CATO CORP
Form 10-Q
December 12, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended ____November 3, 2007____

OR

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

For the transition period from ________to________

Commission file number ___1-31340___

THE CATO CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	56-0484485
(State or other jurisdiction of incorporation or organization)	(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)

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 þ No o

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

Large accelerated filer þ Accelerated filer o Non-Accelerated filer o

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

As of November 20, 2007, there were 29,475,345 shares of Class A common stock and 1,743,525 shares of Class B common stock outstanding.

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FORM 10-Q
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Exhibit 32.2

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

THE CATO CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

	Three Months Ended		Nine Months Ended	
	November 3, 2007 (Unaudited)	October 28, 2006 (Unaudited)	November 3, 2007 (Unaudited)	October 28, 2006 (Unaudited)
	(Dollars in thousands, except per share data)			
REVENUES				
Retail sales	**$ 181,870**	$ 187,727	**$ 624,977**	$ 632,101
Other income (principally finance charges, late fees and layaway charges)	**2,968**	3,155	**9,024**	9,686
Total revenues	**184,838**	190,882	**634,001**	641,787
COSTS AND EXPENSES, NET				
Cost of goods sold	**126,080**	127,229	**417,015**	413,087
Selling, general and administrative	**51,303**	51,482	**154,903**	157,831
Depreciation	**5,684**	5,169	**16,698**	15,561
Interest and other income	**(2,176)**	(2,131)	**(6,385)**	(5,624)
	180,891	181,749	**582,231**	580,855
Income before income taxes	**3,947**	9,133	**51,770**	60,932
Income tax expense	**1,011**	3,272	**17,654**	22,179
Net Income	**$ 2,936**	$ 5,861	**$ 34,116**	$ 38,753
Basic earnings per share	**$ 0.09**	$ 0.19	**$ 1.08**	$ 1.24
Basic weighted average shares	**31,891,308**	31,298,253	**31,713,755**	31,270,347
Diluted earnings per share	**$ 0.09**	$ 0.18	**$ 1.07**	$ 1.22
Diluted weighted average shares	**31,988,081**	31,846,241	**32,020,584**	31,795,150

Dividends per share	**$**	**.165**	$	0.15	**$**	**0.48**	$	0.43
Comprehensive income:								
Net income	**$**	**2,936**	$	5,861	**$**	**34,116**	$	38,753
Unrealized gains on available-for-sale securities, net of deferred income tax expense		**215**		78		**193**		112
Net comprehensive income	**$**	**3,151**	$	5,939	**$**	**34,309**	$	38,865

See notes to condensed consolidated financial statements.

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THE CATO CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

	November 3, 2007 (Unaudited)	October 28, 2006 (Unaudited)	February 3, 2007
		(Dollars in thousands)	
ASSETS			
Current Assets:			
Cash and cash equivalents	**$ 20,187**	$ 21,428	$ 24,833
Short-term investments	**126,797**	86,229	98,709
Accounts receivable, net of allowance for doubtful accounts of $3,194, $3,585 and $3,554 at November 3, 2007, October 28, 2006 and February 3, 2007, respectively	**44,470**	45,229	45,958
Merchandise inventories	**114,066**	110,078	115,918
Deferred income taxes	**7,415**	8,462	7,508
Prepaid expenses	**7,208**	2,438	6,587
Total Current Assets	**320,143**	273,864	299,513
Property and equipment net	**125,377**	130,255	128,461
Other assets	**4,617**	11,150	4,348
Total Assets	**$ 450,137**	$ 415,269	$ 432,322
LIABILITIES AND STOCKHOLDERS EQUITY			
Current Liabilities:			
Accounts payable	**$ 88,169**	$ 63,542	$ 77,046
Accrued expenses	**34,646**	34,334	29,526
Accrued bonus and benefits	**1,881**	11,511	10,756
Accrued income taxes	**2,259**	5,803	5,721
Total Current Liabilities	**126,955**	115,190	123,049
Deferred income taxes	**8,817**	9,261	8,817
Other noncurrent liabilities (primarily deferred rent)	**23,266**	23,187	23,663
Commitments and contingencies:			
Stockholders Equity:			
Preferred stock, $100 par value per share, 100,000 shares authorized, none issued	¾	¾	¾
Class A common stock, $.033 par value per share, 50,000,000 shares authorized; issued 36,100,759 shares, 35,922,824 shares and 35,955,815 shares at November 3, 2007, October 28, 2006 and February 3, 2007, respectively	**1,203**	1,197	1,199
Convertible Class B common stock, $.033 par value per share, 15,000,000 shares authorized; issued 1,743,525 shares, 690,525 shares and 690,525 shares at November 3, 2007, October 28, 2006 and February 3, 2007, respectively	**58**	23	23

