1998 Annual Report

Fiscal Year Ended January 30, 1999

(NASDAQ Symbol: CACOA)

The Cato Corporation, headquartered in Charlotte, N.C., is a leading retailer of popular-priced women's apparel and accessories. The corporation operates over 740 stores in 21 states principally in the Southeast under the names Cato, Cato Fashions, Cato Plus and It's Fashion!. Cato offers quality fashion apparel at everyday low prices in junior, missy and plus sizes.

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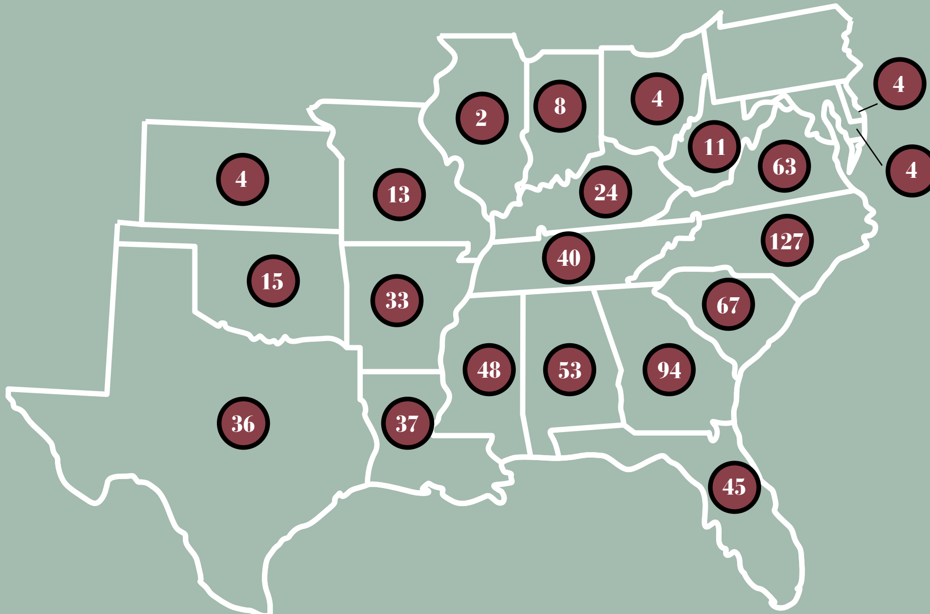
Cato Geographical Regions

At Year End 1998

Cato Division: 575 stores

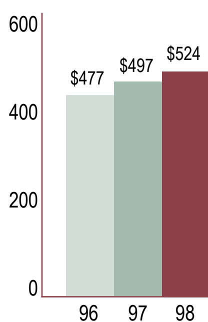
It's Fashion! Division: 157 stores



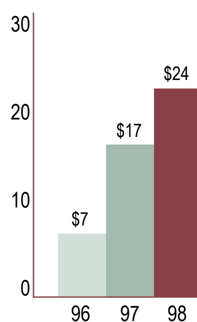
Financial Highlights

	January 30, 1999	January 31, 1998	February 1, 1997
	(Dollars in thousands, except per share data)		
FOR THE YEAR			
Retail Sales	**$ 524,381**	$ 496,851	$ 477,011
Total Revenues	**543,664**	512,448	491,509
Comparable Store Sales Increase (Decrease)	**2%**	4%	(2)%
Income Before Income Taxes	**36,795**	25,407	10,898
Net Income	**23,917**	17,401	7,029
Net Income as a Percent of Retail Sales	**4.6%**	3.5%	1.5%
Cash Dividends Paid Per Share	**.19**	.16	.16
Basic Earnings Per Share	**.87**	.62	.25
Diluted Earnings Per Share	**.85**	.62	.25
AT YEAR END			
Cash and Investments	**$ 86,209**	$ 69,487	$ 50,105
Working Capital	**124,024**	113,327	105,373
Current Ratio	**2.7**	2.6	2.9
Total Assets	**258,513**	241,437	218,243
Stockholders' Equity	**172,234**	157,516	151,903
Number of Stores	**732**	693	655
Number of Stores Opened	**52**	55	28
Number of Stores Closed	**13**	17	44
Net Increase (Decrease) in Number of Stores	**39**	38	(16)

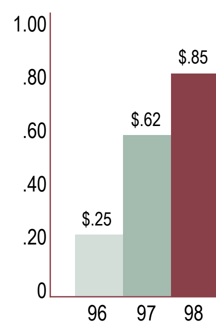
Retail Sales
(in millions)



Net Income
(in millions)



Earnings Per Share



Letter To Our Shareholders

The Cato Corporation made tremendous strides in fiscal 1998. We achieved a 37% increase in earnings per share, matching our previous record. We continued to refine our merchandising strategies, further improving gross margins. A major store-remodeling program was initiated. In addition, a systems conversion project began which will merge our systems of merchandising, distribution and finance into a "total enterprise" system.

Meeting Our Financial Goals

The successful execution of our merchandising initiatives led to our eighth consecutive quarter of earnings increases and a 6% increase in total sales. Net income grew to 4.6% of sales over 3.5% last year. Continued efforts toward expense control resulted in a 60 basis point decrease in selling, general and administrative expenses.

The balance sheet remains strong with cash, cash equivalents, and short-term investments of $86.2 million versus $69.5 million last year. We maintained our debt-free status while increasing working capital to $124.0 million versus $113.3 million last year.

During 1998, we repurchased 1,006,500 shares of Class A common stock at a cost of $10.1 million. At the end of March 1999, there were 2,874,000 shares in Treasury purchased at an average cost of $8.10 per share. During its first meeting of 1999, the Board of Directors approved a resolution to purchase an additional 1,000,000 shares of stock.

Taking Merchandising To The Next Level

In 1998, we moved beyond everyday low pricing and established everyday low price leadership within our segment. Using demographic data, we refined our merchandise mix which allowed us to tailor our merchandise by store. Factors such as the store's climate and geography and its customers' lifestyle and ethnic makeup all contribute to the allocation of merchandise.

Our new weekly flow of inventory is now matched to sales. The resulting leaner inventory levels, coupled with a constant merchandise flow, provide a fresher product assortment for our customer and have aided in decreasing both distribution and store operating costs.

Further improvements in gross margin will be generated by our expanded in-house product development and new direct sourcing function. Their collaboration with our merchandising team will allow us to enhance our merchandise offerings, to deliver quality private label products at lower costs, and to aggressively price our products so that the customer receives excellent value every time she visits our store. The product development and direct sourcing operation will begin to approach its full profit improvement potential during fiscal year 2000. The operation provides fashion and color trends research, technical services and direct sourcing capabilities. The fashion office provides research on emerging fashion and color trends while the technical services function ensures consistent product quality and fit. The direct sourcing operation manages product placement and specifications with our overseas buying agent. These efforts will be aided by extensive marketing and brand-imaging research that will reinforce our knowledge of what is important to our customer.

