

CATO CORP
Form 10-K
March 30, 2015

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

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

For the fiscal year ended January 31, 2015

or

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

Commission File Number 1-31340

The Cato Corporation

Registrant

Delaware
State of Incorporation

8100 Denmark Road

Charlotte, North Carolina 28273-5975

Address of Principal Executive Offices

56-0484485
I.R.S. Employer Identification Number

704/554-8510

Registrant's Telephone Number

Securities registered pursuant to Section 12(b) of the Act:

| <u>Title of Class</u> | <u>Name of Exchange on Which Registered</u> |
|---------------------------------|---|
| Class A Common Stock | New York Stock Exchange |
| Preferred Share Purchase Rights | New York Stock Exchange |

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. Yes No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes 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. Yes 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 (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark, if disclosure of delinquent filers pursuant to Item 405 of the Regulation S-K is not contained herein, and will not be contained, to the best of the 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.

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.

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

(Do not check if a smaller reporting company)

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

The aggregate market value of the Registrant's Class A Common Stock held by non-affiliates of the Registrant as of August 2, 2014, the last business day of the Company's most recent second quarter, was \$796,035,939 based on the last reported sale price per share on the New York Stock Exchange on that date.

As of January 31, 2015, there were 26,174,684 shares of Class A common stock and 1,743,525 shares of Class B common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the proxy statement relating to the 2015 annual meeting of shareholders are incorporated by reference into the following part of this annual report:

Part III — Items 10, 11, 12, 13 and 14

THE CATO CORPORATION

FORM 10-K

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Forward-looking Information

The following information should be read along with the Consolidated Financial Statements, including the accompanying Notes appearing in this report. Any of the following are “forward-looking” statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended: (1) statements in this Annual Report on Form 10-K that reflect projections or expectations of our future financial or economic performance; (2) statements that are not historical information; (3) statements of our beliefs, intentions, plans and objectives for future operations, including those contained in “Business,” “Properties,” “Legal Proceedings,” “Controls and Procedures” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations”; (4) statements relating to our operations or activities for our fiscal year ending January 30, 2016 (“fiscal 2015”) and beyond, including, but not limited to, statements regarding expected amounts of capital expenditures and store openings, relocations, remodels and closures; and (5) statements relating to our future contingencies. When possible, we have attempted to identify forward-looking statements by using words such as “expects,” “anticipates,” “approximates,” “believes,” “estimates,” “hopes,” “intends,” “may,” “plans,” “should” and variations of such words and similar expressions. We can give no assurance that actual results or events will not differ materially from those expressed or implied in any such forward-looking statements. Forward-looking statements included in this report are based on information available to us as of the filing date of this report, but subject to known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from those contemplated by the forward-looking statements. Such factors include, but are not limited to, the following: any actual or perceived deterioration in the conditions that drive consumer confidence and spending, including, but not limited to, levels of unemployment, fuel, energy and food costs, wage rates, tax rates, home values, consumer net worth and the availability of credit; uncertainties regarding the impact of any governmental responses to the foregoing conditions; competitive factors and pricing pressures; our ability to predict and respond to rapidly changing fashion trends and consumer demands; adverse weather or similar conditions that may affect our sales or operations; inventory risks due to shifts in market demand; and other factors discussed under “Risk Factors” in Part I, Item 1A of this annual report on Form 10-K for the fiscal year ended January 31, 2015 (“fiscal 2014”), as amended or supplemented, and in other reports we file with or furnish to the Securities and Exchange Commission (“SEC”) from time to time. We do not undertake, and expressly decline, any obligation to update any such forward-looking information contained in this report, whether as a result of new information, future events, or otherwise.

As used herein, the terms “we,” “our,” “us” (or when the context requires otherwise and similar terms), the “Company” or “Cato” include The Cato Corporation and its subsidiaries, except that when used with reference to common stock or other securities described herein and in describing the positions held by management of the Company, such terms include only The Cato Corporation. Our website is located at www.catocorp.com where we make available, free of charge, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements and other reports (including amendments to these reports) filed or furnished pursuant to Section 13(a) or 15(d) under the Securities Exchange Act of 1934. These reports are available as soon as reasonably practicable after we electronically file these materials with the SEC. We also post on our website the charters of our Audit, Compensation and Corporate Governance and Nominating Committees; our Corporate Governance Guidelines, Code of Business Conduct and Ethics; and any amendments or waivers thereto; and any other corporate governance materials contemplated by SEC or New York Stock Exchange regulations. The information contained on our website, www.catocorp.com, is not, and should in no way be construed as, a part of this or any other report that we filed with

or furnished to the SEC.

PART I

Item 1. *Business:*

General

The Company, founded in 1946, operated 1,346 fashion specialty stores at January 31, 2015, in 32 states, principally in the southeastern United States, under the names “Cato,” “Cato Fashions,” “Cato Plus,” “It’s Fashion,” “It’s Fashion Metro” and “Versona”. The Cato concept seeks to offer quality fashion apparel and accessories at low prices, every day in junior/missy, plus sizes and girls sizes 7 to 16. The Cato concept’s stores and e-commerce website feature a broad assortment of apparel and accessories, including dressy, career, and casual sportswear, dresses, coats, shoes, lingerie, costume jewelry and handbags. A major portion of the Cato concept’s merchandise is sold under its private label and is produced by various vendors in accordance with the concept’s specifications. The It’s Fashion and It’s Fashion Metro concepts offer fashion with a focus on the latest trendy styles for the entire family at low prices every day. The Versona concept offers quality fashion jewelry, accessories and key apparel items at exceptional values every day. The Company’s stores range in size from 2,000 to 19,000 square feet and are located primarily in strip shopping centers anchored by national discounters or market-dominant grocery stores. The Company emphasizes friendly customer service and coordinated merchandise presentations in an appealing store environment. The Company offers its own credit card and layaway plan. Credit and layaway sales under the Company’s plan represented 8% of retail sales in fiscal 2014. See Note 14 to the Consolidated Financial Statements, “Reportable Segment Information,” for a discussion of information regarding the Company’s two reportable segments: retail and credit.

Business

The Company’s primary objective is to be the leading fashion specialty retailer for fashion and value in its markets. Management believes the Company’s success is dependent upon its ability to differentiate its stores from department stores, mass merchandise discount stores and competing specialty stores. The key elements of the Company’s business strategy are:

Merchandise Assortment. The Company’s stores offer a wide assortment of on-trend apparel and accessory items in primarily junior/missy, plus sizes, girls sizes 7 to 16, mens and kids sizes newborn to 7 with an emphasis on color, product coordination and selection. Colors and styles are coordinated and presented so that outfit selection is easily made.

Value Pricing. The Company offers quality merchandise that is generally priced below comparable merchandise offered by department stores and mall specialty apparel chains, but is generally more fashionable than merchandise offered by discount stores. Management believes that the Company has positioned itself as the every day low price leader in its market segment.

Strip Shopping Center Locations. The Company locates its stores principally in convenient strip centers anchored by national discounters or market-dominant grocery stores that attract large numbers of potential customers.

Customer Service. Store managers and sales associates are trained to provide prompt and courteous service and to assist customers in merchandise selection and wardrobe coordination.

Credit and Layaway Programs. The Company offers its own credit card and a layaway plan to make the purchase of its merchandise more convenient for its customers.

Merchandising

Merchandising

The Company seeks to offer a broad selection of high quality and exceptional value apparel and accessories to suit the various lifestyles of fashion and value conscious customers. In addition, the Company strives to offer on-trend fashion in exciting colors with consistent fit and quality.

The Company's merchandise lines include dressy, career, and casual sportswear, dresses, coats, shoes, lingerie, costume jewelry, handbags, men's wear and lines for kids and newborns. The Company primarily offers exclusive merchandise with fashion and quality comparable to mall specialty stores at low prices, every day.

The Company believes that the collaboration of its merchandising team with an expanded in-house product development and direct sourcing function has enhanced merchandise offerings and delivers quality exclusive on-trend styles at lower prices. The product development and direct sourcing operations provide research on emerging fashion and color trends, technical services and direct sourcing options.

As a part of its merchandising strategy, members of the Company's merchandising staff frequently attend trade shows to stay abreast of latest trends and styles, visit selected stores to monitor the merchandise offerings of other retailers, regularly communicate with store operations associates and frequently confer with key vendors. The Company also takes aggressive markdowns on slow-selling merchandise and typically does not carry over merchandise to the next season.

Purchasing, Allocation and Distribution

Although the Company purchases merchandise from approximately 600 suppliers, most of its merchandise is purchased from approximately 100 primary vendors. In fiscal 2014, purchases from the Company's largest vendor accounted for approximately 5% of the Company's total purchases. The Company is not dependent on its largest vendor or any other vendor for merchandise purchases, and the loss of any single vendor or group of vendors would not have a material adverse effect on the Company's operating results or financial condition. A substantial portion of the Company's merchandise is sold under its private labels and is produced by various vendors in accordance with the Company's strict specifications. The Company purchases a majority of its merchandise from domestic importers and

vendors, which typically minimizes the time necessary to purchase and obtain shipments. This enables the Company to react to merchandise trends in a more timely fashion. The Company sources its remaining merchandise directly from manufacturers overseas. The Company opened its own overseas sourcing operations in the fall of 2014 and plans to replace the Company's current sourcing agent with its new overseas sourcing operation beginning in 2015. Although a significant portion of the Company's merchandise is manufactured overseas, the Company does not expect that any economic, political or social unrest in any one country would have a material adverse effect on the Company's ability to obtain adequate supplies of merchandise. However, the Company can give no assurance that any changes or disruptions in its merchandise supply chain would not materially and adversely affect the Company. See "Risk Factors – Risks Relating To Our Business – Because we source a significant portion of our merchandise directly and indirectly from overseas, we are subject to risks associated with international operations, changes, disruptions, cost changes or other problems affecting the Company's merchandise supply chain could materially and adversely affect the Company's business, results of operations and financial condition."

An important component of the Company's strategy is the allocation of merchandise to individual stores based on an analysis of sales trends by merchandise category, customer profiles and climatic conditions. A merchandise control system provides current information on the sales activity of each merchandise style in each of the Company's stores. Point-of-sale terminals in the stores collect and transmit sales and inventory information to the Company's central database, permitting timely response to sales trends on a store-by-store basis.

All merchandise is shipped directly to the Company's distribution center in Charlotte, North Carolina, where it is inspected and then allocated by the merchandise distribution staff for shipment to individual stores. The flow of merchandise from receipt at the distribution center to shipment to stores is controlled by an on-line system. Shipments are made by common carrier, and each store receives at least one shipment per week. The centralization of the Company's distribution process also subjects it to risks in the event of damage to or destruction of its distribution facility or other disruptions affecting the distribution center or the flow of goods into or out of Charlotte, North Carolina generally. See "Risk Factors – Risks Relating To Our Business – A disruption or shutdown of our centralized distribution center or transportation network could materially and adversely affect our business and results of operations."

Advertising

The Company uses television, in-store signage, graphics, a Company website, an e-commerce website and social media as its primary advertising media. The Company's total advertising expenditures were approximately 0.6%, 0.7% and 0.7% of retail sales for fiscal years 2014, 2013 and 2012, respectively.

Store Operations

The Company's store operations management team consists of one director of stores, five territorial managers, 17 regional managers and 147 district managers. Regional managers receive a salary plus a bonus based on achieving targeted goals for sales, payroll and shrinkage control. District managers receive a salary plus a bonus based on achieving targeted objectives for district sales increases and shrinkage control. Stores are typically staffed with a manager, two assistant managers and additional part-time sales associates depending on the size of the store and seasonal personnel needs. Store managers receive a salary and all other store personnel are paid on an hourly basis. Store managers, assistant managers and sales associates are eligible for monthly and semi-annual bonuses based on achieving targeted goals for their store's sales increases and shrinkage control.

The Company constantly strives to improve its training programs to develop associates. Over 80% of store and field management are promoted from within, allowing the Company to internally staff an expanding store base. The Company has training programs at each level of store operations. New store managers are trained in training stores managed by experienced associates who have achieved superior results in meeting the Company's goals for store sales, payroll expense and shrinkage control. The type and extent of district manager training varies depending on whether the district manager is promoted from within or recruited from outside the Company.

Store Locations

Most of the Company's stores are located in the southeastern United States in a variety of markets ranging from small towns to large metropolitan areas with trade area populations of 20,000 or more. Stores average approximately 4,500 square feet in size.

All of the Company's stores are leased. Approximately 97% are located in strip shopping centers and 3% in enclosed shopping malls. The Company typically locates stores in strip shopping centers anchored by a national discounter, primarily Wal-Mart Supercenters, or market-dominant grocery stores. The Company's strip center locations provide ample parking and shopping convenience for its customers.

The Company's store development activities consist of opening new stores in new and existing markets and relocating selected existing stores to more desirable locations in the same market area. The following table sets forth information with respect to the Company's development activities since fiscal 2010:

| <u>Fiscal Year</u> | Store Development | | | Number of Stores End of Year |
|---------------------------|------------------------------|--------------------------|--------------------------|---|
| | Beginning of Year | Number Opened | Number Closed | |
| 2010..... | 1,271 | 37 | 26 | 1,282 |
| 2011..... | 1,282 | 38 | 32 | 1,288 |
| 2012..... | 1,288 | 34 | 12 | 1,310 |
| 2013..... | 1,310 | 32 | 22 | 1,320 |
| 2014..... | 1,320 | 33 | 7 | 1,346 |

The Company expects to open 45 new stores during fiscal 2015. The Company anticipates closing up to 13 stores by year end.

The Company periodically reviews its store base to determine whether any particular store should be closed based on its sales trends and profitability. The Company intends to continue this review process to identify underperforming stores.

Credit and Layaway

Credit Card Program

The Company offers its own credit card, which accounted for 3.9%, 4.3% and 4.5% of retail sales in fiscal 2014, 2013 and 2012 respectively. The Company's net bad debt expense was 4.5%, 3.9% and 4.3% of credit sales in fiscal 2014, 2013 and 2012, respectively.

Customers applying for the Company's credit card are approved for credit if they have a satisfactory credit record and the Company has considered the customer's ability to make the required minimum payment. Customers are required to make minimum monthly payments based on their account balances. If the balance is not paid in full each month, the Company assesses the customer a finance charge. If payments are not received on time, the customer is assessed a

late fee subject to regulatory limits.

Layaway Plan

Under the Company's layaway plan, merchandise is set aside for customers who agree to make periodic payments. The Company adds a nonrefundable administrative fee to each layaway sale. If no payment is made within four weeks, the customer is considered to have defaulted, and the merchandise is returned to the selling floor and again offered for sale, often at a reduced price. All payments made by customers who subsequently default on their layaway purchase are returned to the customer upon request, less the administrative fee and a restocking fee.

The Company defers recognition of layaway sales to the accounting period when the customer picks up and completely pays for layaway merchandise. Administrative fees are recognized in the period in which the customer picks up the merchandise or upon default of the layaway purchase. Recognition of restocking fees occurs in the accounting period when the customer defaults on the layaway purchase. Layaway sales represented approximately 4.5%, 4.5% and 4.8% of retail sales in fiscal 2014, 2013 and 2012, respectively.

