HALIFAX CORP
Form 10-K/A
July 30, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K/A
(AMENDMENT NO. 1)

(Mark One)

þ **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the fiscal year ended March 31, 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 1-08964
Halifax Corporation
(Exact name of registrant as specified in its charter)

Virginia	**54-0829246**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
5250 Cherokee Avenue, Alexandria, VA	**22312**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code **(703) 658-2400**
Securities registered pursuant to Section 12(b) of the Act:

Common Stock, $.24 par value	**American Stock Exchange**
(title of each class)	(Name of each exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: None.
Indicate by check mark if the registrant is a well- known seasoned issuer, as defined in Rule 405 of the Securities Act.
o Yes þ No
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
o Yes þ No
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. þ Yes o No
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or non-accelerated filer See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.
o Large accelerated filer o Accelerated filer þ Non-accelerated filer

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of September 30, 2006 was $5,686,496, computed based on the closing price for that date.

As of July 27, 2007 there were 3,175,206 shares of the registrant s Common Stock, par value $0.24, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE:

None.

EXPLANATORY NOTE

This Amendment No. 1 on Form 10-K/A (the Form 10-K/A) to the Annual Report on Form 10-K for the year ended March 31, 2007, which was initially filed with the Securities and Exchange Commission (SEC) on July 10, 2007 (the Original Filing) is being filed with the SEC to provide the information required pursuant to the rules of the SEC in Part III, Items 10, 11, 12, 13 and 14 of the Original Filing. In addition, pursuant to the rules of the SEC, Item 15 of Part IV of the Original Filing has been amended to contain currently dated certifications from the registrant s Chief Executive Officer and Chief Financial Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002 with respect to this Form 10-K/A. The currently dated certifications of the registrant s Chief Executive Officer and Chief Financial Officer are attached to this Form 10-K/A as Exhibits 31.1 and 31.2. Changes to Item 15 of Part III included in this Form 10-K/A consist of corrections of certain typographical errors and additional exhibits.

All information contained in this Form 10-K/A is as of the original filing date of the Annual Report on Form 10-K for the fiscal year ended March 31, 2007, unless otherwise noted, and does not reflect any subsequent information or events other than as described above.

TABLE OF CONTENTS

	Page
PART III	
Item 10. Directors, Executive Officers and Corporate Governance	1
Item 11. Executive Compensation	4
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	16
Item 13. Certain Relationships and Related Transactions and Director Independence	18
Item 14. Principal Accounting Fees and Services	18
PART IV	
Item 15. Exhibits, Financial Statement Schedules	20
Signatures	24

Forward-Looking Statements

Certain statements in this Annual Report on Form 10-K/A constitute forward-looking statements within the meaning of the Federal Private Securities Litigation Reform Act of 1995. While forward-looking statements sometimes are presented with numerical specificity, they are based on various assumptions made by management regarding future events over which we have little or no control. Forward-looking statements may be identified by words including anticipate, believe, estimate, expect and similar expressions. We caution readers that forward-looking statements, including without limitation, those relating to future business prospects, revenues, working capital, liquidity, and income, are subject to certain risks and uncertainties that would cause actual results to differ materially from those indicated in the forward-looking statements. Factors that could cause actual results to differ from forward-looking statements include the concentration of our revenues, risks involved in contracting with our customers, including the difficulty to accurately estimate costs when bidding on a contract and the occurrence of start-up costs prior to receiving revenues and contracts with fixed price provisions, potential conflicts of interest, difficulties we may have in attracting and retaining management, professional and administrative staff, fluctuation in quarterly results, our ability to generate new business, our ability to maintain an effective system of internal controls, risks related to acquisitions and our acquisition strategy, continued favorable banking relationships, the availability of capital to finance operations and planned growth and ability to make payments on outstanding indebtedness, weakened economic conditions, reduced end-user purchases relative to expectations, pricing pressures, excess and obsolete inventory, acts of terrorism, energy prices, risks related to competition and our ability to continue to perform efficiently on contracts, and other risks and factors identified from time to time in the reports we file with the SEC. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated or projected.

Forward-looking statements are intended to apply only at the time they are made. Moreover, whether or not stated in connection with a forward-looking statement, we undertake no obligation to correct or update a forward-looking statement should we later become aware that it is not likely to be achieved. If we were to update or correct a forward-looking statement, investors and others should not conclude that we will make additional updates or corrections thereafter.

All references to we, our, us, the Company, or Halifax refer, on a consolidated basis to Halifax Corporation unle otherwise indicated.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Our bylaws, as amended, provide that we shall be managed by a Board of Directors consisting of between three and seven members, the precise number of directors to be fixed from time to time by resolution of the Board of Directors. The number of directors is currently fixed at seven. Each director is elected to serve until the next annual meeting of shareholders or until the election and qualification of his respective successor.

In accordance with the merger agreement pursuant to which we acquired Microserv, Inc., referred to as the merger agreement in this document, we agreed that the former shareholders of Microserv, Inc. shall have the right to nominate a director to our Board of Directors so long as such former shareholders collectively own greater than 50% of the number of shares of common stock issued to them pursuant to the merger agreement, referred to as the Microserv nominee in this document. As of June 30, 2007, the former shareholders of Microserv, Inc. collectively owned greater than 50% of the number of shares of common stock issued to them pursuant to the merger agreement. Pursuant to the merger agreement, we also agreed to recommend, consistent with the fiduciary duties of our Board of Directors, the Microserv nominee to our shareholders and to undertake our best efforts to secure the election of such nominee. In addition, pursuant to a voting agreement executed in connection with the merger agreement, Charles L. McNew, Joseph Sciacca, Hugh M. Foley and Thomas J. Basile, subject to certain limitations concerning the qualification of the Microserv nominee, are required to vote their respective shares of our voting capital stock in favor of the Microserv nominee. Gerald F. Ryles was the Microserv nominee for the 2007 fiscal year and served as a member of our Board of Directors in the 2007 fiscal year.

The following table sets forth the name of each of the members of our Board of Directors, together with their respective ages as of June 30, 2007, periods of service as directors, principal occupations or employment for the past five years and the names of other public companies in which such persons hold directorships.

Director	Age	Date First Elected	Principal Occupation and Employment; Other Background
John H. Grover	79	1984	John H. Grover is the Chairman of our Board of Directors. From December 2002 until its liquidation in December 2003, Mr. Grover served as President of Research Industries Incorporated, a private investment company. Prior to such time, he served as Executive Vice President, Treasurer and director of Research Industries Incorporated from 1968 until June 2003, and as a director of TransTechnology Corporation, an aerospace engineering company, from 1969 to 1992. In addition, he presently serves as a director of Westgate Partners, Inc., a real estate investment company, World Resources Co., a recycling company, Parkgate Group, LLC, a real estate investment company, Aviation Facilities Company, Inc., a real estate investment company, and Nano-C, Inc., a chemical manufacturing company. He is a general partner of Grofam, L.P., an investment company.
Thomas L. Hewitt	68	2000	Thomas L. Hewitt has served as Chief Executive Officer of Global Governments LLC, a consulting firm, since June 2000. He founded Federal Sources, Inc. in December 1984, a market research and consulting firm, and served as Federal Sources, Inc. s Chief Executive Officer until the recent sale of Federal Sources, Inc. in 2000. Prior to founding Federal Services, Inc., Mr. Hewitt served as a Senior Vice President of Kentron, an information technology professional services company acquired

by Planning Resource Corporation, a government IT service company, and held several senior level positions at Computer Science Corporation, an information technology systems integration company, including President of the Infonet Government Systems Division and Vice President of Program Development of the Systems Group. Mr. Hewitt is currently a director of GTSI Corp., a reseller of software and hardware.

1

Director	Age	Date First Elected	Principal Occupation and Employment; Other Background
Charles L. McNew	55	2000	Charles L. McNew joined us in July 1999 and was appointed President and Chief Executive Officer in May 2000. He was acting President and Chief Executive Officer from April 2000 to May 2000 and prior to that was Executive Vice President and Chief Financial Officer. Prior to joining our company, from July 1994 through July 1999, Mr. McNew was Chief Financial Officer and later Chief Operating Officer of NumereX Corporation, a public Company which develops and markets communications and information products and services.
Gerald F. Ryles	71	2003	Gerald F. Ryles served as Chairman of the Board of Directors and Chief Executive Officer of Microserv, Inc. from January 1994 until January 2001. From January 2001 until we acquired by merger all of the issued and outstanding capital stock of Microserv, Inc., on August 29, 2003, Mr. Ryles served as the Chairman of the Board of Directors of Microserv, Inc. Mr. Ryles also serves as a director of Giant Campus, Inc., a software company, and Zumiez Inc., a mall based specialty retailer.
Arch C. Scurlock, Jr.	60	2003	Arch C. Scurlock, Jr. has served as a financial analyst consultant since June 2003. Prior to such time, he served as Vice President of Research Industries Incorporated from 1987 until December 2003 and as a director of Research Industries Incorporated from 1983 until December 2003. From 1977 to 1987, Mr. Scurlock was a chemical engineer at Atlantic Research Corporation, a government research company.
Daniel R. Young	73	2001	Daniel R. Young has served as a managing partner for The Turnberry Group, an advisory practice to chief executive officers and other senior executives, since October 2000. He also serves as a director of GTSI Corp. and NCI, Inc., an information technology systems engineer and integration company. Mr. Young was formerly Vice Chairman and Chief Executive Officer of Federal Data Corporation, a government IT service company, until 2000. He joined Federal Data Corporation in 1976 as the Executive Vice President, and in 1985 was elected President and Chief Operating Officer. Following the 1995 acquisition of Federal Data Corporation by The Carlyle Group, a private investment group, Mr. Young assumed the position of President and Chief Executive Officer. In 1998, he was elected Vice Chairman of the Board of Directors. Before joining Federal Data Corporation, Mr. Young was an executive of Data Transmission Company, an information technology company. He ultimately became Executive Vice President, and, prior to that, held various

engineering, sales and management positions at Texas Instruments, Inc., a computer equipment manufacturer. He also served in the U.S. Navy as a sea officer.

Director	Age	Date First Elected	Principal Occupation and Employment; Other Background
John M. Toups	81	1993	John M. Toups currently serves as a director of GTSI Corp. and NVR, Inc., a residential construction company. Mr. Toups served as President and Chief Executive Officer of Planning Resource Corporation from 1978 to 1987. Prior to that he served in various executive positions with Planning Reserve Corporation. For a short period of time in 1990, he served as interim Chairman of the Board of Directors and Chief Executive Officer of the National Bank of Washington and Washington Bancorp.

Information in response to Item 401 of Regulation S-K regarding our executive officers who are not directors is included in Item 1. Business of the Form 10-K filed with the Securities and Exchange Commission, referred to as the SEC in this document, on July 10, 2007 and is incorporated herein by reference.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires our directors and executive officers, and persons who own more than 10% of a registered class of our equity securities, to file with the SEC initial reports of ownership and reports of changes in ownership of our common stock and other equity securities. Officers, directors and greater than 10% shareholders are required by SEC regulation to furnish us with copies of all Section 16(a) reports they file. We believe that all of the filing requirements were complied with by our officers and directors and by the other beneficial owners of more than 10% of our common stock except that Douglas H. Reece reported the grant of stock options late on a Form 3, Jimmie L. May reported the grant of stock options late on a Form 4, John H. Grover, Thomas L. Hewitt, Gerald F. Ryles, Arch C. Scurlock, Daniel R. Young, John M. Toups, Charles L. McNew, Hugh M. Foley and Joseph Sciacca each reported the grant of stock options late on a Form 4 and Douglas H. Reece, John H. Grover, Thomas L. Hewitt, Gerald F. Ryles, Arch C. Scurlock, Daniel R. Young, John M. Toups, Charles L. McNew, Hugh M. Foley and Joseph Sciacca each reported the grant of stock options late on an amended Form 4. On making the foregoing statements, we relied upon copies of the reporting forms that we received and certain written representations.

Code of Ethics

We have adopted a Code of Business Conduct and Ethics that applies to our Chief Executive Officer, Chief Financial Officer and any other accounting officer, controller or persons performing similar functions. A copy of our Code of Business Conduct and Ethics is available on our website, www.hxcorp.com, via the Investors page. It is also available in print to any shareholder on request to the Corporate Secretary at Halifax Corporation, 5250 Cherokee Avenue, Alexandria, VA 22312. We intend to satisfy the disclosure requirement under Item 5.05 of Form 8-K relating to amendments to, or waivers from, any provision of our Code of Business Conduct and Ethics by posting that information on our website.

Information on our website is not and should not be considered a part of this Annual Report on Form 10-K/A.

Audit Committee

The Board of Directors has established a standing Audit Committee. The Audit Committee assists our Board of Directors in maintaining the integrity of our financial statements and financial reporting processes and systems of internal audit controls, and our compliance with legal and regulatory requirements. The Audit Committee reviews the scope of independent audits and assesses the results. The Audit Committee meets with management to consider the adequacy of the internal controls and the objectivity of financial reporting. The Audit Committee also meets with the independent auditors and with appropriate financial personnel concerning these matters. The Audit Committee selects, compensates, appoints and oversees our independent auditors. The independent auditors periodically meet alone with the Audit Committee and always have unrestricted access to the Audit Committee. The Audit Committee also approves related party transactions. The Audit Committee, which currently consists of Messrs. Toups (Chairman), Young and Hewitt, met nine (9) times in the fiscal year 2007. Our Board of Directors has determined that each of Messrs. Toups, Young and Hewitt are independent as defined in the applicable rules of the American Stock Exchange

Company Guide, referred to as the AMEX Company Guide in this document, and Rule 10A-3 of the Exchange Act and that Messrs. Toups and Young qualify as audit committee financial experts as defined under Item 407 of Regulation S-K.

Item 11. Executive Compensation

Compensation Discussion and Analysis

The following discussion and analysis of the compensation arrangements of our Chief Executive Officer, Chief Financial Officer and each of our three other most highly compensated officers whose total compensation exceeded $100,000 in the fiscal year ended March 31, 2007, referred to as the named executive officers in this document, should be read together with the compensation tables and related disclosures set forth elsewhere in this document. This discussion contains forward looking statements that are based on our current plans and expectations regarding future compensation programs. Actual compensation programs that we adopt may differ materially from currently planned programs as summarized in this discussion.

Overview of our Compensation Philosophy. Our overall compensation philosophy is to provide executive compensation packages that enable us to attract, retain and motivate executive officers to achieve our short-term and long-term business goals. Consistent with this philosophy, the following elements provide a framework for our executive compensation program: (i) competitive salary; (ii) bonus and award programs designed to reinforce desired performance metrics; and (iii) use of non-cash compensation to align the interests of our executives with those of our shareholders. The payment of cash compensation serves to reward our executive officers for attaining short term corporate goals and grants of options to purchase our common stock provide executive officers with long term incentive to continue achieving value added results for our shareholders.

Role of our Compensation Committee. Our executive compensation program is approved and monitored by the Compensation Committee of our Board of Directors. The members of the Compensation Committee are John Grover (chairman), John Toups and Thomas Hewitt, each of whom is an independent, non-employee director. The Compensation Committee maintains a practice of meeting prior to each regular Board of Directors meeting and generally holds a session to discuss the compensation of executive officers (without management present) at each regular board meeting.

Under the terms of its charter, the Compensation Committee is responsible for reviewing and approving compensation granted to our named executive officers, including our Chief Executive Officer; however, the independent directors of the Board of Directors make the final determination as to the compensation paid to the Chief Executive Officer. In particular, the Compensation Committee reviews and approves the following components of compensation for the named executive officers:

- annual base salary;
- cash bonuses, including specific goals and amounts;
- other equity compensation;
- employment agreements, severance arrangements and change of control agreements/provisions, as applicable;
- signing bonus or payment of relocation costs for new hires; and
- any other material benefits or compensation or arrangements.