Continuing Our Growth

We concluded 1998 with 732 stores, a 6% increase over fiscal 1997. In fiscal 1999, we plan to increase the rate of new store growth by opening 75 new stores and closing 10 stores, resulting in a planned net increase of 9%. We will focus on the expansion into northern, midwestern and western fringe states as well as continuing to "fill-in" our southeastern core geography.

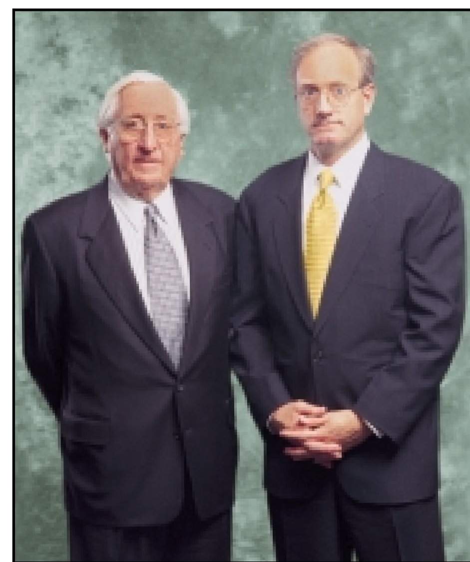
In 1998, we commenced a new program of store remodeling with the objective of improving and updating existing stores to our new prototype design. We plan to remodel 200 stores over the next two years. By 2001, our plan is that approximately 50% of all stores will be less than three years old and/or remodeled within the last three years. We have provided a capital plan of $5.6 million for this program.

Capitalizing On Technology

During 1998, we made significant commitments to new technology for systems of merchandising, distribution and finance. These systems will be implemented over the next two years. The amount capitalized in 1998 for technology was $3.6 million. In fiscal 1999, we expect capital expenditures for technology to be $10.2 million, an increase of 180% over 1998. These new systems will provide the platform to support and merge the merchandising, distribution and finance functions into a "total enterprise" solution. Additional technology will automate many functions at the store level and will significantly reduce paperwork through the use of electronic mail and interactive voice response systems. In addition, communications between the corporate office and the field organization will be improved by the rollout of laptop computers to all district managers. The new technologies will streamline operations, facilitate data gathering and analysis, and reduce the costs of operations.

Outlook For The Future

Over the past 24 months, we implemented new business strategies and made investments in new technologies and systems that will change and improve the way we do business in the future. These strategies, along with the determination and focus of our management team, and the continued hard work and dedication of all our 7,000 associates will allow us to continue the momentum that began in 1997.



Wayland H. Cato, Jr. John P. Derham Cato

Notwithstanding this progress, our stock continues to perform at a level below our expectations. We ended the year trading at 10 times 1998 earnings. The 37% increase in earnings per share over 1997 and our strong debt-free balance sheet lead us to believe there is great potential for our shareholders.

We are optimistic as we look forward to fiscal 1999 and beyond. We will stay focused on and committed to the successful strategies implemented over the past 24 months. A strong management team and our dedicated associates will "make it happen". And as ever, we are committed to giving our customer…"The right look. The right price. Always".

Wayland H. Cato, Jr.

Wayland H. Cato, Jr.
Chairman of the Board and
Chief Executive Officer

John P. Derham Cato

John P. Derham Cato
Vice Chairman of the Board,
President and Chief Operating Officer

Selected Financial Data

	Fiscal Year Ended				
	January 30, 1999	January 31, 1998	February 1, 1997	February 3, 1996	January 28, 1995
	(Dollars in thousands, except per share and selected operating data)				
Statement of Operations Data:					
Retail sales	**$ 524,381**	$ 496,851	$ 477,011	$ 476,638	$ 463,737
Other income	**19,283**	15,597	14,498	13,357	12,449
Total revenues	**543,664**	512,448	491,509	489,995	476,186
Cost of goods sold	**371,005**	354,627	344,919	341,144	324,309
Gross margin percent	**29.2%**	28.6%	27.7%	28.4%	30.1%
Selling, general and administrative	**127,986**	124,439	121,600	122,699	116,144
Selling, general and administrative percent	**24.4%**	25.0%	25.4%	25.7%	25.0%
Depreciation	**7,638**	7,713	8,330	7,785	6,844
Interest	**240**	262	262	292	377
Closed store expense	**—**	—	5,500	—	—
Income before income taxes	**36,795**	25,407	10,898	18,075	28,512
Income tax expense	**12,878**	8,006	3,869	6,055	10,407
Net income	**$ 23,917**	$ 17,401	$ 7,029	$ 12,020	$ 18,105
Basic earnings per share	**$ .87**	$ .62	$ .25	$ .42	$ .64
Diluted earnings per share	**$ .85**	$ .62	$ .25	$ .42	$ .63
Cash dividends paid per share	**$ .19**	$ .16	$ .16	$ .16	$ .145
Selected Operating Data:					
Stores open at end of year	**732**	693	655	671	646
Average sales per store	**$ 740,000**	$ 748,000	$ 710,000	$ 721,000	$ 749,000
Average sales per square foot of selling space	**$ 169**	$ 163	$ 153	$ 158	$ 172
Comparable store sales increase (decrease)	**2%**	4%	(2)%	(5)%	1%
Balance Sheet Data:					
Cash and investments	**$ 86,209**	$ 69,487	$ 50,105	$ 47,894	$ 46,226
Working capital	**124,024**	113,327	105,373	102,169	94,581
Total assets	**258,513**	241,437	218,243	209,895	201,322
Total stockholders' equity	**$ 172,234**	$ 157,516	$ 151,903	$ 149,682	$ 141,508

Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations

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

	Fiscal Year Ended		
	January 30, 1999	January 31, 1998	February 1, 1997
Retail sales	**100.0%**	100.0%	100.0%
Other income	**3.7**	3.1	3.0
Total revenues	**103.7**	103.1	103.0
Cost of goods sold	**70.8**	71.4	72.3
Selling, general and administrative	**24.4**	25.0	25.4
Depreciation	**1.5**	1.5	1.7
Closed store expense	**—**	—	1.2
Selling, general, administrative, depreciation and closed store expense	**25.9**	26.5	28.3
Income before income taxes	**7.0**	5.1	2.3
Net income	**4.6%**	3.5%	1.5%

Fiscal 1998 Compared to Fiscal 1997

Retail sales increased by 6% to $524.4 million in fiscal 1998 from $496.9 million in fiscal 1997. Same-store sales increased 2% from the prior year. Total revenues, comprised of retail sales and other income (principally finance charges and late fees on customer accounts receivable, interest income and layaway fees), increased by 6% to $543.7 million in fiscal 1998 from $512.4 million in fiscal 1997. The Company operated 732 stores at January 30, 1999, compared to 693 stores operated at January 31, 1998.

The increase in retail sales in fiscal 1998 resulted from the Company's adoption of an everyday low pricing strategy, improved merchandise offerings, and an increase in store development activity. In fiscal 1998, the Company increased its number of stores 6% by opening 52 new stores, relocating 18 stores while closing 13 existing stores.

Other income in fiscal 1998 increased $3.7 million or 24% over fiscal 1997. The increase resulted primarily from increased earnings on cash equivalents and short-term investments and from higher finance charge and late fee income partially offset by decreased layaway service charges.

