

CARTERS INC
Form 10-Q
January 15, 2010

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 OCTOBER 3, 2009 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:

001-31829

CARTER'S, INC.

(Exact name of Registrant as specified in its charter)

Delaware
(state or other jurisdiction of
incorporation or organization)

13-3912933
(I.R.S. Employer Identification No.)

The Proscenium
1170 Peachtree Street NE, Suite 900
Atlanta, Georgia 30309
(Address of principal executive offices, including zip code)
(404) 745-2700
(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes
[] No [X]

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Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate website, 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 whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of “accelerated filer, large accelerated filer, and smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one)

Large Accelerated Filer (X) Accelerated Filer () Non-Accelerated Filer () 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)

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.

| Common Stock | Outstanding Shares at January 15, 2010 |
|---|---|
| Common stock, par value \$0.01 per share | 58,077,002 |

CARTER'S, INC.
FORM 10-Q
EXPLANATORY NOTE

As part of this Quarterly Report on Form 10-Q, the Company is hereby amending its results for the three and nine-month periods ended September 27, 2008, which were originally filed with the Securities and Exchange Commission ("SEC") on Form 10-Q on October 30, 2008 ("Original Filing").

Background of the Restatement

On November 10, 2009, the Company announced that its Audit Committee, with the assistance of outside counsel, had commenced a review of customer margin support provided by the Company and an investigation into undisclosed margin support commitments and related matters. As a result of this review, the Company announced that the previously issued consolidated financial statements for the fiscal years 2004 through 2008 included in the Company's Forms 10-K, and for the fiscal quarters from September 29, 2007 through July 4, 2009 included in the Company's Forms 10-Q, should no longer be relied upon (collectively, the "Affected Periods").

Management initially began a review of margin support arrangements with respect to a single wholesale customer (the "Initial Customer") after becoming aware of a disputed amount of margin support with the Initial Customer. In the normal course of business, the Company provides margin support and other allowances (collectively, "accommodations") to its wholesale customers to assist them with the costs related to inventory clearance and sales promotions. The Company's policy is to reflect the amounts of accommodations as reductions to revenue or, in the case of certain co-op advertising expenses, as additions to selling, general, and administrative expenses. As a result of its review, management identified issues with respect to the timing of recognizing customer accommodations with respect to the Initial Customer. Following management's review, the Audit Committee engaged outside counsel to undertake the review and investigation.

The Audit Committee has completed its review and investigation, which was conducted with the assistance of outside counsel and forensic accountants engaged by outside counsel, and has concluded that the Company reported various customer accommodations in incorrect fiscal periods. The investigation uncovered irregularities involving members of the sales organization intentionally not disclosing accommodations arrangements with customers to the Company's finance organization and intentionally providing inaccurate documentation and explanations regarding accommodations to the finance organization. Consequently, such arrangements were not communicated to the Company's independent registered public accounting firm. These accommodations arrangements were made throughout the Affected Periods by certain members of the Company's sales organization and involved the deferral of accommodations into later fiscal periods. The deferrals resulted in the overstatement of net sales and net income in certain of the Affected Periods and the understatement of net sales and net income in certain of the Affected Periods. The deferrals related primarily to the Initial Customer and, to a lesser extent, other wholesale customers.

The cumulative, after-tax impact of the adjustments required to fairly state the previously issued financial statements for the Affected Periods is a 3% reduction in retained earnings in the amount of \$7.5 million as of July 4, 2009. This amount reflects the sum of adjustments to net income for fiscal 2004 through the six-month period ended July 4, 2009, which total \$4.4 million, and a 2003 cumulative adjustment to retained earnings in the amount of \$3.1 million. The adjustments do not impact the Company's reported cash flow from operations for any of the Affected Periods.

The Company has self-reported information concerning this investigation to the SEC. The Company has also been informed that the United States Attorney's Office is conducting an inquiry into this matter. The Company will continue to cooperate with these inquiries.

Restatement of Other Financial Statements

With the filing of this Form 10-Q, we are concurrently filing amendments to our Annual Report on Form 10-K for fiscal 2008 and our Quarterly Reports on Form 10-Q for each of the quarterly periods ended April 4, 2009 and July 4, 2009. The amendment to our Annual Report on Form 10-K/A is being filed to restate our consolidated financial statements for the fiscal years ended January 3, 2009, December 29, 2007, and December 30, 2006, and for the fiscal years ended December 31, 2005 and January 1, 2005, as included in Item 6 – “Selected Financial Data,” as well as our selected condensed consolidated financial data (excluding footnotes) for the quarterly periods in fiscal 2007 and fiscal 2008 included in Item 8 – “Financial Statements and Supplementary Data.” The amendments to our Quarterly Reports on Form 10-Q are being filed to restate our unaudited condensed consolidated financial statements and related financial information for the quarterly periods ended April 4, 2009 and July 4, 2009 and the comparative fiscal 2008 periods for the effects of the restatement.

We do not intend to file any other amended Annual Reports on Form 10-K or Quarterly Reports on Form 10-Q for periods affected by the restatement. The consolidated financial statements and related financial information contained in any of the Company's filings with the SEC during the restated periods should no longer be relied upon.

Internal Control Considerations

Through the investigation, management identified: (i) control deficiencies in its internal controls associated with customer accommodations processes that constitute material weaknesses, as discussed in Part I, Item 4 of this filing, and (ii) the need to restate prior period consolidated financial statements. A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim consolidated financial statements will not be prevented or detected. Management has also determined that the Company's disclosure controls and procedures were ineffective as of October 3, 2009. For a discussion of management's consideration of the Company's disclosure controls and procedures and material weaknesses identified, see Part I, Item 4 included in this filing.

If not remediated, these control deficiencies could result in future material misstatements to the Company's consolidated financial statements. Accordingly, management determined that these control deficiencies represented material weaknesses in internal control over financial reporting.

The Company is amending and restating its financial information for the three and nine-month periods ended September 27, 2008, as modified and superseded where necessary to reflect the restatement in the following items:

- Part I — Item 1. Financial Statements
 - o Unaudited Condensed Consolidated Balance Sheet as of January 3, 2009
 - o Unaudited Condensed Consolidated Statements of Operations for the three and nine-month periods ended September 27, 2008
 - o Unaudited Condensed Consolidated Statements of Cash Flows for the nine-month period ended September 27, 2008
 - o Notes to Unaudited Condensed Consolidated Financial Statements — the impacts are more fully discussed in Note 3 — Restatement of Consolidated Financial Statements
- Part I — Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations for the three and nine-month periods ended September 27, 2008

In accordance with applicable SEC rules, this filing includes certifications from our Chief Executive Officer and Chief Financial Officer dated as of the date of this filing.

CARTER'S, INC.
INDEX

| | | Page |
|-----------------|---|-------|
| <u>Part I.</u> | <u>Financial Information</u> | |
| <u>Item 1.</u> | <u>Financial Statements</u> | |
| | <u>Unaudited Condensed Consolidated Balance Sheets as of October 3, 2009 and January 3, 2009 (Restated)</u> | -- 1 |
| | <u>Unaudited Condensed Consolidated Statements of Operations for the three and nine-month periods ended October 3, 2009 and September 27, 2008 (Restated)</u> | -- 2 |
| | <u>Unaudited Condensed Consolidated Statements of Cash Flows for the nine-month periods ended October 3, 2009 and September 27, 2008 (Restated)</u> | -- 3 |
| | <u>Unaudited Condensed Consolidated Statement of Changes in Stockholders' Equity for the nine-month period ended October 3, 2009</u> | -- 4 |
| | <u>Notes to the Unaudited Condensed Consolidated Financial Statements</u> | -- 5 |
| <u>Item 2.</u> | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | -- 21 |
| <u>Item 3.</u> | <u>Quantitative and Qualitative Disclosures about Market Risk</u> | -- 33 |
| <u>Item 4.</u> | <u>Controls and Procedures</u> | -- 33 |
| <u>Part II.</u> | <u>Other Information</u> | |
| <u>Item 1.</u> | <u>Legal Proceedings</u> | -- 36 |
| <u>Item 1A.</u> | <u>Risk Factors</u> | -- 37 |
| <u>Item 2.</u> | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | -- 43 |
| <u>Item 3.</u> | <u>Defaults upon Senior Securities</u> | -- 43 |
| <u>Item 4.</u> | <u>Submission of Matters to a Vote of Security Holders</u> | -- 43 |
| <u>Item 5.</u> | <u>Other Information</u> | -- 43 |

| | | | |
|-------------------|-----------------|----|-----------|
| <u>Item 6.</u> | <u>Exhibits</u> | -- | <u>43</u> |
| <u>Signatures</u> | | -- | <u>44</u> |
| Certifications | | | 45 |

PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CARTER'S, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(dollars in thousands, except for share data)
(unaudited)

| | October 3, 2009 | January 3, 2009 (Restated) |
|---|---------------------|----------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 214,339 | \$ 162,349 |
| Accounts receivable, net | 127,879 | 85,452 |
| Finished goods inventories, net | 223,510 | 203,486 |
| Prepaid expenses and other current assets | 11,845 | 13,214 |
| Deferred income taxes | 32,005 | 35,545 |
| Total current assets | 609,578 | 500,046 |
| Property, plant, and equipment, net | 84,430 | 86,229 |
| Tradenames | 305,733 | 305,733 |
| Cost in excess of fair value of net assets acquired | 136,570 | 136,570 |
| Deferred debt issuance costs, net | 2,750 | 3,598 |
| Licensing agreements, net | 2,597 | 5,260 |
| Other assets | 405 | 576 |
| Total assets | \$ 1,142,063 | \$ 1,038,012 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Current maturities of long-term debt | \$ 3,503 | \$ 3,503 |
| Accounts payable | 68,009 | 79,011 |
| Other current liabilities | 69,808 | 57,613 |
| Total current liabilities | 141,320 | 140,127 |
| Long-term debt | 331,896 | 334,523 |
| Deferred income taxes | 106,646 | 108,989 |
| Other long-term liabilities | 43,628 | 40,822 |
| Total liabilities | 623,490 | 624,461 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred stock; par value \$.01 per share; 100,000 shares authorized; none issued | -- | -- |

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| | | |
|--|--------------|--------------|
| or outstanding at October 3, 2009 and January 3, 2009 | | |
| Common stock, voting; par value \$.01 per share; 150,000,000 shares authorized; 58,037,018 and 56,352,111 shares issued and outstanding at October 3, 2009 and January 3, 2009, respectively | | |
| | 580 | 563 |
| Additional paid-in capital | 233,565 | 211,767 |
| Accumulated other comprehensive loss | (6,755) | (7,318) |
| Retained earnings | 291,183 | 208,539 |
| Total stockholders' equity | 518,573 | 413,551 |
| Total liabilities and stockholders' equity | | |
| | \$ 1,142,063 | \$ 1,038,012 |

See accompanying notes to the unaudited condensed consolidated financial statements

CARTER'S, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
 (dollars in thousands, except per share data)
 (unaudited)

| | For the three-month periods ended | | For the nine-month periods ended | |
|---|--------------------------------------|--|-------------------------------------|--|
| | October 3, 2009 | September 27, 2008 (Restated) | October 3, 2009 | September 27, 2008 (Restated) |
| Net sales | \$ 481,506 | \$ 434,882 | \$ 1,164,997 | \$ 1,072,403 |
| Cost of goods sold | 295,942 | 281,752 | 727,001 | 708,903 |
| Gross profit | 185,564 | 153,130 | 437,996 | 363,500 |
| Selling, general, and administrative expenses | 115,225 | 104,536 | 314,198 | 289,019 |
| Workforce reduction and facility write-down and closure costs (Note 12) | -- | 2,609 | 11,400 | 2,609 |
| Executive retirement charges (Note 15) | -- | -- | -- | 5,325 |
| Royalty income | (10,637) | (9,576) | (26,871) | (24,693) |
| Operating income | 80,976 | 55,561 | 139,269 | 91,240 |
| Interest expense, net | 2,688 | 4,048 | 8,571 | 13,357 |
| Income before income taxes | 78,288 | 51,513 | 130,698 | 77,883 |
| Provision for income taxes | 28,882 | 19,111 | 48,054 | 27,430 |
| Net income | \$ 49,406 | \$ 32,402 | \$ 82,644 | \$ 50,453 |
| Basic net income per common share (Note 13) | \$ 0.86 | \$ 0.57 | \$ 1.45 | \$ 0.89 |
| Diluted net income per common share (Note 13) | \$ 0.84 | \$ 0.55 | \$ 1.41 | \$ 0.86 |

See accompanying notes to the unaudited condensed consolidated financial statements

CARTER'S, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (dollars in thousands)
 (unaudited)

| | For the nine-month periods ended September 27, 2008 (Restated) | October 3, 2009 |
|---|---|--------------------|
| Cash flows from operating activities: | | |
| Net income | \$ 50,453 | \$ 82,644 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 20,576 | 24,396 |
| Amortization of debt issuance costs | 851 | 848 |
| Non-cash stock-based compensation expense | 6,756 | 5,200 |
| Income tax benefit from exercised stock options | (3,457) | (11,374) |
| Non-cash asset impairment and facility write-down charges | 2,609 | 3,662 |
| Loss on sale or disposal of property, plant, and equipment | 383 | 96 |
| Deferred income taxes | 198 | 1,310 |
| Effect of changes in operating assets and liabilities: | | |
| Accounts receivable | (47,109) | (42,427) |
| Inventories | 11,135 | (20,024) |
| Prepaid expenses and other assets | (2,337) | (1,876) |
| Accounts payable and other liabilities | 17,295 | 16,134 |
| Net cash provided by operating activities | 57,353 | 58,589 |
| Cash flows from investing activities: | | |
| Capital expenditures | (19,197) | (23,238) |
| Proceeds from the sale of fixed assets | -- | 2,805 |
| Net cash used in investing activities | (19,197) | (20,433) |
| Cash flows from financing activities: | | |
| Payments on term loan | (1,751) | (2,627) |
| Share repurchases | (29,774) | -- |
| Income tax benefit from exercised stock options | 3,457 | 11,374 |
| Proceeds from exercise of stock options | 560 | 5,087 |

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| | | |
|--|------------|-----------|
| Net cash provided by (used in) financing activities | 13,834 | (27,508) |
| Net increase in cash and cash equivalents | 51,990 | 10,648 |
| Cash and cash equivalents, beginning of period | 162,349 | 49,012 |
| Cash and cash equivalents, end of period | \$ 214,339 | \$ 59,660 |

See accompanying notes to the unaudited condensed consolidated financial statements

CARTER'S, INC.
CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(dollars in thousands, except for share data)
(unaudited)

| | Common stock | Additional paid-in capital | Accumulated other comprehensive (loss) income | Retained earnings | Total stockholders' equity |
|--|-----------------|----------------------------------|---|----------------------|----------------------------------|
| Balance at January 3, 2009 (Restated) | \$ 563 | \$ 211,767 | \$ (7,318) | \$ 208,539 | \$ 413,551 |
| Exercise of stock options (1,484,276 shares) | 14 | 5,073 | -- | -- | 5,087 |
| Income tax benefit from exercised stock options | -- | 11,374 | -- | -- | 11,374 |
| Restricted stock activity | 3 | (3) | -- | -- | -- |
| Stock-based compensation expense | -- | 4,654 | -- | -- | 4,654 |
| Issuance of common stock (33,656 shares) | -- | 700 | -- | -- | 700 |
| Comprehensive income: | | | | | |
| Net income | -- | -- | -- | 82,644 | 82,644 |
| Derivative hedging adjustment, net of tax of \$307 | -- | -- | 563 | -- | 563 |
| Total comprehensive income | -- | -- | 563 | 82,644 | 83,207 |
| Balance at October 3, 2009 | \$ 580 | \$ 233,565 | \$ (6,755) | \$ 291,183 | \$ 518,573 |

See accompanying notes to the unaudited condensed consolidated financial statements

CARTER'S, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

NOTE 1 – THE COMPANY:

Carter's, Inc., and its wholly owned subsidiaries (collectively, the "Company," "we," "us," "its," and "our") design, source, and market branded childrenswear under the Carter's, Child of Mine, Just One Year, OshKosh, OshKosh B'Gosh, and related brands. Our products are sourced through contractual arrangements with manufacturers worldwide for wholesale distribution to major domestic retailers, including the mass channel, and for our 273 Carter's and 169 OshKosh retail stores that market our branded merchandise and other licensed products manufactured by other companies.