Information Technology Systems

The Company's information technology systems provide daily financial and merchandising information that is used by management to enhance the timeliness and effectiveness of purchasing and pricing decisions. Management uses a daily report comparing actual sales with planned sales and a weekly ranking report to monitor and control purchasing decisions. Weekly reports are also produced which reflect sales, weeks of supply of inventory and other critical data by product categories, by store and by various levels of responsibility reporting. Purchases are made based on projected sales, but can be modified to accommodate unexpected increases or decreases in demand for a particular item.

Sales information is projected by merchandise category and, in some cases, is further projected and actual performance measured by stock keeping unit (SKU). Merchandise allocation models are used to distribute merchandise to individual stores based upon historical sales trends, climatic differences, customer demographic differences and targeted inventory turnover rates.

Competition

The women's retail apparel industry is highly competitive. The Company believes that the principal competitive factors in its industry include merchandise assortment and presentation, fashion, price, store location and customer service. The Company competes with retail chains that operate similar women's apparel specialty stores. In addition, the Company competes with mass merchandise chains, discount store chains, major department stores, off-price retailers and internet-based retailers. Although we believe we compete favorably with respect to the principal competitive factors described above, many of our direct and indirect competitors are well-established national, regional or local chains, and some have substantially greater financial, marketing and other resources. The Company expects its stores in larger cities and metropolitan areas to face more intense competition.

Seasonality

Due to the seasonal nature of the retail business, the Company has historically experienced and expects to continue to experience seasonal fluctuations in its revenues, operating income and net income. Results of a period shorter than a full year may not be indicative of results expected for the entire year. Furthermore, the seasonal nature of our business may affect comparisons between periods. See Note 13 of Notes to the Consolidated Financial Statements for information regarding our quarterly results of operations for the last two fiscal years.

Regulation

A variety of laws affect the revolving credit card program offered by the Company. The Credit Card Accountability Responsibility and Disclosure Act of 2009 (“The Act”) amended the Truth in Lending Act to establish fair and transparent practices relating to the extension of credit under an open end consumer credit plan. The Act contained provisions addressing matters such as change in terms, notices, limits on fees, rate increases, payment allocation and account disclosures. The Act requires creditors to provide consumers with account disclosures that are timely and in a form that is readily understandable. The Federal Fair Credit Reporting Act also requires certain disclosures to potential customers concerning credit information used as a basis to deny credit. The Federal Equal Credit Opportunity Act and Regulation B promulgated thereunder prohibit lenders from discrimination against any credit applicants, establish guidelines for gathering and evaluating credit information and require written notification when credit is denied. Regulation AA, Unfair or Deceptive Acts or Practices, establishes consumer complaint procedures and defines unfair or deceptive practices in extending credit to consumers. The Federal Trade Commission has adopted or proposed various trade regulation rules dealing with unfair credit and collection practices and the preservation of consumers’ claims and defenses. The Company is also subject to the U.S. Patriot Act and the Bank Secrecy Act, which require the Company to monitor account holders and account transactions, respectively. Additionally, the Gramm-Leach-Bliley Act requires the Company to disclose, initially and annually, to its customers, the Company’s privacy policy as it relates to a customer’s non-public personal information.

Associates

As of January 31, 2015, the Company employed approximately 10,000 full-time and part-time associates. The Company also employs additional part-time associates during the peak retailing seasons. The Company is not a party to any collective bargaining agreements and considers its associate relations to be good.

Item 1A. Risk Factors:

An investment in our common stock involves numerous types of risks. You should carefully consider the following risk factors, in addition to the other information contained in this report, including the disclosures under “Forward-looking Information” above in evaluating our Company and any potential investment in our common stock. If any of the following risks or uncertainties occur, our business, financial condition and operating results could be materially and adversely affected, the trading price of our common stock could decline and you could lose all or a part of your investment in our common stock. The risks and uncertainties described in this section are not the only ones facing us. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also materially and adversely affect our business operating results and financial condition.

Risks Relating To Our Business:

If we are unable to anticipate, identify and respond to rapidly changing fashion trends and customer demands in a timely manner, our business and results of operations could materially suffer.

Customer tastes and fashion trends, particularly for women’s apparel, are volatile, tend to change rapidly and cannot be predicted with certainty. Our success depends in part upon our ability to consistently anticipate and respond to changing merchandise trends and consumer preferences in a timely manner. Accordingly, any failure by us to anticipate, identify and respond to changing fashion trends could adversely affect consumer acceptance of our merchandise, which in turn could adversely affect our business and our image with our customers. If we miscalculate either the market for our merchandise or our customers’ tastes or purchasing habits, we may be required to sell a significant amount of unsold inventory at below average markups over cost, or below cost, which would adversely affect our margins and results of operations.

Existing and increased competition in the women's retail apparel industry may negatively impact our business, results of operations, financial condition and market share.

The women's retail apparel industry is highly competitive. We compete primarily with discount stores, mass merchandisers, department stores, off-price retailers, specialty stores and internet-based retailers, many of which have substantially greater financial, marketing and other resources than we have. Many of our competitors offer frequent promotions and reduce their selling prices. In some cases our competitors are expanding into markets in which we have a significant market presence. As a result of this competition, including close-out sales and going-out-of-business sales by other women's apparel retailers, we may experience pricing pressures, increased marketing expenditures, as well as loss of market share, which could materially and adversely affect our business, results of operations and financial condition.

Unusual weather, natural disasters or similar events may adversely affect our sales or operations.

Extreme changes in weather, natural disasters or similar events can influence customer trends and shopping habits. For example, heavy rainfall or other extreme weather conditions over a prolonged period might make it difficult for our customers to travel to our stores and thereby reduce our sales and profitability. Our business is also susceptible to unseasonable weather conditions. For example, extended periods of unseasonably warm temperatures during the winter season or cool weather during the summer season could render a portion of our inventory incompatible with those unseasonable conditions. Reduced sales from extreme or prolonged unseasonable weather conditions would adversely affect our business. The occurrence or threat of extreme weather, natural disasters, power outages, terrorist acts, outbreaks of flu or other communicable diseases or other catastrophic events could reduce customer traffic in our stores and likewise disrupt our ability to conduct operations, which could materially and adversely affect us.

Because we source a significant portion of our merchandise directly and indirectly from overseas, we are subject to risks associated with international operations, changes, disruptions, cost changes or other problems affecting the Company's merchandise supply chain could materially and adversely affect the Company's business, results of operations and financial condition.

A significant amount of our merchandise is manufactured overseas, principally in East Asia. We directly import some of this merchandise and indirectly import the remaining merchandise from domestic vendors who acquire the merchandise from foreign sources. As a result, political, financial or other forms of instability or other events resulting in the disruption of trade from countries affecting our supply chain, increased security requirements for imported merchandise, or the imposition of additional regulations or changes in duties, quotas, tariffs, taxes or other factors affecting the availability or cost of imports, could cause significant delays or interruptions in the supply of our merchandise or increase our costs. Our costs are also affected by currency fluctuations. Any changes in the value of the dollar relative to foreign currencies may increase our cost of goods sold. Any of these factors could have a material adverse effect on our business. In addition, increased energy and transportation costs have caused us significant cost increases from time to time, and future adverse changes in these costs or the disruption of the means by which merchandise is transported to us could cause additional cost increases or interruptions of our supply chain which could be significant. Further, we are subject to increased costs or potential disruptions impacting any port or trade route through which our products move. If we are forced to source merchandise from other countries or other domestic vendors with foreign sources in different countries, those goods may be more expensive or of a different or inferior quality from the ones we now sell.

The inability of third-party vendors to produce goods on time and to the Company's specification may adversely affect the Company's business, results of operations and financial condition.

Our dependence on third-party vendors to manufacture and supply our merchandise subjects us to numerous risks that our vendors will fail to perform as we expect. For example, the deterioration in any of our key vendors' financial condition, their failure to ship merchandise in a timely manner that meets our specifications, or other failures to follow our vendor guidelines or comply with applicable laws and regulations, including compliant labor, environmental practices and product safety, could expose us to operational, quality, competitive, reputational and legal risks. If we are not able to timely or adequately replace the merchandise we currently source with merchandise produced elsewhere, or if our vendors fail to perform as we expect, our business, results of operations and financial condition could be adversely affected. Activities conducted by us or on our behalf outside the United States further subject us to numerous U.S. and international regulations and compliance risks, as discussed below under "Our business operations subject us to legal compliance and litigation risks that could result in increased costs or liabilities, divert our management's attention or otherwise adversely affect our business, results of operations and financial condition."

The operation of our sourcing offices in Asia may present increased legal and operational risks.

In October 2014, we established our own sourcing offices. Our experience with legal and regulatory practices and requirements in Asia is limited. If our sourcing offices are unable to successfully oversee merchandise production to ensure that product is produced on time and within the Company's specifications, our business, brand, reputation, costs, results of operations and financial condition could be materially and adversely affected. Further, the activities conducted by our sourcing office outside the United States further subject us to foreign operational risks, as well as U.S. and international regulations and compliance risks, as discussed elsewhere in this "Risk Factors" section, in particular below under "Our business operations subject us to legal compliance and litigation risks that could result in increased costs or liabilities, divert our management's attention or otherwise adversely affect our business, results of operations and financial condition."

Fluctuations in the price, availability and quality of inventory may result in higher cost of goods, which the Company may not be able to pass on to the customers.

Vendors are increasingly passing on higher production costs, which may impact our ability to maintain or grow our margins. The price and availability of raw materials may be impacted by demand, regulation, weather and crop yields, as well as other factors. Additionally, manufacturers have and may continue to have increases in other manufacturing costs, such as transportation, labor and benefit costs. These increases in production costs result in higher merchandise costs to the Company. Due to the Company's limited flexibility in price point, the Company may not be able to pass on those cost increases to the consumer, which could have a material adverse effect on our results of operations and financial condition.

Any actual or perceived deterioration in the conditions that drive consumer confidence and spending may materially and adversely affect consumer demand for our apparel and accessories and our results of operations.

Consumer spending habits, including spending for our apparel and accessories, are affected by, among other things, prevailing economic conditions and uncertainties, political conditions and uncertainties (such as those currently being debated in the U.S. regarding budgetary, spending and tax policies), levels of employment, fuel, energy and food costs, salaries and wage rates and other sources of income, tax rates, home values, consumer net worth, the availability of consumer credit, consumer confidence and consumer perceptions of adverse changes in or trends affecting any of these conditions. Any perception that these conditions may be worsening or continuing to trend negatively may significantly weaken many of these drivers of consumer spending habits. Adverse perceptions of these conditions or uncertainties regarding them also generally cause consumers to defer purchases of discretionary items, such as our merchandise, or to purchase cheaper alternatives to our merchandise, all of which may also adversely affect our net sales and results of operations. In addition, numerous events, whether or not related to actual economic conditions, such as downturns in the stock markets, acts of war or terrorism, political unrest or natural disasters, or similar events, may also dampen consumer confidence, and accordingly, lead to reduced consumer spending. Any of these events could have a material adverse effect on our business, results of operations and financial condition.

A failure or disruption relating to our information technology systems could adversely affect our business.

We rely on our existing information technology systems for merchandise operations, including merchandise planning, replenishment, pricing, ordering, markdowns and product life cycle management. In addition to

merchandise operations, we utilize our information technology systems for our distribution processes, as well as our financial systems, including accounts payable, general ledger, accounts receivable, sales, banking, inventory and fixed assets. Despite the precautions we take, our information systems may be vulnerable to disruption or failure from numerous events, including but not limited to, natural disasters, severe weather conditions, power outages, technical malfunctions, cyber attacks, acts of war or terrorism, similar catastrophic events or other causes beyond our control or that we fail to anticipate. Any disruption in or failure in the operation of our information technology systems, or our failure to continue to upgrade or improve such systems could adversely affect our business. Modifications and/or upgrades to our current information technology systems may also disrupt our operations.

A disruption or shutdown of our centralized distribution center or transportation network could materially and adversely affect our business and results of operations.

The distribution of our products is centralized in one distribution center in Charlotte, North Carolina and distributed through our network of third-party freight carriers. The merchandise we purchase is shipped directly to our distribution center, where it is prepared for shipment to the appropriate stores and subsequently delivered to the stores by our third-party freight carriers. If the distribution center or our third-party freight carriers were to be shutdown or lose significant capacity for any reason, including but not limited to, any of the causes described under “A failure or disruption relating to our information technology systems could adversely affect our business,” our operations would likely be seriously disrupted. Such problems could occur as the result of any loss, destruction or impairment of our ability to use our distribution center, as well as any broader problem generally affecting the ability to ship goods into our distribution center or deliver goods to our stores. As a result, we could incur significantly higher costs and longer lead times associated with distributing our products to our stores during the time it takes for us to reopen or replace the distribution center and/or our transportation network. Any such occurrence could adversely affect our business, results of operations and financial condition.

Our ability to attract consumers and grow our revenues is dependent on the success of our store location strategy and our ability to successfully open new stores as planned.

Our sales are dependent in part on the location of our stores in shopping centers where we believe our consumers and potential consumers shop. In addition, our ability to grow our revenues has been substantially dependent on our ability to secure space for and open new stores in attractive locations. Centers where we currently operate existing stores or seek to open new stores may be adversely affected by, among other things, general economic downturns or those particularly affecting the commercial real estate industry, the closing of anchor stores, changes in tenant mix and changes in customer shopping preferences. To take advantage of consumer traffic and the shopping preferences of our consumers, we need to maintain and acquire stores in desirable locations where competition for suitable store locations is intense. A decline in customer popularity of the strip shopping centers where we generally locate our stores or in availability of space in desirable centers and locations, or an increase in the cost of such desired space, could adversely affect consumer traffic and reduce our sales and net earnings or increase our operating costs.

Our ability to open and operate new stores depends on many factors, some of which are beyond our control. These factors include, but are not limited to, our ability to identify suitable store locations, negotiate acceptable lease terms, and hire and train appropriate store personnel. In addition, our continued expansion into new regions of the country where we have not done business before may present new challenges in competition, distribution and merchandising as we enter these new markets. Our failure to successfully and timely execute our plans for opening new stores or the failure of these stores to perform up to our expectations could adversely affect our business, results of operations and

financial condition.

If the Company is unable to successfully integrate new businesses into its existing business, the Company's financial condition and results of operations will be adversely affected.

The Company's long-term business strategy includes growth through the development of new store concepts. This growth may require significant capital expenditures and management attention. The Company may not realize any of the anticipated benefits of a new business and integration costs may exceed anticipated amounts. We have incurred substantial financial commitments and fixed costs related to our retail stores that we will not be able to recover if our stores are not successful and that could potentially result in impairment charges. If we cannot successfully execute our growth strategies, our financial condition and results of operations may be adversely impacted.

A security breach that results in unauthorized disclosure of Company, employee or customer information could adversely affect our costs, reputation and results of operations.

The protection of employee, company and customer data is critical to the Company. Any security breach, mishandling, human or programming error or other event that results in the misappropriation, loss or other unauthorized disclosure of employee, company or customer information, including but not limited to credit card data or other personally identifiable information, could severely damage the Company's reputation, expose it to the risks of legal proceedings, disrupt its operations and otherwise adversely affect the Company's business and financial condition. Despite measures the Company has taken to protect confidential information, there is no assurance that such measures will prevent the compromise of such information. If any such compromise or unauthorized disclosure of this information were to occur, it could have a material adverse effect on the Company's reputation, business, operating results, financial condition and cash flows.

The Company's failure to successfully operate its e-commerce website or fulfill customer expectations could adversely impact customer satisfaction, our reputation and our business.

