

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 **July 29, 2006**

OR

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

For the transition period from _____ to _____

Commission file number 1-31340

THE CATO CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

56-0484485

(State or other jurisdiction
of incorporation or organization)

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

8100 Denmark Road, Charlotte, North Carolina 28273-5975

(Address of principal executive offices)

(Zip Code)

(704) 554-8510

(Registrant's telephone number, including area code)

Not Applicable

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

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

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-Accelerated filer

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

Yes No

As of August 15, 2006, there were 30,814,830 shares of Class A common stock and 690,525 shares of Class B common stock outstanding.

THE CATO CORPORATION
FORM 10-Q
Quarter Ended July 29, 2006
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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

THE CATO CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND
COMPREHENSIVE INCOME

| | <u>Three Months Ended</u> | | <u>Six Months Ended</u> | |
|---|---|--|--|--|
| | <u>July 29, 2006 (Unaudited)</u> | <u>July 30, 2005 (Unaudited)</u> | <u>July 29, 2006 (Unaudited)</u> | <u>July 30, 2005 (Unaudited)</u> |
| | (Dollars in thousands, except per share data) | | | |
| REVENUES | | | | |
| Retail sales | \$ 214,633 | \$ 208,316 | \$ 444,374 | \$ 423,380 |
| Other income (principally finance charges, late fees and layaway charges) | 3,212 | 3,648 | 6,531 | 7,511 |
| Total revenues | <u>217,845</u> | <u>211,964</u> | <u>450,905</u> | <u>430,891</u> |
| COSTS AND EXPENSES, NET | | | | |
| Cost of goods sold | 143,746 | 140,426 | 285,858 | 276,860 |
| Selling, general and administrative | 51,762 | 50,765 | 106,329 | 100,097 |
| Depreciation | 5,223 | 5,025 | 10,391 | 10,064 |
| Interest expense | 10 | 10 | 20 | 162 |
| Interest and other income | (1,940) | (1,071) | (3,492) | (2,012) |
| | <u>198,801</u> | <u>195,155</u> | <u>399,106</u> | <u>385,171</u> |
| Income before income taxes | 19,044 | 16,809 | 51,799 | 45,720 |
| Income tax expense | 6,951 | 6,102 | 18,907 | 16,596 |
| Net Income | <u>\$ 12,093</u> | <u>\$ 10,707</u> | <u>\$ 32,892</u> | <u>\$ 29,124</u> |
| Basic earnings per share | <u>\$ 0.39</u> | <u>\$ 0.34</u> | <u>\$ 1.05</u> | <u>\$ 0.94</u> |
| Basic weighted average shares | <u>31,267,637</u> | <u>31,188,146</u> | <u>31,250,921</u> | <u>31,146,236</u> |
| Diluted earnings per share | <u>\$ 0.38</u> | <u>\$ 0.34</u> | <u>\$ 1.04</u> | <u>\$ 0.92</u> |
| Diluted weighted average shares | <u>31,803,875</u> | <u>31,828,039</u> | <u>31,765,992</u> | <u>31,811,183</u> |
| Dividends per share | <u>\$ 0.15</u> | <u>\$ 0.13</u> | <u>\$ 0.28</u> | <u>\$ 0.247</u> |
| Comprehensive income: | | | | |
| Net income | \$ 12,093 | \$ 10,707 | \$ 32,892 | \$ 29,124 |
| Unrealized gains on available-for-sale securities, net of deferred income tax expense | 56 | 70 | 34 | 30 |
| Net comprehensive income | <u>\$ 12,149</u> | <u>\$ 10,777</u> | <u>\$ 32,926</u> | <u>\$ 29,154</u> |

See notes to condensed consolidated financial statements.

THE CATO CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

| | July 29, 2006 <u>(Unaudited)</u> | July 30, 2005 <u>(Unaudited)</u> | January 28, 2006 |
|--|--|--|---------------------|
| | (Dollars in thousands) | | |
| ASSETS | | | |
| Current Assets: | | | |
| Cash and cash equivalents | \$ 21,809 | \$ 23,884 | \$ 21,734 |
| Short-term investments | 94,171 | 86,140 | 86,085 |
| Accounts receivable, net of allowance for doubtful accounts of \$3,589, \$5,955 and \$3,694 at July 29, 2006, July 30, 2005 and January 28, 2006, respectively | 46,436 | 48,229 | 49,644 |
| Merchandise inventories | 91,989 | 84,904 | 103,370 |
| Deferred income taxes | 8,506 | 5,764 | 8,526 |
| Prepaid expenses | 2,464 | 2,180 | 2,318 |
| Total Current Assets | 265,375 | 251,101 | 271,677 |
| Property and equipment – net | 130,422 | 118,599 | 124,104 |
| Other assets | 11,201 | 10,818 | 10,855 |
| Total Assets | \$ 406,998 | \$ 380,518 | \$ 406,636 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | |
| Current Liabilities: | | | |
| Accounts payable | \$ 58,210 | \$ 64,272 | \$ 78,036 |
| Accrued expenses | 32,433 | 29,951 | 31,967 |
| Accrued bonus and benefits | 10,342 | 8,161 | 17,570 |
| Accrued income taxes | 7,779 | 10,252 | 4,990 |
| Total Current Liabilities | 108,764 | 112,636 | 132,563 |
| Deferred income taxes | 9,261 | 10,172 | 9,261 |
| Other noncurrent liabilities (primarily deferred rent) | 23,230 | 23,732 | 24,864 |
| Commitments and contingencies: | | | |
| Stockholders' Equity: | | | |
| Preferred stock, \$100 par value per share, 100,000 shares authorized, none issued | ¾ | ¾ | ¾ |
| Class A common stock, \$.033 par value per share, 50,000,000 shares authorized; issued 35,909,497 shares, 30,650,431 shares and 35,622,516 shares at July 29, 2006, July 30, 2005 and January 28, 2006, respectively | 1,197 | 1,021 | 1,188 |
| Convertible Class B common stock, \$.033 par value per share, 15,000,000 shares authorized; issued 690,525 shares, 5,597,834 shares and 690,525 shares at July 29, 2006, July 30, 2005 and January 28, 2006, respectively | 23 | 187 | 23 |
| Additional paid-in capital | 40,668 | 37,635 | 39,244 |
| Retained earnings | 318,556 | 286,890 | 294,462 |
| Accumulated other comprehensive income | 112 | 101 | 78 |
| Unearned compensation – restricted stock awards | ¾ | (569) | (229) |
| Total Stockholders' Equity | 360,556 | 325,265 | 334,766 |
| Less Class A and Class B common stock in treasury, at cost (5,093,609 Class A and –0– Class B shares at July 29, 2006, and 231 Class A and 4,907,309 Class B at July 30, 2005 and 5,093,840 Class A and –0– Class B at January 28, 2006) | (94,813) | (91,287) | (94,818) |
| Total Liabilities and Stockholders' Equity | \$ 406,998 | \$ 380,518 | \$ 406,636 |