NOTE 2 – BASIS OF PREPARATION:

The accompanying unaudited condensed consolidated financial statements comprise the consolidated financial statements of Carter's, Inc. and its subsidiaries. All intercompany transactions and balances have been eliminated in consolidation.

In our opinion, the Company's accompanying unaudited condensed consolidated financial statements contain all adjustments necessary for a fair presentation of our financial position as of October 3, 2009, the results of our operations for the three and nine-month periods ended October 3, 2009 and September 27, 2008, cash flows for the nine-month periods ended October 3, 2009 and September 27, 2008 and changes in stockholders' equity for the nine-month period ended October 3, 2009. Operating results for the three and nine-month periods ended October 3, 2009 are not necessarily indicative of the results that may be expected for the fiscal year ending January 2, 2010. Our accompanying condensed consolidated balance sheet as of January 3, 2009 is from our audited restated consolidated financial statements included in our most recently filed Annual Report on Form 10-K/A for the fiscal year ended January 3, 2009, but does not include all disclosures required by accounting principles generally accepted in the United States of America ("GAAP").

Certain information and footnote disclosure normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission and the instructions to Form 10-Q. The accounting policies we follow are set forth in our most recently filed Annual Report on Form 10-K/A in the notes to our audited consolidated financial statements for the fiscal year ended January 3, 2009.

Our fiscal year ends on the Saturday, in December or January, nearest the last day of December. The accompanying unaudited condensed consolidated financial statements for the third quarter and first nine months of fiscal 2009 are as of October 3, 2009. The third quarter and first nine months of fiscal 2008 ended on September 27, 2008.

As part of this Quarterly Report on Form 10-Q, the Company is hereby amending its results for the three and nine-month periods ended September 27, 2008, which were originally filed with the Securities and Exchange Commission on Form 10-Q on October 30, 2008 ("Original Filing").

Certain prior year amounts have been reclassified to facilitate comparability with current year presentation.

Subsequent events were evaluated through January 15, 2010, the date these financials were available to be issued, see Note 16, "Subsequent Events."

NOTE 3 – RESTATEMENT OF CONSOLIDATED FINANCIAL STATEMENTS:

Background of the Restatement

On November 10, 2009, the Company announced that its Audit Committee, with the assistance of outside counsel, had commenced a review of customer margin support provided by the Company and an investigation into undisclosed margin support commitments and related matters. As a result of this review, the Company announced that the previously issued consolidated financial statements for the fiscal years 2004 through 2008 included in the Company's Forms 10-K, and for the fiscal quarters from September 29, 2007 through July 4, 2009 included in the Company's Forms 10-Q, should no longer be relied upon (collectively, the "Affected Periods").

CARTER'S, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

NOTE 3 – RESTATEMENT OF CONSOLIDATED FINANCIAL STATEMENTS: (Continued)

Management initially began a review of margin support arrangements with respect to a single wholesale customer (the "Initial Customer") after becoming aware of a disputed amount of margin support with the Initial Customer. In the normal course of business, the Company provides margin support and other allowances (collectively, "accommodations") to its wholesale customers to assist them with the costs related to inventory clearance and sales promotions. The Company's policy is to reflect the amounts of accommodations as reductions to revenue or, in the case of certain co-op advertising expenses, as additions to selling, general, and administrative expenses. As a result of its review, management identified issues with respect to the timing of recognizing customer accommodations with respect to the Initial Customer. Following management's review, the Audit Committee engaged outside counsel to undertake the review and investigation.

The Audit Committee has completed its review and investigation, which was conducted with the assistance of outside counsel and forensic accountants engaged by outside counsel, and has concluded that the Company reported various customer accommodations in incorrect fiscal periods. The investigation uncovered irregularities involving members of the sales organization intentionally not disclosing accommodations arrangements with customers to the Company's finance organization and intentionally providing inaccurate documentation and explanations regarding accommodations to the finance organization. Consequently, such arrangements were not communicated to the Company's independent registered public accounting firm. These accommodations arrangements were made throughout the Affected Periods by certain members of the Company's sales organization and involved the deferral of accommodations into later fiscal periods. The deferrals resulted in the overstatement of net sales and net income in certain of the Affected Periods and the understatement of net sales and net income in certain of the Affected Periods. The deferrals related primarily to the Initial Customer and, to a lesser extent, other wholesale customers.

The Company has self-reported information concerning this investigation to the Securities and Exchange Commission. The Company has also been informed that the United States Attorney's Office is conducting an inquiry into this matter. The Company will continue to cooperate with these inquiries.

Impact of the Restatement

The restatement adjustments detailed below to our previously filed consolidated financial statements reflect adjustments to margin support provided to wholesale customers which impact net income, net sales, and accounts receivable, net, along with the related deferred tax impact.

The effects of the restatement on the unaudited condensed consolidated balance sheet as of January 3, 2009 are summarized in the following table:

| (dollars in thousands) | As of January 3, 2009 | | |
|-----------------------------|------------------------|-------------|----------|
| | Previously Reported | Adjustments | Restated |
| Accounts receivable, net | \$106,060 | \$(20,608) | \$85,452 |
| Deferred income taxes | 27,982 | 7,563 | 35,545 |

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| | | | |
|--|-----------|----------|-----------|
| Total current assets | 513,091 | (13,045) | 500,046 |
| Total assets | 1,051,057 | (13,045) | 1,038,012 |
| Retained earnings | 221,584 | (13,045) | 208,539 |
| Total stockholders' equity | 426,596 | (13,045) | 413,551 |
| Total liabilities and stockholders' equity | 1,051,057 | (13,045) | 1,038,012 |

CARTER'S, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

NOTE 3 – RESTATEMENT OF CONSOLIDATED FINANCIAL STATEMENTS: (Continued)

The effects of the restatement on the unaudited condensed consolidated statements of operations for the three and nine-month periods ended September 27, 2008 are summarized in the following table:

| (dollars in thousands, except per share data) | For the three-month period ended September 27, 2008 | | | For the nine-month period ended September 27, 2008 | | |
|---|---|-------------|-----------|--|-------------|-------------|
| | Previously Reported | Adjustments | Restated | Previously Reported | Adjustments | Restated |
| Net sales | \$436,419 | \$(1,537) | \$434,882 | \$1,068,066 | \$4,337 | \$1,072,403 |
| Gross profit | 154,667 | (1,537) | 153,130 | 359,163 | 4,337 | 363,500 |
| Operating income | 57,098 | (1,537) | 55,561 | 86,903 | 4,337 | 91,240 |
| Income before income taxes | 53,050 | (1,537) | 51,513 | 73,546 | 4,337 | 77,883 |
| Provision for income taxes | 19,675 | (564) | 19,111 | 25,833 | 1,597 | 27,430 |
| Net income | 33,375 | (973) | 32,402 | 47,713 | 2,740 | 50,453 |
| Basic net income per common share (a) | 0.59 | (0.02) | 0.57 | 0.84 | 0.05 | 0.89 |
| Diluted net income per common share (a) | 0.57 | (0.02) | 0.55 | 0.81 | 0.05 | 0.86 |

- (a) Previously reported basic and diluted net income per share have been adjusted to reflect the adoption of new accounting guidance which requires earnings per share to be calculated pursuant to the two-class method for unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid).

The effects of the restatement on the unaudited condensed consolidated statements of cash flows for the nine-month period ended September 27, 2008 are summarized in the following table:

| (dollars in thousands) | For the nine-month period ended September 27, 2008 | | |
|---------------------------------------|--|-------------|-----------|
| | Previously Reported | Adjustments | Restated |
| Cash flows from operating activities: | | | |
| Net income | \$ 47,713 | \$ 2,740 | \$ 50,453 |
| Deferred income taxes | (1,399) | 1,597 | 198 |
| Increase in accounts receivable | (40,387) | (6,722) | (47,109) |

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| | | | |
|--|----------|-------|----------|
| (Increase) decrease in prepaid expenses and other assets | (4,722) | 2,385 | (2,337) |
| Net cash provided by operating activities | 57,353 | -- | 57,353 |

7

CARTER'S, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

NOTE 3 – RESTATEMENT OF CONSOLIDATED FINANCIAL STATEMENTS: (Continued)

The effects of the restatement on the Company's segment information (see Note 11) for the three and nine-month periods ended September 27, 2008 are summarized in the following table:

| (dollars in thousands) | For the three-month period ended September 27, 2008 | | | For the nine-month period ended September 27, 2008 | | |
|--|--|-------------|------------|---|-------------|------------|
| | Previously Reported | Adjustments | Restated | Previously Reported | Adjustments | Restated |
| Carter's wholesale net sales | \$ 151,848 | \$ (1,798) | \$ 150,050 | \$ 364,002 | \$ (1,547) | \$ 362,455 |
| Carter's wholesale operating income (a) | 29,520 | (1,798) | 27,722 | 63,742 | (1,547) | 62,195 |
| Carter's mass channel net sales | 76,694 | 114 | 76,808 | 190,672 | 220 | 190,892 |
| Carter's mass channel operating income (a) | 10,055 | 114 | 10,169 | 23,920 | 220 | 24,140 |
| Carter's total net sales | 341,050 | (1,684) | 339,366 | 846,240 | (1,327) | 844,913 |
| Carter's total operating income | 59,942 | (1,684) | 58,258 | 129,829 | (1,327) | 128,502 |
| OshKosh wholesale net sales | 22,801 | 147 | 22,948 | 55,010 | 5,664 | 60,674 |
| OshKosh wholesale operating income (loss) | 1,546 | 147 | 1,693 | (5,290) | 5,664 | 374 |
| OshKosh total net sales | 95,369 | 147 | 95,516 | 221,826 | 5,664 | 227,490 |
| OshKosh total operating income (loss) | 12,120 | 147 | 12,267 | (2,936) | 5,664 | 2,728 |
| Total net sales | 436,419 | (1,537) | 434,882 | 1,068,066 | 4,337 | 1,072,403 |
| Total operating income | 57,098 | (1,537) | 55,561 | 86,903 | 4,337 | 91,240 |

(a) Previously reported operating income for the nine-month period ended September 27, 2008 reflects a \$656,000 reclassification from Carter's mass channel to Carter's wholesale to further refine allocations of inventory-related charges for comparative purposes.

NOTE 4 – COMPREHENSIVE INCOME (LOSS):

Comprehensive income (loss) is summarized as follows:

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| (dollars in thousands) | For the three-month periods ended | | For the nine-month periods ended | |
|---|---|--|--|--|
| | October 3, 2009 | September 27, 2008 (Restated) | October 3, 2009 | September 27, 2008 (Restated) |
| Net income | \$ 49,406 | \$ 32,402 | \$ 82,644 | \$ 50,453 |
| Unrealized gain (loss) on interest rate collar, net of taxes of \$110, \$216, and \$(199) | -- | 188 | 407 | (375) |
| Unrealized gain on interest rate swap agreements, net of taxes of \$93, \$203, \$91, and \$28 | 159 | 345 | 156 | 28 |
| Total comprehensive income | \$ 49,565 | \$ 32,935 | \$ 83,207 | \$ 50,106 |

NOTE 5 – COST IN EXCESS OF FAIR VALUE OF NET ASSETS ACQUIRED AND OTHER INTANGIBLE ASSETS:

The Carter's cost in excess of fair value of net assets acquired represents the excess of the cost of the acquisition of Carter's, Inc. by Berkshire Partners LLC which was consummated on August 15, 2001 over the fair value of the net assets acquired. The Carter's cost in excess of fair value of net assets acquired is not deductible for tax purposes.

CARTER'S, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

NOTE 5 – COST IN EXCESS OF FAIR VALUE OF NET ASSETS ACQUIRED AND OTHER INTANGIBLE ASSETS: (Continued)

The Carter's cost in excess of fair value of net assets acquired and Carter's and OshKosh tradenames are deemed to have indefinite lives and are not being amortized.

The Company's intangible assets are comprised of the following:

| (dollars in thousands) | Weighted-average useful life | October 3, 2009 | | | January 3, 2009 | | |
|--|------------------------------|-----------------|--------------------------|------------|-----------------|--------------------------|------------|
| | | Gross amount | Accumulated amortization | Net amount | Gross amount | Accumulated amortization | Net amount |
| Carter's cost in excess of fair value of net assets acquired (1) | Indefinite | \$ 136,570 | \$ -- | \$ 136,570 | \$ 136,570 | \$ -- | \$ 136,570 |
| Carter's tradename | Indefinite | \$ 220,233 | \$ -- | \$ 220,233 | \$ 220,233 | \$ -- | \$ 220,233 |
| OshKosh tradename | Indefinite | \$ 85,500 | \$ -- | \$ 85,500 | \$ 85,500 | \$ -- | \$ 85,500 |
| OshKosh licensing agreements | 4.7 years | \$ 19,100 | \$ 16,503 | \$ 2,597 | \$ 19,100 | \$ 13,840 | \$ 5,260 |
| Leasehold interests | 4.1 years | \$ 1,833 | \$ 1,833 | \$ -- | \$ 1,833 | \$ 1,599 | \$ 234 |

(1) \$51.8 million of which relates to Carter's wholesale segment, \$82.0 of which relates to Carter's retail segment, and \$2.7 million of which relates to Carter's mass channel segment.

