticipated losses on completed contracts are recognized as soon as they are determined.

Construction contracts give rise to accounts receivable, contract assets and contract liabilities. We record accounts receivable based on amounts billed to customers. We also record costs and estimated earnings in excess of billings on uncompleted contracts (contract assets) and billings in excess of costs and estimated earnings on uncompleted contracts (contract liabilities) in other current assets and trade accounts payable and accrued expenses, respectively, on the condensed consolidated balance sheets.

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Net Sales

(in thousands of dollars)	Three Months Ended August 4, 2018	July 29, 2017	$ Change
Net sales:			
Retail operations segment	$1,408,803	$1,384,623	$24,180
Construction segment	59,220	42,657	16,563
Total net sales	$1,468,023	$1,427,280	$40,743

The percent change in the Company’s sales by segment and product category for the three months ended August 4, 2018 compared to the three months ended July 29, 2017 as well as the sales percentage by segment and product category to total net sales for the three months ended August 4, 2018 are as follows:

	% Change 2018 - 2017	% of Net Sales
Retail operations segment		
Cosmetics	1.6 %	13 %
Ladies’ apparel	(0.7)	24
Ladies’ accessories and lingerie	1.4	16
Juniors’ and children’s apparel	4.1	8
Men’s apparel and accessories	6.2	18
Shoes	(0.3)	14
Home and furniture	2.4	3
		96
Construction segment	38.8	4
Total		100 %

Net sales from the retail operations segment increased $24.2 million during the three months ended August 4, 2018 compared to the three months ended July 29, 2017, increasing 2% in total and 1% in comparable stores. Sales of men's apparel and accessories increased significantly over the second quarter last year. Sales of cosmetics, juniors' and children's apparel and home and furniture increased moderately, while sales of ladies' accessories and lingerie increased slightly. Sales of ladies' apparel decreased slightly, while sales of shoes remained essentially flat.

The number of sales transactions decreased 1% for the three months ended August 4, 2018 compared to the three months ended July 29, 2017 while the average dollars per sales transaction increased 3%. We recorded a return asset of $12.4 million and $13.4 million and an allowance for sales returns of $18.8 million and $19.6 million as of August 4, 2018 and July 29, 2017, respectively.

During the three months ended August 4, 2018, net sales from the construction segment increased $16.6 million or 38.8% compared to the three months ended July 29, 2017 due to an increase in construction projects. The backlog of awarded construction contracts at August 4, 2018 totaled $244.3 million, decreasing approximately 24% from February 3, 2018 and increasing approximately 34% from July 29, 2017. We expect the backlog to be earned over the next nine to twenty-four months.

(in thousands of dollars)	Six Months Ended August 4, 2018	July 29, 2017	$ Change
Net sales:			

Retail operations segment	$2,820,147	$2,770,492	$49,655
Construction segment	106,138	75,248	30,890
Total net sales	$2,926,285	$2,845,740	$80,545

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The percent change in the Company's sales by segment and product category for the six months ended August 4, 2018 compared to the six months ended July 29, 2017 as well as the sales percentage by segment and product category to total net sales for the six months ended August 4, 2018 are as follows:

	% Change 2018-2017	% of Net Sales
Retail operations segment		
Cosmetics	1.1 %	13 %
Ladies' apparel	0.3	24
Ladies' accessories and lingerie	3.3	15
Juniors' and children's apparel	4.8	9
Men's apparel and accessories	4.5	17
Shoes	(1.6)	15
Home and furniture	4.1	3
		96
Construction segment	41.1	4
Total		100 %

Net sales from the retail operations segment increased $49.7 million during the six months ended August 4, 2018 compared to the six months ended July 29, 2017, increasing 2% in both total and comparable stores. Sales of men's apparel and accessories and juniors' and children's apparel increased significantly over the prior year period. Sales of ladies' accessories and lingerie and home and furniture increased moderately, while sales of cosmetics increased slightly. Sales of shoes decreased moderately, while sales of ladies' apparel remained relatively flat.