See notes to condensed consolidated financial statements.

THE CATO CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Six Months Ended | |
|---|--|--|
| | July 29, 2006 (Unaudited) | July 30, 2005 (Unaudited) |
| | (Dollars in thousands) | |
| OPERATING ACTIVITIES | | |
| Net income | \$ 32,892 | \$ 29,124 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 10,391 | 10,064 |
| Provision for doubtful accounts | 1,627 | 2,443 |
| Share-based compensation | 626 | 341 |
| Excess tax benefits from share-based compensation | (284) | ¾ |
| Deferred income taxes | 20 | 17 |
| Loss on disposal of property and equipment | 569 | 690 |
| Changes in operating assets and liabilities which provided (used) cash: | | |
| Accounts receivable | 1,581 | 217 |
| Merchandise inventories | 11,381 | 15,634 |
| Prepaid and other assets | (493) | (890) |
| Accrued income taxes | 3,073 | 5,787 |
| Accounts payable, accrued expenses and other liabilities | (28,930) | (24,485) |
| Net cash provided by operating activities | 32,453 | 38,942 |
| INVESTING ACTIVITIES | | |
| Expenditures for property and equipment | (17,370) | (11,684) |
| Purchases of short-term investments | (95,287) | (44,877) |
| Sales of short-term investments | 87,235 | 47,355 |
| Net cash used in investing activities | (25,422) | (9,206) |
| FINANCING ACTIVITIES | | |
| Change in cash overdrafts included in accounts payable | 805 | 4,195 |
| Dividends paid | (8,798) | (7,734) |
| Payments to settle long term debt | ¾ | (22,000) |
| Proceeds from employee stock purchase plan | 206 | 230 |
| Excess tax benefits from share-based compensation | 284 | ¾ |
| Proceeds from stock options exercised | 547 | 817 |
| Net cash used in financing activities | (6,956) | (24,492) |
| Net increase in cash and cash equivalents | 75 | 5,244 |
| Cash and cash equivalents at beginning of period | 21,734 | 18,640 |
| Cash and cash equivalents at end of period | \$ 21,809 | \$ 23,884 |

See notes to condensed consolidated financial statements.

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED JULY 29, 2006 AND JULY 30, 2005

NOTE 1 — GENERAL:

The condensed consolidated financial statements have been prepared from the accounting records of The Cato Corporation and its wholly-owned subsidiaries (the "Company"), and all amounts shown as of and for the periods ended July 29, 2006 and July 30, 2005 are unaudited. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. All such adjustments are of a normal, recurring nature. The results of the interim period may not be indicative of the results expected for the entire year.

The interim financial statements should be read in conjunction with the consolidated financial statements and notes thereto, included in the Company's Annual Report on Form 10-K for the fiscal year ended January 28, 2006.

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.

Short-term investments are classified as available-for-sale. As they are available for current operations, they are classified in the Condensed Consolidated Balance Sheets as current assets. Available-for-sale securities are carried at fair value, with unrealized gains and temporary losses, net of income taxes, reported as a component of accumulated other comprehensive income. Other than temporary declines in fair value of investments are recorded as a reduction in the cost of the investments in the accompanying Condensed Consolidated Balance Sheets and a reduction of interest and other income in the accompanying Condensed 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.

During the third quarter of fiscal 2005, the Company revised its process for determining the amount of accounts receivable that should be written off each period. This change in process was consistent with industry and regulatory guidelines and resulted in an acceleration of accounts receivable write-off of approximately \$1,700,000. This write-off reduced the gross Accounts Receivable balance and the Allowance for Doubtful Accounts in the third quarter of 2005. Accordingly, this change in process had no effect on the current period's earnings and management does not expect that the change will have a material effect on the Company's future earnings or financial position.