Additional paid-in capital	**57,639**	41,318	42,475
Retained earnings	**346,901**	319,716	327,684
Accumulated other comprehensive income	**418**	190	225
	406,219	362,444	371,606
Less Class A common stock in treasury, at cost (6,128,015 Class A shares at November 3, 2007, and 5,093,609 Class A shares at October 28, 2006 and February 3, 2007, respectively)	**(115,120)**	(94,813)	(94,813)
Total Stockholders Equity	**291,099**	267,631	276,793
Total Liabilities and Stockholders Equity	**$ 450,137**	$ 415,269	$ 432,322

See notes to condensed consolidated financial statements.

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THE CATO CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended	
	November 3, 2007 (Unaudited)	October 28, 2006 (Unaudited)
	(Dollars in thousands)	
OPERATING ACTIVITIES		
Net income	**$ 34,116**	$ 38,753
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	**16,698**	15,561
Provision for doubtful accounts	**1,812**	2,111
Share-based compensation	**1,282**	983
Excess tax benefits from share-based compensation	**(5,460)**	(312)
Deferred income taxes	**¾**	64
Loss on disposal of property and equipment	**500**	1,323
Changes in operating assets and liabilities which provided (used) cash:		
Accounts receivable	**(324)**	2,304
Merchandise inventories	**1,852**	(6,708)
Prepaid and other assets	**(890)**	(416)
Accrued income taxes	**2,360**	(1,125)
Accounts payable, accrued expenses and other liabilities	**5,651**	(20,327)
Net cash provided by operating activities	**57,597**	34,461
INVESTING ACTIVITIES		
Expenditures for property and equipment	**(14,288)**	(23,169)
Purchases of short-term investments	**(154,470)**	(114,143)
Sales of short-term investments	**126,669**	114,110
Net cash used in investing activities	**(42,089)**	(23,202)
FINANCING ACTIVITIES		
Change in cash overdrafts included in accounts payable	**(500)**	600
Dividends paid	**(15,279)**	(13,508)
Purchases of treasury stock	**(18,314)**	¾
Proceeds from employee stock purchase plan	**461**	395
Excess tax benefits from share-based compensation	**5,460**	312
Proceeds from stock options exercised	**8,018**	636
Net cash used in financing activities	**(20,154)**	(11,565)

Net decrease in cash and cash equivalents	**(4,646)**	(306)
Cash and cash equivalents at beginning of period	**24,833**	21,734
Cash and cash equivalents at end of period	**$ 20,187**	$ 21,428

See notes to condensed consolidated financial statements.

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THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND NINE MONTHS ENDED NOVEMBER 3, 2007 AND OCTOBER 28, 2006

NOTE 1 GENERAL:

The condensed consolidated financial statements have been prepared from the accounting records of The Cato Corporation and its wholly-owned subsidiaries (the Company), and all amounts shown as of and for the periods ended November 3, 2007 and October 28, 2006 are unaudited. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. All such adjustments are of a normal, recurring nature. The results of the interim period may not be indicative of the results expected for the entire year.

The interim financial statements should be read in conjunction with the consolidated financial statements and notes thereto, included in the Company s Annual Report on Form 10-K for the fiscal year ended February 3, 2007.

The year-end condensed consolidated balance sheet data presented for fiscal year ended February 3, 2007 was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

Cash equivalents consist of highly liquid investments with original maturities of three months or less. Investments with original maturities beyond three months are classified as short-term investments. The fair values of short-term investments are based on quoted market prices.