The number of sales transactions decreased 1% for the six months ended August 4, 2018 compared to the six months ended July 29, 2017 while the average dollars per sales transaction increased 3%.

Storewide sales penetration of exclusive brand merchandise for the six months ended August 4, 2018 and July 29, 2017 was 20.8% and 21.5%, respectively.

During the six months ended August 4, 2018, net sales from the construction segment increased $30.9 million or 41.1% compared to the six months ended July 29, 2017 due to a an increase in construction activity.

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Service Charges and Other Income

(in thousands of dollars)	Three Months Ended August 4, 2018	Three Months Ended July 29, 2017	Six Months Ended August 4, 2018	Six Months Ended July 29, 2017	Three Months $ Change 2018-2017	Six Months $ Change 2018-2017
Service charges and other income:						
Retail operations segment						
Income from Wells Fargo Alliance	$ 21,600	$ 23,499	$43,444	$45,301	$ (1,899)	$ (1,857)
Shipping and handling income	5,803	7,139	12,768	14,651	(1,336)	(1,883)
Leased department income	1,290	1,542	2,508	2,974	(252)	(466)
Other	3,248	3,559	6,121	7,136	(311)	(1,015)
	31,941	35,739	64,841	70,062	(3,798)	(5,221)
Construction segment	743	791	1,001	882	(48)	119
Total service charges and other income	$ 32,684	$ 36,530	$65,842	$70,944	$ (3,846)	$ (5,102)

Service charges and other income is composed primarily of income from the Wells Fargo Alliance. Income from the alliance decreased during the three and six months ended August 4, 2018 compared to the three and six months ended July 29, 2017 primarily due to a decrease in the level of balances carried on Wells Fargo accounts by Wells Fargo customers. Shipping and handling income decreased during the three and six months ended August 4, 2018, compared to the three and six months ended July 29, 2017 primarily due to an increase in online orders qualifying for free shipping.

Gross Profit

(in thousands of dollars)	August 4, 2018	July 29, 2017	$ Change	% Change
Gross profit:				
Three months ended				
Retail operations segment	$448,910	$418,561	$ 30,349	7.3 %
Construction segment	1,936	1,665	271	16.3
Total gross profit	$450,846	$420,226	$ 30,620	7.3 %
Six months ended				
Retail operations segment	$1,001,775	$965,410	$ 36,365	3.8 %
Construction segment	3,592	3,191	401	12.6
Total gross profit	$1,005,367	$968,601	$ 36,766	3.8 %

	Three Months Ended August 4, 2018	Three Months Ended July 29, 2017	Six Months Ended August 4, 2018	Six Months Ended July 29, 2017
Gross profit as a percentage of segment net sales:				
Retail operations segment	31.9 %	30.2 %	35.5 %	34.8 %
Construction segment	3.3	3.9	3.4	4.2
Total gross profit as a percentage of net sales	30.7	29.4	34.4	34.0

Gross profit increased by $30.6 million and 127 basis points of net sales during the three months ended August 4, 2018 compared to the three months ended July 29, 2017.

Gross profit from retail operations increased 163 basis points of net sales during the three months ended August 4, 2018 compared to the three months ended July 29, 2017 primarily due to decreased markdowns partially offset by decreased markups. Gross margin increased significantly in juniors' and children's apparel. Gross margin increased moderately in ladies' accessories and lingerie, shoes, men's apparel and accessories and home and furniture. Gross margin increased slightly in ladies' apparel, while decreasing slightly in cosmetics.

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Gross profit from retail operations increased 67 basis points of net sales during the six months ended August 4, 2018 compared to the six months ended July 29, 2017 primarily due to decreased markdowns partially offset by decreased markups. Gross margin increased moderately in ladies' accessories and lingerie and men's apparel and accessories. Gross margin increased slightly in shoes, juniors' and children's apparel and home and furniture. Gross margin was down slightly in cosmetics, while remaining relatively flat in ladies' apparel.

