

CATO CORP
Form 10-Q
September 08, 2010

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended July 31, 2010

OR

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

For the transition period from _____ to _____
Commission file number 1-31340

THE CATO CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

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

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

(Zip Code)

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

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

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes X No

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

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

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No X

As of September 8, 2010, there were 27,734,000 shares of Class A common stock and 1,743,525 shares of Class B common stock outstanding.

THE CATO CORPORATION

FORM 10-Q

Quarter Ended July 31, 2010

Table of Contents

	Page No.	
<u>PART I – FINANCIAL INFORMATION</u>		
<u>Item 1.</u>	<u>Financial Statements:</u>	
<u>Condensed Consolidated Statements of Income and Comprehensive Income</u> <u>For the Three Months and Six Months Ended July 31, 2010 and</u> <u>August 1, 2009</u>	2	
<u>Condensed Consolidated Balance Sheets</u> <u>At July 31, 2010, August 1, 2009, and January 30, 2010</u>	3	
<u>Condensed Consolidated Statements of Cash Flows</u> <u>For the Six Months Ended July 31, 2010 and August 1, 2009</u>	4	
<u>Notes to Condensed Consolidated Financial Statements</u> <u>For the Three Months and Six Months Ended</u> <u>July 31, 2010 and August 1, 2009</u>	5 – 14	
<u>Item 2.</u>	<u>Management’s Discussion and Analysis of Financial</u> <u>Condition and Results of Operations</u>	15 – 20
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About</u> <u>Market Risk</u>	21
<u>Item 4.</u>	<u>Controls and Procedures</u>	21
<u>PART II – OTHER INFORMATION</u>		
<u>Item 1.</u>	<u>Legal Proceedings</u>	22
<u>Item 1A.</u>	<u>Risk Factors</u>	22
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of</u>	22
Table of Contents		3

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Proceeds

<u>Item 3.</u>	<u>Defaults Upon Senior Securities</u>	22
<u>Item 4.</u>	<u>Removed and Reserved</u>	23
<u>Item 5.</u>	<u>Other Information</u>	23
<u>Item 6.</u>	<u>Exhibits</u>	23
<u>Signatures</u>		24 - 28

Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****THE CATO CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND
COMPREHENSIVE INCOME**

	Three Months Ended		Six Months Ended	
	July 31, 2010	August 1, 2009	July 31, 2010	August 1, 2009
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
	(Dollars in thousands, except per share data)			
REVENUES				
Retail sales	\$ 231,865	\$ 225,369	\$ 491,625	\$ 463,423
Other income (principally finance charges, late fees and layaway charges)	2,862	2,897	5,785	5,870
Total revenues	234,727	228,266	497,410	469,293
COSTS AND EXPENSES, NET				
Cost of goods sold (exclusive of depreciation shown below)	143,039	143,459	289,893	285,372
Selling, general and administrative (exclusive of depreciation shown below)	62,268	56,480	130,828	121,124
Depreciation	5,277	5,482	10,547	11,026
Interest and other income	(957)	(861)	(1,849)	(1,921)
Cost and expenses, net	209,627	204,560	429,419	415,601
Income before income taxes	25,100	23,706	67,991	53,692
Income tax expense	9,081	7,048	24,912	18,220
Net income	\$ 16,019	\$ 16,658	\$ 43,079	\$ 35,472

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Basic earnings per share	\$	0.54	\$	0.57	\$	1.46	\$	1.21
Diluted earnings per share	\$	0.54	\$	0.56	\$	1.46	\$	1.20
Dividends per share	\$	0.185	\$	0.165	\$	0.35	\$	0.33
Comprehensive income:								
Net income	\$	16,019	\$	16,658	\$	43,079	\$	35,472
Unrealized losses on available-for-sale securities, net of deferred income tax benefit		130		56		44		30
Comprehensive income	\$	16,149	\$	16,714	\$	43,123	\$	35,502

See notes to consolidated financial statements.

Table of Contents**THE CATO CORPORATION****CONDENSED CONSOLIDATED BALANCE SHEETS**

	July 31, 2010 (Unaudited)	August 1, 2009 (Unaudited)	January 30, 2010 (Unaudited)
	(Dollars in thousands)		
ASSETS			
Current Assets:			
Cash and cash equivalents	\$ 68,336	\$ 28,888	\$ 50,385
Short-term investments	165,755	145,427	147,955
Restricted cash and investments	2,547	9,057	2,575
Accounts receivable, net of allowance for doubtful accounts of \$3,233, \$3,301 and \$3,274 at July 31, 2010, August 1, 2009 and January 30, 2010, respectively	39,747	41,798	40,154
Merchandise inventories	95,720	93,807	118,628
Deferred income taxes	7,748	6,408	7,812
Prepaid expenses	5,352	7,875	3,258
Total Current Assets	385,205	333,260	370,767
Property and equipment – net	100,869	111,001	102,769
Other assets	7,499	7,324	7,454
Total Assets	\$ 493,573	\$ 451,585	\$ 480,990
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current Liabilities:			
Accounts payable	\$ 79,802	\$ 76,923	\$ 103,627
Accrued expenses	32,587	32,648	31,615
Accrued bonus and benefits	18,062	10,742	22,286
Accrued income taxes	22,493	20,817	10,940
Total Current Liabilities	152,944	141,130	168,468
Deferred income taxes	4,087	2,528	4,087
Other noncurrent liabilities (primarily deferred rent)	16,362	18,639	17,123
Commitments and contingencies:	-	-	-
Stockholders' Equity:			
Preferred stock, \$100 par value per share, 100,000 shares authorized, none issued	-	-	-
Class A common stock, \$.033 par value per share, 50,000,000			