Amortization expense for intangible assets was approximately \$0.9 million for the three-month period ended October 3, 2009 and \$1.0 million for the three-month period ended September 27, 2008. Amortization expense for intangible assets was approximately \$2.9 million and \$3.1 million for the nine-month periods ended October 3, 2009 and September 27, 2008. Amortization expense for the remainder of fiscal 2009 and fiscal 2010 for the OshKosh licensing agreements and leasehold interests is expected to be as follows:

| (dollars in thousands) | |
|--|--------------------------------|
| Fiscal Year | Estimated amortization expense |
| 2009 (period from October 4 through January 2, 2010) | \$820 |
| 2010 | 1,777 |

| | |
|-------|---------|
| Total | \$2,597 |
|-------|---------|

NOTE 6 – INCOME TAXES:

The Company and its subsidiaries file income tax returns in the United States and in various states and local jurisdictions. During the first quarter of fiscal 2009, the Internal Revenue Service completed an income tax audit for fiscal 2006, and began an audit of fiscal 2007. In most cases, the Company is no longer subject to state and local tax authority examinations for years prior to fiscal 2006.

During the first nine months of fiscal 2009, we recognized approximately \$1.4 million in tax benefits consisting of \$1.0 million due to the completion of the Internal Revenue Service audit for fiscal 2006 and approximately \$0.4 million due to various statute closures. During the first nine months of fiscal 2008, we recognized approximately \$1.9 million in tax benefits consisting of \$1.6 million due to the completion of an Internal Revenue Service audit for fiscal 2004 and 2005 and approximately \$0.3 million due to various statute closures, primary state and local jurisdictions.

CARTER'S, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

NOTE 6 – INCOME TAXES: (Continued)

As of October 3, 2009, the Company had gross unrecognized tax benefits of approximately \$7.5 million. Substantially all of the Company's reserve for unrecognized tax benefits as of October 3, 2009, if ultimately recognized, will impact the Company's effective tax rate in the period settled. The Company has recorded tax positions for which the ultimate deductibility is highly certain, but for which there is uncertainty about the timing of such deductions. Because of deferred tax accounting, changes in the timing of these deductions would not impact the annual effective tax rate, but would accelerate the payment of cash to the taxing authorities.

The Company settled its ongoing Internal Revenue Service audit of the Company's income tax return for fiscal 2007 in the fourth quarter of fiscal 2009. The Company is not anticipating a material payment or material impact on its effective tax rate as a result of the expected settlement.

Included in the reserves for unrecognized tax benefits are approximately \$0.6 million of reserves for which the statute of limitations is expected to expire in the third quarter of fiscal 2010. If these tax benefits are ultimately recognized, such recognition may impact our annual effective tax rate for fiscal 2010 and the effective tax rate in the quarter in which the benefits are recognized.

We recognize interest related to unrecognized tax benefits as a component of interest expense and penalties related to unrecognized tax benefits as a component of income tax expense. The Company had approximately \$0.5 million of interest accrued as of October 3, 2009.

NOTE 7 – FINANCIAL INSTRUMENTS:

The guidance on fair value measurements defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The fair value hierarchy for disclosure of fair value measurements is as follows:

Level - Quoted prices in active markets for identical assets or
1 liabilities

Level - Quoted prices for similar assets and liabilities in active
2 markets or inputs that are observable

Level - Inputs that are unobservable (for example, cash flow
3 modeling inputs based on assumptions)

The following table summarizes assets and liabilities measured at fair value on a recurring basis at October 3, 2009:

| (dollars in millions) | Level 1 | Level 2 | Level 3 |
|--------------------------|------------|------------|------------|
| Assets | | | |
| Investments | \$ -- | \$ 190.0 | \$ -- |
| | \$ -- | \$ 0.1 | \$ -- |

Interest rate
 hedge
 agreements

Liabilities
 Interest rate
 hedge
 agreements \$ -- \$ 1.9 \$ --

At October 3, 2009, we had approximately \$190.0 million invested in two Dreyfus Cash Management Funds and U.S. Treasury Bills, which are included in cash and cash equivalents on the accompanying unaudited condensed consolidated balance sheet. The funds consisted of the Dreyfus Treasury Prime Cash Management Fund (\$87.9 million), which invests only in U.S. Treasury Bills or U.S. Treasury Notes, and the Dreyfus Tax Exempt Cash Management Fund (\$42.1 million), which invests in short-term, high quality municipal obligations that provide income exempt from federal taxes. We also invested \$60.0 million in U.S. Treasury Bills that mature in the fourth quarter of fiscal 2009.

CARTER'S, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

NOTE 7 – FINANCIAL INSTRUMENTS: (Continued)

Our senior credit facility requires us to hedge at least 25% of our variable rate debt under this facility. The Company enters into interest rate swap agreements in order to hedge the risk of interest rate fluctuations. These interest rate swap agreements are designated as cash flow hedges of the variable interest payments on a portion of our variable rate term loan debt. Our interest rate swap agreements are traded in the over-the-counter market. Fair values are based on quoted market prices for similar assets or liabilities or determined using inputs that use as their basis readily observable market data that are actively quoted and can be validated through external sources, including third-party pricing services, brokers, and market transactions.

As of October 3, 2009, approximately \$243.0 million of our \$335.4 million of outstanding debt was hedged under interest rate swap agreements. These interest rate swap agreements mature at various times through January 2011. We continue to be in compliance with the 25% hedging requirement under our senior credit facility.

The fair value of our derivative instruments in our accompanying unaudited condensed consolidated balance sheet as of October 3, 2009 was as follows:

| | Asset Derivatives | | Liability Derivatives | |
|--------------------------------|---|------------|---------------------------|------------|
| | Balance sheet location | Fair value | Balance sheet location | Fair value |
| (dollars in millions) | | | | |
| Interest rate hedge agreements | Prepaid expenses and other current assets | \$ 0.1 | Other current liabilities | \$ 1.9 |

The effect of derivative instruments designated as cash flow hedges on our accompanying unaudited condensed consolidated financial statements were as follows:

| | For the three-month period ended October 3, 2009 | | For the nine-month period ended October 3, 2009 | |
|------------------------|--|--|---|---|
| | Amount of gain (loss) recognized in accumulated other comprehensive income (loss) into | Amount of gain (loss) reclassified from accumulated other comprehensive income (loss) into | Amount of gain (loss) recognized in accumulated other comprehensive income (loss) into interest | Amount of gain (loss) reclassified from accumulated other comprehensive income (loss) into interest |
| (dollars in thousands) | | | | |

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| | income (loss) on effective hedges (1) | interest expense | income (loss) on effective hedges (1) | expense |
|-----------------------------------|---|---------------------|---|-------------|
| Interest rate hedge agreements | \$ 159 | \$ (720) | \$ 156 | \$ (2,134) |

(1) Amount recognized in accumulated other comprehensive (loss) income, net of tax of \$93,000 and \$91,000 for the three and nine-month periods ended October 3, 2009, respectively.

CARTER'S, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

NOTE 8 – EMPLOYEE BENEFIT PLANS:

Under a defined benefit plan frozen in 1991, we offer a comprehensive post-retirement medical plan to current and certain future retirees and their spouses until they become eligible for Medicare or a Medicare Supplement Plan. We also offer life insurance to current and certain future retirees. Employee contributions are required as a condition of participation for both medical benefits and life insurance and our liabilities are net of these expected employee contributions. See Note 8 “Employee Benefit Plans” to our audited restated consolidated financial statements in our most recently filed Annual Report on Form 10-K/A for further information.

The components of post-retirement benefit expense charged to operations are as follows:

| | For the three-month periods ended | | For the nine-month periods ended | |
|---|---|--------------------------|-------------------------------------|--------------------------|
| | October 3, 2009 | September 27, 2008 | October 3, 2009 | September 27, 2008 |
| (dollars in thousands) | | | | |
| Service cost – benefits attributed to service during the period | \$ 23 | \$ 26 | \$ 69 | \$ 79 |
| Interest cost on accumulated post-retirement benefit obligation | 113 | 132 | 339 | 395 |
| Amortization net actuarial gain | (7) | -- | (21) | -- |
| Total net periodic post-retirement benefit cost | \$ 129 | \$ 158 | \$ 387 | \$ 474 |

We have an obligation under a defined benefit plan covering certain former officers and their spouses. The component of pension expense charged to operations is as follows:

| | For the three-month periods ended | | For the nine-month periods ended | |
|---|---|--------------------------|-------------------------------------|--------------------------|
| | October 3, 2009 | September 27, 2008 | October 3, 2009 | September 27, 2008 |
| (dollars in thousands) | | | | |
| Interest cost on accumulated pension benefit obligation | \$ 12 | \$ 13 | \$ 38 | \$ 39 |

Under a defined benefit pension plan frozen as of December 31, 2005, certain current and former employees of OshKosh are eligible to receive benefits. The net periodic pension benefit associated with this pension plan and included in the statement of operations was comprised of:

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| | For the three-month periods ended | | For the nine-month periods ended | |
|---|---|--------------------------|-------------------------------------|--------------------------|
| | October 3, 2009 | September 27, 2008 | October 3, 2009 | September 27, 2008 |
| (dollars in thousands) | | | | |
| Interest cost on accumulated pension benefit obligation | \$ 567 | \$ 562 | \$ 1,702 | \$ 1,686 |
| Expected return on assets | (651) | (943) | (1,951) | (2,830) |
| Amortization of actuarial loss (gain) | 103 | (19) | 308 | (57) |
| Total net periodic pension expense (benefit) | \$ 19 | \$ (400) | \$ 59 | \$ (1,201) |

CARTER'S, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

NOTE 9 – COMMON STOCK:

On February 16, 2007, the Company's Board of Directors approved a stock repurchase program, pursuant to which the Company is authorized to purchase up to \$100 million of its outstanding common shares. Such repurchases may occur from time to time in the open market, in negotiated transactions, or otherwise. This program has no time limit. The timing and amount of any repurchases will be determined by the Company's management, based on its evaluation of market conditions, share price, and other factors.

During the first nine months of fiscal 2009, the Company did not repurchase any shares of its common stock. During the third quarter and first nine months of fiscal 2008, the Company repurchased and retired approximately 578,098 and 1,898,183 shares of its common stock at an average price of \$16.81 and \$15.69 per share, respectively. Since inception of the program and through October 3, 2009, the Company repurchased and retired approximately 4,599,580 shares, or approximately \$91.1 million, of its common stock at an average price of \$19.81 per share, leaving approximately \$8.9 million available for repurchase under the plan. We have reduced common stock by the par value of such shares repurchased and have deducted the remaining excess repurchase price over par value from additional paid-in capital.

During the first nine months of fiscal 2009, the Company issued 33,656 shares of common stock at a fair market value of \$20.80 to its non-management board members. In connection with this issuance, we recognized approximately \$700,000 in stock-based compensation expense. During the first nine months of fiscal 2008, the Company issued 43,386 shares of common stock at a fair market value of \$14.52 to its non-management board members. In connection with this issuance, we recognized approximately \$630,000 in stock-based compensation expense. We received no proceeds from the issuance of these shares.

NOTE 10 – STOCK-BASED COMPENSATION:

Under our Amended and Restated 2003 Equity Incentive Plan, the compensation committee of our Board of Directors may award incentive stock options (ISOs and non-ISOs), stock appreciation rights (SARs), restricted stock, unrestricted stock, stock deliverable on a deferred basis, performance-based stock awards, and cash payments intended to help defray the cost of awards. The fair value of time-based or performance-based stock option grants are estimated on the date of grant using the Black-Scholes option pricing method with the following weighted-average assumptions used for grants issued during the nine-month period ended October 3, 2009.

Assumptions

| | | |
|-------------------------|-------|---|
| Volatility | 35.75 | % |
| Risk-free interest rate | 2.54 | % |
| Expected term (years) | 7 | |
| Dividend yield | -- | |

The fair value of restricted stock is determined based on the quoted closing price of our common stock on the date of grant.

CARTER'S, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

NOTE 10 – STOCK-BASED COMPENSATION: (Continued)

The following table summarizes our stock option and restricted stock activity during the nine-month period ended October 3, 2009:

| | Time-based stock options | Performance-based stock options | Retained stock options | Restricted stock |
|---------------------------------|-----------------------------|---------------------------------------|------------------------------|---------------------|
| Outstanding, January 3, 2009 | 4,733,080 | 220,000 | 113,514 | 444,589 |
| Granted | 470,000 | -- | -- | 219,500 |
| Exercised | (1,370,762) | -- | (113,514) | -- |
| Vested restricted stock | -- | -- | -- | (134,381) |
| Forfeited | (85,600) | (20,000) | -- | (52,525) |
| Expired | (42,000) | -- | -- | -- |
| Outstanding, October 3, 2009 | 3,704,718 | 200,000 | -- | 477,183 |
| Exercisable, October 3, 2009 | 2,595,048 | -- | -- | -- |

During the three-month period ended October 3, 2009, we granted 22,000 time-based stock options with a weighted-average Black-Scholes fair value of \$11.32 and a weighted-average exercise price of \$26.49. In connection with these grants, we recognized approximately \$9,400 in stock-based compensation expense.

During the nine-month period ended October 3, 2009, we granted 470,000 time-based stock options with a weighted-average Black-Scholes fair value of \$7.78 and a weighted-average exercise price of \$18.48. In connection with these grants, we recognized approximately \$451,000 in stock-based compensation expense.

During the three-month period ended October 3, 2009, we granted 11,000 shares of restricted stock to employees with a weighted-average fair value on the date of grant of \$26.49. In connection with these grants, we recognized approximately \$11,000 in stock-based compensation expense.

During the nine-month period ended October 3, 2009, we granted 219,500 shares of restricted stock to employees with a weighted-average fair value on the date of grant of \$18.50. In connection with these grants, we recognized approximately \$496,000 in stock-based compensation expense.

As a result of the retirement of an executive officer during the first nine months of fiscal 2008, the Company recognized approximately \$2.2 million of stock-based compensation expense as a result of the accelerated vesting of 400,000 performance-based stock options (see Note 15, "Executive Retirement Charges").

Unrecognized stock-based compensation expense related to outstanding unvested stock options and unvested restricted stock awards is expected to be recorded as follows:

| (dollars in thousands) | Time-based stock options | Restricted stock | Total |
|---|--------------------------------|---------------------|----------|
| 2009 (period from October 4 through January 2, 2010) | \$720 | \$717 | \$1,437 |
| 2010 | 2,550 | 2,522 | 5,072 |
| 2011 | 1,987 | 2,059 | 4,046 |
| 2012 | 1,111 | 1,242 | 2,353 |
| Total | \$6,368 | \$6,540 | \$12,908 |

CARTER'S, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

NOTE 11 – SEGMENT INFORMATION:

We report segment information in accordance with accounting guidance on segment reporting which requires segment information to be disclosed based upon a “management approach.” The management approach refers to the internal reporting that is used by management for making operating decisions and assessing the performance of our reportable segments. We report our corporate expenses, workforce reduction, and facility write-down and closure costs separately as they are not included in the internal measures of segment operating performance used by the Company in order to measure the underlying performance of our reportable segments.