Gross profit from the construction segment decreased 63 basis points and 86 basis points of construction sales for the three and six months ended August 4, 2018, respectively.

Inventory increased 5% in total as of August 4, 2018 compared to July 29, 2017. A 1% change in the dollar amount of markdowns would have impacted net income by approximately $3 million and $6 million for the three and six months ended August 4, 2018.

Selling, General and Administrative Expenses (“SG&A”)

(in thousands of dollars)	August 4, 2018	July 29, 2017	$ Change	% Change
SG&A:				
Three months ended				
Retail operations segment	$406,509	$398,235	$8,274	2.1 %
Construction segment	1,853	1,655	198	12.0
Total SG&A	$408,362	$399,890	$8,472	2.1 %
Six months ended				
Retail operations segment	$810,479	$793,528	$16,951	2.1 %
Construction segment	3,753	3,007	746	24.8
Total SG&A	$814,232	$796,535	$17,697	2.2 %

	Three Months Ended		Six Months Ended	
	August 4, 2018	July 29, 2017	August 4, 2018	July 29, 2017
SG&A as a percentage of segment net sales:				
Retail operations segment	28.9 %	28.8 %	28.7%	28.6%
Construction segment	3.1	3.9	3.5	4.0
Total SG&A as a percentage of net sales	27.8	28.0	27.8	28.0

SG&A decreased 20 basis points of net sales during the three months ended August 4, 2018 compared to the three months ended July 29, 2017. SG&A from retail operations increased 9 basis points of net sales during the three months ended August 4, 2018 compared to the three months ended July 29, 2017 mainly due to increases in payroll ($6.9 million), primarily selling payroll.

SG&A decreased 17 basis points of net sales during the six months ended August 4, 2018 compared to the six months ended July 29, 2017. SG&A from retail operations increased 10 basis points of net sales during the six months ended August 4, 2018 compared to the six months ended July 29, 2017 mainly due to increases in payroll ($12 million), primarily selling payroll, services purchased ($2.4 million), and supplies ($1.8 million).

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Depreciation and Amortization

(in thousands of dollars)	August 4, 2018	July 29, 2017	$ Change	% Change
Depreciation and amortization:				
Three months ended				
Retail operations segment	$56,064	$59,701	$(3,637)	(6.1)%
Construction segment	157	167	(10)	(6.0)
Total depreciation and amortization	$56,221	$59,868	$(3,647)	(6.1)%
Six months ended				
Retail operations segment	$111,908	$119,544	$(7,636)	(6.4)%
Construction segment	316	335	(19)	(5.7)
Total depreciation and amortization	$112,224	$119,879	$(7,655)	(6.4)%

Depreciation and amortization expense decreased $3.6 million and $7.7 million during the three and six months ended August 4, 2018, respectively, compared to the three and six months ended July 29, 2017, primarily due to the timing and composition of capital expenditures.

Interest and Debt Expense, Net

(in thousands of dollars)	August 4, 2018	July 29, 2017	$ Change	% Change
Interest and debt expense (income), net:				
Three months ended				
Retail operations segment	$14,333	$15,817	$(1,484)	(9.4)%
Construction segment	(12)	(19)	7	36.8
Total interest and debt expense, net	$14,321	$15,798	$(1,477)	(9.3)%
Six months ended				
Retail operations segment	$28,363	$31,520	$(3,157)	(10.0)%
Construction segment	(20)	(40)	20	50.0
Total interest and debt expense, net	$28,343	$31,480	$(3,137)	(10.0)%

Net interest and debt expense decreased $1.5 million and $3.1 million during the three and six months ended August 4, 2018, respectively, compared to the three and six months ended July 29, 2017, primarily due to lower average debt levels. Total weighted average debt decreased by $49.1 million and $68.1 million during the three and six months ended August 4, 2018, respectively, compared to the three and six months ended July 29, 2017, primarily due to a note maturity in January 2018.

