

CATO CORP
Form 10-Q
August 29, 2014

Table of Contents

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

FORM 10-Q

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

For the quarterly period ended August 2, 2014

OR

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

For the transition period from _____ to _____
Commission file number 1-31340

THE CATO CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

56-0484485
(I.R.S. Employer Identification No.)

8100 Denmark Road, Charlotte, North Carolina 28273-5975
(Address of principal executive offices)

(Zip Code)

(704) 554-8510
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

Edgar Filing: CATO CORP - Form 10-Q

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 X 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes X No

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. (Check one):

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

(Do not check if a smaller reporting company)

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

Yes No X

As of August 2, 2014, there were 26,175,776 shares of Class A common stock and 1,743,525 shares of Class B common stock outstanding.

THE CATO CORPORATION

FORM 10-Q

Quarter Ended August 2, 2014

Table of Contents

	Page No.
PART I – FINANCIAL INFORMATION (UNAUDITED)	
Item 1. Financial Statements (Unaudited):	
Condensed Consolidated Statements of Income and Comprehensive Income For the Three Months and Six Months Ended August 2, 2014 and August 3, 2013	2
Condensed Consolidated Balance Sheets At August 2, 2014, February 1, 2014 and August 3, 2013	3
Condensed Consolidated Statements of Cash Flows For the Six Months Ended August 2, 2014 and August 3, 2013	4
Notes to Condensed Consolidated Financial Statements For the Three Months and Six Months Ended August 2, 2014 and August 3, 2013	5 – 18
Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations	19 – 26
Item 3. Quantitative and Qualitative Disclosures About Market Risk	27
Item 4. Controls and Procedures	27
PART II – OTHER INFORMATION	
Item 1. Legal Proceedings	28
Item 1A. Risk Factors	28
Item 2. Unregistered Sales of Equity Securities and Use of	28
Table of Contents	3

Edgar Filing: CATO CORP - Form 10-Q

	Proceeds	
Item 3.	Defaults Upon Senior Securities	28
Item 4.	Mine Safety Disclosures	29
Item 5.	Other Information	29
Item 6.	Exhibits	29
Signatures		30-34

Table of Contents

PART I FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS****THE CATO CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND****COMPREHENSIVE INCOME****(UNAUDITED)**

	Three Months Ended		Six Months Ended	
	August 2, 2014	August 3, 2013	August 2, 2014	August 3, 2013
	(Dollars in thousands, except per share data)			
REVENUES				
Retail sales	\$ 243,775	\$ 229,378	\$ 526,238	\$ 496,559
Other revenue (principally finance charges, late fees and layaway charges)	2,685	2,340	4,955	4,857
Total revenues	246,460	231,718	531,193	501,416
COSTS AND EXPENSES, NET				
Cost of goods sold (exclusive of depreciation shown below)	149,039	144,950	313,403	301,851
Selling, general and administrative (exclusive of depreciation shown below)	68,332	58,965	135,819	118,354
Depreciation	5,424	5,436	10,875	10,885
Interest and other income	(1,099)	(730)	(1,841)	(1,605)
Cost and expenses, net	221,696	208,621	458,256	429,485
Income before income taxes	24,764	23,097	72,937	71,931
Income tax expense	9,113	8,322	27,279	26,317
Net income	\$ 15,651	\$ 14,775	\$ 45,658	\$ 45,614
Basic earnings per share	\$ 0.56	\$ 0.51	\$ 1.61	\$ 1.56

Edgar Filing: CATO CORP - Form 10-Q

Diluted earnings per share	\$	0.56	\$	0.51	\$	1.61	\$	1.56
Dividends per share	\$	0.30	\$	0.05	\$	0.60	\$	0.10
Comprehensive income:								
Net income	\$	15,651	\$	14,775	\$	45,658	\$	45,614
Unrealized gain (loss) on available-for-sale securities, net of deferred income taxes of \$53 and \$21 for the three and six months ended August 2, 2014 and (\$273) and (\$206) for the three and six months ended August 3, 2013, respectively		87		(453)		36		(342)
Comprehensive income	\$	15,738	\$	14,322	\$	45,694	\$	45,272

See notes to condensed consolidated financial statements (unaudited).