shares authorized; issued 27,736,131 shares, 36,471,549 shares, and 27,842,587 shares at July 31, 2010, August 1, 2009 and January 30, 2010, respectively	925	1,216	928
Convertible Class B common stock, \$.033 par value per share, 15,000,000 shares authorized; issued 1,743,525 shares at July 31, 2010 August 1, 2009 and January 30, 2010	58	58	58
Additional paid-in capital	66,584	63,328	64,706
Retained earnings	252,036	380,101	225,086
Accumulated other comprehensive income	577	443	534
Stockholders' Equity Before Treasury Stock	320,180	445,146	291,312
Less Class A common stock in treasury, at cost (-0- shares, 8,662,902 shares and -0- shares at July 31, 2010, August 1, 2009 and January 30, 2010, respectively)	-	(155,858)	-
Total Stockholders' Equity	320,180	289,288	291,312
Total Liabilities and Stockholders' Equity	\$ 493,573	\$ 451,585	\$ 480,990

See notes to consolidated financial statements.

Table of Contents**THE CATO CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Six Months Ended	
	July 31, 2010	August 1, 2009
	(Unaudited)	(Unaudited)
	(Dollars in thousands)	
Operating Activities:		
Net income	\$ 43,079	\$ 35,472
Adjustments to reconcile net income to net cash provided		
by operating activities:		
Depreciation	10,547	11,026
Provision for doubtful accounts	1,499	1,752
Share based compensation	1,213	1,230
Excess tax benefits from share-based compensation	(133)	(72)
Loss on disposal of property and equipment	220	393
Changes in operating assets and liabilities which provided		
(used) cash:		
Accounts receivable	(1,092)	586
Merchandise inventories	22,908	18,483
Prepaid and other assets	(2,145)	(3,740)
Accrued income taxes	11,686	9,383
Accounts payable, accrued expenses and other liabilities	(27,840)	(20,548)
Net cash provided by operating activities	59,942	53,965
Investing Activities:		
Expenditures for property and equipment	(8,866)	(6,170)
Purchase of short-term investments	(111,454)	(96,292)
Sales of short-term investments	93,768	44,347
Change in restricted cash and investments	28	32
Net cash used in investing activities	(26,524)	(58,083)
Financing Activities:		
Dividends paid	(10,304)	(9,723)
Repurchase of common stock	(5,840)	(49)
Proceeds from employee stock purchase plan	218	200
Excess tax benefits from share-based compensation	133	72
Proceeds from stock options exercised	326	244

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Net cash provided used in financing activities	(15,467)	(9,256)
Net increase in cash and cash equivalents	17,951	(13,374)
Cash and cash equivalents at beginning of period	50,385	42,262
Cash and cash equivalents at end of period	\$ 68,336	\$ 28,888

See notes to consolidated financial statements.

Table of Contents

**THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED JULY 31, 2010 AND AUGUST 1, 2009**

NOTE 1 - GENERAL:

The condensed consolidated financial statements have been prepared from the accounting records of The Cato Corporation and its wholly-owned subsidiaries (the "Company"), and all amounts shown as of and for the periods ended July 31, 2010 and August 1, 2009 are unaudited. In the opinion of management, all adjustments considered necessary for a fair statement have been included. All such adjustments are of a normal, recurring nature unless otherwise noted. The results of the interim period may not be indicative of the results expected for the entire year.

The interim financial statements should be read in conjunction with the consolidated financial statements and notes thereto, included in the Company's Annual Report on Form 10-K for the fiscal year ended January 30, 2010.

The year-end condensed consolidated balance sheet presented as of the fiscal year ended January 30, 2010 was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

On August 26, 2010, the Board of Directors maintained the quarterly dividend at \$.185 per share or an annualized rate of \$.74 per share.

In September 2009, the Company retired all of its treasury stock shares. The excess of the price over par value of common stock of approximately \$155.6 million was charged to retained earnings upon the retirement of the treasury stock.

Table of Contents

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED JULY 31, 2010 AND AUGUST 1, 2009

NOTE 2 - EARNINGS PER SHARE:

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

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

	Three Months Ended		Six Months Ended	
	July 31, 2010	August 1, 2009	July 31, 2010	August 1, 2009
	(Dollars in thousands, except per share data)			
Basic earnings per share:				
Net earnings	\$ 16,019	\$ 16,658	\$ 43,079	\$ 35,472
Earnings allocated to non-vesting equity awards	(270)	(244)	(728)	(516)
Net earnings available to common shares outstanding	\$ 15,749	\$ 16,414	\$ 42,351	\$ 34,956
Basic weighted-average common shares outstanding	28,966,065	29,039,565	28,990,500	28,997,030
Basic earnings per share	\$ 0.54	\$ 0.57	\$ 1.46	\$ 1.21

Diluted earnings per share:

Net earnings	\$	16,019	\$	16,658	\$	43,079	\$	35,472
Earnings allocated to non-vesting equity awards		(270)		(244)		(728)		(516)
Net earnings available to common shares outstanding	\$	15,749	\$	16,414	\$	42,351	\$	34,956
Basic weighted-average common shares outstanding		28,966,065		29,039,565		28,990,500		28,997,030
Dilutive effect of stock options		12,710		21,964		12,109		18,393
Diluted weighted avg. shares outstanding		28,978,775		29,061,529		29,002,609		29,015,423
Diluted earnings per share	\$	0.54	\$	0.56	\$	1.46	\$	1.20

NOTE 3 - SUPPLEMENTAL CASH FLOW INFORMATION:

Income tax payments, net of refunds received, for the six months ended July 31, 2010 and August 1, 2009 were \$13,315,000 and \$9,435,000, respectively.