Other Expense

(in thousands of dollars)	August 4, 2018	July 29, 2017	$ Change	% Change
Other expense:				
Three months ended				
Retail operations segment	$1,915	$1,808	$ 107	5.9 %
Construction segment	—	—	—	—
Total other expense	$1,915	$1,808	$ 107	5.9 %

Six months ended					
Retail operations segment	$3,830	$3,615	$ 215	5.9	%
Construction segment	—	—	—	—	
Total other expense	$3,830	$3,615	$ 215	5.9	%

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During the first quarter of 2018, the Company adopted ASU No. 2017-07 and applied the amendments retrospectively, as required (See Note 2, Accounting Standards). As a result of the adoption of ASU No. 2017-07, the interest cost and net actuarial loss components of net periodic benefit costs, \$1.9 million and \$1.8 million for the three months ended August 4, 2018 and July 29, 2017, respectively, and \$3.8 million and \$3.6 million for the six months ended August 4, 2018 and July 29, 2017, respectively, were included in other expense rather than selling, general and administrative expenses in the condensed consolidated statements of operations and retained earnings.

Income Taxes

The Tax Cuts and Jobs Act (the "Act") was signed into law on December 22, 2017. The Act's primary impact to the Company's consolidated financial statements was its reduction of the federal corporate income tax rate from 35% to 21%, effective January 1, 2018. The Company determined a reasonable estimate of the income tax effects of the Act and recorded provisional amounts within its consolidated financial statements during fiscal 2017. During the six months ended August 4, 2018, no adjustments were made to the provisional amounts recorded. The Company continues to analyze additional information and guidance related to certain aspects of the Act, including, but not limited to, increased expensing of business assets, limitations on the deductibility of executive compensation, conformity or changes by state taxing authorities in response to the Act, and any impact on the final determination of the net deferred tax liabilities. The final income tax effects of the Act may differ from the provisional amounts recorded due to, among other factors, anticipated guidance to be released in the coming year, including IRS notices, and any resulting changes in the Company's interpretation and application of the Act. The Company will finalize its accounting for the income tax effects of the Act within the one-year measurement period provided under SEC Staff Accounting Bulletin No. 118.

The Company's estimated federal and state effective income tax rate, inclusive of income on and equity in earnings of joint ventures, was approximately 25.1% and 36.8% for the three months ended August 4, 2018 and July 29, 2017, respectively. The decline in the effective income tax rate primarily reflects the impact of the reduction of the federal corporate income tax rate from 35% to 21% pursuant to the Act. During the three months ended August 4, 2018 and July 29, 2017, income tax benefit differed from what would be computed using the statutory federal tax rate primarily due to the effect of state and local income taxes and tax benefits recognized for federal tax credits.

The Company's estimated federal and state effective income tax rate, inclusive of income on and equity in earnings of joint ventures, was approximately 21.9% and 34.8% for the six months ended August 4, 2018 and July 29, 2017, respectively. The decline in the effective income tax rate primarily reflects the impact of the reduction of the federal corporate income tax rate from 35% to 21% pursuant to the Act. During the six months ended August 4, 2018 and July 29, 2017, income tax expense differed from what would be computed using the statutory federal tax rate primarily due to the effect of state and local income taxes partially offset by tax benefits recognized for federal tax credits.

The Company expects the fiscal 2018 federal and state effective income tax rate to approximate 21% to 22%. This rate may change if results of operations for fiscal 2018 differ from management's current expectations. Changes in the Company's assumptions and judgments can materially affect amounts recognized in the condensed consolidated balance sheets and statements of operations and retained earnings.

FINANCIAL CONDITION

A summary of net cash flows for the six months ended August 4, 2018 and July 29, 2017 follows:

	Six Months Ended		
(in thousands of dollars)	August 4, 2018	July 29, 2017	\$ Change

Operating Activities	$(15,430)	$22,156	$(37,586)
Investing Activities	(81,851)	(60,159)	(21,692)
Financing Activities	26,800	(173,893)	200,693
Total Cash Used	$(70,481)	$(211,896)	$141,415

Net cash flows from operations decreased $37.6 million during the six months ended August 4, 2018 compared to the six months ended July 29, 2017. This decrease was primarily attributable to a decrease of $58.3 million related to changes in working capital items.

