CATO CORP
Form 10-K
March 30, 2011
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

þ	**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the fiscal year ended January 29, 2011
	or
o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number 1-31340

The Cato Corporation

Registrant

Delaware	**56-0484485**
State of Incorporation	*I.R.S. Employer Identification Number*
8100 Denmark Road	**704/554-8510**
Charlotte, North Carolina 28273-5975	*Registrant's Telephone Number*
Address of Principal Executive Offices	

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

Title of Class	Name of Exchange on Which Registered
Class A Common Stock	New York Stock Exchange
Preferred Share Purchase Rights	New York Stock Exchange

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

None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.   Yes ¨   No þ

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.   Yes ¨   No þ

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 þ   No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes   No

Indicate by check mark, if disclosure of delinquent filers pursuant to Item 405 of the Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

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

(Do not check if a smaller reporting company)

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

The aggregate market value of the Registrant's Class A Common Stock held by non-affiliates of the Registrant as of July 31, 2010, the last business day of the Company's most recent second quarter, was $639,525,415 based on the last reported sale price per share on the New York Stock Exchange on that date.

As of March 29, 2011, there were 27,649,402 shares of Class A Common Stock and 1,743,525 shares of Convertible Class B Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the proxy statement relating to the 2011 annual meeting of shareholders are incorporated by reference into the following part of this annual report:

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

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Forward-looking Information

The following information should be read along with the Consolidated Financial Statements, including the accompanying Notes appearing in this report. Any of the following are “forward-looking” statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended: (1) statements in this Annual Report on Form 10-K that reflect projections or expectations of our future financial or economic performance; (2) statements that are not historical information; (3) statements of our beliefs, intentions, plans and objectives for future operations, including those contained in “Business,” “Properties,” “Legal Proceedings,” “Controls and Procedures” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations”; (4) statements relating to our operations or activities for fiscal 2011 and beyond, including, but not limited to, statements regarding expected amounts of capital expenditures and store openings (including the launch of the new Versona Accessories store concept), relocations, remodels and closures; and (5) statements relating to our future contingencies. When possible, we have attempted to identify forward-looking statements by using words such as “expects,” “anticipates,” “approximates,” “believes,” “estimates,” “hopes,” “intends,” “may,” “plans,” “should” and variatio 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 including, but not limited to, the continuation or worsening of (i) the current adverse or recessionary conditions affecting the U.S. and global economies and consumer spending and (ii) the adverse conditions in the U.S. and global credit market; uncertainties regarding the impact of any governmental responses to the foregoing adverse economic and credit market conditions; competitive factors and pricing pressures; our ability to predict fashion trends; consumer apparel and accessory 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 this annual report on Form 10-K for the fiscal year ended January 29, 2011 (“fiscal 2010”), 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 subsidiaries, except that when used with reference to common stock or other securities described herein and in describing the positions held by management of the Company, such terms include only The Cato Corporation. Our website is located at www.catocorp.com where we make available free of charge, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements and other reports (including amendments to these reports) filed or furnished pursuant to Section 13(a) or 15(d) under the Securities Exchange Act of 1934. These reports are available as soon as reasonably practicable after we electronically file these materials with the SEC. We also post on our website the charters of our Audit, Compensation and Corporate Governance and Nominating Committees; our Corporate Governance Guidelines, Code of Business Conduct and Ethics; and any amendments or waivers thereto; and any other corporate governance materials contemplated by SEC or New York Stock Exchange regulations.

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PART I

Item 1. *Business:*

General

The Company, founded in 1946, operated 1,282 fashion specialty stores at January 29, 2011, in 31 states, principally in the southeastern United States, under the names “Cato”, “Cato Fashions”, “Cato Plus”, “It’s Fashion”, and “It’s Fashion Metro”. The Cato division seeks to offer quality fashion apparel and accessories at low prices, every day in junior/missy, plus sizes and girls sizes 7 to 16. The Cato division’s stores feature a broad assortment of apparel and accessories, including dressy, career, and casual sportswear, dresses, coats, shoes, lingerie, costume jewelry and handbags. A major portion of the Cato division’s merchandise is sold under its private label and is produced by various vendors in accordance with the divisions specifications. The It’s Fashion division offers fashion with a focus on the latest trendy styles and nationally recognized urban brands for the entire family at low prices every day. Most stores range in size from 4,000 to 10,000 square feet and are located primarily in strip shopping centers anchored by national discounters or market-dominant grocery stores. In fiscal 2011, the Company plans to introduce the Versona Accessories division. These stores will offer quality fashion jewelry and accessories accented by key apparel items at exceptional values every day. The Company emphasizes friendly customer service and coordinated merchandise presentations in an appealing store environment. The Company offers its own credit card and layaway plan. Credit and layaway sales represented 10% of retail sales in fiscal 2010. See Note 15 to the Consolidated Financial Statements, “Reportable Segment Information” for a discussion of information regarding the Company’s two reportable segments: retail and credit.

Business

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

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

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

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

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

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

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Merchandising

Merchandising

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

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

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

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

Purchasing, Allocation and Distribution

Although the Company purchases merchandise from approximately 1,500 suppliers, most of its merchandise is purchased from approximately 100 primary vendors. In fiscal 2010, purchases from the Company's largest vendor accounted for approximately 3% of the Company's total purchases. No other vendor accounted for more than 3% of total purchases. The Company is not dependent on its largest vendor or any other vendor for merchandise purchases, and the loss of any single vendor or group of vendors would not have a material adverse effect on the Company's operating results or financial condition. A substantial portion of the Company's merchandise is sold under its private labels and is produced by various vendors in accordance with the Company's strict specifications. The Company purchases most of its merchandise from domestic importers and vendors, which typically minimizes the time necessary to purchase and obtain shipments. This enables the Company to react to merchandise trends in a more timely fashion. Although a significant portion of the Company's merchandise is manufactured overseas, principally in the Far East, the Company does not expect that any economic, political or social unrest in any one country would have a material adverse effect on the Company's ability to obtain adequate supplies of merchandise. However, the Company can give no assurance that any changes or disruptions in its merchandise supply chain would not materially and adversely affect the Company. See "Risk Factors – Risks Relating To Our Business – We source a significant portion of our merchandise directly and indirectly from overseas, and changes, disruptions or other problems affecting the Company's merchandise supply chain could materially and adversely affect the Company's business, results of operations and financial condition."