The table below presents certain segment information for the periods indicated:

| (dollars in thousands) | For the three-month periods ended | | | | For the nine-month periods ended | | | |
|---------------------------------|-----------------------------------|-------------------------------|---------------------------|-------------------------------|----------------------------------|-------------------------------|---------------------------|-------------------------------|
| | Oct. 3, 2009 | % of Total | Sept. 27, 2008 (Restated) | % of Total | Oct. 3, 2009 | % of Total | Sept. 27, 2008 (Restated) | % of Total |
| Net sales: | | | | | | | | |
| Carter's: | | | | | | | | |
| Wholesale | \$ 165,672 | 34.4 % | \$ 150,050 | 34.5 % | \$ 395,550 | 34.0 % | \$ 362,455 | 33.8 % |
| Retail | 137,708 | 28.6 % | 112,508 | 25.9 % | 349,765 | 30.0 % | 291,566 | 27.2 % |
| Mass Channel | 78,584 | 16.3 % | 76,808 | 17.6 % | 181,690 | 15.6 % | 190,892 | 17.8 % |
| Carter's net sales | 381,964 | 79.3 % | 339,366 | 78.0 % | 927,005 | 79.6 % | 844,913 | 78.8 % |
| OshKosh: | | | | | | | | |
| Retail | 74,103 | 15.4 % | 72,568 | 16.7 % | 178,091 | 15.3 % | 166,816 | 15.5 % |
| Wholesale | 25,439 | 5.3 % | 22,948 | 5.3 % | 59,901 | 5.1 % | 60,674 | 5.7 % |
| OshKosh net sales | 99,542 | 20.7 % | 95,516 | 22.0 % | 237,992 | 20.4 % | 227,490 | 21.2 % |
| Total net sales | \$ 481,506 | 100.0 % | \$ 434,882 | 100.0 % | \$ 1,164,997 | 100.0 % | \$ 1,072,403 | 100.0 % |
| Operating income (loss): | | % of segment net sales | | % of segment net sales | | % of segment net sales | | % of segment net sales |
| Carter's: | | | | | | | | |
| Wholesale | \$ 36,954 | 22.3 % | \$ 27,722 | 18.5 % | \$ 80,378 | 20.3 % | \$ 62,195 | 17.2 % |
| Retail | 31,381 | 22.8 % | 20,367 | 18.1 % | 64,544 | 18.5 % | 42,167 | 14.5 % |
| Mass Channel | 14,482 | 18.4 % | 10,169 | 13.2 % | 31,301 | 17.2 % | 24,140 | 12.6 % |
| | 82,817 | 21.7 % | 58,258 | 17.2 % | 176,223 | 19.0 % | 128,502 | 15.2 % |

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| | | | | | | | | | | |
|---|-----------|---------|-----------|---------|------------|---------|-----------|---------|--|--|
| Carter's operating income | | | | | | | | | | |
| OshKosh: | | | | | | | | | | |
| Retail | 10,765 | 14.5 % | 9,810 | 13.5 % | 11,220 | 6.3 % | 431 | 0.3 % | | |
| Wholesale | 4,124 | 16.2 % | 1,693 | 7.4 % | 3,607 | 6.0 % | 374 | 0.6 % | | |
| Mass Channel (a) | 709 | -- | 764 | -- | 1,853 | -- | 1,923 | -- | | |
| OshKosh operating income | | | | | | | | | | |
| | 15,598 | 15.7 % | 12,267 | 12.8 % | 16,680 | 7.0 % | 2,728 | 1.2 % | | |
| Segment operating income | | | | | | | | | | |
| | 98,415 | 20.4 % | 70,525 | 16.2 % | 192,903 | 16.6 % | 131,230 | 12.2 % | | |
| Corporate expenses (b) | | | | | | | | | | |
| | (17,439) | (3.6 %) | (12,355) | (2.8 %) | (41,269) | (3.5 %) | (32,056) | (3.0 %) | | |
| Workforce reduction and facility write-down and closure costs (c) | | | | | | | | | | |
| | -- | -- | (2,609) | (0.6 %) | (12,365) | (1.1 %) | (2,609) | (0.2 %) | | |
| Executive retirement charges (d) | | | | | | | | | | |
| | -- | -- | -- | -- | -- | -- | (5,325) | (0.5 %) | | |
| Net corporate expenses | | | | | | | | | | |
| | (17,439) | (3.6 %) | (14,964) | (3.4 %) | (53,634) | (4.6 %) | (39,990) | (3.7 %) | | |
| Total operating income | | | | | | | | | | |
| | \$ 80,976 | 16.8 % | \$ 55,561 | 12.8 % | \$ 139,269 | 12.0 % | \$ 91,240 | 8.5 % | | |

(a) OshKosh mass channel consists of a licensing agreement with Target Stores. Operating income consists of royalty income, net of related expenses.

(b) Corporate expenses generally include expenses related to incentive compensation, stock-based compensation, executive management, severance and relocation, finance, building occupancy, information technology, certain legal fees, consulting, audit fees, and investments in e-commerce.

(c) Includes closure costs associated with our Barnesville, Georgia distribution facility including severance, asset impairment charges, other closure costs, and accelerated depreciation, asset impairment charges related to our Oshkosh, Wisconsin facility, write-down of our White House, Tennessee facility, and severance and other benefits related to the corporate workforce reduction (see Note 12).

(d) Charges associated with an executive officer's retirement (see Note 15).

CARTER'S, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

NOTE 12 – WORKFORCE REDUCTION AND FACILITY WRITE-DOWN AND CLOSURE COSTS:

Corporate Workforce Reduction

On April 21, 2009, the Company announced to affected employees a plan to reduce its corporate workforce (defined as excluding retail district managers, hourly retail store employees, and distribution center employees). Approximately 150 employees were affected under the plan. The plan includes consolidating the majority of our operations performed in our Oshkosh, Wisconsin office into other Company locations. This consolidation will result in the addition of resources in our other locations.

As a result of this corporate workforce reduction, during the first nine months of fiscal 2009, we recorded charges of \$7.3 million consisting of \$5.5 million in severance charges and other benefits (\$3.3 million which related to corporate office positions in connection with our existing plan and \$2.2 million of special one-time benefits provided to affected employees), and approximately \$1.8 million in asset impairment charges related to the closure of our Oshkosh, Wisconsin office. The majority of the severance payments will be paid through the end of fiscal 2010.

The following table summarizes restructuring reserves related to the corporate workforce reduction which are included in other current liabilities on the accompanying unaudited condensed consolidated balance sheet:

| (dollars in thousands) | Severance and other one-time benefits |
|----------------------------|---------------------------------------|
| Balance at April 4, 2009 | \$ 3,300 |
| Provision | 2,200 |
| Payments | (900) |
| Balance at July 4, 2009 | 4,600 |
| Provision | -- |
| Payments | (1,300) |
| Balance at October 3, 2009 | \$ 3,300 |

Barnesville Distribution Facility Closure

On April 2, 2009, the Company announced to affected employees a plan to close its Barnesville, Georgia distribution center. Approximately 210 employees were affected by this closure. Operations at the Barnesville facility ceased on June 1, 2009.

In accordance with accounting guidance on accounting for the impairment or disposal of long-lived assets, under a held and used model, it was determined that the distribution facility assets became impaired during March 2009, when

it became “more likely than not” that the expected life of the Barnesville, Georgia distribution facility would be significantly shortened. Accordingly, we wrote down the assets to their estimated recoverable fair value in March 2009. The adjusted asset values were subject to accelerated depreciation over their remaining estimated useful life.

In conjunction with the plan to close the Barnesville, Georgia distribution center, the Company recorded approximately \$4.3 million during the first nine months of fiscal 2009, consisting of severance of \$1.7 million, asset impairment charges of \$1.1 million related to the write-down of the related land, building, and equipment, \$1.0 million of accelerated depreciation (included in selling, general, and administrative expenses), and \$0.5 million of other closure costs.

CARTER'S, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

NOTE 12 – WORKFORCE REDUCTION AND FACILITY WRITE-DOWN AND CLOSURE COSTS: (continued)

The following table summarizes restructuring reserves related to the closure of the Barnesville, Georgia distribution center which are included in other current liabilities on the accompanying unaudited condensed consolidated balance sheet:

| (dollars in thousands) | Severance | Other closure costs | Total |
|-------------------------------|-----------|---------------------------|----------|
| Balance at April 4, 2009 | \$ 1,700 | \$ 500 | \$ 2,200 |
| Provision | -- | -- | -- |
| Payments | (700) | -- | (700) |
| Balance at July 4, 2009 | 1,000 | 500 | 1,500 |
| Provision | -- | -- | -- |
| Payments | (500) | -- | (500) |
| Adjustments | (400) | -- | (400) |
| Balance at October 3, 2009 | \$ 100 | \$ 500 | \$ 600 |

White House Distribution Facility

During the first nine months of fiscal 2009, the Company wrote down the carrying value of its White House, Tennessee distribution facility by approximately \$0.7 million to \$2.8 million to reflect the decrease in the fair market value as evidenced by recent negotiations to sell the facility. During the third quarter of fiscal 2009, the Company sold the facility for net proceeds of approximately \$2.8 million.

In the third quarter of fiscal 2008, the Company wrote down the carrying value of the White House, Tennessee distribution facility by approximately \$2.6 million to \$3.5 million to reflect the anticipated selling price of the property at that time.

CARTER'S, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

NOTE 13 – EARNINGS PER SHARE:

Basic net income per share is calculated by dividing net income for the period by the weighted-average common shares outstanding for the period. Diluted net income per share includes the effect of dilutive instruments, such as stock options and restricted stock, and uses the average share price for the period in determining the number of shares that are to be added to the weighted-average number of shares outstanding. The table below summarizes the shares from these potentially dilutive securities, calculated using the treasury stock method.

The Company calculates basic and diluted net income per common share in accordance with new accounting guidance which requires earnings per share to be calculated pursuant to the two-class method for unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid).

The following is a reconciliation of basic common shares outstanding to diluted common and common equivalent shares outstanding:

| | For the three-month periods ended | | For the nine-month periods ended | |
|--|--------------------------------------|--|-------------------------------------|--|
| | October 3, 2009 | September 27, 2008 (Restated) | October 3, 2009 | September 27, 2008 (Restated) |
| Weighted-average number of common and common equivalent shares outstanding: | | | | |
| Basic number of common shares outstanding | 56,825,229 | 56,015,725 | 56,334,860 | 56,462,515 |
| Dilutive effect of unvested restricted stock | 112,370 | 84,593 | 116,483 | 84,119 |
| Dilutive effect of stock options | 1,622,531 | 1,863,623 | 1,684,897 | 1,943,772 |
| Diluted number of common and common equivalent shares outstanding | 58,560,130 | 57,963,941 | 58,136,240 | 58,490,406 |
| Basic net income per common share: | | | | |
| Net income | \$ 49,406,000 | \$ 32,402,000 | \$ 82,644,000 | \$ 50,453,000 |
| Income allocated to participating securities | (411,426) | (274,037) | (694,154) | (423,354) |
| Net income available to common shareholders | \$ 48,994,574 | \$ 32,127,963 | \$ 81,949,846 | \$ 50,029,646 |
| Basic net income per common share | \$ 0.86 | \$ 0.57 | \$ 1.45 | \$ 0.89 |

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Diluted net income per common share:

| | | | | |
|--|---------------|---------------|---------------|---------------|
| Net income | \$ 49,406,000 | \$ 32,402,000 | \$ 82,644,000 | \$ 50,453,000 |
| Income allocated to participating securities | (400,097) | (265,286) | (674,160) | (409,379) |
| Net income available to common shareholders | \$ 49,005,903 | \$ 32,136,714 | \$ 81,969,840 | \$ 50,043,621 |

| | | | | |
|-------------------------------------|---------|---------|---------|---------|
| Diluted net income per common share | \$ 0.84 | \$ 0.55 | \$ 1.41 | \$ 0.86 |
|-------------------------------------|---------|---------|---------|---------|

For the three and nine-month periods ended October 3, 2009, anti-dilutive shares of 474,800 and 1,292,900, respectively, and performance-based stock options of 200,000, were excluded from the computations of diluted earnings per share. For the three and nine-month periods ended September 27, 2008, anti-dilutive shares of 1,400,300 and 1,545,725, respectively, and performance-based stock options of 220,000 were excluded from the computations of diluted earnings per share.

CARTER'S, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

NOTE 14 – RECENT ACCOUNTING PRONOUNCEMENTS:

Effective January 4, 2009, the Company adopted new accounting guidance on fair value measurements. The new guidance defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. See Note 7 for additional information regarding our fair value measurements for financial assets and financial liabilities. The new guidance is effective for non-financial assets and non-financial liabilities recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually).

Effective January 4, 2009, the Company adopted new accounting guidance which addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share under the two-class method. Under the guidance, unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. The guidance is effective for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. All prior period earnings per share data presented shall be adjusted retrospectively. The Company has included the required disclosures in Note 13.

Effective April 4, 2009, the Company adopted new accounting guidance on enhanced disclosures on the effect of derivatives on a company's financial statements. This new guidance impacts disclosures only and requires additional qualitative and quantitative information on the use of derivatives and their impact on an entity's financial position, results of operations, and cash flows. The Company has included the required disclosures in Note 7.

Effective July 4, 2009, the Company adopted new accounting guidance on the disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The guidance applies prospectively to both interim and annual financial periods ending after June 15, 2009. The Company has included the required disclosures in Note 2.

In June 2009, the Financial Accounting Standards Board ("FASB") issued the FASB Accounting Standards Codification™ ("Codification"). The Codification will become the source of authoritative GAAP recognized by the FASB to be applied for financial statements issued for interim and annual periods ending after September 15, 2009. The Company has amended its disclosures accordingly within this Quarterly Report on Form 10-Q.

In December 2008, the FASB issued new accounting guidance on enhanced disclosures about plan assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension or other postretirement plans. The guidance is effective for fiscal years ending after December 15, 2009. The Company is currently evaluating the impact that the required disclosures will have on its consolidated financial statements.

NOTE 15 – EXECUTIVE RETIREMENT CHARGES:

On June 11, 2008, the Company announced the retirement of an executive officer. In connection with this retirement, the Company recorded charges during the first nine months of fiscal 2008 of \$5.3 million, \$3.1 million of which related to the present value of severance and benefit obligations, and \$2.2 million of which related to the accelerated vesting of stock options.

CARTER'S, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

NOTE 16 – SUBSEQUENT EVENTS:

Sale of Oshkosh, Wisconsin Office

Due to the workforce reduction announced in the second quarter of fiscal 2009 (see Note 12) and the subsequent integration of corporate functions, the Company vacated its Oshkosh, Wisconsin office building in December 2009. In the fourth quarter of fiscal 2009, the Company sold this building for approximately \$1.3 million.

Senior Credit Facility Waiver

On November 17, 2009, the Company obtained a waiver to its Senior Credit Facility which waived defaults resulting from the untimely filing of the Company's third quarter fiscal 2009 consolidated financial statements and arising from, or giving rise to, the restatement of prior period financial statements. The waiver resulted in consent fees totaling approximately \$450,000 and requires the Company to deliver to the lenders the restatement of prior period consolidated financial statements and the third quarter of fiscal 2009 consolidated financial statements by January 15, 2010.