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Wells Fargo Bank, N.A. ("Wells Fargo") owns and manages Dillard’s private label credit cards under the Wells Fargo Alliance. Under the Wells Fargo Alliance, Wells Fargo establishes and owns private label card accounts for our customers, retains the benefits and risks associated with the ownership of the accounts, provides key customer service functions, including new account openings, transaction authorization, billing adjustments and customer inquiries, receives the finance charge income and incurs the bad debts associated with those accounts.

Pursuant to the Wells Fargo Alliance, we receive on-going cash compensation from Wells Fargo based upon the portfolio's earnings. The compensation earned on the portfolio is determined monthly and has no recourse provisions. The amount the Company receives is dependent on the level of sales on Wells Fargo accounts, the level of balances carried on Wells Fargo accounts by Wells Fargo customers, payment rates on Wells Fargo accounts, finance charge rates and other fees on Wells Fargo accounts, the level of credit losses for the Wells Fargo accounts as well as Wells Fargo's ability to extend credit to our customers. We participate in the marketing of the private label cards, which includes the cost of customer reward programs. We accept payments on the private label cards in our stores as a convenience to customers who prefer to pay in person rather than by paying online or mailing their payments to Wells Fargo. The Wells Fargo Alliance expires in fiscal 2024.

The Company recorded income of approximately $43 million and $45 million from the Wells Fargo Alliance during the six months ended August 4, 2018 and July 29, 2017, respectively.

Capital expenditures were $86.0 million and $66.0 million for the six months ended August 4, 2018 and July 29, 2017, respectively. The increase in capital expenditures was primarily related to equipment purchases and the remodeling of existing stores during the current year. Additionally, the Company purchased a store at Richland Fashion Square in Waco, Texas (150,000 square feet) and a store at Westgate Mall in Amarillo, Texas (156,000 square feet). The Company plans to operate these stores in 2021. During the six months ended August 4, 2018, the Company received cash proceeds of $1.9 million from the sale of a location classified as an asset held for sale. These proceeds were being held in escrow for the acquisition of replacement property under like-kind exchange agreements. The Company used the proceeds for the acquisition of a replacement property at the Oaks Mall in Gainesville, Florida (104,000 square feet) and plans to open the new store during the fourth quarter of 2018. Capital expenditures for fiscal 2018 are expected to be approximately $140 million compared to actual expenditures of $130 million during fiscal 2017.

We remain committed to closing under-performing stores where appropriate and may incur future closing costs related to such stores when they close.

The Company had cash on hand of $116.5 million as of August 4, 2018. As part of our overall liquidity management strategy and for peak working capital requirements, the Company maintains an unsecured revolving credit facility that provides a borrowing capacity of $800 million with a $200 million expansion option ("credit agreement"). The credit agreement is available to the Company for general corporate purposes including, among other uses, working capital financing, the issuance of letters of credit, capital expenditures and, subject to certain restrictions, the repayment of existing indebtedness and share repurchases. The rate of interest on borrowings is LIBOR plus 1.375%, and the commitment fee for unused borrowings is 0.20% per annum. To be in compliance with the financial covenants of the credit agreement, the Company's total leverage ratio cannot exceed 3.5 to 1.0, and the Company's coverage ratio cannot be less than 2.5 to 1.0, as defined in the credit agreement. At August 4, 2018, the Company was in compliance with all financial covenants related to the credit agreement.

At August 4, 2018, the Company had $233.8 million in outstanding short-term borrowings, and letters of credit totaling $24.8 million were issued under the credit agreement leaving unutilized availability under the facility of $541.4 million.

During the six months ended August 4, 2018, the Company paid the remaining $161.0 million principal on the 7.13% unsecured notes that matured on August 1, 2018.