Short-term investments are classified as available-for-sale. As they are available for current operations, they are classified in the Condensed Consolidated Balance Sheets as current assets. Available-for-sale securities are carried at fair value, with unrealized gains and temporary losses, net of income taxes, reported as a component of accumulated other comprehensive income. Other than temporary declines in fair value of investments are recorded as a reduction in the cost of the investments in the accompanying Condensed Consolidated Balance Sheets and a reduction of interest and other income in the accompanying Condensed Consolidated Statements of Income and Comprehensive Income. The cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. The amortization of premiums, accretion of discounts and realized gains and losses are included in interest and other income.

Merchandise inventories are stated at the lower of cost (first-in, first-out method) or market as determined by the retail inventory method.

On May 24, 2007, the Board of Directors increased the quarterly dividend by 10% from $.15 per share to $.165 per share, or an annualized rate of $.66 per share.

NOTE 2 EARNINGS PER SHARE:

FASB No. 128 requires dual presentation of basic EPS and diluted 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 consolidated statement of income. While the Company s articles of incorporation provide the right for the

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THE CATO CORPORATION
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FOR THE THREE MONTHS AND NINE MONTHS ENDED NOVEMBER 3, 2007 AND OCTOBER 28, 2006
NOTE 2 EARNINGS PER SHARE (CONTINUED):

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 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 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 and the potential vestings of restricted stock computed using the treasury stock method.

	Three Months Ended		**Nine Months Ended**	
	November 3, 2007	October 28, 2006	**November 3, 2007**	October 28, 2006
Weighted-average shares outstanding	**31,891,308**	31,298,253	**31,713,755**	31,270,347
Dilutive effect of :				
Stock options	**40,486**	523,476	**254,722**	511,307
Restricted stock	**55,100**	24,512	**50,524**	13,496
Employee stock purchase plan	**1,187**	¾	**1,583**	¾
Weighted-average shares and common stock equivalents outstanding	**31,988,081**	31,846,241	**32,020,584**	31,795,150

NOTE 3 SUPPLEMENTAL CASH FLOW INFORMATION:

Income tax payments, net of refunds received, for the nine months ended November 3, 2007 and October 28, 2006 were $15,216,000 and $21,121,000, respectively. Cash paid for interest for the nine months ended November 3, 2007 and October 28, 2006 was zero for both periods ended, respectively.

NOTE 4 FINANCING ARRANGEMENTS:

At November 3, 2007, the Company had an unsecured revolving credit agreement, which provided for borrowings of up to $35 million. The revolving credit agreement was amended October 29, 2007 and has been extended from August 2008 to August 2010. The credit agreement contains various financial covenants and limitations, including the maintenance of specific financial ratios with which the Company was in compliance as of November 3, 2007. There were no borrowings outstanding under this credit facility during the first nine months ended November 3, 2007 or October 28, 2006, respectively, or the fiscal year ended February 3, 2007. Interest on any borrowings is based on LIBOR, which was 4.68% at November 3, 2007.

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THE CATO CORPORATION
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FOR THE THREE MONTHS AND NINE MONTHS ENDED NOVEMBER 3, 2007 AND OCTOBER 28, 2006

NOTE 4 FINANCING ARRANGEMENTS (CONTINUED):

At November 3, 2007 and October 28, 2006 the Company had approximately $2,544,000 and $2,151,000, respectively, of outstanding irrevocable letters of credit relating to purchase commitments.

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 November 3, 2007, 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 November 3, 2007	Retail	Credit	Total	Nine Months Ended November 3, 2007	Retail	Credit	Total
Revenues	$182,215	$ 2,623	$184,838	Revenues	$626,220	$ 7,781	$634,001
Depreciation	5,656	28	5,684	Depreciation	16,620	78	16,698
Interest and other income	(2,176)		(2,176)	Interest and other income	(6,385)		(6,385)
Income before taxes	2,803	1,144	3,947	Income before taxes	48,370	3,400	51,770
Total assets	380,967	69,170	450,137	Total assets	380,967	69,170	450,137
Capital expenditures	4,720		4,720	Capital expenditures	14,169	119	14,288

Three Months Ended October 28, 2006	Retail	Credit	Total	Nine Months Ended October 28, 2006	Retail	Credit	Total
Revenues	$188,171	$ 2,711	$190,882	Revenues	$633,718	$ 8,069	$641,787
Depreciation	5,142	27	5,169	Depreciation	15,494	67	15,561
Interest and other income	(2,131)		(2,131)	Interest and other income	(5,624)		(5,624)
Income before taxes	7,948	1,185	9,133	Income before taxes	57,753	3,179	60,932
Total assets	345,075	70,194	415,269	Total assets	345,075	70,194	415,269
Capital expenditures	5,797	2	5,799	Capital expenditures	23,146	23	23,169

