CATO CORP
Form 10-Q
November 22, 2016

Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended October 29, 2016

OR

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

For the transition period from ________________to__________________
Commission file number 1-31340

THE CATO CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	56-0484485
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

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

(Zip Code)

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

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

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

Yes	X	No

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

Yes	X	No

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

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

(Do not check if a smaller reporting company)

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

Yes	No	X

As of October 29, 2016, there were 25,092,156 shares of Class A common stock and 1,751,576 shares of Class B common stock outstanding.

THE CATO CORPORATION

FORM 10-Q

Quarter Ended October 29, 2016

Table of Contents

Table of Contents

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

THE CATO CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (UNAUDITED)

	Three Months Ended		Nine Months Ended	
	October 29, 2016	October 31, 2015	**October 29, 2016**	October 31, 2015
	(Dollars in thousands, except per share data)			
REVENUES				
Retail sales	$ **207,022**	$ 223,311	$ **729,173**	$ 754,101
Other revenue (principally finance charges, late fees and layaway charges)	**2,240**	2,156	**6,949**	6,534
Total revenues	**209,262**	225,467	**736,122**	760,635
COSTS AND EXPENSES, NET				
Cost of goods sold (exclusive of depreciation shown below)	**133,627**	140,263	**446,658**	457,266
Selling, general and administrative (exclusive of depreciation shown below)	**67,815**	70,659	**206,441**	206,354
Depreciation	**5,734**	6,040	**17,082**	16,968
Interest and other income	**(1,288)**	(857)	**(5,593)**	(2,259)
Cost and expenses, net	**205,888**	216,105	**664,588**	678,329
Income before income taxes	**3,374**	9,362	**71,534**	82,306

Income tax (benefit)/expense		**(4,886)**		1,043		**11,513**		27,310
Net income	$	**8,260**	$	8,319	$	**60,021**	$	54,996
Basic earnings per share	$	**0.30**	$	0.30	$	**2.17**	$	1.97
Diluted earnings per share	$	**0.30**	$	0.30	$	**2.17**	$	1.97
Dividends per share	$	**0.33**	$	0.30	$	**0.96**	$	0.90
Comprehensive income:								
Net income	$	**8,260**	$	8,319	$	**60,021**	$	54,996
Unrealized gain (loss) on available-for-sale securities, net of deferred income taxes of ($530) and ($160) for the three and nine months ended October 29, 2016 and $125 and ($18) for the three and nine months ended October 31, 2015, respectively		**(881)**		207		**(269)**		(27)
Comprehensive income	$	**7,379**	$	8,526	$	**59,752**	$	54,969

See notes to condensed consolidated financial statements (unaudited).

Table of Contents

THE CATO CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

	October 29, 2016	January 30, 2016
ASSETS	**(Dollars in thousands)**	
Current Assets:		
Cash and cash equivalents	$ **32,776**	$ 67,057
Short-term investments	**210,173**	215,495
Restricted cash and investments	**4,486**	4,472
Accounts receivable, net of allowance for doubtful accounts of $1,450 and $1,447 at October 29, 2016 and January 30, 2016, respectively	**33,107**	36,610
Merchandise inventories	**153,346**	141,101
Prepaid expenses and other current assets	**8,963**	7,317
Total Current Assets	**442,851**	472,052
Property and equipment – net	**142,008**	138,303
Noncurrent deferred income taxes	**10,442**	10,280
Other assets	**22,280**	21,709
Total Assets	$ **617,581**	$ 642,344
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ **94,656**	$ 113,154
Accrued expenses	**55,815**	52,886
Accrued bonus and benefits	**3,262**	12,034
Accrued income taxes	**226**	1,363
Total Current Liabilities	**153,959**	179,437
Other noncurrent liabilities (primarily deferred rent)	**51,900**	50,242
Stockholders' Equity:		
Preferred stock, $100 par value per share, 100,000 shares authorized, none issued	**-**	-
Class A common stock, $.033 par value per share, 50,000,000 shares authorized; issued 25,092,156 shares and 26,129,692 shares at October 29, 2016 and January 30, 2016, respectively	**843**	877

Convertible Class B common stock, $.033 par value per share, 15,000,000 shares authorized; issued 1,751,576 shares and 1,743,525 shares at October 29, 2016 and January 30, 2016, respectively		**59**		58
Additional paid-in capital		**94,255**		90,336
Retained earnings		**316,034**		320,594
Accumulated other comprehensive income		**531**		800
Total Stockholders' Equity		**411,722**		412,665
Total Liabilities and Stockholders' Equity	**$**	**617,581**	$	642,344

See notes to condensed consolidated financial statements (unaudited).