Table of Contents

THE CATO CORPORATION**CONDENSED CONSOLIDATED BALANCE SHEETS****(UNAUDITED)**

ASSETS	August 2, 2014	February 1, 2014 (Dollars in thousands)	August 3, 2013
Current Assets:			
Cash and cash equivalents	\$ 92,247	\$ 79,427	\$ 88,559
Short-term investments	158,198	161,128	157,326
Restricted cash and investments	4,692	4,701	4,807
Accounts receivable, net of allowance for doubtful accounts of \$1,735, \$1,743 and \$2,036 at August 2, 2014, February 1, 2014 and August 3, 2013, respectively	40,315	39,224	39,908
Merchandise inventories	116,026	150,861	111,206
Deferred income taxes	4,699	4,720	4,837
Prepaid expenses	7,271	6,687	10,997
Total Current Assets	423,448	446,748	417,640
Property and equipment – net	145,614	141,129	139,550
Noncurrent deferred income taxes	1,375	1,373	-
Other assets	9,674	7,668	10,223
Total Assets	\$ 580,111	\$ 596,918	\$ 567,413
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current Liabilities:			
Accounts payable	\$ 86,302	\$ 111,514	\$ 80,674
Accrued expenses	47,735	45,763	49,196
Accrued bonus and benefits	11,416	4,999	1,609
Accrued income taxes	23,481	14,855	22,523
Total Current Liabilities	168,934	177,131	154,002
Deferred income taxes	-	-	3,330
Other noncurrent liabilities (primarily deferred rent)	31,951	28,678	26,520
Commitments and contingencies:	-	-	-
Stockholders' Equity:			
Preferred stock, \$100 par value per share, 100,000 shares authorized, none issued	-	-	-

Class A common stock, \$.033 par value per share, 50,000,000 shares authorized; issued 26,175,776 shares, 27,498,216 shares and 27,510,139 shares at August 2, 2014, February 1, 2014 and August 3, 2013, respectively	873	917	917
Convertible Class B common stock, \$.033 par value per share, 15,000,000 shares authorized; issued 1,743,525 shares at August 2, 2014, February 1, 2014 and August 3, 2013, respectively	58	58	58
Additional paid-in capital	82,612	80,463	78,356
Retained earnings	294,869	308,893	303,751
Accumulated other comprehensive income	814	778	479
Total Stockholders' Equity	379,226	391,109	383,561
Total Liabilities and Stockholders' Equity	\$ 580,111	\$ 596,918	\$ 567,413

See notes to condensed consolidated financial statements (unaudited).

Table of Contents

THE CATO CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Six Months Ended	
	August 2, 2014	August 3, 2013
	(Dollars in thousands)	
Operating Activities:		
Net income	\$ 45,658	\$ 45,614
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	10,875	10,885
Provision for doubtful accounts	548	696
Amortization (purchase) of investment premiums	399	(1,442)
Share-based compensation	1,750	1,489
Excess tax benefits from share-based compensation	(119)	(28)
Loss on disposal and write-offs of property and equipment	178	268
Changes in operating assets and liabilities which provided (used) cash:		
Accounts receivable	(1,639)	(588)
Merchandise inventories	34,835	29,532
Prepaid and other assets	(2,569)	(3,419)
Accrued income taxes	8,745	8,259
Accounts payable, accrued expenses and other liabilities	(15,123)	(16,957)
Net cash provided by operating activities	83,538	74,309
Investing Activities:		
Expenditures for property and equipment	(13,967)	(10,606)
Purchase of short-term investments	(21,430)	(41,741)
Sales of short-term investments	23,997	42,774
Change in restricted cash and investments	8	1,192
Net cash used in investing activities	(11,392)	(8,381)
Financing Activities:		
Dividends paid	(17,127)	(2,939)
Repurchase of common stock	(42,615)	(5,780)
Proceeds from employee stock purchase plan	297	214
Excess tax benefits from share-based compensation	119	28
Proceeds from stock options exercised	-	39
Net cash used in financing activities	(59,326)	(8,438)
Net increase in cash and cash equivalents	12,820	57,490
Cash and cash equivalents at beginning of period	79,427	31,069

Table of Contents

Edgar Filing: CATO CORP - Form 10-Q

Cash and cash equivalents at end of period	\$	92,247	\$	88,559
Non-cash investing activity:				
Accrued plant and equipment	\$	(4,880)	\$	(5,893)

See notes to condensed consolidated financial statements (unaudited).