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

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

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NOTE 5 REPORTABLE SEGMENT INFORMATION (CONTINUED):

	Three Months Ended		Nine Months Ended	
	November 3, 2007	October 28, 2006	**November 3, 2007**	October 28, 2006
Bad debt expense	**$ 678**	$ 722	**$ 1,812**	$ 2,303
Payroll	**251**	246	**738**	760
Postage	**235**	239	**748**	780
Other expenses	**287**	292	**1,005**	980
Total expenses	**$ 1,451**	$ 1,499	**$ 4,303**	$ 4,823

NOTE 6 STOCK BASED COMPENSATION:

Effective January 29, 2006, the Company began recording compensation expense associated with stock options and other forms of equity compensation in accordance with Statement of Financial Accounting Standards (SFAS) No. 123R, *Share-Based Payment,* as interpreted by SEC Staff Accounting Bulletin No. 107. Prior to January 29, 2006, the Company had accounted for stock options according to the provisions of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees,* and related interpretations, and therefore no related compensation expense was recorded for awards granted with no intrinsic value at the date of the grant. The Company adopted the modified prospective transition method provided under SFAS No. 123R, and, consequently, has not adjusted results from prior periods to retroactively reflect compensation expense. Under this transition method, compensation cost associated with stock options recognized in fiscal 2006 and 2007 includes: quarterly amortization related to the remaining unvested portion of all stock option awards granted prior to January 29, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123 and quarterly amortization related to all stock option awards granted subsequent to January 29, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123R.

As of November 3, 2007, 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 Incentive Compensation Plan authorized 1,000,000 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.

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NOTE 6 STOCK BASED COMPENSATION (CONTINUED):

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

	1987 Plan	1999 Plan	2004 Plan	Total
Options and/or restricted stock initially authorized	5,850,000	1,000,000	1,350,000	8,200,000
Options and/or restricted stock available for grant:				
February 3, 2007	9,277		1,091,618	1,100,895
November 3, 2007	9,277		1,003,909	1,013,186

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.

The following is a summary of the changes in stock options outstanding during the nine months ended November 3, 2007:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (a)
Options outstanding at February 3, 2007	1,236,675	$ 8.01	1.86 years	$18,363,084
Granted				
Forfeited or expired	2,400	14.86		
Exercised	1,083,200	7.40		
Outstanding at November 3, 2007	151,075	$12.30	4.78 years	$ 1,218,037
Vested and exercisable at November 3, 2007	102,025	$11.08	3.85 years	$ 946,662

(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.

No options were granted in fiscal 2006 or the first nine months of fiscal 2007.

As of November 3, 2007, there was approximately $196,000 of total unrecognized compensation cost related to nonvested options, which is expected to be recognized over a remaining weighted-average vesting period of 1.64 years. The total intrinsic value of options exercised during the third quarter and nine months ended November 3, 2007 was approximately $28,000 and $15,336,000, respectively.

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NOTE 6 STOCK BASED COMPENSATION (CONTINUED):

Effective with the adoption of SFAS No. 123R, the Company began recognizing share-based compensation expense ratably over the vesting period, net of estimated forfeitures. The Company recognized share-based compensation expense of $470,000 and $1,282,000 for the third quarter and nine month period ended November 3, 2007, respectively, compared to $357,000 and $983,000 for the third quarter and nine month period ended October 28, 2006, respectively. These expenses are classified as a component of selling, general and administrative expenses.

Prior to the adoption of SFAS No. 123R, the Company presented all benefits of tax deductions resulting from the exercise of share-based compensation as operating cash flows in the Statements of Cash Flows. SFAS No. 123R requires the benefits of tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. For the nine months ended November 3, 2007 and October 28, 2006, the Company reported $5,460,000 and $312,000 of excess tax benefits as a financing cash inflow in addition to $8,479,000 and $1,031,000 in cash proceeds received from the exercise of stock options and Employee Stock Purchase Plan purchases, respectively.