The Compensation Committee serves as the administrator for our 2005 Stock Option and Stock Incentive Plan. All option grants, including grants to named executive officers, are approved by the Compensation Committee.

In addition, the Compensation Committee has the authority to retain its own compensation consultant, review and assess the annual incentive plans for our executives, provide feedback regarding proposed employment agreements with our named executive officers and obtain advice and assistance from internal or external legal, accounting or other advisors, as needed.

Executive Compensation Program. Our performance-oriented compensation program consists of a base salary, annual cash bonuses, long-term equity incentives (including stock and option awards), benefits (including health and dental plans, life insurance, disability benefits and a 401(k) plan) and severance and termination protection. We believe that appropriately balancing the total compensation package and ensuring the viability of each component of the package is necessary in order to provide market-competitive compensation and to attract and retain talent. As a small public company, we also try to optimize the mix of components to make such compensation programs cost effective.

The Compensation Committee evaluates each executive officer annually, focusing on the individual s ability to meet performance objectives and his ability to achieve certain company goals. Following this analysis, the Compensation Committee establishes a basis for the pay levels of the executive officers for the new fiscal year. Our Chief Executive Officer assists in this process by offering salary recommendations to the Compensation Committee for executive officers, other than himself. Total compensation for our executive officers may vary significantly from year-to-year based on company and individual performance. Further, the value of equity-based awards to our executives will vary in value based on our stock price performance over time.

The following is a more detailed explanation of the primary components of our executive compensation program.

Base Salary. Base salary is primarily determined by competitive benchmarking and individual job performance. Base salaries for executive officers are reviewed at least annually. In each case, we take into account the results achieved by the executive, his or her future potential, scope of responsibilities, business experience and competitive salary practices. We do not apply specific formulas to determine annual pay increases, if any, and attempt to make decisions regarding changes in base salary in the context of other short-term and long-term compensation components. Approved increases in base salary are generally effective on the first of the month following our annual shareholders meeting each year.

Relative to the fiscal year ended March 31, 2007, we anticipate an approximately 5% to 7% increase in the base salary of our named executive officers, excluding Mr. Reece, for the 2008 fiscal year. Mr. Reece will continue to receive previous base salary and other incentivized compensation based on our ability to reach established revenue targets.

Cash Bonuses. Our named executive officers are eligible for our Senior Management Cash Bonus Plan. In general, this plan provides cash bonuses to executive officers upon the attainment of objectives directly related to our performance against the budget, which are parallel with the interests of our shareholders.

At the start of each fiscal year, the Compensation Committee works directly with our Chief Executive Officer to define specific performance goals for each executive officer, which constitute the basis for each executive s performance objectives under the plan. This process is an integral part of our culture and is intended to reinforce our collaborative, team-oriented and performance-driven environment. In addition, the cash bonuses are designed to reward our executive officers for the attainment of short term corporate goals.

During our fiscal year ended March 31, 2007, we did not attain our budgeted goals and, as a result, the executive officers did not receive any cash bonus compensation. In fiscal year 2008, annual bonus opportunities for our named executive officers may range from 15% to 25% of base salary. In addition, the Compensation Committee may add qualitative components to the Senior Management Cash Bonus Plan. In such case, the weight given to each quantitative and qualitative component used to evaluate the named executive officers will be determined by the Compensation Committee. The Compensation Committee may also decide to make any qualitative performance-based bonus contingent on the achievement of certain quantitative goals. This measure would prevent executive s from receiving cash bonuses based on qualitative performance in the event that we did not achieve preestablished revenue and earnings targets.

Long Term Equity Incentives Stock Options. Consistent with our compensation philosophy, a portion of our compensation program is based on our long-term performance and the price of our common stock. This component consists of options to purchase our common stock. Similar to base salary increases, stock options are also granted to address promotions and significant changes in responsibility. The Compensation Committee does not utilize a specific formula as the basis for granting awards under our stock incentive plans.

Stock options are granted at exercise prices equal to the fair market value (i.e., the closing price) of our stock on the date of grant. Accordingly, stock options will only result in compensation to the executive officer to the extent our stock price increases during the applicable term of the option. Employee stock options previously granted under our 2005 Stock Option and Stock Incentive Plan typically vested over five annual installments, 20% each year on the anniversary of the date of grant.

Although stock options are expensed on and negatively impact our net operating results, we believe that long-term equity-based compensation is a critical element of our overall compensation program because it helps focus our executives on our long-term financial goals and operational performance and also aligns the interests of our executives with those of our shareholders. The potential financial value offered through such options is also an important retention tool.

We attempt to award stock options in a manner that we believe is competitive in the industry and in relation to the particular job function of the executive officer. The Compensation Committee, however, has the ability to award a significantly greater number of stock options if it deems such award to be in the best interests of the Company and our shareholders.

The Compensation Committee seeks to avoid granting stock options under the 2005 Stock Option and Stock Incentive Plan when our directors and executive officers are aware of material non-public information that reasonably may be perceived to impact the market price of our common stock or around the time that such information is released. With that said, grants of stock options for employees and directors, including executive officers, are generally awarded at the first regular meeting of the Compensation Committee following the annual shareholder meeting. All other option awards are made at regularly scheduled Compensation Committee meetings. The Compensation Committee s meetings are scheduled to coincide with established Board of Director meetings. Thus, the proximity of any stock option issuance to an earnings announcement or other market event is coincidental.

Benefits. In general, our practice is to provide commensurate benefits to employees at all levels of our organization. Consistent with this practice, the following is a list of the primary benefits provided to our employees, including our executive officers:

- Health and dental plans, including, at the employee s option, Flexible Spending Accounts and/or a Health Savings Account. In the event that an employee elects to participate in a Health Savings Account, we contribute up to $2,500 to the employee s Health Savings Account annually;
- Term life insurance and optional supplemental life insurance;
- Optional supplemental health coverage;
- Short and long-term disability benefits;
- 401(k) plan, including a company match of 50% of employee contributions up to 1% of the employee s total cash compensation; and
- Paid time off and holidays.

We believe that these benefits are consistent with those offered by other companies and specifically with those companies with which we compete for employees.

Additionally, we provide our Chief Executive Officer with an automobile and compensate him for related operating expenses.

Termination and Severance Benefits. We have entered into termination/separation agreements with all of our named executive officers other than our Chief Executive Officer, Mr. McNew. The agreements are intended to provide the executives with compensation when their jobs are eliminated for business or economic reasons. For a more detailed discussion of the agreements, see Potential Payments Upon Termination or Change-in-Control Termination/Separation Agreements with Mr. Sciacca, Mr. Foley and Mr. Reece.

We have agreed to provide Mr. McNew with severance benefits upon certain separations of his employment in accordance with an Executive Severance Agreement. Mr. McNew is entitled to severance benefits if (i) his employment is terminated by us for any reason other than cause or in connection with his death, disability,

resignation or retirement, or (ii), under certain circumstances, his employment is terminated in connection with a change of control disposition. For a further discussion regarding the termination situations entitling Mr. McNew to severance benefits, see Potential Payments Upon Termination or Change-in-Control Severance Agreement with Mr. McNew.

With regard to the change of control provision, the benefits that may be paid in case of a change of control disposition are based on a double trigger, that is, a defined change of control plus a termination of the executive s employment. We believe that the double trigger is appropriate because it limits the ability of the executive to receive a payment upon a change of control to those situations involving a hostile change of control event that results in the termination of the executive s employment.

In all, the severance benefits were designed to provide Mr. McNew with a certain measure of job security and protection against termination without cause and termination or loss of employment through no fault of Mr. McNew. For more details on these benefits, see Potential Payments Upon Termination or Change-in-Control Severance Agreement with Mr. McNew.

Competitive Market Review and Future Trends. We attempt to align our overall executive compensation with other publicly-traded peer companies who share similar characteristics. Due to our product and service offerings, our peer group includes a broad range of technology and growth companies with whom we compete for executive talent. In general, we consider peer companies based on industry focus, market capitalization, revenue, net income/loss and geographic proximity. Data on compensation practices at such companies has historically been gathered through searches of publicly-available information, including subscription databases and Securities and Exchange Commission filings. We use such information primarily to help guide decisions on base salary, target bonuses and equity-based awards.

In general, we believe that base salary should be targeted at the median (or 50th percentile) of base salary of comparable positions at comparable companies in our peer group. We attempt to set total cash compensation at approximately the 60th percentile of total cash compensation of comparable positions at comparable companies in our peer group. Nevertheless, in determining base salary and total cash compensation we also consider other factors such as job performance, skill set, prior experience, seniority, pay levels of similarly situated positions within the company, retention and market conditions generally.

We intend to continue our strategy of paying competitive short-term cash compensation and offering long-term incentives through equity-based compensation programs that align individual compensation with corporate financial performance. We believe that our total compensation package is consistent with the market in the aggregate. We also believe that, in light of our compensation philosophy, total compensation for our executives should continue to consist of base salary, annual cash bonus awards, long-term equity based compensation and certain other benefits.

We anticipate that the competitive posture of our total compensation will vary year-to-year as a result of our performance, as well as the performance of our peer group companies and the market as a whole. Accordingly, the magnitude and weighting of different compensation components will likely evolve as we grow and continue closer to achieving profitability. As of the date of this document, we do not intend to enter into additional employment agreements.

Accounting and Tax Considerations. Our issuance of stock options is impacted by the implementation of Statement of Financial Accounting Standard No. 123R, Share-Based Payment, referred to as SFAS No. 123R in this document, which we adopted April 1, 2006. Under this accounting standard, we are required to value unvested stock options, from both prior and current years, under the fair value method and expense those amounts in the income statement over the stock option s remaining vesting period. During fiscal year 2007, we recorded $30,000 in stock compensation expense under SFAS No. 123R.

We have structured our compensation program to comply with Section 162(m) of the Internal Revenue Code of 1986, as amended. Under Section 162(m), our tax deduction for compensation paid to certain executive officers is limited to $1.0 million in any tax year, unless the compensation is performance based. We do not have any executive officers who earned non-performance based compensation that would limit our tax deduction under Section 162(m).

Fiscal 2007 Summary Compensation Table

The following table sets forth information concerning the compensation awarded to or earned during our fiscal year ended March 31, 2007 by our named executive officers.

Name and Principal Position	Year	Salary ($)	Option Awards ($)(1)	All Other Compensation ($)(2)	Total ($)
Charles L. McNew President and Chief Executive Officer	2007	$263,390	$6,397	$ 8,201	$274,988
Joseph Sciacca Vice President of Finance and Chief Financial Officer	2007	171,448	3,472	12,004	186,924
Hugh M. Foley Vice President, Operations	2007	161,696	2,588	5,381	169,665
Douglas H. Reece Vice President, Sales and Marketing	2007	157,085	1,220	11,422	169,727

(1) This column represents the dollar amount recognized for financial reporting purposes with respect to the 2007 fiscal year for the fair value of stock options granted to each named director in accordance with SFAS 123R. These amounts were calculated using the Black Sholes option-pricing model based on the following assumptions: an expected volatility of 49.99%, an expected term to exercise of 6.25 years and an interest rate of 4.94%. These

amounts reflect our accounting expense and do not correspond to the actual value that will be recognized by the named directors.

(2) Amounts in this column include: contributions to the 401(k) plans of Mssrs. McNew, Sciacca, Foley and Reece in the amounts of $2,330, $1,667, $1,551 and $1,124, respectively; contributions to the heath insurance premiums of Mssrs. McNew, Sciacca, Foley and Reece in the amounts of $871, $10,337, $3,830 and $10,298, respectively; and a $5,000 automobile allowance granted to Mr. McNew.

Elements of compensation for our named executive officers include salary, options to purchase shares of our common stock and other perquisites, as applicable. We do not have a pension plan, do not pay non-equity incentive plan based compensation and do not offer nonqualified deferred compensation arrangements. Further, we did not pay cash bonuses or grant stock awards in the fiscal year 2007. As a result, columns related to these items have been deleted from the table above. For a further discussion regarding our executive compensation program and the elements thereof and reasons therefore, see Compensation Discussion and Analysis.

Grants of Plan-Based Awards In Fiscal 2007

The following table shows all plan-based awards granted to our named executive officers under our 2005 Stock Option and Stock Incentive Plan during fiscal 2007.

Name	Grant Date	All Other Option Awards: Number of Securities Underlying Options (#)(1)	Exercise or Base Price of Option Awards ($/Sh)	Grant Date Fair Value of Stock and Option Awards ($)(2)
Charles L. McNew President and Chief Executive Officer	7/21/2006	15,000	$ 3.00	$ 24,410
Joseph Sciacca Vice President of Finance and Chief Financial Officer	7/21/2006	7,500	3.00	12,205
Hugh M. Foley Vice President, Operations	7/21/2006	5,000	3.00	8,136
Douglas H. Reece Vice President, Sales and Marketing	7/21/2006	5,000	3.00	8,136

(1) Options to purchase common stock shown in the Table were made under our 2005 Stock Option and Stock Incentive Plan. The exercise price of the options is the closing price of our common stock on the date of grant, which is the date when the Compensation and Employee Benefits

Committee approved such awards.

(2) This column represents the dollar amount recognized for financial reporting purposes with respect to the 2007 fiscal year for the fair value of stock options granted to each named officers in accordance with SFAS 123R. These amounts were calculated using the Black Sholes option-pricing model based on the following assumptions: an expected volatility of 49.99%, an expected term to exercise of 6.25 years and an interest rate of 4.94%. These amounts reflect our accounting expense and do not correspond to the actual value that will be recognized by the named officers.

We did not pay non-equity incentive plan based compensation, equity incentive plan awards or issue stock awards during the 2007 fiscal year. As a result, columns related to these items have been deleted from the table above.

Outstanding Equity Awards at 2007 Fiscal Year End

The following table sets forth the information regarding the outstanding equity awards to our named executive officers at March 31, 2007.

	Option Awards			
Name	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable(1)	Option Exercise Price ($)	Option Expiration Date
Charles L. McNew President and Chief Executive Officer	45,000		$ 5.75	10/2/2009
	25,000		5.50	5/16/2010
	25,000		4.05	3/17/2012
	10,000		3.10	3/17/2013
	25,000		4.45	4/21/2014
	5,000		3.40	9/7/2015
	3,000	12,000	3.00	7/18/2016
Joseph Sciacca Vice President of Finance and Chief Financial Officer	10,000		$ 5.50	12/3/2009
	15,000		5.50	5/16/2010
	10,000		5.50	5/16/2010
	10,000		4.05	3/17/2012
	6,000		3.10	3/17/2013
	10,000		4.45	4/21/2014
	5,000		3.40	9/7/2015
	1,500	6,000	3.00	7/18/2016
Hugh M. Foley Vice President, Operations	10,000		$ 7.56	2/28/2010
	2,500		4.05	3/17/2012
	5,000		3.10	3/17/2013
	12,500		4.45	4/21/2014
	5,000		3.40	9/7/2015
	1,000	4,000	3.00	7/18/2016
Douglas H. Reece Vice President, Sales and Marketing	2,500		$ 3.00	12/4/2011
	500		4.05	3/17/2012
	2,500		5.02	9/14/2014

5,000		3.40	9/7/2015
1,000	4,000	3.00	7/18/2016

(1) All unvested options to purchase common stock vest at a rate of 20% of the initial award each year on each anniversary of the date of grant, July 21, 2006.

We did not grant any stock awards during fiscal 2007. As a result, columns related to these items have been deleted from the table above.

Option Exercises and Stock Vested in Fiscal Year 2007

No restricted stock awards held by our named executive officers vested during fiscal 2007 and no options were exercised by our named executive officers during fiscal 2007.

