

CATO CORP
Form 10-Q
December 07, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended October 29, 2011

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 December 7, 2011, there were 27,415,289 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 October 29, 2011

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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	
	October 29, 2011	October 30, 2010	October 29, 2011	October 30, 2010
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
	(Dollars in thousands, except per share data)			
REVENUES				
Retail sales	\$ 194,094	\$ 198,176	\$ 699,104	\$ 689,055
Other income (principally finance charges, late fees and layaway charges)	2,591	2,799	8,047	8,584
Total revenues	196,685	200,975	707,151	697,639
COSTS AND EXPENSES, NET				
Cost of goods sold (exclusive of depreciation shown below)	125,818	127,136	429,379	418,401
Selling, general and administrative (exclusive of depreciation shown below)	57,505	60,565	179,776	190,986
Depreciation	5,321	5,645	16,096	16,191
Interest and other income	(861)	(1,039)	(2,767)	(2,888)
Cost and expenses, net	187,783	192,307	622,484	622,690
Income before income taxes	8,902	8,668	84,667	74,949
Income tax expense	2,797	2,770	29,938	27,039
Net income	\$ 6,105	\$ 5,898	\$ 54,729	\$ 47,910
Basic earnings per share	\$ 0.21	\$ 0.20	\$ 1.86	\$ 1.62

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Diluted earnings per share	\$	0.21	\$	0.20	\$	1.86	\$	1.62
Dividends per share	\$	0.230	\$	0.185	\$	0.645	\$	0.535
Comprehensive income:								
Net income	\$	6,105	\$	5,898	\$	54,729	\$	47,910
Unrealized gain (loss) on available-for-sale securities, net								
of deferred income tax benefit		(300)		50		283		94
Comprehensive income	\$	5,805	\$	5,948	\$	55,012	\$	48,004

See notes to consolidated financial statements.

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THE CATO CORPORATION**CONDENSED CONSOLIDATED BALANCE SHEETS**

	October 29, 2011 (Unaudited)	October 30, 2010 (Unaudited) (Dollars in thousands)	January 29, 2011 (Unaudited)
ASSETS			
Current Assets:			
Cash and cash equivalents	\$ 36,510	\$ 36,786	\$ 48,630
Short-term investments	205,810	188,097	181,395
Restricted cash and investments	5,325	2,038	4,826
Accounts receivable, net of allowance for doubtful accounts of \$2,567, \$3,109 and \$2,985 at October 29, 2011, October 30, 2010 and January 29, 2011, respectively	38,026	38,762	39,703
Merchandise inventories	127,247	128,558	144,028
Deferred income taxes	3,512	7,781	3,660
Prepaid expenses	3,566	2,967	3,199
Total Current Assets	419,996	404,989	425,441
Property and equipment – net	109,811	100,367	99,773
Other assets	6,888	7,495	7,545
Total Assets	\$ 536,695	\$ 512,851	\$ 532,759
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current Liabilities:			
Accounts payable	\$ 82,248	\$ 86,602	\$ 103,898
Accrued expenses	41,416	35,425	35,318
Accrued bonus and benefits	9,451	21,888	22,841
Accrued income taxes	16,638	17,723	11,861
Total Current Liabilities	149,753	161,638	173,918
Deferred income taxes	9,541	7,328	9,540
Other noncurrent liabilities (primarily deferred rent)	15,431	15,777	15,287
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 27,419,745 shares, 27,760,464 shares and 27,758,123 shares at October 29, 2011, October 30, 2010 and January 29, 2011, respectively	914	925	925
Convertible Class B common stock, \$.033 par value per share, 15,000,000 shares authorized; issued 1,743,525 shares at October 29, 2011, October 30, 2010 and January 29, 2011, respectively	58	58	58
Additional paid-in capital	71,075	67,744	68,537
Retained earnings	289,364	258,754	264,218
Accumulated other comprehensive income	559	627	276
Total Stockholders' Equity	361,970	328,108	334,014
Total Liabilities and Stockholders' Equity	\$ 536,695	\$ 512,851	\$ 532,759

See notes to consolidated financial statements.