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 nine months ended

November 3, 2007 and October 28, 2006, the Company sold 25,535 and 21,982 shares to employees at an average discount of $3.19 and $3.17 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 $81,000 and $70,000 for the nine months ended November 3, 2007 and October 28, 2006, respectively.

In accordance with SFAS No. 123R, the fair value of current restricted stock awards is estimated on the date of grant based on the market price of the Company s stock and is amortized to compensation expense on a straight-line basis over the related vesting periods. As of November 3, 2007 and October 28, 2006, there was $5,330,000 and $4,364,000 of total unrecognized compensation cost related to nonvested restricted stock awards, which have a remaining weighted-average vesting period of 3.76 years and 4.5 years, respectively. The total fair value of the shares recognized as compensation expense during the third quarter and nine months ended November 3, 2007 was $397,000 and $1,095,000 compared to $285,000 and $795,000 for the third quarter and nine months ended October 28, 2006.

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NOTE 6 STOCK BASED COMPENSATION (CONTINUED):

The following summary shows the changes in the shares of restricted stock outstanding during the nine months ended November 3, 2007:

	Number of Shares	Weighted Average Grant Date Fair Value Per Share	
Restricted stock awards at February 3, 2007	214,882	$	22.92
Granted	100,226		21.87
Vested			
Forfeited	11,017		22.67
Restricted stock awards at November 3, 2007	304,091	$	22.59

NOTE 7 INCOME TAXES:

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109. This Interpretation prescribes the recognition threshold a tax position is required to meet before being recognized in the financial statements. The Interpretation also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods and disclosure of uncertain tax positions. The Interpretation is effective for fiscal years beginning after December 15, 2006. The Company adopted Financial Standards Accounting Board Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, on February 4, 2007.

As a result of the implementation of FASB Interpretation No. 48, the Company recognized a transition adjustment increasing beginning retained earnings by $362,000. At February 4, 2007, the Company had a liability of approximately $6,200,000 for unrecognized tax benefits, approximately $4,200,000 of which would affect the effective tax rate if recognized. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of February 4, 2007, the Company had approximately $3,900,000 of accrued interest and penalties related to uncertain tax positions. The tax years after 2003 remain open to examination by the major taxing jurisdictions to which the Company is subject.

Our estimate for the potential outcome for any uncertain tax issue is highly judgmental. We believe we have adequately provided for any reasonable foreseeable outcome related to these matters. However, our future results may include favorable or unfavorable adjustments to our estimated tax liabilities in the period the assessments are made or resolved or when statutes of limitation on potential assessments expire. As a result, the Company s effective tax rate may fluctuate significantly on a quarterly basis.

As of the nine months ending November 3, 2007, there have been no significant changes in unrecognized tax benefits.

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THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND NINE MONTHS ENDED NOVEMBER 3, 2007 AND OCTOBER 28, 2006
NOTE 8 RECENT ACCOUNTING PRONOUNCEMENTS (CONTINUED):

In September 2006, FASB issued SFAS 157, Fair Value Measurements . SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosure of fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company is in the process of evaluating the impact that the adoption of SFAS 157 will have on its financial statements.

In February 2007, the FASB issued SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities. SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS 159 applies to all entities that elect the fair value option. The provisions of SFAS 159 are effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact, if any, that the adoption of SFAS 159 will have on the Company s financial statements.

In December 2007, FASB issued SFAS 141 (Revised 2007), Business Combinations . The objective of SFAS 141 (Revised 2007) is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. SFAS 141 (Revised 2007) requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date. SFAS 141 (Revised 2007) also requires the acquirer to recognize and measure the goodwill acquired in a business combination or a gain from a bargain purchase and how to evaluate the nature and financial effects of the business combination. SFAS 141 (Revised 2007) is effective for financial statements issued for fiscal years beginning after December 15, 2008. The Company is in the process of evaluating the impact, if any, that the adoption of SFAS 141 (Revised 2007) will have on its financial statements.

In December 2007, FASB issued SFAS 160, Noncontrolling Interests in Consolidated Financial Statements-an amendment of ARB No. 51 . The objective of SFAS 160 is to improve the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements. SFAS 160 amends ARB No. 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 also changes the way the consolidated income statement is presented, establishes a single method of accounting for changes in a parent s ownership interest in a subsidiary that do not result in deconsolidation, requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated and expanded disclosures in the consolidated financial statements that clearly identify and distinguish between the interests of the parent s owners and the interest of the noncontrolling owners of a subsidiary. SFAS 160 is effective for financial statements issued for the fiscal years beginning on or after December 15, 2008. The Company is in the process of evaluating the impact, if any, that the adoption of SFAS 160 will have on its financial statements.