Potential Payments Upon Termination or Change-in-Control

Severance Agreement with Mr. McNew

On March 31, 2003, we entered into an amended and restated Executive Severance Agreement with Mr. McNew, our President and Chief Executive Officer. This agreement provides severance benefits to Mr. McNew under certain circumstances and remains in effect so long as we continue to employ Mr. McNew. The agreement confirms that Mr. McNew s employment is at will and provides for termination without additional compensation in the event of death, disability, resignation, retirement or termination for cause, referred to as the excluded circumstances in this document. Cause is defined as gross negligence, willful misconduct, fraud, willful disregard of the Board of Directors direction or breach of a published Company policy.

Termination for any Reason other than in connection with an Excluded Circumstance

Under the terms of the agreement, except in connection with a change of control disposition, in the event that Mr. McNew s employment is terminated other than in connection with an excluded circumstance, Mr. McNew would be entitled to receive his then current salary for a period of twelve months. Based on the foregoing, if Mr. McNew s employment was terminated on March 31, 2007, Mr. McNew would be entitled to receive a severance payment of $263,390.

Termination in connection with a Change of Control Disposition

Under the terms of the agreement, a change of control disposition is generally deemed to occur if (i) 25% or more of the voting power of our stock is acquired by another entity or (ii) there is a sale of substantially all of our assets to another entity. In the event that Mr. McNew s employment is terminated within one year of a change of control disposition, other than in connection with an excluded circumstance, Mr. McNew would be entitled to receive his then current salary for a period of twenty-four months. In the event that Mr. McNew s employment is terminated for any reason within ninety days following a change of control disposition, Mr. McNew would be entitled to receive an amount equal to two times his then current salary. Based on either of the foregoing, if Mr. McNew s employment was terminated on March 31, 2007, Mr. McNew would be entitled to receive a severance payment of $526,780.

The agreement provides that Mr. McNew may elect to receive his severance payments in a lump sum or in equal payments at intervals of no more often than semimonthly over a period of his choice that is not to exceed the number of months of compensation due to him.

General Requirements

Pursuant to the terms of the agreement, Mr. McNew may not disclose, publish or use, or permit anyone else to disclose, publish or use, any of our proprietary or confidential information or trade secrets for any purpose unrelated to his employment at any time during or after his employment. Mr. McNew must also return to us all proprietary material that he possesses on the date his employment is terminated. In addition, should Mr. McNew s employment be terminated for any reason other than Cause, Mr. McNew may not (i) directly or indirectly, sell, market, or otherwise provide any client or previously identified prospective client, products or services similar to or in competition with those sold or distributed by us, in any geographic area in which we offer any such products or services, or (ii) participate directly or indirectly in the hiring or soliciting for employment of any person we employ.

Termination/Separation Agreements with Mr. Sciacca, Mr. Foley and Mr. Reece

We entered into a termination/separation agreement with Mr. Sciacca on May 10, 2000, Mr. Foley on January 17, 2003 and Mr. Reece on April 19, 2006. Mr. Sciacca s termination/separation agreement was subsequently modified on March 20, 2003.

As per Mr. Sciacca s modified termination/separation agreement, in the event that Mr. Sciacca s employment is terminated without cause, Mr. Sciacca would be entitled to receive his then current salary for a period of nine months. As per their respective termination/separation agreements, in the event that the employment of Mr. Foley or Mr. Reece is terminated without cause, each individual would be entitled to receive their then current salary for a period of six months. In each of the aforementioned termination/separation agreements, Cause is defined to mean: A good faith finding by the Company of your failure to perform the duties reasonably assigned to you; dishonesty, gross negligence or misconduct, or your conviction, or your entry of a pleading of guilty or nolo contender, to any crime involving more turpitude or any felony.

If the employment of Mr. Sciacca was terminated without cause on March 31, 2007, Mr. Sciacca would be entitled to receive a payment of $128,586 over a nine month period. If the employment of Mr. Foley or Mr. Reece was terminated without cause on March 31, 2007, each would be entitled to receive a payment of $80,598 and $78,542.50, respectively, over a six month period.

2005 Stock Option and Stock Incentive Plan

Under our 2005 Stock Option and Stock Incentive Plan, in the event of a change of control, all unvested option awards will become fully vested immediately upon the occurrence of a change of control and may be exercised for up to 100% of the total number of shares then subject to the option minus the number of shares previously purchased upon exercise of the option. Notwithstanding the above, in the event of a sale or a proposed sale of the majority of our stock or assets or a proposed change of control, the Compensation and Employee Benefits Committee has the right to terminate any unvested option award upon thirty days written notice, subject to the holder s right to exercise such option to the extent vested prior to such termination.

A change of control is generally deemed to occur if (i) there is a change within a twelve-month period in the holders of more than 50% of our outstanding voting stock; or (ii) the Compensation and Employee Benefits Committee deems any other event to constitute a change of control.

The table below provides an estimate of the value of the potential benefit that each executive might be entitled to receive upon a change of control under this plan as if the change of control had occurred on March 31, 2007.

	Estimated Value of Potential Benefit under the 2005 Stock Option and Stock Incentive Plan Upon Change of Control to:			
Potential Benefit	**Charles L. McNew**	**Joseph Sciacca**	**Hugh M. Foley**	**Douglas H. Reece**
Vesting in full of unvested stock option awards(1)	$600	$ 300	$ 200	$ 200

(1) This amount represents the unrealized value of the unvested portion, or options to purchase 12,000, 6,000, 4,000 and 4,000 shares of common stock granted to Mr. McNew, Mr. Sciacca, Mr. Foley and

Mr. Reece, respectively, under the plan as of March 31, 2007. The unrealized value of unvested options was calculated by multiplying (a) the number of shares underlying the unvested options by (b) the difference between 3.05, the closing price of our common stock on March 30, 2007, the last trading day before March 31, 2007, and the applicable per share exercise price of the options.

Fiscal 2007 Director Compensation

Our compensation program for outside directors is designed to enable us to attract, retain and motivate highly qualified directors to serve on our Board of Directors. It is also intended to further align the interests of our directors with those of our shareholders. Annual compensation for our outside directors in the fiscal year 2007 was comprised of a mix of cash and equity-based compensation.

The following table sets forth information regarding the compensation of our outside directors for the fiscal year 2007.

Name	Fees earned or paid in cash ($)	Option Awards ($)(1)	Total ($)
John H. Grover Chairman of the Board	$ 9,000	$ 488(2)	$ 9,488
John M. Toups Director	9,000	488(2)	9,488
Thomas L. Hewitt Director	9,000	488(2)	9,488
Gerald F. Ryles Director	9,000	2,100(2)(3)	11,100
Arch C. Scurlock, Jr. Director	9,000	1,210(2)(4)	10,210
Daniel R Young Director	9,000	488(2)	9,488

(1) On March 31, 2007, the following represents the aggregate number of option awards outstanding for each of the above named directors: (i) Mr. Grover 19,300; (ii) Mr. Toups 19,300; (iii) Mr. Hewitt 15,300; (iv) Mr. Ryles 8,300; (v) Mr. Scurlock 12,000; (vi) Mr. Young 8,300. During fiscal 2007, Messrs. Grover, Toups, Hewitt, Ryles and

Scurlock were each granted 2,000 options to purchase shares of our common stock at an exercise price of $3.00 per share, which awards are included in the table above.

(2) This column represents the dollar amount recognized for financial reporting purposes with respect to the 2007 fiscal year for the fair value of stock options granted to each named director in accordance with SFAS 123R. These amounts were calculated using the Black Sholes option-pricing model based on the following assumptions: an expected volatility of 49.99%, an expected term to exercise of 6.25 years and an interest rate of 4.94%. These amounts reflect our accounting expense and do not correspond to the actual value that will be recognized by the named

directors.

(3) This represents the dollar amount recognized for financial reporting purposes with respect to the 2007 fiscal year for the fair value of stock options granted to Mr. Ryles in prior years of $1,612 in accordance with SFAS 123R upon being elected to serve on the Board of Directors. These amounts were calculated using the Black Sholes option-pricing model based on the following assumptions: an expected volatility of 36.25%, an expected term to exercise of 6.25 years and an interest rate of 2.63%. This amount reflects our accounting expense and will not correspond to the actual value that will be recognized by Mr. Ryles.

(4) This represents the dollar amount recognized for

financial reporting purposes with respect to the 2007 fiscal year for the fair value of stock options granted to Mr. Scurlock in prior years of $722 in accordance with SFAS 123R upon being elected to serve on the Board of Directors. These amounts were calculated using the Black Sholes option-pricing model based on the following assumptions: an expected volatility of 43.32%, an expected term to exercise of 6.25 years and an interest rate of .95%. This amount reflects our accounting expense and will not correspond to the actual value that will be recognized by Mr. Scurlock.

Director Compensation Description

Non-employee directors receive an annual fee of $1,000. Non-employee directors also receive $2,000 for each regular meeting of our Board of Directors attended in person and $1,000 for each regular meeting of our Board of Directors attended telephonically. In addition, non-employee directors receive $1,000 for each special meeting of our Board of Directors attended.

Under our Non-Employee Directors Stock Option Plan, each director was granted options to purchase 5,000 shares of common stock on the first of the month following the date of the annual meeting of shareholders on which he was initially elected and was granted options to purchase up to 2,000 shares of common stock on each annual re-election by the shareholders as one of our directors. Such options were granted at an exercise price equal to or greater than the fair market value of the common stock on the date of grant. No further options may be granted pursuant to our Non-Employee Directors Stock Option Plan. Each non-employee director is eligible to receive awards under our 2005 Stock Option and Stock Incentive Plan.

Compensation Committee Interlocks and Insider Participation

All members of the Compensation Committee during the fiscal year ended March 31, 2007 were independent directors. During fiscal 2007, none of the members of the Compensation Committee: (i) were officers or employees or former employees of our Company or our subsidiaries; (ii) were former officers of our Company or our subsidiaries; or (iii) had any relationship requiring disclosure by our Company under the SEC s rules requiring disclosure of related party transactions. No executive officer of our Company serves as a member of the board of directors or compensation committee of any entity that has one or more of its executive officers serving as a member of our Board of Directors or the Compensation Committee.

COMPENSATION AND EMPLOYEE BENEFITS COMMITTEE REPORT

The Compensation and Employee Benefits Committee has reviewed and discussed the Compensation Discussion and Analysis section appearing above with the management of the Company. Based on this review and these discussions, the Compensation and Employee Benefits Committee recommended to the Company s Board of Directors that the Compensation Discussion and Analysis be included in the Company s Annual Report on Form 10-K for the fiscal year ended March 31, 2007 and in this document.

This Compensation and Employee Benefits Committee Report shall not be deemed incorporated by reference in any document previously or subsequently filed with the SEC that incorporates by reference all or any portion of this document.

Compensation and Employee Benefits Committee

John H. Grover (Chairman)
John M. Toups
Thomas Hewitt

15

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The following table sets forth as of July 16, 2007 the number of shares of common stock beneficially owned by: (1) each person who owned of record, or is known by us to have beneficially owned, more than 5% of such shares then outstanding; (2) each director; (3) the executive officers named in the Summary Compensation Table contained in this document (the named executive officers); and (4) all executive officers and directors as a group. Information as to the beneficial ownership is based upon statements furnished to us by such persons. Unless otherwise indicated, the address for each of the shareholders in the table below is c/o Halifax Corporation, 5250 Cherokee Avenue, Alexandria, VA 22312.

Name and Address of Beneficial Owner		Amount and Nature of Beneficial Ownership		Percent
Nancy M. Scurlock				
	1/30/04	118	134	158
	1/28/05	168	162	169
	1/27/06	182	184	204
	2/02/07	192	223	228
	2/01/08	140	176	208

The graph assumes an initial investment of $100 on January 31, 2003, the last trading day prior to the commencement of the Company s 2003 fiscal year, and that all dividends were reinvested.

12

Securities Authorized For Issuance Under Equity Compensation Plans

The following table provides information about stock options outstanding and shares available for future awards under all of Cato s equity compensation plans. The information is as of February 2, 2008.

Plan Category	(a) Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	(b) Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	139,075	$ 12.41	1,272,220
Equity compensation plans not approved by security holders			
Total	139,075	$ 12.41	1,272,220

Issuer Purchases of Equity Securities

The following table summarizes the Company s purchases of its common stock for the three months ended February 2, 2008.

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)
November 2007	691,900	$ 18.87	691,900	
December 2007	1,455,100	15.35	1,455,100	
January 2008	186,600	15.33	186,600	

Total	2,333,600	$	16.39	2,333,600	394,660 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 fiscal year end February 2, 2008, the Company had 394,660 shares remaining in open authorizations. There is no specified expiration date for the Company s repurchase program. In fiscal 2007, the Company repurchased 3.162 million shares under this program for approximately $54.1 million or an average market price per share of $17.11. In addition, 205,891 shares at an average market price per share of $21.70 were tendered as partial payment of the exercise price of an employee stock option and the related tax withholding.

(2) Prices include trading costs.

Item 6. ***Selected Financial Data:***

Certain selected financial data for the five fiscal years ended February 2, 2008 have been derived from the Company s audited financial statements. The financial statements and Independent Registered Public Accounting Firm s reports for the three most recent fiscal years are contained elsewhere in this report. All data set forth below are qualified by reference to, and should be read in conjunction with, the Company s Consolidated Financial Statements (including the Notes thereto) and Management s Discussion and Analysis of Financial Condition and Results of Operations appearing elsewhere in this annual report.

The five-year selected consolidated financial data presented in this Item 6 has been adjusted to reflect a three-for-two stock split in the form of a stock dividend of the Company s Class A and Class B Common Stock effected June 27, 2005.

Fiscal Year	**2007**	**2006**	**2005**	**2004**	**2003**
	(Dollars in thousands, except per share data and selected operating data)				
STATEMENT OF OPERATIONS DATA:					
Retail sales	**$ 834,341**	$ 862,813	$ 821,639	$ 773,809	$ 731,770
Other income	**12,096**	13,072	14,742	15,795	15,497
Total revenues	**846,437**	875,885	836,381	789,604	747,267
Cost of goods sold (exclusive of depreciation shown below)	**572,309**	572,712	546,955	528,916	508,991
Gross margin	**262,032**	290,101	274,684	244,893	222,779
Gross margin percent	**31.4%**	33.6%	33.4%	31.6%	30.4%
Selling, general and administrative	**210,892**	212,157	203,156	187,618	174,202
Selling, general and administrative percent of retail sales	**25.3%**	24.6%	24.7%	24.2%	23.8%
Depreciation	**22,212**	20,941	20,275	20,397	18,695
Interest expense	**9**	41	183	717	306
Interest and other income	**(8,218)**	(9,597)	(4,563)	(2,739)	(3,614)
Income before income taxes	**49,233**	79,631	70,375	54,695	48,687
Income tax expense	**16,914**	28,181	25,546	19,854	17,673
Net income	**$ 32,319**	$ 51,450	$ 44,829	$ 34,841	$ 31,014
Basic earnings per share	**$ 1.03**	$ 1.64	$ 1.44	$ 1.13	$ .89
Diluted earnings per share	**$ 1.03**	$ 1.62	$ 1.41	$ 1.11	$ .88
Cash dividends paid per share	**$ .645**	$ .58	$ .507	$ .457	$ .42
SELECTED OPERATING DATA:					
Stores open at end of year	**1,318**	1,276	1,244	1,177	1,102
Average sales per store(1)	**$ 640,000**	$ 685,000	$ 684,000	$ 682,000	$ 692,000
Average sales per square foot of selling space	**$ 165**	$ 175	$ 173	$ 170	$ 171
Comparable store sales increase (decrease)	**(4)%**	(2)%	1%	0%	(7)%

BALANCE SHEET DATA (at period end):					
Cash, cash equivalents and short-term investments	**$ 114,578**	$ 123,542	$ 107,819	$ 107,228	$ 71,402
Working capital	**144,114**	176,464	139,114	136,980	117,403
Total assets	**420,792**	432,322	406,636	397,323	356,284
Total stockholders equity	**247,370**	276,793	239,948	211,175	186,075

(1) Calculated using actual sales volume for stores open for the full year and an estimated annual sales volume for new stores opened during the year.