Cost of goods sold was $371.0 million, or 70.8% of retail sales, in fiscal 1998, compared to $354.6 million, or 71.4% of retail sales, in fiscal 1997. The decrease in cost of goods sold as a percent of retail sales resulted primarily by maintaining timely and aggressive markdowns on slow moving merchandise, eliminating unprofitable promotions and improving inventory flow. Total gross margin dollars (retail sales less cost of goods sold) increased by 8% to $153.4 million in fiscal 1998 from $142.2 million in fiscal 1997.

Selling, general, and administrative expenses (SG&A) were $128.0 million in fiscal 1998, compared to $124.4 million in fiscal 1997, an increase of 3%. As a percent of retail sales, SG&A was 24.4% compared to 25.0% of retail sales in the prior year. The overall increase in SG&A resulted primarily from increased selling-related expenses and increased infrastructure expenses brought about by the Company's store development activities.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Fiscal 1997 Compared to Fiscal 1996

Retail sales increased by 4% to $496.9 million in fiscal 1997 from $477.0 million in fiscal 1996. Same-store sales increased 4% from the prior year. Total revenues increased by 4% to $512.4 million in fiscal 1997 from $491.5 million in fiscal 1996. The Company operated 693 stores at January 31, 1998, compared to 655 stores operated at February 1, 1997.

The increase in retail sales in fiscal 1997 resulted from the Company's adoption of an everyday low pricing strategy, improved merchandise offerings, and an increase in store development activity. In fiscal 1997, the Company increased its selling square footage approximately 3% by opening 55 new stores, relocating or expanding 16 stores while closing 17 existing stores.

Other income in fiscal 1997 increased 8% over fiscal 1996. The increase resulted primarily from increased earnings on cash equivalents and short-term investments and from higher finance charge income partially offset by decreased layaway service charges.

Cost of goods sold was $354.6 million, or 71.4% of retail sales, in fiscal 1997, compared to $344.9 million, or 72.3% of retail sales, in fiscal 1996. The decrease in cost of goods sold as a percent of retail sales resulted primarily from much improved merchandise offerings, more timely markdowns and tighter merchandise planning and control. Total gross margin dollars increased by 8% to $142.2 million in fiscal 1997 from $132.1 million in fiscal 1996.

SG&A expenses were $124.4 million in fiscal 1997, compared to $121.6 million in fiscal 1996, an increase of 2%. As a percent of retail sales, SG&A was 25.0% compared to 25.4% of retail sales in the prior year. The overall increase in SG&A resulted primarily from increased selling-related expenses and increased infrastructure expenses brought about by the Company's store development activities.

Depreciation expense was $7.7 million in fiscal 1997, compared to $8.3 million in fiscal 1996. The 7% decrease in fiscal 1997 resulted primarily from fixed asset dispositions relating to the prior year's store closings.

Liquidity, Capital Resources and Market Risk

At January 30, 1999, the Company had working capital of $124.0 million compared to $113.3 million at January 31, 1998. Cash provided by operating activities was $40.9 million in fiscal 1998, compared to $38.9 million in fiscal 1997. The increase in cash provided by operating activities in fiscal 1998 resulted primarily from an increase in net income and accounts payable and other liabilities, and a decrease in merchandise inventories. At January 30, 1999, the Company had $86.2 million in cash, cash equivalents and short-term investments, compared to $69.5 million at January 31, 1998.

At January 30, 1999, the Company had an unsecured revolving credit agreement which provides for borrowings of up to $35 million. The revolving credit agreement is committed until May 2001. The credit agreement contains various financial covenants and limitations, including maintenance of specific financial ratios and a limitation on capital expenditures of $25 million per year (or $60 million during the length of the agreement). The Company feels the terms of the revolving credit agreement support the Company's future working capital needs. There were no borrowings outstanding under the agreement at January 30, 1999.

The Company has an agreement with a lessor to lease $19.5 million of store fixtures, point-of-sale devices and warehouse equipment. The operating leases are for a term of seven years but may be cancelled annually upon proper notice to the lessor. Upon notice of cancellation, the Company would be obligated to purchase the equipment at a prescribed termination value from the lessor.

Expenditures for property and equipment totaled $13.5 million, $7.4 million and $8.4 million in fiscal 1998, 1997 and 1996, respectively. The expenditures for fiscal 1998 were primarily for store development and new technology for merchandising, distribution and finance. For fiscal 1999, the Company intends to open approximately 75 new stores, close 10 stores, relocate 24 stores, and is currently planning approximately $24 million of capital expenditures, primarily for store development and further system implementations for merchandising, distribution and finance. The Company plans to remodel 200 stores over the next two years.

During 1998, the Company repurchased 1,006,500 shares of Class A Common Stock for $10.1 million, or an average price of $10.05 per share. Over the course of fiscal 1998, the Company increased its quarterly dividend from $.04 per share to $.05 per share. In February 1999, the Board of Directors increased the quarterly dividend by 10% from $.05 per share to $.055 per share and approved a resolution to purchase an additional 1,000,000 shares of stock.

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 does not use derivative financial instruments in its investment portfolio. The Company's investment policy requires investments in instruments that meet high credit quality standards, limits the investment holding period of an instrument to a maximum of 3 years, and limits the amount of credit exposure to any one issue, issuer and type of instrument. At January 30, 1999, all of the Company's investment portfolio was invested in governmental debt securities with maturities of 1 to 33 months. These securities are classified as available-for-sale, and are recorded on the balance sheet at fair value with unrealized gains and losses reported as other comprehensive income. Based on the current portfolio, an immediate change in interest rates would not have a material impact on the Company's financial condition.

The Company developed a two phase approach to address the Year 2000 issue, which involves the exposure to risks in its information technology (IT) systems, as well as potential risks in other non-IT systems with embedded technology. Phase 1 was an analysis to identify and fix all internally developed programs. Phase 2 is the identification and correction to all programs purchased from external sources. The Company has completed Phase 1, and Phase 2 is scheduled to be substantially complete by the end of the second fiscal quarter of 1999 with continued testing of compliance throughout 1999. The Company expects to spend approximately $525,000 in 1998 and 1999 on hardware, software and consulting to ensure proper processing of transactions relating to the Year 2000 and beyond. The Company has initiated formal communications with its third-party suppliers and vendors to determine the extent to which the Company is vulnerable to those third-parties' failure to remediate their own Year 2000 issue. Although lack of compliance for Year 2000 issues by third-party suppliers and vendors could have an adverse effect on the Company's business, results of operations and financial condition, the Company expects its Year 2000 compliance efforts to significantly reduce the risk of business interruption and the level of uncertainty the Year 2000 issue may have on its computer systems. A contingency plan will be established upon the completion of Phase 2.

In March 1998, the American Institute of Certified Public Accountants ("AICPA") issued Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" ("SOP 98-1"), which provides guidance on the capitalization of certain software development costs. Adoption of SOP 98-1 is effective for fiscal 1999, and management is currently evaluating the effect this statement may have on the financial statements.

