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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended August 1, 1998

OR

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

For the transition period from _____ to _____

Commission file number 0-3747

THE CATO CORPORATION AND SUBSIDIARIES

(Exact name of registrant as specified in its charter)

Delaware

56-0484485

(State or other jurisdiction
of incorporation)

(I.R.S. Employer
Identification No.)

8100 Denmark Road, Charlotte, North Carolina 28273-5975

(Address of principal executive offices)
(Zip Code)

(704) 554-8510

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year,
if changed since last report)

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

Yes No

As of August 17, 1998, there were 22,228,040 shares of Class A Common Stock and 5,264,317 shares of Class B Common Stock outstanding.

THE CATO CORPORATION

FORM 10-Q

August 1, 1998

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PART I FINANCIAL INFORMATION

THE CATO CORPORATION
UNAUDITED CONSOLIDATED STATEMENTS OF INCOME

| | Three Months Ended | | Six Months Ended | |
|---|---|-------------------|-------------------|-------------------|
| | August 1, 1998 | August 2, 1997 | August 1, 1998 | August 2, 1997 |
| | (Dollars in thousands, except per share data) | | | |
| REVENUES | | | | |
| Retail sales | \$132,573 | \$120,901 | \$268,747 | \$244,152 |
| Other income (principally finance and layaway charges) | 4,603 | 3,550 | 9,473 | 7,799 |
| Total revenues | 137,176 | 124,451 | 278,220 | 251,951 |
| COSTS AND EXPENSES | | | | |
| Cost of goods sold, including occupancy, distribution and buying | 93,864 | 85,954 | 183,043 | 169,010 |
| Selling, general and administrative | 32,410 | 30,949 | 65,500 | 61,681 |
| Depreciation | 1,909 | 1,967 | 3,774 | 3,908 |
| Interest | 65 | 68 | 131 | 131 |
| Total expenses | 128,248 | 118,938 | 252,448 | 234,730 |
| INCOME BEFORE INCOME TAXES | 8,928 | 5,513 | 25,772 | 17,221 |
| Income taxes | 3,293 | 1,737 | 9,020 | 5,425 |
| NET INCOME | \$ 5,635 | \$ 3,776 | \$ 16,752 | \$ 11,796 |
| BASIC EARNINGS PER SHARE | \$.20 | \$.13 | \$.61 | \$.42 |
| DILUTED EARNINGS PER SHARE | \$.20 | \$.13 | \$.59 | \$.41 |
| DIVIDENDS PER SHARE | \$.045 | \$.04 | \$.09 | \$.08 |

See accompanying notes to consolidated financial statements.

THE CATO CORPORATION
CONSOLIDATED BALANCE SHEETS

| | August 1, 1998 (Unaudited) | August 2, 1997 (Unaudited) | January 31, 1998 |
|--|--|----------------------------------|---------------------|
| | ----- (Dollars in thousands) ----- | | |
| ASSETS | | | |
| Current Assets | | | |
| Cash and cash equivalents | \$ 54,403 | \$ 24,068 | \$ 41,644 |
| Short-term investments | 38,167 | 34,739 | 27,843 |
| Accounts receivable - net | 41,902 | 44,689 | 47,186 |
| Merchandise inventories | 63,063 | 69,401 | 64,226 |
| Deferred income taxes | 2,905 | 2,014 | 2,958 |
| Prepaid expenses | 2,023 | 4,026 | 1,686 |
| | ----- | ----- | ----- |
| Total Current Assets | 202,463 | 178,937 | 185,543 |
| Property and Equipment - net | 49,748 | 50,470 | 49,801 |
| Other Assets | 6,177 | 5,456 | 6,093 |
| | ----- | ----- | ----- |
| Total | \$258,388 | \$234,863 | \$241,437 |
| | ===== | ===== | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | |
| Current Liabilities | | | |
| Accounts payable | \$ 51,813 | \$ 45,471 | \$ 52,931 |
| Accrued expenses | 18,537 | 16,729 | 17,244 |
| Income taxes | 3,956 | 4,616 | 2,041 |
| | ----- | ----- | ----- |
| Total Current Liabilities | 74,306 | 66,816 | 72,216 |
| Deferred Income Taxes | 5,296 | 3,851 | 5,296 |
| Other Noncurrent Liabilities | 6,187 | 6,471 | 6,409 |
| Stockholders' Equity: | | | |
| Class A Common Stock, issued 23,891,040 shares, 23,395,612 shares and 23,502,647 shares at August 1, 1998, August 2, 1997 and January 31, 1998, respectively | 796 | 779 | 783 |
| Convertible Class B Common Stock, issued and outstanding 5,264,317 shares at August 1, 1998, August 2, 1997 and January 31, 1998, respectively | 176 | 176 | 176 |
| Preferred Stock, none | -- | -- | -- |
| Additional paid-in capital | 67,092 | 63,391 | 64,187 |
| Retained earnings | 115,946 | 98,180 | 101,537 |
| | ----- | ----- | ----- |
| Total Stockholders' Equity | 184,010 | 162,526 | 166,683 |
| Less Class A Common Stock in treasury, at cost (1,523,000 shares at August 1, 1998, 800,000 shares at August 2, 1997, and 1,371,500 shares at January 31, 1998) | 11,411 | 4,801 | 9,167 |
| | ----- | ----- | ----- |
| Total Stockholders' Equity | 172,599 | 157,725 | 157,516 |
| | ----- | ----- | ----- |
| Total | \$258,388 | \$234,863 | \$241,437 |
| | ===== | ===== | ===== |