(2) The fiscal year 2006 contained 53 weeks versus 52 weeks for all other years shown.

Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations:***

Results of Operations

The table below sets forth certain financial data of the Company expressed as a percentage of retail sales for the years indicated:

Fiscal Year Ended	**February 2, 2008**	**February 3, 2007**	**January 28, 2006**
Retail sales	**100.0%**	100.0%	100.0%
Other income	**1.4**	1.5	1.8
Total revenues	**101.4**	101.5	101.8
Cost of goods sold	**68.6**	66.4	66.6
Selling, general and administrative	**25.3**	24.6	24.7
Depreciation	**2.7**	2.4	2.5
Interest and other income	**(1.0)**	(1.1)	(0.6)
Income before income taxes	**5.9**	9.2	8.6
Net income	**3.9%**	6.0%	5.5%

Fiscal 2007 Compared to Fiscal 2006

Retail sales decreased by 3.3% to $834.3 million in fiscal 2007 compared to $862.8 million in fiscal 2006. The fiscal year ended February 2, 2008 contained 52 weeks versus 53 weeks in fiscal year ended February 3, 2007. The decrease in retail sales in fiscal 2007 was attributable to the reduction of one week of sales estimated at $18.7 million and the difficult retail environment. On an equivalent 52 week basis, comparable store sales decreased 4% from fiscal 2006. Total revenues, comprised of retail sales and other income (principally finance charges and late fees on customer accounts receivable and layaway fees), decreased by 3.4% to $846.4 million in fiscal 2007 compared to $875.9 million in fiscal 2006. The Company operated 1,318 stores at February 2, 2008 compared to 1,276 stores operated at February 3, 2007.

In fiscal 2007, the Company opened 62 new stores, relocated 18 stores, remodeled 9 stores and closed 20 stores.

Other income in total, as included in total revenues in fiscal 2007, decreased slightly to $12.1 million from $13.1 million in fiscal 2006. The decrease resulted primarily from credit revenue and finance and layaway charges.

Credit revenue of $10.4 million represented 1.2% of total revenue in fiscal 2007. This is comparable to 2006 credit revenue of $10.9 million or 1.2% of total revenue. The decrease in credit revenue was primarily due to reductions in finance charge income as a result of lower accounts receivable balances. 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 $6.1 million in fiscal 2007 compared to $5.9 million in fiscal 2006. The increase in these expenses was principally due to higher bad debt expense in fiscal 2007. See Note 14 of the Consolidated Financial Statements for a schedule of credit related expenses. Total segment credit income before taxes decreased $0.6 million from $4.9 million in 2006 to $4.3 million in 2007 due to decreased finance charge income and increased bad debt expense. Total credit income of $4.3 million in 2007 represented 8.7% of total income before taxes of $49.2 million compared to total credit income of $4.9 million in 2006 which represented 6.1% of 2006 total income before taxes.

Cost of goods sold was $572.3 million, or 68.6% of retail sales, in fiscal 2007 compared to $572.7 million, or 66.4% of retail sales, in fiscal 2006. The increase in cost of goods sold as a percent of retail sales resulted primarily from higher occupancy costs and higher markdowns. 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 9.7% to

$262.0 million in fiscal 2007 from $290.1 million in fiscal 2006. Gross margin as presented may not be comparable to that of other companies.

Selling, general and administrative expenses (SG&A), which primarily include corporate and store payroll, related payroll taxes and benefits, insurance, supplies, advertising, bank and credit card processing fees and bad debts were $210.9 million in fiscal 2007 compared to $212.2 million in fiscal 2006, a decrease of 0.6%. As a percent of retail sales, SG&A was 25.3% compared to 24.6% in the prior year. The overall dollar decrease in SG&A resulted primarily from a decrease in incentive based compensation expenses offset by increased salary expense driven by store development and increased health care expenses.

Depreciation expense was $22.2 million in fiscal 2007 compared to $20.9 million in fiscal 2006. The depreciation expense in fiscal 2007 and 2006 resulted primarily from the Company s store development activity and investment in technology.

Interest and other income was $8.2 million in fiscal 2007 compared to $9.6 million in fiscal 2006. The decrease is due to the settlement of a $2.4 million insurance claim for hurricane losses received in the fourth quarter of fiscal 2006, partially offset by higher interest income due to increased rates and higher average invested balances. See Note 2 to the Consolidated Financial Statements for details.

Income tax expense was $16.9 million, or 2.0% of retail sales in fiscal 2007 compared to $28.2, or 3.2% of retail sales in fiscal 2006. The decrease resulted from lower pre-tax income in conjunction with a reduction in the effective tax rate. The effective tax rate was 34.4% in fiscal 2007 and 35.4% in fiscal 2006. The Company expects the effective rate in 2008 to be approximately 34.0% to 36.0%.

Fiscal 2006 Compared to Fiscal 2005

Retail sales increased by 5% to $862.8 million in fiscal 2006 compared to $821.6 million in fiscal 2005. The fiscal year ended February 3, 2007 contained 53 weeks versus 52 weeks in fiscal year ended January 28, 2006. The increase in retail sales in fiscal 2006 was attributable to sales from new stores and the additional week. The additional week in fiscal 2006 increased total sales by $17.2 million for the year. On an equivalent 53 week basis, comparable store sales decreased 2% from the prior year. Total revenues, comprised of retail sales and other income (principally finance charges and late fees on customer accounts receivable and layaway fees), increased by 5% to $875.9 million in fiscal 2006 compared to $836.4 million in fiscal 2005. The Company operated 1,276 stores at February 3, 2007 compared to 1,244 stores operated at January 28, 2006.

In fiscal 2006, the Company opened 58 new stores, relocated 20 stores, remodeled 8 stores and closed 26 stores.

Credit revenue of $10.9 million represented 1.2% of total revenue in fiscal 2006. This is comparable to 2005 credit revenue of $12.7 million or 1.5% of total revenue. The decrease in credit revenue was primarily due to reductions in finance charge and late fee income as a result of lower accounts receivable balances and a higher percentage of accounts current. 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 $5.9 million in fiscal 2006 compared to $7.9 million in fiscal 2005. The decrease in these expenses was principally due to lower bad debt expense in fiscal 2006. See Note 14 of the Consolidated Financial Statements for a schedule of credit related expenses. Total credit income before taxes increased $0.2 million from $4.7 million in 2005 to $4.9 million in 2006 due to decreased bad debt expense. Total credit income of $4.9 million in 2006 represented 6.2% of total income before taxes of $79.6 million.

Other income in total, as included in total revenues in fiscal 2006, decreased slightly to $13.1 million from $14.7 million in fiscal 2005. The decrease resulted primarily from a decrease in finance and late charges.

Cost of goods sold was $572.7 million, or 66.4% of retail sales, in fiscal 2006 compared to $547.0 million, or 66.6% of retail sales, in fiscal 2005. The decrease in cost of goods sold as a percent of retail sales resulted primarily from lower procurement costs and reduced markdowns. The reduction in procurement costs is primarily the result of increased direct sourcing and the reduction in markdowns is primarily due to improved inventory control and increased sales 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 6% to $290.1 million in fiscal 2006 from $274.7 million in fiscal 2005. Gross margin as presented may not be comparable to those of other companies.

Selling, general and administrative expenses (SG&A), which primarily include corporate and store payroll, related payroll taxes and benefits, insurance, supplies, advertising, bank and credit card processing fees and bad debts were $212.2 million in fiscal 2006 compared to $203.2 million in fiscal 2005, an increase of 4%. As a percent of retail sales, SG&A was 24.6% compared to 24.7% in the prior year. The overall dollar increase in SG&A resulted primarily from increased salary expense driven by store development, offset by a decrease in incentive based compensation expenses.

Depreciation expense was $20.9 million in fiscal 2006 compared to $20.3 million in fiscal 2005. The depreciation expense in fiscal 2006 and 2005 resulted primarily from the Company s store development activity and investment in technology.

Interest and other income was $9.6 million in fiscal 2006 compared to $4.6 million in fiscal 2005. The increase in fiscal 2006 resulted primarily from higher interest rates, settlement of insurance claims for losses attributable to hurricanes during the third quarter of fiscal 2005 of $2.4 million received in the fourth quarter of fiscal 2006, and a refund settlement on third-party credit card fees of $0.5 million received in the second quarter of fiscal 2006.

Income tax expense was $28.2 million, or 3.2% of retail sales in fiscal 2006 compared to $25.5 million, or 3.1% of retail sales in fiscal 2005. The increase resulted from higher pre-tax income, partially offset by a reduction in the effective tax rate. The effective tax rate was 35.4% in fiscal 2006 and 36.3% in fiscal 2005.

Off Balance Sheet Arrangements

Other than operating leases in the ordinary course of business, the Company is not a party to any off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on the Company s financial condition, revenues, expenses, results of operations, liquidity, capital expenditures or capital resources.

Critical Accounting Policies

The Company s accounting policies are more fully described in Note 1 to the Consolidated Financial Statements. As disclosed in Note 1 of Notes to Consolidated Financial Statements, 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 judgement. 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, calculation of asset impairment, shrinkage accrual and reserves for uncertain tax positions.

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

Allowance for Doubtful Accounts

The Company evaluates the collectibility of accounts receivable and records an allowance for doubtful accounts based on estimates of actual write-offs and the accounts receivable aging roll rates over a period of up to 12 months. The allowance is reviewed for adequacy and adjusted, as necessary, on a quarterly basis. The Company also provides for estimated uncollectible late fees charged based on historical write-offs. The Company s financial results can be significantly impacted by changes in bad debt write-off experience and the aging of the accounts receivable portfolio.

Merchandise Inventories

The Company s inventory is valued using the retail method of accounting and is stated at the lower of cost (first-in, first-out method) or market. Under the retail inventory method, the valuation of inventory at cost and resulting gross margin are calculated by applying an average cost to retail ratio to the retail value of inventory. The retail inventory method is an averaging method that has been widely used in the retail industry. Inherent in the retail method are certain significant estimates, including initial merchandise markup, markdowns and shrinkage, which significantly impact the ending inventory valuation at cost and the resulting gross margins. Physical inventories are conducted throughout the year to calculate actual shrinkage and inventory on hand. Estimates based on actual shrinkage results are used to estimate inventory shrinkage, which is accrued for the period between the last inventory and the financial reporting date. The Company continuously reviews its inventory levels to identify slow moving merchandise and uses markdowns to clear slow moving inventory. The general economic environment for retail apparel sales could result in an increase in the level of markdowns, which would result in lower inventory values and increases to cost of goods sold as a percentage of net sales in future periods. Management makes estimates regarding markdowns based on inventory levels on hand and customer demand, which may impact inventory valuations. Markdown exposure with respect to inventories on hand is limited due to the fact that seasonal merchandise is not carried forward. Historically, actual results have not significantly deviated from those determined using the estimates described above.

Lease Accounting

The Company recognizes rent expense on a straight-line basis over the lease term as defined in SFAS No. 13, *Accounting for Leases* . Our lease agreements generally provide for scheduled rent increases during the lease term or rent holidays, including rental payments commencing at a date other than the date of initial occupancy. We include any rent escalation and rent holidays in our straight-line rent expense. In addition, we record landlord allowances for normal tenant improvements as deferred rent, which is included in other noncurrent liabilities in the consolidated balance sheets. This deferred rent is amortized over the lease term as a reduction of rent expense. Also, leasehold improvements are amortized using the straight-line method over the shorter of their estimated useful lives or the related lease term. See Note 1 to the Consolidated Financial Statements for further information on the Company s accounting for its leases.

Impairment of Long-Lived Assets

The Company primarily invests in property and equipment in connection with the opening and remodeling of stores and in computer software and hardware. The Company periodically reviews its store locations and estimates the recoverability of its assets, recording an impairment charge, if necessary, when the Company decides to close the store or otherwise determines that future undiscounted cash flows associated with those assets will not be sufficient to recover the carrying value. This determination is based on a number of factors, including the store s historical operating results and cash flows, estimated future sales growth, real estate development in the area and perceived local market conditions that can be difficult to predict and may be subject to change. In addition, the Company regularly evaluates its computer-related and other long-lived assets and may accelerate depreciation over the revised useful life if the asset is expected to be replaced or has limited future value. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is reflected in income for that period.

Insurance Liabilities

The Company is primarily self-insured for health care, workers compensation and general liability costs. These costs are significant primarily due to the large number of the Company s retail locations and associates. The Company s self-insurance liabilities are based on the total estimated costs of claims filed and estimates of claims incurred but not

reported, less amounts paid against such claims, and are not discounted. Management reviews current and historical claims data in developing its estimates. The Company also uses information provided by outside actuaries with respect to workers compensation and general liability claims. If the underlying facts and circumstances of the claims change or the historical experience upon which insurance provisions are recorded is not indicative of future trends, then the Company may be required to make adjustments to the provision for insurance

costs that could be material to the Company s reported financial condition and results of operations. Historically, actual results have not significantly deviated from estimates.

Uncertain Tax Positions

The Company records liabilities for uncertain tax positions principally related to state income taxes as of the balance sheet date. These liabilities reflect the Company s best estimate of its ultimate income tax liability based on the tax codes, regulations, and pronouncements of the jurisdictions in which we do business. Estimating our ultimate tax liability involves significant judgements regarding the application of complex tax regulations across many jurisdictions. Despite our belief that our estimates and judgements are reasonable, differences between our estimated and actual tax liabilities could exist. These differences may arise from settlements of tax audits, expiration of the statute of limitations, or the evolution and application of the various jurisdictional tax codes and regulations. Any differences will be recorded in the period in which they become known and could have a material effect on the results of operations in the period the adjustment is recorded.

Revenue Recognition

While the Company s recognition of revenue is predominantly derived from routine retail transactions and does not involve significant judgement, revenue recognition represents an important accounting policy of the Company. As discussed in Note 1 to the Consolidated Financial Statements, the Company recognizes sales at the point of purchase when the customer takes possession of the merchandise and pays for the purchase, generally with cash or credit. Sales from purchases made with Cato credit, gift cards and layaway sales are also recorded when the customer takes possession of the merchandise. Gift cards, layaway deposits and merchandise credits granted to customers are recorded as deferred revenue until they are redeemed or forfeited. Gift cards and merchandise credits do not have expiration dates. A provision is made for estimated product returns based on sales volumes and the Company s experience; actual returns have not varied materially from amounts provided historically.

Beginning with the fourth quarter of fiscal 2007, the Company began recognizing income on unredeemed gift cards (gift card breakage) as a component of other income. Gift card breakage is determined after 60 months when the likelihood of the remaining balances being redeemed is remote based on our historical redemption data and there is no legal obligation to remit the remaining balances to relevant jurisdictions. Gift card breakage income will be recognized on a quarterly basis and is not expected to be material.

Credit revenue on the Company s private label credit card portfolio is recognized as earned under the interest method. Late fees are recognized as earned, less provisions for estimated uncollectible fees.

Liquidity, Capital Resources and Market Risk

The Company has consistently maintained a strong liquidity position. Cash provided by operating activities during fiscal 2007 was $74.2 million as compared to $58.7 million in fiscal 2006. These amounts have enabled the Company to fund its regular operating needs, capital expenditure program, cash dividend payments and any repurchase of the Company s common stock. In addition, the Company maintains $35.0 million of unsecured revolving credit facilities for short-term financing of seasonal cash needs, none of which was outstanding at February 2, 2008.

Cash provided by operating activities for these periods was primarily generated by earnings adjusted for depreciation, deferred taxes, and changes in working capital. The increase of $15.5 million for fiscal 2007 over fiscal 2006 is primarily due to an increase in accounts payable due to more favorable terms with certain merchandise vendors, offset by a decrease in accrued bonus and benefits and deferred income taxes combined with the decrease in net earnings of $19.1 million.