4

Table of Contents

THE CATO CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Nine Months Ended	
	October 29, 2016	October 31, 2015
	(Dollars in thousands)	
Operating Activities:		
Net income	**$ 60,021**	$ 54,996
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	**17,082**	16,968
Provision for doubtful accounts	**658**	717
Purchase premium and premium amortization of investments	**(426)**	(4,453)
Share-based compensation	**3,044**	3,074
Excess tax benefits from share-based compensation	**(194)**	(192)
Deferred income taxes	**-**	(1,204)
Loss on disposal and write-offs of property and equipment	**1,495**	353
Changes in operating assets and liabilities which provided (used) cash:		
Accounts receivable	**2,845**	2,101
Merchandise inventories	**(12,245)**	1,448
Prepaid and other assets	**(2,986)**	(126)
Accrued income taxes	**(943)**	(2,780)
Accounts payable, accrued expenses and other liabilities	**(22,097)**	(13,157)
Net cash provided by operating activities	**46,254**	57,745
Investing Activities:		
Purchase of property and equipment	**(24,043)**	(22,432)
Purchase of short-term investments	**(101,461)**	(101,726)
Sales of short-term investments	**107,131**	51,693
Purchase of Other Assets	**(261)**	(5,402)
Sales of Other Assets	**-**	298
Change in restricted cash and investments	**(12)**	6
Net cash used in investing activities	**(18,646)**	(77,563)
Financing Activities:		
Dividends paid	**(26,527)**	(25,202)
Repurchase of common stock	**(36,252)**	(6,148)
Proceeds from line of credit	**21,000**	-
Payments to line of credit	**(21,000)**	-

Proceeds from employee stock purchase plan		**466**		455
Excess tax benefits from share-based compensation		**194**		192
Proceeds from stock options exercised		**230**		-
Net cash used in financing activities		**(61,889)**		(30,703)
Net (decrease) in cash and cash equivalents		**(34,281)**		(50,521)
Cash and cash equivalents at beginning of period		**67,057**		93,946
Effect of exchange rate on cash		**-**		-
Cash and cash equivalents at end of period	**$**	**32,776**	$	43,425
Non-cash activity:				
Accrued other assets and plant and equipment	**$**	**(439)**	**$**	(665)
Accrued treasury stock		**1,852**		-

See notes to condensed consolidated financial statements (unaudited).

Table of Contents

THE CATO CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

FOR THE THREE MONTHS AND NINE MONTHS ENDED OCTOBER 29, 2016 AND OCTOBER 31, 2015

NOTE 1 - GENERAL:

The condensed consolidated financial statements have been prepared from the accounting records of The Cato Corporation and its wholly-owned subsidiaries (the “Company”), and all amounts shown as of and for the periods ended October 29, 2016 and October 31, 2015 are unaudited. In the opinion of management, all adjustments considered necessary for a fair statement have been included. All such adjustments are of a normal, recurring nature unless otherwise noted. The results of the interim period may not be indicative of the results expected for the entire year.

The interim financial statements should be read in conjunction with the consolidated financial statements and notes thereto, included in the Company’s Annual Report on Form 10-K for the fiscal year ended January 30, 2016. Amounts as of January 30, 2016 have been derived from the audited balance sheet, but do not include all disclosures required by accounting principles generally accepted in the United States of America.

During the first quarter of 2016, the Company determined that there was an error in the classification of unrecognized tax benefits for uncertain tax positions as current liabilities in Accrued income taxes that resulted in a revision to the prior year end balance sheet as of January 30, 2016. The Condensed Consolidated Balance Sheet as of January 30, 2016 has been revised to correct the presentation of the amounts, which resulted in a decrease to Accrued income taxes and a corresponding increase to Other noncurrent liabilities of $13.6 million, which primarily consists of deferred rent and deferred compensation liabilities. There was no impact to the statement of income and comprehensive income and no impact to total net cash provided by operating activities or used in investing and financing activities in the statement of cash flows. The Company concluded that the revision was immaterial to prior period financial statements.

During the first quarter of 2016, the Company changed its estimate for recognizing gift card breakage income. The Company changed the dormancy period to 24 months of inactivity from 60 months of inactivity to more closely align with recent Company experience, industry practice and tax treatment. As a result, the Company recognized $2.4 million of additional breakage income (recorded in Interest and other income in the accompanying Condensed Consolidated Statements of Income and Comprehensive Income) for gift cards that were dormant from January 30, 2011 through February 1, 2014.