Table of Contents

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED JULY 31, 2010 AND AUGUST 1, 2009

NOTE 4 – FINANCING ARRANGEMENTS:

As of July 31, 2010, the Company had an unsecured revolving credit agreement of \$35.0 million. Net of the Company's standby letter of credit for payments to the current general liability and workers' compensation insurance processor, the revolving credit agreement provided for borrowings of up to \$33.3 million at July 31, 2010. In August, 2010, the Company extended the revolving credit agreement until August 2013. The credit agreement contains various financial covenants and limitations, including the maintenance of specific financial ratios with which the Company was in compliance as of July 31, 2010. There were no borrowings outstanding under this credit facility during the six months ended July 31, 2010 or August 1, 2009 or during the fiscal year ended January 30, 2010. Interest on any borrowings is based on LIBOR, which was 0.305% at July 31, 2010.

At July 31, 2010 and August 1, 2009 the Company had approximately \$10.3 million and \$8.3 million, respectively, of outstanding irrevocable letters of credit relating to purchase commitments. In addition, the Company has a standby letter of credit in the amount of approximately \$1.7 million at July 31, 2010 for payments to the current general liability and workers' compensation insurance processor.

NOTE 5 – REPORTABLE SEGMENT INFORMATION:

The Company has two reportable segments: retail and credit. The Company operated its women's fashion specialty retail stores in 31 states at July 31, 2010, principally in the southeastern United States. The Company offers its own credit card to its customers and all related credit authorizations, payment processing, and collection efforts are performed by a separate subsidiary of the Company.

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

Three Months Ended July 31, 2010	Retail	Credit	Total	Six Months Ended July 31, 2010	Retail	Credit	Total
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Revenues	\$ 232,607	\$ 2,120	\$ 234,727	Revenues	\$ 493,068	\$ 4,342	\$ 497,410
Depreciation	5,272	5	5,277	Depreciation	10,536	11	10,547
Interest and other income	(957)	-	(957)	Interest and other income	(1,849)	-	(1,849)
Income before taxes	24,257	843	25,100	Income before taxes	66,520	1,471	67,991
Total assets	420,486	73,087	493,573	Total assets	420,486	73,087	493,573
Capital expenditures	4,842	-	4,842	Capital expenditures	8,866	-	8,866
Three Months Ended August 1, 2009	Retail	Credit	Total	Six Months Ended August 1, 2009	Retail	Credit	Total
Revenues	\$ 225,932	\$ 2,334	\$ 228,266	Revenues	\$ 464,541	\$ 4,752	\$ 469,293
Depreciation	5,476	6	5,482	Depreciation	11,010	16	11,026
Interest and other income	(861)	-	(861)	Interest and other income	(1,921)	-	(1,921)
Income before taxes	22,918	788	23,706	Income before taxes	52,288	1,404	53,692
Total assets	380,522	71,063	451,585	Total assets	380,522	71,063	451,585
Capital expenditures	2,631	-	2,631	Capital expenditures	6,170	-	6,170

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

Table of Contents

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED JULY 31, 2010 AND AUGUST 1, 2009

NOTE 5 – REPORTABLE SEGMENT INFORMATION (CONTINUED):

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

	Three Months Ended		Six Months Ended	
	July 31, 2010	August 1, 2009	July 31, 2010	August 1, 2009
Bad debt expense	\$ 676	\$ 828	\$ 1,499	\$ 1,752
Payroll	239	247	474	496
Postage	197	224	425	469
Other expenses	160	241	462	615
Total expenses	\$ 1,272	\$ 1,540	\$ 2,860	\$ 3,332

NOTE 6 – STOCK BASED COMPENSATION:

As of July 31, 2010, the Company had three long-term compensation plans pursuant to which stock-based compensation was outstanding or could be granted. The Company's 1987 Non-Qualified Stock Option Plan authorized 5,850,000 shares for the granting of options to officers and key employees. The 1999 Incentive Compensation Plan and 2004 Amended and Restated Incentive Compensation Plan authorized 1,500,000 and 1,350,000 shares, respectively, for the granting of various forms of equity-based awards, including restricted stock and stock options to officers and key employees. The 1999 Plan has expired as to the ability to grant new awards.

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

	1987 Plan	1999 Plan	2004 Plan	Total
Options and/or restricted stock initially authorized	5,850,000	1,500,000	1,350,000	8,700,000
Options and/or restricted stock available for grant:				
January 30, 2010	18,627	-	737,162	755,789
July 31, 2010	18,627	-	619,476	638,103

In accordance with ASC 718, the fair value of current restricted stock awards is estimated on the date of grant based on the market price of the Company's stock and is amortized to compensation expense on a straight-line basis over the related vesting periods. As of July 31, 2010 and August 1, 2009, there was \$7,312,000 and \$5,105,000 of total unrecognized compensation cost related to nonvested restricted stock awards, which have a remaining weighted-average vesting period of 2.9 years and 3.2 years, respectively. The total fair value of the shares recognized as compensation expense during the second quarter and six months ended July 31, 2010 was \$770,000 and \$1,226,000, respectively, compared to \$757,000 and \$1,087,000 for the second quarter and six months ended August 1, 2009, respectively. These expenses are classified as a component of selling, general and administrative expenses.