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

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

Advertising

The Company uses television, in-store signage, graphics and a Company website as its primary advertising media. The Company's total advertising expenditures were approximately 0.7%, 0.7% and 0.8% of retail sales for fiscal years 2010, 2009 and 2008, respectively.

Store Operations

The Company's store operations management team consists of 1 director of stores, 4 territorial managers, 15 regional managers and 141 district managers. Regional managers receive a salary plus a bonus based on achieving targeted goals for sales, payroll, shrinkage control and store profitability. District managers receive a salary plus a bonus based on achieving targeted objectives for district sales increases and shrinkage control. Stores are typically staffed with a manager, two assistant managers and additional part-time sales associates depending on the size of the store and seasonal personnel needs. Store managers receive a salary and all other store personnel are paid on an hourly basis. Store managers, assistant managers and sales associates are eligible for monthly and semi-annual bonuses based on achieving targeted goals for their store's sales increases and shrinkage control.

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

Store Locations

Most of the Company’s stores are located in the southeastern United States in a variety of markets ranging from small towns to large metropolitan areas with trade area populations of 20,000 or more. Stores average approximately 4,300 square feet in size.

All of the Company’s stores are leased. Approximately 96% are located in strip shopping centers and 4% in enclosed shopping malls. The Company locates stores in strip shopping centers anchored by a national discounter, primarily Wal-Mart Supercenters or market-dominant grocery stores. The Company’s strip center locations provide ample parking and shopping convenience for its customers.

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The Company’s store development activities consist of opening new stores in new and existing markets and relocating selected existing stores to more desirable locations in the same market area. The following table sets forth information with respect to the Company’s development activities since fiscal 2006.

Store Development

Fiscal Year	Number of Stores Beginning of Year	Number Opened	Number Closed	Number of Stores End of Year
2006	1,244	58	26	1,276
2007	1,276	62	20	1,318
2008	1,318	65	102	1,281
2009	1,281	35	45	1,271
2010	1,271	37	26	1,282

In fiscal 2010 the Company relocated 5 stores.

The Company expects to open 54 new stores during fiscal 2011. The expected new store openings include 10 new Cato stores, 34 new It’s Fashion Metro stores (including the conversion of approximately 17 existing It’s Fashion stores) and 10 new Versona Accessories stores. The Company anticipates closing up to 27 stores by year end, including the 17 conversions. In addition, the Company also expects to relocate 6 stores and remodel 10 stores. It’s Fashion Metro has 91 stores open as of fiscal year end January 2011 and is a value-priced fashion format offering the latest styles for the entire family including urban-inspired, nationally recognized brands at everyday low prices. The Versona Accessories stores are new concept stores the Company intends to launch in fiscal 2011 that will offer quality fashion jewelry and accessories accented by key apparel items at exceptional values every day. The Versona Accessories stores will seek to provide an upscale shopping environment comparable to better specialty and department stores.

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

Credit and Layaway

Credit Card Program

The Company offers its own credit card, which accounted for 5.2%, 6.4%, and 7.1% of retail sales in fiscal 2010, 2009 and 2008, respectively. The Company's net bad debt expense was 6.6%, 7.4% and 5.6% of credit sales in fiscal 2010, 2009 and 2008, respectively.

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

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Layaway Plan

Under the Company's layaway plan, merchandise is set aside for customers who agree to make periodic payments. The Company adds a nonrefundable administrative fee to each layaway sale. If no payment is made for four weeks, the customer is considered to have defaulted, and the merchandise is returned to the selling floor and again offered for sale, often at a reduced price. All payments made by customers who subsequently default on their layaway purchase are returned to the customer upon request, less the administrative fee and a restocking fee. The Company defers recognition of layaway sales and its related fees to the accounting period when the customer picks up and pays for layaway merchandise. Layaway sales represented approximately 4.7%, 4.7% and 4.0% of retail sales in fiscal 2010, 2009 and 2008, respectively.

Information Technology Systems

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

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

Competition

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

Seasonality

Due to the seasonal nature of the retail business, the Company has historically experienced and expects to continue to experience seasonal fluctuations in its revenues, operating income and net income. Results of a period shorter than a full year may not be indicative of results expected for the entire year. Furthermore, the seasonal nature of our business may affect comparisons between periods. See Note 14 of the Consolidated Financial Statements for information regarding our quarterly results of operations for the last two fiscal years.

Regulation

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

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Associates

As of January 29, 2011, the Company employed approximately 9,600 full-time and part-time associates. The Company also employs additional part-time associates during the peak retailing seasons. The Company is not a party to any collective bargaining agreements and considers its associate relations to be good.

Item 1A. ***Risk Factors:***

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

Risks Relating To Our Business:

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

Customer tastes and fashion trends, particularly for women's apparel, are volatile and tend to change rapidly. Our success depends in part upon our ability to anticipate and respond to changing merchandise trends and consumer preferences in a timely manner. Accordingly, any failure by us to anticipate, identify and respond to changing fashion trends could adversely affect consumer acceptance of our merchandise, which in turn could adversely affect our business and our image with our customers. If we miscalculate either the market for our merchandise or our customers' tastes or purchasing habits, we may be required to sell a significant amount of unsold inventory at below average markups over cost, or below cost, which would adversely affect our margins and results of operations.

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

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

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

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

We source a significant portion of our merchandise directly and indirectly from overseas, and changes, disruptions or other problems affecting the Company's merchandise supply chain could materially and adversely affect the Company's business, results of operations and financial condition.

A significant amount of our merchandise is manufactured overseas, principally in the Far East. We directly import some of this merchandise and indirectly import the remaining merchandise from domestic vendors who acquire the merchandise from foreign sources. As a result, political instability or other events resulting in the disruption of trade from other countries, increased security requirements for imported merchandise, or the imposition of additional regulations relating to or duties on imports, could cause significant delays or interruptions in the supply of our merchandise or increase our costs. Either of these could have a material adverse effect on our business. In addition, increased energy and transportation costs have caused us significant cost increases, and continued increases in these costs or the disruption of the means by which merchandise is transported to us could cause us additional cost increases or interruptions of our supply chain which could be significant. If we are forced to source merchandise from other countries or other domestic vendors with foreign sources in different countries, those goods may be more expensive or of a different or inferior quality from the ones we now sell. Furthermore, the deterioration in any of our key vendors' financial condition, their failure to perform as we expect, the failure to follow our vendor guidelines or comply with applicable laws and regulations could expose us to operational, competitive and legal risks. If we were not able to timely or adequately replace the merchandise we currently source with merchandise produced elsewhere, or if our vendors fail to perform as we expect, our business, results of operations and financial condition could be adversely affected.