On November 17, 2016, the Board of Directors maintained the quarterly dividend at $0.33 per share and increased, by 2 million shares, the authorization to purchase shares under its share repurchase program.

Table of Contents

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND NINE MONTHS ENDED OCTOBER 29, 2016 AND OCTOBER 31, 2015

NOTE 2 - EARNINGS PER SHARE:

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

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

	Three Months Ended		Nine Months Ended	
	October 29, 2016	October 31, 2015	**October 29, 2016**	October 31, 2015
	(Dollars in thousands)			
Numerator				
Net earnings	**$ 8,260**	$ 8,319	**$ 60,021**	$ 54,996
Earnings allocated to non-vested equity awards	**(170)**	(175)	**(1,223)**	(1,145)
Net earnings available to common stockholders	**$ 8,090**	$ 8,144	**$ 58,798**	$ 53,851
Denominator				
Basic weighted average common shares outstanding	**26,738,809**	27,368,931	**27,039,343**	27,396,760
Dilutive effect of stock options	**1,436**	5,234	**1,807**	5,703
Diluted weighted average common shares outstanding	**26,740,245**	27,374,165	**27,041,150**	27,402,463
Net income per common share				
Basic earnings per share (Class A and B Shares)	**$ 0.30**	$ 0.30	**$ 2.17**	$ 1.97
Diluted earnings per share (Class A and B Shares)	**$ 0.30**	$ 0.30	**$ 2.17**	$ 1.97

6

Table of Contents

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND NINE MONTHS ENDED OCTOBER 29, 2016 AND OCTOBER 31, 2015

NOTE 3 – ACCUMULATED OTHER COMPREHENSIVE INCOME:

The following table sets forth information regarding the reclassification out of Accumulated other comprehensive income (in thousands) for the three months ended October 29, 2016:

		Changes in Accumulated Other Comprehensive Income (a) Unrealized Gains and (Losses) on Available-for-Sale Securities
Beginning Balance at July 30, 2016	$	1,412
Other comprehensive income before reclassifications		(765)
Amounts reclassified from accumulated other comprehensive income (b)		(116)
Net current-period other comprehensive income		(881)
Ending Balance at October 29, 2016	$	531

(a) All amounts are net-of-tax. Amounts in parentheses indicate a debit/reduction to Other Comprehensive Income.
(b) Includes ($185) impact of Accumulated other comprehensive income reclassifications into Interest and other income for net gains on available-for-sale securities. The tax impact of this reclassification was ($69).

The following table sets forth information regarding the reclassification out of Accumulated other comprehensive income (in thousands) for the nine months ended October 29, 2016:

		Changes in Accumulated Other Comprehensive Income (a) Unrealized Gains and (Losses) on Available-for-Sale Securities
Beginning Balance at January 30, 2016	$	800
Other comprehensive income before reclassifications		(101)
Amounts reclassified from accumulated other comprehensive income (b)		(168)
Net current-period other comprehensive income		(269)
Ending Balance at October 29, 2016	$	531

(a) All amounts are net-of-tax. Amounts in parentheses indicate a debit/reduction to Other Comprehensive Income.
(b) Includes ($269) impact of Accumulated other comprehensive income reclassifications into Interest and other

income for net gains on available-for-sale securities. The tax impact of this reclassification was ($101).

7

Table of Contents

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND NINE MONTHS ENDED OCTOBER 29, 2016 AND OCTOBER 31, 2015

NOTE 3 – ACCUMULATED OTHER COMPREHENSIVE INCOME (CONTINUED):

The following table sets forth information regarding the reclassification out of Accumulated other comprehensive income (in thousands) for the three months ended October 31, 2015:

	Changes in Accumulated Other Comprehensive Income (a) Unrealized Gains and (Losses) on Available-for-Sale Securities
Beginning Balance at August 1, 2015	$ 552
Other comprehensive income before reclassifications	227
Amounts reclassified from accumulated other comprehensive income (b)	(20)
Net current-period other comprehensive income	207
Ending Balance at October 31, 2015	$ 759

(a) All amounts are net-of-tax. Amounts in parentheses indicate a debit/reduction to Other Comprehensive Income.
(b) Includes ($32) impact of Accumulated other comprehensive income reclassifications into Interest and other income for net gains on available-for-sale securities. The tax impact of this reclassification was ($12).