Table of Contents

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED JULY 31, 2010 AND AUGUST 1, 2009

NOTE 6 – STOCK BASED COMPENSATION (CONTINUED):

The following summary shows the changes in the shares of restricted stock outstanding during the six months ended July 31, 2010:

	Number of Shares		Weighted Average Grant Date Fair Value Per Share
Restricted stock awards at January 30, 2010	496,428	\$	19.74
Granted	118,020		24.50
Vested	(86,261)		22.83
Forfeited or expired	(7,696)		19.46
Restricted stock awards at July 31, 2010	520,491	\$	20.31

The Company's Employee Stock Purchase Plan allows eligible full-time employees to purchase a limited number of shares of the Company's Class A Common Stock during each semi-annual offering period at a 15% discount through payroll deductions. During the six months ended July 31, 2010 and August 1, 2009, the Company sold 12,729 and 13,686 shares to employees at an average discount of \$3.03 and \$2.57 per share, respectively, under the Employee Stock Purchase Plan. The compensation expense recognized for the 15% discount given under the Employee Stock Purchase Plan was approximately \$39,000 and \$35,000 for the six months ended July 31, 2010 and August 1, 2009, respectively. These expenses are classified as a component of selling, general and administrative expenses.

The following is a summary of the changes in stock options outstanding during the six months ended July 31, 2010:

	Shares		Weighted Average Exercise Price	Weighted Average Remaining Contractual Term		Aggregate Intrinsic Value(a)
Options outstanding at January 30, 2010	64,350	\$	14.08	4.02 years	\$	398,312
Granted	-		-	-		-

Forfeited or expired	-	-	-	-
Exercised	22,550			
Outstanding at July 31, 2010	41,800	\$ 13.87	3.36 years	\$ 360,809
Vested and exercisable at July 31, 2010	41,800	\$ 13.87	3.36 years	\$ 360,809

(a) The intrinsic value of a stock option is the amount by which the market value of the underlying stock exceeds the exercise price of the option.

Table of Contents

**THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED JULY 31, 2010 AND AUGUST 1, 2009**

NOTE 6 – STOCK BASED COMPENSATION (CONTINUED):

No options were granted in the first half of fiscal 2010 or fiscal 2009.

The total intrinsic value of options exercised during the second quarter and six months ended July 31, 2010 was approximately \$51,000 and \$215,000, respectively.

During the quarter, the Company completed amortizing its nonvested options. In accordance with ASC 718, the Company adjusted its related forfeiture assumption. As a result, the Company recognized a reduction in shared based compensation expense of \$53,000 and \$52,000 for the second quarter and six month period ended July 31, 2010, respectively, compared to an expense of \$15,000 and \$55,000 for the second quarter and six month period ended August 1, 2009, respectively. These amounts are classified as a component of selling, general and administrative expenses.

Stock option awards outstanding under the Company's current plans were granted at exercise prices which were equal to the market value of the Company's stock on the date of grant, vest over five years and expire no later than ten years after the grant date.

NOTE 7 – INCOME TAXES:

For the quarter ended July 31, 2010, the Company's effective tax rate was 36.2% compared to 29.7% for the prior year quarter ended August 1, 2009. The prior year quarter was impacted by the reduction of the provision for unrecognized tax benefits resulting from the closing of certain state income tax audits. The effective income tax rate for the first six months of fiscal 2010 was 36.6% compared to 33.9% for the first six months of fiscal 2009. During the next 12

months, various taxing authorities' statutes of limitations will expire which could result in a potential reduction of the provision for unrecognized tax benefits. In addition, certain state examinations may close, the ultimate resolution of which could materially affect the effective tax rate. As a consequence, the balance in unrecognized tax benefits can be expected to fluctuate from period to period. It is reasonably possible such changes could be significant when compared to our total unrecognized tax benefits, but the amount of change is not estimable.

Table of Contents

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED JULY 31, 2010 AND AUGUST 1, 2009

NOTE 8 – FAIR VALUE MEASUREMENTS:

The following tables set forth information regarding the Company's financial assets that are measured at fair value (in thousands) as of July 31, 2010 and January 30, 2010.

Description	(\$ in thousands)			
	July 31, 2010	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
State/Municipal Bonds	\$ 101,837	\$ 101,837		
Corporate Bonds	30,672	30,672		
Auction Rate Securities (ARS)	3,450			3,450
Variable Rate Demand Notes (VRDN)	35,057	35,057		
Privately Managed Funds	1,962			1,962
Corporate Equities	431	431		
Total	\$ 173,409	\$ 167,997	\$ -	\$ 5,412

Description	(\$ in thousands)			
	January 30, 2010	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3

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State/Municipal Bonds	\$	76,056	\$	76,056		
Corporate Bonds		8,989		8,989		
Auction Rate Securities (ARS)		3,450				3,450
Variable Rate Demand Notes (VRDN)		65,382		65,382		
Privately Managed Funds		1,940				1,940
Corporate Equities		407		407		
Total	\$	156,224	\$	150,834	\$	- \$ 5,390

Table of Contents

**THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED JULY 31, 2010 AND AUGUST 1, 2009**

NOTE 8 – FAIR VALUE MEASUREMENTS (CONTINUED):

The Company's investment portfolio was primarily invested in tax exempt variable rate demand notes ("VRDN"), corporate bonds, and governmental debt securities held in managed funds with underlying ratings of A or better at both July 31, 2010 and January 30, 2010. The underlying securities have contractual maturities which generally range from 61 days to 30 years. These securities are classified as available-for-sale and are recorded as short term investments on the accompanying Condensed Consolidated Balance Sheets at estimated fair value, with unrealized gains and losses reported net of taxes in accumulated other comprehensive income.