Although the Company's e-commerce platform provides another channel to drive incremental sales, provide existing customers the on-line shopping experience and introduce the Company to a new customer base, it also exposes us to numerous risks. We are subject to potential failures in the efficient and uninterrupted operation of our website, customer contact center or our distribution center, including system failures caused by telecommunication system providers, order volumes that exceed our present system capabilities, electrical outages, mechanical problems and human error. Our e-commerce platform may also expose us to greater potential for security or data breaches involving the unauthorized disclosure of customer information, as discussed above under "A security breach that results in unauthorized disclosure of Company, employee or customer information could adversely affect our costs, reputation and results of operations." We are also subject to risk related to delays or failures in the performance of third parties, such as shipping companies, including delays associated with labor strikes or slowdowns or adverse weather conditions. If the Company does not successfully meet the challenges of operating an e-commerce website or fulfilling customer expectations, the Company's business and sales could be adversely affected.

Failure to attract, train, and retain skilled personnel could adversely affect our business and our financial condition.

Like most retailers, we experience significant associate turnover rates, particularly among store sales associates and managers. Because our continued store growth will require the hiring and training of new associates, we must continually attract, hire and train new store associates to meet our staffing needs. A significant increase in the turnover rate among our store sales associates and managers would increase our recruiting and training costs, as well as

possibly cause a decrease in our store operating efficiency and productivity. We compete for qualified store associates, as well as experienced management personnel, with other companies in our industry or other industries, many of whom have greater financial resources than we do.

In addition, we depend on key management personnel to oversee the operational divisions of the Company for the support of our existing business and future expansion. The success of executing our business strategy depends in large part on retaining key management. We compete for key management personnel with other retailers, and our inability to attract and retain qualified personnel could limit our ability to continue to grow.

If we are unable to retain our key management and store associates or attract, train, or retain other skilled personnel in the future, we may not be able to service our customers effectively or execute our business strategy, which could adversely affect our business, operating results and financial condition.

Our business operations subject us to legal compliance and litigation risks that could result in increased costs or liabilities, divert our management's attention or otherwise adversely affect our business, results of operations and financial condition.

Our operations are subject to federal, state and local laws, rules and regulations, as well as U.S. and foreign laws and regulations relating to our activities in foreign countries from which we source our merchandise and operate our sourcing offices. Our business is also subject to regulatory and litigation risk in all of these jurisdictions, including foreign jurisdictions that may lack well-established or reliable legal systems for resolving legal disputes. Compliance risks and litigation claims have or may arise in the ordinary course of our business and include, among other issues, employment issues, commercial disputes, intellectual property issues, product-oriented matters, tax, customer relations and personal injury claims. International activities subject us to numerous U.S. and international regulations, including but not limited to, restrictions on trade, license and permit requirements, import and export license requirements, privacy and data protection laws, environmental laws, records and information management regulations, tariffs and taxes and anti-corruption laws, such as the Foreign Corrupt Practices Act, violations of which by employees or persons acting on the Company's behalf may result in significant investigation costs and severe criminal or civil sanctions. These and other liabilities to which we may be subject could negatively affect our business, operating results and financial condition. These matters frequently raise complex factual and legal issues, which are subject to risks and uncertainties and could divert significant management time. In addition, governing laws, rules and regulations, and interpretations of existing laws are subject to change from time to time. Compliance and litigation matters could result in unexpected expenses and liability, as well as have an adverse effect on our operations and our reputation.

If we fail to protect our trademarks and other intellectual property rights or infringe the intellectual property rights of others, our business, brand image, growth strategy, results of operations and financial condition could be adversely affected.

We believe that our "Cato", "It's Fashion", "It's Fashion Metro" and "Versona" trademarks are integral to our store designs, brand recognition and our ability to successfully build consumer loyalty. Although we have registered these trademarks with the U.S. Patent and Trademark Office ("PTO") and have also registered, or applied for registration of, additional trademarks with the PTO that we believe are important to our business, we cannot assure that these registrations will prevent imitation of our trademarks, merchandising concepts, store designs or private label merchandise or the infringement of our other intellectual property rights by others. Infringement of our names, concepts, store designs or merchandise generally, or particularly in a manner that projects lesser quality or carries a negative connotation of our image could adversely affect our business, financial condition and results of operations.

In addition, we cannot assure that others will not try to block the manufacture or sale of our private label merchandise by claiming that our merchandise violates their trademarks or other proprietary rights. In the event of such a conflict, we could be subject to lawsuits or other actions, the ultimate resolution of which we cannot predict;

however, such a controversy could adversely affect our business, financial condition and results of operations.

We may experience market conditions that could adversely impact the valuation and liquidity of, and our ability to access, our short-term investments and cash and cash equivalents.

Our short-term investments and cash equivalents are primarily comprised of investments in federal, state, municipal and corporate debt securities. The value of those securities may be impacted by factors beyond our control, such as changes to credit ratings, rates of default, collateral value, discount rates, and strength and quality of market credit and liquidity. As federal, state and municipal entities struggle with declining tax revenues and budget deficits, we cannot be assured of our ability to timely access these investments if the market for these issues declines. Similarly, the default by issuers could adversely affect our financial condition, results of operations and ability to execute our business strategy. In addition, we have significant amounts of cash and cash equivalents at financial institutions that are in excess of the federally insured limits. An economic downturn or development of adverse conditions affecting the financial sector and stability of financial institutions could cause us to experience losses on our deposits.

Maintaining and improving our internal control over financial reporting and other requirements necessary to operate as a public company may strain our resources, and any material failure in these controls may negatively impact our business, the price of our common stock and market confidence in our reported financial information.

As a public company, we are subject to the reporting requirements of the Securities Exchange Act of 1934, the Sarbanes-Oxley Act of 2002, the rules of the SEC and New York Stock Exchange and certain aspects of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) and related rule-making that has been and will continue to be implemented over the next several years under the mandates of the Dodd-Frank Act. The requirements of these rules and regulations have, and may continue to, increase our compliance costs and place significant strain on our personnel, systems and resources. To satisfy the SEC’s rules implementing the requirements of Section 404 of the Sarbanes-Oxley Act of 2002, we must continue to document, test, monitor and enhance our internal control over financial reporting, which is a costly and time-consuming effort that must be re-evaluated frequently. We cannot give assurance that our disclosure controls and procedures and our internal control over financial reporting, as defined by applicable SEC rules, will be adequate in the future. Any failure to maintain the effectiveness of internal control over financial reporting or to comply with the other various laws and regulations to which we are and will continue to be subject, or to which we may become subject in the future, as a public company could have an adverse material impact on our business, our financial condition and the price of our common stock. In addition, our efforts to comply with these requirements, particularly with new requirements under the Dodd-Frank Act that have yet to be implemented, could significantly increase our compliance costs.

Changes to accounting rules and regulations may adversely affect our reported results of operations and financial condition.

In an effort to provide greater comparability of financial reporting in an increasing global environment, accounting regulatory authorities are entering into collaborative efforts to converge U.S. Generally Accepted Accounting Principles with International Financial Reporting Standards. These changes in accounting rules or regulations may significantly impact our future reported results of operations and financial position. Changes in accounting rules or regulations and varying interpretations of existing accounting rules and regulations have significantly affected our reported financial statements and those of other participants in the retail industry in the past and may continue to do so in the future.

Proposed changes to lease accounting standards may require lessees to capitalize operating leases in their financial statements in the future. If adopted, this change will have a major impact on the Company as a retailer with numerous leased locations. Such a change would require Cato to record a significant amount of lease-related assets and liabilities on our balance sheet and make other changes to the recording and classification of lease-related expenses on our statements of income and cash flows. This change could lead to the perception by investors that we are highly

leveraged and would change the calculation of numerous financial metrics and measures of our performance and financial condition. This and other future changes to accounting rules or regulations may adversely affect our reported results of operations and financial position.

Government enacted health care reform could adversely affect our business and results of operations.

In March 2010, United States government enacted healthcare reform legislation, known as the Patient Protection and Affordable Care Act. This legislation and related guidance expands the Company's responsibility for providing employees with insurance coverage that meets minimum eligibility and coverage requirements or face, alternatively, beginning in 2015, penalties for failure to offer this coverage. The legislation also includes provisions that will impact the number of individuals with insurance coverage, the types of coverage and level of health benefits that will be required and the amount of payment providers performing health care services will receive. The full effect of this legislation is expected to continue to be phased in over several years, and could increase healthcare expenses for the Company and have an adverse effect on the Company's results of operations. The Company is still assessing its potential impact on healthcare expenses. However, to the extent we are required to provide health insurance benefits to our employees that are more extensive than the health insurance benefits we currently provide and to a potentially larger proportion of our employees, or pay penalties if we elect not to provide these benefits, our expenses will increase. If we are unable to offset these cost increases by raising our prices or cutting other costs, such increased expenses could materially and adversely affect our results of operations.

Risks Relating To The Market Value Of Our Common Stock:

Our operating results are subject to seasonal and quarterly fluctuations, which could adversely affect the market price of our common stock.

Our business varies with general seasonal trends that are characteristic of the retail apparel industry. As a result, our stores typically generate a higher percentage of our annual net sales and profitability in the first and second quarters of our fiscal year compared to other quarters. Accordingly, our operating results for any one fiscal period are not necessarily indicative of results to be expected from any future period, and such seasonal and quarterly fluctuations could adversely affect the market price of our common stock.

The interests of a principal shareholder may limit the ability of other shareholders to influence the direction of the Company.

As of March 24, 2015, John P. D. Cato, Chairman, President and Chief Executive Officer, beneficially controlled approximately 41% of the voting power of our common stock. As a result, Mr. Cato may be able to control or significantly influence substantially all matters requiring approval by the shareholders, including the election of directors and the approval of mergers and other business combinations or other significant Company transactions. Mr. Cato may have interests that differ from those of other shareholders, and may vote in a way with which other shareholders disagree or perceive as adverse to their interests. In addition, the concentration of voting power held by Mr. Cato could have the effect of preventing, discouraging or deferring a change in control of the Company, which could depress the market price of our common stock.

Conditions in the stock market generally, or particularly relating to our Company or common stock, may materially and adversely affect the market price of our common stock and make its trading price more volatile.

The trading price of our common stock at times has been, and is likely to continue to be, subject to significant volatility. A variety of factors may cause the price of the common stock to fluctuate, perhaps substantially, including, but not limited to, those discussed elsewhere in this report, as well as the following: low trading volume; general market fluctuations resulting from factors not directly related to our operations or the inherent value of our common stock; announcements of developments related to our business; fluctuations in our reported operating results; general conditions in the fashion and retail industry; conditions affecting or perceived to affect the domestic or global

economy or the domestic or global credit or capital markets; changes in financial estimates or the scope of coverage given to our Company by securities analysts; negative commentary regarding our Company and corresponding short-selling market behavior; adverse customer relations developments; significant changes in our senior management team; and legal proceedings. Over the past several years the stock market in general, and the market for shares of equity securities of many retailers in particular, have experienced extreme price fluctuations that have at times been unrelated to the operating performance of those companies. Such fluctuations and market volatility based on these or other factors may materially and adversely affect the market price of our common stock.

Item 1B. *Unresolved Staff Comments:*

None.

Item 2. *Properties:*

The Company's distribution center and general offices are located in a Company-owned building of approximately 552,000 square feet located on a 15-acre tract in Charlotte, North Carolina. The Company's automated merchandise handling and distribution activities occupy approximately 418,000 square feet of this building and its general offices and corporate training center are located in the remaining 134,000 square feet. A building of approximately 24,000 square feet located on a 2-acre tract adjacent to the Company's existing location is used for receiving and distribution of store and office operating supplies. The Company also owns approximately 326 acres in York County, South Carolina, just south of Charlotte.

Item 3. *Legal Proceedings:*

From time to time, claims are asserted against the Company arising out of operations in the ordinary course of business. The Company currently is not a party to any pending litigation that it believes is likely to have a material adverse effect on the Company's financial position, results of operations or cash flows.

Item 3A. Executive Officers of the Registrant:

The executive officers of the Company and their ages as of March 27, 2015 are as follows:

| <u>Name</u> | <u>Age</u> | <u>Position</u> |
|-----------------------|------------|---|
| John P. D. Cato..... | 64 | Chairman, President and Chief Executive Officer |
| John R. Howe..... | 52 | Executive Vice President, Chief Financial Officer |
| Sally Almason..... | 61 | Executive Vice President, Merchandising Cato and Versona concepts |
| Michael T. Greer..... | 52 | Executive Vice President, Director of Stores |
| Gordon Smith..... | 59 | Executive Vice President, Chief Real Estate and Store Development Officer |

John P. D. Cato has been employed as an officer of the Company since 1981 and has been a director of the Company since 1986. Since January 2004, he has served as Chairman, President and Chief Executive Officer. From May 1999 to January 2004, he served as President, Vice Chairman of the Board and Chief Executive Officer. From June 1997 to May 1999, he served as President, Vice Chairman of the Board and Chief Operating Officer. From August 1996 to June 1997, he served as Vice Chairman of the Board and Chief Operating Officer. From 1989 to 1996, he managed the Company's off-price concept, serving as Executive Vice President and as President and General Manager of the It's Fashion concept from 1993 to August 1996. Mr. Cato is a former director of Harris Teeter Supermarkets, Inc., formerly Ruddick Corporation.

John R. Howe has been employed by the Company since 1986. Since September 2008, he has served as Executive Vice President, Chief Financial Officer. From June 2007 until September 2008, he served as Senior Vice President, Controller. From 1999 to 2007, he served as Vice President, Assistant Controller. From 1997 to 1999, he served as Assistant Vice President, Budgets and Planning. From 1995 to 1997, he served as Director, Budgets and Planning. From 1990 to 1995, he served as Assistant Tax Manager. From 1986 to 1990, Mr. Howe held various positions within the finance area.

Sally Almason has been employed by the Company since 1995. Since November 2010, she has served as Executive Vice President, Merchandising Cato and Versona concepts. From 2009 to 2010, she has served as Executive Vice President, General Merchandise Manager for the Cato concept. From 2004 to 2009, she served as Senior Vice President, General Merchandise Manager for the Cato concept. From 1995 to 2004, she served as Vice President, Divisional Merchandise Manager for the Cato concept.

Michael T. Greer has been employed by the Company since 1985. Since May 2006, he has served as Executive Vice President, Director of Stores of the Company. From November 2004 until May 2006, he served as Senior Vice President, Director of Stores of the Company. From February 2004 until November 2004, he served as Senior Vice President, Director of Stores of the Cato concept. From 2002 to 2003 Mr. Greer served as Vice President, Director of Stores of the It's Fashion concept. From 1999 to 2001 he served as Territorial Vice President of Stores of the Cato concept and from 1996 to 1999 he served as Regional Vice President of Stores of the Cato concept. From 1985 to 1995, Mr. Greer held various store operational positions in the Cato concept.

Gordon Smith has been employed by the Company since 1989. Since July 2011, he has served as Executive Vice President, Chief Real Estate and Store Development Officer. From February 2008 until July 2011 Mr. Smith served as Senior Vice President, Real Estate. From October 1989 to February 2008, Mr. Smith served as Assistant Vice President, Corporate Real Estate.

Item 4. *Mine Safety Disclosures:*

No matters requiring disclosure.