Net comprehensive income for the second quarter and six months ended July 29, 2006 was \$12,149,000 and \$32,926,000, respectively. Net comprehensive income for the second quarter and six months ended July 30, 2005 was \$10,777,000 and \$29,154,000, respectively. Net comprehensive income is composed of net income and net unrealized gains and losses on available-for-sale securities, net of tax.

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

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED JULY 29, 2006 AND JULY 30, 2005

NOTE 1 — GENERAL (CONTINUED):

On May 25, 2006, the Board of Directors increased the quarterly dividend by 15% from \$.13 per share to \$.15 per share, or an annualized rate of \$.60 per share. Prior year basic and diluted earnings and dividends per share have been adjusted for the three-for-two stock split in the form of a stock dividend of the Company's Class A and Class B common stock effected June 27, 2005.

NOTE 2 — EARNINGS PER SHARE:

Basic EPS is computed as net income divided by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur from common shares issuable through stock options and other convertible securities. Unvested restricted stock is included in the computation of diluted EPS using the treasury stock method.

| | Three Months Ended | | Six Months Ended | |
|--|---------------------------|--------------------------|--------------------------|--------------------------|
| | July 29, 2006 | July 30, 2005 | July 29, 2006 | July 30, 2005 |
| Weighted-average shares outstanding | 31,267,637 | 31,188,146 | 31,250,921 | 31,146,236 |
| Dilutive effect of : | | | | |
| Stock options | 522,683 | 520,120 | 509,122 | 549,145 |
| Restricted stock | 13,260 | 119,773 | 5,704 | 115,802 |
| Employee stock purchase plan | 295 | ¾ | 245 | ¾ |
| Weighted-average shares and common stock equivalents outstanding | <u>31,803,875</u> | <u>31,828,039</u> | <u>31,765,992</u> | <u>31,811,183</u> |

NOTE 3 — SUPPLEMENTAL CASH FLOW INFORMATION:

Income tax payments, net of refunds received, for the six months ended July 29, 2006 and July 30, 2005 were \$15,875,000 and \$10,504,000, respectively. Cash paid for interest for the six months ended July 29, 2006 and July 30, 2005 were \$-0- and \$209,000, respectively.

NOTE 4 — FINANCING ARRANGEMENTS:

At July 29, 2006, the Company had an unsecured revolving credit agreement, which provided for borrowings of up to \$35 million. The revolving credit agreement is committed until August 2008. This agreement replaced a prior revolving credit agreement which was due to expire in August 2006. 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 July 29, 2006. There were no borrowings outstanding under these credit facilities during the first six months ended July 29, 2006 or July 30, 2005, respectively, or the fiscal year ended January 28, 2006.

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED JULY 29, 2006 AND JULY 30, 2005

NOTE 4 — FINANCING ARRANGEMENTS (CONTINUED):

On August 22, 2003, the Company entered into a new unsecured \$30 million five-year term loan facility, the proceeds of which were used to purchase Class B Common Stock from the Company's founders. Payments were due in monthly installments of \$500,000 plus accrued interest based on LIBOR. On April 5, 2005, the Company repaid the remaining balance of \$20.5 million on this term loan facility with no early prepayment penalty. With the early retirement of this loan, the Company had no outstanding debt as of July 29, 2006.

At July 29, 2006 and July 30, 2005 the Company had approximately \$5,227,000 and \$4,883,000, respectively, of outstanding irrevocable letters of credit relating to purchase commitments.

NOTE 5 — REPORTABLE SEGMENT INFORMATION:

The Company has two reportable segments: retail and credit. The Company operated its women's fashion specialty retail stores in 31 states at July 29, 2006, principally in the southeastern United States. The Company offers its own credit card to its customers and all related credit authorizations, payment processing, and collection efforts are performed by a separate subsidiary of the Company.

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

| Three Months Ended July 29, 2006 | Retail | Credit | Total | Six Months Ended July 29, 2006 | Retail | Credit | Total |
|-------------------------------------|------------|----------|------------|-----------------------------------|------------|----------|------------|
| Revenues | \$ 215,177 | \$ 2,668 | \$ 217,845 | Revenues | \$ 445,547 | \$ 5,358 | \$ 450,905 |
| Depreciation | 5,203 | 20 | 5,223 | Depreciation | 10,352 | 39 | 10,391 |
| Interest and other income | (1,940) | — | (1,940) | Interest and other income | (3,492) | — | (3,492) |
| Income before taxes | 17,827 | 1,217 | 19,044 | Income before taxes | 49,805 | 1,994 | 51,799 |
| Total assets | 337,564 | 69,434 | 406,998 | Total assets | 337,564 | 69,434 | 406,998 |
| Capital expenditures | 4,601 | 4 | 4,605 | Capital expenditures | 17,348 | 22 | 17,370 |

| Three Months Ended July 30, 2005 | Retail | Credit | Total | Six Months Ended July 30, 2005 | Retail | Credit | Total |
|-------------------------------------|------------|----------|------------|-----------------------------------|------------|----------|------------|
| Revenues | \$ 208,706 | \$ 3,258 | \$ 211,964 | Revenues | \$ 424,296 | \$ 6,595 | \$ 430,891 |
| Depreciation | 4,996 | 29 | 5,025 | Depreciation | 10,006 | 58 | 10,064 |
| Interest and other income | (1,071) | — | (1,071) | Interest and other income | (2,012) | — | (2,012) |
| Income before taxes | 15,567 | 1,242 | 16,809 | Income before taxes | 43,393 | 2,327 | 45,720 |
| Total assets | 315,492 | 65,026 | 380,518 | Total assets | 315,492 | 65,026 | 380,518 |
| Capital expenditures | 4,951 | 2 | 4,953 | Capital expenditures | 11,682 | 2 | 11,684 |