In April 1998, the AICPA issued Statement of Position 98-5, "Reporting on the Costs of Start-Up Activities" ("SOP 98-5"), which provides guidance on the accounting for start-up costs. The Company adopted SOP 98-5 in fiscal 1998, and the effect on the financial statements was immaterial.

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133") which addresses the accounting for derivative instruments, including certain derivative instruments embedded in other contracts and hedging activities. SFAS 133 is effective for the Company's fiscal 2000. The Company has not yet completed its analysis of any potential impact of SFAS 133 on its financial statements.

The Annual Report 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 Annual Report 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.

Consolidated Statements of Income

	Fiscal Year Ended		
	January 30, 1999	January 31, 1998	February 1, 1997
	(Dollars in thousands, except per share data)		
Revenues			
Retail sales	**$ 524,381**	$ 496,851	$ 477,011
Other income (principally finance and layaway charges)	**19,283**	15,597	14,498
Total revenues	**543,664**	512,448	491,509
Costs and Expenses			
Cost of goods sold	**371,005**	354,627	344,919
Selling, general and administrative	**127,986**	124,439	121,600
Depreciation	**7,638**	7,713	8,330
Interest	**240**	262	262
Closed store expense	**—**	—	5,500
Total operating expenses	**506,869**	487,041	480,611
Income Before Income Taxes	**36,795**	25,407	10,898
Income tax expense	**12,878**	8,006	3,869
Net Income	**$ 23,917**	$ 17,401	$ 7,029
Basic Earnings Per Share	**$ .87**	$ .62	$ .25
Diluted Earnings Per Share	**$ .85**	$ .62	$ .25
Dividends Per Share	**$ .19**	$ .16	$ .16

See notes to consolidated financial statements.

Consolidated Balance Sheets

	January 30, 1999	January 31, 1998
	(Dollars in thousands)	
Assets		
Current Assets:		
Cash and cash equivalents	**$ 44,068**	$ 41,644
Short-term investments	**42,141**	27,843
Accounts receivable, net of allowance for doubtful accounts of $4,201 at January 30, 1999 and $3,701 at January 31, 1998	**44,536**	47,186
Merchandise inventories	**61,112**	64,226
Deferred income taxes	**3,372**	2,958
Prepaid expenses	**2,374**	1,686
Total Current Assets	**197,603**	185,543
Property and Equipment - net	**54,740**	49,801
Other Assets	**6,170**	6,093
Total Assets	**$ 258,513**	$ 241,437
Liabilities and Stockholders' Equity		
Current Liabilities:		
Accounts payable	**$ 52,391**	$ 52,931
Accrued expenses	**20,991**	17,244
Income taxes	**197**	2,041
Total Current Liabilities	**73,579**	72,216
Deferred Income Taxes	**5,922**	5,296
Other Noncurrent Liabilities (primarily deferred rent)	**6,778**	6,409
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; 24,070,519 shares issued at January 30, 1999 and 23,502,647 shares issued at January 31, 1998	**802**	783
Convertible Class B Common Stock, $.033 par value per share, 15,000,000 shares authorized; 5,264,317 shares issued and outstanding at January 30, 1999 and January 31, 1998	**176**	176
Additional paid-in capital	**69,878**	64,187
Retained earnings	**120,590**	101,537
	191,446	166,683
Less Class A Common Stock in treasury, at cost (2,368,000 shares at January 30, 1999 and 1,371,500 shares at January 31, 1998)	**19,212**	9,167
Total Stockholders' Equity	**172,234**	157,516
Total Liabilities and Stockholders' Equity	**$ 258,513**	$ 241,437

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

	Fiscal Year Ended		
	January 30, 1999	January 31, 1998	February 1, 1997
		(Dollars in thousands)	
Operating Activities			
Net income	**$ 23,917**	$ 17,401	$ 7,029
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	**7,638**	7,713	8,330
Amortization of investment premiums	**123**	95	183
Provision for doubtful accounts	**4,081**	3,675	3,585
Deferred income taxes	**38**	496	(771)
Loss on disposal of property and equipment	**942**	1,196	412
Changes in operating assets and liabilities which provided (used) cash:			
Accounts receivable	**(1,431)**	(7,669)	(6,985)
Merchandise inventories	**3,114**	(258)	(5,528)
Other assets	**(765)**	(148)	(51)
Accrued income taxes	**(463)**	760	251
Accounts payable and other liabilities	**3,705**	15,674	9,176
Net cash provided by operating activities	**40,899**	38,935	15,631
Investing Activities			
Expenditures for property and equipment	**(13,519)**	(7,377)	(8,371)
Purchases of short-term investments	**(24,624)**	(24,553)	(23,312)
Sales of short-term investments	**10,717**	30,122	11,164
Net cash used in investing activities	**(27,426)**	(1,808)	(20,519)
Financing Activities			
Dividends paid	**(5,204)**	(4,510)	(4,558)
Purchases of treasury stock	**(10,112)**	(8,188)	(756)
Proceeds from employee stock purchase plan	**336**	234	279
Proceeds from stock options exercised	**3,931**	388	333
Net cash used in financing activities	**(11,049)**	(12,076)	(4,702)
Net Increase (Decrease) in Cash and Cash Equivalents	**2,424**	25,051	(9,590)
Cash and Cash Equivalents at Beginning of Year	**41,644**	16,593	26,183
Cash and Cash Equivalents at End of Year	**$ 44,068**	$ 41,644	$ 16,593

See notes to consolidated financial statements.

Consolidated Statements of Stockholders' Equity

	Class A Common Stock	Convertible Class B Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock
			(Dollars in thousands)		
Balance — February 3, 1996	$ 773	$ 176	$ 62,665	$ 86,291	$ 223
*Comprehensive income:					
Net income				7,029	
Unrealized losses on available for sale securities, net of deferred income tax benefit of $58,000				(106)	
Dividends paid ($.16 per share)				(4,558)	
Class A Common Stock sold through employee stock purchase plan — 51,506 shares	2		277		
Class A Common Stock sold through stock option plans — 110,250 shares	3		330		
Purchase of treasury shares — 135,000 shares					756
Balance — February 1, 1997	778	176	63,272	88,656	979
*Comprehensive income:					
Net income				17,401	
Unrealized losses on available for sale securities, net of deferred income taxes of $5,000				(10)	
Dividends paid ($.16 per share)				(4,510)	
Class A Common Stock sold through employee stock purchase plan — 47,194 shares	2		232		
Class A Common Stock sold through stock option plans — 89,050 shares	3		385		
Income tax benefit from stock options exercised			298		
Purchase of treasury shares — 1,196,500 shares					8,188
Balance — January 31, 1998	783	176	64,187	101,537	9,167
*Comprehensive income:					
Net income				23,917	
Unrealized gains on available for sale securities, net of deferred income taxes of $174,000				340	
Dividends paid ($.19 per share)				(5,204)	
Class A Common Stock sold through employee stock purchase plan — 37,122 shares	1		335		
Class A Common Stock sold through stock option plans — 530,750 shares	18		3,913		
Income tax benefit from stock options exercised			1,381		
Purchase of treasury shares —1,006,500 shares					10,112
Contribution of treasury stock to Employee Stock Purchase Plan — 10,000 shares			62		(67)
Balance — January 30, 1999	$ 802	$ 176	$ 69,878	$ 120,590	$ 19,212

*Total comprehensive income for the years ended January 30, 1999, January 31, 1998 and February 1, 1997 was $24,257, $17,391 and $6,923, respectively.