PART II**Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities:****Market & Dividend Information**

The Company's Class A Common Stock trades on the New York Stock Exchange ("NYSE") under the symbol CATO. Below is the market range and dividend information for the four quarters of fiscal 2014 and 2013.

| | Price | | | |
|----------------------|----------------|------------|--|-----------------|
| <u>2014</u> | High | Low | | Dividend |
| First quarter | \$ 30.45 | \$ 25.77 | | \$ 0.30 |
| Second quarter | 32.71 | 27.70 | | 0.30 |
| Third quarter | 36.15 | 31.30 | | 0.30 |
| Fourth quarter | 44.26 | 34.84 | | 0.30 |
| | Price | | | |
| <u>2013</u> | High | Low | | Dividend |
| First quarter | \$ 27.66 | \$ 22.43 | | \$ 0.05 |
| Second quarter | 28.72 | 23.66 | | 0.05 |
| Third quarter | 30.75 | 25.16 | | 0.05 |
| Fourth quarter | 34.28 | 27.96 | | 0.05 |

As of March 27, 2015 the approximate number of record holders of the Company's Class A Common Stock was 5,000 and there were 2 record holders of the Company's Class B Common Stock.

Stock Performance Graph

The following graph compares the yearly change in the Company's cumulative total shareholder return on the Company's Common Stock (which includes Class A Stock and Class B Stock) for each of the Company's last five fiscal years with (i), the Dow Jones U.S. Retailers, Apparel Index and (ii) the Russell 2000 Index.

THE CATO CORPORATION

STOCK PERFORMANCE TABLE

(BASE 100 – IN DOLLARS)

LAST TRADING DAY OF
THE FISCAL YEAR

THE CATO
CORPORATION

DOW JONES U.S.
RETAILERS, APPL INDEX

RUSSELL 2000

| | | | INDEX |
|-----------|-----|-----|-------|
| 1/29/2010 | 100 | 100 | 100 |
| 1/28/2011 | 123 | 124 | 131 |
| 1/27/2012 | 140 | 148 | 135 |
| 2/1/2013 | 160 | 185 | 156 |
| 1/31/2014 | 164 | 210 | 198 |
| 1/30/2015 | 257 | 255 | 207 |

The graph assumes an initial investment of \$100 on January 29, 2010, the last trading day prior to the commencement of the Company's 2010 fiscal year, and that all dividends were reinvested.

Issuer Purchases of Equity Securities

The following table summarizes the Company's purchases of its common stock for the three months ended January 31, 2015:

| Period | Total Number of Shares Purchased | Average Price Paid per Share (1) | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2) | Maximum Number (or Approximate Dollar Value) of Shares that may yet be Purchased Under the Plans or Programs (2) |
|---------------|---|---|---|---|
| November 2014 | - \$ | - | - | |
| December 2014 | - | - | - | |
| January 2015 | - | - | - | |
| Total | - \$ | - | - | 2,195,113 |

(1) Prices include trading costs.

(2) On May 20, 2014, the Board of Directors increased, by 2 million shares, the authorization to purchase shares. During the fourth quarter ended January 31, 2015, the Company did not repurchase shares under this program. As of the fourth quarter ended January 31, 2015, the Company had 2,195,113 shares remaining in open authorizations. There is no specified expiration date for the Company's repurchase program.

Item 6. Selected Financial Data:

Certain selected financial data for the five fiscal years ended January 31, 2015 have been derived from the Company's audited financial statements. The financial statements and Independent Registered Public Accounting Firm's integrated audit 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.

| <u>Fiscal Year (1)</u> | 2014 | 2013 | 2012 | 2011 | 2010 |
|---|--|-------------|-------------|-------------|-------------|
| | (Dollars in thousands, except per share data and selected operating data) | | | | |
| STATEMENT OF OPERATIONS DATA: | | | | | |
| Retail sales | \$977,867 | \$910,500 | \$933,782 | \$920,622 | \$913,079 |
| Other income | 9,047 | 9,533 | 10,266 | 10,836 | 11,606 |
| Total revenues | 986,914 | 920,033 | 944,048 | 931,458 | 924,685 |
| Cost of goods sold (exclusive of depreciation shown below) | 600,569 | 571,246 | 581,961 | 574,176 | 563,262 |
| Selling, general and administrative (exclusive of depreciation shown below) | 276,234 | 245,868 | 244,327 | 238,982 | 250,763 |
| Selling, general and administrative percent of retail sales | 28.3% | 27.0% | 26.2% | 26.0% | 27.5% |
| Depreciation | 22,026 | 21,825 | 22,455 | 21,825 | 21,822 |
| Interest expense | 57 | 75 | 116 | 21 | 37 |
| Interest and other income | 3,445 | 3,267 | 3,782 | 3,817 | 3,971 |
| Income before income taxes | 91,473 | 84,286 | 98,971 | 100,271 | 92,772 |
| Income tax expense | 30,971 | 29,964 | 37,303 | 35,437 | 33,921 |
| Net income | \$60,502 | \$54,322 | \$61,668 | \$64,834 | \$58,851 |
| Basic earnings per share | \$2.15 | \$1.86 | \$2.11 | \$2.21 | \$2.00 |
| Diluted earnings per share | \$2.15 | \$1.86 | \$2.11 | \$2.21 | \$2.00 |
| Cash dividends paid per share | \$1.200 | \$0.200 | \$2.980 | \$0.875 | \$0.720 |
| SELECTED OPERATING DATA: | | | | | |
| Stores open at end of year | 1,346 | 1,320 | 1,310 | 1,288 | 1,282 |
| Average sales per store (2) | \$730,000 | \$692,000 | \$722,000 | \$716,000 | \$716,000 |
| Average sales per square foot of selling space | \$162 | \$154 | \$161 | \$162 | \$168 |
| BALANCE SHEET DATA (at period end): | | | | | |

| | | | | | |
|---------------------------------------|------------------|-----------|-----------|-----------|-----------|
| Cash, cash equivalents, short-term | | | | | |
| investments and restricted cash | \$260,610 | \$245,256 | \$194,646 | \$245,989 | \$234,851 |
| Working capital | 260,550 | 269,617 | 230,612 | 272,139 | 251,523 |
| Total assets | 608,278 | 596,918 | 532,646 | 551,089 | 532,759 |
| Total stockholders' equity | 380,198 | 391,109 | 345,234 | 366,679 | 334,014 |

(1) The fiscal year 2012 contained 53 weeks versus 52 weeks for all other years shown.

(2) 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.

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:

| <u>Fiscal Year Ended</u> | January 31, 2015 | February 1, 2014 | February 2, 2013 |
|---|-----------------------------|-----------------------------|-----------------------------|
| Retail sales | 100.0 % | 100.0 % | 100.0 % |
| Other revenue | 0.9 | 1.0 | 1.1 |
| Total revenues | 100.9 | 101.0 | 101.1 |
| Cost of goods sold | 61.4 | 62.7 | 62.3 |
| Selling, general and administrative | 28.3 | 27.0 | 26.2 |
| Depreciation | 2.3 | 2.4 | 2.4 |
| Interest and other income | 0.4 | 0.4 | 0.4 |
| Income before income taxes | 9.4 | 9.3 | 10.6 |
| Net income | 6.2 % | 6.0 % | 6.6 % |

Fiscal 2014 Compared to Fiscal 2013

Retail sales increased by 7.4% to \$977.9 million in fiscal 2014 compared to \$910.5 million in fiscal 2013. The increase in retail sales in fiscal 2014 was largely attributable to a same-store sales increase of 4% from fiscal 2013 and non-comparable store sales including e-commerce. Same-store sales includes stores that have been open more than 15 months. Stores that have been relocated or expanded are also included in the same-store sales calculation after they have been open more than 15 months. E-commerce sales were less than 1% of sales in fiscal 2014 and fiscal 2013 and are not yet included in the same-store sales calculation. The method of calculating same-store sales varies across the retail industry. As a result, our same-store sales calculation may not be comparable to similarly titled measures reported by other companies. Total revenues, comprised of retail sales and other revenue (principally finance charges and late fees on customer accounts receivable and layaway fees), increased by 7.3% to \$986.9 million in fiscal 2014 compared to \$920.0 million in fiscal 2013. The Company operated 1,346 stores at January 31, 2015 compared to 1,320 stores operated at February 1, 2014.

In fiscal 2014, the Company opened 33 new stores, relocated four stores and closed seven stores.

Other revenue in total decreased to \$9.0 million from \$9.5 million in fiscal 2013. The decrease resulted primarily from lower credit revenue and finance charges offset by higher layaway charges.

Credit revenue of \$5.8 million represented 0.6% of total revenue in fiscal 2014, a decrease compared to fiscal 2013 credit revenue of \$6.2 million or 0.7% of total revenue. The slight decrease in credit revenue was primarily due

to reductions in finance and late 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 \$3.4 million in fiscal 2014 compared to \$3.6 million in fiscal 2013. The decrease in these expenses was principally due to a reduction in bad debt expense of \$0.1 million. See Note 14 of Notes to Consolidated Financial Statements for a schedule of credit-related expenses. Total credit segment income before taxes decreased \$0.3 million from \$2.6 million in fiscal 2013 to \$2.3 million in fiscal 2014 due to lower credit revenue. Total credit income of \$2.3 million in fiscal 2014 represented 2.5% of total income before taxes of \$91.5 million compared to total credit income of \$2.6 million in fiscal 2013, which represented 3.1% of fiscal 2013 total income before taxes of \$84.3 million.

Cost of goods sold was \$600.6 million, or 61.4% of retail sales, in fiscal 2014 compared to \$571.2 million, or 62.7% of retail sales, in fiscal 2013. The decrease in cost of goods sold as a percentage of sales resulted primarily from leveraging of merchandise and distribution costs due to higher sales of regular priced goods. 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 and excluding depreciation) increased by 11.2% to \$377.3 million in fiscal 2014 from \$339.3 million in fiscal 2013. 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 \$276.3 million in fiscal 2014 compared to \$245.9 million in fiscal 2013, an increase of 12.4%. As a percent of retail sales, SG&A was 28.3% compared to 27.0% in the prior year. The increase in SG&A as a percent of sales resulted primarily from an increase in incentive compensation, partially offset by lower closed store and impairment costs.

Depreciation expense was \$22.0 million in fiscal 2014 compared to \$21.8 million in fiscal 2013. Depreciation expense increased slightly from fiscal 2013 due to increases in store development, information technology investments and home office renovations, partially offset by older stores and IT projects being fully depreciated.

Interest and other income increased to \$3.4 million in fiscal 2014 compared to \$3.3 million in fiscal 2013. Miscellaneous income and interest income were greater compared to fiscal 2013. See Note 2 of Notes to Consolidated Financial Statements for further details.

Income tax expense was \$31.0 million, or 3.2% of retail sales in fiscal 2014 compared to \$30.0 million, or 3.3% of retail sales in fiscal 2013. The dollar increase resulted from higher pre-tax income, partially offset by a lower effective tax rate. The effective tax rate was 33.9% in fiscal 2014 compared to 35.6% in fiscal 2013.

Fiscal 2013 Compared to Fiscal 2012

Retail sales decreased by 2.5% to \$910.5 million in fiscal 2013 compared to \$933.8 million in fiscal 2012. The fiscal year ended February 1, 2014 contained 52 weeks versus 53 weeks in fiscal year ended February 2, 2013. The decrease in retail sales in fiscal 2013 was largely attributable to one fewer week of sales and a same-store sales decrease of 3% from fiscal 2012, partially offset by sales from new stores. Same-store sales includes stores that have been open more than 15 months. Stores that have been relocated or expanded are also included in the same-store sales calculation after they have been open more than 15 months. E-commerce sales were less than 1% of sales in fiscal 2013 and are not included in the same-store sales calculation. There were no e-commerce sales in fiscal 2012. The method of calculating same-store sales varies across the retail industry. As a result, our same-store sales calculation may not be comparable to similarly titled measures reported by other companies. Total revenues, comprised of retail sales and other revenue (principally finance charges and late fees on customer accounts receivable and layaway fees), decreased by 2.5% to \$920.0 million in fiscal 2013 compared to \$944.0 million in fiscal 2012. The Company operated 1,320 stores at February 1, 2014 compared to 1,310 stores operated at February 2, 2013.

In fiscal 2013, the Company opened 32 new stores, relocated five stores and closed 22 stores. The Company also launched its online shopping website, which is operated in-house.

Other revenue in total decreased to \$9.5 million in fiscal 2013 from \$10.3 million in fiscal 2012. The decrease resulted primarily from lower credit revenue and finance charges and layaway charges.

Credit revenue of \$6.2 million represented 0.7% of total revenue in fiscal 2013, a decrease compared to fiscal 2012 credit revenue of \$6.9 million or 0.7% of total revenue. The slight decrease in credit revenue was primarily due to reductions in finance and late 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 \$3.6 million in fiscal 2013 compared to \$3.9 million in fiscal 2012. The decrease in these expenses was principally due to a reduction in bad debt expense of \$0.3 million. See Note 14 of Notes to Consolidated Financial Statements for a schedule of credit-related expenses. Total credit segment income before taxes decreased \$ 0.4 million from \$ 3.0 million in fiscal 2012 to \$ 2.6 million in fiscal 2013 due to lower credit revenue. Total credit income of \$2.6 million in fiscal 2013 represented 3.1% of total income before taxes of \$84.3 million compared to total credit income of \$3.0 million in fiscal 2012, which represented 3.0% of fiscal 2012 total income before taxes.

Cost of goods sold was \$571.2 million, or 62.7% of retail sales, in fiscal 2013 compared to \$582.0 million, or 62.3% of retail sales, in fiscal 2012. The increase in cost of goods sold as a percent of retail sales resulted primarily from higher occupancy costs. 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 and excluding depreciation) decreased by 3.6% to \$339.3 million in fiscal 2013 from \$351.8 million in fiscal 2012. 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 \$245.9 million in fiscal 2013 compared to \$244.3 million in fiscal 2012, an increase of 0.6%. As a percent of retail sales, SG&A was 27.0% compared to 26.2% in the prior year. The overall dollar increase in SG&A resulted primarily from an increase in store impairment charges and incentive compensation, partially offset by a decrease in payroll costs and advertising costs.

Depreciation expense was \$21.8 million in fiscal 2013 compared to \$22.5 million in fiscal 2012. Depreciation expense decreased from fiscal 2012 due to older stores and IT projects being fully depreciated, partially offset by investments in store development, information technology investments, and the home office expansion.

Interest and other income decreased to \$3.3 million in fiscal 2013 compared to \$3.8 million in fiscal 2012 due to lower interest income driven by lower interest rates. Miscellaneous income and interest income were lower compared to fiscal 2012. See Note 2 of Notes to Consolidated Financial Statements for further details.

Income tax expense was \$30.0 million, or 3.3% of retail sales in fiscal 2013 compared to \$37.3 million, or 4.0% of retail sales in fiscal 2012. The decrease resulted from a lower effective tax rate combined with lower pre-tax income. The effective tax rate was 35.6% in fiscal 2013 compared to 37.7% in fiscal 2012, due to a correction of an out of period adjustment in fiscal 2012.

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.

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 in the United States ("GAAP") requires management to make estimates and assumptions about future events that affect the amounts reported in the financial statements and accompanying notes. Future events and their effects cannot be determined with absolute certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results inevitably will differ from those estimates, and such differences may be material to the financial statements. The most significant accounting estimates inherent in the preparation of the Company's financial statements include the allowance for doubtful accounts, inventory shrinkage, the calculation of potential asset impairment, workers' compensation, general and auto insurance liabilities, reserves relating to self-insured health insurance, and 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 collectability of accounts receivable and records an allowance for doubtful accounts based on the accounts receivable aging and estimates of actual write-offs. 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 weighted-average cost method and is stated at the lower of cost or market. 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 physical inventory and the financial reporting date. The Company regularly reviews its inventory levels to identify slow moving merchandise and uses markdowns to clear slow moving inventory.