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 proposed capital expenditures, dividends, purchase of treasury stock and other operating requirements for fiscal 2008 and for the foreseeable future.

At February 2, 2008, the Company had working capital of $144.1 million compared to $176.5 million at February 3, 2007. Additionally, the Company had $2.6 million invested in privately managed investment funds and other miscellaneous equities, which are reported under other noncurrent assets of the consolidated balance sheets.

At February 2, 2008, the Company had an unsecured revolving credit agreement, which provided for borrowings of up to $35.0 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 February 2, 2008. There were no borrowings outstanding under these credit facilities during the fiscal year ended February 2, 2008 or the fiscal year ended February 3, 2007.

On August 22, 2003, the Company entered into a new unsecured $30.0 million five-year term loan facility, the proceeds of which were used to purchase Class B Common Stock from the Company s founders. Payments were due in monthly installments of $500,000 plus accrued interest based on LIBOR. On April 5, 2005, the Company repaid the remaining balance of $20.5 million on this loan facility with no early prepayment penalty. With the early retirement of this loan, the Company had no outstanding debt as of February 2, 2008 or February 3, 2007.

The Company had approximately $4.3 million and $4.5 million at February 2, 2008 and February 3, 2007, respectively, of outstanding irrevocable letters of credit relating to purchase commitments.

Expenditures for property and equipment totaled $18.3 million, $27.5 million and $28.5 million in fiscal 2007, 2006 and 2005, respectively. The expenditures for fiscal 2007 were primarily for store development, store remodels and investments in new technology. In fiscal 2008, the Company is planning to invest approximately $18.9 million in capital expenditures. This includes expenditures to open 75 new stores, relocate 15 stores and close up to 32 stores. In addition, the Company plans to remodel 15 stores and has planned for additional investments in technology scheduled to be implemented over the next 12 months.

Net cash used in investing activities totaled $12.1 million for fiscal 2007 compared to $40.0 million used for the comparable period of 2006. The decrease was due primarily to a reduction in expenditures for property and equipment offset by the net reduction in sale 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.

The Company does not use derivative financial instruments. At February 2, 2008, the Company s investment portfolio was primarily invested in auction rate securities and governmental securities held in a managed fund. These securities are classified as available-for-sale as they are highly liquid 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 Consolidated Balance Sheets.

As of February 2, 2008, the Company held $41.9 million in auction rate securities (ARS) backed by tax exempt municipal debt rated A or better. The underlying securities have contractual maturities which generally range from seven to thirty years and are classified as available for sale and recorded at fair value due to the resetting of the interest rates every 7 to 35 days. Of the $41.9 million in ARS, $13.9 million failed their last auction subsequent to February 2, 2008. As a result, our ability to liquidate these investments in the near term may be limited. The Company believes it has sufficient liquidity for its current needs without selling any failed ARS and does not currently intend to liquidate these securities until market conditions improve. The underlying securities of the failed auctions remain sound and the Company does not expect any losses or impairment. To date, the Company has collected all interest payments on all

of its ARS when due and expects to continue to do so in the future.

The following table shows the Company s obligations and commitments as of February 2, 2008, to make future payments under noncancellable contractual obligations (in thousands):

		Payments Due During One Year Fiscal Period Ending					
Contractual Obligations	**Total**	**2008**	**2009**	**2010**	**2011**	**2012**	**Thereafter**
Uncertain tax positions(1)	$ 9,180	$	$	$	$	$	$ 9,180
Merchandise letters of credit	4,274	4,274					
Operating leases	153,046	54,095	40,312	29,501	19,356	9,614	168
Total Contractual Obligations	$ 166,500	$ 58,369	$ 40,312	$ 29,501	$ 19,356	9,614	$ 9,348

(1) Due to the nature of this obligation, the Company is unable to estimate the timing of the cash outflows.

Recent Accounting Pronouncements

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 included: 1) 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 2) 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. The impact on the Company s consolidated financial statements for fiscal 2006 was an additional compensation expense of $235,000.

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. See Note 12 to Consolidated Financial Statements, Income Taxes.

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 applies under other accounting pronouncements that require or permit fair value measurements and, accordingly does not require any new 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 consolidated 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 consolidated financial statements.

On June 14, 2007, the FASB reached consensus on EITF Issue No. 06-11, *Accounting for Income Tax Benefits of Dividends on Share-Based Payment*. EITF No. 06-11 requires that a realized income tax benefit from dividends or

dividend equivalents that are charged to retained earnings and are paid to associates for equity classified nonvested equity shares, nonvested equity share units, and outstanding equity share options should be recognized as an increase to additional paid-in capital. The amount recognized in additional paid-in capital for the realized income tax benefit from dividends on those awards should be included in the pool of excess tax benefits available to absorb tax deficiencies on share-based payment awards. EITF No. 06-11 is effective for fiscal years beginning on or after December 15, 2007. We are currently evaluating the impact that this standard may have on our results of operations and financial position.

Item 7A. ***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.

Item 8. ***Financial Statements and Supplementary Data:***

INDEX TO FINANCIAL STATEMENTS AND SCHEDULE

	Page
Report of Independent Registered Public Accounting Firm	24
Consolidated Statements of Income and Comprehensive Income for the fiscal years ended February 2, 2008, February 3, 2007 and January 28, 2006	25
Consolidated Balance Sheets at February 2, 2008 and February 3, 2007	26
Consolidated Statements of Cash Flows for the fiscal years ended February 2, 2008, February 3, 2007 and January 28, 2006	27
Consolidated Statements of Stockholders Equity for the fiscal years ended February 2, 2008 February 3, 2007 and January 28, 2006	28
Notes to Consolidated Financial Statements	29
Schedule II Valuation and Qualifying Accounts for the fiscal years ended February 2, 2008, February 3, 2007 and January 28, 2006	S-2

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of
The Cato Corporation:

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of The Cato Corporation and its subsidiaries at February 2, 2008 and February 3, 2007, and the results of their operations and their cash flows for each of the three years in the period ended February 2, 2008 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of February 2, 2008, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management s Report on Internal Control over Financial Reporting located under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company s internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

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

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

/s/ PricewaterhouseCoopers LLP

Charlotte, NC
April 1, 2008

THE CATO CORPORATION

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

	Fiscal Year Ended		
	February 2, 2008	**February 3, 2007**	**January 28, 2006**
	(Dollars in thousands, except per share data)		
REVENUES			
Retail sales	**$ 834,341**	$ 862,813	$ 821,639
Other income (principally finance charges, late fees and layaway charges)	**12,096**	13,072	14,742
Total revenues	**846,437**	875,885	836,381
COSTS AND EXPENSES, NET			
Cost of goods sold (exclusive of depreciation shown below)	**572,309**	572,712	546,955
Selling, general and administrative	**210,892**	212,157	203,156
Depreciation	**22,212**	20,941	20,275
Interest expense	**9**	41	183
Interest and other income	**(8,218)**	(9,597)	(4,563)
	797,204	796,254	766,006
Income before income taxes	**49,233**	79,631	70,375
Income tax expense	**16,914**	28,181	25,546
Net income	**$ 32,319**	$ 51,450	$ 44,829
Basic earnings per share	**$ 1.03**	$ 1.64	$ 1.44
Basic weighted average shares	**31,279,918**	31,281,163	31,117,214
Diluted earnings per share	**$ 1.03**	$ 1.62	$ 1.41
Diluted weighted average shares	**31,513,202**	31,815,332	31,789,887
Dividends per share	**$ .645**	$ .580	$ .507
Comprehensive income:			
Net income	**$ 32,319**	$ 51,450	$ 44,829
Unrealized gains on available-for-sale securities, net of deferred income tax liability or benefit	**484**	147	7

Net comprehensive income	**$**	**32,803**	$	51,597	$	44,836

See notes to consolidated financial statements.

THE CATO CORPORATION

CONSOLIDATED BALANCE SHEETS

	February 2, 2008	February 3, 2007
	(Dollars in thousands)	
ASSETS		
Current Assets:		
Cash and cash equivalents	**$ 21,583**	$ 24,833
Short-term investments	**92,995**	98,709
Accounts receivable, net of allowance for doubtful accounts of $3,263 at February 2, 2008 and $3,554 at February 3, 2007	**45,282**	45,958
Merchandise inventories	**118,679**	115,918
Deferred income taxes	**6,756**	7,508
Prepaid expenses	**7,755**	6,587
Total Current Assets	**293,050**	299,513
Property and equipment net	**123,190**	128,461
Other assets	**4,552**	4,348
Total Assets	**$ 420,792**	$ 432,322
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	**$ 110,848**	$ 77,046
Accrued expenses	**27,617**	29,526
Accrued bonus and benefits	**2,543**	10,756
Accrued income taxes	**7,928**	5,721
Total Current Liabilities	**148,936**	123,049
Deferred income taxes	**1,707**	8,817
Other noncurrent liabilities (primarily deferred rent)	**22,779**	23,663
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; 36,109,263 and 35,955,815 shares issued at February 2, 2008 and February 3, 2007, respectively	**1,204**	1,199
Convertible Class B common stock, $.033 par value per share, 15,000,000 shares authorized; issued 1,743,525 and 690,525 shares at February 2, 2008 and February 3, 2007, respectively	**58**	23
Additional paid-in capital	**58,685**	42,475
Retained earnings	**340,088**	327,684

Accumulated other comprehensive income		**709**		225
		400,744		371,606
Less Class A common stock in treasury, at cost (8,461,615 shares at February 2, 2008 and 5,093,609 shares at February 3, 2007, respectively)		**(153,374)**		(94,813)
Total Stockholders Equity		**247,370**		276,793
Total Liabilities and Stockholders Equity	**$**	**420,792**	$	432,322

See notes to consolidated financial statements.

THE CATO CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Fiscal Year Ended		
	February 2, 2008	**February 3, 2007**	**January 28, 2006**
	(Dollars in thousands)		
OPERATING ACTIVITIES			
Net income	**$ 32,319**	$ 51,450	$ 44,829
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	**22,212**	20,941	20,275
Provision for doubtful accounts	**2,844**	2,633	4,650
Share based compensation	**1,694**	1,326	682
Excess tax benefits from share-based compensation	**(5,964)**	(768)	
Deferred income taxes	**(6,358)**	574	(3,656)
Loss on disposal of property and equipment	**1,163**	2,079	1,757
Changes in operating assets and liabilities which provided (used) cash:			
Accounts receivable	**(2,168)**	1,053	(3,405)
Merchandise inventories	**(2,761)**	(12,548)	(2,832)
Prepaid and other assets	**(1,372)**	2,238	(1,065)
Accrued income taxes	**8,533**	1,499	525
Accounts payable, accrued expenses and other liabilities	**24,022**	(11,776)	9,183
Net cash provided by operating activities	**74,164**	58,701	70,943
INVESTING ACTIVITIES			
Expenditures for property and equipment	**(18,330)**	(27,547)	(28,512)
Purchases of short-term investments	**(313,761)**	(180,463)	(94,845)
Sales of short-term investments	**319,960**	167,985	97,355
Net cash used in investing activities	**(12,131)**	(40,025)	(26,002)
FINANCING ACTIVITIES			
Change in cash overdrafts included in accounts payable	**(1,000)**	500	(3,100)
Dividends paid	**(20,277)**	(18,228)	(15,867)
Purchases of treasury stock	**(58,561)**		(3,536)
Payments to settle long term debt			(22,000)
Proceeds from employee stock purchase plan	**481**	413	430
Excess tax benefits from share-based compensation	**5,964**	768	
Proceeds from stock options exercised	**8,110**	970	2,226
Net cash used in financing activities	**(65,283)**	(15,577)	(41,847)

Net increase (decrease) in cash and cash equivalents	**(3,250)**	3,099	3,094
Cash and cash equivalents at beginning of year	**24,833**	21,734	18,640
Cash and cash equivalents at end of year	**$ 21,583**	$ 24,833	$ 21,734

See notes to consolidated financial statements.

THE CATO CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

	Class A Common Stock	Convertible Class B Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Unearned Compensation Restricted Stock Awards	Treasury Stock	Total Stockholders Equity
				(Dollars in thousands)				
Balance January 29, 2005	875	187	103,366	265,499	71	(911)	(157,912)	211,175
Comprehensive income:								
Net income				44,829				44,829
Unrealized gains on available-for-sale securities, net of deferred income tax liability of $3					7			7
Dividends paid ($.507 per share)				(15,866)				(15,866)
Class A common stock sold through employee stock purchase plan 28,684 shares	1		429					430
Class A common stock sold through stock option plans 172,025 shares	5		1,310					1,315
Income tax benefit from stock options exercised			912					912
Purchase of treasury shares 186,531							(3,536)	(3,536)
Cancellation of treasury shares 6,136,354	143		(66,773)				66,630	
Shares reclassified from Class B to Class A 4,907,309 shares	164	(164)						
Unearned compensation restricted stock awards						682		682
Balance January 28, 2006	1,188	23	39,244	294,462	78	(229)	(94,818)	239,948
Comprehensive income:								
Net income				51,450				51,450
Unrealized gains on available-for-sale					147			147

securities, net of deferred income tax liability of $78								
Dividends paid ($.58 per share)				(18,228)				(18,228)
Class A common stock sold through employee stock purchase plan 22,873 shares	1		484					485
Class A common stock sold through stock option plans 95,775 shares	3		1,127					1,130
Class A common stock issued through restricted stock grant plans 214,882 shares	7		857					864
Income tax benefit from stock options exercised			768					768
Cancellation of treasury shares 231 shares			(5)				5	
Unearned compensation restricted stock awards						229		229
Balance February 3, 2007	1,199	23	42,475	327,684	225		(94,813)	276,793
Comprehensive income:								
Net income				32,319				32,319
Unrealized gains on available-for-sale securities, net of deferred income tax liability of $247					484			484
Dividends paid ($.645 per share)				(20,277)				(20,277)
Class A common stock sold through employee stock purchase plan 27,164 shares	1		565					566
Class A common stock sold through stock option plans 39,200 shares	1		514					515
Class B common stock sold through stock option plans 1,053,000 shares		35	7,677					7,712
Class A common stock issued through restricted stock grant plans	3		1,490					1,493

87,085 shares							
Income tax benefit from stock options exercised			5,964				5,964
Repurchase of treasury shares 3,368,006 shares						(58,561)	(58,561)
Adoption of FIN 48				362			362
Balance February 2, 2008	1,204	58	58,685	340,088	709	(153,374)	247,370

See notes to consolidated financial statements.

28

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies:

Principles of Consolidation: The consolidated financial statements include the accounts of The Cato Corporation and its wholly-owned subsidiaries (the Company). All significant intercompany accounts and transactions have been eliminated.

Description of Business and Fiscal Year: The Company has two business segments the operation of women s fashion specialty stores and a credit card division. The apparel specialty stores operate under the names Cato, Cato Fashions, Cato Plus, It s Fashion and It s Fashion Metro and are located primarily in strip shopping centers principa in the southeastern United States. The Company s fiscal year ends on the Saturday nearest January 31. Fiscal 2007 had 52 weeks while fiscal 2006 had 53 weeks and fiscal 2005 had 52 weeks.

Use of Estimates: 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 that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant accounting estimates reflected in the Company s financial statements include the allowance for doubtful accounts receivable, reserves relating to self insured health insurance, workers compensation liabilities, general and auto insurance liabilities, reserves for inventory markdowns, calculation of asset impairment, inventory shrinkage accrual and tax positions.

Cash and Cash Equivalents and Short-Term Investments: 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.

The Company s short-term investments are all classified as available-for-sale. As they are available for current operations, they are classified in 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 Consolidated Balance Sheets and a reduction of interest and other income in the accompanying Statements of Consolidated 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.