The following table sets forth information regarding the reclassification out of Accumulated other comprehensive income (in thousands) for the nine months ended October 31, 2015:

		Changes in Accumulated Other Comprehensive Income (a) Unrealized Gains and (Losses) on Available-for-Sale Securities
Beginning Balance at January 31, 2015	$	786
Other comprehensive income before reclassifications		(154)
Amounts reclassified from accumulated other comprehensive income (b)		127
Net current-period other comprehensive income		(27)
Ending Balance at October 31, 2015	$	759

(a) All amounts are net-of-tax. Amounts in parentheses indicate a debit/reduction to Other Comprehensive Income.
(b) Includes $203 impact of Accumulated other comprehensive income reclassifications into Interest and other income for net gains on available-for-sale securities. The tax impact of this reclassification was $76.

THE CATO CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

FOR THE THREE MONTHS AND NINE MONTHS ENDED OCTOBER 29, 2016 AND OCTOBER 31, 2015

NOTE 4 – FINANCING ARRANGEMENTS:

As of October 29, 2016, the Company had an unsecured revolving credit agreement to borrow $35.0 million less the balance of any revocable letters of credit as discussed below. The revolving credit agreement is committed until August 2018. The credit agreement contains various financial covenants and limitations, including the maintenance of specific financial ratios with which the Company was in compliance as of October 29, 2016. There were no borrowings outstanding under this credit facility at October 29, 2016 or January 30, 2016. The weighted average interest rate under the credit facility was 1.4% at October 29, 2016.

At October 29, 2016 and January 30, 2016, the Company had no outstanding revocable letters of credit relating to purchase commitments.

NOTE 5 – REPORTABLE SEGMENT INFORMATION:

The Company has determined that it has four operating segments, as defined under ASC 280-10, including Cato, It's Fashion, Versona and Credit. As outlined in ASC 280-10, the Company has two reportable segments: Retail and Credit. The Company has aggregated its three retail operating segments, including e-commerce, based on the aggregation criteria outlined in ASC 280-10, which states that two or more operating segments may be aggregated into a single reportable segment if aggregation is consistent with the objective and basic principles of ASC 280-10, which require the segments to have similar economic characteristics, products, production processes, clients and methods of distribution.

The Company's retail operating segments have similar economic characteristics and similar operating, financial and competitive risks. They are similar in nature of product, as they all offer women's apparel, shoes and accessories. Merchandise inventory for the Company's retail operating segments is sourced from the same countries and some of the same vendors, using similar production processes. Merchandise for the Company’s operating segments is distributed to retail stores in a similar manner through the Company’s single distribution center and is subsequently distributed to clients in a similar manner.

The Company operates its women’s fashion specialty retail stores in 33 states as of October 29, 2016, principally in the 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.

Table of Contents

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND NINE MONTHS ENDED OCTOBER 29, 2016 AND OCTOBER 31, 2015

NOTE 5 – REPORTABLE SEGMENT INFORMATION (CONTINUED):

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

Three Months Ended October 29, 2016	**Retail**	**Credit**	**Total**	**Nine Months Ended October 29, 2016**	**Retail**	**Credit**	**Total**
Revenues	$208,060	$1,202	$209,262	Revenues	$732,408	$3,714	$736,122
Depreciation	5,722	12	5,734	Depreciation	17,045	37	17,082
Interest and other income	(1,288)	-	(1,288)	Interest and other income	(5,593)	-	(5,593)
Income before taxes	3,010	364	3,374	Income before taxes	70,330	1,204	71,534
Capital expenditures	14,091	-	14,091	Capital expenditures	24,043	-	24,043

Three Months Ended October 31, 2015	**Retail**	**Credit**	**Total**	**Nine Months Ended October 31, 2015**	**Retail**	**Credit**	**Total**
Revenues	$224,179	$1,288	$225,467	Revenues	$756,591	$4,044	$760,635
Depreciation	6,028	12	6,040	Depreciation	16,931	37	16,968
Interest and other income	(857)	-	(857)	Interest and other income	(2,259)	-	(2,259)
Income before taxes	8,917	445	9,362	Income before taxes	80,914	1,392	82,306
Capital expenditures	11,030	-	11,030	Capital expenditures	22,432	-	22,432

	Retail	**Credit**	**Total**

Total assets as of October 29, 2016	$564,873	$52,708	$617,581
Total assets as of January 30, 2016	540,941	101,403	642,344