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THE CATO CORPORATION**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Nine Months Ended	
	October 29, 2011	October 30, 2010
	(Unaudited)	(Unaudited)
	(Dollars in thousands)	
Operating Activities:		
Net income	\$ 54,729	\$ 47,910
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Depreciation	16,096	16,191
Provision for doubtful accounts	1,263	2,139
Share-based compensation	1,948	1,792
Excess tax benefits from share-based compensation	(128)	(246)
Loss on disposal of property and equipment	473	472
Changes in operating assets and liabilities which provided (used) cash:		
Accounts receivable	414	(747)
Merchandise inventories	16,781	1,090
Prepaid and other assets	289	249
Accrued income taxes	4,905	7,030
Accounts payable, accrued expenses and other liabilities	(28,798)	(15,455)
Net cash provided by operating activities	67,972	60,425
Investing Activities:		
Expenditures for property and equipment	(26,608)	(14,263)
Purchases of short-term investments	(105,837)	(140,896)
Sales of short-term investments	81,855	100,934
Change in restricted cash and investments	(499)	537
Net cash used in investing activities	(51,089)	(53,688)
Financing Activities:		
Dividends paid	(19,008)	(15,758)
Repurchase of common stock	(10,599)	(5,840)
Proceeds from employee stock purchase plan	444	410
Excess tax benefits from share-based compensation	128	246
Proceeds from stock options exercised	32	606
Net cash used in financing activities	(29,003)	(20,336)
Net decrease in cash and cash equivalents	(12,120)	(13,599)

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Cash and cash equivalents at beginning of period		48,630		50,385
Cash and cash equivalents at end of period	\$	36,510	\$	36,786

See notes to 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**

OCTOBER 29, 2011 AND OCTOBER 30, 2010

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 October 29, 2011 and October 30, 2010 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 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 29, 2011. Amounts as of January 29, 2011, have been derived from the audited balance sheet other than the retrospective application of the change in accounting principle (described below).

On November 22, 2011, the Board of Directors maintained the quarterly dividend at \$.23 per share.

CHANGE IN ACCOUNTING PRINCIPLE:

The Company elected to change its method of accounting for inventory to the weighted average cost method from the retail method effective January 30, 2011. In accordance with ASC 250 “Accounting Changes and Error Corrections,” all periods have been retrospectively adjusted to reflect the period-specific effects of the change to the weighted average cost method. The Company believes that the weighted average cost method better matches cost of sales with related sales, as well as having an inventory valuation that more closely reflects the acquisition cost of inventory by valuing inventory on a unit basis versus the product department level under the retail method. The cumulative adjustment as of January 31, 2010, was an increase in inventory of \$11,700,000 and an increase in retained earnings of \$7,300,000.

Additionally, the Company has changed the classification for certain balance sheet items to conform to the 2011 presentation. This change in classification has reduced accounts payable and inventory by \$1,628,000 as of January 29, 2011 and \$618,000 as of October 30, 2010.

In addition, the Company has changed the classification of certain prior year income statement items to conform to the 2011 presentation. The change has no effect on net income; however, it does increase retail sales by \$191,000, cost of goods sold by \$99,000 and selling, general and administrative expense by \$92,000 for the three months ended October 30, 2010. The change also reduces retail sales by \$555,000, cost of goods sold by \$240,000 and selling, general and administrative expense by \$315,000 for the nine months ended October 30, 2010.

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OCTOBER 29, 2011 AND OCTOBER 30, 2010

As a result of this retrospective application of the change in accounting principle and the change in the classification of the Balance Sheet, the following items in the Company's Condensed Consolidated Balance Sheets have been adjusted:

	January 29, 2011		
	(Unaudited)		
	(Dollars in thousands)		
	As		
	Previously	Total	As
	Reported	Changes	Adjusted
Merchandise inventories	\$ 132,020	\$ 12,008	\$ 144,028
Deferred income taxes	5,001	(1,341)	3,660
Total Current Assets	414,774	10,667	425,441
Total Assets	522,092	10,667	532,759
Accounts payable	105,526	(1,628)	103,898
Total Current Liabilities	175,546	(1,628)	173,918
Deferred income taxes	5,695	3,845	9,540
Retained earnings	255,768	8,450	264,218
Total Stockholders' Equity	325,564	8,450	334,014
Total Liabilities and Stockholders' Equity	\$ 522,092	\$ 10,667	\$ 532,759