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

The following is a discussion of our results of operations and current financial position. This discussion should be read in conjunction with our unaudited condensed consolidated financial statements and the accompanying notes included elsewhere in this quarterly report.

Our fiscal year ends on the Saturday, in December or January, nearest the last day of December. The accompanying unaudited condensed consolidated financial statements for the third quarter and first nine months of fiscal 2009 reflect our financial position as of October 3, 2009. The third quarter and first nine months of fiscal 2008 ended on September 27, 2008.

As discussed in the Explanatory Note to this filing, the Company is restating its financial information for the three and nine-month periods ended September 27, 2008.

RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated (i) selected statement of operations data expressed as a percentage of consolidated net sales and (ii) the number of retail stores open at the end of each period:

| | Three-month periods ended | | Nine-month periods ended | |
|---|------------------------------|--|-----------------------------|--|
| | October 3, 2009 | September 27, 2008 (Restated) | October 3, 2009 | September 27, 2008 (Restated) |
| Wholesale sales: | | | | |
| Carter's | 34.4 % | 34.5 % | 34.0 % | 33.8 % |
| OshKosh | 5.3 | 5.3 | 5.1 | 5.7 |
| Total wholesale sales | 39.7 | 39.8 | 39.1 | 39.5 |
| Retail store sales: | | | | |
| Carter's | 28.6 | 25.9 | 30.0 | 27.2 |
| OshKosh | 15.4 | 16.7 | 15.3 | 15.5 |
| Total retail store sales | 44.0 | 42.6 | 45.3 | 42.7 |
| Mass channel sales | 16.3 | 17.6 | 15.6 | 17.8 |
| Consolidated net sales | 100.0 | 100.0 | 100.0 | 100.0 |
| Cost of goods sold | 61.5 | 64.8 | 62.4 | 66.1 |
| Gross profit | 38.5 | 35.2 | 37.6 | 33.9 |
| Selling, general, and administrative expenses | 23.9 | 24.0 | 27.0 | 27.0 |
| Workforce reduction and facility write-down and closure costs | -- | 0.6 | 0.9 | 0.2 |
| Executive retirement charges | -- | -- | -- | 0.5 |
| Royalty income | (2.2) | (2.2) | (2.3) | (2.3) |

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| | | | | |
|---|--------|-------|-------|-------|
| Operating income | 16.8 | 12.8 | 12.0 | 8.5 |
| Interest expense, net | 0.5 | 1.0 | 0.8 | 1.2 |
| Income before income taxes | 16.3 | 11.8 | 11.2 | 7.3 |
| Provision for income taxes | 6.0 | 4.3 | 4.1 | 2.6 |
| Net income | 10.3 % | 7.5 % | 7.1 % | 4.7 % |
| Number of retail stores at end of period: | | | | |
| Carter's | 273 | 234 | 273 | 234 |
| OshKosh | 169 | 163 | 169 | 163 |
| Total | 442 | 397 | 442 | 397 |

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Three and nine-month periods ended October 3, 2009 compared to the restated three and nine-month periods ended September 27, 2008

CONSOLIDATED NET SALES

In the third quarter of fiscal 2009, consolidated net sales increased \$46.6 million, or 10.7%, to \$481.5 million and reflects growth in all channels of distribution. In the first nine months of fiscal 2009, consolidated net sales increased \$92.6 million, or 8.6%, to \$1.2 billion and reflects growth in Carter's brand wholesale and retail store segments and OshKosh brand retail store segment.

| | For the three-month periods ended | | | | For the nine-month periods ended | | | |
|------------------------|-----------------------------------|---------------|--|---------------|----------------------------------|---------------|--|---------------|
| | October 3, 2009 | % of Total | September 27, 2008 (Restated) | % of Total | October 3, 2009 | % of Total | September 27, 2008 (Restated) | % of Total |
| (dollars in thousands) | | | | | | | | |
| Net sales: | | | | | | | | |
| Wholesale-Carter's | \$ 165,672 | 34.4 % | \$ 150,050 | 34.5 % | \$ 395,550 | 34.0 % | \$ 362,455 | 33.8 % |
| Wholesale-OshKosh | 25,439 | 5.3 % | 22,948 | 5.3 % | 59,901 | 5.1 % | 60,674 | 5.7 % |
| Retail-Carter's | 137,708 | 28.6 % | 112,508 | 25.9 % | 349,765 | 30.0 % | 291,566 | 27.2 % |
| Retail-OshKosh | 74,103 | 15.4 % | 72,568 | 16.7 % | 178,091 | 15.3 % | 166,816 | 15.5 % |
| Mass | | | | | | | | |
| Channel-Carter's | 78,584 | 16.3 % | 76,808 | 17.6 % | 181,690 | 15.6 % | 190,892 | 17.8 % |
| Total net sales | \$ 481,506 | 100.0 % | \$ 434,882 | 100.0 % | \$ 1,164,997 | 100.0 % | \$ 1,072,403 | 100.0 % |

CARTER'S WHOLESALE SALES

Carter's brand wholesale sales increased \$15.6 million, or 10.4%, in the third quarter of fiscal 2009 to \$165.7 million, driven by a 7% increase in units shipped and a 3% increase in average price per unit, as compared to the third quarter of fiscal 2008.

Carter's brand wholesale sales increased \$33.1 million, or 9.1%, in the first nine months of fiscal 2009 to \$395.6 million, driven by a 5% increase in units shipped and a 4% increase in average price per unit, as compared to the first nine months of fiscal 2008.

The increase in units shipped during the third quarter and first nine months of fiscal 2009 was primarily driven by strong over-the-counter performance at our wholesale customers. The increase in average price per unit during the third quarter and first nine months of fiscal 2009 was driven primarily by higher average selling prices on off-price sales as compared to the third quarter and first nine months of fiscal 2008.

OSHKOSH WHOLESALE SALES

OshKosh brand wholesale sales increased \$2.5 million, or 10.9%, in the third quarter of fiscal 2009 to \$25.4 million and reflects a 10% increase in units shipped and a 1% increase in average price per unit as compared to the third quarter of fiscal 2008. The increase in units shipped is due to earlier customer demand and higher levels of off-price sales during the third quarter of fiscal 2009.

OshKosh brand wholesale sales decreased \$0.8 million, or 1.3%, in the first nine months of fiscal 2009 to \$59.9 million and reflects a 3% decrease in units shipped partially offset by a 2% increase in average price per unit as compared to the first nine months of fiscal 2008. The decrease in units shipped during the first nine months of fiscal 2009 relate primarily to a reduction in off-price shipments. The increase in average price per unit during the first nine months of fiscal 2009 reflects higher average selling prices on off-price sales as compared to the first nine months of fiscal 2008.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

MASS CHANNEL SALES

Mass channel sales increased \$1.8 million, or 2.3%, in the third quarter of fiscal 2009 to \$78.6 million. The increase was due to a \$6.5 million, or 24.2%, increase in sales of our Just One Year brand to Target, partially offset by a \$4.7 million, or 9.5%, decrease in sales of our Child of Mine brand to Walmart. Mass channel sales decreased \$9.2 million, or 4.8%, in the first nine months of fiscal 2009 to \$181.7 million. The decrease was due to a \$16.4 million, or 14.2%, decrease in sales of our Child of Mine brand to Walmart, partially offset by a \$7.2 million, or 9.5%, increase in sales of our Just One Year brand to Target.

The decrease in Child of Mine brand sales during the third quarter and first nine months of fiscal 2009 resulted from assortment changes made by Walmart and related reduction in floor space at this retailer. The increase in Just One Year brand sales during the third quarter and first nine months of fiscal 2009 was driven largely by increased demand resulting from new playwear programs introduced for Fall 2009, increased floor space, and improved product performance.

We anticipate our mass channel sales will decline approximately 6% in fiscal 2009 as compared to fiscal 2008, primarily due to lower sales of our Child of Mine brand due to assortment changes made by Walmart and related reduction in floor space at this retailer.

CARTER'S RETAIL STORES

Carter's retail store sales increased \$25.2 million, or 22.4%, in the third quarter of fiscal 2009 to \$137.7 million. The increase was driven by incremental sales of \$15.6 million generated by new store openings and a comparable store sales increase of 6.1%, or \$10.0 million. On a comparable store basis, transactions increased 3.8%, units per transaction increased 2.8%, and average prices decreased 0.6% as compared to the third quarter of fiscal 2008.

Carter's retail store sales increased \$58.2 million, or 20.0%, in the first nine months of fiscal 2009 to \$349.8 million. The increase was driven by incremental sales of \$34.9 million generated by new store openings and a comparable store sales increase of 6.5%, or \$23.7 million. On a comparable store basis, transactions increased 4.8%, units per transaction increased 2.1%, and average prices decreased 0.4% as compared to the first nine months of fiscal 2008.

We attribute the increases in transactions during the third quarter and first nine months of fiscal 2009 to strong product performance in all product categories, changes in our merchandising strategies which include a higher mix of opening price point items (high-volume, entry level basic products), a better assortment of in-season merchandise on the floor, in-store product presentation, and direct to consumer marketing efforts which include our new catalog customer mailings. The decrease in average prices during the third quarter and first nine months of fiscal 2009 were due to increased promotional activity and a greater mix of opening price point items such as tees and knit pants.

The Company's comparable store sales calculations include sales for all stores that were open during the comparable fiscal period, including remodeled stores and certain relocated stores. If a store relocates within the same center with no business interruption or material change in square footage, the sales of such store continue to be included in the comparable store calculation. If a store relocates to another center, or there is a material change in square footage, the store is treated as a new store. Stores that are closed during the period are included in the comparable store sales calculation up to the date of closing.

There were a total of 273 Carter's retail stores as of October 3, 2009. During the third quarter of fiscal 2009, we opened two Carter's retail stores. During the first nine months of fiscal 2009, we opened 20 Carter's retail stores. In total, we plan to open 24 Carter's retail stores and close one Carter's retail store during fiscal 2009.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

OSHKOSH RETAIL STORES

OshKosh retail store sales increased \$1.5 million, or 2.1%, in the third quarter of fiscal 2009 to \$74.1 million. The increase was driven by incremental sales of \$2.6 million generated by new store openings, partially offset by a comparable store sales decline of 2.1%, or \$0.7 million, and the impact of store closings of \$0.2 million. On a comparable store basis, units per transaction increased 4.0% and average prices decreased 5.6%.

OshKosh retail store sales increased \$11.3 million, or 6.8%, in the first nine months of fiscal 2009 to \$178.1 million. The increase reflects a comparable store sales increase of 2.9%, or \$7.2 million, and incremental sales of \$4.6 million generated by new store openings, partially offset by the impact of store closings of \$0.5 million. On a comparable store basis, transactions increased 3.6% and average prices decreased 0.6%.

We attribute the increase in units per transaction during the third quarter and transactions during the first nine months of fiscal 2009 to strong product performance in most product categories, changes in our merchandising strategies which include a higher mix of opening price point items (high-volume, entry level basic products), a better assortment of in-season merchandise on the floor, in-store product presentation, and direct to consumer marketing efforts which include our new catazine customer mailings. The decrease in average prices during the third quarter and first nine months of fiscal 2009 were due to increased promotional activity and a greater mix of opening price point items such as tees and knit pants.

There were a total of 169 OshKosh retail stores as of October 3, 2009. During the third quarter of fiscal 2009, we opened two OshKosh retail stores and closed one OshKosh retail store. During the first nine months of fiscal 2009, we opened five OshKosh retail stores and closed one OshKosh retail store. We plan to open six OshKosh retail stores and close one OshKosh retail store during fiscal 2009.

GROSS PROFIT

Gross profit increased \$32.4 million, or 21.2%, to \$185.6 million in the third quarter of fiscal 2009. Gross profit as a percentage of net sales was 38.5% in the third quarter of fiscal 2009 as compared to 35.2% in the third quarter of fiscal 2008. Our gross profit increased \$74.5 million, or 20.5%, to \$438.0 million in the first nine months of fiscal 2009. Gross profit as a percentage of net sales was 37.6% in the first nine months of fiscal 2009 as compared to 33.9% in the first nine months of fiscal 2008.

These increases in gross profit as a percentage of net sales reflect:

- (i) lower levels of excess inventory charges, more favorable loss rates, and improved inventory management;
- (ii) a greater mix of consolidated retail sales which, on average, have a higher gross margin than sales in our wholesale and mass channel segments; and
- (iii) higher consolidated retail gross margins as a percentage of consolidated retail sales.

The Company includes distribution costs in its selling, general, and administrative expenses. Accordingly, the Company's gross profit may not be comparable to other companies that include such distribution costs in their cost of goods sold.

SELLING, GENERAL, AND ADMINISTRATIVE EXPENSES

Selling, general, and administrative expenses in the third quarter of fiscal 2009 increased \$10.7 million, or 10.2%, to \$115.2 million. As a percentage of net sales, selling, general, and administrative expenses in the third quarter of fiscal 2009 were 23.9% as compared to 24.0% in the third quarter of fiscal 2008. Selling, general, and administrative expenses in the first nine months of fiscal 2009 increased \$25.2 million, or 8.7%, to \$314.2 million. As a percentage of net sales, selling, general, and administrative expenses in the first nine months of fiscal 2009 and fiscal 2008 were 27.0%.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

These changes in selling, general, and administrative expenses as a percentage of net sales reflect:

- (i) higher provisions for incentive compensation; and
- (ii) retail store expenses associated with new store growth during the first nine months of fiscal 2009 as compared to the first nine months of fiscal 2008.

Partially offsetting these increases were:

- (i) favorable distribution expenses associated with the closure of our Barnesville, Georgia distribution facility;
- (ii) lower levels of bad debt expense; and
- (iii) reduced discretionary spending and increased overall focus on our corporate cost structure.

WORKFORCE REDUCTION AND FACILITY WRITE-DOWN AND CLOSURE COSTS

As a result of the corporate workforce reduction announced in the first quarter of fiscal 2009, we recorded charges of \$7.3 million consisting of \$5.5 million in severance charges and other benefits, and approximately \$1.8 million in asset impairment charges related to the closure of our Oshkosh, Wisconsin office during the first nine months of fiscal 2009. The majority of the severance payments will be paid through the end of fiscal 2010.

In conjunction with the plan to close the Barnesville, Georgia distribution center, the Company recorded closure costs of approximately \$4.3 million during the first nine months of fiscal 2009, consisting of severance of \$1.7 million, asset impairment charges of \$1.1 million related to the write-down of the related land, building, and equipment, \$1.0 million of accelerated depreciation (included in selling, general, and administrative expenses), and \$0.5 million of other closure costs.

During the first nine months of fiscal 2009, the Company wrote down the carrying value of its White House, Tennessee distribution facility by approximately \$0.7 million to \$2.8 million to reflect the decrease in the fair market value as evidenced by recent negotiations to sell the facility. During the third quarter of fiscal 2009, the Company sold this facility for net proceeds of approximately \$2.8 million.