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

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

	Three Months Ended		**Nine Months Ended**	
	October 29, 2016	October 31, 2015	**October 29, 2016**	October 31, 2015
Bad debt expense	**$ 216**	$ 219	**$ 658**	$ 717
Payroll	**214**	219	**650**	648
Postage	**153**	149	**488**	540
Other expenses	**255**	244	**714**	710
Total expenses	**$ 838**	$ 831	**$ 2,510**	$ 2,615

10

Table of Contents

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND NINE MONTHS ENDED OCTOBER 29, 2016 AND OCTOBER 31, 2015

NOTE 6 – STOCK-BASED COMPENSATION:

As of October 29, 2016, 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 is for the granting of options to officers and key employees. As of October 29, 2016, there were no available stock options for grant. The 2013 Incentive Compensation Plan and 2004 Amended and Restated Incentive Compensation Plan are for the granting of various forms of equity-based awards, including restricted stock and stock options for grant, to officers, directors and key employees. Effective May 23, 2013, shares for grant were no longer available under the 2004 Amended and Restated Incentive Compensation Plan.

The following table presents the number of options and shares of restricted stock initially authorized and available for grant under each of the plans as of October 29, 2016:

	1987 Plan	2004 Plan	2013 Plan	Total
Options and/or restricted stock initially authorized	5,850,000	1,350,000	1,500,000	8,700,000
Options and/or restricted stock available for grant:				
October 29, 2016	-	-	1,028,346	1,028,346

In accordance with ASC 718, the fair value of current restricted stock awards is estimated on the date of grant based on the market price of the Company's stock and is amortized to compensation expense on a straight-line basis over the related vesting periods. As of October 29, 2016 and January 30, 2016, there was $13,967,000 and $12,214,000, respectively, of total unrecognized compensation expense related to nonvested restricted stock awards, which had a remaining weighted-average vesting period of 2.7 years and 2.6 years, respectively. The total fair value of the shares recognized as compensation expense during the three and nine months ended October 29, 2016 was $1,145,000 and $2,948,000, respectively, compared to $1,040,000 and $2,981,000, respectively, for the three and nine months ended October 31, 2015. These expenses are classified as a component of Selling, general and administrative expenses in the Condensed Consolidated Statements of Income.

The following summary shows the changes in the shares of unvested restricted stock outstanding during the nine months ended October 29, 2016:

	Number of Shares		Weighted Average Grant Date Fair Value Per Share
Restricted stock awards at January 30, 2016	576,676	$	29.71
Granted	148,591		36.83
Vested	(103,808)		25.19
Forfeited or expired	(55,229)		31.47
Restricted stock awards at October 29, 2016	566,230	$	32.23

Table of Contents

THE CATO CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

FOR THE THREE MONTHS AND NINE MONTHS ENDED OCTOBER 29, 2016 AND OCTOBER 31, 2015

NOTE 6 – STOCK BASED-COMPENSATION (CONTINUED):

The Company's Employee Stock Purchase Plan allows eligible full-time employees to purchase a limited number of shares of the Company's Class A Common Stock during each semi-annual offering period at a 15% discount through payroll deductions. During the nine months ended October 29, 2016 and October 31, 2015, the Company sold 16,071 and 15,245 shares to employees at an average discount of $5.12 and $5.27 per share, respectively, under the Employee Stock Purchase Plan. The compensation expense recognized for the 15% discount given under the Employee Stock Purchase Plan was approximately $82,000 and $80,000 for the nine months ended October 29, 2016 and October 31, 2015, respectively. These expenses are classified as a component of Selling, general and administrative expenses.

NOTE 7 – FAIR VALUE MEASUREMENTS:

The following tables set forth information regarding the Company's financial assets and liabilities that are measured at fair value (in thousands) as of October 29, 2016 and January 30, 2016:

Description	October 29, 2016	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Assets:				
State/Municipal Bonds	$ 181,324	$ -	$ 181,324	$ -
Corporate Bonds	25,610	-	25,610	-
U.S. Treasury Notes	1,205	1,205	-	-
Cash Surrender Value of Life Insurance	7,752	-	-	7,752
	3,239	-	3,239	-

Asset-backed Securities (ABS)								
Corporate Equities		672		672		-		-
Certificates of Deposit		100		100		-		-
Total Assets	$	219,902	$	1,977	$	210,173	$	7,752
Liabilities:								
Deferred Compensation		(7,243)		-		-		(7,243)
Total Liabilities	$	(7,243)	$	-	$	-	$	(7,243)