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

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

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED JULY 29, 2006 AND JULY 30, 2005

NOTE 5 — REPORTABLE SEGMENT INFORMATION (CONTINUED):

| | Three Months Ended | | Six Months Ended | |
|-----------------------|---------------------------|--------------------------|--------------------------|--------------------------|
| | July 29, 2006 | July 30, 2005 | July 29, 2006 | July 30, 2005 |
| Bad debt expense | \$ 600 | \$ 1,179 | \$ 1,581 | \$ 2,443 |
| Payroll | 262 | 254 | 514 | 550 |
| Postage | 245 | 292 | 541 | 597 |
| Other expenses | 324 | 262 | 689 | 620 |
| Total expenses | \$ 1,431 | \$ 1,987 | \$ 3,325 | \$ 4,210 |

NOTE 6 — STOCK BASED COMPENSATION:

Effective January 29, 2006, the Company began recording compensation expense associated with stock options and other forms of equity compensation in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 123R, *Share-Based Payment*, as interpreted by SEC Staff Accounting Bulletin No. 107. Prior to January 29, 2006, the Company had accounted for stock options according to the provisions of Accounting Principles Board (“APB”) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations, and therefore no related compensation expense was recorded for awards granted with no intrinsic value at the date of the grant. The Company adopted the modified prospective transition method provided under SFAS No. 123R, and, consequently, has not adjusted results from prior periods to retroactively reflect compensation expense. Under this transition method, compensation cost associated with stock options recognized in fiscal 2006 includes: 1) quarterly amortization related to the remaining unvested portion of all stock option awards granted prior to January 29, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123; and 2) quarterly amortization related to all stock option awards granted subsequent to January 29, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123R.

As of July 29, 2006, the Company had three long-term compensation plans pursuant to which stock-based compensation was outstanding or could be granted. The Company’s 1987 Non-Qualified Stock Option Plan authorized 4,612,500 shares for the granting of options to officers and key employees. The 1999 Incentive Compensation Plan and 2004 Incentive Compensation Plan authorized 1,000,000 and 1,350,000 shares, respectively, for the granting of various forms of equity-based awards, including restricted stock and stock options to officers and key employees. The 1999 Plan has expired as to the ability to grant new awards.

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED JULY 29, 2006 AND JULY 30, 2005

NOTE 6 — STOCK BASED COMPENSATION (CONTINUED):

The following table presents the number of options and shares of restricted stock initially authorized and available to grant under each of the plans:

| | 1987 Plan | 1999 Plan | 2004 Plan | Total |
|--|--------------|--------------|--------------|-----------|
| Options and/or restricted stock initially authorized | 4,612,500 | 1,000,000 | 1,350,000 | 6,962,500 |
| Options and/or restricted stock available for grant: | | | | |
| January 28, 2006 | 5,227 | — | 1,300,500 | 1,305,727 |
| July 29, 2006 | 5,227 | — | 1,082,996 | 1,088,223 |

Stock option awards outstanding under the Company's current plans were granted at exercise prices which were equal to the market value of the Company's stock on the date of grant, vest over five years and expire no later than ten years after the grant date.

The following is a summary of the changes in stock options outstanding during the six months ended July 29, 2006:

| | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value (a) |
|---|-----------|--|--|-------------------------------------|
| Options outstanding at January 28, 2006 | 1,343,400 | \$ 8.23 | 3.05 years | |
| Granted | — | — | — | |
| Forfeited or expired | (900) | | | |
| Exercised | (57,625) | | | |
| Outstanding at July 29, 2006 | 1,284,875 | \$ 8.18 | 2.49 years | \$ 18,433,699 |
| Vested and exercisable at July 29, 2006 | 1,178,400 | \$ 7.58 | 2.09 years | \$ 17,617,916 |

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

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions. No options were granted in the first half of fiscal 2006. There were 15,750 options granted in the first quarter and none in the second quarter of fiscal 2005, respectively.

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED JULY 29, 2006 AND JULY 30, 2005

NOTE 6 — STOCK BASED COMPENSATION (CONTINUED):

| | <u>Six Months Ended</u> July 30, 2005 |
|--|---|
| Risk free interest rate | 4.14% |
| Expected life | 5.0 years |
| Expected volatility | 37.63% |
| Expected dividend yield | 2.57% |
| Weighted-average grant date fair value | \$ 6.260 |

As of July 29, 2006, there was approximately \$389,000 of total unrecognized compensation cost related to nonvested options, which is expected to be recognized over a remaining weighted-average vesting period of 2.25 years. The total intrinsic value of options exercised during the second quarter and six months ended July 29, 2006 was approximately \$558,000 and \$778,000, respectively.

Effective January 29, 2006, the Company recognized share-based compensation expense ratably over the vesting period, net of estimated forfeitures. The Company recognized share-based compensation expense of \$382,000 and \$626,000 for the second quarter and six month period ended July 29, 2006, respectively, which was classified as a component of selling, general and administrative expenses. No share-based compensation expense was recognized prior to January 29, 2006 except for the amortization of restricted stock grants.