In the third quarter of fiscal 2008, the Company wrote down the carrying value of the White House, Tennessee distribution facility by approximately \$2.6 million to \$3.5 million to reflect the anticipated selling price of the property at that time.

EXECUTIVE RETIREMENT CHARGES

In the first nine months of fiscal 2008, the Company announced the retirement of an executive officer. In connection with this retirement, the Company recorded charges during the first nine months of fiscal 2008 of \$5.3 million, \$3.1 million of which related to the present value of severance and benefit obligations, and \$2.2 million of which related to the accelerated vesting of stock options.

ROYALTY INCOME

We license the use of our Carter's, Just One Year, Child of Mine, OshKosh B'Gosh, OshKosh, and Genuine Kids from OshKosh brand names. Royalty income from these brands in the third quarter of fiscal 2009 was \$10.6 million (including \$2.3 million of international royalty income), an increase of 11.1%, or \$1.1 million, as compared to the third quarter of fiscal 2008. Royalty income from these brands in the first nine months of fiscal 2009 was \$26.9 million (including \$6.3 million of international royalty income), an increase of 8.8%, or \$2.2 million, as compared to the first nine months of fiscal 2008. These increases were primarily driven by increased sales by our Carter's brand domestic licensees and international licensees.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

OPERATING INCOME

Operating income increased \$25.4 million, or 45.7% to \$81.0 million in the third quarter of fiscal 2009. Our operating income increased \$48.0 million, or 52.6% to \$139.3 million in the first nine months of fiscal 2009. These increases in operating income were due to the factors described above.

INTEREST EXPENSE, NET

Interest expense in the third quarter of fiscal 2009 decreased \$1.4 million, or 33.6%, to \$2.7 million. The decrease is primarily attributable to lower effective interest rates. Weighted-average borrowings in the third quarter of fiscal 2009 were \$336.0 million at an effective interest rate of 3.23% as compared to weighted-average borrowings in the third quarter of fiscal 2008 of \$339.8 million at an effective interest rate of 5.08%. In the third quarter of fiscal 2009, we recorded \$0.7 million in interest expense related to our interest rate swap agreements. In the third quarter of fiscal 2008, we recorded \$0.3 million in interest expense related to our interest rate swap agreement and \$0.4 million in interest expense related to our interest rate collar agreement.

Interest expense in the first nine months of fiscal 2009 decreased \$4.8 million, or 35.8%, to \$8.6 million. The decrease is primarily attributable to lower effective interest rates. Weighted-average borrowings in the first nine months of fiscal 2009 were \$336.9 million at an effective interest rate of 3.47% as compared to weighted-average borrowings in the first nine months of fiscal 2008 of \$340.7 million at an effective interest rate of 5.70%. In the first nine months of fiscal 2009, we recorded \$1.7 million in interest expense related to our interest rate swap agreements and \$0.5 million in interest expense related to our interest rate collar agreement. In the first nine months of fiscal 2008, we recorded \$0.9 million in interest expense related to our interest rate swap agreement and \$0.9 million in interest expense related to our interest rate collar agreement.

INCOME TAXES

Our effective tax rate was 36.9% for the third quarter of fiscal 2009 and 37.1% for the third quarter of fiscal 2008.

Our effective tax rate was 36.8% for the first nine months of fiscal 2009 and 35.2% in the first nine months of fiscal 2008. This change was a result of the reversal of \$1.9 million of reserves for certain tax exposures following the completion of an Internal Revenue Service examination for fiscal 2004 and 2005 and the closing of the statute of limitations in various state and local jurisdictions in the first nine months of fiscal 2008 as compared to the reversal of \$1.4 million related to the completion of an Internal Revenue Service examination for fiscal 2006 and state statute closures in the first nine months of fiscal 2009.

NET INCOME

As a result of the factors described above, our net income for the third quarter of fiscal 2009 increased \$17.0 million, or 52.5%, to \$49.4 million as compared to \$32.4 million in the third quarter of fiscal 2008. Our net income for the first nine months of fiscal 2009 increased \$32.2 million, or 63.8%, to \$82.6 million as compared to \$50.5 million for the first nine months of fiscal 2008.

FINANCIAL CONDITION, CAPITAL RESOURCES, AND LIQUIDITY

Our primary cash needs are working capital and capital expenditures. Our primary source of liquidity will continue to be cash and cash equivalents on hand, cash flow from operations, and borrowings under our revolver, and we expect that these sources will fund our ongoing requirements for working capital and capital expenditures. These sources of liquidity may be impacted by events described in our risk factors, as further discussed in Item 1A of this Form 10-Q.

Net accounts receivable at October 3, 2009 were \$127.9 million compared to \$141.7 million at September 27, 2008 and \$85.5 million at January 3, 2009. The decrease as compared to September 27, 2008 primarily reflects lower levels of mass channel sales. Due to the seasonal nature of our operations, the net accounts receivable balance at October 3, 2009 is not comparable to the net accounts receivable balance at January 3, 2009.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Net inventories at October 3, 2009 were \$223.5 million compared to \$214.4 million at September 27, 2008 and \$203.5 million at January 3, 2009. The increase of \$9.2 million, or 4.3%, as compared to September 27, 2008 is primarily due to an increase in our retail store base. Due to the seasonal nature of our operations, net inventories at October 3, 2009 are not comparable to net inventories at January 3, 2009.

Net cash provided by operating activities for the first nine months of fiscal 2009 was \$58.6 million compared to \$57.4 million in the first nine months of fiscal 2008. The increase in operating cash flow primarily reflects the growth in earnings partially offset by higher net working capital needs.

We invested \$23.2 million in capital expenditures during the first nine months of fiscal 2009 compared to \$19.2 million during the first nine months of fiscal 2008. We plan to invest approximately \$35 million in capital expenditures during fiscal 2009, primarily for retail store openings and remodelings (including retail store fixtures), fixtures for our wholesale customers, investments in our supply chain, and investments in information technology.

On February 16, 2007, the Company's Board of Directors approved a stock repurchase program, pursuant to which the Company is authorized to purchase up to \$100 million of its outstanding common shares. During the first nine months of fiscal 2009, the Company did not repurchase any of its common stock. Since inception of the program and through October 3, 2009, the Company repurchased and retired 4,599,580 shares, or approximately \$91.1 million, of its common stock at an average price of \$19.81 per share, leaving approximately \$8.9 million available for repurchase under the plan. Such repurchases may occur from time to time in the open market, in negotiated transactions, or otherwise. This program has no time limit. The timing and amount of any repurchases will be determined by management, based on its evaluation of market conditions, share price, and other factors.

At October 3, 2009, we had approximately \$335.4 million in term loan borrowings and no borrowings outstanding under our revolver (together with the term loan, our "Senior Credit Facility"), exclusive of approximately \$8.6 million of outstanding letters of credit. Principal borrowings under our term loan are due and payable in quarterly installments of \$0.9 million through June 30, 2012, with the remaining balance of \$325.8 million due on July 14, 2012. Weighted-average borrowings in the first nine months of fiscal 2009 were \$336.9 million at an effective interest rate of 3.47% as compared to weighted-average borrowings in the first nine months of fiscal 2008 of \$340.7 million at an effective interest rate of 5.70%.

The Senior Credit Facility contains and defines financial covenants, including a minimum interest coverage ratio, maximum leverage ratio, and a fixed charge coverage ratio. On November 17, 2009, the Company obtained a waiver to its Senior Credit Facility which waived defaults resulting from the untimely filing of the Company's third quarter of fiscal 2009 financial statements and arising from, or giving rise to, the restatement of prior period financial statements. The waiver resulted in a fee of approximately \$450,000 and requires the Company to deliver to the lenders the restatement of prior period financial statements and the third quarter of fiscal 2009 financial statements by January 15, 2010.

The Senior Credit Facility also sets forth mandatory and optional prepayment conditions, including an annual excess cash flow requirement, as defined, that may result in our use of cash to reduce our debt obligations. There was no excess cash flow payment required for fiscal 2008 or 2007. Our obligations under the Senior Credit Facility are collateralized by a first priority lien on substantially all of our assets, including the assets of our domestic subsidiaries.

Our Senior Credit Facility requires us to hedge at least 25% of our debt under this facility using interest rate swaps or other similar instruments. As of October 3, 2009, \$243.0 million, or 72.5%, of our Senior Credit Facility borrowings

were subject to interest rate swap agreements.

27

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Our operating results are subject to risk from interest rate fluctuations on our Senior Credit Facility, which carries variable interest rates. As of October 3, 2009, our outstanding debt aggregated approximately \$335.4 million, of which \$92.4 million, or 27.5%, was subject to variable interest rates. An increase or decrease of 1% in the applicable rate would increase or decrease our annual interest cost by approximately \$0.9 million, exclusive of variable rate debt subject to our swap agreements, and could have an adverse effect on our earnings and cash flow.

Based on our current outlook, we believe that cash generated from operations and available cash, together with amounts available under our revolver, will be adequate to meet our working capital needs and capital expenditure requirements for the foreseeable future, although no assurance can be given in this regard. We may, however, need to refinance all or a portion of the principal amount, if any, outstanding under our revolver on or before July 14, 2011 and amounts outstanding under our term loan on or before July 14, 2012.

The continuing volatility in the financial markets and the related economic downturn in markets throughout the world could have a material adverse effect on our business. While we currently generate significant cash flows from our ongoing operations and have access to credit through amounts available under our revolver, credit markets have recently experienced significant disruptions and certain leading financial institutions have either declared bankruptcy or have shown significant deterioration in their financial stability. Further deterioration in the financial markets could make future financing difficult or more expensive. If any of the financial institutions that are parties to our revolver were to declare bankruptcy or become insolvent, they may be unable to perform under their agreements with us. This could leave us with reduced borrowing capacity. In addition, tighter credit markets may lead to business disruptions for certain of our suppliers, contract manufacturers or trade customers and consequently, could disrupt our business.

EFFECTS OF INFLATION AND DEFLATION

We are affected by inflation and changing prices primarily through purchasing product from our global suppliers, increased operating costs and expenses, and fluctuations in interest rates. The effects of inflation on our net sales and operations have not been material in recent years. In recent years, there has been deflationary pressure on selling prices. If deflationary price trends outpace our ability to obtain price reductions from our global suppliers, our profitability may be affected.

SEASONALITY

We experience seasonal fluctuations in our sales and profitability, with generally lower sales and gross profit in the first and second quarters of our fiscal year. Over the past five fiscal years, excluding the impact of our acquisition of OshKosh B'Gosh, Inc. in fiscal 2005, approximately 57% of our consolidated net sales were generated in the second half of our fiscal year. Accordingly, our results of operations for the first and second quarters of any year are not indicative of the results we expect for the full year.

As a result of this seasonality, our inventory levels and other working capital requirements generally begin to increase during the second quarter and into the third quarter of each year.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments

that affect the reported amounts of assets, liabilities, revenues, expenses, and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Our significant accounting policies are described in Note 2 to our restated audited consolidated financial statements contained in our most recently filed Annual Report on Form 10-K/A filed on January 15, 2010. The following discussion addresses our critical accounting policies and estimates, which are those policies that require management's most difficult and subjective judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.

Revenue recognition: We recognize wholesale and mass channel revenue after shipment of products to customers, when title passes, when all risks and rewards of ownership have transferred, the sales price is fixed or determinable, and collectibility is reasonably assured. In certain cases, in which we retain the risk of loss during shipment, revenue recognition does not occur until the goods have reached the specified customer. In the normal course of business, we grant certain accommodations and allowances to our wholesale and mass channel customers in order to assist these customers with inventory clearance or promotions. Such amounts are reflected as a reduction of net sales and are recorded based upon agreements with customers, historical trends, and annual forecasts. Retail store revenues are recognized at the point of sale. We reduce revenue for customer returns and deductions. We also maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make payments and other actual and estimated deductions. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, an additional allowance could be required. Past due balances over 90 days are reviewed individually for collectibility. Our credit and collections department reviews all other balances regularly. Account balances are charged off against the allowance when we believe it is probable the receivable will not be recovered.

We contract with a third-party service to provide us with the fair value of cooperative advertising arrangements entered into with certain of our major wholesale and mass channel customers. Such fair value is determined based upon, among other factors, comparable market analysis for similar advertisements. We have included the fair value of these arrangements of approximately \$1.0 million and \$2.6 million in the third quarter and first nine months of fiscal 2009 and \$1.0 million and \$1.9 million in the third quarter and first nine months of fiscal 2008 as a component of selling, general, and administrative expenses in the accompanying unaudited condensed consolidated statements of operations rather than as a reduction of revenue. Amounts determined to be in excess of the fair value of these arrangements are recorded as a reduction of net sales.

Inventory: We provide reserves for slow-moving inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those we project, additional write-downs may be required.

Cost in excess of fair value of net assets acquired and tradename: As of October 3, 2009, we had approximately \$136.6 million in Carter's cost in excess of fair value of net assets acquired and \$305.7 million of aggregate value related to the Carter's and OshKosh tradename assets. The fair value of the Carter's tradename was estimated at the acquisition of Carter's, Inc. by Berkshire Partners LLC which was consummated on August 15, 2001, using a discounted cash flow analysis, which examined the hypothetical cost savings that accrue as a result of our ownership of the tradename. The fair value of the OshKosh tradename was also estimated at its acquisition date using an identical discounted cash flow analysis. The tradenames were determined to have indefinite lives.

The carrying values of these assets are subject to annual impairment reviews as of the last day of each fiscal year. Factors affecting such impairment reviews include the continued market acceptance of our offered products and the development of new products. Impairment reviews may also be triggered by any significant events or changes in circumstances.

Accrued expenses: Accrued expenses for workers' compensation, incentive compensation, health insurance, and other outstanding obligations are assessed based on actual commitments, statistical trends, and estimates based on projections and current expectations, and these estimates are updated periodically as additional information becomes available.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Loss contingencies: We record accruals for various contingencies including legal exposures as they arise in the normal course of business. We determine whether to disclose and accrue for loss contingencies based on an assessment of whether the risk of loss is remote, reasonably possible or probable. Our assessment is developed in consultation with our internal and external counsel and other advisors and is based on an analysis of possible outcomes under various strategies. Loss contingency assumptions involve judgments that are inherently subjective and can involve matters that are in litigation, which, by its nature is unpredictable. We believe that our assessment of the probability of loss contingencies is reasonable, but because of the subjectivity involved and the unpredictable nature of the subject matter at issue, our assessment may prove ultimately to be incorrect, which could materially impact our consolidated financial statements.

Accounting for income taxes: As part of the process of preparing the accompanying unaudited condensed consolidated financial statements, we are required to estimate our actual current tax exposure (state, federal, and foreign). We assess our income tax positions and record tax benefits for all years subject to examination based upon management's evaluation of the facts, circumstances, and information available at the reporting dates. For those uncertain tax positions where it is "more likely than not" that a tax benefit will be sustained, we have recorded the largest amount of tax benefit with a greater than 50% likelihood of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. For those income tax positions where it is not "more likely than not" that a tax benefit will be sustained, no tax benefit has been recognized in the financial statements. Where applicable, associated interest is also recognized. We also assess permanent and temporary differences resulting from differing bases and treatment of items for tax and accounting purposes, such as the carrying value of intangibles, deductibility of expenses, depreciation of property, plant, and equipment, stock-based compensation expense, and valuation of inventories. Temporary differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheets. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income. Actual results could differ from this assessment if sufficient taxable income is not generated in future periods. To the extent we determine the need to establish a valuation allowance or increase such allowance in a period, we must include an expense within the tax provision in the accompanying unaudited condensed consolidated statement of operations.