See accompanying notes to consolidated financial statements.

THE CATO CORPORATION
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Six Months Ended | |
|---|-------------------|-------------------|
| | August 1, 1998 | August 2, 1997 |
| (Dollars in thousands) | | |
| OPERATING ACTIVITIES | | |
| Net income | \$ 16,752 | \$ 11,796 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 3,774 | 3,908 |
| Amortization of investment premiums | 50 | 51 |
| Loss on disposal of property and equipment | 580 | -- |
| Changes in operating assets and liabilities which provided (used) cash: | | |
| Accounts receivable | 5,284 | (1,497) |
| Merchandise inventories | 1,163 | (5,433) |
| Other assets | (421) | (1,851) |
| Accrued income taxes | 1,915 | 3,037 |
| Accounts payable and other liabilities | 82 | 8,073 |
| | ----- | ----- |
| Net cash provided by operating activities | 29,179 | 18,084 |
| | ----- | ----- |
| INVESTING ACTIVITIES | | |
| Expenditures for property and equipment | (4,301) | (3,357) |
| Purchases of short-term investments | (19,479) | (5,103) |
| Sales of short-term investments | 9,273 | 3,825 |
| | ----- | ----- |
| Net cash used in investing activities | (14,507) | (4,635) |
| | ----- | ----- |
| FINANCING ACTIVITIES | | |
| Dividends paid | (2,459) | (2,272) |
| Purchase of treasury stock | (2,310) | (3,822) |
| Proceeds from employee stock purchase plan | 183 | 114 |
| Proceeds from stock options exercised | 2,673 | 6 |
| | ----- | ----- |
| Net cash used in financing activities | (1,913) | (5,974) |
| | ----- | ----- |
| Net Increase in Cash and Cash Equivalents | 12,759 | 7,475 |
| Cash and Cash Equivalents at Beginning of Year | 41,644 | 16,593 |
| | ----- | ----- |
| Cash and Cash Equivalents at End of Period | \$ 54,403 | \$ 24,068 |
| | ===== | ===== |

See accompanying notes to consolidated financial statements.

THE CATO CORPORATION
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
FOR SIX MONTHS ENDED AUGUST 1, 1998 AND AUGUST 2, 1997

NOTE 1 - GENERAL:

The consolidated financial statements have been prepared from the accounting records of The Cato Corporation (the Company) and all amounts shown at August 1, 1998 and August 2, 1997 are unaudited. In the opinion of management, all adjustments (consisting solely of normal recurring adjustments) considered necessary for a fair presentation have been included. The results of the interim period may not be indicative of the entire year.

The Company's short-term investments are classified as available for sale securities, and therefore, are carried at fair value, with unrealized gains and losses, net of income taxes, reported as an adjustment to retained earnings.

In the first quarter of fiscal 1998, the Company adopted Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" ("SFAS 130"). Total comprehensive income for the second quarter and six months ended August 1, 1998 was \$5,814,000 and \$16,861,000 respectively. Total comprehensive income for the second quarter and six months ended August 2, 1997 was \$3,776,000 and \$11,796,000, respectively. Total comprehensive income is composed of net income and unrealized losses on available-for-sale securities.

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

In April 1998, the Company transferred 10,000 shares of Class A Common Stock from treasury stock to its Employee Stock Ownership Plan as the contribution for the fiscal year ended January 31, 1998. In July 1998, the Company repurchased 161,500 shares of Class A Common Stock for \$2,310,000, or an average price of \$14.30 per share. In August 1998, the Company repurchased an additional 230,000 shares of Class A Common Stock for \$2,648,000, or an average price of \$11.51 per share.

The provisions for income taxes are based on the Company's estimated annual effective tax rate.

Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information" ("SFAS 131") was effective in the first quarter of fiscal 1998. Management is currently evaluating the effects of SFAS 131, if any, on the Company's financial reporting disclosures for the year ended January 30, 1999.

THE CATO CORPORATION
 NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
 FOR SIX MONTHS ENDED AUGUST 1, 1998 AND AUGUST 2, 1997

NOTE 2 - EARNINGS PER SHARE:

Earnings per share is calculated by dividing net income by the weighted-average number of Class A and Class B common shares outstanding during the respective periods. The weighted-average number of shares used in the basic and diluted earnings per share computations are as follows:

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|-------------------|-------------------|-------------------|
| | August 1, 1998 | August 2, 1997 | August 1, 1998 | August 2, 1997 |
| Weighted-average shares outstanding | 27,707,347 | 28,328,646 | 27,603,502 | 28,396,205 |
| Dilutive effect of stock options | 869,504 | 44,983 | 820,046 | 42,579 |
| Weighted-average shares and equivalents outstanding | <u>28,576,851</u> | <u>28,373,629</u> | <u>28,423,548</u> | <u>28,438,784</u> |

NOTE 3 - SUPPLEMENTAL CASH FLOW INFORMATION:

Interest paid during the six months ended August 1, 1998 and August 2, 1997 was \$81,000 and \$83,000, respectively. Income tax payments, net of refunds received, for the six months ended August 1, 1998 and August 2, 1997 were \$7,193,000 and \$2,359,000, respectively.

NOTE 4 - FINANCING ARRANGEMENTS:

In May 1998, the Company's unsecured revolving credit agreement was amended to add the \$15 million letter of credit facility to the \$20 million revolving credit facility. The entire \$35 million dollar unsecured credit facility was extended to May 31, 2001 with no change in financial covenants or maintenance of specific financial ratios. There were no borrowings outstanding under the agreement at August 1, 1998 or August 2, 1997.

THE CATO CORPORATION
 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
 CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, certain items in the Company's Unaudited Consolidated Statements of Income as percentages of total retail sales:

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|-------------------|-------------------|-------------------|
| | August 1, 1998 | August 2, 1997 | August 1, 1998 | August 2, 1997 |
| Total retail sales | 100.0% | 100.0% | 100.0% | 100.0% |
| Total revenues | 103.5 | 102.9 | 103.5 | 103.2 |
| Cost of goods sold, including occupancy, distribution and buying | 70.8 | 71.1 | 68.1 | 69.2 |
| Selling, general and administrative | 24.4 | 25.6 | 24.4 | 25.3 |
| Income before income taxes | 6.8 | 4.5 | 9.6 | 7.0 |
| Net income | 4.3 | 3.1 | 6.2 | 4.8 |

Comparison of Second Quarter and First Six Months of 1998 with 1997.

OPERATING RESULTS

Total retail sales for the second quarter were \$132.6 million compared to last year's second quarter sales of \$120.9 million, a 10% increase. Same-store sales increased 7% in this year's second quarter. For the six months ended August 1, 1998, total retail sales were \$268.7 million compared to last year's first six months sales of \$244.2 million, a 10% increase, and same-store sales increased 7% for the comparable six month period. The increase in retail sales for the first six months of 1998 resulted from the Company's continued everyday low pricing strategy, improved merchandise content, and an increase in store development activity. The Company operated 701 stores at August 1, 1998 compared to 677 stores at the end of last year's second quarter.

Other income for the second quarter and first six months of 1998 increased 30% and 21%, respectively, over the prior year's comparable periods. The increase in the current year resulted primarily from increased finance and late charge income on the Company's customer accounts receivable and increased earnings from cash equivalents and short-term investments.

THE CATO CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS

OPERATING RESULTS - CONTINUED

Cost of goods sold, including occupancy, distribution and buying expenses were 70.8% and 68.1% of total retail sales for the second quarter and first six months of 1998, respectively, compared to 71.1% and 69.2% for last year's comparable three and six month periods. The decrease in cost of goods sold as a percent of retail sales resulted primarily from much improved merchandise offerings, more timely and aggressive markdowns and tighter merchandise planning and control.

Selling, general and administrative (SG&A) expenses were \$32.4 million and \$65.5 million for the second quarter and first six months of this year, respectively, compared to \$30.9 million and \$61.7 million for last year's comparable three and six month periods, respectively. Expenses remained well controlled and were under planned levels.

LIQUIDITY AND CAPITAL RESOURCES

At August 1, 1998, the Company had working capital of \$128.2 million, compared to \$112.1 million at August 2, 1997 and \$113.3 million at January 31, 1998. Cash provided from operating activities was \$29.2 million for the six months ended August 1, 1998, compared to \$18.1 million for last year's comparable six month period. The Company had no borrowings under its revolving credit agreement at August 1, 1998 or August 2, 1997. At August 1, 1998, the Company had cash, cash equivalents, and short-term investments of \$92.6 million, compared to \$58.8 million at August 2, 1997 and \$69.5 million at January 31, 1998.