Had stock-based compensation costs been determined based on the fair value at the grant dates, consistent with SFAS No. 123R prior to January 29, 2006, the Company's net income and earnings per share would have been adjusted to the pro forma amounts indicated below:

| | <u>Three Months Ended</u> July 30, 2005 | <u>Six Months Ended</u> July 30, 2005 |
|---|---|---|
| Net Income as Reported | \$ 10,707 | \$ 29,124 |
| Add: Stock-Based employee compensation expense included in reported net income, net of related tax effects | 109 | 217 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (130) | (258) |
| Pro forma Net Income | \$ 10,686 | \$ 29,083 |
| Earnings per share: | | |
| Basic – as reported | \$.34 | \$.94 |
| Basic – pro forma | \$.34 | \$.93 |
| Diluted – as reported | \$.34 | \$.92 |
| Diluted – pro forma | \$.34 | \$.91 |

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED JULY 29, 2006 AND JULY 30, 2005

NOTE 6 — STOCK BASED COMPENSATION (CONTINUED):

Prior to the adoption of SFAS No. 123R, the Company presented all benefits of tax deductions resulting from the exercise of share-based compensation as operating cash flows in the Statements of Cash Flows. SFAS No. 123R requires the benefits of tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. For the six months ended July 29, 2006, the Company reported \$284,000 of excess tax benefits as a financing cash inflow in addition to \$753,000 in cash proceeds received from the exercise of stock options and Employee Stock Purchase Plan purchases.

The Company's Employee Stock Purchase Plan allows eligible full-time 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 six months ended July 29, 2006, the Company sold 11,852 shares to employees at an average discount of \$3.07 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 \$36,000 for the six months ended July 29, 2006. Prior to the adoption of SFAS 123R, the discount was not required to be charged to expense.

In accordance with SFAS No. 123R, the fair value of current restricted stock awards is estimated on the date of grant based on the market price of the Company's stock and is amortized to compensation expense on a straight-line basis over the related vesting periods. As of July 29, 2006, there was \$4,692,000 of total unrecognized compensation cost related to nonvested restricted stock awards, which is expected to be recognized over a remaining weighted-average vesting period of 4.75 years. The total fair value of the shares recognized as compensation expense during the second quarter and six months ended July 29, 2006 was \$339,000 and \$510,000, respectively.

The following summary shows the changes in the shares of restricted stock outstanding during the six months ended July 29, 2006:

| | Number of Shares | Weighted Average Grant Date Fair Value Per Share |
|---|---------------------|--|
| Restricted stock awards at January 28, 2006 | 150,000 | \$ 18.21 |
| Granted | 219,754 | 22.84 |
| Vested | (150,000) | 18.21 |
| Forfeited | (2,250) | 22.89 |
| Restricted stock awards at July 29, 2006 | 217,504 | \$ 22.84 |

NOTE 7 — RECENT ACCOUNTING PRONOUNCEMENTS:

In June 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109." This Interpretation prescribes the recognition threshold a tax position is required to meet before being recognized in the financial statements. The Interpretation also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods and disclosure of uncertain tax positions. The Interpretation is effective for fiscal years beginning after December 15, 2006. The Company is in the process of evaluating the impact of the adoption of this Interpretation on the Company's consolidated financial statements.

THE CATO CORPORATION

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

FORWARD LOOKING INFORMATION:

The following information should be read along with the unaudited Condensed 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 Form 10-Q 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 "Management's Discussion and Analysis of Financial Condition and Results of Operations"; (4) statements relating to our operations or activities for the remainder of fiscal 2006 and beyond, including, but not limited to, statements regarding expected amounts of capital expenditures and store openings, relocations, remodelings 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: general economic conditions; competitive factors and pricing pressures; our ability to predict fashion trends; consumer apparel buying patterns; adverse weather conditions; inventory risks due to shifts in market demand; and other factors discussed under "Risk Factors" in Part I, Item 1A of our annual report on Form 10-K for the year fiscal year ended January 28, 2006, as amended or supplemented, and in other reports we file with or furnish to the 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 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. We make available free of charge, through our website, 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 those 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 documents are also available in print to any shareholder who requests by contacting our corporate secretary at our company offices.

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

CRITICAL ACCOUNTING POLICIES:

We have prepared the financial statements and accompanying notes included in Item 1 of this report in conformity with United States generally accepted accounting principles in the United States of America. This requires us to make estimates and assumptions that affect the amounts reported in our financial statements and accompanying notes. These estimates and assumptions are based on historical experience, analysis of current trends, and various other factors that we believe to be reasonable under the circumstances. Actual results could differ from those estimates under different assumptions or conditions.

We periodically reevaluate our accounting policies, assumptions, and estimates and make adjustments when facts and circumstances warrant. Historically, actual results have not differed materially from those determined using required estimates. Our critical accounting policies are discussed in the management's discussion and analysis of financial condition and results of operations and notes accompanying the consolidated financial statements that appear in our Annual Report on Form 10-K for the fiscal year ended January 28, 2006. Except as disclosed in the financial statements and accompanying notes, there were no material changes in, or additions to, our critical accounting policies or in the assumptions or estimates we used to prepare the financial information appearing in this report.