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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 2007 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 a 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; 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 February 3, 2007 (fiscal 2006), 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.

As used herein, the terms we, our, us (or similar terms), the Company or Cato include The Cato Corporation subsidiaries, except that when used with reference to common stock or other securities described herein and in describing the positions held by management of the Company, such terms include only The Cato Corporation.

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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 in the Company s Annual Report on Form 10-K for the Fiscal Year Ended February 3, 2007. As disclosed in Note 1, the preparation of the Company s financial statements in conformity with generally accepted accounting principles 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 receivable, reserves relating to workers compensation, general and auto insurance liabilities, reserves for inventory markdowns, shrinkage accrual, calculation of asset impairment and reserves for uncertain tax positions.

The Company s critical accounting policies and estimates are discussed with the Audit Committee.

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

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

	Three Months Ended		**Nine Months Ended**	
	November 3, 2007	October 28, 2006	**November 3, 2007**	October 28, 2006
Total retail sales	**100.0%**	100.0%	**100.0%**	100.0%
Total revenues	**101.6**	101.7	**101.4**	101.5
Cost of goods sold	**69.3**	67.8	**66.7**	65.3
Selling, general and administrative	**28.2**	27.4	**24.8**	25.0
Depreciation	**3.1**	2.7	**2.6**	2.5
Interest and other income	**(1.2)**	(1.1)	**(1.0)**	(0.9)
Income before income taxes	**2.2**	4.9	**8.3**	9.6
Net income	**1.6**	3.1	**5.5**	6.1

Comparison of Third Quarter and First Nine Months of 2007 with 2006.

Total retail sales for the third quarter were $181.9 million compared to last year s third quarter sales of $187.7 million, a 3.1% decrease. Same-store sales decreased 4.6% in the third quarter of fiscal 2007. For the nine months ended November 3, 2007, total retail sales were $625.0 million compared to last year s first nine months sales of $632.1 million, a 1% decrease, and same-store sales decreased 3.3% for the comparable nine month period. The third quarter and nine months sales results reflect the difficult retail environment that the Company has faced and expects to face through the fourth quarter.

Total revenues, comprised of retail sales and other income (principally, finance charges and late fees on customer accounts receivable and layaway fees), were $184.8 million and $634.0 million for the third quarter and nine months ended November 3, 2007, respectively, compared to $190.9 million and $641.8 million for the third quarter and nine months ended October 28, 2006, respectively. The Company operated 1,321 stores at November 3, 2007 compared to 1,270 stores at the end of last year s third quarter. For the first nine months of 2007 the Company opened 49 stores, relocated 16 stores and closed 4 stores. The Company expects to open approximately 60 to 65 stores and close approximately 15 stores during its full fiscal 2007 year.

Credit revenue of $2.6 million represented 1.4% of total revenues in the third quarter of 2007, compared to 2006 credit revenue of $2.7 million or 1.4% of total revenues. The slight reduction in credit revenue was due to lower finance charge and late fee income from lower sales under the Company s proprietary credit card compared to the prior year. 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