Additionally, at July 31, 2010, the Company had \$2.0 million of privately managed funds, \$0.4 million of corporate equities and a single auction rate security ("ARS") of \$3.5 million which continues to fail its auction. All of these assets are recorded within Other assets in the Condensed Consolidated Balance Sheets. At January 30, 2010, the Company had \$1.9 million of privately managed funds, \$0.4 million of corporate equities, and a single ARS of \$3.5 million, all of which are recorded within Other assets in the Condensed Consolidated Balance Sheets.

The Company's failed ARS was measured at fair value using Level 3 inputs. Because there is no active market for this particular ARS, its fair value was determined through the use of a discounted cash flow analysis. The terms used in the analysis were based on management's estimate of the timing of future liquidity, which assumes that the security will be called or refinanced by the issuer or settled with a broker dealer prior to maturity. The discount rates used in the discounted cash flow analysis were based on market rates for similar liquid tax exempt securities with comparable ratings and maturities. Due to the uncertainty surrounding the timing of future liquidity, the Company also considered a liquidity/risk value reduction. In estimating the fair value of this ARS, the Company also considered the financial condition and near-term prospects of the issuer, the probability that the Company will be unable to collect all amounts due according to the contractual terms of the security and whether the security has been downgraded by a rating agency. The Company's valuation is sensitive to market conditions and management's judgment and can change significantly based on the assumptions used.

The Company's privately managed funds consist of two types of funds. The privately managed funds cannot be redeemed at net asset value at a specific date without advance notice. As a result, the Company has classified the investments as Level 3.

Table of Contents

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED JULY 31, 2010 AND AUGUST 1, 2009

NOTE 8 – FAIR VALUE MEASUREMENTS (CONTINUED):

The following table summarizes the change in the fair value of the Company's financial assets measured using Level 3 inputs during the first six months of fiscal 2010:

Roll Forward
(\$ in thousands)

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)			Total
	Available-For-Sale Debt Securities ARS	Other Investments Private Equity		
Beginning Balance at January 30, 2010	\$ 3,450	\$ 1,940	\$	\$ 5,390
Total gains or (losses)				
Included in earnings (or changes in net assets)		22		22
Included in other comprehensive income				
Ending Balance at July 31, 2010	\$ 3,450	\$ 1,962	\$	\$ 5,412

Table of Contents

**THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED JULY 31, 2010 AND AUGUST 1, 2009**

NOTE 9 – RECENT ACCOUNTING PRONOUNCEMENTS:

In January 2010, the FASB issued ASU No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*. ASU No. 2010-06 amends ASC 820 and clarifies and provides additional disclosure requirements related to recurring and non-recurring fair value measurements. This ASU was effective for the Company on January 31, 2010, and did not have a material impact on the Company's financial position or results of operations.

Table of Contents

THE CATO CORPORATION

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

FORWARD LOOKING INFORMATION:

The following information should be read along with the Unaudited Condensed Consolidated Financial Statements, including the accompanying Notes appearing in this report. Any of the following are "forward-looking" statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended: (1) statements in this Form 10-Q that reflect projections or expectations of our future financial or economic performance; (2) statements that are not historical information; (3) statements of our beliefs, intentions, plans and objectives for future operations, including those contained in "Management's Discussion and Analysis of Financial Condition and Results of Operations"; (4) statements relating to our operations or activities for fiscal 2010 and beyond, including, but not limited to, statements regarding expected amounts of capital expenditures and store openings, relocations, remodelings and closures; and (5) statements relating to our future contingencies. When possible, we have attempted to identify forward-looking statements by using words such as "expects," "anticipates," "approximates," "believes," "estimates," "hopes," "intends," "may," "plans," "should" and variations words and similar expressions. We can give no assurance that actual results or events will not differ materially from those expressed or implied in any such forward-looking statements. Forward-looking statements included in this report are based on information available to us as of the filing date of this report, but subject to known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from those contemplated by the forward-looking statements. Such factors include, but are not limited to, the following: general economic conditions including, but not limited to, the continuation or worsening of (i) the current adverse or recessionary conditions affecting the U.S. and global economies and consumer spending and (ii) the adverse conditions in the U.S. and global credit markets; uncertainties regarding the impact of any governmental responses to the foregoing adverse economic and credit market conditions; competitive factors and pricing pressures; our ability to predict fashion trends; consumer apparel buying patterns; adverse weather conditions; inventory risks due to shifts in market demand; and other factors discussed under "Risk Factors" in Part I, Item 1A of our annual report on Form 10-K for the fiscal year ended January 30, 2010 ("fiscal 2009"), as amended or supplemented, and in other reports we file with or furnish to the SEC from time to time. We do not undertake, and expressly decline, any obligation to update any such forward-looking information contained in this report, whether as a result of new information, future events, or otherwise.