Table of Contents

**THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED AUGUST 2, 2014 AND AUGUST 3, 2013**

NOTE 1 - GENERAL:

The condensed consolidated financial statements have been prepared from the accounting records of The Cato Corporation and its wholly-owned subsidiaries (the “Company”), and all amounts shown as of and for the three and six month periods ended August 2, 2014 and August 3, 2013 are unaudited. In the opinion of management, all adjustments considered necessary for a fair statement have been included. All such adjustments are of a normal, recurring nature unless otherwise noted. The results of the interim period may not be indicative of the results expected for the entire year.

The interim financial statements should be read in conjunction with the consolidated financial statements and notes thereto, included in the Company’s Annual Report on Form 10-K/A for the fiscal year ended February 1, 2014. Amounts as of February 1, 2014 have been derived from the audited balance sheet, but do not include all disclosures required by accounting principles generally accepted in the United States of America.

During the fourth quarter of 2013, the Company discovered that it had improperly netted purchases and sales activity for investments within cash flows related to investing activities in prior periods. In addition, the Company had also improperly classified the premiums and amortization of premiums on those investments in cash flows related to investing activities when it should have been in cash flows related to operating activities. The Condensed Consolidated Statement of Cash Flows for the six months ended August 3, 2013 has been revised to correct the presentation of the amounts, which resulted in a decrease to Net cash provided by operating activities and a corresponding decrease to Net cash provided (used) in investing activities of \$1.4 million dollars. The revision is not deemed material to the prior period consolidated financial statements.

The decrease in Stockholders’ Equity for the first six months ended August 2, 2014 compared to the fiscal year ended February 1, 2014 is primarily due to a stock repurchase of \$42.6 million and dividends paid of \$17.1 million, partially offset by net income of \$45.7million.

On August 28, 2014, the Board of Directors maintained the quarterly dividend at \$0.30 per share.

Table of Contents

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED AUGUST 2, 2014 AND AUGUST 3, 2013

NOTE 2 - EARNINGS PER SHARE:

Accounting Standard Codification (“ASC”) 260 – *Earnings Per Share* requires dual presentation of basic and diluted Earnings Per Share (“EPS”) on the face of all income statements for all entities with complex capital structures. The Company has presented one basic EPS and one diluted EPS amount for all common shares in the accompanying Condensed Consolidated Statements of Income and Comprehensive Income. While the Company’s certificate of incorporation provides the right for the Board of Directors to declare dividends on Class A shares without declaration of commensurate dividends on Class B shares, the Company has historically paid the same dividends to both Class A and Class B shareholders and the Board of Directors has resolved to continue this practice. Accordingly, the Company’s allocation of income for purposes of the EPS computation is the same for Class A and Class B shares and the EPS amounts reported herein are applicable to both Class A and Class B shares.

Basic EPS is computed as net income less earnings allocated to non-vested equity awards divided by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur from common shares issuable through stock options and the Employee Stock Purchase Plan.

	Three Months Ended		Six Months Ended	
	August 2, 2014	August 3, 2013	August 2, 2014	August 3, 2013
	(Dollars in thousands)			
Numerator				
Net earnings	\$ 15,651	\$ 14,775	\$ 45,658	\$ 45,614
Earnings allocated to non-vested equity awards	(323)	(251)	(860)	(733)
Net earnings available to common stockholders	\$ 15,328	\$ 14,524	\$ 44,798	\$ 44,881
Denominator				
Basic weighted average common shares outstanding	27,357,829	28,736,214	27,846,611	28,784,425
Dilutive effect of stock options	2,516	4,859	1,654	3,537
Diluted weighted average common shares outstanding	27,360,345	28,741,073	27,848,265	28,787,962
Net income per common share	\$ 0.56	\$ 0.51	\$ 1.61	\$ 1.56

Edgar Filing: CATO CORP - Form 10-Q

Basic earnings per share
(Class A and B Shares)

Diluted earnings per share
(Class A and B Shares)

\$	0.56	\$	0.51	\$	1.61	\$	1.56
----	-------------	----	------	----	-------------	----	------

6

Table of Contents

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED AUGUST 2, 2014 AND AUGUST 3, 2013

NOTE 3 – ACCUMULATED OTHER COMPREHENSIVE INCOME:

The following table sets forth information regarding the reclassification out of Accumulated other comprehensive income (in thousands) for the three months ended August 2, 2014:

		Changes in Accumulated Other Comprehensive Income (a) Unrealized Gains and (Losses) on Available-for-Sale Securities
Beginning Balance at May 3, 2014	\$	727
Other comprehensive income before reclassifications		213
Amounts reclassified from accumulated other comprehensive income (b)		(126)
Net current-period other comprehensive income		87
Ending Balance at August 2, 2014	\$	814

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

(b) Includes \$202 impact of Accumulated other comprehensive income reclassifications into Interest and other

income for net gains on available-for-sale securities. The tax impact of this reclassification was \$76.