Lease Accounting

The Company recognizes rent expense on a straight-line basis over the lease term as defined in ASC 840 - *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 for the amount by which carrying value exceeds fair value, if necessary, when the Company decides to close the store or otherwise determines that future estimated 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 health care, 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 judgments regarding the application of complex tax regulations across many jurisdictions. Despite the Company's belief that the estimates and judgments are reasonable, differences between the estimated and actual tax liabilities can and do exist from time to time. 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 judgment, revenue recognition represents an important accounting policy of the Company. As discussed in Note 1 to the Consolidated Financial Statements, the Company recognizes sales from stores at the point of purchase when the customer takes possession of the merchandise and pays for the purchase, generally with cash or credit. E-commerce sales are recorded when the risk of loss is transferred to the customer. 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 are recorded as deferred revenue within accrued expenses until they are redeemed or forfeited. Layaway sales are recorded as deferred revenue within accrued expenses until the customer takes possession or forfeits the merchandise. Gift cards 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.

The Company recognizes 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 is analyzed and recognized on a quarterly basis and is not expected to be material.

Finance 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 2014 was \$117.5 million as compared to \$93.0 million in fiscal 2013. These amounts have enabled the Company to fund its regular operating needs, capital expenditure program, cash dividend payments and selective repurchases of the Company's common stock.

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 \$24.5 million for fiscal 2014 over fiscal 2013 is primarily due to a larger decrease in inventory from the end of the fiscal year and an increase in net income and accrued expenses, partially offset by an increase in accounts receivable and prepaid and other assets.

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 and other operating requirements for fiscal 2015 and for the foreseeable future.

At January 31, 2015, the Company had working capital of \$260.6 million compared to \$269.6 million and \$230.6 million at February 1, 2014 and February 2, 2013, respectively. Additionally, the Company had \$0.9 million, \$1.0 million, and \$1.0 million invested in privately managed investment funds and other miscellaneous equities for fiscal years 2014, 2013 and 2012, respectively, which are reported under Other assets in the Consolidated Balance Sheets.

At January 31, 2015, the Company had an unsecured revolving credit agreement, which provided for borrowings of up to \$35.0 million less the balance of revocable letters of credit discussed below. The revolving credit agreement is committed until August 2015. 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 January 31, 2015. There were no borrowings outstanding under this credit facility during the fiscal year ended January 31, 2015 or the fiscal year ended February 1, 2014.

The Company had no outstanding revocable letters of credit relating to purchase commitments at January 31, 2015. The Company had approximately \$0.4 million and \$2.9 million of revocable letters of credit at February 1, 2014 and February 2, 2013, respectively.

Expenditures for property and equipment totaled \$28.9 million, \$31.5 million and \$45.2 million in fiscal 2014, 2013 and 2012, respectively. The expenditures for fiscal 2014 were primarily for store development, investments in new technology and general office expansion. In fiscal 2015, the Company is planning to invest approximately \$38.1 million in capital expenditures. In addition, the Company has planned for additional investments in technology and the renovation of the current office space.

Net cash used in investing activities totaled \$27.7 million for fiscal 2014 compared to net cash used in investing activities of \$32.9 million for fiscal 2013 and net cash provided by investing activities of \$3.2 million for fiscal 2012. The decrease in cash used was due primarily to lower expenditures for property and equipment and purchases of short-term investments, partially offset by sales of short-term investments and other assets.

On February 26, 2015, the Board of Directors maintained the quarterly dividend at \$0.30 per share, which was paid on March 25, 2015.

The Company does not use derivative financial instruments.

See Note 4, "Fair Value Measurements," for information regarding the Company's financial assets that are measured at fair value.

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 January 31, 2015. The state, municipal and corporate bonds have contractual maturities which range from 15 days to 6.5 years. The U.S. Treasury Notes and Certificates of Deposit have contractual maturities which range from 43 days to 2.1 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 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 January 31, 2015, the Company had \$0.3 million of privately managed funds and \$0.6 million of corporate equities. During the fourth quarter of 2014, the Company had its Auction Rate Security ("ARS") redeemed at par. All of these assets are recorded within Other assets in the Consolidated Balance Sheets. At February 1, 2014, the Company had \$0.4 million of privately managed funds, \$0.6 million of corporate equities, and a single ARS of \$3.1 million, all of which are recorded within Other assets in the 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.

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

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.

The following table shows the Company's obligations and commitments as of January 31, 2015, to make future payments under noncancellable contractual obligations (in thousands):

Payments Due During One Year Fiscal Period Ending

| <u>Contractual Obligations</u> (1) | Total | 2015 | 2016 | 2017 | 2018 | 2019 | Thereafter |
|---|-------------------|------------------|------------------|------------------|------------------|------------------|-------------------|
| Merchandise letters of credit | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Operating leases | 203,776 | 65,330 | 50,109 | 34,775 | 22,525 | 12,425 | 18,612 |
| Land Commitments | 5,000 | 5,000 | - | - | - | - | - |
| Total Contractual Obligations | \$ 208,776 | \$ 70,330 | \$ 50,109 | \$ 34,775 | \$ 22,525 | \$ 12,425 | \$ 18,612 |

(1) In addition to the amounts shown in the table above, \$9.4 million of unrecognized tax benefits have been recorded as liabilities in accordance with ASC 740 and we are uncertain if or when such amounts may be settled. See Note 12, Income Taxes, of the Consolidated Financial Statements for additional information.

Recent Accounting Pronouncements

See Note 1, Summary of Significant Accounting Policies, Recent Accounting Pronouncements.

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 activities, but the Company does not believe such exposure is material.

Item 8. *Financial Statements and Supplementary Data:*

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Report of Independent Registered Public Accounting Firm

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

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income and comprehensive income, stockholders' equity and cash flows present fairly, in all material respects, the financial position of The Cato Corporation and its subsidiaries at January 31, 2015 and February 1, 2014, and the results of their operations and their cash flows for each of the three years in the period ended January 31, 2015 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 January 31, 2015, based on criteria established in *Internal Control - Integrated Framework (2013)* 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 appearing 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

PricewaterhouseCoopers LLP

Charlotte, North Carolina

March 27, 2015

THE CATO CORPORATION

**CONSOLIDATED STATEMENTS OF INCOME AND
COMPREHENSIVE INCOME**

| | Fiscal Year Ended | | |
|---|--|------------------|------------------|
| | January 31, 2015 | February 1, 2014 | February 2, 2013 |
| | (Dollars in thousands, except per share data) | | |
| REVENUES | | | |
| Retail sales | \$ 977,867 | \$ 910,500 | \$ 933,782 |
| Other income (principally finance charges, late fees and layaway charges) | 9,047 | 9,533 | 10,266 |
| Total revenues | 986,914 | 920,033 | 944,048 |
| COSTS AND EXPENSES, NET | | | |
| Cost of goods sold (exclusive of depreciation shown below) | 600,569 | 571,246 | 581,961 |
| Selling, general and administrative (exclusive of depreciation shown below) | 276,234 | 245,868 | 244,327 |
| Depreciation | 22,026 | 21,825 | 22,455 |
| Interest expense | 57 | 75 | 116 |
| Interest and other income | (3,445) | (3,267) | (3,782) |
| Cost and expenses, net | 895,441 | 835,747 | 845,077 |
| Income before income taxes | 91,473 | 84,286 | 98,971 |
| Income tax expense | 30,971 | 29,964 | 37,303 |
| Net income | \$ 60,502 | \$ 54,322 | \$ 61,668 |
| Basic earnings per share | \$ 2.15 | \$ 1.86 | \$ 2.11 |
| Diluted earnings per share | \$ 2.15 | \$ 1.86 | \$ 2.11 |
| Dividends per share | \$ 1.20 | \$ 0.20 | \$ 2.98 |
| Comprehensive income: | | | |
| Net income | \$ 60,502 | \$ 54,322 | \$ 61,668 |
| Unrealized gain (loss) on available-for-sale securities, net of deferred income taxes of \$5, (\$26), and (\$69) for fiscal 2014, 2013 and 2012, respectively | 8 | (43) | (115) |

| | | | | | | |
|----------------------|----|---------------|----|--------|----|--------|
| Comprehensive income | \$ | 60,510 | \$ | 54,279 | \$ | 61,553 |
|----------------------|----|---------------|----|--------|----|--------|

See notes to consolidated financial statements.

THE CATO CORPORATION

CONSOLIDATED BALANCE SHEETS

| | January 31, 2015 | February 1, 2014 |
|--|-------------------------------|------------------|
| | (Dollars in thousands) | |
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 93,946 | \$ 79,427 |
| Short-term investments | 162,185 | 161,128 |
| Restricted cash and investments | 4,479 | 4,701 |
| Accounts receivable, net of allowance for doubtful accounts of \$1,542 at January 31, 2015 and \$1,743 at February 1, 2014 | 41,023 | 39,224 |
| Merchandise inventories | 137,549 | 150,861 |
| Deferred income taxes | 4,291 | 4,720 |
| Prepaid expenses | 10,978 | 6,687 |
| Total Current Assets | 454,451 | 446,748 |
| Property and equipment – net | 135,181 | 141,129 |
| Noncurrent deferred income taxes | 3,363 | 1,373 |
| Other assets | 15,283 | 7,668 |
| Total Assets | \$ 608,278 | \$ 596,918 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Accounts payable | \$ 111,674 | \$ 111,514 |
| Accrued expenses | 48,404 | 45,763 |
| Accrued bonus and benefits | 19,567 | 4,999 |
| Accrued income taxes | 14,256 | 14,855 |
| Total Current Liabilities | 193,901 | 177,131 |
| Other noncurrent liabilities (primarily deferred rent) | 34,179 | 28,678 |
| 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; 26,174,684 and 27,498,216 shares issued at January 31, 2015 and February 1, 2014, respectively | 873 | 917 |
| Convertible Class B common stock, \$.033 par value per share, 15,000,000 shares authorized; 1,743,525 shares at January 31, 2015 and February 1, 2014 | 58 | 58 |
| Additional paid-in capital | 85,029 | 80,463 |
| Retained earnings | 293,452 | 308,893 |
| Accumulated other comprehensive income | 786 | 778 |
| Total Stockholders' Equity | 380,198 | 391,109 |
| Total Liabilities and Stockholders' Equity | \$ 608,278 | \$ 596,918 |

See notes to consolidated financial statements.

THE CATO CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

| | January 31, 2015 | Year Ended | February 2, 2013 |
|---|-------------------------|-------------------------------|-------------------------|
| | | February 1, 2014 | |
| | | (Dollars in thousands) | |
| Operating Activities: | | | |
| Net income | \$ 60,502 | \$ 54,322 | \$ 61,668 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation | 22,026 | 21,825 | 22,455 |
| Provision for doubtful accounts | 875 | 1,009 | 1,259 |
| Purchase premium and premium amortization of investments | (104) | (873) | - |
| Share based compensation | 3,582 | 3,007 | 2,796 |
| Excess tax benefits from share-based compensation | (243) | (88) | (509) |
| Deferred income taxes | (1,563) | (4,766) | (5,540) |
| Loss on disposal of property and equipment | 1,288 | 1,665 | 1,747 |
| Impairment of store assets | 2,249 | 2,646 | 2,011 |
| Changes in operating assets and liabilities which provided (used) cash: | | | |
| Accounts receivable | (2,674) | (217) | 1,749 |
| Merchandise inventories | 13,312 | (10,123) | (10,356) |
| Prepaid and other assets | (6,078) | 2,969 | (6,730) |
| Accrued income taxes | (356) | 651 | (343) |
| Accounts payable, accrued expenses and other liabilities | 24,643 | 20,932 | 9,103 |
| Net cash provided by operating activities | 117,459 | 92,959 | 79,310 |
| Investing Activities: | | | |
| Expenditures for property and equipment | (28,901) | (31,542) | (45,175) |
| Purchase of short-term investments | (49,820) | (65,455) | (108,662) |
| Sales of short-term investments | 48,850 | 62,766 | 156,642 |
| Purchase of Other Assets | (1,267) | - | - |
| Sales of Other Assets | 3,227 | - | 1,041 |
| Change in restricted cash and investments provided (used) | 222 | 1,298 | (674) |
| Net cash (used) in investing activities | (27,689) | (32,933) | 3,172 |
| Financing Activities: | | | |
| Dividends paid | (33,886) | (5,853) | (87,222) |
| Repurchase of common stock | (42,129) | (6,429) | (367) |

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| | | | | | |
|--|------------------|-----------|----------|-----------|----------|
| Proceeds from employee stock purchase plan | 510 | | 394 | | 723 |
| Excess tax benefits from share-based compensation | 243 | | 88 | | 509 |
| Proceeds from stock options exercised | 11 | | 132 | | 51 |
| Net cash provided (used) in financing activities | (75,251) | | (11,668) | | (86,306) |
| Net increase (decrease) in cash and cash equivalents | 14,519 | | 48,358 | | (3,824) |
| Cash and cash equivalents at beginning of period | 79,427 | | 31,069 | | 34,893 |
| Effect of exchange rate changes on cash | - | | - | | - |
| Cash and cash equivalents at end of period | \$ 93,946 | \$ | 79,427 | \$ | 31,069 |
| Non-cash investing activity | | | | | |
| Accrued plant and equipment | \$ 1,780 | \$ | 4,315 | \$ | 2,819 |

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 | Total Stockholders' Equity |
|---|----------------------------|---|----------------------------------|----------------------|---|----------------------------------|
| | (Dollars in thousands) | | | | | |
| Balance — January 28, 2012 | 914 \$ | 58 \$ | 72,030 \$ | 292,741 \$ | 936 | 366,679 |
| Comprehensive income: | | | | | | |
| Net income | - | - | - | 61,668 | - | 61,668 |
| Unrealized losses on available-for-sale securities, net of deferred income tax benefit of (\$69) | - | - | - | | (115) | (115) |
| Dividends paid (\$2.980 per share) | - | - | - | (87,222) | - | (87,222) |
| Class A common stock sold through employee stock purchase plan — 32,995 shares | 1 | - | 849 | - | - | 850 |
| Class A common stock sold through stock option plans — 5,750 shares | - | - | 562 | - | - | 562 |
| Class A common stock issued through restricted stock grant plans 98,743 shares | 3 | - | 2,644 | 23 | - | 2,670 |
| Windfall tax benefit from equity compensation plans | | - | 509 | - | - | 509 |
| Repurchase and retirement of treasury shares – 12,997 shares | - | - | - | (367) | - | (367) |
| Balance — February 2, 2013 | 918 \$ | 58 \$ | 76,594 \$ | 266,843 \$ | 821 | 345,234 |
| Comprehensive income: | | | | | | |
| Net income | - | - | - | 54,322 | - | 54,322 |
| Unrealized gains on available-for-sale securities, net of deferred income tax benefit of (\$26) | - | - | - | - | (43) | (43) |
| Dividends paid (\$.20 per share) | - | - | - | (5,853) | - | (5,853) |
| Class A common stock sold through employee stock purchase plan — 19,070 shares | 1 | - | 463 | - | - | 464 |

| | | | | | | |
|--|---------------|--------------|------------------|-------------------|---------------|----------------|
| Class A common stock sold through stock option plans — 9,050 shares | - | - | 145 | - | - | 145 |
| Class A common stock issued through restricted stock grant plans 198,017 shares | 7 | - | 2,915 | 1 | - | 2,923 |
| Windfall tax benefit from equity compensation plans | - | - | 346 | - | - | 346 |
| Repurchase and retirement of treasury shares – 271,296 shares | (9) | - | - | (6,420) | - | (6,429) |
| Balance — February 1, 2014 | 917 \$ | 58 \$ | 80,463 \$ | 308,893 \$ | 778 \$ | 391,109 |
| Comprehensive income: | | | | | | |
| Net income | - | - | - | 60,502 | - | 60,502 |
| Unrealized gains on available-for-sale securities, net of deferred income tax liability of \$5 | - | - | - | - | 8 | 8 |
| Dividends paid (\$1.20 per share) | - | - | - | (33,886) | - | (33,886) |
| Class A common stock sold through employee stock purchase plan — 20,941 shares | 1 | - | 600 | - | - | 601 |
| Class A common stock sold through stock option plans — 500 shares | - | - | 28 | - | - | 28 |
| Class A common stock issued through restricted stock grant plans 164,927 shares | 5 | - | 3,449 | 20 | - | 3,474 |
| Windfall tax benefit from equity compensation plans | - | - | 489 | - | - | 489 |
| Repurchase and retirement of treasury shares – 1,509,965 shares | (50) | - | - | (42,077) | - | (42,127) |
| Balance — January 31, 2015 | 873 \$ | 58 \$ | 85,029 \$ | 293,452 \$ | 786 \$ | 380,198 |

See notes to consolidated financial statements.