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

$1.5 million in the third quarter of 2007, flat to last year s third quarter expenses of $1.5 million. Bad debt expense and administrative expenses were lower compared to the third quarter of 2006, partially offset by higher payroll expense.
Other income in total, as included in total revenues, was $3.0 million and $9.0 million for the third quarter and first nine months of fiscal 2007, compared to $3.2 million and $9.7 million for the prior year s comparable three and nine months periods, respectively. The overall decrease resulted primarily from lower finance and layaway charges.
Cost of goods sold was $126.1 million, or 69.3% of retail sales and $417.0 million or 66.7% of retail sales for the third quarter and first nine months of fiscal 2007, compared to $127.2 million, or 67.8% of retail sales and $413.1 million, or 65.3% of retail sales for the prior year s comparable three and nine month periods, respectively. The overall increase in cost of goods sold as a percent of retail sales for the third quarter of fiscal 2007 resulted primarily from higher markdowns and occupancy costs, partially offset by lower freight cost. The overall increase in cost of goods sold as a percent of retail sales for the first nine months of fiscal 2007 resulted primarily from higher occupancy cost and higher markdowns. The increase in markdowns was primarily due to lower 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) decreased by 7.8% to $55.8 million and by 5.0% to $208.0 million for the third quarter and first nine months of fiscal 2007 compared to $60.5 million and $219.0 million for the prior year s comparable three and nine month periods, respectively. Gross margin as presented may not be comparable to those of other entities.
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 $51.3 million, or 28.2% of retail sales and $154.9 million, or 24.8% of retail sales for the third quarter and first nine months of fiscal 2007, compared to $51.5 million, or 27.4% of retail sales and $157.8 million, or 25.0% of retail sales for prior year s comparable three and nine months periods, respectively. SG&A expenses as a percentage of retail sales increased 80 basis points for the third quarter of fiscal 2007 as compared to the prior year and decreased 20 basis points for the first nine months of fiscal 2007, as compared to the prior year. The increase in SG&A expenses as a percentage of retail sales for the third quarter of fiscal 2007 was primarily attributable to an increase in store salary expense, partially offset by a decrease in incentive-based compensation expenses. The overall dollar decrease in SG&A expenses for the third quarter of fiscal 2007 resulted primarily from decreased incentive-based compensation and timing of

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

advertising expenses. For the first nine months of fiscal 2007, the decrease in SG&A expenses as a percentage of retail sales and the overall dollar decrease in SG&A expense resulted primarily from decreased incentive-based compensation expenses, partially offset by increased payroll, workers compensation and group health insurance expenses.

Depreciation expense was $5.7 million, or 3.1% of retail sales and $16.7 million or 2.6% of retail sales, for the third quarter and first nine months of fiscal 2007, compared to $5.2 million, or 2.7% of retail sales and $15.6 million, or 2.5% of retail sales, for prior year s comparable three and nine month periods, respectively.

Interest and other income was $2.2 million, or 1.2% of retail sales and $6.4 million, or 1.0% of retail sales for the third quarter and first nine months of fiscal 2007, compared to $2.1 million, or 1.1% of retail sales and $5.6 million, or 0.9% of retail sales, for the prior year s comparable three and nine month periods, respectively. The increase in the third quarter and first nine months of fiscal 2007 resulted primarily from higher interest rates and higher investment balances.

Income tax expense was $1.0 million, or 0.6% of retail sales and $17.7 million, or 2.8% of retail sales, for the third quarter and first nine months of fiscal 2007, compared to $3.3 million, or 1.8% of retail sales and $22.2 million, or 3.5% of retail sales, for the prior year s comparable three and nine month periods. The decrease for the third quarter and nine month period resulted from lower pre-tax income and a lower effective tax rate primarily due to higher tax credits as a percentage of pre-tax income. The effective income tax rate for the third quarter and first nine months of fiscal 2007 was 25.6% and 34.1% respectively, compared to 35.8% and 36.4% for the prior year s comparable three and nine month periods, respectively.

LIQUIDITY, CAPITAL RESOURCES AND MARKET RISK:

The Company has consistently maintained a strong liquidity position. Cash provided by operating activities during the first nine months of fiscal 2007 was $57.6 million as compared to $34.5 million in the first nine months of fiscal 2006. These amounts enable the Company to fund its regular operating needs, capital expenditure program, cash dividend payments and purchase of treasury stock. In addition, the Company maintains a $35 million unsecured revolving credit facility for short-term financing of seasonal cash needs. There were no outstanding borrowings on this facility at November 3, 2007.

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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 nine months of fiscal 2007 was primarily generated by earnings adjusted for depreciation and changes in working capital. The increase of $23.1 million for the first nine months of fiscal 2007 as compared to the first nine months of fiscal 2006 was primarily due to a decrease in inventories and an increase in accounts payable and other liabilities in fiscal 2007, partially offset by lower net income in fiscal 2007.

The Company believes that its cash, cash equivalents and short-term investments, together with cash flows from operations and borrowings available under its revolving credit agreement, will be adequate to fund the Company s planned capital expenditures, dividends, purchase of treasury stock and other operating requirements for fiscal 2007 and for the foreseeable future.