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

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

Our costs are affected by foreign currency fluctuations.

Because we purchase a significant portion of our inventory from foreign suppliers, our cost of these goods is affected by the fluctuation of the local currencies where these goods are produced against the dollar. Accordingly, changes in the value of the dollar relative to foreign currencies may increase our cost of goods sold and, if we are unable to pass such cost increases on to our customers, decrease our gross margins and ultimately our earnings. Accordingly, foreign currency fluctuations may have a material adverse effect on our business, financial condition and results of operations.

A continuation or worsening of adverse conditions in the general economic environment or outlook and its related impact on consumer confidence and spending may materially and adversely affect consumer demand for our apparel and accessories and our results of operations.

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

The failure, disruption or security breach relating to our information technology systems could adversely affect our business.

We rely on our existing information technology systems for merchandise operations, including merchandise planning, replenishment, pricing, ordering, markdowns and product life cycle management. In addition to merchandise operations, we utilize our information technology systems for our distribution processes, as well as our financial systems, including accounts payable, general ledger, accounts receivable, sales, banking, inventory and fixed assets. Any disruption in the operation of our information technology systems, or our failure to continue to upgrade or improve such systems could adversely affect our business. In addition, any security breach or other problem that results in the unauthorized disclosure of confidential customer information, such as personally identifiable information and payment information, could adversely affect our standing with customers and expose us to the risk of litigation and liability. Any such occurrences could result in reputational damage or loss of business or goodwill and could adversely affect our business, results of operations and financial condition.

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

The distribution of our products is centralized in one distribution center in Charlotte, North Carolina and distributed through our network of third party freight carriers. The merchandise we purchase is shipped directly to our distribution center where it is prepared for shipment to the appropriate stores and subsequently delivered to the stores by our third party freight carriers. If the distribution center or our third party freight carriers were to be shutdown or lose significant capacity for any reason, our operations would likely be seriously disrupted. Such problems could occur as the result of any loss, destruction or impairment of our ability to use our distribution center, as well as any broader problem generally affecting the ability to ship goods into our distribution center or deliver goods to our stores. As a result, we could incur significantly higher costs and longer lead times associated with distributing our products to our stores during the time it takes for us to reopen or replace the distribution center and/or our transportation network. Any such occurrence could adversely affect our business, results of operations and financial condition.

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

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

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

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

Like most retailers, we experience significant associate turnover rates, particularly among store sales associates and managers. Our continued store growth will require the hiring and training of new associates. We must continually attract, hire and train new store associates to meet our staffing needs. A significant increase in the turnover rate among our store sales associates and managers would increase our recruiting and training costs, as well as possibly cause a decrease in our store operating efficiency and productivity. We compete for qualified store associates, as well as experienced management personnel with other companies in our industry or other industries, many of whom have greater financial resources than we do.

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

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

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

Our operations are subject to federal, state and local laws, rules and regulations and litigation risk. Compliance risks and litigation claims have or may arise in the ordinary course of our business and may include, among other issues, employment issues, commercial disputes, intellectual property issues, product-oriented matters, tax, customer relations and personal injury claims. These matters frequently raise complex factual and legal issues, which are subject to risks and uncertainties and could divert significant management time. In addition, governing laws, rules and regulations, and interpretations of existing laws are subject to change from time to time. Compliance and litigation matters could result in unexpected expenses and liability, as well as have an adverse affect on our operations and our reputation.

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

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

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

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

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

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

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

Risks Relating To Our Common Stock:

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

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

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

As of March 29, 2011, John P. D. Cato, Chairman, President and Chief Executive Officer, beneficially controlled approximately 39% of the voting power of our common stock. As a result, Mr. Cato may be able to control or significantly influence substantially all matters requiring approval by the shareholders, including the election of directors and the approval of mergers and other business combinations. Mr. Cato may have interests that differ from those of other shareholders, and may vote in a way with which other shareholders disagree or perceive as adverse to their interests. In addition, the concentration of voting power held by Mr. Cato could have the effect of preventing, discouraging or deferring a change in control of the Company, which could depress the market price of our common stock.

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

The trading price of our common stock at times has been, and is likely to continue to be, subject to significant volatility. A variety of factors may cause the price of the common stock to fluctuate, perhaps substantially, including, but not limited to: low trading volume; general market fluctuations resulting from factors not directly related to our operations or the inherent value of our common stock; announcements of developments related to our business; fluctuations in our reported operating results; general conditions in the fashion and retail industry; conditions in the domestic or global economy or the domestic or global credit or capital markets; changes in financial estimates or the scope of coverage given to our Company by securities analysts; negative commentary regarding our Company and corresponding short-selling market behavior; adverse customer relations developments; significant changes in our senior management team; and legal proceedings. Over the past several years the stock market in general, and the market for shares of equity securities of many retailers in particular, have experienced extreme price fluctuations that have at times been unrelated to the operating performance of those companies. Such fluctuations and market volatility based on these or other factors may materially and adversely affect the market price of our common stock.

Item 1B. ***Unresolved Staff Comments:***

None.

Item 2. ***Properties:***

The Company's distribution center and general offices are located in a Company-owned building of approximately 492,000 square feet located on a 15-acre tract in Charlotte, North Carolina. The Company's automated merchandise handling and distribution activities occupy approximately 418,000 square feet of this building and its general offices and corporate training center are located in the remaining 74,000 square feet. A building of approximately 24,000 square feet located on a 2-acre tract adjacent to the Company's existing location is used for receiving and staging shipments prior to processing.

Substantially all of the Company's retail stores are leased from unaffiliated parties. Most of the leases have an initial term of five years, with two to three five-year renewal options. Many of the leases provide for fixed rentals plus a percentage of sales in excess of a specified volume.