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

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 reportable segments — the operation of a fashion specialty stores segment (“Retail Segment”) and a credit card segment (“Credit Segment”). The apparel specialty stores operate under the names “Cato,” “Cato Fashions,” “Cato Plus,” “It’s Fashion,” “It’s Fashion Metro” and “Versona” and are located primarily in strip shopping centers principally in the southeastern United States. The Company’s fiscal year ends on the Saturday nearest January 31 of the subsequent year.

Correction of Prior Period Error: During the fourth quarter of 2013, the Company discovered that we had improperly netted our purchases and sales activity for our investments within cash flows related to investing activities in prior periods. In addition, we had also improperly classified the premiums and amortization of premiums on those investments in cash flows related to investing activities when they should have been in cash flows related to operating activities. The presentation of these amounts was corrected in the consolidated financial statements for the year ended February 1, 2014 and was immaterial to all prior periods presented.

In connection with the preparation of our Consolidated Financial Statements for the year ended February 2, 2013, the Company recorded the following out of period adjustments: (1) corrected its accounting for accrued landlord insurance by recording additional pre-tax expense of \$1.2 million in fiscal 2012 which originated prior to fiscal year 2008; (2) corrected fiscal year 2011 federal income tax expense by recording an additional \$1.1 million of income tax expense in fiscal 2012; and (3) corrected prior period state income tax expense of \$0.6 million in fiscal 2012, of which \$0.5 million originated in fiscal 2011 and \$0.1 million in fiscal 2010. The Company has assessed the materiality of these errors and concluded that the errors were not material to any of the current or previously issued financial statements.

Use of Estimates: The preparation of the Company’s financial statements in conformity with accounting principles generally accepted in the United States (“GAAP”) 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, inventory shrinkage, the calculation of potential asset impairment, workers' compensation, general and auto insurance liabilities, reserves relating to self-insured health insurance, and uncertain tax positions.

Cash and Cash Equivalents: Cash equivalents consist of highly liquid investments with original maturities of three months or less.

Short-Term Investments: Investments with original maturities beyond three months are classified as short-term investments. See Note 3 for the Company's estimated fair value of, and other information regarding, its short-term investments. The Company's short-term investments are all classified as available-for-sale. As they are available for current operations, they are classified on the 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 the 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 Consolidated Statements of Income and Comprehensive Income. The cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. The amortization of premiums, accretion of discounts and realized gains and losses are included in Interest and other income.

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Restricted Cash and Investments: The Company has \$4.5 million and \$4.7 million in escrow at January 31, 2015 and February 1, 2014, respectively, as security and collateral for administration of the Company's self-insured workers' compensation and general liability coverage which is reported as Restricted cash and investments on the Consolidated Balance Sheets.

Supplemental Cash Flow Information: Income tax payments, net of refunds received, for the fiscal years ended January 31, 2015, February 1, 2014 and February 2, 2013 were \$37,888,000, \$34,238,000 and \$43,124,000, respectively.

Inventories: Merchandise inventories are stated at the lower of cost or market as determined by the weighted-average cost method.

Property and Equipment: Property and equipment are recorded at cost, including land. Maintenance and repairs are expensed to operations as incurred; renewals and betterments are capitalized. The Company has changed the purpose of land that was previously classified as property and equipment to land held for investment and is now classified within Other assets as of January 31, 2015. Depreciation is determined 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:

| <u>Classification</u> | 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 invests in property and equipment primarily 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 for the amount by which the carrying value exceeds the fair value, if necessary, when the Company decides to close the store or otherwise determines that future estimated 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 2014 were \$2,249,000. Store asset impairment charges incurred in fiscal 2013 were \$2,646,000. Store asset impairment charges incurred in fiscal 2012 were \$2,011,000. 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.

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Other Assets

Other assets are comprised of long-term assets, primarily insurance contracts related to deferred compensation assets and land held for investment purposes. During the fourth quarter of 2014, the Company had its ARS redeemed at par for \$3,450,000. Prior year amounts have been reclassified to reflect the current presentation on the Consolidated Statements of Cash Flows.

We have revised our 2012 Consolidated Statements of Cash Flows to correctly classify approximately \$1.0 million of cash inflows related to the sales of other assets previously reported in operating activities as investing activities. This amount is immaterial to our previously issued financial statements.

Leases

The Company determines the classification of leases consistent with ASC 840 - *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 begins amortization as of the initial possession date 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 a reduction to Cost of goods sold on the Consolidated Statements of Income and Comprehensive 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.

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 from stores are also recorded when the customer takes possession of the merchandise. E-commerce sales are recorded when the risk of loss is transferred to the customer. Gift cards are recorded as deferred revenue until they are redeemed or forfeited. Layaway sales are recorded as deferred revenue until the customer takes possession or forfeits the merchandise. Gift cards do not have expiration dates. A provision is made for estimated merchandise returns based on sales volumes and the Company's experience; actual returns have not varied materially from historical amounts.

In fiscal 2014, 2013 and 2012, the Company recognized \$553,000, \$370,000 and \$500,000, respectively, of income on unredeemed gift cards ("gift card breakage") as a component of Other income on the Consolidated Statements of Income and Comprehensive 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.

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

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 collectability of accounts receivable and records an allowance for doubtful accounts based on the aging of accounts and estimates of actual write-offs. Finance 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.

Advertising: Advertising costs are expensed in the period in which they are incurred. Advertising expense was approximately \$5,528,000, \$5,741,000 and \$6,186,000 for the fiscal years ended January 31, 2015, February 1, 2014 and February 2, 2013, respectively.

Stock Repurchase Program: For fiscal year ending January 31, 2015, the Company had 2,195,113 shares remaining in open authorization. There is no specified expiration date for the Company's repurchase program. Share repurchases are recorded in Retained earnings, net of par value.

Earnings Per Share: ASC 260 - *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 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 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.

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

| | January 31, 2015 | Fiscal Year Ended | | |
|---|------------------|------------------------|----|------------------|
| | | February 1, 2014 | | February 2, 2013 |
| Numerator | | (Dollars in thousands) | | |
| Net earnings | \$ 60,502 | \$ 54,322 | \$ | 61,668 |
| Earnings allocated to non-vested equity awards | (1,180) | (884) | | (894) |
| Net earnings available to common stockholders | \$ 59,322 | \$ 53,438 | \$ | 60,774 |
| Denominator | | | | |
| Basic weighted average common shares outstanding | 27,600,350 | 28,767,615 | | 28,796,815 |
| Dilutive effect of stock options and restricted stock | 3,903 | 5,063 | | 3,563 |
| Diluted weighted average common shares outstanding | 27,604,253 | 28,772,678 | | 28,800,378 |
| Net income per common share | | | | |
| Basic earnings per share | \$ 2.15 | \$ 1.86 | \$ | 2.11 |
| Diluted earnings per share | \$ 2.15 | \$ 1.86 | \$ | 2.11 |

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 when the related products are sold. Cash consideration received from a vendor is presumed to be a reduction of the purchase cost of merchandise and is reflected as a reduction of inventory. 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.

Unrecognized tax benefits for uncertain tax positions are established in accordance with ASC 740 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 adjusts these liabilities in light of changing facts and circumstances. Potential accrued interest and penalties related to unrecognized tax benefits within operations are recognized as a component of earnings before taxes.

Store Opening 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 on a discounted cash flow basis, reduced by any expected sublease rentals.

Insurance: The Company is self-insured with respect to employee health care, 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 \$325,000 for employee healthcare, \$350,000 for workers' compensation and \$250,000 for general liability.

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

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

Stock Based Compensation: The Company records compensation expense associated with restricted stock and other forms of equity compensation in accordance with ASC 718 - *Compensation – Stock Compensation*. Compensation cost associated with stock awards recognized in all years presented includes: 1) amortization related to the remaining unvested portion of all stock awards based on the grant date fair value and 2) adjustments for the effects of actual forfeitures versus initial estimated forfeitures.

Recent Accounting Pronouncements

In the first quarter of fiscal 2014, the Company adopted new accounting guidance which eliminates diversity in practice on the presentation of unrecognized tax benefits when a net operating loss, a similar tax loss, or tax credit carry-forward exists at the reporting date. The new guidance may affect balance sheet classification of certain unrecognized tax benefits and had no impact on the Company's consolidated results of operations or cash flows.

In May 2014, the Financial Accounting Standards Board issued an accounting standards update that will supersede most current revenue recognition guidance and modify the accounting treatment for certain costs associated with revenue generation. The core principle of the revised revenue recognition standard is that an entity should recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those good or services, and provides several steps to apply to achieve that principle. In addition, the new guidance enhances disclosure requirements to include more information about specific revenue contracts entered into by the entity. The standard is effective for the Company's first quarter of its 2017 fiscal year; early adoption is not permitted. The Company is assessing what impacts this new standard will have on its Consolidated Financial Statements.

2. Interest and Other Income:

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

| | January 31, 2015 | February 1, 2014 | February 2, 2013 |
|-----------------|-----------------------------|---------------------|---------------------|
| Dividend income | \$ (21) | \$ (17) | \$ (19) |

| | | | |
|------------------------------|------------|------------|------------|
| Interest income | (1,266) | (1,288) | (1,518) |
| Miscellaneous income | (1,936) | (1,686) | (1,852) |
| Net gain on investment sales | (222) | (276) | (393) |
| Interest and other income | \$ (3,445) | \$ (3,267) | \$ (3,782) |

3. Short-Term Investments:

At January 31, 2015, the Company's investment portfolio was primarily invested in governmental debt securities held in managed accounts. These securities are classified as available-for-sale as they are highly liquid and are recorded on the Consolidated Balance Sheets at estimated fair value, with unrealized gains and temporary losses reported net of taxes in Accumulated other comprehensive income.

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The table below reflects gross accumulated unrealized gains (losses) in short-term investments at January 31, 2015 and February 1, 2014 (in thousands):

| | January 31, 2015 | | | February 1, 2014 | | |
|-------------------------|--|---------------------------------|------------|--|---------------------------------|------------|
| | Debt securities issued by various states of the United States and political subdivisions of the states | Corporate debt securities | Total | Debt securities issued by various states of the United States and political subdivisions of the states | Corporate debt securities | Total |
| Cost basis | 147,227 | 13,996 | 161,223 | 157,358 | 2,795 | 160,153 |
| Unrealized gains | 906 | 56 | 962 | 971 | 4 | 975 |
| Unrealized (loss) | - | - | - | - | - | - |
| Estimated fair value | \$ 148,133 | \$ 14,052 | \$ 162,185 | \$ 158,329 | \$ 2,799 | \$ 161,128 |

Accumulated other comprehensive income on the Consolidated Balance Sheets reflects the accumulated unrealized net gains in short-term investments in addition to unrealized gains from equity investments and restricted cash investments. The table below reflects gross accumulated unrealized gains in these investments at January 31, 2015 and February 1, 2014 (in thousands):

| Security Type | January 31, 2015 | | | February 1, 2014 | | |
|---------------------------|---------------------------|----------------------------|-----------------------------------|---------------------------|----------------------------|-----------------------------------|
| | Unrealized Gain/(Loss) | Deferred Tax Benefit | Unrealized Net Gain/ (Loss) | Unrealized Gain/(Loss) | Deferred Tax Benefit | Unrealized Net Gain/ (Loss) |
| Short-Term Investments | \$ 963 | \$ (362) | \$ 601 | \$ 978 | \$ (368) | \$ 610 |
| Equity Investments | 297 | (112) | 185 | 270 | (102) | 168 |
| Total | \$ 1,260 | \$ (474) | \$ 786 | \$ 1,248 | \$ (470) | \$ 778 |

4. Fair Value Measurements:

The following tables set forth information regarding the Company's financial assets that are measured at fair value (in thousands) as of January 31, 2015 and February 1, 2014:

| Description | January 31, 2015 | Prices in Active Markets for Identical Assets Level 1 | Significant Other Observable Inputs Level 2 | Significant Unobservable Inputs Level 3 |
|--|-------------------------|--|--|--|
| Assets: | | | | |
| State/Municipal Bonds | \$ 148,650 | \$ - | \$ 148,650 | \$ - |
| Corporate Bonds | 14,052 | - | 14,052 | - |
| Auction Rate Securities (ARS) | - | - | - | - |
| U.S. Treasury Notes | 3,758 | 3,758 | - | - |
| Cash Surrender Value of Life Insurance | 4,558 | - | - | 4,558 |
| Privately Managed Funds | 306 | - | - | 306 |
| Corporate Equities | 613 | 613 | - | - |
| Certificates of Deposit | 100 | 100 | - | - |
| Total Assets | \$ 172,037 | \$ 4,471 | \$ 162,702 | \$ 4,864 |
| Liabilities: | | | | |
| Deferred Compensation | (4,272) | - | - | (4,272) |
| Total Liabilities | \$ (4,272) | \$ - | \$ - | \$ (4,272) |
| Prices in Active Markets for Identical Assets Level 1 | | | | |
| Description | February 1, 2014 | Level 1 | Significant Other Observable Inputs Level 2 | Significant Unobservable Inputs Level 3 |
| State/Municipal Bonds | \$ 159,074 | \$ - | \$ 159,074 | \$ - |
| Corporate Bonds | 2,799 | - | 2,799 | - |
| Auction Rate Securities (ARS) | 3,140 | - | - | 3,140 |
| U.S. Treasury Notes | 3,405 | 3,405 | - | - |
| Cash Surrender Value of Life Insurance | 2,957 | - | - | 2,957 |
| Privately Managed Funds | 392 | - | - | 392 |
| Corporate Equities | 585 | 585 | - | - |
| Certificates of Deposit | 100 | 100 | - | - |
| Total | \$ 172,452 | \$ 4,090 | \$ 161,873 | \$ 6,489 |
| Liabilities: | | | | |
| Deferred Compensation | (3,298) | - | - | (3,298) |
| Total Liabilities | \$ (3,298) | \$ - | \$ - | \$ (3,298) |

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

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 January 31, 2015. The state, municipal and corporate bonds have contractual maturities which range from 15 days to 6.5 years. The U.S. Treasury Notes and Certificates of Deposit have contractual maturities which range from 43 days to 2.1 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 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 January 31, 2015, the Company had \$0.3 million of privately managed funds and \$0.6 million of corporate equities. During the fourth quarter of 2014, the Company had its Auction Rate Security ("ARS") redeemed at par. All of these assets are recorded within Other assets in the Consolidated Balance Sheets. At February 1, 2014, the Company had \$0.4 million of privately managed funds, \$0.6 million of corporate equities, and a single ARS of \$3.1 million, all of which are recorded within Other assets in the 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.