	October 30, 2010		
	(Unaudited)		
	(Dollars in thousands)		
	As Previously	Total Changes	As Adjusted
	Reported	Total Changes	As Adjusted
Merchandise inventories	\$ 120,557	\$ 8,001	\$ 128,558
Deferred income taxes	7,727	54	7,781
Total Current Assets	396,934	8,055	404,989
Total Assets	504,796	8,055	512,851
Accounts payable	87,220	(618)	86,602
Total Current Liabilities	162,256	(618)	161,638
Deferred income taxes	4,087	3,241	7,328
Retained earnings	253,322	5,432	258,754
Total Stockholders' Equity	322,676	5,432	328,108

Total Liabilities and Stockholders' Equity	\$	504,796	8,055	\$	512,851
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THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND NINE MONTHS ENDED

OCTOBER 29, 2011 AND OCTOBER 30, 2010

As a result of this retrospective application of the change in accounting principle and the change in the classification of the Income Statement, the following items in the Company's Condensed Consolidated Statements of Income and Condensed Consolidated Statement of Cash Flows have been adjusted:

Three Months Ended
October 30, 2010
(Unaudited)

(Dollars in thousands, except per share data)

	As Previously Reported	Total Changes	As Adjusted
Retail Sales	\$ 197,985	\$ 191	\$ 198,176
Total Revenues	200,784	191	200,975
Cost of goods sold	125,694	1,442	127,136
Selling, general and administrative	60,473	92	60,565
Cost and expenses, net	190,773	1,534	192,307
Income before income taxes	10,011	(1,343)	8,668
Income tax expense	3,275	(505)	2,770
Net income	\$ 6,736	\$ (838)	\$ 5,898
Basic earnings per share	\$ 0.23	\$ (0.03)	\$ 0.20
Diluted earnings per share	\$ 0.23	\$ (0.03)	\$ 0.20

Nine Months Ended
October 30, 2010
(Unaudited)

(Dollars in thousands, except per share data)

	As Previously Reported	Total Changes	As Adjusted
Retail Sales	\$ 689,610	\$ (555)	\$ 689,055
Total Revenues	698,194	(555)	697,639
Cost of goods sold	415,588	2,813	418,401
Selling, general and administrative	191,301	(315)	190,986
Cost and expenses, net	620,192	2,498	622,690
Income before income taxes	78,002	(3,053)	74,949
Income tax expense	28,187	(1,148)	27,039
Net income	\$ 49,815	\$ (1,905)	\$ 47,910
Basic earnings per share	\$ 1.69	\$ (0.07)	\$ 1.62

Diluted earnings per share	\$	1.69	\$	(0.07)	\$	1.62
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**Nine Months Ended
October 30, 2010
(Unaudited)
(Dollars in thousands)**

	As Previously Reported	Total Changes	As Adjusted
Cash flow from operating activities:			
Net income	\$ 49,815	\$ (1,905)	\$ 47,910
Merchandise inventories	(1,929)	3,019	1,090
Accounts payable, accrued expenses and other liabilities	\$ (14,341)	\$ (1,114)	\$ (15,455)

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THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND NINE MONTHS ENDED

OCTOBER 29, 2011 AND OCTOBER 30, 2010

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		Nine Months Ended	
	October 29, 2011	October 30, 2010	October 29, 2011	October 30, 2010
	(Dollars in thousands, except share data and per share data)			
Basic earnings per share:				
Net earnings	\$ 6,105	\$ 5,898	\$ 54,729	\$ 47,910
Earnings allocated to non-vesting equity awards	(95)	(100)	(895)	(803)
Net earnings available to common stockholders	\$ 6,010	\$ 5,798	\$ 53,834	\$ 47,107
Basic weighted average common shares outstanding	28,851,509	28,970,179	28,936,177	28,995,380
Basic earnings per share	\$ 0.21	\$ 0.20	\$ 1.86	\$ 1.62
Diluted earnings per share:				
Net earnings	\$ 6,105	\$ 5,898	\$ 54,729	\$ 47,910
Earnings allocated to non-vesting equity awards	(95)	(100)	(894)	(803)