Employee benefit plans: We sponsor a defined benefit pension, defined contribution, and other post-retirement plans. Major assumptions used in the accounting for these employee benefit plans include the discount rate, expected return on the pension fund assets, and health care cost increase projections. See Note 8 "Employee Benefit Plans" to our restated audited consolidated financial statements in our most recently filed Annual Report on Form 10-K/A for further details on rates and assumptions.

Stock-based compensation arrangements: The Company accounts for stock-based compensation in accordance with the fair value recognition provisions of accounting guidance on stock-based compensation. The Company adopted this guidance on stock-based compensation using the modified prospective application method of transition. The Company uses the Black-Scholes option pricing model, which requires the use of subjective assumptions. These assumptions include the following:

Volatility – This is a measure of the amount by which a stock price has fluctuated or is expected to fluctuate. The Company uses actual monthly historical changes in the market value of our stock since the Company's initial public offering on October 29, 2003, supplemented by peer company data for periods prior to our initial public offering covering the expected life of stock options being valued. An increase in the expected volatility will increase compensation expense.

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Risk-free interest rate – This is the U.S. Treasury rate as of the grant date having a term equal to the expected term of the stock option. An increase in the risk-free interest rate will increase compensation expense.

Expected term – This is the period of time over which the stock options granted are expected to remain outstanding and is based on historical experience and estimated future exercise behavior. Separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. An increase in the expected term will increase compensation expense.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Dividend yield – The Company does not have plans to pay dividends in the foreseeable future. An increase in the dividend yield will decrease compensation expense.

Forfeitures – The Company estimates forfeitures of stock-based awards based on historical experience and expected future activity.

Changes in the subjective assumptions can materially affect the estimate of fair value of stock-based compensation and consequently, the related amount recognized in the accompanying unaudited condensed consolidated statement of operations.

In accordance with accounting guidance on stock-based compensation, the Company records stock-based compensation expense related to performance-based awards over the vesting term of the awards that are expected to vest based on whether it is probable that the performance criteria will be achieved. The Company reassesses the probability of vesting at each reporting period for awards with performance criteria and adjusts stock-based compensation expense based on its probability assessment.

RECENT ACCOUNTING PRONOUNCEMENTS

Effective January 4, 2009, the Company adopted new accounting guidance on fair value measurements. The new guidance defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. See Note 7 for additional information regarding our fair value measurements for financial assets and financial liabilities. The new guidance is effective for non-financial assets and non-financial liabilities recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually).

Effective January 4, 2009, the Company adopted new accounting guidance which addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share under the two-class method. Under the guidance, unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. The guidance is effective for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. All prior period earnings per share data presented shall be adjusted retrospectively. The Company has included the required disclosures in Note 13.

Effective April 4, 2009, the Company adopted new accounting guidance on enhanced disclosures on the effect of derivatives on a Company's financial statements. This new guidance impacts disclosures only and requires additional qualitative and quantitative information on the use of derivatives and their impact on an entity's financial position, results of operations, and cash flows. The Company has included the required disclosures in Note 7.

Effective July 4, 2009, the Company adopted new accounting guidance on the disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The guidance applies prospectively to both interim and annual financial periods ending after June 15, 2009. The Company has included the required disclosures in Note 2.

In June 2009, the Financial Accounting Standards Board ("FASB") issued the FASB Accounting Standards Codification™ ("Codification"). The Codification will become the source of authoritative GAAP recognized by the FASB to be applied for financial statements issued for interim and annual periods ending after September 15,

2009. The Company has amended our disclosures accordingly within this Quarterly Report on Form 10-Q.

In December 2008, the FASB issued new accounting guidance on enhanced disclosures about plan assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension or other postretirement plans. The guidance is effective for fiscal years ending after December 15, 2009. The Company is currently evaluating the impact that the required disclosures will have on our consolidated financial statements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

FORWARD-LOOKING STATEMENTS

Statements contained herein that relate to our future performance, including, without limitation, statements with respect to our anticipated results of operations or level of business for fiscal 2009 or any other future period, are forward-looking statements within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Such statements are based on current expectations only and are subject to certain risks, uncertainties, and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, or projected. These risks are described herein under Item 1A of Part II. We undertake no obligation to publicly update or revise any forward-looking statements or other information, whether as a result of new information, future events, or otherwise.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

CURRENCY AND INTEREST RATE RISKS

In the operation of our business, we have market risk exposures including those related to foreign currency risk and interest rates. These risks and our strategies to manage our exposure to them are discussed below.

We contract for production with third parties primarily in Asia and South and Central America. While these contracts are stated in United States dollars, there can be no assurance that the cost for the future production of our products will not be affected by exchange rate fluctuations between the United States dollar and the local currencies of these contractors. Due to the number of currencies involved, we cannot quantify the potential impact of future currency fluctuations on net income (loss) in future years. In order to manage this risk, we currently source products from approximately 90 vendors worldwide, providing us with flexibility in our production should significant fluctuations occur between the United States dollar and various local currencies. To date, such exchange fluctuations have not had a material impact on our financial condition or results of operations. We do not hedge foreign currency exchange rate risk.

Our operating results are subject to risk from interest rate fluctuations on our Senior Credit Facility, which carries variable interest rates. As of October 3, 2009, our outstanding debt aggregated approximately \$335.4 million, of which \$92.4 million bore interest at a variable rate. An increase or decrease of 1% in the applicable rate would increase or decrease our annual interest cost by approximately \$0.9 million, exclusive of variable rate debt subject to our interest rate swap agreements, and could have an adverse effect on our net income (loss) and cash flow.

OTHER RISKS

We enter into various purchase order commitments with full-package suppliers. We can cancel these arrangements, although in some instances, we may be subject to a termination charge reflecting a percentage of work performed prior to cancellation. As we rely exclusively on our full-package global sourcing network, we could incur more of these termination charges, which could increase our cost of goods sold and have a material impact on our business.

ITEM 4. CONTROLS AND PROCEDURES

Restatement of Previously Issued Financial Statements

On November 10, 2009, the Company announced that its Audit Committee, with the assistance of outside counsel, had commenced a review of customer margin support provided by the Company and an investigation into undisclosed margin support commitments and related matters. As a result of this review, the Company announced that the previously issued consolidated financial statements for the fiscal years 2004 through 2008 included in the Company's Forms 10-K, and for the fiscal quarters from September 29, 2007 through July 4, 2009 included in the Company's Forms 10-Q, should no longer be relied upon (collectively, the "Affected Periods").

Management initially began a review of margin support arrangements with respect to a single wholesale customer (the "Initial Customer") after becoming aware of a disputed amount of margin support with the Initial Customer. In the normal course of business, the Company provides margin support and other allowances (collectively, "accommodations") to its wholesale customers to assist them with the costs related to inventory clearance and sales promotions. The Company's policy is to reflect the amounts of accommodations as reductions to revenue or, in the case of certain co-op advertising expenses, as additions to selling, general, and administrative expenses. As a result of its review, management identified issues with respect to the timing of recognizing customer accommodations with respect to the Initial Customer. Following management's review, the Audit Committee engaged outside counsel to

undertake the review and investigation described above.

The Audit Committee has completed its review and investigation, which was conducted with the assistance of outside counsel and forensic accountants engaged by outside counsel, and has concluded that the Company reported various customer accommodations in incorrect fiscal periods. The investigation uncovered irregularities involving members of the sales organization intentionally not disclosing accommodations arrangements with customers to the Company's finance organization and intentionally providing inaccurate documentation and explanations regarding accommodations to the finance organization. Consequently, such arrangements were not communicated to the Company's independent registered public accounting firm. These accommodations arrangements were made throughout the Affected Periods by certain members of the Company's sales organization and involved the deferral of accommodations into later fiscal periods. The deferrals resulted in the overstatement of net sales and net income in certain of the Affected Periods and the understatement of net sales and net income in certain of the Affected Periods. The deferrals related primarily to the Initial Customer and, to a lesser extent, other wholesale customers.

Evaluation of Disclosure Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined under Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were not effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements because of the identification of material weaknesses in our internal control over financial reporting described further below.

Specifically, through the investigation discussed above, management identified: (i) control deficiencies in its internal controls associated with customer accommodations processes that constitute material weaknesses, and (ii) the need to restate prior period financial statements. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis. The material weaknesses in internal control over financial reporting identified are as follows:

(1) Revenue Recognition - The control over the timing of the recording of customer accommodations was improperly designed and was not effective in capturing the accuracy, completeness, and timing of accommodations arrangements. The controls that had been in place focused primarily on the review of internal Company documentation and the representations of members of the sales organization to ensure deductions taken by customers were valid and authorized; however, the controls were not effective in recording completely and accurately the accommodations arrangements in the appropriate accounting periods.

(2) Control Environment - Sales Organization - Training and oversight of the sales organization were not effective, which resulted in an insufficient understanding by the sales organization regarding the impact of failing to accurately and completely account for customer accommodations in correct periods on the Company's reported financial results.

If not remediated, these control deficiencies could result in future material misstatements to the Company's financial statements. Accordingly, management has determined that these control deficiencies constitute material weaknesses.

Remediation Plan

Management has been actively engaged in developing remediation plans to address the above control deficiencies. The remediation efforts in process or expected to be implemented include the following:

- Making personnel changes, including the separation of certain employees from the Company, and a restructuring of the Company's sales organization;
- Implementing a periodic training program for all sales personnel regarding the appropriate accounting for accommodations and the impact on the Company's financial statements of recording such customer accommodations;
- Implementing procedures to improve the capture, review, approval, and recording of all accommodation arrangements in the appropriate accounting period;
- Establishing more comprehensive procedures for authorizing accommodations, including tiered accommodations approval levels that include the Chief Financial Officer and Chief Executive Officer;

- Establishing a new position in the finance organization with responsibilities to include tracking, monitoring, and reviewing all customer accommodations, including certain budgetary responsibilities for accommodations;
- Improving the method of educating employees on the Company's Code of Business Ethics and Professional Conduct; and
- Reemphasizing to all employees the availability of the Company's Financial Accounting and Reporting Hotline and communicating information to the Company's vendors and customers about this Hotline, which is available to both Company employees and its business partners.

The Audit Committee has directed management to develop a detailed plan and timetable for the implementation of the foregoing remediation efforts and will monitor the implementation. In addition, under the direction of the Audit Committee, management will continue to review and make necessary changes to the overall design of the Company's internal control environment, as well as to policies and procedures to improve the overall effectiveness of internal control over financial reporting.

Management believes the foregoing efforts will effectively remediate these material weaknesses. As the Company continues to evaluate and work to improve its internal control over financial reporting, management may determine to take additional measures to address control deficiencies or determine to modify the remediation plan described above.

Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal controls over financial reporting during the period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS:

A shareholder class action lawsuit was filed on September 19, 2008 in the United States District Court for the Northern District of Georgia entitled Plymouth Country Retirement System v. Carter's, Inc., No. 1:08-CV-02940-JOF (the "Plymouth Action"). The Amended Complaint filed on May 12, 2009 in the Plymouth Action asserts claims under Sections 10(b), 20(a), and 20A of the 1934 Securities Exchange Act, and alleges that between February 1, 2006 and July 24, 2007, the Company and certain current and former executives made misrepresentations to investors regarding the successful integration of OshKosh into the Company's business, and that the share price of the Company's stock later fell when the market learned that the integration had not been as successful as represented. Defendants in the Plymouth Action filed a motion to dismiss the Amended Complaint for failure to state a claim under the federal securities laws on July 17, 2009, and briefing of that motion was complete on October 22, 2009.

A separate shareholder class action lawsuit was filed on November 17, 2009 in the United States District Court for the Northern District of Georgia entitled Mylroie v. Carter's, Inc., No. 1:09-CV-3196-JOF (the "Mylroie Action"). The Complaint in the Mylroie Action asserts claims under Sections 10(b) and 20(a) of the 1934 Securities Exchange Act, and alleges that between April 27, 2004 and November 10, 2009, the Company and certain current and former executives made misstatements to investors regarding the Company's accounting for discounts offered to some wholesale customers. The Court consolidated the Plymouth Action and the Mylroie Action on November 24, 2009 (the "Consolidated Action"), and the parties have agreed that an amended complaint in the Consolidated Action will be filed after the Company releases a planned restatement of prior financial results. By stipulation, the Company will respond to the amended complaint to be filed by the Lead Plaintiff in the Consolidated Action. The Company intends to vigorously defend against the claims in the Consolidated Action.

A class action lawsuit was filed on September 29, 2008 in United States District Court for the Northern District of Illinois against the Company claiming breach of contract arising from certain advertising and pricing practices with respect to Carter's brand products purchased by consumers at Carter's retail stores nationally. The complaint seeks damages and injunctive relief. Plaintiff has since filed an amended complaint, alleging breach of contract on behalf of a nationwide class and Illinois Consumer Fraud Act claims on behalf of Illinois consumers. On February 3, 2009 the same plaintiff's attorney filed a second, nearly identical action against the Company in the same court but in the name of a different plaintiff. The parties filed an agreed upon motion to consolidate this second action with the first case and to stay the need for response in the second case until after the court had ruled upon a pending motion to dismiss the first case. On April 15, 2009, the Amended Complaint in the first case was dismissed for failure to state a claim for breach of contract and for failure to adequately allege damages. The Company subsequently filed a motion to dismiss the second case on the same grounds, which the Court granted on April 29, 2009. The plaintiffs filed a notice of appeal in each action on May 1, 2009. The appeals have been consolidated and fully briefed. On December 2, 2009, plaintiffs and the Company presented oral arguments before the Seventh Circuit. The ruling on the appeal is pending.

The Company is subject to various other claims and pending or threatened lawsuits in the normal course of our business. We are not currently party to any other legal proceedings that we believe would have a material adverse effect on our financial position, results of operations or cash flows.

ITEM 1A. RISK FACTORS:

You should carefully consider each of the following risk factors as well as the other information contained in this Quarterly Report on Form 10-Q and other filings with the Securities and Exchange Commission in evaluating our business. The risks and uncertainties described below are not the only we face. Additional risks and uncertainties not presently known to us or that we currently consider immaterial may also impact our business operations. If any of the following risks actually occur, our operating results may be affected.

Risks Relating to Our Business

The loss of one or more of our major customers could result in a material loss of revenues.