Item 3. ***Legal Proceedings:***

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

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Item 3A. ***Executive Officers of the Registrant:***

The executive officers of the Company and their ages as of March 29, 2011 are as follows:

Name	Age	Position
John P. D. Cato........................	60	Chairman, President and Chief Executive Officer
Michael T. Greer.......................	48	Executive Vice President, Director of Stores
John R. Howe...........................	48	Executive Vice President, Chief Financial Officer
Howard A. Severson................	63	Executive Vice President, Chief Real Estate and Store Development Officer
Sally Almason...........................	57	Executive Vice President, General Merchandising Manager – Cato Division

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

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

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

Howard A. Severson has been employed by the Company since 1985. Since January 1993, he has served as Executive Vice President, Chief Real Estate and Store Development Officer. From 1993 to 2001 Mr. Severson also served as a director. From August 1989 through January 1993, Mr. Severson served as Senior Vice President — Chief Real Estate Officer.

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

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PART II

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

Market & Dividend Information

The Company's Class A Common Stock trades on the New York Stock Exchange ("NYSE") under the symbol CATO. Below is the market range and dividend information for the four quarters of fiscal 2010 and 2009.

	Price		
2010	**High**	**Low**	**Dividend**
First quarter	$ 25.11	$ 18.70	$ .165
Second quarter	25.21	21.49	.185
Third quarter	28.47	22.27	.185
Fourth quarter	29.60	24.23	.185

	Price		
2009	**High**	**Low**	**Dividend**
First quarter	$ 19.61	$ 13.13	$ .165
Second quarter	20.84	15.32	.165
Third quarter	22.86	16.46	.165
Fourth quarter	21.84	18.67	.165

As of March 29, 2011 the approximate number of record holders of the Company's Class A Common Stock was 5,000 and there were 2 record holders of the Company's Class B Common Stock.

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Stock Performance Graph

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

THE CATO CORPORATION

STOCK PERFOMANCE TABLE

(BASE 100 – IN DOLLARS)

LAST TRADING DAY OF THE FISCAL YEAR	THE CATO CORPORATION	DOW JONES U.S. RETAILERS, APPL INDEX	RUSSELL 2000

			INDEX
1/27/2006	100	100	100
2/2/2007	108	121	112
2/1/2008	82	95	102
1/30/2009	68	50	63
1/29/2010	109	95	87
1/28/2011	133	118	113

The graph assumes an initial investment of $100 on January 27, 2006, the last trading day prior to the commencement of the Company's 2006 fiscal year, and that all dividends were reinvested.

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Issuer Purchases of Equity Securities

The following table summarizes the Company's purchases of its common stock for the three months ended January 29, 2011:

Period	Total Number of Shares Purchased	Average Price Paid per Share (1)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2)	Maximum Number (or Approximate Dollar Value) of Shares that may yet be Purchased Under the Plans or Programs (2)
November 2010	857	$ 27.02	857	
December 2010	-	-	-	
January 2011	-	-	-	
Total	857	$ 27.02	857	442,942

(1) Prices include trading costs.

(2) On January 30, 2010, the Company’s share repurchase program had 695,942 shares remaining in open authorizations. At fiscal year ending January 29, 2011, the Company had 442,942 shares remaining in open authorizations. There is no specified expiration date for the Company’s repurchase program.

(3) In March 2011, subsequent to year-end, the Company repurchased 110,000 shares for approximately $2.6 million or an average market price per share of $23.48.

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Item 6. ***Selected Financial Data:***

Certain selected financial data for the five fiscal years ended January 29, 2011 have been derived from the Company's audited financial statements. The financial statements and Independent Registered Public Accounting Firm's integrated audit reports for the three most recent fiscal years are contained elsewhere in this report. All data set forth below are qualified by reference to, and should be read in conjunction with, the Company's Consolidated Financial Statements (including the Notes thereto) and "Management's Discussion and Analysis of Financial Condition and Results of Operations" appearing elsewhere in this annual report.

Fiscal Year (1)	2010	2009	2008	2007	2006
	(Dollars in thousands, except per share data and selected operating data)				
STATEMENT OF OPERATIONS DATA:					
Retail sales	$ **913,922**	$ 872,132	$ 845,676	$ 834,341	$ 862,813
Other income	**11,606**	11,863	12,042	12,096	13,072
Total revenues	**925,528**	883,995	857,718	846,437	875,885
Cost of goods sold (exclusive of depreciation shown below)	**565,710**	552,016	562,056	572,309	572,712
Selling, general and administrative (exclusive of depreciation shown below)	**251,121**	245,483	227,645	210,892	212,157
Selling, general and administrative percent of retail sales	**27.5%**	28.2%	26.9%	25.3%	24.6%
Depreciation	**21,822**	21,829	22,572	22,212	20,941
Interest expense	**37**	66	53	9	41
Interest and other income	**(3,971)**	(4,313)	(7,218)	(8,218)	(9,597)
Income before income taxes	**90,809**	68,914	52,610	49,233	79,631
Income tax expense	**33,070**	23,149	18,976	16,914	28,181
Net income	$ **57,739**	$ 45,765	$ 33,634	$ 32,319	$ 51,450
Basic earnings per share (2)	$ **1.96**	$ 1.55	$ 1.14	$ 1.02	$ 1.64
Diluted earnings per share (2)	$ **1.96**	$ 1.55	$ 1.14	$ 1.02	$ 1.61
Cash dividends paid per share	$ **0.720**	$ 0.660	$ 0.660	$ 0.645	$ 0.580
SELECTED OPERATING DATA:					
Stores open at end of year	**1,282**	1,271	1,281	1,318	1,276
Average sales per store (3)	$ **716,000**	$ 678,000	$ 640,000	$ 640,000	$ 685,000
Average sales per square foot of selling space	$ **168**	$ 165	$ 162	$ 165	$ 175

BALANCE SHEET DATA (at period end):					
Cash, cash equivalents, short-term investments and restricted cash	$ **234,851**	$ 200,915	$ 144,803	$ 114,578	$ 123,542
Working capital	**239,228**	202,299	164,639	144,114	176,464
Total assets	**522,092**	480,990	435,353	420,792	432,322
Total stockholders' equity	**325,564**	291,312	261,813	247,370	276,793

(1) The fiscal year 2006 contained 53 weeks versus 52 weeks for all other years shown.