Net earnings available to common stockholders	\$	6,010	\$	5,798	\$	53,835	\$	47,107
Basic weighted average common shares outstanding		28,851,509		28,970,179		28,936,177		28,995,380
Dilutive effect of stock options		5,368		6,908		6,644		6,385
Diluted weighted average common shares outstanding		28,856,877		28,977,087		28,942,821		29,001,765
Diluted earnings per share	\$	0.21	\$	0.20	\$	1.86	\$	1.62

NOTE 3 - SUPPLEMENTAL CASH FLOW INFORMATION:

Income tax payments, net of refunds received, for the nine months ended October 29, 2011 and October 30, 2010 were \$25,045,000 and \$21,282,000, respectively.

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THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND NINE MONTHS ENDED

OCTOBER 29, 2011 AND OCTOBER 30, 2010

NOTE 4 – FINANCING ARRANGEMENTS:

As of October 29, 2011, the Company had an unsecured revolving credit agreement of \$35.0 million. The revolving credit agreement is committed 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 October 29, 2011. There were no borrowings outstanding under this credit facility during the nine months ended October 29, 2011 or October 30, 2010. Interest on any borrowings is based on LIBOR, which was 0.25% at October 29, 2011.

At October 29, 2011 and October 30, 2010 the Company had approximately \$4.2 million and \$5.7 million, 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 fashion specialty retail stores in 31 states at October 29, 2011, 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 October 29, 2011			Nine Months Ended October 29, 2011		
	Retail	Credit	Total	Retail	Credit	Total
Revenues	\$ 194,769	\$ 1,916	\$ 196,685	\$ 701,361	\$ 5,790	\$ 707,151
Depreciation	5,302	19	5,321	16,069	27	16,096

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Interest and other income	(861)	-	(861)	Interest and other income	(2,767)	-	(2,767)
Income before taxes	8,100	802	8,902	Income before taxes	82,284	2,383	84,667
Total assets	462,588	74,107	536,695	Total assets	462,588	74,107	536,695
Capital expenditures	10,857	-	10,857	Capital expenditures	26,522	86	26,608
Three Months Ended October 30, 2010	Retail	Credit	Total	Nine Months Ended October 30, 2010	Retail	Credit	Total
Revenues	\$ 198,878	\$ 2,097	\$ 200,975	Revenues	\$ 691,200	\$ 6,439	\$ 697,639
Depreciation	5,641	4	5,645	Depreciation	16,176	15	16,191
Interest and other income	(1,039)	-	(1,039)	Interest and other income	(2,888)	-	(2,888)
Income before taxes	7,880	788	8,668	Income before taxes	72,690	2,259	74,949
Total assets	438,983	73,868	512,851	Total assets	438,983	73,868	512,851
Capital expenditures	5,397	-	5,397	Capital expenditures	14,263	-	14,263

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.

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THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
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OCTOBER 29, 2011 AND OCTOBER 30, 2010

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		Nine Months Ended	
	October 29, 2011	October 30, 2010	October 29, 2011	October 30, 2010
Bad debt expense	\$ 381	\$ 640	\$ 1,263	\$ 2,139
Payroll	233	242	722	716
Postage	186	195	574	620
Other expenses	295	228	821	690
Total expenses	\$ 1,095	\$ 1,305	\$ 3,380	\$ 4,165

NOTE 6 – STOCK BASED COMPENSATION:

As of October 29, 2011, 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 29, 2011	18,627	-	627,872	646,499
October 29, 2011	19,677	-	538,725	558,402

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 October 29, 2011 and October 30, 2010, there was \$6,665,000 and \$6,705,000 of total unrecognized compensation cost related to nonvested restricted stock awards, which have a remaining weighted average vesting period of 2.5 years and 2.6 years, respectively. The total fair value of the shares recognized as compensation expense during the third quarter and nine months ended October 29, 2011 was \$613,000 and \$1,870,000, respectively compared to \$545,000 and \$1,771,000 for the third quarter and nine months ended October 30, 2010, respectively. These expenses are classified as a component of selling, general and administrative expenses in the Condensed Consolidated Statements of Income.