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

RESULTS OF OPERATIONS:

The following table sets forth, for the periods indicated, certain items in the Company's unaudited Condensed Consolidated Statements of Income and Comprehensive Income as a percentage of total retail sales:

| | Three Months Ended | | Six Months Ended | |
|-------------------------------------|---------------------------|--------------------------|--------------------------|--------------------------|
| | July 29, 2006 | July 30, 2005 | July 29, 2006 | July 30, 2005 |
| Total retail sales | 100.0% | 100.0% | 100.0% | 100.0% |
| Total revenues | 101.5 | 101.7 | 101.5 | 101.8 |
| Cost of goods sold | 67.0 | 67.4 | 64.3 | 65.4 |
| Selling, general and administrative | 24.1 | 24.4 | 23.9 | 23.6 |
| Depreciation | 2.4 | 2.4 | 2.4 | 2.4 |
| Interest expense | — | — | — | — |
| Interest and other income | (0.9) | (0.5) | (0.8) | (0.4) |
| Income before income taxes | 8.9 | 8.0 | 11.7 | 10.8 |
| Net income | 5.6 | 5.1 | 7.4 | 6.9 |

Comparison of Second Quarter and First Six Months of 2006 with 2005.

Total retail sales for the second quarter were \$214.6 million compared to last year's second quarter sales of \$208.3 million, a 3% increase. Same-store sales decreased 1% in the second quarter of fiscal 2006. For the six months ended July 29, 2006, total retail sales were \$444.4 million compared to last year's first six months sales of \$423.4 million, a 5% increase, and same-store sales were flat for the comparable six month period. Total revenues, comprised of retail sales and other income (principally, finance charges and late fees on customer accounts receivable and layaway fees), were \$217.8 million and \$450.9 million for the second quarter and six months ended July 29, 2006, respectively, compared to \$212.0 million and \$430.9 million for the second quarter and six months ended July 30, 2005, respectively. The Company operated 1,259 stores at July 29, 2006 compared to 1,197 stores at the end of last year's second quarter. For the first six months of 2006 the Company opened 21 stores, relocated 11 stores and closed six stores. The Company plans to open approximately 60 stores and close approximately 15 stores during fiscal 2006.

Credit revenue of \$2.7 million represented 1.2% of total revenues in the second quarter of 2006, compared to 2005 credit revenue of \$3.3 million or 1.5% of total revenues. The reduction in credit revenue was due to lower finance charge and late fee income from lower sales under the Company's proprietary credit card and improved collections compared to the prior year. 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 \$1.4 million in the second quarter of 2006 compared to last year's second quarter expenses of \$2.0 million. The decrease in costs was principally due to lower bad debt expense and payroll costs.

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

RESULTS OF OPERATIONS – (CONTINUED):

Other income in total, as included in total revenues was \$3.2 million and \$6.5 million for the second quarter and first six months of fiscal 2006, compared to \$3.6 million and \$7.5 million for the prior year's comparable three and six months periods, respectively. The decrease resulted primarily from lower finance charges and late fee income.

Cost of goods sold was \$143.7 million, or 67.0% of retail sales and \$285.9 million or 64.3% of retail sales for the second quarter and first six months of fiscal 2006, compared to \$140.4 million, or 67.4% of retail sales and \$276.9 million, or 65.4% of retail sales for the prior year's comparable three and six months periods, respectively. The overall decrease in cost of goods sold as a percent of retail sales for the second quarter and first six months of 2006 resulted primarily from lower procurement costs and lower markdowns. The reduction in procurement cost was primarily the result of increased direct sourcing and the reduction in markdowns was primarily due to improved inventory management and better sell-throughs of regular priced merchandise. Cost of goods sold includes merchandise costs, net of discounts and allowances, buying costs, distribution costs, occupancy costs, freight and inventory shrinkage. Net merchandise costs and in-bound freight are capitalized as inventory costs. Buying and distribution costs include payroll, payroll-related costs and operating expenses for the buying departments and distribution center. Occupancy expenses include rent, real estate taxes, insurance, common area maintenance, utilities and maintenance for stores and distribution facilities. Total gross margin dollars (retail sales less cost of goods sold) increased by 4.4% to \$70.9 million and by 8.2% to \$158.5 million for the second quarter and first six months of fiscal 2006 compared to \$67.9 million and \$146.5 million for the prior year's comparable three and six month periods, respectively. Gross margin as presented may not be comparable to those of other entities.

Selling, general and administrative expenses ("SG&A") primarily include corporate and store payroll, related payroll taxes and benefits, insurance, supplies, advertising, bank and credit card processing fees and bad debts. SG&A expenses were \$51.8 million, or 24.1% of retail sales and \$106.3 million, or 23.9% of retail sales for the second quarter and first six months of fiscal 2006, compared to \$50.8 million, or 24.4% of retail sales and \$100.1 million, or 23.6% of retail sales for prior year's comparable three and six months periods, respectively. SG&A expenses as a percentage of retail sales decreased 30 basis points for the second quarter of fiscal 2006 as compared to the prior year and increased 30 basis points for the first six months of fiscal 2006, as compared to the prior year. The decline in SG&A expenses as a percentage of retail sales for the second quarter of fiscal 2006 was primarily attributable to a decrease in incentive based compensation expenses. The overall dollar increase in SG&A expenses for the second quarter of fiscal 2006 resulted primarily from increased worker's compensation expenses and salary expense. For the first six months of fiscal 2006, the increase in SG&A expenses as a percentage of retail sales and the overall dollar increase in expenses resulted primarily from increased incentive based compensation expenses and selling related expenses attributable to the Company's store growth.