Concentration of Credit Risk: Financial instruments that potentially subject the Company to a concentration of credit risk principally consist of cash equivalents and accounts receivable. The Company places its cash equivalents with high credit qualified institutions and, by practice, limits the amount of credit exposure to any one institution. Concentrations of credit risks with respect to accounts receivable are limited due to the dispersion across different geographies of the Company s customer base.

Supplemental Cash Flow Information: Income tax payments, net of refunds received, for the fiscal years ended February 2, 2008, February 3, 2007 and January 28, 2006 were $15,012,000, $26,651,000 and $28,415,000, respectively. Cash paid for interest for the fiscal years ended February 2, 2008, February 3, 2007 and January 28, 2006 were $8,000, $-0- and $143,000, respectively.

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

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Property and Equipment: Property and equipment are recorded at cost. Maintenance and repairs are charged to operations as incurred; renewals and betterments are capitalized. The Company accounts for its software development costs in accordance with the American Institute of Certified Public Accountants Statement of Position (SOP) 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use.* Depreciation is provided on the straight-line method over the estimated useful lives of the related assets excluding leasehold improvements. Leasehold improvements are amortized over the shorter of the estimated useful life or lease term. For leases with renewal periods at the Company s option, the Company generally uses the original lease term plus reasonably assured renewal option periods (generally one five year option period) to determine estimated useful lives. Typical estimated useful lives are as follows:

Classification	**Estimated Useful Lives**
Land improvements	10 years
Buildings	30-40 years
Leasehold improvements	5-10 years
Fixtures and equipment	3-10 years
Information Technology equipment and software	3-10 years

Impairment of Long-Lived Assets

The Company primarily invests in property and equipment in connection with the opening and remodeling of stores and in computer software and hardware. The Company periodically reviews its store locations and estimates the recoverability of its assets, recording an impairment charge, if necessary, when the Company decides to close the store or otherwise determines that future undiscounted cash flows associated with those assets will not be sufficient to recover the carrying value. This determination is based on a number of factors, including the store s historical operating results and cash flows, estimated future sales growth, real estate development in the area and perceived local market conditions that can be difficult to predict and may be subject to change. Store asset impairment charges incurred in fiscal 2007, 2006 and 2005 were $1,039,120, $479,178 and $387,139, respectively. In addition, the Company regularly evaluates its computer-related and other long-lived assets and may accelerate depreciation over the revised useful life if the asset is expected to be replaced or has limited future value. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is reflected in income for that period.

Leases

The Company determines the classification of leases consistent with FASB issued Statement No. 13 (SFAS 13). *Accounting for Leases*. The Company leases all of its retail stores. Most lease agreements contain construction allowances and rent escalations. For purposes of recognizing incentives and minimum rental expenses on a straight-line basis over the terms of the leases including renewal periods considered reasonably assured, the Company uses the date of initial possession to begin amortization which is when the Company enters the space and begins to make improvements in preparation for intended use.

For construction allowances, the Company records a deferred rent liability in Other noncurrent liabilities on the consolidated balance sheets and amortizes the deferred rent over the term of the respective lease as reduction to Cost of goods sold on the consolidated statements of income.

For scheduled rent escalation clauses during the lease terms or for rental payments commencing at a date other than the date of initial occupancy, the Company records minimum rental expenses on a straight-line basis over the terms of the leases as defined by SFAS 13.

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Revenue Recognition

The Company recognizes sales at the point of purchase when the customer takes possession of the merchandise and pays for the purchase, generally with cash or credit. Sales from purchases made with Cato credit, gift cards and layaway sales are also recorded when the customer takes possession of the merchandise. Gift cards, layaway deposits and merchandise credits granted to customers are recorded as deferred revenue until they are redeemed or forfeited. Gift cards and merchandise credits do not have expiration dates. A provision is made for estimated product returns based on sales volumes and the Company s experience; actual returns have not varied materially from amounts provided historically.

In the fourth quarter of fiscal 2007, the Company recognized $79,000 of income on unredeemed gift cards (gift card breakage) as a component of other income. Beginning in fiscal 2007, gift card breakage is determined after 60 months when the likelihood of the remaining balances being redeemed is remote based on our historical redemption data and there is no legal obligation to remit the remaining balances to relevant jurisdictions.

Credit revenue on the Company s private label credit card portfolio is recognized as earned under the interest method. Late fees are recognized as earned, less provisions for estimated uncollectible fees.

Cost of Goods Sold: 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 our buying departments and distribution center. Occupancy expenses include rent, real estate taxes, insurance, common area maintenance, utilities and maintenance for stores and distribution facilities. Buying, distribution, occupancy and internal transfer costs are treated as period costs and are not capitalized as part of inventory.

Credit Sales: The Company offers its own credit card to customers. All credit activity is performed by the Company s wholly-owned subsidiaries. None of the credit card receivables are secured. Finance income is recognized as earned under the interest method and late charges are recognized in the month in which they are assessed, net of provisions for estimated uncollectible amounts. The Company evaluates the collectibility of accounts receivable and records an allowance for doubtful accounts based on the aging of accounts and estimates of actual write-offs.

Advertising: Advertising costs are expensed in the period in which they are incurred. Advertising expense was $6,760,000, $6,546,000 and $6,103,000 for the fiscal years ended February 2, 2008, February 3, 2007 and January 28, 2006, respectively.

Stock Repurchase Program: On August 30, 2007, the Company s Board of Directors authorized an increase in the stock repurchase program of two million shares, bringing total shares to repurchase to 9.581 million shares. At fiscal year end February 2, 2008, the Company had repurchased 9.186 million shares under this program, leaving 394,660 shares remaining to open authorizations. There is no specified expiration date for the Company s repurchase program. For fiscal 2007, the Company repurchased 3.162 million shares for approximately $54.1 million or an average market price per share of $17.11. In addition, 205,891 shares for approximately $4.5 million or an average market price per share of $21.70 were tendered as partial payment of the exercise price of an employee stock option and the related tax withholding.

Earnings Per Share: FASB No. 128, *Earnings Per Share*, 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 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 CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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, warrants and other convertible securities. No dilutive shares were included for the three-month period ending February 2, 2008, however, as the Company had a loss for the period and the inclusion of diluted shares would be anti-dilutive in the calculation of diluted EPS. Unvested restricted stock is included in the computation of diluted EPS using the treasury stock method.

	Three Months Ended		Twelve Months Ended	
	February 2, 2008	February 3, 2007	**February 2, 2008**	February 3, 2007
Weighted-average shares outstanding	**29,978,405**	31,326,640	**31,279,918**	31,281,163
Dilutive effect of :				
Stock options		545,350	**187,593**	512,814
Restricted stock		37,464	**45,691**	21,355
Employee stock purchase plan				
Weighted-average shares and common stock equivalents outstanding	**29,978,405**	31,909,454	**31,513,202**	31,815,332

Vendor Allowances: The Company receives certain allowances from vendors primarily related to purchase discounts and markdown and damage allowances. All allowances are reflected in cost of goods sold as earned as the related products are sold in accordance with EITF 02-16, *Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor*. Under this EITF, cash consideration received from a vendor is presumed to be a reduction of the purchase cost of merchandise and should be reflected as a reduction of cost of sales. The Company does not receive cooperative advertising allowances.

Income Taxes: The Company files a consolidated federal income tax return. Income taxes are provided based on the asset and liability method of accounting, whereby deferred income taxes are provided for temporary differences between the financial reporting basis and the tax basis of the Company s assets and liabilities.

The Company adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes (FIN 48) an interpretation of FASB Statement No. 109*, on February 4, 2007. Unrecognized tax benefits for uncertain tax positions are established in accordance with FASB Interpretation No. 48, when, despite the fact that the tax return positions are supportable, the Company believes these positions may be challenged and the results are uncertain. The Company will adjust these liabilities in light of changing facts and circumstances. As a result of the implementation of FASB Interpretation No. 48, the Company recognized a transition adjustment increasing beginning retained earnings by $362,000.

Store Opening and Closing Costs: Costs relating to the opening of new stores or the relocating or expanding of existing stores are expensed as incurred. A portion of construction, design, and site selection costs are capitalized to

new, relocated and remodeled stores.

Closed Store Lease Obligations: At the time stores are closed, provisions are made for the rentals required to be paid over the remaining lease terms, reduced by expected sublease rentals.

Insurance: The Company is self-insured with respect to employee healthcare, workers compensation and general liability. The Company s self-insurance liabilities are based on the total estimated cost of claims filed and estimates of claims incurred but not reported, less amounts paid against such claims, and are not discounted. Management reviews current and historical claims data in developing its estimates. The Company has stop-loss insurance coverage for individual claims in excess of $250,000 for employee healthcare, $350,000 for worker s compensation and $200,000 for general liability. Employee health claims are funded through a VEBA trust to which the Company makes periodic contributions. Contributions to the VEBA trust were $12,065,000, $10,430,000 and

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

$12,110,000 in fiscal 2007, 2006 and 2005, respectively. Accrued healthcare was $1,304,000 and $814,000 and assets held in VEBA trust were $852,000 and $791,000 at February 2, 2008 and February 3, 2007, respectively. The Company paid worker s compensation and general liability claims of $4,080,000, $3,329,000 and $2,977,000 in fiscal years 2007, 2006 and 2005, respectively. Including claims incurred, but not yet paid, the Company recognized an expense of $4,739,000, $3,971,000 and $3,518,000 in fiscal 2007, 2006 and 2005, respectively. Accrued workers compensation and general liabilities were $4,127,000 and $4,602,000 at February 2, 2008 and February 3, 2007, respectively. The Company had no outstanding letters of credit relating to such claims at February 2, 2008 or at February 3, 2007.

Fair Value of Financial Instruments: The Company s carrying values of financial instruments, such as cash and cash equivalents, approximate their fair values due to their short terms to maturity and/or their variable interest rates.

Recent Accounting Pronouncements

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 included: 1) 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 2) 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. The impact on the Company s consolidated financial statements for fiscal 2006 was an additional compensation expense of $235,000.

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.

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 applies under other accounting pronouncements that require or permit fair value measurements and, accordingly does not require any new 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.

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

On June 14, 2007, the FASB reached consensus on EITF Issue No. 06-11, *Accounting for Income Tax Benefits of Dividends on Share-Based Payment*. EITF No. 06-11 requires that a realized income tax benefit from dividends or dividend equivalents that are charged to retained earnings and are paid to associates for equity classified nonvested equity shares, nonvested equity share units, and outstanding equity share options should be recognized as an increase to additional paid-in capital. The amount recognized in additional paid-in capital for the realized income tax benefit from dividends on those awards should be included in the pool of excess tax benefits available to absorb tax deficiencies on share-based payment awards. EITF No. 06-11 is effective for fiscal years beginning on or after December 15, 2007. We are currently evaluating the impact that this standard may have on our results of operations and financial position.

2. Interest and Other Income:

The components of Interest and other income are shown below in gross amounts (in thousands):

	February 2, 2008	**February 3, 2007**	**January 28, 2006**
Dividend income	**$ (17)**	$ (23)	$ (17)
Interest income	**(5,729)**	(4,221)	(2,593)
Hurricane claims settlement		(2,384)	
Visa/Mastercard claims settlement		(470)	
Miscellaneous income	**(2,207)**	(2,100)	(1,836)
(Gain)/loss investment sales	**(265)**	(399)	(117
Interest and other income	**$ (8,218)**	$ (9,597)	$ (4,563)

3. Short-Term Investments:

The Company s investment portfolio was primarily invested in auction rate securities and governmental debt securities held in managed funds. These securities are classified as available-for-sale as they are highly liquid 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.

As of February 2, 2008, the Company held $41.9 million in auction rate securities (ARS) backed by tax exempt municipal debt rated A or better. The underlying securities have contractual maturities which generally range from seven to thirty years and are classified as available for sale and recorded at fair value due to the resetting of the interest rates every 7 to 35 days. Of the $41.9 million in ARS, $13.9 million failed their last auction subsequent to February 2, 2008. To date, the Company has collected all interest payments on all of its ARS when due.

The Company also held $41.5 million of governmental debt securities and $9.0 million in VRDN s (variable rate demand notes) in managed funds as of February 2, 2008. The underlying securities of the governmental debt have contractual maturities of less than 36 months and are classified as available for sale and recorded at fair value due to

being marketable and highly liquid. The underlying securities of the VRDN s have contractual maturities from one to twenty-eight years and are classified as available for sale and recorded at fair value due to resetting every 7 to 35 days.

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The table below reflects accumulated unrealized gains in short-term investments at February 2, 2008 of $408,000 net of a deferred income tax liability of $214,000 and accumulated unrealized losses in short-term investments at February 3, 2007 of $34,000, net of a deferred income tax benefit of $18,000.

	February 2, 2008			February 3, 2007		
Security Type:	**Cost**	**Unrealized Gain/(Loss)**	**Estimated Fair Value**	**Cost**	**Unrealized Gain/(Loss)**	**Estimated Fair Value**
Debt Securities issued by states of the United States and political subdivisions of the states:						
With unrealized gain (loss)	$ 92,373	$ 622	$ 92,995	$ 98,761	$ (52)	$ 98,709
Total	$ 92,373	$ 622	$ 92,995	$ 98,761	$ (52)	$ 98,709

Additionally, the Company had $2.6 million invested in privately managed investment funds and other miscellaneous equities at February 2, 2008 and $2.7 million at February 3, 2007, which are reported within other noncurrent assets in the Consolidated Balance Sheets.

Accumulated other comprehensive income in the Consolidated Balance Sheets reflects the accumulated unrealized losses in short-term investments shown above, which at February 2, 2008 was offset by unrealized gains in equity investments of $301,000, net of a deferred income tax liability of $157,000 and at February 3, 2007 was offset by the accumulated unrealized gains in equity investments of $259,000, net of a deferred income tax liability of $141,000. All investments with unrealized losses disclosed were in a loss position for less than 12 months.

As disclosed in Note 2, the Company had realized gains of $265,000 in fiscal 2007, realized gains of $399,000 in fiscal 2006 and realized gains of $117,000 in fiscal 2005.

4. Accounts Receivable:

Accounts receivable consist of the following (in thousands):

	February 2, 2008	**February 3, 2007**
Customer accounts principally deferred payment accounts	**$ 42,007**	$ 43,939
Miscellaneous trade receivables	**6,538**	5,573
Total	**48,545**	49,512

Less allowance for doubtful accounts		**3,263**		3,554
Accounts receivable net	**$**	**45,282**	$	45,958

Finance charge and late charge revenue on customer deferred payment accounts totaled $10,370,000, $10,866,000 and $12,507,000 for the fiscal years ended February 2, 2008, February 3, 2007 and January 28, 2006, respectively, and charges against the allowance for doubtful accounts were $2,844,000, $2,633,000 and $4,650,000 for the fiscal years ended February 2, 2008, February 3, 2007 and January 28, 2006, respectively. Expenses charged relating to the allowance for doubtful accounts are classified as a component of selling, general and administrative expenses in the accompanying Consolidated Statements of Income.

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Property and Equipment:

Property and equipment consist of the following (in thousands):

	February 2, 2008	February 3, 2007
Land and improvements	**$ 3,681**	$ 3,266
Buildings	**18,518**	17,990
Leasehold improvements	**53,938**	51,308
Fixtures and equipment	**160,688**	158,614
Information Technology equipment and software	**48,649**	45,594
Construction in progress	**1,741**	2,833
Total	**287,215**	279,605
Less accumulated depreciation	**164,025**	151,144
Property and equipment net	**$ 123,190**	$ 128,461

Construction in progress primarily represents costs related to a new store development and investments in new technology.