During the six months ended August 4, 2018, the Company repurchased 0.5 million shares of Class A Common Stock at an average price of $73.15 per share for $37.9 million, completing the authorization under the February 2016 stock repurchase plan and beginning share repurchases under the Company's new $500 million stock repurchase plan authorized by the Company's Board of Directors in March 2018 (the "March 2018 Plan"). Additionally, the Company paid $2.0 million for share repurchases that had not yet settled but were accrued at February 3, 2018. During the six months ended July 29, 2017, the Company repurchased 3.1 million shares of Class A Common Stock at an average price of $52.08 per share for $160.6 million. Additionally, the Company paid $6.0 million for share repurchases that had not yet settled but were accrued at January 28, 2017. At August 4, 2018, $496.9 million of authorization remained under the March 2018 Plan. The ultimate disposition of the repurchased stock has not been determined.

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During fiscal 2018, the Company expects to finance its capital expenditures, working capital requirements and stock repurchases from cash on hand, cash flows generated from operations and utilization of the credit facility. Depending on conditions in the capital markets and other factors, the Company may from time to time consider other possible financing transactions, the proceeds of which could be used to refinance current indebtedness or for other corporate purposes.

There have been no material changes in the information set forth under caption "Contractual Obligations and Commercial Commitments" in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, in the Company's Annual Report on Form 10-K for the fiscal year ended February 3, 2018.

OFF-BALANCE-SHEET ARRANGEMENTS

The Company has not created, and is not party to, any special-purpose entities or off-balance-sheet arrangements for the purpose of raising capital, incurring debt or operating the Company's business. The Company does not have any off-balance-sheet arrangements or relationships that are reasonably likely to materially affect the Company's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or the availability of capital resources.

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NEW ACCOUNTING STANDARDS

For information with respect to new accounting pronouncements and the impact of these pronouncements on our consolidated financial statements, see Note 2, Accounting Standards, in the "Notes to Condensed Consolidated Financial Statements," in Part I, Item I hereof.

FORWARD-LOOKING INFORMATION

This report contains certain forward-looking statements. The following are or may constitute forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995: (a) statements including words such as “may,” “will,” “could,” “should,” “believe,” “expect,” “future,” “potential,” “anticipate,” “intend,” “plan,” “esti
or the negative or other variations thereof; (b) statements regarding matters that are not historical facts; and (c) statements about the Company’s future occurrences, plans and objectives, including statements regarding management’s expectations and forecasts for the remainder of fiscal 2018 and beyond, statements concerning the opening of new stores or the closing of existing stores, statements concerning capital expenditures and sources of liquidity, statements concerning share repurchases, statements concerning pension contributions and statements concerning estimated taxes. The Company cautions that forward-looking statements contained in this report are based on estimates, projections, beliefs and assumptions of management and information available to management at the time of such statements and are not guarantees of future performance. The Company disclaims any obligation to update or revise any forward-looking statements based on the occurrence of future events, the receipt of new information, or otherwise. Forward-looking statements of the Company involve risks and uncertainties and are subject to change based on various important factors. Actual future performance, outcomes and results may differ materially from those expressed in forward-looking statements made by the Company and its management as a result of a number of risks, uncertainties and assumptions. Representative examples of those factors include (without limitation) general retail industry conditions and macro-economic conditions; economic and weather conditions for regions in which the Company's stores are located and the effect of these factors on the buying patterns of the Company's customers, including the effect of changes in prices and availability of oil and natural gas; the availability of consumer credit; the impact of competitive pressures in the department store industry and other retail channels including specialty, off-price, discount and Internet retailers; changes in consumer confidence, spending patterns, debt levels and their ability to meet credit obligations; high levels of unemployment; changes in tax legislation; changes in legislation, affecting such matters as the cost of employee benefits or credit card income; adequate and stable availability of materials, production facilities and labor from which the Company sources its merchandise at acceptable pricing; changes in operating expenses, including employee wages, commission structures and related benefits; system failures or data security breaches; possible future acquisitions of store properties from other department store operators; the continued availability of financing in amounts and at the terms necessary to support the Company's future business; fluctuations in LIBOR and other base borrowing rates; potential disruption from terrorist activity and the effect on ongoing consumer confidence; epidemic, pandemic or other public health issues; potential disruption of international trade and supply chain efficiencies; world conflict and the possible impact on consumer spending patterns and other economic and demographic changes of similar or dissimilar nature. The Company's filings with the Securities and Exchange Commission, including its Annual Report on Form 10-K for the fiscal year ended February 3, 2018, contain other information on factors that may affect financial results or cause actual results to differ materially from forward-looking statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes in the information set forth under caption “Item 7A-Quantitative and Qualitative Disclosures About Market Risk” in the Company’s Annual Report on Form 10-K for the fiscal year ended February 3, 2018.