Depreciation expense was \$5.2 million, or 2.4% of retail sales and \$10.4 million or 2.4% of retail sales, for the second quarter and first six months of fiscal 2006, compared to \$5.0 million, or 2.4% of retail sales and \$10.1 million, or 2.4% of retail sales, for prior year's comparable three and six month periods, respectively.

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

RESULTS OF OPERATIONS – (CONTINUED):

The Company had no interest expense for the second quarter of fiscal 2006 or fiscal 2005, except for accretion resulting from the amortization of the retirement liability created upon the co-founders' retirement in January 2004. The decline for the six month period was attributable to the early retirement of the remaining balance of \$20.5 million on the Company's unsecured loan facility, paid on April 5, 2005.

Interest and other income was \$1.9 million, or 0.9% of retail sales and \$3.5 million, or 0.8% of retail sales for the second quarter and first six months of fiscal 2006, compared to \$1.1 million, or 0.5% of retail sales and to \$2.0 million, or 0.4% of retail sales, for the prior year's comparable three and six month periods, respectively. The increase in the second quarter and first six months of fiscal 2006 resulted primarily from higher interest rates and a refund settlement on third-party credit card fees of \$0.5 million in the second quarter of fiscal 2006.

Income tax expense was \$7.0 million, or 3.3% of retail sales and \$18.9 million, or 4.3% of retail sales, for the second quarter and first six months of fiscal 2006, compared to \$6.1 million, or 2.9% of retail sales and \$16.6 million, or 3.9% of retail sales, for the prior year's comparable three and six month periods. The second quarter increase resulted from higher pre-tax income. The effective income tax rate for the second quarter and first six months of fiscal 2006 was 36.5%, compared to 36.3% for the prior year's comparable three and six month periods.

As of the date of this Form 10-Q filing, the Company has submitted insurance claims for losses attributable to Hurricanes Katrina, Rita and Wilma incurred during the third quarter of fiscal 2005. The total amount of the proceeds, which are uncertain at this time, will be classified against selling, general and administrative expenses.

LIQUIDITY, CAPITAL RESOURCES AND MARKET RISK:

The Company has consistently maintained a strong liquidity position. Cash provided by operating activities during the first six months of fiscal 2006 was \$32.4 million as compared to \$38.9 million in the first six months of fiscal 2005. These amounts enable the Company to fund its regular operating needs, capital expenditure program, cash dividend payments and purchase of treasury stock. In addition, the Company maintains \$35 million of unsecured revolving credit facilities for short-term financing of seasonal cash needs. There were no outstanding borrowings on these facilities at July 29, 2006.

Cash provided by operating activities for the first six months of fiscal 2006 was primarily generated by earnings adjusted for depreciation and changes in working capital. The decrease of \$6.5 million for the first six months of fiscal 2006 as compared to the first six months of fiscal 2005 was primarily due to a more moderate decline in inventories and a relatively higher payables reduction in fiscal 2006, partially offset by higher net income in fiscal 2006.

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

LIQUIDITY, CAPITAL RESOURCES AND MARKET RISK (CONTINUED):

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 planned capital expenditures, dividends, purchase of treasury stock and other operating requirements for fiscal 2006 and for the foreseeable future beyond twelve months.

At July 29, 2006, the Company had working capital of \$156.6 million compared to \$138.5 million at July 30, 2005. Additionally, the Company had \$1.9 million invested in privately managed investment funds at July 29, 2006, which are included in other assets on the Condensed Consolidated Balance Sheets.

At July 29, 2006, the Company had an unsecured revolving credit agreement, which provided for borrowings of up to \$35 million. The revolving credit agreement is committed until August 2008. This agreement replaced a prior revolving credit agreement which was due to expire in August 2006. 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 July 29, 2006. There were no borrowings outstanding under these credit facilities during the first six months ended July 29, 2006 or the fiscal year ended January 28, 2006.

On August 22, 2003, the Company entered into a new unsecured \$30 million five-year term loan facility, the proceeds of which were used to purchase Class B Common Stock from the Company's founders. Payments were due in monthly installments of \$500,000 plus accrued interest. Interest was based on LIBOR. On April 5, 2005, the Company repaid the remaining balance of \$20.5 million on this loan facility with no early prepayment penalty. With the early retirement of this loan, the Company had no outstanding debt as of July 29, 2006.

At the July 29, 2006 and July 30, 2005, the Company had approximately \$5.2 million and \$4.9 million, respectively, of outstanding irrevocable letters of credit relating to purchase commitments.

Expenditures for property and equipment totaled \$17.4 million in the first six months of fiscal 2006, compared to \$11.7 million in last year's first six months. The expenditures for the first six months of 2006 were primarily for store development and investments in new technology. In fiscal 2006, the Company is planning to invest approximately \$30.0 — \$33.0 million for capital expenditures. This includes expenditures to open 60 new stores, relocate 22 stores and remodel 15 stores. The decrease in previously disclosed capital expenditure expectations of \$44 million is primarily attributable to technology projects deferred to fiscal 2007 and reduced store openings previously projected at approximately 90 new stores.

Net cash used in investing activities totaled \$25.4 million in the first six months of fiscal 2006 compared to \$9.2 million provided for the comparable period of 2005. The increase was due primarily to the purchase of short-term investments.