In May 1998, the Company's unsecured revolving credit agreement was amended to add the \$15 million letter of credit facility to the \$20 million revolving credit facility. The entire \$35 million dollar unsecured credit facility was extended to May 31, 2001 with no change in financial covenants or maintenance of specific financial ratios. There were no borrowings outstanding under the agreement at August 1, 1998 or August 2, 1997.

THE CATO CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS

LIQUIDITY AND CAPITAL RESOURCES - CONTINUED

Expenditures for property and equipment totaled \$4.3 million for the six months ended August 1, 1998, compared to \$3.4 million in the first six months of 1997. The Company expects total capital expenditures to be approximately \$13 million for the current fiscal year. The Company intends to open approximately 34 new stores, close 9 stores, and relocate 9 stores during the second half of fiscal 1998. For the six months ended August 1, 1998, the Company had opened 16 new stores, relocated 8 stores, and closed 8 stores.

The Company believes that its cash, cash equivalents and short-term investments, together with cash flow from operations and borrowings available under its revolving credit agreement, will be adequate to fund the Company's proposed capital expenditures and other operating requirements.

The Company is in the process of addressing the Year 2000 issue. The Company expects to be substantially complete with the project by December 1998, and the total cost is not anticipated to be material to the Company's financial position or results of operations in any given year. Conclusions regarding the cost of the project and the expected completion date are based on management's best estimates.

Form 10-Q includes "forward-looking statements" within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. All statements other than statements of historical facts included in the Form 10-Q and located elsewhere herein regarding the Company's financial position and business strategy may constitute forward-looking statements. Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to be correct.

PART II OTHER INFORMATION

THE CATO CORPORATION

ITEM 1. LEGAL PROCEEDINGS

None

ITEM 2. CHANGES IN THE RIGHTS OF THE COMPANY'S SECURITY HOLDERS

None

ITEM 3. DEFAULTS BY THE COMPANY ON ITS SENIOR SECURITIES

Not Applicable

ITEM 4. RESULT OF VOTES OF SECURITY HOLDERS

Following are the results of the matters voted upon at the Company's Annual Meeting which was held on May 21, 1998.

Election of Directors:

| | | | | | | |
|-----------------------|---|-----|------------|---|------------|---------|
| Mr. Thomas E. Cato | - | For | 71,794,038 | ; | Abstaining | 552,154 |
| Mr. George S. Currin | - | For | 71,793,888 | ; | Abstaining | 552,304 |
| Mr. A.F. (Pete) Sloan | - | For | 71,794,038 | ; | Abstaining | 552,154 |

Amendment to The Cato Corporation 1993 Employee Stock Purchase Plan

For 71,880,536 ; Abstaining 454,658 ; Against 10,989

Ratification of Deloitte & Touche LLP as Independent Auditors

For 72,336,749 ; Abstaining 3,702 ; Against 5,742

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(A) None

(B) No Reports on Form 8-K were filed during the quarter ended August 1, 1998.

PART II OTHER INFORMATION (CONTINUED)

THE CATO CORPORATION

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

THE CATO CORPORATION

September 10, 1998

Date/s/ Wayland H. Cato, Jr.
-----Wayland H. Cato, Jr.
Chairman of the Board of
Directors and Chief Executive Officer

September 10, 1998

Date/s/ Michael O. Moore
-----Michael O. Moore
Executive Vice President
Chief Financial Officer and Secretary

THE SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE BALANCE SHEET AND INCOME STATEMENT AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

1,000

| | | |
|---------|-------------|---------|
| 6-MOS | | |
| | JAN-30-1999 | |
| | AUG-01-1998 | |
| | | 54,403 |
| | | 38,167 |
| | | 46,562 |
| | | 4,660 |
| | | 63,063 |
| | 202,463 | |
| | | 99,431 |
| | | 49,683 |
| | | 258,388 |
| | 74,306 | |
| | | 0 |
| | 0 | |
| | | 0 |
| | | 972 |
| | | 171,627 |
| 258,388 | | |
| | | 268,747 |
| | 278,220 | |
| | | 183,043 |
| | | 183,043 |
| | | 0 |
| | | 2,138 |
| | | 131 |
| | | 25,772 |
| | | 9,020 |
| 16,752 | | |
| | | 0 |
| | | 0 |
| | | 0 |
| | | 16,752 |
| | | 0.61 |
| | | 0.59 |