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies:

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

Description of Business and Fiscal Year — The Company has principally two segments of business — operation of women's apparel specialty stores and a credit card division. The Company's stores operate under the names Cato, Cato Fashions, Cato Plus and It's Fashion! and are located primarily in strip shopping centers in the Southeast. The Company's fiscal year ends on the Saturday nearest January 31. Fiscal years ended January 30, 1999, January 31, 1998 and February 1, 1997 each included fifty-two weeks.

Use of Estimates — The preparation of the Company's financial statements in conformity with generally accepted accounting principles 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.

Cash and Cash Equivalents and Short-Term Investments — Cash equivalents consist of highly liquid investments with original maturities of three months or less. Investments with original maturities beyond three months are classified as short-term investments. The fair values of short-term investments are based on quoted market prices.

The Company's short-term investments held at January 30, 1999 and January 31, 1998 are classified as available-for-sale. Available-for-sale securities are carried at fair value, with unrealized gains and losses, net of income taxes, reported as a component of other comprehensive income. The amortized 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 other income.

Accounts Receivable — Accounts receivable include customer trade accounts, customer layaway receivables and miscellaneous trade receivables. Customer receivables related to layaway sales are reflected net of a reserve for unrealized profit. Net layaway receivables totaled approximately $308,000 and $1,749,000 at January 30, 1999 and January 31, 1998, respectively.

Supplemental Cash Flow Information — Interest paid during the fiscal years ended January 30, 1999, January 31, 1998 and February 1, 1997 was $193,000, $255,000 and $308,000, respectively. Income tax payments, net of refunds received, for the fiscal years ended January 30, 1999, January 31, 1998 and February 1, 1997 were $13,394,000, $6,754,000 and $4,324,000, respectively.

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

Property and Equipment — Property and equipment are recorded at cost. Maintenance and repairs are charged to operations as incurred; renewals and betterments are capitalized. Depreciation of property and equipment is provided on the straight-line method over the estimated useful lives of the related assets, which are as follows:

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

Retail Sales — Revenues from retail sales (including layaway transactions) are recognized at the time of the sale, net of returns, and exclude sales taxes.

Advertising — Advertising costs are expensed in the period in which they are incurred. Advertising expense was $5,755,000, $7,334,000 and $8,898,000 for the fiscal years ended January 30, 1999, January 31, 1998 and February 1, 1997, respectively.

Earnings Per Share — Basic earnings per share excludes dilution of stock options and is computed by dividing net earnings by the weighted-average number of Class A and Class B common shares outstanding for the respective periods. The weighted-average number of shares used in the basic earnings per share computations was 27,522,582, 28,058,934 and 28,499,843 for the fiscal years ended January 30, 1999, January 31, 1998 and February 1, 1997, respectively. The weighted-average number of shares representing the dilutive effect of stock options was 659,003, 73,450 and 69,732 for the fiscal years ended January 30, 1999, January 31, 1998 and February 1, 1997, respectively. The weighted-average number of shares used in the diluted earnings per share computations was 28,181,585, 28,132,384 and 28,569,575 for the fiscal years ended January 30, 1999, January 31, 1998 and February 1, 1997, respectively.

Income Taxes — The Company and its subsidiaries file 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.

Store Opening and Closing Costs — Costs relating to the opening of new stores or the relocating or expanding of existing stores are expensed as incurred. The Company evaluates all long-lived assets, including certain identifiable intangibles related to those assets, for impairment. Impairment losses are recognized when expected future cash flows from the use of the assets are less than the assets' carrying values.

Closed Store Lease Obligations — At the time stores are closed, provision is made for the rentals required to be paid over the remaining lease terms. Rentals due the Company under non-cancelable subleases are offset against the related obligations in the year the sublease is signed. There is no offset for assumed sublease revenues.

Fair Value of Financial Instruments — The Company's carrying values of financial instruments, other than short-term investments, approximate their fair values due to their short terms to maturity and/or their variable interest rates.

Recent Accounting Pronouncements — In March 1998, the American Institute of Certified Public Accountants ("AICPA") issued Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" ("SOP 98-1"), which provides guidance on the capitalization of certain software development costs. Adoption of SOP 98-1 is effective for fiscal 1999, and management is currently evaluating the effect this statement may have on the financial statements.

In April 1998, the AICPA issued Statement of Position 98-5, "Reporting on the Costs of Start-Up Activities" ("SOP 98-5"), which provides guidance on the accounting for start-up costs. The Company adopted SOP 98-5 in fiscal 1998, and the effect on the financial statements was immaterial.

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133") which addresses the accounting for derivative instruments, including certain derivative instruments embedded in other contracts and hedging activities. SFAS 133 is effective for the Company's fiscal 2000. The Company has not yet completed its analysis of any potential impact of SFAS 133 on its financial statements.

Reclassifications — Certain reclassifications have been made to the consolidated financial statements for prior fiscal years to conform with classifications used for the 1998 fiscal year.

Notes to Consolidated Financial Statements

2. Short-Term Investments:

Short-term investments at January 30, 1999 include the following:

Security Type	Cost	Unrealized Gains	Estimated Fair Value
		(In thousands)	
Obligations of states and political subdivisions	$ 41,796	$ 345	$ 42,141
Corporate debt securities	—	—	—
Total	$ 41,796	$ 345	$ 42,141

Short-term investments at January 31, 1998 include the following:

Security Type	Cost	Unrealized (Losses)	Estimated Fair Value
		(In thousands)	
Obligations of states and political subdivisions	$ 26,012	$ (94)	$ 25,918
Corporate debt securities	2,000	(75)	1,925
Total	$ 28,012	$ (169)	$ 27,843

The unrealized gains at January 30, 1999 of $224,000, net of an income tax expense of $121,000, and the unrealized losses at January 31, 1998 of $116,000, net of an income tax benefit of $53,000, are reflected in other comprehensive income.

The amortized cost and estimated fair value of debt securities at January 30, 1999, by contractual maturity, are shown below:

Security Type	Cost	Estimated Fair Value
	(In thousands)	
Due in one year or less	$ 7,148	$ 7,112
Due in one year through three years	34,648	35,029
Total	$ 41,796	$ 42,141

3. Accounts Receivable:

Accounts receivable consist of the following:

	January 30, 1999	January 31, 1998
	(In thousands)	
Customer accounts – principally deferred payment accounts	**$ 46,913**	$ 48,948
Miscellaneous trade receivables	**1,824**	1,939
Total	**48,737**	50,887
Less allowance for doubtful accounts	**4,201**	3,701
Accounts receivable - net	**$ 44,536**	$ 47,186

Finance charge and late charge revenue on customer deferred payment accounts totaled $11,113,000, $8,262,000 and $6,937,000 for the fiscal years ended January 30, 1999, January 31, 1998 and February 1, 1997, respectively, and the provision for doubtful accounts was $4,081,000, $3,675,000 and $3,585,000, for the fiscal years ended January 30, 1999, January 31, 1998 and February 1, 1997, respectively. The provision for doubtful accounts is classified as a component of selling, general and administrative expenses.