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

LIQUIDITY, CAPITAL RESOURCES AND MARKET RISK (CONTINUED):

On May 25, 2006, the Board of Directors increased the quarterly dividend by 15% from \$.13 per share to \$.15 per share, or an annualized rate of \$.60 per share. Prior year basic and diluted earnings per share have been adjusted for the three-for-two stock split in the form of a stock dividend of the Company's Class A and Class B common stock effected June 27, 2005.

The Company does not use derivative financial instruments. At July 29, 2006, the Company's investment portfolio was primarily invested in governmental and other debt securities with maturities less than 36 months. These securities are classified as available-for-sale and are recorded on the balance sheet at fair value, with unrealized gains and temporary losses reported net of taxes as accumulated other comprehensive income. Other than temporary declines in fair value of investments are recorded as a reduction in the cost of investments in the accompanying Condensed Consolidated Balance Sheets.

THE CATO CORPORATION
QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

ITEM 3. 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.

ITEM 4. 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 July 29, 2006. Based on this evaluation, our principal executive officer and principal financial officer concluded that, as of July 29, 2006, our disclosure controls and procedures, as defined in Rule 13a-15(e), under the Securities Exchange Act of 1934 (the "Exchange Act"), were effective to ensure that information we are required to disclose in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING:

No change in the Company's internal control over financial reporting has occurred during the Company's fiscal quarter ended July 29, 2006 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II OTHER INFORMATION

THE CATO CORPORATION

ITEM 1. LEGAL PROCEEDINGS

Not Applicable

ITEM 1A. RISK FACTORS

In addition to the other information in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for our fiscal year ended January 28, 2006. These risks could materially affect our business, financial condition or future results; however, they are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may also materially adversely affect our business, financial condition or results of operations.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not Applicable

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not Applicable

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Following are the results of the matters voted upon at the Company's Annual Meeting which was held on May 25, 2006.

Election of Directors:

| | <u>For</u> | <u>Withheld</u> | <u>Voting Power For</u> | <u>Voting Power Withheld</u> |
|----------------------|------------|-----------------|-------------------------|------------------------------|
| Mr. John P. D. Cato | 27,881,605 | 988,347 | 34,055,605 | 988,347 |
| Mr. William H. Grigg | 14,220,220 | 14,649,732 | 20,394,220 | 14,649,732 |
| Mr. James H. Shaw | 27,849,509 | 1,020,218 | 34,023,734 | 1,020,218 |

Ratification of Independent Auditor:

| | <u>For</u> | <u>Withheld</u> | <u>Voting Power For</u> | <u>Voting Power Withheld</u> |
|--|------------|-----------------|-------------------------|------------------------------|
| | 28,654,043 | 215,908 | 34,828,043 | 215,908 |

ITEM 5. OTHER INFORMATION

Not Applicable

PART II OTHER INFORMATION (CONTINUED)

THE CATO CORPORATION

ITEM 6. EXHIBITS

| <u>Exhibit No.</u> | <u>Item</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. |
| 3.2 | Registrant's By Laws, incorporated by reference to Exhibit 4.2 to Form S-8 of the Registrant Filed February 7, 2000. |
| 31.1 | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer. |
| 31.2 | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer. |
| 32.1 | Section 1350 Certification of Chief Executive Officer. |
| 32.2 | Section 1350 Certification of Chief Financial Officer. |

PART II OTHER INFORMATION

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.

September 5, 2006

Date

September 5, 2006

Date

September 5, 2006

Date

THE CATO CORPORATION

/s/ John P. D. Cato

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

/s/ Reynolds C. Faulkner

Reynolds C. Faulkner
Executive Vice President
Chief Financial Officer

/s/ Robert M. Sandler

Robert M. Sandler
Senior Vice President
Controller

**CHIEF EXECUTIVE OFFICER CERTIFICATION PURSUANT TO
SECURITIES EXCHANGE ACT OF 1934 RULE 13a-14a/15d-14(a), AS ADOPTED
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, John P. D. Cato, certify that:

1. I have reviewed this report on Form 10-Q of The Cato Corporation (the “registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: September 5, 2006

/s/ John P. D. Cato

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

**CHIEF FINANCIAL OFFICER CERTIFICATION PURSUANT TO
SECURITIES EXCHANGE ACT OF 1934 RULE 13a-14a/15d-14(a), AS ADOPTED
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Reynolds C. Faulkner, certify that:

1. I have reviewed this report on Form 10-Q of The Cato Corporation (the “registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: September 5, 2006

/s/ Reynolds C. Faulkner

Reynolds C. Faulkner
Executive Vice President
Chief Financial Officer

CERTIFICATION OF PERIODIC REPORT

I, John P. D. Cato, Chairman, President and Chief Executive Officer of The Cato Corporation (the "Company"), certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, that on the date of this Certification:

1. the Form 10-Q of the Company for the quarter ended July 29, 2006 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: September 5, 2006

/s/ John P. D. Cato

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

CERTIFICATION OF PERIODIC REPORT

I, Reynolds C. Faulkner, Executive Vice President, and Chief Financial Officer of The Cato Corporation (the "Company"), certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, that on the date of this Certification:

1. the Form 10-Q of the Company for the quarter ended July 29, 2006 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: September 5, 2006

/s/ Reynolds C. Faulkner
Reynolds C. Faulkner
Executive Vice President
Chief Financial Officer