The following table sets forth information regarding the reclassification out of Accumulated other comprehensive income (in thousands) for the first six months ended August 2, 2014:

		Changes in Accumulated Other Comprehensive Income (a) Unrealized Gains and (Losses) on Available-for-Sale Securities
	\$	778

Beginning Balance at February 1, 2014		
Other comprehensive income before reclassifications		181
Amounts reclassified from accumulated other comprehensive income (b)		(145)
Net current-period other comprehensive income		36
Ending Balance at August 2, 2014	\$	814

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

(b) Includes \$232 impact of Accumulated other comprehensive income reclassifications into Interest and other

income for net gains on available-for-sale securities. The tax impact of this reclassification was \$87.

Table of Contents

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED AUGUST 2, 2014 AND AUGUST 3, 2013

The following table sets forth information regarding the reclassification out of Accumulated other comprehensive income (in thousands) for the three months ended August 3, 2013:

		Changes in Accumulated Other Comprehensive Income (a) Unrealized Gains and (Losses) on Available-for-Sale Securities
Beginning Balance at May 4, 2013	\$	932
Other comprehensive income before reclassifications		(436)
Amounts reclassified from accumulated other comprehensive income (b)		(17)
Net current-period other comprehensive income		(453)
Ending Balance at August 3, 2013	\$	479

(a) All amounts are net-of-tax. Amounts in parentheses indicate a debit/reduction to Other Comprehensive Income.
(b) Includes \$28 impact of Accumulated other comprehensive income reclassifications into Interest and other

income for net gains on available-for-sale securities. The tax impact of this reclassification was \$11.

The following table sets forth information regarding the reclassification out of Accumulated other comprehensive income (in thousands) for the six months ended August 3, 2013:

		Changes in Accumulated Other Comprehensive Income (a) Unrealized Gains and (Losses) on Available-for-Sale Securities
Beginning Balance at February 2, 2013	\$	821

Other comprehensive income before reclassifications		(283)
Amounts reclassified from accumulated other comprehensive income (b)		(59)
Net current-period other comprehensive income		(342)
Ending Balance at August 3, 2013	\$	479

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

(b) Includes \$94 impact of Accumulated other comprehensive income reclassifications into Interest and other

income for net gains on available-for-sale securities. The tax impact of this reclassification was \$35.

Table of Contents

**THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED AUGUST 2, 2014 AND AUGUST 3, 2013**

NOTE 4 – FINANCING ARRANGEMENTS:

As of August 2, 2014, the Company had an unsecured revolving credit agreement to borrow \$35.0 million, less the value of revocable letters of credit discussed below. During 2013, the revolving credit agreement was amended and extended to August 2015. The credit agreement contains various financial covenants and limitations, including the maintenance of specific financial ratios with which the Company was in compliance as of August 2, 2014. There were no borrowings outstanding under this credit facility during the periods ended August 2, 2014, February 1, 2014 or August 3, 2013. The weighted average interest rate under the credit facility was zero at August 2, 2014 due to no borrowings during the year.

At August 2, 2014, February 1, 2014 and August 3, 2013, the Company had approximately \$0.3 million, \$0.4 million and \$0.6 million, respectively, of outstanding revocable letters of credit related to purchase commitments.

NOTE 5 – REPORTABLE SEGMENT INFORMATION:

The Company has determined that it has four operating segments, as defined under ASC 280-10, including Cato, It's Fashion, Versona Accessories and Credit. As outlined in ASC 280-10, the Company has two reportable segments: Retail and Credit. The Company has aggregated its retail operating segments based on the aggregation criteria outlined in ASC 280-10, which states that two or more operating segments may be aggregated into a single reportable segment if aggregation is consistent with the objective and basic principles of ASC 280-10, if the segments have similar economic characteristics, similar product, similar production processes, similar clients and similar methods of distribution.