(2) Per share amounts for 2008 and earlier periods have been retroactively restated for the adoption of guidance related to participating dividends on unvested restricted stock awards. See Note 1 to the Consolidated Financial Statements.

(3) Calculated using actual sales volume for stores open for the full year and an estimated annual sales volume for new stores opened during the year.

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Item 7. ***Management's Discussion and Analysis of Financial Condition and Results of Operations:***

Results of Operations

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

Fiscal Year Ended	January 29, 2011	January 30, 2010	January 31, 2009
Retail sales	**100.0 %**	100.0 %	100.0 %
Other income	**1.3**	1.4	1.4
Total revenues	**101.3**	101.4	101.4
Cost of goods sold	**61.9**	63.3	66.5
Selling, general and administrative	**27.5**	28.2	26.9
Depreciation	**2.4**	2.5	2.7
Interest and other income	**(0.4)**	(0.5)	(0.9)
Income before income taxes	**9.9**	7.9	6.2
Net income	**6.3 %**	5.2 %	4.0 %

Fiscal 2010 Compared to Fiscal 2009

Retail sales increased by 4.8% to $913.9 million in fiscal 2010 compared to $872.1 million in fiscal 2009. The increase in retail sales in fiscal 2010 was largely attributable to sales from store development and same store sales improvement. Same store sales increased 3% from fiscal 2009. Same store sales includes stores that have been open more than 15 months. Stores that have been relocated or expanded are also included in the same store sales calculation after they have been open more than 15 months. The method of calculating same store sales varies across the retail industry. As a result, our same store sales calculation may not be comparable to similarly titled measures reported by other companies. Total revenues, comprised of retail sales and other income (principally finance charges and late fees on customer accounts receivable and layaway fees), increased by 4.7% to $925.5 million in fiscal 2010 compared to $884.0 million in fiscal 2009. The Company operated 1,282 stores at January 29, 2011 compared to 1,271 stores operated at January 30, 2010.

In fiscal 2010, the Company opened 37 new stores, relocated five stores and closed 26 stores.

Other income in total, as included in total revenues in fiscal 2010, decreased slightly to $11.6 million from $11.9 million in fiscal 2009. The decrease resulted primarily from lower credit revenue and finance charges, partially offset by an increase in layaway charges.

Credit revenue of $8.5 million represented .9% of total revenue in fiscal 2010, a decrease compared to 2009 credit revenue of $9.4 million or 1.1% of total revenue. The slight decrease in credit revenue was primarily due to reductions in finance and late charge income as a result of lower accounts receivable balances and regulatory changes. 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 $5.4 million in fiscal 2010 compared to $6.6 million in fiscal 2009. The decrease in these expenses was principally due to a reduction in postage expense and bad debt expense of $906,000. See Note 15 of the Consolidated Financial Statements for a schedule of credit-related expenses. Total segment credit income before taxes increased $.2 million from $2.9 million in 2009 to $3.1 million in 2010 due to a decrease in related operating expenses. Total credit income of $3.1 million in 2010 represented 3.4% of total income before taxes of $90.8 million compared to total credit income of $2.9 million in 2009 which represented 4.2% of 2009 total income before taxes.

Cost of goods sold was $565.7 million, or 61.9% of retail sales, in fiscal 2010 compared to $552.0 million, or 63.3% of retail sales, in fiscal 2009. The decrease in cost of goods sold as a percent of retail sales resulted primarily from lower procurement costs and reduced markdowns. 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 8.8% to $348.2 million in fiscal 2010 from $320.1 million in fiscal 2009. Gross margin as presented may not be comparable to that of other companies.

Selling, general and administrative expenses (SG&A), which primarily include corporate and store payroll, related payroll taxes and benefits, insurance, supplies, advertising, bank and credit card processing fees and bad debts were $251.1 million in fiscal 2010 compared to $245.5 million in fiscal 2009, an increase of 2.3%. As a percent of retail sales, SG&A was 27.5% compared to 28.2% in the prior year. The overall dollar increase in SG&A resulted primarily from an increase in salary expenses driven by store development and workers' compensation expense, partially offset by a reduction in store closing costs.

Depreciation expense was $21.8 million in both fiscal 2010 and fiscal 2009. Depreciation expense was flat from period to period because the Company's store count and related investments in store development, as well as its information technology investments were both relatively stable.

Interest and other income was $4.0 million in fiscal 2010 compared to $4.3 million in fiscal 2009. The decrease was due to lower interest income due to reduced interest rates. See Note 2 to the Consolidated Financial Statements for further details.

Income tax expense was $33.1 million, or 3.6% of retail sales in fiscal 2010 compared to $23.1 million, or 2.7% of retail sales in fiscal 2009. The increase resulted from higher pre-tax income in conjunction with an increase in the effective tax rate. The effective tax rate was 36.4% in fiscal 2010 compared to 33.6% in fiscal 2009 primarily as a result of the favorable resolution of various state income tax matters in the prior year.

Fiscal 2009 Compared to Fiscal 2008

Retail sales increased by 3.1% to $872.1 million in fiscal 2009 compared to $845.7 million in fiscal 2008 which was primarily attributable to an increase in comparable store sales and sales from store development. Comparable store sales increased 1% in fiscal 2009. Total revenues, comprised of retail sales and other income (principally finance charges and late fees on customer accounts receivable and layaway fees), increased by 3.1% to $884.0 million in fiscal 2009 compared to $857.7 million in fiscal 2008. The Company operated 1,271 stores at January 30, 2010 compared to 1,281 stores operated at January 31, 2009.

In fiscal 2009, the Company opened 35 new stores, relocated one store and closed 45 stores.

Other income in total, as included in total revenues in fiscal 2009, decreased slightly to $11.9 million from $12.0 million in fiscal 2008. The decrease resulted primarily from lower credit revenue and finance charges offset by an increase in layaway service charges.