In the third quarter and first nine months of fiscal 2009, we derived approximately 43% and 42% of our consolidated net sales from our top eight customers, including mass channel customers. We do not enter into long-term sales contracts with our major customers, relying instead on long-standing relationships and on our position in the marketplace. As a result, we face the risk that one or more of our major customers may significantly decrease its or their business with us or terminate its or their relationships with us. Any such decrease or termination of our major customers' business could result in a material decrease in our sales and operating results.

The acceptance of our products in the marketplace is affected by consumers' tastes and preferences, along with fashion trends.

We believe that continued success depends on our ability to provide a unique and compelling value proposition for our consumers in the Company's distribution channels. There can be no assurance that the demand for our products will not decline, or that we will be able to successfully evaluate and adapt our product to be aware of consumers' tastes and preferences or fashion trends. If consumers' tastes and preferences are not aligned with our product offerings, promotional pricing may be required to move seasonal merchandise. Increased use of promotional pricing would have a material adverse affect on our sales, gross margin, and results of operations.

The value of our brand, and our sales, could be diminished if we are associated with negative publicity.

Although our employees, agents, and third-party compliance auditors periodically visit and monitor the operations of our vendors, independent manufacturers, and licensees, we do not control these vendors, independent manufacturers, licensees, or their labor practices. A violation of our vendor policies, licensee agreements, labor laws, or other laws by these vendors, independent manufacturers, or licensees could interrupt or otherwise disrupt our supply chain or damage our brand image. As a result, negative publicity regarding our Company, brands or products, including licensed products, could adversely affect our reputation and sales.

In addition, the Company's brand image, which is associated with providing a consumer product with outstanding quality and name recognition, makes it valuable as a royalty source. The Company is able to generate royalty income from the sale of licensed products that bear its Carter's, Child of Mine, Just One Year, OshKosh, Genuine Kids from OshKosh, and related trademarks. The Company also generates foreign royalty income as our OshKosh B'Gosh label carries an international reputation for quality and American style. While the Company takes significant steps to ensure the reputation of its brand is maintained through its license agreements, there can be no guarantee that the Company's brand image will not be negatively impacted through its association with products outside of the Company's core apparel products.

We may incur substantial costs as a result of litigation, investigations or other proceedings, including those related to our recently announced restatements.

We are currently involved in litigation matters and investigations and may be subject to additional actions in the future. As we announced on November 10, 2009, our Audit Committee, with the assistance of outside counsel, had commenced a review of customer margin support provided by the Company and an investigation into undisclosed margin support commitments and related matters. The Company has self-reported information concerning this investigation to the SEC and has also been informed that the United States Attorney's Office is conducting an inquiry into this matter. The Company has incurred, and expects to continue to incur, substantial expenses for legal and accounting services due to the investigation, the SEC and United States Attorney's Office inquiries and any resulting litigation. These matters may divert management's time and attention away from operations and cause the Company to continue to incur substantial costs. The Company also may bear additional costs to the extent we are required, under the terms of organizational documents or under Delaware law, to indemnify former officers of the Company in respect of costs they incur in connection with any proceedings related to these matters. At this point, the Company is unable to predict the duration, costs, scope or result of these inquiries. In addition to the costs and diversion of management's attention referred to above, any such inquiries may result in the Company being subject to penalties and other remedial measures, which could have an adverse impact on the Company's business, results of operations, financial condition, and liquidity.

As described in more detail in Item I of Part II, the Company is also currently subject to two class action lawsuits, as well as various other claims and pending or threatened lawsuits in the normal course of our business. We have only limited amounts of insurance, which may not provide coverage to offset a negative judgment or a settlement payment, which could be substantial. We may be unable to obtain additional insurance in the future, or we may be unable to do so on favorable terms. Our insurers may also dispute our claims for coverage. Further, these lawsuits may result in diversion of management's time and attention, the expenditure of large amounts of cash on legal fees and other expenses, and injury to our reputation, all of which may adversely affect our operations and financial condition.

The Company's databases containing personal information of our retail customers could be breached, which could subject us to adverse publicity, litigation, and expenses. In addition, if we are unable to comply with security standards created by the banks and payment card industry, our operations could be adversely affected.

Database privacy, network security, and identity theft are matters of growing public concern. In an attempt to prevent unauthorized access to our network and databases containing confidential, third-party information, we have installed privacy protection systems, devices, and activity monitoring on our network. Nevertheless, if unauthorized parties gain access to our networks or databases, they may be able to steal, publish, delete, or modify our private and sensitive third-party information. In such circumstances, we could be held liable to our customers or other parties or be subject to regulatory or other actions for breaching privacy rules. This could result in costly investigations and litigation, civil or criminal penalties, and adverse publicity that could adversely affect our financial condition, results of operations, and reputation. Further, if we are unable to comply with the security standards, established by banks and the banks and payment card industry, we may be subject to fines, restrictions, and expulsion from card acceptance programs, which could adversely affect our retail operations.

There are deflationary pressures on the selling price of apparel products.

Due, among other things, to the actions of discount retailers, the worldwide supply of low cost garment sourcing, and the reaction of many retailers to lower consumer spending, the average selling price of children's apparel continues to decrease. To the extent these deflationary pressures are not offset by reductions in manufacturing costs, there would be an affect on the Company's gross margin. Additionally, the inability to leverage certain fixed costs of the Company's design, sourcing, distribution, and support costs over its gross sales base could have an adverse impact on the Company's operating results.

Our business is sensitive to overall levels of consumer spending, particularly in the young children's apparel segment.

Consumers' demand for young children's apparel, specifically brand name apparel products, is impacted by the overall level of consumer spending. Consumer spending is impacted, among other things, by employment levels, gasoline and utility costs, business conditions, availability of consumer credit, tax rates, interest rates, levels of consumer indebtedness, and overall levels of consumer confidence. Recent and further reductions in the level of consumer spending could have a material adverse affect on the Company's sales and results of operations.

We face risks associated with the current global credit crisis and related economic downturn.

The continuing volatility in the financial markets and the related economic downturn in markets throughout the world could have a material adverse effect on our business. While we currently generate significant cash flows from our ongoing operations and have access to credit through amounts available under our revolving credit facility, credit markets have recently experienced significant disruptions and certain leading financial institutions have either declared bankruptcy or have shown significant deterioration in their financial stability. Further deterioration in the financial markets could make future financing difficult or more expensive. If any of the financial institutions that are parties to our revolver were to declare bankruptcy or become insolvent, they may be unable to perform under their agreements with us. This could leave us with reduced borrowing capacity. In addition, tighter credit markets may lead to business disruptions for certain of our suppliers, contract manufacturers or trade customers and consequently, could disrupt our business.

We source substantially all of our products through foreign production arrangements. Our dependence on foreign supply sources could result in disruptions to our operations in the event of political instability, unfavorable economic conditions, international events, or new foreign regulations and such disruptions may increase our cost of goods sold and decrease gross profit.

We source substantially all of our products through a network of vendors primarily in Asia, coordinated by our sourcing agents. The following could disrupt our foreign supply chain, increase our cost of goods sold, decrease our gross profit, or impact our ability to get products to our customers:

- financial instability of one of our major vendors;
- political instability or other international events resulting in the disruption of trade in foreign countries from which we source our products;
- increases in transportation costs as a result of increased fuel prices;
- the imposition of new regulations relating to imports, duties, taxes, and other charges on imports;
- the occurrence of a natural disaster, unusual weather conditions, or an epidemic, the spread of which may impact our ability to obtain products on a timely basis;
- changes in the United States customs procedures concerning the importation of apparel products;
- unforeseen delays in customs clearance of any goods;
- disruption in the global transportation network such as a port strike, world trade restrictions, or war;
- the application of foreign intellectual property laws;
- the ability of our vendors to secure sufficient credit to finance the manufacturing process including the acquisition of raw materials; and
- exchange rate fluctuations between the United States dollar and the local currencies of foreign contractors.

These and other events beyond our control could interrupt our supply chain and delay receipt of our products into the United States.

We source all of our products through a network of vendors. We have limited control over these vendors and we may experience delays, product recalls or loss of revenues if our products do not meet our quality standards or regulatory requirements.

Our vendors, independent manufacturers, and licensees may not continue to provide products that are consistent with our standards. We have occasionally received, and may in the future continue to receive, shipments of product that fail to conform to our quality control standards. A failure in our quality control program may result in diminished product quality, which may result in increased order cancellations and returns, decreased consumer demand for our products, or product recalls, any of which may have a material adverse affect on our results of operations and financial condition. In addition, notwithstanding our strict quality control procedures, because we do not control our vendors, products that fail to meet our standards, or other unauthorized products, could end up in the marketplace without our knowledge. This could materially harm our brand and our reputation in the marketplace.

Our products are subject to regulation of and regulatory standards set by various governmental authorities with respect to quality and safety. Regulations and standards in this area are currently in place. These regulations and standards may change from time to time. Our inability to comply on a timely basis with regulatory requirements could result in significant fines or penalties, which could adversely affect our reputation and sales. Issues with the quality and safety of merchandise we sell in our stores, regardless of our culpability, or customer concerns about such issues, could result in damage to our reputation, lost sales, uninsured product liability claims or losses, merchandise recalls, and increased costs.

We operate in a highly competitive market and the size and resources of some of our competitors may allow them to compete more effectively than we can, resulting in a loss of market share and, as a result, a decrease in revenue and gross profit.

The baby and young children's apparel market is highly competitive. Both branded and private label manufacturers compete in the baby and young children's apparel market. Our primary competitors in our wholesale and mass channel businesses include Disney, Gerber, and private label product offerings. Our primary competitors in the retail store channel include Old Navy, The Gap, The Children's Place, Gymboree, and Disney. Because of the fragmented nature of the industry, we also compete with many other manufacturers and retailers. Some of our competitors have greater financial resources and larger customer bases than we have and are less financially leveraged than we are. As a result, these competitors may be able to:

- adapt to changes in customer requirements more quickly;
- take advantage of acquisition and other opportunities more readily;
- devote greater resources to the marketing and sale of their products; and
- adopt more aggressive pricing strategies than we can.

The Company's retail success and future growth is dependent upon identifying locations and negotiating appropriate lease terms for retail stores.

The Company's retail stores are located in leased retail locations across the country. Successful operation of a retail store depends, in part, on the overall ability of the retail location to attract a consumer base sufficient to make store sales volume profitable. If the Company is unable to identify new retail locations with consumer traffic sufficient to support a profitable sales level, retail growth may consequently be limited. Further, if existing outlet and strip centers do not maintain a sufficient customer base that provides a reasonable sales volume, there could be a material adverse

impact on the Company's sales, gross margin, and results of operations.

Our leverage could adversely affect our financial condition.

On October 3, 2009, we had total debt of approximately \$335.4 million.

Our indebtedness could have negative consequences. For example, it increases our vulnerability to interest rate risk and could:

- limit our ability to obtain additional financing to fund future working capital, capital expenditures, and other general corporate requirements, or to carry out other aspects of our business plan;
- require us to dedicate a substantial portion of our cash flow from operations to pay principal of, and interest on, our indebtedness, thereby reducing the availability of that cash flow to fund working capital, capital expenditures, or other general corporate purposes, or to carry out other aspects of our business plan;
- limit our flexibility in planning for, or reacting to, changes in our business and the industry; and
- place us at a competitive disadvantage compared to our competitors that have less debt.

In addition, our Senior Credit Facility contains financial and other restrictive covenants that may limit our ability to engage in activities that may be in our long-term best interests such as selling assets, strategic acquisitions, paying dividends, and borrowing additional funds. Our failure to comply with those covenants could result in an event of default which, if not cured or waived, could result in the acceleration of all of our debt which could leave us unable to meet some or all of our obligations.

Profitability could be negatively impacted if we do not adequately forecast the demand for our products and, as a result, create significant levels of excess inventory or insufficient levels of inventory.

If the Company does not adequately forecast demand for its products and purchases inventory to support an inaccurate forecast, the Company could experience increased costs due to the need to dispose of excess inventory or lower profitability due to insufficient levels of inventory.

We may not achieve sales growth plans, cost savings, and other assumptions that support the carrying value of our intangible assets.

As of October 3, 2009, the Company had Carter's cost in excess of fair value of net assets acquired of \$136.6 million, a \$220.2 million Carter's brand tradename asset, and an \$85.5 million OshKosh brand tradename asset on its unaudited condensed consolidated balance sheet. The carrying value of these assets is subject to annual impairment reviews as of the last day of each fiscal year or more frequently, if deemed necessary, due to any significant events or changes in circumstances.

Estimated future cash flows used in these impairment reviews could be negatively impacted if we do not achieve our sales plans, planned cost savings, and other assumptions that support the carrying value of these intangible assets, which could result in potential impairment of the remaining asset value.

Our inability to remediate our material weaknesses could have a material adverse effect on our business, results of operations, and financial condition.

In connection with the restatement and our reassessment of our internal control over financial reporting pursuant to the rules promulgated by the Commission under Section 404 of the Sarbanes-Oxley Act of 2002 and Item 308 of Regulation S-K, management has concluded that as of October 3, 2009, our disclosure controls and procedures were not effective and that we had material weaknesses in our internal control over financial reporting. Please refer to Part I – Item 4 of this Form 10-Q for further discussion of the ineffectiveness of, and material weaknesses, in our controls. Should we be unable to remediate such material weaknesses promptly and effectively, an unresolved weakness could have a material adverse effect on our business, results of operations, and financial condition, as well as impair our ability to meet our quarterly, annual, and other reporting requirements under the Securities Exchange Act of 1934 in a timely manner. These effects could in turn adversely affect the trading price of our common stock and could result in a material misstatement of our financial position or results of operations and require a further restatement of our financial statements. In addition, even if we are successful in strengthening our controls and procedures, such controls and procedures may not be adequate to prevent or identify control weaknesses.

The Company's success is dependent upon retaining key individuals within the organization to execute the Company's strategic plan.

The Company's ability to attract and retain qualified executive management, marketing, merchandising, design, sourcing, operations, and support function staffing is key to the Company's success. If the Company were unable to attract and retain qualified individuals in these areas, an adverse impact on the Company's growth and results of operations may result.

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

N/A

ITEM 3. DEFAULTS UPON SENIOR SECURITIES:

N/A

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

N/A

ITEM 5. OTHER INFORMATION:

N/A

ITEM 6. EXHIBITS:

(a) Exhibits:

| Exhibit Number | Description of Exhibits |
|----------------|--|
| 31.1 | Rule 13a-15(e)/15d-15(e) and 13a-15(f)/15d-15(f) Certification |
| 31.2 | Rule 13a-15(e)/15d-15(e) and 13a-15(f)/15d-15(f) Certification |
| 32 | Section 1350 Certification |

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the Registrants have duly caused this report to be signed on their behalf by the undersigned thereunto duly authorized.

CARTER'S, INC.

Date: January 15, 2010

/s/ MICHAEL D.
CASEY
Michael D. Casey
Chief Executive
Officer
(Principal Executive
Officer)

Date: January 15, 2010

/s/ RICHARD F.
WESTENBERGER
Richard F.
Westenberger
Executive Vice
President and
Chief Financial
Officer
(Principal Financial
and Accounting
Officer)