Table of Contents

**THE CATO CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

CRITICAL ACCOUNTING POLICIES:

The Company's accounting policies are more fully described in Note 1 to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the fiscal year ended January 30, 2010. As disclosed in Note 1 of Notes to Consolidated Financial Statements, the preparation of the Company's financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions about future events that affect the amounts reported in the financial statements and accompanying notes. Future events and their effects cannot be determined with absolute certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results inevitably will differ from those estimates, and such differences may be material to the financial statements. The most significant accounting estimates inherent in the preparation of the Company's financial statements include the allowance for doubtful accounts, workers' compensation, general and auto insurance liabilities, group health insurance, inventory markdowns, litigation, calculation of asset impairment, store closings, inventory shrinkage and uncertain tax positions.

The Company's critical accounting policies and estimates are discussed with the Audit Committee on a quarterly basis.

RESULTS OF OPERATIONS:

The following table sets forth, for the periods indicated, certain items in the Company's unaudited Condensed Consolidated Statements of Income as a percentage of total retail sales:

	Three Months Ended		Six Months Ended	
	July 31, 2010	August 1, 2009	July 31, 2010	August 1, 2009
Total retail sales	100.0%	100.0%	100.0%	100.0%
Other income	1.2	1.3	1.2	1.3
Total revenues	101.2	101.3	101.2	101.3
Cost of goods sold	61.7	63.7	59.0	61.6

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Selling, general and administrative	26.9	25.1	26.6	26.1
Depreciation	2.3	2.4	2.1	2.4
Interest and other income	(0.4)	(0.4)	(0.4)	(0.4)
Income before income taxes	10.8	10.5	13.8	11.6
Net income	6.9	7.4	8.8	7.7

Table of Contents

**THE CATO CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

RESULTS OF OPERATIONS – (CONTINUED):

Comparison of Second Quarter and First Six Months of 2010 with 2009.

Total retail sales for the second quarter were \$231.9 million compared to last year's second quarter sales of \$225.4 million, a 2.9% increase. Same-store sales increased 2.0% in the second quarter of fiscal 2010 due to sell throughs of regular price merchandise. For the six months ended July 31, 2010, total retail sales were \$491.6 million compared to last year's first six months sales of \$463.4 million, and same-store sales increased 5.0% for the comparable six month period. Total revenues, comprised of retail sales and other income (principally, finance charges and late fees on customer accounts receivable and layaway fees), were \$234.7 million and \$497.4 million for the second quarter and six months ended July 31, 2010, respectively, compared to \$228.3 million and \$469.3 million for the second quarter and six months ended August 1, 2009, respectively. The Company operated 1,275 stores at July 31, 2010 compared to 1,285 stores at the end of last year's second quarter, respectively. For the first six months of 2010 the Company opened 13 new stores, relocated three stores and closed nine stores. The Company currently expects to open approximately 41 stores, relocate six stores and close approximately 35 stores in fiscal 2010.

Credit revenue of \$2.1 million represented 0.9% of total revenues in the second quarter of fiscal 2010, compared to the second quarter of fiscal 2009 credit revenue of \$2.3 million or 1.0% of total revenues. Credit revenue decreased for the comparable period due to lower finance charge income due to decreased sales under the Company's proprietary credit card. Credit revenue is comprised of interest earned on the Company's private label credit card portfolio and related fee income. Related expenses include principally bad debt expense, payroll, postage and other administrative expenses and totaled \$1.3 million in the second quarter of 2010, compared to last year's second quarter expenses of \$1.5 million. The decrease was primarily due to lower bad debt expense as well as reduced administrative expenses compared to the second quarter of 2009.

Other income in total, as included in total revenues, was \$2.9 million and \$5.8 million for the second quarter and first six months of fiscal 2010, compared to \$2.9 million and \$5.9 million for the prior year's comparable second quarter and first six months. The slight overall year-to-date decrease resulted primarily from lower finance charges and late

fees partially offset by an increase in layaway charges.

Cost of goods sold was \$143.0 million, or 61.7% of retail sales and \$289.9 million or 59.0% of retail sales for the second quarter and first six months of fiscal 2010, compared to \$143.5 million, or 63.7% of retail sales and \$285.4 million or 61.6% of retail sales for the prior year's comparable three and six month periods, respectively. The overall decrease in cost of goods sold as a percent of retail sales for the second quarter and first six months of 2010 resulted primarily from leveraging higher sales and lower markdowns. The decrease in markdowns was primarily attributable to inventory management and higher sell-throughs of regular priced merchandise. Cost of goods sold includes merchandise costs, net of discounts and allowances, buying costs, distribution costs, occupancy costs, freight and inventory shrinkage. Net merchandise costs and in-bound freight are capitalized as inventory costs. Buying and distribution costs include payroll, payroll-related costs and operating expenses for the buying departments and distribution center. Occupancy expenses include rent, real estate taxes, insurance, common area maintenance, utilities and maintenance for stores and distribution facilities. Total gross margin dollars (retail sales less cost of goods sold) increased by 8.4% to \$88.8 million for the second quarter of fiscal 2010 and increased by 13.3% to \$201.7 million for the first six months of fiscal 2010 compared to \$81.9 million and \$178.1 million for the prior year's comparable three and six month periods, respectively. Gross margin as presented may not be comparable to those of other entities.