Item 4. Controls and Procedures

The Company has established and maintains disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). The Company's management, with the participation of our Principal Executive Officer and Co-Principal Financial Officers, has evaluated the effectiveness of the Company's disclosure controls and procedures as of the end of the fiscal quarter covered by this quarterly report, and based on that evaluation, the Company's Principal Executive Officer and Co-Principal Financial Officers have concluded that these disclosure controls and procedures were effective.

There were no changes in our internal control over financial reporting that occurred during the fiscal quarter ended August 4, 2018 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, the Company is involved in litigation relating to claims arising out of the Company's operations in the normal course of business. This may include litigation with customers, employment related lawsuits, class action lawsuits, purported class action lawsuits and actions brought by governmental authorities. As of September 7, 2018, the Company is not a party to any legal proceedings that, individually or in the aggregate, are reasonably expected to have a material adverse effect on the Company's business, results of operations, financial condition or cash flows.

Item 1A. Risk Factors

There have been no material changes in the information set forth under caption "Item 1A-Risk Factors" in the Company's Annual Report on Form 10-K for the fiscal year ended February 3, 2018.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(c) Purchases of Equity Securities
Issuer Purchases of Equity Securities

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
May 6, 2018 through June 2, 2018	39,400	$ 77.75	39,400	$496,936,705
June 3, 2018 through July 7, 2018	—	—	—	496,936,705
July 8, 2018 through August 4, 2018	—	—	—	496,963,705
Total	39,400	$ 77.75	39,400	$496,936,705

In February 2016, the Company’s Board of Directors authorized the repurchase of up to $500 million of the Company’s Class A Common Stock under an open-ended stock repurchase plan, which was completed during the the first quarter of fiscal 2018. In March 2018, the Company's Board of Directors authorized a new $500 million stock repurchase plan ("March 2018 Plan"). These repurchase plans permit the Company to repurchase its Class A Common Stock in the open market, pursuant to preset trading plans meeting the requirements of Rule 10b5-1 under the Securities Exchange Act of 1934 or through privately negotiated transactions. The repurchase plans have no expiration date.
During the three months ended August 4, 2018, the Company repurchased 39 thousand shares totaling $3.1 million. As of August 4, 2018, $496.9 million of authorization remained under the March 2018 Plan. Reference is made to the discussion in Note 9, Stock Repurchase Program, in the “Notes to Condensed Consolidated Financial Statements” in Part I of this Quarterly Report on Form 10-Q, which information is incorporated by reference herein.

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Item 6. Exhibits

Number	Description
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Co-Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.3	Certification of Co-Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
32.2	Certification of Co-Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
32.3	Certification of Co-Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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SIGNATURES

Pursuant to the requirements 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.

		DILLARD'S, INC. (Registrant)
Date:	September 7, 2018	/s/ Phillip R. Watts Phillip R. Watts Senior Vice President, Co-Principal Financial Officer and Principal Accounting Officer
		/s/ Chris B. Johnson Chris B. Johnson Senior Vice President and Co-Principal Financial Officer

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