The Company's retail operating segments have similar economic characteristics and similar operating, financial and competitive risks. They are similar in nature of product, as they all offer women's apparel, shoes and accessories. Merchandise inventory of the Company's operating segments is sourced from the same countries and some of the same vendors, using similar production processes. Customers of the Company's operating segments have similar characteristics. Merchandise for the Company's operating segments is distributed to retail stores in a similar manner through the Company's single distribution center and is subsequently distributed to customers in a similar manner, through its retail stores.

The Company operates its women's fashion specialty retail stores in 32 states as of August 2, 2014, principally in the southeastern United States. The Company offers its own credit card to its customers and all credit authorizations, payment processing and collection efforts are performed by a separate subsidiary of the Company.

Table of Contents

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED AUGUST 2, 2014 AND AUGUST 3, 2013

NOTE 5 – REPORTABLE SEGMENT INFORMATION (CONTINUED):

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

Three Months Ended				Six Months Ended			
August 2, 2014	Retail	Credit	Total	August 2, 2014	Retail	Credit	Total
Revenues	\$ 245,024	\$ 1,436	\$ 246,460	Revenues	\$ 528,281	\$ 2,912	\$ 531,193
Depreciation	5,412	12	5,424	Depreciation	10,850	25	10,875
Interest and other income	(1,099)	-	(1,099)	Interest and other income	(1,841)	-	(1,841)
Income before taxes	24,188	576	24,764	Income before taxes	71,879	1,058	72,937
Total assets	513,174	66,937	580,111	Total assets	513,174	66,937	580,111
Capital expenditures	9,851	-	9,851	Capital expenditures	13,967	-	13,967
Three Months Ended				Six Months Ended			
August 3, 2013	Retail	Credit	Total	August 3, 2013	Retail	Credit	Total
Revenues	\$ 230,163	\$ 1,555	\$ 231,718	Revenues	\$ 498,242	\$ 3,174	\$ 501,416
Depreciation	5,427	9	5,436	Depreciation	10,863	22	10,885
Interest and other income	(730)	-	(730)	Interest and other income	(1,605)	-	(1,605)
Income before taxes	22,474	623	23,097	Income before taxes	70,808	1,123	71,931
Total assets	501,281	66,132	567,413	Total assets	501,281	66,132	567,413
Capital expenditures	5,001	-	5,001	Capital expenditures	10,606	-	10,606

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

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

Three Months Ended**Six Months Ended**

Edgar Filing: CATO CORP - Form 10-Q

	August 2, 2014		August 3, 2013	August 2, 2014		August 3, 2013
Bad debt						
expense	\$	240	\$	314	\$	548
Payroll		211		234		417
Postage		188		180		379
Other expenses		209		195		485
Total expenses	\$	848	\$	923	\$	1,829

10

Table of Contents

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED AUGUST 2, 2014 AND AUGUST 3, 2013

NOTE 6 – STOCK BASED COMPENSATION:

As of August 2, 2014, the Company had three long-term compensation plans pursuant to which stock-based compensation was outstanding or could be granted. The Company's 1987 Non-Qualified Stock Option Plan is for the granting of options to officers and key employees. As of May 1, 2013, there were no available stock options for grant under this plan. The 2013 Incentive Compensation Plan and 2004 Amended and Restated Incentive Compensation Plan are for the granting of various forms of equity-based awards, including restricted stock and stock options for grant, to officers, directors and key employees. Effective May 23, 2013, shares for grant were no longer available under the 2004 Amended and Restated Incentive Compensation Plan.

The following table presents the number of options and shares of restricted stock initially authorized and available for grant under each of the plans as of August 2, 2014:

	1987 Plan	2004 Plan	2013 Plan	Total
Options and/or restricted stock initially authorized	5,850,000	1,350,000	1,500,000	8,700,000
Options and/or restricted stock available for grant:				
February 1, 2014	-	-	1,488,902	1,488,902
August 2, 2014	-	-	1,277,890	1,277,890

In accordance with ASC 718, the fair value of current restricted stock awards is estimated on the date of grant based on the market price of the Company's stock and is amortized to compensation expense on a straight-line basis over the related vesting periods. As of August 2, 2014, February 1, 2014 and August 3, 2013, there was \$12,330,000, \$8,298,000 and \$9,922,000 of total unrecognized compensation expense related to nonvested restricted stock awards, which have a remaining weighted-average vesting period of 3.1 years, 2.6 years and 4.5 years, respectively. The total fair value of the shares recognized as compensation expense during the three and six months ended August 2, 2014 was \$1,183,000 and \$1,689,000, respectively, compared to \$1,018,000 and \$1,448,000, respectively, for the three and six months ended August 3, 2013. These expenses are classified as a component of Selling, general and administrative expenses in the Condensed Consolidated Statements of Income and Comprehensive Income.