Table of Contents

**THE CATO CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

RESULTS OF OPERATIONS – (CONTINUED):

Selling, general and administrative expenses (“SG&A”) primarily include corporate and store payroll, related payroll taxes and benefits, insurance, supplies, advertising, bank and credit card processing fees and bad debts. SG&A expenses were \$62.3 million, or 26.9% of retail sales and \$130.8 million, or 26.6% of retail sales for the second quarter and first six months of fiscal 2010, respectively, compared to \$56.5 million, or 25.1% of retail sales and \$121.1 million, or 26.1% of retail sales for the prior year’s comparable three and six month periods, respectively. SG&A expenses as a percentage of retail sales increased 180 basis points for the second quarter of fiscal 2010 as compared to the prior year primarily as a result of higher accrued incentive compensation and workers’ compensation costs. For the first six months of fiscal 2010, SG&A expenses increased 50 basis points as compared to the prior year. The overall dollar increase for the first six months of fiscal 2010 was primarily attributable to increased incentive based compensation, payroll and workers’ compensation expenses partially offset by a reduction in legal expense.

Depreciation expense was \$5.3 million, or 2.3% of retail sales and \$10.5 million, or 2.1% of retail sales for the second quarter and first six months of fiscal 2010, respectively, compared to \$5.5 million, or 2.4% of retail sales and \$11.0 million, or 2.4% of retail sales for the prior year’s comparable three and six month periods, respectively. The decrease in depreciation expense was due to lower store development in the past two years and decreased information technology investments.

Interest and other income was \$1.0 million, or 0.4% of retail sales and \$1.8 million, or 0.4% of retail sales for the second quarter and first six months of fiscal 2010, respectively, compared to \$0.9 million, or 0.4% of retail sales and \$1.9 million, or 0.4% of retail sales for the prior year’s comparable three and six month periods, respectively. The slight decrease for the first six months of fiscal 2010 was primarily due to lower interest income due to reduced yields.

Income tax expense was \$9.1 million or 3.9% of retail sales and \$24.9 million, or 5.1% for the second quarter and first six months of fiscal 2010, respectively, compared to \$7.0 million, or 3.1% of retail sales and \$18.2 million, or 3.9% of retail sales for the prior year’s comparable three and six month periods, respectively. The second quarter increase

resulted from higher pre-tax income and a higher effective tax rate. The effective income tax rate for the second quarter of fiscal 2010 was 36.2% compared to 29.7% for the second quarter of 2009. The prior year quarter was impacted by the reduction of the provision for unrecognized tax benefits resulting from the closing of certain state income tax audits. The effective income tax rate for the first six months of fiscal 2010 was 36.6% compared to 33.9% for the six months of fiscal 2009.

LIQUIDITY, CAPITAL RESOURCES AND MARKET RISK:

The Company has consistently maintained a strong liquidity position. Cash provided by operating activities during the first six months of fiscal 2010 was \$59.9 million as compared to \$54.0 million in the first six months of fiscal 2009. These amounts enable the Company to fund its regular operating needs, capital expenditure program, cash dividend payments and share repurchases. In addition, the Company maintains a \$35.0 million unsecured revolving credit facility for short-term financing of seasonal cash needs. There were no outstanding borrowings on this facility at July 31, 2010, and borrowing capacity under the facility was \$33.3 million, net of standby letter of credit obligations.

Table of Contents

**THE CATO CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

LIQUIDITY, CAPITAL RESOURCES AND MARKET RISK (CONTINUED):

Cash provided by operating activities for the first six months of fiscal 2010 was primarily generated by earnings adjusted for depreciation and changes in working capital. The increase of \$5.9 million for the first six months of fiscal 2010 as compared to the first six months of fiscal 2009 was primarily due to an increase in net income, a change in inventories, and accrued income taxes partially offset by a decrease in imports payable and payment of incentive based compensation.

The Company believes that its cash, cash equivalents and short-term investments, together with cash flows from operations, will be adequate to fund the Company's operating requirements, dividends, share repurchases and expected capital expenditures for the balance of fiscal 2010 and for the foreseeable future.

At July 31, 2010, the Company had working capital of \$232.3 million compared to \$192.1 million at August 1, 2009. Additionally, the Company had \$2.4 million invested in privately managed investment funds and other miscellaneous equities at July 31, 2010, which are included in Other assets on the Condensed Consolidated Balance Sheets.

At July 31, 2010, the Company had an unsecured revolving credit agreement, which provides for borrowings of up to \$33.3 million, net of standby letter of credit obligations. In August 2010, the Company extended the revolving credit agreement until August 2013. The credit agreement contains various financial covenants and limitations, including the maintenance of specific financial ratios with which the Company was in compliance as of July 31, 2010. There were no borrowings outstanding under the credit facility during the second quarter ended July 31, 2010 or the fiscal year ended January 30, 2010.

At July 31, 2010 and August 1, 2009, the Company had approximately \$10.3 million and \$8.3 million, respectively, of outstanding irrevocable letters of credit relating to purchase commitments. In addition, the Company has a standby letter of credit in the amount of approximately \$1.7 million at July 31, 2010 for payments to the current general

liability and workers' compensation insurance processor.

Expenditures for property and equipment totaled \$8.9 million in the first six months of fiscal 2010, compared to \$6.2 million in last year's first six months. The expenditures for the first six months of 2010 were primarily for the development of 13 new stores and additional investments in new technology. For the full fiscal 2010 year, the Company expects to invest approximately \$20.8 million for capital expenditures. This includes expenditures to open 41 new stores and relocate six stores.

Net cash used in investing activities totaled \$26.5 million in the first six months of fiscal 2010 compared to \$58.1 million used in the comparable period of 2009. The decrease was due primarily to the increase in sales of short-term investments over purchases of such investments.