6. Accrued Expenses:

Accrued expenses consist of the following (in thousands):

	February 2, 2008	February 3, 2007
Accrued payroll and related items	**$ 4,476**	$ 5,524
Accrued advertising	**299**	504
Property and other taxes	**11,159**	11,446
Accrued insurance	**5,225**	5,227
Other	**6,458**	6,825
Total	**$ 27,617**	$ 29,526

7. Financing Arrangements:

At February 2, 2008, the Company had an unsecured revolving credit agreement which provided for borrowings of up to $35.0 million. This revolving credit agreement was entered into on August 22, 2003, amended October 24, 2007 and 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 February 2, 2008. There were no borrowings outstanding under this facility during the fiscal year ended February 2, 2008 or February 3, 2007. Interest is based on LIBOR, which was 3.14% on February 2, 2008.

On August 22, 2003, the Company entered into an unsecured $30.0 million five-year term loan facility, the proceeds of which were used to purchase Class B Common Stock from the Company s founders. Payments were due in monthly installments of $500,000 plus accrued interest. Interest was based on LIBOR. On April 5, 2005, the Company repaid the remaining balance of $20.5 million on this loan facility. With the early retirement of this loan, the Company had no outstanding debt as of February 2, 2008 or February 3, 2007.

The Company had approximately $4.3 million and $4.5 million at February 2, 2008 and February 3, 2007 respectively, of outstanding irrevocable letters of credit relating to purchase commitments.

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Stockholders Equity:

The holders of Class A Common Stock are entitled to one vote per share, whereas the holders of Class B Common Stock are entitled to ten votes per share. Each share of Class B Common Stock may be converted at any time into one share of Class A Common Stock. Subject to the rights of the holders of any shares of Preferred Stock that may be outstanding at the time, in the event of liquidation, dissolution or winding up of the Company, holders of Class A Common Stock are entitled to receive a preferential distribution of $1.00 per share of the net assets of the Company. Cash dividends on the Class B Common Stock cannot be paid unless cash dividends of at least an equal amount are paid on the Class A Common Stock.

The Company s certificate of incorporation provides that shares of Class B Common Stock may be transferred only to certain Permitted Transferees consisting generally of the lineal descendants of holders of Class B Stock, trusts for their benefit, corporations and partnerships controlled by them and the Company s employee benefit plans. Any transfer of Class B Common Stock in violation of these restrictions, including a transfer to the Company, results in the automatic conversion of the transferred shares of Class B Common Stock held by the transferee into an equal number of shares of Class A Common Stock.

In April 2004, the Board of Directors adopted the 2004 Incentive Compensation Plan, of which 1,350,000 shares are issuable. As of February 2, 2008, 343,967 shares had been granted from this Plan.

In May 2003, the shareholders approved a new 2003 Employee Stock Purchase Plan with 250,000 Class A shares of Common Stock authorized. Under the terms of the Plan, substantially all associates may purchase Class A Common Stock through payroll deductions of up to 10% of their salary, up to a maximum market value of $25,000 per year. The Class A Common Stock is purchased at the lower of 85% of market value on the first or last business day of a six-month payment period. Additionally, each April 15, associates are given the opportunity to make a lump sum purchase of up to $10,000 of Class A Common Stock at 85% of market value. The number of shares purchased by participants through the plan were 27,164 shares, 22,873 shares and 28,684 shares for the years ended February 2, 2008, February 3, 2007 and January 28, 2006, respectively.

In December 2003, the Board of Directors authorized a dividend of one preferred share purchase right (a Right) for each share of Class A Common Stock and Class B Common Stock, each par value $.033 per share of the Company outstanding at the close of business on January 7, 2004. In connection with the authorization of the Rights, the Company entered into a Rights Agreement, dated as of December 18, 2003 (the Rights Agreement), with American Stock Transfer & Trust Company, as Rights Agent (the Rights Agent).

The Company adopted in 1987 an Incentive Compensation Plan and a Non-Qualified Stock Option Plan for key associates of the Company. Total shares issuable under the plans are 5,850,000, of which 1,237,500 shares were issuable under the Incentive Compensation Plan and 4,612,500 shares are issuable under the Non-Qualified Stock Option Plan. The purchase price of the shares under an option must be at least 100 percent of the fair market value of Class A Common Stock at the date of the grant. Options granted under these plans vest over a 5-year period and expire 10 years after the date of the grant unless otherwise expressly authorized by the Board of Directors. As of February 2, 2008, 5,837,723 shares had been granted under the plans.

In August 1999, the Board of Directors adopted the 1999 Incentive Compensation Plan, of which 1,000,000 shares are issuable. The ability to grant awards under the 1999 Plan expired on July 31, 2004.

In May 2002, the Board of Directors approved and granted to a key executive under the 1999 Incentive Compensation Plan restricted stock awards of 150,000 shares of Class B Common Stock, with a per share fair value of $18.21. These stock awards cliff vested after four years and the unvested portion is included in stockholders equity as unearned compensation in the accompanying financial statements. The charge to compensation expense for these stock awards was $-0-, $229,000 and $682,000 in fiscal 2007, 2006 and 2005, respectively. As of February 2, 2008, all such shares were fully vested.

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Option plan activity for the three fiscal years ended February 2, 2008 is set forth below:

	Options	Range of Option Prices		Weighted Average Price
Outstanding options, January 29, 2005	1,505,325	$ 5.13	$17.84	$ 8.05
Granted	22,250	18.96	21.75	20.05
Exercised	(172,025)	5.13	17.84	7.63
Cancelled	(12,150)	11.50	20.50	14.62
Outstanding options, January 28, 2006	1,343,400	5.50	21.75	8.23
Granted				
Exercised	(95,775)	5.50	21.37	10.12
Cancelled	(10,950)	13.47	21.37	17.24
Outstanding options, February 3, 2007	1,236,675	5.50	21.75	8.01
Granted				
Exercised	(1,092,200)	5.50	17.84	7.41
Cancelled	(5,400)	13.52	19.53	17.45
Outstanding options, February 2, 2008	139,075	$ 6.39	$21.75	$ 12.41

The following tables summarize stock option information at February 2, 2008:

Range of Exercise Prices		Options Outstanding: Options	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Options Exercisable: Options	Weighted Average Exercise Price
$ 6.39	$ 8.96	42,650	1.49 years	$ 8.28	42,650	$ 8.28
11.10	14.79	74,025	5.67 years	13.30	45,375	12.98
15.08	19.99	20,900	6.91 years	17.00	12,500	17.20
21.75	21.75	1,500	7.08 years	21.75	600	21.75

$	6.39	$21.75	139,075	4.59 years	$	12.41	101,125	$ 11.58

Outstanding options at February 2, 2008 covered 139,075 shares of Class A Common Stock and no shares of Class B Common Stock. Outstanding options at February 3, 2007 covered 183,675 shares of Class A Common Stock and 1,053,000 shares of Class B Common Stock. See Note 15 to the Consolidated Financial Statements for further information on the Company s Stock Based Compensation.

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.

9. Employee Benefit Plans:

The Company has a defined contribution retirement savings plan (401(k)) which covers all associates who meet minimum age and service requirements. The 401(k) plan allows participants to contribute up to 60% of their annual compensation up to the maximum elective deferral, designated by the IRS. The Company is obligated to

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

make a minimum contribution to cover plan administrative expenses. Further Company contributions are at the discretion of the Board of Directors. The Company s contributions for the years ended February 2, 2008, February 3, 2007 and January 28, 2006 were approximately $1,530,000, $1,455,000 and $1,589,000, respectively.

The Company has an Employee Stock Ownership Plan (ESOP), which covers substantially all associates who meet minimum age and service requirements. The Board of Directors determines contributions to the ESOP. The Company s contributions for the years ended February 2, 2008, February 3, 2007 and January 28, 2006 were approximately $-0-, $1,789,000 and $5,637,000, respectively.

The Company is primarily self-insured for healthcare. These costs are significant primarily due to the large number of the Company s retail locations and associates. The Company s self-insurance liabilities are based on the total estimated costs of claims filed and estimates of claims incurred but not reported, less amounts paid against such claims, and are not discounted. Management reviews current and historical claims data in developing its estimates. If the underlying facts and circumstances of the claims change or the historical trend is not indicative of future trends, then the Company may be required to record additional expense or a reduction to expense which could be material to the Company s reported financial condition and results of operations. The Company has stop-loss insurance coverage for individual claims in excess of $250,000. Employee health claims are funded through a VEBA trust to which the Company makes periodic contributions.

10. Leases:

The Company has operating lease arrangements for store facilities and equipment. Facility leases generally are fixed rate for periods of five years with renewal options and most provide for additional contingent rentals based on a percentage of store sales in excess of stipulated amounts. For leases with landlord capital improvement funding, the funded amount is recorded as a deferred liability and amortized over the term of the lease as a reduction to rent expense on the Consolidated Statements of Income. Equipment leases are generally for one to three year periods.

The minimum rental commitments under non-cancelable operating leases are (in thousands):

Fiscal Year	
2008	$ 54,095
2009	40,312
2010	29,501
2011	19,356
2012	9,614
Thereafter	168
Total minimum lease payments	$ 153,046

The following schedule shows the composition of total rental expense for all leases (in thousands):

Fiscal Year Ended	February 2, 2008	February 3, 2007	January 28, 2006
Minimum rentals	**$ 51,142**	$ 49,169	$ 47,278
Contingent rent	**54**	106	74
Total rental expense	**$ 51,196**	$ 49,275	$ 47,352

11. Related Party Transactions:

The Company leases certain stores from entities in which Mr. George S. Currin, a director of the Company, has a controlling or non-controlling ownership interest. Rent expense and related charges totaling $423,631, $371,716 and $303,612 were paid to entities controlled by Mr. Currin or his family in fiscal 2007, 2006 and 2005,

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

respectively, under these leases. Rent expense and related charges totaling $1,008,664, $939,443 and $770,563 were paid to entities in which Mr. Currin or his family had a non-controlling ownership interest in fiscal 2007, 2006 and 2005, respectively, under these leases.

In November 2006, the Company received $6,996,021 as payment for the purchase of a split-dollar life insurance policy by The Wayland H. Cato, Jr. Irrevocable Trust, the grantor of which is Wayland H. Cato, Jr., a Company founder and Chairman Emeritus. Mr. Cato was the insured and owned 50% of the death benefit, while the Company owned the policy and any cash value associated with it and 50% of the death benefit. The purchase was made under an agreement between the Company and the trust that allowed the trust to purchase the policy within three years of the date of Mr. Cato s termination of employment for an amount equal to the policy s cash value as of the date of transfer to the trust. Mr. Cato s employment with the Company terminated January 31, 2004.

12. Income Taxes:

The Company adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes (FIN 48) an interpretation of FASB Statement No. 109*, on February 4, 2007. Unrecognized tax benefits for uncertain tax positions are established in accordance with FIN 48, when, despite the fact that the tax return positions are supportable, the Company believes these positions may be challenged and the results are uncertain. The Company will adjust these liabilities in light of changing facts and circumstances. As a result of the implementation of FIN 48 in 2007, the Company recognized a transition adjustment increasing beginning retained earnings by $362,000. At February 4, 2007, the Company had approximately $6.2 million of gross unrecognized tax benefits and approximately $3.9 million of interest and penalty accrued related to uncertain tax positions. As of February 2, 2008, the Company had gross unrecognized tax benefits totaling $9.2 million, approximately $5.9 million of which would affect our effective tax rate if recognized. As of February 2, 2008, the Company had approximately $5.1 million of interest and penalties accrued related to uncertain tax positions. The Company continues to recognize interest and penalties related to uncertain tax positions in income tax expense. Generally, tax years after 2003 remain open to examination by the federal, state and local taxing jurisdictions to which the Company is subject. No significant changes are expected in the next 12 months.

A reconciliation of the beginning and ending amount of gross unrecognized tax benefits is as follows:

		In thousands
Balance, February 4, 2007	$	6,193
Additions for tax positions of the current year		1,686
Additions for tax positions prior years		1,301
Reduction for tax positions of prior years for:		
Changes in judgement		
Settlements during the period		
Lapses of applicable statue of limitations		
Balance, February 2, 2008	$	9,180

40

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The provision for income taxes consists of the following (in thousands):

Fiscal Year Ended	February 2, 2008	February 3, 2007	January 28, 2006
Current income taxes:			
Federal	**$ 23,800**	$ 26,480	$ 27,895
State	**(280)**	1,205	1,311
Total	**23,520**	27,685	29,206
Deferred income taxes:			
Federal	**(5,902)**	443	(3,271)
State	**(704)**	53	(389)
Total	**(6,606)**	496	(3,660)
Total income tax expense	**$ 16,914**	$ 28,181	$ 25,546

Significant components of the Company s deferred tax assets and liabilities as of February 2, 2008 and February 3, 2007 are as follows (in thousands):

	February 2, 2008	February 3, 2007
Deferred tax assets:		
Bad debt reserve	**$ 1,227**	$ 1,364
Inventory valuation	**2,164**	1,830
Unrealized losses on short-term investments		
Restricted stock options		184
Write-down of short term investments		
Capital loss carryover	**274**	393
Other		
Deferred lease liability	**9,148**	5,277
Reserves	**3,817**	2,245
Other taxes	**1,203**	1,932
Federal Benefit of FIN 48	**3,906**	
Equity Compensation Expense	**1,297**	651
Total deferred tax assets	**23,036**	13,876

Deferred tax liabilities:		
Fixed assets	**16,010**	13,489
Unrealized gains (losses) on short-term investments	**371**	123
Other	**1,606**	1,573
Total deferred tax liabilities	**17,987**	15,185
Net deferred tax liabilities (assets)	**$ (5,049)**	$ 1,309

Capital loss carryovers included in the Company s deferred tax assets have a limited life and will expire in 2009 if not utilized. The Company believes realization is more likely than not.

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The reconciliation of the Company s effective income tax rate with the statutory rate is as follows:

Fiscal Year Ended	February 2, 2008	February 3, 2007	January 28, 2006
Federal income tax rate	**35.0%**	35.0%	35.0%
State income taxes	**7.7**	2.4	3.2
Tax Credits	**(3.1)**	(1.3)	(0.4)
Federal benefit of FIN 48	**(9.0)**		
Other	**3.8**	(0.7)	(1.5)
Effective income tax rate	**34.4%**	35.4%	36.3%

13. Quarterly Financial Data (Unaudited):

Summarized quarterly financial results are as follows (in thousands, except per share data):

Fiscal 2007	First	Second	Third	Fourth
Retail sales	$ 224,134	$ 218,973	$ 181,870	$ 209,364
Total revenues	227,228	221,934	184,838	212,436
Cost of goods sold (exclusive of depreciation)	143,422	147,514	126,080	155,294
Income before income taxes	29,172	18,650	3,947	(2,538)
Net income	18,670	12,510	2,936	(1,798)
Basic earnings per share	$ 0.60	$ 0.39	$ 0.09	$ (0.06)
Diluted earnings per share	$ 0.59	$ 0.39	$ 0.09	$ (0.06)

Fiscal 2006	First	Second	Third	Fourth
Retail sales	$ 229,741	$ 214,633	$ 187,727	$ 230,712
Total revenues	233,060	217,845	190,882	234,097
Cost of goods sold (exclusive of depreciation)	142,113	143,746	127,229	159,625
Income before income taxes	32,754	19,044	9,133	18,698
Net income	20,799	12,093	5,861	12,696
Basic earnings per share	$ 0.67	$ 0.39	$ 0.19	$ 0.41
Diluted earnings per share	$ 0.65	$ 0.38	$ 0.18	$ 0.40

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

14. Reportable Segment Information:

The Company has two reportable segments: retail and credit. The Company operates its women s fashion specialty retail stores in 32 states, principally in southeastern United States. The Company offers its own credit card to its customers and all 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):

Fiscal 2007	**Retail**	**Credit**	**Total**
Revenues	$ 836,023	$ 10,414	$ 846,437
Depreciation	22,112	100	22,212
Interest and other income	(8,218)		(8,218)
Income before taxes	44,983	4,250	49,233
Total assets	354,001	68,491	422,492
Capital expenditures	18,211	119	18,330

Fiscal 2006	**Retail**	**Credit**	**Total**
Revenues	$ 864,987	$ 10,898	$ 875,885
Depreciation	20,849	92	20,941
Interest and other income	(9,597)	0	(9,597)
Income before taxes	74,772	4,859	79,631
Total assets	368,786	63,536	432,322
Capital expenditures	27,483	64	27,547

Fiscal 2005	**Retail**	**Credit**	**Total**
Revenues	$ 823,685	$ 12,696	$ 836,381
Depreciation	20,173	102	20,275
Interest and other income	(4,563)	0	(4,563)
Income before taxes	65,682	4,693	70,375
Total assets	339,788	66,848	406,636
Capital expenditures	28,477	35	28,512

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company evaluates performance based on profit or loss from operations before income taxes. The Company does not allocate certain corporate expenses to the credit segment.