Credit segment revenue of $9.4 million represented 1.1% of total revenue in fiscal 2009 compared to 2008 credit revenue of $10.1 million or 1.2% of total revenue. The decrease in credit revenue was primarily due to reductions in finance and late charge income as a result of lower accounts receivable balances. Credit revenue is comprised of interest earned on the Company’s private label credit card portfolio and related fee income. Related expenses include principally bad debt expense, payroll, postage and other administrative expenses and totaled $6.6 million in fiscal 2009 compared to $7.0 million in fiscal 2008. The decrease in these expenses was principally due to a decrease in late fee reserves of $0.5 million. See Note 15 of the Consolidated Financial Statements for a schedule of credit related expenses. Total segment credit income before taxes decreased $0.2 million from $3.1 million in 2008 to $2.9 million in 2009 due to decreased finance charge income offset by a decrease in bad debt expense. Total credit income of $2.9 million in 2009 represented 4.2% of total income before taxes of $68.9 million compared to total credit income of $3.1 million in 2008 which represented 5.9% of 2008 total income before taxes.

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Cost of goods sold was $552.0 million, or 63.3% of retail sales, in fiscal 2009 compared to $562.1 million, or 66.5% of retail sales, in fiscal 2008. The decrease in cost of goods sold as a percent of retail sales resulted primarily from lower occupancy costs, freight charges and markdowns. The decrease in markdowns was primarily attributable to inventory management and higher sell throughs of regular priced merchandise. Total gross margin dollars (retail sales less cost of goods sold) increased by 12.9% to $320.1 million in fiscal 2009 from $283.6 million in fiscal 2008. Gross margin as presented may not be comparable to that of other companies.

Selling, general and administrative expenses (SG&A), which primarily include corporate and store payroll, related payroll taxes and benefits, insurance, supplies, advertising, bank and credit card processing fees and bad debts were $245.5 million in fiscal 2009 compared to $227.6 million in fiscal 2008, an increase of 7.9%. As a percent of retail sales, SG&A was 28.2% compared to 26.9% in the prior year. The overall dollar increase in SG&A resulted primarily from an increase in incentive based compensation expenses, payroll and legal reserves partially offset by a reduction in workers' compensation expense and the costs associated with the closure of underperforming stores from fiscal 2008.

Depreciation expense was $21.8 million in fiscal 2009 compared to $22.6 million in fiscal 2008. Depreciation expense was flat from period to period because the Company's store count and related investments in store development, as well as its information technology investments were both relatively stable.

Interest and other income was $4.3 million in fiscal 2009 compared to $7.2 million in fiscal 2008. The decrease was due to lower interest income due to reduced interest rates. See Note 2 to the Consolidated Financial Statements for details.

Income tax expense was $23.1 million or 2.7% of retail sales in fiscal 2009 compared to $19.0 million or 2.2% of retail sales in fiscal 2008. The increase resulted from higher pre-tax income, partially offset by a decrease in the effective tax rate. The effective tax rate was 33.6% in fiscal 2009 and 36.1% in fiscal 2008 due to non-recurring settlements of various state audits resulting in reversals of certain income tax reserves for uncertain tax positions.

Off-Balance Sheet Arrangements

Other than operating leases in the ordinary course of business, the Company is not a party to any off-balance sheet arrangements.

Critical Accounting Policies

The Company's accounting policies are more fully described in Note 1 to the Consolidated Financial Statements. As disclosed in Note 1 of Notes to Consolidated Financial Statements, the preparation of the Company's financial statements in conformity with generally accepted accounting principles in the United States (GAAP) requires management to make estimates and assumptions about future events that affect the amounts reported in the financial statements and accompanying notes. Future events and their effects cannot be determined with absolute certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results inevitably will differ from those estimates, and such differences may be material to the financial statements. The most significant accounting estimates inherent in the preparation of the Company's financial statements include the allowance for doubtful accounts receivable, reserves relating to workers' compensation, general and auto insurance liabilities, reserves for inventory markdowns, shrinkage, uncertain tax positions, and calculation of potential asset impairment.

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The Company's critical accounting policies and estimates are discussed with the Audit Committee.

Allowance for Doubtful Accounts

The Company evaluates the collectibility of accounts receivable and records an allowance for doubtful accounts based on estimates of actual write-offs and the accounts receivable aging. The allowance is reviewed for adequacy and adjusted, as necessary, on a quarterly basis. The Company also provides for estimated uncollectible late fees charged based on historical write-offs. The Company's financial results can be significantly impacted by changes in bad debt write-off experience and the aging of the accounts receivable portfolio.

Merchandise Inventories

The Company's inventory is valued using the retail method of accounting and is stated at the lower of cost (first-in, first-out method) or market. Under the retail inventory method, the valuation of inventory at cost and resulting gross margin are calculated by applying an average cost to retail ratio to the retail value of inventory. The retail inventory method is an averaging method that has been widely used in the retail industry. Inherent in the retail method are certain significant estimates, including initial merchandise markup, markdowns and shrinkage, which can significantly impact the ending inventory valuation at cost and the resulting gross margins. Physical inventories are conducted throughout the year to calculate actual shrinkage and inventory on hand. Estimates based on actual shrinkage results are used to estimate inventory shrinkage, which is accrued for the period between the last physical inventory and the financial reporting date. The Company regularly reviews its inventory levels to identify slow moving merchandise and uses markdowns to clear slow moving inventory. The general economic environment for retail apparel sales could result in an increase in the level of markdowns, which would result in lower inventory values and increases to cost of goods sold as a percentage of net sales in future periods. Management makes estimates regarding markdowns based on inventory levels on hand and customer demand, which may impact inventory valuations. Markdown exposure with respect to inventories on hand is limited due to the fact that seasonal merchandise is not carried forward. Historically, actual results have not significantly deviated from those determined using the estimates described above.

Effective with the first quarter of 2011, the Company has elected to change its inventory valuation method from the retail method to the weighted-average cost method.

Lease Accounting

The Company recognizes rent expense on a straight-line basis over the lease term as defined in ASC 840 - *Leases*. Our lease agreements generally provide for scheduled rent increases during the lease term or rent holidays, including rental payments commencing at a date other than the date of initial occupancy. We include any rent escalation and rent holidays in our straight-line rent expense. In addition, we record landlord allowances for normal tenant improvements as deferred rent, which is included in other noncurrent liabilities in the consolidated balance sheets. This deferred rent is amortized over the lease term as a reduction of rent expense. Also, leasehold improvements are amortized using the straight-line method over the shorter of their estimated useful lives or the related lease term. See Note 1 to the Consolidated Financial Statements for further information on the Company's accounting for its leases.