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THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND NINE MONTHS ENDED

OCTOBER 29, 2011 AND OCTOBER 30, 2010

NOTE 6 – STOCK BASED COMPENSATION (CONTINUED):

The following summary shows the changes in the shares of restricted stock outstanding during the nine months ended October 29, 2011:

	Number of Shares		Weighted Average Grant Date Fair Value Per Share
Restricted stock awards at January 29, 2011	509,456	\$	20.32
Granted	102,449		25.41
Vested	(125,403)		20.51
Forfeited or expired	(18,877)		21.26
Restricted stock awards at October 29, 2011	467,625	\$	21.44

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 October 29, 2011 and October 30, 2010, the Company sold 21,810 and 22,745 shares to employees at an average discount of \$3.59 and \$3.19 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 \$78,000 and \$72,000 for the nine months ended October 29, 2011 and October 30, 2010, 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 nine months ended October 29, 2011:

Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value(a)
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Options outstanding at January 29, 2011	21,675	\$	13.86	2.78 years	\$	228,434
Granted	-					
Forfeited or expired	1,050		12.00			
Exercised	3,450		13.47			
Outstanding at October 29, 2011	17,175	\$	14.05	2.49 years	\$	182,514
Vested and exercisable at October 29, 2011	17,175	\$	14.05	2.49 years	\$	182,514

(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.

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**THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND NINE MONTHS ENDED**

OCTOBER 29, 2011 AND OCTOBER 30, 2010

NOTE 6 – STOCK BASED COMPENSATION (CONTINUED):

No options were granted in the first nine months of fiscal 2011 or fiscal 2010.

The total intrinsic value of options exercised during the third quarter and nine months ended October 29, 2011 was zero and \$41,000, respectively.

During the second quarter of 2010, the Company completed amortizing its nonvested options. In accordance with ASC 718, the Company adjusted its related forfeiture assumption and recognized a reduction in share based compensation expense of \$0 and \$52,000 for the third quarter and nine month period ended October 30, 2010. There was no stock option compensation expense for the third quarter and nine month period ended October 29, 2011.

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 October 29, 2011, the Company's effective tax rate was 31.4% compared to 32.0% for the prior year quarter ended October 30, 2010. The current year quarter was impacted by the reduction of a reserve for certain unrecognized tax benefits from the closing of a state income tax audit. The effective income tax rate for the first nine months of fiscal 2011 was 35.4% compared to 36.1% for the first nine months of fiscal 2010. During the next 12 months, various taxing authorities' statutes of limitations are expected to expire which could result in a potential

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reduction of unrecognized tax benefits. In addition, certain tax 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 currently estimable.

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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 October 29, 2011 and January 29, 2011.

Description	October 29, 2011	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
State/Municipal Bonds	\$ 146,936	\$ -	\$ 146,936	\$ -
Corporate Bonds	29,670	-	29,670	-
Auction Rate Securities (ARS)	3,450	-	-	3,450
Variable Rate Demand Notes (VRDN)	30,439	30,439	-	-
US Treasury Notes	1,421	1,421	-	-
Privately Managed Funds	1,910	-	-	1,910
Corporate Equities	481	481	-	-
Certificates of Deposit	100	100	-	-
Total	\$ 214,407	\$ 32,441	\$ 176,606	\$ 5,360

Description	January 29, 2011	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
State/Municipal Bonds	\$ 129,678	\$ -	\$ 129,678	\$ -
Corporate Bonds	34,288	-	34,288	-

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Auction Rate Securities (ARS)	3,450	-	-	3,450
Variable Rate Demand Notes (VRDN)	19,308	19,308	-	-
Privately Managed Funds	1,925	-	-	1,925
Corporate Equities	480	480	-	-
Total	\$ 189,129	\$ 19,788	\$ 163,966	\$ 5,375