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

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.

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following tables summarize the change in fair value of the Company's financial assets and liabilities measured using Level 3 inputs as of January 31, 2015 and February 1, 2014 (in thousands):

| | Fair Value Measurements Using Significant Unobservable Asset Inputs (Level 3) | | | | Total |
|--|---|----------------------------------|----------------------|----------|-------|
| | Available-For-Sale Debt Securities ARS | Other Investments Private Equity | Cash Surrender Value | | |
| Beginning Balance at February 1, 2014 | \$ 3,140 | \$ 392 | \$ 2,957 | \$ 6,489 | |
| Redemptions | (3,450) | (93) | - | (3,543) | |
| Additions | - | - | 753 | 753 | |
| Total gains or (losses) Included in interest and other income (or changes in net assets) | 311 | 147 | 848 | 1,306 | |
| Included in other comprehensive income | - | (140) | - | (140) | |
| Ending Balance at January 31, 2015 | \$ - | \$ 306 | \$ 4,558 | \$ 4,865 | |
| | Fair Value Measurements Using Significant Unobservable Liability Inputs (Level 3) | | | | |
| | Deferred Compensation | Total | | | |
| Beginning Balance at February 1, 2014 | \$ (3,298) | \$ (3,298) | | | |
| Additions | (719) | (719) | | | |
| Total (gains) or losses Included in interest and other income (or changes in net assets) | (255) | (255) | | | |
| Ending Balance at January 31, 2015 | \$ (4,272) | \$ (4,272) | | | |
| | Fair Value Measurements Using Significant Unobservable Asset Inputs (Level 3) | | | | Total |
| | Available-For-Sale Debt Securities ARS | Other Investments Private Equity | Cash Surrender Value | | |

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| | | | | | | | | |
|--|----|-------|----|-------|----|-------|----|-------|
| Beginning Balance at February 2, 2013 | \$ | 3,450 | \$ | 561 | \$ | 2,051 | \$ | 6,062 |
| Redemptions | | - | | (122) | | - | | (122) |
| Additions | | | | | | 775 | | 775 |
| Total gains or (losses) Included in interest and other income (or changes in net assets) | | (311) | | 121 | | 131 | | (59) |
| Included in other comprehensive income | | - | | (168) | | - | | (168) |
| Ending Balance at February 1, 2014 | \$ | 3,140 | \$ | 392 | \$ | 2,957 | \$ | 6,489 |

Fair Value Measurements Using Significant Unobservable Liability Inputs (Level 3)

| | | Deferred Compensation | | Total |
|--|----|------------------------------|----|--------------|
| Beginning Balance at February 2, 2013 | \$ | (2,178) | \$ | (2,178) |
| Additions | | (863) | | (863) |
| Total (gains) or losses Included in interest and other income (or changes in net assets) | | (257) | | (257) |
| Ending Balance at February 1, 2014 | \$ | (3,298) | \$ | (3,298) |

Quantitative information regarding the significant unobservable inputs related to the ARS as of February 1, 2014 were as follows:

| Fair Value | Valuation Technique | Unobservable Inputs |
|------------|---------------------------------|--|
| \$3,140 | Net present value of cash flows | Total Term Yield Comparative bond discount rate |
| | | 8.66 Years 0.07% 0.14% |

5. Accounts Receivable:

Accounts receivable consist of the following (in thousands):

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| | January 31, 2015 | February 1, 2014 |
|---|-------------------------|------------------|
| Customer accounts — principally deferred payment accounts | \$ 26,071 | \$ 27,414 |
| Miscellaneous trade receivables | 16,494 | 13,553 |
| Total | 42,565 | 40,967 |
| Less allowance for doubtful accounts | 1,542 | 1,743 |
| Accounts receivable — net | \$ 41,023 | \$ 39,224 |

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Finance charge and late charge revenue on customer deferred payment accounts totaled \$5,773,000, \$6,220,000 and \$6,929,000 for the fiscal years ended January 31, 2015, February 1, 2014 and February 2, 2013, respectively, and charges against the allowance for doubtful accounts were approximately \$875,000, \$1,009,000 and \$1,259,000 for the fiscal years ended January 31, 2015, February 1, 2014 and February 2, 2013, respectively. Expenses relating to the allowance for doubtful accounts are classified as a component of Selling, general and administrative expense in the accompanying Consolidated Statements of Income and Comprehensive Income.

6. Property and Equipment:

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

| | January 31, 2015 | February 1, 2014 |
|---|-------------------------|------------------|
| Land and improvements | \$ 7,968 | \$ 7,851 |
| Buildings | 25,807 | 27,269 |
| Leasehold improvements | 100,808 | 94,185 |
| Fixtures and equipment | 214,969 | 208,902 |
| Information technology equipment and software | 59,829 | 58,705 |
| Construction in progress | 12,243 | 12,300 |
| Total | 421,624 | 409,212 |
| Less accumulated depreciation | 286,443 | 268,083 |
| Property and equipment — net | \$ 135,181 | \$ 141,129 |

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

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

7. Accrued Expenses:

Accrued expenses consist of the following (in thousands):

| | January 31, 2015 | February 1, 2014 |
|-----------------------------------|-------------------------|------------------|
| Accrued payroll and related items | \$ 7,905 | \$ 7,608 |
| Property and other taxes | 16,091 | 15,285 |
| Accrued self-insurance | 11,589 | 10,605 |
| Other | 12,819 | 12,265 |
| Total | \$ 48,404 | \$ 45,763 |

8. Financing Arrangements

As of January 31, 2015, the Company had an unsecured revolving credit agreement to borrow \$35.0 million less the balance of revocable credits discussed below. During 2013, the revolving credit agreement was amended and extended to August 2015. 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 January 31, 2015. There were no borrowings outstanding under this credit facility during the periods ended January 31, 2015, February 1, 2014 or February 2, 2013. The weighted average interest rate under the credit facility was zero at January 31, 2015 due to no borrowings during the year.

At January 31, 2015, the Company had no outstanding revocable letters of credit relating to purchase commitments. At February 1, 2014 and February 2, 2013, the Company had approximately \$0.4 million and \$2.9 million, respectively, of outstanding revocable letters of credit relating to purchase commitments.

9. 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.

On March 25, 2015, the Company paid a quarterly dividend of \$0.30 per share.

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

10. Employee Benefit Plans:

The Company has a defined contribution retirement savings plan (“401(k) plan”) 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 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 January 31, 2015, February 1, 2014 and February 2, 2013 were approximately \$1,268,000, \$1,196,000 and \$1,186,000, respectively.

The Company has a trustee, non-contributory Employee Stock Ownership Plan (“ESOP”), which covers substantially all associates who meet minimum age and service requirements. The amount of the Company’s discretionary contribution to the ESOP is determined annually by the Compensation Committee of the Board of Directors and can be made in Company Class A Common stock or cash. The Company has chosen to contribute cash and the plan purchases stock on the open market consistent with prior years. The Committee approved a contribution of approximately \$7,784,000 for the year ended January 31, 2015. The Company’s contribution for the year ended February 1, 2014 was \$887,000 and year ended February 2, 2013 was \$508,000.

The Company is primarily self-insured for health care. 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. 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 funds health care contributions to a third-party provider.

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

11. Leases:

The Company has operating lease arrangements for store facilities and equipment. Facility leases generally are at a fixed rate for periods of five years with renewal options. 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 and Comprehensive Income. Equipment leases are generally for one to three year periods.

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

| <u>Fiscal Year</u> | | |
|------------------------------|----|---------|
| 2015 | \$ | 65,330 |
| 2016 | | 50,109 |
| 2017 | | 34,775 |
| 2018 | | 22,525 |
| 2019 | | 12,425 |
| Thereafter | | 18,612 |
| Total minimum lease payments | \$ | 203,776 |

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

| <u>Fiscal Year Ended</u> | | January 31, 2015 | | February 1, 2014 | | February 2, 2013 |
|--------------------------|----|-------------------------|----|------------------|----|------------------|
| Minimum rentals | \$ | 66,040 | \$ | 61,889 | \$ | 59,887 |
| Contingent rent | | 4 | | 4 | | 16 |
| Total rental expense | \$ | 66,044 | \$ | 61,893 | \$ | 59,903 |

12. Income Taxes:

Unrecognized tax benefits for uncertain tax positions are established in accordance with ASC 740 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 adjusts these liabilities in light of changing facts and circumstances. As of January 31, 2015, the Company had gross unrecognized tax benefits totaling approximately \$9.4 million, of which

approximately \$10.0 million, inclusive of interest, would affect the effective tax rate if recognized. The Company had approximately \$4.8 million, \$5.4 million and \$5.0 million of interest and penalties accrued related to uncertain tax positions as of January 31, 2015, February 1, 2014 and February 2, 2013, respectively. The Company recognizes interest and penalties related to the resolution of uncertain tax positions as a component of income tax expense. The Company recognized \$740,000, \$927,000 and \$899,000 of interest and penalties in the Consolidated Statements of Income and Comprehensive Income for the years ended January 31, 2015, February 1, 2014 and February 2, 2013, respectively. The Company is no longer subject to U.S. federal income tax examinations for years before 2011. In state and local tax jurisdictions, the Company has limited exposure before 2004. During the next 12 months, various state and local taxing authorities' statutes of limitations will expire and certain state examinations may close, which could result in a potential reduction of unrecognized tax benefits for which a range can not be determined.

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

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

| <u>Fiscal Year Ended</u> | January 31, 2015 | February 1, 2014 | February 2, 2013 |
|---|-------------------------|------------------|---------------------|
| Balances, beginning | \$ 9,214 | \$ 8,892 | \$ 8,689 |
| Additions for tax positions of the current year | 877 | 1,209 | 1,222 |
| Reduction for tax positions of prior years for: | | | |
| Settlements during the period | (170) | (464) | (581) |
| Lapses of applicable statute of limitations | (490) | (423) | (438) |
| Balances, ending | \$ 9,431 | \$ 9,214 | \$ 8,892 |

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

| <u>Fiscal Year Ended</u> | January 31, 2015 | February 1, 2014 | February 2, 2013 |
|---------------------------------|-------------------------|------------------|---------------------|
| Current income taxes: | | | |
| Federal | \$ 33,108 | \$ 31,699 | \$ 38,415 |
| State | 514 | 3,032 | 4,429 |
| Total | 33,622 | 34,731 | 42,844 |
| Deferred income taxes: | | | |
| Federal | (1,863) | (4,260) | (4,952) |
| State | (611) | (507) | (589) |
| Foreign | (177) | - | - |
| Total | (2,651) | (4,767) | (5,541) |
| Total income tax expense | \$ 30,971 | \$ 29,964 | \$ 37,303 |

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Significant components of the Company's deferred tax assets and liabilities as of January 31, 2015 and February 1, 2014 are as follows (in thousands):

| | January 31, 2015 | February 1, 2014 |
|---|---------------------|---------------------|
| Deferred tax assets: | | |
| Allowance for doubtful accounts | \$ 543 | \$ 598 |
| Inventory valuation | 2,717 | 2,349 |
| Deferred lease liability | 1,881 | 2,940 |
| Non-deductible accrued liabilities | 1,895 | 1,133 |
| Other taxes | 1,664 | 1,668 |
| Federal benefit of uncertain tax positions | 4,237 | 4,292 |
| Equity compensation expense | 3,862 | 3,246 |
| Accrued Bonus | - | 800 |
| Other | 2,422 | 2,065 |
| Total deferred tax assets | 19,221 | 19,091 |
| Deferred tax liabilities | | |
| Property and equipment | 6,458 | 8,690 |
| Unrealized gains on short-term investments | 472 | 469 |
| Health care expense | 2,117 | 1,383 |
| Other | 2,517 | 2,456 |
| Total deferred tax liabilities | 11,564 | 12,998 |
| Net deferred tax assets | \$ 7,657 | \$ 6,093 |

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

| <u>Fiscal Year Ended</u> | January 31, 2015 | February 1, 2014 | February 2, 2013 |
|----------------------------------|-----------------------------|---------------------|---------------------|
| Federal income tax rate | 35.0 % | 35.0 % | 35.0 % |
| State income taxes | (0.2) | 2.8 | 3.2 |
| Tax credits | (1.8) | (1.4) | (1.1) |
| Tax exempt interest | (0.5) | (0.5) | (0.5) |
| Effects of permanent differences | 0.6 | 0.1 | 0.1 |
| Other | 0.8 | (0.4) | 1.0 |
| Effective income tax rate | 33.9 % | 35.6 % | 37.7 % |

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Quarterly Financial Data

13. (Unaudited):

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

| <u>Fiscal 2014</u> | First | Second | Third | Fourth |
|--|--------------|---------------|--------------|---------------|
| Total revenues | \$ 284,732 | \$ 246,461 | \$ 215,608 | \$ 240,113 |
| Gross profit (exclusive of depreciation) | 120,369 | 97,422 | 79,515 | 89,039 |
| Net income | 30,006 | 15,652 | 5,692 | 9,152 |
| Basic earnings per share | \$ 1.04 | \$ 0.56 | \$ 0.22 | \$ 0.33 |
| Diluted earnings per share | \$ 1.04 | \$ 0.56 | \$ 0.22 | \$ 0.33 |
| <u>Fiscal 2013</u> | First | Second | Third | Fourth |
| Total revenues | \$ 269,698 | \$ 231,718 | \$ 201,043 | \$ 217,574 |
| Gross profit (exclusive of depreciation) | 112,797 | 86,768 | 72,256 | 76,966 |
| Net income | 30,839 | 14,775 | 4,885 | 3,823 |
| Basic earnings per share | \$ 1.05 | \$ 0.51 | \$ 0.17 | \$ 0.13 |
| Diluted earnings per share | \$ 1.05 | \$ 0.51 | \$ 0.17 | \$ 0.13 |

14. 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 have similar economic characteristics, similar products, similar production processes, similar clients and similar methods of distribution.

The Company's retail operating segments have similar economic characteristics and similar operating, financial and competitive risks. They are similar in terms of product offered, as they all offer women's apparel, shoes and accessories. Merchandise inventory of 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 retail 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 32 states as of January 31, 2015, 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.