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

	February 2, 2008	February 3, 2007	January 28, 2006
Bad debt expense	**$ 2,844**	$ 2,633	$ 4,650
Payroll	**983**	1,008	1,043
Postage	**985**	1,034	1,061
Other expenses	**1,252**	1,272	1,147
Total expenses	**$ 6,064**	$ 5,947	$ 7,901

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

15. 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 includes: 1) 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 2) 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 February 2, 2008, 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 associates. 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 associates. 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 to grant under each of the plans as of February 2, 2008:

	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
February 2, 2008	12,277		1,006,033	1,018,310

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 twelve months ended February 2, 2008:

	Weighted Average	**Aggregate**

	Shares	Weighted Average Exercise Price	Remaining Contractual Term	Intrinsic Value(a)
Options outstanding at February 3, 2007	1,236,675	$ 8.01	1.86 years	$ 18,363,084
Granted				
Forfeited or expired	5,400	17.45		
Exercised	1,092,200	7.41		
Outstanding at February 2, 2008	139,075	$ 12.41	4.64 years	$ 494,087
Vested and exercisable at February 2, 2008	101,125	$ 11.58	3.94 years	$ 443,411

(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.

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

No options were granted in fiscal 2007 and no options were granted in fiscal 2006. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model.

As of February 2, 2008, there was approximately $164,505 of total unrecognized compensation cost related to nonvested options, which is expected to be recognized over a remaining weighted-average vesting period of 1.43 years. The total intrinsic value of options exercised in fiscal 2007 was approximately $15,390,000.

Effective January 29, 2006, 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 $435,000 and $1,715,000 for the fourth quarter and twelve month period ended February 2, 2008, respectively, which was classified as a component of selling, general and administrative expenses. No share-based compensation expense was recognized prior to January 29, 2006 except for the amortization of restricted stock grants.

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 twelve months ended February 2, 2008, the Company reported $5,964,000 of excess tax benefits as a financing cash inflow in addition to $8,591,000 in cash proceeds received from the exercise of stock options and Employee Stock Purchase Plan purchases.

The Company s Employee Stock Purchase Plan allows eligible full-time associates 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 twelve months ended February 2, 2008, the Company sold 27,164 shares to associates at an average discount of $3.87 per share under the Employee Stock Purchase Plan. The compensation expense recognized for the 15% discount given under the Employee Stock Purchase Plan was approximately $85,000 for fiscal 2007 compared to $73,000 for fiscal 2006. Prior to the adoption of SFAS 123R, the discount was not required to be charged to expense.

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 February 2, 2008, there was $4,913,000 of total unrecognized compensation cost related to nonvested restricted stock awards, which is expected to be recognized over a remaining weighted-average vesting period of 3.49 years. The total fair value of the shares recognized as compensation expense during the fourth quarter and twelve months ended February 2, 2008 was $398,000 and $1,493,000, respectively.

The following summary shows the changes in the shares of restricted stock outstanding during the twelve months ended February 2, 2008:

	Number of Shares	Weighted Average Grant Date Fair Value Per Share

Restricted stock awards at February 3, 2007	214,882	$	22.92
Granted	102,399		21.41
Vested			
Forfeited	15,314		19.90
Restricted stock awards at February 2, 2008	301,967	$	22.56

16. Commitments and Contingencies:

Workers compensation and general liability claims are settled through a claims administrator and are limited by stop-loss insurance coverage for individual claims in excess of $350,000 and $200,000, respectively. The Company paid claims of $4,080,000, $3,329,000 and $2,977,000 in fiscal 2007, 2006 and 2005, respectively.

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Including claims incurred, but not yet paid, the Company recognized an expense of $4,739,000, $3,971,000 and $3,518,000 in fiscal 2007, 2006 and 2005, respectively. Accrued workers compensation and general liabilities was $4,127,000 and $4,602,000 at February 2, 2008 and February 3, 2007, respectively. The Company had no outstanding letters of credit relating to such claims at February 2, 2008 or at February 3, 2007. See Note 7 for letters of credit related to purchase commitments, Note 9 for 401(k) plan contribution obligations and Note 10 for lease commitments.

The Company does not have any guarantees with third parties. The Company has placed a $2.0 million deposit with Cedar Hill National Bank (Cedar Hill), a wholly owned subsidiary, as security and collateral for the payment of amounts due from CatoWest LLC, a wholly owned subsidiary, to Cedar Hill. The deposit has no set term. The deposit was made at the request of the Office of the Comptroller of the Currency because the receivable is not settled immediately and Cedar Hill has a risk of loss until payment is made. CatoWest LLC purchases receivables from Cedar Hill on a daily basis (generally one day in arrears). In the event CatoWest LLC fails to transfer to Cedar Hill the purchase price for any receivable within two business days, Cedar Hill has the right to withdraw any amount necessary from the account established by the Company to satisfy the amount due Cedar Hill from CatoWest LLC. Although the amount of potential future payments is limited to the amount of the deposit, Cedar Hill may require, at its discretion, the Company to increase the amount of the deposit with no limit on the increase. The deposit is based upon the amount of payments that would be due from CatoWest LLC to Cedar Hill for the highest credit card sales weekends of the year that would remain unpaid until the following business day. The Company has no obligations related to the deposit at year-end. No recourse provisions exist nor are any assets held as collateral that would reimburse the Company if Cedar Hill withdraws a portion of the deposit.

In addition, the Company has $5.0 million in escrow with Branch Banking & Trust Co. on behalf of Zurich American Insurance Company as security and collateral for administration of the Company s self-insured workers compensation and general liability coverage.

The Company is a defendant in legal proceedings considered to be in the normal course of business and none of which, singularly or collectively, are expected to have a material effect on the Company s results of operations, cash flows and financial position.

Item 9. ***Changes in and Disagreements with Accountants on Accounting and Financial Disclosure:***

None.

Item 9A. ***Controls and Procedures:***

Conclusion Regarding the Effectiveness of Disclosure 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 February 2, 2008. Based on this evaluation, our principal executive officer and principal financial officer concluded that, as of February 2, 2008, 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.

Management s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we carried out an evaluation of the effectiveness of our internal control over financial reporting as of February 2, 2008 based on the *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this evaluation, our management concluded that our internal control over financial reporting was effective as of February 2, 2008.

PricewaterhouseCoopers LLP, our independent registered public accounting firm, has audited the effectiveness of our internal control over financial reporting as of February 2, 2008, as stated in their report which is included herein.

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 February 2, 2008 that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

Item 9B. ***Other Information:***

None.

PART III

Item 10. ***Directors, Executive Officers and Corporate Governance:***

Information contained under the captions Election of Directors, Meetings and Committees, Corporate Governance Matters and Section 16(a) Beneficial Ownership Reporting and Compliance in the Registrant s Proxy Statement for its 2008 annual stockholders meeting (the 2008 Proxy Statement) is incorporated by reference in response to this Item 10. The information in response to this Item 10 regarding executive officers of the Company is contained in Item 4A,

Part I hereof under the caption Executive Officers of the Registrant.

Item 11. *Executive Compensation:*

Information contained under the captions Executive Compensation in the Company s 2008 Proxy Statement is incorporated by reference in response to this Item.

Item 12. ***Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters:***

Equity Compensation Plan Information.

The following table provides information about stock options outstanding and shares available for future awards under all of Cato s equity compensation plans. The information is as of February 2, 2008.

Plan Category	(a) Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights(1)	(b) Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights(1)	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a)) (2)
Equity compensation plans approved by security holders	139,075	$ 12.41	1,272,220
Equity compensation plans not approved by security holders			
Total	139,075	$ 12.41	1,272,220

(1) This column contains information regarding employee stock options only; there are no outstanding warrants or stock appreciation rights.

(2) Includes the following:

1,006,033 shares available for grant under the Company s stock incentive plan, referred to as the 2004 Incentive Compensation Plan. Under this plan, non-qualified stock options may be granted to key associates. Additionally, 12,277 shares available for grant under the Company s stock incentive plan, referred to as the 1987 Non-qualified Stock Option Plan. Stock options have terms of 10 years, vest evenly over 5 years, and are assigned an exercise price of not less than the fair market value of the Company s stock on the date of grant; and

253,910 shares available under the 2003 Employee Stock Purchase Plan. Eligible associates may participate in the purchase of designated shares of the Company s common stock. The purchase price of this stock is equal to 85% of the lower of the closing price at the beginning or the end of each semi-annual stock purchase period.

Information contained under Security Ownership of Certain Beneficial Owners and Management in the 2008 Proxy Statement is incorporated by reference in response to this Item.

Item 13. ***Certain Relationships and Related Transactions and Director Independence:***

Information contained under the caption Related Party Transactions and Director Independence in the 2008 Proxy Statement is incorporated by reference in response to this Item.

Item 14. ***Principal Accountant Fees and Services:***

The information required by this Item is incorporated herein by reference to the section entitled Audit Fees and Policy on Audit Committee Pre-Approval of Audit and Permissible Non-Audit Service by the Independent Auditor in the 2008 Proxy Statement.

PART IV

Item 15. ***Exhibits and Financial Statement Schedules:***

(a) The following documents are filed as part of this report:

(1) Financial Statements:

	Page
Report of Independent Registered Public Accounting Firm	24
Consolidated Statements of Income and Comprehensive Income for the fiscal years ended February 2, 2008, February 3, 2007 and January 28, 2006	25
Consolidated Balance Sheets at February 2, 2008 and February 3, 2007	26
Consolidated Statements of Cash Flows for the fiscal years ended February 2, 2008, February 3, 2007, and January 28, 2006	27
Consolidated Statements of Stockholders Equity for the fiscal years ended February 2, 2008, February 3, 2007, and January 28, 2006	28
Notes to Consolidated Financial Statements	29

(2) Financial Statement Schedule: The following report and financial statement schedule is filed herewith:

Schedule II Valuation and Qualifying Accounts	S-2

All other schedules are omitted as the required information is inapplicable or the information is presented in the consolidated financial statements or related notes thereto.

(3) Index to Exhibits: The following exhibits are filed with this report or, as noted, incorporated by reference herein. The Company will supply copies of the following exhibits to any shareholder upon receipt of a written request addressed to the Corporate Secretary, The Cato Corporation, 8100 Denmark Road, Charlotte, NC 28273 and the payment of $.50 per page to help defray the costs of handling, copying and postage. In most cases, documents incorporated by reference to exhibits to our registration statements, reports or proxy statements filed by the Company with the Securities and Exchange Commission are available to the public over the Internet from the SEC s web site at http://www.sec.gov. You may also read and copy any such document at the SEC s public reference room located at Room 1580, 100 F. Street, N.E., Washington, D.C. 20549 under the Company s SEC file number (1-31340).

gistrant 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
Registrant s By Laws incorporated by reference to Exhibit 4.2 to Form S-8 of the Registrant filed February 7, 2000 (SEC File No
dated December 18, 2003, incorporated by reference to Exhibit 4.1 to Form 8-A12G of the Registrant filed December 22, 2003 and as
lan dated August 26, 1999, incorporated by reference to Exhibit 4.3 to Form S-8 of the Registrant filed February 7, 2000 (SEC File No.
ted as of August 29, 2003, between the Registrant and Wayland H. Cato, Jr., incorporated by reference to Exhibit 99(c) to Form 8-K of
dated as of August 29, 2003, between the Registrant and Edgar T. Cato, incorporated by reference to Exhibit 99(d) to Form 8-K of the
Retirement Agreement between Registrant and Wayland H. Cato, Jr. dated August 29, 2003 incorporated by reference to Exhibit

Retirement Agreement between Registrant and Edgar T. Cato dated August 29, 2003, incorporated by reference to Exhibit 10.2 to Form
gnation Agreement between Registrant and Reynolds C. Faulkner dated as of October 30, 2006, incorporated by reference to Exhibit 99
Letter Agreement between Registrant and Thomas W. Stoltz dated as of December 4, 2006, incorporated by reference to Exhibit 99.1
on Determinations, incorporated by reference to Item 5.02 of Form 8-K filed April 4, 2007.
Subsidiaries of Registrant.
ent of Independent Registered Public Accounting Firm.
4(a)/15d-14(a) Certification of Chief Executive Officer.
4(a)/15d-14(a) Certification of Chief Financial Officer.
Section 1350 Certification of Chief Executive Officer.
Section 1350 Certification of Chief Financial Officer.

* Management contract or compensatory plan required to be filed under Item 15 of this report and Item 601 of Regulation S-K.

EXHIBIT INDEX

Designation of Exhibit		Page
21	Subsidiaries of the Registrant	53
23.1	Consent of Independent Registered Public Accounting Firm	54
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer	55
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer	56
32.1	Section 1350 Certification of Chief Executive Officer	57
32.2	Section 1350 Certification of Chief Financial Officer	58

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, Cato has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

The Cato Corporation

By
/s/ JOHN P. D. CATO

John P. D. Cato
Chairman, President and
Chief Executive Officer

By
/s/ THOMAS W. STOLTZ

Thomas W. Stoltz
Executive Vice President
Chief Financial Officer

By
/s/ JOHN R. HOWE

John R. Howe
Senior Vice President
Controller

Date: April 1, 2008

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

/s/ JOHN P. D. CATO	/s/ WILLIAM H. GRIGG
John P. D. Cato (President and Chief Executive Officer (Principal Executive Officer) and Director)	William H. Grigg (Director)
/s/ THOMAS W. STOLTZ	/s/ GRANT L. HAMRICK
Thomas W. Stoltz (Executive Vice President Chief Financial Officer (Principal Financial Officer))	Grant L. Hamrick (Director)
/s/ JOHN R. HOWE	/s/ JAMES H. SHAW
John R. Howe (Senior Vice President Controller (Principal Accounting Officer))	James H. Shaw (Director)

/s/ ROBERT W. BRADSHAW, JR.	/s/ A.F. (PETE) SLOAN
Robert W. Bradshaw, Jr. (Director)	A.F. (Pete) Sloan (Director)
/s/ GEORGE S. CURRIN	/s/ D. HARDING STOWE
George S. Currin (Director)	D. Harding Stowe (Director)

SCHEDULE II

VALUATION AND QUALIFYING ACCOUNTS

	Allowance for Doubtful Accounts(a)	Self Insurance Reserves(b)
Balance at January 29, 2005	$ 6,122	$ 4,155
Additions charged to costs and expenses	4,650	3,518
Additions (reductions) charged to other accounts	1,117(c)	(46)
Deductions	(8,195)(d)	(2,977)
Balance at January 28, 2006	3,694	4,650
Additions charged to costs and expenses	2,633	3,971
Additions (reductions) charged to other accounts	1,600(c)	(690)
Deductions	(4,373)(d)	(3,329)
Balance at February 3, 2007	3,554	4,602
Additions charged to costs and expenses	2,844	4,739
Additions (reductions) charged to other accounts	1,038(c)	(1,134)
Deductions	(4,173)(d)	(4,080)
Balance at February 2, 2008	$ 3,263	$ 4,127

(a) Deducted from trade accounts receivable.

(b) Reserve for Workers Compensation and General Liability.

(c) Recoveries of amounts previously written off.

(d) Uncollectible accounts written off.