On August 26, 2010, the Board of Directors maintained the quarterly dividend at \$.185 per share or an annualized rate of \$.74 per share.

In September 2009, the Company retired all of its shares of treasury stock. The excess of the price over par value of common stock of approximately \$155.6 million was charged to retained earnings upon the retirement of the treasury stock.

Table of Contents

**THE CATO CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

LIQUIDITY, CAPITAL RESOURCES AND MARKET RISK (CONTINUED):

As of July 31, 2010, the Company had 442,942 shares remaining available for repurchase under its share repurchase program. There is no specified expiration date for the Company's repurchase program. For the three months ended July 31, 2010, the Company repurchased 108,654 shares at a cost of \$2,571,629.

The Company does not use derivative financial instruments.

The Company's investment portfolio was primarily invested in tax exempt variable rate demand notes ("VRDN"), corporate bonds, and governmental debt securities held in managed funds with underlying ratings of A or better at both July 31, 2010 and January 30, 2010. The underlying securities have contractual maturities which generally range from 61 days to 30 years. These securities are classified as available-for-sale and are recorded as short term investments on the accompanying Condensed Consolidated Balance Sheets at estimated fair value, with unrealized gains and losses reported net of taxes in accumulated other comprehensive income.

Additionally, at July 31, 2010, the Company had \$2.0 million of privately managed funds, \$0.4 million of corporate equities and a single auction rate security ("ARS") of \$3.5 million which continues to fail its auction. All of these assets are recorded within Other assets in the Condensed Consolidated Balance Sheets.

Information regarding new accounting pronouncements is provided in Note 9 to the Company's Condensed Consolidated Financial Statements.

Table of Contents

**THE CATO CORPORATION
QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK:

The Company is subject to market rate risk from exposure to changes in interest rates based on its financing, investing and cash management activities, but the Company does not believe such exposure is material.

ITEM 4. CONTROLS AND PROCEDURES:

We carried out an evaluation, with the participation of our Principal Executive Officer and Principal Financial Officer, of the effectiveness of our disclosure controls and procedures as of July 31, 2010. Based on this evaluation, our Principal Executive Officer and Principal Financial Officer concluded that, as of July 31, 2010, our disclosure controls and procedures, as defined in Rule 13a-15(e), under the Securities Exchange Act of 1934 (the "Exchange Act"), were effective to provide reasonable assurance that information we are required to disclose in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to our management, including our Principal Executive Officer and Principal Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING:

No change in the Company's internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) has occurred during the Company's fiscal quarter ended July 31, 2010 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents

PART II OTHER INFORMATION

THE CATO CORPORATION

ITEM 1. LEGAL PROCEEDINGS

Not Applicable

ITEM 1A. RISK FACTORS

In addition to the other information in this report, you should carefully consider the factors discussed in Part I, “Item 1A. Risk Factors” in our Annual Report on Form 10-K for our fiscal year ended January 30, 2010. These risks could materially affect our business, financial condition or future results; however, they are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may also materially adversely affect our business, financial condition or results of operations.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table summarizes the Company’s purchases of its common stock for the three months ended July 31, 2010:

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number Of Shares Purchased	Average Price Paid per Share (2)	Total Dollar Value of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number (or Approximate Dollar Value) of Shares that may Yet be Purchased Under The Plans or Programs (1)
May 2010	108,654	\$ 23.67	\$ 2,571,629	
June 2010	-	-	-	
July 2010	-	-	-	
Total	108,654	\$ 23.67	\$ 2,571,629	442,942

(1) On August 30, 2007, the Company's Board of Directors authorized an increase in the share repurchase program to two million shares. An additional increase of 500,000 shares was authorized on February 26, 2009. As of January 30, 2010, the Company's share repurchase program had 695,942 shares remaining in open authorizations. At the second quarter ending July 31, 2010, the Company had 442,942 shares remaining in open authorizations. There is no specified expiration date for the Company's repurchase program.

(2) Prices include trading costs.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not Applicable

Table of Contents

PART II OTHER INFORMATION

THE CATO CORPORATION

ITEM 4. REMOVED AND RESERVED

Not Applicable

ITEM 5. OTHER INFORMATION

Not Applicable

ITEM 6. EXHIBITS

Exhibit No.	Item
3.1	Registrant's Restated Certificate of Incorporation dated March 6, 1987, incorporated by reference to Exhibit 4.1 to Form S-8 of the Registrant filed February 7, 2000 (SEC File No. 333-96283).
3.2	Registrant's By Laws incorporated by reference to Exhibit 99.2 to Form 8-K of the Registrant Filed December 10, 2007.
4.1	Rights Agreement dated December 18, 2003, incorporated by reference to Exhibit 4.1 to Form 8-A12G of the Registrant filed December 22, 2003 and as amended in Form 8-A12B/A filed January 6, 2004.
31.1	Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer.
31.2	Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer.
32.1	Section 1350 Certification of Principal Executive Officer.
32.2	Section 1350 Certification of Principal Financial Officer.

Table of Contents

PART II OTHER INFORMATION

THE CATO CORPORATION

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.

THE CATO CORPORATION

September 8, 2010
Date

/s/ John P. D. Cato
John P. D. Cato

Chairman, President and

Chief Executive Officer

September 8, 2010
Date

/s/ John R. Howe
John R. Howe

Executive Vice President

Chief Financial Officer