Edgar Filing: CATO CORP - Form 10-Q

The following summary shows the changes in the shares of restricted stock outstanding during the six months ended August 2, 2014:

	Number of Shares		Weighted Average Grant Date Fair Value Per Share
Restricted stock awards at February 1, 2014	505,623	\$	24.52
Granted	206,713		28.25
Vested	(108,155)		22.41
Forfeited or expired	(24,611)		25.75
Restricted stock awards at August 2, 2014	579,570	\$	26.19

Table of Contents

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED AUGUST 2, 2014 AND AUGUST 3, 2013

The Company's Employee Stock Purchase Plan allows eligible full-time employees to purchase a limited number of shares of the Company's Class A Common Stock during each semi-annual offering period at a 15% discount through payroll deductions. During the six months ended August 2, 2014 and August 3, 2013, the Company sold 12,748 and 10,418 shares to employees at an average discount of \$4.11 and \$3.62 per share, respectively, under the Employee Stock Purchase Plan. The compensation expense recognized for the 15% discount given under the Employee Stock Purchase Plan was approximately \$52,000 and \$38,000 for the six months ended August 2, 2014 and August 3, 2013, respectively. These expenses are classified as a component of Selling, general and administrative expenses.

NOTE 7 – FAIR VALUE MEASUREMENTS:

The following tables set forth information regarding the Company's financial assets that are measured at fair value (in thousands) as of August 2, 2014, February 1, 2014 and August 3, 2013:

Description	August 2, 2014	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Assets:				
State/Municipal Bonds	\$ 152,479	\$ -	\$ 152,479	\$ -
Corporate Bonds	6,452	-	6,452	-
Auction Rate Securities (ARS)	3,140	-	-	3,140
U.S. Treasury Notes	1,503	1,503	-	-
Cash Surrender Value of Life Insurance	3,812	-	-	3,812
Privately Managed Funds	324	-	-	324
Corporate Equities	606	606	-	-
Certificates of Deposit	100	100	-	-
Total Assets	\$ 168,416	\$ 2,209	\$ 158,931	\$ 7,276
Liabilities:				
Deferred Compensation	(4,132)	-	-	(4,132)
Total Liabilities	\$ (4,132)	\$ -	\$ -	\$ (4,132)

Table of Contents

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED AUGUST 2, 2014 AND AUGUST 3, 2013

Description	February 1, 2014	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Assets:				
State/Municipal Bonds	\$ 159,074	\$ -	\$ 159,074	\$ -
Corporate Bonds	2,799	-	2,799	-
Auction Rate Securities (ARS)	3,140	-	-	3,140
U.S. Treasury Notes	3,405	3,405	-	-
Cash Surrender Value of Life Insurance	2,957	-	-	2,957
Privately Managed Funds	392	-	-	392
Corporate Equities	585	585	-	-
Certificates of Deposit	100	100	-	-
Total Assets	\$ 172,452	\$ 4,090	\$ 161,873	\$ 6,489
Liabilities:				
Deferred Compensation	(3,298)	-	-	(3,298)
Total Liabilities	\$ (3,298)	\$ -	\$ -	\$ (3,298)

Description	August 3, 2013	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Assets:				
State/Municipal Bonds	\$ 158,080	\$ -	\$ 158,080	\$ -
Corporate Bonds	-	-	-	-
Auction Rate Securities (ARS)	3,450	-	-	3,450
Variable Rate Demand Notes (VRDN)	-	-	-	-
U.S. Treasury Notes	1,504	1,504	-	-
Cash Surrender Value of Life Insurance	2,633	-	-	2,633
Privately Managed Funds	471	-	-	471
Corporate Equities	591	591	-	-

Edgar Filing: CATO CORP - Form 10-Q

Certificates of Deposit		100		100		-		-
Total Assets	\$	166,829	\$	2,195	\$	158,080	\$	6,554
Liabilities:								
Deferred Compensation		(2,746)		-		-		(2,746)
Total Liabilities	\$	(2,746)	\$	-	\$	-	\$	(2,746)

13

Table of Contents

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED AUGUST 2, 2014 AND AUGUST 3, 2013

The Company's investment portfolio was primarily invested in corporate bonds and tax-exempt and taxable governmental debt securities held in managed accounts with underlying ratings of Aa3 or better at August 2, 2014, February 1, 2014 and August 3, 2013. The state, municipal and corporate bonds have contractual maturities which range from one month to 12.3 years. The U.S. Treasury Notes and Certificates of Deposit have contractual maturities which range from one month to 1.1 years. These securities are classified as available-for-sale and are recorded as Short-term investments, Restricted cash and investments and Other assets on the accompanying Condensed Consolidated Balance Sheets. These assets are carried at fair value with unrealized gains and losses reported net of taxes in Accumulated other comprehensive income.