Description		**January 30, 2016**		**Quoted Prices in Active Markets for Identical Assets Level 1**		**Significant Other Observable Inputs Level 2**		**Significant Unobservable Inputs Level 3**
Assets:								
State/Municipal Bonds	$	193,500	$	-	$	193,500	$	-
Corporate Bonds		10,941		-		10,941		-
U.S. Treasury Notes		1,203		1,203		-		-
Cash Surrender Value of Life Insurance		6,409		-		-		6,409

Asset-backed Securities (ABS)		11,054		-		11,054		-
Corporate Equities		578		578		-		-
Certificates of Deposit		100		100		-		-
Total Assets	$	223,785	$	1,881	$	215,495	$	6,409
Liabilities:								
Deferred Compensation		(6,187)		-		-		(6,187)
Total Liabilities	$	(6,187)	$	-	$	-	$	(6,187)

12

Table of Contents

THE CATO CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

FOR THE THREE MONTHS AND NINE MONTHS ENDED OCTOBER 29, 2016 AND OCTOBER 31, 2015

The Company's investment portfolio was primarily invested in corporate bonds and tax-exempt and taxable governmental debt securities held in managed accounts with underlying ratings of A or better at October 29, 2016 and January 30, 2016. The state, municipal and corporate bonds have contractual maturities which range from three days to 26.8 years. The U.S. Treasury Notes and Certificates of Deposit have contractual maturities which range from four months to 1.4 years. These securities are classified as available-for-sale and are recorded as Short-term investments, Restricted cash and investments and Other assets on the accompanying Condensed Consolidated Balance Sheets. These assets are carried at fair value with unrealized gains and losses reported net of taxes in Accumulated other comprehensive income.

Additionally, at October 29, 2016, the Company had $0.7 million of corporate equities and deferred compensation plan assets of $7.8 million. At January 30, 2016, the Company had $0.6 million of corporate equities and deferred compensation plan assets of $6.4 million. All of these assets are recorded within Other assets in the Condensed Consolidated Balance Sheets.

Level 1 category securities are measured at fair value using quoted active market prices. Level 2 investment securities include corporate and municipal bonds for which quoted prices may not be available on active exchanges for identical instruments. Their fair value is principally based on market values determined by management with assistance of a third-party pricing service. Since quoted prices in active markets for identical assets are not available, these prices are determined by the pricing service using observable market information such as quotes from less active markets and/or quoted prices of securities with similar characteristics, among other factors.

Deferred compensation plan assets consist of life insurance policies. These life insurance policies are valued based on the cash surrender value of the insurance contract, which is determined based on such factors as the fair value of the underlying assets and discounted cash flow and are therefore classified within Level 3 of the valuation hierarchy. The Level 3 liability associated with the life insurance policies represents a deferred compensation obligation, the value of which is tracked via underlying insurance funds. These funds are designed to mirror existing mutual funds and money market funds that are observable and actively traded. Cash surrender values are provided by third parties and reviewed for reasonableness by the Company.

Table of Contents

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND NINE MONTHS ENDED OCTOBER 29, 2016 AND OCTOBER 31, 2015

The following tables summarize the change in fair value of the Company's financial assets and liabilities measured using Level 3 inputs as of October 29, 2016 and January 30, 2016 (in thousands):

	Fair Value Measurements Using Significant Unobservable Asset Inputs (Level 3)		
	Other Investments Private Equity	Cash Surrender Value	Total
Beginning Balance at January 30, 2016	$ -	$ 6,409	$ 6,409
Redemptions	-	-	-
Additions	-	1,059	1,059
Total gains or (losses)			
Included in interest and other income (or changes in net assets)	-	284	284
Included in other comprehensive income	-	-	-
Ending Balance at October 29, 2016	$ -	$ 7,752	$ 7,752

	Fair Value Measurements Using Significant Unobservable Liability Inputs (Level 3)	
	Deferred Compensation	Total
Beginning Balance at January 30, 2016	$ (6,187)	$ (6,187)
Additions	(592)	(592)
Total (gains) or losses		
Included in interest and other income (or changes in net assets)	(464)	(464)
Included in other comprehensive income	-	-
Ending Balance at October 29, 2016	$ (7,243)	$ (7,243)

14

THE CATO CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

FOR THE THREE MONTHS AND NINE MONTHS ENDED OCTOBER 29, 2016 AND OCTOBER 31, 2015

	Fair Value Measurements Using Significant Unobservable Asset Inputs (Level 3)
	Cash
Other Investments	Surrender