Impairment of Long-Lived Assets

The Company primarily invests in property and equipment in connection with the opening and remodeling of stores and in computer software and hardware. The Company periodically reviews its store locations and estimates the recoverability of its assets, recording an impairment charge, if necessary, when the Company decides to close the store or otherwise determines that future estimated undiscounted cash flows associated with those assets will not be sufficient to recover the carrying value. This determination is based on a number of factors, including the store's historical operating results and cash flows, estimated future sales growth, real estate development in the area and perceived local market conditions that can be difficult to predict and may be subject to change. In addition, the Company regularly evaluates its computer-related and other long-lived assets and may accelerate depreciation over the revised useful life if the asset is expected to be replaced or has limited future value. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is reflected in income for that period.

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Insurance Liabilities

The Company is primarily self-insured for health care, workers' compensation and general liability costs. These costs are significant primarily due to the large number of the Company's retail locations and associates. The Company's self-insurance liabilities are based on the total estimated costs of claims filed and estimates of claims incurred but not reported, less amounts paid against such claims, and are not discounted. Management reviews current and historical claims data in developing its estimates. The Company also uses information provided by outside actuaries with respect to workers' compensation and general liability claims. If the underlying facts and circumstances of the claims change or the historical experience upon which insurance provisions are recorded is not indicative of future trends, then the Company may be required to make adjustments to the provision for insurance costs that could be material to the Company's reported financial condition and results of operations. Historically, actual results have not significantly deviated from estimates.

Uncertain Tax Positions

The Company records liabilities for uncertain tax positions principally related to state income taxes as of the balance sheet date. These liabilities reflect the Company's best estimate of its ultimate income tax liability based on the tax codes, regulations, and pronouncements of the jurisdictions in which we do business. Estimating our ultimate tax liability involves significant judgments regarding the application of complex tax regulations across many jurisdictions. Despite the Company's belief that the estimates and judgments are reasonable, differences between the estimated and actual tax liabilities can and do exist from time to time. These differences may arise from settlements of tax audits, expiration of the statute of limitations, or the evolution and application of the various jurisdictional tax codes and regulations. Any differences will be recorded in the period in which they become known and could have a material effect on the results of operations in the period the adjustment is recorded.

Revenue Recognition

While the Company's recognition of revenue is predominantly derived from routine retail transactions and does not involve significant judgment, revenue recognition represents an important accounting policy of the Company. As discussed in Note 1 to the Consolidated Financial Statements, the Company recognizes sales at the point of purchase when the customer takes possession of the merchandise and pays for the purchase, generally with cash or credit. Sales from purchases made with Cato credit, gift cards and layaway sales are also recorded when the customer takes possession of the merchandise. Gift cards and layaway sales are recorded as deferred revenue until they are redeemed or forfeited. Gift cards do not have expiration dates. A provision is made for estimated product returns based on sales volumes and the Company's experience; actual returns have not varied materially from amounts provided historically.

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The Company recognizes income on unredeemed gift cards (“gift card breakage”) as a component of other income. Gift card breakage is determined after 60 months when the likelihood of the remaining balances being redeemed is remote based on our historical redemption data and there is no legal obligation to remit the remaining balances to relevant jurisdictions. Gift card breakage income is recognized on a quarterly basis and is not expected to be material.

Credit revenue on the Company’s private label credit card portfolio is recognized as earned under the interest method. Late fees are recognized as earned, less provisions for estimated uncollectible fees.

Liquidity, Capital Resources and Market Risk

The Company has consistently maintained a strong liquidity position. Cash provided by operating activities during fiscal 2010 was $79.5 million as compared to $84.7 million in fiscal 2009. These amounts have enabled the Company to fund its regular operating needs, capital expenditure program and cash dividend payments. In addition, the Company maintains $35.0 million of unsecured revolving credit facilities for short-term financing of seasonal cash needs, none of which was outstanding at January 29, 2011.

Cash provided by operating activities for these periods was primarily generated by earnings adjusted for depreciation, deferred taxes, and changes in working capital. The decrease of $5.2 million for fiscal 2010 over fiscal 2009 is primarily due to an increase in merchandise inventories offset by an increase in accounts payable, accrued expenses, net income and deferred income taxes.

The Company believes that its cash, cash equivalents and short-term investments, together with cash flows from operations and borrowings available under its revolving credit agreement, will be adequate to fund the Company’s proposed capital expenditures, dividends and other operating requirements for fiscal 2011 and for the foreseeable future.

At January 29, 2011, the Company had working capital of $239.2 million compared to $202.3 million at January 30, 2010. Additionally, the Company had $2.4 million and $2.3 million invested in privately managed investment funds and other miscellaneous equities for fiscal years 2010 and 2009, respectively, which are reported under Other assets in the Consolidated Balance Sheets.

At January 29, 2011, the Company had an unsecured revolving credit agreement, which provided for borrowings of up to $35.0 million. The revolving credit agreement is committed until August 2013. The credit agreement contains various financial covenants and limitations, including the maintenance of specific financial ratios with which the Company was in compliance as of January 29, 2011. There were no borrowings outstanding under this credit facility during the fiscal year ended January 29, 2011 or the fiscal year ended January 30, 2010.

The Company had approximately $7.2 million and $8.2 million at January 29, 2011 and January 30, 2010, respectively, of outstanding irrevocable letters of credit relating to purchase commitments.

Expenditures for property and equipment totaled $19.6 million, $10.0 million and $19.4 million in fiscal 2010, 2009 and 2008, respectively. The expenditures for fiscal 2010 were primarily for store development and investments in new technology. In fiscal 2011, the Company is planning to invest approximately $32.3 million in capital expenditures. This includes expenditures to open 10 new Cato stores, 34 new It's Fashion Metro stores including the conversion of up to 17 It's Fashion stores to It's Fashion Metro stores, 10 new Versona Accessories stores and the relocation of six Cato stores. In addition, the Company plans to remodel 10 stores and has planned for additional investments in technology to be implemented over the next 12 months.

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Net cash used in investing activities totaled $55.7 million for fiscal 2010 compared to $58.1 million used for the comparable period of 2009. The decrease was due primarily to the change in short-term investments and partially offset by an increase in expenditures for property and equipment.