Additionally, at August 2, 2014, the Company had \$0.3 million of privately managed funds, \$0.6 million of corporate equities and a single auction rate security ("ARS") of \$3.1 million which continues to fail its auction, and deferred compensation plan assets of \$3.8 million. At February 1, 2014, the Company had \$0.4 million of privately managed funds, \$0.6 million of corporate equities, a single ARS of \$3.1 million and deferred compensation plan assets of \$3.0 million. At August 3, 2013, the Company had \$0.5 million of privately managed funds, \$0.6 million of corporate equities, a single ARS of \$3.5 million and deferred compensation plan assets of \$2.6 million. All of these assets are recorded within Other assets in the Condensed 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 ARS of \$3,450,000 par value was issued by the Wake County, NC Industrial Facilities & Pollution Control Financing Authority. The security is an obligation of Duke Energy Progress and has a credit rating of Aa3. The Company has collected all interest payments when due since the security was purchased and continues to expect that it will receive all interest due on the security in full and on a timely basis in the future.

The Company's failed ARS is recorded at \$3,139,500, which approximates fair value using Level 3 inputs. Because there is no active market for this particular ARS, its fair value was analyzed through the use of a discounted cash flow analysis and observations from previous trades. 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 recent trading activity, 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.

Table of Contents

THE CATO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE THREE MONTHS AND SIX MONTHS ENDED AUGUST 2, 2014 AND AUGUST 3, 2013

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

Deferred compensation plan assets consist of life insurance policies. These life insurance policies are valued based on the cash surrender value of the insurance contract, which is determined based on such factors as the fair value of the underlying assets and discounted cash flow and are therefore classified within Level 3 of the valuation hierarchy. The Level 3 liability associated with the life insurance policies represents a deferred compensation obligation, the value of which is tracked via underlying insurance funds. These funds are designed to mirror existing mutual funds and money market funds that are observable and actively traded. Cash surrender values are provided by third parties and reviewed for reasonableness by the Company.

The following tables summarize the change in fair value of the Company's financial assets measured using Level 3 inputs as of August 2, 2014 and August 3, 2013 (in thousands):

	Fair Value Measurements Using Significant Unobservable Asset Inputs (Level 3)				Total
	Available-For-Sale Debt Securities ARS	Other Investments Private Equity	Cash Surrender Value		
Beginning Balance at February 1, 2014	\$ 3,140	\$ 392	\$ 2,957	\$ 6,489	
Redemptions	-	(70)	-	(70)	
Additions	-		753	753	
Total gains or (losses) Included in interest and other income (or changes in net assets)	-	2	102	104	
Included in other comprehensive income	-	-	-	-	
Ending Balance at August 2, 2014	\$ 3,140	\$ 324	\$ 3,812	\$ 7,276	
	Fair Value Measurements Using Significant Unobservable Liability Inputs (Level 3)				
	Deferred Compensation	Total			

Edgar Filing: CATO CORP - Form 10-Q

Beginning Balance at February 1, 2014	\$	(3,298)	\$	(3,298)
Additions		(672)		(672)
Total (gains) or losses Included in interest and other income (or changes in net assets)		(162)		(162)
Included in other comprehensive income		-		-
Ending Balance at August 2, 2014	\$	(4,132)	\$	(4,132)

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

		Available-For-Sale Debt Securities ARS	Other Investments Private Equity	Cash Surrender Value		Total		
Beginning Balance at February 2, 2013	\$	3,450	\$	561	\$	2,051	\$	6,062
Redemptions		-		(97)		-		(97)
Additions				494				494
Total gains or (losses) Included in interest and other income (or changes in net assets)		-		7		88		95
Included in other comprehensive income		-		-		-		-
Ending Balance at August 3, 2013	\$	3,450	\$	471	\$	2,633	\$	