4. Property and Equipment:

Property and equipment consist of the following:

	January 30, 1999	January 31, 1998
	(In thousands)	
Land and improvements	**$ 1,709**	$ 1,661
Buildings	**15,784**	15,445
Leasehold improvements	**19,190**	17,484
Fixtures and equipment	**66,817**	61,635
Construction in progress	**3,449**	298
Total	**106,949**	96,523
Less accumulated depreciation	**52,209**	46,722
Property and equipment - net	**$ 54,740**	$ 49,801

5. Accrued Expenses:

Accrued expenses consist of the following:

	January 30, 1999	January 31, 1998
	(In thousands)	
Accrued bonus and retirement savings plan contributions	**$ 6,371**	$ 3,761
Accrued payroll and related items	**2,705**	2,492
Closed store lease obligations	**2,168**	2,901
Property and other taxes	**2,266**	1,451
Accrued health care	**2,068**	938
Other	**5,413**	5,701
Total accrued expenses	**$ 20,991**	$ 17,244

6. Financing Arrangements:

At January 30, 1999, the Company had an unsecured revolving credit agreement which provides for borrowings of up to $35 million. The revolving credit agreement is committed until May 2001. The credit agreement contains various financial covenants and limitations, including the maintenance of specific financial ratios. There were no borrowings outstanding under the agreement at January 30, 1999 or January 31, 1998.

The Company had approximately $5,524,000 and $7,641,000 at January 30, 1999 and January 31, 1998, respectively, of outstanding irrevocable letters of credit relating to purchase commitments. Upon satisfaction of the terms of the letters of credit, the Company is obligated to pay the issuing bank the dollar amount of the commitment.

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

In October 1993, the Company registered 250,000 shares of Class A Common Stock available for issuance under an Employee Stock Purchase Plan (the "Plan"). In May 1998, the shareholders approved an amendment to the Plan to increase the maximum number of Class A shares of Common Stock authorized to be issued from 250,000 to 500,000 shares. Under the terms of the Plan, substantially all employees may purchase Class A Common Stock through payroll deductions of up to 10% of their salary. The Class A Common Stock is purchased at the lower of 85% of market value on the first or last business day of a six-month payment period. Additionally, each April 15, employees are given the opportunity to make a lump sum purchase of up to $10,000 worth of Class A Common Stock at 85% of market value. The number of shares purchased by participants through the plan were 37,122 shares and 47,194 shares for the years ended January 30, 1999 and January 31, 1998, respectively.

The Company has an Incentive Stock Option Plan and a Non-Qualified Stock Option Plan for key employees of the Company. Total shares issuable under the plans are 3,900,000, of which 825,000 shares are issuable under the Incentive Stock Option Plan and 3,075,000 shares are issuable under the Non-Qualified Stock Option Plan. The purchase price of the shares under option must be at least 100 percent of the fair market value of Class A Common Stock at the date of the grant and must be exercisable not later than 10 years after the date of the grant unless otherwise expressly authorized by the Board of Directors.

Notes to Consolidated Financial Statements

Option plan activity for the three fiscal years ended January 30, 1999 is set forth below:

	Options Outstanding	Range of Option Prices	Weighted Average Price
Outstanding options, February 3, 1996	3,017,800	$ 1.42 - $ 8.42	$ 7.28
Granted	76,000	4.94 - 9.31	6.70
Exercised	(110,250)	1.42 - 7.69	3.03
Cancelled	(151,800)	2.09 - 7.81	7.61
Outstanding options, February 1, 1997	2,831,750	1.42 - 9.31	7.41
Granted	1,023,000	5.03 - 9.25	8.10
Exercised	(89,050)	1.42 - 7.69	4.36
Cancelled	(979,968)	6.97 - 8.25	7.51
Outstanding options, January 31, 1998	2,785,732	1.50 - 9.31	7.73
Granted	302,000	10.66 - 14.59	13.03
Exercised	(530,750)	1.50 - 9.31	7.38
Cancelled	(95,000)	4.94 - 12.56	7.63
Outstanding options, January 30, 1999	2,461,982	$ 1.50 - $ 14.59	$ 8.45

The following tables summarize information about stock options outstanding at January 30, 1999:

	Options Outstanding		
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price
$ 1.50 - $ 7.63	838,782	3.49 years	$ 7.35
$ 7.96 - $ 8.25	1,293,000	7.86 years	$ 8.08
$ 9.25 - $ 14.59	330,200	9.64 years	$ 12.69
$ 1.50 - $ 14.59	2,461,982	6.61 years	$ 8.45

	Options Exercisable	
Range of Exercise Prices	Number Exercisable	Weighted Average Exercise Price
$ 1.50 - $ 7.63	777,782	$ 7.52
$ 7.96 - $ 8.25	414,400	$ 7.95
$ 9.25 - $ 14.59	4,000	$ 9.31
$ 1.50 - $ 14.59	1,196,182	$ 7.68

Outstanding options at January 30, 1999 covered 517,000 shares of Class B Common Stock and 1,944,982 shares of Class A Common Stock. Outstanding options at January 31, 1998 covered 317,000 shares of Class B Common Stock and 2,468,732 shares of Class A Common Stock. Options available to be granted under the option plans were 184,368 shares at January 30, 1999 and 391,368 shares at January 31, 1998.

The Company applies APB Opinion No. 25, “Accounting for Stock Issued to Employees”, and related interpretations in accounting for its stock options plans. Accordingly, no compensation expense has been recognized for stock-based compensation where the option price of the stock approximated the fair market value of the stock on the date of grant. Had compensation expense for fiscal 1998, 1997 and 1996 stock options granted been determined consistent with Statement of Financial Accounting Standards No. 123 (SFAS 123), “Accounting for Stock-Based Compensation”, the Company's net income and basic and diluted earnings per share amounts for fiscal 1998, 1997 and 1996 would approximate the following proforma amounts (dollars in thousands, except per share data):

	As Reported	Proforma
Net Income — Fiscal 1998	$ 23,917	$ 22,822
Basic Earnings Per Share	$ .87	$ .83
Diluted Earnings Per Share	$ .85	$ .81
Net Income — Fiscal 1997	$ 17,401	$ 16,476
Basic Earnings Per Share	$ .62	$ .59
Diluted Earnings Per Share	$ .62	$ .59
Net Income — Fiscal 1996	$ 7,029	$ 6,668
Basic Earnings Per Share	$ .25	$ .23
Diluted Earnings Per Share	$ .25	$ .23

The weighted-average fair value of each option granted during fiscal 1998, 1997 and 1996 is estimated as $6.71, $4.02 and $3.34 per share, respectively. The fair value of each option grant is estimated using the Black-Scholes option-pricing model with the following assumptions for grants issued in 1998, 1997 and 1996, respectively: expected dividend yield of 2.20%, 1.49% and 2.67%; expected volatility of 66.44%, 58.14% and 59.24%, adjusted for expected dividends; risk-free interest rate of 5.07%, 5.44% and 6.69%; and an expected life of 5 years, 5 years and 4 years. The effects of applying SFAS 123 in this proforma disclosure are not indicative of future amounts.