On May 27, 2010, the Board of Directors increased the quarterly dividend by 12% from $.165 per share to $.185 per share, or an annualized rate of $.74 per share.

The Company does not use derivative financial instruments.

The following tables set forth information regarding the Company's financial assets that are measured at fair value ($ in thousands) as of January 29, 2011 and January 30, 2010.

Description	January 29, 2011	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
State/Municipal Bonds	$ 129,678	$	$ 129,678	$
Corporate Bonds	34,288		34,288	
Auction Rate Securities (ARS)	3,450			3,450
Variable Rate Demand Notes (VRDN)	19,308	19,308		
Privately Managed Funds	1,925			1,925
Corporate Equities	480	480		
Total	$ 189,129	$ 19,788	$ 163,966	$ 5,375

		Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs

Description	January 30, 2010	Level 1	Level 2(A)	Level 3
State/Municipal Bonds	$ 76,056	$	$ 76,056	$
Corporate Bonds	8,989		8,989	
Auction Rate Securities (ARS)	3,450			3,450
Variable Rate Demand Notes (VRDN)	65,382	65,382		
Privately Managed Funds	1,940			1,940
Corporate Equities	407	407		
Total	$ 156,224	$ 65,789	$ 85,045	$ 5,390

(A) The state/municipal bonds were reclassed to Level 2 upon further interpretation.

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The Company's investment portfolio was primarily invested in tax exempt variable rate demand notes ("VRDN"), corporate bonds and governmental debt securities held in managed funds with underlying ratings of A or better at both January 29, 2011 and January 30, 2010. The underlying securities have contractual maturities which generally range from 3 days to 30 years. Although the Company's investments in VRDN's have underlying securities with contractual maturities longer than one year, the VRDN's themselves have interest rate resets of 7 days and are considered short-term investments. These securities are classified as available-for-sale and are recorded as short-term investments in the accompanying Consolidated Balance Sheets at estimated fair value, with unrealized gains and losses reported net of taxes in accumulated other comprehensive income.

Additionally, at January 29, 2011, the Company had $1.9 million of privately managed funds, $0.5 million of corporate equities and a single auction rate security ("ARS") of $3.5 million which continues to fail its auction. All of these assets are recorded within Other assets in the Consolidated Balance Sheets. At January 30, 2010, the Company had $1.9 million of privately managed funds, $0.4 million of corporate equities, and a single ARS of $3.5 million, all of which are recorded within Other assets in the Consolidated Balance Sheets.

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

The Company's failed ARS is measured at fair value using Level 3 inputs. Because there is no active market for this particular ARS, its fair value was determined through the use of a discounted cash flow analysis. The terms used in the analysis were based on management's estimate of the timing of future liquidity, which assumes that the security will be called or refinanced by the issuer or settled with a broker dealer prior to maturity. The discount rates used in the discounted cash flow analysis were based on market rates for similar liquid tax exempt securities with comparable ratings and maturities. Due to the uncertainty surrounding the timing of future liquidity, the Company also considered a liquidity/risk value reduction. In estimating the fair value of this ARS, the Company also considered the financial condition and near-term prospects of the issuer, the probability that the Company will be unable to collect all amounts due according to the contractual terms of the security and whether the security has been downgraded by a rating agency. The Company's valuation is sensitive to market conditions and management's judgment and can change significantly based on the assumptions used.

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

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The following tables summarize the change in the fair value of the Company's financial assets measured using Level 3 inputs during fiscal 2010 and fiscal 2009 ($ in thousands):

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)		
	Available-For-Sale Debt Securities ARS	**Other Investments Private Equity**	**Total**
Beginning Balance at January 30, 2010	$ 3,450	$ 1,940	$ 5,390
Transfers into Level 3			
Total gains or (losses)			
Included in earnings (or changes in net assets)	-	(15)	(15)
Included in other comprehensive income	-	-	-
Ending Balance at January 29, 2011	$ 3,450	$ 1,925	$ 5,375

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)		
	Available-For-Sale Debt Securities ARS	**Other Investments Private Equity**	**Total**
Beginning Balance at January 31, 2009	$ -	$ 1,955	$ 1,955
Transfers into Level 3	3,450	-	3,450
Total gains or (losses)	-	-	-
Included in earnings (or changes in net assets)	-	(15)	(15)
Included in other comprehensive income	-	-	-
Ending Balance at January 30, 2010	$ 3,450	$ 1,940	$ 5,390

The following table shows the Company's obligations and commitments as of January 29, 2011, to make future payments under noncalcellable contractual obligations (in thousands):

	Payments Due During One Year Fiscal Period Ending						
Contractual Obligations	**Total**	**2011**	**2012**	**2013**	**2014**	**2015**	**Thereafter**
Merchandise letters of credit	$ 7,179	$ 7,179	$ -	$ -	$ -	$ -	$ -
Operating leases	143,315	56,943	40,041	25,664	12,792	7,395	480
Total Contractual Obligations	$ 150,494	$ 64,122	$ 40,041	$ 25,664	$ 12,792	$ 7,395	$ 480

(1) In addition to the amounts shown in the table above, $8.3 million of unrecognized tax benefits have been recorded as liabilities in accordance with ASC 740 and we are uncertain if or when such amounts may be settled. See Note 13, Income Taxes, of the Consolidated Financial Statements for additional information.

Recent Accounting Pronouncements

Effective July 1, 2009, the FASB's Accounting Standards Codification ("ASC") became the single official source of authoritative, nongovernmental generally accepted accounting principles (GAAP) in the United States. The historical GAAP hierarchy was eliminated, and the ASC became the only level of authoritative GAAP, other than guidance issued by the Securities and Exchange Commission. This statement is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Company's accounting policies were not affected by the conversion to ASC.

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In January 2010, the FASB issued ASU No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*. ASU No. 2010-06 amends ASC 820 and clarifies and provides additional disclosure requirements related to recurring and non-recurring fair value measurements. This ASU was effective for the Company on January 31, 2010, and did not have a material impact on the Company's disclosures.

Item 7A. ***Quantitative and Qualitative Disclosures About Market Risk:***

The Company is subject to market rate risk from exposure to changes in interest rates based on its financing, investing and cash management.

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Item 8. ***Financial Statements and Supplementary Data:***

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of

The Cato Corporation:

In our opinion, the