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

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

| <u>Fiscal 2014</u> | Retail | Credit | Total |
|---------------------------|---------------|---------------|--------------|
| Revenues | \$ 981,141 | \$ 5,773 | \$ 986,914 |
| Depreciation | 21,981 | 45 | 22,026 |
| Interest and other income | 3,445 | - | 3,445 |
| Income before taxes | 89,131 | 2,342 | 91,473 |
| Total assets | 533,236 | 75,042 | 608,278 |
| Capital expenditures | 28,871 | 30 | 28,901 |
| <u>Fiscal 2013</u> | Retail | Credit | Total |
| Revenues | \$ 913,813 | \$ 6,220 | \$ 920,033 |
| Depreciation | 21,785 | 40 | 21,825 |
| Interest and other income | 3,267 | - | 3,267 |
| Income before taxes | 81,709 | 2,577 | 84,286 |
| Total assets | 524,908 | 72,010 | 596,918 |
| Capital expenditures | 31,423 | 119 | 31,542 |
| <u>Fiscal 2012</u> | Retail | Credit | Total |
| Revenues | \$ 937,119 | \$ 6,929 | \$ 944,048 |
| Depreciation | 22,404 | 51 | 22,455 |
| Interest and other income | 3,782 | - | 3,782 |
| Income before taxes | 95,972 | 2,999 | 98,971 |
| Total assets | 463,527 | 69,119 | 532,646 |
| Capital expenditures | 44,924 | 251 | 45,175 |

The accounting policies of the segments are the same as those described in the Summary of Significant Accounting Policies in Note 1. 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 direct expenses of the credit segment which are reflected in selling, general and administrative expenses (in thousands):

| | January 31, 2015 | February 1, 2014 | February 2, 2013 |
|------------------|-------------------------|------------------|------------------|
| Bad debt expense | \$ 875 | \$ 1,009 | \$ 1,259 |
| Payroll | 841 | 907 | 919 |
| Postage | 737 | 744 | 751 |

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| | | | | |
|----------------|----|--------------|----------|-------|
| Other expenses | | 933 | 943 | 950 |
| Total expenses | \$ | 3,386 | 3,603 \$ | 3,879 |

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THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

15. Stock Based Compensation:

As of January 31, 2015, 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. The 2013 Incentive Compensation Plan and 2004 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 January 31, 2015:

| | 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: | | | | |
| February 1, 2014 | - | - | 1,488,902 | 1,488,902 |
| January 31, 2015 | - | - | 1,287,396 | 1,287,396 |

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 a five-year vesting period. As of January 31, 2015, there was \$10,357,000 of total unrecognized compensation expense related to nonvested restricted stock awards, which is expected to be recognized over a remaining weighted-average vesting period of 2.6 years. The total fair value of the shares recognized as compensation expense during the twelve months ended January 31, 2015, February 1, 2014 and February 2, 2013 was \$3,474,000, \$2,924,000 and \$2,669,000, respectively. The expenses are classified as a component of Selling, general and administrative expenses in the Consolidated Statements of Income and Comprehensive Income.

The following summary shows the changes in the shares of unvested restricted stock outstanding during the years ended January 31, 2015, February 1, 2014 and February 2, 2013:

| Number of | Weighted Average Grant Date Fair |
|-----------|-------------------------------------|
|-----------|-------------------------------------|

| | Shares | | Value Per Share |
|---|---------------|----|------------------------|
| Restricted stock awards at January 28, 2012 | 461,341 | \$ | 21.44 |
| Granted | 110,397 | | 28.23 |
| Vested | (114,172) | | 18.83 |
| Forfeited or expired | (17,420) | | 24.95 |
| Restricted stock awards at February 2, 2013 | 440,146 | \$ | 23.70 |
| Granted | 214,637 | | 23.57 |
| Vested | (121,692) | | 19.82 |
| Forfeited or expired | (27,468) | | 24.71 |
| Restricted stock awards at February 1, 2014 | 505,623 | \$ | 24.52 |
| Granted | 206,713 | | 28.25 |
| Vested | (108,155) | | 22.41 |
| Forfeited or expired | (51,686) | | 26.00 |
| Restricted stock awards at January 31, 2015 | 552,495 | \$ | 26.19 |

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (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 twelve month periods ended January 31, 2015, the Company sold 20,941 shares to employees at an average discount of \$4.30 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 \$90,000, \$70,000 and \$128,000 for fiscal years 2014, 2013 and 2012, respectively. These expenses are classified as a component of selling, general and administrative expenses.

The following is a summary of changes in stock options outstanding during the year ended January 31, 2015:

| | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
|--|--------|--|---|---------------------------------|
| Options outstanding at February 1, 2014 | 20,627 | \$ 23.33 | 9.04 years | \$ 163,000 |
| Granted | - | - | | |
| Forfeited or expired | - | | | |
| Exercised | (500) | - | | |
| Outstanding at January 31, 2015 | 20,127 | \$ 23.56 | 8.25 years | \$ 194,628 |
| Vested and exercisable at January 31, 2015 | 4,025 | \$ 23.56 | 8.25 years | \$ 38,926 |

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

No options were granted in fiscal 2014, 20,127 options were granted in fiscal 2013, and no options were granted in fiscal 2012. The Company utilizes the Black-Scholes method to estimate the fair value of share based payments.

The total intrinsic value of options exercised during the years ended January 31, 2015, February 1, 2014 and February 2, 2013 was \$11,000, \$112,000 and \$79,000, respectively.

The stock option expense was \$17,000 for the twelve months ended January 31, 2015, \$13,000 for the twelve months ended February 1, 2014, and zero for the twelve months ended February 2, 2013.

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.

16. Commitments and Contingencies:

The Company does not have any guarantees with third parties.

The Company is a defendant in legal proceedings considered to be in the normal course of business. The resolution of such currently pending matters, individually or collectively, is not expected to have a material effect on the Company's results of operations, cash flows or financial position. We accrue for these matters when the liability is deemed probable and estimable. The Company has committed to purchase approximately \$5 million of land that it expects to close no later than November 2015.

THE CATO CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

17. Accumulated Other Comprehensive Income:

The following table sets forth information regarding the reclassification out of Accumulated other comprehensive income (in thousands) as of January 31, 2015:

| | | Changes in Accumulated Other Comprehensive Income (a) Unrealized Gains and (Losses) on Available-for-Sale Securities |
|--|----|---|
| Beginning Balance at February 1, 2014 | \$ | 778 |
| Other comprehensive income before reclassification | | 148 |
| Amounts reclassified from accumulated other comprehensive income (b) | | (140) |
| Net current-period other comprehensive income | | 8 |
| Ending Balance at January 31, 2015 | \$ | 786 |

(a) All amounts are net-of-tax. Amounts in parentheses indicate a debit/reduction to other comprehensive income (“OCI”).

(b) Includes \$224 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 \$84. Amounts in parentheses indicate a debit/reduction to OCI.

The following table sets forth information regarding the reclassification out of Accumulated other comprehensive income (in thousands) as of February 1, 2014:

| | | Changes in Accumulated Other Comprehensive Income (a) Unrealized Gains and (Losses) on Available-for-Sale Securities |
|--|--|---|
|--|--|---|

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| | | |
|--|----|-------|
| Beginning Balance at February 2, 2013 | \$ | 821 |
| Other comprehensive income before reclassification | | 125 |
| Amounts reclassified from accumulated other comprehensive income (b) | | (168) |
| Net current-period other comprehensive income | | (43) |
| Ending Balance at February 1, 2014 | \$ | 778 |

(a) All amounts are net-of-tax. Amounts in parentheses indicate a debit/reduction to OCI.

(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. Amounts in parentheses indicate a debit/reduction to OCI.

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 January 31, 2015. Based on this evaluation, our Principal Executive Officer and Principal Financial Officer concluded that, as of January 31, 2015, 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 SEC’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

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 January 31, 2015 based on the *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). Based on this evaluation, management concluded that our internal control over financial reporting was effective as of January 31, 2015.

PricewaterhouseCoopers LLP, our independent registered public accounting firm, has audited the effectiveness of our internal control over financial reporting as of January 31, 2015, as stated in its 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 January 31, 2015 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 Compliance" in the Registrant's Proxy Statement for its 2015 annual stockholders' meeting (the "2015 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 3A, Part I hereof under the caption "Executive Officers of the Registrant."

Item 11. Executive Compensation:

Information contained under the captions “2014 Executive Compensation,” “Fiscal 2014 Director Compensation,” “Corporate Governance Matters-Compensation Committee Interlocks and Insider Participation” in the Company’s 2015 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 January 31, 2015.

| Plan Category | (a) | (b) | (c) |
|--|---|---|--|
| | Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights(1) | Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights(1) | 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 | 20,127 | \$23.56 | 1,515,220 |
| Equity compensation plans not approved by security holders | - | - | - |
| Total | 20,127 | \$23.56 | 1,515,220 |

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

(2) Includes the following:

Under the Company's stock incentive plan, referred to as the 2013 Incentive Compensation Plan, 1,287,396 shares are available for grant. Under this plan, non-qualified stock options may be granted to key associates.

Under the 2013 Employee Stock Purchase Plan, 227,824 shares are available. 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 2015 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 “Certain Relationships and Related Person Transactions,” “Corporate Governance Matters-Director Independence” and “Meetings and Committees” in the 2015 Proxy Statement is incorporated by reference in response to this Item.

Item 14. *Principal Accountant Fees and Services:*

Information contained under the captions “Ratification of Independent Registered Public Accounting Firm-Audit Fees” and “Policy on Audit Committee Pre-Approval of Audit and Permissible Non-Audit Service by the Independent Registered Public Accounting Firm” in the 2015 Proxy Statement is incorporated by reference in response to this item.

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 | 31 |
| Consolidated Statements of Income and Comprehensive Income for the fiscal years ended January 31, 2015, February 1, 2014 and February 2, 2013..... | 32 |
| Consolidated Balance Sheets at January 31, 2015 and February 1, 2014..... | 33 |
| Consolidated Statements of Cash Flows for the fiscal years ended January 31, 2015, February 1, 2014 and February 2, 2013..... | 34 |
| Consolidated Statements of Stockholders' Equity for the fiscal years ended January 31, 2015, February 1, 2014 and February 2, 2013..... | 35 |
| Notes to Consolidated Financial Statements..... | 36 |
| (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 listed in the Index below 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).

| <u>Exhibit Number</u> | <u>Description of Exhibit</u> |
|------------------------------|---|
| 3.1 | Registrant's Restated Certificate of Incorporation of the Registrant dated March 6, 1987, incorporated by reference to Exhibit 4.1 to Form S-8 of the Registrant filed February 7, 2000 (SEC File No. 333-96283). |
| 3.2 | Registrant's By Laws incorporated by reference to Exhibit 99.2 to Form 8-K of the Registrant filed December 10, 2007. |
| 4.1 | Rights Agreement dated December 18, 2003, incorporated by reference to Exhibit 4.1 to Form 8-A12G of the Registrant filed December 22, 2003 and as amended in Form 8-A12B/A filed on January 6, 2004. |
| 10.3* | 2004 Incentive Compensation Plan, amended and restated as of May 22, 2008, incorporated by reference to Appendix A to Definitive Proxy Statement on Schedule 14A filed April 11, 2008. |
| 10.4* | 2013 Incentive Compensation Plan, incorporated by reference to Exhibit 4.1 to Form S-8 of the Registrant filed May 31, 2013 (SEC file No. 333-188993). |
| 10.5* | Form of Agreement, dated 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 the Registrant filed on July 22, 2003. |
| 10.6* | Form of Agreement, 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 Registrant filed on July 22, 2003. |

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- 10.7* Retirement Agreement between Registrant and Wayland H. Cato, Jr. dated August 29, 2003 incorporated by reference to Exhibit 10.1 to Form 10-Q of the Registrant for quarter ended August 2, 2003.
- 10.8* Retirement Agreement between Registrant and Edgar T. Cato dated August 29, 2003, incorporated by reference to Exhibit 10.2 to Form 10-Q of the Registrant for the quarter ended August 2, 2003.
- 10.9* Letter Agreement between the Registrant and John R. Howe dated as of August 28, 2008, incorporated by Reference to Exhibit 99.1 to Form 8-K of the Registrant filed September 3, 2008.
- 10.10* Deferred Compensation Plan effective July 28, 2011, incorporated by reference to Exhibit 10.1 to Form 8-K of the Registrant filed on July 19, 2011.
- 21.1** Subsidiaries of Registrant.
- 23.1** Consent of Independent Registered Public Accounting Firm.
- 31.1** Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer.
- 31.2** Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer.
- 32.1** Section 1350 Certification of Chief Executive Officer.
- 32.2** Section 1350 Certification of Chief Financial Officer.
- 101.1** The following materials from Registrant's Annual Report on form 10-K for the fiscal years ended January 31, 2015, formatted in XBRL: (i) Consolidated Statements of Income and Comprehensive Income for the fiscal years ended January 31, 2015, February 1, 2014 and February 2, 2013; (ii) Consolidated Balance Sheets at January 31, 2015 and February 1, 2014; (iii) Consolidated Statements of Cash Flows for the fiscal years ended January 31, 2015, February 1, 2014 and February 2, 2013; (iv) Consolidated Statements of Stockholders' Equity for the fiscal years ended January 31, 2015, February 1, 2014 and February 2, 2013; and (v) Notes to Consolidated Financial Statements.

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

** Filed or submitted electronically herewith.

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/ JEFFREY R. SHOCK
Jeffrey R. Shock

Senior Vice President

Controller

By /s/ JOHN R. HOWE
John R. Howe

Executive Vice President

Chief Financial Officer

Date: March 27, 2015

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on March 27, 2015 by the following persons on behalf of the Registrant and in the capacities indicated:

/s/ JOHN P. D. CATO

/s/ BAILEY W. PATRICK

John P. D. Cato

Bailey W. Patrick

(President and Chief Executive Officer)

(Director)

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(Principal Executive Officer) and Director)

/s/ JOHN R. HOWE

/s/ THOMAS B. HENSON

John R. Howe

Thomas B. Henson

(Executive Vice President

(Director)

Chief Financial Officer (Principal Financial Officer))

/s/ JEFFREY R. SHOCK

/s/ BRYAN F. KENNEDY III

Jeffrey R. Shock

Bryan F. Kennedy III

(Senior Vice President

(Director)

Controller (Principal Accounting Officer))

/s/ THOMAS E. MECKLEY

/s/ D. HARDING STOWE

Thomas E. Meckley

D. Harding Stowe

(Director)

(Director)

/s/ EDWARD I. WEISIGER, JR

Edward I. Weisiger, Jr.

(Director)

Schedule II

VALUATION AND QUALIFYING ACCOUNTS

(in thousands)

Allowance
forDoubtful
Accounts(a)Self
Insurance
Reserves(b)

| | | | | |
|--|----|------------|----|---------|
| Balance at January 28, 2012 | \$ | 2,362 | \$ | 6,332 |
| Additions charged to costs and expenses | | 1,259 | | 3,525 |
| Additions (reductions) charged to other accounts | | 756 (c) | | 1,974 |
| Deductions | | (2,324)(d) | | (3,744) |
| Balance at February 2, 2013 | | 2,053 | | 8,087 |
| Additions charged to costs and expenses | | 1,221 | | 4,497 |
| Additions (reductions) charged to other accounts | | 425 (c) | | (611) |
| Deductions | | (1,956)(d) | | (2,861) |
| Balance at February 1, 2014 | \$ | 1,743 | \$ | 9,112 |
| Additions charged to costs and expenses | | 1,070 | | 4,518 |
| Additions (reductions) charged to other accounts | | 428 (c) | | (680) |
| Deductions | | (1,699)(d) | | (2,888) |
| Balance at January 31, 2015 | \$ | 1,542 | \$ | 10,062 |

(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.

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