At November 3, 2007, the Company had working capital of $193.2 million compared to $158.7 million at October 28, 2006. Additionally, the Company had $1.9 million invested in privately managed investment funds at November 3, 2007 and October 28, 2006, which are included in other assets on the Condensed Consolidated Balance Sheets.

At November 3, 2007, the Company had an unsecured revolving credit agreement, which provided for borrowings of up to $35 million. The revolving credit agreement is committed until August 2010. The credit agreement contains various financial covenants and limitations, including the maintenance of specific financial ratios with which the Company was in compliance as of November 3, 2007. There were no borrowings outstanding under these credit facilities during the first nine months ended November 3, 2007 or the fiscal year ended February 3, 2007.

At November 3, 2007 and October 28, 2006, the Company had approximately $2.5 million and $2.2 million, respectively, of outstanding irrevocable letters of credit relating to purchase commitments.

Expenditures for property and equipment totaled $14.3 million in the first nine months of fiscal 2007, compared to $23.2 million in last year s first nine months. The expenditures for the first nine months of 2007 were primarily for store development and investments in new technology. For the full fiscal 2007 year, the Company expects to invest approximately $19.2 million for capital expenditures. This includes expenditures to open 60 to 65 new stores, relocate 18 stores and remodel 15 stores.

Net cash used in investing activities totaled $42.1 million in the first nine months of fiscal 2007 compared to $23.2 million provided for the comparable period of 2006. The increase was due primarily to the net increase in purchases over sales of short-term investments.

On May 24, 2007, the Board of Directors increased the quarterly dividend by 10% from $.15 per share to $.165 per share, or an annualized rate of $.66 per share.

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THE CATO CORPORATION
MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)
LIQUIDITY, CAPITAL RESOURCES AND MARKET RISK (CONTINUED):

On August 31, 2007, the Board authorized an increase in the Company s share repurchase program of two million shares. There is no specified expiration on any shares authorized in the program. For the nine months ended November 3, 2007, the Company has repurchased or accepted 1,034,406 shares at a cost of $20,309,042.

The Company does not use derivative financial instruments. At November 3, 2007, the Company s investment portfolio was primarily invested in governmental and other debt securities with maturities less than 36 months. These securities are classified as available-for-sale and are recorded on the balance sheet at fair value, with unrealized gains and temporary losses reported net of taxes as accumulated other comprehensive income. Other than temporary declines in fair value of investments are recorded as a reduction in the cost of investments in the accompanying Condensed Consolidated Balance Sheets.

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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 November 3, 2007. Based on this evaluation, our principal executive officer and principal financial officer concluded that, as of November 3, 2007, 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 ensure 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 November 3, 2007 that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

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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 February 3, 2007. 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 November 3, 2007:

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number Of Shares Purchased	Average Price Paid per Share (2)	Total Number 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)
August 2007	306,500	$ 19.39	306,500	
September 2007				
October 2007	522,015	18.96	522,015	
Total	828,515	$ 19.12	828,515	2.728 million shares

(1) On August 30, 2007, the Company s board of directors authorized an increase in the share repurchase program of two million shares. At the third quarter ending

November 3, 2007, the Company had 2.728 million shares remaining in open authorizations. There is no specified expiration date for the Company s repurchase program. During the month of November 2007, the Company repurchased 761,900 additional shares at a cost of $14,120,000.

(2) Prices include trading costs.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not Applicable

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not Applicable

ITEM 5. OTHER INFORMATION

Not Applicable

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ITEM 6. EXHIBITS

Exhibit No.	Item
3.1	Registrant s Restated Certificate of Incorporation of the Registrant 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 as amended and restated, incorporated by reference to Exhibit 99.2 to Form 8-K of the Registrant Filed December 10, 2007.
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer.
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer.
32.1	Section 1350 Certification of Chief Executive Officer.
32.2	Section 1350 Certification of Chief Financial Officer.

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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
December 12, 2007	/s/ John P. D. Cato
Date	John P. D. Cato Chairman, President and Chief Executive Officer
December 12, 2007	/s/ Thomas W. Stoltz
	Thomas W. Stoltz Executive Vice President Chief Financial Officer
December 12, 2007	/s/ John R. Howe
Date	John R. Howe Senior Vice President Controller

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