In February 1999, the Board of Directors increased the quarterly dividend by 10% from $.05 per share to $.055 per share.

In fiscal 1998, the Company adopted Statement of Financial Accounting Standards No. 130, “Reporting Comprehensive Income”, which requires the components of comprehensive income to be disclosed in the financial statements. Total comprehensive income is composed of net income and unrealized gains or losses on available-for-sale securities. Total comprehensive income for the years ended January 30, 1999, January 31, 1998 and February 1, 1997 is as follows:

	Fiscal Year Ended		
	January 30, 1999	January 31, 1998	February 1, 1997
		(In thousands)	
Net income	**$ 23,917**	$17,401	$ 7,029
Unrealized gains (losses) on available for sale securities, net of taxes	**340**	(10)	(106)
Total comprehensive income	**$ 24,257**	$17,391	$ 6,923

The following schedule summarizes the activity in other comprehensive income for the year ended January 30, 1999 (in thousands):

	Pre-tax	Tax Expense	Net of Tax
Net unrealized gains arising during the year	$ 299	$ 99	$ 200
Add: Reclassification adjustments for losses included in net income	215	75	140
Other comprehensive income	$ 514	$ 174	$ 340

8. Employee Benefit Plans:

The Company has a defined contribution retirement savings plan (401(k)) which covers all employees who meet minimum age and service requirements. The 401(k) plan allows participants to contribute up to 16% of their annual compensation. The Company is obligated to make a minimum contribution and further Company contributions, at the discretion of the Board of Directors, based on a formula of percentages of pre-tax profits. The Company’s contributions for the years ended January 30, 1999, January 31, 1998 and February 1, 1997 were approximately $1,606,000, $1,177,000 and $798,000, respectively. The Company has an Employee Stock Ownership Plan (ESOP), which covers substantially all employees who meet minimum age and service requirements. The Board of Directors determines contributions to the ESOP. The contributions for the fiscal years ended January 30, 1999 and January 31, 1998 were $531,000 and $130,000, respectively. No contribution was made to the ESOP for the year ended February 1, 1997. The Company is self-insured with respect to employee health, workers compensation and general liability claims. Employee health claims are funded through a VEBA trust to which the Company makes periodic contributions. The Company has stop-loss insurance coverage for individual claims in excess of $200,000. Contributions to the VEBA trust were $4,177,000, $3,854,000 and $3,200,000 in fiscal 1998, 1997 and 1996, respectively.

9. Leases:

The Company has operating lease arrangements for store facilities and equipment. Facility leases generally are for periods of five years with renewal options, and most provide for additional contingent rentals based on a percentage of store sales in excess of stipulated amounts. Equipment leases are generally for three-to seven-year periods. The Company has an agreement with a lessor to lease $19.5 million of store fixtures, point-of-sale devices and warehouse equipment. These leases, which do not meet criteria for capital lease accounting, are being accounted for as operating leases and have terms of seven years. However, these leases may be cancelled annually upon proper notice to the lessor. Upon notice of cancellation, the Company would be obligated to purchase the equipment at a prescribed termination value from the lessor. If the Company cancelled the leases, the purchase price for the equipment would be approximately $11,381,000.

Notes to Consolidated Financial Statements

The minimum commitments relating to future payments under non-cancelable operating leases are (in thousands):

Fiscal Year	
1999	$ 27,501
2000	20,582
2001	16,889
2002	12,350
2003	6,408
Thereafter	2,787
Total minimum lease payments	$ 86,517

The following schedule shows the composition of total rental expense for all leases:

	Fiscal Year Ended		
	January 30, 1999	January 31, 1998	February 1, 1997
		(In thousands)	
Minimum rentals	**$ 30,313**	$ 29,660	$ 30,028
Contingent rent	**270**	226	218
Total rental expense	**$ 30,583**	$ 29,886	$ 30,246

10. Income Taxes:

The provision for income taxes consists of the following:

	Fiscal Year Ended		
	January 30, 1999	January 31, 1998	February 1, 1997
		(In thousands)	
Current income taxes:			
Federal	**$ 12,502**	$ 6,825	$ 4,056
State	**338**	685	584
Total	**12,840**	7,510	4,640
Deferred income taxes:			
Federal	**(190)**	205	(477)
State	**228**	291	(294)
Total	**38**	496	(771)
Total income tax expense	**$ 12,878**	$ 8,006	$ 3,869

Significant components of the Company's deferred tax assets and liabilities as of January 30, 1999 and January 31, 1998 are as follows:

	January 30, 1999	January 31, 1998
	(In thousands)	
Deferred tax assets:		
Bad debt reserve	**$ 1,623**	$ 1,432
Inventory valuation	**1,134**	1,197
Unrealized losses on short-term investments	**—**	53
Reserves	**958**	1,202
Total deferred tax assets	**3,715**	3,884
Deferred tax liabilities:		
Tax over book depreciation	**6,326**	6,426
Unrealized gains on short-term investments	**121**	—
Other, net	**(182)**	(204)
Total deferred tax liabilities	**6,265**	6,222
Net deferred tax liabilities	**$ 2,550**	$ 2,338

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

	Fiscal Year Ended		
	January 30, 1999	January 31, 1998	February 1, 1997
Federal income tax rate	**35.0%**	35.0%	35.0%
State income taxes	**1.2**	2.9	4.0
Other	**(1.2)**	(6.4)	(3.5)
Effective income tax rate	**35.0%**	31.5%	35.5%

11. Quarterly Financial Data (Unaudited):

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

Fiscal 1998	First	Second	Third	Fourth
Retail sales	$ 136,174	$ 132,573	$ 113,834	$ 141,800
Total revenues	141,044	137,176	118,600	146,844
Cost of goods sold	89,179	93,864	81,364	106,598
Net income	11,117	5,635	2,809	4,356
Basic earnings per share	$ .40	$ .20	$ .10	$ .16
Diluted earnings per share	$ .39	$ .20	$ .10	$ .16
Fiscal 1997				
Retail sales	$ 123,251	$ 120,901	$ 109,886	$ 142,813
Total revenues	127,500	124,451	113,743	146,754
Cost of goods sold	83,056	85,954	80,028	105,589
Net income	8,020	3,776	1,390	4,215
Basic earnings per share	$ .28	$ .13	$ .05	$ .15
Diluted earnings per share	$ .28	$ .13	$ .05	$ .15

12. Store Closings:

In the normal course of business, the Company routinely closes those stores which fail to demonstrate the ability to consistently generate an acceptable return on investment and contribution to corporate overhead. Although such closings generally occur throughout the year as a result of management's ongoing profitability analysis, in the fourth quarter of fiscal 1996 the Company, in an effort to better align store operations with the current apparel industry environment, decided to close 40 underperforming stores by the end of the fiscal year. All of these stores were closed by late January 1997. The costs of closing these stores included the write-off of leasehold improvements and store fixtures that will not be utilized at other stores, employee severance pay and the remaining non-cancelable lease payments. Total costs were $5,500,000, of which $242,000 and $998,000 was unpaid and accrued at January 30, 1999 and January 31, 1998, respectively. The remaining accrued lease payments at January 30, 1999 will be paid over the remaining lease terms which range from 2 to 23 months.

13. Reportable Segment Information:

The Company has two reportable segments: retail and credit. The Company operates its women's apparel specialty retail stores in 21 states, principally in the Southeast. The Company offers its own credit card to its customers, and all credit authorizations, payment processing, and collection efforts are performed by a separate division of the Company.

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

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

Fiscal 1998	Retail	Credit	Total
Revenues	$ 532,330	$ 11,334	$ 543,664
Depreciation	7,613	25	7,638
Interest expense	192	48	240
Income before taxes	33,044	3,751	36,795
Total assets	200,946	57,567	258,513
Capital expenditures	13,459	60	13,519
Fiscal 1997			
Revenues	$ 503,914	$ 8,534	$ 512,448
Depreciation	7,685	28	7,713
Interest expense	262	—	262
Income before taxes	24,535	872	25,407
Total assets	197,871	43,566	241,437
Capital expenditures	7,377	—	7,377
Fiscal 1996			
Revenues	$ 484,292	$ 7,217	$ 491,509
Depreciation	8,277	53	8,330
Interest expense	262	—	262
Income (loss) before taxes	11,160	(262)	10,898
Total assets	180,361	37,882	218,243
Capital expenditures	8,371	—	8,371

14. Commitments and Contingencies:

Workers compensation and general liability claims are settled through a claims administrator and are limited by stop-loss insurance coverage for individual claims in excess of $250,000 and

$100,000, respectively. The Company paid claims of $1,347,000, $970,000 and $1,158,000 in fiscal years 1998, 1997 and 1996, respectively. The Company had approximately $1,600,000 at January 30, 1999 and $1,832,000 at January 31, 1998, respectively, of outstanding letters of credit relating to such claims. See Note 6 for letters of credit related to purchase commitments, Note 8 for 401(k) plan contribution obligations and Note 9 for lease commitments.

The Company is a defendant in legal proceedings considered to be in the normal course of business and none of which, singularly or collectively, are considered to be material to the Company as a whole.

Independent Auditors' Report

To The Board of Directors and Stockholders of The Cato Corporation

We have audited the accompanying consolidated balance sheets of The Cato Corporation and subsidiaries (the Company) as of January 30, 1999 and January 31, 1998, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended January 30, 1999. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company at January 30, 1999 and January 31, 1998, and the results of its operations and its cash flows for each of the three years in the period ended January 30, 1999, in conformity with generally accepted accounting principles.

Charlotte, North Carolina
March 12, 1999

Management Executive Group

Wayland H. Cato, Jr.
Chairman of the Board and Chief Executive Officer

John P. Derham Cato
Vice Chairman of the Board, President and Chief Operating Officer

Michael O. Moore
Executive Vice President, Chief Financial Officer and Secretary

Howard A. Severson
Executive Vice President, Chief Real Estate and Store Development Officer and Assistant Secretary

B. Allen Weinstein
Executive Vice President and Chief Merchandising Officer of the Cato Division

David P. Kempert
Executive Vice President and Chief Store Operations Officer of the Cato Division

C. David Birdwell
Executive Vice President, President and General Manager of the It's Fashion! Division

Stephen R. Clark
Senior Vice President, Human Resources and Assistant Secretary

Board of Directors

Wayland H. Cato, Jr.+~
Chairman of the Board and Chief Executive Officer

John P. Derham Cato
Vice Chairman of the Board, President and Chief Operating Officer

Edgar T. Cato
Former Vice Chairman of the Board and Co-Founder

Howard A. Severson
Executive Vice President, Chief Real Estate and Store Development Officer and Assistant Secretary

Clarice Cato Goodyear+~
Special Assistant to the Chairman and President, and Assistant Secretary

Thomas E. Cato
Vice President, Divisional Merchandise Manager

Robert W. Bradshaw, Jr.+*
Partner - Robinson, Bradshaw & Hinson, P.A.

George S. Currin+*
Chairman and Managing Director of The Fourth Stockton Company and Chairman, Currin-Patterson Properties LLC

Paul Fulton+*
Chairman and Chief Executive Officer, Bassett Furniture Industries, Inc.

Grant L. Hamrick+*
Retired Senior Vice President, Chief Financial Officer American City Business Journals

James H. Shaw+*
Retired Chairman and Chief Executive Officer, Ivey's Department Stores

A. F. (Pete) Sloan+*
Retired Chairman of the Board of Lance, Inc.

+ Member of the Compensation Committee
** Member of the Audit and Stock Option Committee*
~ Member Audit Committee

Corporate Information

A copy of the Company's Annual Report to the Securities and Exchange Commission (Form 10-K) for the fiscal year ended January 30, 1999 is available to stockholders without charge upon written request to Mr. Michael O. Moore, Executive Vice President, Chief Financial Officer and Secretary, The Cato Corporation, P.O. Box 34216, Charlotte, North Carolina 28234.

Independent Auditors
Deloitte & Touche LLP
Charlotte, North Carolina 28202-1675

Transfer Agent and Registrar
First Union National Bank
Securities Transfer Department, CMG-5
Charlotte, North Carolina 28288

Corporate Counsel
Robinson, Bradshaw & Hinson, P.A.
Charlotte, North Carolina 28246

Corporate Headquarters
The Cato Corporation
8100 Denmark Road
Charlotte, North Carolina 28273-5975
Telephone: (704) 554-8510

Mailing Address
P.O. Box 34216
Charlotte, North Carolina 28234

Market & Dividend Information

The Company's Class A Common Stock trades in the over-the-counter market under the NASDAQ National Market System symbol CACOA. Below is the market range and dividend information for the four quarters of 1998 and 1997.

	Price		
1998	**High**	**Low**	**Dividend**
First quarter	$ 15 1/8	$ 10 1/2	$ .045
Second quarter	19 1/8	13 1/8	.045
Third quarter	15 1/2	7 1/2	.05
Fourth quarter	15 5/8	7 11/16	.05

	Price		
1997	**High**	**Low**	**Dividend**
First quarter	$ 6 1/4	$ 3 63/64	$ .04
Second quarter	7 5/8	4 1/8	.04
Third quarter	10	7	.04
Fourth quarter	12	7	.04

As of March 26, 1999 the approximate number of holders of the Company's Class A Common stock was 3,626 and there were 12 record holders of the Company's Class B Common Stock.

Annual Meeting Notice

The Annual Meeting of Stockholders will be held at 11:00 a.m., Thursday, May 20, 1999 at the Company's corporate offices located at 8100 Denmark Road, Charlotte, North Carolina.

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The Cato Corporation

8100 Denmark Rd.

Charlotte, NC 28273-5975